Written evidence submitted by George Dibb

"Reform of the Treasury is one pivot on which national renewal hangs"

Will Hutton, *The State We're In*

"Some government, someday, will re-create a department on the lines of the [Department for Economic Affairs] and limit the out-dated authority of the Treasury. When that happens - and it is bound to happen - the thinking that went into the DEA will be acclaimed."

George Brown MP, Secretary of State for Economic Affairs, 1964-6

Summary

Since March 2021, the Treasury has held responsibility for the UK's economic growth strategy and industrial policy in the 'Plan for Growth'. This has been criticised given long-held criticism of the Treasury for its structural short-termism, centralising, and "penny-pinching" instincts. These same characteristics led to Harold Wilson attempting to break up the power of the Treasury with the creation of the Department for Economic Affairs (DEA) over 50 years ago. This paper reflects on criticism of the Treasury and its ability to manage industrial policy and considers the case study of the creation of the DEA and its relevance to economic policymaking today. Whilst the functions of the DEA are not relevant to today's policy landscape, as an institutional innovation in economic and industrial policymaking, it is instructive.

Background

As the UK economy seeks to recover from the Covid-19 pandemic and to structurally transform the economy towards one based on high-wages, investment and productivity, attention has turned to whether the "machinery of government" is correctly structured to achieve these goals.

A commonly cited challenge within government is the power of the Treasury across Whitehall and its instinct (and explicit role) to control expenditure. This has led to criticism of the Treasury as short-termist and penny- or pound-pinching at the expense of long-term investment and coordination towards an economic strategy. The Treasury has been critiqued as "knowing the price of everything and the value of nothing".

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The Roles of the Treasury and Criticism

Giles Wilkes and Stian Westlake (2014) summarise the main roles of the Treasury in their Nesta pamphlet as:

- **a budgetary ministry** – held by Treasury spending teams, responsible for agreeing how much departments can spend in particular novel or contentious expenditure
- **a fiscal ministry** - setting tax policy
- **a financial ministry** - responsible for financing and managing the UK's public sector debt and its macroeconomic consequences
- **an economics ministry** - responsibility for the long-term growth of the UK economy
- **a financial services ministry** – responsible for and a sponsor of the UK's financial services sector

They note that in many countries these responsibilities are separated between two or more ministries. Criticism of the Treasury can be summarised in six main points:

1. **Too powerful and obstructionist** - By the very nature of the wide-ranging and politically important roles the Treasury combines into one department, with political proximity to the Prime Minister, the Treasury is simply too powerful and consequently skews Whitehall policy.
2. **Too concerned with expense, over potential return** - The Treasury has a conflict of interest between its role as economics ministry and finance ministry. It is responsible for all government expenditure but brings to this a powerful tendency towards short-term budgetary control over the long-term potential returns that can accrue from investment.
3. **Short term thinking** - The Treasury has a particular bias towards short-termism and concern for the next few years budgetary control resulting in a structural bias against projects with short-term costs but long-term payoffs. Problematically these are often the type of investment needed for effective industrial or growth policies.
4. **Centralised and centralising** – Because of the structure of Whitehall and the position of the Treasury it has a significant amount of centralised power that is not conducive to the sharing or spreading of power regionally or among other departments.
5. **Advocacy for the financial sector** – Whilst BEIS is the formal representative for business interests in government because its historical proximity the Treasury represents the interests of the financial sector. This is arguably inseparable from the financialisation of the UK economy.
6. **Self-Reinforcing structures, policies, and analysis** – The analytical frameworks, economic models and policies of the Treasury manifest the criticisms set out above and reinforce them. For example, Green Book cost-benefit analysis struggles to assess programs of long-term industrial policy and Treasury frameworks for calculating net public sector borrowing are a structural barrier to a national investment bank common in other countries.

Whilst it is undoubtedly true that any ministry responsible for assessing and controlling the expenditure of other departments will find itself in the crosshairs for criticism, there appears to be some truth to this understanding of the Treasury's role.

This criticism of the Treasury's short-termist and overly cautious approach should **NOT** be confused with a desire for uncontrolled spending. It is essential that expenditure is analysed for value-for-money and that waste is controlled. However, such concerns should be balance with and considered alongside longer-term visions for transformation of the economy and the potential benefits of investment beyond the political or fiscal cycle. This is not an argument against fiscal restraint, but rather an argument that fiscal constraint alone, unbalanced by an equal and opposite argument for the value of long-term investment, can be detrimental to economic policy.

