



RETHINKING THE TREASURY

Kerslake Review of the Treasury



An independent review of the Treasury to consider how it should work to promote and manage more sustainable growth in a fairer and more equal society

Report by Lord Kerslake

February 2017

Commissioned by the Shadow Chancellor of the Exchequer,
John McDonnell MP



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Independent Review
of the Treasury



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Foreword

The Treasury is a relatively small department by Whitehall standards but wields immense power. This is in large part due to its role in controlling the government's finances but also reflects the power and status of those who have held the role of Chancellor.

Despite its very influential role, the Treasury has been subjected to relatively little scrutiny in the past. The reviews that have been done have largely been internal to government and some have only been published at a later stage through a Freedom of Information request.

The commission by John McDonnell to undertake a review shortly after he became Shadow Chancellor therefore seemed to me to be a good opportunity to take a fresh look at how the Treasury works and how it could be improved. Although commissioned by John, the work of the Review has been entirely independent and its findings are entirely the responsibility of myself and the Panel.

In undertaking the Review, we have sought to take a balanced approach, recognising both the strengths of the Treasury as well as its weaknesses. In this, we were helped by contributions from a wide range of sources and I would like to record my thanks to them. The department was invited to make a contribution but in the end chose not to participate.

One of the points that was made to us very early on was that how the Treasury operates is hugely influenced by the style and approach of the person who is Chancellor. This is not surprising and indeed how it should be in a democratic system. However, notwithstanding this, there are enduring characteristics and trends that have gone beyond the impact of any one Chancellor.

One striking example of this for us was the increasing role that the Treasury has played in recent years in arbitrating and even initiating domestic policy. This seemed to us to go well beyond the core Treasury roles of overseeing the macro-economy and managing the government's finances. Its effect has been to both disempower departments and stretch the Treasury beyond its underlying capabilities. The more recent move of the Treasury back to its traditional role is therefore welcome.

Whilst it would be wrong to lay responsibility for all of the successes and the failures of the UK economy at the door of the Treasury, it does nevertheless provide an important context to any judgement on its performance. Here the story is not a good one. Slowing growth, stagnant wages, low investment and poor productivity have been long standing problems. It is not much of a comfort to say that some other European countries such as Italy have done worse since the financial crisis. One of the central parts of our brief was to look at how the Treasury could better play its part in delivering fair and sustainable growth.

Two other important pieces of context for our Review were how the centre of government operates more widely and the centralised nature of the British state. Some have argued that the expanded role of the Treasury in domestic policy reflects weakness elsewhere in the central departments. Others believe that it has been a cause of the weakening, blocking necessary reform. We recognise that our recommendation to narrow the role of the Treasury to focus on its core purposes will have wider consequences for how the centre of government is organised which will need further work.

Equally, the shared view of the Panel is that the UK would benefit from much greater devolution of power away from Whitehall. At times the Treasury has been the resolute blocker of such devolution, at others such as in the city devolution deals, its enabler, albeit within a framework specified by the Treasury. Significant further devolution would require further change in the way that the Treasury itself works.

The Review was originally anticipated to complete in the summer of last year and most of the fieldwork was completed by that stage. However June saw the Referendum vote to leave the European Union, one of the most profound decisions that this country has taken since the Second World War. This decision was quickly followed by the resignation of the Prime Minister and a new contest for the leadership of the Labour Party.

In the circumstances it did not seem to us to make sense to publish our report into this political maelstrom, but to wait instead until a later date when the position was at least a bit more settled. This turned out to be a wise move. Since then, we have seen Theresa May become Prime Minister and Jeremy Corbyn reelected as Leader of the Opposition. The May Government have made some significant changes, both in policy and in the organisation of government. Some, such as the development of a more explicit industrial policy and strengthening of the role of the Business Department to lead this would have formed part of our recommendations. Others, such as the reduced push for devolution, much less so.

Both the result of Referendum itself and its implementation have the most profound implications for the Treasury. The vote in favour of Leave suggests amongst other things that a majority of the public simply did not believe the dire forecasts that the Treasury (and many other mainstream economists) made about its potential impact. Whilst there is a debate still to be had as to whether the Treasury forecasts were completely wrong or just wrong in the timing, and how other factors such as the febrile political climate and criticisms of “experts” played a part, there is no arguing that the standing and credibility of the Treasury was damaged by the widespread rejection of its warnings. It has consequently been left weakened in the crucial economic debates about free movement of goods and services and the free movement of people post Brexit.

Whilst we need a strong Treasury that can make its voice heard in the crucial economic debates, we do not need an overweening one. One positive outcome of the changes following the Referendum is that we may have reached the high water mark of an expansionist Treasury, which can now focus more on better performing its core roles.

One of the structural options that we explored was the breaking up of the Treasury and the creation of a separate Finance department as exists in other countries such as Germany and Ireland. Strong arguments were put forward by others in favour of this split, not least that it would reduce the Treasury's power and influence. On balance, we concluded that the disruption caused by such a reorganisation outweighed the benefits and they should stay together. However this was subject to two crucial caveats. Firstly, that the Treasury stuck to its core roles and secondly, that the disciplines of good economic and financial management were given equal weighting, which they clearly are not at present.

As a high profile and influential department, the Treasury attracts the best and brightest civil servants who then go on to take up senior roles elsewhere. Despite this enormous inherent strength, our report finds that there are aspects of the Treasury culture that mean that it does not make the most of these talents. In making these comments, we are clear that they relate to the culture of the department as a whole and not the skills and commitment of individual civil servants, which is very often outstanding.

Finally, I would like to place on record my thanks to the excellent Panel who supported me and to the hard work of Ros Dunn who acted as Secretary to the Review and Rod Dowler who provided sterling support to the work.



A handwritten signature in black ink, appearing to read 'R W Kerlake'.

LORD KERSLAKE

Summary of Recommendations

Our key recommendations are summarised below and set out in more detail at the end of the relevant sections.

The Operating Mandate

- To provide absolute clarity on what is expected and to avoid mission creep, the operating mandate should be reviewed to set out in detail what the Treasury is expected to deliver through its core functions. Those functions which are not seen as core to the Treasury's role, including some current regulatory and oversight roles should be moved elsewhere.
- The revised mandate should be supplemented with an agreed set of supporting targets and measures designed to improve the clarity against which performance on its core responsibilities of macroeconomic and financial management will be measured and reported on. Changes are needed in four areas:
 - o to address things not being done
 - o to address things being done, but in the wrong way; and
 - o to identify things being done that should not be done or be done by others
 - o to encourage openness and transparency and re-establish credibility.

The detail for each of these areas is set out in the main body of the report.

Structural Changes

- The macroeconomic and financial management responsibilities should be kept together in a single Treasury department but organised as a group structure with each function being given equal weighting and focus. The responsibilities between the Treasury and the Bank of England should be kept as now, but the resources of the Treasury strengthened to ensure that it is able to provide an independent perspective on macroeconomic policy and financial stability and to focus more effectively on analysing possible risks to the economy as well as the design of monetary policy and fiscal rules.
- The transfer of responsibility for industrial strategy and long term development to the Department for Business, Energy and Industrial Strategy should be consolidated and strengthened to include promoting city region development through devolution deals. This would free up the Treasury, which should concentrate its economic effort on its broad macroeconomic responsibilities in line with a revised and more precise operating mandate. This should specifically include measures to improve the relative economic performance of different regions, including greater fiscal devolution.
- The leadership responsibility of the Treasury for ensuring effective financial management across government should be confirmed, but within a devolved framework in which departments are unambiguously responsible for developing policy within their remit. Effective financial control by the Treasury must no longer be seen as synonymous with policy agenda control.

- A new, high powered, 'Strategy and Delivery Unit' should be established in the Cabinet Office with joint oversight from the Cabinet Office and the Prime Minister's Office to focus on longer term strategic planning, coordination of policy across departments and monitoring of departmental performance. This could also function as an "honest broker" in Treasury negotiations with spending departments in cases (including the Spending Review) where a shared position has not been reached through bilateral discussions.
- HMRC should play a greater role in developing new tax policy, working within the principles of fairness, simplicity, and maximising collection. Changes in tax policy which have financial implications should be considered in a consistent way with other spending proposals and not be simply in the gift of the Chancellor.
- A fundamental review of the bodies that have come under the Treasury's responsibilities since the financial crisis should be undertaken to assess whether they still need to be carried out in the current way and if so, whether they could be carried by another government department. Treasury responsibility should be kept only where there is no other viable alternative.
- The Treasury mandate should include a specific responsibility to promote greater fiscal devolution to both the devolved nations and within England on the basis of clear goals, including improving regional economic performance. A dedicated unit should be established in the Treasury to promote this goal.
- Where potential changes have implications for the current Parliamentary arrangements for requiring Treasury consent, the reviews proposed above should be conducted with involvement and assistance from the National Audit Office.

Culture, Capability and Capacity

- The capacity and capability of the Treasury should be reviewed against its revised mandate and the structural changes proposed above. The policy of 'equal austerity', whilst laudable in principle, should not be pursued as the expense of basic effectiveness.
- To tackle concerns about lack of openness, the Treasury should take steps to become more public facing, and should hold an annual Open Forum with associated regional events. Greater openness is essential to creating greater trust and even more important in the aftermath of the decision to leave the EU and adverse reaction to Treasury forecasts.
- Beyond this, steps need to be taken to ensure that alternative economic views are regularly and actively considered by the Treasury. The Council of Economic Advisers could follow the example of its counterpart in the Scottish Government by publishing an Annual Report; other measures could include holding an Annual Conference designed to promote genuine discussion and debate.
- The underlying culture of the department, which has been described by many contributors as often arrogant, overbearing and negative towards other departments, should be redirected in favour of a more enabling approach. Financial control should be secured through sound systems and developing departmental capacity rather than second guessing their decisions.

