

1 (11.30 am)

2 SIR NICHOLAS MACPHERSON

3 THE CHAIRMAN: Good morning.

4 SIR NICHOLAS MACPHERSON: Good morning.

5 THE CHAIRMAN: Let's restart the second session of the
6 morning and the last one of the day. At this session,
7 we are hearing from Sir Nicholas Macpherson, the
8 Permanent Secretary at the Treasury -- welcome,
9 Sir Nicholas -- and we will be asking about the cost of
10 the UK's involvement in Iraq, including mechanisms for
11 providing funding, asking about expectations before the
12 conflict of what the costs of invasion and not least its
13 potential aftermath might be, and the monitoring of
14 expenditure thereafter.

15 Now, we are very grateful to Sir Nicholas. We have
16 got a witness statement which he has provided for the
17 Inquiry and this is being published now on our website.
18 Thank you for that.

19 I say this on every occasion, we recognise that
20 witnesses are giving evidence based in part on their
21 recollection of events. We, of course, are
22 cross-checking what we hear against the papers to which
23 we have access and some of it is still coming in.

24 Again, I remind every witness that he will later be
25 asked to sign a transcript of his evidence to the effect

1 that the evidence given is truthful, fair and accurate.

2 With that, I'll ask Sir Martin Gilbert to open the
3 questions, thank you.

4 SIR MARTIN GILBERT: Sir Nicholas, my first question relates
5 to the Treasury in its trans-Whitehall role.

6 Can you tell us how, when the government decides to
7 embark on an operation of the scale of its involvement
8 in Iraq, it wills the means as well as the ends. What
9 is the process?

10 SIR NICHOLAS MACPHERSON: Certainly. This war was certainly
11 different from some, in the sense that there was a good
12 nine months or so during which the likelihood of
13 military action clearly increased. So it enabled the
14 Treasury, from quite an early stage, to think through
15 what it might cost, what some of the implications around
16 reconstruction might be and to remind itself of the
17 mechanisms for funding the intervention.

18 Now, there is a key principle on defence
19 spending that the Ministry of Defence is funded through
20 the spending review process to be ready for war, but it is not
funded to go to
22 war. That's because, by their nature, wars are
23 unpredictable, in terms of their length and their cost,
24 and I think this principle has been accepted by
25 successive governments.

1 So once a war is either likely or takes
2 place, there are effectively two mechanisms for funding
3 military operations. The first is a term of art called
4 "urgent operational requirements". These are urgent
5 requirements of equipment that
6 arise due to the particular demands in a specific
7 operational theatre.

8 So, for example, if you are going to war
9 in a desert, there will be a whole lot of things you
10 need to have which it doesn't make sense for the
11 Ministry of Defence to stock during peace time.

12 So that's one element, and, actually, even before
13 the war got underway, through the autumn of 2002, the Ministry of
Defence requested urgent
15 operational requirements and the Treasury was quick to
16 provide them.

17 I think it is important to understand that,
18 the Treasury may have a view on some areas of
19 spending, but on the whole, when a war is in
20 prospect, the narrow Treasury view that public
21 spending is a bad thing tends to be put to one side and
22 you get behind the national interest and you start
23 signing the cheques.

24 Then just finally, one further point is, the UORs or
25 urgent operational requirements are about getting extra

1 kit or adapting your tanks or getting new combat
2 gear. Then there is the actual additional cost, which doesn't
relate to kit, it just relates to
4 the additional cost of having a whole lot of armed
5 forces on the ground, and that is called the net
6 additional cost of military operations. So that is simple things,
like having to pay overseas
8 allowances, having latrines, providing food and so on.

9 What happens with
10 that is the Ministry of Defence just sends us bills as
11 we go along. We obviously check them, but we don't hold
12 up provision of expenditure, and the Ministry of Defence
13 will make a forecast ahead of the year in
14 question and then will revise the forecast through the
15 year, and at each point the Treasury pays the bill.

16 SIR MARTIN GILBERT: Could you give us an overview? I know
17 that Sir Lawrence wants to talk about the UOR
18 specifically a little later. Can you give us an
19 overview of the key elements of the funding that were
20 needed specifically for the Iraq conflict?

21 I'm thinking, for example, of personal funding for
22 the military preparation, then the invasion itself, and
23 then humanitarian assistance and the occupation phase
24 and, of course, the aftermath phase, which is very much
25 of concern to us.

1 SIR NICHOLAS MACPHERSON: Well, in my witness statement

2 I set out some detailed tables, and first the current assessment of
the overall cost of the

4 war and reconstruction to the UK taxpayer is £8 billion

5 and that is broken down in the table in my witness

6 statement.

7 Clearly upfront there is the cost of

8 fighting the war itself. We were making estimates

9 through the autumn of 2002The Treasury doesn't always get forecasts
right,

11 and it didn't get this forecast totally right, but it

12 wasn't that far off.

13 We started from looking at the previous Iraq war. My
recollection of it was the British

15 intervention was on a larger scale, but obviously there

16 had been quite a lot of inflation since then and I think

17 we always assumed that the actual conflict itself would

18 cost around £2.5 billion, and that estimate

19 proved pretty accurate.

20 The issue subsequently was both, how long would the

21 occupation be, and what would the cost of reconstruction

22 be, and humanitarian support and so on?

23 We were conscious that there were scenarios where we

24 might have to be in an Iraq for a while, that the cost

25 of reconstruction could be considerable and I think --

1 THE CHAIRMAN: Could I just ask, these scenarios were
2 essentially Treasury-generated or were they shared ones?

3 SIR NICHOLAS MACPHERSON: I don't know the answer
4 offhand. I have been reminding myself of the
5 papers which were written at the time. My guess is they
6 reflected discussions. This wasn't some private
7 Treasury estimate, we had an interest of working very
8 closely with the Ministry of Defence, the
9 Foreign Office, the International Development
10 Department.

11 What I haven't been able to find is any
12 papers which reflect cross-Whitehall work on this.
13 We just got on with it, but I think they were informed
14 estimates, and at that time we could see
15 a scenario where the war would cost something like
16 6 billion and that was looking to the end of the then
17 spending review period, which -- we had a spending
18 review in 2002, so it would have been to the end of
19 2005/2006, and, again, that's not hugely wide of the
20 mark. It was several billion pounds.

21 SIR MARTIN GILBERT: The table you attached to your witness
22 statement is incredibly helpful. Is it right in saying
23 that there are additional costs arising from our
24 involvement in Iraq that are not covered by these
25 figures? I'm thinking, for example, of the ongoing

1 disability costs and medical costs and disability
2 payments to returning service personnel.

3 SIR NICHOLAS MACPHERSON: I think that is a very fair point.

4 There will be costs like that which

5 wouldn't be picked up in a table like this, and I think there are
also costs with interventions like

7 this which inform subsequent spending review settlements,

8 for the Ministry of Defence, and you could argue that,

9 had we not been involved in Iraq, the

10 Ministry of Defence wouldn't have got settlements of the

11 sort they got in the spending reviews of 2004 and 2007.

12 SIR MARTIN GILBERT: Can you tell us what calculations have

13 been made now of the overall cost of the UK's

14 involvement in Iraq? Up to whatever the most recent

15 calculation --

16 SIR NICHOLAS MACPHERSON: As I say, the current estimate,

17 which excludes some of those additional points, is

18 8 billion. With the passage of time,

19 it will be possible to make even more comprehensive

20 estimates.

21 SIR MARTIN GILBERT: Are these costs readily available to

22 Parliament, these calculations?

23 SIR NICHOLAS MACPHERSON: Well, what I don't know, in

24 terms of the sort of costs you mentioned,

25 for example, the costs of disability, pension

1 arrangements and so on, is whether
2 the MoD break down those costs between different
3 theatres, because obviously there are costs arising from
4 the intervention in Afghanistan and so on.

5 SIR MARTIN GILBERT: What were the consequences for other
6 government funding commitments of diverting funds to
7 Iraq for what turned out to be a much longer period of
8 both occupation and military presence than originally
9 intended?

10 SIR NICHOLAS MACPHERSON: I think that's an interesting
11 question, because it goes back to how you try and manage
12 the public finances.

