



The capabilities of finance ministries: United Kingdom

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1 Introduction

1.1 HM Treasury in the context of ministries of finance

In many developing countries, the ability of central finance agencies – and principally the ministry of finance – to develop and deliver effective economic and fiscal policy is weak. As a result, economic and financial decision-making is often uncertain, with negative impacts on development outcomes. However, certain ministries of finance have emerged that appear to demonstrate noticeably a stronger ability to develop and deliver public policy than the rest of the public sector. This better-than-average ministry of finance capability could be a positive driver of development outcomes. However, there is little literature reviewing what such capability would look like, and what would drive it, in developing country contexts.

This study takes the framework that conceptualises ‘capability’ for a ministry of finance and reviews the UK’s HM Treasury (HMT) against it. The details of the framework of capability for ministries of finance conceptualises four areas of ‘capability’:

- Analytical capability – the ability to understand and analyse key policy-relevant trends, which in the case of a ministry of finance will relate to the intellectual ability of its staff to be seen as experts in a wider policy field.
- Delivery capability – the ability to deliver policy and other services. In the context of a ministry of finance, ‘delivery’ is usually in the form of policy advice to ministers; however, some ministries of finance do have externally facing delivery responsibilities, such as oversight of the government mint.
- Coordinative capability – the ability to bring together different constituencies and be able to access knowledge in dispersed fields, of which the annual budgeting process is a key test for a ministry of finance.
- Regulatory capability – the ability to control the production of certain services delivered by others, such as the operation of the public spending system in general, or the regulation of financial services, where the ministry of finance might set the overall regulatory framework but expects actual services to be delivered by others.

There is a comparatively extensive literature on the role and operation of HMT as an economics and finance ministry (e.g. Hecló and Wildavsky, 1974; Jenkins, 1996; Allen, 2014). The institution has been subject to a number of informal reviews and studies – some academic, others journalistic – with both positive and negative conclusions regarding the institution’s abilities. Within the UK government, HMT has also been subject to a number of formal internal reviews over the recent past. Together, these will also provide material against which the capability framework can be used.

The study uses both a literature review and a case study approach. First, the study reviews the background macroeconomic and fiscal situation of the UK over the recent past. The study then reviews the formal powers and informal influence of HMT with reference to the extensive secondary literature on the institution. Third, the study uses a step-by-step tracking approach to two key processes run by all ministries of finance in order to review in detail how HMT demonstrates capability in delivering core outcomes. In this case, the study reviews step by step how HMT (i) creates the revenue and expenditure forecast and (ii) deals with unexpected spending requests.

2 The economic and fiscal context

2.1 The usefulness of external indicators

Ministries of finance do not simply manage expenditure within government – they have wider responsibilities and objectives in terms of overall economic and fiscal management (Dunleavy, 1992; Allen and Krause, 2013). The record of the UK in such overall macroeconomic management might therefore provide a tentative answer to the question of long-term HMT capability.

Using overall macroeconomic and fiscal outcomes is an imperfect method of judging capability, however. Separating ministry of finance capability from contingent ‘external’ events is a challenge. For example, revenue arising from the discovery of a significant and unexpected natural resource may improve a range of key macro-fiscal statistics without any real improvement in ministry of finance capability. Furthermore, a key ‘external’ factor that may impact on macro-fiscal outcomes would be poor political decision-making by the ministerial leadership. It is entirely possible for a ministry to be capably and consistently providing high-quality advice on key fiscal and economic issues, but for the political leadership to be unwilling to accept the consequences of it. This would be expressed as poor economic outcomes, despite a capable ministry. Equally, good ministerial decisions could have been made by chance, or in the face of resistance from officials. Examples of such problems are not difficult to find in the literature surrounding HMT, particularly in the area of spending control (Jenkins, 1996; Hecló and Wildavsky, 1974). In addition, institutional capability may gradually change – through improvement or decline – over time.

To reduce such impacts this study reviews macro-fiscal outcome data over the long term and reviews performance against comparable European countries. By reviewing key macro-fiscal data over decades, the external shocks from certain time periods, and from decisions of particular governments, can be expected to ‘even out’ and affect the underlying trend less. This underlying trend could, therefore, be more attributable to HMT’s long-term management of the economy. The discussion focuses on HMT’s macro-fiscal management and outcomes, rather than other areas of responsibility, such as tax policy or HMT’s role in international financial governance, given the centrality of these issues to the institution’s role.

2.1.1 Long-term economic performance

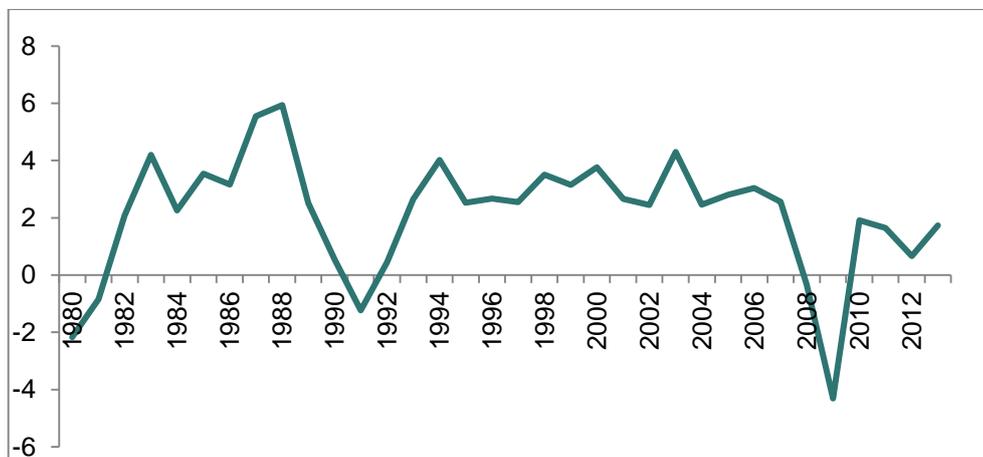
The background macro-fiscal data for the past 30 years or so suggest there have been notable improvements in key economic outcomes for the UK. The conclusions from a recent in-depth study comparing the economic performance of the UK with that of its main competitors (France, Germany and the US) over the past three decades suggest a clear improvement in key economic indicators (Aghion et al., 2013). Real UK GDP per capita was below that of the US, Germany and France in 1979. By 2007 – just before the impact of the global financial downturn – UK GDP per capita slightly exceeded that of Germany and France, and the gap with the US had narrowed

by around 25%. Other data on growth of GDP per working adult and productivity growth in the ‘market sector’ (excluding non-tradable, predominantly public service, sectors) align with this finding, showing higher annual growth in the UK than the other three countries up until the onset of the financial crisis. The authors also conclude that this was not simply a result of massive growth in the financial sector, but was due to sustained productivity improvements across the market sector in the UK. They note that this improvement in underlying economic performance should be sustainable through the recent downturn if accompanied with the right policies. Furthermore, the authors of the study attribute this improvement in large part to better policy-making across a number of policy areas related to productivity improvements. Given HMT’s role as a finance and economics ministry, with policy responsibility in all areas most related to productivity growth, it will have been a key contributor to this development.

2.1.2 UK economic performance over the past decade

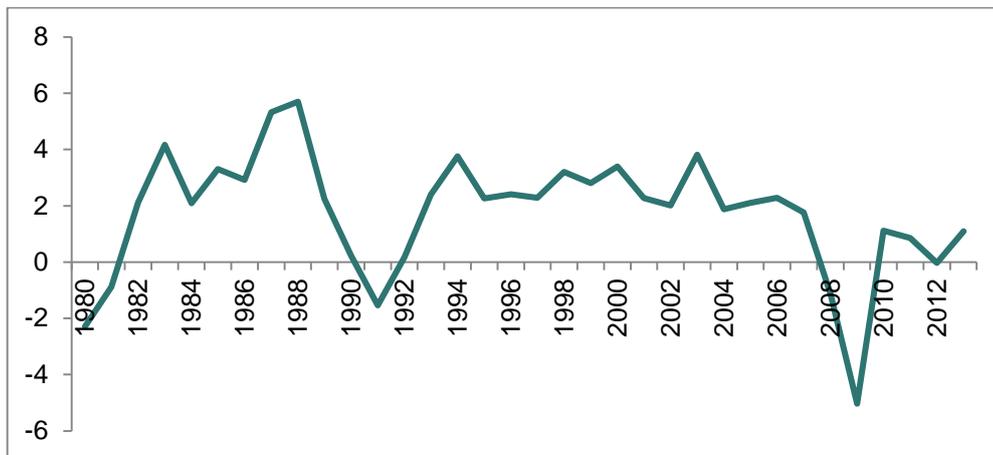
The headline economic data from the past decade clearly show a less positive picture; one made up of two halves – before and after the financial crisis. General background economic circumstances were relatively buoyant from the mid-1990s until around 2008/9, according to economic figures such as GDP growth, inflation and employment. However, the onset of the financial crisis from 2008 onwards dramatically changed the UK’s economic performance, with steep falls in GDP (Figure 1), a rise (though less strong) in unemployment and a surge in inflation. Notably, GDP per capita has risen at a slower rate than overall GDP growth in the post-crisis era (Figure 2).

Figure 1: Real UK GDP growth, percentage change on previous quarter 1980-2013



Source: World Development Indicators

Figure 2: GDP per capita growth (percentage change on previous year), 1980-2013

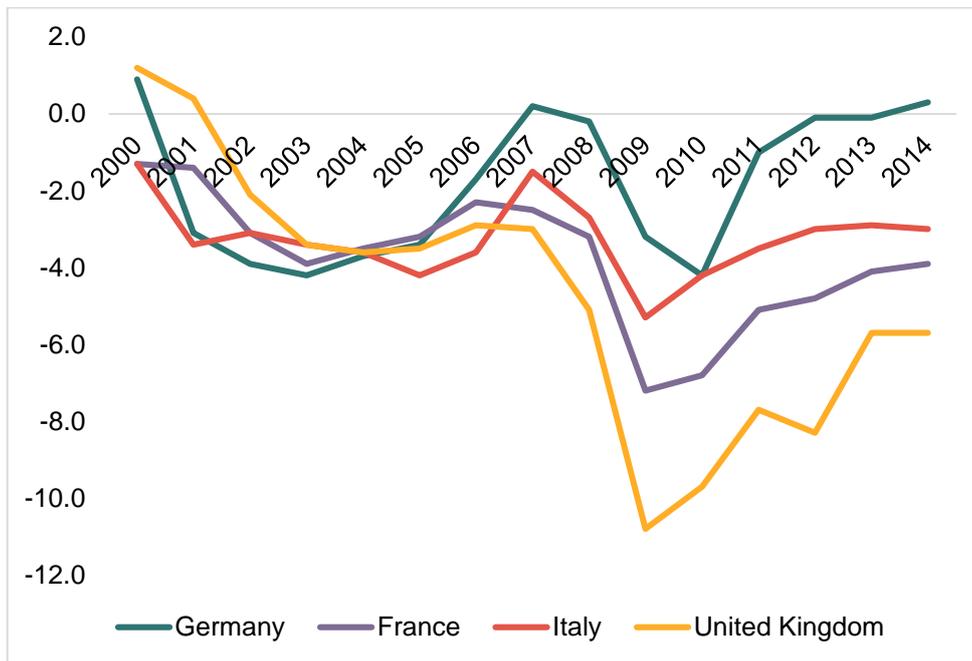


Source: World Development Indicators

Drawing clear conclusions from the deterioration of the UK's economic performance from 2008 is difficult. The worsening economic circumstances since 2008 have been shared among all developed countries, although to varying degrees. This suggests that HMT is – or was – not uniquely more or less capable than many other ministries of finance in anticipating and managing the more challenging economic circumstances of recent times.

