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Friday, 9 July 2010

(10.00 am)

SIR JONATHAN CUNLIFFE

THE CHAIRMAN: Good morning everyone and welcome to this morning's witness, Sir Jon Cunliffe, formerly a very senior member of the Treasury and still in the Crown's service. Welcome.

We are going to be discussing Sir John's role vis a vis Iraq as Managing Director, Financial Regulation and Industry in 2002. Then he became a Managing Director for Macroeconomic Policy and International Finance, I think, some time in 2002 until 2007.

I say on each occasion, we recognise that witnesses give evidence based on their recollection of events and we, of course, check what we hear against the papers to which we have access and some of which we are still receiving.

I remind each witness on each occasion that they will later be asked to sign a transcript to the effect that the evidence given is truthful, fair and accurate.

With those preliminaries out of the way, I'll ask Sir Roderic Lyne to open the questions. Roderic?

SIR RODERIC LYNE: Sir Jon, as the risk of a conflict in Iraq became more apparent in the course of 2002, what advice were you providing to the Chancellor on the

1 impact it could have on the British economy?

2 SIR JONATHAN CUNLIFFE: Somewhere around
3 probably August 2002, probably early July/August 2002,
4 various parts of the Treasury started working on the
5 possibility of a conflict in Iraq. Most of that work
6 was led on the public expenditure side of the Treasury
7 because they were more in direct contact with the
8 military and the costs and how we would pay for it.

9 I think a lot of that was conducted on a quite
10 tight, need-to-know basis. So I'm not sure what went on
11 on that side.

12 But around July/August, we started thinking about
13 the global effects of the conflict and how it would
14 impact on the global economy. We had just come out of
15 the tech bust, the 2000/2001 tech bubble bust, so we had
16 seen things -- how shocks were transmitted --

17 SIR RODERIC LYNE: Dot.com.

18 SIR JONATHAN CUNLIFFE: Yes, sorry. But we had also seen
19 with September 11 just how shocks, political and
20 military shocks could be -- security shocks, could be
21 transmitted through global markets and I had some
22 history with the Asian crisis beforehand.

23 So round about the summer, we started thinking about
24 it. There was a team in my directorate in the Treasury
25 which, although it may have changed its name or my

1 titles may have changed from June -- I took over
2 in June 2002 and basically the job remained the same all
3 the way through to 2007.

4 We wanted to look both at the international
5 implications and then how those would impact on the UK
6 and we discussed it with the Treasury management board.
7 The Treasury management board has a general risk
8 register, and I think we had a meeting in September on
9 risk, and it then appeared sensible not to do an
10 international impact/UK macroeconomic impact, but to try
11 to look at all of the Treasury's objectives and how
12 conflict might impact on that and we launched that work
13 in the autumn of 2002.

14 It was predominantly forecasting. What we did is we
15 took the effects, we tried to quantify them as far as we
16 could, but then we ran them through the Treasury
17 forecasting and modelling process and the idea was not
18 to come up with the war costs -- you know, could cost so
19 much or reconstruction could cost so much, but just to
20 put different assumptions about the impact of a conflict
21 into the Treasury model and to see what it said and then
22 to assess that and to look at it against a range of
23 Treasury objectives.

24 We produced that report, I think, in October. It
25 was discussed at the Treasury management board. We

1 looked at it, and we sent it, I think, at that point, to
2 the Chancellor in October of that year.

3 Do you want me to go on and say something about what
4 it showed?

5 SIR RODERIC LYNE: Yes, please.

6 SIR JONATHAN CUNLIFFE: Basically, no surprises. It is
7 quite difficult to model a conflict that hasn't
8 happened, we didn't know whether it would be short, short
9 or protracted or really a nightmare scenario with use of
10 weapons of mass destruction, possibly sort of the
11 closure of the Straits of Hormuz and the denying of
12 Middle East oil to the world economy.

13 So we looked at a number of fairly simple scenarios,
14 short, protracted and severe, with the use of weapons of
15 mass destruction, and what it showed is exactly what you
16 would expect it to show, which was that a short conflict
17 that lasted a few months and where the main impact on
18 the UK were the costs of the military conflict and the
19 costs of reconstruction would be absorbed relatively
20 easily by the economy.

21 If it went on for a long time, there would be more
22 significant problems, and then, if it really turned into
23 a conflagration, with the use of nuclear or biological
24 weapons and it spread round the Gulf, then we had a much
25 larger problem on our hands and, in a way, that's what

1 I would have expected it to show.

2 It showed that the public finances, the fiscal
3 framework and the like, would cope in the first two
4 scenarios but, in the latter scenario, we would have
5 a problem, although, if it turned into that sort of
6 conflagration, that would be just one of a number of
7 problems.

8 I thought it was -- in the end, the analysis was
9 designed to -- and the reason you do these modelling
10 exercises, they are designed to check your range of
11 intuitions in a more structured way, but it didn't come
12 up with anything, I think, surprising --

13 THE CHAIRMAN: Just on a point of detail, if I may, Sir Jon,
14 although it is a kind of large detail, you mentioned
15 nuclear, but there was no intelligence to suggest that
16 Iraq or, indeed, any other country in the region was
17 anywhere near nuclear capability.

18 SIR JONATHAN CUNLIFFE: We had no information there at all.
19 We modelled -- it was a much cruder exercise, I am
20 afraid - we modelled weapons of mass destruction and
21 just the -- the idea behind the modelling was that this
22 was a conflict which would spread and where large chunks
23 of the oil industry in Iraq, but also outside of Iraq,
24 Kuwait, et cetera, you know, could be rendered in one
25 way or another, inaccessible to the rest of the global

1 economy.

2 SIR RODERIC LYNE: Where did you import, or from where did
3 you import, the assumptions on which you based these
4 scenarios of the kind of war, the length of war and so
5 on and, indeed, you know, the nature of it, whether or
6 not what the risk was of us getting into weapons of mass
7 destruction, the important distinction between chemical,
8 biological -- were these purely internal?

9 SIR JONATHAN CUNLIFFE: I don't think they were based on --
10 I am pretty sure they weren't based on a separate
11 exercise carried out in the --

12 SIR RODERIC LYNE: Sorry, they were based?

13 SIR JONATHAN CUNLIFFE: No, I don't think --

14 SIR RODERIC LYNE: You don't think they were, no?

15 SIR JONATHAN CUNLIFFE: -- no, they were not. Not based on
16 a separate exercise carried out on the military and
17 security side which then fed in.

18 There had been discussions at working level between
19 Treasury teams and some of the Treasury teams were
20 involved in the military planning which enabled us to
21 map out broad scenarios, but I don't think, at that
22 point, we based it on detailed military assessment.

23 SIR RODERIC LYNE: Just recalling the old adage of
24 computers, "garbage in, garbage out". You were coming
25 out -- you were going through a sophisticated process of

1 economic modelling, but I'm just curious as to where the
2 sort of baseline assumptions were that you put into it
3 at the front end. You had a lot of economic data, but
4 what about the broader political and strategic data?

5 SIR JONATHAN CUNLIFFE: I suspect that rather overstates the
6 precision and the nature of economic modelling.

7 Economic modelling is a process which involves a range
8 of judgments, many of which you can't substantiate fully
9 with econometric evidence.

10 The reason one does it that way is because it is
11 a consistency check and it ensures that, when you look
12 at impacts to the economy, you take into account, not
13 just one effect, but how it ripples across to others,
14 and that you have considered all of the impacts.

15 So comparing it to computers is a bit unfair because
16 it sounds as if we had a terrifically precise process,
17 and we put an imprecise input into a terrifically precise
18 process. We didn't. The process was -- by nature of
19 forecasting is imprecise --

20 SIR RODERIC LYNE: I'm curious to what extent this was just
21 an internal Treasury exercise or whether, at the
22 beginning of it, your officials will have gone to the
23 Foreign Office, the JIC, the intelligence agencies, the
24 MoD, to get the basic information about what was likely
25 to happen.