- Whilst the strengthening of the financial management capabilities of the Department in recent years is welcome, it needs to go much further. If the Treasury is to truly be the 'Chief Financial Officer of Government', it must up its game and put its financial management capabilities on the same expert footing as economic management. We need to move away from a Treasury made up of 'professional economists trying to be amateur accountants'.
- To tackle concerns about experience levels, greater emphasis should be placed on the external recruitment of people with experience and not just bright graduates. Industry experienced finance staff and a wider spectrum of economic, especially macroeconomic, and regulatory skills are needed at all levels. This, and the recommendation above, should be used to address the concerns raised about the lack of high quality finance staff.
- The Treasury has a 'hair shirt' approach to pay and retention, relying on its high profile and influence to attract bright young graduates who then move on rapidly to other better paid roles. This needs to change. Reducing turnover should be a specific goal and progressions paths and pay levels should be structured competitively to deliver this.

Brexit

- All the recommendations set out above and in more detail in the rest of this report would greatly help to meet the two key requirements flowing from Brexit, not least because the immediate aftermath remains politically charged, and is likely to be so for some considerable time:
 - o the need for the Treasury, in common with all other government departments, to be as ready as it can be to meet the challenges of the additional workload – quantity and complexity – and to be able to respond rapidly to new demands; and
 - o the specific need to re-establish the department's credibility in terms of the impartiality of its advice and hence the importance of its economic expertise in designing Brexit.

1. Introduction

1 The Treasury's core responsibilities in recent years have been the overall management of the macroeconomic framework; creating the conditions for economic growth and keeping control of public expenditure; regulation of the financial sector; and strategic oversight of the tax system. It then oversees a series of related arms-length bodies over which the department has strategic oversight. The central core of just over 1,200 staff accounts for about a quarter of the total staff who make up the wider Treasury group. The current descriptions of the department's role and responsibilities, and information about the bodies for which it is responsible, are set out at Appendix D.

2 In line with our Terms of Reference, this Review focuses mainly on the strategic departmental core. And to provide focus we have concentrated on the main issues, rather than trying to cover everything.

3 There is a consensus that the core Treasury has great natural strengths. Its underlying power and the importance of its responsibilities allow it to recruit the brightest and the best in order to manage an exceptionally demanding and complex brief. For a small department, it has huge impact, influencing almost every aspect of government affairs. The acid test however is how well it has performed as a department with the responsibilities outlined above – and how much of the UK's economic successes and failures of the past decades should be attributed to the Treasury's own performance.

4 Here, the story is less positive. The backdrop to the Review is the state of the UK economy, which is still recovering from the financial crisis but has not performed well and now faces significant additional challenges after Brexit. There are commonly recognised problems including low productivity, under investment, considerable imbalances in regional economic performance, stalled growth in real wages and a rising trade deficit as well as the unforeseen great financial crisis, followed by a subsequent rise in public and private debt. If the Treasury could not and should not be blamed for all this, we can ask why it has not contributed more to the solution of the long-standing problems about economic underperformance, and how much of the answer is a consequence of the Treasury's own thinking, or of a more general "intellectual crisis of economics"¹.

5 A scholarly overview of Treasury policy was not within our remit. Nor did we think we could or should set our thinking and conclusions in anything other than relatively recent history, as our remit is to make recommendations in the context of the challenges we face today. In that context, the Panel was unanimous in its verdict on three key points:

¹ "The Bank of England's chief economist [Andrew Haldane] has warned of the dangers of placing too much faith in economic forecasts while reiterating that the central bank believes the vote for Brexit will hit the economy in 2017." *Financial Times*, 6 January 2017

- First, on macro- economic management, the Treasury has since 2010 pressed fiscal austerity too hard and in an ill- judged way which has depressed growth and incidentally damaged local government services and capabilities. Active economic policy has been delegated to the Bank of England with its non- standard monetary policies of quantitative easing and ultra-low interest rates, which have boosted asset prices more than they have stimulated economic growth. The independent status of the Bank of England and the OBR are valuable gains but, in the context of macro- miscalculation, they have provided an excuse for the Treasury’s lack of independent macro expertise and judgement which would give it an overview of policy and a basis for corrective action.

“Towards the end of the Coalition government, and unambiguously under the Conservatives, there has been no pretence that the policy objective is to reduce the ‘current deficit’. ‘The deficit’ was redefined as all government borrowing regardless of whether it was for current or capital purposes.” Oral evidence

“The main threat to living standards is not the current state of the public finances but the collapse of productivity. The idea that, with record low borrowing costs, the government should be borrowing to finance productivity-enhancing infrastructure projects, with the welcome by-product of boosting aggregate demand and, hopefully, inflation is the mainstream view.” Written evidence

- Second, on re- balancing the economy, the Treasury after 2010 recognised the fundamentally unbalanced nature of the UK economy and saw the need to build a stronger economic base outside financial services and to redress the related problem of a growing imbalance between London and the rest of the economy where GVA per capita is often half or less that in London. But the development of industrial policy from 2010-15 owed much to one strong non Treasury minister (Vince Cable) and the coalition’s much vaunted March of the Makers came to nothing with no sustained growth in manufacturing output and investment.
- Thirdly, the Treasury has curiously not engaged with the wider economic debates on fairness, underlying public disaffection and the failure of economic performance and theory. This may be a reflection of the available disciplinary perspectives (eg an absence of formal contributions from economic historians and social scientists) but is in marked contrast to others such as the IMF and the Bank of England and may partly explain the reluctance to believe Treasury forecasts in the run up to the Referendum.

⑥ Many of those we interviewed have given examples of recent and systemic Treasury contributions to underperformance: the failure to mount an effective assessment of the impact of austerity; the failure to be taken seriously in the Brexit debate; “omnishambles” budgets; poor banking supervision as RBS fails the most recent Bank of England stress test; and systemically wasteful government programmes that suggest poor financial management. These

are seen by others to be over harsh judgements that underestimate the scale of the challenges that the Treasury has faced.

7 We concluded that our key task was to understand the forces acting within the department that contributed to such failures and, more broadly, the failure to find solutions to long standing economic problems about economic management, sustainability and balance. The rest of this report looks at the evidence received, the conclusions we drew and our recommendations for the way forward.

2. The Evidence: Overview

8 We reviewed evidence from the following sources:

- A literature review of some of the key recent reports written about the Treasury.
- Written evidence submitted – where people and/or organisations have submitted evidence written specifically for the Review, commenting on some or all of the specific points listed in Terms of Reference.
- Published reports – where people and/or organisations have drawn our attention to a relevant piece of work that has already been done but which is relevant to the Terms of Reference.
- Round table meetings – hosted either by individual Panel members, or by other organisations.
- Interviews – with specific individuals either at our invitation or in response to offers to give evidence.

9 In reviewing the evidence, we concentrated on the issues which were most relevant to the department's performance. Some were specific to particular areas (eg conduct of macroeconomic policy), some systemic (eg departmental culture and experience levels) and some single issues that affect the whole department (eg the imprecision of the operating mandate). There was a consensus about these issues, as viewed from the outside from a wide range of perspectives (including with the benefit of hindsight from former employees - both official and political) but differing views about the causes and hence the solutions.

10 There was considerable praise for the department, but we were told – in the spirit of constructive criticism - that there were a number of significant issues that affected the department's overall effectiveness. The key issues we identified from this were:

- The mandate: it was too imprecise about the boundaries of the Treasury's responsibilities, and there were a number of problems with the performance measurement used to underpin the mandate. In some cases, this encouraged the wrong approach eg too much focus on short term gains at the expense of longer term achievements. The lack of precision on what the Treasury should and shouldn't focus on has enabled the department to use its powers of financial control to effectively control the policy agenda as well. At the same time the Treasury has been less than effective at some of its core responsibilities eg financial management.

- The structure of both the core Treasury and the wider Treasury group: there is clearly an appetite amongst many to consider radical structural changes - both to the core functions of the department and to the range of bodies in the wider Treasury Group which come under Treasury supervision. In particular, we were encouraged to look at examples in other countries such as Germany and Ireland where the responsibility for budgets and financial control is run in a separate department to macroeconomic policy. The key test for the Review has been to assess whether the disruptive impact of these changes would outweigh the benefits.
- Departmental culture: in the context of universal and positive recognition of the Treasury's intellectual capacity and ability to deliver, three related concerns came up: groupthink (tendency to follow a standard organisational line), an arrogance and inwardness (reluctance to value the views of departments or seek external advice other than from known supporters) and a lack of openness (reluctance to consult and invite external comment during policy design, or to engage meaningfully with a wider audience or members of the public). Some felt the culture was driven by particular Ministers or senior officials; others felt that it was more of an embedded departmental culture. It is clearly hard to define the dividing line, given the duty of civil servants to support their political masters. Encouragingly, there was no concern about the department's ability to support ministers of different political persuasions.
- Capacity and capability: it was noted that the Treasury was inclined to offer up budget and staff cuts in spending reviews to set an example to other departments. Whilst laudable in its intent, the effect of this when combined with below average rates of pay by Whitehall standards, raised real capacity issues. The result was too few people in some key areas, and very young and often inexperienced staff drawn from a high calibre but relatively narrow talent pool being given very major responsibilities for providing advice to ministers or taking decisions themselves. (The average age of Treasury officials is currently 27). This was particularly concerning given the very considerable additional demands from Brexit. Considerable concern was expressed about the department's lack of qualified finance staff, which was felt to reflect a view that finance work was less glamorous or important than economics based policy advice to Ministers.