Consistent fiscal deficits over the past decade suggest a more contestable picture of capability, however. HMT has more direct control over tax and spending policies – and therefore over the annual deficit and overall debt – in the short to medium term than it does over broader indicators, such as GDP growth, inflation or employment. As can be seen in Figure 3, the UK's deficit position has deteriorated in line with other economic indicators since the 2008 onset of the financial crisis. However, and notably, even at the height of the 'good times' of strong growth prior to the crisis (2000-2008) the UK did not generate a countercyclical surplus, as sound fiscal policy would suggest. When the crisis hit, the UK fiscal deficit was wider and more enduring than those of comparable countries, with the Organisation for Economic Co-operation and Development (OECD) noting that the UK entered the post-financial crisis period with one of the largest structural deficits among industrialised countries and was one of only five countries to have increased government net liabilities over the period of strong growth prior to the crisis (Riley and Chote, 2014). In addition, despite the significant consolidation over the past few years and faster output growth, UK public debt dynamics are yet to stabilise. According to the IMF, there remains a clear need to put debt on a downward path to ensure long-term fiscal sustainability (IMF, 2014).

Figure 3: General government net lending/borrowing as percentage of GDP, selected countries, 2000-2014

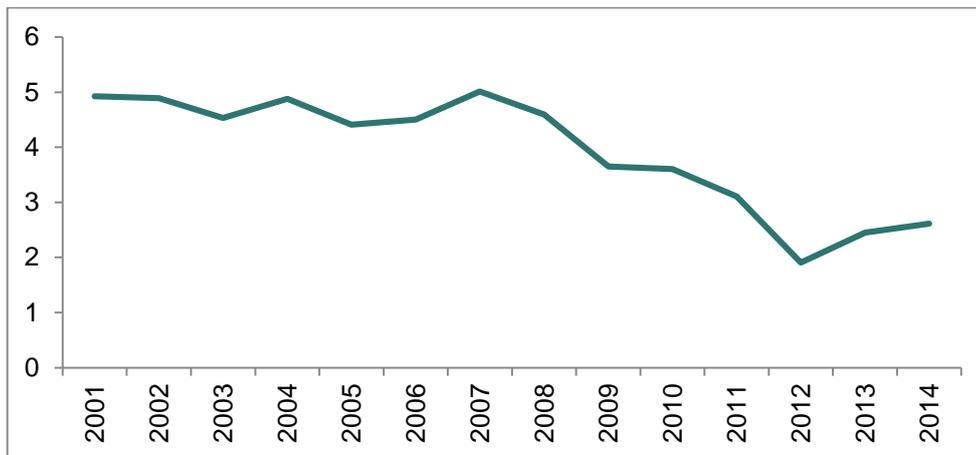


Source: Eurostat, 2014

Relating this relatively poor fiscal outcome to questions of ‘capability’ is not straightforward. The issue of ‘political capability’ – noted above – is particularly relevant here. If the decision to continue to follow this fiscal policy from the early 2000s came as a result of official-level advice and recommendations then HMT’s own technical capability could be called into question. If, however, the decision to spend at this level came from ministerial decisions regarding the best political strategy for the ruling government, and went against HMT’s advice, it would be more clearly an example of weak political capability, over which HMT has limited influence. Indeed, it could be argued that the creation of the Office for Budget Responsibility (OBR) is an implicit recognition that HMT’s technical fiscal policy advisory capability is not at fault, but rather it is the political decision-making process that is weak in this regard. This issue is discussed in more detail in Section 3.

Despite the challenging outcome regarding overall fiscal policy, on current market expectations HMT is receiving a ‘vote of confidence’ from the market regarding its ability to manage the medium-term fiscal position of the UK. Interest rates paid on government bonds – and other financial products – can be used as a proxy to predict future movement in the economy (Bernanke, 1990). On this basis, market actors appear content to continue committing their resources to UK government bonds on the expectation of a low risk of non-repayment. Relative borrowing costs (compared with those of other nations) will be affected by a number of other factors, not least the ability of the UK to borrow in its own currency and the current positive position of the UK *relative* to other countries. Nevertheless, the current status of the market for UK debt represents a significant piece of evidence that the medium-term policy response to the UK’s fiscal position – despite the immediate significant challenges – remains credible, and therefore demonstrates capability.

Figure 4: Annual average yield from UK government ten-year bond



Source: Bank of England

2.1.3 Wider measures of economic governance

A number of worldwide ‘governance indicators’ cover attributes that are indirectly affected by HMT’s capability, although the same caveats would apply to direct interpretation. Over the recent past the UK has improved its standing on a number of indicators that measure the degree to which the country offers a business-friendly environment (Table 1). Given that microeconomic reform to improve competition, productivity and the business environment has been a key part of the UK Government’s agenda in recent times (Balls et al., 2004), this suggests a good picture of capability.

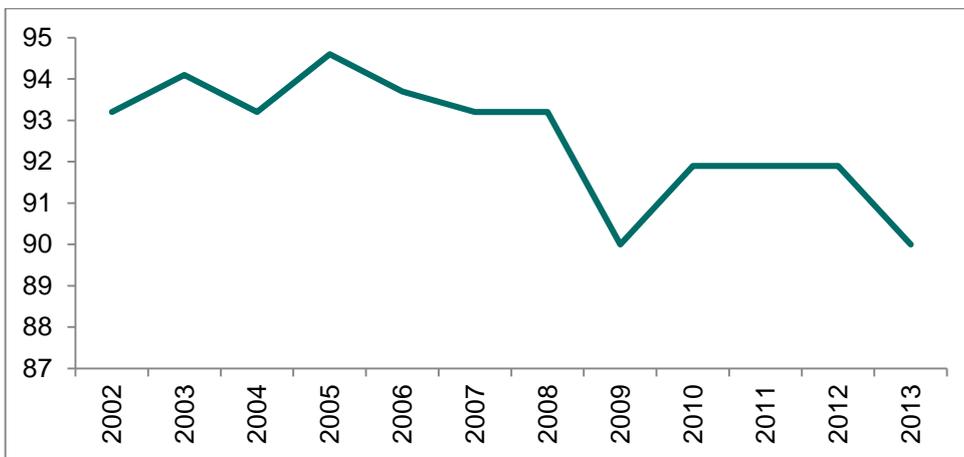
Table 1: UK ranking on economic governance measures

| Governance indicator | Institution | UK rank (year) |
|---------------------------------|----------------------|-------------------|
| Ease of Doing Business | World Bank | 7th of 185 (2013) |
| Global Competitiveness Rankings | World Economic Forum | 8th of 144 (2013) |

Source: Data sets referenced above

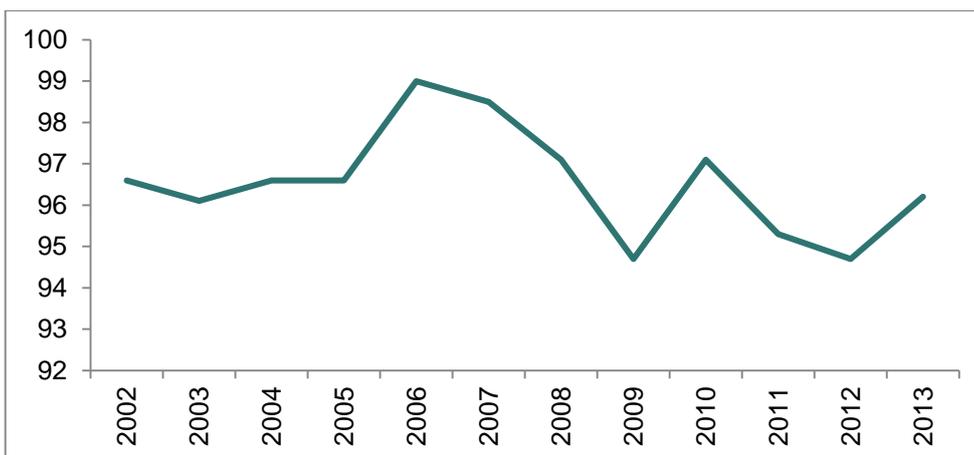
The UK also performs highly on the World Bank’s Worldwide Governance Indicators. It scores particularly well for government effectiveness (Figure 5) and regulatory quality (Figure 6), the two indicators that might be considered most relevant to the role and operation of HMT. Although there has been movement within the strong performance, and slight deterioration on both indicators since the onset of the financial crisis, both scores place the UK high in the top 10% of economies surveyed.

Figure 5: Worldwide Governance Indicators – government effectiveness, 2001-2011 (0-100 percentile, with 100 as highest performance)



Source: World Bank

Figure 6: Worldwide Governance Indicators – regulatory quality 2001-2011 (0-100 percentile, with 100 as highest performance)



Source: World Bank

One indicator that is more or less directly under the control of HMT relates to the availability of budget information. On the measures collected by the Open Budget Index, the UK scores very highly with regard to transparency, with an overall score of 88 out of a possible 100. The UK comes third out of the 100 countries surveyed for budget participation, transparency and oversight (International Budget Partnership, 2012).

The above discussion suggests a mixed picture with regard the UK’s key economic and fiscal outcomes. Broadly, they can be split into a relatively positive picture from the mid-1990s to 2008, with clear structural improvements in many aspects of the economy, and a significantly worse position following the financial crisis. The lack of anticipation of the crisis might itself be a comment on HMT’s analytical capability, although this lack of anticipation was shared among other Western ministries of finance. However, the UK’s fiscal situation is particularly poor when compared with other comparator countries, and is something more directly in HMT’s control.

Nevertheless, while economic and fiscal performance has deteriorated substantially post-2008, HMT still retains the confidence of the market with regard to forward expectations of fiscal credibility; and the UK remains near the top of a set of broader indicators of business environment and economic governance that relate most directly to HMT's work.

2.2 Institutional context of HMT

This section considers the formal and informal powers of HMT. It discusses the origins of HMT as an institution and outlines its formal powers with regard to budget management, alongside those of Parliament. It also discusses the changes HMT has made to the way it manages spending frameworks as well as to its own formal staffing complement. The section then turns to discussion of HMT's informal and unofficial powers to review how these might contribute to its capability as an institution, bearing in mind that formal and informal powers are often mutually reinforcing and that, in the context of such a long-standing institution as HMT, it may not always be possible to fully separate the two.

2.2.1 Origins of the institution and key trends in HMT's evolution

The institution of an English 'Treasury' has existed for nearly 1,000 years. Some of the academic research on the beginnings of the institution reaches far back into history (Hollister, 1978; Roseveare, 1969) and posits the origins of HMT as an extension of the royal household that paid for the costs of the king. Over time, the institution has been removed from the personal control of the monarch and institutionalised as a branch of the state. In 1667, the principle of all expenditure being approved by the Treasury, even if voted by Parliament, was instituted. Around this time saw the emergence of 'modern' forms of financial governance, including national bonds, nationalisation of tax raising authority and establishment of the Bank of England (Hollister, 1978).

HMT's emergence therefore follows the more general pattern of shifts in power in English and British history with authority – and also fiscal powers – moving from the king's person to Parliament and ultimately towards democratic control. This is in keeping with the 'long view' of the political history of Western states that sees a gradual and centuries long shift in state authority from the person of the king towards the executive ruling under the ultimate supremacy of Parliament (Krause, 2013).

HMT's development can also be seen as part of the long-term increase in capability of public administration in many Western European states. Typically this is attributed to the need of governments to finance increasingly large and complex military actions (Tilly, 1992). The growing sophistication of the UK's financial and fiscal sector in the 19th century increased the role of HMT in managing large deficits and public debt as a result of such warfare. In 1730, the principle of annual budgets was established, and during the 1800s the elements of a modern civil service were progressively established as part of the growing professionalism of general public administration (HM Treasury, 2013).

