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Maj.-Gen. Dutton
James Tansley, Basra
Special Advisers

IRAQ VISIT, 4-6 OCTOBER 2005

SUMMARY

The political, economic and security context remains challenging. A "yes" vote for the referendum seems likely (though not inevitable). ~~Onus on incoming Government to take forward difficult reforms which have been shirked hitherto, not least on unrealistic subsidies which are costing Iraq \$12 billion a year.~~ This must be tackled with our help, sensitively, but firmly, with safety nets for the poor. This will be a key part of the process of agreeing and implementing a SBA with the Fund. We need to work in step with the US on this, including through Ministerial contacts.

~~Donor coordination has improved.~~ In encouraging other donors to provide support and make good their pledges, we must help ensure that aid is channelled coherently and does not incur heavy transaction costs for the Iraqis. A more immediate worry for the first year of an incoming Government is the likelihood of a funding crisis as US money thins out and the multilaterals are not yet on stream.

~~Security is more difficult than anywhere else we operate.~~ Staff remain "locked down" for the present in the South. Despite the constraints,

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there have been good results in some areas, notably power and water provision in the South and capacity building in both locations; as well as some clear lessons from our audit of employment generation in the south. We have been creative in pressing on with activities in the South despite the lock down; but delays and lower effectiveness are inevitable. We must continue to assure ourselves that we are achieving acceptable outcomes for the substantial costs and risks incurred. This will be even more the case post-military transition.

For the future, we should draw lessons from the US's own approach to graduation from reconstruction and development work in Iraq between 2007 and 2009. We recommend a focus on our comparative advantage in reinforcing institutional capacity at the centre, while retaining a presence in Basra to further other donor activity and coordination. Following Ministerial consideration of future options, we should draw up a succinct Country Assistance Plan setting out our intentions.

DFID staff – buoyed by excellent support from FCO and MOD colleagues – have been outstanding in delivering results in constrained and frequently dangerous circumstances. We salute their commitment and professionalism, and the unique courage of our national staff.

DETAIL

1. We visited Baghdad and Basra from 4-6 October 2005. The main purpose was to review DFID programmes and consider future plans, particularly in the light of forthcoming elections and military transition planning. We met several of Ja'afari's advisers; senior US officials, including Khalilzad's deputy, Ambassador Satterfield (Khalilzad was away); other donors; and a wide range of UK military and civilian officials, including DFID staff, chargé Tim Torlot, new Consul-General James Tansley, Lieutenant-General Brimms and Major-General Dutton.

Some context

a) Political process

2. Despite adversity, Iraq is still on schedule to meet the political timeline laid out eighteen months ago. Polls suggest turnout for the constitutional referendum next month will be high, despite the mid-Ramadan date. We continue to support this through our Political Participation Fund. The draft constitution is the imperfect product of a necessarily hasty process. Critically, it postpones many fundamental questions, particularly on the extent and details of political and administrative devolution. It does not encourage unity or stability. It promises generous social service provision across the board where there is no credible plan for financing this.

3. A "yes" vote is considered the most likely outcome, though not a foregone conclusion provided the recent blatant attempt by the Assembly to manipulate the arrangements for defining voting majorities (reported in recent telegrams) is pushed back. There were two schools of thought expressed to us on

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whether a "no" vote would in fact be a better outcome. Some informed voices, including in the PM's office, argued in favour of this: it would prove, not least to the Sunnis, that the process was genuinely transparent; give more time to iron out deficiencies in the Constitution; and bind the Sunnis more closely into the process. Others, including Ambassador Satterfield, felt strongly that a "no" vote would be dangerous and destabilising: it would anger the Shias; encourage the Sunnis to press unreasonably for more; and lead to a further year of uncertain transitional government and shirked decisions.