11 In short, the consensus is that whilst the Treasury has considerable strengths, it has also shown significant weaknesses that have contributed to the UK's economic underperformance. It isn't clear enough about its role, doesn't staff itself up properly to discharge its key responsibilities, including long term strategic planning, has become overstretched with an increasingly wide brief and shrinking numbers of staff and is culturally unwilling to admit these are issues that need to be addressed.

12 In passing, it is also worth recording that some of these concerns, particularly about long term planning, are felt to apply to some degree more widely across other Whitehall departments, but this is clearly outside the scope of this Review and so not discussed further. It is important however to note that the concerns about the Treasury's role and capabilities are not raised in relation to any government in particular, but reflect a spectrum of concerns across a number of governments that people felt should be considered.

13 The evidence reviewed and meetings and interviews held are at Appendix B and C.

3. The Evidence: Detail

14 The key points that were made to us in evidence are set out below.

3i. The Treasury as an Economics Ministry

On the macro side, the main concerns were:

- The lack of departmental capacity and leadership, including concerns about the department's tendency to "leap from one intellectual paradigm to another", and a lack of breadth in disciplinary perspective. This affected its ability to anticipate macroeconomic risks, and to develop macro rules. In particular, good fiscal rules should go beyond expenditure control, and be robust to macroeconomic risks. These impacted on both what was delivered and how well it was delivered.
- Senior officials do not have a consistent view about how to advise ministers;
 - o A - speak the truth to power
 - o B - tell them what they want to hear
 - o C - admit genuine differences of view and ask ministers to decide
- In recent years, under successive governments the impression is that the tendency has been to follow B, with the other options being seen as career limiting. This is seen as a contributory factor to the Department's handling of the financial crisis, and the failure to pursue alternatives to austerity.
- The creation of the Office for Budget Responsibility reflected a conscious decision to outsource Treasury responsibility for forecasting and assessing the long term sustainability of the public finances, but it was felt that the resulting shrinking of macroeconomic capacity within the department went further than was justified by that decision, and threatens its ability to anticipate or respond to economic shocks. It was noted that the Treasury's macroeconomic capacity now lagged considerably behind that of the Bank of England, even though its responsibilities were ultimately more far reaching.
- This includes the ability to support the management of macro prudential risk which could not be left to other parties to manage without Treasury involvement or leadership. It was suggested that the Treasury is "the country's risk manager of last resort" and that this should be reflected explicitly in the department's operating mandate.
- There has been and continues to be insufficient opportunity for scrutiny of the fiscal rules and framework, which it was felt had led to fiscal rules that many thought were incorrectly specified. This, plus poor alignment of fiscal and monetary policy within the macroeconomic framework, argues for much greater openness about policy design.
- The biannual Budget/Autumn Statement cycle drives a short term focus; secrecy surrounding these events limits real scrutiny (also affects finance ministry role). Even though Philip Hammond has decided to dispense with the Autumn Statement, the concerns will still apply to an annual Budget.

"... economic policy is made in a way that involves partial analysis and frequently very little involvement of stakeholders. Good examples can be found in the way an extra levy on North Sea extraction was announced in the March 2011 budget, and also the Carbon Price Floor." NESTA The End of the Treasury

15 On the micro/supply side, it was felt that:

- there were long standing tensions between the Treasury and BIS which had disempowered our industry ministry and that this was one of the clearest examples of where roles, responsibilities and the dividing line were not clear enough.
- Through its ability to exercise tight budgetary control over departmental budgets, Treasury effectively exerts almost total control over industrial policy and many other areas.
- Treasury policy has in many ways favoured the finance sector since “big bang” in the 1980s; other sectors have received little or no consistent help from Treasury policy.
- There is a need to give higher priority to high quality jobs, key industrial sectors and regional development.
- The downgrading of company regulation (previously BIS’s responsibility) as part of an industrial policy of deregulation and resulting changes in corporate behaviour here played a part in the financial crisis and more general corporate social irresponsibility.

3ii. The Treasury as a Finance Ministry

16 The Treasury is seen as highly successful in its finance ministry function of managing and controlling the public expenditure aggregates in year once they have been agreed. But this comes at a price. It has been argued that the way the functions have been exercised have not always guaranteed that the best value for money has been achieved. Holding the purse strings gives the department a uniquely powerful position across the rest of Whitehall but this, combined with the lack of precision in its mandate, has had the effect of allowing mission creep into policy design and stifling policy development in departments.

"There is a major dysfunctionality resulting from the imbalance between the Treasury and other government departments. This starves policy development in departments, and creates a feel of “no room for debate” in the civil service. Examples of this were the policies on pension reform and on public sector pay, and the ability of departments to make their own decisions about the allocation of their spending where the Treasury continued to get involved in the detail." Oral evidence

17 Specific concerns are that:

- Because the Treasury is the dominant department in Whitehall, “nothing really happens until the Treasury is in the room”
- But the power is often not matched by knowledge and experience; this is particularly noticeable when other departments have considerably more resources and expertise in their areas of responsibility but little chance to influence policy.

“We heard multiple examples of where the Treasury has ridden roughshod over other departments’ objectives, changing and cancelling long-established environmental policies and projects at short notice with little or no consultation with relevant businesses and industries....” EAC Sustainability and HM Treasury

“Most officials who have dealt with the Treasury will be aware of the pressure to come up with proposals to go into the Budget and Autumn Statement. Many will also be aware of the temptation for Treasury officials to not only solicit ideas but to help craft them, and in some cases to develop their own in parallel to their spending departments.” NESTA The End Of the Treasury

- And it is often unseen because it is not based on the exercise of powers within clearly defined boundaries. The department has used its position –including its control of the two key annual economic statements (the budget and Autumn Statement) - to become the de facto lead policy designer in Whitehall, leading on policies that are the responsibilities of other departments (eg welfare reform) This is exacerbated by Treasury control exercised through the series of other bodies which make up the Treasury Group bodies.
- The desire to maintain tight control of public expenditure aggregates has also meant that there has been very little real devolution other than to Scotland; the UK system of spending control remains one of the most highly centralised in developed countries. As devolution rises up the political agenda, this is becoming more of a problem.

“... there is insufficient recognition at a political level and within the civil service that financial management needs to be undertaken and managed by people with the right skills and experience. Indeed it has been reported that the current lack of both reward and recognition for professional finance staff is leading to an exodus of business critical skills and experience from government as something the country can ill afford. ” - ICAEW A Modern Finance Ministry

- Whilst the Treasury is regarded as good at controlling aggregate public expenditure, it is seen as less good at exercising the associated function of financial management. Oversight of departmental spending, investment appraisal and financial reporting is seen as poor, resulting from lack of financial experience amongst staff and a sense that this work is regarded as less valuable or important within the department.

“ the Whole of Government Accounts (WGA) is a remarkable undertaking providing a genuine improvement in the transparency of the public finances and most government departments produce relatively high-quality financial accounts. The reporting systems that support and enable this are, however, largely geared towards annual external reporting andthere is little emphasis on the balance sheet for management purposes.” ICAEW A Modern Finance Ministry

- This last point also means that insufficient attention is paid to potentially useful sources of information eg Whole of Government Accounts. This is not merely a technical point. It has led for example to an unbalanced approach to issues such as debt and could be seen as a missed opportunity to support the kind of longer term strategy or horizon scanning that many think should be carried out by the Treasury and the Cabinet Office.
- The Treasury justifies its decisions to step in to control major infrastructure projects because of their spending implications and concerns about the robustness of departments’ own financial management expertise, but it lacks sufficient financial management expertise itself to justify this, and its intervention is seen as further evidence of its desire to assert its authority over departmental policy.
- If the Treasury does not have enough focused financial control, it has too much policy control over other Departments and over devolved government² which must work to a Treasury agenda of what’s acceptable policy against a background of Treasury suspicion of sectional interests and policy capture. The problem of Treasury over-control of policy has in part been recognised by giving BEIS explicit responsibility for industrial strategy. But the terms and conditions of BEIS autonomy have not been specified and the problem is broader because it is also relevant for departments responsible for transport and housing and for devolved government in the nations and now the city regions. In all these areas policy continues to be framed by the Treasury which has decided that, e.g. tram operations should not be subsidised and fares will consequently be higher than in many European cities; that earn back of local tax revenues under city deals should be linked to GVA growth and that the Welsh government’s modest borrowing powers will be exhausted by building just 14 miles of motorway.

² This doesn’t apply directly to the devolved administrations whose funding is determined by the Barnett formula, and have financial and policy freedom over devolved matters, and are subject to different additional controls.

“Not only do current challenges demand a more effective financial architecture but future policy goals will also add to the need for it. The devolution of tax powers and spending to devolved administrations will also require structural change away from the currently highly centralised model.” ICAEW A Modern Finance Ministry

3iii. Other functions: financial regulation and tax policy

18 On financial regulation:

- In changing the tripartite oversight of financial services in 2010 and transferring much responsibility for banking stability and many staff to the Bank of England in 2012 George Osborne greatly reduced the responsibility of the Treasury for financial regulation.
- There were problems with the management of UKFI which managed the controlling Government stake in RBS and a major stake in Lloyds on the grounds that it did not successfully address:
 - o The heavy concentration in four big banks which have, together, over 80% of the UK market.
 - o Increased lending to SMEs which suffered badly in the aftermath of 2008 when the wholesale credit market contracted.
 - o Poor IT systems in all of the big four banks, but most noticeably in RBS.
 - o High executive pay.
 - o Risk management in RBS which failed a recent Bank of England stress test.