In the more recent past, and in common with the experience of many OECD countries, the UK's post-war fiscal history, and HMT's role in it, can be seen as falling into three broad periods (Krause, 2013). The first period includes the relatively stable expansion of public expenditure and avoidance of serious fiscal crises in the 30 years after the Second World War. The second, from the mid-1970s to 2008, sees a permanent worsening of economic circumstances compared with the previous 30 years, including repeated challenges in ensuring spending control (which, in the UK's case, culminated in the receipt of an IMF loan) and the search for credible fiscal policy frameworks that could manage spending in the medium

term. In the third period, from 2008 onwards, following on from the onset of the global financial crisis, the UK (along with other countries) finds itself with dramatic and long-term imbalances in public revenues and receipts and needing to undertake a significant and prolonged fiscal consolidation.

2.2.2 Formal powers of expenditure management

Although HMT's fiscal and economic policy levers are well established, they do not have a commensurately clear formal underpinning. HMT's own official guidance on public spending notes that 'In the absence of a written constitution, the powers used to deploy public resources are a blend of common law, primary and secondary legislation, Parliamentary procedure, the duties of ministers, and other long-standing practice' (HM Treasury, 2007). Ministers have the broad power to do anything that legislation does not specifically prohibit, including the use of common law powers to deliver their objectives through public expenditure. In contrast to many other countries' public expenditure manuals and documents, HMT's own expenditure guidance makes limited references to actual laws, Acts or statutes.

In theory – and from precedents dating back to the 1600s – no expenditure may be undertaken by government without authorisation by HMT. In practice, delegated authority – which has increased substantially in recent decades – means that HMT does not have to approve the many thousands of public sector transactions taking place each day. All legislation with an expenditure implication must be approved by HMT before being submitted to Parliament, and since very little legislation of importance is passed that has absolutely no financial implication, HMT retains a key ability to be involved in policy development across government. Given the volume of legislation passing through Parliament, it is impossible for the institution to actively monitor every last clause reaching the legislature, but it provides at least the right to engage in policy debates across all of government. While most financial legislation does not attract particular Parliamentary interest, some specific points, for example controversial reforms being enacted through Budget Bills, can result in more substantive Parliamentary debates. Spending ministries, by convention, do not approach Parliament directly to request appropriations and all appropriations legislation is channelled through – and approved by – HMT. This convention allows HMT the final say in the control and coordination of departmental budgets that are ultimately sent to Parliament for approval.

As well as approval over spending, HMT controls the accounting and control frameworks by which expenditure must take place. These include technical issues such as financial reporting standards, internal audit guidelines, accounting practices and relations with the National Audit Office (NAO). HMT has introduced a number of financial reforms over the past two decades that have put the UK in the forefront of certain public expenditure practices. For example, Whole of Government Accounts have been published for the first time, the OSCAR (Online System for Central Accounting and Reporting) database provides information on a great deal of public spending, and a move has been made towards resource-based budgeting. In some cases these reform programmes have taken over a decade to complete.

HMT also remains a unified economics and finance ministry. In some countries, for example Germany, the finance and economics functions of government are taken forward separately by different government departments. Certain functions of an economics ministry are also located in the Department for Business, Innovation and Skills (BIS), and since 2010 HMT has delegated some spending control powers on specific issues, such as marketing and recruitment, to a unit within the Cabinet Office; however, none of the literature reviewed suggests that the Cabinet Office or BIS (or its predecessor department) operated with the same level of influence as HMT. While difficult to prove in the absence of a clear counterfactual, the combining

of both functions in a central ministry arguably increases the influence of the institution by providing licence to engage with departments beyond simply ‘making the numbers add up’. HMT is also responsible for a number of smaller and somewhat self-contained agencies, such as the Debt Management Office (DMO), the Royal Mint, and National Savings and Investments. None of these agencies features prominently in the literature surrounding discussion of the capabilities of HMT as an institution and so can be considered of limited relevance to the wider discussion of HMT’s role in managing and coordinating public financial management.

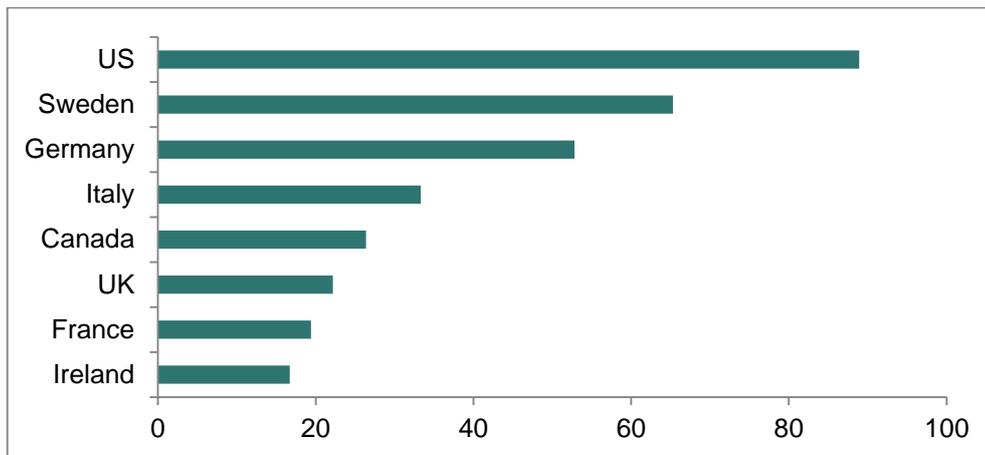
2.2.3 Formal Parliamentary control over the budgeting process

HMT’s formal role in public expenditure management is also shared with Parliament (HM Treasury, 2007). HMT proposes spending estimates to Parliament, but (following a precedent set in 1862) no spending at all should take place until Parliamentary approval of the expenditure in annual estimates. All ongoing expenditures must be approved on an annual basis through an Appropriation and Supply Act, or supplementary act where necessary. In addition, Parliament must ultimately approve all new services requiring expenditure through specific legislation.

While in theory this gives Parliament a great deal of power to control spending, the majoritarian approach of the UK’s Parliamentary system means that government appropriations requests are rarely refused or amended. Indeed, while national *budget* speeches setting out overall tax and spending plans attract substantial public interest, the annual *estimates and appropriations* procedures pass almost entirely without public coverage or comment. In practice, the details on expenditure estimates provided by government to Parliament for approval are at a very high level, meaning that substantive ex ante investigation of specific expenditure proposals through the estimates procedures is not possible. The emphasis on Parliamentary oversight of public spending, and by extension HMT’s role in the process, comes in ex post scrutiny. The NAO, and subsequent follow-up by the Public Accounts Committee (PAC), provides regular audit and scrutiny of government spending. In certain circumstances this can be of high-profile expenditure areas and can lead to significant public interest. HMT is sometimes the directly accountable institution for NAO and PAC reports, but in other cases HMT may have a supporting role in defending the retrospective review of certain high-profile expenditure decisions.

Overall, the UK Parliament has comparatively restricted powers over government fiscal policy. This limited control is widely recognised in the literature. Commentators have characterised the UK model of spending authority as a ‘delegated’ model, in which significant powers over spending are invested in the Chancellor, rather than there being real sharing of authority with the legislature (Hallerberg, 2004; Hallerberg et al., 2004). Comparative studies confirm that, in common with other Westminster-style governments, the UK Parliament has only weak powers to control spending (Figure 7) (Wehner, 2006); so much so that some claim that the UK Parliament has essentially lost its influence over taxation and expenditure (Schick, 2002).

Figure 7: Index of legislative budget institutions (selected countries)



Note: A higher score indicates greater Parliamentary capacity for financial scrutiny.
Source: Wehner, 2006.

2.2.4 Evolution in HMT's formal approach to delivering its economic management mandate in the post-war era

While HMT's formal powers have stayed relatively constant over many decades, its policy objectives, and the policy frameworks through which these objectives are achieved, have changed considerably. These changes have often been motivated by economic and political challenges and, in some cases, policy failures.

In common with trends throughout the Western world, over the past 40 years HMT has participated in an *ideologically motivated* shift from managing demand in the economy in order to secure full employment and growth to instead delivering a general background context of low inflation and macroeconomic stability in which private actors in the market may operate. This is widely referred to in the literature on HMT, and also in the wider discussion of changes in Western economic policy-making (e.g. Krause, 2013). For example, Hecló and Wildavsky's 1970s study described an institution that attempts to manage public expenditure, prices and wages through a never-ending bargaining game so as to balance growth and employment. The failure of this approach resulted in the loss of spending control and the embarrassment of having to turn to the IMF for a loan. Following this experience, by the end of the 1980s HMT is described as operating a 'top down' approach to allocating budgets that was more in keeping with an ideology of using policy levers to restrict public spending rather than using them to manage aggregate demand (Thain in Jenkins, 1996: 227). Indeed, later coverage of the institution takes great pride in outlining HMT's leadership role in establishing rules that enshrine fiscal stability (e.g. Brown's fiscal rules; Osborne's fiscal framework), remove political interference (e.g. Bank of England independence and creation of the OBR) and deliver a greater focus on business-friendly supply-side microeconomic reforms, rather than income and price management (e.g. Brown's focus on a plethora of policy reforms to promote long-term productivity growth and improve incentives to work) (Balls et al., 2004).

In public spending, there has been a conscious and voluntary *relinquishing of intrusive 'command and control' powers* in favour of greater departmental autonomy, subject to HMT-determined higher level rules and frameworks. This shift from 'microbudgetary' to 'macrobudgetary' control is mirrored in many other ministries of finance (Krause, 2009; Wanna et al., 2003), and in HMT's context it

can be seen as an example of the ‘New Public Management’ concepts that influenced reform across large parts of UK public administration. From a system in which all large expenditures had to be continually approved by HMT (e.g. Hecló and Wildavsky, 1974), HMT has moved to set a simpler framework, with departments now operating with substantially devolved authority, (in theory) over a multi-year period and with explicit HMT approval required only for a small number of high-value, highly consequential or ‘novel and contentious’ issues. HMT has given up direct management of the civil service and several other government management functions that were previously considered core spending control issues.

This trend is mirrored in the detail of HMT’s macroeconomic management. In decisions that may seem surprising to staff from earlier decades, HMT has ‘contracted out’ key aspects of monetary policy to the Bank of England, and of macroeconomic and fiscal forecasting responsibility to the independent OBR. These decisions are not unique. The global move to independent central banks substantially precedes the 1997 Labour government’s decision to hand interest rate setting to the Bank of England; and the creation of the OBR put the UK among a rapidly growing number of countries using ‘independent fiscal councils’ as a tool to improve long-term policy-making (IMF, 2013). This can be seen as another example of how central finance agencies have interpreted and implemented the New Public Management paradigm of creating autonomous executive agencies to carry out public functions (Krause, 2009). The result is a system in which HMT is the overseer of the ruling frameworks that manage the UK’s economic and financial levers, rather than the manager of these levers directly. This is reflected in Table 2, which borrows a framework from Allen and Krause (2013) regarding the centralisation of functions of central finance agencies. It shows that HMT operates relatively few core functions entirely alone, and manages most of its key work in cooperation with other institutions – several of which it has specifically created in order to undertake this role.

Table 2: Central finance agency functions and HMT’s role

| Function | Responsibility |
|--|--|
| Macro-fiscal forecasting and analysis | HMT and OBR |
| Fiscal policy formulation | HMT and OBR |
| Fiscal risk analysis | HMT and OBR |
| Interface between monetary and fiscal policy | HMT |
| International economic and financial relations | HMT |
| Tax policy | HMT |
| Budget preparation | HMT |
| Treasury and cash management | HMT, Bank of England, Government Banking Service and line ministries |
| Internal control | Line ministries |
| Internal audit | HMT and line ministries |
| Accounting policy | HMT |

| | |
|---|---|
| Debt management | DMO |
| Tax administration | HM Revenue and Customs (HMRC) |
| Customs administration | HMRC |
| Intergovernmental financial relations | HMT |
| Regulation of banks and other financial institutions | HMT, Bank of England (Prudential Regulation Authority) and Financial Conduct Authority |
| Management of public assets, including public enterprises | HMT, UK Financial Investments (for financial institutions); line ministries (for other state-owned companies and enterprises) |
| Public procurement | HMT, Efficiency and Reform Group (Cabinet Office)/Crown Commercial Services, line ministries |

Source: Author's application of the Allen and Krause (2013) framework

These trends have not been entirely one way, however. HMT returned to being a more active manager of the economy following the 2008 financial crisis. It remains the direct owner of large parts of the UK banking industry, and is in effect the ultimate guarantor of an even larger amount of bank deposits. HMT is mid-way through introducing a whole new system of financial regulation as well as actively intervening in bank markets (e.g. the Funding for Lending scheme). HMT has recently introduced a formal arm's-length system of management and performance oversight over the finance directors of all spending departments and, as noted above, additional spending controls have been enacted through the Cabinet Office in certain areas of spend (e.g. marketing and consultancy). On the fiscal side overall, HMT has moved from determining how best to allocate marginal increases in expenditure for departments to spend on new or improved programmes, into more actively managing the finances of government to ensure an unprecedented reduction of public expenditure in real terms (HM Treasury, 2010).

