



**IXTH CONSTITUTIONAL GOVERNMENT  
MINISTRY OF TRADE AND INDUSTRY**

**NATIONAL INDUSTRY DEVELOPMENT POLICY**

***Vision Statement for 2030:***

*"Timor-Leste with dynamic and innovative manufacturing industries that supply the national market and contribute to increasing exports, attracting private investment, creating jobs, fostering and diversifying the economy, and complying with the Sustainable Development Goals and the Strategic Development Plan 2011-2030."*

***Elements of Timor-Leste's National Industry Development Policy Vision to 2030***

- *Industrialization, in the short and medium term, of the strategic sectors of agriculture, forestry, fishing, tourism, mineral resources and construction, as industries based on local resources and also processing industries for export, but not exclusively based on local resources;*
- *Development of industries that process raw materials and semi-finished products into final consumer goods, mainly for export;*
- *Gradual substitution of imports of industrial products that can be produced locally;*
- *Gradual reduction of economic dependence on non-renewable sources of oil and gas;*
- *Contributing to Timor-Leste joining the ranks of upper-middle-income countries, eradicating extreme poverty and establishing a sustainable and diversified non-oil economy.*

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## I. GENERAL FRAMEWORK AND NATIONAL CONTEXT

### 1. INTRODUCTION

The IX Constitutional Government continues to implement the *Strategic Development Plan 2011 - 2030 (SDP)*, whose economic vision is that, by 2030, *"Timor-Leste will have joined the ranks of upper-middle income countries, extreme poverty will have been eradicated and a sustainable and diversified non-oil economy will have been established"*<sup>1</sup>. Aware that Timor-Leste is still a predominantly agricultural country, *"our political focus must first be on developing the efficiency and productivity of this sector. The development of industries in this sector will be an important first step towards industrialization, to achieve upper-middle income status, which will require both an increase in agricultural production and the development of an industrial sector."*<sup>2</sup>

Subsistence farming will be upgraded to commercial and smallholder farming. Timor-Leste will produce a range of agricultural products for niche markets worldwide, including staples, livestock, fruit and vegetables and other cash crops, as well as forestry and fisheries products. On the other hand, to build the nation and provide employment and income for the people, Timor-Leste needs to develop key industrial sectors, partner with international companies to build infrastructure and support local companies to grow and promote themselves technically and economically.

In line with this vision and the strategic objectives, the *Program of the IX Constitutional Government* assumes the commitment *"to industry as one of the determining engines of national economic development, leveraged on rural development"*,<sup>3</sup> in the quest to build the foundations of a modern and diversified economy. This commitment includes the political option of investing in the growth of three main industries: agriculture, tourism and petroleum, since *Timor-Lest has considerable advantages in terms of these industries due to its natural resources, geographical location and economic profile" and "has all the conditions to develop other industries that are subsidiary to the development of the primary production sectors."*<sup>4</sup>

Focusing on areas that generate employment and contribute to economic growth makes it imperative *to work towards improving the business environment and promoting entrepreneurship, with the aim of attracting foreign direct investment and supporting domestic companies*. From this perspective, it is essential to *improve the tax administration system, improve the private sector's access to credit by providing guarantees in the form of effective enforcement of the land law; prepare qualified human resources that are adequate and geared towards responding to market demand; and build quality infrastructure, such as faster road and internet access networks*.

As part of its economic development agenda, Timor-Leste has prioritized integration into the *Association of Southeast Asian Nations (ASEAN)*, accession to the *European Union's Economic Partnership Agreement (EPA-EU)* and the *World Trade Organization (WTO)*, as well as better integration into the *Pacific Islands Forum* and the economic dynamics within the framework of the *Commonwealth*.

<sup>1</sup> Strategic Development Plan 2011 - 2030 (SDP), p. 276.

<sup>2</sup> Idem, p. 249.

<sup>3</sup> Program of the IX Constitutional Government, p. 101.

<sup>4</sup> Idem, p. 99.

*of Portuguese-speaking Countries (CPLP)*, as fundamental strategies for building a commercial network, accessing the global market and accelerating international and regional integration, in order to catalyze economic growth and achieve ever higher levels of sustainable and inclusive development.

*Timor-Leste intends to promote the development of existing industries, with a focus on resource-based industrialization and innovation, through the introduction of new industries.* Reducing dependence on imports of essential goods that can potentially be developed in Timor-Leste will be the first step towards industrialization, which will have a positive impact on improving the country's trade balance.

Efforts to achieve the sustainable and inclusive development goals of the 2011-2030 SDP require *the* government to go *beyond focusing on the oil and gas sector*, which are non-renewable resources, to also *adopt and implement public policy measures aimed at fostering other productive sectors of the economy, such as agriculture and its various value chains, forestry, fisheries, tourism, livestock farming, without excluding the tertiary sector, with particular attention to support services for the secondary sector.*

To this end, an *Industrial Policy* document began to be developed in 2014, having gone through a substantial interactive and collaborative process of research, analysis, surveys, stakeholder consultations and drafting. There were also (i) assessments of the level of manufacturing companies operating in Timor-Leste at the enterprise level; (ii) analyses of the trade balance context and opportunities in key sectors; (iii) comprehensive stakeholder consultations and engagement with the private sector, government agencies, development partners and civil society organizations; and (iv) the drafting of this policy document. This whole process received the support of some Development Partners and, as a result, the IX Constitutional Government undertook the finalization, approval and implementation of *the "National Industry Development Policy based on the National Planning Framework, determining production priorities in relation to available resources, including the selection of priority products for domestic consumption and for export."*<sup>5</sup>

## 2. MACROECONOMIC CONTEXT AND TRADE BALANCE

Timor-Leste is a market economy, still small and relatively open, where the economic environment, especially at the macroeconomic level, has been strengthened by oil revenues since the 2004 period until the recent oil price crisis and the impact of the COVID-19 pandemic, which caused a slowdown in the global stock market and imported inflation in the price of essential products.

The economy is highly dependent on oil revenues, while non-oil economic activity remains sluggish. *A development model based on public spending and financed by oil resources is unsustainable and the government is committed to reversing the current model of a publicly financed economy to one in which the private sector is the engine of the economy, with a solid fiscal base and economic diversification as a priority.*

<sup>5</sup> Program of the IX Constitutional Government, p. 101.

Timor-Leste's growth has historically been more inward-oriented than export-oriented, but the domestic market is small and Timor-Leste needs to seek opportunities in larger global markets in order to grow and generate employment and income for the Timorese people. Improving domestic production capacity and timely integration/accession to regional and multilateral organizations such as ASEAN, the WTO and the EU-EPAs are fundamental if Timor-Leste is to strengthen its position in the global market. However, *the necessary institutional reform, human capital and private sector development are preconditions for achieving the desired goal.*

Timor-Leste has had low levels of exports, based on a fairly limited portfolio of products, although it has steadily improved over time, but the country still remains at a relatively lower level than its regional neighbors. Timor-Leste's Trade Statistics<sup>6</sup> show that the Balance of Trade has been in deficit year after year. National exports accounted for \$351,189,000 (three hundred and fifty-one million, one hundred and eighty-nine thousand dollars) in 2022, with the main contribution being the export of crude oil (in the order of \$321,841,000). The second export product, coffee, reached \$26,106,000 during the same year. The seven largest destinations for Timor-Leste's exports in 2022 were China (32.6%), Korea (27.7%), Japan (27.0%), Singapore (2.6%), the United States (2.6%) and the United States (2.6%). America (2.1%), Canada (1.7%) and Indonesia (11.1%).

On the other hand, in 2022, Timor-Leste imported \$933,462,000.00 (nine hundred and thirty-three million, four hundred and sixty-two thousand dollars), most of which was refined petroleum. Historically, cereals, particularly rice, have also remained the main import products, which predominantly come from the Asian region, with the following seven main trading partner countries in 2022 (in millions of dollars): Indonesia (\$249.5), China (\$104.1), Taiwan (\$94.5), Singapore (\$89.0), Malaysia (53.6), India (\$42.2) and Hong Kong (\$21.2).

### 3. PRODUCTIVITY AND COMPETITIVENESS

*Productivity has been a major constraint on Timor-Leste's international competitiveness.* Technical studies highlight that Timor-Leste's productivity, in all sectors, has been quite low compared to neighboring countries and international standards. In general terms, *global competitiveness* refers to the *ability of nations to provide high-quality goods and services at reasonable costs, resulting in satisfactory returns.* The *2018 Global Competitiveness Index (GCI)* defines national competitiveness as the set of institutions, policies and factors that determine the level of productivity,<sup>7</sup> which in turn defines the level of prosperity that can be achieved by an economy. The competitiveness index emphasizes that the level of productivity also determines the rates of return obtained by investments in an economy, which are key factors in the growth rates that are likely to boost the economy.

The Global Competitiveness Report, published by the World Economic Forum in 2019 (latest data), ranked Timor-Leste 136th out of 140 countries studied,<sup>8</sup>

<sup>6</sup> Source: National Statistics Institute, Annual Trade Statistics 2022, pp. 3-4.

