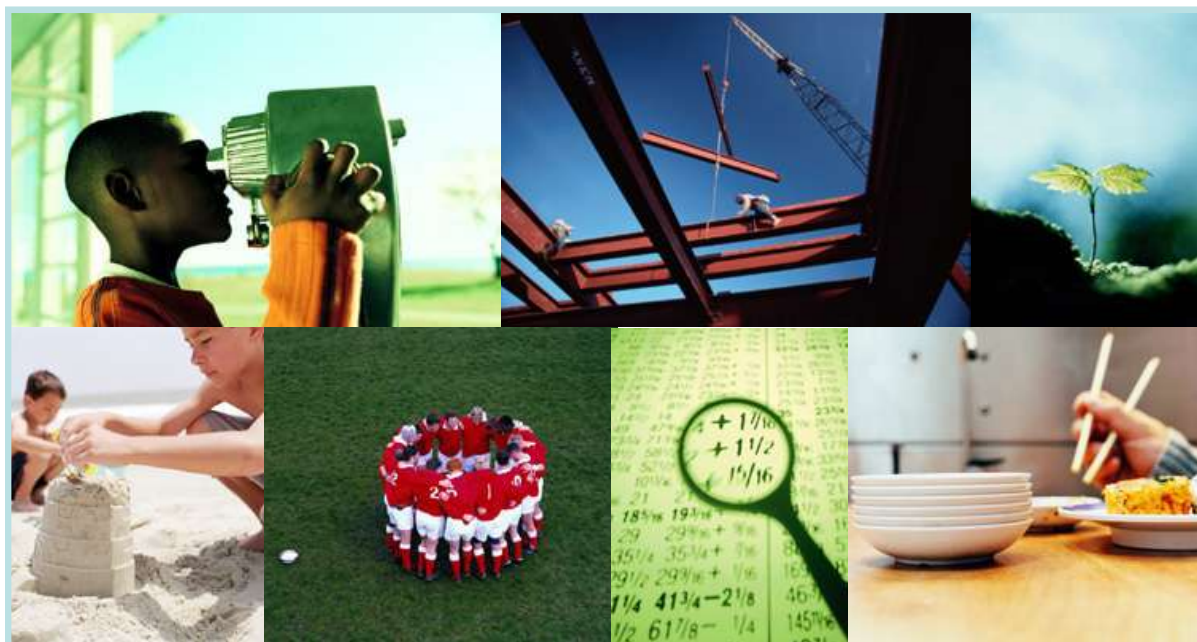


IBM Business Consulting Services
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Maxwell-Stamp



**Needs Assessment of Trade and
Trade-Related Assistance
For the Democratic Republic of
Timor-Leste**

Lot n°6 – project N°2005/100991

The views expressed in this report are those of the consultant and do not necessarily reflect those of the European Commission.

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**Needs Assessment of Trade and Trade-Related Assistance
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ABBREVIATIONS AND ACRONYMS

ACP	Asia Caribbean and Pacific
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of South East Asia Nations
ASYCUDA	Automated SYstem for CUsoms DAta
BPA	Banking & Payment Authority
CEPT	Common Effective Preferential Tariff
CFET	Consolidated Fund for East Timor
CIF	Cost Insurance Freight
CoCI	Chamber of Commerce and Industry
CPI	Consumer Price Index
CSB	Combined Sources Budget
CTD	Committee on Trade and Development
DDA	Doha Development Agenda
DG	Directorate General
DTI	Direct Trader Input
EBA	Everything But Arms
EC	European Commission
EDI	Electronic Data Interchange
EEZ	Exclusive Economic Zone
EPA	Economic Partnership Agreement
EU	European Union
FMO	Fisheries Management Organisation
FOB	Free on Board
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
GoTL	Government of Timor-Leste
GPS	Global Positioning Satellite
GSP	General System of Preferences
HS	Harmonised System
IDA	International Development Agency
ICT	Information Communications Technology
IF	Integrated Framework
IFC	International Finance Corporation
IMF	International Monetary Fund
IPR	Intellectual Property Rights
kWh	Kilo Watt Hour
LDC	Least Developed Countries

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MCS	Monitoring, Control and Surveillance
MFN	Most favoured Nation
MDE	Ministry of Development and Environment
MOAFF	Ministry of Agriculture, Forestry and Fisheries
MOFAC	Ministry of Foreign Affairs and Cooperation
MoJ	Ministry of Justice
MPF	Ministry of Planning Finance
MSME	Micro, small and medium enterprise
MSY	Maximum Sustainable Yield
NAMA	Non Agricultural market Access
NDP	National Development Plan
NIP	National Indicative Programme
NTB	Non Tariff Barriers
PACER	Pacific Agreement for Closer Economic Relations
PICTA	Pacific Islands Countries Trade Agreement
RDTL	Democratic Republic Timor-Leste
PIF	Pacific Island Forum
S&D	Special and Differential
SECI	Secretariat of State for Commerce and Industry
SIP	Sector Investment Programme
SIS	Small Island State
SPS	Sanitary and Phyto-Sanitary Standards
TBT	Technical Barriers to Trade
TEU	Twenty feet Equivalent Unit
TFET	Trust Fund for East Timor
TNC	Trade Negotiating Committee
TPRM	Trade Policy Review Mechanism
TRIPS	Trade Related Intellectual Property Rights
TRTA	Trade Related Technical Assistance
UNMISET	UN Mission to East Timor
UNTAET	United Nations Transitory Administration for East Timer
UR	Uruguay Round
URA	Uruguay Round Agreements
WTO	World Tourism Organisation
WTO	World Trade Organisation

1 Executive Summary

The objective of this assignment is to undertake a needs analysis of the trade sector in Timor-Leste to identify specific technical assistance requirements to support Timor-Leste's greater participation in the global economy. The recommendations in this report primarily focus on how to improve the capacity to produce sound trade policies that would simultaneously assist the national development objectives of poverty reduction and equitable and sustainable economic growth.

Timor-Leste is a small country with a dispersed population. After independence in 1999, a new nation had to be created both physically and in terms of building national governance capacity. Poverty is prevalent especially in rural areas and literacy is low. Growth rates have been negative to modest and state budget deficits have been covered by donor contributions; more than US\$ 1 billion has been disbursed. Inflation has been low due to the use of the US\$ as legal tender. However, the choice of tender and the presence of a large contingent of peace keeping forces have contributed to creating an artificially high price level on goods and labour, reducing the economy's competitive edge and impoverishing the local population. As a result, per capita Gross Domestic Product (GDP) has dropped from US\$ 478 to US\$ 369 in 2004. The economy is characterised by an emerging (and booming) petrol sector and a traditional agriculture sector, the latter contributing 29% to GDP. Within the agriculture sector, the growing of coffee cherries is socio-economically important and provides direct income to an estimated 25,000 families and an additional 15,000 families has coffee as a sideline income. Export of green coffee beans constitutes 99% of all non-petrol merchandise exports. The exhaustible natural resources, oil and gas, will change the economic outlook to some extent as of 2005. Revenues and investment returns put through a petroleum fund will make carefully calculated and controlled annual amounts available for the Government's budget needs, for both operating expenses and development needs, on a sustainable, long term basis. Meanwhile the economy will still need donor input for the foreseeable future.

The main factor endowments of Timor- Leste include:

Marine and fish Resources

Resource endowments for fisheries exist in terms of a vast Exclusive Economic Zone (EEZ), potentially covering 75,000 km², and a lake area of 50 km². Fishing activities are limited to near coastal areas using canoes. Licensing of high sea fisheries may start this year. Aquaculture activities are not practiced beyond subsistence. The assumed fish resources have not been tapped and the expectation is that high values species thrive.

Environmental resources for tourism

The waters off Timor Island constitute a unique marine environment with spectacular coral reefs, blue waters, and a pristine coast of 750 km, ideal for all sort of water sport tourism.

The dramatic island environment, as the only tectonically created island of the Indonesian archipelago, with mountains reaching 2,963 m and six ecological zones, is another incentive to do tracking and adventure tourism. Thus varied climatic zones, rugged topography and the relaxing atmosphere suggest a potential for a constant growth of the Timorese tourism industry. A natural park is under establishment at the eastern end of the island.

Preliminary strategic thinking is to base tourism development on the resort principle, whereby one operator leases a piece of land and develops facilities focusing on the high value end of the market. Thus low volume at high value is the key concept. As of now the number of beds and catering services is limited and mostly concentrated in Dili. One notable exception is the resort at Com, which is developed by a Timorese in cooperation with an Australian group.

Agriculture resources

Land for agricultural use is limited at 28% (food and other crops 23 % and estate crops 5%) of the approximately total area of 15,000 km², where half of the landscape has slopes of more than 40%.

Soils are composed of tectonically folded layers of limestone and metamorphosed marine clays with little fertility. Erosion resulting of overexploitation has rendered otherwise productive land idle. The commercial crops include predominantly coffee and rice; otherwise agriculture is at subsistence level.

Other land use includes 57% of forested areas but forestry is not plantation operations. The commercially valuable species thrive naturally and are harvested sporadically in small volumes without much concern for the environment and generally without replanting. As an example, the exploitation of the valuable sandalwood has led to a virtual halt of harvesting, due to fear of extinction. More recent agricultural/forestry aid programmes urge the practice of sustainable forestry and other techniques that may help restore the natural resource.

Main Constraints and Opportunities to Economic Development:

- Terms of trade are affected negatively as flexible management of monetary and interest policy is not possible
- High factor costs of production (expensive labour, high energy and transport costs)
- Inadequate farming skills, poor rural market facilities and poor rural access roads limit domestic trade, and lack of microfinance has led to a cash based economy
- Enterprises are predominantly micro and small and medium sized enterprises (MSMEs), most working under donor funded government contracts
- The domestic market is negligible in terms of volume and purchasing power
- The concentration of businesses around Dili reduces opportunities for rural employment
- A complicated business registration procedure and corporate taxation system further reduce investor interest, both FDI and NI.
- Difficult access to investment capital as there is little risk taking by the banks, which is further aggravated by the inability use land as collateral.
- Poor port and road infrastructure increases the cost of production
- Lack of skills in terms of craftsmanship and management.
- High cost of electricity and limited access to clean water.
- Oecussi is expensive and difficult to integrate due to a lack of officials
- Lack of data for fish stock assessment, no landing statistics and no vessel registry, virtually no MSC enforcement capacity.
- The level of accommodation is low and highly concentrated in Dili
- There are no training facilities for the hospitality professions

Agriculture

The image of the Timor-Leste agricultural products as ecological by default allows the building of a brand, as in case of 'Café Timor', for catering in tourism resorts. In addition promotion of valuable spices, on the same ecological and fair trade basis, should be aimed at the international markets.

- Agricultural produce that may act as an intermediary product for other sectors should be encouraged to create further value added.
- The option to increase the production of poultry products for import substitution should be considered
- Develop niche type products and productions for import substitution
- Effort should be devoted to improve productivity for all crop and livestock sub-sectors

Fisheries

- Expanding the catch of high sea species via licensing.
- Encouraging marine ranging of high-value species, such as sea cucumber for the Asian markets, and investigating other types of marine and brackish water aquaculture.
- Developing a cluster-type industry in one port of the northern side and one on the southern side, to cater to up- and down stream sector activities.

Tourism

Increase the socio-economy gains from tourism by creating local employment and increase family income through the development of opportunities in the sideline activities of tourism:

- The concept of developing cultural villages for the tourist to experience local products, folklore, handicrafts, restaurants, family visits, traditional farming and (potentially fishing), archaeological exploration etc.
- There is also scope for small scale specialist tourism, such as guest houses and “farmer or fisherman” vacations whereby the tourists stay and experience the “real” Timorese way of life in local communities rather than in resorts.
- There is potential for catering (restaurant and picnic cruise operations)
- Water sports activities and game fisheries

International trading environment

a. WTO rules and potential benefits of accession

As an LDC, Timor-Leste enjoys greater flexibility and consideration (Special & Differential provisions) in the application of trade rules, obligations and commitments. The basic principles of reciprocity and non-discrimination apply. Although the DDA covers a whole spectrum of issues, the main areas of agreements and negotiation which will affect Timor-Leste are:

Non-Agriculture Market Access (NAMA) The average applied rate is 6%. Therefore, WTO members would have to agree on a relatively high level of reduction before the applied rate in Timor-Leste would be affected. Consequently, the impact of NAMA negotiations on Timor-Leste’s applied tariffs (and therefore import prices and tariff revenue) under the Doha Round is likely to be negligible.

Agriculture: Current negotiations have agreed modalities for the reduction of both agricultural subsidies and import duties. Since Timor-Leste operates no agricultural subsidies, the impact of changes in modalities on the tariff and revenue are likely to be negligible.

GATS rules: Not being a member of WTO Timor-Leste has not scheduled any sector, it operates a fully liberal regime in the services sectors. Therefore, scheduling some services sectors under GATS should not present any problems,

Rules: Part of the negotiations on rules will clarify coverage in free trade areas. If negotiations agree on a strict definition, liberalisation of trade in ASEAN-AFTA could be extended and Timor-Leste would be required to further liberalise regional imports.

TRIPS: Part of the negotiations focuses on geographical indications which are examining how article 23 of the TRIPS Agreement. Listing “Café Timor” as a geographical indication under Article 23 of TRIPS could be used to prevent the use/abuse of this “name” to the detriment of Timor-Leste trade.

Market Access

In terms of exports, all are traded under MFN terms and with EBA valid for exports to EU. However, it would be necessary to implement a number of institutional reforms to comply the Non-Tariff Barriers to trade (NTB). These include two major agreements under the WTO:

The Technical Barriers to Trade (TBT): The TBT agreement requires that traded goods are tested for conformity with the international standards of a technical nature;

The Sanitary and Phyto-Sanitary (SPS) rights: These rules and regulations concern the protection of human health or safety and of animal and plant life or health or the environment (the natural resource endowments).

Trade related technical assistance

The various provisions of WTO, which encourage support and technical assistance to help least developed countries participate in WTO and fulfil their obligations, results in greater attention at WTO and other institutions on providing trade related technical assistance targeted towards least-developed countries as Timor-Leste.

Benefits and costs of further integration

The benefits are related to the potential up-grading of skills and quality in production and control that would derive from the implementation of the necessary economic reforms and the improvement of institutional capacity building that would foster economic development in the long run.

The costs include membership fees. In addition, the GoTL will have to make (trained) staff available for participation in the trade round negotiations and in other committee meetings and conferences.

It is recommended that Timor-Leste applies for observer status with WTO, which is done by addressing a request to the Secretary General of WTO. The status will allow Timor-Leste officials to get acquainted with the WTO environment and the working procedures, without having to face the costs and meet the rather steep human resource demands.

b. Regional arrangements ASEAN- AFTA or PIF- PICTA

With its narrow export base, traditionally low level of trade and lack of market diversification, Timor-Leste could benefit more from economic integration in ASEAN than in PIF, in terms of:

- Variety of import goods accessible, such as essential food items, machinery and equipment, and apparel, is much larger from the economically more efficient and diversified ASEAN region
- Potential to become a sub-supplier to the ASEAN regional industries as Timor-Leste enhances its trade capacity, technically and in quality terms
- Potential to export value added products from e.g. fisheries to a much larger consumer group. Integration with PIF is not likely to increase fish exports as this is a main export from PIF member countries
- Trade transaction costs will be smaller with ASEAN due to better and more coordinated infrastructures for maritime and aviation transport.

Timor-Leste has applied for status as observer with ASEAN AFTA, and it is recommended that this status is kept for a period of at least three years after which full membership should be sought. The costs involve a membership fee, establishment of embassies and participation in meetings. However, the benefits of joining an organisation with international political clout and a huge trade potential clearly outweigh the costs in the long term.

c. Trilateral agreement

One of the most significant trade opportunities which Australia and the Northern Territory offer Timor-Leste is that of developing linkages through a trilateral relationship with Indonesia. It would be in Timor-Leste's interest to have this Trilateral Ministerial meeting formalised as an annual event and to have trade and economic issues given due focus on the agenda. This is particularly relevant as Timor-Leste is well down on Indonesia's priority list, so third party assistance to encourage Indonesia to address its relationship with Timor-Leste should be utilised whenever possible.

d. EU Relationship

The present ALA agreement will end for Timor-Leste and be replaced by the Cotonou agreement signed between EU and 77 ACP countries. The most interesting part for Timor-Leste is the development assistance package. The benefits in terms of cooperation aid for Timor-Leste under the agreement will therefore be mainly financial and technical support. In particular, under Cotonou trade-related assistance programmes are provided.

Membership of Cotonou would require representation in Brussels and participation in one of the groupings of partner countries. The personnel requirements would amount to 2-3 staff in a representation office in Brussels and about 2-3 people in Dili. In addition, attendance at regional conferences would be necessary.

The benefits of the Cotonou agreement in terms of economic growth and poverty reduction are potentially significant but likely to appear only in the longer-term. However, to realise them, Timor-Leste will have to start to prepare now, studying the issues at stake and developing its capacity to negotiate a comprehensive Economic Partnership Agreement (EPA) with a clear sense of its assistance needs. Negotiations for an EPA will need to start in time so that they are completed by end December 2007. Timor-Leste should seek the active support of Portugal in maximizing and accelerating the potential benefits of Cotonou, and prepare for negotiations on an EPA in the regional Pacific context.

The key aim of Timor-Leste should be to agree on a programme of financial and technical assistance from the EU that would enable it to develop its trade-related infrastructure. The Cotonou agreement stresses the importance of regional integration of the partner countries in the African, Caribbean and Pacific groupings. During an initial phase Timor-Leste may wish to be an observer in the Pacific group.

Institutional Issues

There is no coherent trade policy at the moment. The main reason is that this policy area has been second to the need for rehabilitation and government building. At the same time, the structural conditions in the Government have not been favourable to a structured policy dialogue. There is no single body to carry out the coordinating and consultative work¹. The focal unit according to the first organic law would be SECI. Though the legal mandate is in place, SECI has not emerged in this role.

The main constraint is lack of institutional and human resource capacity. SECI management has academic qualifications at the level of a bachelor degree (three year studies after high school) and the number of staff is small as well. In addition SECI is also the regulatory body for metrology and standardisation (TBT agreement) and responsible for one of three business registers. Finally, responsibility for maintaining contact with the regional and international trade organisations lies with the Policy Planning Directorate. MoFAC is responsible for contact with the financing institutions such as the World Bank and IMF.

There are units within other ministries with trade related responsibilities:

- The MDE are responsible for energy (except gas and oil which are with the PM's office), and for export and investment promotion, as a result of their efforts, new foreign and national investment laws have been promulgated.
- The macro-economic unit of MPF is supposed to participate in the discussion of the economic aspects of trade policy, but is not very active due to limited capacity.
- Customs and corporate taxation services are located with MPF as well.
- The Directorate of Quarantine Services, MoAFF, is responsible for the SPS agreement aspects, but has no access to laboratory facilities or any contact to an appropriate academic institute.
- Finally the MoJ is active in the Notary's Office s and the Directorate of Land Reform.
- Autonomous bodies such as the BPA who manages the Petroleum Fund, and the EIPA, which is under establishment, are also responsible within their respective domains.

Civic organisations, professional associations, and academia are not involved in the policy debate.

¹ The new Government structure as outlined in the Decree Law no 03/2005, promulgated on 28 June 2005 (i.e. after the completion of this mission's field work), has placed trade with the new Ministry of Development, which is considered a favourable development by this mission as trade now is directly linked to economic development and thereby may ease the process of mainstreaming trade into the poverty reduction context.

Needs Assessment and Recommendations

Based on the analysis of the global trade issues affecting Timor-Leste, the constraints to competitiveness and the capacity of the various institutions, the following needs have been identified:

Trade policy formulation

- Develop a trade policy framework to provide strategic direction
- Enhance the Capacity of the International Trade Policy Division

Trade policy coordination/consultation

- Establish a Trade Policy Coordinating Committee to oversee the formulation implementation of trade policies
- Participate in selected negotiations in a structured and more effective manner.

General legal issues

- Align existing legislation to a common preferably lusophone frame of reference.

Import tariff and taxation barrier

- A shift towards lower tariffs should be instituted
- Compensate the treasury for the loss of tariff and add-on taxes by introducing a VAT model

Non-tariff barriers –TBT

- Establish an accreditation and standardization facility/laboratory to carry out actual testing.
- Equip the facility to handle documentation required under the Rules of Origin (RoO)

Non-Tariff Barriers – SPS

- Establish and accredit an SPS laboratory to carry out the necessary tests and analyse
- Arrange a link-up with the appropriate research faculty at NUTL.
- Potential for a mobile field unit should be included.
- A staff assessment should be made

Physical needs

- Expand the number of customs entry points to cover the entire customs territory
- Study the option to divert part of the cargo traffic to e.g. the aviation mode.
- Up-grade road infrastructure on the North coast to handle at least TEU traffic

Institutional needs

- Implement the automated cargo manifest module, risk management and proper customs valuation procedures, and remote lodgement of information.
- Increase staffing to exercise border control at the additional three maritime entry points and an additional five land based border stations
- The procedure related to the handling of exemptions should be simplified.
- Oecussi enclave needs
- Establish a kind of bonded transport system, known in Europe as Transports International Routiers
- Export and investment promotion
 - Establish the Export and Investment Promotion Agency (EIPA) as soon as possible.
 - Prepare a detailed business plan for the EIPA, Rules based needs

Capacity Building

- Strengthen the trade policy competence of the civil servants.
- Attend courses on negotiating techniques

The Cotonou agreement

- Initiate the negotiation for an EPA immediately following the ratification of the Cotonou agreement

Enabling environment

- Revise the Commercial Company law to simplify procedures.
- Create a one stop shop to business registration and with only one registration number.
- Simplify of the corporate taxation system
- Develop adequate skills for product diversification and up-grade general management skills. Establish a dedicated technical training centre for the different trades. .

Fisheries Sector

- Develop a fisheries management plan (FMP) for the different sections of the Timorese waters. The plan should be based on co-management principles
- Indicate the government bodies responsible for data collection and collation on landings and fleet registration
- Link the plan to a genuine system of Monitoring Surveillance and Control (MSC)

Suggested priority areas for external assistance

Based on an assessment of the immediate and medium term needs of Timor Leste and the relative importance of each issue, the Consultants recommend the following projects for technical assistance:

1. Support in Trade Policy Formulation and Coordination
2. Support to development of a Fisheries Co-Management Plan (FMP) and Monitoring, Surveillance and Control (MSC) enforcement mechanisms
3. Support to Sanitary and Phyto-Sanitary (SPS) agreement rights and obligations
4. Business plan for the Export & Investment Promotion Agency (EIPA)

2 Introduction

2.1 Objectives

The objective of this assignment is to undertake a needs analysis of the trade sector in Timor-Leste to identify specific technical assistance requirements to support Timor-Leste's greater participation in the global economy. This mission has to be seen in the broader context of the Doha Development Agenda's (DDA) objective to integrate trade with economic development. Therefore, the recommendations in this report primarily focus on needs related directly to trade related technical assistance, but also consider how trade can be used to support economic development and pro-poor growth as expressed in the Poverty Reduction Strategy (PRS) embedded with Timor-Leste's National Development Plan (NDP)². An intervention matrix will be designed whereby international donors will each support a component so as to eliminate overlap and ensure coverage of all issues in trade development.

2.2 Summary TOR

The terms of reference (ToR) for this assignment are presented in Annex A to this report and are summarised below. The broad objectives of the EU Development Policy towards Timor-Leste are founded on principles of sustainable, equitable and participatory human and social development. EC co-operation focuses on two core objectives: Enhancing regional development (social, economic and physical infrastructure) in combination with Human Resources Development taking into account environmental aspects and Enhancing Trade Capacity and Economic Development. Appropriate efforts should be made to further mainstream Trade Related Assistance (TRA) into overall development approaches. This policy objective reflects the recognition that, under certain conditions, trade can play an important role in generating pro-poor growth. Thus the overall objectives of the study are:

- to mainstream trade matters in its development policy and strategy (or PRS);
- to benefit more from external trade;
- to participate more effectively in the multilateral and regional trading system;
- to facilitate donor co-ordination and catalyse additional funding in the trade area.

The *specific objectives* of the Trade Needs Assessment (TNA) are:

1. to summarise and analyse the main constraints for East Timor to benefit from trade;
2. to comprehensively articulate its needs in the area of TRA in order to facilitate more systematic engagement of different stakeholders;
3. to outline a prioritised action plan towards removing the identified constraints;
4. to increase awareness and understanding in the area of TRA through broad consultations throughout the assignment.

The stakeholder groups to be consulted are:

1. Representatives of relevant government and quasi-governmental institutions;
2. Representatives of the business sector, especially importers and exporters and small agro-business entrepreneurs;
3. Local members of the Academia specialised in trade, trade research and related matters;
4. Relevant members of the donor and technical assistance communities within East Timor, including Member States embassies in Jakarta and Dili.

² Timor-Leste. Planning Commission: National Development Plan, May 2002

The mission team was requested to:

Analyse and as appropriate provide advice on the institutional infrastructure for international trade in the government of Timor-Leste, assess the existing needs for specific technical assistance, training, and other means of co-operation that have the strong potential to improve Timor-Leste's capacity to beneficially engage in international trade, e.g. through improved understanding of relevant issues and increased capacity to participate in international trade discussion's and negotiations, through improved capacity to implement rules based trading obligations, etc.

Analyse and as appropriate provide advice on the existing and potential future export sectors (e.g. agriculture, fisheries, tourism) and assess the existing needs for specific studies, technical assistance or training to promote these sectors in their size and economic performance.

The expected result is a report that gives a descriptive and analytical overview of the execution and outcome of the assignment, puts forward a needs analysis based on the constraints identified and includes detailed project proposals addressing these needs.

2.3 Approach and Methodology

The approach to this assignment was based on the principles of dialogue and partnership and comprised a combination of desk research, briefings and a field mission to Timor-Leste. It was structured upon the three phases indicated in the Terms of Reference:

1. review the documentation received from EC Brussels, Jakarta and the representative office in Dili, and any stakeholder visited
2. conduct field visits including organising one stakeholder workshop
3. prepare a detailed set of prioritized recommendations to support the programming activities

A total of six deliverables were submitted before the end of the field visit (Phase II) and an additional even after, including this draft final report.

Phase 1 included two activities:

- a) a review of the comprehensive set of background documentation including the EC country strategy paper (CSP), the National Indicative Programme (NIP), various EC trade related policy papers, the National Development Plan (NDP), and an elaborate set of legal and policy background papers from Timor-Leste received before the mission; and
- b) the team's local consultant initiated a meeting schedule.

A briefing visit on 20th May 2005 from the European Commission (EC) in Brussels (DG RELEX, DG Development, DG TRADE), from the EC delegation in Jakarta (Trade and Development Departments) on 23rd May, and from the EC representative office in Dili of 24th May. During the briefings the consultant received additional documentation (see Annex C for a complete list of documentation) and contact points.

Phase 2 included all activities carried out in Timor-Leste in the period 24th May to 08th June. The following activities were carried out:

- Further background documentation was collected and reviewed;
- A total of 29 meetings and three telephone interviews were held including all four stakeholder groups mentioned above (see Annex B for a list of consultations);
- A workshop was planned and organised on 3rd June with 25 stakeholder participants;
- Two full day field trips were carried out; and
- Six written deliverables were submitted taking into account the comments and suggestions received at the workshop.

Phase 3 was devoted to detailed analyses of documentation and input received during the discussions and the workshop. The analysis of the issues was undertaken and used to produce the set of recommendations forming and integrated part of this report. A debriefing session with the EC-

delegation, Jakarta, was held on 9th June, where a Power Point presentation was given and an Aide Mémoire handed over. Since return the consultant has submitted four deliverables including this draft report.

2.4 Recent Donor Trade Related Interventions in Timor-Leste

Timor-Leste's road to independence in May 2002 has been long and has required extensive international support since 1999. In September 1999 Indonesian integrationists and militia rampaged, killing over 1,000 displacing 250,000+ persons, going mostly to West Timor. Three-quarters of the infrastructure (road, power distribution systems, schools etc) and housing was destroyed. The Australian-led UN INTERFET peace-keeping forces were subsequently admitted and peace re-established in October 1999. The UN Security Council established the UN Transitional Administration for East Timor (UNTAET) that governed Timor-Leste until the presidential election in May 2002, which was based on the Constitution reflecting a presidential republic system. UNTAET progressively handed over the administration to Timor-Leste leaders and administrators, and was phased out.

Table1: Trends in Assistance to Timor-Leste

Type of assistance	1999-00	2000-01	2001-02	2003-03	2003-04
Development & Technical Assistance off-budget	63	121	146	119	108
Development & Technical Assistance on-budget	27	34	33	37	26
UN Security Council Posts	0	0	0	14	8
Humanitarian Assistance	84	30	12	3	2
Budget & Commodity Support	27	45	32	31	33
Donor Administrative Expenses	1	7	6	5	5
Total	202	236	228	209	181

Source: GoTL: Combined Sources budget 2005-06

Timor-Leste has attracted considerable attention from the donor community, the exact level of commitments is not known to the consultant, but US\$ 1.05 billion of development assistance funding has been disbursed since 1999. However, the main point is that there is a steady downward trend in levels of external support.

It should be noted that there are several characteristics in external assistance to Timor-Leste. First, all the external assistance to date are grants provided to support the government policy. Second, the Trust Fund for East Timor (TFET), which was established at the initial stage and has been administered by the World Bank and the Asian Development Bank, has played an important role for reconstruction and development of Timor-Leste, but its operation is scheduled to come to a close. Lastly, general budget support is a part of external assistance. The Transition Support Program (TSP) was initiated in 2002-03 as a three-year program and now is planned to be transformed to the Consolidation Support Program (CSP) for another three years starting from 2005-06. This mechanism not only provided the necessary financing to bridge the resource gap in the State Budget but also contributed greatly to reinforcing the Government's internal performance management systems. The "Development and Technical Assistance" type of external assistance during the period from 1999-00 to 2003-04 were allocated to governance (34.9% of the total program), basic services (28.8%), basic infrastructure and housing (21.1%), and production-related sectors (15.2%). Major specific sectors supported by external assistance included education and training (17.9%), public sector management (14.9%), health (10.9%), agriculture, forestry and fisheries (9.9%), and water supply and sanitation (8.4%).

The above figures highlight the level of donor dependence to finance the domestic and external deficits. The source of funding to replace the donor contributions will to a large extent come from the significant revenues from offshore oil and gas fields in the Timor Sea, which have now started to flow following the exploration agreement for the Bayu Undan field signed with Australia in 2004. It may be more than doubled when an agreement on the Greater Sunrise Field is reached; thereafter (after 2009) alleviating East Timor's financing problems. However, Timor-Leste remains a small,

least-developed island society whose development challenge is compounded by the wholesale destructions of 1999, by the challenge of establishing institutional systems and frameworks, a need for reconciliation, and by its very limited economic base and market size.

The sources of funding include 21 countries of the Organization for Economic Cooperation and Development (OECD), seven developing countries, Asian Development Bank (ADB), European Commission (EC), International Monetary Fund (IMF), and UN family (FAO, ILO, UNDP, UNFPA, UNHCR, UNICEF, UNMISSET, WFP, and WHO). The multitude of funds and donors creates another set of challenges; those of co-coordinating and managing the many different aid programmes:

- To ensure the assistance is to the priority national needs; and
- To promote efficiency and effectiveness in the programmes.

