La'o Hamutuk
Timor-Leste Institute for Development Monitoring & Analysis
Rua dos Martires da Patria, Bebora, Dili, Timor-Leste
Tel: +670 332 1040
Email: laohamutuk@gmail.com Website: www.laohamutuk.org

Submission to the Timor-Leste Ministry of State for Coordinating Economic Issues from La'o Hamutuk on the Proposed Private Investment Policy

14 April 2016

Contents

Introduction

La'o Hamutuk appreciates the openness of the State Ministry in considering our ideas on the draft Private Investment Law and the summary of the Investment Policy Paper.[1] This submission includes some suggestions and observations to complement our earlier submission on the draft Private Investment Law.[2] We hope it will help our Government to implement a fair and comprehensive investment policy that serves the interests of all the people of Timor-Leste by mobilising private investment to help build an equitable, sustainable economy.

This Investment policy should put the public interest first, rather than prioritizing the wishes of investors. The draft Policy is framed on documents and ideas from international organizations including the World Bank, IMF, UNCTAD, ASEAN and OECD. La'o Hamutuk feels strongly that the Timorese public (citizens, potential workers and local communities as well as the private sector) should be represented in this process. Civil society, human rights, women's groups and other non-profit, socially-oriented organizations should participate meaningfully in shaping investment policy.

[1] We have been told that the complete draft paper is not available, so we offer these observations on the English version of the "Summary Draft" dated 17 March 2016, which is available at http://www.laohamutuk.org/econ/invest/PoliticaInvestPrivadoResumo17Mar2016en.pdf

[2] http://www.laohamutuk.org/econ/invest/LHSubMECAEInvestLaw29Mar2016en.pdf

'Free markets' and the primacy of foreign investment

"Free market" dogma underlies this policy, and Margaret Thatcher was wrong – there are indeed alternatives. Economic success can be achieved through many paths, and none of the ones which work rely on a completely 'free' market alone. Today's richest countries became wealthy not by eliminating all barriers to international trade and relying solely on unfettered market activity, but by employing import tariffs and quotas to nurture domestic industries until they could compete with those of other countries. In fact, all major economies – not least the United States – still practice some protectionism, particularly in agriculture.

Timor-Leste's Private Investment Policy should not include ideological assertions that private investment is the only solution to Timor-Leste's economic challenges. An example of this can be found in Section 2.1, which says that the UNCTAD Investment Policy for Sustainable Development views investment as "**the** main driver of economic growth and development" [emphasis added]. In reality, other factors are at least as important as investment, including a skilled labour force, renewable and non-renewable natural resources, and agricultural potential.

Many countries have built their economies through state-managed and state-financed development, including government investment in infrastructure and other areas to generate employment and increase standards of living. Private investment should therefore be seen as complementary to other factors and other forms of investment. Government should only encourage private investment in projects which create local jobs, improve productivity and efficiency in the domestic economy, enable technological and skill transfer and/or provide revenues to the state. The state is responsible for the public interest, and should not facilitate projects which will not benefit the people of Timor-Leste.

How can Timor-Leste benefit from foreign direct investment?

The draft Policy mostly discusses foreign direct investment (FDI) from the perspective of investors, rather than that of the Government or the public whom it serves. For example, section 5.0 discusses the 'motivation for FDI', saying that "FDI exists for two main reasons: (1) to develop and control sources of supply of natural resources, both non-renewable and renewable, used as raw material to produce goods for the economic market worldwide, and/or (2) to dominate or defend market or segment thereof within the target country or in the regional market." However, profit is the primary motivation of investors, and the Policy should focus on how FDI can be used to advance the public interest in Timor-Leste, rather than discussing what foreign investors hope to gain from it.

Foreign investment should be seen as a means to an end, rather than an end in itself. If policymakers believe that FDI can improve Timor-Leste's economy and the lives of its people then the Policy should discuss the linkages, and not assume that foreign investment will automatically benefit people in host countries. Therefore, this section of the policy should analyse the kinds of foreign investment (and investors) which Timor-Leste is hoping to attract, in which sectors, and how these investments will improve the social, economic and environmental conditions of Timorese people. Private investment – including FDI – should be encouraged **only** if it results in net benefits to Timor-Leste, in the form of job creation, development of local technical or productive capacity, increased state revenues or other benefits.