Yet, even in the relative confusion of the recent financial crisis, there are continued elements of the new preferred stance of HMT – managing at a distance rather than holding executive authority itself. On the banking side, UK Financial Investments – an arm's-length body set up by HMT – manages the taxpayer's interest in various banks in which government is a shareholder, rather than HMT managing this directly. The Prudential Regulation Authority and the Bank of England will continue to lead on financial system regulation, rather than HMT taking this back in-house. Public spending frameworks still operate on a 'rules based' system, offering a substantial degree of devolution and autonomy for departments, rather than moving back towards individual 'line item' control authorisation, even if their overall orientation is now to reduce expenditure rather than increase it. This suggests that even during an unprecedented economic crisis there is a continued emphasis on HMT demonstrating capability by creating and managing higher level frameworks rather than on actively delivering outcomes itself.

2.3 Bureaumerics and staff complement

An assessment of HMT's changing staffing levels and reviews of its workforce provide additional information on formal capability. Overall, HMT's staffing and budget figures show a shrinking institution (Table 3) (HM Treasury, 2012a, 2014a). Treasury Group – including HMT and the smaller agencies for which it is responsible

– reduced in size between 2010 and 2014, and this trend is expected to continue. HMT’s administration budget – broadly the amount of money to be spent on running HMT as an institution rather than undertaking programme expenditure – is also projected to have declined steeply in nominal terms over the period 2007/8 to 2014/15. A rise in administration costs (Table 4) coincided with the onset of the worst of the financial crisis in financial year 2009/10 and represents a one-off additional expenditure on accessing external technical advice.

Table 3: HMT staffing, 2010-2014

| Core HMT full-time equivalents | 2010 | 2011 | 2012 | 2013 | 2014 |
|--------------------------------|-------|-------|-------|-------|-------|
| Permanent | 1,278 | 1,204 | 1,048 | 1,084 | 1153 |
| Casual | 72 | 45 | 30 | 49 | 38 |
| Total | 1,350 | 1,249 | 1,078 | 1,133 | 1,091 |

Note: The figures for 2014 do not sum but are as originally presented in the documents listed. The documents note that final figures exclude some temporary and contract workers.

Source: Compiled from HM Treasury, 2012b, 2014a

Table 4: HMT administration costs 2007/8-2014/15

| £ million | 2007/8 | 2008/9 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 |
|---------------------------|--------|--------|---------|---------|---------|---------|---------|---------|---------|
| HMT Administration budget | 130 | 116 | 133 | 127 | 117 | 118 | 109 | 109 | 93 |

Note: Values for 2014/15 and 2015/16 are budgeted figures.

Source: HM Treasury 2012b, 2014a

HMT’s internal organisational structure has also changed significant in the post-crisis era, towards an overtly more flexible model. The institution has moved away from a strictly hierarchical approach of senior officials leading departments, directorates and teams, and towards a more flexible structure of ‘groups’, operating with a less rigidly defined integrated vertical structure (Figure 8). The conclusion from HMT’s own reviews of its workforce management in the financial crisis is that staff resources must be able to move much more flexibly between different groups in order to meet emerging priorities (HM Treasury, 2012a).

Figure 8: HMT organisational structure, 2012/13

| Executive Management Board | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|--|---------|---------|---------|-----|----|----|---|--|---------|---------|-----|-----|-----|---|--|---------|---------|-----|-----|-----|---|--|---------|---------|-----|----|----|
| <p>Ministerial and Communications Responsible for decision-making and communications with media and the public</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>88</td> <td>87</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 88 | 87 | <p>Corporate Centre Management and development of corporate politics; processes and change programmes</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>202</td> <td>175</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 202 | 175 | <p>Strategy, Planning and Budget Responsible for forward strategy, work programme, budget & short-term projects</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>47</td> <td>44</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 47 | 44 | <p>Treasury Legal Advisers Responsible for provision of advisory and other legal services across Treasury</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>3</td> <td>3</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 3 | 3 |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 88 | 87 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 202 | 175 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 47 | 44 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 3 | 3 | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>Fiscal Responsible for fiscal strategy, funding and debt management, and monitoring the fiscal position</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>53</td> <td>52</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 53 | 52 | <p>International & EU Responsible for advancing the United Kingdom's economic and financial interests</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>129</td> <td>110</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 129 | 110 | <p>Business and International Tax Responsible for business tax, indirect taxes and international tax</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>99</td> <td>90</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 99 | 90 | <p>Public Spending Responsible for public spending control</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>58</td> <td>57</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 58 | 57 |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 53 | 52 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 129 | 110 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 99 | 90 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 58 | 57 | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>Economics Responsible for United Kingdom economic analysis, surveillance and professionalism</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>46</td> <td>46</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 46 | 46 | <p>Financial Regulation Responsible for financial services regulatory framework and market issues</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>49</td> <td>41</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 49 | 41 | <p>Personal tax, Welfare, Pensions Responsible for personal tax, welfare, HMRC/DWP expenditure & pensions</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>77</td> <td>80</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 77 | 80 | <p>Public Services Responsible for oversight of major public service expenditure</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>72</td> <td>66</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 72 | 66 |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 46 | 46 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 49 | 41 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 77 | 80 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 72 | 66 | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>Financial Stability Responsible for ongoing stability issues and resolution of financial interventions</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>51</td> <td>49</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 51 | 49 | <p>Financial Services Responsible for policy with respect to financial services</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>49</td> <td>43</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 49 | 43 | <p>Enterprise and Growth Responsible for growth-related policy and expenditure</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>124</td> <td>114</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 124 | 114 | <p>Financial Management and Reporting Embedding good FM practice</p> <table border="1"> <thead> <tr> <th></th> <th>Mar. 12</th> <th>Mar. 13</th> </tr> </thead> <tbody> <tr> <td>FTE</td> <td>83</td> <td>70</td> </tr> </tbody> </table> | | Mar. 12 | Mar. 13 | FTE | 83 | 70 |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 51 | 49 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 49 | 43 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 124 | 114 | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Mar. 12 | Mar. 13 | | | | | | | | | | | | | | | | | | | | | | | | | |
| FTE | 83 | 70 | | | | | | | | | | | | | | | | | | | | | | | | | |

Source: Allen (2014), based on internal documents provided by HMT

HMT's staffing, reward and human resources management policies reveal some particularly interesting insights relevant to capability (Tables 5 and 6). As of 2012, HMT policy officials were the lowest paid in UK central government, with limited use of allowances and bonuses for specialist staff and no specific career recognition for professions such as economists or tax specialists (HM Treasury, 2012a). Median pay was roughly 10% lower than in other departments, rising to 14% in the Senior Civil Service grades. Leading by example on pay restraint has been noted by older accounts of HMT as being necessary if other departments are to accept the same medicine (Heclo and Wildavsky, 1974). While there exist cross-government schemes for certain professionals working in HMT, such as the Government Economic Service, with regard to career progression and job opportunities, there has not historically been a separate salary scale or progression structure for such staff within the institution itself. The recent introduction of the new 'E2' grade (equivalent to Grade 6 in other departments) can be seen as an effort to retain experienced staff at this important middle level of expertise.

Table 5: Senior pay ranges within HMT (£ per annum)

| Grade within HMT | Pay range (average of starting and end pay ranges for listed individuals) | Mid-point average of pay range |
|--|--|--------------------------------|
| Permanent Secretary (SCS4/Grade1: 1 post) | 180,000-184,999 | 183,000 |
| Second Permanent Secretary (SCS4: 2 posts) | 152,500-157,499 | 155,000 |
| Director General (SCS3/Grade 2: 4 posts) | 125,000-129,999 | 127,500 |
| Director (SCS2/Grade 3: 14 posts) | 90,000-94,999 | 92,500 |
| Deputy Director (SCS1/Grade 5: 65 posts) | Not clear from public data. SCS1 pay band average across the civil service (2013 figures) is £60,000-£117,000, with a median pay of £73,049. HMT tends to pay less than other departments, so this may be an overestimate of HMT SCS1 pay. | |

Note: There is considerably more variation in the Director (SCS2) pay ranges than in the other grades listed above. SCS = Senior Civil Service.

Source: HM Treasury, 2014b; HM Government, 2014

Table 6: Middle and junior pay ranges within HMT (£ per annum)

| Grade within HMT | Pay range |
|--------------------------------------|---------------|
| E2 – Senior Policy Analyst (Grade 6) | 49,000-60,000 |
| E – Senior Policy Analyst (Grade 7) | 42,000-58,000 |
| D – Policy Analyst (SEO/HEO) | 25,000-38,000 |
| C – Policy Support Officer | 19,000-27,000 |
| B – Policy Support Officer | 16,000-22,000 |

Source: HM Treasury, 2014b

HMT's staff are relatively diverse by the standards of some departments (Table 7). Just under half of staff are female, around 17% from ethnic minorities and just under 6% with disabilities. Staff with these characteristics are concentrated in the lower grades.

Table 7: HMT workforce diversity, March 2014 (percentages)

| HMT range | Broad function | Female | Ethnic minority background | People with disabilities |
|-----------|-----------------------------------|--------|----------------------------|--------------------------|
| B | Administrative support | 61.6 | 30.0 | 6.7 |
| C | Administrative and policy support | 66.7 | 34.1 | 8.3 |
| D | Policy advice | 44.4 | 20.8 | 6.6 |
| E | Policy advice | 41.4 | 5.5 | 4.7 |
| E2 | Policy advice | 41.3 | 3.2 | 6.3 |
| F, G, H | Senior management | 42.7 | 4.5 | 4.5 |
| Total | | 46.9 | 16.8 | 5.9 |

Source: HM Treasury, 2014a

Regarding staffing patterns, HMT's own review of its response to the financial crisis reveals facts relevant to a discussion of capability (HM Treasury, 2012a). HMT's turnover is the highest of any department in central government, and three times higher than the UK civil service average (HM Treasury, 2012a). Since 2005/6 turnover has stayed stable at around 23%, although it peaked in 2008 at 38%¹ before returning to 23% in March 2014 (HM Treasury, 2014a). As some external commentators have noted, this rate of turnover is more usually associated with McDonald's than an economics and finance ministry (Giles and O'Connor, 2012). As a result, as of 2012 half the workforce had joined after the onset of the financial crisis in 2008, and in the policy and senior policy adviser grades (Range D and Range E) more than half had served less than three years at HMT, although many of these staff will have come from other government departments and therefore have experience of the civil service from other quarters. In a recent staff survey, only a quarter of staff wanted work for HMT for at least the next three years, and a quarter wanted to leave within a year or sooner (HM Treasury, 2014c). However, and perhaps in some tension with this assessment, in the same survey a high percentage of staff (62%) agreed or strongly agreed that they felt a strong identification with the institution, which was notably higher than the scores reported for other high-performing civil service departments.

HMT's own previous reviews attribute this to the two related issues of uncompetitive salaries and limited prospects for promotion and career progression to higher grades, partly as a result of HMT's relatively flat hierarchy. This can be seen more clearly in the grading structure (Table 8), which has a noticeable reduction in the numbers of staff between Grade 7/6 and the Senior Civil Service grades.