Given the substantial amounts of aid inflow and the limitations in the institutional and human resource capacity, the issue of absorptive capacity is critical. The sections below provide a brief overview and analysis of the aid provided directly and indirectly towards trade development and capacity building, and a list of the main trade relevant programmes is presented at the end.

2.4.1 The Trust Fund for East Timor (TFET)

The TFET was established in December 1999. It is the single largest fund of aid money, amounting to US\$ 175 million, receiving contributions from ADB, EC, IMF, the World Bank, and individual countries. The EC participates in this important programme as co-founder of the TFET by 1/3 of the total fund. The TFET is administered by the World Bank and coordination takes place in terms of half year TFET donor council meetings. The TFET is oriented towards rehabilitation work of key physical infrastructures (health centres, water supply), policy development and private sector development. It will wind down when the funds are exhausted, and hand over to the GoTL.

The main trade related programmes are within the private sector development area. The Small Entrepreneurs Programmes (SEP) I and II are the key private sector oriented interventions. The SEP I ended in 2001 with a somewhat dubious result, in particular as the credit component fared poorly. SEP II is on-going. It provides technical assistance to establish an enabling environment for business development. The programme assists the development of the legal framework for business establishment and operation; sets up physical facilities, technical assistance, and training to the district-based Business Development Centres (BDC), it will be engaged in setting up physical market places as district level for the local trade of agricultural produce and other needed commodities. These interventions aim to simulate the development of local business activities, by producing goods that are tradable primarily domestically, but could also reach quality levels that are of international standards. If successful the end result is not only pro-poor employment creation but also support to the process of diversification. It further includes:

- Credit and collateral support
- Public awareness campaigns on credit mechanisms, with emphasis on reaching women and youth
- Training programs for bankers and micro-lending institutions

The SEP II also includes a component on the development of industrial zones/parks, which would be accessible to producers mainly with an export focus. It is the intention to equip the industrial park with adequate physical infrastructures and incentives packages for the industries that may wish to establish themselves there. The geographical location identified is near Boucau, in an area with no particular infrastructure available – except a road that needs upgrading and an airport that, if developed, would become a real asset in facilitating trade. The consultant appointed to undertake a detailed feasibility study of the park arrived as this mission ended, thus no conclusions nor recommendations are known at present.

The TFET fund also finances technical assistance to establish an Export and Investment Promotion Agency (EIPA). The agency is designed to play a key role in the future export promotion of goods and services from Timor-Leste. It targets both products originating from Timorese sources and products based on re-exports. The agency is also seen as the first point of contact for investors that aim to establish a business in Timor-Leste – this includes foreign and domestic investors. Thus the services of the EIPA are much needed to stimulate both export led growth and to foster investment; the former is present at a very low level as the banking system is not conducive to savings³ - interest levels are low and the branches of the three commercial banks are located in Dili with a few exceptions; investment banking is not for real as the standard 150-200% collateral requirements are exercised, and title deeds to land are not yet possible to obtain.

Overall foreign direct investment (FDI) has recorded an impressive total of US\$ 1.7 billion, however, the number is severely skewed as US\$ 1.6 billion are investments in the oil and gas sector, and the balance of US\$100 million is mostly invested into companies that work under Government contracts (donor funded rehabilitation work).

2.4.2 Activities of Individual Donors

Contributions from the individual donors vary in type and volume. Some donors contribute to highly specific areas, for example, **Norway** has funded the technical assistance/advisory services to set-up the Petroleum Fund. The Bayu Undan field is now in operation and revenues are flowing into the Fund for further investments; the return to the fund is in the range of approximately US\$ 100 million per year. The terms of cooperation for the Greater Sunrise Field are presently being negotiated with Australia.

Norway further funds the preparatory activities leading to the underground hydro power development scheme at the eastern end of the Timor Leste. The project, when implemented, may cover all needs for electricity in Timor-Leste and even allow exports.

USAID initiated funding in Timor-Leste in 1994 with the Timor Economic Rehabilitation and development Project (TERADP), which was identified and implemented with the NGO National Cooperative Business Association (NCBA). The aim was to develop cooperative structures within sectors with high economic development potential to increase rural livelihood and household incomes. The Cooperativa Café Timor (CCT) was founded to produce high quality green coffee beans for export. Exports have been achieved with the best grade attracting US\$ 1.41 per kg compared to US\$ 0.40 for poor quality. Thus quality pays, but the management side is still not efficient and the huge potential is not realised in full. However, the social benefit side is indisputable as 17,562 participating families benefit directly, thus providing jobs and sustaining livelihood for 140,000 persons, and creating an additional 2,000 jobs in up- and down-stream activities. In addition, to diversify the CCT, the growing of vanilla for export, cattle fattening and marketing (including export to West Timor) and a tree nursery have been introduced. Finally a number of social activities have been funded such as health clinics, pre-school activities etc.

USAID also funds essential legal advisory services. These include economic and investment advisors:

- One to the Director of Investment, MDE, who has helped develop the foreign investment law (FIL), the FIL is expected to be promulgated soon and
- One for the Prime Minister's Office with focus on economic development

In addition USAID funds advisory services and technical assistance to develop the land reform law including titling services.

³ The total savings were at US\$ 88 mio all with the three commercial banks. AMFITIL. Financial Services Sector in Timor-Leste. January 2005. Lending was at US\$ 62.6 mio all through Microfinance credit Institutions

EC provides funding through the ALA programme for agro-business development via the ARP I - III programme. The support aims to increase value added production locally which will lead towards additional jobs, agricultural diversification, development of skills and business management techniques. The activities include:

- Market studies and feasibility analysis (value chain analysis) completed and implementation of recommendations underway; and
- Coordination mechanisms between MAFF and IEPA to ensure sharing of information on agribusiness options and potential markets and investors.

In addition, the EC has funded, through the Centre for Development of Enterprise (CDE), a study aiming at private sector development. The objective was to identify a number of local enterprises as potential partners for European companies. No concrete results so far.

UNDP funds a World Tourism Organisation (WTO) technical assistance program. A substantial team of international experts assists the GoTL with the development of services to develop the tourism industry, the project started in 2005 and has succeeded in developing a package of information material that aims to present Timor-Leste as a destination, and creates a sector inventory.

UN Mission in East Timor (UNMISET) has funded a large number of advisors in key positions with various ministries. A trade advisor has been funded to the Prime Minister's Office, with fairly broad terms of reference. The incumbent arrived in February 2005 and was scheduled to leave at the end of May. However the position has been extended but will be ended this year. Meanwhile, a trade advisor funded by the Government of Thailand has arrived at the end of May to serve in the same office. There appears to be a lack of coordination, which is aggravated by the impending reduction and eventual withdrawal of UNMISET; this makes urgent the need to define transition arrangements for continued advisory service.

A number of other donors have been involved with funding of studies and technical assistance related to various aspects of trade, investment, and economic development in export oriented sectors such as fishery and tourism (see list below for details). Some of the more specialised interventions such as UNCTAD's ASYCUDA 1 projects have led to impressive results in terms of trade facilitation and the building of capacity. In addition, funds have been allocated from the donor sources towards filling the financial gaps of the GoTL budget, contributions are made directly to the consolidated budget.

In summary, it appears that the assistance gradually is moving from relief aid, via rehabilitation towards more and more focus on pro-poor economic development. The need for GoTL budget support from donor sources may cease to be relevant in medium term pending the outcome of the Greater Sunrise Oil Field negotiations. Specialised technical assistance produces efficient and tangible results. The use of advisors has grown rapidly since 2002 and the results are in some cases productive and in other cases less tangible. Aside from the TFET there is no formal structure for donor coordination, which may prove counter productive in a situation where the absorptive capacity is at the limit.

**Needs Assessment of Trade and Trade-Related Assistance
For the Democratic Republic of Timor-Leste**

Table 1: List of TRA related interventions

Start date	End date	Donor(s) / funding agency	Program/ project type	Government unit / or other affiliation	Sector(s) targeted	Main components	Results
8.1994	12.2005	USAID (through NCBA an NGO)	Technical Assistance	Cooperativa Café Timor (CCT)	Export Agriculture	Develop the management capacity of CCT; Improve quality of growing; Introduce branding; Train local staff to take over the project; Social infrastructure as health etc.	Quality improvements in Coffee price premium of 1 US\$ per kg; Wet and dry processing established; marketing and general management has improved; Branding is carried out
5.2001	12.2002	TFET	SEP I Technical Assistance	MDE	Private sector	Credit line to SMEs; TA to businesses	1,300 jobs created; Very low loan repayment 69%; WB took all risks
8.2002	10.2002	USAID (executed by Asia Foundation)	Study	Centre for Economic Studies	Trade and economic growth	A detailed analysis of trade patterns and practices in Timor-Leste	Recommendations for Normalisation of border control; Export led strategy - no follow-up
10.2002	08.2005	UNCTAD (funded by UNDP)	TA and advisory	Customs Services	Trade	Implement the ASYCUDA system; training of staff; Improvement of tax collection	ASYCUDA implemented with impressive increases in tax collection and trade data; Shortened delay periods; Improved trade facilitation; Staff trained
1.2003	3.2003	SIDA, Sweden	Pre-study	MDE	Trade	Identification of key issue to be discussed when formulating trade policy	Comprehensive coverage of many aspects of trade and its integration with economic development; Recommendations for international trade strategies
1.2003	12.2007	TFET	Technical Assistance (SEP II)	MDE	Private sector	Legislative requirements; Establishment of Business Development Centres; Competitiveness studies	Legal framework is develop; 5 regional BDCs are established, Training carried out of 5,000 individuals
1.2003	12.2007	TFET	Advisor (SEP II)	SECI	Trade & Investment	Define the ToR for an Export and Investment promotion Agency (EIPA)	ToRs are developed. The legal framework is in place. A national Director is being sought
7.2003	10.2003	Irish Government	Study	Dir. of Investment, MDE	FDI	Short term study	General recommendations - however, no follow-up
12.2003	5.2004	Korean International cooperation Agency	Advisor	SECI	Trade	Trade policy formulation; Trade negotiation skills; Institutional issues	General recommendation within the areas or ToR - no follow-up
4.2004	6.2004	EC - ACP program / CDE	Study	SECI	Private sector	Detailed analysis of the enabling environment; The actors and their roles; A list of companies	8 project proposal for CDE funding developed including company profiles - no follow-up

**Needs Assessment of Trade and Trade-Related Assistance
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10-2004	10.2005	USAID	Advisor	Dir, Of Investment MDE	Investment / PSD	Development of the Foreign Investment Law. PSD issues	FIL is now promulgated. Workshops and seminars have been executed
10.2004	10.2006	EC	Studies, Technical Assistance	MAFF	Private sector/agriculture	Markets and feasibility studies.	
2.2005	7.2005	UNMISSET	Advisor (may be further extended)	Prime Minister's Office	Trade and Investment	Develop trade policy; Assist the introduction of policy coordination; Legal advice	Discussion paper drafted; Staff in training
2.2005	12.2005	UNDP (executed by World Tourism Organization)	Technical Assistance	Dir. of Tourism and Environment, MDE	Tourism	Develop tourism policy; Establish a tourism promotion agency; Train Staff; Develop Database on tourism inventory; Develop tourism promotions activities	Tourism policy is drafted; A tourism office is established; Staff are trained; A web-site, a CD rom and several printed material are issued; Participation in two international exhibitions
4.2005	6.2007	Gov't of Thailand	Technical Assistance	MOAFF	Fisheries	Trial fishery to develop collate data for stock assessment, mostly for tuna species	
5.2005	7.2005	EC - Framework contract	Study (the present study)	SECI	Trade and economic development	Identify constraints; Define need to remove constraints; Develop Actions plan of projects in prioritized time frame	
6.2005	2.2006	TFET	SEP II - Study on economic zones	SECI	Private sector	Detailed study on the feasibility of the establishment of industrial parks/ economic zones	

3 Background

3.1 Review of current economic performance

Timor-Leste constitutes approximately 60% of the area of Timor Island, and two islets (Atauro and Jaco). The main part is further divided into a geographically coherent share and the small Oecussi enclave to the west. The total area is 15,007 km², which is mostly characterised by rugged hills and mountains sitting on top of the tectonically created island. It is located geographically close to the equator at 8-10° south.

A 2004 census registered a total of 924,000 people, who generated an overall output measured in terms of Gross Domestic Product (GDP) at US\$ 341 million in 2004. The average GDP per capita is calculated at US\$ 369, the population growth rate is calculated at 3% per annum, which is considerably higher than expected. The use of the US\$ as national tender and limited domestic demand have led to a situation where local prices have been increased artificially by the presence of up to 15,000 peacekeeping forces and aid workers, who imports high value products. The influence on local product prices is markedly, and the low income available for buying goods further limits the overall domestic market. In addition the price level has had a clear up-wards pressure on local salaries, where three US\$ per day is not unusual for blue collar work, compared to one US\$ per day in Indonesia. On the positive side the same factors results in very low inflationary pressures, inflation levels having ranged between 2 - 5% per annum.

The decline in the UN presence since 2002 has led to contraction in the economy, with adverse effects on the non-agricultural private sector. There has been some contraction in retail services and construction, but in areas such as transportation, growth has continued. The further phase down of UNMISSET supported activities in 2004 and 2005 will continue to exert downward economic pressures for perhaps another year, after which economic growth is expected to recover.

Table 2: Basic information (2004)

Categories	Indicators
Area	15,007 km ²
Population	924,000 (census 2004)
GDP	US\$ 341 million
GDP per capita	US\$ 369
Currency	US\$
Unemployment	20% +
Poverty	39%

Source: World Bank. Background paper, May 2005.

Economic activity over history has focused on agriculture and forestry. Agriculture (the most important economic sector including cereals, field crops, horticulture) forestry and fishing contribute approximately 30% to GDP. It employs approximately 80% of the population living in rural areas. Farming is the main economic activity, while forestry and especially fishing are today considered negligible in terms of GDP contribution. Horticulture products, especially coffee and to a much lesser extent vanilla, are the main cash crops. Copra and other coconut based products used to be important, but a coconut plague has virtually destroyed the production that used be important with Baucau as the centre for processing and trade. Sandalwood is another product that has virtually disappeared from the market, in this case due to severe over logging as the tree grows only naturally on Timor Island. Good conditions seem to be in place for teak growing, which is being explored.

**Needs Assessment of Trade and Trade-Related Assistance
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Table 3: Key economic indicators

	1999	2000	2001	2002	2003	2004
GDP, total (in million USUS\$)	270	394	419	392	374	341
GDP per capita (USUS\$)	337	396	478	472	405	369
Change in real GDP growth (%)	-37	15	6.4	-6.5	-4.4	-4.2
Inflation rate (CPI: Dili)	+140	+3	0	+5	+4	+2
Real GDP by sector (as % of total GDP)	100.0	100.0	100.0	100.0	100	100
Agriculture	34.2	25.8	24.0	27.3	29.0	
Mining and Quarrying	1.1	1.2	1.0	0.9	0.8	
Manufacturing Industry	2.8	2.8	3.0	3.2	3.4	
Electricity, Gas and Water	0.8	0.8	0.4	0.8	1.0	
Construction	12.4	13.7	12.0	10.7	8.9	
Trade, Hotel & Restaurant	6.3	7.8	6.9	7.0	7.2	
Transportation & Communication	5.7	7.2	6.9	8.0	9.1	
Finance & Business Services	6.1	6.5	6.6	7.2	7.6	
Public Administration & Defence	30.0	33.6	38.7	34.3	32.4	
Personal, Community Services	0.6	0.6	0.5	0.6	0.6	
Fiscal deficit (% of GDP)	-37	-18	-34			

Source: World Bank. Background paper, May 2005.

UNDP. Recent Macro-economic Development and Medium Term Outlook, Dili 2004

During the last years, structural changes in the economy are gradually occurring. The construction sector that used to count for 14% is contracting to 9%, reflecting the gradual reduction in emergency type rehabilitation work and the transfer to more periodic maintenance activities. New sectors are indicating growth, such as tourism at 7%, and transportation/communication at 9%. The latter two are important trends, indicating the increasing availability of services and trade facilitation infrastructure.

Industry is clearly the least developed sector. Reasons include the foreign exchange regime, the extra freight costs, and the customs policies that add a price tag of up to 50% on imported goods (see section below). Producing for the local market is not feasible, as it is small and with limited purchasing power and producing for re-exports is probably not competitive as the salary level, the import price tag and cost of utilities are high. Other factors, such as a virtually embryonic though growing investment banking sector and the lack of a capital market (stock exchange and securities market are non-existent) further limit the scope for development of investment heavy activities.

The decline of the international presence with the winding down of UNMISSET slows the economy further. Urban centres have been most impacted, as the decline affects predominantly the services and construction sectors that have catered to expatriates. Employment has not been expanded and opportunities may have contracted due to the decline in economic activity. The unemployment rate is estimated to be at least 20% among urban males, and reaches at least 40% among urban male youth. 15,000 new entrants come into the labour force each year. Reducing unemployment is one of biggest challenges facing the country.

With the initiation of petroleum production, Gross National Product is rising considerably. At the same time, non-oil GDP is expected to grow only modestly. A recent revision of national accounts indicates that non-petroleum GDP has fallen by about 6.5 percent in both 2002 and 2003, and 4.2% in 2004 following growth of about 15 percent in 2001. It is estimated that non-oil GDP has grown modestly at about 4.2 percent in 2004, reflecting an increase in agricultural productivity following a period of drought as well as a significant expansion in banking sector activity. Hence, per-capita GDP – currently measured at USD 305 (April 2005)⁴ – is decreasing and poverty is in all likelihood increasing.

3.2 Poverty

Timor-Leste is a new country and one of the world's poorest countries. About 39% of its population, thus 369,000 individuals, lives below the minimum subsistence standard of living. The minimal standard of living was defined as the poverty line in September 2001 at US\$0.51 per capita per day.

⁴ World Bank. Background paper. May 2005, page 3

This equals a food basket that provides 2,100 calories per person per day, including an allowance for non-food consumption needs such as clothing and housing.

Poverty in Timor-Leste is overwhelmingly a rural phenomenon, with 75% of the poor living in rural areas, amounting to 280,000 individuals. Geographically, the incidence of poverty (headcount) increases from East to West. The districts in the West (Oecussi, Bobonaro and Covalima) that support one fifth of the population, account for a quarter of the poor. In contrast, the three districts of the East (Baucau, Lautem and Viqueque) with a quarter of the population have less than one fifth of the poor. A factor which may have contributed to the disparities between East and West is that the violence of 1999 has caused much more damage and affected households much more than in the farther East. Poverty also rises in the *sucos* in the highlands as well as in the coastal and landlocked lands.⁵ Average productivity in rural areas is a meagre US\$150 per capita per year. As a result, poverty incidence in rural areas (46%) is much higher than that in urban areas (26%), and in the two major urban centres of Dili and Baucau (14%). The Multiple Indicator Cluster Survey found that ownership of durable goods is very low and is confined mainly to the major urban areas. The promotion of public education programmes generally and in health particularly will be negatively affected by the relative lack of modern communication devices of radio, television and telephone (and access to the electricity and distribution networks to support these). Access to primary education is lower compared to that in urban areas with net enrolment below 70% as compared with 90% in urban areas. In addition, the quality of teaching and learning seem to be lower in rural areas. Access to health services is more difficult for rural residents, especially to hospitals. Perhaps, it is also more expensive due to the distance to health centres and difficult transport.

An urban bias is evident in the provision of other services too. While 72% of urban people have access to improved water, the comparable figure for the rural inhabitants is only 51%.⁶ About 44% of urban people have access to improved sanitation compared with only 10% of rural residents. In the two major urban centres of Dili and Baucau, 92% of the households have access to electricity in 2001. Only about 10% of rural dwellers have access to electricity.

Only one third of the total public expenditure and one-fifth of the goods and services go to the districts, which demonstrates a significant urban bias in public spending. The issue of spatial inequality is fundamental to sustaining the country's human development initiatives. The implication of this is that poverty reduction programmes should target rural areas, in order to ensure that benefits accrue evenly to all citizens, not just the advantaged ones living in urban areas. The Government's decentralization programme needs to be supported by empowering local authorities to take on more governance responsibilities and by streamlining revenue mobilization responsibilities between the centre and the local governments.

In addition to urban-rural disparities, poverty in Timor-Leste is strongly correlated with household size and composition. Large families with more non-earning dependents, such as children and the elderly are often poorer than smaller families. The human tragedy of lost family members is exacerbated by the economic effects on those remaining, who often lack the physical capabilities to labour for agricultural production or wage employment.

Education is highly correlated with poverty. Close to three in five individuals live in families where the head has not completed primary education. The probability of households' heads having completed primary or junior secondary education increases substantially in richer sections. Low education levels are not only a reason for poverty, but also a consequence of poverty. Increased literacy and primary school enrolment will most likely reduce poverty, and will certainly have a positive impact on the livelihoods of the poor. Enrolment in secondary level education is still low and with an urban focus, as educational institutions are there.

⁵ *Ibid.* What is meant by "coastal" lands (or lowlands) are those located between 100 and 500 meters above sea level.

⁶ World Bank *et al.* *Timor-Leste: Poverty in a New Nation: Analysis for Action*. Dili, 2003

3.2.1 Inequality

A common measure of income inequality is to look at what proportion of the total national income is received by each income level. Income inequality can be derived from the ratio of the incomes received by the bottom 40% (the very poor) and top 20% (very rich) of the population. The poorest two-fifths of the population (40%) have an expenditure share of less than 18% of total expenditure, with expenditures US\$15.49 per capita per month. By contrast, the upper income group (20%) have an expenditure share of about two-thirds, with a monthly expenditure of US\$28.22 per capita. Opportunities for human development in Timor-Leste are unequal if one looks at the level of inequality in spatial terms. Inequality is much higher in the Centre than in the West and East regions. At current poverty rates, the administrative costs involved in targeting transfers and development project benefits to the poorest may outweigh the benefits.

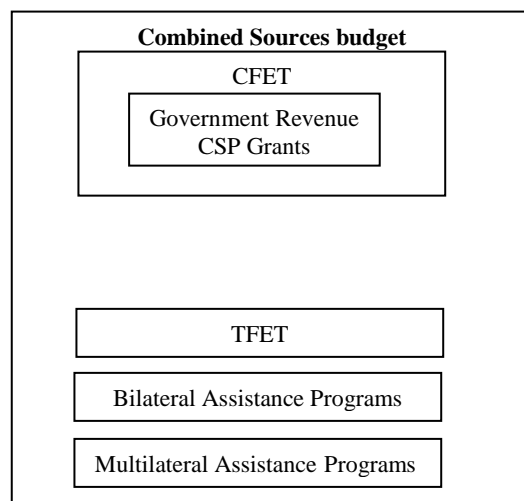
The most important reason in explaining inequality comes from urbanization and education. Migration from rural areas to Dili and Baucau and other urban centres has been a symptom of the lack of options in the countryside. The choice to migrate to urban centres has probably become one of the coping strategies adopted by rural people when faced the dire uncertainties of the neglect of the rural economy. With urbanization came urban slums and the “ruralization” of urban areas. Rural residents have less access to education, health care, jobs, information and other human opportunities than their urban counterparts. It is certainly a challenge for Timor-Leste with a weak rural economy to provide infrastructure and social services to many of the poor because they live very much fragmented and dispersed over mountainous and difficult terrains.

3.3 The Government Budget

The GoTL has developed a system of planning underpinning the preparation of the Combined Sources Budget (CSB), which comprises the Consolidated Fund for East Timor (CFET), non-disbursed balances of TFET, and other multilateral and bilateral assistance programs. A model of the principle structure of the CSB is presented in Figure 1. The CFET is made up of the Government’s own revenues sourced from customs duties and taxation.

In the medium term, the CSB is guided by the National Development Plan (NDP) and the Stability Priorities issued in early 2003, structured around governance (law and order, justice and the legitimization of local authorities); employment creation; and service delivery for poverty reduction. The CSB has an additional set of planning instruments which is the recently developed 17 Sector Investment Programs (SIP). The SIPs are designed to present strategy, program, and expenditure for the rest of the mandate of the current Government for areas such as agriculture, fishery, forestry, and private sector development.

Figure 1: The NDP and the SIPs Guide the Combined Sources Budget



Source: World Bank. Background Paper. Dili, May 2005

At mid-April 2005, Timor-Leste's Financial Year 2005 budget (FY05) execution is characterized by higher than expected revenues and slower than projected expenditures. The GoTL now expects total FY05 revenues to reach USD 276 million, with domestic revenues totalling USD 33 million, and Timor Sea revenues USD 243 million.

It is noteworthy that the domestic revenues benefited from improved administration in both the revenue and customs services, assisted by the implementation of an audit system in the former and the computerized ASYCUDA system in the latter. Revenue collection in the power sector has also continued to improve. Timor Sea revenues have increased dramatically owing to a significant boost in world oil prices, deferred implementation of tax depreciation schedules, and good progress in the development of the Bayu Undan oil and gas field.

3.4 The role of Oil and Gas

Production at the Bayu Undan oil and gas field began in April 2004 and is now fully operational. The proceeds from production are divided between the Timor Sea Treaty partners, Australia and Timor-Leste. Following the approval of the petroleum production regime by Parliament, licensing for the exploration of reserves on-shore and in non-disputed waters along Timor-Leste's southern coast is expected to begin before the end of 2005. Finally, negotiations with Australia over the petroleum reserves in areas of overlapping claims are progressively improving the prospects for the exploitation of the Greater Sunrise field, which has much larger reserves still than Bayu Undan. Oil and gas exploration will benefit Timor-Leste in several ways:

- It provides a major source of income to the Government that is able to sustain the annual operating budget of GoTL and an important part of the development investment budget as well; the latter is expected to cover SIP needs for infrastructure, utilities, schools and health care centres;
- It is anticipated the crude oil and gas will be transported to Australia for processing, but facilities to service the exploring companies may well be based in Timor Leste and thus provide new jobs and increase the skills level in the service sector; and
- It may foster development on the southern coast in terms of exploring on-shore finds and thereby stimulate decentralisation of the economy, help reduce poverty in these remote parts, and maybe develop exportable technologies on how to make use of seepage finds.

3.4.1 The Petroleum Fund

Timor-Leste has decided on a strategy to optimize the sustainable use of the proceeds from the oil and gas exploration for funding of development state budget gaps. It is estimated that the known oil and gas reserves equal at least 11 trillion cubic feet (TCF) of gas and 700 million of barrels of oil, considering both the Bayu Undan and the Greater Sunrise fields. Other finds have been made in Timorese territorial waters and on shore, but their reserves have not yet been estimated. The known reserves may last up to 30 years.

To secure the sustainable use of the flow of funds in the long term of an otherwise exhaustible natural resource a Petroleum Fund is in being established – its organic law has been promulgated before the approval of the 2005-006 Budget, and the Fund is expected to be operational as of the 1st July 2005. Establishment of the fund has been carried out in close cooperation with advisors from Norway, which is most advanced in this field. The Fund will receive the proceeds according to the GoTL petroleum taxation law. Funds will accrue from the following sources:

- The shore based areas and off shore areas in Timorese territorial waters, which are exclusively regulated by Timor-Leste;
- The exploration from the Bayu Undan Field, which is regulated by the Timor Sea Treaty signed between the Timor-Leste and Australia. The Treaty includes a production agreement

for the exploration of the Joint Petroleum Development Area (JPDA). Day-to-day management of the treaty is in the hands of the jointly operated Timor Sea Designated Authority (TSDA). Timor-Leste gets up to 90% of the proceeds from the exploration within JPDA (Bayu Undan) carried out by an international consortium; and

- Considerable proceeds from the Greater Sunrise Field are expected in the future. The Greater Sunrise Field is not exclusively within the JPDA, and negotiations are still on-going with Australia. The Prime Minister has nominated a special Timor Sea Office (TSO) to assist with the negotiations, which are expected to lead towards the signature of an exploration treaty/agreement.

It is often argued that petroleum revenues are different in nature from other revenues as they represent a transformation of a natural exhaustible resource into cash, which may encourage further spending / consumption rather than the opposite. In addition, they are volatile and uncertain, e.g. the international prices level and potential disasters may intermittently stop further exploitation. Saving revenues for the future is thus an important step to secure sustainable use and management.

The GoTL has overall responsibility for the Petroleum Fund through the MoPF that will be advised by an Investment Advisory Board. The operational management is delegated to the Banking & Payment Authority (BPA) of Timor-Leste, who will outsource investment management to the US central bank. All revenues (taxes and royalties) are immediately deposited into a special account with BPA, which will transfer the funds to a designated account with the US central bank, where investment in conservative long term high yielding papers to secure fixed income (maybe later equities) will be handled by professional brokers. This way a conservatively estimated average yield on investment of 5-6% per annum will be generated. This strategy secures an almost fixed income level at very low risk. The yields will be transferred back to the BPA, who will release funds to the State Budget following normal budget negotiation procedure, thus funds are only transferred into a single State Budget account upon agreement. It is the Parliament that sets a ceiling on the total transfer per year from the Petroleum Fund; and that ceiling will equal the financing needs for the State Budget. Government savings will reduce the use of the Fund and *mutadis mutandis* the application of the Fund will be equal to the Government saving effort.

If the GoTL is able to keep spending at the estimated sustainable income from the petroleum wealth (Petroleum Fund + petroleum reserves value) the real value of the wealth is kept constant and spending at that level of withdrawal can go on forever (in theory). Looking at the estimated increases in the value of exploration from the Bayu Undan field, the peak in 2011 is at US\$ 350 million and over 30 years accumulates into \$ 5, 0 billion. With the volume of funds available the investment spin-off is not less than US\$ 100 million per year. Last year the State Budget deficit was US\$ 35 million and the GDP at \$ 341 million. With the increasing oil prices and the increased efficiency of the customs duties and taxation revenues the gaps are more than likely to be filled, and funds will be available for further investment in development activities and poverty reduction. Of course these numbers are changing: the international oil trade and price regimes are today higher than those estimated above.

The Petroleum Fund will be exposed to external audit and transparency is further secured through regular reporting on important aspects such as fund management, consistency between spending of petroleum revenues and long-term considerations, and follow-up of discrepancies between Fund receipts and actual company payments.

3.5 Actual international trade patterns

The Timorese trade system is heavily skewed towards imports, which results in a constantly negative trade balance since 1999 (see table 4 below). However, the exact figures in the table should be taken with a grain of salt as statistical information before mid 2003 was not collected in accordance with internationally recognised standards. Reporting of trade statistics was sporadic as the border stations were not manned, the recording procedures were non-existent and the limited staff was not trained. It

is therefore likely illegal trade took place, especially over the land borders, but also in the Port of Dili and at the airport. Thus the figures in grey (1999-2003) in Table 4 below are probably too low. The figures include non-merchandise imports such as luxury items (cars, air conditioning systems, coolers etc.) needed by the international staff working in Timor-Leste. However, such imports are not directly related to the economic activities in the country, and are often re-exported. Another methodological problem related to the collation and interpretation of statistics for the period 1999-2002 was the lack of a uniform customs coding system. Customs duties were only sporadically calculated and collected, corruption was reportedly widely practised. It is likely that the export figures are more correct.

However, the overall picture demonstrates that the trade deficit is at the level of 1/3 of the GDP, which clearly indicates the trade dependant nature of the economy. Since mid-2003 the trade statistics are collected according the Harmonised System (HS) of coding, and the AYCUSDA system delivers import and export figures directly into the Department of Statistics at the level of HS six digits.