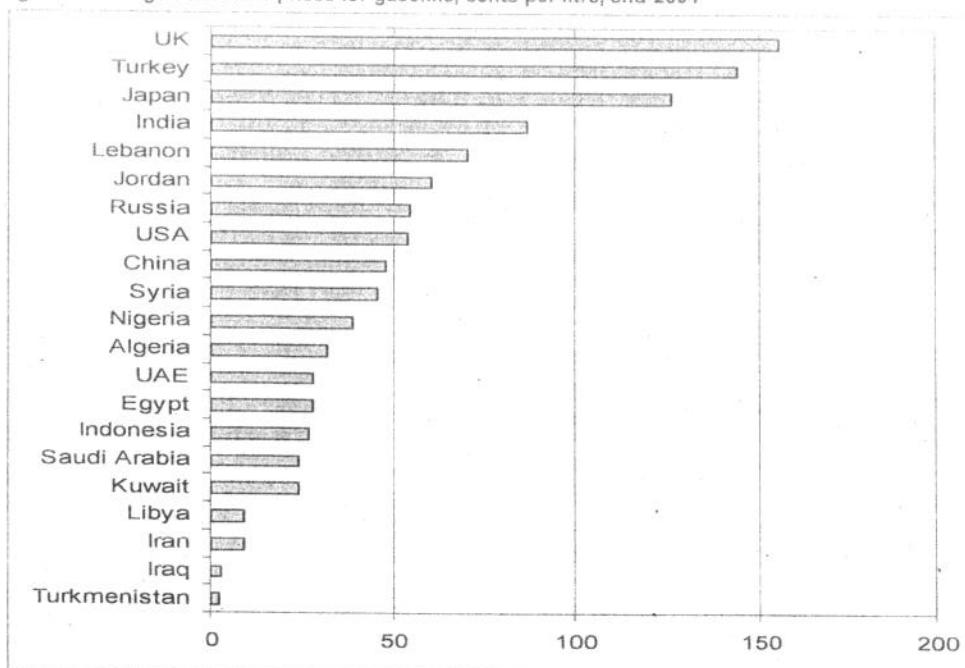
4. Both camps, though, felt that even if the referendum were approved by a narrow margin, the resulting Government would be more serious and representative than the present one. It would also have a mandate for longer term action. It will need to take forward some difficult reforms notably on economic and governance issues and be held to account for the outcomes of its decisions. This would require a stronger Prime Minister than Ja'afari. International players can assist but not substitute. Careful advice will be required from diplomatic colleagues during the coalition and government formation phases, and donors will need to demand a clear government platform and priorities at the next donor conference, due in early spring 2006. All of our work on fragile states suggests we must all be careful to limit expectations of what the government can do, and encourage them to focus on a small number of key priorities.

b) The economy and capacity building

5. Iraq's economy has deep structural problems. More than two-thirds of the budget is spent on subsidies for food, electricity, and fuel. Iraq has the most heavily subsidised oil products in the world (see figure 1 below). This is unsustainable, reducing not only the investment budget but also the funds available for security services and other urgent needs. Reforming the subsidy regime is the only way forward: it could release up to \$12bn a year – a sum that dwarfs donor assistance (see figure 2 below). The subsidies encourage smuggling and illicit activity that probably helps to fund the insurgency.

