

Interim Report Phase I

Economic Impact of Peacekeeping

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Purpose

This report has been prepared as part of a project commissioned by the Peacekeeping Best Practices Unit (PBPU) of the UN Department of Peacekeeping Operations. The analysis and the findings contained in the report are preliminary and caution should be used in interpreting these results in advance of the full report. The full report will be available in December 2005. This report and the findings are not for citation, and should not be reproduced without the permission of the authors.

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Executive Summary

1. Introduction

There is little analysis of the economic impact of peacekeeping beyond anecdotes

The international community spends a large amount of money on peacekeeping operations. Yet there is little qualitative assessment of the economic impact of peacekeeping interventions, and even less quantitative analysis. The discussions that are presented generally focus on a handful of negative anecdotes. They rarely address the single biggest economic impact of a peacekeeping mission – the provision of peace and security, which is fundamental to even the most basic of economic development.

In the first phase of research, some anecdotes don't hold

This report represents the first phase of a study attempting to put a higher level of quantitative and analytical rigour around these anecdotes. Some of the populist criticisms that are made have a foundation in the data, others do not. This study has found that:

- like the inflationary impact;

- inflation in Timor-Leste had more to do with the removal of Indonesian subsidies on staples and supply disruptions after the referendum, than with international spending;

but others do

- the increased economic activity around accommodation and restaurants may have created perceptions of a dual economy, but it did provide employment for many previously unemployed Timorese; but

- like the negative impact of wage rises

- criticisms that the wage setting policies adopted by the United Nations have had a negative impact on private sector growth and competitiveness are borne out.

But the anecdotes draw the focus away from the many ways that the mission could make a positive impact

In many cases the criticisms are soft, as they benchmark the United Nations against an ideal situation, not a genuine counterfactual. Perhaps more importantly, the criticisms draw attention away from the many opportunities that a peacekeeping operation has to use its economic footprint to reinforce and advance its mandate.

2. Fiscal Impact

The fiscal impact of the mission on the local economy was \$94m ...

From December 1999 until June 2004 just over \$1.75b was provided by the General Assembly for the operation of the UNTAET and UNMISSET missions in Timor-Leste. Of this amount the direct fiscal impact on the economy of Timor-Leste was \$94m, comprised of:

...out of a total

- \$63m in spending from allowances paid to international personnel;
- \$23m in wages paid to UNTAET/UNMISSET national

budget of \$1.75b ...

staff; and

- \$8m from local procurement and local spending by externally procured contractors.

...but this impact did contribute just under 10% of the GNP of Timor-Leste

The spending in Timor-Leste would have had a multiplier effect as Timorese receiving wages or profits spend some of that money in the local economy. Given the high level of imports in the economy, this multiplier effect is estimated to have added around another \$50m to the GNP of Timor-Leste over the period studied – although there is a lack of good macroeconomic data to estimate this impact precisely. Overall, this impact represented just under 10% of the GNP in 2000-02

\$133m was spent in Timor but paid for imports of goods and services ...

An additional \$133m was spent in Timor-Leste but did not remain in the economy. It was either used directly to purchase imported goods, paid wages for international workers or was repatriated as profits by foreign firms.

The remaining \$1.5bn was spent on externally procured goods and services, including:

...the remaining \$1.5bn covered military contingents, civilian staff costs, air transport and operational costs

- \$626m to pay for military contingents;
- \$281m to cover the salary and other costs of international staff, civilian police and military observers (excluding allowances);
- \$180m on air transportation;
- \$150m to cover accommodation, facilities, infrastructure and communications; and
- \$126m paid in staff allowances that were retained by staff as part of their overall remuneration.

3. Economic Impact

The major economic impact was peace and security ...

The major economic impact of the mission related to its peace and security mandate. By delivering a safe and secure environment the mission laid the foundation for economic development. Without security there is no investment as people are not prepared to spend resources today to get a return tomorrow when the tomorrow is so uncertain. This impact is so fundamental that it is regularly overlooked.

... which underpins any economic activity...

In terms of more traditional economic impacts:

...the inflationary impact of the mission appeared to be

- The common perception that peacekeeping missions make a major contribution to inflation is hard to support in Timor-Leste. There was a major inflation event, and there was a peacekeeping mission, but this correlation does not demonstrate causality. The relatively small size of the fiscal impact means it was unlikely to have an inflation

benign ...

... meaning there was scope for more local spending ...

In the labour market the mission created jobs, but may have attracted too many of the high skilled workers...

...spending on hotels and restaurants has laid the ground for tourism.

Most of the benefits accrued in Dili to the well-educated and the well-off

The wage setting policy of the mission has harmed development

Short term horizons have led to sub-optimal decisions

And expectations of the Timorese have been raised

Mission staff see the potential for a better

impact. But it also means that there was greater scope for enhanced local procurement to stimulate the economy without triggering an inflationary episode.

- The United Nations was a major player in the labor market – particularly in the formal wage sector of the market. There are concerns that UNTAET/UNMISSET attracted too many of the higher skilled workers away from other jobs. However by providing these jobs the mission both provided financial resources directly to Timorese and developed the human capital of those it hired.
- The spending by international staff on hotels and restaurants appears to have laid the foundation for a basic tourism industry – at least in Dili. As the demand has reduced there does not appear to be massive closings – rather, establishments are replacing high wage internationals in management positions with lower wage Timorese to cut costs, and are altering their products to maintain profits.
- Around 80% of the economic benefits have been felt in Dili, and they have been gained by the well-educated, and those already with some wealth. It was only those with at least a high school diploma who could obtain UN jobs, while only those with land could rent it out.

There have been other economic impacts in Timor-Leste associated with the way in which the UN has done, and continues to do business. These have generally been negative.

- The approach to setting wages for national staff has led to a level of local wages that is not internationally competitive.
- Mission planners are constrained by short time horizons due to the length of mission mandates determined by the Security Council. This has led to inefficient expenditure and sub-optimal investment in infrastructure. The legacy of this will be left to the Timor-Leste government and ultimately their taxpayers.
- The working conditions (both physical amenities and work benefits) have created expectations amongst government employees that the Timor-Leste budget is not well-placed to meet.

4. Operating Realities

There is a broad acceptance of the importance of fostering economic development amongst mission staff, and an

economic footprint...

*...but this hasn't
translated into
action ...*

*... possibly because
there is no person
explicitly responsible
for maximizing the
development impact*

*The economic
footprint was
smaller than
expected, so there
may be opportunities
to expand it ...*

*...but systemic
challenges must be
addressed ...*

*... a list of concrete
proposals is
included ...*

*...the next step is to
expand the coverage
of the study to ten
more missions ...*

*...to test the
conclusions and the
broader applicability
of the practical
proposals*

understanding that the mission has the potential to leave a better fiscal and economic footprint. However this broad understanding has not been translated into operating rules and procedures and until it is there will be little movement.

- At this stage procurement guidelines do not allow local impact to be taken into consideration when awarding contracts.

More importantly there is not a dedicated person who is explicitly responsible for maximizing the direct developmental impact of the peacekeeping operation. Without this dedicated focus and given the multiplicity of competing tasks, deadline and goals, it is not surprising that the developmental impact falls to the wayside.

5. Preliminary Conclusions

The economic footprint was smaller than expected; meaning both that the disruption was lower than people had claimed, but that the inflationary impact was also lower. If this pattern is repeated in other missions it suggests that there is considerable scope to use the mission's spending to support economic development without causing inflation.

In moving forward, however, it is important to recognize and address the negative impacts that peacekeeping missions cause; which are systemic. Addressing the way in which the UN sets wages, so that does so in a way that is mindful of both its market power and of the broader impact on development of its wage setting practices is of utmost importance.

A list of concrete proposals were presented by UNMISSET staff in the course of this research. These are presented in the paper and will be explored in the context of the other missions that will be studied in the next phase.

The next stage in the project is to apply this analysis to nine current and one former peacekeeping mission to assess whether the results are consistent across missions. It will also allow an assessment of which challenges and negative impacts are systemic and which are mission specific; as well as an opportunity to test the proposals by UNMISSET staff in other environments. Based on this research a detailed list of concrete recommendations will be developed to ensure that the economic impact of peacekeeping missions is used to advance, not inhibit the mission's mandate.

Chapter 1. Introduction

In partnership with the Peacekeeping Best Practices Unit (PBPU) and the Office of Mission Support (OMS) of the UN Department of Peacekeeping Operations (DPKO), Peace Dividend Trust's *Economic Impact of Peacekeeping* (EIP) project aims to develop practical measures to minimize the negative economic effects and maximize the economic benefit of peacekeeping operations on host economies. Creating strategic operational procedures and mission management methods, can support the achievement of the broader mission objectives of establishing conditions that enable long-term sustainable development.

The project has been broken into two phases. The first phase of the project involved three parts: a thorough review of existing and related work on the economic impact of peacekeeping missions; the development of a methodology to estimate this impact and the piloting of the methodology in one mission; and the development of a plan to extend the study to a number of other missions, including modifying the methodology if necessary. This paper reports on the work that has been conducted, including the piloting of the approach in Timor-Leste. The second phase of the project involves implementing the plan presented at the end of this report.

The next chapter of the report reviews the existing research and literature on economic dimensions of peacekeeping operations, including the available work that has been done specifically on the economic *impacts* of peacekeeping. However, direct references to the economic impacts on a host country of peacekeeping missions themselves are found to be rare and quantitative studies even less frequently available. One quantitative study of the United Nations Transitional Authority in Cambodia's economic impact demonstrates some of the negative and positive aspects, including potential inflationary and market-distorting effects, as well as contribution to private sector development and human capital development. Similar results are stated in brief sections of several qualitative studies, however these were primarily based on the experiences and observations of the authors. The conclusive lack of quantitative studies on the topic clearly emerged. The need for more substantive empirical work in this area is identified by several authors.

The existing body of literature on the economic aspects of broader peace operations, including their civil and humanitarian dimensions, is extensive and diverse. The role of economic agendas and significant actors such as the private sector in conflict and post-conflict scenarios has come to form a large area of inquiry for political economists, as has the distinct nuances of post-conflict development for practitioners and academics in the broad area of international development. Macroeconomic analysis of developing countries provides an interesting framework in which to study post-conflict dynamics. There is also much discussion about ways to reform peacekeeping to be more effective, including in its role to set social and economic development in motion.

In Chapter 3, a brief summary of how economic growth occurs as a result of the presence of a peacekeeping mission is followed by a case study of the economic impacts of the United Nations Transitional Administration in East Timor (UNTAET) and its successor mission the United Nations Mission in Support of East Timor (UNMISSET). This impact is presented in two parts. First, the direct fiscal impact of the international presence is

estimated. Using a combination of published budgets and reports, surveys and other data, it is possible to divide the international spending under the Assessed Contribution Budget into four components: funds spent externally, staff allowance payments that were not spent; funds spent in Timor Leste that were used to purchase imported goods and services; and funds that were used to purchase goods and services produced in the local economy. Mindful of this impact, the next section in the chapter looks at the broader economic impact of UNTAET/UNMISSET including examining the impact on inflation, the labour market and the tourism industry, as well as a discussion of both the distributional impacts (that is trying to identify the beneficiaries) and the negative impacts of the way in which the United Nations conducts its engagement with the local economy.

The assessment of the fiscal and economic impacts is followed by a discussion of the operational realities that affect the missions ability to procure and hire locally. Mission staff are already challenged by the day to day demands of running a peacekeeping mission. This must be taken into account before any realistic changes can be made in order to improve the economic impact of the mission. Through interviews with senior mission managers, Timorese, and international observers, the paper reviews the operational challenges. The concluding section of the chapter outlines a series of general issues and discusses some of the preliminary recommendations provided by UNMISSET staff on how current mission procedures for local procurement and hiring of national staff could be improved.

Chapter 4 outlines the work plan for Phase II of the EIP project. The pilot fieldwork conducted in Timor-Leste led to fine-tuning of the methodological approach that will be used in upcoming fieldwork in nine existing missions and one former mission. The targeted data and interview subjects are profiled, as is the projected timeline for completion of Phase II.

Chapter 2. The Economic Impacts of Peacekeeping Operations: A Review of the Literature

2.1 Introduction

The war to peace transition facilitated by peace operations is not just played out on battlefields, but in the multitude of socio-political and economic links with the local community and immediate environment. In addition to restoring law and order, peace operations function under the guiding principle of setting the stage for long-term security and development, which necessitates involvement in “complex and often paradoxical social, political and economic processes” (Pouligny 2005). The multifaceted nature of involvement in a host country, accompanied by wealth and personnel that typically exceed that of the national administration, lead to the intuitive conclusion that impacts on the local economy are likely, and the outcomes are not always desirable.

Nevertheless, while the economic aspects of conflict and war have been studied in some detail, peacekeeping missions themselves have not often been the focus of inquiry. Quantitative studies are rare, and specific quantitative studies of the economic impact of missions even more so. The studies that are available tend to be qualitative and anecdotal, reflecting the need for more data to undertake quantitative analysis and subsequently devise new methods for minimizing harmful impacts. Consequently, the present survey of existing literature on the economic dimensions of peacekeeping casts a broad net, including related areas of research that support the need to further inquire into the impacts of peacekeeping missions on the host economy.

The next section of this chapter summarizes the results of studies that directly refer to the impacts of peacekeeping missions. What is found is that not only are systematic quantitative studies missing, but such analysis is identified as a priority area of concern for peace implementation.

Following that, five related categories of literature are examined, starting with *macroeconomic analyses of the effects of aid flows*. The economic effects of a large fiscal contribution from a peacekeeping mission in the host country have not been a focus of research. However, however parallel literature looking at the effects of an inflow of foreign exchange and subsequent market changes in developing countries provides a framework within which the post-conflict scenario may be studied. The economic dimensions of conflict that in fact have been extensively studied include economic causes for war and the ways in which power and wealth form agendas for conflict. These issues have been examined in a body of research classified as *political economy of war*, underlining the need for key actors in peace operations to be cognizant of economic agendas in conflict so as not to fuel further conflict and instability.

The area of literature looking at *post-conflict development* is then outlined to provide some insight into the evolving roles of peacekeeping missions in reconstruction, humanitarian activities, and “peacebuilding”. In addition to restoring law and order, the way missions’ activities are carried out often have enduring effects on longer-term

development. Next, the *role of the private sector in conflict and post-conflict zones* is considered as multinational enterprises (MNEs) and indigenous businesses have recently come under the spotlight as economic actors that can fuel conflict but also facilitate its resolution. Businesses also play a significant role in post-conflict development by generating economic activity and creating employment opportunities. Finally, recent *analysis and reform of peacekeeping operations* is summarized, with particular attention to the recommendations of the Panel on UN Peacekeeping Operations (the “Brahimi Report”). In this area of inquiry, recognition of the increasingly complex nature of peace operations places further emphasis on integral economic aspects of peacekeeping and peacebuilding.

2.2 Direct References to Economic Impact of Peacekeeping

Formal or informal analysis of the economic impacts of UN peacekeeping is quite scarce in both the economic literature and other studies of peace and conflict, post-conflict development, and peacekeeping operations. Little systematic quantitative analysis has been undertaken of the direct and indirect impacts, however a small body of literature incorporates these issues into broader discussions. As a result of the dearth in analysis of this topic, reference to these impacts is not often extensive, but rather a tangential consideration. Most often impacts that have been observed are reported as stylized facts based on anecdotal evidence. However the evidence strongly suggests peacekeeping missions do have a pronounced ripple effect throughout the host economy, warranting further examination.

The remainder of this section will review items that refer directly to economic impacts of peacekeeping operations, highlighting most commonly raised issues. First, a summary of a report on the economic impacts of the United Nations Transitional Authority in Cambodia (UNTAC) on the local economy will be provided, alongside one observer’s assessment of the report’s findings. Although UNTAC concludes that its impacts were not as acute as some would propose and has “provided the impetus for socio-economic change”, Curtis (1993) indicates that the report does not take several important factors into account, including the sustainability of UNTAC’s economic contributions. This is followed by examples of anecdotes of similar observable impacts briefly discussed in other works, with particular reference to distortions created in rental and retail markets, as well the creation of a temporary service economy serving the needs of internationals. Particular attention is paid to impacts on the labour market, including changes in wages and salaries, and the effects on skilled and non-skilled sectors.

2.2.1 UNTAC in Cambodia

A report produced by UNTAC’s Economic Advisor’s Office, called *The Impact of UNTAC on Cambodia’s Economy* (1992), is the only available systematic analysis of economic impacts by a UN peace mission. Quantitative data such as economic indicators and outlays in Cambodia were compiled mostly from quoted statistics and official sources, such as the National Bank of Cambodia and UNTAC records. Qualitative research also informed the study, including interviews with development agencies and “senior local Cambodians” (UNTAC 1992, 2).

Cambodia experienced persistent levels of inflation throughout the peace process, and in particular during the presence of the United Nations Advance Mission in Cambodia (UNAMIC) and UNTAC (ibid, 16 & 18-21). The report denies that UNTAC was primarily responsible for this inflation since only a small proportion of UNTAC's \$3 billion budget was spent in Cambodia, and an observed increase in imports is asserted to balance the increase in aggregate demand spurred by UNTAC's expenditures. The report states that the opening of markets and the end of administered prices were possible causes of rising prices (ibid, 2-4). What *is* acknowledged is the rapid escalation of "certain selected consumer prices" that accompanied a large influx of international personnel in July and August of 1992 (ibid, 5). In particular, rental and restaurant costs rose substantially as a result of increased demand from UNTAC staff.

A "dramatic increase in labour payments" with a "corresponding upsurge in local purchases" is recounted for the second half of 1992, and the report admits that "lack of knowledge of local conditions, combined with the presence of profiteering and speculative pressures have undoubtedly exacerbated in some areas, the underlying problems of inflation" (ibid, 7). Rising prices in the certain sectors is partially attributed to UNTAC's largest expenditure: wages and allowances paid in Cambodia. Although the report does concede responsibility for the "bidding up of salaries of locally recruited staff" as a result of increased competition for skilled labour and higher paid wages, it maintains that relatively high incomes and distinct consumption patterns of expatriates did not substantially affect local cost of living. The increased wages of local staff, however, are recognized to have increased their purchasing power, contributing to domestic inflation (ibid, 9-12).

Among the positive contributions that are reported are UNTAC's creation of employment within the mission, which has spilled over into other sectors of the local economy, capacity-building through on-the-job training and its advisory role to the public administration. With regards to private sector development, the report concludes that "private enterprise finds expression in the spate of personal and family investment in small shops, home renovation, construction of homes and other service industries." Furthermore, "UNTAC's contractual and local procurement activities, in addition to setting standards and exposing local suppliers to competition, has encouraged firms to seek new business outlets and contacts with neighbouring countries" (ibid, 14).

In his analysis of the report, Curtis (1993) argues that an unsustainable pattern of development results from UNTAC's heavy investment in the service sector to meet the needs of international personnel. Most of this investment was in Phnom Penh with little being directed to the provinces and productive sectors. Also, by paying Phnom Penh-based rents at the provincial and district levels, UNTAC's activities resulted in an increase in the rental and land prices throughout the country. Although Curtis does acknowledge that UNTAC was able to contribute to human capital development through job training and improved language skills, he claims that their recruitment of highly skilled and experienced Cambodians "from already disintegrating administrative structures could only have had a negative impact upon the delivery of government services" (Curtis 1993, 21). He describes the expected difficulties that resulted in the

labour market on UNTAC's departure, asserting that difficulties of being re-absorbed into the workforce with expectations of inflated wages and the absence of jobs were typical.