1 SIR JONATHAN CUNLIFFE: Well, I think the officials were in
2 contact with the Ministry of Defence, the agencies and
3 I think at that point, certainly that autumn, a sort of
4 Whitehall group was set up and, you know, the Cabinet
5 Office had then to look at it. But, you know, it wasn't
6 based on that sort of analysis.

7 I would be interested to know just how accurate and
8 precise they could have made that sort of analysis at
9 that time, to be honest, but I didn't --

10 SIR RODERIC LYNE: You have raised an interesting question
11 as to what extent (overtalking) --

12 SIR JONATHAN CUNLIFFE: I'm here to answer questions, not to air
them --

13 SIR RODERIC LYNE: -- that sort of analysis existed in
14 Whitehall.

15 To what extent -- well, what were your projections
16 about the possible effects on the oil market and oil
17 prices and how big did that feature in your work?

18 SIR JONATHAN CUNLIFFE: Quite a lot, because the oil market
19 was the main transmission mechanism to the world economy
20 of that sort of conflict. There are general confidence
21 effects; markets don't like wars, they don't like
22 political situations they can't read, but the main --
23 the more concrete transmission channel through which
24 a crisis, a war, it would impact the global economy, we
25 thought would be oil and oil price shock, and that's

1 just looking back to the history of the 70s and what we
2 had seen happen there.

3 We modelled that quite closely. There was work
4 going on at that time in the DTI, as then was, as well,
5 on the oil price, potential oil shocks, what had
6 happened in the first Gulf War. There was a fair amount
7 of historical data that you could use.

8 I think we modelled the oil price -- today, this
9 seems very comforting, we modelled the oil price
10 doubling from \$20 to \$40 in the extreme scenario and
11 then we made some assumptions about how that would
12 impact the world economy.

13 Just underlining my earlier point about modelling,
14 we have seen the oil price go up to nearly \$150 with
15 relatively little impact on the world economy. So the
16 assumptions we were making about what would happen from
17 20 to 40 in that paper were probably wrong.

18 SIR RODERIC LYNE: So you were making an assumption of
19 a short-term spike of 20 to 40, but medium- to
20 longer-term, what were your calculations suggesting
21 about the effect of the end of sanctions, production in
22 Iraq being restored or, indeed, developed towards its
23 potential levels? What effect -- was there some upside
24 in the medium- to longer-term, from our perspective, for
25 the oil market?

1 SIR JONATHAN CUNLIFFE: I'm pretty sure that we didn't take
2 the upside into account. We looked at supply as
3 being fairly constant and I think the forecast only ran
4 two years out. So you would have expected any major
5 increase in Iraqi oil production to take a bit longer
6 than that, I think. Some of the later work -- I think
7 there was later work that we did on reconstruction of
8 the oil industry in Iraq suggested (overtalking --)

9 SIR RODERIC LYNE: You weren't assuming a benefit for
10 western energy security as a result of changing the
11 regime in Iraq?

12 SIR JONATHAN CUNLIFFE: No.

13 SIR RODERIC LYNE: No.

14 SIR LAWRENCE FREEDMAN: Now, there was just a question
15 I wanted to raise as well. Was any work done in the
16 Treasury on benefits, particular benefits to UK energy
17 supply or to the UK oil industry as a result of your
18 work?

19 SIR JONATHAN CUNLIFFE: No, the only thing that I think
20 comes close is that, in the fiscal impacts of a crisis,
21 a high oil price benefits the UK, because we are an oil
22 producer and we have tax and licence revenues, so we
23 took that upside.

24 That's one of the reasons why the impact on the UK
25 economy is not straightforward. So we took into account

1 what would happen with an oil price spike. It would
2 actually mean damage to the UK economy, but more revenue
3 coming in, but we weren't trying to do an exercise about
4 the economic pros and cons of the war. That was not the
5 object of the exercise.

6 The exercise was, if conflict happens, can we trace
7 through how it would impact the UK in a variety of ways
8 in a fairly short-term exercise. I think the furthest
9 we went ahead was looking at the fiscal position 2006.

10 SIR LAWRENCE FREEDMAN: The question was whether anywhere in
11 the Treasury there was an interest in potential upsides
12 in terms of the UK oil industry.

13 SIR JONATHAN CUNLIFFE: Not as far as I'm aware, no.

14 SIR LAWRENCE FREEDMAN: Thank you very much.

15 SIR RODERIC LYNE: You say that the public expenditure side
16 of the Treasury were looking at more direct costs. Do
17 you recall -- and, also, that this was fairly closely
18 held on a need-to-know basis.

19 Do you recall anything about their calculations on
20 the direct effects on tax base from which we would have
21 to -- tax revenues from which we would have to fund our
22 involvement, were we to be involved, implications for
23 our borrowing and so.

24 SIR JONATHAN CUNLIFFE: That was part of our exercise.

25 SIR RODERIC LYNE: That was part of your exercise?

1 SIR JONATHAN CUNLIFFE: The thing we didn't do, the numbers
2 we took from the other side of the Treasury, is how much
3 is a war likely to cost - what is the impact on the
4 Reserve over a number of years.

5 Our exercise of course looked at the public finance
6 position, because the macroeconomic part of the Treasury
7 was responsible for the fiscal framework and the public
8 finances. But there was nothing in the analysis, as
9 I recall, that suggested we would have problems in the
10 debt markets, borrowing -- we had to fund --

11 SIR RODERIC LYNE: But this was based on the assumption that
12 this would be a fairly short-term involvement, a fairly
13 short conflict, and that we wouldn't be involved in it
14 for years?

15 SIR JONATHAN CUNLIFFE: No, the analysis looked at the
16 impact of a short or a medium or a protracted conflict.
17 It didn't look at the -- how protracted is protracted -
18 it didn't look at the idea of a six- or seven-year
19 protracted conflict. But it also looked at how those
20 fiscal pressures, you know, the costs, the higher public
21 expenditure, both on the reconstruction and on the
22 military side, would impact on the economy, which could
23 be weakened by a global shock. So it looked to see
24 whether a war in itself would weaken the global economy,
25 put up the oil price, how those two impacts would feed

1 through to the UK economy and how the UK economy that
2 would be weaker if the shock was very pronounced, would
3 then have to cope with the extra public expenditure.

4 At a macro level, the impacts were not from the
5 public expenditure. I think the forecasts going in were
6 2.5 to 5 billion for the military conflict and the
7 public expenditure was probably then running at
8 £350 billion to £400 billion a year. So we are not
9 looking at a huge shock.

10 Had we gone into the WMD, the very severe scenario,
11 I think the forecast was that could take 1.5 percentage
12 points off growth in 2004, which would have been a very
13 big impact. It would have weakened the economy, it
14 would have weakened the public finances and we would
15 have had to taken a decision whether to absorb the
16 public expenditure costs through increased borrowing,
17 and the public expenditure costs are now not just the
18 costs of the war but the so-called automatic
19 stabilisers -- unemployment rises, tax revenues are
20 down -- to have absorbed that through borrowing, which
21 is traditionally what governments do with wars, or
22 whether we should actually have tried to tighten the
23 fiscal position.

24 But that was in the extreme scenario only. In the
25 kind of other scenarios, it didn't really register as

1 a large macro impact.

2 SIR RODERIC LYNE: You say this work, when it was done, was
3 presented to the Treasury management board and to the
4 Chancellor. Was it then disseminated into Whitehall and
5 particularly towards Number 10 and places where the
6 decisions were actually being made?