19 On strategic oversight of tax:

- The treatment of tax and spending in the aggregate budget and public expenditure planning processes is too secretive, especially on the tax side, where decisions on tax are only known to the Treasury and HMRC. This results in insufficient scrutiny and the potential for “Omnishambles”³.
- The department is criticised for treating HMRC as a subordinate, but without exercising the level of oversight necessary to ensure its effectiveness. This has included overlooking the perceived closeness of HMRC with the big four banks and big four accounting firms over PFI.
- The UK tax system – which is twice as complicated as continental European systems – needs simplification.
- The Treasury does not prioritise revenue collection over, for example, head count reduction and also seems to focus more on small scale tax cheats rather than major companies and high net worth individuals.
- The Treasury has not effectively pursued the clarification of international tax rules to reduce the scope for tax evasion and avoidance by international companies.

³ *Better Budgets: making tax policy better Report by Chartered Institute of Taxation (CIOT), Institute for Fiscal Studies (IFS) and Institute for Government (IfG)*

3iv. Central Control vs Greater Devolution

20 The Treasury's over-control described above is thought to make least sense on issues like regional development where centrally driven mainstream policies of investing in infrastructure and skills have had little demonstrable success on the standard metrics. It is of course important to maintain Treasury prudent financial control. But, within agreed budgetary limits on current and capital accounts and potentially subject to suitable measures of performance and programme evaluation, it would make much more sense for the Treasury then to stand back and encourage diversity and innovation in many policy areas.

- There is a sense that the desire for greater devolution has grown as dissatisfaction with Treasury control (particularly when this morphs from financial to agenda control) has grown among a wide range of stakeholders. In such cases, policy experiment and evaluation would be sensible and in many other cases, as with housing, the adaptation of policy to local specifics is inhibited by a one size fits all policy template.
- The department has been noticeably slow to respond to this pressure – much of what is called devolution is in fact decentralisation. Great emphasis is put on having the right structures to devolve to, which in turn can act as a barrier to progress.
- The argument that more power for eg regions must mean less power for the Treasury, threatening its ability to manage and control the public finances, is often used to resist calls for greater devolution. But it is important to recognise two things. First, with the right conditions in place, devolution is not a zero sum game; there is no incompatibility with sensible devolution and a strong Treasury. And second, while attempts to create strong alternative (national) growth ministries have not been wholly successful – the impact of BEIS remains to be seen - the different dynamic of devolution to sub national layers of government is potentially a better antidote to national over-control.
- While there is international evidence that suggests that more devolved states benefit from better economic performance, this does not appear to happen in isolation, but when devolution is supported by a clear industrial strategy which reflects sub national differences, together with strong and effective local governance which can bring forward the necessary infrastructure development.

“The UK's major cities cite the Treasury as the main opponent to their attempts to gain borrowing powers, especially with regard to their housing assets. Such borrowing would contribute towards the totals that the Treasury feels it needs to control to satisfy financial markets. Since, as we discussed earlier, that takes an absolute priority over other, it is straightforwardly unacceptable for real financial discretion to be yielded to local authorities.” NESTA The End of the Treasury

4. Responding to the Key Issues

4i. The Operating Mandate

21 On the basis of the evidence we reviewed, we approached the task in the following way:

- Start by developing a clear view of the operating mandate - what the Treasury is there to do - that would be needed to focus the department on the task of promoting and managing sustainable growth in a fairer and more equal society (our terms of reference)
- Then, on the principle that form should follow function, consider the case for structural changes to help focus on and deliver the mandate; options include structural changes within a single department, transferring responsibilities to different departments, and could include altering the wider Group structure.
- Finally, consider “people related” changes; how the department’s culture and the levels of skills and capacity among its staff affect its delivery performance and what changes to how the Treasury manages itself are needed.

22 The Treasury currently says⁴ that it is

- a. *“ the government’s economic and finance ministry, maintaining control over public spending, setting the direction of the UK’s economic policy and working to achieve strong and sustainable economic growth”*

The issues

23 On the basis of the evidence we have reviewed, we consider that the mandate – role (above), responsibilities, priorities, and objectives - is a comprehensive reflection of the department’s current responsibilities, but it is not properly defined. Many of the priorities and objectives, eg increasing employment and productivity, should involve action not just by the Treasury but by other parts of government or the wider public sector. This allows room (some have argued deliberately so) for “mission creep” - when the Treasury makes policy announcements in the Budget and Autumn Statement in which other departments have little detailed involvement or chance for scrutiny and which should be the responsibility of other Secretaries of State, for example, the proposals on extended academisation of schools in the 2016 Budget.

24 On the principle that what gets measured gets done, this lack of precision makes the selection of the target structure supporting the mandate particularly important. It has been argued that there are three problems with the targets chosen by the Treasury against which to measure the department’s performance; some important things are not being done; some important things are being done, but in the wrong way; and some things are being done that should either not be done or be done by others. Our main concerns are set out below:

- *Things not being done...*
 - o that the Treasury is essentially “the country’s risk manager of last resort” should be reflected explicitly in the department’s operating mandate as this could not be left to other parties to manage without Treasury involvement or leadership.

⁴ See Appendix D, which sets out the Treasury’s current role, responsibilities, priorities and objectives.

- o the targets need to include specific measures which give higher priority to high quality jobs, key industrial sectors and regional development and economic performance.
- *Things being done, but in the wrong way...*
 - o The current focus on GDP growth as the primary measure of strong, sustainable and balanced growth is too narrow as it neglects measures of broader wellbeing, equality, balanced regional growth and environmental sustainability. This implies that there is no requirement to demonstrate that these other factors of wellbeing are being pursued or maintained.
 - o Because GDP growth is measured by comparing latest quarter growth on the corresponding quarter of the previous year, the policy focus will be on measures to deliver short term rather than necessarily sustainable growth. This is a serious issue when, for example, UK consumption is over dependent on housing equity withdrawal which in turn depends on rising asset prices.
 - o The fiscal framework target of an overall surplus drives an inappropriate bias against capital investment. So valuable public sector infrastructure projects which could be financed at historically low interest rates, and could have helped to stimulate growth, do not proceed.
 - o Fiscal accounting rules around Public Sector Net Debt (PSND) drive an inappropriate policy bias towards financial transactions.
 - o Although the coalition's main fiscal rule excluded public investment, the general instruction to departments was to cut quickly, and as a result public investment fell rapidly in 2010 and 2011, which clearly held back the recovery from the financial crisis. More generally the coalition's fiscal rules failed to adequately allow for macroeconomic risks, particularly when monetary policy was constrained by interest rates being stuck at their lower bound. There seems little appreciation within the Treasury about the gravity of this mistake.

"[We] recognise the fundamental end is broadly distributed welfare improvement. Growth and jobs (like tax receipts) have some merit as activity indicators but are no longer means to that end. Hence the need for a dashboard of welfare indicators as proposed by the Sen, Stiglitz and Fitoussi (2009) commission; with special emphasis on minimum standards for all citizens and scope for measurable improvement in left behind localities + regions which are not closing the GVA gap...." written evidence

"The current preoccupation with growth alone must be widened and in time the convention of growth should be replaced with a range of more complex and sophisticated indices of economic performance. We have suggested (Hay and Payne, 2015) that this could take the form of a new sustainable economic development index (SED)." written evidence [SPERI]

*“The Treasury should be charged with responsibility for gathering data on the imbalances in the British economy and monitoring progress towards their rectification. Broadly the indicators that can be used to assess this include the imbalances between the financial and manufacturing sectors, Northern and Southern regions, imports and exports, investment and consumption, and debt and saving).”
written evidence [SPERI]*

“The Treasury’s resistance to the wellbeing agenda is likely a strong factor in explaining the lack of policy influence of the Measuring National Wellbeing programme.” New Economics Foundation

- *Things being done that should not be done or be done by others...*
 - o Clarity and precision is needed about the boundaries of the Treasury’s responsibilities because it is the dominant department in Whitehall and has used its position to become the de facto lead policy designer and agenda setter in Whitehall. This also leads to the proliferation of bodies in the wider Treasury Group, with very little examination of the how they these arrangements came about.

25 The Treasury is not actually silent on the issues raised here (and elsewhere in the evidence we have received) in terms of eg balanced growth or improved financial supervision, and it could be argued that the issues that seem to be ignored are being addressed. Contributors to this Review feel that what the department says is either not backed up by what they do, or is not being done effectively. The key point is that if eg broader measures of wellbeing, or balanced regional growth are not specifically included in the mandate, or how the performance against the mandate is measured, it is difficult to see how and where policy choices and trade-offs can be made.

Possible Solutions

26 The Panel concludes that there is a strong case for reviewing and amending the operating mandate and the target framework used to measure the Treasury’s performance to improve clarity and precision about what the department will – and will not – do, and how it will demonstrate its achievements. This would provide an opportunity to commit to a more inclusive suite of indicators to include measures of wellbeing, sustainable growth and provide more of a focus on long term as well as short term growth.