Curtis also draws attention to the report's tendency to oscillate between admitting and denying UNTAC's impacts on the economy. For example, while the report states that the direct impacts of UNTAC's presence are far less significant than they appear, it still contends that:

“the arrival of UNTAC in Cambodia has had a considerable impact on the local economy. UNTAC purchasing power has brought in substantial amounts of dollars that have had an evident catalytic effect on economic activity but have also contributed to significant price and wage increases in several sectors (UNTAC 1992, 2).”

Both the UNTAC report and Curtis' critique of its findings point to the need for similar analysis of other missions. In particular, there is a need for more quantitative analysis around issues such as the sustainability of the patterns of economic activity spurred by the mission's presence or the true extent to which locals are shielded from effects of the international staff's consumption patterns.

2.2.2 Other references to economic impacts

Although parallel reports for other missions have not been produced, Chesterman (2004), Higate and Henry (2004), and Woodward (2002) cite similar observations in Timor-Leste, Afghanistan, the Democratic Republic of Congo (DRC), Sierra Leone, and Mozambique among other countries. Chesterman contends that UN missions creates an unsustainable economy to serve the needs of the transient internationals who invariably have high levels of disposable income (200). Woodward refers to this phenomenon – which entails distorted labour, rental and retail markets, the creation of a temporary service economy (i.e. restaurants and bars), and the rise of illegal drug use and prostitution – as the creation of a “bubble economy”. He notes that increased demand in such sectors as housing and office space, and for various goods and services including supplies for peacekeeping troops, has an inflationary effect that is felt most intensely by the local population.

Chesterman demonstrates that the size of UN mission budgets can be misleading when assessing the proportion of funds that assist the local population. In *You, the Peoples: The United Nations, Transitional Administration, and State-Building* (2004), Chesterman suggests that in Timor-Leste, only around \$50 million, or one-tenth of the UN Transitional Administration's budget, reached the local people, contrasted with \$27 million spent on bottled water for international staff – “approximately half the budget of the embryonic Timorese government, and money that might have paid for water purification plants to serve both international staff and locals well beyond the life of the mission” (183).

Anderson (1999) mentions the same effects from the presence of the aid and relief industry in post-conflict societies. In her widely-cited book *Do No Harm: How Aid Can*

Support Peace – or War (1999) Anderson refers to the tendency for aid agencies to “glut the market”, delivering large quantities of aid with the adverse effect of undermining local production. Jean (1996) looks at the macroeconomic consequences of an injection of humanitarian aid and the effects of an overvalued domestic currency. Jean refers to the more direct effects felt in the capital city and larger provincial towns.

Of particular interest are the impacts of peace missions on the local labour market and human capital development. The UNTAC report did acknowledge its role in increasing local wage and salary levels (UNTAC staff salaries were at least 15 times higher than local Cambodians). Each of Anderson, Chesterman, Higate and Henry, and Woodward observe increased demand for local skilled and unskilled labour, and higher salaries for those employed by the UN, and aid and relief agencies. Income for internationals is estimated by Chesterman as being between 15 and 400 percent higher in Afghanistan than local civil service positions, and between 500 and 1000 times the per capita income of locals in the DRC according to Higate and Henry.

Despite the cited potential for human capital development and increase in savings and local investment, in practice the effects are less clear. Often what is observed is that local government is unable to compete with the higher salaries and wages offered by international bodies, luring away skilled professionals from state-building (Curtis 1993, Woodward 2002). Some actually lose skills while employed by short-term contracts as translators or drivers. In some cases this means “a judge is working as a driver, or an electrical engineer as a security guard” (Chesterman 2004, 201).

Similarly, the OECD Development Assistance Committee (1998) notes that local hiring by civil and military operations is not always compatible with longer-term development work in a report on humanitarian assistance during conflict. The report cites the possible “disruption that short-term job creation causes in the local economy” with the potential of “actually hinder[ing] sustainable development” (19, para 61).

The observed effects of the swift arrival of large numbers of expatriates, and the accompanying accommodation of their needs and demands, are ubiquitously reported as cause for concern by all the above authors. Chesterman asserts that the international presence dominates and distorts the local economy during “precisely the period in which international assistance should be making its greatest contribution to the establishment of a self-sustaining economy” (2004, 200). An effect such as inflated prices negatively affects consumption by locals, while uneven salaries and wages in the local labour market have significant distributional repercussions (Anderson 1999, Woodward 2002). Furthermore, resentment is generated among locals regarding their own economic hardship in relation to the situation of international staff (Woodward 2002).

Despite the mounting evidence that the effects of peace operations can often be contrary to the overarching goals of self-governance and sustainable economic development, Woodward argues that “this problem is rarely discussed” (10) and Chesterman argues that it is “one of the least studied aspects of humanitarian and development assistance” (200). That there is clearly a great paucity of quantitative data regarding economic

impacts of peace missions is evident from the explicitly anecdotal nature of the examples presented above. Furthermore, few if any articles apart from UNTAC's analysis spend more than a few paragraphs on the topic, undoubtedly as a result of minimal existing data to form the foundation of longer commentary.

Because of the persuasive evidence that some activities of peace operations can be counter-productive, a systematic examination of the economic impacts of peacekeeping missions is necessary. This analysis will guide the design of strategies and operational guidelines that are needed to minimize harmful effects and optimize benefits.

2.3 Related Categories of Literature and Research

2.3.1 Macroeconomic Analyses of the Effects of Aid Flows

The role of both humanitarian and development aid as a key resource in conflict economies, for better or worse, has been looked at in some detail through a political economy lens (Anderson 1999, Jean 1996, Prendergast 1996). However, more formal analysis of the macroeconomic impacts of aid flows in a recipient post-conflict society has received relatively little attention. Demekas et al. (2002) present a theoretical model of these impacts, drawing from numerous studies of foreign aid that focus on either its effects on growth or resource allocation (White 1992, Hansen and Tarp 2001).

In the traditional Harrod-Domar (Domar 1947, Harrod 1939) model of economic growth (and in variants of this model), foreign aid closes the domestic savings gap in order to increase investment or finance imports, leading to higher growth. However several recent empirical studies have not been able to reproduce this result robustly across different time periods and countries (Easterly 1999, Gang and Khan 1991, McGillivray 2000, Tsikata 1998). A sound policy environment is also a variable that has been considered in this strand of literature, but again, results have been inconclusive (Alesina & Rodrik 1994, Burnside and Dollar 2000, Hansen and Tarp 2000, 2001).

The "Dutch Disease" literature (Michaely 1981, Corden and Neary 1982, Paus 1995, Van Wijnbergen 1986) is often considered as a close analog to the situation when a country receives a large influx of foreign assistance. In these models the extraction of a major natural resource and the associated inflow of foreign exchange actually leads to an overall decline in the tradeable goods sector of the economy. In the case of foreign aid, the booming sector is the inflow of capital from aid. Using a similar framework, Younger (1992) has shown an increase in aid will lead to an appreciation of the real exchange rate, as well as a crowding out of the private sector. Van Wijnbergen has also shown the contraction to hinder export promotion objectives of some aid programs.

Demekas et al. have argued that the traditional strands of the aid literature do not provide an adequate framework for understanding aid in post-conflict economies. They show that while development aid going to low income countries fluctuates very little, post-conflict aid reaches very high levels in the emergency phase (humanitarian aid) and is then reduced quickly as the society enters the reconstruction phase. Reconstruction aid has different objectives and is directed towards rebuilding infrastructure, state-building, private sector development, establishing a tax system, etc. Collier and Hoeffler (2002)

have also found in an empirical analysis of 27 post-conflict economies that the absorptive capacity for aid doubles after the first three years. Demekas et al. point out that these distinct characteristics of post-conflict aid suggest that the impacts will not be the same as demonstrated by the models cited above.

In their attempt to create a model for post-conflict aid, Demekas et al. include reconstruction aid in the production function since it contributes directly to productivity through rehabilitation and restoring public services. Furthermore, humanitarian aid is differentiated from reconstruction aid and is included as a consumption transfer as it is intended for emergency consumption needs and not production. A rule is linked to humanitarian aid, taking into account that it is not permanent and stops at a defined minimum level of domestic consumption. Demekas et al. found that although humanitarian aid does reduce long term capital accumulation, such as in traditional aid-growth literature, it enhances welfare in the short run, particularly in a scenario of very low labour supply. Reconstruction aid is found generally to raise the equilibrium capital stock, and does not necessarily have to result in Dutch Disease since higher factor productivity in both sectors could offset the contraction of the tradable goods sector. The higher demand for domestic goods and services may be met without considerable reallocation of labour and capital, allowing both sectors to expand (Demekas et al. 2002, 8-21).

There may be some similarities between countries that receive large inflows of foreign capital in association with natural resource extraction and those that receive large aid flows, allowing the Dutch Disease literature to be used in analysis of aid flows. However, there is one significant difference that limits the applicability. Most of these models assume both market clearing and full employment. Yet countries which are large aid recipients, particularly those recovering from conflicts, are generally characterized by surplus productive capacity, including high unemployment and also underemployment. Nkusu (2002) found similar results to Demekas et al. in her study of Dutch Disease in low-income countries when the idle productive capacity can be drawn on to satisfy the increased demand induced by aid. A second challenge in applying either the Harrod-Domar or the Dutch Disease framework is that the results may be significantly muted when so much of foreign assistance is provided 'in-kind' or as technical assistance. This will lead to a much lower impact in the real economy of the recipient country than a direct injection of foreign exchange of the same dollar amount.

This area of literature does not directly deal with the fiscal and economic impacts of the peace operation itself. However, it does provide a framework within which the overall impact of the inflow of foreign exchange, and dramatic increases in consumption of domestic goods and services that accompany peacekeeping missions, can be studied.

2.3.2 Political Economy of War

The prevalence of civil and regional conflicts in the past half-century has prompted academics and practitioners involved in peace implementation to inquire into causes of war. Without diminishing the importance of political, socio-cultural and religious factors,

proponents of the political economy approach emphasize economic dimensions of conflict and their interplay with power and politics cannot be ignored.

Philippe LeBillon refers to the political economy approach as “one which focuses on how the distribution of wealth and power is affected during conflict” (LeBillon et al. 2000). In 2000, as part of the Overseas Development Institute’s project, *Political Economy of War: Translating Theory into Practice*, LeBillon assembled an annotated bibliography on this expanding area of inquiry. His survey of the literature in this area shows the general categories of discussion as: i) economic causes for conflict, ii) economic incentives and agendas for continuing conflict, iii) the consequences of conflict on the economy, and iv) the importance of economic dimensions to ceasing conflict. All of these dimensions interact with existing political and social realities to make up the aspects of a resulting conflict and post-conflict society.

A recent strand of literature looking at economic causes for civil conflict (Carbonnier & Flemming 2000, Collier and Hoeffler 2001, Berdal and Malone 2000, Jean & Rufin 1996, Lamb & Nathan 2000) refers to “greed and grievances”, arguing that while “grievances” are commonly perceived to be primary factors, “greed” could possibly have equal or more explanatory power. Grievances can include high levels of inequality or chronic unemployment, ethnic and religious clashes, or political repression. Greed, on the other hand, encompasses increased access to finance, including donations from a diaspora population, and the scope to gain from extraction of local resources. Greed and opportunity also relate to economic incentives for prolonging conflict. Those who are sustaining themselves through wartime economic activities will be resistant to demobilization efforts. Conditions of war allow foreign resources, including aid, to continue to be accessible, and instability and the absence of law and order mean continued gain from resource extraction for a small group.

Conflict leads to a dramatic disruption of economic activity. (Collier 1999, Funkhouser 1997, Stewart 1993, Stewart and Fitzgerald 2000). This occurs on both macro and microeconomic levels. Some economic consequences include loss of livelihoods and high levels of unemployment, great inequality in the distribution of resources, fall in food security and public-service entitlements, loss and damage of existing capital and infrastructure, and reduced investment. Thus, economic opportunities for those carrying out the conflict and most vulnerable to being recruited (especially youth) are very important for both ceasing conflict and discouraging the potential of future outbreaks (Atkinson 1997, Woodward 2002). Without economic opportunities for soldiers, incentives to demobilize are not present. Furthermore, reconstruction efforts should also try to meet the needs of those who are financing the conflict and benefiting from it as they have financial motive to continue violence (Berdal & Keen 1997).

From a macroeconomic perspective, international actors can use economic incentives and disincentives to encourage peace and discourage conflict. Uvin (1999) describes economic *incentives* as “purposeful uses of aid” that help the peace process by “influencing actors’ behaviours; strengthening pro-peace actors’ capacities; changing the relations between conflicting actors (ethnic groups, the state and civil society); and

influencing the social and economic environment in which conflict and peace dynamics take place” (7). Disincentives, on the other hand, “weaken and discourage the dynamics that favour violence” (7). In an analysis of four case studies, Uvin found that all aid creates incentives and disincentives and advises that the focus for aid agencies should be how to manage them to support non-violent conflict resolution.

The political economy approach emphasizes that war and post-conflict economies need to be studied further to make efforts by the international community more effective and reduce the probability that existing economic agendas for continuing conflict are compounded. Because of the implications for longer term development, conflict should be alleviated and mediated as quickly as possible. Economic improvement is significant for helping to cease or avoid eruption of further conflict. Those intervening in both the conflict and post-conflict environment must be cognizant of how their presence may be fuelling economic agendas or further destabilizing the economy.

2.3.3 Post-Conflict Development

Post-conflict development literature deals mostly with observations about and strategies for the reconstruction phase after violence and instability have been abated, emergency needs have been met, and long-term security and sustainable development become the focal point. Complex political and socio-economic factors are the focus, rather than military or humanitarian aspects. References to “peacebuilding”, “peace implementation” and “peace support” can fall into this category. The primary actors in post-conflict development are such international institutions peacekeeping missions and multilateral aid agencies, and also donor governments and their bilateral aid agencies, NGOs, and local governance structures.

Post-conflict development has grown to be of increasing interest as it has become evident that immediate relief efforts are only one part of the solution for long-term security and growth (Bradbury 1998, Duffield 1994, Mooney 1995, Munro 2001). The often dramatic falls in aid and involvement after the emergency phase have been shown to be counterproductive to a country’s long-term needs. Strategies for the post-emergency phase deter the reemergence of violence and nurture the environment for sustainable development. Mainstream post-conflict development thinking also emphasizes that development needs must be addressed both mid-conflict and in the early post-conflict stages in order to achieve medium to long-term goals, and not left until entering the reconstruction phase.

According to a white paper by the Center for Strategic and International Studies (CSIS) and the Association of the United States Army (AUSA) success in the reconstruction phase “is clearly premised on four conditions: 1) establishing security; 2) restoring good governance 3) ensuring the rule of law, and 4) creating economic opportunity” (Mendelson 2002). The OECD Development Assistance Committee *Guidelines on Conflict, Peace and Development Cooperation* also recognizes the strengthening of civil society actors as integral to success. An assessment of peacebuilding initiatives by the Swedish development agency Sida (Sørensen et al. 2000) reports there to be very little baseline data about peacebuilding activities and therefore insufficient grounds to derive

indisputable input-outcomes relationships, however some rudimentary “lessons-learned” are presented. Notable examples include the need for creating culturally specific solutions, the importance of local ownership of the process, appropriate timing and sequencing of activities, and the centrality of economic policy to recovery.

The dynamics of post-conflict economic activity can significantly affect long-term development and also the likelihood of repeated conflict (Lake 1990, Lewarne and Snelbecker 2004, Miller 1992, Smoljan 2003, Tschirgi 2004, World Bank 1999). For this reason, strategies for economic opportunity and economic governance are a priority in the early stages. Reintegration of ex-combatants to dissuade their involvement in further conflict is of utmost importance, consequently making employment opportunities for locals vital. Nurturing the local business community and putting an economic regulatory framework into place spurs the creation of economic opportunities, restores internal provision of goods and services, and instills public confidence. Stable, functioning, democratic institutions are crucial for long term development, and immediate state-building efforts are therefore also a significant priority (Chesterman 2003, Chesterman et al. 2004, Hyden 2000, IPA 2003, Macrae and Zwi 1994, Paris 2004, Wilde 2001).

Peacekeeping missions are being increasingly involved in post-conflict development efforts, often working side-by-side with humanitarian organizations, non-governmental organizations (NGOs), and aid agencies (Daniel & Hayes 1994, Swift 1996, Smoljan 2003, Stedman 2001, UN 1992/1995). Missions play an essential role in bringing about all the conditions for successful reconstruction, including demilitarization, establishing law and judicial systems, rebuilding infrastructure, monitoring human rights and electoral processes, and economic rehabilitation.

The responsibilities are also evolving as traditional peacekeeping is not always sufficient for post-conflict needs. This is leading to an increased focus on programs that support local private sector development. However, there remains almost no attention on the key role that the *way* in which the peacekeeping activities take place will likely have a far greater impact on private sector development than any specific private sector support program. In this regard, identifying the ways in which peacekeeping missions can support post-conflict development will help to produce best practices.

2.3.4 Role of the Private Sector in Conflict and Post-Conflict Zones

Research is being undertaken by NGOs, government, and intergovernmental organizations on private sector operations in conflict zones in an attempt to minimize their negative impacts and encourage positive contributions. Regularly coming under scrutiny for reaping economic benefits in unstable conditions and at times deepening the conflict itself, the private sector, including multinational enterprises (MNEs) and indigenous companies, is now under mounting pressure to take into account the social and economic impacts of their operations. Although companies are often painted in a negative light, the development of a robust private sector is increasingly recognized as central to the transition of conflict societies.

The role of the private sector in conflict and post-conflict zones is typically examined in two spheres. The first is their role in the continuation or sometimes instigation of conflict (Drohan 2003, Humphreys 2003, Nelson 2000, Sullivan 2003, Taylor 2002) when appropriate legal and regulatory structures are not working. Some examples of how the private sector can sustain or even provoke conflict include: relations with repressive or corrupt regimes, unintentionally funding a war economy through investments, unequal distribution of economic growth resulting from investments, unfair distribution of costs and benefits from the extraction of natural resources, fueling corruption through bribery, and allowing human rights violations in, and undermining the security of, surrounding communities by using rogue security forces. In many cases companies face unintended consequences as a result of their daily operations, however sometimes the effects are direct and actively pursued as a benefit to the company.

While risk assessment tools to analyze the impacts of conflict on a company's long-term investment and daily operations are readily available, the reverse risk – their ability to aggravate a conflict – has rarely been taken into account (Campbell 2002).

The second sphere in which the private sector is involved is conflict prevention/resolution and contribution to a country's economic rehabilitation in the reconstruction phase (Amnesty International & Pax Christie International 2000, Campbell 2002, DFID 2000, Gantz 2003, International Alert 2004, Nelson 2000, OECD 2001a, Sullivan 2003). In the past, conflict prevention and resolution were seen by companies to be a state responsibility. However, not only does this disregard the often enhanced leveraging power of companies with local authorities, but growing recognition of the costs of conflict to business has made prevention and resolution a “bottom-line imperative” for companies that cannot or do not want to relocate.