¹ Some consultees have suggested that the particularly high figure for 2008 may be an outlier in this series, as during this year many fixed-term contractors who had been hired to provide specific short-term advice on financial system and financial services reform in the immediate wake of the financial crisis left the institution.

Table 8: HMT staffing at different grades (estimate), 2013

| Grade of staff | % of Treasury Group workforce | Number of core HMT staff (applying Treasury Group percentage to HMT core staff figures) |
|---|-------------------------------|---|
| Senior Civil Servants | 7.3 | 80 |
| Grade 7/6 | 27.6 | 301 |
| Higher and Senior Executive Officers | 35.5 | 387 |
| Executive Officers | 10.5 | 115 |
| Administrative Assistants and Officers (excluding students) | 7.2 | 79 |
| Other grades | 11.9 | 130 |

Source: HM Treasury, 2014a

Frequent changes in personnel and the resulting relative inexperience of HMT staff have been noted in several previous reviews of the institution. HMT's own 2012 internal review notes the long-standing nature of these issues, reporting that back in 1994 the Fundamental Expenditure Review mentioned challenges to the model of a single civil service grading structure focused on a generalist career path (HM Treasury, 1994). Similar observations were made in 2002 by the then Permanent Secretary, followed by a Workforce and Skills Strategy in 2006 (HM Treasury, 2012a). In contrast to high turnover at middle and junior levels, the tenures of Permanent Secretaries in the institution show, in contrast, very long-standing experience within the institution at senior level, as demonstrated in Table 9. It is also worth noting, in terms of the wider influence of HMT (and therefore the reach of its capability), that both Andrew Turnbull and Gus O'Donnell went on to be Cabinet Secretaries – the head of the domestic UK civil service. This pattern may well have served to bring an informal yet powerful 'Treasury view' to the most senior decision-making body in government.

Table 9: Tenures of Permanent Secretaries

| Permanent Secretary | Dates in post of Permanent Secretary | Date of first joining HMT | Total length of association with HMT (see note) |
|---------------------|--------------------------------------|---------------------------|---|
| Andrew Turnbull | 1998-2002 | 1970 | 32 years |
| Gus O'Donnell | 2002-2005 | 1979 | 26 years |
| Nicholas Macpherson | 2005-present | 1985 | 30 years + |

Note: 'Total length of association with HMT' represents the time period between first joining HMT and leaving the position of Permanent Secretary. Within that time the relevant individuals spent periods on various secondments or on loan to other institutions, but since they ultimately returned to lead the institution they are assumed to have retained their 'association' with HMT during this period.

Source: HM Treasury website; newspaper reports

The long-standing situation of HMT having high turnover at junior and middle levels combined with much longer-serving senior leadership at the top raises some interesting issues. On the one hand, a recurrent lack of action to reduce turnover at middle and junior levels might be interpreted as HMT lacking serious will – and perhaps capability – to tackle the problem. In this view, HMT has not demonstrated capability with regard to retaining staff in its lower levels, and the resulting high turnover unnecessarily reduces the institution’s capability. On the other hand, this enduring state of affairs can be seen as a rational response to the labour market pressures affecting HMT. In this view, HMT staff at junior and middle grades informally benchmark themselves against much better remunerated industries such as finance, banking and professional business services. Given that HMT is constrained by cross-government civil service pay and grading rules, and will therefore never be able to offer salaries that match those available in these industries, adopting an approach of keeping a steady stream of talented staff engaged in the institution for a relatively short period at the start of their careers, and accepting they will probably leave quickly, is the most rational course of action. Interviews with current and former staff do suggest that, in practice, HMT long ago implicitly accepted a binary workforce model, whereby a long-serving cadre of senior officials with significant institutional memory operates at the top, supported by a fast-changing group of talented mid-level and junior officials who are not all expected to make long-term careers in the institution.

In terms of relating this discussion to capability, on the one hand a gradually reducing amount of staffing and budget will reduce the amount of ‘economic and fiscal management’ output that HMT can produce. However, more efficient working would potentially outweigh the reduction in staffing and budget. HMT also has the option to make explicit trade-offs in its activity – it can choose to be involved with the ‘basics’ of its finance ministry role and ensure that spending and taxation are controlled and macroeconomic frameworks managed; or it can choose to engage in a wide range of government policy through its economics ministry role at the heart of government. Under Gordon Brown, HMT was heavily involved in a wide range of detailed policy debates (Lipsey, 2000); whereas the scale and urgency of the fiscal consolidation required by the Coalition government’s plans might suggest a more tightly focused role – centred more on spending control and less on the details of policy – which could conceivably be undertaken with fewer staff.

The facts on staff pay, retention and attachment to the institution do raise questions about HMT’s capability. Rapid turnover of mid-level staff will reduce institutional memory, and therefore coordinative capability, as new members of staff must continually relearn the details of different policy networks, and some relevant information is simply forgotten. It will also affect analytical capability, as knowledge is lost in the transition between staff. It will similarly impact on regulatory capability, which is reduced as the staff who establish and run regulatory systems move on, again requiring others to relearn frequently the basics of the system. On the other hand, the observation of high turnover in middle and junior grades is long-standing, and HMT has managed to deliver its objectives despite this. It could therefore be suggested that, in fact, the de facto binary workforce model that HMT operates – significant experience at the top and a fast churn at the middle and bottom – is sufficient to deliver its objectives, even while the institution is aware of its drawbacks.

2.4 Informal powers and qualitative assessments of HMT's broader influence

This section reviews secondary literature – both formal reviews and informal commentary – regarding HMT's ability to influence, persuade and use informal channels to achieve its objectives, rather than simply relying on its formal powers. This exercise has been aided by the relatively large number of qualitative reviews of HMT's performance and capability, both internal and external, formal and informal. Many of these are directly relevant to the issue of HMT's 'capability' as an institution. Indeed, the frequency and relative openness of these reviews, some of which were authored by HMT and are quite critical of the institution, could itself be seen as a kind of 'capability' in terms of a high analytical and 'self-regulatory' capability for criticism.

Table 10: Summary of existing reviews of HMT capability and performance

| Year | Name | Approach |
|------|--|--|
| 1994 | Fundamental Expenditure Review | Review of HMT's internal management and approach to deployment of resources, including: internal changes to HMT's management structure; removal of policy responsibility for the civil service; reduction in certain controls over departmental expenditure; increased focus on the economics ministry role. |
| 2007 | Capability Review | Part of a central government-wide approach to measuring all departments against a set of core competencies related to: strategy; leadership; and delivery. |
| 2008 | Capability Review update | An update of progress against diagnosed reform areas one year after the review. |
| 2009 | Capability Review: Progress and Next Steps | A further review of follow-up actions taken by HMT in its response to the original Capability Review. |
| 2009 | NAO report into HMT's handling of the nationalisation of Northern Rock | The NAO report is not a full review of HMT's generic capability, but instead an assessment of how HMT handled the collapse of Northern Rock, occurring just before the peak of the global financial crisis, and the effectiveness of its policy response. |
| 2010 | Strategic Review | Internal review – not available externally. A review of HMT's structure and operations in light of the response to the financial crisis of 2008. |
| 2012 | Capability Review Action Plan | Following on – and finishing – the Capability Review process, this was a final follow-up review of progress against previous Capability Review findings. |
| 2012 | Review of HMT's management of the response to the financial crisis ('The White Review'). | Internally produced review of HMT's handling of the financial crisis, authored by a senior HMT official. This includes some of the conclusions and recommendations from the internal-only Strategic Review. |
| 2012 | NAO report into HMT's approach to managing budgeting in government | A value for money assessment of HMT's approach to budgeting in the 2010 Spending Review. |

Source: Author's compilation

HMT's informal powers and influence have certainly received widespread recognition in the secondary literature. The images of HMT as a 'necessary evil' (Lipsey, 2000), as 'lofty and distant at the centre of British government' (Hecló and Wildavsky, 1974) or as a 'magpie's nest' (Jenkins, 1996) are well recognised. This frequently negative characterisation of the institution is perhaps inevitable: as a central finance agency responsible for overall fiscal control, HMT has an institutionalised adversarial relationship with spending departments in a classic common-pool resource dilemma (von Hagen, 2005).

In common with other ministries of finance, HMT is seen as having substantial informal powers due to its unique role in seeing and coordinating across the whole of government. Along with Number 10 (the Prime Minister's Office) and the Cabinet Office, HMT has a relationship with all departments and as a result HMT has a 'window into every ministry and departmental activity across Whitehall' (Hennessy, 1989: 395). In particular, its formal spending control role in coordinating the government's budget provides it with a line of sight across all government business. However, unlike the Cabinet Office, or even arguably Number 10, HMT has an immediate and real policy lever in terms of expenditure and budgeting authority that can be used to try and generate behavioural change in departments.

Further informal influence is attributed to the specific qualities of HMT's people. Staff at HMT are typically rated as intellectually adept and some of the 'brightest' in Whitehall, contributing to a strong reputation for analytical capability. Hecló and Wildavsky's review of the public administration of UK public spending in the 1970s noted that a 'Treasury man [sic] ... relies on ability to argue, to find internal contradictions, to pick out flaws in arguments whose substance he has not fully mastered and of whose subtleties he can only be dimly aware' (Hecló and Wildavsky, 1974: 60). Similarly, in a review of the institution 25 years later it was noted that 'Anyone who is not clever would not greatly enjoy working [at HMT]; and the Treasury's idea of "clever" is a good deal more elevated than that common in lesser circles' (Lipsey, 2000: 31). Over 30 years after the studies of the 1970s, a formal review of HMT's major stakeholders noted that 'The Treasury is highly regarded for its analytical capability, strong evidence based approach to policy making' (Cabinet Office, 2009: 10). The intellectual capability to engage with other departments, including their spending proposals, is widely recognised as contributing to HMT's ability to influence other departments' behaviour.

However, the informal influence of HMT on the rest of government does not rest on the capability of permanent staff alone – it is also heavily dependent on the political strength of the Chancellor of the Exchequer in power. While formal legal and technical rules may govern the ability of HMT to set budgets and authorise expenditure, the willingness to stick to agreed budgets and moderate demands for spending is fundamentally a political issue. As authors have commented in the literature, 'the power of the Treasury is only as great as the political status of the Chancellor or the political will of the Cabinet' (Jenkins, 1996: 223). In some periods of the recent past, for example the 1970s, the political-business cycle has been characterised as parties competing over 'who could deliver more in terms of "welfare" spending' (Thrain and Wright, 1995), and the lack of political support for a restrictive Chancellor and strong belief in the need for government to actively manage demand in the economy (Hecló and Wildavsky, 1974) contributed to a weakened ability of HMT to restrict expenditure in this period. A broad change of political attitudes and political standing of the Chancellor in recent times, for example under Gordon Brown from 1997 to 2008, has led to a similar change in control of public spending. As an example, Gordon Brown's status in cabinet and his political will to restrict spending and maintain the outgoing government's

expenditure plans in the late 1990s resulted in the UK's first budget surplus for many years.

The relationship between the Prime Minister and the Chancellor is seen as crucial to creating an environment in which HMT can fully exercise its powers. There is a natural tendency for Chancellors and Prime Ministers to share an interest in controlling public expenditure that other members of the Cabinet do not share, as part of the continuous common-pool resource dilemma. Indeed, the literature notes that a 'minority of two' in Cabinet is not an unusual place for a Prime Minister and Chancellor to find themselves in regarding limiting public expenditure (Lipsey, 2000). However, a minority of one in such a disagreement is a dangerous place for a Chancellor to be and, as a result, Chancellors who lose the confidence of their Prime Minister are usually seen as fundamentally undermined, with a negative impact on the capability of HMT to deliver its objectives.