FDI in developing countries: advantages and disadvantages

In section 5.1, the policy document briefly describes four main types of FDI: resource-seeking, market-seeking, efficiency-seeking and strategic-asset seeking. However, the policy needs to be clear in its recommendations and strategy of which kinds of FDI can benefit Timor-Leste and how, and therefore it should include a deeper analysis of FDI as experienced in other contexts. Again, we suggest examining what specific kinds of investment would help Timor-Leste, rather than looking from the investors' point of view.

For example, while Timor-Leste has benefited from foreign investment in the oil and gas sector, the benefits from resource-seeking FDI in other developing countries have often accrued disproportionately to foreign investors who take advantage of weak governance to evade fiscal responsibilities, violate workers' rights or flout environmental regulations. The majority of FDI in the Least-Developed Countries (LDCs) has been in the extractive industries, which create few local jobs and often cause severe environmental degradation. Such FDI contributes to corruption in many LDCs, through kickbacks to local elites who further enrich and entrench themselves at the expense of their citizens. Timor-Leste's Investment Policy should avoid repeating these mistakes, deterring investors and projects which could bring suffering or malfeasance to our nation.

It would therefore be helpful to examine the outcomes from FDI in similar contexts to Timor-Leste, such as the Pacific island nations. For example, FDI in Papua New Guinea and the Solomon Islands in the extractive industries contributed to increased corruption, environmental degradation and displacement of local communities. On the other hand, FDI in agriculture and tourism has improved local employment and domestic productivity. The successes and failures of small island nations can teach valuable lessons.

We are also concerned that viewing FDI as the key to economic development is a form of rent-seeking which can take up policy space and lead to neglect of other sectors. It may also displace domestic investment, crowding out Timorese companies, workers and consumers.

In addition, some developing countries have been helped by FDI in export-oriented, green-field manufacturing which creates employment, doesn't displace local production, creates backward linkages through opportunities for suppliers of materials and business services and leads to skill-development and technology diffusion. However, La'o Hamutuk wonders if Timor-Leste currently has the human or infrastructural capacity to benefit from this kind of investment.

Constitutional obligations and international treaties

The Policy states that the Constitution of the Republic of Timor-Leste is one the main documents guiding the policy, in addition to the Strategic Development Plan 2011-2030 (which is about to be reviewed) and the program of the VI Constitutional Government. La'o Hamutuk would like to recall Article 6 of the Constitution on the Fundamental Objectives of the State:

e) To promote the building of a society based on social justice, by establishing the material and spiritual welfare of the citizens;
f) To protect the environment and to preserve natural resources;
g) To assert and value the personality and the cultural heritage of the Timorese people;

Timor-Leste is party to several international treaties including the International Covenant on Economic, Social and Cultural Rights, and our leaders were deeply involved in the developing the Sustainable Development Goals. The rights and aspirations expressed in these documents should also guide this policy.

Section 2.2 discusses adopting the principles of ASEAN's Comprehensive Investment Agreement (ACIA) in anticipation of our acceptance into ASEAN. ACIA will be implemented gradually **after** Timor-Leste joins ASEAN. Rather than prematurely surrendering decision-making space to comply with ACIA, we suggest a phased approach for these free trade agreements – as was done by Cambodia, Laos, Vietnam and Myanmar – so that nascent domestic industries are not immediately exposed to tariff-free imports with which they cannot compete. If Timor-Leste implements these requirements in its policies now, it will become much harder to negotiate timetables, special provisions or exceptions after ASEAN accession.

Section 11.4 states that foreign investors should receive 'national treatment' as mandated by ACIA. However, our Government should support national investors, as they are more likely to re-invest here, employ local workers and keep their profits within the country.

Finally, Section 7.0 recognizes that the investment policies of many ASEAN members are not yet in line with ACIA, meaning that they maintain some ability to control their own investment rules. Timor-Leste should also do this, at least until our domestic economy is strong enough to benefit from exporting to ASEAN economies.

Analysis of Timor-Leste's economy

The analysis of the economy in section 8.0 on Timor-Leste's context should better reflect our nation's unique needs, strengths and weaknesses. A thorough assessment of our current situation will allow policymakers and investors to identify areas which need improvement or appropriate sectors for investment, which will help Timor-Leste benefit from future private investments.