<sup>7</sup> The Global Competitiveness Report 2018, p. xi

<sup>8</sup> Source: *World Economic Forum*, <URL: <https://tradingeconomics.com/east-timor/competitiveness-index>

confirming the country's relatively weak competitiveness. Compared to other Asian developing countries, Timor-Leste is less competitive in terms of infrastructure, micro-environment, higher education and training, workforce skills, agricultural production, goods market efficiency, financial market development, technological readiness, business sophistication, innovation and management skills. In addition, the absence of a conducive, effective and efficient business environment, combined with the small size of the market and the lack of comprehensive and clear strategic development objectives contribute to the country's low level of industrial development.

It is in this context of development challenges that the National Industry Development Policy emerges as a prerequisite for structural reforms for Timor-Leste's industrial development.

## 4. COMPLEMENTARY SECTORS FOR INDUSTRIALIZATION

*The largest non-oil sectors in the Timorese economy are agriculture, construction and services.* Focusing on the primary and secondary sectors of the economy, the following are brief references to **Manufacturing Industries**, focusing on **Agriculture and Forestry, Fisheries, Tourism and Construction**, as well as **Extractive Industries (Minerals, Oil and Gas)**.

### 4.1. AGRICULTURE AND FORESTRY

*Agriculture is one of the areas with multiple links to other sectors of the economy and has the most potential effects for economic diversification.* Especially in low-income and middle-income countries, agriculture is the backbone of the rural economy. Evidence suggests that the agricultural sector has the potential to reduce poverty due to its multiple upstream linkages<sup>9</sup>. *The main agricultural and livestock products in Timor-Leste are coffee, rice, coconuts, cassava, sweet potatoes, corn, beans, fish, beef, pork, goat meat and poultry products.*

The 2019 Agricultural Census identified 75 agricultural products grown in the country. However, a significant number of products such as coconuts, cassava, sweet potatoes and peanuts have poor access to markets due to the lack of transport infrastructure to the main urban centers. Other products such as nutmeg, cashew nuts and animal skins are also available and have the potential for production on a commercial scale.

*Timor-Leste is not yet in a position to successfully manage the introduction of new commercial crops.* The returns and more immediate impact would be much higher if existing crops and agricultural businesses were exploited or improved, for which there is already some investment and a skills base, and for which there is also potential for progress.

The development of the agricultural sector involves the **introduction of new technologies in the primary and secondary sectors, with a view to developing** agro-industry, focusing on people in order to: increase local productivity and production; establish a dynamic agro-business sector; introduce seed banks; advance the rural extension program; overcome constraints

<sup>9</sup> United Nations Conference on Trade and Development (UNCTAD), Least Developed Countries Report, 2013.

related to agriculture and introduce curricular content in Secondary Technical-Vocational Education with a view to agro-industrial production.

*Some immediate products can be identified that could be raw materials for the processing industry, with a view to gradually replacing imports of selected products for domestic consumption and export:*

- **For import substitution and domestic consumption:** rice, coffee, corn, mushrooms, onions and their varieties (e.g. shallots), peanut butter, alcoholic beverages, chicken meat, beef and pork, peas, spices, eggs, sweet potatoes, salt, cooking oil, animal feed (livestock and poultry), fish, fruit, soya, vegetables, *pickles*, bamboo and teak products.
- **For export:** coffee, nutmeg, *konjac* (a root vegetable), pepper, honey, mung beans, peanuts, vanilla, cattle, bamboo, sandalwood and teak products.

*In the area of forestry, Bamboo is a promising product with strong potential for downstream processing.* Timor-Leste's tropical soil is conducive to growing Bamboo, which only takes four years to be commercialized. Timor-Leste has some of the most valued Bamboo species, such as "*Bambusa Lako*",<sup>10</sup> known as *Timor Black Bamboo*, due to its aesthetics and the fact that it is unique to Timor-Leste. On the other hand, *East Timor has excellent natural conditions for growing trees for the production of high-value hardwood, such as Teak, Mahogany and Sandalwood, as well as for faster-growing species such as Eucalyptus and Acacia. There is strong potential to develop both small-scale and commercial forestry*, with the possibility of establishing a link with processing activities. The development of production potential will need to be coupled with efforts to build infrastructure, such as roads, refrigeration and storage facilities, and the use of better seeds to increase production and people's incomes.

## 4.2. FISHING

*Timor-Leste has abundant marine resources due to its vast coastline of approximately 735 km, with an Exclusive Economic Zone (EEZ) of around 72,000 km<sup>2</sup> and seas rich in marine resources, which have great potential for fisheries development, with only the Municipality of Aileu and Ermera having no access to the coast. However, there are a number of challenges along the value chain that need to be overcome, including a lack of infrastructure, cold chain storage and regulations on the protection of overfishing and illegal fishing activities.*

Data shows that fish accounts for 31% of animal protein consumption in the Timorese diet. It is estimated that the average consumption of fish is only 6.1 kg/person/year (17 kg in coastal areas and 4 kg in inland communities), which is much lower than the current global average of 19.7 kg.<sup>11</sup> *The government, with the support of Development Partners, is promoting the consumption of fish in the country in a sustainable way, through campaigns to raise awareness of its nutritional value, with the aim of increasing its consumption to 10 kg/person/year<sup>12</sup>*, while at the same time encouraging an increase in fish consumption.

<sup>10</sup> Bambusa Lako, known as Timor black bamboo, is a large species of bamboo native to the island of Timor.

<sup>11</sup> Government department responsible for agriculture and fisheries, through *WorldFish Timor-Leste*.

<sup>12</sup> Program of the IX Constitutional Government, p. 84.

fish catches and the production of fish in aquaculture, which contribute to increasing this *per capita* consumption.

Worldwide, there is a growing export market. According to the *Food and Agriculture Organization of the United Nations (FAO, 2022)*,<sup>13</sup> ***global consumption of aquatic foods (excluding algae) has increased at an average annual rate of 3.0% since 1961, compared to a population growth rate of 1.6%.*** On a per capita basis, aquatic food consumption has grown from an average of 9.9 kg in the 1960s to a record high of 20.5 kg in 2019. Rising incomes and urbanization, improvements in post-harvest practices and changes in dietary trends are expected to lead to a 15% increase in aquatic food consumption, to provide an average of 21.4 kg per capita in 2030.

***International trade in fisheries and aquaculture products has grown significantly in recent decades, expanding across continents and regions.*** In 2020, world exports of aquatic products, excluding algae, were worth \$151 billion. The value of traded aquatic products represented 11% of total agricultural trade (excluding forestry) and around 1% of total merchandise trade in 2020.

***Potential annual fish catches in Timor-Leste have been projected at 116,000 tons/year, although the estimated actual annual catches, excluding losses from illegal, unreported and unregulated fishing, are less than 10,000 tons/year.***<sup>14</sup> This indicates that there is a huge opportunity to develop the fisheries sector in Timor-Leste, both for domestic consumption and for global export, bearing in mind that the sector remains underdeveloped, as the vast majority of fishing in the country relies on artisanal methods and is subsistence or semi-subsistence, consisting of various small-scale, low-capital fishing practices in which individual fishing families are involved.

***Aquaculture is another sector with high potential for domestic fish supply by 2030.*** Aquaculture in Timor-Leste has been practiced on a small scale, focusing on the production of milkfish, tilapia, carp, shrimp, abalone, crabs and oysters, and the harvesting of seaweed. The potential for community-based coastal aquaculture and mariculture activities, which need to go beyond the subsistence and semi-industrial level by encouraging the opening of an appropriate community-led private sector, can offer sustainable employment opportunities to a large part of Timor-Leste's population in general, contributing significantly to improving the incomes of coastal communities that are most vulnerable to poverty based on Timor-Leste's vulnerability assessment.

### 4.3. TOURISM

Timor-Leste has great tourism potential due to its geographical location, natural beauty and rich culture and history. The country has great scenic options and attributes, including spectacular mountains, pristine beaches and crystal-clear waters. Timor-Leste is also located next to the coral triangle which is home to a third of the world's marine life.

<sup>13</sup> FAO (2022). The State of World Fisheries and Aquaculture 2022. Towards Blue Transformation. Rome, FAO.

<sup>14</sup> FAO (2019). National Fishery Sector Overview Timor Leste. Fishery and Aquaculture Country Profile.

As a specific sector, tourism has a National Tourism *Policy 2017 - 2030, Timor-Leste National Tourism Policy 2017 - 2030 (Growing Tourism to 2030: Strengthening National Identity)* whose vision *"is that, by 2030, we have a vibrant and attractive tourism sector that contributes significantly to employment throughout the country; is economically, socially and environmentally sustainable; helps to promote a positive image of Timor-Leste abroad; and is an industry where people want to work"*.<sup>15</sup> As part of the implementation of the National Tourism Policy 2017 - 2030, the Government adopted the *National Strategic Plan for Tourism Development 2023-2030*.<sup>16</sup>

The government considers the tourism sector to be one of the high-potential economic alternatives for gradually reducing the country's dependence on oil and gas revenues.

Recently, the island of Ataúro in Timor-Leste was identified as one of the richest in biodiversity in the world. Studies also indicate that Timor-Leste's water corridor is essential for the economic diversification of the tourism industry and for a sustainable blue economy zone. According to the World Economic Forum, 2019, coral reefs shelter marine life, as they are home to a quarter of all marine species in the ocean and contribute \$172 billion to the global economy.

