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From:
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Extn: 4901
Room 3/20

CHIEF SECRETARY

cc: Mark Bowman
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IRAQ FUNDING FY 2003-04: DEALING WITH RESERVE CLAIMS

Issue

Options for dealing with Reserve claims for Iraq funding for the remainder of this FY, following the Prime Minister's recent call for a step-change in the UK's effort in Iraq.

Recommendation

That you note the strategy we intend to pursue at official level, scrutinising Reserve claims on a case-by-case basis and maintaining pressure on departments to look at reprioritisation and efficiency savings to cover increased Iraq expenditure in the first instance.

Timing

Routine

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Background

UK Spend to Date: DFID Costs

DFID has so far committed £210m for humanitarian and reconstruction assistance in Iraq. These funds have been drawn from DFID's pre-conflict allocation for Iraq (£15m), their Unallocated Reserve (DUP) for 2003-04 (£75m), and from the Reserve (£120m). In addition, a further £60 million was announced during the Budget for Iraq reconstruction bringing the total to £270m.

	2002-03 £m	2003-04 £m	Total
DFID Resources	15	255	270

2. Of the £60 million announced in the Budget, c£20 million has been transferred to the FCO to cover the costs of HMG secondees to the CPA, including the provision of increased security.

MOD Costs

3. The most recent formal cost forecast update is as follows:

Phase / £m	2002-03	2003-04	SUB-TOTAL	2004-05	2005-06	TOTAL
1 + 2: Plan / Prepare	682	180	862			862
3: Conflict	543	112	655			655
4: In-theatre		1082	1082	800	200	2082
5: recuperation		400	400	400	200	1000
TOTAL	1225	1774	2999	1200	400	4599

- MOD have always estimated that the costs of Op.Telic would be about £3bn for 02-03 and 03-04
- This fits with the £3 billion put aside to cover the costs of the conflict
- This is 20% Capital: £600m, the rest is Resource DEL.
- The total is also near their original estimate of £5bn
- More recent estimates are that this figure, currently at £4.6bn will go down to £4.2bn, due to inflated recuperation cost forecasts

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A Step-Change in UK Effort: The Potential for Reserve Claims

4. Following the Prime Minister's recent call for a step-change in the UK's efforts in Iraq, with a more immediate focus on rebuilding the country's infrastructure and improving the security situation, there has been much talk at official level of various Reserve claims which may, or may not, be forthcoming. The message from the PM that he wants to see a significant increase in resources in the short-term (in terms of both personnel and funding) in order to secure long-term benefits for the Iraqi people, has the potential to increase pressure on the Reserve from departments who see this as a legitimate invitation to bid for more resources.

5. Details of possible Reserve claims in the pipeline but not yet received are as follows:

i) Security - approx. £10m (MOD/Home Office):

6. Possible claims relating to:

- Costs to cover UK police training teams to train Iraqi police in Jordan – no firm cost estimate yet.
- Increased training of Iraqi Civil Guard and Army by MOD personnel – costs still uncertain.

ii) Media Strategy - £26m (FCO):

7. The Iraq Media Network is perceived as doing a poor job in conveying the Coalition's message. Al Jazeera, whose emphasis is not in the Coalition's best interests, are providing the majority of news coverage for ordinary Iraqis. The Prime Minister has suggested to President Bush that developing a more effective media operation should therefore be a priority. Gary Thatcher (CPA Director of Communications) has proposed a development package costing £26.5 million. The Prime Minister is reportedly very keen for the UK to cover these costs. However, we understand that President Bush has suggested that he does not expect the UK to provide funding for this.

8. The FCO are taking the lead on this, with DFID claiming that it is outside the scope of the IDA. There is a strong sense of urgency from the PM on this, so we need to engage even if we do not actually cover the costs. The latest position is that the CPA is now expected to cover the majority of these costs, with a much smaller UK contribution than originally anticipated.

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iii) Security - £1 to 2m (FCO):

9. During your discussion with Jack Straw two weeks ago, he said he would come back to you on the £16m claim you rejected. FCO senior officials laid out their case to Jonathan Stephens last week and are pushing for us to advise you to concede a further small allocation to prevent the Foreign Secretary from taking this further. Officials will write to us next week and we provide advice in due course.

iv) DFID Call on remainder of £60m held in Reserve

10. Valerie Amos wrote to you on 10 September requesting immediate access to £6.5m from the £60m announced by the Chancellor during the Budget, with the remaining £33.5m earmarked for anticipated requirements later this year. This money will be spent on immediate reconstruction work in the CPA South region, additional funding for NGOs, technical advice to the Iraqi Governing Council and further support for the UN. We will be providing advice in due course for dealing with this claim.

v) UK Contribution to the proposed Multi-Donor Trust Fund

11. Pressure is also building on the UK to make clear its position on an additional financial support for Iraq. Specifically, the UK will need to make a public financing pledge for Iraq at the international Donors' Conference in Madrid on 23-24 October. Until the World Bank/UN Needs Assessment is available and the 2004 budget for Iraq is finalised, it is difficult to estimate what the likely UK contribution will be. However, DFID are beginning to build up a case for a substantial UK contribution – in the region of £250 million – which they will argue will require them to make a further claim on the Reserve.

vi) Iraqi Internees (MOD)

12. On the UK's behalf, US forces are detaining 102 Iraqi nationals at a holding facility in Basrah. These are not POWs, but have been interned on the basis of intelligence or acts against UK forces since the end of major hostilities. Geoff Hoon has suggested establishing an independent board to oversee the treatment of these internees and that the Reserve should cover these costs on behalf of the Lord Chancellor's Department. There are no estimates of costs at this stage.