7 SIR JONATHAN CUNLIFFE: We didn't, as I recall, formally
8 send it to Number 10. It was an exercise that was
9 designed to check for our benefit what the impacts would
10 be. As I say, I don't think it was ever intended as an
11 economic pros and cons of a conflict.

12 It was disseminated, though, I think, through --
13 I think the Whitehall groups changed their name, but it
14 was, I think, disseminated through the Cabinet Office
15 group and I think at one point the Contingencies Unit
16 became involved in the cross-Whitehall exercise. Some
17 of the analysis (overtalking) --

18 SIR RODERIC LYNE: So this is --

19 SIR JONATHAN CUNLIFFE: -- a high level version went into that.

20 I think -- my guess is that, had it come up with
21 something extremely sort of worrying across a range of
22 scenarios, had it been a very big impact, then of
23 course, we would have said "This factor needs to be
24 recognised across Whitehall", but actually, what it came
25 up with, as I say, was in line with what, intuitively,

1 you would expect.

2 SIR RODERIC LYNE: Through what channel would the then
3 Prime Minister, Foreign Secretary and Defence Secretary
4 have been informed of the possible economic consequences
5 of the conflict in the period in which we were heading
6 towards decisions, which really means from, what, autumn
7 2002 onwards?

8 SIR JONATHAN CUNLIFFE: As say, I think the high-level
9 information was fed into the Whitehall groups. I can't
10 remember which Whitehall group. I remember there was
11 a note, I think, in January. For some reason, it came
12 out of the Civil Contingencies -- sorry -- yes, the
13 Civil Contingencies Unit, about the economic impacts, and
14 I think, on the specific public expenditure impacts,
15 those were being fed in separately to Number 10 in
16 a range of ways --

17 SIR RODERIC LYNE: Are you confident Mr Blair would, for
18 example, have been aware of the worst-case scenario, the
19 WMD scenario that you have just described and a possible
20 effect of up to 1.5 per cent off growth?

21 SIR JONATHAN CUNLIFFE: I don't know that he would have been
22 aware of the numbers specifically, no. I imagine he
23 would have been aware that there was an outside chance
24 of -- of an extreme scenario in the war.

25 SIR RODERIC LYNE: Did you see any signs of interest from

1 Number 10?

2 SIR JONATHAN CUNLIFFE: Not on this subject, no.

3 SIR RODERIC LYNE: Thank you.

4 THE CHAIRMAN: I'll turn to Sir Martin Gilbert now.

5 SIR MARTIN GILBERT: If I could stay for a moment with the

6 pre-war economic period, we understand that, before

7 military action started, Treasury teams produced

8 estimates of Iraq reconstruction costs and particularly

9 scenarios for international costs sharing.

10 Can you tell us what assumptions you were making

11 with regard to the contributions of the World Bank and

12 the IMF in the reconstruction of Iraq?

13 SIR JONATHAN CUNLIFFE: I can't give you the numeric

14 apportionment of the costs and the costs of

15 reconstruction -- I can remember, during that period,

16 I was a bit sceptical about some of the forecasting of

17 the costs of reconstruction, because I had been through

18 Kosovo and Bosnia and, until you get in there and you do

19 a needs assessment, and sometimes, even after you have

20 done the first needs assessment, you can't really know.

21 And we were dealing with a wide range of scenarios, we

22 were trying to work out the costs of reconstruction

23 before we knew the extent of deconstruction, if I can

24 put it that way. So it is not an easy exercise.

25 What I do remember is we made some assumptions about

1 the way in which the international machinery would be
2 used in a post-conflict situation. This was not new.
3 I mean, we had had post conflict situations before. It is
4 a messy process, but the IMF and the World Bank have
5 certain roles in dealing with that.

6 We were making, I think, some broad assumptions
7 about the extent to which they could deal with this and,
8 in the past, they have taken a very sizeable chunk of,
9 particularly, reconstruction expenditure, mainly through
10 the World Bank. So I think all of the planning over the
11 autumn was really in a world in which the international
12 machinery was swinging into action in the kind of
13 stabilisation and reconstruction phase.

14 SIR MARTIN GILBERT: Did you have specific discussions with
15 the World Bank, the IMF?

16 SIR JONATHAN CUNLIFFE: We wouldn't have done. I think --
17 I should say reconstruction in the UK system,
18 stabilisation and reconstruction, is primarily a DFID
19 responsibility. We are not like the US Treasury which
20 has direct development responsibilities. The UK Treasury
21 gave those up in the 1960s and, to be honest, we don't
22 have much expertise in low/middle-income countries
23 coming out of conflicts.

24 So I wouldn't have expected, in that whole phase,
25 the Treasury to be that engaged with the World Bank or

1 others on the nature of reconstruction.

2 The part that we normally got involved in, looking
3 back to the Balkans and Afghanistan, actually, is where
4 the IMF comes in and looks at the macro framework and
5 how to stabilise countries at a macroeconomic level, and
6 there we had some expertise but, in the main, we also --
7 operated quite closely with DFID traditionally, when
8 you got to countries that were poor or low/middle income
9 countries.

10 SIR MARTIN GILBERT: But during this pre-conflict phase,
11 were there concerns within the Treasury that the
12 United Nations wouldn't endorse the reconstruction
13 efforts and, therefore, it would impact on the
14 possibility of international (overtalking) --

15 SIR JONATHAN CUNLIFFE: I don't -- there may have been.

16 I don't remember those concerns sort of coming up until,
17 really, the beginning of the following year, certainly
18 not in the autumn of 2002.

19 SIR MARTIN GILBERT: In terms of your own contacts with your
20 US Treasury counterpart, was this an issue that was
21 being discussed?

22 SIR JONATHAN CUNLIFFE: No.

23 SIR MARTIN GILBERT: Thank you.

24 THE CHAIRMAN: I would like to ask one or two questions
25 about the Chancellor's own concerns and priorities in

1 respect of Iraq.

2 Thinking essentially of the run-up period, mid-2002,
3 to early 2003, rather than afterwards, can you say
4 something about what kind of concerns/priorities he had
5 and what kind of steer or direction you were getting
6 from the Chancellor himself at the time?

7 SIR JONATHAN CUNLIFFE: On my side, which is -- again,
8 I think, the public expenditure side was more involved -
9 on my side, I don't think there was a sort of huge
10 ministerial steer on the war, et cetera. We put up the
11 note on the risks. I have looked at it again and it said "no
12 action necessary", because we thought no action was
13 necessary. We weren't engaged in, as it were, assessing
14 pros and cons for any broad Whitehall discussion.

15 I think his main interest was in the cost of
16 reconstruction and in the cost of the military exercise.

17 So there wasn't a -- from the Treasury -- a huge steer
18 from the ministerial side, that they wanted to deal with it
19 this way or the other. I think because actually --
20 I don't think the Treasury had a huge role in this
21 particular issue, other than how was it going to be
22 funded and just to check whether it was going to cause
23 a large problem in macroeconomic terms.

24 THE CHAIRMAN: Clare Short, in her evidence to us, described
25 in one phrase the Chancellor as:

1 "Unhappy and marginalised on Iraq."

2 This is in the run-up to the military action as
3 opposed to the invasion itself and afterwards. So from
4 what you have been saying, is it right to interpret that
5 as being his position, as a very senior member of the
6 Cabinet, and the general policy, rather than the
7 macroeconomic concerns of the Treasury itself
8 departmentally?

9 SIR JONATHAN CUNLIFFE: I saw no evidence that he was
10 unhappy and, actually, I'm not sure, as a civil servant,
11 how I would know whether that was the case or not, nor
12 that he was marginalised.