Tourism also provides inclusive economic progress; this sector is also influenced by the involvement of women, which requires substantial investment in capacity building to create quality product offerings. *UNESCO's recognition of Timor-Leste's Tais as intangible cultural heritage offers significant opportunities for cultural tourism and contributes to the economy of people, especially women.* Investment in women-led industry, as the studies show, is essential to eradicating poverty, boosting economic growth, creating inclusive societies and accelerating the achievement of the *Sustainable Development Goals (SDGs)*.

This policy document highlights the need to develop manufacturing industries that complement the tourism industry, including handicrafts that can be sold to tourists. It also highlights the development of infrastructure, construction and public services for the preservation of historic buildings and monuments.

#### 4.4. CONSTRUCTION

*Timor-Leste's economic development also means that construction is a highly sought-after activity.* Electricity, roads, airports, bridges, ports, hospitals, schools, office buildings, markets and essential housing are some of the main development programs that the government has launched in recent years. Construction has been booming in order to meet the country's infrastructure needs.

Although demand for construction is increasing, which would represent an opportunity for the domestic supply of building materials, this trend has ended up attracting massive imports of building materials instead. Therefore, although the expansion of construction

<sup>15</sup> National Tourism Policy 2017 - 2030, Government Resolution no. 16/2017, of April 5.

<sup>16</sup> National Strategic Plan for Tourism Development 2023-2030, Government Resolution no. 16/2023, of April 12.

***In order to reduce imports, the government encourages the production of construction inputs such as cement, concrete, wood and bricks in the country.***

The construction sector also generates complementary synergies for the country's agriculture, mining and quarrying and tourism sectors. The development of other productive sectors must therefore be synchronized with the construction sector, with ample opportunities for public-private partnerships.

#### 4.5. MANUFACTURING INDUSTRY

***Timor-Leste's manufacturing sector is still in its infancy and has a small domestic market, but the country has the conditions to aim for large-scale industrialization in the long term. With the exception of coffee processing, brewing and the processing of small niches of other agricultural products, companies produce mainly for the domestic market, where growth in coffee production, which contributes to industry, reached 7.0% in 2022, representing \$26.1 million<sup>17</sup> or the equivalent of 1.16% of real GDP (constant, adjusted for inflation).***

***Efforts to stimulate the manufacturing sector and its complementary activities, including the strategic sectors identified in the Strategic Development Plan 2011 - 2030, remain desirable and feasible, since this sector is essential for supporting engineering and light consumer goods: downstream oil and gas, agriculture, fisheries, tourism and highly qualified and specialized services.*** The industry must focus on absorbing *know-how*, innovation and cutting-edge technology by adopting best practices in foreign direct investment and transferring knowledge to domestic companies. Learning from foreign technology should be the main channel for developing highly skilled and specialized manufacturing and service capabilities in Timor-Leste.

Due to the small size of the economy and the rural orientation of Timor-Leste, achieving value addition will require the implementation of strategies to stimulate upgrading to higher value-added stages. Natural resources, as well as economically important products in the country, should be promoted to stimulate value addition through selection, processing and packaging. Due to its size, ***the country's strategy should focus on highly qualified and specialized education and training programs in order to provide high-quality services and limit the import of qualified and specialized skills.*** Innovation and new technologies, as well as research and development, can be an area of focus, but require significant investment.

The obstacles to promoting the manufacturing industry can also be explained by the scarcity of capital (financial and human), as well as the weakness of existing infrastructure and technological capacities, but targeted and focused investments can solve the problem. In addition, the productivity of the sectors, measured in terms of output per worker and contribution to GDP, is low. ***The shortage of skilled workers and infrastructure is a key constraint for the manufacturing sector to become an engine of economic growth in Timor-Leste and to improve the country's international competitiveness.*** Lack of access to markets

<sup>17</sup> Timor-Leste's Annual Trade Statistics, 2022, p. 4.

as a consequence of the lack of competitiveness of most Timorese products, can be overcome with the introduction, initially, of an effective resource-based industrialization policy and, in the long term, a broader industrialization policy and, subsequently, a solid implementation of the policy with a clear roadmap of action plans and indicators.

#### 4.6. EXTRACTIVE INDUSTRIES

*Timor-Leste's complex geology suggests the presence of a wide variety of minerals as well as hydrocarbons, including expensive metal ores.* Thus, an important sub-sector is quarrying, due to the huge demand for construction in the country. There are more than 200 minerals distributed throughout the country. Some important deposits of metallic minerals known in Timor-Leste are gold, copper, *manganese, silver and chromite*. The main potential for metallic minerals in Timor-Leste is found in ultramafic rocks. *The important non-metallic minerals in Timor-Leste are sand and clay, gravel and limestone, which are important inputs for the production of cement and bricks.* The country's important foreign direct investment (FDI) envelopes are for the construction of a cement factory in Baucau and the exploitation of marble in Manatuto, which will increase demand for these minerals.

The preliminary study by the *National Institute of Petroleum and Geology (IPG, I.P.)* showed that *the country is endowed with limestone, marble, gypsum, bentonites, kaolinite and phosphate, which have a high economic value.* The widespread presence of limestone and marble, especially on the east and west coasts of Timor-Leste, is among the few minerals that have been exploited for many years. Clay alteration has resulted in the development of a red to white clay complex in the Aileu Formation. It extends from Dili to the municipalities of Aileu and Ermera.

The country has adopted a Mining Code, approved by Law No. 12/2021 of June 30, which provides transparency and guarantees for investors wishing to participate in mining activities. The national mining company *Murak-Rai Timor E.P.* is an important instrument of state intervention in the sector.

#### 4.7. OIL & GAS

*The petroleum industry is still considered the backbone of Timor-Leste's economy.* Oil and gas are being produced *offshore*, in the southern part of Timor-Leste's territory, and are the country's main income-producing assets.

*The Strategic Development Plan 2011-2030 stipulates that the oil and gas sector is an imperative pillar of the country's current and future development.* Timor-Leste's growth in the non-petroleum sector and macroeconomic balance have been largely ensured by this sector. The Government is working to ensure that the wealth generated in the petroleum sector serves to finance economic and social needs in the medium term, and also to contribute significantly to investments with sustainable returns, in order to guarantee the long-term prosperity of the Timorese people. The recent and historic ratification of the Maritime Boundary Treaty has paved the way for a new phase in the vision of developing Oil and Gas with exclusive jurisdiction for Timor-Leste.

The income generated by the sale of non-renewable oil wealth is kept in the Petroleum Fund. Several onshore drilling and exploration projects are underway and *the government reiterates its commitment to developing the necessary infrastructure to support the oil industry*. A plan is underway for *an onshore oil industrial complex on the country's southern coast, known as the "Tasi Mane Project"*. As part of the plan, the Suai Highway and its airport have been built to serve the supply base, as well as *an oil center in Betano and Beaço to serve the petrochemical industry*. These support infrastructures, as well as helping to develop an *onshore* processing center, also develop other potential sectors in the south of the country.

Due to its specificity, the oil and gas sector is guided by its own public policies, aware of the need for the country to develop support industries, based on human resources in adequate quantity and quality, which are essential to operate and manage the national petroleum sector. A proper and comprehensive analysis of the *upstream* and *downstream* is pertinent to seize the opportunities and fully benefit the industry in the development of Timor-Leste, as well as mitigate the constraints and expand the petroleum sector, creating a solid foundation for the development of a successful downstream manufacturing industry, promoting the export of goods and services from a competitive and dynamic private sector.

Although the endowment of minerals is welcome, as it helps to obtain foreign currency to finance imports and economic development, given that oil and gas are non-renewable resources, *the government considers it pertinent to define policies to extract more added value by promoting downstream processing activities in the country*. Timor-Leste currently imports chemical products from abroad, so efforts will also be made to start up petrochemical industries to further increase added value in the country, including preparing young Timorese to be seconded to work in this industry.

## 5. MICROECONOMIC CONTEXT

*With regard to the microeconomic context and taking the business environment as a reference*, based on the classification of the World Bank's *Doing Business* Report 2020, *Timor-Leste presents constraints and an unattractive framework in the indicators of Enforcing Contracts, Registering Property, Resolving Insolvency and Obtaining Credit, Protecting Minorities, Processing Construction Permits and Enforcing Contracts*, although it is in a slightly better position than some of the neighbouring countries in terms of business creation.

The government carried out a survey of the situation of the manufacturing industry and related companies in Timor-Leste, analysing the characteristics of the companies in four systemic pillars: basic infrastructure, high-tech infrastructure, network cohesion and global integration. The companies belonged to coffee processing, printing, construction materials, furniture manufacturing, bottled water and handicrafts. Some of the main conclusions of the assessment can be summarized as follows:

- *Coffee companies show experience of exporting, accounting for almost 100% of production. Printing, construction, furniture and bottled water companies only supply the domestic market, while handicraft companies export, mainly to Australia.* The majority of companies do not allocate formal funds for training their workers and

acquire knowledge through learning-by-doing methods or a hands-on approach. ***Companies participate in incremental engineering activities***, adopting strategies to adapt existing technologies to improve their efficiency and production quality, which shows that technological updating is taking place in the country, albeit at a still incipient level.

