

# Working Towards Higher Living Standards for New Zealanders

Speech delivered by  
John Whitehead, Secretary to the Treasury

25 May 2011

Thank you everyone for coming along this evening. It is an honour to be speaking to an audience of this calibre, and I am looking forward this evening to discussing an issue which is quite fundamental to the work that we do here at Treasury. It is also fundamental to the sort of country we aspire to be.

Before I do so I want to say that this will be the last public speech I make as Secretary to the Treasury. It has been an enormous privilege for me to do this job. It is an agency of highly capable public servants who are resolutely determined to build a better future for this country. Like other New Zealanders, they want a more prosperous future for themselves and their families. They want safer communities and lower levels of crime. They want better education and health outcomes, and greater protection for our fragile natural environment. They want more jobs and fewer people unemployed. And of course they want a strong economy that will give people the potential to succeed. In short, they hanker for a better standard of living for all. As I've travelled up and down this country I've found that lots of different groups of New Zealanders refer to much of the same thing.

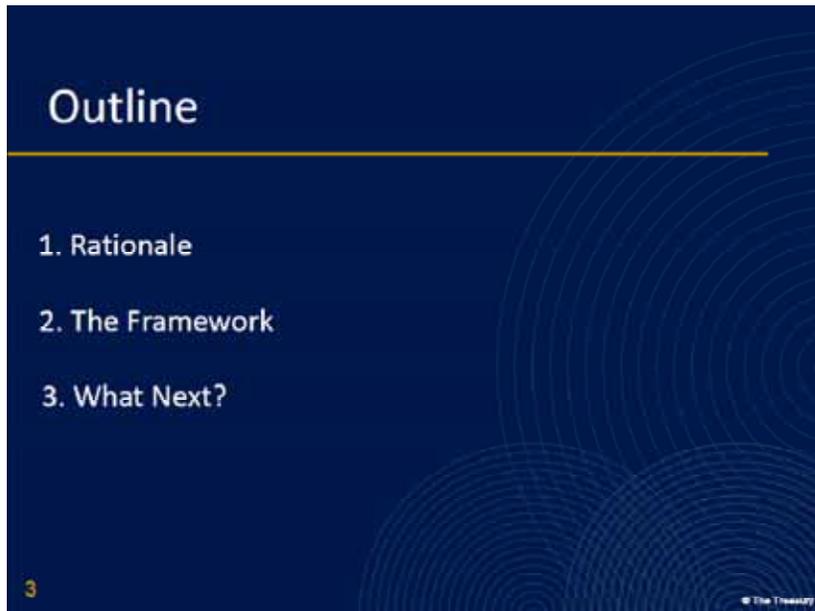
## Treasury's Vision



Improving the living standards of New Zealanders is at the heart of Treasury's vision. It is referred to every time the Treasury publishes one of its accountability documents, such as an annual report or a Statement of Intent. It is easy to say - higher living standards for New Zealanders - without contemplating what that really means. It is certainly a challenging concept to define and measure. However, we recognise that we have not been explicit enough in the past about what we do mean. This evening I am going to talk about an important piece of work we have been doing to provide some clarity around the ultimate aims of our work. The work in question is a descriptive framework that brings together the factors that Treasury considers make up what we refer to as living standards. It's not a framework that automatically generates the right answer to every question, but it does help describe the factors that we consider when providing advice.

## Outline

I intend to approach what I have got to say in three parts.



**First**, I will provide some background and context to the work and elaborate on what we hope it will achieve. It is also worthwhile spending a bit of time reflecting on how the Framework meshes with Treasury’s role in the public policy process.

**Second**, I will talk about the framework itself and some of the thinking that underpins it. There are a broad range of factors that matter to living standards and they warrant some discussion. It is worth taking a few minutes to assess how New Zealand is getting on when one moves beyond average income, consumption and wealth statistics.

In the **third** and final part of this address I will tell you what might happen next – so having devoted some time and energy to developing the framework, what do we intend to do with it, and how will it inform the advice we formulate. We also hope that the framework will contribute to wider public debate on the objectives of public policy.