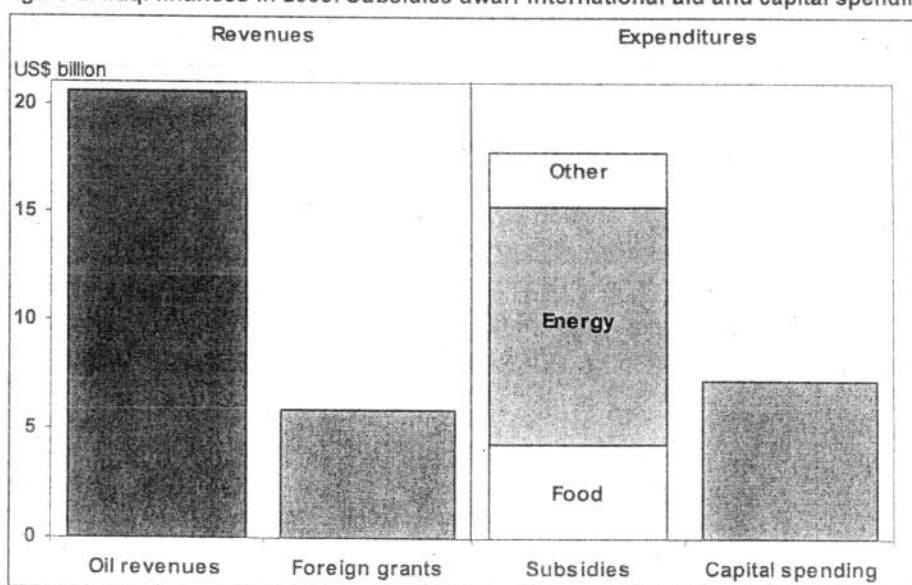
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Figure 1. Average consumer prices for gasoline, cents per litre, end-2004



Source: World Bank

Figure 2. Iraqi finances in 2005: Subsidies dwarf international aid and capital spending



Source: World Bank

6. Subsidy reform can be political dynamite, as the riots in Yemen showed in July. The gains from reform need to be explained, a consensus built, and the poor protected in some measure during the transition phase. This will require political courage and determination: the need for reform is poorly understood in Iraq and there is no public acceptance of its painful side-effects. Iraqis have a strong sense of entitlement and little propensity to pay for services. Fuel prices have been raised slightly – enough to convince the IMF to start

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SBA negotiations. But Iraqi politicians and advisers do not combine technical skills with a good sense of what the public will bear. Iraqi civil servants keep the government ticking over, but years of dictatorship inculcated policymaking by diktat and a fear of risk-taking. Well-educated individuals give the impressive façade of a middle-income country, temporarily impoverished, but weak capacity, insecurity, corruption and economic mismanagement have now given Iraq more of the characteristics of a fragile state.

7. Over the last year DFID has continued to help the Iraqis with their budget planning and economic analysis. This is a long-term process at a fairly basic level. It has brought some progress and needs to continue. We will also need to work increasingly closely with the US in the period between now and the end of the calendar year, when some difficult and sensitive work on reform will be needed if the SBA is to be secured.

8. Ambassador Satterfield made clear to us that securing the SBA was a key US objective: without it the Paris debt deal would unravel, which would be a disaster. To help ensure the SBA, the US would be taking a harder line with the Iraqi Government – both the present Transitional Government and its successor – on the need for much greater Iraqi ownership of the reform process. US resources would be limited in future – he could not say how much more Congress would be ready to pledge for Iraq, but unless the Government started to assume responsibility for taking and implementing some hard reform decisions, the US would make clear that its willingness to provide additional support would be severely constrained. Satterfield noted that this “tough love” approach was a significant shift in posture for the US. We will need to take the initiative to keep abreast of US thinking and actions in this area, making sure these are channelled in a constructive direction. This will require close working in Iraq and in capitals; and would strongly benefit from Ministerial engagement when needed. We will advise further on this.

c) Role of the international community

9. There is now a somewhat wider range of non-coalition donors in Baghdad. Two years after the traumatic Canal Hotel bombing, UN staff are back in country, playing a key role in donor coordination, and supporting the government in critical areas such as humanitarian planning and election preparation. The Canadians have also been instrumental in the donor community, and the European Commission is visible, albeit with a small and focused presence.

10. Yet the donor community is still small. That would not necessarily be a bad thing if the alternative was a host of small, poorly coordinated bilateral programmes, making little impact but adding transaction costs for the Iraqi Government. Our aim here should be to encourage: (i) those donors, Gulf and non-Gulf, who have not made good on their Madrid pledges to do so; (ii) those same donors to channel their funds through joint multilateral channels rather than through small programmes of their own; and (iii) the multilaterals to play an increasingly pro-active and visible role. A key gap is still the absence of a World Bank or IMF representative in-country, helping to steer the

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government through the complex reforms it needs to take. As you know we have been pressing on this and there is now the prospect of the World Bank setting up an office in Baghdad.