- ***The government should invest in developing high-quality basic infrastructure in the country.*** Good roads will make it easier to collect products from processing factories, which will help reduce processing costs and thus help amortize the investment in these factories; coconut oil, rice mills, peanut sorting and packaging are some of the industries that will benefit from this expansion;
- ***Ambiguity in land ownership is one of the biggest concerns facing industrial companies in Timor-Leste.*** Law No. 13/2017, of June 5, on the Special Regime for Defining the Ownership of Real Estate (land and property law) is a good step towards resolving these concerns, but it needs to be regulated and effectively implemented, bearing in mind that the development of the manufacturing industry requires a secure environment with adequate legal enforcement for the protection of land ownership and tenure;
- ***Environmental regulations in the country need to be effectively implemented***, with the necessary speed in the process of technical assessment of projects and the respective decision.
- ***High-tech infrastructures must be improved to support the transformation of the manufacturing industry*** from low value-added to high value-added activities and also to pave the way for the digital economy.
- For ***intermediation and links to global market niches***, companies use marketing representatives hired by them, while industry advisory and coordination services are still weak, which is understandable given the small number of companies in each of the manufacturing industries.
- ***Coordination between companies and critical support organizations in Timor-Leste is quite strong***, given the nascent nature of its development. On the other hand, companies maintain fairly strong links between buyers and suppliers, business support organizations, government programs for small and medium-sized enterprises, and technical collaboration, and companies' strategy for networking and technical collaboration. They note, however, that coordination between companies, the government and other organizations supporting basic and high-tech infrastructure is still weak, as is the promotion of external links, followed by companies' links with financial institutions.

It is clear from the analysis at company level that Timor-Leste is at an early stage of economic development, however, for a nascent nation, it has managed to make significant improvements in some areas. All the areas considered require capacity building, in terms of strategies, human and financial resources, in order to

stimulate industrialization and the structural transformation of the economy, in particular manufacturing industries, which should be promoted with the aim of adding value to resource-based clusters with low to high value-added activities.

## II. WHY INDUSTRIALIZE?

### 1. INDUSTRIALIZATION, GROWTH AND DIVERSIFICATION OF THE ECONOMY

***Industrialization is an instrument of economic growth and diversification.*** It is a well-known fact that countries that have relied heavily on natural resources to finance development spending have rarely benefited from sustained economic development. Governments of countries that have ignored the need to develop dynamic sectors in agriculture, manufacturing and services, specifically those linked to the development of a digital economy, have been caught out by problems associated with the fallacy of composition. Real sectors suffer squeezes during periods of natural resource *boom*, as imports become cheaper than domestic production due to high exchange rates.

Timor-Leste uses the US dollar as its currency and therefore does not face the same problems as other resource-rich countries in terms of exchange rate appreciation. However, the lessons from other countries are relevant in terms of natural resource-driven spending patterns referred to as the problem of the "*curse of natural resource-based growth*". The complacency that sets in with the abundance of natural resources, accompanied by unproductive practices, leads to underdevelopment. The most convincing explanation of the curse, from an economic point of view, is that the growth of the natural resources sector excludes the manufacturing and agricultural sectors. The large export revenues from natural resources inject additional purchasing power into the national economy, which pushes up the prices of non-traded goods and non-traded factors of production, such as services, wages, land rents and the costs of industrial services. Meanwhile, the prices of manufactured products, which are traded internationally and cannot deviate from global standards, remain unchanged. Thus, the manufacturing sector loses international competitiveness due to the high costs of factors of production in relation to production prices. In addition, national factors of production, such as human capital (managers, engineers and skilled workers), capital (if capital mobility is less than perfect) and the technology embodied in them, compete with the dominant sector of non-renewable natural resources. Faced with a reduced supply and higher costs of domestic factors of production, the manufacturing and agricultural sectors shrink as exports of natural resources increase, with the consequent compression effect on the manufacturing and agricultural sectors. However, the development of highly qualified and specialized services can help mitigate the risk.

***The exponents of industry development policy argue that manufacturing and its appendages of construction and utilities have income-increasing properties, so their expansion not only stimulates the expansion of their sectors, but also of other sectors through intersectoral links.*** Only once the primary sectors have matured will services be able to take on the role of growth driver, as knowledge becomes a key element of the economy.

the sector's main driving force. Until then, any expansion in services will only slow down the other sectors, since they tend to specialize in non-productive subsectors<sup>18</sup>.

Evidence has not only shown that *industrialization is linked to economic growth*, but also that *manufacturing can play a catalytic role in transforming the economic structure of agrarian societies. There is a close relationship between per capita income and industrial structure. Agriculture and mining dominate GDP in the poorest economies, while manufacturing becomes important in middle- and upper-middle-income countries*. Services take over in the more developed economies.

*The manufacturing sector is less exposed to external shocks, price fluctuations, weather conditions and unfair competition practices*, even during the COVID-19 pandemic, having recovered quickly from the initial slump. As of the third quarter of 2021, global industrial production growth reached 5.7% compared to the same quarter of the previous year. The price of manufactured goods tends to be more stable than that of commodities. The main reason for this is that manufacturing companies, unlike commodities, are exposed to rapid product maturity and have shorter gestation periods<sup>19</sup>.

*The manufacturing industry generates stronger technical externalities (including cross-sectoral ones), skills creation and learning that are crucial for competitiveness*. For example, manufacturing is the main vehicle for technological development and innovation, representing the center of technological progress in many countries. Industry and services use technology in many forms and at different levels to increase the return on investment, moving from low-productivity to high-productivity activities. Manufacturing also offers great potential for informal innovation activities, such as *ad hoc* incremental improvements in products and processes.

*Manufacturing has a "knock-on effect" on other sectors of the economy. The development of the manufacturing sector stimulates demand for more and better services: banking, insurance, communications and transport*. Digitalization and information technology systems are shaping the way companies in the service sector operate and must operate. Finally, the internationalization of production has extended the benefits of the manufacturing industry to many parts of the world. The geographical distribution of multinational companies' activities, as well as the global outsourcing of production, has benefited manufacturing in the developing world more than other sectors of the economy. *The trend towards vertical dispersion of production activities in industrialized countries means that developing countries have a better chance of integrating into global value chains*.<sup>20</sup>

## 2. INDUSTRIALIZATION AND JOB OPPORTUNITIES

*Industrialization is a tool for creating job opportunities and achieving the Sustainable Development Goals (SDGs)*. Job creation is a key objective of the Government of Timor-Leste. The recent 2021 census estimates Timor-Leste's population at 1,340,434

<sup>18</sup> Rowthorn and Wells (1987).

<sup>19</sup> Rasiah, Osman and Rokiah (2000).

<sup>20</sup> Rasiah, McFarlane and Kuruvilla (2015); Rasiah, Kimura and Oum (2015).

inhabitants, with an annual growth rate of 1.8%. Timor-Leste's population is expected to double in less than 25 years if this growth rate continues. The youth population is expected to increase sharply, with between 15,000 and 16,000 people entering the job market each year. Recent figures indicate that around 74% of the country's population is under 35 years of age and that the majority are neither employed nor studying. The 4th National Report on Human Development (RNDH) reveals that 80% do not have a formal job and 25% do not look for a job because they feel discouraged by the difficulty in finding work. However, the working-age population has been increasing steadily, at an annual growth rate of 2.4%. In addition, one of the main conclusions highlights that 45% have basic education as their highest level of schooling and 60% aspire to further education/training, but only 1/3 have received any training.

It is essential to outline the appropriate workforce/skills gaps before exploring the role of industrialization in providing opportunities for young people to participate in economic activities. This can also serve as an avenue for them to continue learning and improving their skills, while contributing to national development. In addition, the government must create the right environment to encourage young entrepreneurs to become more innovative and high-tech oriented for the development of highly qualified and specialized services. However, the current private sector involved in the productive sector is small and can absorb only a limited part of the available national workforce.

***To generate employment, it is necessary to diversify industries and develop new ones.*** However, it is difficult to diversify industries by leaving industrialization solely in the hands of market forces, since the Timor-Leste market is small due to the small population, as well as the oil sector which can exclude real sectors, since it is relatively large. Thus, ***the industry development policy aims to shift from the non-renewable petroleum sector to the sectors of the real economy.***

***The focus of Timor-Leste's industry development policy is the development of manufacturing industries complementary to the strategic sectors of tourism, agriculture and forestry, fisheries, mining and construction, oil and gas, and highly qualified and specialized services.*** The industries to be promoted must also be economically and environmentally sustainable in order to ensure a catalytic effect on poverty reduction, long-term employment demand and the achievement of the Sustainable Development Goals<sup>21</sup>.

### 3. INDUSTRIALIZATION AND IMPORT SUBSTITUTION

***Industrialization is an instrument for import substitution.*** Timor-Leste's economy is still heavily dependent on oil and gas, which are non-renewable and therefore finite resources. The trade balance for non-oil and gas goods has remained strongly negative. As of 2019, Timor-Leste's export deficits for commodities and non-commodities reached up to (- 95%). ***Reducing imports of essential goods that can potentially be developed in Timor-Leste will be the first step towards industrialization.*** But the

<sup>21</sup> As Kalecki (1976) argues, creating only jobs can be counterproductive. Job creation must therefore take sustainability into account.

he promotion of import substitution will be carried out in a manner consistent with Timor-Leste's obligations under the WTO, the EU-EPA and membership of ASEAN.