## Rationale



There has long been argument about whether GDP is an adequate indicator of the well-being of a nation. Some contend that while tallying up the total value of goods and services produced might be something of a blunt-instrument approach, it is still the most dependable measure of a nation's economic progress, and therefore its prosperity. Others point to the deficiencies of the GDP measure, pointing out that it doesn't account for some non-market production, or for factors like the gap between rich and poor or the amount of leisure time people have, or their quality of life.

I want to begin by saying that the Treasury has not experienced some Road to Damascus type recognition of the importance of measures other than GDP. I know the sceptics will take that with a grain of salt. But the truth is that we have been wrestling with this topic for some time now. I can remember when living standards were first proposed as our vision. The now disbanded Growth and Innovation Advisory Board, created in 2002 to provide independent advice on growth issues, immediately asked the question: Why not well-being or quality of life?

Well, I don't think there is any point in getting into a semantic wrangle over the issue. I believe the framework we are publishing today shows that the way we interpret living standards is probably quite similar to concepts of well-being, though we do focus the framework on particular values that are consistent with our role as the government's lead advisor on economic, fiscal and regulatory policy.

The reality is that the framework reflects, in a number of ways, what Treasury has been advising over the last 10 years or even longer. This is not a sudden lurch into new territory, however, it does seek to establish a broader intellectual basis for our work - one that provides a guide for how we should be thinking about the complex and multidimensional nature of living standards.

The framework will therefore mean a shift in how Treasury formulates its advice. At the same time I – and the Treasury at large – would like to see a shift - hopefully quite a noticeable shift - in the way that our work is perceived externally. I see that as an important sub-objective of this exercise.

It is fair to say that the Treasury I joined at the start of the 1980s was a very different Treasury from the one that I will leave next week. It is clear however that some of the historical baggage is still with us. Misperceptions of the role Treasury has played during and since the 1980s have limited our ability to be persuasive when talking about what matters most for living standards. Some people have never got beyond believing that we are the root of all New Zealand's economic evils. Others see us as little more than the defenders of fiscal virtue, obsessed with eliminating deficits and debt – the organisation that knows the price of everything but the value of nothing. But of course the Treasury is about a lot more than just fiscal rectitude.

So I hope that this paper will address some of the misconceptions that have dogged us in recent times. It proposes a more descriptive framework of the factors that, in Treasury's view, comprise living standards, and formalises what until now we have only done informally.

It will also enable the Treasury to monitor progress towards our vision. That is, it will allow us to ascertain whether or not our policy advice is being effective in focussing on what matters most for living standards, and actually helping those standards to improve – in particular for those that need it most.

## Treasury's Role



As I mentioned earlier, I want to spend a minute or two expanding on Treasury's role in the public policy process. Our lead advisor role on economic, fiscal and regulatory affairs has tended to lead to quite a strong focus on economic objectives.

However, we also have an important role as a central agency along with SSC and DPMC, which in our case requires us to look across all areas of spending within the public sector.

When thinking about what makes spending “cost-effective”, we don’t just think about how much it will increase growth, or how much we can avoid spending in the first place. Our aim in life is not just to be fiscally responsible. But in the current economic climate, where we find ourselves some considerable way from the sunlit uplands of budget surpluses, a conservative approach to spending is particularly important. In doing this we want to make sure the decisions made on what to spend are based on a recognition of the broad range of social and environmental benefits that result from government intervention as well as the costs. Tighter budgets also require an even greater focus on making sure that resources go to those that need it most.

In providing advice we therefore need to understand what the broad range of benefits actually is, and to recognise that they are significant to the lives of New Zealanders - and therefore relevant to those whom Treasury advises. As an economic agency, Treasury generally takes what we call a social welfare or utility-based approach to determine what the best regulatory environment and allocation of public finances should be. One can take the phrase ‘living standards of New Zealanders’ and use it to represent the concept of social welfare commonly used in economics. So Treasury’s goal can therefore be thought of as aiming to improve welfare, or well-being, within society.

