THE TREASURY
Kaitohutohu Kaupapa Rawa

The Treasury Approach to the Living Standards Framework

New Zealand Treasury

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1 Introduction

The Living Standards Framework (LSF) has been developed by the New Zealand Treasury to consider the collective impact of policies on intergenerational wellbeing. This is a Treasury Paper describing an overview of our approach to understanding and measuring living standards.

In parallel to this paper we are publishing four discussion papers on:

1. Wellbeing Frameworks for the Treasury
2. The Value of New Zealand's Human Capital
3. The Value of New Zealand's Natural Capital, and
4. The Value of New Zealand's Social Capital.

The discussion papers are not the Treasury's position on these issues. Broadly, they describe other, usually academic and international work as a step towards measuring intergenerational wellbeing and its sustainability in New Zealand. The reader will find marked differences between the papers. This reflects differences in the subject matter and the state of knowledge. The Treasury very much welcomes comments on these papers to help bring these strands of work together into a cohesive set of indicators.

The papers do not cover all the issues and work has already begun on cultural capital, financial and physical capital and dealing with uncertainty. Further discussion papers will be released on these and other topics as our work develops.

The key points in this overview paper are:

- The Treasury LSF is a way to support government agencies to be more cohesive so public policy on wellbeing, spending and other government interventions is aligned to improving intergenerational wellbeing.

- The LSF builds on the Organisation for Economic Cooperation and Development (OECD) approach to wellbeing because its work provides a robust evidence base for understanding intergenerational wellbeing.

- The Treasury's approach is framed using four capitals as a way of organising indicators of long-term wellbeing. Working definitions of these capitals will develop in a similar way to the development of the national accounting framework.

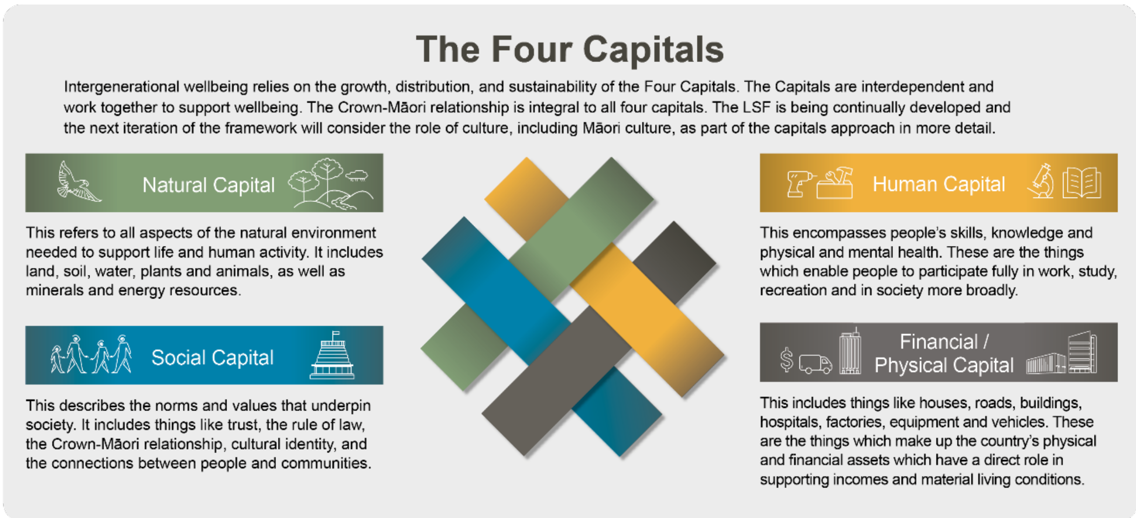
- There is much work to be done to convert the work by international organisations and academics into a practical approach to measuring living standards.

Our approach is unapologetically pragmatic: just as the Treasury expects government agencies to show where their work adds value, the Treasury's work on the LSF is focused on a wellbeing approach that can improve the quality of policy advice and government services.

2 What is the Living Standards Framework (LSF)

The New Zealand Treasury has always recognised the importance of the diverse outcomes of government interventions.[1] The Living Standards Framework (LSF) formalises this by drawing on OECD analysis starting with four capitals to organise indicators of sustainable **intergenerational wellbeing**.

Figure 1 – The Living Standards Framework



There are many possible ways to understand intergenerational wellbeing.[2] Our approach starts with a definition of **current** wellbeing, based on the OECD's "How's Life" analysis.[3] The four capitals are a way to organise indicators of **intergenerational** wellbeing. The working definitions in Figure 1 above are based on the OECD's definitions of the four capitals.[4] These working definitions are likely to change as our work develops.