13 For the Treasury,
14 permanent increases in spending are far more problematic
15 than temporary increases in spending. If you go back in
16 history over the last 200 years,
17 whether it was in the Napoleonic wars or the
18 First World War or the Second World War, it was always
19 expected that you would try and mobilise as much
20 resource as possible, but that you would also run up
21 greater debt and then pay it back in peacetime.

22 Obviously, this intervention was on a completely
23 different scale. Although very important, the
24 sums involved, just don't bear comparison to
25 those wars I mentioned, and so the Treasury

1 while obviously wanting to ensure value for
2 money, is generally reasonably relaxed about short-term
3 increases in spending which are for a one-off
4 purpose, and where you know that things will
5 revert to a steady state with the passage of time.

6 THE CHAIRMAN: The short-term could be as long as five/seven
7 years in this case?

8 SIR NICHOLAS MACPHERSON: Absolutely. I don't think at
9 a macro level this intervention has had a significant
10 effect on spending elsewhere.

11 SIR MARTIN GILBERT: So the passage of time was not
12 a meaningful passage of time in that regard?

13 SIR NICHOLAS MACPHERSON: No, I think it is both the passage
14 of time and the level of spending. If I look at the
15 table, I think the peak year of spending was 2003/2004,
16 which was about 1.6 billion. When you are spending
17 500 billion, 1.6 billion is significant and it bears
18 a lot of attention and focus, but it is not going to
19 divert fiscal policy in a massive sense.

20 I think the one supplementary point I would want to
21 make is that's a macro level. At a more micro level,
22 there is an issue about how you fund some of the
23 spending. I mentioned that the defence part of it
24 unambiguously is an addition to the defence budget and
25 is paid for out of the reserve.

1 If you look at, say, the international development
2 budget, increasingly through the period, rather than
3 funding DFID through the reserve, we worked with them to
4 see whether their budget could be reprioritised. Now,
5 at that time, DFID, as it is today, was very focused on
6 supporting the poorest countries in the world. It had
7 a commitment, I think, to spend 90 per cent of its
8 budget on that, but that still left 10 per cent of its
9 budget for what is known in the trade as
10 medium-income countries, which technically, I think,
11 Iraq qualified as.

12 So I think there was some reprioritisation in terms
13 of other medium-income countries, and also DFID has a --
14 like all departments, set up a departmental
15 unallocated provision which it could draw on, and it is
16 also worth bearing in mind that this was a period
17 when the DFID budget was rising very rapidly as part of
18 a government policy to get nearer the UN 0.7 per cent
19 ratio.

20 THE CHAIRMAN: So even the 10 per cent is expanding quite
21 fast?

22 SIR NICHOLAS MACPHERSON: Exactly, and I think my colleague,
23 Suma Chakrabarti, has borne this out. I don't think
24 Treasury parsimoniousness was the issue in this case.
25 Here was a big budget from which money could be allocated

1 out. One of the challenges, more generally in
2 this situation, was that it wasn't so much finding the money, it
3 was how you translated the money into real
4 resource on the ground and the transmission mechanisms
5 around that.

6 THE CHAIRMAN: Funding mechanisms as shorthand, or is it
7 more than a funding mechanism?

8 SIR NICHOLAS MACPHERSON: No, I think it's more -- the
9 funding is the easy bit. I mean, --

10 THE CHAIRMAN: Even the mechanism?

11 SIR NICHOLAS MACPHERSON: Relatively easy, anyway. It is
12 actually how you translate the money into concrete
13 outcomes on the ground while inevitably there are lags
14 in the process.

15 SIR MARTIN GILBERT: I would like to ask now about really
16 a question which relates to chronology, and that is, at
17 what stage -- when did the Treasury become involved in
18 the Whitehall planning, first for the possible invasion,
19 and then, at what point did the aftermath discussions
20 become factored into that?

21 SIR NICHOLAS MACPHERSON: The Treasury was clearly thinking
22 about this in the summer of 2002. What I don't know
23 offhand and can't remember is what triggered this work.
24 One of my colleagues on the spending side at that time
25 I remember writing a paper for the Chancellor's chief

1 economic adviser, Ed Balls. We certainly,
2 by September 2002, were doing deeper work, both on the
3 economic consequences of a war, but also the more
4 prosaic issue of how we would fund it.

5 What I can't recall is precisely who went
6 to which meeting when. No doubt, there was
7 a Cabinet Committee process and the Chancellor and
8 Chief Secretary would have been involved in that. But
9 there was a steady increase in focus on the Iraq
10 issue through the autumn, and, indeed, we started
11 signing off the urgent operational requirements.

12 I think, first, it was 100 million and then another
13 100 million, and I think, by December or the very
14 beginning of January, we had signed off 500 million.
15 My own personal involvement in this process was not --
16 was not huge, but I do recall going to a meeting with
17 Paul Boateng, who was the Chief Secretary for the
18 Treasury at that time, on December 23rd 2002, to be
19 briefed by the Chief of the Defence Staff about the
20 contingent plans. There was a view that the Treasury
21 needed to understand what was going on to
22 facilitate the debate around the funding.

23 So I think there was a steady cranking up of
24 the Treasury's involvement.

25 SIR MARTIN GILBERT: In the pre-budget report, the Treasury

1 pre-budget report in November 2002, it was announced
2 that a figure of 1 billion was going to be held in
3 a special reserve, and the phrase used was "to meet the
4 UK's defence and overseas needs in the fight against
5 global terrorism". The budget report of April 2003 said
6 the resources were relating to possible action in Iraq.

7 Can you explain why it had been described as the
8 fight against terrorism originally, when that was not
9 what the Iraq conflict was about?

10 SIR NICHOLAS MACPHERSON: I think the Treasury's interest at
11 that time was making sensible provision for whatever
12 might lie ahead. As regards the pre-budget report -- when
13 making fiscal projections, if you think there
14 is a reasonable likelihood of something happening, it is sensible
15 to make provision for it.

16 We had already made provision, or indeed financed
17 some of the -- I think what could be described as
18 counter-terrorism activity post-11 September 2001, and
19 I seem to recall the Treasury providing for various
20 reserve claims, for example, from the intelligence
21 agencies and others.

22 So I think -- this was shorthand for
23 a continuation of that, whilst also cover for wider
24 interventions. Clearly, at that stage, there
25 was a possibility of war and it was essential that the

1 armed forces were resourced to get into a more
2 forward position in terms of being ready.

3 My guess is there was not some great theological
4 debate in the Treasury at that time about the difference
5 between the words "counter-terrorism" and "war in Iraq".

6 SIR MARTIN GILBERT: We have heard from many military
7 witnesses of the problems that were created by the
8 desire of the government not to create a sense in the
9 public mind that there was a possibility of war. Might
10 this have been a factor in this terminology? That this
11 would have been somehow a red light flashed up?

12 SIR NICHOLAS MACPHERSON: It could have been. I would have
13 to -- I would have to go through the newspapers and
14 so on at the time. There was a sense -- and it may be
15 just with the benefit of hindsight -- that the
16 possibility of some sort of intervention was increasing.
17 There was activity in the UN and so on. My
18 personal involvement, as I said, was limited. I do
19 recall that the briefing we received from the Chief of
20 the Defence Staff in December, it was still --
21 this was still very much a contingent possibility and we
22 needed to be ready for that, but my perception, as
23 I went away from that meeting, was it was still
24 perfectly possible that war might not take place
25 but, as I say, I was not privy to the

1 wider debates which were clearly going on in the
2 government and questions about intelligence and so on.

3 If you are in the Treasury you can't really second
4 guess that. You just take it as given and plan
5 accordingly.

6 SIR MARTIN GILBERT: In terms of the cost assessments, on
7 2 April 2003 the Chief Secretary of the Treasury, in
8 answer to a Parliamentary question on what assessment
9 the Treasury had made as to the cost of British
10 involvement in Iraq, he was asked for one year, for two
11 years, for three years, for four years and for five
12 years, and indeed for more, what the different
13 assessments were. The Chief Secretary replied:

14 "The Treasury does not estimate costs for such
15 operations in the manner requested."