It is clear that other economic agencies also take this broad-focus approach. For example, the Australian Treasury has crafted a well-being framework to underpin analysis and advice across the full range of its public policy responsibilities. The OECD also has also been very active recently in promoting similar concepts to those that exist within our framework, building off work done by the Commission on Measuring Economic Performance and Social Progress. And the World Bank has for some time been promoting a broader and long-term view of development.

## The Framework



So let me turn now to our framework, and the factors that we have included in it.

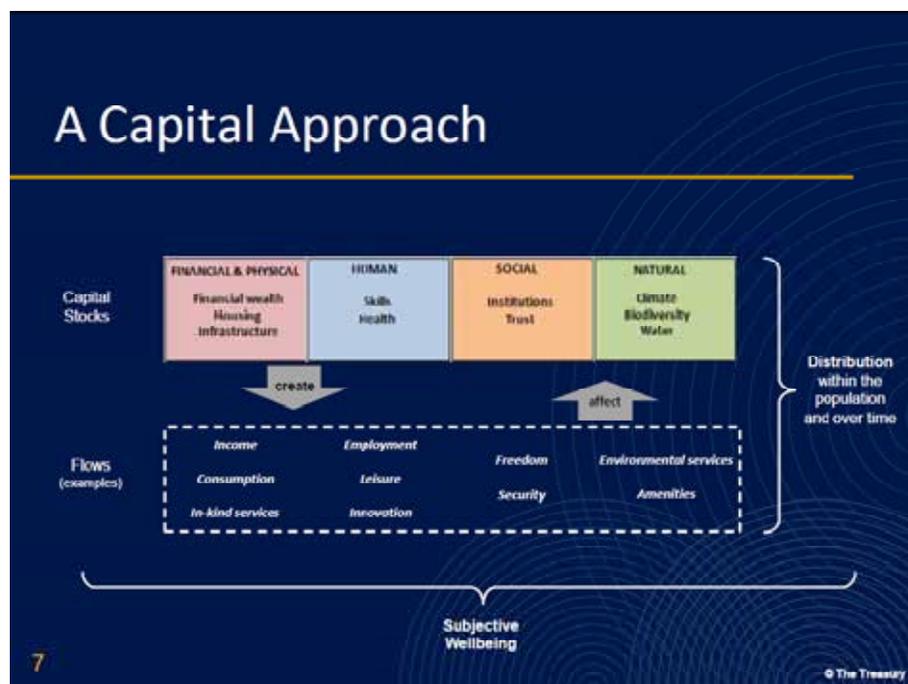
As I have just touched on, there is a growing acceptance among like-minded economies that there is a need to develop a more comprehensive view and measurement of societal progress. While GDP and gross national income per capita are part of what contributes to living standards, they are not all that matters. This is why Treasury's use of the term living standards is broader than material living standards. We recognise that growth and incomes are generated from a well-educated, healthy, safe and contented society. We also acknowledge that these outcomes matter - not just for the contribution they make to material living standards, but because they improve the lives of people irrespective of any economic gain.

Overall, the framework has five elements that it recognises:

- One, that there is a broad range of material and non-material determinants of living standards.
- Two, that individual freedoms and capabilities are very important for living standards [The events we are witnessing in North Africa and the Middle East at present are a potent reminder of the peril of aggressively denying those rights and freedoms].
- Three, that the distribution of living standards across different groups in society is an ethical concern for the public, and a political one for governments, and economic analysis can provide useful insights.
- Four, that the distribution of living standards over time is of high importance, both for equity concerns but also to make sure we are sustainably managing our resources.
- And five, that measuring living standards directly, using self-assessed subjective measures of well-being, provides a useful cross-check of what is important for people's living standards.