Table 4: Trade statistics

	1999	2000	2001	2002	2003 ^{a)}	2004 ^{a)}
Imports (in million US\$)	119	235	248	201	174	113
Exports (in million US\$)	52	5	4	6	7	7
Trade balance (in million US\$)	-67	-230	-244	-195	-167	-106

a) Figures are only for merchandise

Source: National Department of Statistics, Trade Statistics

3.5.1 Imports

Imports by value

It is not possible to make a time series analysis and the only year where there is a full and coherent set of data is 2004. However, to illustrate the latest development figures from January through April 2005 are also presented (see table 5 below). The import pattern of Timor Leste shows that fuel is the main need with a share of 32%, there is no local production of oils and derivative products in the country. Otherwise Timor-Leste is an importer of technology (vehicles, and electrical machinery and equipment 22%) of which the local production is virtually nil. Finally, cereals are imported at a value of US\$ 8 million or more than the value of the exports. The cereals group is almost entirely rice, which makes Timor-Leste a net importer of food - the much lower figure for cereals in the first four months of 2005 represents seasonality. The fairly large group 'Other Merchandise' is composed of luxury items such as tobacco, alcohol and plastic items and a large range of other items.

Table 5: Imports by code HS 2 digits (in US\$ million)

Merchandise only	Value	2004 Share	2005	Jan-Apr.
Fuel, minerals etc.	37	32%	14	39%
Vehicles	15	13%	3	7%
Electrical machinery & equipment	10	9%	1	4%
Cereals (rice mostly)	8	7%	2	6%
Other machinery	7	6%	2	6%
Other merchandise	37	32%	13	37%
Total	113	100%	35	100%

Source: National Department of Statistics, Trade Statistics 2004-05

Imports by origin

The main trading partner is Indonesia with 53% of all imports (see table 6 below). The most important items from Indonesia are fuel, tobacco, technology and cereals. In fact most of the rice is imported from Indonesia. It is most likely that the figure is underestimated as the traditional practise of allowing goods "travelling on two feet or two wheels" to enter duty free, at the land border crossing points with West Timor. The consequence is strongly negative as Indonesian rice is subsidised and thus out-competes locally produced rice.

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Other main trading partners are Australia and the ASEAN member countries (in total 39%). Most of the items imported are fuel products, technology and luxury items. The trade with Europe includes technology items at a share of 5%.

Table 6: Import by country of Origin in 2004

Country of origin	Value (US\$ Mio)	Share
Indonesia	60	53%
Australia	20	18%
Singapore	15	13%
Vietnam	5	5%
EU countries	5	5%
Other Asia	4	3%
Other world	4	3%
Total	113	100%

Source: National Department of Statistics, Trade Statistics 2004

3.5.2 Exports

The pattern of exports (excluding gas and oil) clearly indicates an economy with very little diversification. The total value of exports equals US\$ 6.97 million, of which 99% is green coffee beans (see Table 6 below). Exports of other products thus are negligible, but include agricultural vanilla, hard wood and some handcraft products. There is no export of industrial products.

It is interesting to analyse the average prices for green coffee beans. A simple calculation indicates that the average price ranges from US\$ 1.28 per kg⁷ to US\$ 0.50 per kg. The better the quality of the harvested cherries and the better the quality control in wet and dry processing, the higher the price for the end product. It is noteworthy that these prices are attracted from major international marketers such as 'Starbucks' – the specialist coffee stores. The prices are for ecologically certified products based on the fair trade principle, where the economic benefit is tracked back to the farmers. Similar certification procedures are now attempted for vanilla products to be marketed as ecological and under the fair trade label.

The main trading partner is USA with a share of 51%, followed by Indonesia. EU-member countries buy 15% of the exports, with Portugal being the most significant importer.

Table 6: Export by country of destination (2004)

Country of Destination	Export (US\$ Mio)	Share	Coffee Average Price (US\$/kg)
USA	3.55	51%	1.16
Indonesia	1.28	18%	0.50
Portugal	0.58	8%	1.28
Australia	0.51	7%	1.26
Germany	0.44	6%	0.61
Netherlands	0.09	1%	
Other Asia	0.33	5%	
Other World	0.19	3%	
Total	6.97	100%	
Of which coffee	6.90	99%	

Source: National Department of Statistics, Trade Statistics 2004

⁷ The CCT advisor Dr. David Bouyce informed at the workshop that process of up to US\$ 1.41 per kg had been attracted in USA for a period in 2004.

3.6 Factor Endowments of Timor-Leste

3.6.1 Marine resources

Resource endowments for fisheries exist in terms of a vast Exclusive Economic Zone (EEZ) potentially covering 75,000 km², and a lake area of 50 km²⁸. Aquaculture activities are not practiced beyond subsistence despite the 700 km long and pristine coast line. The EEZ is divided into a coastal zone, from 0 – 75 km, reserved for exploitation by the coastal Timorese fishing vessels, and the outer zone, from 76 – 200 km, which is used by international vessels as there are no Timorese high sea vessels. Up till this year there has been no licensing system, thus high sea fishing activities are illegal. The actual size of the EEZ is around 75.000 km but can not be determined as there are still areas where the boundaries are disputed with Indonesia. The drop off to the sea bed (outside the island) is steep and water depths reach 1,000 m within just 25 nautical miles to the South – called the Timor Trough, and with a less steep continental shelf to the North. These marine topographic characteristics make marine resources an important natural endowment, which is only little exploited commercially by fishery and tourism.

Fish resources and utilisation

The MoAFF has established a brief policy and strategy framework⁹ for the fishery and aquaculture sector with detailed regulations on fisheries¹⁰. The National Directorate of Fisheries and Aquaculture (N DFA) is the main regulatory body. It centralises and is answerable for the implementation and monitoring of policies, plans, programmes and projects, as well as for other matters related to the sustainable use and development of fishing and aquaculture resources, with a view to increasing the national food security, the generation of resources, and export revenue. However, its staff is limited to one B. Sc in biology (not in marine biology) and other staff at lower levels of education.

The regulation of fisheries covers both catching of fish and aquaculture activities. It is very detailed and seems to follow standards for western European regulations - forbidden gears, mesh size, seasonality, catch quota etc. However, the MSC activities including enforcement mechanisms are not defined except in the case of the licensing of high sea fishing rights. In this case the licensee is required to employ one Timorese national, who will stay on-board during the fishing trip and report daily by radio to the authority on shore on the fishing methods and gear applied, and the volume and composition of the catch. The first licenses are expected to be granted this year.

Despite the good intentions with the policy and legal framework the sector is characterized by two rather unique features for a small island state:

- Extremely low level of activity; and
- Extremely little knowledge about the stock, landings and fleet composition

Knowledge of the diversity and volume of marine life in these waters is very limited. A consolidated effort to collect primary (i.e. research) data has not been launched. Only this spring a small research oriented project, on trial fishery for tuna species, has been initiated under assistance for the Government of Thailand. Secondary data collection has not been carried out. No comprehensive study to identify the diversity and ecology within the EEZ has been conducted. Thus the situation is that there is no scientific base for carrying out stock assessment. Anecdotal information suggests that inshore and near costal zones are characterised by high species diversity accompanied by a variety of marine habitat types.

⁸ MoAFF: Policy and Strategy Framework, page 1

⁹ MoAFF, Policy and Strategic Framework, Dili September 2004

¹⁰ Ministry of Planning and Finance, Ministry of Internal Administration, Ministry of Agriculture, Forestry and Fisheries Ministry of Health, Joint Instruction 13 December 2002; Decree No. 4/2003, Of 13 November 2003, On The Organic Structure Of The Ministry Of Agriculture, Forestry And Fisheries; Government Decree No. 5/2004, Of General Regulation On Fishing

The only kind of fisheries that take place at the moment is very near costal fishing from small out-rigged canoes (10-20 feet) with equally small engines. To date, of the pelagic¹¹ species, Timorese fishermen have exploited mostly the smaller species, mackerel and anchovies, that are caught by simple gill nets, hook and line and various traditional types of traps. Other species landed include various reef fish such as groupers, mullets, sharks, marlin, sea cucumbers, crustaceans, shrimp, and lobsters. There is no collection of landing statistics or skipper's logbooks.

A few larger vessels exist but are not operational. Fishing methods for high sea fishing are presently being acquired through collaboration with Australian fishermen and is environmentally friendly and sustainable. As a result the Timorese coastal fisheries are 'dolphin safe', which is the highest possible category. However, nothing is exported.

The methods applied include gill nets, hook and line and various traps. The result is a peculiarly low local consumption of fish for an island society – at 3 kg per year per person, and no exports. The explanation is most likely related to historic events, whereby the Indonesians carried out high sea fisheries and still do, but now illegally, landing the catch in Indonesian ports. However, training in high sea fishing methods is limited to an on-going training programme in the southern waters funded and implemented by the Government of Australia.

The absence of a marine research institute and the only just initiated academic training in marine biology at B.Sc. level serves to explain the lack of information on fish stocks. A recently initiated trail fishery project, funded and implemented by the Government of Thailand, focuses on the tagging of migratory species such as tuna. However, the results are not likely to be available before three years. There is no other stock related research going on within this important sector, which is capable to supply protein to the poor, generate export revenue, and create sustainable jobs¹². A project funded by AusIAD with focus on building institutional capacity within the MoAFF to manage the tuna fisheries has just been completed. However, the consultant is not aware of the actual outcome of the project, except that the training in management planning for this particular type of fishery has been transferred.

Landings are not registered and hence cannot be a source of additional tax revenue. Fish is seen in the small markets of Dili and in the restaurants. However, the indication is that fisheries is basically a subsistence level activity. This is further supported by the lack of infrastructure such a fishing ports with bunkering facilities, shipyards, slipways for repair and maintenance, and flake ice and cold store plants. The Hera port outside Dili would appear to be suitable as a fishing port, but is presently a military port. There is no central (nor district) registration authority for fishing vessels.

The capacity to carry out MSC activities is limited to outdated costal inspection vessels owned by the Coast Guard. Thus there is an urgent need to develop this sector that could become an important element in the food security system (approximately 64% of the population suffers from insufficient nutrition¹³) and which can generate foreign exchange and jobs for the coastal poor.

Marine and inland aquaculture is still in its infancy. Experiments with extensive methods such as the ranging of sea cucumbers have indicated some potential.

3.6.2 Environmental resources for tourism

The GoTL, through its State Secretariat for Tourism, Investment and Environment (SoSTIE), under the MDE, is in the process of developing a 15 year strategic plan for tourism development assisted by the World Tourism Organisation. It will be based on sustainable use of Natural Resources, facilitate economic growth through building tourism management capacities at national and district level,

¹¹ Pelagic fish refers to species living in the free water column (from surface to near sea bed) such as tuna, mackerel, sardines, anchovy etc.

¹² One fisherman at sea or in aquaculture generates an average of 2.4 more jobs on shore in up- and down stream sector activities such as gear repair, boat building and repair, trade, inspection etc.

¹³ Ibidem page 2

developing strong community participation in tourism and formulating an integrated long-term tourism policy, strategic structure plan, together with the short to medium term action plans and programs to implement the plan. The first strategy formulation phase of the plan will be ready later this year.

It is generally recognised that the waters off Timor Island constitutes a unique marine environment with spectacular coral reefs, blue waters, and a pristine coast of 750 km. The environment, especially the coral reefs, is exposed to detrimental effects induced by both human activity and external climatic factors. Rapid climate and sea level changes caused by e.g. variation in El Niño's pattern may cause extensive bleaching of corals. Pollutants, as well as sand and mud from construction activities or extreme run-off in the south from the rainy season up to 2,000 mm per year, may cover the corals and further add to their deterioration. However, as they stand beautiful the scope for snorkelling and diving is endless.

The dramatic island environment of Timor, as the only tectonically created island of the Indonesian archipelago, with mountains reaching 2,963 m and six ecological zones, is another incentive to do trekking and adventure tourism; the six zones are mountainous areas, high land plains, moist lowland (on the southern coast) and arid low lands (on the northern coast). Thus the varied and rugged topography and the relaxing atmosphere further add to the factors behind the idea for a constant growth of the Timorese tourism industry. A natural park is under establishment at the eastern end of the island.

The preliminary strategic thinking is to base tourism development on the resort principle, whereby one operator leases a piece of land and develops facilities focusing on the high value end of the market. As of now, the number of beds is limited and mostly concentrated in Dili, however, with one notable exception the resort a Com, which is developed by a Timorese in cooperation with an Australian group. The quality of the hotels and simpler types of accommodation is not registered in an inventory following internationally agreed quality standards. Based on personal inspection and information gleaned from the SoSTIE, the best hotels in Dili would qualify for four stars. The catering industry is also focused on Dili, with a few high quality restaurants, and with more simple nature catering facilities at district level. A detailed inventory of the sector is under elaboration.

At institutional level 'Tourismo de Timor-Leste' has been established as the centre for collection and dissemination of information, and to function as the marketing arm for the tourism industry. It has produced valuable material in terms of a CD-Rom, posters and collaboration agreements with travel agencies in Europe.

3.6.3 Agriculture resources

The GoTL has developed a policy and legal framework for the sector as a whole, and for the sub-sectors of agriculture (field crops), livestock, and forestry. These documents provide a description of the situation and a general framework for the development of agricultural activities; they further identify some of the constraints. As an example land for agricultural use is limited a total of 28% of the approximately 15,000 km² as a result of the topography of the island, where half of the landscape has slopes of more than 40%, and the soils are composed of tectonically folded layers of limestone and metamorphosed marine clays with little fertility. Erosion resulting of overexploitation has rendered otherwise productive land idle.

Other land use includes forested areas that cover 57%, but forestry is not systematic in terms of plantation operations. The commercially valuable species thrive naturally and are harvested sporadically in small volumes without much concern for the environment and generally without replanting. As an example the exploitation of the valuable sandalwood has led to a virtual halt of harvesting, due to fear of extinction. More recent agricultural/forestry aid programmes urge the practise of sustainable forestry and other techniques that may help restore the natural resource.

The balance (14%) is non-productive land or is used for roads and other infrastructure, towns and villages. The quite distinct climatic differences in terms of rainfall between North (500 - 1,500 mm precipitation per year) and South (with up to 2,000 mm per year) suggest that the agricultural potential is highest on the southern side, where the landscape provides large gently sloping areas suitable for irrigation. Whereas the northern side, in the rain shadow of the mountains, has a short rainy season, and most farming is rain fed except in some relatively small estuary areas where irrigated crops (mostly paddy) are grown. Currently there is no up-to-date information on land use or land coverage.

Farming provides the livelihood base of 80% of the rural households, with average family sizes of 8.5 persons. It is estimated that 40% of these households carry out subsistence farming; the most frequently grown crops are maize, sweet potato and cassava. Subsistence farming is prevalent in the eastern region with up to 80% of all households; it is also the area with the highest degree of illiteracy (more than 60% of the adult population). Only 11% in the central and 32% in the western region are considered subsistence farmers. The balance of the households is commercially oriented and produces mostly rice and coffee for the market. Rice is produced on the northern coast in irrigated systems on about 67,000 ha; and dry-land and up-hill rain fed farming involves 160,000 ha. Most of the irrigated areas have been rehabilitated with assistance from the ARP I and II projects funded by the EC.

Estate production of coffee organised in cooperatives is a promising route to help reduce poverty. It is estimated that 25,000 families in total get their main income from coffee growing and that an additional 15,000 families have coffee as a sideline income¹⁴. Two varieties of coffee are grown, Arabica coffee is grown in the higher elevations (1,100-1,400 m) and Robusta from 600 – 1,100 m. The largest group of growers is part of the Cooperative Café Timor (CCT), which involves 17,567 households, supporting 140,000 family members, who produce and pick the cherries. The CCT farmers sell to the wet plant where the pulp is moved and the beans cleaned. The farmer gets first payment at the gate (or roadside). Transport is outsourced to small transport companies who deliver the produce to the wet processing plant. The price for the cherries is determined on the basis of the quality, and payment to the farmer is done on a monthly basis, prices range from US\$ 0.15 to US\$ 0.22 per kg. Following washing and cleaning the green beans are transported to the drying field near Dili where de-husking, packaging and shipping to the port of Dili takes place. It is estimated that the number of up- and downstream jobs created amount to 2,000 in season. The CCT is supported by the National Cooperative Business Association (NCBA) funded by USAID.

Plantation management in the sector is not encouraging. Most of the coffee trees are 30- 50 years old and are not pruned regularly, and the shading trees are suffering from disease. Though NGOs and CBA offer technical assistance and have set-up demonstration plots, plantation management still is traditional. Low yields of 100-200 kg green beans per hectare results from poor practices and the quality of the harvested cherries is mixed, i.e. good red cherries are mixed with blacks from the ground and green cherries form the plant. However, the coffee sector is the single most important foreign exchange earner with a share of 99% of all exports.

There used to be a copra industry in Timor-Leste, but a coconut tree pest has destroyed most of the groves in Baucau area. Today production is limited to supply of the local market and oil is extracted by simple, inefficient methods. If production is resumed it is likely that Timor-Leste can produce enough oil for cooking – assuming new processing technologies – to replace imports of cooking and edible oils.

It is further estimated that the collection of wild candlenuts can be resumed. The kernels are processed into oil, which was then sold to traders. The same situation is valid for niche products such as vanilla and other spices, where small volumes are now produced making a way for diversification and thereby reducing dependency on coffee. In Indonesian times the farmers were supplied with

¹⁴ Oxfam: Overview of the coffee sector in Timor-Leste. An up-date. August 2003.

inputs by the Indonesian traders, who at the end of the season bought the harvested or collected products at farm gate at a set price. These traders have now disappeared. Active input procurement and final product marketing are not part of the culture and it will take time acquire these skills. In addition, the rural road infrastructure is in shambles and there are no local markets in operation. Hence the farmer keeps production at a low level and swaps local products to satisfy the basic needs of the family. Promoting new concepts and ideas to the largely illiterate rural population is complicated as less than 30% have access to radios, and the farther away from city centres, the lower the density of radios.

4 Constraints and Opportunities for Economic Development Potential and Trade

4.1 Constraints

The GoTL has decided to develop an open, transparent market oriented economy governed by a civil legal system. Though these intensions are commendable, there are multi-facetted problems to be resolved before the goals of reduction poverty and equality are achieved. Problems are found in areas such as difficult macro-economic conditions with little manoeuvrability and flexibility, the environment for business development, at the level of physical infrastructures and there are also some more sector specific issues. However, underlying the problems are some fairly objective constraints. The sections below aim to identify the constraints that are most relevant as obstacles to economic development and forestall the realisation of the gains from international trade.

4.1.1 Economic constraints

Terms of trade

Timor-Leste chose the US\$ as its national tender, which was justified at the time as it provided a base to carry out economic interactions in the international markets without the costly endeavour to establish a national tender. However, the downside is that it limits the Government's ability to manage monetary and interest policy in a flexible manner to support economic development policies. The Banking and Payment Authority's (BPA) role is limited to regulate the flow of liquid money and to oversee the three commercial banks in operation. The US\$ value is based mostly on the performance of the world's largest economy. Its role as a main payment currency of the international economy results in a *de facto* overvaluation of the local Timorese economy, and hence influences the price of Timorese exports upwards in international markets. Local Interest rates at 12-16% further increase the cost of investment and trade compared to financing costs at international rates of 4-7%.

The BPA has initiated discussions on the potential shift towards other currency regimes. However, no specific recommendation has been made to the Government. It may be a sustainable option to introduce a weighted basket system supported by the International Monetary Fund (IMF). If realised the new basket system should be tailored to include interest rate concerns.

Other historic events further distort the Timorese economy internally. The long term presence of a fairly huge contingent of international peace keeping forces, members of the transition government, a volume-wise relatively high presence of donor funded technical assistance staff, advisors and NGO staff, has caused much larger than normal for a Least Developed Country (LDC), imports of high value goods. The result is an artificially high price level in the local markets.

High factor costs of production:

The high local price level has forced labour cost to increase to a level of 1: 3 compared to neighbouring Indonesia. A traditional competitive advantage of an LDC is lost and reduces the country's attractiveness for foreign investors, hence Foreign Direct Investment (FDI) in productive sectors is limited. 94% of the impressive volume (compared to other LDCs) of FDI received, US\$ 1.7 billion, is destined to the oil and gas sector; the balance of approximately US\$ 100 million is invested in the construction industry that benefits from donor funded government contracts in infrastructure rehabilitation.

Remoteness and dispersion of population increase the per capita cost of delivering basic social services such as education and health. Inadequate market facilities and poor rural access roads limit the incentive for the farmer to increase production beyond subsistence level. In addition, the level skills in farming is very low and is conducive only to traditional farming patterns and marketing methods. It is assumed that part of this constraint will be removed by the on-going technical assistance projects such as the ARP II and III and RDP I and II funded by the EC: the NCBA's coffee development project funded by USAID; and the Food security project funded by GTZ.

4.1.2 Enabling Environment of the Private Sector

To encourage inward investment (investment originating from national Timorese) and FDI, there is a need to improve the business environment. A Private Sector policy exists with a legal framework in place and a Sector Investment Programme (SIP)¹⁵ has been approved. The framework generally points in the direction of a transparent open market oriented economy which aims to improve the trade and investment conditions. It is the intention to increase further commercialization of agriculture and the production of marketable surpluses for domestic and export markets. Increased agricultural productivity and improved rural livelihoods translate into increased demand for off-farm goods and services. This requires increased private investment that leads to diversification of the economic base.

The business community in Timor-Leste is small, a total of 10,210 businesses since independence have registered with Ministry of Planning and Finance (MPF), of which 4,370 re-registered in 2005. However, it is estimated that little more than 1,000¹⁶ are actually in operation. These are predominantly micro and small and medium sized enterprises (MSMEs), most work under government contracts funded by the international donor rehabilitation projects. Businesses are obliged to register in Dili, as the three ministerial offices needed for registration (the Secretariat of State of Commerce and Industry (SECI), Ministry of Planning and Finance, and the Notary's Office under the Ministry of Justice) are located there.

A major part of the explanation for relatively confined business community is the very low turn-over of the economy, when rehabilitation work is excluded. There is very little financial surplus in the poverty stricken country (see section 3.2). Thus the domestic market is negligible in terms of consumption and purchasing power. The concentration of business life in and around Dili does not leave much opportunity for alternative rural employment. The growth of the non-farm private sector, which currently employs about 60,000 people, must be accelerated to provide increased employment opportunities for the 15,000 new entrants into the labour force each year. It is the intention of the SIP that the private sector must increasingly become the primary source of growth in incomes and employment for Timor-Leste. Finally, the number of long term sustainable jobs depends to a large extent on the continuing financing from the donor community, the situation, however, is likely to be eased somewhat with the beginning of the net flow from the proceeds of the Petroleum Fund investments (see section 3.4).

However, provisions in the Commercial Company law need revision to simplify procedures. It would seem reasonable to create a one-stop-shop for business registration with only one registration number. Simplification of the corporate tax system, including changes in taxation levels, should be considered to make Timor-Leste a more interesting country for investment (both FDI and NI). The national businesses may make use of the Business Development Centres (BDC) established under the World Bank SEP II project, which is funded by TFET (including EC participation) to develop adequate skills for product diversification and up-grade general management skills, but the educational structure does not produce craftsmen (carpenters, plumbers, electricians, and mechanics).

Exports are overwhelmingly dominated by green coffee beans. Only limited attention has been devoted to provide producers and traders with information regarding demands and technical specifications in the regional and international markets for other agriculture and non-agriculture products. In a similar manner the issues of attraction Foreign Direct Investment (FDI) by providing easy access to information on legal aspects, import and export regimes, business registration, business environments in terms of taxation and economic aspects, networking etc, has been neglected until this year. In mid-June 2005 the Foreign Investment Law (FIL) was promulgated, and it foresees the establishment of an Export and Investment Promotion Agency (EIPA). Preparatory work funded under the SEP II has been done to launch the EIPA later this year. It is expected that the EIPA will be able to cover most of the gaps identified above, though the EIPA as it stands has not secured long-

¹⁵ GoTL. Private Sector Development. Priorities and Proposed Sector Investment Programme, April 2005

¹⁶ Corporate taxation Directorate, MPF

term sustainable funding¹⁷. A National Investment Law (NIL) has also been promulgated in mid-June with the objective to encourage and regulate inward investment.

The trade regime is not favourable at the moment. Port infrastructure requires the vessels to carry their equipment for container handling adding an estimated 15% to the freight cost¹⁸, and the tariff and tax structure (6% tariff on CIS, the excise tax varies between 12-36% on most tariff lines, and a flat rate 5% sales tax – excises and sales taxes are add-ons to the CIS plus tariff, thus percentage on percentage on percentage) adds up to a total of up to 50% on some tariff lines. This makes it difficult for producers to gain a competitive edge. It is likely that the price paid for imports is skewed upwards as a result of Timor-Leste using the US\$ as the only legal tender. As regards exports the situation is even more skewed¹⁹ as 99% of all exports are green coffee beans. Positive aspects includes the increased level of efficiency of the customs services now using the ASYCUDA system, which not only shortens delay periods, simplifies procedures, and adds transparency, but also feeds very important statistical information directly into the system, which is accessible on-line by potential investors, local and foreign.

Investment levels are very low. The local banking system is not conducive to productive investment as the banks only lend at zero risk²⁰. The limited amounts of surplus money in the local economy are not put into savings accounts, but stuffed under mattresses. The low inward investment level is supplemented by a highly skewed pattern of foreign direct investment (FDI).

As specified in the SIP, the GoTL envisions undertaking a series of activities aimed specifically at improving the environment of the private sector by addressing current deficiencies in the business environment. These include the following:

- Land and property regulatory development;
- Business regulatory environment development;
- Trade and industrial policy development;
- Financial sector policy and institutional development;
- Policies for labour and employment generation;
- Capacity building for policy-making and business regulation; and
- Policy analysis of the economic, including formal and informal, operations.

These initiatives would be complemented by specific programs aimed at promoting domestic business activity and attracting additional foreign direct investment, e.g. the EIPA. These programs would give particular attention to the following areas of business activity:

- Further development of agri-business, including increased production of specialty crops for export and import replacement;
- Development of forestry and fisheries products for domestic and export markets;
- Private participation in infrastructure, including perhaps power and water supply;
- Development of the onshore hydrocarbon potential and minerals industry;
- Development of the tourism potential of the country;
- Build capacity of cooperatives, specially related with agriculture production and credit; and
- Build on the existing economic sectors fostering demand for local services and products and strengthening and developing supply.

¹⁷ During the round or interviews the USAID indicated a willingness to fund the first year of operation.

¹⁸ Crocodile Chipping Line, Dili

¹⁹ Export value of merchandise was US\$ 7 mio, in 2004.

²⁰ The local branches of three international banks only lends to companies that hold Government contracts (donor funded); and to staff on the Government payroll

Finally, the Government is also proposing a continuation of support for the ongoing microfinance programs that have been supported by various Development Partners. Current programs are expected to be completed in the near future.

The SIP calls for total public expenditures of US\$ 31 million over the next five years. Of this amount US\$ 3.4 million would originate from the CFET budget allocations equal to 11% of the program needs. The implication is that implementation of the proposed program would require new donor funding in the amount of US\$ 26.6 million over the next five years. A stronger private sector is essential for increased job creation, for improved tax revenues and fiscal capacities and an improved trade balance through reduced imports and increased exports.

In short, the obstacles to SME development are: (1) legal provisions and deficiencies in access to capital do not favour an increased local SME participation in the industry; (2) employment of Timorese staff in blue collar and management positions is hampered by limitation in craftsmen's skills and training capacity; (3) limited access of SME to know-how and sector specific technologies for more innovative and value-added development opportunities; and (4) there is a substantial financing gap.

4.1.3 Utilities and Infrastructure

The physical constraints exist in terms of only one port of entry, Dili port, which is and will remain a bottleneck for trade facilitation. The port is easily accessible from a navigational point of view and water depth is sufficient. However, the port suffers from the lack of a shore based container crane. Thus arriving vessels carry their own gear for off-loading / loading of containers adding to the freight cost (an estimated 15% compared to Singapore) and only Twenty feet Equivalent Unit (TEU) containers can be handled inside the port area. Outside the port fence the roads of Dili city and outside Dili, are not suitable for transporting even TEUs. The carrying capacity of the best northern road going to Com is assessed by the consultant to have long term sustainability at a maximum of 10 ton trucks. Thus moving a TEU (weighing up to 18 ton) to the East by road is not feasible. Country roads leading into the hills and mountains ranges have even less carrying capacity.

Geographical remoteness and substandard airport capacity are not conducive to tourism development. The only airport in operation is located near Dili. The runway allows only short range aircraft to land, thus tourists have to change planes regionally (Bangkok, Singapore, Jakarta, Denpasar, Darwin). The best airport in Timor-Leste is near Baucau equipped with a 3,400 m runway allowing long range carriers to land. However, the radar, radio and other airport operational aids and security systems need to be up-graded.

Poor road transport infrastructure results from the destruction by the withdrawing Indonesian administration in 1999. Dili is the one commercial port and has limited capacity in terms of handling equipment. It is the only point of customs clearance. Demolition of utilities such as electricity supply and distribution network further limits expansion outside Dili and has increased the costs. These factors increase costs of production, which deter FDI and local investment.

4.1.4 Oecussi Specific Constraints

The geographical separation of Oecussi District, an enclave within West Timor, and its land border with Indonesia are its main constraints. Separation poses special problems for the delivery of Government services and development activities. Though a road link exists, it is under the exclusive control of Indonesia and the cost and formalities of crossing the border by land are prohibitive for virtually all East Timorese citizens. The ferry connection between Oecussi and the main part of Timor-Leste operates normally and is affordable, but is limited and takes a lot of time.

However, it is difficult and costly to develop normal economic activities as this would require extra Government staff to carry out agricultural extension, and educational, social and health related services, and to collect customs duties and taxes. In fact the latter issue has caused substantial problems, which have been so serious that one proposal is to make Oecussi a free trade zone. There is

no effective customs control at the land and sea borders of Oecussi, through the enclave is part of the Timor-Leste customs territory.

In general terms the economic activities are of the same nature as in the main part, i.e. agriculture production. In addition, the regular ferry traffic between Oecussi and Dili allows for the transshipment of goods to the rest of Timor-Leste from West Timor, tax and tariff free and without control of origin. Illegal border trade in agricultural products, and other products such as fuel and tobacco, have been indicated to be a regular feature, thus levying unfair competition on Timorese farmers in general, and depriving the GoTL of a revenue source.

4.1.5 Sector Specific Constraints

Fisheries

The main constraints to fisheries are related to the lack of institutional capacity and the low level of human resource qualification:

- There is no marine research institute
- There is no scientifically based knowledge on fish stocks and hence sustainable yields
- There is no record of landings
- There is no knowledge about the size of the fleet and no registry of fishing vessels and the fishing effort
- There is no training centre for fishermen
- There are no port infrastructures to support even medium scale fishery, i.e. there is a lack of shipyards, repair and maintenance facilities for engines and gear, flake ice plants, and there are no operational cold stores or any fish processing facilities.
- The capacity to carry out monitoring surveillance and control (MSC) of the vast EEZ is limited to the Coast Guard's two outdated vessels (said to be non-operational upon inspection).

The only kind of fisheries that take place at the moment is very near coastal fishing from small outriggered canoes (10 feet) with equally small engines. The methods applied include gill nets, hook and line and various traps. The result is a peculiarly low local consumption of fish for an island society.