13 THE CHAIRMAN: Thank you. I'll turn to Baroness Prashar.

14 BARONESS USHA PRASHAR: Thanks very much indeed. I want to
15 move to the CPA and, as I understand it, one of the UK's
16 objectives was to help increase the immediate financial
17 resources available to Iraq, at the same time build the
18 capacity of Iraq to use its own resources, and the
19 Security Council Resolution 1483 provided the
20 United Nations' endorsement for the transition
21 governments and arrangements.

22 Now, did this lead to the level of cost sharing
23 among the international donors and international
24 financial institutions that the Treasury had hoped for?

25 SIR JONATHAN CUNLIFFE: No.

1 BARONESS USHA PRASHAR: It didn't?

2 SIR JONATHAN CUNLIFFE: No, it didn't, and it is a bit
3 difficult to disentangle the sequence in my mind, but
4 what I recall happening was somewhere before, I think --
5 before the invasion, it became clear that this was not
6 going to be the sort of exercise that, perhaps wrongly,
7 we had just intuitively assumed it was going to be, and
8 that we were going to have to deal with, not just the
9 fact that we didn't have UN -- specific UN authority, as
10 we had in the first Gulf War, as we had in Afghanistan,
11 as indeed existed in the Balkan crisis that I was more
12 familiar with, but that we were into a different world.

13 We didn't really know what the political authority
14 would be after the invasion. It is quite important,
15 when you are trying to plan how you deal with economic
16 reconstruction and stabilisation, that you understand
17 the structure you are working with. I think we had
18 assumed there would be some kind of UN leadership of the
19 post-conflict phase. It may have been a naive
20 assumption because of other things, but I think that
21 assumption started to be -- we started to realise that
22 it wasn't going to be like that.

23 In February/March, just in the period beforehand,
24 I remember we were concerned with sort of the typical
25 sort of shortsightedness everybody expects from the

1 Treasury and its dead hand, we were concerned that the
2 reconstruction costs -- you know, we could be left with
3 the US just sharing the reconstruction because we
4 weren't able to involve the international community, and
5 I remember that sort of narrow Treasury concern about
6 the public expenditure impact being high because we
7 couldn't bring in the international community.

8 I think I can remember that before the invasion, and
9 it was our objective at least to get 1483 -- to get the
10 resolution afterwards to a point where we could bring in
11 the international community. But I was -- I mean, I went
12 to the meeting of finance ministers just before the
13 European Council, which was immediately before the
14 invasion. It was just on the day, I think, one or two
15 days beforehand, I had to go to the Finance Minister's
16 dinner, and it was clear there that that it was going to
17 be hard work getting support from the French and the
18 Germans and that the European Union, you know, the
19 Commission and others would need to reflect the balance
20 throughout Europe and the invasion had put a kind of
21 dividing line, you know, between some big players in the
22 European Union. So both bilateral and multilateral
23 assistance, it was clear around the time of the invasion
24 we weren't going to get that.

25 The aim was to try to get enough authority in the

1 resolution to deploy the international machinery, and
2 the other aim was to get enough authority to deploy the
3 resources that Iraq itself had, and that was one of the
4 differences between Iraq and, say, Afghanistan or
5 Sierra Leone or Kosovo, et cetera; that you were dealing
6 with a country that did actually have a large income
7 stream if only you could release it.

8 So there was understandably a view that we didn't --
9 we would not have to pay for the reconstruction in the
10 same way as we had in much poorer countries because the
11 country could afford to pay for some of it itself.

12 BARONESS USHA PRASHAR: But post-1483, they established
13 the Development Fund for Iraq which held the revenues,
14 and then they had the Madrid donor conference. Did that
15 in any way lead to the Treasury adjusting its estimates
16 against the money that you were able to get from the
17 Madrid conference and the establishment of the
18 Development Fund for Iraq?

19 SIR JONATHAN CUNLIFFE: It was a more protracted process,
20 I think, because the Madrid conference was October and
21 1483 was May, and 1483 and the discussions around the
22 DFI, and of monitoring the DFI, raised some fundamental
23 questions about the nature of the authority that would
24 be operating in Iraq after the conflict, and this was
25 a time when the Office of Humanitarian Aid and -- ORHA,

1 was being set up and then it got into trouble and had to
2 change its head and structure.

3 I think by the time we got to the Madrid conference,
4 we had a much better idea of the revenues and we took
5 into account those revenues and how much would be
6 needed.

7 I think the initial estimates of reconstruction and
8 what came out in October weren't that far out of line.
9 We were talking -- but then we were talking numbers sort
10 of 20 to 50. So you could say the original estimates
11 were just pretty wide and that's the result. But
12 I don't think, in the end, we were surprised by the
13 costs of reconstruction, nor were we surprised by the
14 revenue that we could count on on the -- from Iraqi
15 sources. I don't remember that being a surprise or us
16 changing our estimates materially.

17 But beforehand, we just didn't know -- we didn't
18 know anything about the Iraqi economy. We had had no
19 contact with this country for a number of years. We
20 didn't know what impact the war would have. We didn't
21 know what state the oil industry would be in. I mean,
22 you can plan and -- what's that saying of the German
23 staff college? "No plan survives contact with the
24 enemy".

25 BARONESS USHA PRASHAR: You did not get what you hoped for

1 from the international bodies?

2 SIR JONATHAN CUNLIFFE: We did not get, in October 2003, the
3 sort of assistance that I think, intuitively, we would
4 have expected in September 2002, no. Because -- but
5 that's because we were dealing with a completely
6 different construct in which the aftermath of this
7 conflict was not being managed through the usual
8 machinery.

9 BARONESS USHA PRASHAR: Thank you.

10 THE CHAIRMAN: I'll turn now to Sir Lawrence Freedman.

11 SIR LAWRENCE FREEDMAN: I want to ask you a couple of
12 questions about debt relief. The British worked with
13 the Americans to secure 80 per cent cancellation of
14 Iraqi debts, \$31 billion, through the Paris Club
15 by November 2004.

16 I would be grateful if you could just take us you
17 through this process, because I imagine there were quite
18 different interests involved here. So what were the
19 main issues and how did they get resolved?

20 SIR JONATHAN CUNLIFFE: It was picked up early, I think
21 in September 2002, as an issue that we would have to
22 deal with, and Iraq had not been paying its debt for
23 a while and we had claims domestically and in terms of the
24 IMF.

25 I think the first part of the issue that we thought

1 important was that, when sanctions were lifted, which we
2 expected to happen after the conflict and the position
3 around Iraq's assets regularised -- because we had
4 frozen a lot of the assets of the Saddam regime and
5 there were financial sanctions. When all that was
6 lifted, what we didn't want was all the claims from
7 people who hadn't been paid in the Saddam era to
8 suddenly come in and take this money. We needed to
9 stabilise the debt position until we could get to debt
10 relief.

11 I think we were also quite clear that -- because the
12 Paris Club is -- I keep using the word "machinery", but
13 it is a well -- it is a well-known part of the
14 international machine, but the Paris Club requires an
15 IMF programme to operate and requires a certain amount
16 of stability and, of course, the Paris Club has to reach
17 an agreement with a government.

18 So in order to know when you could do a Paris Club
19 deal, you had to know when there would be an IMF
20 programme and when there would be a government, and we
21 didn't know that in the run-up but I think the initial
22 view was it would be some time before we could do that. So
23 what we had to do was stabilise the debt position and
24 there were discussions with the French, Germans and
25 others from, I recall, the April, spring, meetings --

1 the IMF and World Bank in 2003 through to September --
2 on how to do that.

3 Clearly, we knew that would be awkward because
4 a number of European countries had lent and guaranteed
5 large sums. The UK did not have a big debt problem, but
6 there were large French, German, Italian, I think, debts
7 to be written off and I spoke before about the fault
8 line between the European countries.

9 SIR LAWRENCE FREEDMAN: And Russian?

10 SIR JONATHAN CUNLIFFE: And Russian. Well, Russia and the
11 Paris Club, Russia had a special relationship with the
12 Paris Club.