#### 4. MAIN CONSTRAINTS ON PRODUCTION

*Timor-Leste faces two fundamental barriers to the development of the manufacturing industry:*

- *High costs, low productivity and economic geography prevent foreign direct investment from being attracted to the manufacturing industry.* This means that non-natural resource-based industrialization has not developed to date in Timor-Leste. These factors are also preventing Timor-Leste from participating in regional value chains and production networks. ***Production networks in ASEAN are the main driver of industrialization in Southeast Asia.***
- *Coordination failures and a weak general business environment are also preventing resource-based industrialization from occurring.* These constraints apply to the majority of companies operating in Timor-Leste. ***The development of the manufacturing industry will therefore depend on a general improvement in the business environment.***

Economic take-off in East Asian countries typically begins with the arrival of a critical mass of foreign direct investment in **manufacturing that carries out simple assembly or processing of light industry products for export, such as clothing, footwear, food products and other household goods.** Currently, Timor-Leste is unable to attract this type of investment in manufacturing and non-resource-based industrialization depends on the government's efforts to improve its business environment, but also to resolve structural issues already mentioned in the macro and micro analyses.

### III. LINK WITH OTHER PUBLIC POLICIES

#### 1. SOME STRATEGIES AND PUBLIC POLICIES AT HOME

*The Strategic Development Plan 2011 - 2030 is the strategic planning instrument guiding the country's governance.* It sets out an economic development agenda, while providing a framework for identifying priorities. In this context, the Government is carrying out various reforms and strategic decisions that will contribute to economic growth and the integration and opening up of Timor-Leste. ***However, it is necessary to design and implement complementary policies, such as the industry development policy, to target a specific development sector.***

Timor-Leste has been a member of the Community of Portuguese Speaking Countries (CPLP) since 2002, a multilateral platform that offers vast market opportunities and is home to more than 260 million inhabitants. In addition, Timor-Leste also prioritizes full integration into the Association of Southeast Asian Nations (ASEAN), membership of the World Trade Organization (WTO) and the European Union Economic Partnership Agreement (EU-EPA) as key strategies for accelerating international economic integration, without neglecting its position within the Pacific Forum. The SDP 2011 - 2030 specifically states that ***"in order to build our nation and provide jobs and incomes for our people, Timor-Leste needs to attract investors to our key industrial sectors, establish partnerships with international companies***

*in building our infrastructure and supporting local businesses to start up and grow.*<sup>22</sup> Timor-Leste therefore needs to attract forms of investment other than natural resources and find better ways to link the domestic economy to regional and global trade and investment.

At the country level, Timor-Leste established the *Special Administrative Region of Oe-Cusse Ambeno (RAEOA)*, as well as the *Special Zone of Social Market Economy (ZEESM)* in 2014 with the aim of developing agribusiness in an inclusive manner, the creation of a free trade zone, the development of industrial, export and import activities, and other economic activities that create added value for the Region, as well as strengthening its international competitiveness.

The government is in the process of adopting a *National Policy for Special Economic Zones (SEZ)* as a public policy option aimed at inducing structuring economic development, which has already been widely experimented with around the world, with plenty of examples of success both in developed economies and, above all, in developing economies.

Since the restoration of independence, Timor-Leste has experienced progressive economic growth rates, largely due to the petroleum sector, although government spending on agriculture, infrastructure and basic services, as well as a still incipient non-petroleum private sector, have also contributed to economic expansion until, as recently as 2020, the economy contracted drastically due to the COVID-19 pandemic.

Therefore, *Timor-Leste now needs to consolidate all the results achieved and create the conditions to move on to the next phase of its development, with fiscal sustainability being a fundamental condition for this to happen.* With the continuous decline in petroleum revenues, maintaining the current spending policy in the short and medium term would require increasing withdrawals from the Petroleum Fund, above the Estimated Sustainable Income (ESI). On the other hand, maintaining withdrawals at or below the ESI would imply severe cuts in public spending or an increase in external debt to unsustainable levels. *The only alternative to guarantee the country's long-term fiscal sustainability is to increase the resources available to the state from non-oil sources, while ensuring that spending grows at a rate compatible with the expected growth of these resources.*

The government's priorities in terms of Public Administration Reform and Tax Reform are aimed at creating more efficiency and increasing state revenues, in addition to oil and gas revenues. *Fiscal Reform is the sum of three distinct but interrelated reform processes: Tax Reform and Public Expenditure Reform and Economic Reform.* Reform in these three areas will greatly contribute to fiscal sustainability. Tax reform will increase the availability of non-oil resources to the state, while public expenditure reform has the potential to improve the quality of public spending by controlling its growth rate, while increasing the quantity and quality of public services and promoting productivity and economic diversification.

<sup>22</sup> Strategic Development Plan 2022 - 2030, p. 273

It is also necessary to adopt a strategy to promote increased private investment, economic diversification and sustainable job creation, along the lines of the ***Economic Development and Reform Guide (GRFE) implemented from 2015 to 2017***, which was structured in a matrix format consisting of five priority economic pillars, including (1) agriculture, (2) fisheries, (3) tourism, (4) oil and gas (downstream) and (5) light industry, and seven reform areas, including (1) land and property regulation, (2) economic infrastructure development, (3) labor market regulation and workforce development, (4) business enabling environment, (5) tax reform, (6) private investment regime reform and (7) private sector development. The aim of the measures envisaged under the Private Investment Regime Reform (6) is to introduce far-reaching changes to the regime in order to significantly improve the framework and its procedures, so as to create favorable and competitive conditions capable of inducing greater attraction and retention of private investment in Timor-Leste. This governance action needs to be taken up as a complementary measure to the National Industry Development Policy.

Increasing domestic and foreign private investment is fundamental to Timor-Leste's economic strategy. It is therefore important to resume the effective implementation of the ***National Investment Policy*** and the ***Investment Roadmap***, which were drawn up in conjunction with the ***Investment Guide*** and the ***Private Investment Law*** No. 15/2017 of August 23. ***Increased investment will boost the diversification of the economy beyond the oil and gas sector, with an emphasis on investment in agriculture, tourism, manufacturing and infrastructure.*** Investment can drive economic transformation and the transition to higher value-added economic activities.

It was within the framework of these initiatives to promote the development of sectoral policies and strategies that, in 2017, the Government approved ***Timor-Leste's National Tourism Policy 2017 - 2030 (Growing Tourism to 2030: Strengthening National Identity)***, in order to provide a clear path for the Government, the private sector and civil society to work together to develop sustainable eco-tourism, as already mentioned in this document. On the basis of this policy document, the government adopted the National Strategic Plan for Tourism Development 2023-2030.

On the other hand, it is important to continue implementing the ***Timor Coffee Development Plan***, which aims to double coffee production by 2030 and increase income from coffee exports by up to 270% by modernizing the sectors and improving their quality; as well as a ***National Forestry Policy*** to safeguard, promote and accelerate the development of a national heritage of commercial trees in Timor-Leste.

## 2. REGIONAL, INTERNATIONAL AND MULTILATERAL INTEGRATION

***The timely development of the National Industry Development Policy will help Timor-Leste maximize the impact of its application for membership of the Association of Southeast Asian Nations (ASEAN), the World Trade Organization (WTO) and the Economic Partnership Agreement with the EU and the Pacific Islands. Membership of these economic blocs has the potential to accelerate Timor-Leste's economic diversification and growth through better integration into the global economy.***

In addition to cultural affinity and solidarity with ASEAN, regional and global economic integration will (i) facilitate more business and investment opportunities and (ii) solidify Timor-Leste's access to regional and global supply chains. Timor-Leste can also take advantage of ASEAN's specific focus by taking a myriad of measures to stimulate growth, sustain and create employment opportunities, strengthen supply chains, improve transport and logistics efficiency and accelerate digital transformation.

In addition, accession to the WTO offers a huge opportunity for national institutional and regulatory reforms, as well as for the predictability and transparency of internal trade, which guarantees the stability of legislation and reduces investment risks, thus providing a business environment conducive to foreign direct investment and boosting national production. Similarly, accession to the Economic Partnership Agreement with the EU-ACP (African, Caribbean and Pacific countries) would open up an export market of 500 million people for national companies, as it allows free access to the EU market duty-free and quota-free for all products except arms (EBA)<sup>23</sup>.

## IV. INDUSTRY DEVELOPMENT POLICY STATEMENT

### 1. VISION OF THE NATIONAL INDUSTRY DEVELOPMENT POLICY

#### *Vision Statement for 2030:*

*"Timor-Leste with dynamic and innovative manufacturing industries that supply the national market and contribute to increasing exports, attracting private investment, creating jobs, fostering and diversifying the economy, and fulfilling the Sustainable Development Goals and the Sustainable Development Goals".  
Strategic Development Plan 2011-2030."*

The government is committed to the country's innovative industrialization, based on agriculture, fishing, forestry, tourism, mining, construction and manufacturing, complementing the oil and mining industries, which have a significant impact on the country:

- Job creation, especially for the younger population;
- Increased income and improved quality of life for people; and
- Increase in the country's economic growth rates.