Tourism

It is noted the WTO programme to develop a tourism sector strategic plan for 2005-2020 is well underway. The legal framework is therefore assumed to be in place. This may help reduce the constraints that exist. However, the main known constraints directly related to tourism development are in terms of:

- Poor transport infrastructure as the airport capacity is insufficient to cater for wide bodied aircraft
- The roads would require up-grading
- The level of accommodation is low and highly concentrated in Dili
- There are no training facilities within the hospitality professions

4.2 Opportunities and integration with Poverty Alleviation Strategy

4.2.1 Niche Approach for agriculture

Imports of agricultural produce to feed the population, and for the growing tourism sector, are costly and constitute a drain on foreign exchange reserves. There is scope for reducing the foreign exchange cost by increasing the local production of field crops, horticultural products and tropical fruits. The image of the Timor-Leste agricultural products as ecologically healthy should also be promoted, as in case of 'Café Timor', towards catering in tourism resorts. In addition promotion of valuable spices on the same ecological and fair trade basis should be carried out on international markets.

- Agricultural produce that may act as an intermediary product for other sectors should be encouraged to create further value added, e.g. in terms of input to feed production for poultry and potentially aquaculture development.

- The option to increase the production of poultry products such as eggs and poultry meat for local consumption and the tourist resorts should be investigated. However, due to the level of skills in farm management and the poorly functioning rural marketing systems only niche type products and productions should be considered.

4.2.2 Fisheries

The traditional near coast fisheries with sustainable technologies should be continued and potentially expanded by the acquisition of more modern and larger vessels.

For the high sea fishery it will take time to develop a fleet with sufficient capacity. Meanwhile licensing to international operators should be carried out – a system that may actually be implemented this year for the first time.

Though the resource composition and size is not known, it is expected that valuable high sea species are present. To derive the optimal benefits from this resource it may prove an interesting avenue to investigate establishment of a shipyard that produces fibre glass vessels with low fuel consumption and travel at higher speeds than the near coastal vessels. Potentially, this would increase the catch of higher value reef fish and pelagic species including valuable tuna species (big eye, albacore) and swordfish at sustainable levels, and thus improve the basis for exporting value added fresh and frozen products to the large Asian and growing European markets. The marketing effort should be directed towards introducing the ‘Timor-Leste Ecolabel’ of ecologically top quality products that are dolphin safe. A similar approach has been taken by the Maldives in promoting their sustainably caught tuna, obtaining a premium price. Thus potential is found for:

- Application of the licensing approach to expand the catch of high sea species as tuna (yellow fin, big eye and albacore),
- Developing export of fresh products as the international markets for fresh tuna loins and reef fish species is substantial.
- Developing and promoting higher value niche markets based on the Timor-Leste image
- Encouraging marine ranging of high value species such as sea cucumber for the Asian markets, and investigate other types of marine and brackish water aquaculture.
- Develop a cluster type industry in one port of the northern side and one on the southern side that is able to cater for up- and down stream sector activities (production of vessels and gear, flake ice production, boxes for marketing etc.)

4.2.3 Tourism

Tourism development is now being guided by the WTO project, and the opportunities identified for a low volume but high end tourism are being pursued. Whereas the capital gains may be difficult to realise in the short to medium term (as structural constraints within the general economic conditions and in terms of access to capital prevail), there are a number of attractive areas where returns to the economy at large and for redistribution to the population are readily available. The objective is to increase the socio-economy gains from tourism by creating local employment and increase family income through the development of opportunities in the sideline activities of tourism. The following list is not exhaustive:

- The concept of developing cultural villages is an option, whereby one or more villages in a district are designated for the tourist to experience local products, folklore, handicrafts, restaurants, family visits, traditional farming and (potentially fishing), archaeological exploration etc. The community would benefit in terms of jobs in shops, catering, guiding and the sale of locally produced products (agricultural, fishery, handicraft).
- There is also scope for small scale specialist tourism such as guest houses and “farmer or fisherman” vacations whereby the tourists stay and experience the “real” Timorese way of life in local communities rather than in resorts.

Additional options for the involvement of local fishermen in resort water related sport activities should be encouraged. Potential for competitive production is found in these areas:

- Transport to and from the resorts
- Catering in terms of restaurant and picnic cruise operations
- Island circumnavigation and inter island cruising
- Water sports activities and game fisheries

4.2.4 IT and ICT

The application of IT and ICT towards development purposes should be explored. Being a new nation Timor-Leste may be able to jump several steps in the historic development patterns of these services and move to install the latest – and most cost effective technology. This is still a costly undertaking, but the returns may prove equally high if application is done with pro-poor development perspectives. It would be possible to overcome some of the constraints in reaching the more remote district centres by using USB sticks or CD-Rom as the mean of storage and transportation. In the centres the technology may be used as part of vocational training and instruction in farming technologies, marketing and general and financial management.

The rugged geography requires the installation of an ICT infrastructure based on broadband cabling, micro wave and satellite technology. In the short and medium term ICT should act as support to private sector development efforts in the regions. In the medium to long term the option of introducing e-learning to provide training outreach to the more remote areas should be investigated. Experience from this endeavour may prove to be an exportable product to other small island states.

5 International Trading Environment

Timor-Leste is at present not a member of the intentional trading system governed by rules. However, it is a member of the World Customs Organisation (WCO) and has asked for observer ship with ASEAN and its free trade agreement called AFTA. Thus important steps towards a full integration in the world economy have been taken. Further steps involve decisions regarding whether to join international organisations such as the World Trade Organisation (WTO) or whether to join regional or tri-lateral/bilateral systems. The sections below present some of the important aspects relevant to a Least Developed Country (LDC) such as Timor-Leste, when joining the international rules based trading system.

5.1 Rules Based Trading

Though Timor-Leste is not a member of the World Trade Organisation (WTO) and, hence, not party to the 17²¹ multi-lateral Agreements of the Uruguay Round and its many associated decisions and declarations, including the Doha Ministerial Declaration, rules based trading is the future as evidenced by the 148 member countries. For the members this means that all 95% of world trade is governed by the international rules based system agreed between themselves, and its numerous commitments and obligations, which sets the framework within which national policies and actual trade takes place. However, as a LDC, Timor-Leste enjoys greater flexibility and consideration (Special & Differential provisions) in the application of these rules, obligations and commitments. The basic principles are reciprocity (i.e. that the advantage a nation gets has to be offered in return) and non-discrimination (goods imported of a similar nature to goods produced in the importing country have to be treated on equal terms). However, to stimulate development within LDCs, preferential benefits are often offered on non-reciprocal terms by developed countries.

The international rules based system of trade is an evolving process and rules, obligations and commitments that are renewed and changed over time through a process of negotiations (so-called "Rounds"). Currently the membership of the WTO is engaged in talks, the Doha Development Agenda (DDA), which seek to deepen and widen the areas of trade liberalisation, as well as clarify certain rules. The results of this round of negotiations will have an impact on Timor-Leste. Although the DDA covers a whole spectrum of issues, the main areas of agreements and negotiation which will affect Timor-Leste are examined in the next sections:

- Non-Agriculture Market Access (NAMA)
- Agriculture
- General Agreement on Trade in Services (GATS)
- Rules
- Trade Related Intellectual Property Rights (TRIPS)
- Market Access Non-Tariff Barriers to Trade
- Trade facilitation
- Trade related technical assistance

5.1.1 Non-Agriculture Market Access

The current negotiations have agreed modalities²² for the reduction of bound tariffs based on a formula approach; that is, all members of WTO will commit to the reduction of their bound rates for all industrial and for e.g. horticulture, forestry and fisheries products. The levels and rate of reduction will be agreed and could differ by sector (even if a uniform rate is agreed for all industrial tariffs, it is

²¹ Marrakech Agreement; GATT1947; GATT94; Agreement on Agriculture; SPS Agreement; Agreement on Textiles and Clothing (expired); TBT Agreement; TRIMs Agreement; Agreement on Anti-dumping (Implementation of Article VI of GATT94); Agreement on Customs Valuation (Implementation of Article VII of GATT94); Agreement on Pre-shipment Inspection; Agreement on Rules of Origin; Agreement on Import Licensing Procedures; Agreement on Subsidies and Countervailing Measures; Agreement on Safeguards; General Agreement on Trade on Services and; Agreement on TRIPS.

²² Annex B, Doha Work Programme, Decision Adopted by the General Council on 1 August 2004 (WT/L/579)

likely that different rates for fisheries products will be agreed) and by degree of development (least-developed countries are unlikely to have to make any reductions in bound rates). However, since in Timor-Leste, only applied rates exist, the impact on imports (prices) and tariff revenue are likely to be limited in the short and medium term. The average applied rate is 6% per cent. Therefore, WTO members would have to agree a relatively high level of reduction before the applied rate in Timor-Leste would be affected. Therefore, the impact of NAMA negotiations on the Timor-Leste applied tariff under the Doha Round is likely to be nil or negligible. However, if, in the future, rates are bound by Timor-Leste and if the bound rates approach and equal applied rates, future negotiations and reductions will result in the reduction of actual tariff rates leading to substantial losses in government revenue (as revenue from import duties are approximately 60% of tax revenue).

In addition, because the bound rates²³ of Timor-Leste's major export markets will be reduced, and currently Timor-Leste receives a preference (mostly duty free), there will be an erosion of this preference and reduced relative market access (compared with competing non-least-developed country countries). However, the extent of this preference erosion is likely to be small as most of the Timor-Leste's coffee exports enjoy zero Most Favoured Nations (MFN) rates in USA, Australia, and EU, the latter where Timor-Leste enjoys Everything But Arms (EBA) preference a zero rate. Effectively, Timor-Leste has only limited preference value for most of its current exports.

5.1.2 Agriculture

Current negotiations have agreed modalities²⁴ for the reduction of both agricultural subsidies and import duties by a formula approach. A tiered approach has been agreed so that countries with the highest rates of trade distorting subsidies and tariffs will be required to make the largest reductions. Similarly to industrial tariff reductions, special and differential treatment (to be determined) will be applied to developing countries in both subsidies and tariff reductions and least-developed countries such as Timor-Leste will be exempted from any commitments. In addition, a limited number of tariff lines can be nominated by all members as sensitive products, which would be exempted from tariff reductions.

Since Timor-Leste operates no agricultural subsidies in general for agricultural imports, the impact of the current negotiations on tariff and revenue are likely to be nil or negligible. Exports of agricultural products from Timor-Leste will benefit little from tariff reductions in foreign markets. As Timor-Leste is a net food importer, mostly of rice which is subsidised in Indonesia, reduction of subsidies on rice would benefit Timorese consumers and potential producers (who will be more competitive).

As a net food importer Timor-Leste will be concerned by rising world prices for agriculture which may result from future reductions in subsidies in the OECD countries. For example, if all domestic support and export subsidies in OECD countries were removed, the world price of wheat is estimated²⁵ to rise by 14%, rice by 3.9%, vegetable and fruits by 2.9%, vegetable oil by 7.9%, sugar by 4.9%, livestock and meat by 8.6% and processed food by 2.8%. Such increases in prices will also adversely affect the balance of payments and foreign currency requirements of the country.

5.1.3 Trade in Services

GATS negotiations are currently focusing on a request-offer system and clarification of some GATS rules. WTO members initially make requests to partner countries to liberalise certain sectors (in theory this would be a concern for the future oil and gas related services, environmental, and tourism services, which Timor-Leste may like to protect). Following these requests, countries should enter into consultations (effectively bi-lateral negotiations) and then make initial offers which will be applied to all WTO members, not just those which made the request. In addition, members are expected to make initial offers on other sectors.

²³ Bound rates are close or equal to applied rates in most industrial and developing countries which are Timor-Leste's main export destination (US, Australia, ASEAN and EU)

²⁴ Annex A, Doha Work Programme, Decision Adopted by the General Council on 1 August 2004 (WT/L/579)

²⁵ "Cost of Agricultural Distortions" (2001) Economic Research Service, USDA

Not being a member of WTO Timor-Leste has not scheduled any sector, it operates a fully liberal regime in the services sectors. Therefore, scheduling some services sectors under GATS should not present any problems, even in typically difficult areas such as mode 4 (mode of delivery). For example, participation in tourism resorts is open to both foreign and local investors (and resorts are allowed to have more than 50% foreign employees).

5.1.4 Rules

Negotiations will clarify GATT Article XXIV on defining, amongst other issues, coverage in free trade areas which could directly affect the potential relationship to ASEAN Free Trade Area (AFTA). If the rules negotiations specify a strict definition, liberalisation of trade in AFTA could be extended and Timor-Leste would be required to further liberalise regional imports causing greater reductions in government revenue from import tariffs

5.1.5 TRIPS

Some of the negotiations focus on geographical indications (geographical indications are place names used to identify the origin and quality, reputation or other characteristics of products) and are examining how article 23 of the TRIPS Agreement could be extended beyond wines and spirits. Of relevance to Timor-Leste, could be the inclusion of “Café Timor”, which is marketed by ‘Starbuck’ in the region and worldwide. Only if other regional producers copy the process and sell their products under the same name in direct competition is article 23 relevant. Listing “Café Timor” as a geographical indication under Article 23 of TRIPS could be used to prevent the use/abuse of this “name” to the detriment of Timor-Leste trade.

5.1.6 Market Access Non-Tariff Barriers to Trade

In terms of exports all are traded under MFN terms and with EBA valid for exports to EU. However, it will be necessary to implement a number of institutional reforms to comply the Non-Tariff Barriers to trade (NTB). These include two major agreements under the WTO:

The Technical Barriers to Trade (TBT): The TBT agreement requires the traded goods are tested for conformity with the various valid international standards of a technical nature, such as those guarded by the International Standards Organization (ISO), the International Electrotechnical Commission (IEC) and the International Telecommunication Union (ITU). Their activities have had major impact on trade, especially in industrial products. For example, ISO has developed more than 9,600 international standards covering almost all technical fields. In addition, a standards and accreditation facility would assist with provision of necessary documentation as required under the Rules of Origin (RoO) in order for the exporters to obtain Certificates of Origin (CoO). TBT standards may specify packaging requirements, the actual presentation of a product according the preferences of a country’s consumers.

To comply with the TBT agreement a test laboratory should be available in the country and documentation should be provided. Goods that are not tested and certified according to the TBT standards may prove difficult to trade.

The Sanitary and Phyto-Sanitary (SPS) rights: These rules and regulations protect human health or safety, protect animal and plant life or health or the environment (the natural resource endowments). Within this broad area, the WTO reference agreement Phyto-Sanitary (SPS) remains and it describes the agreed rules, procedures and standards, which otherwise are compiled in the Codex Alimentarius of the FAO, the WHO reference library, the Office International des Epizooties (OIE), and the international and regional organizations operating within the framework of the FAO International Plant Protection Convention (IPPC). There is a need to establish and accredit an SPS laboratory to carry out the necessary tests and analyses leading towards a national level certification of export enterprises. Products from traders or enterprises without SPS certification will become difficult to export.

A fully equipped national laboratory would be needed with the potential to carry out field work. The laboratory should be linked-up with the appropriate research faculty at National University of Timor-

Leste to secure future linkages between basic and applied research environments.

5.1.7 Trade facilitation

Trade facilitation involves the implementation of simple, uniform, and transparent procedures for handling trade at the point of entry in order to make the goods flow without unnecessary delays. Implicit is the requirement for a well trained customs service that applies modern services in terms of one-stop form procedures (preferably using electronic document handling), application of the harmonised system of coding to calculate the tariffs applying internationally agreed customs valuation methods.

Trade facilitation further involves the availability of a reasonably well functioning transport infrastructure, and other physical features such as handling equipment in ports and airport.

5.1.8 Dispute Settlement

The WTO has a Dispute Settlement Body (DSB) where claims raised by one nation against another for breaking the rules and procedures can be handled. The procedure is long – up to several years. Most of the claims raised concerns dumping for products (selling products to an importer below the cost of production), or the application of the safeguards mechanisms, whereby a country may levy quota restrictions against another country to protect its own industry against unfair trade (for example Timor-Leste may want to raise a quota or introduce a temporary stop against the import of subsidised rice for Indonesia). Using the DSB requires skilled negotiators and/or trade lawyers.

In most cases when a claim is raised the two nations in question decides to settle via bilateral negotiations in the corridors of WTO. This is expensive as mostly lawyers are used as arbitrators.

5.1.9 Trade related technical assistance

The various provisions of WTO which encourage support and technical assistance to least developed countries in their participation in WTO and the fulfilment of their obligations result in greater attention at WTO and other institutions on providing trade related technical assistance targeted towards least-developed countries.

5.1.10 Benefits and costs

The benefits of joining the WTO for Timor-Leste are not so much related to immediate trade gains in terms of increased volumes of exports, or generation of increased revenue from tariffs and other customs duties. The benefits are much more related to the requirement to implement the necessary economic reforms and carry out the required institutional capacity building. These activities will lead towards a general up-grading of skills and quality in production and control, and hence foster economic development.

The costs include a membership fee equal to a percentage of the actual Timorese share of the world trade; it is equivalent to US\$ 115,000 at present. In addition, the GoTL will have to make (trained) staff available for participation in the trade round negotiations and other required committee meetings and conferences.

It is recommended that Timor-Leste applies for observer status at WTO, which is done by addressing the Secretary General of WTO. The status will allow Timor-Leste officials to get acquainted with the WTO environment and the working procedures without having to face the costs and meet the rather steep human resource demands. Observer status is for an initial period of five years during which period Timor-Leste benefits from the services/training offered under trade related technical assistance program.

5.2 Regional Integration

5.2.1 ASEAN Free Trade Area (AFTA)

The Association of South East Asian Nations (ASEAN) was formed in 1967 and is composed of 10 regional countries. At the core of ASEAN economic cooperation is the Framework Agreement on Enhancing Economic Cooperation, which was adopted at the Fourth ASEAN Summit in Singapore in 1992, and includes the Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area (AFTA).

On 26 July 2005, the Democratic Republic of Timor-Leste became the 11th member of the ASEAN Regional Forum (ARF). The Secretary General of the Timorese Ministry of Foreign Affairs and Co-operation, Mr Nelson Santos, expressed his country's gratitude to the ASEAN countries which have supported Timor-Leste's bid and "particularly to Indonesia who spearheaded our campaign to join the ARF". Mr Santos stated that "geographically Timor-Leste is part of ASEAN" and added "it is important for us to gain our goal one day of becoming a member of the ASEAN organisation".

The strategic objective of AFTA is to increase the ASEAN region's competitive advantage as a single production unit through the elimination of tariff and non-tariff barriers among the member countries, thereby promoting greater economic efficiency, productivity, and competitiveness. The Fifth ASEAN Summit held in Bangkok in 1995 adopted the Agenda for Greater Economic Integration, which included the acceleration of the timetable for the realisation of AFTA from the original 15-year timeframe to 10 years. In 1997, the ASEAN leaders adopted the ASEAN Vision 2020, which called for ASEAN Partnership in Dynamic Development aimed at forging closer economic integration within the region.

The vision statement also resolved to create a stable, prosperous and highly competitive ASEAN Economic Region, in which there is a free flow of goods, services, investments, capital, and equitable economic development and reduced poverty and socio-economic disparities. ASEAN has also embarked on negotiations on the liberalization of trade in services covering all service sectors and all modes of supply, as well as creating an ASEAN Investment Area (AIA) and an electronic ASEAN (e-ASEAN). Under these schemes, goods, services and capital are to flow freely within the region. In addition to trade and investment liberalization, regional economic integration is being pursued through the development of Trans-ASEAN transportation network consisting of major inter-state highway and railway works, principal ports and sea lanes for maritime traffic, inland waterway transport, and major civil aviation links. ASEAN is promoting the interoperability and interconnectivity of the national telecommunications equipment and services.

The framework of the Initiative for ASEAN Integration (IAI) has now also been put in place. It is a program that covers infrastructure, information and communications technology, human resource development, and capacity building for regional economic integration. ASEAN is now looking for funding assistance for these programmes. This is designed to accelerate the narrowing of the development gap between the initial ASEAN members and the more recent four members whose economies are considerably less developed. During the accession process, the Secretariat has an "attachment programme" whereby a civil servant from the acceding country is employed for a six month term in the Secretariat. This process has sometimes been repeated over five or more years.

This region houses some of the most important present and future trade partners. It has a combined population of approximately 500 million people and the organisation covers 96% of the regional trade. Discussions between ASEAN and some of the major countries in the region such as China are on-going.

Aside from the direct trade perspective it is an important forum as the organisation's political clout extends well beyond regional boundaries. A useful feature when later negotiations with Indonesia on trade and economic cooperation are to take place.

Since Timor-Leste generates most of its government revenue from import duties, elimination of duties on one quarter of imports will inevitably adversely affect government revenues. Government revenues on existing regional imports will be lost (static effects) as well as loss of revenue on imports from other countries (dynamic effect) as buyers in Timor-Leste switch to “cheaper” duty free regional imports. A static analysis of imports suggests that 25 per cent of government tariff revenue could be lost from AFTA implementation. This figure could be higher when the dynamic effects are taken into account.

Moreover, since Timor-Leste has a limited export and production base, it has limited potential for significantly increasing exports to the region. However, producers and consumers may gain from cheaper products.

Membership is expensive as it requires:

- Each member government must set up an ASEAN bureau to facilitate coordination with the ASEAN Secretariat, as well as policy units in the relevant ministry or ministries; usually this would mean a political unit in the foreign ministry and an AFTA-specific unit in the trade ministry.
- Payment of a membership fee. This is the same for all members: an equal share of the costs of the ASEAN Secretariat. Hence a small country is required to pay the same amount as a large country. The current budget of the Secretariat is roughly US\$10 million. This implies an annual membership fee for Timor-Leste, the 11th member, of approximately US\$1 million dollars. This is a significant sum given Timor-Leste’s financial resource constraints. It would probably need donor assistance to meet this requirement (Japan is currently paying Cambodia’s membership fee).
- Each member must attend a number of annual ministerial and working group meetings, which can amount to 400 meetings per year. These meetings do not take place in the Secretariat’s headquarters in Jakarta but alternate among the member countries. There are Heads of Government meetings every year (formal every third year, informal the others) as well as at least one meeting each of ASEAN foreign ministers (AMM) and of ASEAN economic ministers (AEM). In addition, each of the latter two groups holds a “retreat” each year. There are also senior official meetings (SEOM) four times a year for each Ministerial. Thus, there are at least ten or so core meetings every year. Furthermore, there are a number of working groups and committees (several under each SEOM) who also meet four times each year for each Ministerial (these cover specific issues such as customs, CEPT implementation, intellectual property rights, standards and conformance, industrial co-operation, information technology and regional integration). Such a level of activity is currently well beyond the human and financial capacity of Timor-Leste, absent significant assistance.
- Significantly for Timor-Leste, given that it has chosen Portuguese and Tetun as its official languages, English is the official language for ASEAN. Hence Timor-Leste would need to develop its human capacity accordingly if it were to participate effectively in ASEAN.
- 10 diplomatic representations need to be established.

The potential trade and economic benefits of ASEAN membership are as follows - the comment in () refers to similar types of benefits that Timor-Leste may gain via a PIF-membership see next section:

- Encourage, bolster and lock-in Timor-Leste’s developing liberal trading and economic regime (however this is the same benefits under the PICTA agreement for the Pacific Island Forum, PIF, countries);
- Increase the variety of import goods, such as essential food items, machinery and equipment, and apparel, (much larger from the economically more efficient and diversified ASEAN region than from the PIF membership group)
- Potential to become a sub-supplier to the ASEAN regional industries as Timor-Leste enhances its trade capacity technically and in quality terms

- Potential to export value added products from e.g. fisheries to a much larger consumer group. (Integration with PIF is not likely to increase fish exports as this is a main export from PIF member countries)
- Trade transaction costs will be smaller with ASEAN due to better and more coordinated infrastructure for maritime and aviation transport
- Provide Timor-Leste with access to additional financial and technical assistance (the same benefits will apply through the EU EPA package if Timor-Leste decides to integrate with the PIF).
- Expand Timor-Leste's market access opportunities by joining it to a regional grouping of large, expanding and vibrant (notwithstanding the residual impact of the Asian economic crisis) economies;
- Give Timor-Leste some influence and voice in a regional grouping with international clout;
- Assist the development of Timor-Leste's trade and economic linkages in the South East Asian region beyond Indonesia (the same of course is true with a PIF membership) ; and
- Act as a stepping stone towards WTO membership (which would be the case if Timor-Leste ratifies the Cotonou-agreement including negotiating an EPA).

The growth of trade among ASEAN members since the inception of AFTA demonstrates the value that ASEAN membership could offer Timor-Leste in terms of trade growth potential. Within six years from the launching of AFTA, exports among ASEAN countries grew from US\$43.26 billion in 1993 to almost US\$80 billion in 1999 an average yearly growth rate of 28.3 percent. In the process, the share of intra-regional trade in ASEAN's total trade rose from 20 percent to almost 25 percent. Tourists from ASEAN countries themselves represent an increasingly important share of tourism in the region. In 1996, of the 28.6 million tourist arrivals in ASEAN, 11.2 million or almost 40 percent came from within ASEAN itself. Therefore, with its narrow export base, traditionally low level of trade and lack of market diversification, Timor-Leste could benefit immensely from economic integration in ASEAN.

Timor-Leste has applied for status as observer with ASEAN AFTA, and it is recommended that this status is kept for a period of at least three years after which full membership should be sought. The benefits of joining an organisation with international political clout and huge trade potential clearly outweigh the costs in the long term

5.2.2 Pacific Island Forum (PIF)

The free trade Pacific Island Countries Trade Agreement (PICTA) under the Pacific Agreement for Closer Economic Relations (PACER) is not likely to result in increased trade for Timor-Leste. The markets in the PIF group of countries are smaller than for the ASEAN and trade transaction costs are higher, due to the more complicated geography. PIF countries tend to produce more of what Timor-Leste can produce in the future e.g. value added production based on fish. However, the sharing of experience and information with countries of same nature and access to funding for technical assistance is of some interest. The Forum has a number of related agencies and institutions, which could offer assistance and advice to Timor-Leste. In particular, the Forum Fisheries Agency (FFA), which assists its member countries in the management of their Exclusive Economic Zones and development of their tuna industries, could assist Timor-Leste in the management of its potential tuna resource. Although the FFA is an agency of the Forum, and all the current members of the FFA are also Forum members, membership is not restricted to Forum Island Countries (FICs). However, as with Forum membership, it would be expedient for Timor-Leste to limit itself to informal involvement with the FFA, at least until it is clarified how ASEAN would perceive more formal involvement.

Given the similarities between Timor-Leste and many of the FICs in terms of size, development and geographical placement, Timor-Leste might stand to learn a lot from the experiences of FICs, especially the small island states (SIS), in developing government administrations, collective promotion of shared interests in international forums, and pursuing sustainable economic development. In particular, a number of FICs are WTO members or are in the midst of the accession

process, and so have a wealth of experience that is very relevant to issues concerning consideration of WTO accession for Timor-Leste. Similarly, the FICs offer useful experiences and guidance vis-à-vis the EC and the Cotonou Agreement.

Forum membership would also allow Timor-Leste to join the South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA), a non-reciprocal trade agreement under which the two developed nations of the Pacific Island Forum, Australia and New Zealand, offer duty free and unrestricted or concessional access for virtually all products originating from the developing island members of the Forum. The Agreement also includes provisions for general economic, commercial and technical co-operation, safeguard provisions relating to dumped and subsidised goods and suspension of obligations, general exceptions and revenue duties and special treatment and assistance to be extended to SIS. Although both New Zealand and Australia have already committed to extending duty free access to Timor-Leste by virtue its LDC status, membership of SPARTECA would have the advantage of not being dependent on LDC status and providing a wider range of benefits than just zero tariffs.

However, ultimately Forum membership offers only limited benefits to Timor-Leste in terms of trade expansion potential, financial or technical assistance, or international clout. Moreover, as noted above, ASEAN membership is probably not compatible with full membership of the Forum. As ASEAN membership offers much greater security and economic benefits to Timor-Leste, it would not be worth jeopardising Timor-Leste's prospects of ASEAN membership by establishing formal links with the Forum, if this proves to be a real issue. Therefore, it would be better for Timor-Leste to restrict itself to informal linkages with the Forum as long as it maintains aspirations to full ASEAN membership (see the bulleted section under ASEAN above for a comparison of benefits).

5.2.3 Tri-lateral Agreement

One of the most significant trade opportunities which Australia and the Northern Territory offer Timor-Leste is that of developing linkages through a trilateral relationship with Indonesia. At one level this would be pursued by the national governments (Canberra, Dili and Jakarta). A first Trilateral Ministerial forum involving Timor-Leste was established in February 2002. This forum is intended to provide a format to discuss all matters of trilateral concern, and economic cooperation was one of the issues discussed in the first meeting. It would be in Timor-Leste's interest to have this Trilateral Ministerial meeting formalised as an annual event and to have trade and economic issues given due focus on the agenda. This could assist to accelerate the development of both trilateral trade cooperation as well as bilateral trade relations, particularly between Timor-Leste and Indonesia, where such a forum should contribute to normalising their relations and the pursuit of bilateral trade initiatives such as an FTA, with Australia acting as an encouraging agent (both in terms of goodwill and in potentially offering financial assistance to facilitate cooperative activities). This is particularly relevant as Timor-Leste is well down on Indonesia's priority list, so third party assistance to encourage Indonesia to address its relationship with Timor-Leste should be utilised whenever possible.

A Trilateral Ministerial should also serve to deflate lingering suspicions and bad feelings between Indonesia and Australia with regard to Timor-Leste; Timor-Leste's interests will only suffer if Australia and Indonesia are not fully cooperating.

5.2.4 Timor-Leste and Indonesia Cooperation

Since independence the ambition to normalise the relationship with Indonesia has been pursued. A Joint Ministerial Commission was established and met in 2002. The main purpose was to discuss the conditionality around normalisation e.g. regarding the problem with illegal border trade, the handling of the Oecussi road transport link etc. However, the ambition is to establish a wider economic cooperation including potentially a Free Trade Agreement.

The benefit of the FTA would clearly be in favour Indonesia with her substantial trade surplus. Granting tariff free access for subsidised Indonesian rice would just out-compete the local Timorese

production. Thus an FTA should only be considered if the wider economic cooperation and security issues are resolved first.

5.3 EC relations

5.3.1 EU – Everything But Arms (EBA)

Timor-Leste's relationship with the EU is presently governed by the Asia Latin America (ALA) programme, where funds for development assistance are made available through the ALA Regime (if Timor-Leste decides to ratify the Cotonou-agreement and thereby become a member of the ACP community, it will receive funding through the 9th EDF).

In terms of trade however, Timor-Leste as an LDC enjoys preferential treatment under the EBA. The result is that all goods presently exported from Timor-Leste enter duty and quota free on a non-reciprocal basis.

However, negotiations regarding the transfer of Timor-Leste to the Cotonou Agreement began in 2002. Due to the presence to the above funding program, it was agreed that Timor-Leste would wait until the ALA funding was exhausted. This will happen in 2006, and it is expected that ratification will take place this autumn.

5.3.2 The Cotonou Agreement

Timor-Leste became a member the ACP countries in March 2003 but has not yet ratified the Cotonou Agreement, although it is expected to do so before the end of 2005. Once Timor-Leste ratifies the agreement, the EC co-operation with the country will be implemented in the framework of the European Development Fund (EDF), while co-operation with ASEAN and its members will continue to be implemented in the framework of the Asia and Latin America (ALA) Regulation.