So Treasury's notion of living standards therefore has multiple dimensions. It is mindful of distributional concerns, and also draws on social, cultural, civic and environmental aspects. That is how it should be if we are to capture the things that really do matter to people. As I mentioned earlier, standard economics will tell you that what matters is utility - that is, the capacity of a commodity or service to satisfy some human want. That is indeed derived from multiple factors. But in addition to utility, other values such as rights and freedoms - which are intimately related to a person's relationship to the state and society - are also included.

## A Capital Approach



We have used a 'capital approach' to incorporate all the above elements into a single framework. Our starting point has been thinking about the stewardship role we can take to ensure our stocks of financial, human, social, and natural capital are managed in such a way that we maximise current living standards while not disadvantaging future generations. I should pause and briefly explain what these four stocks of capital are.

**Financial** and physical capital essentially refers to economic wealth. It is the value of fixed assets, be they machinery or buildings, and the level of financial capital, including equities, assets and liabilities that have a degree of liquidity. They are important for determining material standard of living and how much income can be generated.

**Human** capital is the knowledge, skills and capabilities embodied in a person, and their health status. It is a key factor in determining employability and income, and overall wellbeing.

**Social** capital is defined as the degree of trust in a society and the ability of people to work together for common purpose. Individual rights and freedoms are an integral part of social capital. So too are public institutions.

**Natural** capital refers to the Earth's natural resources and the ecological systems that provide life-support and other services to society. Natural capital is a key input into economic production and wealth creation, as well as a direct contributor to wellbeing.

These stocks create *flows* of goods and services which contribute to the living standards of New Zealanders, such as their income, employment, freedom and amenities they enjoy.

In generating these flows, other stocks can be *affected*, for example employment can lead to greater stocks of skills, while income may increase consumption and reduce natural capital.

Why is this capital stock and flows approach important?

They enable us to take a broad view of living standards and consider multiple dimensions and values. When we think about these multiple dimensions and values, we care about both the current level and the future, and the capital approach highlights the importance of sustainability. For example, it would not be sensible to be borrowing continually to pay for current consumption, as the debt we accrue would ultimately need to be paid in the future. Think about this another way. If we choose not to invest in the education and skills of our young New Zealanders, we will be failing to set ourselves up well for the future. So how to allocate funding across time is therefore crucially relevant.

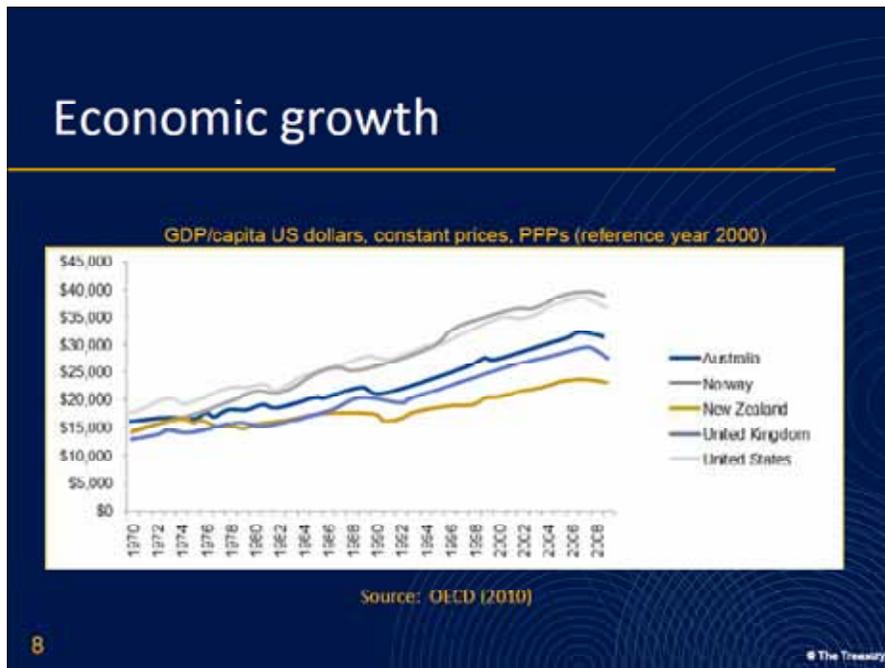
In addition to thinking about the distribution of resources across time, the Treasury's framework also recognises that it is important to understand the distribution of living standards within the current generations. Every administration under which I have served – and that covers 10 Prime Ministers – have had a central concern for the outcomes for those with the lowest standards of living. The current Prime Minister, for example, has raised concerns about the emergence of an underclass in New Zealand. We also recognise that decisions about distribution can make policy interventions more cost-effective, as it is often the case that a dollar of the right services going to the least well off will produce the greatest long-term benefit to society. The upshot will be that living standards overall will improve.