The vision statement integrates the following main elements of Timor-Leste's National Industry Development Policy until 2030:

- Industrialization, in the short and medium term, of the strategic sectors of agriculture, forestry, fishing, tourism, mineral resources and construction, as industries based on local resources and also processing industries for export, but not exclusively based on local resources;
- Development of industries that process raw materials and semi-finished products into final consumer goods, mainly for export;
- Gradual replacement of imports of industrial products that can be produced locally;

<sup>23</sup> <https://ec.europa.eu/trade/policy/countries-and-regions/development/economic-partnerships/>

- Gradual reduction of economic dependence on non-renewable sources of oil and gas.
- Contributing to Timor-Leste joining the ranks of upper-middle-income countries, eradicating extreme poverty and establishing a sustainable and diversified non-oil economy.

Timor-Leste now has the advantage of "*learning from the mistakes of others*", defining more appropriate strategies to accelerate the growth and diversification of the economy, creating conditions that allow it to avoid pitfalls that other countries faced during their industrialization process.

From this perspective, ***the country is pursuing industrialization by incorporating strategies to protect and preserve the environment and natural resources***, encouraging the use of more environmentally friendly technologies that contribute to mitigating and adapting to climate change, thus ensuring sustainability, as well as ***incorporating its young population with more knowledge and better training and professional qualifications***.

## 2. APPROACH TO NATIONAL INDUSTRY DEVELOPMENT POLICY

The national policy for the development of industry puts into practice the vision of industrialization in the medium and long term through:

- ***Strengthening the capacity of the public sector*** to effectively implement the policy measures recommended for the development of industry;
- Providing ***incentives for complementary industrialization*** in agriculture, fisheries, forestry, tourism, mining and construction, complementing efforts in the oil and gas sector;
- ***Encouraging industrialization based on innovation***, by realizing the potential value of new technologies, enabling industries based on new technologies to rapidly achieve greater scale;
- Improving the ***enabling environment for*** resource-based ***industrialization*** and innovation, including manufacturing and related services;
- Promoting and attracting ***resource-based foreign direct investment*** to improve local competitiveness and the transfer of knowledge and technologies;
- Articulation of initiatives within the framework of the Private Investment Law, in order to promote the ***investment in the manufacturing industry***;
- ***Coordination between the activities of the public sector, the private sector and Development Partners*** in support of manufacturing and other sectors, including services;
- Fostering the ***capacity of the private sector and cooperatives*** to develop profitable manufacturing and other businesses, including their support services;
- Promoting ***public-private partnerships*** for the development of the manufacturing industry and other highly qualified and specialized activities; and
- Promoting ***technology and innovation*** to maintain rapid development progress.

The national industry development policy seeks to make up for East Timor's relative backwardness *in* relation to neighboring countries, placing ***emphasis on developing national technological capabilities*** with the aim of contributing to improving people's standard of living. In this process, the Government promotes the learning of foreign technology, both through licenses and other forms of direct transfer to the Timorese and foreign direct investment, promoting domestic acceptance and the adhesion of the private sector. The policy document sets out various measures for the active transformation of Timor-Leste's endogenous factors and resources into high value-added activities.

The policy document contains the general framework for Timor-Leste to improve its enabling environment for domestic and foreign investors and for high-level coordination of economic policies. Investment Policy and Industrial Policy work together to actively attract and facilitate investment in light industry and other relevant sectors, including related services. ***Investment provides the financing for industrialization. In addition to financing, foreign direct investment provides access to technology and higher productivity work practices in support of the industrialization process.*** Industrial policy should be informed by demand-side assessments of investor interest in manufacturing and/or other relevant strategic sectors.

***The policy priorities are industrialization based on endogenous resource factors and industrialization based on innovation.*** Resource-based industrialization focuses on agricultural products, construction materials, and cultural products (e.g. handicrafts), in addition to downstream processing of petrochemical products. The industrialization of innovation, a mechanism and combination of forces, creates the link between scientific and technological innovation and industrial innovation. This can be achieved through ***industry-university-research coordination and technological entrepreneurship.***

This means coordination between the functions of improving and developing new industries, new technologies and new talents in the industrialization of innovation. The incentive mechanism must motivate both innovation and coordination. Technological entrepreneurship is the industrialization of new technologies through the creation of companies, which takes place beyond the incubation and development phase of new technologies. The capital will consist of knowledge capital manifested through technological innovation, human capital manifested through entrepreneurs and physical capital in the form of venture capital.

Based on the studies carried out by the Government and Development Partners to determine potential areas for further transformation, the main economic activities identified as priorities to be supported within the framework of this policy include:

- ***Processing of agricultural raw materials*** such as rice, coffee, soybeans, edible oils and fats (including coconut oil), candelabra oil, fruit, recycling materials, soaps, mushrooms, vanilla, corn flour, animal feed, peanuts, etc..;
- Increased production of ***salt and organic fertilizers***;
- ***Substitution of imports of construction materials*** (including cement, concrete, wood, bricks, etc.);

- Promoting the supply of **wood-based products** (including teak) and bamboo, particularly in the manufacture of furniture and in construction;
- **Enhancing the value** of handicrafts through modern processing and assembly technologies, including the protection of Tais;
- Transformation of oil (from crude oil exports) and oil waste (into carbon fiber) and development of downstream petrochemical industries.

***The policy targets two markets in the short and medium term:***

- ***Increasing supply on the domestic market by existing economic activities*** - diversifying the economy through activities aimed at the domestic market (growth of existing activities). Although domestic companies can play a dominant role in meeting the needs of the local economy, foreign direct investment seeking the market can also be an important player; and
- ***Competitive import substitution*** - encouraging the emergence of new activities. Foreign direct investment seeking the market will also be an important player.

The policy contains measures to improve the business environment so that it is conducive and more attractive, as well as Timor-Leste's competitive position. A more competitive environment can validate the long-term aspiration to develop an export-oriented, non-natural resource-based manufacturing industry.

### 3. POLICY AREAS

The Government's approach to the National Industry Development Policy focuses on the following ***four (4) areas of policy intervention and governance actions***:

- First: Policy guidelines, coordination and effectiveness;
- Second: Complementary industrialization;
- Third: Industrial human resources; and
- Fourth: Development of the private sector and cooperatives

The areas of intervention are detailed below under policy measures and classified under governance actions:

#### 3.1. FIRST AREA: Policy Guidelines, Coordination and Effectiveness

The measures within these areas aim to increase the systemic coordination of the national industry development policy with other policies; focus the overall orientation on resource-based industrialization and innovation industrialization; and ensure the effectiveness of implementation through periodic review and evaluation.

##### 3.1.1. ENCOURAGING INDUSTRIALIZATION BASED ON NATURAL RESOURCES AND INNOVATION

***In the short and medium term, the government will focus on encouraging industrialization based on natural resources and innovation, geared towards the domestic market and competitive import substitution.***

Making the most of existing resources in the agriculture, fisheries, timber, mining and handicraft sectors, as well as oil and gas and services, can help create jobs and increase people's incomes.

### 3.1.2. ENCOURAGING EXPORTS AND INNOVATION

*The government will implement the necessary measures to promote exports of manufactured products and innovative industrialization not based on oil resources.* The aim of this measure is to ensure that the actions of the public sector are aimed at developing a long-term plan for exporting manufactured products; developing production not based on natural resources; and also developing industrialization based on innovation.

In order to achieve this goal, the government will:

- Coordinate the implementation of measures aimed at *improving the environment conducive to industrialization* (natural resource-based, non-natural resource-based and innovation), through appropriate strategies and policies necessary to *promote investment*.
- *Determine* the physical infrastructure needed to develop industrialization based on innovation and *export-oriented* production, including export *processing zones, trade corridors, industrial parks and special economic zones*. This analysis will include carrying out studies to determine the infrastructure that can help reduce costs for exporters.
- Developing and implementing *export promotion strategies and measures*, namely through a comparative assessment of successful export promotion strategies implemented in the region.

### 3.1.3. INVESTMENT PROMOTION STRATEGY AND INDUSTRIAL POLICY

*The government will ensure better articulation and coordination between the investment promotion strategy and the industry development policy.* Through the Investment Policy, the Government promotes the attraction of private investment and contributes to increasing the volume of investments in the country, both domestic and foreign, in key economic sectors.

### 3.1.4. STRATEGY TO PROMOTE LIGHT INDUSTRY AND INNOVATION

*The Government will develop a strategy to promote light industry and innovation to guide the implementation of the National Industry Development Policy.* The Government will seek the support of Development Partners for the implementation of practical strategies based on concrete actions that contribute to *speeding up the implementation of the recommended policy measures*. This strategy should identify short-, medium- and long-term priorities and should be linked to annual action planning and the budget cycle. It should also identify the resources needed to implement the strategy and the actions needed to strengthen the resources available to meet these needs. The aim of this measure is to ensure an orderly implementation of the National Industry Development Policy.

### 3.1.5. CLOSE COORDINATION BETWEEN THE INVESTMENT GUIDE AND INDUSTRIAL POLICY

***Increasing the volume of domestic and foreign investment will sustain industrialization in Timor-Leste.*** Close coordination is therefore required during the implementation of both the Investment Guide and the National Industry Development Policy. ***The members of the Government with responsibility for economic coordination, investment and industry should establish a coordination mechanism at both political and technical levels.*** The support of Development Partners should also be coordinated.