The 20 year Cotonou Agreement, signed in June 2000, is the successor to the four successive Lomé Conventions. Under these arrangements the EU has offered trade preferences to the African, Caribbean and Pacific States (ACP), most of which are former colonies of its member states. Among other objectives, one overriding goal was to improve the capacity of member states to integrate with the world economy. The Cotonou Agreement reflected a wide consensus amongst the ACP and the EU that while market access is important, it is in itself not sufficient to generate trade. Only if integrated into the wider field of trade-related issues (e.g. competition policy, trade facilitation or investment policies) and combined with development co-operation most importantly regional integration, will trade performance increase. EPAs are based on a new approach which combines trade and development cooperation. The emphasis is put on the creation and the consolidation of a regional sustainable economic market providing legal certainty and enforceability of WTO compatible trade rules to investors. Development cooperation should support this objective. Negotiations on EPAs started in September 2002 and they are to be completed by December 2007. The aid component of the Cotonou Agreement provides support for the 77 ACP countries in the form of 13.5 billion Euro under the 9th European Development Fund (EDF) in addition to balances from the earlier Lomé Agreements and loans from the European Investment Bank (EIB). A considerable amount of EDF funds has already been earmarked for trade-related assistance programmes (e.g. in the areas of negotiation assistance, capacity strengthening, sanitary and phytosanitary standards) to ASEAN.

The Cotonou Agreement includes both trade preferences and aid programmes. The trade preferences will cease to exist at the beginning of 2008 when the new WTO compatible trade agreements (EPAs) currently negotiated with the ACP will enter into force. Assistance to any signatory country is set for a five-year period. Stable funding will allow a country to use the aid more effectively. A proportion of that money is earmarked for technical assistance to trade topics such as trade in services, intellectual property rights and other non-tariff obstacles such as sanitary and phytosanitary

restrictions. Special provisions are made for Island states, and those least development countries in post-conflict situations.

Timor-Leste has two priorities for its development policy. One is to develop economically to bring increased prosperity and opportunity to its people and the second is to ensure that its institutions are efficient, transparent and promote the private sector. The Cotonou Agreement is well suited to help Timor-Leste achieve these ends. In addition, the Agreement can provide important political benefits by fostering regional integration. An explicit aim is to encourage the ACP countries to integrate more closely with other member countries in their particular region.

The main economic benefit that Timor-Leste can expect from Cotonou will be in the form of development assistance. However, the Cotonou Agreement is unlikely to provide Timor-Leste with improved market access given EBA. As an island state, it will also be accorded special treatment in accordance with Articles 84-90 of the Cotonou Agreement.

The benefits for Timor-Leste under the agreement will therefore be mainly financial and technical support. The following programmes might be of particular interest to Timor-Leste:

- **A €20 million facility to ensure that ACP countries are ready to open EPA negotiations.**
- A €10 million facility to assist ACP States deal with WTO issues including the ACP Antenna in Geneva (€1.4 million) serving as a WTO focal point for ACP States.
- Programmes to promote foreign direct investments and entrepreneurship. PROINVEST (110 M€) managed by Centre For Development of Enterprise (CDE)
 - Investment and technology flows to enterprises.
 - to support intermediary organisations and professional associations
 - to develop inter-enterprise partnerships
- ACP horizontal Fisheries programme (€45 million) to assist in meeting sanitary standards and development in the fisheries sector.
- ACP Pesticides Initiative Programme (29M€) to assist in meeting sanitary standards and development in the horticultural sector
- Investment Facility: 2.2 billion from the EIB which facilitates loans, equity and guarantees for investment projects.
- Trade.com with 50 M€ started in 2005. Main components:
 - (i) A facility to reinforce local analytical and research capacity for trade policy formulation including stakeholder participation;
 - (ii) A facility to provide immediate assistance for ongoing negotiations through the recruitment of a pool of more than 55 ACP trade experts and training for negotiators;
 - (iii) A facility to promote pilot initiatives for institutional reinforcement in the area of trade support services which can then be developed through other financing mechanisms, with particular attention being given to the enabling regulatory environment to overcome TBT (Technical barriers to Trade) and SPS (Sanitary, Phytosanitary and biotechnology) barriers to trade.

It is difficult to indicate how much assistance would be involved and when it could be available. It is uncertain whether Timor-Leste can benefit from the existing €13.5 billion, which is earmarked for current signatories. That money is to be disbursed over the period 2002 until 2007. Any funds for Timor-Leste might have to come from another source. Much of the financing under section 61.1.C can be in the form of direct budgetary support in much the same way as CFET. Hence, it appears unlikely that Timor-Leste would receive any additional assistance funds through Cotonou in the short term. In the medium term, and as soon as it becomes formal member of ACP Timor-Leste will have access to the European Development Fund, and thus to all ACP Trade Related Assistance programmes abovementioned, which are demand driven, so it is up to Timor Leste to decide whether or not it wants to make use of the funds immediately. In the longer term, Timor-Leste can expect to receive an assistance that is comparable to other ACP countries of similar size and with similar development challenges.

If Timor-Leste were to receive the same amount per capita as the current Pacific ACP countries receive under EDF 9 (envelopes A and B), it could expect to receive between 20 and €25 million over a five-year period, i.e. €4-5 million annually. If it were to receive the same amount as earmarked for Papua New Guinea during the first five years of the Cotonou agreement, it would receive approximately €6 million annually. These simple calculations indicate roughly the amounts involved.

The Economic Partnership Agreement will have to reflect the needs that arise. The terms of the Cotonou Agreement require that an EPA be concluded by the end of 2007. This means that Timor-Leste would have to begin to study the issues at stake and determine its trade policy orientation in the very near future.

Membership of Cotonou would require representation in Brussels and participation in one of the groupings of partner countries. The personnel requirements would amount to 2-3 staff in a representation office in Brussels and about 2-3 people in Dili. In addition, attendance at regional conferences would be necessary. Although, the EU could be expected to provide about 2 experts to assist in managing the EPA in an initial phase, it is clear that costs of representation in Brussels and attendance would be significant. However, if we take into account that many of the funds that Pacific is receiving to finance the Road map to WTO and EPA negotiations under the 10€M the 20€M and in the future under the Trade.Com Facility. Nevertheless, the the costs are off-set by the expected benefits.

The benefits of the Cotonou agreement in terms of economic growth and reduction of poverty are potentially significant but likely to appear only in the longer-term. However, to realise them, Timor-Leste will have to start to prepare itself now, studying the issues at stake and commencing to develop its capacity to negotiate an EPA with a clear sense of its assistance needs. Negotiations for an EPA will need to start in time so that they are completed by end December 2007. Timor-Leste should seek the active support of Portugal in maximizing and accelerating the potential benefits of Cotonou, and prepare for negotiations on an EPA in the regional pacific context.

The key aim of Timor-Leste should be to agree on a programme of financial and technical assistance from the EU that would enable it to develop its trade-related infrastructure. The Cotonou agreement stresses the importance of regional integration of the partner countries in the Caribbean, African and Pacific groupings. During an initial phase Timor-Leste may wish to be an observer in the Pacific group.

A potential complicating issue is that the Commission has indicated that it would expect Timor-Leste to accede to PICTA, the free trade agreement between Pacific Island countries, as part of its Cotonou accession. This reflects the fact that regional integration is a key outcome envisaged under the Cotonou Agreement. But as has been noted in previous sections of this report, regional integration in the Pacific may impinge on Timor-Leste's ambitions vis-à-vis association with ASEAN. Timor-Leste therefore will need to carefully pursue its interests in both directions (ASEAN and the Pacific). Timor-Leste should avoid having to choose between the financial and technical benefits offered under Cotonou and available in the short run, the medium and long term benefits of signing the EPA agreement with EU. The EPA is not only trade in goods but also services and investment among others the trade potential offered by integration into AFTA. Moreover, it is important to avoid as early as possible the creation of a dual trade agreement membership which will represent an obstacle to the conclusion of an EPA.

6 Institutional Capacity and Constraints

6.1 Hierarchical Structure within Trade Related Policy Making

In May 2002 the first constitutionally elected Government of Timor-Leste (GoTL) took seat. The structure adopted was outlined in the Decree Law 3/2002, commonly referred to as ‘the first organic law’²⁶. It establishes the legal mandates for the ten ministries and four secretariats of state (SoS) that are considered at the same level as level with ministries. The law outlines the main areas of responsibilities for the individual unit and requests each unit to prepare a detailed organic law for their own organisation, structure, services and functionalities.

The Prime Minister is Head of Government and the Council of Ministers is nominated as the main law approving body, with the ten ministers and the four Secretaries of State as full members with voting rights. Other secretaries of state, who are heads of sub-units in the full ministries, and vice-ministers, participate in the meetings without voting rights. The policy making process (and law making) is to be initiated by the ministry or SoS designated responsible for the portfolio area and then to be approved by the Council of Ministers. The Council has its own SoS that makes it possible to draw upon the Ministry of Justice for legal advice.

In sum, two hierarchical levels for policy formulation and debate are identified. These are:

- Level 1 The Prime Minister’s Office and the Council of Ministers
- Level 2 The full ministries headed by a minister, and the Secretariats of State which share the same status as a ministry.

A special case is the Timor Sea Office, which is an integrated part of the Prime Minister’s Office, and acts as his advisor in matters related to the negotiations concerning the Greater Sunrise Field exploration agreement.

The new Government structure is outlined in the Decree Law no 03/2005, promulgated on 28 June 2005 (i.e. after the completion of this mission’s field work). Trade is now the responsibility of the new Ministry of Development. This change is considered a favourable development by this mission as trade now is directly linked to economic development and this may ease the process of mainstreaming trade into the poverty reduction context.

6.1.1 First policy then law

The main development policy framework is the National Development Plan (NDP)²⁷, which embeds the elements of a poverty reduction strategy (PRS). The policies and laws would then be elaborated to contribute towards achieving the national development goals, which are:

- a) To reduce poverty in all sectors and regions of the nation, and
- b) To promote economic growth that is equitable and sustainable, improving the health, education, and well being of everyone in Timor-Leste.

The trade policy area and associated legal framework has not been given high priority during the first years of government, and there is no coherent international or domestic trade policy formulated. The National Development Plan (NDP) states, in general, that the objective is to establish an open and sustainable market economy. The economy is indeed open and transparent and many aspects of it can be accessed from the Internet. At macro level the state budget and Sector Investment Plans (SIPs) are made available, and e.g. customs procedures are explained. The SIPs are developed to define sector priorities as a response to the NDP.

²⁶ Decree-law no. 3/2002, of 20 September 2002. On the organic structure of the first constitutional government

²⁷ Planning Commission. East Timor National Development Plan, Dili May 2002

Trade policy formulation lags behind in several areas. At this moment only broad scope trade policy outlines have been presented via donor funded reports and a discussion paper²⁸. Policies for trade related sub-sectors have been devised which include a Private Sector policy, Customs Code, and most recently a short Foreign Investment policy has been developed. However, in some cases the associated organic laws and subsequent regulations are drafted and promulgated before the policy is agreed.

By drafting laws before the policy framework is in place is to reverse logic of the process. It has resulted in a haphazardly developed legal framework which may prove an obstacle to the implementation of later defined policies. It represents a piecemeal approach that may lead to the need for continuous revisions of laws and regulations, aggravated further by the different civil legal systems (Portuguese and Anglo-Saxon) that the advisors have applied reflecting their own background. A situation that is not conducive to development and that leaves potential foreign investors with questions rather than answers.

There are a number of reasons that may contribute to explain why a comprehensive and coherent policy framework has not yet been formulated. The most important reason is probably limitations in institutional and human resource capacity. As an example, no single body is responsible for carrying out coordination and consultation procedures as an integrated part of policy debate. In addition, human resources are a constraint not only in numbers of staff but even more so in terms of staff with adequate training in trade related academic disciplines.

The implementation of policies and laws is the responsibility of directorates, which are sub-units to the ministries or the secretariats of state. The directorates are administrative units responsible for designated areas of policy in respect of valid laws and regulations; they may provide technical inputs towards the policy debate. Other regulatory bodies and/or institutions to implement policy in accordance with regulations are sub-units to the directorates, mostly labelled divisions.

Quasi-government or autonomous bodies such as the Export and Investment Promotion Agency (EIPA) and the Banking and Payment Authority have their own management structures. These units are headed by directors and function within the respective mandates of their governing laws and regulations. Until the Central bank Law is promulgated, the BPA still operates under an old Indonesian law, whereas the EIPA will operate under a regulation of the recently promulgated Foreign Investment Law.

6.2 Government Institutions and Legal Mandates

6.2.1 State Secretariat of Commerce and Industry

The first organic law points to one unit as the focal point in trade policy formulation:

“The Secretariat of State for Trade and Industry (SECI) is the government department responsible for designing, executing, coordinating and assessing the policy, as defined and approved by the Council of Ministers, for business activities of production of goods and services, namely the industry, activities of provision of services and trade, under the terms to be defined in its organic law”²⁹.

However, SECI has not developed its own organic law. Under-staffing is obvious with a total of 43 staff, where a Bachelor degree (corresponding to three years post high school training) is the highest level of education. The unit designated responsible of international trade policy and planning is the ‘Directorate of Policy and Planning for Trade and Industry’. It is headed by a commercially educated S1 level economist, which is equal to 2 years training following high school. The total staffs counts eight people. The Directorate is, among others, responsible for formulating the trade policies on

²⁸ Sida report, Korean Report and, Irish report, The SECI paper

²⁹ Ibidem Section 17

accession to regional trade organizations, ASEAN-AFTA, UNESCAP and international trade organizations WTO, Unido etc. (as it says in the job description of the Director).

However, the capacity of SECI to effectively carry out the trade policy formulation and trade strategy development, both regarding accession (observer status) and its interface with economic development as envisioned under DDA, is limited. Given the range and coverage of issues at both WTO and ASEAN, it is impossible for the small team to follow and participate in these fora in any meaningful way. The limited ability to follow the negotiation process is further exacerbated by the lack of representation in Geneva, though an office has been provided free of charge by the Government of Japan.

The SECI Directorate of Commerce is involved with implementation of the international trade policy agreements and regulations of which there are none at the moment. This unit is headed by a Development Economist (S1 level) and staffed by a total of 16 with various lower level degrees. The capacity to carry out trade policy analysis, let alone formulation, is limited. Responsibility for international trade agreements are delegated to the Sub-Directorate of International trade. Under the same directorate the Sub-directorate of Metrology and Standardization is responsible for implementing the regulation related to the TBT agreement, however, the unit has no technical laboratory or calibration equipment. The business license registry is also maintained by the Sub-Directorate of Business Registration, it is an important source of information about the structure and organization of the non-farm private sector. Although the information in the registry requires further development, it is probably the best information repository of the type of economic activity emerging in Timor Leste, and especially in Dili. The staff totals four persons with less than bachelor degrees

Within SECI the Directorate of Industry is responsible for implementing industrial policies for all level of industries.

The Private Sector Development Sector Investment Programme (PSD-SIP) provides details of some aspects related to trade policy, such as investment and business development perspectives. PSD policy framework and a five year investment plan and operating budget are presented. The analysis of the financial needs indicates a total requirement of US\$ 31 million and the gap is estimated at US\$ 26 million, or 89%, which would require additional donor funding outside the consolidated budget. However, the estimate it is very recent, dated April 2005, and the expected proceeds from the Petroleum Fund may be applicable towards filling the gap in the longer term.

There are two trade issues advisors assigned to the Prime Minister's Office. One advisor, funded by UNMISSET, focuses on trade policy formulations a development. He started in January 2005 and the term is up in mid July 2005; but his position is likely to be extended. The other advisor focuses on foreign direct investment and export promotion. His term is up in October 2005.

With the restructuring of the Government, the Ministry of Development was defined as the Government's central organism responsible for the conception, execution, coordination and evaluation of the policies approved by the Council of Ministers in the area of private sector and cooperatives' development, as well as for the promotion of tourism. Details on the full structure are not yet available (they will be defined in the Ministry's organic law). However, the Ministry will be headed by the ex-Vice Minister of Development and Environment, with the support of a Vice Minister.

6.2.2 Ministry of Foreign Affairs & Cooperation (MFAC)

Government Decree no 1/2003 dated 22.07.2003 is the organic law of the MFAC. It stipulates that the Directorate of regional Affairs shall monitor implementation of policies and conduct negotiations regarding e.g. accession to ASEAN. There is 3 staff with bachelor level education.

The Directorate of Multilateral Affairs will monitor policies and carry out negotiations related to the dealing with multilateral organisations e.g. World Bank, IMF and UN etc. The staffing is 4 persons with bachelor degree education levels.

6.2.3 The Ministry of Planning and Finance (MPF)

There is no organic law for the MPF. However, the Macro Economy and Tax Policy unit (METP) is placed in between the Vice Minister and the directorates (eight in total) and has the role of coordinating economic policies with other ministries and internally. The METP has only little role in trade policy coordination, but the director is member of the Joint Committee between Timor-Leste and Indonesia on economic cooperation and trade.

The METP has been active in defining a policy for the potential revenues to accrue from the oil and gas sector. The main mechanism to transfer the revenues at sustainable levels from the treaties with Australia to the treasury is a new Petroleum Fund. Management of the fund is delegated to the BPA (see section 3.4).

At present only internal coordination is instituted, e.g. with the Internal Tax Directorate, Customs Services and the Budget Office (a directorate). The METP is staffed with just two Timorese S1 level economists and has two international advisors, one for general macro economic coordination and one specifically for the revenue side of the petroleum fund.

The Tax Office is responsible for the registration of businesses to obtain a tax number. NGOs need to be registered with tax number if commercial activities are carried out. However, the NGO regulation is under review. The Tax office also collects corporate tax following an audit of the commercial companies' self-assessment forms.

The Customs Services have a Customs Code (Decree Law 11/2004 dated 19.05.2004) as the regulatory base. Through the AYSCUDA 1 project the customs services role in trade facilitation has been greatly improved. Feedback to the GoTL on needs for further adjustments in the policy framework is on-going. The services encompass 185 officers trained mostly by Indonesian officers. Dili is the only point of entry for customs clearance (60 more staff are needed if other border stations are to be manned).

6.2.4 The Ministry of Development and Environment

There is no organic law for the Ministry at the moment. One State Secretariat of the Ministry is responsible for energy policies, and tourism, investment and environment policy aspects.

The secretariat has played an active role in the preparation of tourism sector promotional material, and has initiated the formulation of a tourism policy. The investment arm has prepared the ground for the successful promulgation of the Foreign Investment Law (FIL) and National Investment Law (NIL). A regulation establishing the EIPA has been drafted and will be promulgated soon.

Trade and revenue aspects of the oil and natural gas sector from the Bayu Undan field are regulated by the Timor Sea Treaty. It is administered by the Timor Sea Designated office jointly with Australia, outside government structures.

The Ministry of Development and Environment has now been dissolved and replaced by the Ministry of Development, which includes all the functions previously entrusted to the Secretariat for Commerce and Industry and some of the functions covered by the State secretariat for Tourism, Environment, and Investment. The Natural and Mineral Resources along with the Energy Policy have now been entrusted to the Ministry of Natural and Mineral Resources, and the energy policy headed by the Prime Minister (PM).

6.2.5 Ministry of Agriculture, Forestry and Fishery (MAFF).

In the restructuring the name remained the same, but the Vice Minister will be specifically responsible for Coffee and Forestry while a State Secretary will be responsible for Fisheries. The Government Decree no 4/2003 dated 13.11.2003 remains the organic law for the MAFF. Policies for all main areas of the ministry's portfolio exist. The policies are implemented with reference to the following legal instruments:

- Joint Ministerial Instruction (MI) dated 13.12.2002 empowers the Directorate of Quarantine Services of MAFF as the only authority entitled to carry out quarantine services and inspection of control of animal and plant food products (alive and dead) following the stipulations of the WTO Sanitary and Phyto-Sanitary agreement (SPS). However, due to capacity constraints only the quarantine part is operational, and there is no national competent authority for SPS. Decree Law no 21/2003 dated 31.12.2003 expands the aforementioned MI and details the role and functions the Directorate of Quarantine Services.
- Decree law no 6/2004 dated 21.04.2004 on General Bases Of The Legal Regime For The Management And Regulation Of Fisheries And Aquaculture requires that a competent authority is established as part of the Directorate of Quarantine Services. This has not happened due to capacity and financial constraints. Government Decree no 5/2004 explains in greater detail how the aforementioned Decree Law should be implemented. In both cases the legal instruments refer to the need for a fisheries management plan based on direct involvement of the local fishing communities. The plan has not been developed.

6.2.6 Ministry of Justice (MoJ)

Government Decree no 3/2003 dated 29/10/2003 established the Ministry. There is no direct involvement in trade policy formulation. The Directorate of Registries and Notaries Services, however, is important as all businesses must register through the Directorate that has only one office located in Dili.

The Land and Property Directorate is a key unit for the trade related aspects of investments. As the land reform law is only in draft form it is not possible to obtain long term land lease contracts from Government, which is a real constraint to investment development.

6.3 Joint Ministerial Committee (JMC) on Trade, Investment and Finance

The JMC was established in June 2002, with the main objective to negotiate a broad scope economic cooperation agreement between Timor-Leste and Indonesia. The agreement would solve border issues, illegal trade, and aim to establish a free trade agreement. The JMC is by nature international and thereby autonomous from the GoTL. Two meetings have been held and a third was scheduled for March 2005 then postponed to May 2005, but the meeting has not been held. An inter-ministerial working group on trade, investment, and finance aspects of the JMC agenda is established as an informal forum for discussion of relevant issues.

6.4 Other Stakeholders in Trade Policy

The private sector civil institutions such as chambers of commerce and other professional associations exist, but do not at present have any legal mandates to participate in either trade policy formulation or in its implementation. The chambers of commerce and the other professional associations met were not aware that they should have a role in discussing and lobbying in the interest of their members.

Academic institutions as University National of Timor-Leste (UNTL) are still embryonic, and have not yet been invited to participate in the policy analysis and formulation. In fact, there are no specific curricula on trade related topics. The closest courses are in development economics.

Thus there is no government body specifically assigned to stimulate and coordinate trade policy debate and discussion internally. Similarly there is no body assigned to establishing and maintaining

a fruitful dialogue process with extra-government stakeholders such as Chambers of Commerce, professional associations, and academia.

7 Draft Action Plan

7.1 Overview

In the sections below, the needs identified are linked in a logical sequence. It is effective to group constraints that are to be addressed by similar types of projects. For example human resource capacity constraints require in some cases interventions of a similar nature and are hence grouped under one “need” (with (N) as its prefix). In general needs identified reflect the status of affairs at this particular moment in time. In order to avoid overlapping of funding already committed by donors only additional activities required will be discussed.

Trade is an important part of the present Timorese economy, with a trade deficit amounting to \$ 106 million in 2004 (merchandise trade only) against a GDP of just \$ 341 million. Thus increasing the volume of exports and improving the terms of trade on imports and exports are necessary elements to create economic growth. Removing or reducing constraints directly related to the trade sector therefore has linkages in support of the goals of the national Development Plan (NDP).

The GoTL has not devised a poverty reduction strategy (PRS) per se, but the NDP embeds the elements of a PRS. Detailed planning, implementation arrangements and finance issues are presented in the 17 Sector Investment Plans (SIP). The NDP describes the main objective as increasing the productivity of the poor by achieving strong economic growth within an enabling environment. Seeking to encourage decentralisation and development at district level, the focus is on the rural areas.

There is a critical need for new jobs to absorb the growing number of youths entering the workforce. Fostering an enabling business environment will be critical to encouraging private sector development and thereby job creation. Given that most of the poor reside in rural areas and migration to cities is already placing pressure on urban employment, productive rural jobs are particularly crucial for poverty reduction. Creating rural jobs may involve trade as the surplus of quality agricultural produce could be marketed domestically and even aimed at exports.

The NDP involves several aspects that have linkages to trade including international trade. Dedicated policies to improve household incomes and combat unemployment will be needed. First, to increase productivity requires introduction of new skills and potentially new products in agriculture, horticulture, forestry and fishery. The present study sees needs within the skills building area as indirectly related to international trade. A second aspect is related to the marketing of surplus products which, provided a satisfactory level of quality is reached, may become internationally tradable. Increased productivity and the marketing of quality produce are important competitiveness factors that may lead to increases in export volumes and price levels; reference is made to the price premium gained for quality green coffee beans.

Creating an enabling environment for small rural and urban businesses is necessary to encourage establishment of niche size productions. It is considered important that niche size production becomes the mainstream type development as there is no base to achieve economies of scale. Creating an enabling environment for Small and Medium Enterprises (SME) is part of trade related interventions. However, interventions aimed directly at the fostering nationally owned rural and urban enterprises are part of the Business Development Centres (BDCs) activities. BDCs are established under the SEP II program funded by the TFET. The recent approval of the domestic and foreign investment laws, and submission to Parliament of the insurance law, are commendable achievements to encourage support towards national and foreign direct investment (FDI). The imminent launching of the Export and Investment Promotion Agency (EIPA) is a further reflection of these business enabling activities. Such needs are to be complemented by reduced administrative requirements for business operation, as well as streamlining of business registration, property titling, and customs procedures, improved access to electricity and practicable roads, and strengthening of the justice system.

7.2 List of Prioritised Needs (N)

Directly trade related needs are presented first, followed by needs associated with economic development. The latter are placed in context of the NDP.

The action plan is based on three categories of assistance: a) studies, technical assistance and advice; b) budget support; and c) procurement assistance, with the level of priority assigned as follows: High, Important, and Low. Finally, a time sequencing indicating the start-up point is included: Now (as soon as possible or less than six months); Short term (within a year), Medium term (within 1- 3 years); and Long term (3 + years to be indicated). A graphical presentation is provided at the last page.

7.2.1 Trade policy formulation and coordination

N1: Trade policy formulation

The government lacks a clear trade policy. The NDP provides a good overall framework for development policy, including the intention to establish an open market economy and base society on a civil legal system, but there is no clearly defined role for trade. A trade policy document is required to clearly state the objectives of international and domestic trade in economic development and then define the role and interaction between the various international issues including: bilateral, tri-lateral trade agreements, regional (ASEAN, PIF), international (WTO), WTO compliance, WTO negotiations, and accession to these bodies as well as national trade measures. These components are inter-related and need to be considered together. Until there is such a framework within Timor-Leste, each international trade policy issue and national trade measure will be determined in isolation which could lead to contradictory policies and positions that are not in the overall national interests. Such a trade policy framework document would not be a long drawn out document but a concise statement of aims, strategic direction and principles across international trade issues, domestic trade regime and resolution to border control issues. To be effective, it must be a document well formulated, discussed, debated, adopted and owned by the stakeholders. Once completed and adopted by the Government, this will provide clear guidelines to officials across all Ministries so that all policies and decisions are taken in a cohesive and consistent way.

→Urgent technical assistance followed by advisory service, high priority to be implemented now

N2: Trade policy coordination/consultation

The process of trade policy debate is haphazard and conducted in fora such as the sub-committees to the Joint Ministerial Commission negotiating normalisation with Indonesia, the Timor Sea Office, or within units of MoPF for particular issues such as tariff policy (Customs Services), corporate taxation etc. It is therefore very important to designate a single body within the government to coordinate the trade policy debate between relevant units of government, and quasi government bodies such as the Banking & Payment Authority (BPA), EIPA, the Timor Sea Office, JMC. The designated body should further institute a consultative process with extra-government policy support organizations representing the private sector (chambers of commerce, professional associations, the financial sector), academia, and the donor community.

Establish a Trade Policy Coordinating Committee to oversee the implementation of trade policies and actively participate in selected negotiations in a structured and more effective manner. The process of coordination should be made clear in terms of meeting schedules, drafting of agendas, minutes from meetings, and circulation of materials. The designated body should be provided with a clear mandate from a legal instrument in terms of a regulation or by decree. The body may be part of SECI or be a unit placed directly under the PM's office. The following ministries are likely to have trade related interests:

- MoDE (the state secretariats of investment and tourism and environment, the directorate of energy and natural resources)
- MoFAC (the directorates of international cooperation and regional affairs)
- MoAFF (directorate of quarantine services, and the agribusiness unit),

- MoPF (the macro-economic unit, customs services, and corporate taxation)
- Ministry of Transport (aviation authority, Dili port authority)

The details will have to be assessed against the planned Government reshuffle in July this year. Staff would need targeted training in policy formulation and capacity building.

→Urgent technical assistance followed by advisory service, high priority to be implemented in the now

N3: General legal issues

The legal base of the civil system represents a mix of different approaches originating from the backgrounds of the individual advisors. These originate from lusophone countries as Portugal, Macao, Brazil, Capo Verde, or represent the Anglo-Saxon way or thinking. This concoction creates legal instruments that are not coherent. It is necessary to seek over time to align existing legislation to a common frame of reference as a basis for the civil legal system. As part of the cultural heritage is Portuguese in origin and as Portuguese has been declared one of two national languages, the other being Tetun, the base reference should preferably be modelled on a lusophone system. Organic laws for Ministries and Secretariats of State and regulations for Directorates and associated institutions should be adapted to fit the chosen reference system.

→Advisory service, low priority to be implemented in the medium term

7.2.2 Market access needs

Though market access for imports into Timor-Leste has improved in terms of uniform customs procedures following implementation of ASYCUDA, barriers to trade persist both in terms of tariff structures and non-tariff barriers

N4: Import tariff and taxation barrier

The import policy prescribes that applied tariffs in accordance with HS 6 digits are at 6% based on the Cost Insurance and Freight (CIF) value. However, add-on taxes, such as excise taxes at varying levels from 12%-36% (some items have 0%) and application methods, and a fixed sales tax of 5%, are added making a total of up to 50% tax level before the merchandise leaves the Dili port. This is a serious constraint to potential re-exporters as their prices of final products carry-on this disadvantage.

A shift towards lower tariffs should be instituted as it has a twofold impact: a) it reduces the price level for local manufacturers and re-exporters increasing their competitiveness, b) it will discourage illegal border trade. To compensate the treasury for the loss of tariff and add-on taxes a Value Added Tax (VAT) should be considered. VAT is a domestic tax, which is normally removed before exporting. It does not act as a subsidy in WTO terms. VAT is neutral to the consumer, if the level is calculated to substitute the value of the tariffs and add-on taxes. There is a need for technical assistance to carry out the analyses of the economic consequences of a potential shift towards lower tariffs and introduction of VAT. The assistance should also include expansion of the customs officer staff with a view to man the land border stations including the Oecussi enclave.

→Technical assistance and budget support, high priority, short term

N5: Non-tariff barriers -TBT

In general exports from Timor-Leste do not face non-tariff barriers at the importing country port, due to the fact that it is an LDC. For exporters and importers facilities to carry out assessment of products regarding compliance with the valid international technical standards is limited to the presence of a regulatory body, the Directorate of Metrology, SECI. There is no accreditation and standardization facility/laboratory to carry out actual testing. This is required to comply with the WTO agreement on Technical Barriers to Trade (TBT). It is noted that compliance also covers a number of international environmental agreements as well as international agreements relative to the working environment.

The TBT facility would assist with information on the various valid international standards of a technical nature, such as those of the International Standards Organization (ISO), the International Electrotechnical Commission (IEC) and the International Telecommunication Union (ITU). In addition, the facility would assist with provision of necessary documentation as required under the Rules of Origin (RoO) in order for the exporters to obtain Certificates of Origin (CoO). TA to implement a TBT required accreditation and standardisation authority, including training packages, is needed, as is the acquisition of necessary testing equipment. It is noted that imports and exports through the Oecussi enclave should have access to similar testing facilities and comply with the RoO as well.