16 Can you elaborate on this and explain why not?

17 SIR NICHOLAS MACPHERSON: Partly because there are so many
18 different potential scenarios in terms of how long a war
19 may go on and the peacekeeping efforts and so on. So,
20 we regularly reviewed the situation and
21 looked at the broad orders of magnitude, but we
22 didn't get into that level of specifics.

23 That's generally the case in
24 wider public spending policy, that there is
25 a limit to how many scenarios you can look at. I think

1 the key thing from a Treasury perspective is just having
2 an understanding of the broad orders of magnitude so you
3 can factor that into fiscal policy development.

4 SIR MARTIN GILBERT: So in these calculations that were
5 being made, what considerations were you taking, what
6 did you understand would be the potential occupation
7 phase, the potential aftermath phase, and what this
8 might mean in terms of an ongoing budgetary demand?

9 SIR NICHOLAS MACPHERSON: Looking back over the papers,
10 I think our analysis was very much focused on the
11 spending review period which had been agreed in the
12 summer of 2002, which basically covered 2003/2004,
13 2004/2005, 2005/2006. So we were really looking forward
14 about three years and looking at -- I wouldn't say
15 worst-case scenarios, but looking at scenarios where we
16 might be involved for a while.

17 Obviously, that didn't rule out that we would be
18 involved beyond 2005/2006, but generally, the Treasury
19 plans detailed spending only three years ahead. Beyond
20 that, we make broad assumptions, but you can get overly
21 precise about these things. Obviously, if the
22 orders of magnitude had been a lot bigger and we were
23 talking about 10/20 billion a year, then I think
24 we would have looked far more carefully at how much it
25 would cost beyond 2006, rather like we do with pensions,

1 for example. So we were really focused on the three
2 years ahead.

3 SIR MARTIN GILBERT: So how did this take into account,
4 after March 2003, our responsibilities for the four
5 southern governorates for Basra and the south of Iraq,
6 which clearly were to be quite an open-ended
7 responsibility that we had taken on?

8 SIR NICHOLAS MACPHERSON: Well, we focused on --
9 I happen to have in front of me a paper from March 2003,
10 which attempted to look at this. First, we
11 looked at the military action. We assumed that would be
12 over reasonably quickly. There would be costs of
13 recuperation. There would also be costs of
14 post-conflict stabilisation, and at that time,
15 we were putting in 600 million in 2003/2004, 800
16 in 2004/2005, 300 in 2005/2006. So that obviously had,
17 as it turns out, an optimistic assumption that by
18 2005/2006 we would be winding down, but we had also had
19 speculative lines at that stage around humanitarian
20 costs and reconstruction costs, and, again, we thought
21 that the humanitarian costs might peak pretty much after
22 the conflict, carry on into 2004/2005, but definitely be
23 declining, possibly to zero, by 2005/2006. Then on
24 reconstruction, we assumed that that would
25 carry on at around 250 million to 500 million

1 a year.

2 On reconstruction, it is worth just coming back to
3 the fact that some of our thinking was informed by the
4 view that Iraq did have a lot of its own natural
5 resources, that the UK taxpayer had made a pretty big
6 contribution at the time of the war and that
7 subsequently other countries
8 who hadn't been involved in the war period would
9 come back and step up to the plate, and we could
10 get the IMF and World Bank involved, because their
11 involvement would strengthen that reconstruction
12 process.

13 THE CHAIRMAN: We weren't looking for cost recovery to the
14 UK Exchequer, we were simply looking at displacement of
15 other funds?

16 SIR NICHOLAS MACPHERSON: No, no. Very early on, I think
17 some of us -- I was working on public spending
18 at the time of the last Iraq war and remembered fondly
19 Mr Mellor going round the Gulf, and I think we recovered
20 the vast majority of our costs. I think the
21 war cost 2.5 billion or 3 billion and we got all but
22 400 million or so back. But it was clear to us that
23 that was very unlikely this time around.

24 SIR MARTIN GILBERT: With regard to the winding down which
25 you mentioned, where did you factor in -- what

1 assumptions did you make in that about Iraq's own
2 ability to meet the costs, the growing costs, and
3 particularly, say, by using its oil revenues and the
4 money allocated by the Americans and the international
5 community and, of course, the Madrid donors' conference?

6 SIR NICHOLAS MACPHERSON: I think in March/April 2003, this
7 was still very uncertain. Various estimates had been
8 made around the global reconstruction costs,
9 which were beginning to get reasonably high and towards
10 the general territory which we reached by Madrid, which
11 I think was in October or November of that year.

12 SIR MARTIN GILBERT: End of October.

13 SIR NICHOLAS MACPHERSON: By then, the estimates were
14 getting up to 30/40/50 billion
15 dollars. We were very involved -- working with
16 the development department in strengthening our
17 estimates, we were keen to use our influence
18 internationally to get other countries to focus on these
19 issues, and, indeed, the Chief Secretary Paul Boateng
20 did go to the Madrid conference in person and we
21 regarded that conference as a success because -- my
22 recollection is that something like
23 \$33 billion/\$35 billion was committed at the conference.

24 SIR MARTIN GILBERT: With regard to that, and of course to
25 the pre-dominant American position, could you tell us

1 something about the Treasury's liaising with the
2 United States about how these funds would be allocated
3 and deployed?

4 SIR NICHOLAS MACPHERSON: I think we did engage with the
5 United States. I was running the public
6 spending side at the time. Those who were on the
7 international side would have done that. I think
8 Stephen Pickford appeared before this Inquiry before
9 Christmas. We had regular contact with the
10 United States through a whole lot of processes, in
11 particular the G7 and so on, so we would have been
12 engaging with them and I think Chancellor Brown met
13 US Treasury Secretary Snow that summer to discuss some of these
14 issues.

15 So I would say regular discussion, and we
16 also had seconded people out to the CPA itself and they
17 were quite actively involved in some of the economic
18 issues at that time.

19 Having said that, we were
20 minority partners in this venture and there
21 are limits to your influence if you are
22 providing -- if you have got a 10 per cent share or
23 whatever the share was.

24 SIR MARTIN GILBERT: With regard to these discussions, what
25 was the result so far as the Treasury was concerned?

1 Was it a positive result?

2 SIR NICHOLAS MACPHERSON: I think we would regard it as
3 positive. There were issues where we had
4 influence and we were quite pleased that we did get some
5 traction, but inevitably there were limits to
6 our influence.

7 SIR MARTIN GILBERT: We heard from previous witnesses -- and
8 I'm sure you have followed this -- about the delays
9 experienced by departments in securing Treasury
10 agreements for additional funding.

11 For example, Sir Suma Chakrabarti told us that DFID
12 had been in discussions with the Treasury
13 since December 2002, that its claim on the Treasury
14 reserve was not approved until March 27, which was
15 a week after the invasion.

16 Can you tell us why this was the case and whether
17 the Treasury could have done more to ensure the
18 departments could have been told earlier what their
19 allocations would be?

20 SIR NICHOLAS MACPHERSON: I think the Treasury was pretty
21 responsive. DFID may have been raising -- beginning to
22 think through the funding issues from December, but bear
23 in mind that they had quite big budget which they could
24 deploy from. I always felt that when the
25 money was needed, the Treasury came up with it and

1 a good example of that was in -- we gave
2 120 million in a reserve claim in March to DFID, and
3 then, in the budget a few weeks later, the Chancellor
4 provided an extra £60 million which could have
5 been accessed for further aid-related effort.

6 One issue with Whitehall
7 departments is that when you are in late
8 autumn, October/November/December, you can get quite
9 worried that you are going to overspend and you come to
10 the Treasury and ask for money. Often, it turns out, as
11 you get through to March, you haven't spent the money.
12 The incentives in the public spending system perhaps are
13 perhaps slightly asymmetric, so people are desperately
14 worried about overspending, but I think what probably
15 happened with DFID was that through January, February,
16 March, they found they had rather more money than they
17 had thought and certainly with the 60 million in the
18 following year, 20 million I think was given to the
19 Foreign Office, I think 6.5 million was given to DFID,
20 and the other money was never fully claimed.