27 We consider that this change requires further and more detailed consideration beyond the scope of this Review. Suggestions put forward for areas for review and potential changes are set out for consideration below:

On the description of the mandate:

- Review with a view to defining clearly where the Treasury has sole or lead responsibility and where it works with others to deliver, with whom, and what its role will be. The aim is to provide clarity and avoid mission creep, and the expectation is that the process would be carried out with the involvement of other departments.

- There will need to be an iterative process; the first review should decide what is needed to deliver the core functions, and therefore what is no longer core and should be changed, and the second review should finalise the mandate, taking account of agreed structural or organisational changes.

On targets and measurement:

- To address things not being done...
 - o Broaden the measure to include other indicators of balance etc.
 - o Given the increasing focus on greater devolution as a policy goal, this should include measures to assess regional balance.
 - o Strengthen the commitment to financial regulation and introduce appropriate performance measures.
 - o Clarify the role the Treasury plays in the management of macro prudential risk.
- To address things being done, but in the wrong way...
 - o Introduce longer term measurement of economic performance alongside the current short term measurement.
 - o Amend the fiscal framework target of an overall surplus, potentially to a surplus on current budget, and contingent on effectiveness of monetary policy.
 - o Review the status of PSND as the key measure of government debt.
- To address things being done that should not be done or be done by others...
 - o define clearly where the Treasury has sole or lead responsibility and where it works with others to deliver, and who, and what its role will be.
- In all cases, agree a suite of clear and accepted indicators against which performance will be measured against and reported on.
- To encourage openness and transparency, include measures to capture the “how”; how the Treasury will work with departments, other public sector bodies and the private and third sectors.

28 On the assumption that it would be possible to revise the Treasury’s operating mandate to ensure that it properly addresses the concerns highlighted above, we consider that it is equally important to clarify exactly how the mandate is promulgated within the department.

4ii. Structural Issues

29 With a more precisely defined mandate based on the same core responsibilities, the Treasury’s current configuration needs to be tested for its strategic fit with the clearer mandate:

- We know that with a broadly constant remit, the core department has undergone significant structural changes over the years, with the most frequently quoted and relevant example being the creation of the Department of Economic Affairs in 1964 under the Wilson government. This was responsible for long term planning and industrial policy, lasting until 1969. Since our Review started, there has been a change of Prime Minister from David Cameron to Theresa May, who announced the restructuring of BIS to BEIS,

with an enhanced remit including industrial policy. The evidence we received suggests that this move will be welcomed (but possibly with caveats) by many.

- The number of bodies in the Treasury Group for which the core department has sole or joint oversight responsibility has grown considerably in recent years, particularly in the aftermath of the financial crisis of 2008, and with three quarters of the Group's staff in these bodies and not the core department. The latest Treasury Annual Report⁵ notes that the Group is responsible for the management of net assets of £105.5 bn at 31 March 2016 (£130.5 bn at 31 March 2015). It is worth asking whether the management oversight requirement is consistent with the revised mandate. More recently, it has been agreed that the Public Works Loan Board (PWLB) established in 1793 is to be abolished with its functions for lending to local authorities being handed over to the Treasury. The point about capacity stands irrespective of whether oversight of each body has been carried out effectively, which we have not been able to explore in detail through this Review.
- As we have noted earlier, in terms of management of the economy, the UK is one of the most highly centralized jurisdictions in the developed world and there is increasing pressure for greater devolution of responsibility and control from the central departments to sub national layers of government. Indeed, this sort of greater devolution may be a natural consequence of the refinement of the operating mandate and greater clarity about where the boundary of departmental responsibility lies.
- At a more fundamental level, there is the question of whether even the core responsibilities of budget finance and macroeconomic policy should continue to be housed in the same department or located separately as in a number of other countries. This would reduce the concentration of power in one department and allow a greater focus on each of the areas, particularly budget and financial management.

The issues

30 On the basis of the evidence we have reviewed, we concluded that the benefits of a complete split of the core functions are outweighed by the disruptive consequences. This is particularly so given the impact on the department of Brexit. There would also be a risk that tensions between the economic and financial roles that exist now would simply be played out between two departments rather than contained as now within a single one. The focus instead should be on ensuring the Treasury core role is concentrated on ensuring that these core functions are done well within an open and enabling culture. Our specific findings are set out below:

31 *On the core department:*

- We have recommended earlier introducing much more clarity and transparency about where the department's responsibilities start and end in a revised mandate, and also considered the case for taking explicit steps to strengthen the role of Business, Innovation and Skills (BIS) further in leading on the government's industrial policy. That the current government has announced its intention to make this change itself is therefore welcome so long as some key conditions are met: that there is a very clear and defined

⁵ *Treasury Annual Report and Accounts, HC339 published in June 2016*

understanding across government of the respective roles and responsibilities of the Treasury and the new Department for Business, Energy and Industrial Strategy (BEIS), to ensure that the Treasury does not use its financial control levers to exert agenda and detailed policy control, as is frequently argued. The Treasury should have a role as the enabler of the industrial strategy, engaging constructively and recognising that it is key to delivering a supportive macroeconomic environment; but it is not the Treasury's role to prescribe the form and content of industrial policy. And it is important that the Treasury supports the aims of the Government's industrial policy by acknowledging the role that greater devolution can play.

- There is insufficient coordination between the Treasury's wide range of responsibilities, and as a result it is hard to assess the appropriateness of policy choices made; for example, the choices between increasing public spending by raising taxes or by borrowing, stimulating the economy by reducing taxes or increasing spending, or supporting financial services more strongly than other sectors of the economy. This is not helped by the lack of transparency about how decisions are made, particularly with an increasing tendency to make spending announcements in the Budget and Autumn Statement, and the lack of precision in the current mandate.
- The opportunity to challenge Treasury decisions which become government policy through announcement in budgets and spending reviews is too weak; the Treasury holds nearly all the cards and can (and does) use its financial control to exert agenda control, by telling departments what they have to do in order to receive funding. There is a strong feeling that some countervailing forces are required, to give departments a more equal part in the process.

32 *On the wider Treasury Group:*

- We are concerned about the decision making processes that have led to the creation of a number of new bodies (eg Help to Buy Ltd, the Office of Financial Sanctions Implementation) generically described in the Treasury's Annual Report as "entities" because their basis varies, including the transparency of the process. It is clear that in aggregate, proper oversight of these bodies – the Group's net assets were £105.5bn at 31 March 2016- represents a significant departmental responsibility (most of the direct financial risk carried by the department flows from them).
- We consider that there is a strong case for reviewing the Treasury's responsibilities for these bodies both in the light of a revised and more sharply defined operating mandate and because their creation appears to have had very little actual scrutiny. The criteria for the review should include the financial exposure and risks involved, and where these can best be managed. We also recommend that there is a case for reviewing the effectiveness of the Treasury's supervision of these bodies⁶, but note that it is outside of our Terms of Reference.
- Although HMRC is not a part of the Treasury Group but a Treasury related public body, we note and support the recommendations set out in the Initial Report on the Review of HMRC, commissioned by the Shadow Chancellor and led by Professor Prem Sikka, which

⁶ *The recent failure of RBS to pass the Bank of England's stress test is a potential cause for concern in this respect.*

aimed to enhance HMRC's efficiency effectiveness and public accountability. There are some critical issues to be addressed here on tax collection, policing of the minimum wage, and modernising of systems. Alongside the operation of HMRC itself however, there is also the critical issue of the relationship between HMRC and its overseer, the Treasury. Many have argued to us during our Review that the dominance of the Treasury in setting tax policy and the inclination of successive Chancellors to use tax policy to secure wider political and policy goals, has contributed to creating one of the most complex and hard to operate tax systems in the world. There is also a mismatch between the scrutiny given to spending proposals and that given to changes in tax policy with often much larger fiscal implications.

Potential solutions

33 Many contributors addressed these issues of “structure”, but without a clear consensus on the best way forward. As noted above, some key restructuring is already taking place; the decision by the new Prime Minister to transform the department for Business, Innovation and Skills into the new Department for Business, Energy and Industrial Strategy looks intended to strengthen the government's focus on industrial strategy and should therefore be welcomed⁷. In terms of the scope for potential further structural changes, the Panel recommends that:

34 *On core Treasury responsibilities (including consequential changes):*

- With the transfer of responsibility for industrial/growth strategy to BEIS, the Treasury should concentrate its economic effort on its broad macroeconomic responsibilities. This, together with its Finance functions and its role in financial regulation should remain in the departmental core, but as part of a more clearly defined Group Structure, with clearer Ministerial oversight, to improve coordination and the ability to make tradeoffs. With a more precise operating mandate which requires the department to deliver sustainable growth in a fairer and more equal society, the need for transparency about how policy choices and trade-offs are made to deliver these outcomes will be very important.
- Following on from this approach, the division of broad macroeconomic responsibilities between the Treasury and the Bank of England should be kept as now, but the resources of the Treasury strengthened to ensure that it is able to provide an independent perspective on macroeconomic policy and financial stability to focus more effectively on analysing possible risks to the economy as well as the design of monetary policy and fiscal rules.
- The BEIS remit for industrial policy/growth strategy should be strengthened, with clarity about the respective roles and responsibilities of the Treasury, BEIS and sub-national government entities, such as city regions. The Government's recent Green Paper⁸ identifies these issues and recognises the need to drive growth “across the whole country”, and to have the “right institutions to bring together sectors and places”, but remains vague about that this will mean in practice.

⁷ We also note and support the transfer of skills back to the department for Department for Education to provide a comprehensive end to end view of skills and education.