The private sector also has an interest in post-conflict development and can make a significant contribution in areas where it has a comparative advantage, such as in building infrastructure or enhancing the investment climate (de Luca 2003, DFID 2000, Harris 2003, Newton and Culverwell 2003, World Bank 2001). As the OECD-DAC Guidelines, *Helping Prevent Violent Conflict* point out, “Fostering private sector-led growth in jobs and income within a rights and rules-based approach is a basic long-term component of conflict prevention” (2001b, para. 23). At a conference held by the UK's Department for International Development in 2000, the following strengths and capacities that private sector could contribute were outlined: human and financial resources, experience of managing complexity and change, potential to organize itself collectively, potential to build relationships across sectors, and influence over political actors. Furthermore, it is argued that “over the long term, only the private sector is capable of growing new enterprises, opening investment opportunities, and providing employment and enduring security” (Gerson 2001).

There is scope for other actors involved in peacebuilding and reconstruction to benefit from the lessons of private sector activity. In the interest of minimizing costs, local procurement of supplies and local hiring are common practices for foreign companies and contribute to economic growth by supporting local businesses and increasing economic

opportunities (Gerson 2001, World Bank 2001). Human capital is also enhanced by helping to build the skills of those employed (de Luca 2003). Learning how to support the local economy from the private sector presents an interesting opportunity for dialogue between companies, government, and non-governmental sectors, opening a space to encourage the private sector to espouse socially responsible principles in their operations.

International mechanisms to raise the norms of corporate behavior include the UN Global Compact and corporate social responsibility indices such as the Dow Jones Sustainability Index and FTSE4Good (BSR 2003, Humphreys 2003). The former is a compact between companies and the UN to embrace a set of globally established principles in the areas of labour standards, human rights and environment in an attempt to solicit voluntary cooperation in the absence of a regulatory mechanism. The latter allows internal and external stakeholders to measure and monitor a company's impacts to ensure accountability and transparency. The OECD Guidelines for MNEs are also widely used by both governments and companies as they are "the only government-backed mechanism that also has provisions for implementation" (International Alert 2004).

2.3.5 Analysis and Reform of Peacekeeping Operations

The most comprehensive, instructive and influential of recent inquiries into the state of peacekeeping operations is what is known as the "Brahimi Report". On 7 March 2000, Secretary-General Kofi Annan convened the Panel on United Nations Peacekeeping Operations to review the organization's peace and security activities and make concrete recommendations to help the UN improve their performance in this realm. The panel was necessary to address the difficulties faced by UN troops throughout the 1990s, notably those in Somalia, Rwanda, the former Yugoslavia, and Sierra Leone among others. By August of the same year, the Panel had released their final report, which came to be known as the Brahimi Report after the chair, former Algerian Foreign Minister Lakhdar Brahimi (United Nations 2000).

The Brahimi Report was immediately recognized to be "not just the product of yet another cosmetic exercise for which United Nations bureaucracy is so often accused" – its language and recommendations were remarkably frank, concrete, and realistic (O'Shea 2002). The opening paragraph of the Executive Summary tells the audience that "Over the last decade, the United Nations has repeatedly failed to meet the challenge" that it was founded upon: "to save succeeding generations from the scourge of war" (UN 2000). Most analyses of peacekeeping acknowledge that post-Cold War operations have become increasingly complex, including explicitly political tasks of implementing peace agreements, higher levels of involvement with civil and humanitarian factions, a more significant role in post-conflict reconstruction and development, and less clearly defined roles of victim and aggressor among warring parties, which are often ethnic and religious groupings (Durch 2001, O'Shea 2002, UN 2000). The Brahimi Report, and its implementation process, opened a space for peacekeeping operations to develop and grow to meet modern realities.

Most notable of the report's practical recommendations are: the creation of a new UN intelligence gathering entity for improved planning; more frequent fact-finding missions

to areas of tension; strengthening the permanent capacity of the UN to develop and implement peacebuilding; measures for rapid and effective troop deployment including establishing multinational brigade-size forces; and establishing Headquarter support of peacekeeping as a core activity of the UN, thus channeling its resource requirements through the UN's regular budget and significantly increasing staff and management support at the Department of Peacekeeping Operations and Headquarters.

The panel also advised that several methodological changes be made in peacekeeping operations. The report encourages measures to make peacekeeping and the rules of engagement more robust to address situations where one party is clearly violating a peace agreement. The report states, "No failure did more to damage the standing and credibility of United Nations peacekeeping in the 1990s than its reluctance to distinguish victim from aggressor." Furthermore, the report stresses that every UN operation must have a clear and achievable mandate, avoiding volatile environments and acknowledging its own limitations. Troop availability and capability must be assessed by the Secretary General before the Security Council passes a resolution to deploy a peacekeeping operation, and troops should not be deployed if they are not able to meet requirements or if an adequate number is not committed. Worst-case scenarios should be used for planning.

The Brahimi Report spurred a necessary dialogue about peacekeeping operations in a post-Cold War, globalized world (O'Shea 2002, Tardy 2004, Zittel 2002). Critical reviewers asserted that it did not pay enough attention to the needs of the local people and focused too much on structural issues of the UN. Others argue that the report's counsel that peacekeepers feel able to use force against aggressors neither recognizes the difficulty of actually discerning victim from aggressor on the ground, nor takes into account that a more robust force can only result from a clear mandate to use aggressive action under Chapter VII of the UN Charter.

Regardless, the report was by and large a realistic and welcome motivation for the reform of peacekeeping operations, as was acknowledged by critics and proponents alike. Some progress has been noted in the area of rapid deployment, adequate assessment of troops and resources before deployment, and strengthening of the Department of Peacekeeping Operations. Also, as one observer notes, "one of the most valuable benefits of the Brahimi report is not tangible: it began to restore self-confidence in peacekeeping" (Zittel 2002).

Economic aspects of peacekeeping and peacebuilding are being increasingly appreciated, in particular through the Brahimi Report's emphasis on increased integration of entities working in military, humanitarian, political, reconstruction and other aspects of a mission. The report acknowledges, "Economic issues of poverty, distribution, discrimination or corruption can make peace implementation more difficult," and peacebuilders' main task is to "support the political, social and economic changes that create a secure environment that is self-sustaining". Indeed, the extent to which a peacekeeping mission is able to lay the foundation for economic growth and opportunity has become one of the yardsticks by which its success is measured (Hentges & Coicaud 2002, Smoljan 2003).

2.4 Conclusion

The body of available literature that is related to economic dimensions of peacekeeping operations is wide-ranging and diverse. The above review provides a cross-section of the most relevant areas of inquiry, from which interesting elements of discussion may be gleaned and valuable questions highlighted. For example, Dutch Disease literature provides analogous discussion regarding the inflow of foreign exchange in developing countries, and functions as a framework within which to study the impacts of large amounts of aid that accompany a peacekeeping mission. Furthermore, a political economy lens and post-conflict development discourse provide insights into the role and influence of significant actors, including the private sector, in setting the stage for long-term development and spurring economic activity.

Nevertheless, in the face of a growing understanding of the complex nature of peace operations and their involvement in economic, social, and political processes, there is still very little analysis of the extent to which the nature of mission activities can affect long-term development goals. The observed impacts of the sudden and dramatic entrance of an international presence remain anecdotal, and what little analysis does exist is speculative in nature.

Those who have included short descriptions of these phenomena readily admit that it is an important area of peace implementation that is rarely discussed but a priority for securing development prospects. Against this background the Economic Impact of Peacekeeping Project is designed as a first step towards filling this gap.

Chapter 3. Case Study: Timor-Leste

3.1 Introduction

The Security Council established the United Nations Transitional Administration in East Timor, by its resolution 1272 of 25 October 1999.¹ The mandate for UNTAET included *inter alia* the provision of security and law and order in Timor-Leste, establishment of an effective administration; assist in the development of civil and social services; and assist in the establishment of the conditions for sustainable development. This last element mandated UNTAET to work towards the local economic development, because it is only with a functioning private sector that sustainable development is possible.

The focus of the broader 'Economic Impact of Peacekeeping' project is to examine the impact of an international peacekeeping mission on the host economy. In the case of Timor-Leste, the analysis also provides the opportunity to assess the extent to which this aspect of the Security Council mandate was carried out.

The analysis presented in this chapter first looks at the nature of economic growth from a conceptual perspective to provide a framework within which the subsequent empirical work can be anchored. The third section of the chapter presents the fiscal impact of the mission – dividing the Assessed Contribution budget into the portion that was spent locally and that which was spent externally. The portion spent locally is then divided further into that portion that remained in the local economy and that which immediately leaked offshore.

The fourth section of the paper looks at a range of economic impacts including the impact on inflation, the labour market, the tourism and hospitality sector, the distributional impact across the economy and the negative economic impact of the way in which the United Nations conducts its business. Some of the practical obstacles faced by UNTAET/UNMISSET staff in trying to deliver a greater local economic impact are discussed in the fifth section. The final section summarises the conclusion and outlines a set of general and specific issues for consideration in the context of the planned future fieldwork.

3.2 Background - How economic growth occurs

Before examining the fiscal and economic impact of UNTAET/UNMISSET on the Timor-Leste economy it is important to understand, from a conceptual perspective, how economic growth occurs. This section provides a short discussion of how economic growth occurs as a result of a peacekeeping mission and then addresses two related

¹ The initial mandate established UNTAET for an initial period until 31 January 2001. Security Council Resolution 1338 (2001) of 31 January 2001 extended the mandate to 31 January 2002. Resolution 1392 (2002) of 31 January 2002 extended the mandate of UNTAET until 20 May 2002. Resolution 1410 (2002) of 17 May 2002 established the United Nations Mission of Support in East Timor (UNMISSET) as the successor mission to UNTAET for an initial period until 20 May 2003. This mandate was extended for a further 12 months by resolution 1480 (2003) of 19 May 2003. Resolution 1543 (2004) of 14 May 2004 extended UNMISSET for a further six month period. The mandate was extended for a further six months by Resolution 1573 (2004) of 16 November 2004.

issues: whether the growth will be sustainable; whether the growth can occur without simply causing inflation.

In the simplest terms the output of an economy is determined by the amount of resources (traditionally land, labour and capital) that are utilised, and the way in which they are combined. When economic growth occurs the amount of output that is produced increases from one period to the next. This will only happen if one of two things occurs: either more resources are utilised; or the resources that are utilized operate at a higher level of productivity.

There are four distinct ways in which a major intervention like a peacekeeping operation can lead to the increase in output in a country such as Timor-Leste.

- ***Direct utilization of previously unused or underused resources.*** If a peacekeeping mission hires a previously unemployed Timorese as a national staff member, or rents a previously unused piece of land, the level of output in Timor-Leste increases. Other ways in which the direct utilization of resources in response to the peacekeeping mission may occur are if an international staff member hires a cleaner or a driver, or if a restaurant opens because of the international presence and local staff are hired.
- ***Providing peace and security which encourages higher levels of investment.*** Economic growth occurs when people invest, either in capital such as equipment, or in skills or in improving the quality of land. Investment only happens when the investor believes they will get a return. The absence of peace and security is the biggest single factor that inhibits economic growth, so providing a secure and stable environment makes a major contribution to growth.
- ***Increasing local wealth provides funds for investment.*** When the UN employs national staff directly or supports local industry, wealth is generated in local hands. This wealth then becomes a source of funds for future investment – which increases the level of future productive resources (like capital).
- ***Increasing the skills of Timorese through providing employment opportunities.*** When people are actually employed their productivity increases. This is partly because they gain skills directly from their employment,² and partly because they pick up positive workplace behaviours which increase their productivity simply by being in employment.³

There are also a range of other ways that a peacekeeping mission will impact on the level of output in the economy, including the approach it takes to development, and any economic policies it influences – either directly or indirectly. These are discussed in more detail in section four.⁴

² These could be specific skills such as how to operate machinery, or general skills such as improved numeracy or basic computer skills.

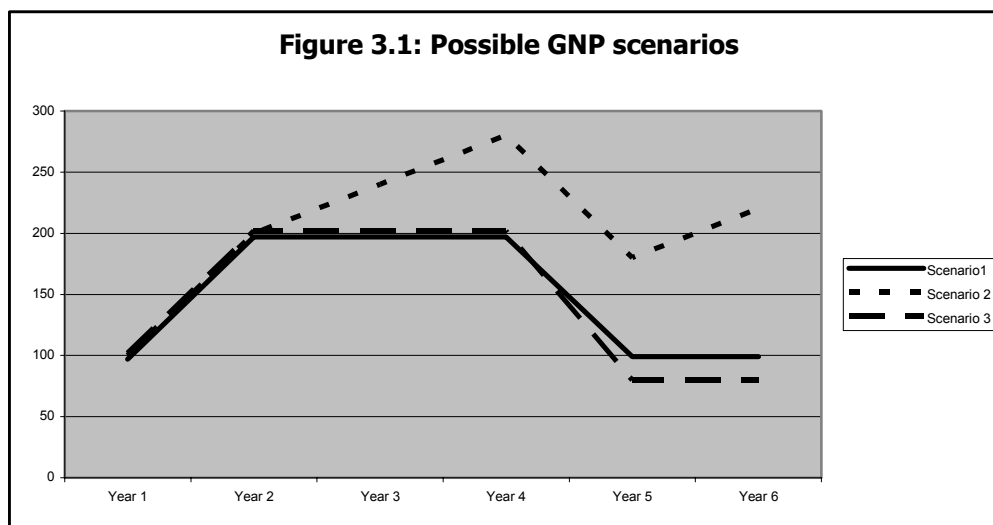
³ These behaviours can be as simple as regularly turning up to work.

⁴ A particular issue around wealth transfer involves the transfer of assets from the mission to the host government, either in terms of renovated buildings or actual equipment left behind. This issue is also addressed in section four – such transfers may be a mixed blessing.

Equally important as understanding how a peacekeeping mission can lead to growth is understanding whether the increase in output will be sustained after the mission departs. Of the four ways listed above, the first way – direct employment – is likely to have the largest impact, but it will not provide a sustainable impact. Once the mission leaves this impact will disappear. Economic growth will only be sustained if the other factors have increased the capacity of the economy to produce goods and services that they can sell.

Three stylized scenarios are presented in Figure 3.1 and discussed below. In each scenario a peacekeeping mission is in the country for three years and in each year buys an extra \$100 of output.

- Scenario 1 assumes that the only effect is a direct one – that is for the two years of the overall output is increased by the \$100. When the mission leaves the output reverts back to its original level.
- Scenario 2 assumes that there are spin-off benefits, through the other factors discussed above. That is there is greater investment, because of both a more stable environment and because people who have been hired have accumulated some wealth. Moreover, the workers who were employed by the UN gains skills through their employment so when they leave the UN they are more productive. This means that in the first year of the mission the impact on output is just the \$100. But in the subsequent years the increased investment and greater productivity contributes to a higher and increasing output. So when the mission leaves there is a reduction in the level of output associated with the departure, but this is offset by the increased domestic production capacity.
- Scenario 3 is the worst case scenario. The mission increases output while it is there, but output drops back to an even lower level when it leaves. This could occur if the negative impacts of the international presence that have been touched on by some authors, such as inflation and labour misallocation reduce the overall productivity.



A common criticism of the impact of peacekeeping missions is that they increase inflation in the host country. If there is little excess productive capacity or underutilized resources then the increased demand from the international community will not increase output. Rather the international community simply increases the demand for a fixed supply of resources. The result is twofold – firstly the price for the resources goes up, making them unaffordable for the local population; and secondly the resources end up with the international community as only they can afford the higher prices.

Analysing the inflationary impact of an international intervention has a number of distinct dimensions. First, as discussed in more detail in section 3.4 below, the inflation that occurred in Timor-Leste was caused by a number of distinct factors, and disentangling the impact of each of these factors is not straightforward. Second, one way that inflation is moderated in the presence of domestic supply shortages is through the import of goods and services. So any criticisms of the role played, or the profits made by ‘fly-by-night’ companies needs to be seen in the light that these companies moderated any inflationary impact. Finally if the primary goal of the mission was to spend in such a way that long term economic output was maximized with little inflationary impact, then the time profile of the spending would be different – in particular the economic interventions would be longer and slower.

A final point related to the inflationary impact is the dynamic nature of economic growth and the adjustments caused by the market system. In a market system it is through the movement of relative prices resources are directed to their most efficient uses. When there is a new or different demand for goods there may be a time lag before the local economy has the capacity to produce those goods. A temporary price increase may be what is needed to encourage producers to redirect increased resources to that area of production, and thus meet the demand.

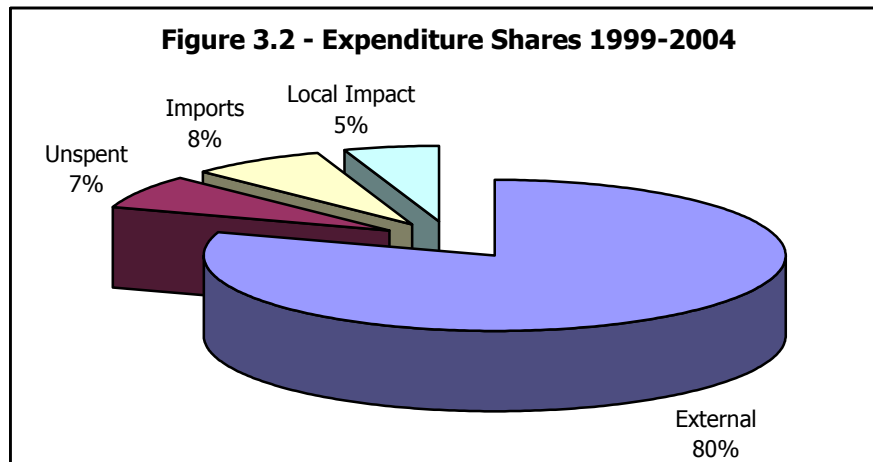
One of the ways that economies grow is that an increase in demand provides the stimulus to develop a new industry, so a high price level associated with a temporary shortage may be what is needed to generate the local industry. In this regard, and linking back to the sustainability discussion above, the peacekeeping mission has the potential to provide a stimulus to a domestic industry which can then stand on its own feet. The initial high level of demand from the peacekeeping mission provides enough certainty and cash flow to cover the upfront set-up costs, and the time needed for the industry to increase its productivity. So when the demand from the mission is removed the industry is able to be competitive and stand on its own, either exporting its products or selling them domestically.⁵

3.3 Assessing the fiscal impact of UNTAET/UNMISSET

Over the four and a half years from December 1999 to June 2004, just over \$1.75b was allocated by the General Assembly and spent to fund the mandate of UNTAET and then UNMISSET. Of this amount, \$94m, or around five percent, stayed in the local economy. An additional \$133m was spent in Timor-Leste but on imported goods and services, including foreign labour and profits earned by foreign firms. Over three quarters of the

⁵ This is similar to the ‘infant industry’ argument made by industry lobbies in many developed countries.

spending was on costs, primarily civilian and military personnel related, where the money never landed in Timor-Leste.