13 So the key thing was to stabilise and somewhere in
14 that period, I think the agreement was probably done at
15 the G8 meeting at Deauville in France in May
16 or June 2003, but it wasn't regularised until July where
17 the Paris Club said that they didn't expect to get any
18 money back that year. It wasn't a formal moratorium, but that
19 point was made and, in the UN Resolution, we ensured
20 that creditors could not attach the assets of Iraq in
21 the interim period and, from that period on, what
22 determined the pace and the nature of debt relief was
23 the progress towards an Iraqi Government and an IMF
24 programme.

25 Though we pushed away at the issue through the rest of

1 2003 and 2004, we were always trying to push it forward
2 while, if you like, the political situation was going
3 more slowly than we thought it would, and then it became
4 important in June 2004 -- I forget the numbers for the June
5 resolution, but the resolution that set up the interim
6 government of Iraq - it became very important to us that
7 they had the power to conclude a debt deal and we worked
8 very hard, both persuading the Americans that that was
9 necessary and getting it through the United Nations and,
10 once we had that, it was then possible.

11 There then had to be complicated negotiations in the
12 second half of 2004 to make the debt deal work. The
13 Americans sent Baker round as a debt envoy to try to get
14 people to go to 100 per cent. The opening offer from
15 the French was 50. We compromised on 80, which we
16 thought was not a bad deal in the end, given that there
17 was a legitimate argument to say Iraq is not a highly
18 indebted, poor country. It does have resources. Over
19 time, it can afford to pay some of this back.

20 But we put a lot of effort in the second half of
21 2004 into getting that deal and pushing it forward as
22 part of a general approach to debt and including to the
23 highly indebted countries.

24 SIR LAWRENCE FREEDMAN: You say we put a lot of effort, that
25 presumably includes you?

1 SIR JONATHAN CUNLIFFE: Yes.

2 SIR LAWRENCE FREEDMAN: What sort of role were you playing?

3 SIR JONATHAN CUNLIFFE: Over this period, I think I had --

4 on the debt issue, I had two roles: one to ensure that

5 the US was securing the international engagement that we

6 needed for the debt deal, particularly I remember this

7 whole question about what that resolution in June 2004

8 would include and whether we would give the next

9 iteration of Iraqi Government the powers to conclude the

10 debt deal, on the one hand, and bring the IMF back in

11 again.

12 We did a lot of work with the US Treasury and others

13 to push it and also within Whitehall, and then, within

14 the G7, with my colleagues from other countries, to try

15 to push it forward where a debt deal was done. The final

16 deal was done, actually, with side meetings, at the G20

17 Finance Ministers' meeting in November 2004. So it was

18 all being done through the normal Finance Ministry

19 machinery.

20 SIR LAWRENCE FREEDMAN: Was Britain's upcoming presidency of

21 the G7/G8 a factor in this?

22 SIR JONATHAN CUNLIFFE: No. We had wanted to get the debt

23 issue sorted much earlier than we did and we wanted to

24 sort it out at the first possible opportunity.

25 SIR LAWRENCE FREEDMAN: What role was the Chancellor himself

1 playing?

2 SIR JONATHAN CUNLIFFE: He played a pretty active role once
3 we got to the point where the pre-conditions for
4 a Paris Club deal existed. So in the second half of
5 2004, he played a pretty active role with his European
6 colleagues, with advocacy at the Finance Ministers'
7 meeting around the IMF meetings, it would have been
8 September 2004.

9 I remember he had conversations with the French and
10 with the Germans, Francis Mer, I think it would have
11 been, and Hans Eichel, and also with Jon Snow to try and
12 make sure.

13 SIR LAWRENCE FREEDMAN: Jon Snow, the American?

14 SIR JONATHAN CUNLIFFE: On the American side -- to make sure
15 we had the conditions. I think he was not so involved
16 from the invasion to June 2004, simply because -- he was
17 involved in getting the moratorium, I remember, the
18 Deauville meeting, in -- I think it was May or
19 early June 2003, but in the interim you couldn't deploy
20 high-level political pressure for a debt deal because
21 the necessary conditions didn't exist.

22 SIR LAWRENCE FREEDMAN: So the basic compromise you reached
23 was to actually move the Americans off 100 per cent and
24 the French up from 50 per cent?

25 SIR JONATHAN CUNLIFFE: Yes -- well, we played a part in

1 that. I'm not sure I would claim the whole credit for
2 it and I'm not sure how much the Americans ever thought
3 they would get 100 per cent.

4 SIR LAWRENCE FREEDMAN: But they tried?

5 SIR JONATHAN CUNLIFFE: They tried.

6 SIR LAWRENCE FREEDMAN: Can I move on now to the question of
7 managing resources, particularly oil, and this is within
8 the context of the CPA.

9 You mentioned, I think, before in answer to
10 Baroness Prashar that, though the UNSCR 1483 established
11 the Development Fund for Iraq to hold Iraqi financial
12 resources, including the assets Oil For Food and oil
13 resources, that questions of authority emerged quite
14 quickly. The resolution stated that the fund would be
15 disbursed at the discretion of the authority in
16 consultation with the Iraqi interim administration and
17 the authority referred to the joint occupying powers,
18 which is Britain as well as the United States.

19 In practice, were the British able to exercise joint
20 authority with the United States over the disbursement
21 of the DFI resources?

22 SIR JONATHAN CUNLIFFE: The disbursement of the resources
23 was decided by the -- I think it was the Project Review
24 Board, it was called, the PRB -- within the CPA, which
25 was chaired by Paul Bremer but we had a UK

1 representative, and there was an Australian
2 representative on it as well. I think John Sawers, when
3 he was -- and I imagine, after John, Greenstock and
4 others were the UK representatives on it.

5 I recall from that period some cases where we did
6 change things, we did stop things. Some of the work was
7 about tendering and ensuring that the tendering process
8 kept as far as possible to international guidelines -
9 remember, we were in a post-conflict, or actually
10 the conflict was going on and getting worse in some
11 ways, situation - and how much of it was being taken to
12 the budget and I can remember instances -- but I think
13 it was towards the end of the period -- where we slowed
14 down or changed a number of the projects and the
15 direction of it.

16 We were not involved, in the Treasury and Whitehall,
17 in day-to-day decisions, as "Should this money be used
18 for this electricity project or this transport project?"
19 or where it should go? That was left to the CPA. We
20 had good secondees in the CPA and very good links to
21 them and they would put a flag up if they thought there
22 was a particular problem. But I don't recall that we
23 were involved in a sort of detailed scrutiny of how that
24 budget was used. We left that to the people on the
25 ground and left them to come back to us if they thought

1 there was a problem.

2 We were much more interested in the overall
3 fiscal -- the overall framework for the use of that
4 money for reasons of accountability and legitimacy, and
5 then in the overall fiscal framework, because, of
6 course, this revenue was part of what we saw as the
7 consolidated budget for Iraq at that time.

8 SIR LAWRENCE FREEDMAN: If something was flagged up from the
9 British representatives in the CPA, were you able to do
10 much about it?

11 SIR JONATHAN CUNLIFFE: I think the position changed over
12 time. The initial few months of the CPA were pretty
13 chaotic. I think that is a matter of
14 historical fact rather than opinion,
15 they had to change the head of the CPA, et cetera.
16 We weren't sure what its structure was for dealing with
17 economic issues. We didn't have the secondees in there.
18 I think we sent a couple of secondees -- did they ever
19 arrive? - We sent a couple to ORHA when we realised
20 in March that ORHA was going to be dealing with this and
21 I think we had General Cross there all the time. But
22 once we got Andy Bearpark and some of the Bank of
23 England and the Treasury secondees in to the
24 CPA -- then it became better and we were able to raise
25 issues.