⁸ *Building our Industrial Strategy*, HM Government January 2017

- A review of the Treasury’s detailed financial management responsibilities and the role this activity plays in delivery of the revised operating mandate should be undertaken, on the basis that where these responsibilities are not demonstrably essential to the delivery of the mandate, there should be a presumption in favour of greater devolution of financial management responsibility to departments.
- To pick up the concerns expressed about the lack of central horizon scanning, a new, high powered, ‘Strategy and Delivery Unit’ should be established with the Cabinet Office and No 10 to focus on longer term strategic planning, coordination of policy across departments and monitoring of departmental performance⁹.
- As part of this new central unit, the remit should include working with Treasury and spending departments to provide an “honest broker” function in Treasury negotiations with spending departments in cases (including the spending Review) where a shared position has not been reached through bilateral discussions, to ensure that finance control doesn’t become agenda control.

35 *On the wider Treasury group:*

- A fundamental review of the bodies within the Group which are collectively responsible for the £105.5bn of net assets on the Treasury Group’s balance sheet should be carried out to consider: whether they should exist at all; whether the current configuration is the best arrangement for managing these assets, whether their continued sponsorship is consistent with the Treasury’s operating mandate, and if not, where this responsibility should reside instead.

36 We note that potential changes could have implications for the current Parliamentary arrangements for requiring Treasury consent and so further recommend that the reviews proposed above should be conducted with assistance from the National Audit Office.

37 *On the relationship with HMRC:*

- We recommend that proposals on tax changes be developed in closer collaboration with HMRC, taking advantage of their considerable operational experience, within the clear principles of fairness, increasing simplicity and maximising tax collection. Tax changes which have a fiscal impact should be considered alongside spending proposals in the budget process and not simply in the gift of the Chancellor of the day.

38 Given the resources at our disposal, it was not possible to conduct a detailed comparison of how other developed countries organise the functions carried out in the UK by the Treasury. But we were told by various contributors that there is an increasing focus in many other Treasuries on financial management which is consistent with our own thinking.

⁹ *In considering this proposal, it would be worth revisiting the story of the National Economic Council set up in 2008 to coordinate the Government’s response to the financial crisis.*

4.iii Devolving Responsibility

39 Whatever happens to the structure of the core Treasury or the wider Treasury Group, with greater clarity over the boundaries of Treasury responsibility in the context of a clearer operating mandate, there is a strong case for a greater focus on devolution as a catalyst for improving economic performance as a policy goal in its own right.

The issues

40 On the basis of the evidence received, we consider that:

- The UK's very highly centralised system of government is largely due to the Treasury's unwillingness to devolve powers for fear of losing control of the public finance.
- In practice, local government has often proved to be more effective in controlling costs than central government.
- There is some international evidence to suggest that devolution to sub national layers of government – cities, city regions – in the context of a clear industrial strategy and strong local governance increases economic performance overall.
- Greater devolution is strongly supported, but it should be genuine and not come with strings attached as eg City Deals do.

Potential solutions

41 The Treasury mandate should include a specific responsibility to promote greater fiscal devolution to both the devolved nations and within England on the basis of clear goals, including improving regional economic performance. A dedicated unit should be established in the Treasury to promote this goal.

4.iv Culture, Capability and Capacity

42 A number of reviews of the Treasury have identified concerns about capability and capacity that are still being raised as concerns today. For example, the Fundamental Expenditure Review carried out by Jeremy Heywood, the current Cabinet Secretary, in 1994¹⁰ made a number of recommendations about length of postings and time to learn about the job in advance of taking up a new post that are echoed in the more recent report by Sharon White on the Treasury's response to the financial crisis, published in 2012.¹¹

“Two years on from its publication, much of the substance of the 2013 FMR [Financial Management Review] appears from outside the HM Treasury to remain work in progress. According to the NAO, HM Treasury does not appear to have moved quickly to widespread FMR implementation or did not devote sufficient resources or control to bring about the required scale of change in a faster time frame.” ICAEW A Modern Finance Ministry

¹⁰ Fundamental Review of HM Treasury's Running Costs, Report to the Chancellor, October 1994

¹¹ HM Treasury's response to the financial crisis 2007-2009, published by HM Treasury, March 2012

This suggests that whilst lessons are being learned, changes recommended in response are not being implemented. This may have something to do with the culture of the department, which is considered below.

43 The Treasury launched a corporate reform programme “Building a great Treasury” (or BgT) in the autumn of 2014. This was subsequently refreshed in November 2015 and it is clearly the department’s latest attempt to tackle the issues that have been identified but not fully resolved in previous reviews. Whilst this is welcome and we would support much of its focus, we draw attention to some obvious gaps below.

The issues

44 *On the basis of the evidence we have reviewed, we consider that:*

In terms of culture:

- Externally, including across the rest of Whitehall, the department is widely seen as a “closed” environment, in terms of explaining what it does and asking for advice or being seen to take it when it is given. This looks like a consequence of the department’s power, derived from its control over public spending and its “elite” staff. It has been suggested that since a large proportion of Treasury staff have been recruited from elite universities, the prevailing views held are a reflection of a relatively narrow range of academic opinions; which is not at all to denigrate the opinions, but suggest that the received wisdom may be difficult to challenge.
- These factors create the conditions for a type of groupthink within the department, which is frustrating for outsiders and, coupled with organizational considerations mentioned elsewhere in this Report, exposes the department to greater risk of failure to anticipate and respond effectively to economic shocks.
- Public reaction to the Treasury’s stance during the Referendum campaign and its aftermath was exceptionally hostile, and many of the criticisms made could be interpreted as consequences of some of the characteristics identified above. Public policy desperately needs more expertise, but the public is hostile to what it sees as (the wrong kind of) experts and public administration needs to respond to this judgement – not by disowning expert advice, but by improving communication to make it more of a shared endeavor and less like ex cathedra statements from on high.
- A large part of this groupthink relates to the management and control of public expenditure, which has been described to us as the Treasury’s overwhelming priority as, in their view, financial controllers of last resort.

This partly explains the department’s extreme reluctance to relinquish control even when it appears to do so eg city “devolution deals” which come with strings attached and have to be approved.

In terms of capability and capacity:

- Whilst the Building a Great Treasury programme is welcome, the problem is that its performance metric is the results in the annual Staff Survey. Consequently, there is no

independent external measure of whether the capacity and capability concerns it is designed to address are being met.

“One specific example of lack of capacity from 2007 was that only one person was monitoring financial stability as the banking liquidity crisis was building.” Former Treasury insider

- Treasury staff are highly talented – but they are seriously and increasingly overstretched as spending controls bite and responsibilities increase. This will be massively exacerbated by Brexit.
- Because staff in the main working levels responsible for advice to ministers and policy design (grade 7 and Grade 5) are young to start with, often in post for relatively short periods before rapid promotion to the next level, the policy of employing bright young people means that there is a worrying lack of skills and experience and depth to management and decision-taking by the time people reach levels where this is required.
- Because one of the effects of reducing overall numbers at key organisational levels has been a greater reliance on secondments from sectors subject to departmental oversight (eg financial services, and PPP control), there are risks that this will lead to some narrowing of perspective about policy options.
- Because some skills are more highly valued than others so advising ministers, policy design and economic analysis are more highly valued than the accountancy and finance specialisms and the department does not perform as strongly in these areas as it needs to, given its current responsibilities. Many external commentators were highly critical of the Treasury’s weakness in financial management.
- This is further exacerbated by pay differentials, with higher pay available in other government departments, the Bank and the private sector which contributes to the unhealthy high turnover rates and inability to recruit and retain staff in some key areas. The latest Treasury Staff Survey¹² records nearly 40 percent of staff as very dissatisfied with their pay, and only 24 per cent of staff as satisfied with their pay and benefits package – 13 per cent less than civil Service “high performers.”

“More than half of policy advisers ... have three years or less length of service ... There is a general perception that promotion prospects for policy officials are enhanced by acquiring generalist policy skills and gaining experience of working in a variety of high profile roles on Ministerial priorities. This is a factor in the length of time policy officials spend in post – the internal churn in the labour market – and also has an impact on expertise and experience.” HM Treasury’s Response to the financial crisis 2012

¹² HM Treasury Staff Survey 2016, published on 6 December 2016

“The Treasury has the highest turnover of any Whitehall department – three times higher than the UK civil service average ... Uncompetitive salaries and limited career progression are the key reasons cited by staff who leave.” HM Treasury’s response to the financial crisis, 2012

Potential solutions

45 To address these issues we make the following recommendations:

On culture:

- To tackle concerns about lack of openness, the Treasury could follow and potentially build on the example set by the Bank of England, which now holds an annual Open Forum with associated regional events. Creating a genuine two-way consultation process could help to mitigate concerns about groupthink, especially if the mechanism was used to test ideas at an early stage of development. We cannot emphasise too strongly how important this greater openness is likely to be in the aftermath of the decision to leave the EU, given the public response to the Treasury’s contribution to the Referendum debate and more recently the first post Referendum forecast. Brexit will require a great deal of consideration and consultation to reach an agreed negotiating position, and then agree and implement the exit arrangements, and a sense of greater openness and genuine consultation will be essential to restore credibility.
- Potentially going even further, the Treasury could follow the BoE model of Regional Agencies¹³. This need not involve large numbers of staff but could be a way of signalling greater support for regional economic activity.
- Whilst clarity about the Treasury’s mandate should go some way to mitigate concerns over its dominant role, particularly in the area of public expenditure management and control, this would be strengthened further by the introduction of the proposed new “honest broker” central unit, which could also act as a cross government coordination mechanism to ensure collective decisions are taken in a genuinely collective way.