The breakdown of expenditure on a year by year basis is presented in Table 3.1 and Figure 3.3. The shares across categories were reasonably constant over the four and a half years. A detailed discussion of the estimation process is presented in the appendix. The remainder of this section discusses the breakdown of expenditure within each of the categories.

Table 3.1 – Overall level of UNTAET/UNMISSET spending (\$US 000)

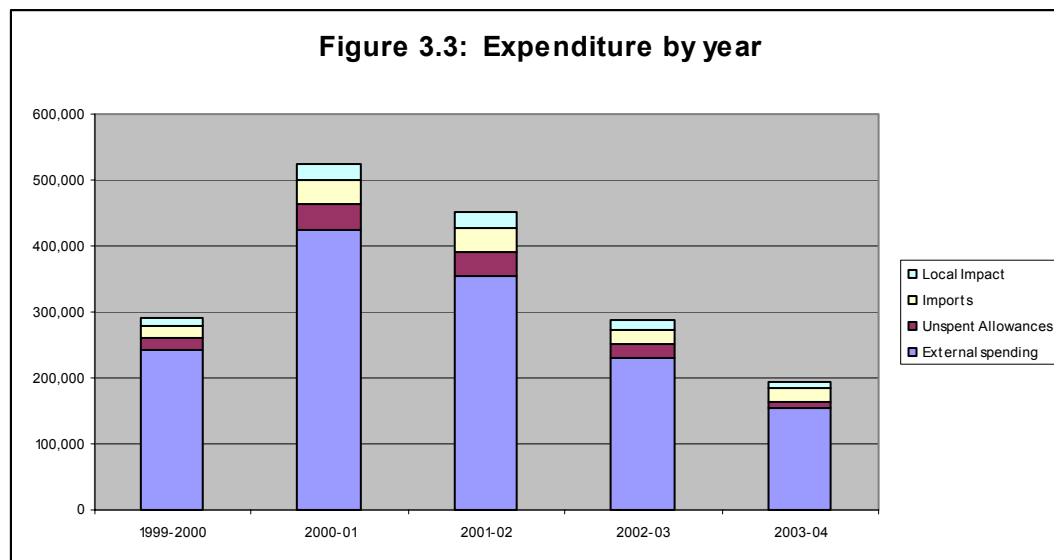
	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Local Impact						
Allowances spent	7,884	17,765	18,763	11,193	7,163	62,769
National staff salaries	4,013	6,355	5,834	3,601	3,440	23,243
Local procurement (retained)	316	1,055	1,019	814	1,562	4,767
Local impact from external contractors	470	1,126	702	500	329	3,128
Subtotal	12,683	26,301	26,318	16,108	12,494	93,907
External Impact						
External spending (less local impact)	242,916	424,547	354,386	229,420	153,104	1,404,372
Allowances not spent	18,097	37,871	36,929	21,484	11,771	126,152
Spending on imports	18,315	38,866	36,425	20,928	18,639	133,174
Subtotal	279,328	501,284	427,740	271,832	183,514	1,663,698
Total	292,011	527,587	454,058	287,941	196,008	1,757,605

3.3.1 Local expenditure

The amount of money spent from the mission that stayed within the Timor-Leste economy over the period was \$93.9m. This amount peaked during the second and third years of the mission and has been steadily declining over the fourth and fifth years.

National staff wages

Employment of national staff by UNTAET/UNMISSET represents the most direct fiscal impact of the mission. Expenditure on national staff salaries accounted for \$23.2m over the period. This represented 1.3% of the overall mission expenditure and around



a quarter of the overall local impact. The average monthly level of national staff peaked in 2000-01 as the mission initially ramped up and has been gradually declining since that time.

Table 3.2 – UNTAET/UNMISSET national staff and wages

	12/99-6/00	7/00-6/01	7/01-6/02	7/02-6/03	7/03-6/04	Total
National staff (monthly average staff level)	1,139	1,804	1,656	924	794	
Wages & salaries (annual expenditure, \$000)	4,013	6,355	5,834	3,601	3,440	23,243

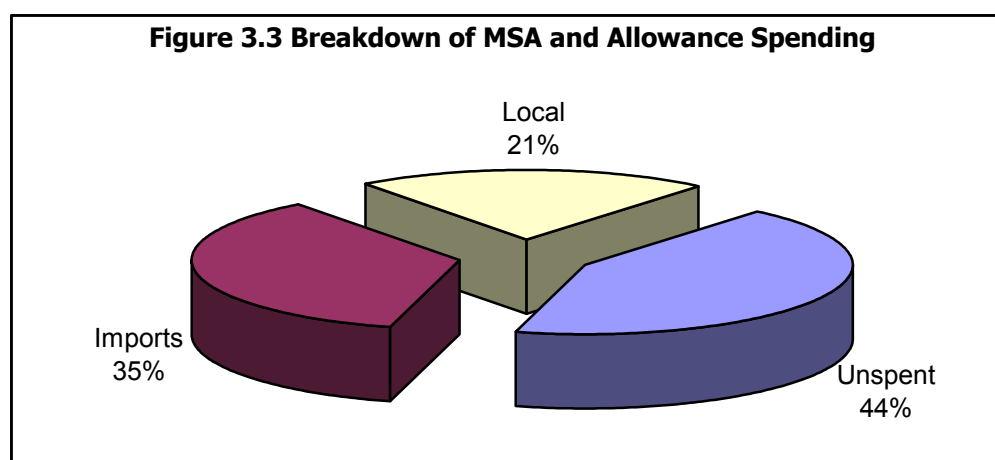
Spending of allowances by international staff

The second way in which resources are injected into the local economy is through the impact of spending by international staff. International staff are paid allowances that they can either save or spend. They are intended to cover basic subsistence, including accommodation, food and other expenses. Over the period 1999-2004, a total of \$293m or seventeen percent of total mission expenditure was on allowances for international civilian staff, civilian police and UN volunteers. Of this amount an estimated \$126m was saved by staff and not spent in Timor. A further \$104m is estimated to have been spent in Timor, but spent on either imported goods and services, paying the wages of foreign staff specifically brought in to provide these services for international staff or repatriated in profits by foreign businesses that set up to meet the demand for accommodation and meals from the international community.

The remaining \$63m was injected into the local economy – mainly through wages paid to Timorese hired by these foreign firms, to local land owners who leased the land to the businesses, and in some cases to local Timorese businesses – either separately or as joint venture partners with the foreign firms. More detailed estimates are in Table 3.3 below, and a more detailed discussion of the estimation process is presented in Appendix A.

Table 3.3 – Breakdown of MSA and allowances spending (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Not spent in Timor-Leste	18,097	37,871	36,929	21,484	11,771	126,152
Imported goods and services	16,374	32,383	30,162	15,926	9,043	103,889
Local goods and services	7,884	17,765	18,763	11,193	7,163	62,769
Total	42,355	88,020	85,854	48,603	27,978	292,810



Local procurement

The third area of local spending is on goods and services that were procured locally by the mission. In the case of UNTAET/UNMISET this included procuring services such as small construction and repair works or goods such as diesel. Again, a considerable portion of the procurement expenditure was used to cover the costs of importing the goods or paying foreign labour. The remainder, which represents payments for the locally provided goods or services, including labour, provided an injection of funds into the local economy.

Table 3.4 – Local procurement (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Imported goods and services	1,941	6,483	6,263	5,003	9,596	29,285
Local goods and services	316	1,055	1,019	814	1,562	4,767
Total	2,257	7,538	7,282	5,817	11,158	34,052

The final area of local spending is that undertaken by external contractors or military contingents who were received contracts from UNTAET/UNMISET, and who purchased local goods and services, including employing local Timorese in order to fulfill their contracts. This is estimated to be around \$3.1m in total over the period.

3.3.2 External spending

Of the total budget of \$1.75b, \$1.4b was spent externally. The major categories of expenditure were military contingents, civilian personnel (excluding allowances) and air transportation. Together these three categories of expenditure accounted for over sixty

percent of the total expenditure. A breakdown is presented in Table 3.5 below. A more detailed breakdown is presented in Appendix A.

Table 3.5 – Breakdown of UNTAET/UNMISSET external spending (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Military contingents	94,080	225,297	140,424	100,041	65,709	625,550
Military Observer and Civpol (non-MSA)	3,256	11,872	7,349	2,499	3,651	28,627
International civilian (non-MSA)	21,997	84,408	73,647	41,173	32,441	253,667
Air transportation	18,311	56,219	50,701	32,754	21,619	179,603
Accommodation, facilities and infrastructure	24,787	11,497	26,944	20,348	15,350	98,926
Communications	22,144	8,874	9,145	7,352	4,735	52,250
Other goods and services	58,342	26,381	46,176	25,253	9,599	165,751
Total	242,916	424,547	354,386	229,420	153,104	1,404,372

Note: for simplicity, the local content of the external procurement has been subtracted from the other goods and services column, it has not been apportioned across the three categories (accommodation, communications and other).

3.3.3 – The indirect effect of UNTAET/UNMISSET expenditure

Up to June 2004 \$93.9m was spent on locally produced goods and services by the international community. However the impact on GNP would have been greater than this. Each dollar spent locally by the UN or its staff provides income to a Timorese. This income would have then either been spent or saved by the Timorese person who received it. Each dollar of this income that was spent would have either been spent on locally produced goods and services or imported goods and services. The portion of this income that is spent on locally produced goods and services then becomes income for another Timorese. This second Timorese person then saves a portion of this income and spends a portion on imported goods and services and a portion on local goods and services – creating a multiplier effect.⁶

The size of this multiplier effect is determined by the allocation between savings, imported spending and local spending. There is not good data on either of these elements. Based on discussions with government officials around the structure of the economy and staff from the International Financial Institutions, for the purposes of this study it is assumed that the multiplier effect is in the range of 1.5.⁷

3.4 Assessing the economic impact of UNTAET/UNMISSET

The previous section focused primarily on the direct fiscal impact of UNTAET/UNMISSET – that is on the impact that the mission had on the aggregate demand for goods and services in the Timor-Leste economy. In contrast this section considers the impact on the economy more broadly. The section looks at a number of distinct aspects of the economic impact in Timor-Leste: (1) the size of the demand impact in the context of the overall economy of Timor-Leste; (2) the impact of increased peace and security; (3) the impact on inflation, which provides insights to the nature of the aggregate supply response; (4) the labour market; (5) the tourism and hospitality industry;

⁶ For readers unfamiliar with macroeconomics, this is known as the Keynesian multiplier.

⁷ A discussion of this estimate is presented in the appendix.

(6) the construction industry, including residential housing; (7) infrastructure; (8) the distributional impact of the international presence; and (9) the impact on overall economic development of the way the UNTAET/UNMISSET did business.

3.4.1 The fiscal impact in the overall economic context

In assessing the overall impact of UNTAET/UNMISSET on the Timorese economy it is important to adopt the appropriate frame of reference. The direct fiscal impact of the mission is a small percentage of the overall mission expenditure. However, the direct and indirect fiscal effect (including the multiplier effect of the spending through the economy) does represent just under 10% of GNP during the peak years of the mission.

Table 3.6 – Local spending as a share of GNP

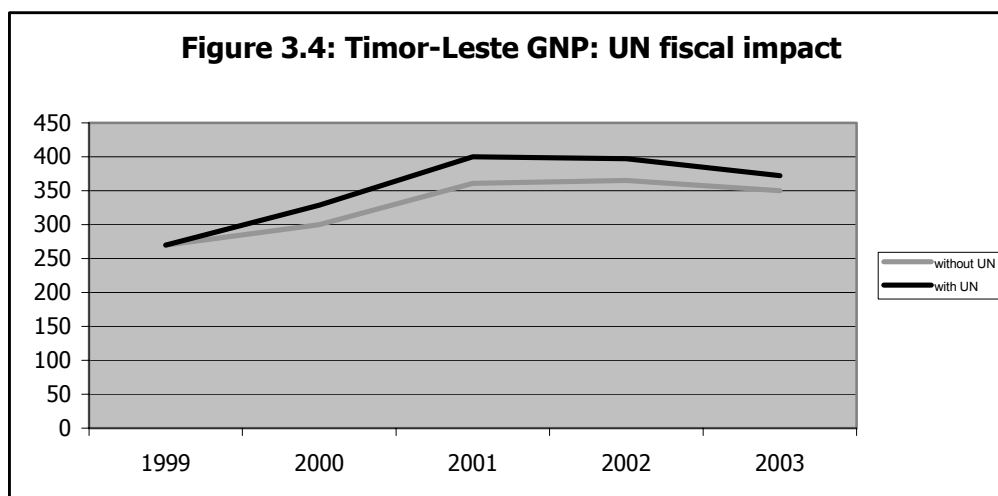
	2000	2001	2002	2003
GNP	329	400	397	372
Local expenditure (direct and indirect)	29.2	39.5	31.8	21.5
Percentage	8.9%	9.9%	8.0%	5.8%

Note: GNP figures are based on IMF staff estimates. The IMF estimates contained in the 2004 Article IV consultation are on a calendar year basis, so the local expenditure figures have been averaged across years to allow presentation on a calendar year. A multiplier of 1.5 has been used to estimate the indirect impact.

3.4.2 The economic impact of increased peace and security

The presence of peace and security, a basic system of property rights and some sort of rule of law are fundamental to economic development and growth. In much of the discussion about economic policy these are taken for granted. Yet in the sort of environment that peacekeeping missions operate this is not the case. The impact of peace and security to economic development is so central that it is not easy to quantify. Put simply, without these features people will not invest and economic activity reverts to a short term subsistence and survival approach.

One illustration of this impact is to consider the GNP of Timor-Leste when the impact of the local spending is excluded. Figure 3.4 presents GNP, with the estimated direct and indirect fiscal impact removed.



While this represents a considerable simplification, it does support the argument that the presence of increased peace and security has led to a once-off increase in the productive capacity associated with the return to a peaceful environment. The challenge for Timor-Leste is to now build on this.

In terms of building peace and security there are important interlinkages between the different ways in which a peacekeeping mission operates. As former SRSG to Afghanistan, Lakhdar Brahimi pointed out in the design of UNAMA's "light footprint", increasing the level of local participation can have a significant impact on the overall effectiveness of the mission. Including more national staff at various levels of the mission creates a broader sense of local "buy-in" and can increase the host nation's sense of ownership in the broader political goals of the mission. Similarly, increasing the local economic benefit of the mission creates goodwill and increases the stake that the host business community has in a continued international presence. This doctrine is often used by military contingents to improve the level of security in their area of operations. As an example, again in Afghanistan, the Canadian contingent in the international security force (ISAF) consciously sourced labour from the surrounding neighborhoods of their base in a what was considered to be a successfully campaign to win "hearts and minds".

3.4.3 – Inflation

The extent to which the international presence in Timor-Leste was associated with increasing inflation is both an emotive issue and a technically important one. Critics of peacekeeping missions argue that the missions do little good for the local economy, but cause significant inflation which has a negative impact on the local economy. Conversely, if inflation is relatively low it may indicate that there continues to be excess supply capacity in the local economy – suggesting that there is scope for more local spending by the mission.

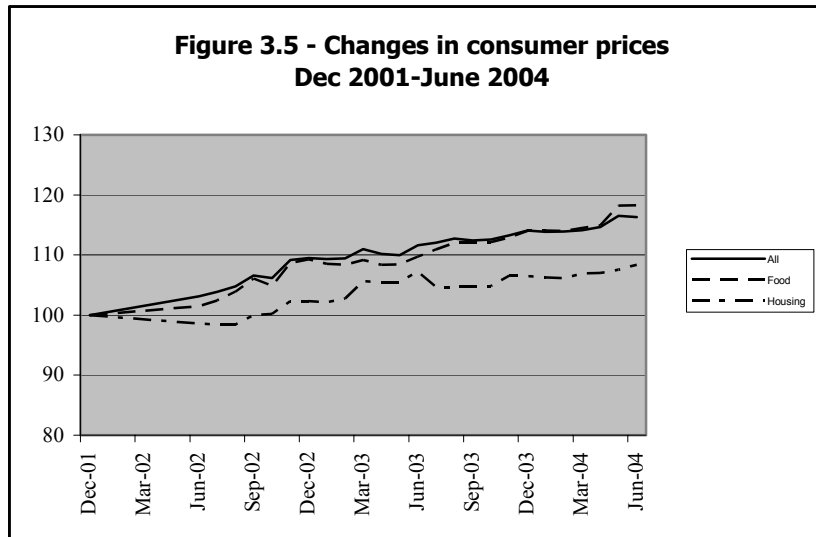
Examination of the available inflation data suggests that the inflationary impact associated with UNTAET/UNMISSET appears to have been quite limited. The major inflation took place in Timor-Leste in 1999, associated with the supply shocks that occurred during and following the referendum. For the five years from 2000 to 2004, inflation was below 5% in four of the years and only 10% for the other year.

Inflation estimates for the period 1999-2004 are presented in Table 3.7. More detailed estimates of the consumer price level, including a disaggregation between all goods, food and housing for the period December 2001 to June 2004 is presented in Figure 3.5.

Table 3.7 – Inflation in Timor-Leste 1998-2004

	1999	2000	2001	2002	2003	2004
Inflation (percentage change at end of period)	140	3	0	10	4	4

Source IMF Article IV consultation June 2004, based on data from Timor-Leste authorities and IMF staff estimates



Source: National Directorate of Statistics, Ministry of Planning and Finance, Government of Timor Leste, data available at <http://dne.mopf.gov.tp/>.

The major inflation in Timor-Leste occurred in advance of, and during the first couple of months of the UNTAET mission. The post-referendum violence caused both a reduction in domestic output and the disruption to transportation and distribution networks curtailed supply. These factors, combined with the removal of subsidies that had previously been provided by the Indonesian Government on a set of staple products including rice, sugar, cooking oil, milk, eggs, sweet soy sauce, flour, salt, and noodles, led to the major price increases. However, for the local community and opponents of the mission, the international community presented an easy target for inflation related complaints.

During the period of the mission, the overall level of inflation has been low. There may have been some inflationary pressures caused by the mission that were offset by price falls associated with the improvement in supply and distribution networks as the reconstruction and rehabilitation of the infrastructure network took place. More likely, though, is that the relatively small level of domestic spending that was undertaken by the international community coupled with some excess supply meant that the international presence did not put major upward pressure on prices. During the course of the mission there was an increasing proportion of international personnel living in the community, in local accommodation and shopping at local markets. Yet from December 2001 until June 2004, the prices for food and housing did not rise significantly, suggesting that this additional expenditure was accommodated by increasing supply.

A second factor reducing any price pressure is the extent to which demand for goods and service from the international community were met through imports – either directly through imported goods, or goods produced by foreign labour and capital. A common complaint surrounding peacekeeping missions relates to the presence of an associated industry that supplies amenities such as accommodation or food services, or general construction services. Critics need to be aware that in the absence of this industry the inflationary risks of an international presence are heightened. That said, if inflation is low, it can be argued that a greater level of spending should have been directed at the local market.

One major area where UNTAET/UNMISSET led to inflationary pressures was in the local labour market. This issue is discussed in more detail below.