1 Did we have any traction? Well, I think the process
2 in Washington itself was pretty disorganised for
3 a while. It wasn't clear how the CPA reported into the
4 US authorities and they were working out their own
5 interagency process.

6 I think it got much better after June 2003 and then,
7 at some point in the period, the White House deputy
8 national security adviser took over co-ordination in
9 Washington and then it was easier. But certainly for
10 the first three months it was -- we had to work quite
11 hard to have an impact. Sometimes because views were
12 different, bluntly, but sometimes because the actual
13 organisation wasn't there, either on the ground in Iraq
14 or in Washington, to get decisions or to have issues
15 considered.

16 SIR LAWRENCE FREEDMAN: Did you raise concerns with
17 ministers about the lack of UK influence over US
18 decisions on Iraqi resources?

19 SIR JONATHAN CUNLIFFE: Yes. At the beginning of that
20 period, immediately afterwards, we were concerned
21 that -- I think it was after we had the 148¹ -- I can't
22 remember whether it is 6 or 3 -- the resolution
23 immediately after the conflict, and we then became
24 formally an occupying power and, at that point, we
25 started to think about where we stood in the

¹ It is UNSCR 1483 passed on 22 May 2003.

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1 post-conflict government of Iraq.

2 Bearing in mind that the pre-invasion assumption had
3 been some UN umbrella, similar to previous instances, we
4 now found ourselves in a very different situation and
5 the kind of authority and control arrangements for the
6 post-conflict government -- immediate post-conflict
7 governance, I should say, rather than Government of
8 Iraq -- were being worked out on the ground and we were
9 concerned that we didn't have people on the ground in
10 the CPA. And normal contacts in Washington weren't
11 necessarily able to play the role they played in
12 previous instances of this type because it was being run
13 in a different way and, of course, post-conflict things
14 are chaotic. That's what you expect.

15 So we had some concerns that we weren't -- being
16 taken into account is one way of putting it. We
17 couldn't see the structural arrangement in which the UK,
18 as a joint occupying power, you know, could play its
19 role and its part and be responsible and accountable for
20 things.

21 SIR LAWRENCE FREEDMAN: But you felt in general that this
22 improved after three months?

23 SIR JONATHAN CUNLIFFE: Yes, I think what became apparent --
24 and we may have been a bit naive in that period as well
25 because -- I keep going back to sort of previous

1 conflicts, but we had not been so directly engaged in
2 post-conflict government, probably since the
3 Second World War, I would think, and we didn't really
4 think about it in those terms. There was machinery and
5 this was how it dealt -- it was normally an arm's length
6 relationship with people who specialised in this sort of
7 thing and, all of sudden, a lot of the international
8 machinery wasn't there and we were doing it ourselves.

9 I think what we envisaged, as we moved away from the
10 idea that this would be an UN-led exercise, was that it
11 would be overseen by some control arrangements in
12 Washington and in London and the CPA would be reporting up
13 in that way and there would be a kind of top-down
14 setting of the structures and then a bottom-up
15 management.

16 What became apparent first of all was that we
17 pre-supposed a level of organisation on the ground in
18 Iraq that didn't exist, and the Iraqi civil machinery as
19 well, it just wasn't there. So it was a bit naive maybe
20 to think it would be structured in quite that way. But
21 also that the US Government were giving a lot of
22 authority to Paul Bremer on the ground to do things and
23 the best way to influence and to be involved was to put
24 people into the CPA and to work through them and then to
25 use London as a place that the -- our CPA secondees

1 could say "We think there is a problem here, we think
2 more needs to be done" and then to use our influencing
3 channels from London to go back into Washington,
4 wherever in Washington it needed to be, and influence
5 that way, and that's really the modus operandi we
6 evolved over those three months.

7 SIR LAWRENCE FREEDMAN: There is a particular question here,
8 which we have had evidence on, of Iraqi oil resources.
9 We have heard both from Sir Jeremy Greenstock and
10 Andy Bearpark that the Americans were very resistant to
11 UK engagement here. Was that your experience? Were you
12 concerned about that?

13 SIR JONATHAN CUNLIFFE: Yes.

14 SIR LAWRENCE FREEDMAN: Why were you concerned about it?

15 SIR JONATHAN CUNLIFFE: I was concerned about it because of
16 legitimacy and accountability. So -- we had had -- and
17 bear in mind that, as I say, we hadn't done this sort of
18 stuff probably for 50 years, been an occupying power in
19 quite that way. So it was a bit new to us, but we were
20 concerned throughout that we had the -- as far as
21 possible, the authority and the legitimacy to take on
22 these roles. Some instances around currency caught
23 exactly the same issues and I think the Americans had
24 less concern about that and they were prepared to
25 operate as an occupying power under their own view of

1 what an occupying power could do and we were concerned
2 to operate under some international umbrella.

3 So we wanted to ensure that the Iraqi oil
4 revenues -- and there was great suspicion that you,
5 know, the war was designed to get hold of Iraqi oil
6 revenues and was being inspired by the US oil industry,
7 et cetera - so we thought it was very important for the
8 perception in the international community that these
9 resources were controlled transparently and at arm's
10 length and in a proper way we could account for them.
11 We thought it would make a huge difference as to whether
12 we could get other countries to join us in the
13 reconstruction effort to show that these resources were
14 being used in that way, and we also thought that it was
15 important for the UK generally to ensure they were used
16 efficiently on the ground in Iraq.

17 So our view of how this should be managed, accounted
18 for, was different to the US view and there was a lot of
19 discussion around the drafting of the resolution, and
20 just how the resources would feed into the CPA and who
21 would have control over them. There was huge discussion
22 about the transparency and accountability arrangements
23 through the monitoring -- the accountability and
24 monitoring board, which, as I recall went on all the way
25 through to 2004, and the CPA was very resistant to

1 external monitoring and external accountability. They
2 had a very different view of how the thing should
3 operate and this tension and compromise carried on,
4 I think, for -- until the end of the CPA.

5 SIR LAWRENCE FREEDMAN: It was basically a CPA problem
6 rather than once the Iraqi Government itself arrived?

7 SIR JONATHAN CUNLIFFE: When the Iraqi Government itself
8 arrived, I think both occupying powers decided there was
9 joint interest in having transparency, accountability
10 and control and, indeed, I think that the US were with
11 us in pushing for the interim Iraqi Government to take
12 on the DFI with all of its monitoring machinery. So it
13 was a CPA period issue.

14 SIR LAWRENCE FREEDMAN: Just a final question. The
15 International Monitoring and Advisory Board which was
16 supposed to order the development for Iraq, do you think
17 this worked effectively? Andy Bearpark told us he
18 didn't think it actually met until January 2004, by
19 which time the CPA had already spent billions of
20 dollars. Did this concern you?

21 SIR JONATHAN CUNLIFFE: Yes, and I spent a lot of time of
22 that year at various points dealing with the
23 US administration. I think I went to a meeting to try
24 to set it up in June of 2003 in Washington and all
25 through the period we were involved -- I was involved

1 with the US Treasury, who were our normal contacts, but
2 it became apparent round about May -- early April/May,
3 that the direct financial management of the CPA was
4 being conducted through the US Department of Defence and
5 through the Controller, who is in charge of the US
6 Department of Defence, the Undersecretary Controller
7 there. So clearly he was the person who was dealing
8 with this not the US Treasury. So we opened up a channel
9 to him and, unusually for a Treasury civil servant,
10 I made a number of trips to the Pentagon to discuss
11 these things and we tried to put pressure on.

12 I think the Madrid conference helped because the
13 international community was not going to sign up to
14 a big effort unless it had some assurance on this.
15 But -- and we got some compromises - but it really was
16 hard going. But, of course, things were slowed down and
17 slowed down and slowed down and I think Andy Bearpark's
18 analysis is probably correct.