For example, the analysis of the agriculture sector reflects the neglect this critical sector has received from policy-makers for many years. Although agriculture involves the majority of Timor-Leste's people, it comprises only 5% of GDP, or 17% of 'non-oil' GDP. With modest investment this could easily be increased, improving household incomes and nutrition. In addition, the policy says that rice and corn are the main subsistence crops; however, many other crops are widely grown for consumption, such as cassava, avocadoes, tomatoes, beans, peanuts, sweet potatoes, water spinach, fruits etc.

It is also disappointing that the policy identifies coffee as the 'main commercial crop', as coffee comprises less than 10% of agriculture's contribution to GDP (the other 90% being mentioned above). Agricultural investment should look beyond industrial and export-oriented crops, and the policy should discuss investing in crops which are already widely produced, sold and eaten by people in Timor-Leste. Through private investment in agriculture and food processing, we can boost production levels, increase incomes, reduce dependency on imported food and improve our people's nutrition and health.

The policy identifies forestry as the sector with 'the greatest economic potential.' We have doubts about this assertion, as most of Timor-Leste has already been severely deforested by Portuguese logging and Indonesian military operations. According to the FAO, Timor-Leste lost 23% of its forest cover between 1990 and 2010, without substantial logging. Logging can also degrade soil, accelerate erosion, destroy watersheds and habitats, and inflict other deleterious consequences. We wonder how Timor-Leste will avoid these effects, especially if we give investors special incentives which shortcut legal processes. In addition, new plantations of hardwoods will take decades before they can be harvested, and this sector therefore cannot address Timor-Leste's urgent, short-term economic needs.

In addition, the cited unemployment rate of 13% is a statistical artefact, as the majority of the working-age population (more than 2/3) is outside the formal labour force. La'o Hamutuk estimates that only about 30% of the working population is formally employed, and we recommend that job needs and human resources be estimated more realistically.

In 2015, Timor-Leste exported $16 million worth of non-oil goods, while importing $578 million. The huge trade deficit is filled with oil money, which is running out rapidly, and soon Timor-Leste will not be able to pay for the food imports we rely on today. Section 12.2 on the Guidelines for Revision of the Investment Law states that the purpose of the revision of the private investment law and policy is to increase production of goods and services for export; however, we believe that investment is also needed to increase **production for domestic consumption**. La'o Hamutuk recommends investment in agriculture and small industries to produce goods which can replace imports while promoting local livelihoods, nutrition and self-sufficiency. We also believe that this is much more realistic than expecting goods produced in Timor-Leste to compete in highly competitive foreign markets.

Finally, the policy does not suggest other sectors which could be developed with investment. The Strategic Development Plan envisions manufacturing, agriculture and tourism as key sectors, but the Policy does not discuss non-export agriculture, and leaves out tourism and manufacturing entirely. As Timor-Leste's guiding framework for investment, it should include comprehensive recommendations on how private investment can diversify the economy, including all potential sectors.

Special arrangements and dispute settlement

The Policy also discusses special arrangements to attract investors to Timor-Leste. However, the Policy should not suggest granting favours to investors which outweigh the benefits from the investment. For example, section 6.3 on 'artificial incentives' should stress evaluating how much the incentives detract from what the investment will bring to Timor-Leste; if they cancel out the value of the investment (such as by giving away more land or tax revenues than the benefits produced by the project, or providing special access to state services) then the project is not worth doing. Incentives can encourage responsible investors to put their money here instead of elsewhere, but they should keep safeguards in place to guarantee the protection of our people's rights.

Section 11.0 on 'Assistance to Investors' states that all investors must be treated equally; however, this will be difficult because international and local investors vary widely in capacity and needs. Also, in practice, 'equal treatment' for foreign investors could mean that they receive privileged treatment, as multinational companies will often have greater resources to produce bids and offer lower costs, thus crowding out local investors from projects. Instead, we recommend that 'equitably,' 'fairly' or 'according to the law' is used in the Policy, to avoid special favours for particular investors and potential corruption or nepotism.