As the framework incorporates more data it will inform answers to questions regarding:

- whether or not the four capitals are growing and likely to be sustained
- social and demographic inequalities in wellbeing
- how the flow of current benefits impacts on long-term outcomes, and
- the impact of resource allocation decisions on current or long-term wellbeing.

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1 For example, "The basic aim of an equitable welfare state is to provide assistance to those in need", The Treasury (1990). See also, for example, Jacobsen et al. (2002); Gleisner, Llewellyn-Fowler, and McAlister (2011).

2 For example, CIPFA (2016) six capitals framework and the United Nations (2015) "sustainable development goals".

3 See King, Huseynli, and MacGibbon (2018).

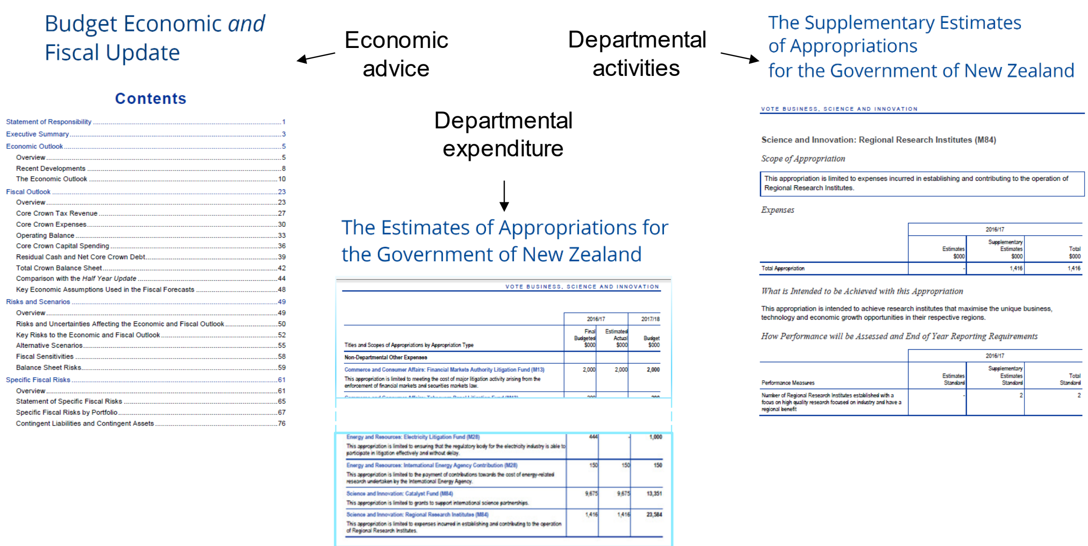
4 OECD (2015).

3 Why Does the Treasury Need a Living Standards Framework?

Much of the academic discussion of wellbeing focuses on the limitations of using income as a proxy for wellbeing and the availability of alternative measures.[5] However, the issue for government agencies is rather more practical. There is already a wide array of easily accessible measures available for policy purposes. A New Zealand selection would include the Ministry for the Environment's publications on the environment; the annual report by Bryan Perry on income and its distribution; and the Treasury's monthly publication of economic data.[6] The question for us is how policy advice would *improve* if the imperfect measure of wellbeing – income – was brought together with this other data in a single framework?

We believe the answer to this "so what" question is simply that it will improve the Treasury's delivery of its core functions of providing economic and fiscal advice. As noted in Section 2, the New Zealand Treasury has always recognised the diversity of outcomes. Nonetheless, like other government organisations, it tends to silo its policy advice. As *Figure 2* shows, the Treasury analysis of economic policy focuses on increased incomes, and is separated from departmental expectations and expenditures that have wider wellbeing objectives. Across all this advice there is little or no reference to the 40-year perspective of the *Long-Term Fiscal Statement*.

Figure 2 – The streams of the Treasury's advice



Source: The Treasury http://www.treasury.govt.nz/budget/2017

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5 Dalziel and Saunders (2014).

6 See Ministry for the Environment (2018), Perry (2017) and The Treasury (2018a).

The LSF is the means to draw together the measurement of the variety of outcomes from government expenditure so they are consistent across the whole range of economic, social and environmental policy, and consistent with the intentions of the expenditure.

The four capitals put sustainable, intergenerational wellbeing at the core of the system. In the language of the State Sector Act (1988), the health of the four capitals is a way of assessing how well agencies are delivering their “stewardship role” for New Zealand public policy.

4 What is our Approach to Developing the Living Standards Framework?

We are focusing our efforts where value can be added to what is already tried and tested. Thus our approach is to build up the LSF so that it improves on the scope of income measures of national wellbeing, but emulates them where they are useful.