19 SIR LAWRENCE FREEDMAN: Thanks very much.

20 THE CHAIRMAN: Roderic, over to you.

21 SIR RODERIC LYNE: Just a couple of quick questions on
22 reconstruction. You said earlier that we didn't know
23 anything about the Iraqi economy -- we weren't
24 represented in Iraq before the conflict happened, but
25 the UN Secretariat and Security Council would have

1 accumulated a lot of information about the Iraqi economy
2 as a result of monitoring sanctions and administering
3 the Oil For Food programme. Did the Treasury tap into
4 the UN storehouse of knowledge about Iraq?

5 SIR JONATHAN CUNLIFFE: I certainly didn't directly.

6 I think we tapped into -- I do know we tapped into UN
7 numbers and figures through DFID who were in contact
8 with the UN. That's the normal channel: the Treasury
9 deals with IMF, DFID normally deals with the World Bank
10 and the UN, and some numbers came in, but I don't
11 think -- nothing that I saw before the invasion
12 suggested we had detailed knowledge of the Iraqi economy.

13 We knew that a large chunk of it was not monetised,
14 that Oil For Food and ration cards were operating. But
15 there was no real -- I think we had no real in-depth
16 knowledge of it. DFID may have had.

17 SIR RODERIC LYNE: Then, on the disbursements of funds for
18 reconstruction, between 2003 and 2009, we chose to put
19 some £70 million of British resources into the UN and
20 World Bank trust funds but, as we have heard from other
21 witnesses, both military and DFID, this was a source of
22 great frustration because these funds disbursed -- these
23 trust funds disbursed the money far too slowly from the
24 point of view of our military in seeking to achieve
25 consent and create a visible effect and from the point

1 of view of DFID.

2 Should we have used a better vehicle than these two

3 trust funds for that £70 million?

4 SIR JONATHAN CUNLIFFE: I have to say I think that's

5 a question you need to ask DFID. My experience of

6 reconstruction and development on the ground is pretty

7 limited.

8 SIR RODERIC LYNE: Did you observe -- were you aware of

9 these frustrations, that the funds were performing --

10 SIR JONATHAN CUNLIFFE: I was certainly aware of the

11 frustrations and certainly aware that a lot of work --

12 a lot of negotiational work was being done between DFID,

13 who are responsible, as for of the British contribution

14 of the World Bank, their Secretary of State is the

15 governor - they were having intensive discussions with

16 the World Bank. And I have to say I have seen that

17 happen in a number of African countries and elsewhere --

18 southern Sudan is a good example -- but that wouldn't

19 have been a primary Treasury issue to deal with.

20 SIR RODERIC LYNE: Did you have any influence over this, or

21 was this entirely a DFID decision?

22 SIR JONATHAN CUNLIFFE: No, I don't think we had -- well.

23 SIR RODERIC LYNE: You just wrote the cheques?

24 SIR JONATHAN CUNLIFFE: No, you asked the right question,

25 "Did we have any influence over this?" and I think the

1 bodies to be influenced were the World Bank and its
2 distribution channel and the answer is the Treasury
3 doesn't have much influence over the World Bank, but
4 DFID has enormous influence because it is one of the
5 major contributors to it.

6 SIR RODERIC LYNE: But DFID would have taken these decisions
7 off their own bat and without involving --

8 SIR JONATHAN CUNLIFFE: If it is about the management of aid
9 money, through a multilateral channel, I hope so. The
10 Treasury certainly shouldn't be second-guessing on the
11 ground decisions by DFID.

12 SIR RODERIC LYNE: You have a completely hands-off attitude
13 to it?

14 SIR JONATHAN CUNLIFFE: That's not what I said. No, we
15 don't have a hands-off attitude, but I think the
16 management of aid and the management of the main
17 multilateral aid channel, which for the DFID is the
18 World Bank, should lie with the development department.
19 They have the expertise and they are there.

20 We will take on advocacy and we'll put their points
21 when we deal with other international donors like the
22 US Treasury, et cetera, where the discussion is on
23 Finance Ministry channels, even though it is
24 development, because a number of other
25 Finance Ministries have more direct involvement in

1 development and aid than we do, but certainly I don't
2 think we would be -- so we would be lending support to
3 DFID, but I think the management of that and the
4 relationship with the World Bank is most certainly and
5 properly for them.

6 SIR RODERIC LYNE: Thanks.

7 BARONESS USHA PRASHAR: I just want to cover the issue of
8 the advice and capacity building for the Iraqis on
9 managing their own resources but, before we do that, can
10 you just tell me what were the main macroeconomic
11 challenges that Iraq faced during the CPA and what
12 contribution did the Treasury make to tackling these?

13 SIR JONATHAN CUNLIFFE: I think -- let me talk about the
14 main issues, whether they were the main challenges or
15 not. One has to think back with hindsight.

16 THE CHAIRMAN: I'm sorry to interrupt, I should say the time
17 is beginning to press on us.

18 SIR JONATHAN CUNLIFFE: You want me to be shorter, yes?

19 The issues we were confronting were a fiscal and
20 monetary framework for a country that at the time didn't
21 have it. A currency, a new currency, which was clearly
22 going to be an issue. The only question was when.
23 Within the monetary framework is the central bank, is
24 a way of managing a currency. Within the fiscal
25 framework is a budget, is proper expenditure control, is

1 proper recording of expenditure.

2 The second set of challenges were around moving to
3 monetisation of the economy -- the whole Oil For Food
4 sort of instances -- and dealing with the oil subsidies
5 that they had. Then there was some more medium-term
6 challenges around privatisation, the Iraqi industry,
7 creating growth in Iraq, and I should have mentioned
8 somewhere around the second stage, the creation of the
9 banking industry - there were two banks in Iraq --
10 banking laws and the like.

11 I think we saw this as quite phased. You know, the
12 things you do at the beginning were about immediate
13 fiscal and monetary control, and then issues like
14 privatisation or moving away from the whole Oil For Food
15 rationing system, you would do once you had an Iraqi
16 authority in place. The CPA tended to take them all
17 together as upstream issues.

18 Some of that was -- we just didn't -- the pace at
19 which we wanted to do economic construction and
20 development didn't keep pace -- sorry, was not matched
21 by the pace with which the Iraqi Government developed.
22 So I think there was always a tension between things you
23 wanted to do on the economic side and just not having
24 the Iraqi Government that was able to do it.

25 BARONESS USHA PRASHAR: We heard from Andy Bearpark that we

1 did not quite agree with the United States on the
2 priority we wanted to give to privatisation.

3 SIR JONATHAN CUNLIFFE: Correct.

4 BARONESS USHA PRASHAR: Was that your understanding?

5 SIR JONATHAN CUNLIFFE: But for the reason I gave. I mean,
6 it was the right thing to do --

7 BARONESS USHA PRASHAR: But it was the pace?

8 SIR JONATHAN CUNLIFFE: -- but -- well, it took the UK itself
9 a number of years to get round to it. So you need
10 a functioning government to do that and, also, for the
11 reason I gave about legitimacy and accountability. We
12 weren't sure that the CPA really had the authority to
13 take those decisions.

14 BARONESS USHA PRASHAR: The Treasury had secondees as well
15 as DFID. Were they complementary or did they have a
16 duplication? I mean, how did you work with them?

17 SIR JONATHAN CUNLIFFE: It seemed to me wholly complementary
18 and some of our secondees were working for
19 DFID-appointed external consultants.

20 One of the things I thought worked extremely well
21 was this network of secondees out there who were linked
22 into DFID, Treasury, FCO officials here and some of the
23 embassies, and I felt for some of that period we had
24 quite good and direct links into what was happening in
25 the CPA.