Additionally, seeking to reduce "waste" in expenditure is not always the universal good it may at first appear to be. A government that wastes nothing, takes no risks. Public support for science, innovation, research, and development has led to the discovery and development of transformational technologies that enhance our economies and our lives. Yet this investment is inherently uncertain by its very nature. For every success you may encounter ten failures, yet the value of that one success may exceed the cost of the failures. One person's investment in risky-yet-transformational innovation may be viewed by someone else as "waste".

Case Study of the Department for Economic Affairs (1965-69)

The 20th century history of the Treasury features one significant attempt to curtail the political power of the department which is potentially instructive today.

History

Harold Wilson won a narrow victory for Labour in the 1964 election and embarked on a domestic economic policy based around economic planning. The government's strategy involved developing a "National Plan" for the economy to promote growth and investment. Wilson and his cabinet were sceptical that the Treasury were sufficiently aligned with this policy programme and doubted that the fiscal ministry with such a focus on short term spending restraint was capable of setting long-term economic strategy. Advised by Patrick Blackett (Professor of Physics and Nobel prize winner) and economist Thomas Balogh, Wilson set up the Department of Economic Affairs (DEA) in 1964 which would draw up and deliver the National Plan. George Brown MP was installed as the department's first Secretary of State as well as Deputy Prime Minister.

The intention of the new ministry was explicitly to divide the functions of the Treasury to reduce its power. Wilson was explicit in his belief that there should be "creative tension" between the DEA and the Treasury – one setting the direction of long-term planning of the economy and the other scrutinising the expenditure and short-term fiscal constraints. The National Plan for the economy was published in September 1965. To quote Christopher Clifford, the idea was of two ministries: *"the tactical, day-to-day Treasury managing the currency and the short-term fluctuations of the markets, and agreeing the appropriate fiscal and monetary responses; while the DEA took the strategic view, coming up with a brand-new National Plan to help Britain plan its economic priorities for the years ahead."*

Structure

Inspired by the wartime Ministry of Production, the DEA's internal structure was organised along functional lines. This is now the norm for Whitehall departments but was unusual at the time. When set up the DEA had four divisions:

- Economic Planning (medium-long and very-long range forecasts of the economy)
- Industrial Policies (medium and long-term measures affecting industry and the promotion of efficiency and growth)
- Economic Co-ordination (co-ordination of inter-departmental work, application of prices and incomes policy)

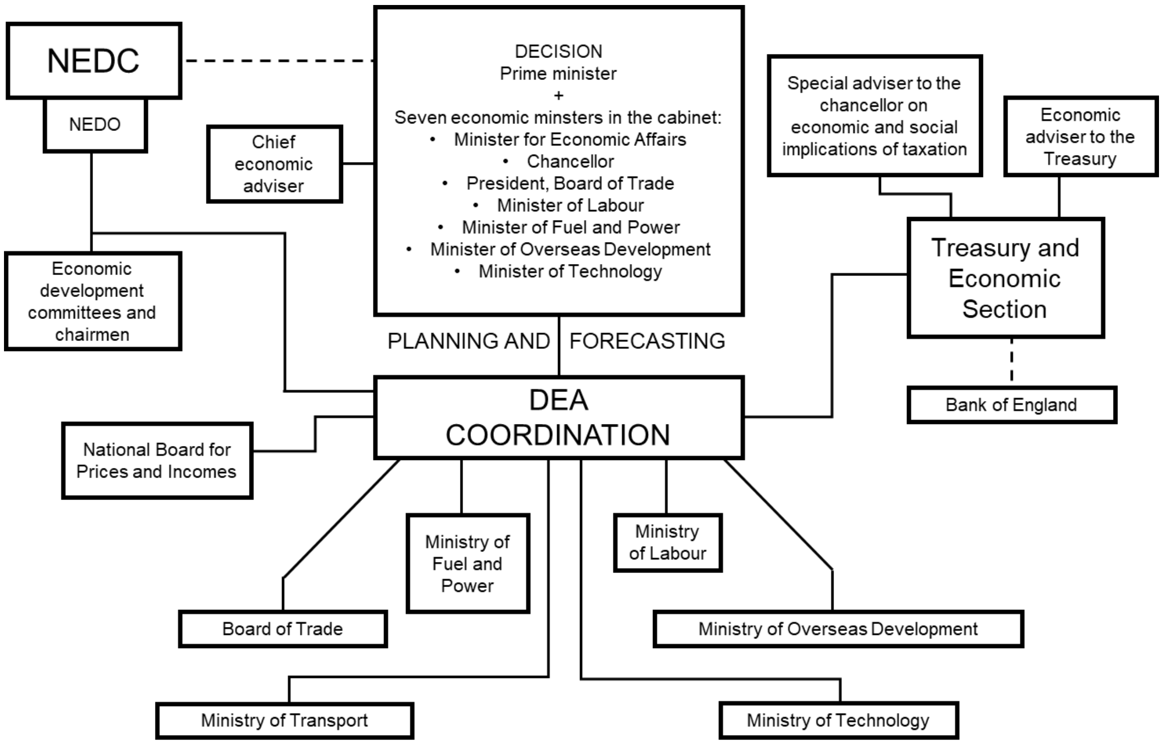
- Regional Policy (regional aspects of policies of industry, employment, land use and transport)

Ultimately, the Economic Planning and Economic Co-ordination divisions were merged, and prices and incomes responsibility moved from Economic Planning to the Industrial Policy division.