On capability and capacity:

- To tackle concerns that the department has shed too many staff to deal effectively with its current responsibilities, an urgent review should be carried out to ensure the department has the resources and skills commensurate in terms of both quality and quantity with the demands of its responsibilities, especially in the light of increasing demands from Brexit.
- To tackle concerns about experience levels that may not be fully addressed in BgT, greater emphasis should be placed on the external recruitment of people with relevant experience and not just bright graduates. Industry experienced finance staff and a wider spectrum of economic, especially macroeconomic, and regulatory skills are needed at all levels. This,

¹³ “The Agencies are the Bank’s “eyes, ears and voice” in the regions, collecting information about trends and developments across the country, and explaining the Bank’s policy decisions to local businesses, industry and labour groups”. From the Bank of England website

and the recommendation above, should be used to address the concerns raised about the lack of high quality finance staff.

- On the basis that pay, which should be sufficient to recruit, retain and motivate staff, is recognised to be a factor in the department's significantly poor retention rates, levels and progression paths should be reviewed to ensure Treasury pay is competitive at all levels in important skill areas.
- The Treasury should develop external measures of performance improvement to measure the success of the Building a Great Treasury programme in addition to the Annual Staff Survey response.

5. Brexit and its implications

46 Given the timing of the evidence gathering stage of the Review, which was organised to deliver a report in Summer 2016, we had received nearly all our evidence in advance of the EU Referendum.

47 Since then, the Panel has had an opportunity to consider the impact of Brexit and equally important for this review, the process of leaving the EU. We have tested our proposals against the challenge that delivering Brexit poses for both the Treasury and the Government as a whole. We conclude that there is no reason to delay implementation of any of our recommendations, and that on the contrary, early implementation would considerably help the department to play its part in delivering Brexit and, as importantly, retain public confidence during a period of great uncertainty.

48 It is clear that the Treasury did a great deal of work in the run up to the EU Referendum which was directed towards making the Government's case for Remain. Even allowing for the exceptionally highly politically charged atmosphere during the campaign, including the concern about too many "experts", the public reaction to the Treasury's analysis was unprecedentedly hostile. The response to the first post decision forecast in the 2016 Autumn Statement was much the same. Even though Treasury forecasts were in line with those of other external forecasts, it is hard not to see this reaction as a major challenge to the department's credibility and as potentially a consequence of departmental cultural hubris.

49 In line with Government policy, the Treasury's work did not include detailed preparations in the event of a decision to leave the EU. It is now clear that the Treasury, and indeed the rest of the UK Government, is unprepared and under-resourced for the tasks it faces in the immediate future and for some years to come.

50 In considering this issue, we have therefore looked at the findings and recommendations in the report that was commissioned by the department at the request of the PAC into the management response to the financial crisis referred to above (para 38)¹⁴, as this is the closest recent example of a situation where the Treasury has had to respond very rapidly to a major threat to the UK economy for which it was inadequately prepared.

¹⁴ *HM Treasury's response to the financial crisis 2007-2009, published by HM Treasury, March 2012*

51 Sadly the past is not a good guide to the future. The challenge of Brexit is of a different order of magnitude and will occupy the Treasury for a long period. It will also involve the formation of effective relationships with the three key departments leading on Brexit negotiations and trade negotiations post Brexit (the FCO, Department for Exiting the European Union and the Department for International Trade) to ensure that all are working from a shared set of economic assumptions. What is clear is that the Treasury, alongside the rest of government should do a full assessment of the resources it requires to deliver Brexit alongside its other core responsibilities. This should draw on a properly developed Government Plan for Brexit. At the time of writing, such a plan has yet to be produced.

52 We strongly believe that the Treasury would improve public confidence in the Brexit process by implementing a number of recommendations in our report now. Our recommendations for greater openness and transparency to help to regain credibility for the impartiality of department's advice and hence the importance of its economic expertise in designing Brexit.

6. Conclusion

53 The Panel is very grateful to all those who gave evidence, either in writing, or orally, or both, to assist the work of this Review. It has been lightly resourced with all those on the Panel and supporting the Panel's work doing so as volunteers, and it has therefore not been possible to go beyond the high level recommendations presented here.

54 However, Brexit means that the UK is facing wrenching economic changes. To undertake these with an overstretched, poorly focused Treasury is a recipe for problems. Clarifying the roles of our major institutions responsible for financial matters and focusing the Treasury on providing world class financial management would help government decision making at this critical juncture, strengthen the control of key projects and help to deliver a much needed restoration of confidence in the forecasts and recommendations upon which good government acts and receives support. It would also enable the Treasury to work closely with BEIS and other departments on the development of innovative economic and industrial strategy and plans to help rebalance the economy towards regional development and the sectoral growth that the UK needs to support the high skill, high wage economy we deserve.

Appendix A

Terms of Reference for the Review

To consider whether the current role, responsibilities and operating mandate of HM Treasury are appropriate for the task of promoting and managing sustainable growth in a fairer and more equal society, and to make recommendations. The Review will consider:

- The “economics ministry” relationship between the Treasury and other key government institutions with related responsibilities, specifically the Bank of England, the Department for Business, Innovation and Skills and HMRC
- The “finance ministry” relationship between the Treasury and all government spending departments.

The recommendations will be expected to look specifically at and report on whether organisational, structural or operating mandate changes are needed to deliver:

- A strategy for deficit reduction that avoids damaging the country’s growth potential
- A sustainable economy, with appropriate balances between levels of investment and consumption and our trade with the rest of the world.
- A more equal economy, with reduced differences between regional economic performance and prosperity and inequality between those at the top and bottom of the income scale
- Support which enables the delivery of key policies and Manifesto commitments led by other government departments.

The Panel will be asked specifically to consider whether and if so how far devolution of fiscal responsibilities from national government can and should play a part in achieving these objectives.

Kerslake Review Panel support team

Ros Dunn (Secretary)

Rod Dowler

With assistance from Rupert Beharrell

The Panel



Alan Buckle is an accountant and management consultant. He was deputy chairman of KPMG International, during which time he was accountable for the overall strategic direction and organisation of their business. He has been an adviser to a number of major corporates on a wide range of financial issues. Alan led the Labour Party's policy work on Low Pay and was a member of the party's Infrastructure Commission. He also managed the work to prepare for government in the event of a Labour victory, which included proposals for the better working of the Whitehall machine.



Stephen Hughes has had a long career in local government including eight and a half years as Birmingham City Council's Chief Executive. Since leaving Birmingham he has carried out a number of roles including as a strategic adviser to the CIPFA, Interim Executive Director at the Local Government Association, associate adviser to Bevan Brittan, freelance consultancy work and Non-executive Director roles with Big Bang PLC and Housing and Care 21.



Frances O'Grady is the General Secretary of the TUC. She first joined the TUC as Campaign's Officer in 1994, and went on to launch the TUC's Organising Academy in 1997. As Deputy General Secretary from 2003, Frances led on the environment, industrial policy, the NHS and winning an agreement covering the 2012 Olympics. She has served as a member of the Low Pay Commission, the High Pay Centre and the Resolution Foundation's Commission on Living Standards.



Karel Williams is a professor at the University of Manchester's Alliance Manchester Business School where he was Director of the ESRC funded Centre for Research on Socio Cultural Change (cresc.ac.uk). He is best known as a senior member of a research team that pioneered critical work on shareholder value, financialization and corporate strategy in the 2000's and subsequently produced a broad inter disciplinary analysis of the post 2008 financial crisis as an "elite debacle".



Simon Wren-Lewis is currently Professor of Economic Policy at the Blavatnik School of Government at Oxford University and an Emeritus fellow of Merton College. He began his career in H.M. Treasury and then moved to the National Institute of Social and Economic Research. In 1990 he became a Professor at Strathclyde University, and from 1995 to 2006 he was at Exeter University. He has published papers on macroeconomics in a wide range of leading academic journals.

List of Written evidence reviewed

Published reports

Fundamental Review of HM Treasury's Running Costs, Report to the Chancellor, October 1994
Capability review of HM Treasury - Sir Gus O'Donnell, December 2007
HM Treasury's response to the financial crisis 2007-2009, HM Treasury, March 2012
HM Treasury Staff Surveys, 2015 and 2016
HMT Annual report and accounts 2014-2015 and 2015-2016
HM Treasury Single departmental Plan 2015-2020
A short guide to the Treasury – July 2015 NAO
The Performance of the Treasury 2013-2014 NAO

Publications drawn to the Panel's attention

The End of the Treasury – Nesta, September 2014

The Fabian Society

- *Tax for our times*
- *The Treasury on Trial*
- *2030 Vision: Report of the Fabian Commission on Future Spending Choices*
Institute of Chartered Accountants for England and Wales
- *CFO at the Cabinet table*
- *A Modern Finance Ministry*

Institute of Directors: Evidence on Taxation the Treasury Select Committee March 2016

Evolution of the Modern Treasury: Speech by Sir Nicholas Macpherson to an ESRC Seminar, All Souls College, Oxford, 2009

DBIS Better Regulation Delivery Office: Ethical Business Regulation

CIPFA: Manifesto 2015; Things can only get worse

Dan Corry: *Power At the Centre: is the National Economic Council a model for a new way of organising things?* The Political Quarterly 2011

Friends of the Earth: *Evidence to Environment Select Committee*

Written evidence

Association of Chartered Certified Accountants (ACCA)