Furthermore, in considering who the least well off are, it is important to take a dynamic view, and focus attention on those that are likely to face a lifetime of poverty and disadvantage, which has the added potential drawback of negative intergenerational effects. Treasury is therefore alert to the need to improve the living standards of those who have a poor long-term outlook. What this comes down to is improving opportunities for mobility of those at the bottom of the socio-economic ladder.

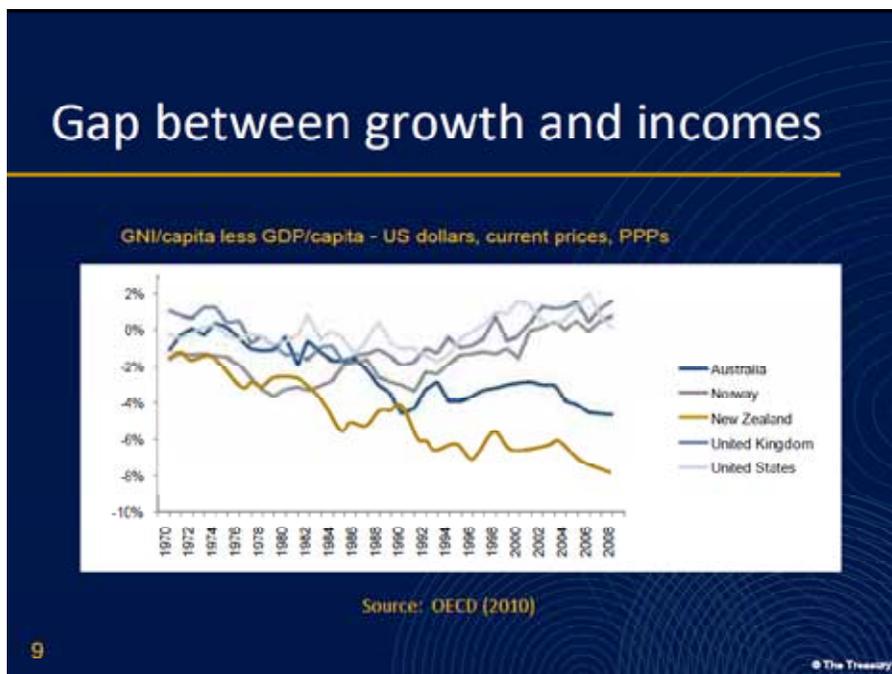
Subjective measures are also considered in Treasury's framework – essentially how people feel about their living standards, including how they are distributed. This area is sometimes known as the “science” of happiness - people are being asked about the degree to which they are happy or satisfied with their lives. While they have limitations, subjective measures are important as they allow us to assess how well someone is living, based on that person's own perspective or experience, and enable us to cross-check whether we are focusing on the right areas. The subjective well-being literature confirms our intuitive understanding that factors such as good health and employment are important in people's lives. It also emphasises the

importance of social connectedness, such as having strong relationships with families, and friends, and our communities.