Within Whitehall the DEA functioned as a strong coordination centre between different ministries and departments with significant economic portfolios, as well as between government advisors and non-departmental bodies such as the National Economic Development Council (NEDC) (Figure 1). Ultimately decision-making sat with the Prime Minister and economic ministers of the cabinet, but with control of the National Plan and coordination capacity, the DEA was a powerful actor in economic policy. However, the DEA never had any control over fiscal (tax) policy, exchange rates, or – perhaps most importantly – budgetary matters, all of which remained in the Treasury. Of this arrangement between the Treasury and the DEA, Dell (1997) wrote:

> "If neither department was superior to the other, how would decisions be made in those cases where the two departments had different priorities? A concordat dictating who should do what was painfully worked out between the Treasury and the DEA… Under the concordat, fiscal and monetary policy would remain with the Treasury. Planning, whatever that turned out to mean, would lie with the DEA together with prices and incomes policy… Lacking the direct responsibility for fiscal and monetary policy, the DEA would be watching the Treasury hawk-eyed because its own reputation and that of its Ministers would depend on the rate of growth. The DEA would want the Treasury's fiscal and monetary policies to validate, not obstruct, its growth policies."

Figure 1 – Government Economic Machinery, late 1964



Source: reproduced from Middleton (2012)

Downfall

Commenting on the creative tension intended between the DEA and the Treasury, Christopher Clifford wrote "if the creativity was occasionally hard to spot, the tension was never in short supply". Labour won re-election in 1966 but Brown was shuffled out of the DEA to become Foreign Secretary in August of that year. Ultimately, the Treasury was viewed to have won the Whitehall power-struggle and in 1969 the DEA was wound-up with its functions being merged back into the Treasury.

The most cited cause for the failure of the DEA was ultimately the failure of the Wilson government to deliver the National Plan (the *raison d'etre* of the DEA) against an unexpectedly poor economic landscape.

When Labour took power, the government were informed that instead of inheriting an expected £400M surplus in the UK's balance of trade, in fact the situation was an exceptionally large £800M *deficit*. Managing this took most of the government's economic "bandwidth" and derailed much of the optimism of economic planning that led to the creation of the DEA. To address the deficit, the Wilson government put in place deflationary policies (that worked against the supposed aim of the National Plan to target expansionist growth) to maintain Sterling's parity with other currencies. The National Plan initially targeted a 25% growth in GDP over the course of the parliament, or 3.8% annually. The actual annual growth rate between 64 and 70 was a more modest 2.2%. Ultimately, the government undertook devaluation of Sterling, but after a lengthy delay during which time, deflationary policies had ensured the failure of the National Plan.

George Brown was strongly personally identified with the National Plan and was at least personally responsible for its delivery. Brown was undoubtedly a skilled secretary of state and his enthusiasm for the National Plan long after its clear demise was likely part of its limited success. However, he was also a somewhat controversial character. Brown's Wikipedia entry has an entire section titled 'Personal Problems' and Private Eye magazine invented the now-common phrase 'tired and emotional' to describe him. Whilst some of the downfall of the DEA was due to economic events, some must also have been due to Brown's individual character and position within Wilson's Cabinet.

Reflections and Current Significance

The UK economic environment and institutions of economic policy are markedly different today to in 1964. Following the end of fixed exchange rates and lifting of international capital controls that came with the end of the Bretton Woods era, the government (and Treasury) no longer has to make day-to-day decisions on deflation, currency devaluation, and the balance of trade. Looking at the structure of the DEA in 1964, much seems redundant to todays policy discussion; no one is proposing a return to centrally administered prices and incomes policy. Yet even if the DEA is not an inspiration functionally, as an attempt to break the power of the Treasury and as an institutional innovation in economic strategy it is instructive.