Interestingly, the strategies used by HMT in engaging with and managing departments appear to vary over time. The discussion of HMT's operation in the 1970s repeats that HMT staff were able to do their jobs because of a strong 'relationship of trust' with departments, noting 'the most important skill Treasury people learn is personal trust and where it should be put' (Hecllo and Wildavsky, 1974). However, moving forward to more recent evaluations of HMT's relationships with departments – during the time of Gordon Brown, who was perceived to be a very directive Chancellor in comparison with the norm – a diagnosis suggests that 'HMT could be more effective at building trust and productive relationships' and that 'there is a pressing need for greater inclusiveness and humility in its dealing with others' (Cabinet Office, 2007: 26). Journalistic reviews of the institutions at the time also found a growing – and unwelcome, from the point of view of the department concerned – reach for HMT's policy development compared with previous years (Elliot et al., 2002). A few years later a change of approach – and change of Chancellor – appears to have resulted in a move back towards relationships built on trust and cooperation, and subsequently yielded 'tangible progress in improving its approach to working openly and constructively with partners across Whitehall' (Cabinet Office, 2012:10). Such a dependent and contingent quality as 'trust' between administrative units is not possible to measure rigorously over time, but the above discussion suggests that trust and collaborative working are typically key ingredients in HMT's informal powers. However, the political strength and attitude of the Chancellor can make a marked difference to the degree to which 'trust' is the basis on which HMT officials operate in their dealings with other departments.

In terms of structured reviews of HMT's informal capabilities, there are two main sources. The Capability Review process (2007-2012) provides a time-series review of HMT's capability across numerous dimensions; and case study evidence from the NAO and from HMT itself on two key events (HMT's management of the spending review and HMT's response to the financial crisis) provides detailed information on the actual behaviour of HMT staff on the ground.

The Capability Review process was a unique attempt to articulate a view of 'capability' in central government – defined as 'strategy', 'leadership' and 'delivery' – and then to qualitatively assess and measure all central government departments against it. The underlying model is one of a 'behavioural standard' approach. Statements articulating what would comprise good performance were prepared and external reviewers asked to determine the degree to which departments attained these standards, based primarily on key informant interviews and reviews of key documentation. The Capability Review approach attracted international attention and

modified versions of the approach were subsequently introduced in New Zealand, Australia and, to a lesser extent, Canada.²

The Capability Review findings show similarities with conclusions regarding HMT from elsewhere. Comparing scores across the ranking criteria suggested that HMT had a reasonably strong performance relative to other Whitehall departments. In the initial review of 2007, HMT was judged to be strong on evidence-based choices, setting direction, focusing on outcomes and prioritising and using resources. However, building staff capabilities (relating to developing and retaining staff) and building common purpose (in terms of engaging positively with stakeholders) were identified as in need of improvement. Both these issues emerged from other sources (as reviewed above). Improvement was noted in the least performing areas in follow-up reviews in later years, which may be linked to the impact of the change of Chancellor noted above. In 2012 the Coalition government abolished the Capability Review process with the intention to replace it with forthcoming Departmental Improvement Plans.

The reports into HMT's handling of the financial crisis and its approach to budgeting are the only recent attempts at 'case study' reviews of events from which conclusions can be drawn. The two case studies reviewed different aspects of HMT's work. The first – an internally led review into HMT's response to the financial crisis – considered a one-off acute challenge that requires difficult decisions to be made on rapid timescales (the 'White Review'; HM Treasury, 2012a); the second – a review of HMT's management of the 2010 Spending Review – looked at the institution's more day-to-day work (NAO, 2012).

These are detailed reports, but key issues emerge in relation to capability. First, and in line with the findings from other reviews, HMT was identified as needing greater capability in respect of specific technical skills. The NAO found that HMT spending teams lack consistency in their approach to spending departments, and spent a great deal of their time chasing information and data necessary to complete the formal side of the spending review process (NAO, 2012). The report into HMT's handling of the financial crisis found that relatively few HMT staff had the specialised skills necessary to deal with financial services and banks, and that when it came to purchasing external advice, they did not have strong procurement skills (HM Treasury, 2012a). This may suggest that HMT's 'generalist' approach to providing analytical advice may be under pressure in certain areas of significant and increasing technical complexity, although it may remain an effective model in others areas of its work. Second, both studies found that HMT's stakeholders experienced challenges in engaging with the institution as a result of rapid turnover of staff in key positions. This long-standing deficiency, discussed at length above, would cut across all aspects of the capability framework, as noted, but might have particular negative impacts on analytical capability (with regard to institutional memory), regulatory capability (in terms of the experience of controlling the production of services by others) and coordinative capability (in terms of building and maintaining relationships with key stakeholders). Third, and related more to the day-to-day operation of the institution, HMT appears to perform effectively when coordinating the delivery of major 'set piece' activities, such as spending reviews, which require hundreds of people across government to undertake interrelated actions on a strict timescale.

² See for example the Australian government's 'Capability Review' programme (<http://www.apsc.gov.au/aps-reform/current-projects/capability-reviews>) and the New Zealand government's 'Performance Improvement Framework' model (<http://www.ssc.govt.nz/pif>).

2.4.1 Summary of literature and desk review

The literature review suggests that while certain parts of HMT's 'personality' as a department have remained constant, other key aspects of its role and behaviour in the changing world have evolved considerably. Formal constitutional powers and legal procedures for managing expenditure have changed relatively little, and grant HMT a wide range of powers. Parliament – while important in theory – has little practical power to affect budget and expenditure policy ex ante, although it has some influence in ex post evaluation of spending. However, the policy frameworks in place to manage HMT's core role in public expenditure control have changed considerably, alongside significant changes in the external environment. HMT now actively seeks to demonstrate capability by setting the rules, being the 'manager of frameworks' and delegating authority, rather than be the direct deliverer of many economic and financial services itself.

The relative strength of the Chancellor in Cabinet and his relationship with the Prime Minister have varied over time, but they remain key to the capability of HMT to actually deliver its expenditure ambitions. The style and approach of the Chancellor can have a real impact on the way in which HMT as an institution approaches relationships with its spending departments. A relationship based on trust and mutual understanding between HMT staff and their counterparts appears to be an enduring feature of expenditure management, even if its strength varies sometimes.

The Treasury of the 1970s and the Treasury of the 2010s appear to share strengths in terms of the intellectual capability of their staff compared with other departments and their staff's ability to draw on a strong personal identification with the department. However, set against this, the Treasury has for decades lived with very high turnover in middle and junior ranks, and rapid movement within the institution, albeit moderated by much greater stability at the top. This model of rapid movement and turnover at middle and junior levels may be the most rational choice senior managers can make given the labour market pressures the institution faces. Given the general perception of HMT as one of the most capable of government institutions, this model appears to have served the institution at least adequately in many areas. However, the high turnover rate is not without cost; it is noted to have negative impacts across HMT's capabilities in certain instances, and may lead HMT to face particular stress in policy areas requiring specific technical skills.

3 Case study review of core processes

3.1 Review of core processes

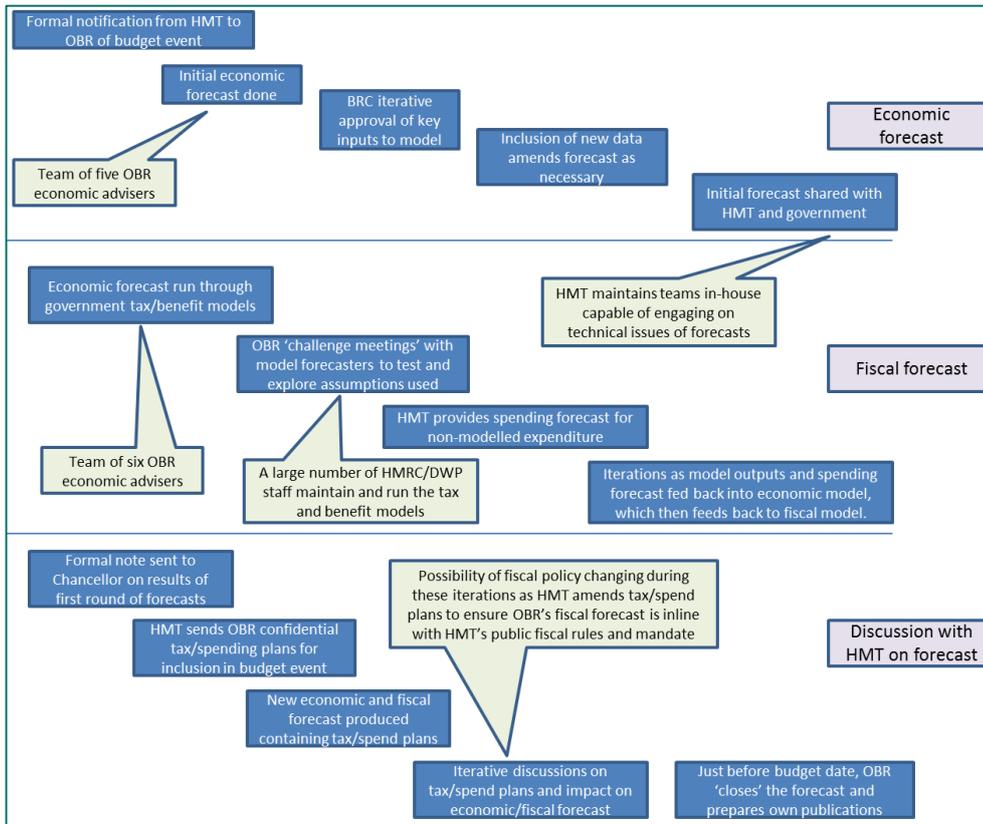
This section reviews the findings of the literature desk review against ‘case study’ examples of key processes undertaken by HMT. The case studies cover: (i) the creation of the final revenue forecast and spending envelope for the budget, and (ii) the consideration of a new spending request. By comparing the two, it is possible to see how the capabilities identified in the literature review play out in practice.

3.1.1 Creating the final revenue forecast and spending envelope for next year’s budget

The creation of the revenue forecast and spending envelope has undergone significant reform in recent years. The creation of the OBR in 2010 marked a fundamental shift in the way in which HMT approaches the creation of final revenue and expenditure plans. Whereas previously HMT would produce economic and fiscal forecasts and present its spending and taxation plans on the basis of these figures, the OBR now also presents its own economic and fiscal forecasts. The OBR also presents a judgement as to whether the government is on track (‘has a greater than 50 per cent chance’) to meet its own fiscal framework on its current plans for taxation, spending and debt management. The government’s belief is that, over the recent past, and certainly under the previous government, economic and fiscal forecasts have been consistently over-optimistic and have therefore been used to justify higher levels of spending, deficits and debt than is appropriate (HM Treasury, 2011).

HMT has committed politically to using the OBR forecasts as its own in the creation of its fiscal plans, although it retains the right to use its own forecasts as it wishes. It also maintains the capacity to generate forecasts ‘in-house’ through its own cadre of technical staff, which has access to the same data and modelling processes as the OBR. An iterative process is undertaken for the OBR to create the economic and fiscal forecast in which HMT and other departments are heavily involved (Figure 9).

Figure 9: Stylised representation of the process used to draw up economic and fiscal forecasts



Note: BRC = Budget Responsibility Council, the independent senior body that oversees the work of the OBR.

Source: Author's representation

Around 17 staff work in advisory and leadership roles in the OBR. However, this small team is able to generate economic and fiscal forecasts by using of other parts of government to produce key inputs for their economic and fiscal models. HMRC, the Department for Work and Pensions (DWP) and some smaller departments are critical in providing their forecasts for revenue and spending through tax receipts and demand-led benefit spending. The OBR has access to their modelling and forecasting approaches and can use its own baseline assumptions to challenge departments on their forecasting, but ultimately relies to a degree on the departments to run the figures they will use to create their own forecasts. In the longer term, and beyond the time frame of this study, this system means that the OBR will therefore be a particularly useful case study in whether this kind of independent fiscal council improves fiscal policy. Given that the OBR staff, systems and processes are drawn directly from pre-existing HMT and wider government bodies, and that the OBR continues to rely on government systems to run some of its forecasting, the significant change in circumstances is the institutional and political relationship between the OBR and HMT. If better fiscal policy does emerge over the long term following the establishment of the OBR, then there is a good chance this relates to the *institutional* arrangements of the new system, rather than being an effect of OBR having more *technically capable* staff, systems and processes than HMT.