Section 11.3.1 on the role of TradeInvest should reduce the risk of corruption by requiring transparency and public consultation on special favours or conditions applied to particular investors; this is more important than an arbitrary time limit for processing investment requests. If Timor-Leste develops a reputation of shortcutting standard processes, it will lure more unscrupulous companies while deterring legitimate companies who choose not to participate in a corrupt business environment.

Section 12.3.1 on 'Removal of Customs and Tax Incentives' states that the provisions on tax incentives are to be removed from the Investment Policy and shifted to Timor-Leste's general tax legislation; however, the proposed VAT policy is being designed to privilege export-producing industries, and it also forgoes the chance to nurture local companies in the local market by protecting them from cheap imports. This section should be reviewed in light of some of these concerns, with incentives added to encourage investment in local production.

Section 12.3.5 on 'Benefits and Incentives' refers to land "belonging to the state"; however, communal land is not necessarily state-owned, and recent confusion over land ownership in Oecusse should serve as a cautionary tale. Protecting citizens' rights, especially in rural areas, is essential, and the Investment Law and Policy should therefore not be implemented before the Land Laws, which are currently pending Parliamentary approval. Furthermore, the Investment Law should not override the Land Laws' protections of vulnerable people's right to land, and not offer special privileges to investors simply because they have economic and political influence.

Finally, as La'o Hamutuk pointed out in our submission on the draft Investment Law, disputes between investors and the State should be resolved in Timor-Leste's domestic courts, and not through a group such as the Chamber of Commerce, which represents business interests, or through international dispute settlement mechanisms like the World Bank-run ICSID which privilege multinational corporate interests over the interests of the public. Such mechanisms allow companies to sue governments to secure special treatment, such as mining or logging concessions which have been rejected due to social or environmental concerns. ICSID's consistent bias toward the private sector has led to many countries such as Indonesia, India, South Africa and others reconsidering its jurisdiction.

Investment policy neglects informal workers

Section 11.1 on informal sectors recommends that a 'minimum level of discipline' be introduced in this area. However, this fails to recognize that those working in the unregulated street economy already experience more than the 'minimum level' of discipline in the form of harassment from the police. A recent survey of 85 street vendors found that 19% have to pay authorities every day to be allowed to work. The Government should therefore promote the ability of these workers to provide their services and earn a living, including increased investment in facilities and training for vendors, rather than rationalizing harassment by appealing to notions of 'public health and public order.' The history of government interactions with market and street vendors over the past decade shows a need for significant improvement, not increased authoritarianism.

Conclusion

To conclude, La'o Hamutuk recommends that Timor-Leste's investment policy facilitates and encourages private investment which will benefit the people of this nation, rather than promoting abstract concepts like 'free trade' and providing favours to wealthy foreign investors. By enacting a robust, clear investment law and policy, Timor-Leste can attract the most professional, scrupulous and sound companies to invest in sustainable sectors, while discouraging those who simply wish to take advantage of our natural resources and limited experience.

However, implementing a new investment policy and law is not enough; the Government also needs to address underlying issues which currently make Timor-Leste's economy unattractive to investors,[3] rather than offering potential investors special arrangements to bypass inefficient or dysfunctional processes. The most important factors in attracting investment – both foreign and domestic – are macroeconomic: human resources (education, health and skills); functional local infrastructure; market size; and growth potential. In other words, good local conditions and appropriate capabilities are much more important than temporary barriers such as policies and laws. Enhancing these areas will not only make it easier for investors to do business, but will improve the lives of all Timor-Leste's people, while also increasing the likelihood that private investment will benefit our citizens.

As always, La'o Hamutuk remains ready to respond to any questions or provide additional information, and we look forward to continued engagement with MECAE and other organs as Timor-Leste designs, revises and implements its policies and rules for Private Investment.

Thank you for your attention.

Sincerely,

Adilson da Costa Junior Charles Scheiner Niall Almond
La'o Hamutuk Researchers on Economy and Natural Resources

[3] Many of these are outlined in the World Bank/PWC annual *Doing Business* reports (http://www.laohamutuk.org/DVD/2015/DB16TimorLeste.pdf), and we suggest that Timor-Leste address the more challenging ones (such as contract enforcement and rule of law), rather than focusing exclusively on "low-hanging fruit" like the business registration process. Serious investors will look at the reality, not just the ranking.