Key lessons that can be learnt from the rise and fall of the Department for Economic Affairs include:

- **Division of responsibilities** between the Treasury and a new counterpart are critically important but perfection is not possible and there will always be conflicts and coordination needed
- Strong leadership by a dynamic and **capable Secretary of State** is important, as is the **quality of civil servants** staffing any new ministry
- No institutional innovation can be a replacement for **Prime Ministerial decision-making**

- By definition a new ministry must have a **different remit and clear purpose** distinct from the Treasury
- An economic strategy ministry should be an **active coordinator and manager of stakeholders** from across the economy, including employers, trade unions, industry bodies, academics, etc.
- Some components of economic policy, such as **the budget**, are so significant that ownership by the Treasury or a new counterpart will create practical issues – these should either have shared ownership or ownership by a third institution, for example, the US Office of Management and Budget

George Brown argued that “Some government, someday, will re-create a department on the lines of the DEA and limit the out-dated authority of the Treasury. When that happens - and it is bound to happen - the thinking that went into the DEA will be acclaimed." It was reported prior to the 1997 General Election that the Shadow Chancellor, Gordon Brown, was considering reform of the treasury. Somewhat ironically given the relationship between the Prime Minister and the Chancellor during the Blair-Brown years, Brown was cited as dismissing the creation of a new separate ministry on the basis that “the lesson of the DEA is that splitting responsibility between departments is a recipe for turf wars and policy confusion”.

Many of the challenges Harold Wilson, George Brown and Gordon Brown identified still exist today. These have been highlighted all the more since the scrapping of the Industrial Strategy (held by BEIS) in March 2021 and the shifting of responsibility for the ‘Plan for Growth’ to the Treasury. Given the structural constraints and critiques set out earlier in this piece, there are valid concerns for industrial policy or long-term economic strategy if it is to be stewarded by the Treasury.

The urgent need to shift our economy towards sustainability and decarbonisation to achieve “net zero” and avoid catastrophic climate change presents a unique context with particular relevance to the constraints of the Treasury. Climate change is a long-term, distributed problem that requires the consideration of non-financial costs (i.e. damage to natural environments). It will also require sustained and well-directed public investment. This is particularly problematic for the Treasury given its short-term centralising instincts and its reliance on economic orthodoxy that doesn’t account for environmental externalities. Various authors have made specific critiques of the need for the Treasury to adapt to solve climate change (Craig 2016, Green Alliance 2014).

In Will Hutton’s book *The State We’re In* he reflected on the out-sized power of the Treasury and described it as “the embodiment of the book-keeping night-watchman view of the state”. Hutton wrote that “reform of the Treasury is one pivot on which national renewal hangs” and advocated breaking up the ministry into its constituent parts, as did Giles Wilkes and Stian Westlake. Wilkes and Westlake cite the economist John Kay ascribing the “demise of major British industrial firms like ICI and GEC to this penny-wise, pound-foolish mentality” of the Treasury.

Arguably the creation of the Department for Business, Energy, and Industrial Strategy (BEIS) by Theresa May in 2016 and the publication of the industrial strategy white paper by then Secretary of State Greg Clark MP were attempts to create a strategic rival within Whitehall to the Treasury. If that was the case the success of the Industrial Strategy was short lived and the Treasury was very much the victor in the Whitehall power struggle, much like the rise and fall of the National Plan in 1964. The independent Industrial Strategy Council, an attempt akin to the NEDC to bring together external stakeholders in industrial policy for assessment of policies, was disbanded at the same time as the scrapping of the Industrial Strategy itself in March 2021.

If the Industrial Strategy was the primary economic development program of the May government the analogue under the Johnson government is "Levelling Up", intended to address regional economic inequality across the UK, and achieving Net Zero. If BEIS was the guardian of the Industrial Strategy with responsibility for economic strategy, the Whitehall dynamics are now more complicated. The Treasury is ostensibly responsible for the Plan for Growth (the little-mentioned successor to the Industrial Strategy), BEIS holds responsibility for Net Zero, and the newly created Department for Levelling Up, Housing and Communities is responsible for the as yet undefined 'Levelling Up' policy. Against such a confused Whitehall backdrop, its likely that the same characteristics of the Treasury – short-termism, penny-pinching, centralising – will continue to dominate UK economic policy.

International Examples

Other developed economies tend to divide finance and economic departmental portfolios into separate ministries. Whilst this does not aim to be comprehensive, and differences between ministerial briefs vary in all these cases, the UK Treasury remains unusual in its combined financial and economic roles.

Country	**Finance Ministry**	**Economic Ministry**
Germany	Federal Ministry of Finance (Bundesministerium der Finanzen)	Federal Ministry for Economic Affairs and Energy (Bundesministerium für Wirtschaft und Energie)
USA	US Department of the Treasury NB responsibility for the budget sits with the Office of Management and Budget	US Department of Commerce
Canada	Department of Finance	Department of Industry (colloquially Innovation, Science and Economic Development Canada)
Japan	Ministry of Finance	Ministry of Economy, Trade, and Industry (METI, formerly MITI)

Further Reading and Sources

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