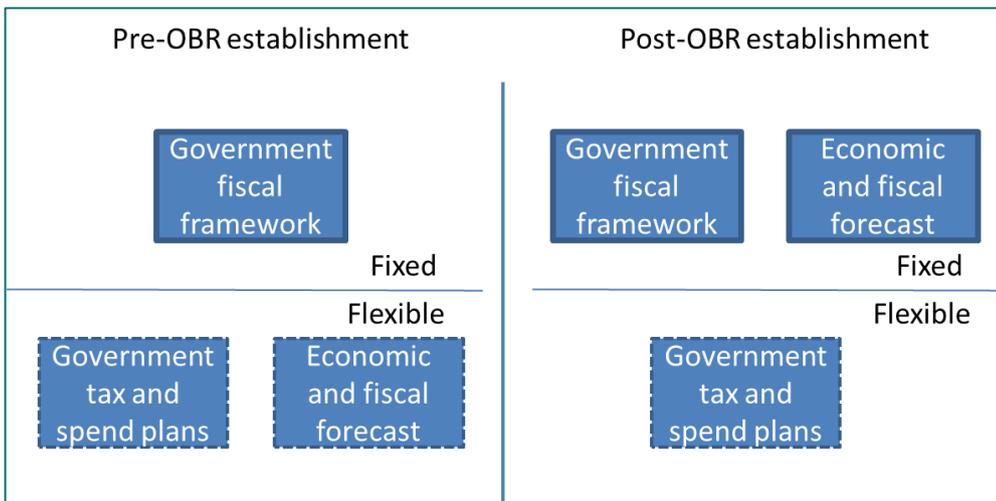
OBR's staff are currently mostly drawn from HMT's own previous forecasting staff, with others from HMRC, the DWP and elsewhere. As the backgrounds of OBR staff change it would be interesting to see if the relationship between OBR and HMT staff begins to change. In their book on HMT in the 1970s, Hecló and Wildavsky note

strong ties of ‘kinship and culture’ between senior officials, both inside and outside HMT, operating the UK’s public expenditure system as a result of inward and outwards transfers, and that this was a crucial part of the informal networks allowing the system to operate (Hecló and Wildavsky, 1974).

Development of the forecasts is iterative for technical reasons, such as a release of new economic data on employment or growth. However, the forecasts also involve a feedback loop based on the *expectations of government policy*. During the period of eight to ten weeks during which the forecasts are drawn up, HMT will share its confidential planned tax proposals and spending plans, including its plans for managed expenditure for each department over the period in question. These will be fed into the OBR’s economic and fiscal forecasts prior to their final agreement. The combined effect of HMT’s tax proposals and spending plans may result in an economic and fiscal forecast from the OBR that is not in line with HMT’s stated fiscal policy framework. This leads to a process by which HMT reviews and amends its spending and taxation plans through this iterative process – prior to final agreement and publications – so as to ensure that they ‘balance’ with the fiscal framework and forecasts that will eventually be produced by the OBR. As a result, government’s fiscal policy is ‘made’ to a degree through iterative engagement with the OBR’s forecasts and judgements. Following the conclusion of the engagement between the two institutions, HMT prepares detailed expenditure plans using the figures agreed with the OBR.

The overall effect of this process is to use political capital to turn independent economic and fiscal forecasts into a ‘fixed’ variable, alongside the government’s fiscal framework, and make HMT spending and taxation decisions the only scalable variable (Figure 10).

Figure 10: Representation of the relationship between fixed and flexible variables before and after creation of the OBR system



Source: Author’s representation

Prior to this arrangement, the economic and fiscal forecast could be changed – within the broad boundaries of credibility – to accommodate the government’s intended fiscal plans. As mentioned, the position of the current government is that this was routinely done under previous administrations, resulting in deficits rather than surpluses over the medium term, as over-optimism in the economic and fiscal forecasts failed to materialise. Certainly the UK government has not run a budget surplus since the early 2000s, even during periods of steady growth, raising issues

about the interplay between HMT's technical fiscal policy capability and the 'political capability' of ministerial decision-making.

Within the OBR/HMT system, in terms of *analytical* capability, HMT – and the executive more widely – has not relinquished significant resources or capability. HMT retains significant macroeconomic and fiscal policy capability, and is fully able to engage in technical debates with the OBR. As mentioned above, the OBR itself is a relatively small institution, comprised mostly of ex-HMT officials, and intentionally relies on other parts of government, notably HMRC and the DWP, to provide critical technical inputs into the process, under its scrutiny.

Regarding delivery capability, HMT has arguably not increased its ability to provide policy advice, but has decreased the margin for poor 'political capability' acting on this advice. Earlier parts of the discussion have suggested that it is not possible to accurately determine the quality of HMT's policy advice given its confidential nature, and that poor political decision-making has the potential to outweigh even very capable policy advice provided by officials. The new structure of the OBR has strengthened the hand of HMT in this regard. The economic and fiscal forecast is now externally determined through OBR processes and is therefore less subject to political pressure. The new system aims to increase the delivery capability of HMT by strengthening the importance of the technical element of policy-making, and reducing the scope for behind-closed-doors political amendment to key figures. However, it may be too early to tell the actual impact on UK fiscal policy.

The impact of the new system on coordinative capability is less clear. The coordinative effort required to operate the system of independent forecasts does not appear to present particular challenges to HMT or the OBR. HMT is certainly capable of operating large multi-stakeholder 'set piece' processes, such as the spending review and budget events, and so engagement with the OBR over a ten-week period is not, presumably, a significant challenge.

The creation of the OBR and the system of independent forecasts demonstrates a continuation of the trends regarding HMT's regulatory capability noted above. Many countries have long-standing experience of fiscal structures designed to 'regulate' the ministry of finance itself, and there appears to be a growing trend towards the use of independent fiscal councils (IMF, 2013). The OBR system follows on from the trend of HMT's approach to economic and fiscal management since the late 1990s, which focuses on managing a regulatory framework and system with some form of independence, rather than directly managing individual actions and activities. The creation of the OBR, and its underlying logic of using external independent analysis to force hard choices on government spending plans rather than allowing a soft option of changing government forecasts, can be seen as part of this general trend. However, it is too early to conclusively determine whether the new OBR-led regulatory system actually improves the operation of fiscal policy over the long term. Currently, as noted, bond markets appear to be viewing the UK's fiscal prospects positively.

Within the Westminster tradition, and in the absence of a written constitution providing a higher level of protection, the OBR system can be altered or abolished at will by any future Parliament. The OBR-led forecasting process therefore depends critically on political commitment to the system. For now, the government has committed to using key OBR figures as its own, and to build its fiscal policy around the economic and fiscal forecasts that the OBR provides. Certainly, the experience of granting independence to the Bank of England's Monetary Policy Committee to set interest rates – where there is no serious discussion of moving this power back to HMT – suggests that independent economic and fiscal bodies can, over time, become strongly institutionalised. The implicit view of current political leaders is presumably

that the credibility-raising effect of using OBR forecasts to inform, assure and restrict fiscal policy provides a greater political pay-off than knowingly running a looser fiscal policy that allows for greater public spending (and higher deficits). A change in government, or dramatic change in economic prospects, might affect the balance of that calculation, and in doing so change the OBR system and thus the capabilities of HMT to manage fiscal policy.

3.1.2 Consideration of a new spending request

Consideration of a new spending request from a department would take place against a backdrop of pre-agreed spending totals. Spending Reviews – which set spending ceilings for various categories of expenditure by department for three years – are undertaken every two to three years by HMT. It is during these negotiations that any ‘new’ expenditure requests should be presented by departments. The requests will then be either accepted or rejected and, if accepted, their financial implications factored into the agreed final expenditure total. Fiscal events, such as Budgets or the Autumn Statement/Pre-Budget Reports, may revise spending review control totals slightly during the year. However, these are usually ‘fiscally neutral’ from the point of view of the department in that any commitment by a department to deliver additional services will be matched by commensurate additions in the department’s overall control total.

As a result, under the current framework, it would be expected that any request for ‘additional’ expenditure from a spending department to fund newly identified activities outside of a spending review event would be dealt with within the department’s existing control total. HMT spending teams would normally see new spending proposals as a question of *reprioritising* spending within a department’s existing allocation. Departments can therefore fund ‘new’ spending requests if they wish, provided that this is offset by reductions in expenditure elsewhere. The fact that departments both have significant flexibility to reallocate funds within their control totals and know that HMT’s first response to requests for additional funding for new priorities will be a refusal and an instruction to reprioritise serves to prevent a constant stream of relatively small additional spending requests being made to HMT. In practice, over the course of the financial years of a spending review period a department’s real-world expenditure profile will inevitably move around. Unexpected savings in certain areas or delays and/or cuts in other areas of spending may allow space to fund within existing totals any new spending pressures that emerge.

If a department determines that the size, importance and/or unexpected nature of a new spending priority means it cannot reasonably be accommodated through reprioritisation it may then put forward a request for a formal increase to its control total. This is usually seen as a claim on the reserve. The reserve is a small amount of funding held centrally to accommodate unexpected spending pressures arising through the year that cannot reasonably be met by reallocation by the department concerned.

The process of a reserve claim (see Figure 11) relies on ongoing and regular contact between HMT and departmental staff, and a shared view of key risks and issues. HMT has regular contact with spending department finance teams through its ‘spending teams’, which shadow and oversee the expenditure of departments, within the HMT directorate responsible for public spending. The shared understanding and regularity of contact help create mutual trust and honesty between the HMT spending teams and spending departments’ finance functions. This trust is crucial to spending control since departments always have an information advantage over HMT staff regarding their true financial positions. HMT spending teams need to have confidence in departments’ information and intentions during the process of

adjudicating and judging whether reserve claims are ‘genuine’. Simply saying ‘no’ to all claims on the reserve would not be an option for solving the departments’ information advantage because it would undermine a system that tries to accommodate genuine claims.

The formal requirements for a reserve claim are relatively small, and significantly less than the informal discussion and debate that would surround the process. The formal reserve claim would take the form of a simple letter from the relevant Secretary of State to the Chief Secretary to the Treasury, outlining the unforeseen and uncontrollable spending pressure, and formally requesting an amendment to the department’s relevant control total in order to accommodate it. These letters would not necessarily be particularly long or detailed. In practice, a large amount of discussion and exchange of information and views would have taken place before at middle and senior official level to iron out the details of the origin of the spending pressure, whether the department could reasonably have foreseen it, what steps the department could, or should, take to accommodate it within its current budget, and the amount of extra funding required. This could take several weeks, and might involve HMT asking the department to prepare various kinds of evidence of the nature of the cost pressure and perhaps cost-benefit analyses of different options for their review.

As well as the process of assessment and challenge from spending teams, HMT maintains a cross-government view of reserve claims. The central spending control team within HMT will maintain a list of all claims on the reserve, alongside a list of cross-government spending risks in general. This team will also be the final arbiter of whether to recommend to ministers that claims should be met by the reserve. This allows for some cross-government consistency in terms of which requests might be agreed or denied.