21 I think it was asked for at one point and we said we
22 needed more evidence that it was necessary. It was
23 totally open to Baroness Amos, who I think was the
24 Secretary of State, to come back, but she didn't.

25 So I think there is a risk of getting too focused on

1 specific spending lines. You have always got to look at
2 the overall budget as well.

3 SIR MARTIN GILBERT: I have just two more questions before
4 I hand over to Sir Lawrence Freedman. The first one,
5 which follows on from my previous one, relates to the
6 national audit report from December 2003 which
7 essentially said with relation to Iraq and with relation
8 to Operation Telic that there was a need for greater
9 co-ordination and planning and early execution between
10 MoD, FCO, DFID, when responding to situations such as
11 that in southern Iraq.

12 Can you say what changes were made as a result of
13 the NAO suggestion and whether these were effective from
14 a Treasury point of view?

15 SIR NICHOLAS MACPHERSON: I think Whitehall
16 governance improved with the passage of time, both in
17 terms of relevant Cabinet Committees, but also official
18 committees. That was partly just because, when
19 you are doing something for a while, you get better at
20 it. I couldn't identify any hard and fast change, but
21 I certainly had a sense that, partly because we were --
22 there were more opportunities to work across
23 departmental boundaries and there was a stronger
24 sense of commonality between MoD, the Foreign Office,
25 DFID and organisations like the Cabinet Office and the

1 Treasury. I do think we got better at it over time.

2 SIR MARTIN GILBERT: I'm sure my colleagues will have more
3 to ask about that, but my final question is about the
4 pre-budget report of 2003. In that, only Iraq-related
5 reserve claims were scored to the special reserve.

6 I wonder if you could tell us at what point
7 Afghanistan and also domestic counter-terrorism claims
8 entered the equation and how they affected the
9 Iraq-related claims?

10 SIR NICHOLAS MACPHERSON: I can come back to you on --
11 I just can't recall precisely when we started having to
12 crank up expenditure on Afghanistan again. Some
13 Afghanistan-related expenditure would have been covered
14 by the ordinary reserve, but I would be happy to
15 provide a note to give you greater clarity on that
16 point.

17 SIR MARTIN GILBERT: That would be most helpful, thank you
18 very much.

19 THE CHAIRMAN: Thanks. Lawrence?

20 SIR LAWRENCE FREEDMAN: Can I just ask you a couple of
21 questions relating back to what you have already said
22 and then I want to look at the UOR process and its
23 relationship with the defence budget.

24 If I heard you right, you sort of suggested at the
25 start that the role of the Treasury in much of this was

1 sort of signing the cheques. This isn't the normal
2 position the Treasury would like to take in areas of
3 major public expenditure. How much did the Treasury get
4 involved in what the cheques were for?

5 SIR NICHOLAS MACPHERSON: I think the Treasury is quite
6 cautious about getting involved in things where its
7 expertise is perhaps rather less relevant.

8 I think if you research the Treasury's role in
9 1938/1939, there is a point when you -- someone
10 does have to focus on signing the cheques and sorting
11 out the finances, but, you know, you really do not want
12 to be in the business of second guessing one
13 bit of kit over another bit of kit.

14 SIR LAWRENCE FREEDMAN: I can understand the Treasury
15 doesn't want to put itself in the position where it
16 could be accused of denying servicemen their kit, but
17 this was not 1939, this was a more discretionary
18 military involvement and there were a variety of choices
19 to be made in it and some of the choices had financial
20 implications, in fact quite a few of them did. So it is
21 really a question of the role that the Treasury could
22 play in influencing the various choices that were made
23 by the government in 2002/2003.

24 SIR NICHOLAS MACPHERSON: Well, all
25 I can do is speak for the official Treasury machine.

1 I wasn't at the Cabinet Committee meeting.

2 SIR LAWRENCE FREEDMAN: We will have a chance to explore
3 those issues.

4 SIR NICHOLAS MACPHERSON: Indeed. Treasury did not have
5 a view on whether you should have a bigger intervention
6 versus a smaller intervention. Clearly, one was
7 cheaper than the other and no doubt the
8 instincts of the Treasury are always for the cheaper
9 option, but we certainly did not get into the business
10 of advising ministers to support one
11 intervention over another on cost grounds.

12 SIR LAWRENCE FREEDMAN: Just to take -- there are two issues
13 that come up where we know these issues were relevant.
14 The first, as you have indicated, is whether we sent
15 a division or not, and we know the Prime Minister was
16 concerned about the cost implications of that. So I'm
17 just wondering, as this was discussed, were you able to
18 give the Chancellor any advice on what the different
19 implications would be in terms of options that the
20 government might pursue?

21 SIR NICHOLAS MACPHERSON: I think from time to time we would
22 draw to Ministers' attention that different options had different
23 cost implications. But we didn't make value judgments
24 about them.

25 SIR LAWRENCE FREEDMAN: The second issue is related to oil

1 prices which is, again, a concern that was mentioned.
2 How concerned was the Treasury that yet another crisis
3 in the Middle East might push up oil prices, might
4 create serious shortages, and, therefore, have a major
5 impact on the macroeconomic conditions in which the UK
6 was operating?

7 SIR NICHOLAS MACPHERSON: I think we were interested in that
8 issue. We did analysis around it. Obviously, we have
9 an interest in a stable and growing international
10 economy.

11 Equally, rather like -- it parallels in
12 a sense the fiscal policy implications. We had had the
13 experience of the first Gulf War and what tends to
14 happen in these situations is the markets
15 anticipate the effect on oil prices. You get a big
16 spike and then things tend to calm down, because markets
17 always tend to overestimate the effect.

18 I think we were pretty certain this was not
19 going to be a 1973-type oil spike, which had
20 a very serious effect on the world economy. We thought
21 it would be more localised. I don't think that
22 particularly drove economic policy. I think our
23 interest was more that we should be able to take that --
24 those effects into account in considering macroeconomic
25 prospects in the UK and how we would seek to respond to

1 them.

2 SIR LAWRENCE FREEDMAN: Were you doing any analyses of the
3 likely impact of the conflict, successful or not, on
4 the -- on oil markets, on OPEC itself?

5 SIR NICHOLAS MACPHERSON: I'm pretty sure we did, yes:
6 not so much in terms of the structure of
7 OPEC, but in terms of potential scenarios of the oil
8 price.

9 SIR LAWRENCE FREEDMAN: Were these largely for internal use,
10 or were they fed into wider policy discussions? There
11 is a view that for the UK and the United States, this
12 was the main issue.

13 SIR NICHOLAS MACPHERSON: I'm quite sure we worked with the
14 Foreign Office and others in terms of our analysis and
15 would have readily shared it with -- certainly, sitting
16 in the Treasury, I had no sense that military
17 intervention was being driven by concerns about oil
18 supply or the oil price.

19 Our only focus was on the short-term
20 implications for the oil price on inflation and
21 certainly we are interested in long-term
22 economic growth, but we certainly would never advocate
23 military intervention as a way of shoring up that
24 growth.

25 SIR LAWRENCE FREEDMAN: Thank you. Let me now turn to the

1 questions of the UOR process and the defence budget.

2 First, the role that urgent operational requirements
3 can play. I think the National Audit Office report
4 of December 2003 has already been mentioned by
5 Sir Martin. It recognised that the UORs were quite
6 a good way of delivering extra capabilities quickly, but
7 it also noted a number of disadvantages, including value
8 for money, penalties, in that urgent items might only be
9 purchased quickly at a premium price. Do you share that
10 view?

11 SIR NICHOLAS MACPHERSON: It is certainly a risk. You know,
12 there is a tendency that, when you are buying these
13 requirements, that other people are buying them too, and
14 certainly there must be quite a bit of kit
15 which would have been bought from US suppliers, who no
16 doubt were also supplying the US armed forces and that
17 could potentially drive up the price.

18 I think there is a trade-off here. In an
19 ideal world where there was no resource constraint, you
20 could stock all sorts of equipment on a contingency basis, but
21 it would cost a great deal of money. So you try and
22 reach a happy medium.