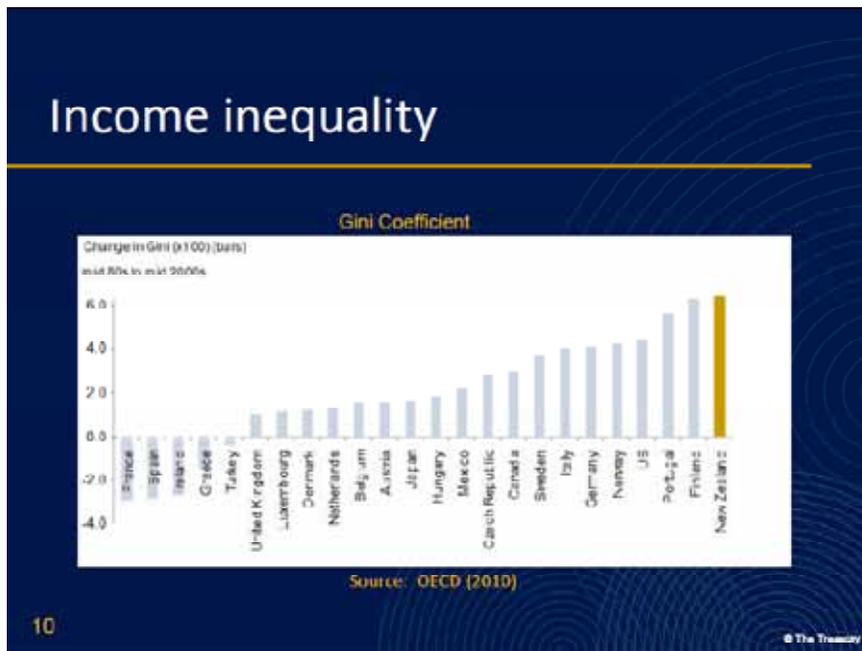
So turning to some of the indicators we have used to capture living standards. Compared to other OECD countries our GDP growth rates have been generally lacklustre, however, since early 1990s they have been broadly stable in proportional terms.



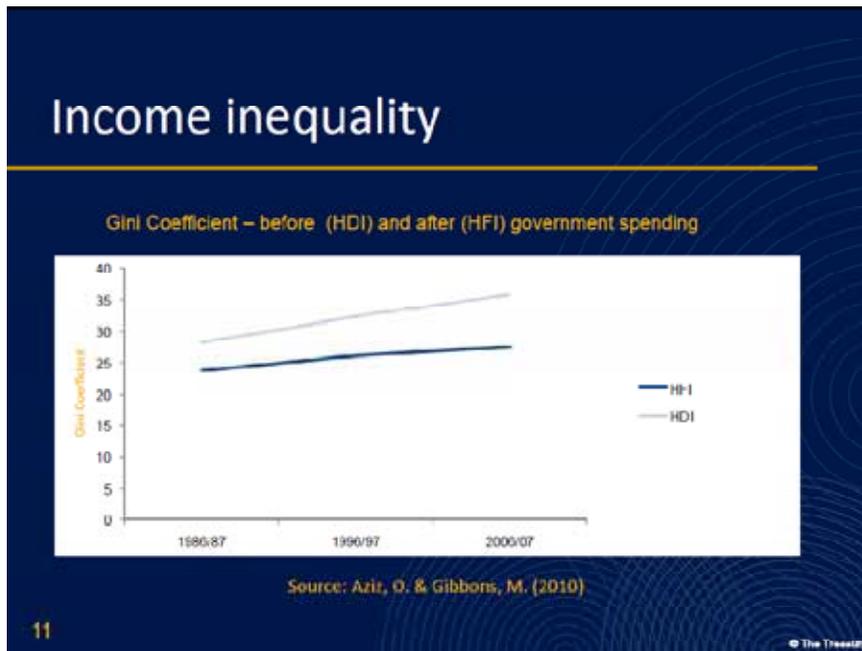
At the same time, the gap between GDP and GNI (the income that accrues to New Zealanders) is growing, which is particularly concerning as our GNI is not growing strongly.



Income inequality - measured by the gini coefficient - has been growing faster than any other OECD country over the last 20 or so years, to a point where we now have the unenviable standing of 7<sup>th</sup> place in the 'most unequal' stakes.