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vii) Quick Impact Projects - £10m (MOD)

13. MOD are seeking a further £10 million for Quick Impact Projects. QIPs sit on the boundary between military and development activity. They are essential targeted projects which directly lead to increased force protection. Ideally they should be appraised on the same basis as development bids, though pragmatically it is difficult to do so. £10m has been spent to date, as a subprogramme within the Iraq spending figures. We have requested that future spend is identified in the Op.Telic cost updates and controlled as a separate envelope requiring your agreement.

How to deal with further Iraq Reserve Claims in 2003-04

14. It is clear that we need a strategy to assess a potential influx of Reserve claims before the end of this Financial Year. However, it is vitally important to maintain pressure on departments, both at official and Ministerial level, to reduce the possibility of claims being submitted in the first place. We will also continue to push for greater coordination between the MOD, FCO and DFID on funding for Iraq reconstruction and security programmes.

15. After discussing internally with GEP, officials have concluded that the best course of action in the short-term is to continue to scrutinise individual Reserve claims on a case-by-case basis, assessing the extent to which proposals represent Value For Money, the degree of impact they will have in country, whether the costs are robust and well-targeted with key risks identified and, where applicable, contingency measures in place to mitigate these risks.

16. The emphasis will be on satisfying ourselves over the degree of reprioritisation that has taken place to accommodate Iraq-related pressures within existing baselines. DFID received an 8 per cent real terms budget increase over the SR2002 period, the FCO nearly 3 per cent and the MOD received their most generous settlement for 20 years. We are therefore far from convinced that further reprioritisation within existing baselines is not possible. Iraq has clearly become a priority for DFID, the MOD and the FCO and they will therefore be required to scale back some lower order priorities in order to free up resources and provide clear evidence of the degree to which reprioritisation has taken place. This is how we dealt with Reserve claims immediately following the events of September 11 2001 and the subsequent conflict in Afghanistan.

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17. A further reason to maintain pressure on departments and not open the floodgates for further UK funding is the need to push for greater access to CPA resources to cover the costs of rebuilding the country and securing assistance from other donors. The UK has already made a significant contribution to Iraq, both militarily and in terms of post-conflict reconstruction. We are second only to the US in terms of funding for Iraq.

18. Provision of CPA funding is key. Hilary Synnott, the UK Head of CPA South, sent an email on 17 September stating that the problems of resource transfer from CPA Baghdad to the South are beginning to ease and that funding is starting to flow again. However, some officials within the CPA(S) have stated that they find the Whitehall machine easier to navigate than the CPA machine and may therefore pursue funds from London rather than Baghdad. We need to guard against an impression that London is the line of least resistance on funding. We should therefore continue to push for the mobilisation of CPA resources to fund reconstruction initiatives in the South, rather than providing a significant increase in the level of UK funding, which could create the potential for expenditure overlaps with the CPA and alleviate the pressure on Baghdad to resolve the problems of transferring money to the regions. Synnott has stated that by November/December, he expects CPA(S) to be 'awash with funding'. It therefore makes sense to maintain pressure on UK bilateral spending now in advance of the expected increase in access to CPA funding over the coming weeks.

A Central Pool for Iraq claims?

19. A second option we have discussed, given the various claims from MOD, DFID and FCO in the pipeline, is the creation of a pooled arrangement for future Iraq claims. This would potentially involve the creation of two pools: one for military activity and the other for reconstruction and related activity, which DFID would manage. This may help to ensure more effective prioritisation of funding for Iraq programmes and prevent a piecemeal stream of Reserve claims. The idea of a pooled Iraq fund has also been raised by departments.

20. After consideration, we do not feel that such a pool would suit the current situation where costs are so variable and difficult to forecast. If we did set up a pool now it would encourage departments to allocate money prematurely, before we know the

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outcome of the International Donor's conference in October or the effect of an anticipated increase in resources from CPA Centre to the South over the next few months. The potential demand for spending in Iraq is so high that a pool could be exhausted rapidly by departments, prompting further requests for other unforeseen activities.

21. The current arrangement, whereby we fully assess each claim on its merits, is therefore preferable for the time being. GEP support this plan of action. However, we should not completely rule out the idea of an Iraq Pool at this stage and may wish to revisit the idea of a pooled budget in the future if the situation changes.

Recommendation

22. Following discussions between Spending Teams and GEP, we recommend that you agree to officials continuing to deal with Iraq claims on a case-by-case basis for the remainder of this FY. We judge that this is the most effective means of dealing with Iraq cost pressures until CPA resources are mobilised over the coming weeks and the outcome of the International Donors' Conference in Madrid next month is clearer. **GEP and the DDI team support this recommendation.**

23. We will continue to emphasis to departments that the Treasury is not presenting unnecessary obstacles to spending in Iraq. Departments have the resources in their budgets this year, and from Reserve claims already granted, to fund immediate pressures. The emphasis is on effective budgetary discipline and the efficient use of resources in times of increased pressure.

International Poverty Reduction Team

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