23 As I say, the MoD is funded for being ready for war,
24 and quite a lot of equipment will be
25 in the generalised equipment programme.

1 Obviously the MoD, through the strategic defence
2 review process in 1998, had plans consistent with
3 certain interventions. I can't remember the
4 precise theology, but there is one medium-sized military
5 intervention -- Enduring, medium-sized one, and one
6 short-term one, and so you are kitted out and resourced
7 for that, but you don't know precisely where that
8 intervention is going to be and, "Is it going to be
9 mainly military or could it be Naval?" and you are
10 trying to optimise, really, across a range of
11 possibilities.

12 SIR LAWRENCE FREEDMAN: I mean, you have introduced the
13 relationship between UORs and the defence budget, and
14 I want to come back to that in a second, and the
15 question of the funding of the strategic defence review.

16 Just on the UOR itself, how efficient a process did
17 it turn out to be in practice?

18 SIR NICHOLAS MACPHERSON: Well, I think there are two issues
19 here. One is just how the UOR process was turned round.
20 I think that was pretty efficient. I'm not aware of any
21 time the Treasury was foot-dragging on UORs and --
22 actually, to the best of my knowledge, the Treasury
23 never turned down an eligible UOR. There is a set of
24 principles which inform what constitutes a UOR as
25 opposed to something else, and occasionally I think

1 there may have been the odd occasion when something was
2 put forward as a UOR but it did not actually fit within
3 those principles, but subject to that, we always
4 provided it.

5 There were de minimis limits which meant that, for
6 UORs of less than £10 million, the MoD could just sign
7 it off on its own, off its own bat. We were always
8 committed to giving an initial reaction, I think, within
9 24 hours, in terms of the business case and
10 so on.

11 So I think the process worked pretty well.
12 But there is a second question, which is --
13 and it comes back to a point I was making earlier, which
14 is it is one thing to ensure that the MoD has got the
15 cash to pay for the UOR. Then there is a second issue
16 around how quickly the supplier of that UOR can provide
17 it. Then there is a third issue, which is how quickly
18 can you ensure that this bit of kit is in theatre?
19 There are some quite interesting logistics and
20 procurement issues around that.

21 We clearly have an interest in an efficient
22 system and would have done all we could to support the
23 MoD on that, but, ultimately, the 24 second and third part
of the transmission mechanism
25 is very much a matter for the Defence Department and the

1 Treasury would not want to be second guessing or
2 interfering in that process.

3 SIR LAWRENCE FREEDMAN: From what you say, timing is
4 everything.

5 SIR NICHOLAS MACPHERSON: Yes.

6 SIR LAWRENCE FREEDMAN: If you leave it too late, then
7 however quickly the Treasury is responding and saying
8 "Okay", it can still arrive too late, and that, in fact,
9 is what happened with quite a lot of the kit that was
10 required for Telic; by the time it could be authorised,
11 ordered and then got to the Gulf, the conflict was
12 either just about to happen or even underway. We know
13 some examples of this.

14 So that's partly the problem of efficiency. If you
15 don't start the process quickly, you may just have a lot
16 of nugatory expenditure.

17 SIR NICHOLAS MACPHERSON: Just going back to the autumn of
18 2002, we did start paying money out in UORs at that
19 time. As I said earlier, I think we did it in
20 three tranches. You know, there will always be
21 a trade-off between the point at which you could
22 get the kit on the ground and the point when you really,
23 really need it.

24 Again, -- the Treasury can respond to
25 requests. I think it is quite difficult for the

1 Treasury to get ahead --

2 SIR LAWRENCE FREEDMAN: This is about the efficiency of the
3 process, it is not a particularly --

4 THE CHAIRMAN: Lawrence, could I come in on this one?

5 Because I need to understand it better than I do.

6 If a UOR claim is in respect of something that will
7 require to be manufactured albeit to a standard
8 specification, would the Treasury take an interest in
9 the capability of the supplier to manufacture to spec on
10 the timescale that the UOR relates to, or is that for
11 the MoD to do?

12 SIR NICHOLAS MACPHERSON: I think that's for the MoD. My
13 guess is, if you had a long period of really quite high
14 UOR expenditure and there were perceived to be problems
15 on that front, then I think the Treasury would get
16 interested in it just as the National Audit Office
17 subsequently were interested in it.

18 But the sums involved in this case
19 in one sense they are big, you know, £2 billion
20 were spent on UORs over the course of the campaign, but
21 in another sense, in terms of what goes through the
22 Treasury day in and day out, that's not a massive amount
23 of expenditure.

24 SIR LAWRENCE FREEDMAN: How did the process evolve during
25 the operation?

1 SIR NICHOLAS MACPHERSON: I don't have a sense that it
2 evolved hugely from a Treasury perspective. The MoD
3 came along with its list, we went through it, the money
4 was released. It may be that the Ministry of Defence
5 became more adept at their end of the process.
6 I suppose they are better placed to answer than I am.

7 At that time, I was running public spending.
8 At no point did anybody from the MoD get in
9 touch and express concerns about the process.
10 It seemed to be working reasonably well. The money was
11 going out of the door and, on the face of it, the kit
12 was being acquired.

13 SIR LAWRENCE FREEDMAN: But you were aware that afterwards,
14 after the major combat operations, there had been
15 problems in getting all the kit to the area in time and
16 getting it to the right place?

17 SIR NICHOLAS MACPHERSON: Certainly and it is the sort of
18 thing which I'm always keen to ensure that we learn
19 from, and obviously it continues to be an
20 issue in relation to Afghanistan and so on. Again, my
21 guess is that a lot of the problems arise
22 as you go further along the transmission mechanism
23 from the cash to getting it on the ground, and others
24 will be able to tell you more about that than I can.

25 SIR LAWRENCE FREEDMAN: I would like to move on to the

1 broader defence budget because, as you indicated, there
2 is a relationship between the need for UORs and what the
3 Ministry of Defence has already been able to provide out
4 of its existing stocks and general resources.

5 Now, you said before that the strategic defence
6 review had been funded to deal with certain
7 contingencies, but we have been told that actually the
8 strategic defence review hadn't been fully funded. Do
9 you have a view on that? How did it seem from the
10 Treasury, especially as you were dealing with public
11 expenditure at the time?

12 SIR NICHOLAS MACPHERSON: Well, just to be clear, the
13 strategic defence review was, I think --

14 SIR LAWRENCE FREEDMAN: That was in 1998, but the question
15 of being funded was coming all the way through.

16 SIR NICHOLAS MACPHERSON: It is a good question. I thought,
17 and indeed assumed, that it had been funded because
18 it is a longstanding principle that the reason you
19 have the defence review is to set out the capability
20 that you want to have and that the resources then
21 support that capability, and that's agreed collectively.
22 It is agreed by Cabinet, but obviously the
23 critical players in a review such as that are the
24 Prime Minister, the Secretary of State for Defence and
25 the Chancellor. So the 1998 settlement, I thought and

1 I think the Treasury thought, was consistent with that
2 strategic defence review.

3 Now, over time you can -- if, for example, the cost
4 base rises faster, you can get some tensions within the
5 budgeting process.

6 SIR LAWRENCE FREEDMAN: But moving forward into the years
7 just before the Iraq war, we have had evidence from
8 Sir Kevin Tebbitt, who acknowledged that the Treasury
9 had been fine in providing money for the actual
10 operation -- they didn't withhold money for the
11 operation -- but the problem was that the defence budget
12 itself was too small. Geoff Hoon said that:

13 "In the comprehensive spending review programmes we
14 asked for significantly more money than we eventually
15 received."

16 So we have had some evidence that the difficulty
17 that was faced and the need for so many UORs, which
18 meant that some equipment didn't arrive and some --
19 particularly clothing didn't an arrive in time, was
20 partly the result of the fact that the defence budget
21 was very stretched at this point.