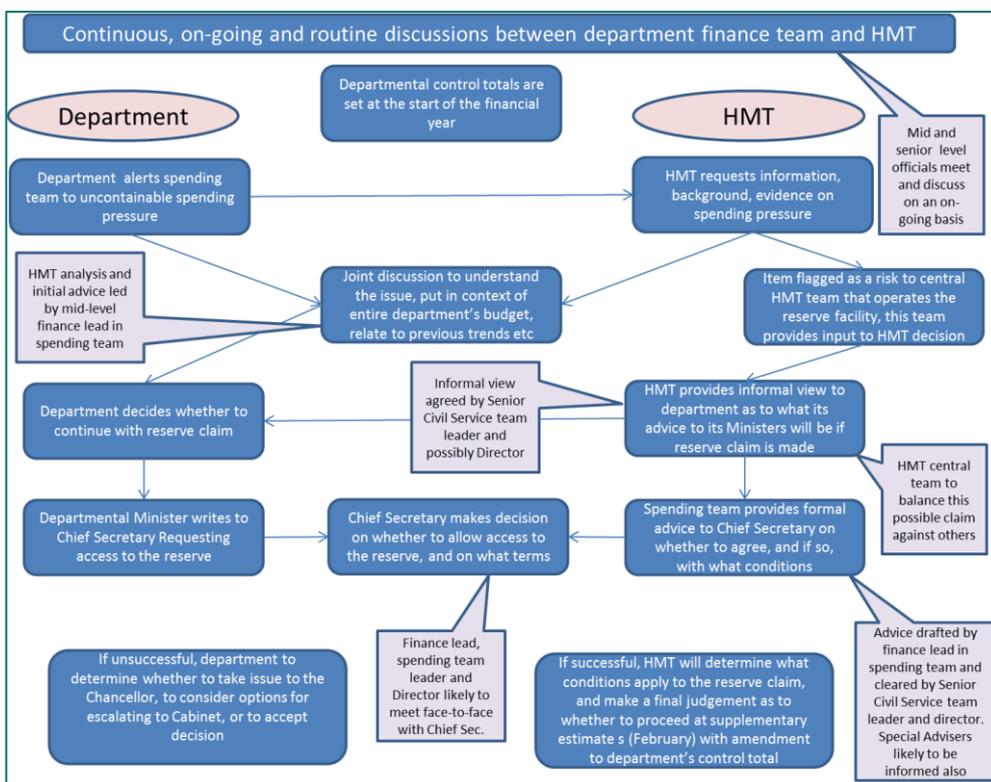
The formal request for a reserve claim is framed by the regard for a good reputation by the department concerned. Public spending, as a typical common-pool resource problem, might motivate rational departments to submit numerous reserve claims in order to maximise their chances of receive additional funding. However, in practice, reserve claims are small in number and the process is not undertaken lightly. One obvious factor limiting requests, as noted above, is HMT’s ability to refuse claims it does not consider justified and require departments to simply reprioritise and reallocate within their allocation to meet new pressures. As noted, this would be the default position of an HMT spending team if faced with a new spending request from a department. Beyond this, submitting a reserve claim is interpreted as a negative comment on the requesting department’s ability to manage its finances. All reserve claims are publicly reported, both explicitly in HMT documents and through notification to Parliament. Parliament, through its committee system, may well undertake further public investigation – and perhaps unwelcome commentary – as to why spending limits have been increased. HMT’s new spending control policy also allows for certain sanctions to be taken in response to a reserve claim, such as additional reviews of a department’s financial management practices and reduced delegated authority. It is not clear how often and regularly these ‘penalties’ are enforced, but they remain credible options for HMT and an uncomfortable prospect for the department concerned.

The politics of relationships between ministers can impose further incentives for not making a reserve claim. The requirement to come and explain what many will see as financial mismanagement to the Chief Secretary and, perhaps, the Chancellor – potentially in person – is usually not one actively sought by a minister. Where a political administration has made spending control a key policy objective – as under the current UK government – reserve claims are particularly damaging for the

department and minister concerned. These informal incentives provide strong reasons why departments try to avoid reserve claims and they remain relatively few in number.

In practice, the uncertainty of departmental spending over the course of the year may mean that even a reserve claim that HMT is inclined to accept can be delayed until the final Parliamentary estimates of the year, in the hope that it may not in fact be needed. As noted above, during a financial year, and in the run-up to the submission of final Parliamentary estimates, departments may run significant underspends in some areas, or drop certain expenditure plans entirely, so as to allow for an unexpected pressure to ultimately be managed without amendment to overall control totals. HMT can continue to apply pressure to meet the spending need from within existing resources by not finally and formally approving a reserve claim until right up to the last estimates before the year end.

Figure 11: Stylised representation of the process of a reserve claim



Source: Author's representation

Regarding the capability framework, the process of a reserve claim relies on the analytical capability of the department concerned as much as that of HMT. While it is the responsibility of the department concerned to present the case for the reserve claim, including supporting evidence, the capability of HMT relates to its ability to interpret, challenge and determine the credibility of the evidence presented. Therefore, to successfully manage a reserve claim requires not only analytical understanding of the technical evidence, but also coordinative capability to judge the underlying nature of the relationship with, and motivations of, the department in putting forward the claim.

Regarding delivery capability – in terms of policy advice to HMT ministers on a reserve claim – it is difficult to make judgements from this process given its

confidential nature. However, the process of a reserve claim is not particularly delivery intensive for HMT in terms of the complexity of the actions required to move one through the system.

The coordinative and regulatory capability of HMT is not particularly challenged by a single reserve claim when viewed in relation to the totality of public spending. The real coordinative and regulatory capability of HMT is in successfully managing the public spending system as a whole. The fact that reserve claims are managed through an established process, that there is cross-HMT consideration of the totality of reserve claims so they can be compared and traded off, and that there are some credible policy levers to apply to applicant departments (ex ante delays in final approval to motivate better performance in-year, ex post reductions in departmental spending autonomy as a sanction) suggests there is a high potential level of capability in operating the wider regulatory system.

The overall level of HMT's coordinative capability in resolving additional spending claims is heavily dependent on the incentives of the Chancellor and Prime Minister within the wider political context. As has been discussed above, the ability of HMT to resist spending pressures does not lie solely in its powers as an institution. Spending ministers who see themselves as politically strong, intellectually justified in asking for more money and standing high in the Prime Minister's favour may decide that HMT's capability in maintaining a strict system of access to the reserve is not sufficient to stop them accessing additional funds. On the other hand, a binding Cabinet understanding that spending totals are to be adhered to, and knowledge that the Prime Minister will back the Chancellor in all matters of spending, will do much to strengthen HMT's capability to manage the reserve system. These are not areas that HMT can control directly, but will crucially affect its coordinative and regulatory capability in delivering effective spending management.

4 Conclusion

4.1 Reviewing human and institutional capabilities

This study has reviewed a number of sources of information to put forward some tentative conclusions regarding HMT's 'capability' across four areas. The assumption has been that HMT demonstrates relatively high capability – certainly in comparison with the wide range of ministries of finance across the world – and the emphasis has been on identifying specific elements of this capability. A review of macro-fiscal outputs, secondary literature and case study evidence suggests some initial findings.

Regarding analytical capability, the institution's reputation for analytical sharpness appears well established, both from external commentators and from government's own internal processes, such as its Capability Reviews. This is a constant running through the literature from the 1970s to the present day. This intellectual ability is clearly recognised as a contributor to HMT's ability to wield influence throughout Whitehall, over and above its formal roles in managing public expenditure. The evidence on analytical capability suggests one obvious exception – the apparently unforeseen impact of the financial crisis of 2008 – although, as noted, this exception appears to be widely shared. However, the conclusions of the recent internal review of the institution might suggest that the 'generalist' approach to analytical capability may be under pressure in certain key – and increasingly important – policy areas, such as financial services regulation.

In terms of delivery capability, the evidence suggests varying levels of performance in three aspects. If delivery capability is taken as meaning delivery of *effective economic and fiscal policies*, the evidence from the past has been broadly positive, but there are some significant uncertainties at present. Genuine structural improvements of the UK economy over the past 30 years and improvements and consistently high scores in many indices of economic and budget effectiveness that relate to HMT's policy areas are significant achievements. The institution has also successfully delivered a number of more technical changes to the budgeting process, including moving towards accrual-based budgeting and speedier reporting. Two recent case study reviews – internally and externally produced – of specific policy decisions made by HMT (into Northern Rock and the financial crisis, respectively) generally suggest HMT is an institution that gets major policy decisions right, although it has room for improvement in particular aspects of its operation. This ability to get the decisions right is clearly linked to its analytical capability, as discussed above.

However, reviewing from the point of view of a post-financial crisis position, HMT's 'policy delivery' capability appears more mixed. The post-financial crisis fiscal position of the UK remains extremely challenging, and notably worse than many other comparable European countries. If HMT can be associated with macroeconomic and fiscal policy successes over the past 20-30 years, then by the same token it can be associated, to some degree, with the fiscal policy decisions that have left the UK in a particularly precarious position. Despite this, bond markets

appear to have confidence in HMT's capability with regard to the current policy framework that aims to improve the UK's position.

There is less evidence available in terms of HMT's capability to deliver high-quality *policy advice* to ministers. The NAO review of the nationalisation of Northern Rock noted that HMT came to the right policy conclusion in terms of handling the failing bank (NAO, 2009). The NAO also notes that HMT's policies and advice in a spending round are effective in controlling public expenditure, but had some weaknesses elsewhere (NAO, 2012). The quality of policy advice will be strongly linked to the analytical capability of HMT, which has been noted to be broadly effective. Unfortunately, there is little clear evidence in terms of what ministers think of the advice they receive from HMT, and/or their views of HMT advice compared with advice they receive elsewhere in order to cross-check ministers' 'consumer satisfaction'. Similarly, there is little evidence on the tensions that may arise when political decision-makers ignore effective and capable technical advice. This particular – but crucial – aspect of delivery capability remains largely off-screen to external observers. The current government perhaps implies that this issue of 'political capability' in decision-making is indeed an issue with regard to macroeconomic and fiscal forecasts, given its introduction of the OBR system to consciously restrain HMT's decisions in this area.

In terms of delivery capability meaning *externally facing responsibilities* for certain outputs (e.g. the Royal Mint, the Debt Management Office), there has been little discussion of performance and capability in the relevant literature. It could be tentatively concluded that in the absence of significant discussion of the performance of these institutions in terms of 'strong' or 'weak' performance, they can be considered to deliver at least adequately against their mandates.

Several conclusions can be drawn regarding different kinds of regulatory and coordinative capability. First, HMT is widely seen as having strong capability in coordinating the lower level logistics and processes of complex and interdependent 'set pieces', such as the budget and spending review events. These involve hundreds of officials working for many months across numerous government departments and external agencies with a view to planning expenditure for a large share of the national economy. The strong sense of identification with the institution reported by staff is perhaps instrumental in making these time-consuming and finely detailed processes work well. Second, alongside the formal rules-based systems that HMT has set up, the institution's 'softer' ability to coordinate and regulate departments through building relationships of trust and mutual understanding remains a key aspect of its spending management system. The enduring nature of this ability to build trust and mutual understanding is even more remarkable given the high turnover of staff and the consequent need for new people to rebuild relationships at regular intervals. The evidence from the Capability Review process suggests HMT has now returned to better relationships after a more challenging period in the recent past, which is perhaps particularly noteworthy given the likely increase in policy disagreements between HMT and spending departments that a more strained fiscal position will imply.

Third, HMT's capability in the higher level question of managing government macroeconomic and fiscal policy areas has shifted focus considerably in the recent past, in line with global trends. Substantial policy responsibility has been delegated in new policy frameworks for the Bank of England (in terms of interest rates), the OBR (in terms of fiscal and economic forecasts) and spending departments (in terms of delegated authorities). This is reflected in a review of HMT's responsibility for key central finance agency functions, where a high number are shared with, or contracted out to, other institutions. HMT's capability in coordination is now more

focused on successfully managing a number of economic and fiscal policy frameworks that are substantively run by others in pursuit of its policy goals, rather than delivering the relevant services itself. However, judging the effectiveness of the entire system is perhaps not possible at this stage. Some of the individual reforms of this nature (such as giving operational independence to the Bank of England) are relatively long-standing, whereas others (such as the OBR system) are quite new. It may take decades before relative improvement or decline in HMT's capability as a result of these systems can be clearly determined.

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