### 3.1.6. MEASURING PROGRESS IN IMPLEMENTING THE POLICY

***The government will develop a baseline, objectives and indicators to measure progress in the implementation of this policy.*** This measure will ensure that the implementation of this policy is assessed against objective indicators. Benchmarks, targets and indicators can be developed to assess the success of the policy in terms of production development, coordination and capacity building of the public sector.

### 3.1.7. PERIODIC AND SYSTEMATIC REVIEW OF THE POLICY

***The National Industry Development Policy should be subject to periodic and systematic review conducted jointly by the members of the Government responsible for economic coordination, investment and industry.*** The Government's objective is to ensure the continued relevance of the policy in the light of changing circumstances and the evolution of the Government's broader policies and strategies, as well as regional and global changes. The systematic review should monitor the implementation of the policy against the indicators developed and identify bottlenecks encountered during implementation.

### 3.1.8. DEVELOPMENT OF INDUSTRIAL PARKS

***The government will promote the creation of industrial parks in order to provide the infrastructure to support light industry and the industrialization of innovation.*** The Government will contribute to the development of light industry and industrialized innovation by seeking to establish industrial parks through public investment, private investment, or public-private partnerships.

***These parks should be accompanied by feasibility studies and detailed engineering designs.*** The parks should also be developed in conjunction with other interrelated government agencies, so as to enable the targeting of investment promotion strategies for the parks and liaison with private investors willing to participate in the industrial parks.

***One of the objectives of industrial parks is to provide user-friendly land with basic infrastructure*** as part of investment facilitation to attract foreign direct investment and accelerate industrialization. ***Industrial parks are also expected to create and foster local micro, small and medium-sized enterprises,*** such as suppliers of intermediate goods, hotels, restaurants and the development of local content.

## 3.2. SECOND FIELD: Complementary Industrialization

The government will encourage industrialization complementary to agriculture, tourism, mining, timber, construction, in addition to oil and gas, and related services.

### A. DEVELOPMENT OF AGRO-PROCESSING INDUSTRIES

***The government will prioritize the development of agro-processing industries. Timor-Leste has raw materials that can be used as production factors in these industries.*** The country is endowed with abundant resources, including the availability of more than half a million hectares of gross agricultural area for cultivation and 240,000 hectares for forestry production.

The agricultural sector is also one of the sectors that absorbs a lot of labor and generates jobs. The 2019 Agricultural Census highlighted that around 63% of the population is involved in agricultural livelihoods. This provides a substantial opportunity for import substitution of agro-processed products.

At the same time, in the short and medium term, the policy field can focus on competitive import substitution; in the long term, companies can develop capacities to export agro-processed products by promoting climate-smart agricultural practices and technologies.

***The government will adopt five measures to guarantee the development of agro-processing industries:***

### **3.2.1. PROMOTING VALUE CHAINS IN THE AGRICULTURAL SECTOR**

***The government will promote the development of value chains in the agricultural sector as a mechanism to increase agricultural production for processing.***

Timorese farmers have developed agricultural systems based on food security rather than market orientation. Thus, ***the shift from subsistence to commercial agriculture requires building trust in market systems, as well as behavioral changes.*** This requires an integrated approach to value chain development and the transformation of the community's mentality towards economic orientation.

This approach must take into account all parts of the development of the value chain, including production, processing, transportation, distribution, agro-industrial information, the introduction of technology, including the construction of water points for livestock, communication systems, storage, including the cold chain (refrigeration equipment), packaging and marketing.

The policy measure should ensure that efforts to develop agricultural value chains are coordinated between government departments and agencies responsible for the areas of economic coordination, planning, trade and industry, agriculture, fisheries and forestry, public works, cooperatives, vocational training, business development support, quality control, investment promotion and exports, in addition to organizations representing the private sector and development partners.

### **3.2.2. PROMOTING MANUFACTURING INDUSTRIES**

***The government department responsible for trade and industry should support and encourage the creation of manufacturing industries.*** Support can be provided for the establishment, operation and management of processing industries. ***The creation of private processing industries shall be based on private sector participation and domestic demand for processed products.*** Domestic processing of commodities may use domestic agricultural, livestock, forestry and fish products.

The government department responsible for trade and industry will promote small-scale, labour-intensive domestic industries with farmers' groups, community organizations, farmers' organizations and cooperatives.

### 3.2.3. PROMOTING THE AGRO-INDUSTRIAL SECTOR

*The promotion and encouragement of agri-business is essential to stimulate entrepreneurship in agriculture.*

The government department responsible for trade and industry will work closely with the government department responsible for agriculture and agri-business, the youth business center and the agency responsible for investment and export to promote private sector participation in agriculture. Specific actions include strengthening business management, market linkage, supply chain management and the economic activity of private entrepreneurs, such as farmers' groups/women's groups, youth groups, cooperatives, processing industries and traders. The government department responsible for trade and industry will work together with the agency responsible for investment and export to promote opportunities in the agribusiness sector in order to encourage and mobilize private sector participation.

### 3.2.4. COMPETITIVE IMPORT SUBSTITUTION

*The government promotes the competitive and gradual substitution of imports of products from agro-processing industries.* Timor-Leste currently imports a substantial number of products that could be produced domestically. The government department responsible for trade and industry has already been successful in supporting the domestic processing of salt and coffee, both for the domestic market and for export.

Under this policy measure, this government department will promote more competitive import substitution in agricultural processing, targeting products that can be manufactured using domestic agricultural goods as factors of production and that focus on the domestic market.

### 3.2.5. PROMOTING EXPORTS OF AGRO-PROCESSED PRODUCTS

The government department responsible for trade and industry, in cooperation with the agency responsible for investment and exports, will develop a strategy for promoting exports of existing agro-industry products and those to be developed in the short term, as well as addressing how competition arising from regional and multilateral economic integration and the sensitive sectors of other states can be dealt with in order to ensure that Timorese exports are not overshadowed.

*The short-term export strategy will focus on coffee, nutmeg, virgin coconut oil, figs, vanilla, black pepper and other niche agricultural products where the supply chain is developed and can meet greater export demand.*

## B. HANDICRAFTS AND WOOD PRODUCTS

*The focus of industrialization in the tourism sector should be on handicrafts that can be sold to tourists, but should also enable digital payment mechanisms for tourists.* The production of more handicrafts

in Timor-Leste supports the objectives of Timor-Leste's National Tourism Policy 2017 - 2030, to increase the added value of tourism and reduce leakage of tourism expenditure.

***Wood products are another area of comparative advantage for Timor-Leste.*** The Government is pushing ahead with plans to accelerate the development of commercial forestry plantations through the ***National Forestry Policy (2017)*** and the ***National Forestry Investment Plan***. Bamboo has already been identified as a promising resource, and the Government has created the Bamboo ***Research, Development, Training and Promotion Institute (Instituto do Bambu)*** to promote the cultivation and processing of bamboo products and to explore the enormous potential of this "green gold" for economic diversification.

### 3.2.6. IMPLEMENT A PROGRAM TO ENHANCE LOCAL HANDICRAFTS

***The handicraft industry already exists in Timor-Leste, but it is underdeveloped and operates in a traditional way.*** Its modernization will require the conversion of scientific knowledge into a designated science park that brings together university and foreign expertise to add value to existing products and create new ones.

***The existing handicraft industry, such as Tais weaving,*** which was recently recognized by UNESCO as part of Timor-Leste's intangible cultural heritage, ***Mahanaim clothing, the Atauro doll, Empreza Diak, the Rui Collection, wood-based handicrafts and others,*** was intended to complement and support the tourism industry and has made progress in designing and producing high-quality "Tais-based shoes" and Atauro uniforms and dolls.

However, most handicraft initiatives are led by women's cooperatives, which requires improvements in developing a good reputation in the market as a producer of high-quality handicrafts and in improving market sales. Sales have stagnated due to high prices and little product innovation after the original Tais, handmade wood and dolls were designed and introduced to the market, over-reliance on institutional sales and the limited capacity of cooperative staff and members in product design, textile design, communication and financial literacy to improve the company's profit margin.

***It is necessary to invest in developing staff skills in the areas of product design, textile design, graphic design, learning English and Portuguese, marketing, branding, financial literacy and business management.***

### 3.2.7. WOOD PROCESSING

***Promote the use of more efficient wood processing techniques through practical training and demonstration of techniques.*** Current wood harvesting and primary processing techniques are inefficient, and it is estimated that only 15% of the volume of wood grown is captured for end use.

The Government will implement with Development Partners a program to increase the efficiency of wood processing techniques through practical training and demonstration of more efficient techniques.

### 3.2.8. PROFESSIONAL TRAINING COURSES

***Develop vocational training courses for the wood processing industries.*** In the medium term, the government will develop and implement vocational training courses for the wood processing industries.

These training courses should be based on similar courses in neighboring countries. The government department responsible for trade and industry should work together with the government department responsible for vocational training and other related training agencies to implement a training curriculum, including specific subjects on innovative tropical agriculture and livestock breeding, which should be integrated into the national curriculum of vocational schools and training centers.