22 SIR NICHOLAS MACPHERSON: I was involved quite closely in
23 the 2002 spending review. That concluded, I think,
24 in July of 2002. It didn't appear at the time to be an
25 acrimonious spending review process. I can remember

1 when agreement was reached because I'm pretty
2 sure I was in the room at Number 10 Downing Street, and
3 at that time I didn't get the sense that the MoD was
4 being starved of resource. Indeed, the 2002 settlement
5 gave them small real increases. It is important
6 not to get too fixated on the quantities of money the
7 MoD were asking for. Those former civil servants
8 amongst you will no doubt remember times in the past in
9 spending reviews, that the convention is that
10 departments write in demanding very large sums of money,
11 which everybody knows the Treasury ultimately will not
12 be able to provide, and so there is a slight
13 tendency to exaggerate the needs of each department.
14 That's a perfectly legitimate negotiating device.

15 The point I'm making about 2002 is that
16 it is open to the Secretary of State, it is
17 indeed open to the Chief of Defence Staff, to -- I mean,
18 the Chief of Defence Staff has direct access to the
19 Prime Minister. It has been known that they -- for them
20 to approach the Prime Minister and raise concerns.

21 The Secretary of State could have taken it to
22 Cabinet and he could have held out. They didn't, and
23 actually I was looking at the letter this morning which
24 the Secretary of State sent in reply to the
25 Chief Secretary on 10 July 2002, and he said:

1 "I welcome the increase in defence spending that is
2 proposed. It will enable me to sustain the
3 effectiveness of the armed forces while intensifying our
4 modernisation plans and provide a clear statement of the
5 government's commitment to defence."

6 That seemed to me a reasonably positive response to
7 the Chief Secretary's settlement.

8 THE CHAIRMAN: Could you turn the question the other way
9 round? The quite high frequency and quite large volume,
10 proportionately, of UOR applications and claims, was
11 that in itself not a claim that baseline funding had not
12 met what was going to arise in terms of need in the Iraq
13 campaign?

14 SIR NICHOLAS MACPHERSON: I don't think so. The
15 nature of a desert war raises quite considerable issues
16 around kit, and I haven't done the research on what the
17 demands for UORs were before the first Gulf War.
18 It might merit comparison, and if I can access
19 the information, I would be happy to share it with you.

20 UOR sums are not -- on the face of it they
21 are quite big, but in relation to both the defence
22 budget -- and remember they were being asked for over
23 a period of time. They didn't come along and just say,
24 "We need £2 billion worth of kit now." Actually, what
25 happened was, they came along saying, "We need

1 100 million of this," and then a month or two later it
2 would be another couple of hundred million of that. So
3 I'm not --

4 SIR LAWRENCE FREEDMAN: It all adds up, though. I think it
5 was about half a billion -- quite a lot. In the world
6 of the Treasury these may be small change but these
7 still seem quite large sums.

8 SIR NICHOLAS MACPHERSON: I accept that and I don't regard
9 them as small change. All public money matters
10 and we regard it as important. I suppose the point I'm
11 driving at is, at any point in time the
12 Ministry of Defence has to take a view on how it equips
13 itself to be ready for war and a judgment has to be made
14 about what sort of war the department is going to be
15 facing, and at any point in time, the
16 department has to take a view on whether it is going
17 to buy more helicopters or is it going to have an
18 aircraft carrier and so on. So, inevitably, there is
19 some prioritisation which goes on there and
20 when wars happen and you have to adapt to the
21 specific circumstances.

22 SIR LAWRENCE FREEDMAN: I would like to follow it on, but,
23 just back to the 2002/2003 settlement, we have seen
24 evidence that one of the reasons why the
25 Ministry of Defence may have been content with the

1 settlement is that it thought it was able, as a result
2 of the way the public expenditure rules worked -- and
3 I'm not sure I'm going to understand this properly,
4 although I think I understand it -- that basically they
5 could squeeze the capital and they could vire between the
6 non-cash and the cash, that actually, by being efficient
7 in one area, they could generate more cash for
8 themselves, with the result that when this became
9 apparent in late 2003, this led to a pretty big row
10 between the Treasury and the Ministry of Defence, which
11 went right up to Cabinet level.

12 So I would just be interested if that's a correct
13 analysis of what was going on and the implications of
14 that for the Ministry of Defence's overall budget.

15 SIR NICHOLAS MACPHERSON: You are right to identify a change
16 in budgeting at that time. There was a general move
17 away from cash accounting to resource accounting, and it
18 did turn out, through late summer 2003 and early autumn,
19 that the Ministry of Defence was moving large amounts of
20 resource out of non-cash into cash spending.

21 I don't think this was part of a conscious strategy.
22 I mean -- clearly in one sense it was, in that
23 this freed up cash to buy things. On the other hand,
24 over a period of weeks the sum -- the estimate of the
25 sum involved rose almost exponentially. I can remember,

1 in late summer it was £400 million. That
2 rapidly turned into £870 million, and at the point we
3 pulled the plug on enabling the department to shift
4 resource across this boundary, it had topped out at
5 1.15 billion, which meant that cash spending was growing
6 at 9 per cent a year, compared to something like
7 3.5 per cent, which had been provided for in the
8 settlement.

9 What was very striking was that
10 the central MoD understanding of this was perhaps not as
11 strong as one might have hoped. So you are right that
12 it was an issue. We did have to intervene in September
13 to put a -- put things on hold. We initiated an
14 external review of how it had arisen. I don't think
15 this is particularly relevant to the provision of the
16 Iraq war, partly because, by September of that year,
17 a lot of the heavy lifting had taken place, and
18 we had made clear in the previous settlement letter what
19 we expected in terms of cash spending. So there was
20 a bit of a control issue. But you quite
21 rightly raise it as an area of tension in the autumn of
22 2003.

23 SIR LAWRENCE FREEDMAN: Well, I think, in terms of the
24 implications, we can ask and try and find out more about
25 the MoD's perspective. We have already raised it a bit

1 with Geoff Hoon. And I guess they would argue that the
2 incentives created by the new form of budgeting suited
3 MoD very well, given the sheer size of their estate and
4 the opportunities they had created for themselves; they
5 were just taking advantage of the incentives.

6 But I think the issue for Iraq goes back to the fact
7 that you were now in a conflict which could last some
8 time. So, though in terms of immediate expenditure this
9 was not necessarily going to have an impact, in terms of
10 the ability to make provision for the future and to
11 develop resources to cope with the changing nature of
12 the conflict, it did have an impact, and I think the
13 Secretary of State did suggest that in his
14 correspondence with the Chancellor.

15 SIR NICHOLAS MACPHERSON: I think Treasury ministers, in
16 their correspondence with Mr Hoon, were very keen to
17 reinforce their commitment to funding the intervention
18 in Iraq, both through Urgent Operational Requirements
19 and the more conventional net additional cost of
20 military operations, and indeed that's what we did.

21 SIR LAWRENCE FREEDMAN: One example of -- there were
22 a number of things that had to be cut quite quickly as
23 a result of the need to -- when the Treasury intervened,
24 and agreement had to be reached on immediate cuts or
25 forms of expenditure not going forward, and this did

1 have -- one example that has been cited is work on
2 helicopters, for example.

3 So it is hard to say that if you are -- if you are
4 suddenly asking a department to cut back on its plans,
5 that this isn't going to have some impact, not
6 necessarily in the immediate term, I think that's
7 understood, but in two or three years ahead, and again
8 Geoff Hoon did suggest that this did have an effect in
9 that way.

10 SIR NICHOLAS MACPHERSON: My understanding is that Mr Hoon
11 said that he did not think it was relevant to
12 helicopters in Iraq but you quite rightly --

13 THE CHAIRMAN: Because of the timescale?

14 SIR NICHOLAS MACPHERSON: Yes.

15 SIR LAWRENCE FREEDMAN: But it was relevant, potentially, to
16 Afghanistan?

17 SIR NICHOLAS MACPHERSON: Well, the Treasury had agreed
18 a spending settlement in 2002 which was based on a set
19 of assumptions around the growth in cash spending. It
20 provided for real increases. What it didn't do was
21 provide for the really very rapid increases which took
22 place through the summer of 2003. So we did need to get
23 the spending programme back on track, and I think,
24 through the efforts of the Ministry of Defence, we
25 succeeded in doing that. Inevitably, it did have

1 implications for the precise trajectory at that point
2 because, as I said, it was growing at 9 per cent and
3 that had to be pulled back and that meant that
4 the MoD couldn't spend as much as it would have
5 liked. But had it stuck to the cash figures in the
6 original settlement, that situation wouldn't have
7 arisen.

