

From:
Date: 20 February 2003
Extn:
Room: 1/8

Chancellor
Chief Secretary

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Iraq: update on potential cost and how should we present them?

Issue: Update on likely total costs of conflict.
How do we handle presentation of the costs of the Iraq conflict in the Budget? Should we further increase our allocated special Reserve?

2. We now have MODs first estimates of the likely total cost of conflict in Iraq if a decision is made to stay "in theatre" after an operation and provide a medium term stabilisation/peace keeping force. These are "upper limits" based on what is feasible in military terms but our experience to date with MOD estimates, suggest that these could well become central case estimates in time. The totals are set out in the table below

Military action in Iraq	2002-3	2003-4	2004-5	2005-6
Preparatory activity	1000			
Running costs - war fighting	100	300		
Fighting (cost of ammunition)	200	200		
Running costs - immediate aftermath		600		
Recuperation		400	400	200
Running costs - post conflict stabilisation		600	800	200
Total MOD costs	1300	2100	1200	400

3. The extent to which any of this is optional is unclear. We think that, because of our Geneva convention obligations, it will be impossible to resist keeping a substantial force in theatre for at least six months post the end of fighting. This is the 'immediate

aftermath' line in the table above. In practice the emerging politics of a post-conflict Iraq point to a much more substantial commitment both in terms of size and length of stay.

4. We will also need to take account of potential costs of humanitarian and reconstruction aid. Our line to date has been that departments (mainly DfID) should meet these through re-prioritisation. We would welcome your steer on this but, based on past conflicts, we suspect it is unlikely to be a sustainable line in the long term. In the worst case then total costs might look something like this:

Military action in Iraq	2002-3	2003-4	2004-5	2005-6
Preparatory activity	1000			
Running costs - war fighting	100	300		
Fighting (cost of ammunition)	200	200		
Running costs - immediate aftermath		600		
Recuperation		400	400	200
Running costs - post conflict stabilisation		600	800	200
Total MOD costs	1300	2100	1200	400
DfID humanitarian costs?		250?		
DfID reconstruction costs?		250?		
Grand total	1300	2600	1200	400

How will we fund this?

5. For **2002-3** we have made provision of **£1.75 billion**. MOD have now drawn down £1 billion of that in their Spring Supplementary Estimate. If conflict begins in earnest in March then the total spend for the year could rise to some £1.3 billion otherwise MOD are unlikely to spend more than the billion they have drawn down.

6. This suggests we may have an under-spend on the Special Reserve. It looks likely that overspends in other areas, including the total cost of other military operations this year, will more than soak up this under-spend (indeed, we risk an overall DEL overspend).

7. For **2003/4**, assuming a budget in the next month, we think you

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have three options:

- a) **Increase DEL** to reflect our best estimate of likely costs if a conflict does occur. For 2003-4 we would need to score this as a direct spending hit on the current deficit in the fiscal tables, because it would not be containable within the existing spending envelope (unless we made offsetting spending cuts elsewhere). This option has a number of disadvantages: it would have a very substantial fiscal impact; it would remove the pressure on No 10 to properly consider costs in taking further political decisions; and it would also reduce the pressure on MOD and other departments to contain costs. Finally it might make other departments believe the existing Reserve was "open for business" for other bids. For these reasons we do not recommend this option.
- b) **Make some additional provision for direct military costs** by rolling forward and perhaps increasing the Special Reserve. The fiscal envelope does not currently contain any provision for this over and above the existing Reserve. So, simply rolling forward the potential surplus 0.75bn would mean we would need to score an equivalent fiscal increase.
- c) **Make no further provision at this time** In public presentation we would point to the existing Reserve and the provision we'd already made in 2003/4. In narrow public finance terms this option is probably the safest. It reflects the considerable degree of remaining uncertainty over total costs and their profile (indeed it is of course possible that Saddam might still disarm). In the event conflict did go ahead then it would allow us to take a more considered view of the public finance impact in the PBR. It would also give you the discretion, if the public finances worsened, to make offsetting savings elsewhere rather than permanently building in higher spending. There are two caveats though to this approach. The first is whether saying nothing further about total costs is politically sustainable given what we've said to date. The second is whether, on balance, it would be better to reflect some of the fiscal pain now.

8. In the event the Budget slips much beyond early April then we

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will need to think again to reflect the actual situation on the ground. If by that point we have clearly made a substantial commitment then we think option 3 would cease to be credible. In that case we may need either to make a further allocation to the Special Reserve, which we would score fiscally, or look for offsetting public expenditure savings elsewhere (on which you have separate advice).

9. For **2004-5 and beyond** the combination of very real uncertainty about the actual costs and a healthier overall Reserve suggest that the additional impact of the conflict on the public finances could still be credibly contained within existing totals. For this reason we do not think there is any need at this point to consider making decisions about these years.

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4