1 BARONESS USHA PRASHAR: How did that role change after the
2 CPA? What was the role of the Treasury after --

3 SIR JONATHAN CUNLIFFE: Very materially. We moved from
4 being an occupying power, in a way that had been
5 unfamiliar to us, into a much more normal relationship,
6 even though the government was not a full government at
7 that stage. That happened a year later. But it then
8 became a job of capacity building, influencing and there
9 the Treasury again -- the main role moved to DFID, to
10 assist what was a post-conflict -- conflict country and
11 the Treasury exerted its influence through the IMF,
12 through the G7, et cetera.

13 So secondees came out and it became the sort of
14 relationship -- not easy, but the sort of relationship
15 one might have imagined we were going into a year
16 earlier.

17 BARONESS USHA PRASHAR: What was your assessment of Iraq's
18 main economic challenges and opportunities when you left
19 your post in 2007?

20 SIR JONATHAN CUNLIFFE: Well, the period 2004 to 2006, the
21 security situation had got much, much worse and,
22 actually, I think the first thing you can do for
23 economic development is to have to have stability and,
24 without stability, it is just very difficult.

25 So my assessment for a lot of that period was that

1 the economic challenge, the economic challenges for
2 Iraq, could not be really dealt with until the security
3 situation had been -- had been stabilised.

4 When I left in 2007, we were much more -- by that
5 point, we were much more focused on Basra, but for Iraq
6 as a whole, the issues were around budget management
7 again. In 2005 - 2006, gaps started to open up. In the bank,
8 capability -- getting the capability and the central
9 bank and the Finance Ministry up to standard. And then,
10 throughout that period 2005/2006, they managed to start
11 to bring fuel prices into line with market prices and to
12 remonetise the economy completely, to get rid of the Oil
13 For Food.

14 The other big challenge, we thought -- but this goes
15 back to the politics -- was always the oil law, because
16 that's at the root of what I would call the sort of fiscal
17 federal system and the politics.

18 BARONESS USHA PRASHAR: My final question really is, when
19 the Chancellor became the Prime Minister in 2007, he
20 asked the government departments to invigorate the focus
21 on private sector development and investment and you had
22 looked at this issue for the occupied territories. Did
23 you contribute to this thinking on Iraq?

24 SIR JONATHAN CUNLIFFE: You mean the Middle East?

25 BARONESS USHA PRASHAR: Indeed.

1 SIR JONATHAN CUNLIFFE: No, I mean, I -- when I moved jobs,
2 I moved to a sort of Europe and global issues job, not
3 dealing with Iraq specifically. I mean, that was dealt
4 with on the other --

5 BARONESS USHA PRASHAR: Did you contribute to the thinking?

6 SIR JONATHAN CUNLIFFE: I was not involved.

7 BARONESS USHA PRASHAR: You were not involved at all? Thank
8 you.

9 SIR MARTIN GILBERT: Just one question, which is: looking
10 back over the whole period when you were involved, what
11 results do you think the Treasury's contribution to the
12 UK effort in Iraq achieved, both in the CPA period and
13 right up to the end of your period?

14 SIR JONATHAN CUNLIFFE: When we mean Treasury, we can include
15 Bank of England and some parts of DFID and the
16 Foreign Office. I mean, on the economic side, I think
17 the macro -- sorry, the fiscal framework, which meant
18 the drawing up of the 2003/2004 budget, the financial
19 law that was passed, I think, just in June 2004, when
20 the first Iraqi sort of government came in, capability
21 building in the Finance Ministry, the recording of
22 expenditure on that side.

23 On the monetary side, the central bank, the terrific
24 work the Bank of England did around the currency.
25 I don't mean the physical currency, I mean around the

1 backing for the currency and the monetary framework,
2 Treasury bill auctions, foreign currency auctions, and
3 then I think actually the currency exchange itself was
4 an enormous achievement.

5 I think we made a contribution in acting as
6 a channel to the IFIs when they weren't in the field,
7 which was for the CPA period, and trying to bring them
8 in. I think we made a contribution in getting them
9 engaged again as soon as we could. We made
10 a contribution on debt relief, and I think we made
11 a contribution, in a really chaotic period with our
12 American colleagues, in just -- I'm not saying
13 persuading them to do some things that they otherwise
14 wouldn't have done, but just in adding another
15 perspective and being prepared in some instances to dig
16 in and say "No, we don't think this is the right way to
17 do it". I think those were the right interventions.

18 SIR MARTIN GILBERT: The capacity building and the
19 Finance Ministry --

20 SIR JONATHAN CUNLIFFE: Those three², yeah.

21 SIR MARTIN GILBERT: -- has created an effective
22 Finance Ministry?

23 SIR JONATHAN CUNLIFFE: I have lost track of what has
24 happened in Iraq since 2007. I think Iraq has, in
25 reconstruction, in political terms, still a number of

² Refers to the three areas of interventions the witness had just outlined above.

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1 enormous challenges but, as far as I know, the monetary
2 and fiscal frameworks are still operating and the
3 currency has confidence. They haven't had inflation,
4 they didn't get dollarisation. So, yes, there is some
5 achievement there.

6 SIR MARTIN GILBERT: Thank you.

7 THE CHAIRMAN: We are coming to the close. Ours is
8 a lessons learned Inquiry, as well as a narrative
9 writing exercise, and I just wondered, from a number of
10 things you observed through this session, does Iraq
11 offer lessons, particularly in terms of the Treasury's
12 field of interest or was it so much a one-off situation,
13 especially early on in the CPA situation era, that there
14 isn't too much to learn from it for future situations?

15 SIR JONATHAN CUNLIFFE: I think I would see it predominantly
16 as a one-off. An obvious lesson learned is that if you
17 try to deal with a post-conflict situation without the
18 international machinery, life is just much more
19 difficult than it would otherwise be and I think
20 that's -- there is a lesson there. But I think we knew
21 that beforehand.

22 If anything, that has reinforced the importance of
23 using the tools that are built for that job rather than
24 trying to invent your own tools. I had hoped we
25 wouldn't need to have within the Treasury standing

1 capability to deal with this sort of situation, because
2 I don't expect it to happen again. Some things,
3 I think, though, some lessons, I think are important.

4 The interdepartmental co-ordination on the economic
5 and financial issues was very good, but it might have
6 been at a more senior level, particularly in the run-up
7 to --

8 THE CHAIRMAN: Co-ordination between the economic, financial
9 sphere within the whole of the British Government and
10 the other spheres, military, political --

11 SIR JONATHAN CUNLIFFE: Beforehand, we might have linked up
12 more on that. I don't recall whether there were --
13 there wouldn't have been, there wasn't on my side, but
14 I don't recall whether there were discussions in Cabinet
15 or in the run-up to the second half of 2002
16 on the pros and cons of doing this across a wide
17 range of fields, I think we kind of took the fact that
18 it was going to happen as a given and looked at the
19 possible impacts of it. I mean, maybe there is
20 something to be said for that, maybe there is
21 something that says that when you consider actions
22 which may be completely necessary on the security and
23 military side, you also need to take into account the broader
24 economic issues. I mean, I think that's a good lesson.
25 One that may have been learnt to some extent.

1 THE CHAIRMAN: Is it for them to ask or for the Treasury to
2 suggest?

3 SIR JONATHAN CUNLIFFE: A bit of both.

4 THE CHAIRMAN: Yes. Thank you very much.

5 With that, we will close this part of the morning.

6 Our thanks to our witness, to Sir Jon Cunliffe. We will
7 resume at 11.30 when we are going to hear from
8 Mark Etherington, who was head of the Provincial
9 Reconstruction Team between April 2006 and January 2007.

10 Thank you.

11 (11.15 am)

12 (Short break)

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