8 SIR LAWRENCE FREEDMAN: I think we obviously need to explore
9 this more. Can I just ask about whether other
10 departments -- DFID, we have talked about a bit, but I'm
11 particularly interested in the Foreign Office, as to
12 whether they were making representations that the extra
13 costs of Iraq were having a big impact on their budget
14 and whether provisions were made to improve their
15 position?

16 SIR NICHOLAS MACPHERSON: The Foreign Office's budget was
17 agreed in the 2002 spending review and there were
18 certain enhancements at that point. I recall the
19 creation of something called the Global Opportunities
20 Fund. They also potentially could access some of the
21 global conflict pools, which had been provided to
22 encourage interdepartmental cooperation and working.

23 THE CHAIRMAN: They weren't new money, were they? They were
24 a pooling of existing provision?

25 SIR NICHOLAS MACPHERSON: That's it, yes, but they had been

1 rolled forward and from time to time were enhanced.
2 We did provide extra money to the Foreign Office
3 in 2003 through -- I think 20 million was transferred
4 from the money which DFID had been given access to, and
5 we did have a dialogue with the Foreign Office
6 on their funding. I'm not aware of any great
7 differences, and I think it is the case for
8 the Foreign Office, at any point in time there are
9 pressure points in the world. For example, right now
10 I suspect the Foreign Office needs more
11 resource in Haiti. At that time they needed more
12 resource in Iraq, not least because they closed the
13 embassy down at an earlier point in time.

14 But I think it has been the case over the
15 last couple of decades that the department is reasonably
16 flexible and has capacity to shift resource
17 to particular pressure points.

18 SIR LAWRENCE FREEDMAN: This is a period when the
19 Foreign Office budget is under steady threat and
20 (inaudible) becomes tighter and tighter, I think, over
21 this past decade. So it becomes more and more difficult
22 for the Foreign Office to move money around because it
23 is not dealing with the sort of sums that other
24 departments are dealing with in the first place.

25 SIR NICHOLAS MACPHERSON: Clearly it has got a smaller

1 budget than, say, the Ministry of Defence, but it has
2 still got a reasonable budget and that is agreed as part
3 of the spending review between the Foreign Secretary and
4 the Chancellor and others. Historically the
5 Foreign Office tends to get a reasonable deal, not least
6 because usually the Foreign Secretary is a highly
7 influential person and it is important that his or her
8 department is funded. I'm not aware of the
9 Foreign Office budget being under massive pressure
10 through this period, but the Foreign Office may have
11 a different view.

12 SIR LAWRENCE FREEDMAN: They may. Let me just -- because we
13 have got to watch the time. Let me just ask you a few
14 questions on post-invasion funding mechanisms. You have
15 just mentioned the global conflict pool. This isn't --
16 hasn't been getting a very good press in this Inquiry
17 for a variety of reasons. We heard some more this
18 morning. What was your impression of the efficiency
19 with which this amount of money was disbursed?

20 SIR NICHOLAS MACPHERSON: The first point I would make is
21 that these pools were not of a very large scale.

22 SIR LAWRENCE FREEDMAN: One of the points that has been made
23 to us is the amount of aggravation they generated for
24 actually quite a small amount of money.

25 SIR NICHOLAS MACPHERSON: The genesis of these pools was

1 a desire to promote, I think, what was then and maybe
2 still is known as "joined-up government", namely that
3 the departments live in their silos and
4 critical to success -- and I think Iraq really
5 bore this out -- is cooperation across the three
6 big departments in this context, which is defence and
7 the Foreign Office and DFID. They were in one sense an
8 experiment because these things were
9 introduced possibly in the 1998 spending review -- it
10 could have been 2000, I can't remember which -- and
11 I think perhaps they were created more with a view to
12 a Sierra Leone-type intervention, a smaller
13 intervention, where these departments could come
14 together.

15 For something like Iraq, clearly, they were not on
16 a scale to fund what had to be funded and it had to be
17 supplemented, but I think the Treasury's view was that
18 just having the funds institutionalised cooperation in
19 a way which, if you didn't there would not be
20 the same opportunity and context for the departments to
21 get together. I don't want to oversell them and they
22 have evolved since then.

23 SIR LAWRENCE FREEDMAN: Just to take Sir Suma Chakrabarti's
24 evidence from this morning, what he said is that where
25 there is unity of purpose, they can work, as with the

1 Africa one, but where there isn't a unity of purpose --
2 he gave us the interesting notion of DFID taking the
3 Maoist line while the Foreign Office took a royalist
4 line. But where there isn't a unity -- I'm not sure
5 where the Treasury would come on this spectrum. But
6 where there isn't a unity of purpose, it doesn't work
7 very well, and this was the basic problem with the pool.

8 SIR NICHOLAS MACPHERSON: Well I suppose our, it
9 may have been excessively optimistic, hope is that where
10 there isn't unity of purpose, creating an opportunity
11 to -- creating something which incentivises people to
12 create one is worth doing. I don't want to oversell it,
13 as I say, because the sums were not huge in this
14 context, but I would hope that all
15 departments would share at least the objective that, as
16 a matter of principle, it would be good if the
17 Defence Department, Foreign Office and International
18 Development Department could work together.

19 SIR LAWRENCE FREEDMAN: Indeed. Can I just ask
20 two questions relating to funds that are outside in a
21 sense the military's operational needs, and as you have
22 said, this seems to have been funded, in immediate terms
23 anyway, quite well. We had a discussion with
24 General Rollo, who was in Basra in 2004. He said:

25 "I had £10 million under my own hand but I could

1 only dole it out in chunks of up to 50,000 without
2 reference to the Treasury."

3 And when he tried to do that, he said -- I asked him
4 what had happened. He said:

5 "Well, they asked for an investment appraisal.
6 Investment appraisals are things -- I suppose one of the
7 options is you don't do it at all and it took two
8 months. I thought, we haven't got time to do this or
9 the staff effort to do it, and the American system was
10 much easier, so we just used that."

11 I said:

12 "So you just gave up on the Treasury."

13 "Yes, it was just common sense."

14 Had he got it wrong? Had he misunderstood the
15 rules?

16 SIR NICHOLAS MACPHERSON: I do think sometimes people --
17 I know I'm bound to say this, but I do think there is
18 a tendency across government sometimes to blame the
19 Treasury for things for which it is not responsible. I
20 am not aware of the Treasury micromanaging the budget in
21 Basra. I will correct -- I will correct myself
22 if it turns out I go back to the Treasury and people
23 says, yes, they were looking at investment appraisals.
24 We delegated the budgets. We were not responsible
25 for spending on the ground, nor should we be.

1 Different departments account for their spending in
2 different ways and it may be that, in requiring budget
3 holders to account for their spending, they claim that
4 this is the Treasury demanding it. All of us
5 have got an obligation to know where our money is spent.
6 We have responsibilities as accounting
7 officers to Parliament but there are different ways of
8 doing this. I would be quite surprised if it was the
9 Treasury who was demanding these things.

10 But, as I say, if I'm wrong, I will --

11 SIR LAWRENCE FREEDMAN: I think it would be helpful if you
12 could check because this is something, presumably, that
13 can be checked.

14 SIR NICHOLAS MACPHERSON: Yes.

15 SIR LAWRENCE FREEDMAN: And we have had a similar complaint
16 from Dominic Asquith but that was more about not being
17 able to get more money out of the departmental
18 allocation, but a sense of the inflexibility of the
19 system.

20 SIR NICHOLAS MACPHERSON: As a matter of principle --

21 SIR LAWRENCE FREEDMAN: So it would be helpful, I think, if
22 you could perhaps come back to us on that. Thank you.

23 THE CHAIRMAN: Usha?

24 BARONESS USHA PRASHAR: Can I come to the question of
25 accountability? Did the Treasury receive from

1 departments the level of detail you we needed to monitor
2 the expenditure properly during this period?