3.4.4 – Labour Market

The hiring of local staff peacekeeping missions is a second area where there is considerable controversy and strongly held views. On the one hand, local employment provides the most direct way to undertake a Keynesian style fiscal stimulus to kick-start an economy after the negative economic shock of a conflict. It also provides the most direct benefit – cash – to those people who receive the jobs. Finally, employment provides the opportunity to increase the skill level of those employed. Conversely the peacekeeping industry is filled with anecdotes of trained doctors or engineers taking high paying jobs as drivers or general assistants with the United Nations or other international organizations, and of local wages being bid up by the United Nations.

In Timor-Leste UNTAET was the largest single employer in the country until the formation of the East Timor Transitional Authority. At its height UNTAET employed just under 2000 local staff. Of these staff, around 55% were recruited under the Locally Recruited General Service for Limited Duration (LGLD) arrangements, the remainder were recruited under short-term consultancy (SSA) arrangements.⁸ While comprehensive labour market data is scarce, this could have represented as much as 10-20% or more of the wage employment in the formal labour market.⁹

An area requiring further research is estimating the overall employment impact of the international presence. In addition to the employment by UNTAET/UNMISSET there was employment associated with the increased expenditure on hotels and restaurants. There were also employment impacts caused by the local spending of external contractors.

Over the course of the mission, around 65% of the employment for national staff was generated in Dili. Given the distribution of international staff across the country it is estimated that over 80% of the additional employment was also created in Dili. In terms of population distribution, around 18% of the population of Timor-Leste live in Dili.¹⁰

One of the particular challenges endemic to countries that host peacekeeping operations is a severe shortage of skilled and qualified labour. In this context, UNTAET recruited many of the most qualified people. While the data is not comprehensive, based on a 2001 survey, the average years of schooling in Timor-Leste was estimated at less than five years, while only four percent of the population are estimated to have attended a university.¹¹ Over 90% of the staff recruited on both LGLD and SSA contracts by UNTAET were at the GL-2 level or above. This level requires at least a high school diploma or equivalent for appointment.

⁸ This split is based on 2000 and 2001 data.

⁹ The labour force was estimated as around 360,000 in 1998 and this would have been slightly reduced after the referendum, as military, police and civil servants would have returned to Indonesia. Of the remaining labour force, around 75-80% are estimated to be involved in agriculture. Most of the non-agriculture labour force are categorized as self-employed.

¹⁰ Based on 2004 census, results available at <http://dne.mopf.gov.tp/census/results.html>.

¹¹ Data taken from the TLSS.

The main reason that UNTAET could attract the most talented people was that it was paying higher wages than its competitors. Comparative data from the three major ‘public sector’ employers are presented below.

Table 3.8 – Wage rates paid by different organisations

	ETTA	UNTAET	NGO Agreement	NGOs Actual
Level 1	85	111 – 134	77 – 88	69 – 94
Level 2	100	144 – 174	88 – 110	86 – 152
Level 3	123	191 – 231	--	125 – 240
Level 4	155	253 – 335	121 – 198	120 – 263
Level 5	201	335 – 445	176 – 242	172 – 285
Level 6	266	445 – 538	176 – 242	263 – 550
Level 7	361	589 – 713	--	--

Note: The NGO Agreement was negotiated between the NGOs in order to try and limit wage inflation as they competed for the same small pool of resources. ETTA is the East Timor Transitional Authority.

Source: Valentine, Theodore. 2001. *Civil Service Pay in East Timor: Current Status and Recommendations*. The World Bank. (Draft), based on data supplied by ETTA, UNTAET and NGOs operating in Timor-Leste.

Not only did the UN offer higher wages than its competitors it also offered better benefits. In particular, UN staff had access to the UN health clinic – a significant benefit in a country with such low health indicators as Timor-Leste.

A significant problem with the United Nations paying higher wages is that employees who are needed at senior levels to establish the permanent public administration are drawn into the transitional United Nations administration. This will have a negative impact on economic development as the government will not be as well equipped to carry out the public sector functions needed to support and enable private sector development.

However, the United Nations approach to wage setting in Timor-Leste has created a much more direct problem for economic development. The United Nations set its wages when the mission commenced in December 1999. The government set their wages in May 2000, balancing the need for fiscal sustainability with the need to be somewhat competitive with UNTAET. Subsequently the de facto minimum wage has been \$85 per month. The minimum wage in the neighbouring Indonesian province of West Nusa Tenggara in 2003 was \$40 per month. Both the government in its National Development Plan and private sector representatives in discussions outline the challenges that the high wages (and therefore high business costs) create for the development of an internationally competitive private sector in Timor-Leste.¹²

As discussed above, there are significant economic benefits created through the employment of local staff including directly injecting money into the economy and increased human capital associated with employment. In Timor-Leste and in other missions, these benefits could have been delivered by hiring more people at lower wages. This would have increased the distributional equity as the amount spent would have been spread over more people. The geographic equity could also have been improved.

¹² It is not just in the wage area that the United Nations creates increased costs for its competitors. Both NGOs and the government are under pressure to match the generous travel allowances paid by UNMISSET.

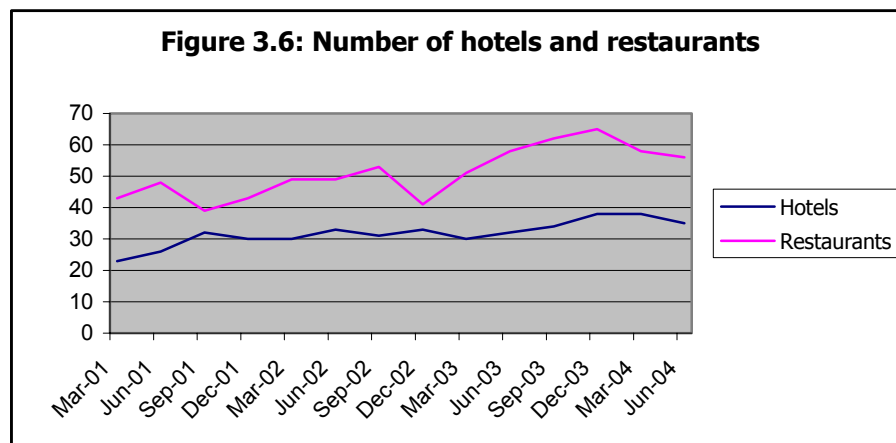
In terms of actually filling the positions at lower wages, it is important to note that there was rarely a shortage of applicants for any position.¹³

The way in which the United Nations has historically set local staff wages and the challenges for this approach with the changing nature of UN interventions is discussed in more detail later in this section when the impacts of the way in which the United Nations does business is presented.

3.4.5 – Tourism and Hospitality Industry

A major sector that is supported by the international presence is the tourism and hospitality industry. Around \$100m is estimated to have been spent from international staff allowances over the period December 1999 to June 2004 in hotels, foreign-owned restaurants and foreign-owned shops.¹⁴ In response to this demand, many new hotels and restaurants were rapidly constructed. A major concern is that this sector will face a significant boom-bust cycle, with over-investment when there is a large peacekeeping mission, and business closures once the mission winds down.

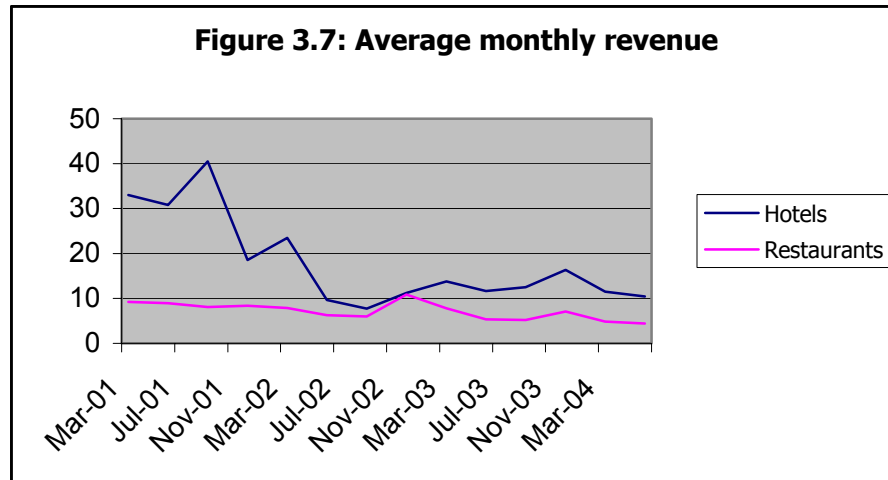
While it is still early, this cycle does not appear to be playing out in Timor-Leste. Rather than closing, these businesses appear to be altering their cost and pricing structure in response to the lower level of international demand. The number of hotels and restaurants filing services taxes and the average amount of revenue that each establishment was earning on a monthly basis are presented below.¹⁵



¹³ It could also be argued that lowering the wages would have reduced the quality of applicants. There are two responses. First, as the UN was paying above the level of its competitors there was already scope to pay lower wages. Second, in many cases the people that were actually hired and those that were not hired were of similar caliber. There was a large supply of low-skilled and unskilled labour – many of whom were employed.

¹⁴ More detail is provided in the appendix.

¹⁵ Hotels and restaurants with revenue above a threshold are required to collect and remit services tax to the Revenue Service. Discussion with Revenue Service officials suggest that there may have been some compliance challenges in the early months of the services tax – suggesting that there may have been more establishments, than recorded. Discussions with private sector representatives, including hotel and restaurant proprietors indicated that the vast majority of establishments filing services tax were foreign-owned – in a few cases there may have been Timorese partners.



Source: Data from Timor-Leste Revenue Service

The number of hotels and restaurants has gradually increased over the life of the mission, with a small decline in 2004. This was occurring despite the reduction in international staff and the decreased number of international staff living in hotels. Of particular interest is the average revenue being earned by these establishments. In the case of hotels the average revenue has dropped significantly from around \$30,000 per hotel per month during 2001-02, but then stabilized at around \$10-15,000. In the case of restaurants, the average revenue has been gradually declining from around \$9,000 per month to around \$5,000 per month.

Empirically what appears to be happening in this industry is the drop in demand is driving both an increasing Timorization of the labour force and an increase in price competition. International staff that previously occupied middle and senior management positions are being replaced by Timorese staff, dramatically reducing the costs of the businesses and allowing them to remain profitable with lower revenues. In the case of hotels, lower demand and associated lower occupancy rates is inducing not only price competition but also innovation – including converting two or three hotel rooms into long-stay apartments. Moreover the market seems to be segmenting with three or four hotels retaining high prices and slightly higher quality and catering for the diplomatic and development community, who are less sensitive to price; while the remainder of the hotels drop their prices.

In many cases, the strong international demand allowed investors to recoup their upfront construction and capital costs. What is left is the basic infrastructure for a tourism industry, particularly in Dili. Even more price competition and innovation will be needed to make the industry regionally competitive. But this looks like an industry undergoing adjustment to a sustainable level, not one that is going bust.

3.4.6 – Residential housing

An additional area where the international presence may have had a significant impact is on the residential housing market. There are questions around the number of internationals who lived in the community and the impact this had both on the quality and quantity of the housing stock, whether there were either localized inflationary effects, and

whether the rental income was used for housing or other investments. Survey work has been commissioned on this in Timor-Leste, but is not available in time for inclusion in this interim report.

3.4.7 – Infrastructure

The impact of the international presence on the level of infrastructure is difficult to assess. While considerable resources were expended on infrastructure rehabilitation and maintenance, the value of this spending to the economy of Timor-Leste remains unclear. In addition, the peacekeeping forces also contributed to the deterioration of some infrastructure, making it hard to value the net contribution.

In terms of the transportation infrastructure, considerable work was done by military contingents, including the Japanese Engineering Group, to keep the main supply routes open.¹⁶ Rapid repair work was also done on the ports and airport to make them operational. The military contingents were keeping the supply routes open for their own purposes. However, many of the military vehicles were heavier than the recommended weights for the roads. According to Timor-Leste government officials, the longer term structural damage done to these roads outweighed the amount spent on the ongoing maintenance and repair of these roads. In addition, the actual benefit to the economy of this road infrastructure, in terms of facilitating economic activity, was limited. If the same funds were to have been spent with the goal of maximizing the economic development impact, different roads would have been chosen.

UNTAET/UNMISSET also spent funding from the Assessed Contribution budget on the repair and rehabilitation of buildings some of which were subsequently handed over to the government for their purposes. Again however there are questions about the value to the Government of Timor-Leste of some of these renovations. The major challenge is that the renovations were done to a higher standard than would have been the case had the rehabilitation been done by the government, and the resulting ongoing maintenance costs were higher.¹⁷ Some additional work is needed to further quantify the expenditure in this area.

3.4.8 – Distributional Impacts

The arrival of the UNTAET mission in Timor-Leste generated economic opportunities for many Timorese. The average annual salary for a national staff member of UNTAET/UNMISSET was around \$3,000, a significant amount in a country where the per capita income is around \$370. Many staff employed in hotels or restaurants earned only slightly less than this. Land owners renting their residential property to international staff made large returns.

¹⁶ There are not good estimates of the dollar value of this work. Even if an estimate of the resources that the JEG allocated to this task could be obtained, this would be a considerably larger figure than if the work had been tendered out.

¹⁷ A particular challenge was that the majority of buildings rehabilitated by the United Nations were rehabilitated with air-conditioning. This fact, along with the example set by most other UN offices has meant that the Government has expected its offices to be air-conditioned. It is not clear that air-conditioned offices should be the highest priority for the government.

Yet these benefits accrued to a relatively narrow segment of the population. The benefits accrued primarily to those living in Dili, and within Dili to the well-educated and the land-owners. Of the \$93.9m injected directly into the local economy around eighty percent was in Dili. Over the life of the mission the benefits became even more concentrated in Dili. In particular with the change in mandate from UNTAET to UNMISSET, in 2002, the international presence became even more Dili-based.¹⁸ More detail on the geographic distribution of both national and international staff is presented in Appendix B.

The education requirements for national staff meant that only the well-educated had the chance to get an UNTAET/UNMISSET job. The majority of Timorese were excluded from obtaining a position. Similarly, in the service industries catering to international staff, ability to speak basic English and a basic level of education again limiting access to economic opportunities to the better educated. Finally, only the existing land-owners were in a position to benefit from the increased demand for residential and commercial property.

While the direct benefits of the international mission may have been limited, the indirect economic benefits of the peacekeeping mission, particularly the benefits associated with peace and security were enjoyed by all Timorese. A common criticism is that these indirect benefits are offset by the costs associated with an increase in inflation, that is felt by all Timorese. In the case of Timor-Leste the inflation impact of the international presence on the Timorese was benign – and particularly so for Timorese living outside of Dili.^{19,20}

3.4.9 – The impact of the way the United Nations does business

The previous parts of this section outlined the major economic impacts of the peacekeeping mission, including the creation of jobs, creation of wealth and development of the tourism industry. However the way that the United Nations undertakes its business also has a major impact on the way in which the economy develops. These challenges primarily come about because the modalities of operation for United Nations missions were developed assuming that the United Nations would represent a relatively small part of the economy. However when the United Nations undertakes peacekeeping operations it plays a large role in the economy.

As the line between peacekeeping and peacebuilding, nation-building or State-building continues to blur, the established modalities of United Nations operations need to be addressed – especially as the United Nations takes on a much broader range of responsibilities. There are four specific areas where the way in which the United Nations operates has negative consequences for the development of the economy more broadly: (1) the interaction in the labour market, (2) the relationship between the United Nations

¹⁸ In 2000-01 it was estimated that 78 percent of the benefits accrued in Dili, but by 2003-04 this number had increased to just over 85 percent.

¹⁹ This does not mean that the inflation impact was benign, which it wasn't. Rather, that the international presence was not the major cause of inflation – despite being an easy and public scapegoat for it.

²⁰ A separate issue is whether the increased gap between rich and poor caused by the increased opportunities for the land owners and the educated would lead to social problems.

and the host government; (3) the way in which a mission can establish expectations for both professional working environments and personal living standards that cannot be afforded by a developing country; and (4) the planning horizons with which the mission operates.

Labour market

Historically the United Nations is a relatively small employer and so established principles for setting wages are adopted, to ensure that appropriately qualified staff can be attracted. In short, the United Nations takes the wage rate that has been set by the market for a set of skills and pays at the top end of that range.²¹ This remains the case in many countries where the United Nations operates. However when the mission operates following a conflict there are complications. First, as was the case in Timor-Leste, when the labour market is disrupted by a conflict there are no obvious comparators. Second, in a peacekeeping situation the United Nations becomes a major employer, particularly in the formal wage employment sector. This means that the United Nations has market power and is a price-setter, not a price taker in the labour market.

When these two factors are combined, largest employer and no established market, the United Nations has a major responsibility as its wage decisions will have ramifications significantly beyond the ability of the mission to attract staff. In the case of Timor-Leste the fiscal sustainability of the government was affected when wages were set in response to the United Nations wage scale.²² It also directly inhibited economic growth in Timor-Leste by de facto raising wage expectations, thus increasing business costs.

The major problem is that the broader consequences of the wage decisions are not well understood, and they have not needed to be in the past – but moving forward with peacekeeping operations they become critical. For the United Nations local wages are not a major overall cost driver – a 50% increase in national staff wages would have led to 0.6% increase in the overall cost of the mission – so in setting wages there is little sensitivity to the cost impact. This means in setting wages or increasing wages, the United Nations can afford to be “socially concerned” and worry about cost of living, as the increase does not introduce real cost pressures. This is also the case for many of the businesses that have significant international staff on their books. In contrast local wages are a much bigger cost driver for the government of Timor-Leste – a fifty percent increase in local wages would lead to an increase in the government budget of around seventeen percent. For a local businessman trying to compete internationally – particularly if they have a labor intensive industry – a 50% increase in local wages could increase costs by 30 or 40% - probably making them unable to compete internationally – but it is only as the Timor-Leste private sector becomes able to compete internationally that sustainable growth will be delivered.

²¹ According to the International Civil Service Commission: “(General Service Staff) are paid on a local basis. The level of salaries is established in accordance with the Flemming Principle which provides that the conditions of service for locally recruited staff should reflect the best prevailing conditions found locally for similar work. Consequently, the local salaries are established on the basis of salary surveys which identify the best prevailing conditions.” Source: FAQs on www.icsc.un.org

²² When the government has to pay higher wages it must either raise more taxes, which reduces private sector returns and therefore private sector growth, or deliver less services, which will also reduce the economy’s growth potential.

The need to balance the competing objectives of the mission between attracting staff while ensuring that broader economic development needs are addressed suggests that the established approach to wage-setting needs to be fundamentally revisited in the light of the broader role that the United Nations is now called to play.

Relationship with the host government

In most countries in which it operates the United Nations lobbies the government to obtain the maximum advantage from the Convention on the Privileges and Immunities of the United Nations. When there is a functioning State, there is some scope for contestation and balance between the claims of the United Nations under the Convention and the rights of the sovereign State. The United Nations faces a clear conflict of interest when it undertakes a mission and also fulfils the role of a national government, or at least of creating and nurturing a prototype national government.

The Special Representative of the Secretary-General will try and extract the maximum concessions from the Transitional Administrator who will be concerned with the broader implications on the host country of granting generous concessions. When this role is played by the same person there is an inherent conflict. When the participants on both sides of this notionally conflictual relationship have been brought up within the United Nations system and both look to the United Nations for their future opportunities there will be little conflict – the interests of the institution of the United Nations will outweigh the interests of the nascent State.