11. There has been notable progress on donor coordination structures amongst the donors who are currently involved. The structure we helped to design, agreed at the Dead Sea conference in July, is being implemented. Sectoral working groups in country are beginning to produce results in health and education, and hopefully soon in the critical sectors of rule of law and energy. The resulting increase in government scrutiny of what is done by donors is encouraging others to face up to the prospect of the Iraqi Government telling them what to do, rather than vice versa, including the prospect of tough cross-examination on security costs and project rationale. We will continue to lead by example. The US will be the hardest nut to crack in this area: despite the rhetoric about country ownership, they are the most resistant to having their freedom of manoeuvre constrained by country preferences or donor harmonisation. Their sudden decision to focus on civil service reform (not an American strength) in 10 central Ministries is an example: we will need to ensure close working with them in this area to avoid overlap and confusion.

12. For the last two years, there has been a strong sense from the international community and Iraqis alike that the coalition was expected to fund and 'deliver' reconstruction. And despite the constraints, there have been significant and tangible signs of progress, as our recent paper around Whitehall on the impact of reconstruction has shown. But funding is now becoming scarce. While the US has spent an impressively large sum of money in Iraq - its \$18.4bn second Supplemental budget is now largely gone - high security costs, a focus on inputs, picking soft targets that could be delivered, and a more expensive security sector programme than expected mean that outcomes have been less than hoped. The US is looking to others to pick up the tab, and none have yet stepped up. There is the risk of a crunch in discretionary funding during the first year of a critically important government.

13. However, in the medium to longer term, Iraqi reconstruction will be funded largely from Iraq's own resources. Ideally, future international support should be skewed towards strategic and technical advice, and away from direct delivery. There is likely to be Iraqi resistance to this. The legacy of the CPA and IRMO is that technical assistance is seen as 'free' and its quality seen to be variable. The government has been trying to steer grant funders like us towards infrastructure, yet in an environment where we cannot put aid through the budget, and where security costs are high, this is not efficient, and not where we can add most value.

d) Security

14. We operate in an environment where security comprehensively limits our operations. The security environment for reconstruction and development is on a different scale to anywhere else DFID operates, including Afghanistan, Nepal and Sudan. And many of the alternative channels for disbursement in

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secure environments elsewhere – NGOs, civil society, multilaterals – are unavailable or inefficient as a result.

15. Until recently, we were able to continue programmes as designed in both southern Iraq and Baghdad. However, as you know, a lethal change in tactics by insurgents in Southern Iraq has "locked down" our UK-based staff in Basra and the surrounding provinces for the last few weeks. It is difficult to see the security environment easing in Basra for at least several months. Even in the other provinces where the situation is currently less acute we will be recommending to you that our handful of UK staff there remain locked down until we can review the situation after Ramadan.

Implications for our work

16. So what are the implications of this uniquely difficult context for DFID's current and future work in Iraq?

Current programme

17. The first thing to say is that ~~our current programme has been achieving results in astonishing adversity~~. We received ~~plaudits from the US, from the Prime Minister's office, from other donors, and from our diplomatic and military colleagues~~ for the focus and relevance of what we have been doing. Indeed, our relationships with the full range of other government departments, including the military and intelligence agencies, are excellent. The DFID team has a distinct identity but significant influence in a joined up Embassy operation led by William Patey. We have first rate support for DFID's operations and aims from William and his deputy Tim Torlot and their staff. General Brimms and his predecessor General Kiszely in Baghdad, and Generals Dutton and Riley in Basra deserve particular thanks for the extraordinary logistic support they have extended to our teams – and indeed to us on this visit – and for the real strengthening of DFID/MOD cooperation. One of the highlights of the visit was a presentation by MND (SE) about the mutually-reinforcing nature of the MOD and DFID operations in the South over the past twelve months, ~~putting to rest the baggage of the tenuous periods of the past~~.