3 SIR NICHOLAS MACPHERSON: Yes, I think we did.

4 BARONESS USHA PRASHAR: Because members of Parliament on
5 a number of occasions, you know, we have been looking
6 at, criticised departments for the lack of detail and
7 the clarity of expenditure in Iraq. So what
8 responsibility do you have to ensure that Parliament is
9 properly kept informed about expenditure?

10 SIR NICHOLAS MACPHERSON: I think we have -- we are
11 responsible for the overall framework and there are --
12 there are documents -- I think at that time it would
13 have been called Government Accounting; it is now called
14 Managing Public Money -- which set out what the Treasury
15 expects from departments in reporting to Parliament.

16 So I certainly felt, in terms of the information we
17 got in terms of signing off spending on Iraq, that we
18 got pretty good information from the Ministry of Defence
19 in particular. So -- again, if there are
20 lessons on this, I would be keen to learn them but
21 I don't feel that the reporting was somehow inadequate.

22 BARONESS USHA PRASHAR: Because, I mean, one MP described it
23 as short of visibility and lack of transparency. Do you
24 think it is the way they are presented which is not
25 easily accessible? Is that an issue?

1 SIR NICHOLAS MACPHERSON: There has been a longstanding
2 issue around the defence budget that the
3 defence budget is agreed in a big block and perhaps it
4 doesn't set out in enough detail the way the
5 overarching total is allocated.

6 But I think -- all I can speak for is in
7 terms of the information we got in the signing off of
8 things like the UORs, which did go into a pretty
9 impressive level of detail.

10 BARONESS USHA PRASHAR: Any (inaudible) inconsistencies in
11 the way the different departments -- because I think
12 DFID's figures vary to what you are saying. I mean,
13 there are inconsistencies. Are there reasons why that
14 might be the case?

15 SIR NICHOLAS MACPHERSON: Someone pointed out to me that the
16 figures I have put in in terms of DFID spending aren't
17 quite the same as the spending figures which DFID had provided.
18 I think that is because we relied on published
19 statistics -- in terms of reporting to international
20 bodies and so on. All I can say is,
21 from my own Treasury experience it doesn't half help if
22 people are reporting figures on a similar basis so that
23 you are comparing like with like, and again I think we
24 have an interest in improving reporting so that people
25 get a common set of numbers, and indeed there is a

1 broader agenda which the Treasury is pursuing at the
2 moment called the "Clear Line of Sight project", which
3 is trying to bring the planning, reporting, the
4 estimates process, in Parliament together to create more
5 comprehensible information for Parliament and for the
6 public.

7 BARONESS USHA PRASHAR: So this is work in progress? You
8 are trying to make it more accessible?

9 SIR NICHOLAS MACPHERSON: Yes, it slightly relates to the
10 issue which Sir Lawrence raised earlier, which is the move
11 towards resource accounting. We have an obligation to
12 try and make a complex system rather more intelligible.

13 BARONESS USHA PRASHAR: My next question is really about
14 hindsight. Do you think, if more funds had been
15 available in the early stages of the preparation for the
16 invasion, that departments would have been able to be
17 more effective plans for the invasion and the aftermath?

18 SIR NICHOLAS MACPHERSON: I don't think I have a view on
19 that. With hindsight,
20 one can always look back at areas where one would have
21 liked more resources but, as I said earlier, I'm not
22 convinced that there was any great resource constraint
23 in cash terms at this time. There may have been
24 planning constraints but I don't think those derive from
25 the hard cash which was available.

1 BARONESS USHA PRASHAR: So you are saying it was more about
2 the planning for the preparation rather than the
3 resources that --

4 SIR NICHOLAS MACPHERSON: I think it is the way money
5 translates into outcomes on the ground, and I'm not in
6 a position to comment on that. I don't feel I have got
7 enough knowledge.

8 BARONESS USHA PRASHAR: Thanks.

9 THE CHAIRMAN: I have got a couple of final questions, if
10 I may, really going straight on from what
11 Baroness Prashar has just been saying.

12 The first question is: we have been hearing a lot
13 from both FCO and DFID witnesses, as indeed from some
14 military witnesses, about the evolving comprehensive
15 approach, particularly to reconstruction in
16 security-sensitive situations around the world. For the
17 moment the process of accessing a reserve is primarily
18 one for military, or indeed for the agencies, to
19 exercise. With the comprehensive approach, is that
20 sustainable in the future or would it be wise to sort
21 of, as it were, construct a pool indeed, when it comes
22 to reserve claims?

23 SIR NICHOLAS MACPHERSON: I think it is important always to
24 keep these things under review. We have just been
25 discussing a period where there was an

1 evolution in terms of budgeting, with the conflict pools
2 and so on, and in principle you could expand
3 those pools considerably, and this would be a matter for
4 the next spending review, which will no doubt get
5 underway after the election, and it will also relate to
6 the defence review, which I think both main parties are
7 now committed to having. So I think we do need to look
8 again at this.

9 It is less of an issue, funnily enough, for
10 the Department for Development, simply because their
11 budget has expanded, continues to expand, and both main
12 parties are committed to reaching the UN target. So
13 there is quite a lot of money in that budget and
14 so the resource constraint perhaps there is
15 less.

16 I'm mindful of the Foreign Office and indeed
17 that's had some publicity in recent days. So I think we
18 need to look at this again.

19 THE CHAIRMAN: Okay, thanks. Final question, which is
20 pretty broad and fuzzy around the edges. It is really
21 the question whether -- with hindsight, did this
22 country, our government, really will the means, as well
23 as the ends, for Iraq, not necessarily in terms of cash
24 provision but more generally, and the striking contrast,
25 I think, is between Jeremy Greenstock, for example,

1 saying, "No, on the whole things become more expensive
2 for us because we don't over-insure, we don't
3 overprovide" -- I'm not quoting him -- "but when we come
4 to the pinch point, we do have to pay"; contrast the
5 Americans voting -- what was it Congress voted,
6 18 billion for reconstruction back in 2002/2003,
7 I think? Ahead of the game. Much of that money, we
8 have heard a lot of evidence, was either not spent or
9 not well spent, but it was there and providing
10 a planning envelope.

11 Is there a question there for us -- future
12 provisioning, or at any rate setting up arrangements
13 which enable people to plan, not against the hard
14 argument of absolutely necessity but against the
15 prospect?

16 SIR NICHOLAS MACPHERSON: I think you are driving at really
17 quite a big macro-level question, which is there is an
18 issue for government and society about what sort of
19 armed forces it wants and what level of intervention it
20 wants to be capable of. The Treasury stands ready to
21 fund that, when society and government
22 answers the question.

23 But it is something which I think
24 evolves. In the 1990s the defence budget was cut back
25 on the basis of the Cold War dividend. There was

1 considerable public acceptance of that.

2 The debate which no doubt is taking place in front
3 of this Inquiry will inform the democratic system, and
4 the next government, whoever that will be, in the
5 defence review is going to have to appraise
6 where it wants to be.

7 THE CHAIRMAN: And it may be more for the defence review,
8 given that conflict and post-conflict situations, as we
9 keep hearing in evidence, go wider than the military,
10 though resting heavily on the military.

11 SIR NICHOLAS MACPHERSON: Absolutely, and more generally we
12 have to decide how much tax we are prepared as a country
13 to pay and how much we want to spend.

14 THE CHAIRMAN: Thank you.

15 I was going to ask you -- in fact I will ask you
16 whether there are any final reflections you want to
17 make, although that might be it. Is there anything else
18 you would like to say?

19 SIR NICHOLAS MACPHERSON: I think that's a good note to end
20 on.

21 THE CHAIRMAN: Can I thank our witness and those of you who
22 have been here through the morning.

23 We meet again for our next set of hearings at 2 pm
24 in the afternoon on Monday, when we shall be taking
25 evidence from Des Browne and John Hutton as

1 Defence Secretaries. Thank you very much.

2 (1.05 pm)

3 (The Inquiry adjourned until Monday 25 January 2010 at

4 2.00 pm)

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