The area where this played itself out in most detail in Timor-Leste was in regard to the payment of taxes and user charges by UNTAET/UNMISSET, its staff and its contractors. In most cases UNTAET staff claimed blanket exemptions from all government charges, significantly greater than the exemptions granted under the Convention. There are two consequences of this which have a negative economic impact. First, government revenue is reduced when user charges are not paid. More important than this is the negative demonstration effect that is provided to the rest of the economy. It is hard for the government to introduce income tax on its staff when UN staff who already earn higher wages were exempt from income tax. It is equally hard to get compliance when collecting user charges from private businesses.

Given that in most post-conflict economies the national government is dependent on budget support for several years, this issue could be addressed in a fiscally neutral fashion. Rather than funding a budget support trust fund, the donors and the United Nations could agree that the United Nations operations would be taxable, but that donors would provide the additional funds needed to cover the tax burden. Such an approach would see the host government provided with the same amount of money, yet it would both create a strong tax-paying compliance demonstration effect, and support the development and functioning of the revenue service.²³

Raising Expectations

International staff whether working on missions or at headquarters have expectations about their working conditions. These often included a constant working temperature,

²³ Such an approach is consistent with the spirit of the ICSC guidelines which note that some countries do not grant income tax exemptions to national staff, and that in this situation the salaries are grossed up.

regular electricity, modern computing facilities, access to transportation and communications infrastructure, good quality furniture and a comfortable office, or access to the internet. Many of these working conditions are not common in developing countries where domestic revenues are low and harsh trade-offs are needed when allocating resources between competing needs. However, in Timor Leste the presence of UNTAET staff with a certain standard of amenities created considerable pressure from Timor-Leste government officials for a similar standard of amenity. This issue was exacerbated when UNTAET/UNMISSET gifted accommodation at a certain standard to the government, but the operation and maintenance of the accommodation fell on the government's budget. This created cost pressures on the government that will be felt for many years. A specific example would be the large number of government offices that are air-conditioned, which was not the case prior to 1999.

A similar problem extends to the expectations of living standards. International staff enjoy a higher standard of living than most of the local population in the host country. This can cause general discontent but can also have negative economic impacts. In discussions in Timor-Leste there were reports of people using the new access to credit to borrow money to finance higher levels of consumption – not to invest in productive assets that would be used to repay the loans. In many cases these loans were being collateralized with property, which will be forfeited if the loan is not repaid.

Unlike the issues around the labour market and the conflict of interest that the mission faces, there are no obvious ways forward on this issue. However it is one that mission planners need to be aware of.

Planning Horizons

In the case of Timor Leste, the various mandates of UNAMET, INTERFET, UNTAET, and UNMISSET, were rarely ever more than 12 months.²⁴ Each mission was given a finite period for budget planning, with the inevitable extensions only being considered as they came due. As a result, procurement or hiring decisions that made sense in a 6 or 12 month timeframe, are clearly seen to be counterproductive when considered in the longer timeframe of the UN mission's actual time on the ground. As an example, training of national staff was limited by the uncertainty of mandate length. It appeared unwise to invest significantly into national staff training if the mission was "winding down". Hindsight has demonstrated, however, that the mission has been "winding down" almost continually since January 2002 and may have its mandate extended once more in April 2005.

The short planning horizon has also led to inefficient choices in the case of the design of UN facilities. In general, the offices set up by the mission are portable, rely on air-conditioners, and are designed for expatriate needs. As a result, the UNMISSET compound at Obrigado Barracks has an annual operating and maintenance cost of \$744/m². This is 3% more expensive than premium office space in downtown Tokyo and 10% more expensive than the best office space in midtown Manhattan.²⁵ When these offices are handed over to the Timorese government, they will not be able to afford its

²⁴ Over the last six years there have been seven distinct Security Council resolutions to either establish or extend the mandate of UNTAET and UNMISSET.

²⁵ Cushman & Wakefield's "2005 Business Space Across the World", April 2005

upkeep and therefore it is unlikely that the capital investment in this facility will ultimately have a positive economic benefit for Dili.

As many operating decisions are being taken in the context of artificially shortened timeframes, important decisions on capital investments are being constrained by the structure of mission funding and the differences between assessed contributions and trust funds. In Timor-Leste there was a very significant example of this. In 2001, mission managers were faced with a national electrical grid that had been entirely destroyed by the Indonesian army and militias. Due in part to the fact that the assessed budget could not be used for anything that could be regarded as a fixed infrastructure investment, the decision was taken to use a series of large portable generators to provide power to the UNTAET facilities and major Timorese population centres. The fledgling Timorese government inherited this network and did not have a budget to reverse the decision and build a power plant. As a result, Timor now has the most expensive power generation system in Asia at \$0.20/kilowatt-hour (compared to \$0.05 in Indonesia and \$0.03 in China). In recent market surveys, the Timorese government identified the cost of power as the single biggest deterrent to attracting foreign investment.

3.5 Operating realities facing UNMISSET

Before there can be any adjustment to procedures designed to increase the economic benefit or minimize the economic distortion of a UN peacekeeping mission, a thorough analysis of the operational realities which dictate current procedures and policies is needed. In the pilot fieldwork, the project staff interviewed all of the senior mission managers of UNMISSET and reviewed similar interviews conducted in UNMIK and UNAMA during previous PBPU research. The following issues were identified by staff as having an important impact on decisions related to local procurement or hiring.

3.5.1 Factors Affecting Local Procurement

UNMISSET has no explicit mandate to support local private sector development through procurement, nor human capital development through the use of national staff. While there is an overarching assumption that the strategic mission goal includes Timor Leste's economic development, this is rarely seen as a relevant factor in operational decision-making. At the working level, the existing UN operating procedures and manuals take precedence, as they should. To illustrate this point, while UNMISSET procurement officers recognize the significant developmental impact of procuring certain goods locally, their only operational directions come from the UN procurement guidelines which do not allow for local impact to be taken into consideration when awarding contracts.

Similarly, there is no one in the UNMISSET mission who is explicitly responsible for maximizing the direct developmental impact of the peacekeeping operations. While all senior managers recognize the importance of encouraging a positive economic benefit to the host nation, on a day-to-day basis there is no one who is charged with making it happen, or even monitoring the impact. In light of the extraordinary existing demands on individual managers, it is not surprising then that the issue falls by the wayside.

This dedicated focus is critical as in some cases encouraging a positive economic impact will force a trade-off with other mission objectives. Local procurement will often take longer, with extra effort required of staff to assist and support local businesses that may be unfamiliar with United Nations procedures. Active efforts to seek out local companies may initially be needed. Encouraging local industry could involve modifying specifications so that local companies can compete. With only a general commitment to economic development these trade-offs will not be faced. Staff will naturally take the approach of delivering the most effective and efficient solution in the absence of local development concerns – unless these concerns are explicitly factored into the decision-making process.

There are smaller, more practical issues facing mission management, too. For example, there is no Timorese business directory. As a result, potential local vendors must be found by word of mouth. While this is not surprising, it is surprising that donors have not attempted to close this important gap in private sector development.

Due to administrative restrictions, the liquidation of mission assets may not be as economically valuable as it could be. The UN Liquidation Manual explicitly limits the national organizations to which the mission can donate assets. In the case of Timor Leste, UNMISSET can only give the assets to the Timor-Leste government, which has a limited absorptive capacity. Those materials that are not needed by the government will likely not be passed on to other elements of civil society (such as NGOs, schools, or local cooperatives). In addition, due to the very limited national budget, the government will not be able to maintain these assets for very long. As an example, the cost of ink cartridges for printers is more than the current depreciated value of the printers.

3.5.2 Factors Affecting Local Hiring

The mission's ability to find the right national staff has a direct relationship to the mission's ultimate economic impact. If a mission is unable to efficiently find national staff with the appropriate skills for a specific task, it must rely on international staff to meet that need or at least assist. Inefficient use of national staff discourages further Timorization and hampers skills transfer. A mission that is able to quickly find skilled national staff, match them to the appropriate positions, and train them to become effective members of the mission team will contribute significantly more to the human capital development of the local economy than a mission that does not.

Finding national staff is difficult for a wide variety of reasons. Chief among these is the complete disruption of the local labour economy in a post-conflict economy. In the case of Timor Leste, 25 years of Indonesian occupation had limited the amount of skilled Timorese. During the violence of 1999 more than half the labour force fled the country. UNTAET found an economy with no apparent skilled labour and as a result, in the earliest stages of the mission only the most basic jobs could be filled by national staff.

To date, there is still no national labour database or human resource agency in Timor Leste. When the UN mission is seeking staff, it must go to considerable lengths to

advertise locally and cannot turn to an existing, pre-screened list of skilled labour. Unlike other mission areas, no donor or local NGO has filled this void. Due to the small market size, no private sector firm has done so either. This puts an added burden on mission administration and hampers its ability to find the best talent available.

The UN requires National Professional Officers to possess a master's degree. In Timor-Leste, the disruption of the occupation severely limited university education. There are skilled candidates with undergraduate degrees, but they cannot be offered the more lucrative NPO contracts. This hinders the ability of UNMISSET to place national staff in positions of responsibility, diminishing the missions overall reliance on local labour.

There is a widely held belief that peacekeeping missions turn local doctors into taxi drivers. This does not appear to be the case in Timor Leste. Nonetheless, as the national government struggles to build its civil service, it suspects UNMISSET of poaching talent with offers of higher salaries. Even if this is not the case in practice, the SRSG is compelled to address these concerns and has pledged to Prime Minister Alkatiri that the mission will not hire Timorese who are currently working for the government.

The training of national staff is a major undertaking, particularly in a post-conflict economy with a limited skills base to begin with. Due to the chronically heavy workload of peacekeeping mission staff, on-the-job-training is never going to be an easy task. This is exacerbated by the fact that international staff are not inherently skilled as trainers. This is an ability that generally needs to be learnt and currently international staff are not receiving the appropriate training to act as effective mentors and to pass on skills and knowledge to national staff. It should also be noted that on-the-job training is also required for NPOs. Theoretically, NPOs should be sufficiently educated to step in cold to a post normally staffed by an international. In reality, however, this is rarely the case. Thus, any efforts to increase the number of NPOs in a mission such as UNMISSET will also increase training requirements.

UNMISSET's efforts to redesign itself and evolve into a mission with a "light footprint" face similar challenges to other missions that have undergone downsizing. Efforts by the SRSG to reduce the size of a mission mid-stream can face resistance from middle managers. This is due to several reasons, including the apparent lack of training resources. Managers fear that replacing internationals with national staff will be too disruptive as there is no one available to bring them up to speed. As well, there are no built-in incentives for managers to nationalize their office. In some cases, in fact, there are strong disincentives for doing so. As an example, a manager's position can be reclassified downwards if the number of international staff working beneath them is reduced.

3.6 Preliminary conclusions

The economic footprint of UNTAET/UNMISSET in Timor-Leste was, in some regards less than expectations.

- The size of the fiscal impact was smaller than expected. At its peak the direct impact of international spending on the local economy was around \$25m, though;

- related to this, the inflationary effect of the international presence was small, and not as significant as many claimed.

The expenditure by the United Nations and its staff generated significant benefits, including:

- providing employment and incomes to a significant number of Timorese – although these benefits were primarily concentrated amongst the well-educated and landowners in Dili; and
- establishing the basic infrastructure for a tourism industry – again mainly in Dili.

The mission also generated some major negative impacts on the local economy. The most significant of these was the impact on the labour market of the wages set and the wage setting process followed by the United Nations.

Based on this analysis there are a number of areas that require consideration. These will be the focus of attention during the next phase of the project. The issues are divided below into some general concerns and also a series of specific suggestions.

3.6.1 General issues for consideration

Increased focus on local procurement

The low level of local spending, particularly the low level of local procurement, coupled with the low inflationary impact of the mission suggests that there may have been scope for increased local purchasing without negatively impacting on the economy. However, such an approach requires a careful approach, so that the local economy is stimulated in a non-inflationary way. First there needs to be a better understanding of what can be purchased locally, including how this changes over the life of the mission. But there also needs to be an appreciation of what may not be immediately available, but what could be produced if a tender was let. It is this dynamic ability of the economy to respond to new demands that, if fostered, can become the engine of rapid growth.

Some specific suggestions are included below. This increased focus on local procurement to support economic development will often initially involve trade-offs, either increased work from international staff or an acceptance of a slightly longer delivery time. In the presence of these costs, unless there is a structural response involving changes to mission procedures, increased local spending will simply remain a good intention.

Possibility for contracting out common services

One area that did not receive a great deal of attention was the scope to contract out the provision of a number of services that were carried out in Timor-Leste by a combination of international and national staff. Examples of these services could include transportation, motor maintenance, or unarmed security. In Timor-Leste many other international agencies contract out some of these common services.

Reforming the structural issues

A number of structural issues associated with the way the mission operated were identified as generating negative impacts on the local economy. The most significant of

these was the national staff wages that were set and the wage setting process of the mission. The conflict between the mission representing the United Nations and the mission as forming the prototype government, and the difficulties of the short planning horizons also need further examination. If these structural issues led to negative impacts across other missions there is a need to consider structural reforms to reduce or eliminate these negative impacts

3.6.2 Specific areas for further consideration

In the course of interviews, UNMISSET managers discussed possible operational innovations that could address the issues described above. These operational suggestions will be examined in more depth during the course of Phase 2 with managers from other missions and at headquarters. Listed below is a sample of the recommendations grouped according to the themes of local procurement and hiring and training of staff.

Local procurement

1. The SRSB should appoint an officer with the explicit task of monitoring and maximizing the economic impact of the mission. This officer would be responsible for reporting on the economic implications of operational and policy decisions and coordinate with other aid agencies.
2. The duty free PX should be closed down once the local marketplace can provide similar consumer goods.
3. The mission should seek opportunities to partner with donor agencies who are funding local private sector development projects. Two likely area of coordination would be local production of bottled water and the creation of “procurement marketplaces”.
4. Right from the beginning, mission planning should take into consideration the inevitable liquidation of assets and the maintenance legacy of certain procurement decisions. For example, regional UN offices may be better equipped with typewriters than computers, or overhead fans instead of air-conditioners. Similarly, decisions on mission vehicles should take into consideration the local availability of parts and the long term maintenance costs. This would also be true of larger items like generators or even repairs to the power grid.
5. At the beginning of the mission and at regular periods the local marketplace should be surveyed to determine what is available locally. This information should then be shared with NGOs and other UN agencies.
6. The application of “capital adequacy” requirements should be subjectively applied to local vendors.
7. All procurement tenders should be widely advertised locally and translated into local languages.
8. Missions should use existing public information campaigns to draw attention to the significant amount of UN money that is spent locally, creating a peace dividend.
9. Missions could provide more formal assistance to vendors on how to bid on UN contracts, or missions could partner with the World Bank or other PSD programs to achieve this.

Hiring and Training of National Staff

1. Mission recces should include representatives from personnel tasked with conducting a survey of the local labour market before decisions are made regarding the staffing composition of the mission.
2. At the beginning of a mission, the recruitment and screening of national staff should be assisted by professional HR firms or possibly outsourced entirely.
3. Efforts to link recruitment to IDP/Refugee return projects or demobilization efforts should be expanded and standardized.
4. Missions should increase the use of NPOs from the earliest stages of deployment.
5. Professional trainers should be brought in to the mission to both train national staff and to assist international staff's ability to provide on-the-job training.
6. Missions should make a larger financial investment in training national staff, and apportion a specific element of the overall training budget for this purpose.
7. The UNMISSET practice of providing certification programs for national staff should be expanded and adopted by other missions.
8. Online training programs on standard mission practices (such as software, filing systems, vehicle maintenance) should be developed or if they exist should be advertised more broadly.

Chapter 4. Next Steps

4.1 Introduction

Thanks to the assistance of UNMISSET staff, the project team was able to fine tune its methodological approach and determine the most efficient means of collecting data from the field. The overall methodology as described for Phase 1 will be replicated for Phase 2, but it will take less time to gather the mission-specific information, both at headquarters and in the field. There will be, however, a greater emphasis in Phase 2 on reviewing the information from the field with headquarter staff.

4.2 Targeted data

The project team will spend approximately 7 days at each mission and divide its focus between conducting interviews to gather subjective data and information on the operational issues related to local procurement and hiring. The following individuals or groups will be targeted for interviews:

- Senior UN mission management;
- Mission Procurement Officers;
- Mission Personnel Officers;
- Administrative management of UN/Int. agencies and NGOs;
- Local business owners;
- Host government; and
- Interested third parties such as the World Bank and donors.

The initial work with UNMISSET produced almost all of the desired data and due to the assistance of the mission staff, the project team was able to identify where similar data will be found in other missions. The major data sets that will be targeted include:

- UN mission spending patterns;
- International and National staffing patterns;
- Staffing and spending data from comparable agencies in the mission area;
- MSA Spending survey;
- Rental rate survey;
- Local business surveys; and
- Tax revenue from spending.

4.3 Missions of focus

In Phase 2 the project team will focus on nine current missions and one former mission. In 2004, the nine active missions and UNMISSET had a combined operating budget of \$3.4 billion. This represents just over 87% of the overall budget for DPKO. In addition, these missions represent a complete cross section geographically and operationally. There is also a broad range of mission stages in this group. The following table describes which missions will be visited, when, and by whom.

	Dr. Michael Carnahan	Prof. Bill Durch	Scott Gilmore	Gary Gray	
UNMIL Liberia			✓	✓	June
UNAMSIL Sierra Leone	✓	✓			
UNMIK Kosovo	✓	✓			
UNOCI Cote d'Ivoire				✓	July
ONUB Burundi				✓	
MONUC Dem. Rep. Congo				✓	
MINUSTAH Haiti			?	✓	August
UNMIS Sudan	✓		✓		
UNTAC Cambodia	✓				September

4.4 Researchers

In order to cover as many missions as possible within the time and budget constraints of the mission, a research assistant will be tasked with conducting field work in 4 missions. To ensure continuity in the methodology, the assistant will visit two missions with a project leader first.

4.5 Timeline for Deliverables

Phase 1 has been completed according to schedule, and Phase 2 is expected to also follow the original timeline as follows:

May	Prepare Phase 2 fieldwork
June	Liberia, Sierra Leone, and Kosovo
July	Cote d'Ivoire, Congo, Burundi
	Update to Steering Committee
August	Haiti, Sudan
September	Cambodia
	Update to Steering Committee
	Update to Member Group
October	Collation of Findings
	Review of preliminary findings with DPKO staff
November	First Draft of final report and recommendations
	Review with DPKO staff, steering committee
December	Final draft completed
	Presentation to DPKO staff, steering committee, member group and wider audience

Appendix A: Technical and Data Appendix

1. Derivation of the Estimated Fiscal Impact

1.1 Introduction

This appendix outlines the methodology, data, and assumptions that were used to derive the fiscal impact presented in the report. The appendix is structured in the way that the analysis was undertaken – that is the starting point for each year was the funds actually spent and reported in the performance report on the budget of UNTAET/UNMISSET presented to the General Assembly. This figure was then reduced in three successive steps:

- funds spent outside of Timor;
- allowances allocated to staff that were not spent in Timor; and
- funds spent in Timor, that were spent directly on imports (either of goods or services).