### 3.2.9. COMMERCIAL FORESTRY AND INDUSTRIAL DEVELOPMENT

***Coordination between the government departments responsible for commercial forestry and industrial development.*** These departments should coordinate actions with the departments responsible for forestry in order to ensure that the development plans for commercial forestry plantations are articulated and converge with the plans for the wood sector's processing facilities.

## C. SMELTING, PROCESSING AND OTHER DOWNSTREAM INDUSTRIES OF MINERALS AND METALS

Timor-Leste's main export is oil and gas. However, ***processed mineral products and metals make up around a quarter (¼) of all imports to Timor-Leste.***

Since Timor-Leste has oil, gas and metal ores, it should be feasible to support the development of downstream industries to improve the country's balance of payments.

### 3.2.10. MINERAL PROCESSING

***Investigate the long-term potential of mineral processing in conjunction with government plans for the development of the minerals sector.***

The government department responsible for trade and industry should work with the agencies responsible for mineral resources to investigate the potential for processing these resources in parallel with plans to develop the minerals sector. Timor-Leste has minerals with potential for processing, such as sand and gravel, limestone for cement, clay for bricks, marble, gypsum, phosphate, etc.

## D. INDUSTRIALIZATION OF CONSTRUCTION

Timor-Leste is building significant amounts of new infrastructure. ***The construction materials market is driven by public investment in infrastructure. Timor-Leste can capture more value from infrastructure development if it can manufacture construction materials in-house.***

Existing studies show that Timor-Leste has resources in clays, limestones, sand and gravel, which can support small to large-scale raw materials for the building materials industries.

Clustering effects can be substantial in construction-related industries. Investments in this sector and its subsequent development can help reduce imports of raw materials and ready-to-use building materials.

## E. INVESTMENT STRATEGY FOR THE BUILDING MATERIALS SECTOR

*The government will work towards developing an investment strategy for the building materials sector.*

The government departments and agencies responsible for trade and industry, investment and exports, infrastructure and public works will jointly develop a strategy to promote investment in the building materials sector.

### 3.3. THIRD AREA OF INTERVENTION: Industrial Human Resources

The development of human resources is fundamental to industrial development. *The need for skills development is even more pressing given the increasing pace of global technological change, the spread of information technologies and the intensification of global competition.* Recent data from the World Bank highlights that Timor-Leste's human capital index is 0.45 in 2020, lower than the average for the East Asia and Pacific region, which is 0.59. In addition, the quality of higher education also needs to improve significantly, both in private and public universities. This would increase the country's productivity and efficiency. It is also necessary to provide viable training mechanisms for workers and line managers. Training schemes would also help workers develop local design skills and more sustainable production and marketing practices.

Technical assistance and other training actions, such as Kaizen methods, optimized management, *just in time*, *Six Sigma*, technology and innovation, would also be beneficial. If these strategies were adopted throughout the sector, it would improve productivity and promote the use of capital-intensive production instead of labor-intensive production. Timor-Leste could thus lower production costs and become more competitive.

#### 3.3.1. SKILLS AUDIT FOR THE IMPLEMENTATION OF THE POLICY

*Carry out an immediate audit of public sector competencies to implement the National Industry Development Policy. Following the skills audit, develop a capacity building program.* The aim of this measure is to ensure that the government has the capacity to successfully implement the National Industry Development Policy. Conducting a skills audit can help the government department responsible for trade and industry to design a long-term capacity building program. The assistance of Development Partners should be sought to carry out the skills audit and develop a capacity building program.

#### 3.3.2. VOCATIONAL EDUCATION AND TRAINING FOR INDUSTRIAL DEVELOPMENT

*Coordination between the government departments responsible for trade, industry and vocational training to strengthen the orientation of vocational education and training towards industrial development.*

The coordination mechanisms to be established between these government departments could ensure that training and skills development support industrial development.

and market needs. The National Employment Strategy 2017 - 2030 stresses the need to match skills needs with training. Close coordination with vocational training centers will be necessary to ensure that the required skills are offered by training institutions.

### 3.3.3. LINKING VOCATIONAL EDUCATION AND TRAINING INSTITUTIONS WITH INDUSTRY

***Develop a program to link vocational education and training institutions to industry.*** The government departments responsible for trade, industry and vocational training should work together to link vocational training directly to industry, including the creation of business incubation centers and training centers in industrial parks. This will ensure that vocational training is aligned with market needs.

## 3.4. FOURTH AREA OF INTERVENTION: Private Sector and Cooperatives

***Development of the private sector and cooperatives for the manufacturing industry: promotion of distribution, business consultancy and a standards certification center.*** The government, in collaboration with the private sector, should set up a center to attract young entrepreneurs and new companies, so that they can receive training to enable them to deal effectively with the business environment.

***The center should be a public-private initiative to equip national entrepreneurs with the business skills they need to succeed in their industries.*** This action plan is intended to support processing industries in transporting target products produced by farmer groups/women's groups, youth groups and processors between production, processing and consumption sites.

There should be more packaging companies in approved industrial zones to package fresh produce and other products to high quality standards to make their distribution effective and efficient.

### 3.4.1. MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES

***Supporting the development of micro, small and medium-sized enterprises through direct support, capacity building at policy level and capacity building of services.*** Micro, small and medium-sized enterprises have a vital role to play in economic development in general and industrial development in particular. The National Industry Development Policy will support the development of these enterprises notably through the following actions:

- ***Capacity building at policy level:*** strengthen the capacity of relevant bodies to plan, monitor and coordinate efforts to support micro, small and medium-sized enterprises. Capacity building efforts should include an assessment of the capacity of ministries and agencies to support micro, small and medium-sized enterprises.
- ***Direct support:*** making recommendations to the government on improvements to the policy and regulatory framework, including, among others, those relating to registration procedures, organic and quality certification, import/export procedures and regulatory disincentives or obstacles affecting micro, small and medium-sized enterprises, through mechanisms such as regular private sector forums or annual meetings.

- ***Strengthening service*** capacities: strengthening the capacities of selected public and private institutions to provide effective market-oriented business development services in the fields of technological information, consultancy and advice, technical training, promotion of subcontracting and business planning.
- ***Access to finance***: creating an enabling environment that allows financial institutions to grant loans to micro, small and medium-sized enterprises, including micro-credits to rural communities and family businesses. This can be made possible by setting ***up an appropriate credit guarantee system or by creating an appropriate legal environment*** through the adoption of a certain set of laws that are essential for the effective and efficient functioning of financial institutions, such as the ***enforcement law, the law on guarantees and the law on insolvency and business recovery***.

### 3.4.2. TECHNICAL ADVICE MECHANISM FOR COMPANIES

***Consider creating a technical consultancy mechanism aimed at advising companies.*** Many companies in Timor-Leste suffers from low productivity and inexperienced management. A technical consultancy could advise and solve day-to-day technical problems and also help improve and update products and processes.

The government will carry out the necessary studies and establish a technical consultancy mechanism to advise companies, based on the relevant experience of existing government institutions, especially through the government department and agency responsible for trade, industry and business development support, in conjunction with organizations representing the private sector and with the support of Development Partners.

### 3.4.3. COOPERATIVE DEVELOPMENT

***Support the development of cooperatives through direct support, organizational capacity building, service-oriented agriculture and production, and business capacity building.*** The cooperative sector is an effective contributor to economic and industrial development. Cooperatives contribute to the production of agricultural raw materials, value-added products and as an effective actor in the service sector.

The government departments responsible for trade, industry and cooperatives should work together to build an ecosystem of cooperatives and provide access to the market.

The National Industry Development Policy will support the development of cooperatives, namely through the following actions:

- ***Strengthening entrepreneurial capacity***: strengthening the capacity of the primary, secondary and tertiary cooperative movement in the field of entrepreneurship, financial literacy, the value chain and market linkages through the government department and agency responsible for the areas of cooperatives and business development support, the cooperative training center and relevant bodies to plan, monitor, evaluate and coordinate cooperative support efforts, in addition to support for the capitalization of the sector.

- ***Strengthening organizational capacity:*** strengthening the organizational capacity of the cooperative movement in the areas of governance, leadership development, information and technology, research and development. Capacity building efforts should include an assessment of the capacity of ministries and agencies to support cooperatives.
- ***Direct support:*** carry out a national diagnosis to develop a high-quality program and policy, provide recommendations to the government on improvements to the policy and regulatory framework, including but not limited to those related to financial and non-financial, as well as multi-sectoral, registration, audit and inspection procedures, and regulatory disincentives or barriers affecting cooperatives.
- ***Production centered on agriculture and the service sector:*** stimulate the participation of cooperatives in high-value economic sectors. The financial sector, which is the pulse of the country's cooperative movement, must be strengthened to ensure the solid development of the cooperative movement. In addition, other important service sectors of the cooperative movement, namely tourism, fisheries, agriculture, food production, livestock, plantations and trade, must be improved and expanded. It is necessary to develop the expansion of economic activities and increase added value through value chain activities in related industries, such as sorghum, bee honey, dairy products, beef, local rice, mushrooms, virgin coconut oil and coconut water, peanuts, soybeans, local chicken meat (*manu Timor*), bamboo, drinking water, among others.

Dili, November 2023.