18. On the programme itself, ~~in the South, our priority is to continue with the infrastructure work – power and water – on which we are embarked, with a view to delivering the additional capacity we have promised by next summer.~~ We should also press on to the extent we can with strengthening ~~the capacity of the governorates to manage themselves and deliver services.~~

19. Our teams have made particularly good progress to date on water and power rehabilitation, increasing capacity in appropriate low technology ways which have been sensitive to local community needs, creating employment on the way. There are some real success stories here which bear wider reporting and on which we could brief you in more detail. We have been less successful as you know in our attempts to draw the World Bank into financing power generation activities alongside us, by diverting resources from their Trust Fund. We thought we were there with the Najibiyah power station

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project in Basra – with the Bank providing some \$20 m financing, alongside technical help from us, but the Ministry of Energy has been unenthusiastic for a number of reasons and we see no point in pushing this further. A better option is likely to be for the Bank to blend its Trust Fund resources into IDA money for a power project at Hartha which would add another 400 MW to the grid. Again we should be ready to offer help from our technical team in Basra for as long they remain on contract. [MENAD to pursue].

20. More widely, the teams in the south have of late been ingenious and creative in dealing with the constraints imposed by the lock-down, which in Basra has been compounded by the Governor's ban on contact with HMG following the flare up last month. We were briefed on the ways in which our national staff – for whom mobility has been less problematic though they too need to operate with great care – have been able to make progress on our infrastructure and governance programmes, and ensure some continuing measure of monitoring and quality control. We have also despite the ban, and by dint of the trust carefully built up over recent months, been able to sustain activity and contact with key local government interlocutors in Basra.

21. But we must recognise that having to operate in this way, with the safety of all our staff as a paramount consideration, has undoubted value for money implications in terms of our effectiveness and for the time taken to complete tasks. This is an expensive operation in every sense and at each step we need to assure ourselves that we are achieving acceptable outcomes for this investment. At present we believe that to be the case. But the recent Internal Audit Report we commissioned on our earlier employment generation programme in the South – which revealed a substantial failure to meet objectives because of our inability for security reasons to monitor progress – shows how careful we must be. Needless to say we have brought that programme to a halt.

22. In Baghdad, mobility for our teams though limited outside the Green Zone, has remained broadly constant and we are well-placed to continue to provide economic advice to the Ministry of Finance in the critical period up to the negotiation of the SBA with the Fund by the end of the year. Our work on strengthening central government should also continue where we are having an impact, for example in our work with the Prime Minister's Office and on communications. But where there is internal resistance, for example over our support to COMSEC (the Cabinet Office equivalent), we should be ready to pull the plug and return to this later if there is more commitment from the Iraqi side. [MENAD to pursue].

Future programme

23. We spent some time during the visit reflecting on what the future shape of DFID's programme should be. We were struck by the very clear exposition of US thinking on the future from Ambassador Satterfield. The US are now focusing on a clear 2+2 year timeline. Between now and 2007 they plan to engage in an intensive period of capacity building of both the civilian and security infrastructure, leading to what they hope will be a substantial degree of Iraqi self sufficiency. For the subsequent two years they will move

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to a reduced and more regular level of technical assistance and smaller scale financial involvement, with IRMO disappearing, and USAID taking the lead. By 2009, they envisage effective graduation from assistance to Iraq, beyond some modest political funding, taking the view that as a resource-rich middle-income country, Iraq should by then be ready to manage without significant bilateral donor support.