This leaves the amount of money that was directly injected into the local economy. An estimate of the indirect injection of funds that occurred when external contractors hired local resources (primarily labour) to deliver their services was added to this amount. To then calculate the overall fiscal impact, an estimate of the multiplier effect of this injection on the economy is presented.

1.2 Overall spending by UNTAET/UNMISSET

Information on the overall spending undertaken by UNTAET/UNMISSET is presented in Table A1 below. Information on the actual human resource deployment is presented in Table A2. The primary source for this information is the annual performance reports of the budget for the mission. The specific reports to the General Assembly are: A55/925 (Dec 1999 – June 2000) A56/922 (July 2000 – June 2001); A57/666 (01–02); A58/636 (02–03); and A59/655 (03–04).

These reports did not provide the degree of disaggregation, particularly between MSA and non-MSA expenditure that was needed for the subsequent analysis. More detail for budget year 2001-02 was available from an interoffice memo provided to the ACABQ.²⁶ Additional detail for 2002-03 and 2003-04 was provided by United Nations officials. The disaggregation between MSA and non-MSA spending was not available for 1999-2000 or 2000-01, so this split was estimated based on data from the subsequent years. The assumptions are presented as notes to Table A1. In addition there were differences in categorization across the years in the performance reports; changes in classification to allow consistency across the years are also included in the notes to Table A1.

²⁶ Memo dated 28 Jan 2003 from Catherine Pollard, Director, Office of Programme Planning, Budget and Accounts, Peacekeeping Finance Division to Jules Corwin, Executive Secretary, ACABQ.

Table A1 – Overall Spending (\$US 000)

	12/99-6/00	7/00-6/01	7/01-6/02	7/02-6/03	7/03-6/04	Total
Military and police personnel						
Military observers (excl MSA)	680	953	458	497	449	3,037
Military observer MSA ^a	3,930	4,823	4,138	3,869	2,931	19,690
Military contingents ^b	94,080	225,297	140,424	100,041	65,709	625,550
civilian police (excl MSA) ^{c,d}	2,576	6,929	3,232	2,002	1,154	15,893
Civpol MSA	17,597	41,006	38,551	24,702	9,143	131,000
Formed Police Units		3,991	3,658	0	2,049	9,698
Subtotal	118,863	282,997	190,461	131,110	81,435	804,866
Civilian personnel^e						
International Staff (excl MSA) ^f	19,985	79,241	66,173	36,944	30,233	232,575
International Staff MSA	16,627	31,991	28,028	13,576	10,460	100,682
National Staff	4,013	6,355	5,834	3,601	3,440	23,243
UNVs (excl allowances) ^g	2,012	5,167	7,475	4,230	2,208	21,092
UNV allowances	4,200	10,200	15,138	6,457	5,444	41,438
Subtotal	46,836	132,954	122,647	64,806	51,785	419,029
Operational costs^h						
General Temporary Assistance			791	6,838	4,600	12,229
Premises/Accommodation/Facilities & Infrastructure	24,787	11,497	26,944	20,348	15,350	98,926
Consultants			916	4,265	4,611	9,792
Official Travel			1,257	1,170	593	3,020
Transport Operations	19,162	12,532	7,552	8,518	3,858	51,622
Air Transportation	18,311	56,219	50,701	32,754	21,619	179,603
Naval Transportation	492	466	513	913	573	2,956
Communications	22,144	8,874	9,145	7,352	4,735	52,250
IT			870	894	576	2,339
Medical			7,311	4,282	3,012	14,604
Special/Other Equipment	16,358	7,063	1,751	1,361	1,091	27,624
Miscellaneous Supplies and Services	5,154	12,547	28,215	3,329	2,172	51,416
Air and Surface Freight	19,903	2,437	4,987	0		27,327
Subtotal	126,311	111,635	140,950	92,025	62,788	533,709
TOTAL EXPENDITURE	292,010	527,587	454,058	287,941	196,008	1,757,604
Less Staff Assessment	4,042	14,444	13,109	8,233	6,946	46,774
Net Expenditure	287,968	513,143	440,949	279,708	189,062	1,710,830

Notes:

- The breakdown between MSA and non-MSA is an estimate for 1999-2000 and 2000-01. Only the aggregate amounts of \$4.6m (1999-2000) and \$5.8 (2000-01) were presented in the performance reports. The MSA figure was estimated by multiplying the average MSA per military observer using 2001-02 data by the number of military observers actually present in Timor-Leste. The non-MSA spending was then calculated as the residual when the MSA estimate was subtracted from the aggregate amount.
- The figure for military contingents appears to drop significantly from 2001-02. This is in part because of the reduced military contingent (dropping from an average strength of 7,889 to 6,820), but also because from 2001-02 many contingent-owned equipment expenses were presented under operational costs. Note also the increase in operational costs from \$111m to \$141m.
- The breakdown between civpol MSA and non-MSA is an estimate for 1999-2000 and 2000-01. Only the aggregate amounts of \$20.2m (1999-2000) and \$51.9m (2000-01) were presented in the performance reports. The Civpol MSA was estimated using the same approach as outlined in note a. for military observer MSA. The cost of the formed police units were estimated based on the per unit cost of providing the formed police unit in 2001-02. The non-MSA spending was again calculated as a residual.
- The full cost of civilian police is not captured in the performance reports. In general civilian police receive their wages from their home country and their MSA from the Assessed Contribution budget. For this reason the non-MSA costs of civilian policing appears significantly lower than civilian staffing.
- The breakdown between international staff costs, international staff MSA and national staff for 1999-2000 and 2000-01 is an estimate. Only the aggregate amounts of \$40.6m (1999-2000) and \$117.6m (2000-01) were presented in the performance reports. The breakdown is estimated using the same approach as outlined in notes a. and c. above.

- f. The staff assessment charge is reported separately in the 1999-2000 and 2000-01 performance reports, but is included as part of international staff costs in subsequent years. For consistency of presentation the staff assessment charge has been included as part of the non-MSA civilian staff costs in 1999-2000 and 2000-01. This means that (for example) the aggregate amount for international staff costs is \$117.6m comprising the \$103.1m presented in A56/922 plus \$14.5m presented as staff assessment costs.
- g. The breakdown between UNV allowances and UNV is an estimate for 1999-2000, 2000-01, and 2001-02. Only the aggregate amounts of \$6.2m (1999-2000), \$15.4m (2000-01), and \$22.6m (2001-02) were presented in the performance reports. The breakdown between allowances and other costs is estimated using the same approach as outlined in notes a., c. and d. above. [This methodology could not be applied for the first two years as multiplying the average allowance rate by the average UNV staff strength led to an allowance amount greater than the total expenditure. So the approximately 1/3:2/3 split in subsequent years was applied.]
- h. Some items in operational costs do not match identically with the information presented in the performance reports. This is because some categories have been aggregated together to allow consistent reporting across the five years. It is also because some minor items and programs classified separately, and outside of the operational costs have been included under 'special/other programs'.

Table A2 – Human Resource Deployment

	12/99-6/00	7/00-6/01	7/01-6/02	7/02-6/03	7/03-6/04	7/04-6/05
International civilian staff	474	896	785	392	315	277
National staff	1,139	1,804	1,656	924	794	614
Military contingents	5,496	7,889	6,820	4,010	2,143	310
Civilian police	860	1,169	1,099	688	250	157
Formed police units	0	240	220	-	117	-
Military observers	190	136	117	111	81	42
Civilian advisers	-	-	-	-	-	58
UNVs	211	554	522	225	166	144

1.3 Estimating the external spending of UNTAET/UNMISSET

Of the overall spending of UNTAET/UNMISSET, around 80% was spent externally. That is while goods or services may have been delivered in Timor-Leste they were purchased from foreign suppliers or foreign governments.

The two single largest categories of spending are the reimbursements paid to troop contributing countries and the expenditure on civilian staff (excluding MSA, discussed below). The other personnel related costs are the costs (excluding MSA) associated with military observers and civilian police.

The other category of expenditure is the operational costs of the mission. The vast majority of this expenditure, which includes such things as communications, transportation, support costs for troops and IT, represents purchases procured from external providers. The performance reports do not distinguish between local and external procurement. However, information on the operational costs that were incurred through local procurement can be obtained from the UN procurement systems; the Reality system from the start of the mission until the late 2002 and then the Mercury system subsequently. The information in these systems is captured in a calendar year, not a fiscal year basis. In order to present the information on a fiscal year it is assumed that the expenditure occurs evenly through the year.

Based on the information from the procurement systems, the breakdown between local and external procurement is presented in Table A3 below.

Table A3 – Local and External procurement (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
External procurement	124,054	104,097	133,668	86,208	51,630	499,657
Local procurement	2,257	7,538	7,282	5,817	11,158	34,052
Total	126,311	111,635	140,950	92,025	62,788	533,709

Combining the information on the breakdown between local and external procurement with the information contained in Table A1 allows the budgeted funds spent outside of Timor to be estimated.

Table A4 – Summary of external spending (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Military contingents, Civpol and Observers	97,336	237,169	147,773	102,539	69,360	654,177
Civilian staff	19,985	79,241	66,173	36,944	30,233	262,230
External procurement	124,054	104,097	133,668	86,208	51,630	499,657
Total	243,386	425,673	355,088	229,920	153,432	1,407,500
% of overall spending	83.3%	80.7%	78.2%	79.8%	78.3%	79.9%

Notes: Figures exclude MSA and allowances

1.4 Estimating the amount of MSA spent in Timor-Leste

A major source of economic activity associated with the UNTAET/UNMISSET presence is from the spending by international staff from their allowances. There is no definitive accounting of the extent of spending by international staff. Based on survey data it is estimated that of the \$293m paid in allowances, around 57% or \$167m was spent in Timor, with the remaining \$126m retained by international personnel or remitted to their home countries.

The overall level of MSA and allowances paid to international staff is presented in Table A5 below.

Table A5 – Overall amount paid in allowances (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Civilian staff (non-MSA)	16,627	31,991	28,028	13,576	10,460	100,682
UNV allowances	4,200	10,200	15,138	6,457	5,444	41,438
Civilian Police and Military Observer (non-MSA)	21,528	45,829	42,688	28,571	12,074	150,690
Total	42,355	88,020	85,854	48,603	27,978	292,810

To estimate the amount of MSA spent in Timor the following information was used:

- UN survey on spending by international staff;
- PDT survey on spending by international staff;
- Distribution of civilian police and international staff across the country;
- hotel, bar and restaurant turnover data from the Timor-Leste Revenue Service; and
- PDT commissioned surveys on spending outside of Dili.

1.4.1 MSA spending by international civilian staff

Overall it was estimated that international civilian staff spent just over two-thirds of their MSA or just under \$2,000 per month when based in Timor-Leste.

As part of an ongoing process to determine the appropriate level of allowance, the Office of Human Resource Management in the United Nations conducted a survey of all UN staff in Timor in November 2003. The survey yielded a response rate of 65% (594 from 912). Duplicate responses (eg spouses or multiple people at the same address) were then removed, leaving a total of 295 responses.

As part of this project PDT also undertook a survey of international staff who worked during the last five years at the UN mission.²⁷ The survey was sent to 800 international staff members and 207 responses were received. The following average monthly expenditure was reported by the UN staff who responded to the surveys.

Table A6 –International staff expenditure in Timor-Leste, by category

	UN survey	PDT survey	Combined	Share
Housing (including rent, utilities, staff)	\$728	\$818	\$768	39%
Restaurants	\$523	\$460	\$470	24%
Self prepared food	\$419	\$600	\$506	25%
Miscellaneous	\$230	\$290	\$241	12%
Total	\$1900	\$2168	\$1984	100%

For the purposes of estimating how much MSA was not spent in Timor the results of the two surveys were combined. This yielded a total of 434 separate responses – 78 staff members responded to both surveys. The combined average monthly spending is presented in the final column of the table.

The average monthly MSA received by international staff in Timor-Leste was \$2910.²⁸ Based on the survey data, international staff spent just over two-thirds (68%) of their MSA in Timor-Leste. Put another way, of the approximately \$100m in MSA paid to international civilian staff, just under \$70m was spent in Timor-Leste.

The \$70m figure is likely to be an upper, rather than a lower estimate of the actual spending for several reasons. First, it is in survey respondents' personal interest to indicate higher, rather than lower levels of spending. The UN survey is specifically carried out as part of a review process to set the allowances, so respondents, acting in their own self-interest may inflate expenditure to ensure that allowances are maintained or increased. While the PDT survey was not carried out in order to revise allowances, staff may have considered it would be an input into a review.

²⁷ This survey can be found online at <http://www.peacedividendtrust.org/EIP-Survey.htm>.

²⁸ MSA was \$132 per day for the first month and then \$90 per day for subsequent. The \$2910 figure assumes a six month contract.

There were also several features of the PDT survey that would have biased up the results. The survey used ranges of spending and used the midpoint of the range as the estimate of spending. By excluding the option to include zero as a response, if a person spent nothing then they would be recorded as having spent the midpoint of the lowest range. For example, if someone never ate at a local restaurant (which was the case for some international staff) they would record an entry of \$0-100 and be recorded as spending \$50. In addition, when examining the survey data, some responses were at a level that would seem to be above the credible. For example a quarter of the respondents to the PDT survey reported spending over \$200 per month in local restaurants. Yet few local restaurants charged over \$2 per meal, meaning that even if 3 meals per day were eaten at a local restaurant every day of a month it would be hard to spend over \$200. Finally, the responses for furnishings a house seem high in the PDT survey (included under miscellaneous expenses above). It may be that people included once-off expenditures as a monthly expenditure rather than spreading the single expenditure over the full period.

Each of these concerns would have biased the estimated spending up. There do not appear to have been any offsetting factors that would have biased the estimates down. While the latter three of these factors can be addressed in future surveys the first bias cannot be removed easily.

1.4.2 MSA spending by civilian police and spending by UNVs

In the case of civilian police it is estimated that 50% of the MSA was spent in East Timor and 50% was retained or remitted to their home country, while in the case of UNVs it is estimated that 60% of the allowances were spent. No similar surveys of spending by civilian police or by UNVs have been undertaken. Accordingly, this section presents a qualitative discussion of how the civilian MSA results have been amended to construct an estimate of the amount of allowances spent in Timor-Leste.

In the case of civilian police two factors have led to assumption that the level of MSA spent in Timor is significantly lower than for civilian staff. The major factor is the different terms and conditions for international civilian staff and civilian police. International civilian staff are contracted to the United Nations and receive a salary from the UN as well as their MSA. For most mission staff of UNTAET/UNMISSET the MSA represented less than half of their overall remuneration (salary plus MSA).^{29,30} In contrast, civilian police are seconded from their home forces. In general, civilian

²⁹ International staff fall into three categories: professional staff (P or D levels); field service staff; and general service staff. Professional staff at level P-2 and above receive monthly salaries greater than the MSA paid. In the case of FSS and GSS there are seven levels, with ten or more increments within levels. An FSS level 1 on the first increment receives a net monthly salary of around \$2300, an FSS level 2 on the middle increment level receives the same amount in salary as they receive in MSA, all other FSS staff receive more in salary than they do in MSA. A GSS level 1 on the first increment receives a net monthly salary of \$1582, while a GSS level 3 on the second increment receives the same amount in salary as they receive in MSA. In terms of the breakdown of international staff, over half of the staff were professional staff at P-2 level or above, around 30% of the staff were FSS, while just under 20% of the staff were GSS.

³⁰ Professional and FSS staff also receive considerable other benefits as part of their overall remuneration package, which would be far more generous than benefits accruing to most civilian police in their home jurisdictions.

police continue to be paid their salary by their home police force. So their total remuneration is comprised of their domestic salary and their MSA. Over the first five years of the UNTAET/UNMISSET mission 70% of the civilian police came from non-OECD countries and half of the civilian police came from countries where the average wage of government employees was below \$500 per month.^{31,32} Specifically, around 27% of civilian police were deployed from the following nine countries with average monthly government wages below \$250: Bangladesh; China; Gambia; Ghana; Nepal; Nigeria; Pakistan; Senegal and Sri Lanka. A further 23% of the civpol deployment was from countries with average monthly government wages between \$250 and \$500: Jordan; Philippines; and Samoa.

In the case of a police officer from the nine countries with the lowest average wages, the MSA received for a six month deployment would be equal to more than five years of regular salary and in several cases more than ten years of regular salary. In the case of the other three countries, six months of MSA would be equal to three to five years of regular salary. Given the value in regular salary that the MSA represented to these police officers it is likely that they would have spent a significantly lower level of MSA, saving the remainder to take back to their home country.

The second factor limiting the ability of the civilian police to spend their MSA is that around half of the civilian police were deployed outside Dili, where the ability to actually spend MSA was limited. In most of the country there were very limited goods and services available for purchase. The Timor-Leste Revenue Service reported that there were no businesses turning over sufficient revenue to need to file services tax returns outside of Dili and Baucau, and in Baucau there were less than five businesses that met this threshold.^{33,34}

Based on this information, for the purposes of estimating the amount of MSA spent in Timor-Leste it was assumed that half of the civpol, including the 30% of civpol from OECD countries, had MSA spending patterns similar to those of the international civilian staff – that is they spent around two-thirds of their MSA, just under \$2000 per month. We then assume that the remaining civilian police, where the average civil service wage is below \$500 per month, spent half this amount, or just under \$1000 per month.

In the case of UNVs there is even less data to base an estimate on. However as the UNV figure is the smallest of the three this lower precision will have less of an impact. As UNVs do not receive any other income apart from their allowances it is likely that they would spend less than international staff who are also receiving a salary. For the

³¹ Percentages in this section are calculated using six monthly data on civpol deployment provided by UN.

³² Information on average salaries for police in these countries was not readily available. Estimates of average government employee wages were constructed using data from country data from a World Bank database: <http://www1.worldbank.org/publicsector/civilservice/development.htm>. The average wage data was not directly available, but was estimated by multiplying the per capita GNI by the ratio of average government wage to per capita GDP.

³³ In the case of restaurants, the turnover threshold was \$500 per month.

³⁴ Additional local research on expenditure by civilian police in the districts has been commissioned. Results will be included in the final report.

purposes of estimating the amount of allowances spent in Timor-Leste it is assumed that UNVs spent 60% of their allowances.

Applying these assumptions to the data on the level of MSA and allowances paid yields the following estimates of the amount that was spent in Timor-Leste.

Table A7 – MSA and allowances spent in Timor-Leste (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Civilian staff (MSA)	10,974	21,114	18,498	8,960	6,904	66,450
UNV allowances	2,520	6,120	9,083	3,874	3,266	24,863
Civilian Police and Military Observer (MSA)	10,764	22,914	21,344	14,285	6,037	75,345
Total	24,258	50,149	48,925	27,119	16,207	166,658

1.5 Estimating the additional leakages and injections

Combining the results of the previous two sections provides an estimate of the amount of money that was actually spent in Timor-Leste by UNTAET/UNMISSET and its staff. This is presented in Table A8.