Chartered Institute of Management Accountants

Sheffield Political Economy Research Institute

Green House Think Tank

Institute of Economic Affairs

LGA Labour Group

New Economics Foundation

Positive Money

Royal Society of Arts

Packaging Federation

Stephen Parsons

Alasdair Smith

Andrew Smith

Joel Benjamin

Vince Cable

Appendix C

Meetings, Discussions and Interviews held

Round table meetings

By invitation, hosted by Panel Members

- Alan Buckle: Reconfiguring the Treasury
- Stephen Hughes: Regional Economic Policy and Devolution
- Frances O'Grady: Avoiding group think; how the Treasury manages itself and faces out to other sectors
- Karel Williams: Sectoral and Industrial Policy
- Simon Wren-Lewis: Delivering Macroeconomic Outcomes

Discussions with/hosted by interested organisations

- Association of Certified Chartered Accountants
- Institute of Chartered Accountants for England and Wales
- Local Government Association
- Industry Forum
- Chartered Institute for Public Finance and Accountancy
- Better Government Initiative
- Future of London

Presentations to the Panel

- Stian Westlake, NESTA
- Dan Corry, former Treasury Special Adviser

Interviews

A number of other interviews were conducted with senior politicians, accountancy and public policy professionals, trade unions, the voluntary sector and interested individuals

The current Treasury Group

1. The Treasury's role, responsibilities, priorities and objectives¹⁵

What we do

HM Treasury is the government's economic and finance ministry, maintaining control over public spending, setting the direction of the UK's economic policy and working to achieve strong and sustainable economic growth.

Responsibilities

We are responsible for:

- public spending: including departmental spending, public sector pay and pension, annually managed expenditure (AME) and welfare policy, and capital investment
- financial services policy: including banking and financial services regulation, financial stability, and ensuring competitiveness in the City
- strategic oversight of the UK tax system: including direct, indirect, business, property, personal tax, and corporation tax
- the delivery of infrastructure projects across the public sector and facilitating private sector investment into UK infrastructure
- ensuring the economy is growing sustainably;

Priorities

Our priorities are:

- achieving strong and sustainable growth
- reducing the deficit and rebalancing the economy
- spending taxpayers' money responsibly
- creating a simpler, fairer tax system
- creating stronger and safer banks
- making corporate taxes more competitive
- making it easier for people to access and use financial services
- improving regulation of the financial sector to protect customers and the economy

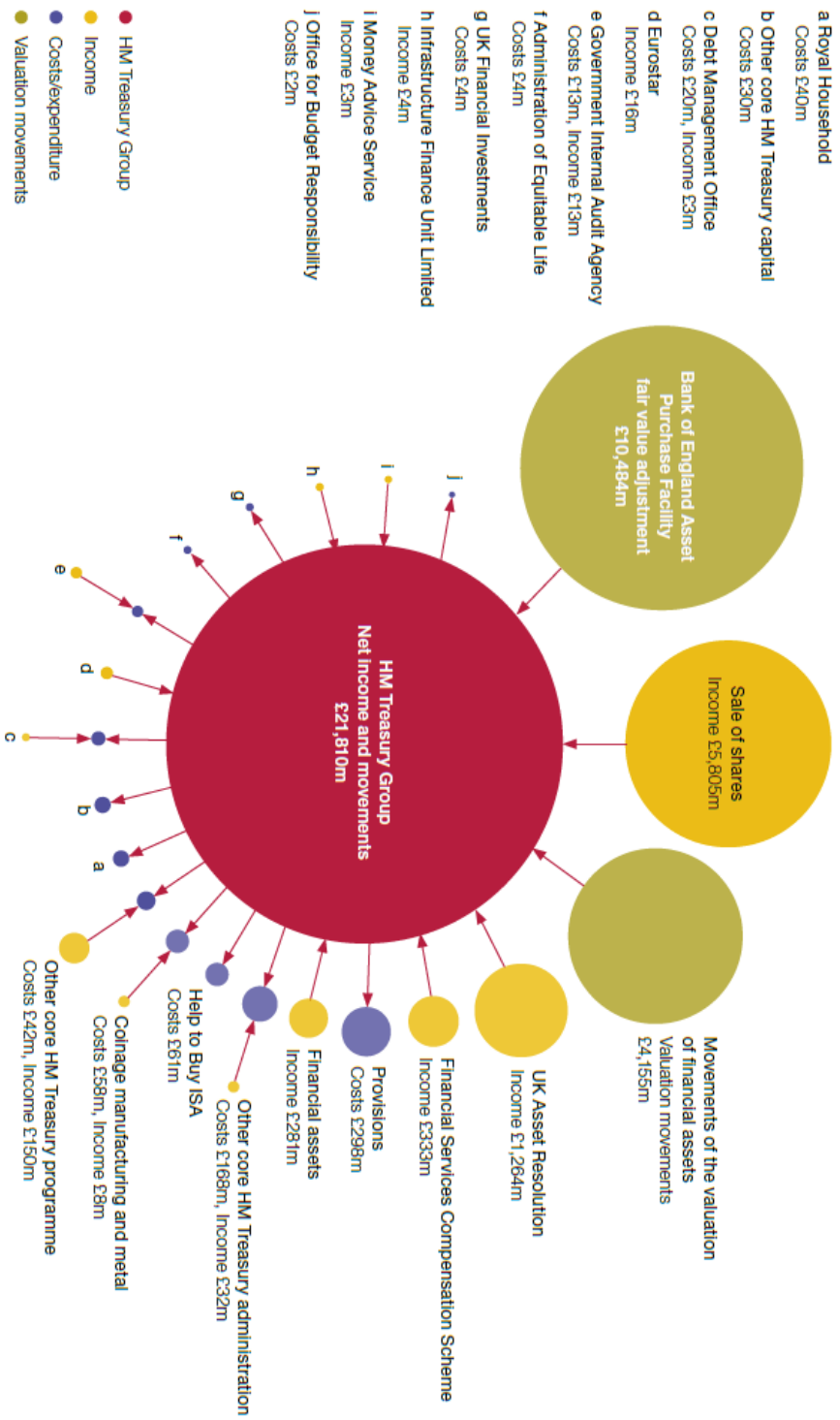
Objectives

Our objectives are:

1. Place the public finances on a sustainable footing.
2. Ensure the stability of the macro-economic environment and financial system, enabling strong, sustainable and balanced growth.
3. Increase employment and productivity, and ensure strong growth and competitiveness across all regions of the UK through a comprehensive package of structural reforms.

¹⁵ From GOV.UK

Departmental spending



Source: National Audit Office analysis of HM Treasury Annual Report and Accounts 2015-16

4 Departmental Overview: HM Treasury | © National Audit Office 2016 | DP Ref: 11244-001

2. The Treasury Group¹⁶

¹⁶ Extract from NAO, HM Treasury Departmental Overview 2015-2016

3. Treasury bodies

HM Treasury bodies

Core HM Treasury and agencies

- [HM Treasury](#)
- [UK Debt Management Office \(DMO\)](#)
- [Government Internal Audit Agency \(GIAA\)](#)
- [Office of Tax Simplification](#)
- [Office of Financial Sanctions Implementation](#)

HM Treasury Group

- [Office for Budget Responsibility \(OBR\)](#)
- [Financial Services Compensation Scheme \(FSCS\)](#)
- [The Money Advice Service \(MAS\)](#)
- [UK Financial Investments Ltd \(UKFI\)](#)
- [UK Government Investments Ltd \(& UKGI Financing plc\)](#)
- [UK Asset Resolution Ltd \(UKAR\)](#)
- [HM Treasury UK Sovereign Sukuk plc](#)
- [Help to Buy \(HMT\) Ltd](#)
- [Infrastructure Finance Unit Ltd](#)

- [IUK Investments Holdings Ltd](#)
- [Royal Household Sovereign Grant](#)
- [Royal Mint Advisory Committee](#)

Other accounts prepared by HM Treasury

- [Whole of Government Accounts \(WGA\)](#)
- [Central funds](#)
- [National Loans Fund \(NLF\)](#)
- [Consolidated Fund](#)
- [Contingencies Fund](#)
- [Exchange Equalisation Account](#)

Other HM Treasury-related bodies

- [Bank of England](#)
- [Bank of England Asset Purchase Facility Fund Ltd \(BEAPFF\)](#)
- [Prudential Regulation Authority \(PRA\)](#)
- [Financial Conduct Authority \(FCA\)](#)

- [Financial Ombudsman Service \(FOS\)](#)
- [Payment Systems Regulator \(PSR\)](#)
- [Royal Mint Ltd](#)
- [National Savings and Investments \(NS&I\)](#)
- [The Crown Estate](#)
- [Local Partnerships LLP](#)
- [Royal Bank of Scotland Group plc](#)
- [Lloyds Banking Group plc](#)


4. Staff in key Treasury bodies

Core staff breakdown









Staff breakdown (FTE) 2015-16

2,127 (47%) UKAR	153 (3%) MAS
1,300 (29%) Core HM Treasury	118 (3%) DMO
437 (10%) Royal Household	19 (0.5%) OBR
193 (4%) FSCS	15 (0.5%) UKFI
153 (3%) GIAA	



4,515 HM Treasury total average staff 

Core staff numbers (FTE) 2009-2016

1,243	2009	
1,350	2010	
1,249	2011	
1,178	2012	
1,133	2013	
1,091	2014	
1,140	2015	
1,297	2016	

Calculated on a year ending 31 March