→Technical assistance and procurement assistance, high priority, short term

N6: Non-Tariff Barriers – SPS

The same situation is valid regarding the import and export of live animals including also fish and plants, feed, food and plant products. The Directorate of Quarantine is the regulatory body that oversees whether the rules and regulations are complied with as regards the protection of human health or safety, protection of animal and plant life or health or the environment (the natural resource endowments). However, real quarantine stations are only operated at one land border crossing points, in the Dili Port, and the airport, and even there under-staffing in numbers and qualifications prevail.

There is need to establish and accredit an SPS laboratory to carry out the necessary tests and analyses leading towards a national level certification of export enterprises

A fully equipped national laboratory should be established with the potential to carry out field work. The laboratory should be linked with the appropriate research faculty at NUTL to secure future linkages between basic and applied research. To cover the needs of the border areas, the more remote districts, and the Oecussi enclave the potential for a mobile field unit should be included. A staff assessment should be made with a view to identify the future staffing needs in terms of quality and quantity. The SPS laboratory should attain a level of competence that equals the requirements for an EU Competent Authority in order to establish a local certification process.

→Technical assistance and procurement assistance, high priority, short term

7.2.3 Trade facilitation

N7: Physical needs

Physical constraints exist in terms of only one port of entry, Dili port, which is and will become a bottleneck for trade facilitation though the clearance procedures are now more efficient. The port is easily accessible from a navigational point of view and water depth alongside quay is sufficient. However, arriving vessels carry their own gear for off-loading / loading of containers adding to the freight cost (an estimated 15% estimated by the local office of an Australian shipping line compared to Singapore) and only Twenty feet Equivalent Unit (TEU) containers can be handled inside the port area. →There is a need for equipment in terms of a shore based container crane.

Outside the port fence the road infrastructure in Dili city and outside, is not suitable for heavy duty transport of TEUs. The carrying capacity of the best northern coast road going to Com is assessed by the consultant to have long term sustainability load at maximum 10 ton trucks. Thus moving a TEU (weighing up-to 18 ton) to the East by road is not feasible. Country roads leading into the hills and mountains ranges have even less carrying capacity.

→There is need to up-grade the road infrastructure

There is a need to expand the number of customs entry points to cover the entire national customs territory including the mainland Timor-Leste, the Oecussi enclave and Ilha de Ataúro. New maritime entry points are needed potentially at either of the ports of Hera, Baucau, or Com. Other entry port

points should be established in the Oecussi enclave, at Pante Macassar, to serve local clearance and transshipment needs, and finally, an entry point at Ilha the Ataúro would be needed.

The option to divert part of the cargo traffic to the airborne mode should be studied. Baucau airport, which has a runway of 3.4 km, should be up-graded (traffic control system, security systems and the terminal building to allow) airborne cargo traffic, and potentially also to receive passenger traffic (tourists) by long range aircraft. Road infrastructure on the North coast should be up-graded to handle at least TEU traffic on long term sustainable basis.

→Study, technical assistance and procurement assistance, important, medium term

N8: Institutional needs

Introduction of the ASYCUDA system is a major leap forward. All the provisions and the principles in the World Customs Organisation's (WCO) instruments are compatible with and complimentary to the Articles V, VIII and X of the GATT 1994 referred to in the context of trade facilitation in the Doha Development Agenda. It is considered that these GATT 1994 Articles set out the high principles for formalities and procedures for movement and clearance of goods, transit of goods and publication and administration of trade regulations. However, the potential use of AYCUDA functionalities is not fully realized in this respect which reduces their effect on trade facilitation. There is a need to implement the automated cargo manifest module, risk management and proper customs valuation procedures, and remote lodgement of information. This involves a comprehensive training package.

In order to exercise border control at the additional three maritime entry points and an additional five land based border stations, additional staff will be needed would need staffing. Timor-Leste has to establish customs stations along a land border where none existed before and where traders traditionally have been unaccustomed to such barriers. There is a need to exercise border control but also to facilitate a smooth transfer of goods. However, more staff requires more training partially in customs service operations, basic clearance procedures, and the ASYCUDA programme, and partially in the more advanced aspects of facilitation mentioned above.

In addition, the procedure related to the handling of exemptions should be simplified. This may require initiatives in two areas: a) the role of importer should be clearly stated as to whether it is a commercial type business operation or a non-profit type organisation, and b) that business tax number registration procedures with MoPF are simplified and merged with the business activity registration procedure under SECI. The MoPF should consider instituting a one stop decision point regarding exemptions and associated payment of tariffs and add-on taxes in order to reduce the fairly long delays in the port.

→Study, technical assistance, budget support procurement assistance, medium term

N9: Oecussi enclave needs

The GoTL has to implement the customs regime to be determined for Oecussi, and control the transit corridor by land to be established between Oecussi and the rest of Timor-Leste. It has been decided to include Oecussi as part of the Timor-Leste customs territory. Oecussi would then benefit from the liberal and open trade regime of Timor-Leste. The implication is that the customs service would need to effectively man the customs stations along the land border with West Timor and in the harbour; no customs stations would then be needed between Oecussi and Timor-Leste. Goods would then be shipped from Pante Macassar to Dili or travel by road.

The attractiveness of using the land corridor prevails. Successful operation of this route in terms of trade facilitation would require the establishment of a kind of bonded transport system, known in Europe as Transports International Routiers (TIR), whereby the goods are inspected and sealed (bonded) at the point of dispatch and travel in transit passing multiple borders without inspections until it arrives a the country of import. In the case of Timor-Leste goods that enter Oecussi or are produced there would be loaded unto trucks and travel in transit to the point of delivery in main part

of Timor-Leste, where final customs inspection takes place. The technical assistance required to set up such a system for the island of Timor should be assessed. It could contain elements similar to those codified in the TIR system. Although involving a cost for special vehicles, such a system would allow goods to flow freely between the Oecussi region and the rest of Timor-Leste. Indonesia is already a member of the TIR convention and familiar with the system.

→Technical assistance, important, medium term

N10: Export and investment promotion

The newly signed Foreign Investment Law and National Investment Law opens the opportunity to establish an Export and Investment Promotion Agency (EIPA). However, the plan envisions that the EIPA would be (become) financially self-sufficient over time, and the donor funds will cease after year 2006. There is an urgent need to prepare a detailed business plan for the EIPA, that will define the precise areas of activity, associated staffing requirements and other operating aspects, such as participation in exhibitions and trade fairs, B-t-B training packages and visit programs etc. The business plan will further identify the overall development and operating costs and the potential sources of funding including contributions from income generating activities, such as consulting services.

→Urgent study, technical assistance, procurement assistance, now.

7.2.4 Rules based needs

N11: Capacity Building

Rules based trading is new to Timor-Leste and the choices between which part of the international, regional, tri- and bilateral systems to join are complicated as both benefits and costs have to be weighed. Institutional knowledge and capacity is very limited, and the educational system does not include courses on trade related matters, except for general economics and certain legal aspects. Thus deficiencies exist at institutional and human resource levels. Analytic skills to judge the pros and cons of choosing between regional and international integration are limited.

It is urgent to strengthen the trade policy capacity of the civil servants. Timor-Leste should seek funding to enhance trade capacity building at the institutional level. This may entail training programmes for existing and future civil servants through developing technical assistance / training projects, and by utilizing further long term advisory services. Outstanding talents should be selected to attend specialized courses such as:

- The 10-12 week long trade policy courses run by the WTO. There is a high demand and a waiting list for these courses, but Timor-Leste would likely be given priority, even though it is not a member
- The Practice of Trade Policy: Economics, Negotiations, and Rules, J.F. Kennedy School of Government, Harvard University, or
- World Trade Organization: Rights and Obligations at the International Law Institute, Washington, D.C. Courses at the Joint Vienna Institute sponsored by the major international organisations, for instance, the trade policy course given annually by WTO.
- The Applied Economic Policy Course given twice a year by the IMF.

Trade policy officers should be given the opportunity to attend courses on negotiating techniques developed at e.g. the University of Sussex Institute for European Studies or the Swedish Foreign Policy Institute. A training package preferably from WTO should be designed and executed to establish a key base of adequately trained officials within the following areas; a) understanding rules based trade b) trade negotiation skills c) accession procedures, and d) calculations of economic consequences of, first the regional integration, ASEAN, then WTO.

→Technical assistance, high, short term

N12: Integrated framework

Another avenue to supplement Timor-Leste's trade policy capacity is the Integrated Framework for Trade-related Technical Assistance to Least Developed Countries (IF), which is designed to integrate trade related technical assistance provided to LDCs by the WTO, IMF, ITC, UNCTAD, UNDP and the World Bank. At the moment Timor-Leste is not scheduled for an IF. The function of the IF is to:

- Assess LDCs' trade priority needs;
- Programme effective, efficient and complementary technical assistance to address these needs
- Schedule donor consultation meetings to endorse multi-year programmes to address these needs; and
- Implement and evaluate the programme.

The IF Pilot Scheme is funded by the IF Trust Fund, managed by UNDP, on behalf of the six Agencies. Resources of the core agencies in terms of staff contributions and budgetary outlays also support its implementation.

The IF could be a very useful tool to ensure that Timor-Leste takes advantage of all available trade policy technical assistance from these institutions and in the most beneficial way, both to formulate its trade policy and to develop its trade policy capacity. The IF Pilot Scheme is currently being implemented in Cambodia; Timor-Leste should apply to UNDP to be included in the IF Pilot Scheme. However, the IF should not be interpreted to offer a shortcut to extra financing. It is a process, and usually takes two to three years during which a diagnostic study is performed, which covers all development issues. Only at the end of the process are donors approached to fund specific outcomes from the study. However, this could still be a useful tool given the breadth of the development exercise in Timor-Leste and the possibility of including trade policy as a fundamental element.

→Study, technical assistance, important, short term.

N13: The Cotonou agreement – Economic Partnership Agreement

It is considered utmost important that Timor-Leste initiates the negotiation for an EPA immediately following the ratification of the Cotonou agreement expected in the autumn this year. The Cotonou process prescribes that all EPAs enter into force in 1st January 2008. The need to emphasize regional trade integration is underscored further by the potential graduation of Timor-Leste to gain status as developing country, eventually a result of the booming petroleum economy.

→Technical assistance, high, now.

7.2.5 Private sector development and sector needs

N14 Enabling environment

Provisions in the Commercial Company law need revision to simplify procedures. It would seem reasonable to create a one stop shop for business registration and with a need to have only one registration number. Simplification of the corporate taxation system including changes in taxation levels should be considered. The national businesses may make use of the Business Development Centres to develop adequate skills for product diversification and up-grade general management skills, but the fundamental educational structure does not yet produce craftsmen (carpenters, plumbers, electricians, and mechanics). There is a need to establish a dedicated technical training centre for the different trades. The feasibility of turning the privately owned Dili Institute of Technology into a true technical school of apprenticeship should be subjected to a study including also the feasibility of establishing district level vocational training centres.

→Studies, technical assistance, procurement assistance, important, medium

N15: Fisheries Sector

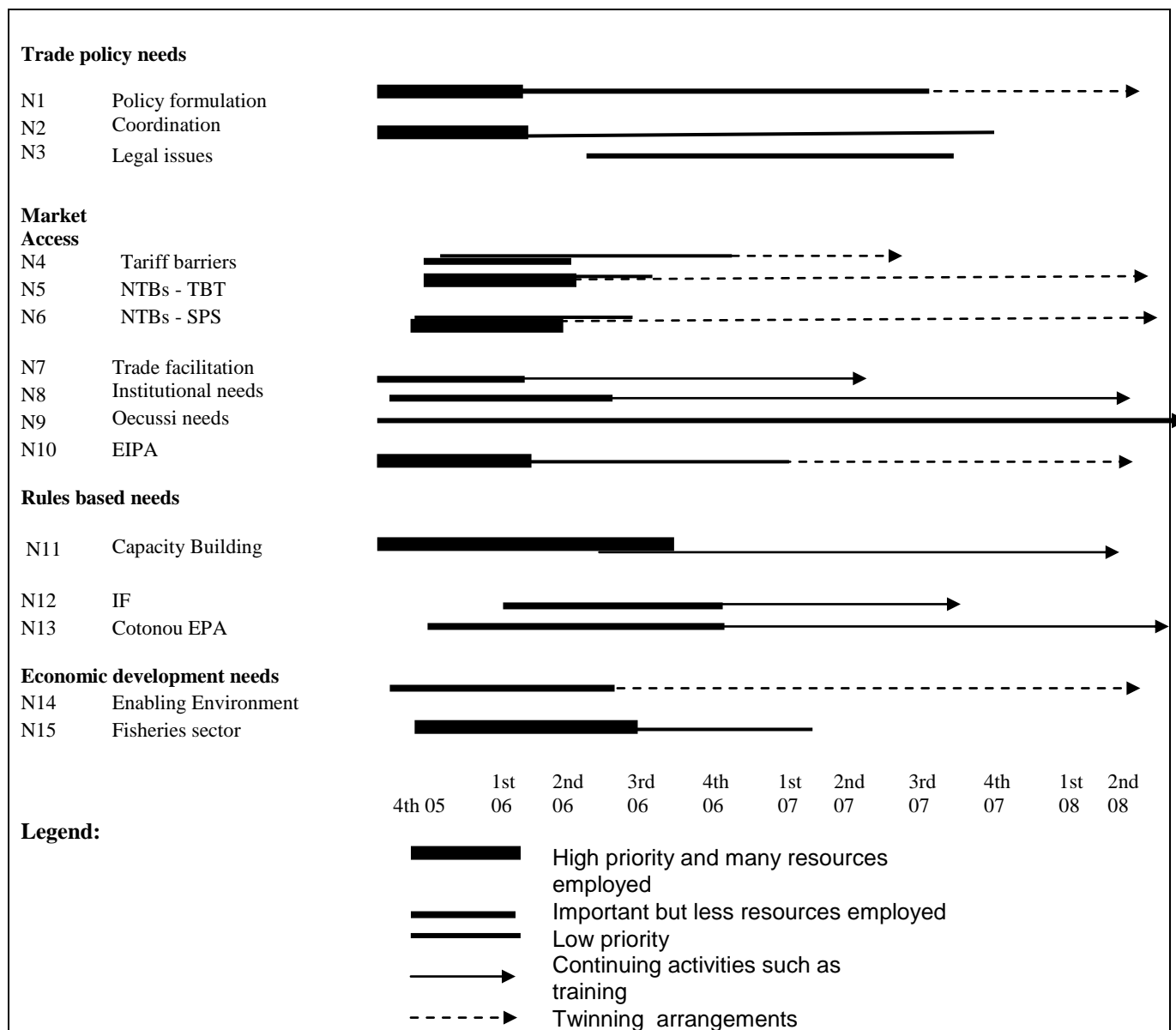
There is an urgent need a fisheries management plan (FMP) for the different sections of the Timorese waters. The FMP should not be limited to catch fisheries, but should include the potential for marine aquaculture in particular the production of high value species of fish, crustaceans, bivalves and sea plants (including algae and sea weeds). The plan should be based on co-management principles involving the local fishing communities and other stakeholders such as traders, academia, any up- and down stream actors, and government bodies. The plan should also indicate the government bodies responsible for data collection and collation on landings and fleet registration. The plan should be linked to a genuine system of Monitoring Surveillance and Control (MSC), where the appropriate enforcement mechanisms would be indicated as well. The MSC system is likely to be costly as the Coast Guard only has two out-dated vessels for inspection, which are not able to carry the duties considering the vast Exclusive Economic Zone (EEZ) of Timor-Leste. A comprehensive study should indicate the optimal and cost effective way implement the FMP, and the associated MSC activities, both in terms of necessary investment into research capacity, training needs, inspection vessels and /or helicopters, operating costs and how the stakeholders may contribute toward the financial needs.

It is important that the FMP emphasises the socio-economic development aspects in terms of the potential for job creation and increased household income. National economic benefits in terms of the derived multiplier effect should be considered.

→Study, technical assistance, procurement assistance, short term

Needs Assessment of Trade and Trade-Related Assistance For the Democratic Republic of Timor-Leste

Figure2: Needs action plan



8 Set of Recommendations

These recommendations serve to define a realistic strategy for Timor-Leste's integration with the international rules based training system given the benefits and cost of the different trade systems. Secondly it serves to integrate trade related aspects with the economic development policies and pro-poor growth of the PRS. Growth opportunities were identified earlier for fisheries, agriculture and tourism.

Section 8.1 provides the list of summary recommendation presented under the main headings: International Trade Policy and Trade Development. The main items from the list, that are not funded under any on-going or known future programmes, are then grouped into suggested areas of technical assistance deemed appropriate for external assistance funding (section 8.2) with the potential sources of funding indicated. From this set of technical assistance activities, the ones proposed for funding under EC sources are derived and presented in detail in Annex E.

8.1 Summary Recommendations

8.1.1 International Trade Policy

Institutional Capacity

- Develop a trade policy framework to provide strategic direction and a coherent approach to cover all potential international, regional, and tri-lateral trade negotiations.
- Establish a Trade Policy Coordinating Body (TPCB) to carry out coordination and analysis of issues with other relevant Government and quasi-government bodies. This body should be responsible for a consultative process involving non government stakeholders. The TPCB should be placed at a sufficiently high level of government and should oversee the implementation of trade policies and actively participate in selected negotiations in a structured and more effective manner. The number of staff needed should be identified as should the level of professional qualifications, but it is deemed appropriate that at least the following staff would be needed:
 - 1 trade coordinator/communications officer (M.Sc level);
 - 1 senior economist (M.Sc level) and
 - 2 research economists (B.SC level)
- Enhance the capacity of the TPBC:
 - 1) Train personnel on research, analysis and negotiations skills
 - 2) Provide adequate funds for participation in negotiations first at regional level then for international negotiations

Accession to WTO

The costs of seeking full membership Timor-Leste are high weighed against the limited benefits. Hence, observer status is recommended for a period of five years before acceding. As an LDC and with observer status Timor-Leste will still be able to enjoy the benefits of technical assistance funding from WTO and Integrated Framework funding sources.

Accession to regional trade organisations (ASEAN-AFTA, PIF)

- Timor-Leste has applied for status as observer with ASEAN AFTA, and it is recommended that this status is kept for a period of at least three years after which full membership should be sought. Full membership incur substantial costs However, the benefits of joining an organisation with international political clout and huge trade potential clearly outweigh the costs in the long term.
- Seek observer status in the medium term (1 to 3 years from now) with PIF. The free trade agreement Pacific Island Countries Trade Agreement (PICTA) under the Pacific Agreement for Closer Economic Relations (PACER) is not likely to result in increased trade for

Timor-Leste. However, the sharing of experience and information with countries of same nature and access to funding for technical assistance is of some interest.

- Engage in negotiations for a tri-lateral trade agreement between Timor-Leste, Australia and Indonesia. Further engage in bilateral negotiations for an Economic Partnership Agreement (EPA) with the EC.
- Join the Association of Small Island States (AOSIS) as it functions primarily as an ad hoc lobby and negotiating voice for Small Island developing States (SIDS) within the United Nations system.

Develop rules based (WTO) negotiation skills

- Systematically identify issues of interest to Timor-Leste and concentrate negotiation efforts and monitoring in these areas such as:
 - i. General Agreement of Trade in Services (GATS) of particular relevance are aspects related to tourism, and services in the oil and gas sector
 - ii. Rules and Geographical Indications, the latter is part of the TRIPS agreement and can be used by Timor-Leste to create a green label (focus on ecology) for the country as a marketing tool for products and tourism
- Undertake analyses of the implications of these negotiations on Timor-Leste and develop position papers.
- Observe and note the results of the negotiation process to influence (joining with and supporting like minded group) and be forewarned about issues that may affect Timor-Leste's development.

Market access

- Remove all industrial import tariffs and replace with a non-discretionary turnover or sales tax with neutral revenue and price effects) to protect current revenues during trade negotiations.
- Maintain low level tariffs on certain agricultural products (no sales/turnover tax applied to agriculture, fisheries, oil or exports) so as to protect local producers. Ensure these products are in any sensitive products list in ASEAN-AFTA.
- Place excise duties for the public good on luxury, disease propagating, and environmentally hazardous products as tobacco, alcohol, plastic bags and cars.
- Carry out a study and associated technical assistance to establish a TBT facility to test imports and exports in order to comply with WTO requirements.
- Carry out a detailed study with associated technical assistance to establish the required SPS laboratory to protect human and animal welfare, and to protect plant life. An optimal organisational fit with academic institutions should be considered. The SPS laboratory should attain a level of competence that equals the requirements for an EU Competent Authority in order to establish a local certification process.

Trade facilitation

- Expand the number of customs entry points, one more port entry and five land border points of entry, and increase the overall staffing of the customs services to ease the flow of goods and reduce illegal border trade. More staff requires more training partially in customs service operations, basic clearance procedures, the ASYCUDA programme, and partially in the more advanced aspects of facilitation as customs valuation.

- Carry out a feasibility study for the diversion of part cargo traffic to the airborne mode. Baucau airport may be up-graded to allow airborne cargo traffic and passenger traffic by long range/wide bodied aircraft.
- Road infrastructure on the North coast should be up-graded to handle at least TEU traffic on a long term sustainable basis.
- The procedure related to the handling of exemptions should be simplified by instituting a one stop decision point regarding exemptions and associated payment of tariffs and add-on taxes
- Implementation by the GoTL of the customs regime for Oecussi as an integrated part of the Timor-Leste customs territory should be carried out. In terms of trade facilitation the transit corridor by land should be operated as a kind of bonded transport system.
- Prepare a detailed business plan for the EIPA, which will define the precise areas of activity, associated staffing requirements and other operating aspects, such as participation in exhibitions and trade fairs, B-t-B training packages and visit programs etc.

WTO Compliance

- Initiate the structures and procedure to develop a system of notifications for WTO obligations
- Extend and develop trade facilitation through Customs Service
- Develop SPS rights for the protection of consumers in Timor-Leste

8.1.2 Trade Development

Trade enabling environment

- Establish efficient capital markets and to assure easy access to capital for local investors.
- Reorient, over time, the monetary and exchange rate policies away from the US\$ bind towards a weighted basket of the major international trading currencies that are used for trade in Timor-Leste.
- Revisit the entire structure of local bank lending terms in order to provide competitive and attractive interest levels and conditions for MSMEs. This may spur the use of local capital over international capital. A specifically designed mechanism for easier access to investment capital for SMEs in agriculture, agro-industry and fisheries in the districts should be studied. The Wold Bank will launch a study to this effect in November 2005; it is prudent to await the results. A mechanism for government supported export guarantees and credit should be investigated to support the exporters.
- Revisit the legal framework surrounding business development and registration procedures. Registration procedures should be streamlined and a one stop window should be implemented. Finalisation of the land law is urgent as land titles are excellent collateral.
- Provide immediate assistance the development of a business plan for the EIPA.
- Focus investment into productive and trade oriented activities on foreign exchange saving activities. Clusters within fisheries, tourism, and agriculture are expected to increase production with multiplier effects creating jobs for local staff and thereby improving livelihoods of part of the Timorese poor. Any activities proposed should aim to preserve the Timor-Leste unique position as a natural producer of high quality ecological products.

- Provide technical assistance and budget support to establish educational facilities for craftsmen. Vocational training facilities should be considered at district level to develop local skills.

Fisheries sector

- Initiate the development of a fisheries management plan (FMP) based on co-management principles. The FMP should indicate the needs for investment and operating costs including appropriate MSC enforcement procedures. This intervention should be coordinated with the tuna fishery management plan funded under the Australia East Timor Fishery Management Capacity Building project.
- Study the options for diversification of fisheries products towards niche markets. The potential for environmentally safe aquaculture development should be explored.

Tourism

Follow up on the outcome of the WTO technical assistance and advisory service programme in on-going.

Agriculture

Study the feasibility of introducing foreign exchange saving and environmentally sustainable agriculture produce, that would form integral parts of the cluster development approach. Such activities are presently funded by the EC-funded ARP III project and the World Bank SEP II.

8.2 Suggested areas for External Assistance

- 1 Trade Policy Formulation:** In order to develop a coherent trade policy document, international technical assistance will be needed. The TA should also act as “facilitator” to stimulate debate and discussion. The Facilitator would be a trade expert with experience of the international trade issues affecting Timor-Leste and formulation of national trade policies. Funding should be sourced through the EC Cotonou agreement instrument: Trade.com.
- 2 Policy Coordinating and Consultative Body.** The task of setting up this important body will require technical assistance from a consultant with experience in trade policy formulation, implementation, and organisational issues. The TA should to be followed-up by advisory services and potentially be continued into a twinning arrangement. Funding should be sourced through the EC Cotonou instrument Trade.com or the Asia Trust Fund (funded by EC and executed by ITC).
- 3 Accession Issues:** A special adviser assists with the basic analyses of the pro’s and con’s of joining the various international (WTO) and regional (ASEAN-AFTA, PIF, tri-lateral negotiations with Australia and Indonesia) trade systems. Development of a clear strategy with associated economic analyses and preparation of submissions to WTO, ASEAN, and EU should be carried out. The adviser could represent GoTL at non-key meetings at WTO or ASEAN to ensure flow of information. Funding for training should be sourced through TRTA facility of DDA Global Trust Fund, administered by WTO.
- 4 Trade Analysis and Negotiation Training:** Initially, WTO courses could be used including the WTO course on Negotiating Skills. However, specific training programmes on trade research and analysis (including simple model building) will be required at recognised institutions (see N11, section 7.2.4). Funding may be sourced from WTO Global Trust Fund, (and EC Cotonou agreement).
- 5 Domestic Tariffs and Taxes:** Tax specialist would be required to detail the feasibility of the proposed changes and design a sales tax/turnover tax system which would meet the features described, including determining a tax rate and ensuring a neutral impact on government revenue and consumer prices. In addition, provision of recommendations for a simplification of the business registration procedure through a one stop window approach, and a simplified procedure for handling

exemptions should be included. Funding should be sourced through the DDA Global trust Fund (WTO).

6 Institutional Capacity Building of Customs Services. To further develop and implement the ASYCUDA functionalities for trade facilitation a consultant with expertise in risk assessment and customs valuation should be engaged. The consultant would also provide recommendations on how to implement the recommendation to cover the particular aspects of land border trade, the Oecussi situation, the land corridor between Oecussi and the main part of Timor-Leste. Generous allowance should be made for expansion of customs staff and training packages. Funding should be sourced through WTO (or EC Cotonou agreement Trade.com).

7 Export and Investment Promotion. An international consultant with expertise in export promotion, attraction of foreign direct investment, and agency financing should be engaged soonest to assist the national director of the EIPA with the development of a detailed business plan. In addition, the consultant should contemplate to use to same agency to collect and collate data on price and marketing information on imported materials to help secure optimal prices in the future. Funding should be sourced from the Asia Trust Fund (or from Pro@invest of the EC, CDE managed).

8 Exercising the TBT Agreement. A detailed feasibility study on the establishment of a TBT compliance system should be carried by an international consultant with experience in accreditation and standardization issues. The activities should be followed-up by a technical assistance and training package to establish the actual testing facility preferably in conjunction with a university level technological institute. Potentially a twinning arrangement with a parallel institute within the EU should be pursued. Funding should be sourced through the Trade.com and /or the Standards & Trade Development Fund, administered by WTO.

9 Exercising of SPS Rights: An international consultant with experience in SPS agreement issues should be recruited. The consultant would be required to undertake a strategic plan for operating an SPS system including adaptation of the existing legislative framework. In addition, the expert would pay particular attention to the scope of SPS regulations required to select only those relevant to Timor-Leste. The consultant would specify the educational level of staff required and technical specifications of the laboratory for it to serve as a competent body. The potential for a mobile SPS unit to serve border areas and Oecussi enclave should be included. Funding should be sourced through the EC Cotonou horizontal programme for fisheries of Trade.com.

10 Capital Market Establishment and Access to Capital. The legal framework for capital market development and improvements in local access to equity and loan funding is urgently needed to activate and increase local participation in development investment. The role of the three international banks present in Timor-Leste should be included with the potential for these to assume to role as true investment bank. The assessment should include a proposal for the cost structure for a decentralised level of investment and commercial banking. This may to include a system of credit extension based on the revolving fund principle. An advisor with background in development banking and credit extension is required. Funding should be sourced through the IMF or the World Bank.

11 Fisheries Sector Management Plan. A TA is needed to cover all aspects pertaining to the establishment of a set of co-management plans for the different fisheries in operation including potentially new activities in freshwater and marine aquaculture. Associated MSC enforcement procedures should be designed and included in an overall cost/benefit analysis. The FMP should be based on existing legislative framework and should focus on the transfer of ownership through workshops, other participatory methods, and co-management organisation business plans. Appropriate MSC measures should be identified and costed to secure that the different stakeholder groups comply with the provisions of the co-management plans. Funding to be sourced through the World Bank and/or the EC-Cotonou instruments.

12 Fisheries Product Identification. To direct the development of fisheries towards tradable products; a markets and linkages study should be carried out. It is essential that the study is demand driven i.e. that it reflects international consumers' preferences and simultaneously is based on a least cost investment option involving local skills and input material available. A niche market approach should be taken. Funding to be sourced through Asia Trust Fund, but should be coordinated with the activities funded under ARP III,

13 Import substitution in agriculture. For the agricultural sector it is recommended to carry out feasibility studies of the development of foreign exchange saving products and methods that lead towards integrated production systems. Selection of the products should be based on their potential contribution towards cluster development with tourism and fisheries, and be based on a niche market approach, Funding to be sourced through Asia Trust Fund or Pro@invest.

Annex A: Terms of Reference

TERMS OF REFERENCE
FOR A
NEEDS ASSESSMENT
OF
TRADE AND TRADE-RELATED ASSISTANCE
FOR THE DEMOCRATIC REPUBLIC OF EAST TIMOR

INTRODUCTION

In line with the recommendations in the Communication on Trade and Development (September, 2002), the Commission Services have initiated a number of joint activities intended to facilitate more comprehensive integration of Trade-related assistance (TRA) in EC development cooperation. Trade and development is one of six priority areas set out in the Development Policy Statement (November, 2000). The new generation of Country Strategy Papers (CSP) will set the EC development cooperation strategy with all the partner countries for the years 2007-2012 and while TRA is already partially integrated in the ongoing programming cycle, appropriate efforts should be made to further **mainstream TRA** into overall **development approaches**. This policy objective reflects the recognition that, under certain conditions, **trade** can play an important role in generating **pro-poor growth**. TRA can only be effective when it is based on comprehensive analysis and when integrated into a broader national or regional development and poverty reduction strategy and subsequent action plans. As a first step, the EC aims to ensure that its planning process for TRA will be based on the best international practices. According to the EC Guidelines on TRA (May, 2003), these programmes should be based on Needs Assessments (NAs) that:

Identify all the **constraints** a country is facing in participating in the world trading system;
Recommend a **prioritised list of actions** to remove these constraints.

BACKGROUND

The Delegation of the Commission of the European Communities in the Democratic Republic of East Timor (EC Delegation), in coordination with the Government of the Democratic Republic of East Timor, has commissioned a **Trade Needs Assessment** (NA) assignment which is the subject of the present ToR.