Table A8 – Spending in Timor-Leste (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
National Staff salaries	4,013	6,355	5,834	3,601	3,440	25,896
Allowances spent in Timor	24,258	50,149	48,925	27,119	16,207	166,658
Local procurement	2,257	7,538	7,282	5,817	11,158	34,052
Total	30,527	64,042	62,041	36,537	30,805	223,952

This estimate of spending needs two further adjustments in order to provide an estimate of the demand impact on the local economy. First, a considerable portion of the goods and services purchased under local procurement or by internationals with their allowances would have been imported. In this regard the imports may have been in the form of goods (such as oil, bottled water or furnishings and fittings) or in the form of labour services – ie foreign workers operating hotels or restaurants. Moreover, the profits from these businesses would have been received by the owners, so profits from foreign owned businesses would also have leaked out of the economy. Partially offsetting this, some of the funds spent externally, either to contractors such as Eurest, or on military contingents may have leaked back into the economy, particularly if these groups hired local Timorese staff.

To estimate the amount of money that stayed in Timor-Leste requires breaking down spending from allowances into several different categories, and where breaking out Timorese and foreign suppliers. The estimated breakdown is presented in Table A9 below.

To determine the leakages out of the economy the following assumptions were made. In the case of foreign-owned hotels, restaurants and stores it was assumed that 75% of the revenue was used to pay for imported goods, foreign staff or repatriated profits. The remaining 25% was assumed to cover the costs of local staff wages, and local purchases

of inputs, including food and supplies.³⁵ For rental accommodation it was assumed that 75% of the revenue stayed with the local landowners and 25% of the rent was used to pay for capital improvements.³⁶ For purchases from local markets it was also assumed that 75% of the revenue stays in the local economy and the remaining 25% is used to purchase imported goods sold at the local markets.

Table A9 – Estimated breakdown of allowance expenditure by category (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
Hotel accommodation	7,568	12,713	9,540	3,702	1,264	34,788
Private rental housing	1,892	6,845	9,540	6,875	5,057	30,209
Foreign owned restaurants	4,075	8,425	8,219	4,556	2,723	27,999
Local restaurants	1,747	3,611	3,523	1,953	1,167	11,999
Purchases from foreign owned stores	6,014	12,432	12,129	6,723	4,018	41,315
Purchases from local markets	2,962	6,123	5,974	3,311	1,979	20,349
Total	24,258	50,149	48,925	27,119	16,207	166,658

Notes:

- For the purposes of this estimation it is assumed that the spending shares between categories of expenditure were the same across international civilian staff, police and UNVs. That is, it is assumed that all staff spent 39% of their allowances on accommodation (see Table A6).
- The UN and PDT survey did not distinguish between hotel and private rental housing. Based on survey data and an understanding of the local accommodation market, it is assumed that half of the international personnel lived in hotel accommodation in 99-00, and that around ten percent of international personnel were living in hotels in 2003-04. It is also assumed that international staff moved out of hotels into the local community in a roughly even fashion, that is the share in hotels declined by 10% per year.³⁷
- The split between purchases at foreign-owned and local restaurants and markets is drawn from the PDT survey. In this survey respondents were asked to separate spending at local and foreign owned establishments. In the case of purchases of food, the split was 67% of purchases in foreign owned shops and 33% of purchases at local markets. For local restaurants the split is 70% in foreign owned restaurants and 30% in locally owned restaurants.
- Purchases from foreign owned stores includes food and miscellaneous purchases.

³⁵ The figure of 25% staying in the domestic economy aligns with the IMF approximate estimate of the overall amount of money that stays in the domestic economy from aid spending more broadly.

³⁶ This figure assumes that the land is owned locally. An additional source of leakage is if the landowners live overseas and repatriate the rental income.

³⁷ In the early stages of the mission many international staff were housed on one of two barges that were converted into floating hotels. The maximum capacity of these barges was around 900 beds³⁷ and for the first few months of the mission the hotels were close to capacity. In the middle of 2000, at any given time there were between 1500 and 2000 international personnel in Dili, meaning that even in the earlier stages of the mission possibly half the staff were living in some form of rental housing.

The two surveys of MSA spending also provide an insight. In these surveys respondents reported the amount they spent on accommodation. In Dili hotels were charging more than \$30/night, and in some cases considerable more, even for long term tenants. This means that respondents who reported paying under \$900/month on accommodation would have been living in rental accommodation, while most of those paying over this amount would have been staying in hotels. In the UN survey, 10% of the respondents reported spending over \$900/month on accommodation, suggesting that by November 2003, only 10% of these staff were still living in hotels. In the PDT survey, which covered the entire life of the mission, 25% of respondents reported spending over \$1000 per month on accommodation, indicating that for the overall period around 25% of international staff were living in hotels. An overall figure of 25% for the period is consistent with a first year figure of around fifty percent and a steady decline over the five years to ten percent.

Importantly in calculating the financial impact, the 10% of people paying over \$900/month in the UN survey accounted for 20% of the aggregate reported spending on accommodation, while the 25% paying over \$1000 per month accounted for 50% of the aggregate reported spending.

In the case of local procurement, examination of the procurement data from the Reality and Mercury systems indicates that around 90% of the local procurement was undertaken by foreign firms operating in Timor-Leste.³⁸ In these cases, and based on an examination of the actual procurements it is assumed that 90% of the revenue was used to cover imported goods, foreign staff or repatriated profits.³⁹ In the remaining 10% of cases it is assumed that 50% of the revenue was used to cover these costs.

Finally, some of the funds paid to external contractors who received contracts from the United Nations was injected into the economy. The primary way this happened was through local employment. In the case of the military, discussions with troop contributing countries confirmed that local hiring and local purchases were small.⁴⁰ In the case of external contractors, Eurest, one of the major recipients of contracts from UNTAET/UNMISSET contracts in Timor-Leste, reported employing around eighty staff. For the purposes of estimation it was assumed that 0.5% of the value of the military contingent and external procurement expenditure was injected into the local economy.

Combining these factors together provides an estimate of the adjustment that is needed to the amount of spending presented above.

Table A10 – Adjustments due to leakages and additional expenditure (\$US 000)

	12/99-6/00	00-01	01-02	02-03	03-04	Total
MSA spending on imports	16,374	32,383	30,162	15,926	9,043	103,889
Local procurement on imports	1,941	6,483	6,263	5,003	9,596	29,285
Spending associated with military/contractors	-470	-1,126	-702	-500	-329	-3,128
Estimated impact	17,845	37,740	35,723	20,428	18,311	130,046

1.6 Estimating the overall direct fiscal impact

Combining the results of the previous sections yields an overall fiscal impact on the local economy from the peacekeeping mission of \$93.9m over the period from December 1999 to June 2004. Table A11 presents a summary of the results presented in the previous sections, including the overall amount of spending that has occurred locally.

³⁸ This estimate was based on a case by case examination of the procurement data from the Mercury system, and information on specific firm origin provided by UNMISSET procurement staff.

³⁹ The majority of local procurement was for goods, which were imported. For example, in calendar year 2004, over 85% of the local procurement was spent on oil procured from Petermina.

⁴⁰ Military contingents are not reimbursed for the cost of hiring local staff – this means that the costs incurred are incurred by the actual country. This makes it less likely that contingents from non-OECD countries would incur these costs. In addition, many contingents also include enlisted personnel who undertake support roles, reducing the requirement to hire local staff. In the case of the Australian contingent, approximately 40-50 local staff were hired, with an annual wage bill of around \$120,000. In discussions Australian military personnel, reported that it was their understanding that few other contingents hired local staff.

Table A11 – Overall level of UNTAET/UNMISSET spending (\$US 000)

	12/99 -6/00	00-01	01-02	02-03	03-04	Total
External spending (less local impact)	242,916	424,547	354,386	229,420	153,104	1,404,372
Allowances not spent	18,097	37,871	36,929	21,484	11,771	126,152
Spending on imports	18,315	38,866	36,425	20,928	18,639	133,174
Subtotal	279,328	501,284	427,740	271,832	183,514	1,663,698
Allowances spent	7,884	17,765	18,763	11,193	7,163	62,769
National staff salaries	4,013	6,355	5,834	3,601	3,440	23,243
Local procurement (retained)	316	1,055	1,019	814	1,562	4,767
Local impact from external contractors	470	1,126	702	500	329	3,128
Subtotal	12,683	26,301	26,318	16,108	12,494	93,907
Total	292,011	527,587	454,058	287,941	196,008	1,757,605

1.7 Estimating the overall fiscal impact

Up to June 2004 \$94m was spent on locally produced goods and services by the international community. However the impact on GDP would have been greater than this because of the Keynesian multiplier effect (see section 3.3.3 for a discussion. The size of this multiplier effect is determined by two factors: the percentage of income that is saved and the percentage that is spent on imported goods. In both cases there is little data available, so the estimates are based primarily on qualitative considerations.

Savings rate

The primary economic beneficiaries from the international presence were those that gained employment either directly with UNTAET/UNMISSET or indirectly through the expansion in the provision of services for international staff; and those that either had land to lease, or capital to expand their businesses. Given that at its peak UNTAET employed less than 2,000 people, it is not unreasonable to think that less than 10,000 people derived a direct benefit from the international presence – and these 10,000 people would have occupied the upper portion of the wealth distribution, and been well placed to save a portion of this income. Moreover, these people would also have been aware of the transitory nature of the economic windfall they were receiving from the international presence, so would be unlikely to have spent it all. While this discussion does not represent economic data, in the absence of such data, it is postulated that the saving rate out of this income may have been in the range of 15-30%.⁴¹

Import ratio

Again, in determining the likely leakage into imports it is important to remember that the group receiving this economic windfall were at the upper end of the socio-economic distribution. Hence their consumption spending would have a higher import content than that of the average consumer in Timor-Leste.

There are two features of the Timor-Leste economy that are relevant. First, very few consumption goods outside food and some furniture are made in Timor-Leste. While

⁴¹ One could make a strong argument based on the permanent income hypothesis that this estimate of the saving rate may be a significant underestimate.

more is being produced domestically, during the first couple of years of UNTAET, Timorese who wished to purchase consumption goods had to purchase imports. Second, the nature of the Timorese economy is that there are very few intermediate 'value-adding' industries. Most production involves taking either raw materials or imports, and then transforming these directly into a finished product. This means that the import content of consumption is always going to be higher than in a country where there are several intermediate production steps. The only non-imported value-added is either the natural raw material or the labour of the business doing the production. These two features together suggest that the leakage into imports could be quite high.

In terms of quantifying this effect, one possible measure would be the overall leakage of aid funds into imports. While there is again no definitive data on this, IMF staff estimates place this figure at around 70-80%. For the purposes of this study, and noting that the leakage of aid funds into imports also includes a sizeable portion of imported technical assistance, it was assumed that 50% of consumption spending by Timorese consumers went into imports.

Combining these two features gives a multiplier in the range of 1.5 -1.6, that is for every dollar injected into the local economy by the international presence GNP is estimated to increase by around \$1.50 to \$1.60. Additional work is required to improve this estimate. However, the low level of inflation in the domestic economy, coupled with the relatively low growth in GNP (particularly over the period from 2001-2003) suggests that the multiplier would have been at the lower, rather than higher end. Moreover, in the absence of improved national accounts statistics for Timor-Leste, the scope for improvements is limited.

2. Derivation of the distributional impact

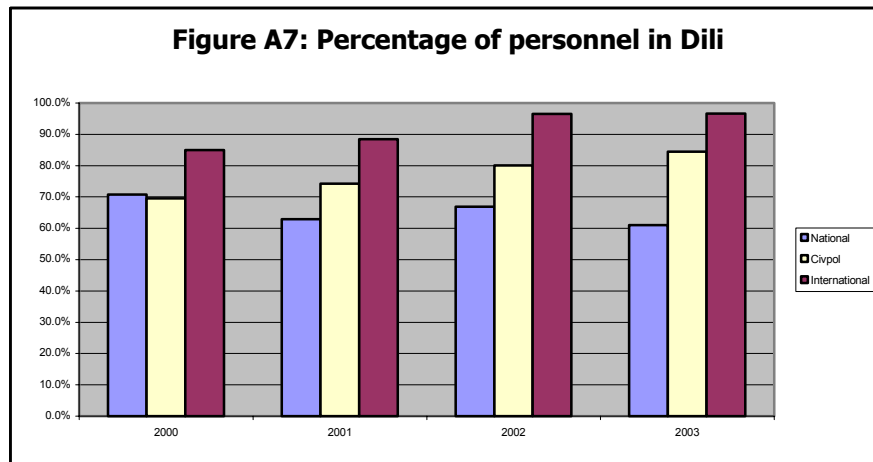
The distributional impact of the spending from UNTAET/UNMISSET was estimated by apportioning the major elements of local spending across the districts in proportion to the international presence.

Information on the location of national and international staff over the four year period is presented in Figure A7 and Table A14. Figure A7 highlights the extent to which the mission was focused on Dili during its duration. Over 80% of international staff (rising to well over 90% and over 70% (rising to over 80%) of civilian police were located in Dili. As the overall size of the mission declined the share of national staff based in Dili actually declined – representing the fact that national staff employment in Dili was dropping more rapidly than national staff employment in the districts.

In order to estimate the economic impact and assess the level of benefit accruing in different parts of the country the location data was combined with the fiscal data on national wages and allowances spending.

The distribution of benefits across the country is presented in Table A13. Over three quarters of the benefits accrued in Dili, primarily because so much of both the international and national presence was centred there. In 2000-01, 77% of the benefits were being accrued in Dili, and this figure had risen to over 85% by 2003-04.

In the first two years of the mission slightly more benefits were accrued outside of Dili as the national and international presence was in place across the country – although the level of the presence was always heavily weighted to Dili. With the change in mission mandate from UNTAET to UNMISSET the footprint became even more centred on Dili. The only districts to continue to receive benefits were Baucau, Bobonaro, Cova Lima and Oecussi, which retained a reduced national and very reduced international presence.



Source: UN staffing data

Table A13 – Distribution of benefits from international presence

	00-01	01-02	02-03	03-04
Dili	77.1%	78.5%	84.3%	85.4%
Regions				
Aileu	1.3%	1.0%	0.3%	0.4%
Ainaro	1.4%	1.3%	0.5%	0.4%
Baucau	3.2%	2.9%	3.6%	2.6%
Bobonaro	2.3%	2.1%	2.0%	2.4%
Covalima	2.3%	2.5%	4.1%	4.2%
Ermera	2.1%	2.1%	0.7%	0.6%
Lautem	1.8%	1.9%	0.5%	0.3%
Liquica	1.8%	1.5%	0.6%	0.3%
Manatuto	1.8%	1.7%	0.3%	0.3%
Manufahi	1.4%	1.3%	0.4%	0.5%
Oecussi	2.0%	1.7%	2.2%	2.2%
Viqueque	1.4%	1.4%	0.6%	0.3%
Regions Sub-total	22.9%	21.5%	15.7%	14.6%

Table A14 – Distribution of UNTAET/UNMISSET staff over the life of the mission

	National Staff					International Civilian Staff					Civilian Police			
	Sep-00	Sep-01	Sep-02	Sep-03	Sep-04	Sep-00	Sep-01	Aug-02	Aug-03	Sep-04	Jun-01	Dec-01	Dec-02	Dec-03
Dili	1224	1130	629	485	319	683	799	436	400	255	284	316	102	41
Dili Region						16	8	4	3	3	336	376	213	48
Other											333	317	274	243
Sub-total	1224	1130	629	485	319	699	807	440	403	258	953	1009	589	332
Regions														
Aileu	15	29	3	3	13	11	7	0	0	0	23	13	4	5
Ainaro	14	36	6	5	2	12	8	0	0	0	27	22	6	4
Baucau	85	85	35	46	19	15	12	4	3	2	56	56	46	8
Bobonaro	50	60	45	44	33	10	10	4	3	3	49	37	10	5
Covalima	72	103	90	85	38	10	12	4	3	2	33	29	26	6
Ermera	39	55	10	9	3	10	8	0	0	0	47	44	8	5
Lautem	43	56	7	2	2	7	9	0	0	0	35	32	7	4
Liquica	32	35	6	4	3	7	7	0	0	0	44	33	8	3
Manatuto	49	64	3	2	2	13	12	0	0	0	23	14	4	4
Manufahi	15	37	4	2	4	11	7	0	0	0	28	21	5	8
Oecussi	52	57	42	35	28	10	8	4	5	1	34	26	16	5
Viqueque	41	49	9	3	2	8	5	0	0	0	18	23	7	4
Sub-total	507	666	260	240	149	124	105	16	14	8	417	350	147	61
Bank transfer			51	69	117									
Total	1731	1796	940	794	585	823	912	456	417	266	1370	1359	736	393

Notes:

National staff data came from UNTAET/UNMISSET payroll records. The records did not distinguish between Dili and Dili district.

International civilian staff and civilian police data were provided by the United Nations.

Civilian Police were allocated either to a district, to Dili, to the HQ function, which was in Dili, or to a range of specialist positions. The specialist positions included the Rapid Response Unit, different investigative arms of the police, the courts, or border, immigration and customs units. Almost all, if not all of these other posts were located in Dili.

Appendix B: Literature Review

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Appendix C: List of People Interviewed

Name	Position	Organization
Baidya, Chandan	OIC Finance Section	UNMISSET
Beazley, David	Advisor	Ministry of Finance
De Lemos, Manual	Assistant Coordinator Finance Office	Ministry of Finance
De Sousa, Jerry	Businessman	
Fitzgibbon, Margaret	IMF Advisor	National Statistics Directorate
Fleming, Col. Wayne	Australian Defence Attache	Department of Defence,
Freitas, Joao Cancio	Director	Dili Institute of Technology
Goncalves, Dr. Jose	Investment Advisor	Office of the Minister of Investments
Gray, Gary	Chief, Political Affairs	UNMISSET
Hasegawa, Dr. Sukehiro	SRSRG	UNMISSET
Huybens, Elizabeth	Country Manager	World Bank
Inton, Rufus	Chief, Procurement Office	UNMISSET
Jones, Stretton	Adviser	Timor-Leste Revenue Service
Khare, Atul	DSRSG	UNMISSET
Locatelli, Fr. Elegio	Head of Community	Salesian Don Boscho Schools
Manson, Douglas	Senior Liquidation Coordinator	UNMISSET
Mendoca, Manuel	Director	National Statistics Directorate,
Parr, Annelise	Special Assistant to the DSRSG	UNMISSET
Rao, Amareswara	Chief of Personnel	UNMISSET
Redding, Lance	Dili District Security Officer	UNMISSET
Redshaw, Tina	Ambassador	British Embassy
Ribeiro, Ricardo da Costa	Advisor to the PM	Office of the Prime Minister
Saldhana, Dr. Joao	Executive Director	Timor Institute of Development Studies
Seibel, Nicole	Program Manager	USAID'
Shadwick, Mick	Advisor	Ministry of Finance
Simon, Margaret	Chief Administrative Officer	UNMISSET
Sipple, Richard	Country Manager	JDS Engineering
Smith, James	CISS	UNMISSET
Soares, Francisco	Deputy Commissioner	Timor-Leste Revenue Service
Staples, Peter	Procurement Officer	UNMISSET
Stein, Sean	Deputy Chief of Mission	Embassy of the United States
Sukacz, Victor	OIC Security	UNMISSET
Taplin, Bruce	Advisor	Ministry of Finance
Teixeira, Jose	Secretary of State for Investment	Ministry of Investment
Turner, Ann	Director	East Timor Tourism Association
Ward, Malcolm	Project Manager	Compass/Eurest