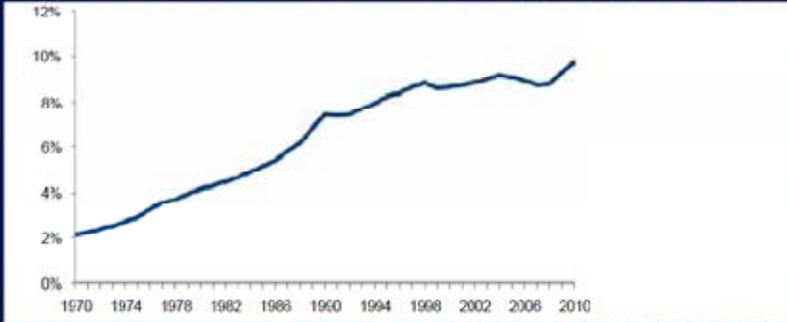
However, when you compare inequality *before* government assistance is included - using household disposable income as the measure - with inequality after government spending, such as on health and education – a term economists refer to as ‘final income’ - inequality is much less and has been growing more slowly.



The proportion of working age people on benefits is steadily mounting. The rates of benefit dependency among certain groups are frankly alarming.

## Growth in benefits

% of working age population on benefits other than unemployment benefit



Source: Welfare Working Group (2011)

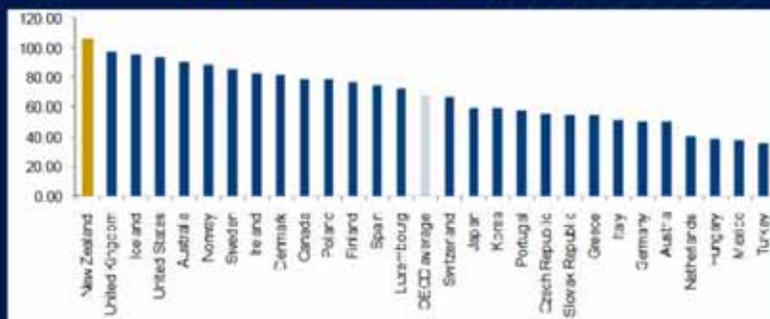
12

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But on the positive side of the ledger we have health and education outcomes that are better than OECD averages, although inequality in education outcomes within schools is extremely high. As shown in this graph, we have the biggest difference between the best and worst performers within schools, on the internationally recognised PISA scoring in 2006.

## Variance in education outcomes

Variance in 2006 PISA scores within schools



Source: OECD (2011)

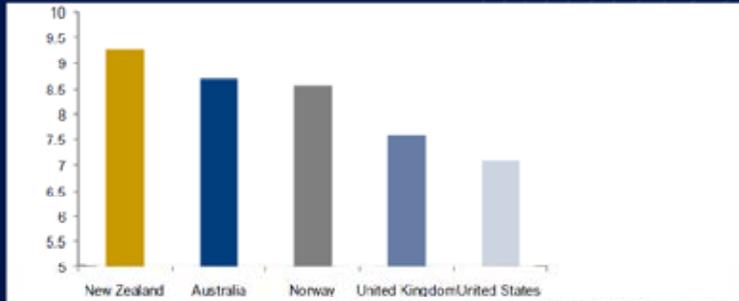
13

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A more pleasing statistic is that New Zealanders are generally highly trusting of other citizens and also of government – we are rated as being the least corrupt of all countries in the world.

## Lack of perceived corruption

Lack of perceived corruption in government (2010)



Source: Transparency International (2010)