The purpose of the Needs Assessment mission is to identify the constraints facing East Timor's integration into the world trade system and to propose a strategy to address these constraints, where the EC could have a specific and effective action. Constraints will be categorised and prioritised by the NA so as to facilitate the design and pre-programming of an intervention strategy addressing or eliminating some of the identified constraints.

It is envisaged to conduct the **NA mission in three (3) phases**:

(Phase 1) To conduct a review of the **documentation** relevant to the purposes of the mission for East Timor. This review is based on documentation provided by the EC Delegation and other literature available;

(Phase 2) To conduct **field visits** to determine, verify and complete missing portions of the review of documentation so as to profile the state-of-play for trade-related issues in East Timor. This phase will include the organisation of a stakeholders' workshop;

(Phase 3) To analyse the results of Phase 2 and subsequently prepare a **detailed set of prioritized recommendations** to support the programming activities in East Timor.

There are specific sets of deliverables associated with these 3 phases and they are detailed below in Section II under “Deliverables”. Due to the relevance of the results of the NA mission’s findings and recommendations for future trade-related assistance, frequent communication with the designated representatives of the EC Delegation will be required.

DESCRIPTION OF THE ASSIGNMENT

3.1 Objectives

The *overall objectives* of the Trade Needs Assessment are to identify the most efficient and direct contribution that the EC could give to East Timor, in order to support the Government:

- to **mainstream trade matters** in its development policy and strategy (or PRS);
- to **benefit** more from external trade;
- to **participate more effectively** in the multilateral and regional trading system;
- to facilitate **donor co-ordination** and catalyse additional **funding** in the trade area.

The *specific objectives* of the TNA are:

- to summarise and analyse the main **constraints** for East Timor to benefit from trade;
- to comprehensively articulate its **needs** in the area of TRA in order to facilitate more systematic engagement of different stakeholders;
- to outline a **prioritised action plan** towards removing the identified constraints;
- to increase **awareness and understanding** in the area of TRA through broad consultations throughout the assignment.

3.2 Beneficiaries

The people of East Timor that will benefit from the growth generated by trade;

The Government of East Timor, particularly those involved in trade policy making and implementation;

Non-state actors involved in trade matters (farmers, fishermen and small agro-business entrepreneurs) and the international or bilateral development agencies involved in trade related assistance.

3.3 Activities

In addition to the meetings with the EC Delegation in Jakarta and Dili, the experts shall meet with at least **four (4) key stakeholder groups** in the course of the Needs Assessment Mission. These include:

- (1) Representatives of relevant **government and quasi-governmental institutions**;
- (2) Representatives of the **business sector**, especially importers and exporters and small agro-business entrepreneurs;
- (3) Local members of the **Academia** specialised in trade, trade research and related matters;
- (4) Relevant members of the **donor and technical assistance communities** within East Timor, including Member States embassies in Jakarta and Dili.

At least **one workshop** will be held with representatives of all relevant stakeholders. Ideally this should be held during the phase two in order to gather the maximum of relevant input.

DELIVERABLES

All Experts will cooperate with guidance from the EC Delegation in the Republic of Indonesia and the Government of the Republic of Indonesia to produce the following deliverables. They are intended to form portions of the **Final Report** to be submitted, taking into account the comments made during the meetings by the EC Delegation and, at the Headquarters, by DG Relex, DG Trade, DG Development and DG Aidco. The Phase during which each deliverable becomes due is in brackets at the end of each item:

Mission Work Programme: A 1-page Summary Mission Work Program or Timetable (outlining how and when the mission intends to conduct its work); **[Beginning of PHASE 1]**

(2) **Stakeholder Organisational Chart:** In not more than 5 pages, identify and describe trade policy-making institutional actors in East Timor in a chart (with attached descriptive text) graphically showing hierarchical relationships where they are relevant and legislative mandates for areas of trade policy; **[PHASE 1]**

(3) **Trade-Related Assistance (TRA) Report:** Identify and briefly summarize all previous, existing and (known) future Trade-Related Assistance (TRA) actions by other donors or providers for East Timor. **[PHASE 2]**

(4) A **Matrix of Constraints to Trade Development:** The *set of problems*, which categorises and prioritises the constraints in a logical manner; **[PHASE 2]**

(5) A **Matrix of Needs:** The *set of solutions*, which links the key and priority constraints with the basic actions necessary to address each key constraint; **[PHASE 2]**

(6) **Analytical Trade Profile (ATP):** A comprehensive, but concise study and analysis of East Timor's trade profile (maximum 6,000 words), the ATP should include a section on key stakeholders as identified in Deliverable Number 2 above, a section on constraints and a section on needs as identified in the above Deliverables Number 3 and 4 respectively. Finally, it should include the results of Deliverable Number 5 above; **[PHASE 2 draft, PHASE 3 final]**

(7) **Draft action plan:** Prepare a draft action plan clearly showing how to address constraints as articulated in the Needs Matrix, in particular, the *ideal sequential programming* of intervention and assistance by priority. Due attention should be paid to ensuring that the strategy is aligned with East Timor's poverty reduction strategy. Different types of intervention which may best address problems should be presented, including (a) technical assistance and advice, (b) budgetary support and (c) procurement support, with an emphasis on technical assistance and advice; (this deliverable should ideally not exceed 4,000 words).

[PHASE 3]

(8) **Set of Recommendations:** Describe how the action plan may be integrated in the national development policy of East Timor, paying close attention to integrate this Intervention Strategy with the poverty reduction strategy under the national development strategy. **[PHASE 3]**

(9) **Annex of projects to be funded by the EC:** Prepare an annex for the EC and Government of the country only with recommendations which activities could be funded by the EC and provide a description of those activities.

At the debriefing that follows the conclusion of the field work, the team will propose a short **presentation (PowerPoint)** and a concise **aide-mémoire**, which will represent the major findings of the mission and give an overview of the major content of the Final Report.

The **Final Report** will take in account the comments provided by the EC Delegation at the debriefing meeting and should be submitted to the EC Delegation **within 7 calendar days** from the debriefing at the EC Delegation. The Delegation will comment on the Final Report (including the input received from the Headquarters) within 14 calendar days of submission of the Final Report.

Following the comments made by the EC, the final version of the Report should be submitted **within 7 calendar days** as follows: one (1) hard copy and one (1) copy on cd-rom (should be sent by express courier) to the EC Delegation in Jakarta. Similar sets should be sent to DG Aidco, DG Relex and DG Trade at the Headquarters.

LOCATION AND DURATION

The Exploratory Mission will take place primarily in **East Timor (Dili)**, under the guidance of the EC Delegation in **Jakarta**. **Dili** is expected to be the primary venue for activity, although a briefing in Jakarta will be necessary at the beginning and at the end of the mission.

Indicative starting date: Mid-May 2005

Indicative end date: The deadline for completion of the Mission and submission of all final documents is **End-June 2005**.

Total duration of the assignment: 46 days

Each Expert will have a total time input according to the following table, including travel to and from East Timor and Indonesia for any non-locally based experts.

LOCATION/ACTIVITY	Team Leader	Local expert
Europe/Home base	7	
<i>Meetings in Brussels</i>	<i>1</i>	
<i>Final Report: (a) draft and (b) after EC comments</i>	<i>6</i>	
East Timor & Indonesia	18	18
<i>Mission Work Programme</i>		
<i>Briefing and de-briefing meetings at the Jakarta Delegation</i>		
<i>Meetings with relevant above-mentioned parties</i>		
<i>TRA Summary, draft ATP</i>		
Total days	25	18

EXPERTISES REQUIRED

6.1 Core Team

The team shall be composed of two experts:

- (A) One (1) Trade Expert and Team Leader;
- (B) One (1) Local Expert

The team should consist of two experts, one senior expert with international experience and one expert with local experience.

The Experts must be proficient in English and at least one Expert must also have some knowledge of Portuguese and/or Bahasa Indonesia.

EXPERT 1: INTERNATIONAL TRADE EXPERT AND TEAM LEADER

The Team Leader must be an expert in the field of international trade, preferably with an economics background.

SPECIFIC DUTIES AND REPORTING REQUIREMENTS

- The Team Leader will be responsible for the organization of the team's work and the timely delivery of outputs and deliverables. S/he will lead the drafting process for the Final Report and the other necessary deliverables;
- The Team Leader will ensure that the Needs Assessment mission (NA) is conducted in a professional manner, with courteous consultation and inclusion of the primary stakeholders (EC Delegation and the host government) during the mission;
- The Team Leader will report to the Head of Trade section for the NA at the EC Delegation for the purposes of these Terms of Reference.

QUALIFICATIONS AND SKILLS

- Minimum Masters degree or equivalent in economics, public sector economics, development economics or in another discipline related to international trade and trade policy is an absolute requirement;
- A thorough understanding of prevailing methodologies for best-practices in Needs Assessments and Trade Policy Analysis is a requirement. Familiarity with the Integrated

Framework on Trade Related Assistance (IF) and/or the Joint Integrated Trade Assistance Programme (JIITAP), would be a significant advantage, including the process of evaluating strengths and weaknesses in trade policy, trade regulation and related matters at a national level;

- A thorough knowledge of the trade and trade-related issues facing developing countries as well as a thorough understanding of the international trade regime and rules-based multilateral trade system is also required. Familiarity with the Doha Development Agenda and its impact on developing countries would be an added advantage.
- Some knowledge and experience in SPS, health and consumer issues, as well as in relevant standards and certification issues.
- An ability to work in a multicultural environment.

PROFESSIONAL EXPERIENCE

- At least ten (10) years of experience in the field of trade policy, international trade negotiations, a similar area within trade or a combination thereof, mainly acquired in countries with a similar level of development (mainly Least developed ACP countries);
- Proven track record of leading teams conducting evaluations of policy or needs assessments in the area of trade;
- Prior experience with developing Strategic Plans, Work Plans or actionable Recommendations.

LOCATION

Dili, East Timor
Jakarta, Indonesia

EXPERT 2: LOCAL EXPERT

The Local Expert will work to support the Team Leader in preparing the relevant analysis and documents as specified under “Deliverables”.

QUALIFICATIONS AND SKILLS

University degree in economics, law, political science, development, or in another field closely related to international trade and trade policy, from a recognized institution;

A good understanding of the research process and analytical skills;

Demonstrated familiarity with prevailing trade and trade-related issues for East Timor or at regional level;

An ability to work in a multicultural environment.

PROFESSIONAL EXPERIENCE

At least ten (10) years of relevant professional experience, mainly acquired in countries with a similar level of development (mainly least developed ACP countries).

LOCATION

Dili, East Timor
Jakarta, Indonesia

IMPORTANT REMARKS

During all contacts with the Timor Lest authorities, other Timorese stakeholders, or any project or Organisation, the consultant will clearly identify him/herself as an independent consultant and not as official representative of the European Commission. All documents and papers produced by the consultant will clearly mention on its first page a disclaimer stating that these are the views of the consultant and do not necessarily reflect those of the European Commission.

Documents acquired during the mission will be submitted to the Delegation together with the Final Report. All document, reports, or other material acquired during the mission and relevant to EU-East Timor relations will be submitted to the Delegation at the end of the mission, and will remain available for further missions and/or projects

Attention is drawn to the fact that the European Commission reserves the right to have the reports redrafted by the mission, as many times as necessary, and that financial penalties will be applied if deadlines indicated for the submission of reports (drafts and final, in hard and electronic copy) are not strictly adhered to.

Prior to the commencement of the mission, the experts should obtain, where necessary, visas for East Timor and Indonesia. The framework contractor must foresee a local budget available to the consultants covering inter alia, personnel, transport and office supplies

These TOR may be elaborated upon further by the Commission and/or be completed in greater detail during the briefings in Jakarta

BUDGET

The maximum budget for this mission is **EUR 50,000**. A budget should also be allocated for transportation between East Timor and Indonesia, local transportation, workshop and working expenditure.

No provision is foreseen for renting office space. Local transport and office space should thus be arranged directly by the Mission.

Annex B: Reference Documents

- Centre for Economic studies. Asia Foundation: Trade and Economic Development. 2002
ECON, SIDA: A future Trade Policy for East Timor. Aide-Mémoire. 2002
EC: Country Strategy Paper, 2002-06
EC, ALA: National Indicative Programme 2005-06 Timor-Leste
GTZ: Food Security Programme Timor-Leste. 2005
MDE: Private Sector Development Priorities SIP. 2005
MDE: Natural Resources And Environment Priorities And Proposed SIP, 2005
- MDE: A politica do investimento privado em Timor-Leste. 2004
MDE: Policy on Private Investment in Timor-Leste, Synthesis. 2004
MoAFF: Policy and Strategic Framework. 2004
MPF: Overview Of Sector Investment Programs Volume I: Strategies And Priorities For The Medium-Term.2005
MPF: Overview Of Sector Investment Programs Volume II: Sectoral Priorities, Programs And Expenditures
MPF: Combined Sources Budget. 2005-06. Draft Budget/Background Paper. *For Discussion At The Timor-Leste Development Partners' Meeting 25-26 April 2005*
- MPF: Directorate of Statistics: Overseas Trade Statistics. 2004
MPF: Timor-Leste Petroleum Fund. Draft Act. 2005
MPWTT: Power Priorities And Proposed SIP. 2005
- Kevin Moore, Gov't of Ireland: Report on Short Term Mission. 2003
OXFAM: Overview of the Coffee Sector In Timor-Leste. Up-date. 2004
Planning Commission: National Development Plan. 2002
UNDP: Policy Research International: A strategy Framework for Timor-Leste. TCDC. 2003
SECI: Joint Ministerial Commission working Group on trade, investment and finance. Agenda.2004
SECI, Keatinge: EU Trade Needs Assessment Mission - Briefing Paper, 2005
SECI, D.H Kim: Final Report on Trade Sector Development and Adjustment
SECI Real/Keatinge: Trade Policy Discussion Paper and Draft Action Plan, 2005
UNCTAD: ASUCUDA. 2005
UNDP. L. Hansen: Financial Services Sector Assessment in Timor-Leste and Seminar/ Workshop on "The Millennium Development Goals and The Eradication of Poverty – The Role of Microfinance in Timor-Leste" FINAL REPORT.2005
UNDP: Recent Macro Economic Trends and Medium Term Outlook, 2004
UNDP: Sustainable Tourism Sector Development And Institutional Strengthening, Republic Of Timor-Leste PHASE I. 2005
- UNDP: Sustainable Tourism Sector Development And Institutional Strengthening, RDTL.2005
UNFPA: Census Timor-Leste. (2004)
UNMISSET: The Laws of Timor Leste. 2005
USAID: CAS results matrix 2006-08. 2005
USAID: The Timor Economic Rehabilitation and Development Project. 2004
USAID: Economic Growth Assistance in Timor-Leste. 2004
USDA: Cost of Agricultural Distortions. Economic Research Service, 2001
World Bank: Background Paper for the Timor-Leste Development Partners Meeting. 2005

Annex C: List of Consultations

**Needs Assessment of Trade and Trade-Related Assistance
For the Democratic Republic of Timor-Leste**

**Needs Assessment of Trade and Trade-Related Assistance
For the Democratic Republic of Timor-Leste**

No	Date	Organisation/unit	Name	Position	Phone	Email
1.	20.05	EC Brussels, DG RELEX	Mr. Aldo DELL ' ARACCIA	Head of Unit SE Asia	+32-2- 2295271	Aldo.dell'araccia@cec.eu.int
2.	20.05	EC Brussels, DG DEV	Mr. Valeriano DIAZ	Head of Unit, Pacific region	+32-2-296 2731	Valeriano.diaz@cec.eu.int
3	20.05	EC Brussels, DG DEV	Ms. Cheri B. CHAPMAN	Desk Officer	+32-2-295 0030	Cheri.chapman@cec.eu.int
4	20.05	EC Brussels, DV Trade	Ms. Belen FIGUEROLA-SANTOS	Desk Officer	+32-2-298 80 01	Belen.figuerola-santos@cec.eu.int
5	23.05	EC Delegation, Jakarta	Mr. Raffaele QUARTO	FS Head of Trade Section	+6221 5706076 (223)	Raffaele.quarto@cec.eu.int
6	23.05	EC Delegation, Jakarta	Mr. Christophe HORVATH	Programme Manager	+ (346)	Christophe.horvath@cec.eu.int
7	23.05	EC Delegation, Jakarta	Ms- Hermine DONCEEL	Trade Section	(224)	Hermine.donceel@cec.eu.int
8	23.05	Royal Norwegian	Ms. Marit ROTI	Counsellor Development	+6221 576 1523	maro@mfa.no
9	23.05	Royal Danish Embassy	Mr. Geert Aagaard ANDERSEN	Ambassador	+6221 576 1478 +62 0816 901334	geeand@um.dk
10	24.05	EC Office, Dili	Mr. Gugleilmo COLOMBO	Head of Office	+670 3 325 171 / 172	ectimor@arafura.net.au
11	25.05	Ministry of Foreign Affairs and Cooperation	Dr. Jose RAMOS-HORTA	Minister	+670 723 0067	
12	25.05	Prime Ministers Office	Mr. Douglas KEATINGE	Advisor	+670 727 2294	keatinged@un.org
13	25.05	Cooperativa Café Timor	Mr. David BOYCE	Advisor	+670 723 2995	
14	25.05	USAID	Mr. Stephen Vance	Senior Economic Development Advisor	+670 723 0573	
15	25.05	USAID	Mr. Cancio da CONCEICAO	Project Mgt Specialist	+670 723 0579	
16	26.05	SECI	Mr. Arlindo RANGEL	Secretary of State	+670 723 6698	
17	26.05	SECI	Ms. Gina CORTE-REAL	Director of Commerce	+670 723 6698	
18	26.05	SECI	Mr. Manuel ALVES	Director of Industry	+670 723 6698	
19	26.05	World Bank (SEP II)	Ms. Maria Fernanda SIMOES	Legal Advisor to SEP II	+670 725 8283	
20	26.05	Young Entrepreneurs Association	Mr. Jorge SERRANO	President	+670 723 8766	
21	26.05	Crocodile Line	Mr. Constancio GUTERRES	Owner & General Manager	+670 332 2109	Ariana_oceano@yahoo.com.au
22	27.05	Ministry of Development and Environment	Mr. Abel XIMENES	Vice Minister of Development and Environment	+670 333 9039	
23	27.05	Ministry of Development and Environment	Dr. Jose GONCALVES	Advisor on Investment Policy to the Prime Minister and MDE	+670 724 7716	isgoncalves@yahoo.com
24	27.05	Banking and Payment Authority	Ms. Maria Jose SARMENTO	Deputy General Manager for Supervision	+670 3313 712 / 4 /	mjjsarmento@yahoo.com
25	27.05	Banking and Payment Authority	Dr. Gustavo BUSSINGER	Advisor to Director General	+670 3313 712 / 4 /	gbussinger@bctl.east-timor.org
26	27.05	Banking and Payment Authority	Gastao de SOUSA	Advisor for Stats & Economic Management		
27	27.05	World Bank(SEP II &	Ms. Georgina de MELLO	Advisor to SEP II & IPEA	+670 727 4002	

**Needs Assessment of Trade and Trade-Related Assistance
For the Democratic Republic of Timor-Leste**

		IPEA)				
28	28.05	East Timor Roofing	Mr. Berry DOVEY	Director of East Timor Roofing Company		
29	30.05	Ministry of Agriculture, Forest and Fisheries (MAFF)	Mr. Estanislau da SILVA	Minister of MAFF	+670 725 7565	
30	30.05	Customs Services Directorate	Mr. Uldarico RODRIGUES	National Director	+670 726 7820	
31	30.05	Customs Services Directorate	Mr. Domingo PEREIRA	National Sub-Director		
32	30.05	Customs Services Directorate	Mr. Olivio BORGES	ASYCUDA National Project Director	+670 724 0064	Olivio.borges@undp.org
33	30.05	Customs Services Directorate	Mr. Lourenco CARVALHO	ASYCUDA's Supervisor		
34	30.05	Customs Services Directorate	Ms. Miwako KAMIMURA	UNDP Programme Officer	+670 312 481	miwako.kamimura@undp.org
35	30.05	International Development Law Organization (IDLO)	Mr. Miles YOUNG	Programme Legal Counsel of IDLO	+612 8585 6700	myoung@idlo.int
36	30.05	BNU	Mr. Correai PINTO	General Director of BNU	+670 723 0909	Cdg.timor@mail.timortelecom.tp
37	30.05	Macau Electricity Company	Mr. Resende PINTO	Technical Director	+670 725 5575	
38	30.05	EDTL	Mr. Jose EDUARDO	Financial Director	+670 725 5575	
38	31.05	UNATIL	Dr. Benjamin CORTE-REAL	Vice Chancellor of UNATIL	+670 724 3705	Bcorte_real@hotmail.com
40	31.05	GTZ	Dr. Manfred METZ	Advisor		Metz@codeplan.de
41	31.05	OXFAM Australia	Mr. Keryn CLARK	Country Director of OXFAM Australia	+670 723 0830	Kerync@oxfam.org.tp
42	31.05	OXFAM H. Kong	Mr. Frank ELVEY	Programme Manager	+670 331 2605	franke@oxfam.org.tp
43	31.05	OXFAM GB	Ms. KYLIE			
44	31.05	National Department of Statistics	Mr. Manuel MENDONCA	Director of NDS	+670 723 0149	
45	31.05	NDS	Ms. Margaret FITZGIBBON	Statistics Advisor	+670 723 2945	mfitzgibbon@imf.org
46	01.06	Tourism, Investment & Environment	Mr. Miguel SARMENTO	Advisor on Tourism for SoS		
47	01.06	World Bank	Mr. Bernard DRUM	Lead Private Sector Development Specialist	+670 202-473-2038	bdrum@worldbank.org
48	01.06	Consultant to World Bank	Mr. John CONROY	Economist	+61 7 3870 4762	johnconroy@uq.net.au
49	01.06	World Bank	Ms. Johanna LARSON	Training Specialist		
50	01.06	Microfinance Inst Tuba Rai Metin	Mr. Jose' GUSMAO	Director	+670 3322062	turame@mail.timortelecom.tp
51	02.06	Ministry of Planning and	Ms. Aicha Bassarewan	Vice Minister		

**Needs Assessment of Trade and Trade-Related Assistance
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		Finance (MoPF)				
	03.06	SECI, MoFAC	Workshop with 28 participants			
52	04.06	Estado, Ermera (CCT)	Mr. David BOYCE	Advisor	+670 723 2995	boycedjs@bigpond.com
53	04.06	McKinnon (CCT)	Mr. John KUMAR	Chief Engineer	+91 422 2460829	
54	06.06	MoPF	Mr. Jose EDUARDO	Vice-Director of Taxation	+670 723 0079	
55	06.06	MoPF	Mr. Bernardo AMARAL	Manager of Large Business	+670 723 0079	
56	06.06	MoPF	Mr. Jose dos SANTOS	Tax Council Advisor	+670 723 0079	
57	06.06	MoPF	Mr. Thomas EKELI	Advisor on Petroleum Fund at Macroeconomics Division	+670 726 4760	tekeli@mopf.gov.tp
58	07.06	SECI	Mr. Arlindo RANGEL	Secretary of State		
59	07.06	Imani Development (World Bank consultant)	Mr. Keith ATKINSON	Managing Director	+61 (0)8 9361 9520	imanius@bigpond.net.au
60	09.06	EC Delegation, Jakarta	Mr. Raffaele QUARTO	FS Head of Trade Section	+6221 5706076 (223)	Raffaele.quarto@cec.eu.int
61	09.06	EC Delegation, Jakarta	Mr. Christophe HORVATH	Programme Manager	+ (346)	Christophe.horvath@cec.eu.int
62	09.06	EC Delegation, Jakarta	Ms- Hermine DONCEEL	Trade Section	(224)	Hermine.donceel@cec.eu.int

Annex D: Projects for EC Funding

Project Fiche 1: Support in Trade Policy Formulation and Coordination

Implementing Agency:	State Secretariat of Commerce and Industry
Total Project Cost:	€ 475,000
Duration:	24 months
Technical Assistance:	1 Category 1 experts totalling, 20 man-months 1 Category 2 expert, 6 man-months

1. Problems to be addressed

The priorities for the new Government for the Democratic Republic Timor-Leste (RDTL) in May 2002 were set for the continuous effort to rehabilitate the damage done to the physical and social infrastructure in 1999, when Indonesian forces and militia left the country. However, the damage was not only physical and social. During the 25 year period of Indonesian occupation governance and administrative issues were handled largely by Indonesian officials carrying out their tasks based on Indonesian policy priorities and legal framework. The first Timor-Leste Government (still in seat) was left with very limited officials available with a sufficient level of education and practical experience to carry out policy analysis, formulate policy, and implement policies within a suitably defined legal framework.

The first law of civil administration¹ created the base for the establishment of ten ministries and four secretariats of state (SoS). The law assigns the legal mandate and main areas of responsibilities to the individual unit and requests that each unit prepare an organic law for their own organisation, structure and services/functionalities. The Council of Ministers is nominated as the main law approving body with the ministers and the four independent secretariats of state as full members, whereas secretaries of state under the ministries, and vice-ministers, participate in the meetings without voting rights. The policy making process (and law making) is intended to be initiated by the ministry or SoS designated responsible and then to be approved by the Council, who has its own SoS that is able to draw upon the Ministry of Justice for legal advice.

The trade policy area and associated legal framework has not been given high priority during the first years of government, and there is no coherent international or domestic trade policy formulated. The law points to one unit as the focal point in policy formulation: "The Secretariat of State for Trade and Industry (SECI) is the government department responsible for designing, executing, coordinating and assessing the policy, as defined and approved by the Council of Ministers, for business activities of production of goods and services, namely the industry, activities of provision of services and trade, under the terms to be defined in its organic law"². However, the organic law for SECI is not in place and the SECI is under-staffed has only limited levels of qualification, at best equal to a BA or Bs. Econ level with no specialization in trade related matters. SECI is responsible for developing the regulatory framework for metrology aspects (accreditation and standardization which is required under the TBT agreement), however as an LDC Timor-Leste would be granted 'special and differential treatment' thus making obligation under the TBT less harsh.

Meanwhile other units of government have developed piecemeal policies and legal documents within their respective portfolios:

¹ Decree-law no. 3/2002, of 20 September 2002. On the organic structure of the first constitutional government

² Ibidem Section 17

- Prime Ministers office houses the Timor Sea office, where advice is provided regarding the Greater Sunrise oil and gas field negotiations; and the Joint Ministerial Commission (JMC) for negotiations with Indonesia.
- Ministry of Planning and Finance (MPF) has no organic law. Policies and legal instruments are developed and approved within areas as customs³, corporate taxation, and company's registration. The macroeconomic unit is supposed to function as a policy formulation and coordination unit, but is staffed only by 2 national economists (BA level).
- Ministry of Development and Environment (MDE) has no organic law, but as regards trade the important 'Law no 4/2004 of 21 April 2004 Commercial Companies' is adopted. Three SoSs are important for trade policy formulation and implementation⁴:
 - The Secretariat of State for Mineral Resources and Energy Policy; and the
 - Secretariat of State for Tourism, Environment and Investment. The foreign investment law and the national investment laws have just been promulgated. The foreign investment law and its associated regulation foresees the establishment of the Export and Investment Promotion Agency to be placed as an autonomous body with reference to the Prime Minister's Office
- Ministry of Foreign Affairs and Cooperation (MoFAC) has an organic law⁵, though trade policy is not mentioned directly it is assumed to be part of foreign economic policy. The Directorates of Bilateral, Regional and Multilateral Affairs handle aspects of RDTL integration into the respective geographical systems. These directorates were reported to be staffed with sufficient level of qualification. However, the consultant was not provided with a detailed break-down.
- Ministry of Agriculture Forestry and Fisheries (MoAFF) has an organic law⁶. Policies and regulations have been developed for agriculture and part of fisheries (fishing). The Directorate for Quarantine services is established, but with very limited capacity (2 trained staff at B.SC. level) and no laboratory to fulfil SPS requirements (see project no 3). The

Thus there is no government body specifically assigned the task to stimulate and coordinate trade policy debate and discussion internally. Similarly there is no body assigned to task to establish and maintain a fruitful dialogue process with extra-government stakeholders as Chambers of Commerce, professional associations, and academia.

However, the capacity of SECI to effectively carry out the trade policy formulation and trade strategy development, both regarding accession (observer ship) and its interface with economic development as envisioned under DDA, is limited. Given the range and coverage of issues at both WTO and ASEAN, it is impossible for the small team to follow and participate in these fora in any meaningful way. The limited ability to follow the negotiation process is further exacerbated by the lack of representation in Geneva, though an office has been provided free of charge by the Government of Japan.

It will be necessary with expertise in understanding key agreements under WTO (Non-Agriculture Market Access (NAMA), Agriculture, GATS, TRIPS, and Rules) and the relevance to RDTL. The expertise would then be deployed towards providing assistance in the research and analysis of policy papers (position papers) for elaboration into a coherent international trade policy paper. This paper may form the base for future accession discussion and negotiations.

2. Objectives

The principal objective of the project is to provide the RDTL with assistance and support for her to derive the maximum benefits from the trade potential and thereby enhance economic development.

³ Decree-law no. 11 /2004, of 19 may 2004 customs code of Timor-Leste

⁴ Decree Law 3/2002, op. cit. Section 9

⁵ Decree no. 1/2003, 22 July 2002, On the organic structure of the ministry of foreign affairs and cooperation

⁶ Decree no. 4/2003, of 13 November 2003, on the organic structure of the ministry of agriculture, forestry and fisheries. Government decree no 5/2004, of 18 March 2004. General Regulation of Fisheries

A secondary objective will be to provide officials with “on-job” training and build institutional and human resource capacity in trade policy formulation, coordination and implementation skills.

3. Beneficiaries and stakeholders

The primary beneficiary will be SECI (which may be placed under the Ministry of Development and Environment), where the staff of the Directorates of Policy and Planning and the Trade will receive advice, technical assistance and participate in training tours and workshops. Other Ministries as MDE, MPF, MoAFF would also benefit as their relevant staff will participate in both the trade policy formulation and coordination activities. These ministries are responsible for trade related aspects within their general portfolios.

Private sector consultations would be held and the Chamber of Commerce and professional organisations would benefit from greater awareness, understanding and the potential to lobby their interest. Ultimately, improved trade conditions will reflect positively on the income levels of the poor mostly agricultural producers, near coastal fishermen, and the urban youth.

It is estimated the project will contribute towards funding the gap of € 20 mio, over five within the Private Sector Program SIP by € 0.6 mio over two years.

4. Expected Results

1. A coherent international trade policy document
2. International trade strategies and key DDA issues based on well researched, analysed and consulted issues.
3. Establishment of appropriate coordination and decision making structures in government to discuss and agree policies and strategies.
4. Establishment of a consultative process to secure ownership of the policies and strategies developed.
5. Development of trade policy analysis and negotiation skills
6. The main output would be a coherent international trade policy with clear indications of how and when RDTL should join the multilateral, regional, tri- and bilateral trade systems. .