24. There are lessons for us in this kind of approach. Long term involvement by DFID has never been on the cards, but nor is short-term departure. Our challenge is to ensure that in the period immediately ahead we play to our comparative advantage, and focus on where we can really make a difference in an unusually difficult environment. We received a remarkable unanimity of advice from a range of interlocutors, including our political and military colleagues in both Baghdad and Basra, on where that comparative advantage lay. The advice was that our main area of concentration should be at the centre of government in Baghdad building up institutional capacity in the Prime Minister's office and the secretariats, and strengthening the key treasury, audit and budget management functions in the Ministry of Finance, and donor coordination by the Ministry of Planning (which ought to be merged with Finance). This was where we were particularly good and where our work could have a wide-ranging multiplier effect, including in the establishing of proper funding and institutional links to the provinces.

25. If we are to proceed along this road we will need to consider whether the current modalities for carrying out this type of work – which have worked well up to now – will remain fit for purpose. Our initial feeling is that alternative options now need to be explored. The costs of expatriate consultants, with their attendant security bill, are very high – and they will certainly continue to appear that way to Iraqi Government Ministers and officials, who are already starting to turn down technical assistance they want and need primarily on cost grounds.

26. One option will be to make increasing use on our teams of Iraqi expertise drawn from the wider Iraqi diaspora. The Prime Minister's office itself is already employing well-educated and reform-minded Iraqis from overseas who are keen to help their country develop and are prepared to work at modest salaries. This causes some tensions with existing staff – in part because of cultural clashes and in part because the incoming staff are impatient to see progress and in some cases show up their more traditional long-serving colleagues. But with care this was being managed. We should certainly explore this.

27. Another option is to bring in senior existing or former British civil servants – as we are doing in Africa (eg Sir Andrew Turnbull's work with the Zambian Government) – on short visits to review and advise on institutions and structures. And another again is to look at our staff mix in Baghdad and consider the deployment on site of one or two more advisers – for governance and economics for example. We will need to think laterally about recruiting for these posts if the normal cluster arrangements fail to deliver volunteers.

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28. These are all ideas for Michael and the Iraq team to consider and explore and put recommendations to us in due course.

29. For the South, again the advice we received was clear. MND (SE) could see no realistic way in which we could operate outside Basra itself when the military eventually go. The risks from organised crime, let alone politically motivated violence, would be too great to guard against for the foreseeable future. Our comparative advantage would also not lie in infrastructure work. We had done well in keeping bits of the power and water infrastructure going; but the real future need was for major investment – not least in some substantial new power stations, costing several billion dollars. This would have to be for the multilaterals and for the Iraq Government itself. The most useful role multiplier role DFID will be able to play post-military transition, given our links and experience, will be as part of a Consulate General focusing on donor coordination work and seeking to encourage the multilaterals to return and play a substantial and joined up part in long-term reconstruction and development. This would be justifiable in terms of cost-effectiveness and staff safety, while enabling us to proceed with an enhanced operational involvement at the centre.

30. All this will be discussed by Ministers at DOP(I) on October 12th, for which DFID has led on a paper agreed with OGDs on the implications of the eventual military transition for HMG's future civilian presence in Iraq. In the light of that discussion, the reflections in this report, and further discussion with you when we are both back in the office and your diary allows, we would like to see MENAD draw together a short Country Assistance Plan, setting out some plans for the future. This should also contain an assessment of what we have achieved to date in Iraq which we can use to meet our commitment to the International Development Committee last year to report on progress. **[MENAD to keep in view]**

DFID staff

31. We would like to reserve our final words for DFID staff, expatriate and Iraqi, who have done an outstanding job in unique circumstances. Morale in Basra has been hit recently as the result of the long "lock down", the deaths of two of the CRG protection team and the kidnapping at the front gate of an Iraqi national contracted to the logistics provider for the HMG presence in Basra. But we remain full of admiration and respect for the commitment, dedication and professionalism of our volunteer staff and consultants – and above all our national staff – in both Basra and Baghdad, who continue to show courage and results in equal measure and under extraordinary constraints. We assured them that their safety remained our, and your, top priority. Our warm thanks extend equally of course to former members from both locations as well as the full team in London who have been calm, professional and good humoured in the face of unreasonable demand.

SUMA CHAKRABARTI

MARTIN DINHAM