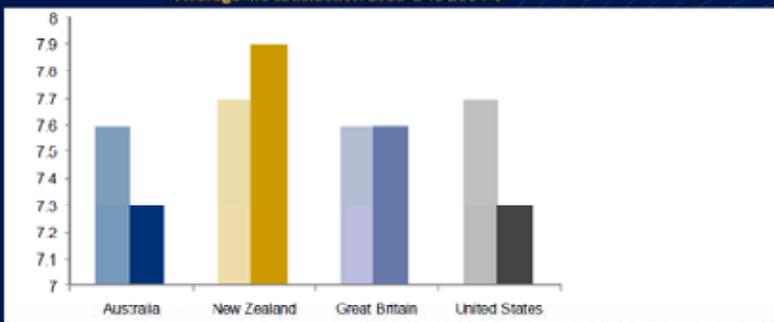
14

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Throw all this data together, along with other findings in respect of our performance, and what do people say about how their life is in New Zealand? Well, we find that Kiwis have a higher level of life satisfaction compared to most OECD countries, and it is growing (unlike many other OECD countries) when you compare data from the mid 90s with that from about 5 years ago.

## Subjective well-being

Average life satisfaction 1995-8 vs 2004-6



Source: World Values Survey (2009)

15

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That is an encouraging trend. Economic measurements are an important tool for tracking our progress as a nation, but perhaps they don't fully capture what is important to us, and what really fuels our sense of well-being. On the other hand, perhaps complacency is a risk. If people were more aware of the risks to the sustainability of our economic income perhaps they would be a little less satisfied.

## What next?



So that brings me back to Treasury's Living Standards framework. It has been a rigorous and exhaustive exercise bringing it together. Now that it is complete, you may well be asking - what happens next? Well, we want you to read it. We would also like you to discuss it. The framework does not provide a strict hierarchy of what is important for living standards, as this will differ in different circumstances. Similarly, it does not seek to specify a list of policy priorities. At any given time Treasury's priorities will be modified by policy objectives of the government of the day, and also where we can make the most impact. To reiterate what I said earlier, the framework is designed to bring a considered philosophical approach to how we think about the big public policy issues we are grappling with. What is important for us is that it builds external credibility around our vision.

The process of developing the framework has been valuable as a means of encouraging internal debate about living standards, and gaining clarity around what living standards means for Treasury. There are a number of further steps to be taken now to realise the full value of this work, so that we achieve internal consistency and external credibility. One will be ensuring that our staff are familiar with the framework and its implications for their work. Another will be identifying areas where further work may be needed to develop a more robust understanding of living standards.

## Conclusion

So let me finish by urging you all to take an interest in this framework, and in the objectives that lie behind it. It is really important that we hear the views of others. If our concept of living standards is to be effectively integrated into policy-making, we need to hear what others have got to say. Treasury does certainly not have all the answers, and it is important that we admit to the limits of our certainty and our empirical ability.

I stress again that Treasury certainly cares about more than just growth. While a well-performing economy is one of the key drivers of higher living standards and advising on how to improve economic performance is one of our core roles, we recognise that there are a broad range of factors that contribute to New Zealanders' lives. We have higher living standards in our vision statement, and we are looking to be more purposeful about achieving that aim. We are certainly mindful of distributional outcomes, and it is our intention to use this living standards framework to advise Ministers on them. Let me assure you that we want to work towards ensuring security and prosperity and better living standards for all, not just a select few groups of New Zealanders. In particular, Treasury is focussed on the need to improve the living standards of those who have a poor long-term outlook – and improving their mobility up the socio-economic ladder.

All sorts of factors influence living standards, and of course we cannot control all of them. We also recognise that there will be differences and debate around what really matters. What we are doing here is wrapping a descriptive framework around the factors that in Treasury's view comprise living standards. By doing that I am optimistic that it will make our advice more robust, more relevant and more persuasive.

Finally, I want to say I am proud of this piece of work and of the teams at Treasury who have been responsible for bringing it together. In particular can I thank Ben Gleisner, Mary Llewellyn-Fowler and Fiona McAlister for the lead role they have played.

I will be leaving the Treasury at a time of great challenges for this country, but also a time of great opportunities. It is critical that we seize these opportunities, and I hope this work will help us do that.

We are all going to need to work together to build new foundations as we strive to realise the promise of New Zealand, and the promise of better living standards for those who live here.

All of us have great expectations for our country. Let's get on with the job of fulfilling them.

Thank you.