5. Programme Activities

1. Support in the establishment of key structures in the government to coordinate, discuss and agree positions on general trade policy – a trade policy coordinating committee
2. Support the establishment of a consultative process with extra-government stakeholders
3. Advice and support in the development of a strategy for integration with the various part of the international and regional trade systems as observer ship in DDA negotiations
4. Determine the impact of membership in regional economic integration arrangements on the prevailing policy stance by explicitly considering the benefits and costs of such agreements in terms of policy freedom and investment incentives.
5. An assessment of the benefits of (and need for) applying for an Integrated Framework study (entitled: Diagnostic Trade Integration Study), where the aim would be:
 - a. To mainstream trade into Timor-Leste’s NDP and the embedded Poverty Reduction Strategy
 - b. To assist in the coordinated delivery of trade-related technical assistance in response to needs identified by Timor-Leste (amongst other thought action matrix of the present study).
6. Advice and assistance in the research and preparation of briefings, position papers and formulation of trade policy papers
7. Participation with officials at key meetings to provide key advice and input to the process
8. Assistance in raising support with key ASEAN members on Timor-Leste.
9. The initial TA and advisory activities should be continued into a twinning arrangement with similar activities preferably in a lusophone country.

6. Inputs

International expertise:

Expert 1 (category 1): The trade policy formulation expert will be a policy adviser with a strong background in multilateral, regional and bilateral trade policy formulation and economics, who can provide the GoTL with well researched and analysed positions on strategies for accession as well as support and advice in negotiations. He/she should have a strong background in WTO issues and negotiations and have extensive knowledge of the current issues of the DDA. This expert will be required to assist with the establishment of negotiation structures and undertake training and awareness raising seminars on DDA issues. He/ she would also provide advice on the need for an Integrated Framework study. (20 man-months)

Expert 2 (category 1): Legal and institutional advisor with long term experience in organising institutional development including participatory workshops and seminars. The main duty is to define and establish the optimal institutional set-up considering the expected government reshuffle (6 man-months).

Experts 1 will be nominated as team leader.

The following flights and associated per diems would be required across the three experts to ensure effective participation and support:

Up to 8 flights to Geneva and
Up to 4 flights to Brussels
Up to 4 ASEAN countries
Up to 10 flights to Timor-Leste will be required

In addition, a budget for seminars, printing, report writing and local transport will be required.

7. Risks and Sustainability

Risks and assumptions related to the project:

- It is assumed that GoTL will actively participate in the process and provide adequate support and officers responsible for international trade policy analysis formulation
- The Government itself can agree and obtain consensus on each issue
- The greatest risk comes from external events in the international / regional trade environment which are beyond the control of the project: this could include delays in progress on discussions and negotiations, and political pressure exerted to determine a specific outcome

The long term sustainability of the project shall be ensured through:

The short term support is vital in order that RDTL can effectively articulate its position on international trade strategies to obtain an appropriate outcome without adverse effects on the Timorese economy. Thus trade policy analysis and formulation will have to be developed over time by building capacity into GoTL and therefore, long term support is the over-riding priority. However, through working closely with officials from GoTL these officials will gain valuable on-job training in analysis, formulation of trade strategies, research, and presentation of issues. Therefore, this project will fulfil two functions: meeting a very important short term need to develop a policy and coordination/consultation continuing into the process of developing capacity which will be useful not only in future WTO negotiations, but also in ASEAN AFTA and trilateral negotiations.

Project Fiche 2: Business plan for the Export & Investment Promotion Agency (EIPA)

Implementing Agency:	EIPA
Total Project Cost:	€ 275,000
Duration:	12 months
Technical Assistance:	2 Category 1 experts totally 10 man-months 1 Category 2 experts totalling 2 man-months

1. Problems to be addressed

The business community in Timor-Leste is small, a total of 10,210 businesses since independence have registered with Ministry of Planning and Finance (MPF) for a tax number and 4,370 re-registered in 2005. However, it is estimated that only little more the 1,000¹ are actually in operation. These are predominantly micro and small and medium sized enterprises (SMEs), of which most work under government contracts on donor funded rehabilitation projects. Businesses are obliged to register in Dili, as the three ministerial offices needed for registration, the Secretariat of State of Trade and Industry (SECI), Ministry of Planning and Finance, and the Notary's Office under the Ministry of Justice, are located there.

A major part of the explanation for relatively confined business community is the very low turn-over of the economy, when rehabilitation work is excluded. There is very little financial surplus in the poverty stricken country, where 42% are estimated to live under the poverty line of 0.55\$ per person per day with a calorie intake of less than 2200 per day, and the average unemployment rate is 20% and 38% for urban youth². Thus the domestic market is negligible in terms of consumption and purchasing power. The concentration of business life in and around Dili thus has not been able to absorb the growing annual numbers of youth turning out. Migration from the districts to Dili is a commencing phenomenon aggravating the situation. Finally, the number of long term sustainable jobs depends to a large extent on the continuing financing of the donor community, a situation that is likely to be eased somewhat with the beginning of the agreed flow of contributions from the proceeds of the Petroleum Fund investments³.

The trade regime is not favourable at the moment. Port infrastructure requires the vessels to carry their equipment for container handling adding an estimated 15% to the freight cost⁴, and the tariff and tax structure adds up to a total of 35% on some tariff lines making it difficult for producers of products for local consumption and re-exports to gain a competitive edge. It is found likely that the price level paid for imports is skewed upwards as a result of Timor-Leste using the US\$ as the only legal tender⁵. As regards exports the situation is even more skewed⁶ as 99% of all exports are green coffee beans. However, the latter provides a clear indication that quality pays, the prices received in 2004 ranges from poor quality beans to top quality goes from \$ 0.45 per kg to \$1.41. Other positive aspects includes the increased level of efficiency of the customs services now using the ASYCUDA system, which not only shortens delay periods, simplifies procedures, and adds transparency, but also feeds very important statistical information directly into the system, which is accessible on-line by potential investors local as foreign.

¹ Corporate taxation Directorate, MPF

² World Bank estimated, Background Paper May 2005

³ The potential net flow from the Petroleum Fund, to be managed by the Banking & Payment Authority, is estimated to reach US\$ 100 mio. annually from the Baya Undan field. (the amount may be more than doubled once an agreement is reached with Australia on exploration of the Greater Sunrise field). The actual annual transfer to the State budget is part of the budget negotiations. Thomas Ekele, IMF Resident Petroleum Fund Advisor

⁴ Crocodile Chipping Line, Dili

⁵ The trade balance was in deficit at \$ 106 mio. in 2004

⁶ Export value of merchandise was US\$ 7 mio. in 2004.

Investment levels are very low. The local banking system is not conducive to productive investment as the banks only lend at zero risk⁷. The little amounts of surplus money in the local economy is not put into savings accounts, but stuffed under mattresses leading to a cash based local economy. The low inward investment level is supplemented by a highly skewed pattern of foreign direct investment (FDI). Though Timor-Leste has been able to record an FDI level totalling \$ 1.7 billion about \$ 1.6 billion has been for the oil and gas industry⁸, yielding only few jobs in Timor-Leste. The balance of \$ 100 mio is mostly invested into construction and road building companies that do provide jobs as long as the Government contracts are available.

The GoTL has taken an important step to assist the process of creating more long term sustainable jobs by the promulgation of the foreign investment law (FIL) in mid-June. The national investment law (NIL) was promulgated at the same time. The FIL points to the need for a one stop window to assist potential investors and exporters with obtaining information and contact points in their endeavour to establish business and carry out import and exports. To serve this need, and designed by the SEP II under TFET funding, a new agency, the Export and Investment Promotion Agency (EIPA), is under establishment. Preparatory work has been done to launch the EIPA later this year. It is expected that the EIPA will be able cover most of the gaps identified above, though the EIPA as it stands has not been secured a plan for long term sustainable funding⁹. A National Investment Law (NIL) has also been promulgated in mid-June with the objective to encourage and regulate inward investment.

The EIPA is conceived as the first point of contact for investors and exporters. For it to function as a stimulator and facilitator for both investment and export activities it will be necessary to ensure long term financial sustainability of the agency. A business plan that covers the activities foreseen, staffing, associated cost and the potential sources of funding needs to be developed.

The Private Sector Development Priorities and Proposed Sector Investment Program (SIP) calls for total public expenditures of US\$ 31 mio over the next five years to help reduce the above stated constraints (see more detail in section 4.1.2). Of this amount US\$ 3.4 mio would originate from the CFET budget allocations equal to 11% of the program needs. The implication is that implementation of the proposed program would require new donor funding in the amount of US\$ 26 mio over the next five years. A stronger private sector is essential for increased job creation, for improved tax revenues and fiscal capacities and an improved trade balance through reduced imports and increased exports.

In short, the problem analysis reveals that there are several sources of weakness leading to the unbalanced imports, exports and investment regimes that together forms obstacles to SME development : (1) legal provisions and deficiencies in access to capital do not favour an increased local SME participation in the industry; (2) employment of Timorese staff in blue colour and management positions is hampered by limitation in craftsmen's skills and training capacity ; (3) limited access of SME to know-how and sector specific technologies for more innovative and value-added development opportunities; and (4) there is a substantial financial gap.

In light of these issues, the up-dating of the business plan for EIPA is intended to:

- Create an enabling environment conducive to an increase in local participation in economic development, in particular at district level; and
- Establish a true one stop window for exporter and investor information on the overall business environment, import and export regimes, customs procedures, business networks, legal aspects etc. that support the creation of enterprises.

⁷ The local branches of three international banks only lends to companies that hold Government contracts (donor funded); and to staff on the Government payroll

⁸ USAID, Country Strategy Paper

⁹ During the round of interviews the USAID indicated a willingness to fund the first year of operation.

It is noted that USAID has expressed an interest in funding an unknown part of the EIPA needs, be it for operating cost coverage for the development activities. It is therefore important to coordinate with UDAID in the planning phase.

2. Objectives

The global objective of business plan for EIPA is to support the GoTL pro-poor strategy by improving the income distributive effects through sustainable job creation generated within economic sectors of export potential via promotion of local and foreign investors' participation.

The purpose is to strengthen the EIPA's capacity to operate efficiently to serve the investors and exporters, on a financially sustainable basis. Local and foreign participation in economic development, be fostered through job creation with SME's that may utilise local production of quality agricultural, forestry, fishery and tourism products

3. Beneficiaries and stakeholders

Direct beneficiaries of increased would be government officials administering SME-related regulations, representatives of business associations, and private persons engaged in activities associated with economic development such as fishermen, farmers, service workers and women. Ultimate beneficiaries will be the people of the Timor-Leste in particular present and future business owner-managers and employees.

The stakeholders will be today's local fishing, agricultural and tourism service communities, and the future SME operators related to economic development activities. Governmental training institutions as the Faculty for Economics and Public Administration, professional associations as the Chambers of Commerce and Industry, and other professional associations are further stakeholders.

4. Expected Results

- Improved regulatory environment for the participation of private SMEs in sector growth at district/local level, while still maintaining the high environmental status of the sectors
- Improved consultative process and constructive dialogue at the interface of government, EIPA, and private sector interests in SME sector development.
- Enhanced capacity of business associations to defend private sector needs and increased availability of business support services at regional level
- Accelerated new enterprise start-ups and thereby alternative job creation. It is necessary that the plan produces an environment that is conducive to local participation.
- Increased income at rural household level.
- Readily available information to local and foreign investors on the Timorese business community, legal framework, registration procedures, taxation, and trade statistics etc.
- Readily available information on sources of 'best buy' prices for imports
- An assessment of the usefulness of the industrial park/economic zone concepts towards generating more investment and industry activity
- A plan of finance that considers as well continued donor contribution in the medium term, Government contributions and own generated income against services delivered

5. Programme Activities

- Carry out a brief diagnostics study of the EIPA framework based on background material as the FIL, NIL and documents related directly to the EIPA and its management structure.
- Assess the need of any changes in the legal and regulatory framework to allow a higher degree of local participation and providing an enabling environment for SME establishment.

- Asses the importance of the lack of a land reform law as an obstacle to investment, paying due respect towards the potential to use leasing agreements of Government owned land as collateral.
- Assist the integration of the EIPA into the global Investment Promotion Agencies network to ensure Timor-Leste exposure to potential foreign investors.
- Establish databases (or links to) on topics as business community networks, legal and financial aspects of business registration and operation, tariff schedules and customs procedures, best-buy import sources and potential overseas partners in exports.
- Assist the civil society structure in support of private business development such as chambers of commerce and sector professional associations to become more equal dialogue partners.
- Ensure that overlapping of funding is avoided by duly coordinating with the activities of components of other relevant donor funded activities (as the SEP II, the activities of the Business Development Centres, the Industrial Park study)
- Organise and execute workshops on key topics including finance aspects of SMEs and preparation of SME business plans
- Investigate the feasibility of EIPA as a manger of an export credit and guarantee scheme
- Establish a detailed plan of finance based on the potential sources of funding for the EIPA including (but not limited to): Donor sources, Government budget, own income generation from subscriptions and sale of services.

6. Inputs

International expertise:

Expert 1 and Team Leader (category 1): EIPA consultant with particular experience in development and business economics; Agency budgeting as financial needs; he/she should be familiar with Timor-Leste in particular and economies of Small Island states in particular: (6 man-months)

Expert 2 (category 1): Legal expert with particular experience in wider SME business legislation and international trade (4 man-months)

Expert 3 (category 2): Export credit and financial expert with knowledge about best practises, and export credit and guarantee schemes: (2 man-months)

Local expertise: The National Director will make himself available for TA and study tours.

The following flights and associated per diems would be required across the international experts to ensure effective participation and support:

Experts Travel to Brussels	6
ASEAN	2
MIGA	1
RDTL	10

National Director travel	
Brussels	2
Washington MIGA	1
Other IPA	1
Trade fair ASEAN	1

In addition, a budget for local transport, report preparation, hard & software and workshops/seminars will be required.

7. Risks and Sustainability

Risks and assumptions related to the project:

The overall state on the international economy may have a significant impact on investment and trade flows in Timor-Leste.

The TA to the EIPA success depends largely on the commitment of the National Director and his staff, for the effective development of support to the SME sector through improvement of the regulatory environment, removal of bottle-necks for private sector development such as fair access to capital, and the promotion of SME support structures.

Sustainability depends also on the quality and continuity of the participating local and foreign investors/SME operators so that the knowledge transferred is not lost.

The long term sustainability of the project shall be ensured through:

The development of institutional links between business representatives and central and local authorities needs to have an influence in shaping SME policies and facilitate economic growth. The commitment and mutual interest of the parties involved in the implementation of the plan, as reflected in the approval of the contribution budget.

Project Fiche 3: Support to Sanitary and Phyto-Sanitary (SPS) agreement rights and obligations

Implementing Agency:	Quarantine Directorate, Ministry of Agriculture, Forestry and Fishery
Total Project Cost:	€ 340,000
Duration:	10 months
Technical Assistance:	2 category 1 experts for 8 man-months in total 1 category 2 experts for 4 man-months

1. Problems to be addressed

The MoAFF has established a brief policy and strategy framework¹ for the three main areas of its portfolio, and the associated organic laws and detailed regulations exits² for each area, based on the international standards are approved. However, the institutional capacity is limited to its own regulatory body, the Directorate of Quarantine Service. The Directorate is the regulatory body that oversees whether the rules and regulations are complied with as regards the protection of human health or safety, protection of animal and plant life or health or the environment (the natural resource endowments). However, only rudimentary quarantine services are actually carried out at three entry/exit points, one land border crossing point, the Dili Port, and at the airport. Even at these points under-staffing in numbers and qualifications prevail. Quarantine services and procedures are limited to just a waiting period without testing for epizootic conditions or diseases.

The import and export of live organisms and products can not be tested checked at present in accordance with the internationally agreed standards thereof as there is no accredited laboratory facility, to test such products. Within this broad area the WTO reference agreement on Sanitary Phyto-Sanitary (SPS) remains and it describes the agreed rules, procedures and standards, which otherwise are compiled in the Codex Alimentarius of the FAO; the WHO reference library on public health issues; the database on animal health issues catalogues in databases of the Office International des Epizooties (OIE), and the international and regional organizations operating within the framework of the FAO International Plant Protection Convention (IPPC).

There is need to establish and accredit an SPS laboratory to carry out the necessary tests and analyses leading towards a national level certification of export enterprises. Products from enterprises without SPS certification will become difficult to export as potential importers are obliged to request documentation for origin and quarantine/testing procedures carried out. If testing is not carried out, in the worst case, pandemic situations may occur; envision a situation where bird flu infested poultry were imported from Indonesia into Timor-Leste with the aim to establish a local poultry industry. Thus market access is difficult as satisfactory control of exports and imports is not possible within the non-tariff barriers to trade agreements

It is noted the EC funded ARP III program has scheduled some activities within its fisheries components that may overlap with a part of the proposed activities of the present project. Therefore close coordination with ARP III is encouraged.

2. Objectives

¹ MoAFF, Policy and Strategic Framework, Dili September 2004

² Ministry of Planning and Finance, Ministry of Internal Administration, Ministry of Agriculture, Forestry and Fisheries Ministry of Health, Joint Instruction 13 December 2002; Decree No. 4/2003, Of 13 November 2003, On The Organic Structure Of The Ministry Of Agriculture, Forestry And Fisheries; and Decree-Law No. 21/2003 Of 31 December 2003, Quarantine and Sanitary Control on Goods Imported and Exported

The objective of this project is to enhance the trade potential of Timor-Leste by improving market access under the non-tariff barriers to trade within the areas of live animals, fish and plant and derived products.

A secondary objective is to increase the institutional and human resource capacity to comply with the rules of the SPS agreement of the WTO, by introducing modern laboratory facilities and training packages for the staff.

3. Beneficiaries and stakeholders

Government Officials in the Quarantine services will work with the consultant in designing and implementing laboratory facilities in accordance with the international standards and those valid under the national law (decree law 21/2003), and thereby up-grade their skills.

A number of other organisations will benefit from greater understanding and consultations during the process. These will include key private sector associations: Chambers of Commerce, professional associations and the academic institutions involved with applied research in agriculture, fish and food science

The end-beneficiaries from this intervention will be poor rural people of Timor-Leste, who will be able to develop more exportable products, and thereby create diversification and increase household income. The Timorese consumers will get access to products that are documented healthy in the SPS sense of the term.

The project addressed the activities covered by SIP for the fisheries sector, where there is gap of US\$ 11 millions. Over five years (or 2.1 million per year). The budget for this project contributes with 18 % of the gap the first year.

4. Expected Results

1. After the completion of the project the organisational framework for an EC Competent Authority (CA) should be in place and staff trained in the basic procedures.
2. The CA should be in a position to improve its surveillance scheme for live animals and plants and product thereof; and to elaborate elements for further projects towards sustainable control in line with modern international standards.
3. Standards that comply with international systems for quality assurance (QA) and own control such as Hazard Analysis Critical Control Points (HACCP); ISO 9001 and 14001 series should be familiar to the officials; and a manual with procedures for their implementation at enterprise level should be ready.
4. CA staff would be trained in enterprise level inspection services and how to deliver consulting service to the industry. The aim would be to assure that requirements of internal QA and the use modern standards do guarantee production of high quality animal and fish products.
5. Detailed design and specifications for a CA laboratory preferably in conjunction with an appropriate university level research facility.
6. Recommendations as to changes in legislation and other activities required to ensure full benefit of the CA should be produced including assistance to the passing of legislation to establish an inquiry point for SPS measures

5. Programme Activities

1. Assist in laying down the national legislation “at least equivalent” to WTO SPS agreement (or to the EU rules) and demonstrating clear competences for the inspecting services.
2. Assist in organising an appropriate structure of the CA, including purchase of needed material for communication and mobility, for improved surveillance of sanitary condition in all steps of the animal and fish processing chain.

3. Elaborate a relevant “Manual of Inspections / SOPs” as base to regular and reported inspections of the stake holders in the animal and fish sector.
4. Prepare detailed design of a CA laboratory including lists of equipments and testing machinery and/or items to be purchased.
5. Establish a reference system for the rules and regulations on working environment that equal the standards of the International Labour Organisation (ILO).
6. Procedures for the establishment of environmental and/or residue monitoring from primary production activities as cattle fattening and aquaculture.
7. Make optimal use of funding facilities for training and study tours under this assignment and in the longer term (e.g. the Standards & Trade Development Fund, WTO managed).
8. Identify a suitable regional twinning partner for the CA and establish the framework for collaboration.

6. Inputs

International expertise:

Expert 1 (category 1): A veterinary inspection service consultant with experience from implementing SPS procedures and facilities, the drafting of inspection manuals: (4 man-months).

Expert 2 (category 1): A fish or food science consultant with experience in the establishment of Competent Authorities in LDCs, and extensive experience in drafting fish inspection manuals both at the level of catching (vessels), aquaculture production, and processing, The consultant should be intimately familiar the requirements under HACCP and ISO standards, and how to implant these QA measures at enterprise level (4 months).

Expert 3 (category 2): A laboratory technologist with experience from the animal and fish QC laboratories. Solid experience in training of local staff in laboratory procedures: (4 man-months).

Local experts:

The Director of Quarantine Services and his/her staff will make them available for this TA, training activities and 2 short study tours

The following flights and associated per diems would be required across the international experts to ensure effective participation and support:

Experts Travel to	
Brussels	3
SPS institutions	2
Geneva	6
RDTL	6
National staff travel	
Brussels	2
Geneva WTO/ITC	2
Other SPS Asia	2

In addition, a budget for local transport, report preparation, laboratory equipment and IT hard & software, and workshops/seminars will be required.

7. Risks and Sustainability

Risks and assumptions related to the project:

It is assumed that GoTL will actively participate in the process and provide adequate support and officers responsible from the Quarantine services

The long term sustainability of the project shall be ensured through:

The short term support is vital in order that Timor-Leste can effectively deliver the services required under the SPS agreement. However, in providing awareness raising and on-job training, this project will also provide the government with the means and experience to independently undertake SPS services research and analysis in the future.

Project Fiche 4: Support to development of a Fisheries Co-Management Plan (FMP) and Monitoring, Surveillance and Control (MSC) enforcement mechanisms

Implementing Agency:	National Directorate of Fisheries and Aquaculture (NDFA), Ministry of Agriculture, Forestry and Fishery (MoAFF)
Total Project Cost:	€ 375,000
Duration:	12 months
Technical Assistance:	2 category 1 experts for 12 man-months in total 1 category 2 expert for 4 man-months

1. Problems to be addressed

The MoAFF has established a brief policy and strategy framework⁴⁷ for the fishery and aquaculture sector with detailed regulations on fisheries⁴⁸. The National Directorate of Fisheries and Aquaculture (NDFA) is the main regulatory body. It centralises and is answerable for the implementation and monitoring of policies, plans, programmes and projects, as well as for other matters related to the sustainable use and development of fishing and aquaculture resources, with a view to increasing the national food security, the generation of resources, and export revenue. However, its staff is limited to one B. Sc in biology (not marine biology) and other staff at lower levels of education.

The regulation of fisheries covers both catching of fish and aquaculture activities. It is very detailed and seems to follow standards for western European regulations - forbidden gears, mesh size, seasonality, catch quota etc. However, the MSC activities including enforcement mechanisms are not defined except in the case of the licensing of high sea fishing rights. In this case the licensee is required to employ one Timorese national, who will stay on-board during the fishing trip and report daily by radio to the authority on shore on the fishing methods and gear applied, and the volume and composition of the catch.

Despite the good intentions with the policy and legal framework the sector is characterized by two rather unique features for a small island state:

- Extremely low level of activity; and
- Extremely little knowledge about the stock, landings and fleet composition

The only kind of fisheries that take place at the moment is very near costal fishing from small out-rigger canoes (10 feet) with equally small engines. The methods applied include gill nets, hook and line and various traps. The result is a peculiarly low local consumption of fish for an island society – at 3 kg per year per person, and no exports. The explanation is most likely related to historic events, whereby the Indonesians carried out high sea fisheries and still do, but now illegally, landing the catch in Indonesian ports. However, training in high sea fishing methods is limited to an on-going training programme in the southern waters funded and executed by the Government of Australia.

The absence of a marine research institute and the only just initiated academic training in marine biology at B.Sc. level serves to explain the lack of information on fish stocks. A recently initiated trail fishery project, funded and executed by the Government of Thailand, focuses on the tagging of migratory species as tuna. However, the results are not likely to be available before three years from now. There is no other stock related research going on within this important sector, which is capable

⁴⁷ MoAFF, Policy and Strategic Framework, Dili September 2004

⁴⁸ Ministry of Planning and Finance, Ministry of Internal Administration, Ministry of Agriculture, Forestry and Fisheries Ministry of Health, Joint Instruction 13 December 2002; Decree No. 4/2003, Of 13 November 2003, On The Organic Structure Of The Ministry Of Agriculture, Forestry And Fisheries; Government Decree No. 5/2004, Of General Regulation On Fishing

to supply protein to the poor, generate export revenue, and create sustainable jobs⁴⁹. Landings are not registered and hence cannot be a source of additional tax revenue. Fish is seen in the small markets of Dili as in the restaurants. However, the indication is that fisheries is basically a subsistence level activity, which is further supported by the lack of needed infrastructure such as fishing ports with bunkering facilities, shipyards, slipways for repair and maintenance, and flake ice and cold store plants. The Hera port outside Dili would appear to be suitable as a fishing port, but has not been developed; it is presently a military port. There is no central (nor district) level registration authority for fishing vessels.

Resource endowments for fisheries exist in terms of a vast Exclusive Economic Zone (EEZ) potentially covering 75,000 km², and a lake area of 50 km²⁵⁰. Aquaculture activities are not practiced beyond subsistence despite the 700 km long and pristine coast line. The capacity to carry out MSC activities is limited to outdated coastal inspection vessels owned by the Coast Guard. Thus there is an urgent need to develop this sector that could become an important element in the food security system, approximately 64% of the population suffers from insufficient nutrition⁵¹, and which can generate foreign exchange and jobs for the coastal poor.

The lessons learned from the Ausaid fisheries management capacity building intervention that ends this summer, should be considered as well. May be a co-funding scheme should be pursued in particular within the area of fish stock assessment.

2. Objectives

The objective of this project is to enhance the sustainable utilisation of marine and coastal resources to benefit the economy at large through improving the food security situation and generating foreign exchange. In particular, the project provides sustainable jobs for the coastal poor.

A secondary objective is to introduce an effective institutional framework for community-driven co-management of aquatic resources by involving Fisheries Management Organisations (FMOs) and strengthening the public sector's capacity, the institutional and human resource capacity to manage marine and coastal resources, and to transfer ownership of the plan to the fishing communities by applying co-management principles. A MSC system will be an integrated part of the FMP to secure compliance and enforcement.

3. Beneficiaries and stakeholders

Government Officials of the NDFA and its services and academic institutions will benefit from this through transfer of skills and on the job training. In addition a general academic up-grading will follow for the initiation of the establishment of a marine research institute.

The end-beneficiaries from this intervention will be coastal poor people of Timor-Leste, who will be able to develop skills and more exportable products, and thereby create diversification to increase household income. The Timorese consumers will get access to new fishery products produced on a sustainable basis and healthy.

The project addressed the activities covered by SIP for the fisheries sector, where there is a gap of US\$ 11 millions. Over five years (or 2.1 million per year). The budget for this project contributes with 21% of the gap in the first year.

4. Expected Results

1. After the completion of the project an FMP based on co-management principles would have been developed for the different types of fisheries in question.

⁴⁹ One fisherman at sea or in aquaculture generates an average of 2.4 more jobs on shore in up- and down stream sector activities such as gear repair, boat building and repair, trade, inspection etc.

⁵⁰ MoAFF: Policy and Strategy Framework, page 1

⁵¹ Ibidem page 2

2. An outline of a feasible MSC system with clear identification of the responsible organisational unit(s) for enforcement would be an integrated part of the FMP.
3. The general legal framework for the co-management units, called the Fisheries Co-management Organisations (FMOs), would be in place and integrated with existing legislation. Pilot projects for FMO units in aquaculture and marine fishery would be established.
4. An outline of a business plan for the FMOs is developed.
5. The first layout for a computerised fish stock assessment database would be in place. The methods of how to calculate maximum sustainable yields would be developed and equipped with a manual for the users.
6. A method on how to register fishing vessels and their fishing efforts would be in place and a computerised database be in operation (e.g. like the ADRIAMED system of the EC)
7. The general layout of one new fishing port on the northern and one on the southern coast would have been developed based on a pre-selection of suitable sites.

5. Programme Activities

1. Rapid review of the state of each marine fishery (by species, season, region, gear type used, etc.) and the biology of the most important species targeted in the fishery (life cycle, size, growth patterns, etc.); and rapid review of the state of each freshwater fishery (by species, season, region, gear type used, etc.) and the biology of the most important species targeted in the fishery (life cycle, size, growth patterns, etc.);
2. Develop a quantitative model of the sector to estimate the value added and its distribution at each stage in the production and distribution system
3. Assess, with assistance from NDFA staff and sector active donors the current status of key marine fish stocks and identify coastal resource use issues;
4. Assess the role of key stakeholders in coastal resources management (to be presented in the form of a stakeholder analysis);
5. Advise the NDFA on preparation of a FMO training module on fisheries management and approaches to co-management;
6. Prepare marine fisheries management plans for key fish stocks (by fishing zone or FMO as appropriate).
7. Assess options for developing MCS capacity within Timor-Leste, including the role of FMOs, use of electronic surveillance (VMS), coastal radar and surveillance platforms and the role of observers;
8. Design an appropriate pilot fisheries-surveillance demonstration programme for possible funding by the project;
9. Prepare basic course material for a training programme entitled “The role of MCS in fisheries management in Timor- Leste.” Material to include (but not limited to) MCS tools/mechanisms, MCS design considerations and planning, role of self-regulation, the role of Fisheries Inspectors and operational procedures;
10. Deliver a 2-day MCS training course/workshop to NDFA staff and potential FMO members and academia. The course is to be designed to be repeated as part of a “training road-show” and should be as participatory as possible (i.e., used as an input to assessing options for developing MCS national capacity).

6. Inputs

International expertise:

Expert 1 (category 1): A senior marine an aquaculture biologist / fisheries management expert with long term experience in fisheries management and development and knowledge and experience of aquatic environmental issues and solutions; Experience of the principles of fisheries co-management essential: (6 man.-months)

Expert 2 (category 1): Fisheries economist/political scientist with a significant economics component; experience in development of co-management legal and financial aspects and general fishery sector planning/development; experience from small island states required: (6 man-months)

Expert 3 (category 2): An experienced MCS Specialist working within the fisheries sector, including planning and/or managing national monitoring, control and surveillance operations at a senior level he/she should ideally have had some professional exposure to working in small island states environment: (4 man-months)

The team leader should be either Expert 1 or 2

Local experts:

The Director of NDFA and his/her staff will make themselves available for this TA, training activities, workshops and 2 short study tours

The following flights and associated per diems would be required across the international experts to ensure effective participation and support:

International travel

Brussels	6
FAO Rome	1
ASEAN country with FMP /MSC	6
Timor Leste	8

National Director / NDFA Staff travel

Brussels	2
FAO Rome	1
ASEAN country with FMP / MSC	2

In addition, a budget for local transport, report preparation, AdriaMED programme or similar, IT hard & software, and workshops/seminars will be required.

7. Risks and Sustainability

Risks and assumptions related to the project:

- It is assumed that GoTL will actively participate in the process and provide adequate support and officers responsible from the NFDA
- It is assumed the eh local fishing communities are willing to participate in the process an top take ownership

The long term sustainability of the project shall be ensured through:

The TA support is vital in order that Timor-Leste can effectively deliver 'mange her own marine and aquaculture resources. However, in providing awareness raising and on-job training, this project will also provide the government with the means and experience to independently undertake marine research (stock assessment and fishing effort) and carry out analysis in the future.