Current wellbeing

There is an emergent consensus on the best way of measuring current wellbeing that means the variety of available indices are very similar.[7] In choosing a variant for the LSF, our measure of current wellbeing is similar to income measures of wellbeing by being:

- *Internationally comparable* – To inform us on New Zealand's levels of wellbeing relative to the countries we wish to compare ourselves with. This helps us identify opportunities for improvement.

- *Inter-temporally comparable* – Knowing how we are performing over time by meaningfully comparing the current period with previous time periods. This is also important if we wish to project into the future.

- *Data available* – A framework is of little use if we cannot get data for it on a timely basis. Ideally, there will be a long official time series of each measure in a framework in its original units available from New Zealand sources and able to be divided up in several different ways, such as by ethnicity, region or income level.

- *Suitability for developed countries* – New Zealand is a developed country and the indicators used need to reflect this. In particular, indicators that focus on the needs of developing countries, such as obtaining sufficient nutrition or primary school education, are a low bar and leave little or no room for policy improvement.

- *Measure what is uniquely important to New Zealanders* – Like every country, there are things that make New Zealand unique (for example, our Treaty of Waitangi obligations). These form part of the wellbeing of New Zealanders and so should be reflected in any measurement frameworks that we use.

- *Credible* – The chosen measure must have both technical and political credibility. Political credibility is likely to be enhanced if the measure is designed by internationally well-respected apolitical bodies, particularly intergovernmental agencies such as the OECD or the United Nations (UN). Technical credibility includes the criteria above, and the use of high-quality data sources, having appropriate coverage and sound techniques for indexing and averaging.

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7 See King et al. (2018), pp. 6/7.

But improves on income and physical and financial wealth indicators of wellbeing by:

- *A dashboard approach* – While there is debate on whether or not wellbeing can be summarised in a single number, there is agreement that wellbeing itself is multidimensional.[8] A dashboard approach ensures these dimensions are clearly represented without pre-judging the variety of aspects of life that people value. The best framework will comprehensively cover all areas contributing to wellbeing.

- *Coverage* – The chosen measure should provide good coverage of all generally recognised aspects of wellbeing. This includes health, income, environment and social connection.

The four capitals

The four capitals are core to the LSF. As with the indicators of current wellbeing, we are aligning our approach to the LSF capitals with the national accounts and the approach taken there to solving conceptual and practical measurement issues. In particular, the definitions in national accounts continually evolve and what matters is that everything is included, not *where* it is included.

For instance, national income in an economy is usually defined as the combined value of household expenditure, investment by firms, government spending and the balance of expenditure on imports and exports. Though each of the terms in the previous sentence has a clear intuition, they are actually *used* in national accounts as identities that define national income. That is, categories like “household expenditure” and “investment by firms” incorporate expenditure by charities but exclude transfer payments and unpaid work. They are not, and are not intended to be, “real” entities. Rather they are accounting identities that help us understand what has been included and their definition changes as our knowledge of what needs to be included improves.[9]

This approach is sometimes confusing because it may appear to exclude important aspects of future wellbeing. For instance, a number of additional capitals have been proposed, including a distinct “cultural capital”, “knowledge” and “intangible assets”.[10] These are not excluded by the four capitals approach, but can be incorporated under the four capitals analogously to the way charities’ earnings are, for the purposes of national accounts, treated in the same way as for-profit organisations.

This sparse approach has three huge practical advantages. First, the four capitals approach is simple and aligns with an internationally consistent approach. This makes it easier for the New Zealand Treasury to use the work of a wide variety of experts. As noted above, the development of the LSF focuses the Treasury’s work where it can add value. Reworking wide-ranging conceptual issues that others are addressing does not add much value.

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8 Nussbaum (2004).

9 See Stats NZ (2017) for latest data revisions.

10 Cf Frieling (2018), Dalziel and Saunders (2014) and CIPFA (2016).

Second, it separates the practical issues of measurement from more conceptual discussions about the entities themselves. The discussion of, say, the role of the charitable sector in national income is distinguished from the practical measurement issue of deciding whether family trusts or private schools have been properly measured and if they should count as firms or households. They are counted somewhere, and the second order definitional issues are treated as second order.

Finally, treating entities as accounting categories creates a common language for discussing them where both sides of any debate may agree to use the language without making a philosophical commitment to what is “really” happening. Thus in the national accounts, estimating the size of the economic role of private schools by treating them as firms does not commit the discussion to a view of their status.

5 Challenges

The first attempts to develop national income accounting were in the 17th century and modern variants have been in continuous development since the 1940s.[11] Academics and international bodies have started to develop wider wellbeing measures, but as practitioners apply their work, gaps in current analysis will become increasingly apparent. Below is a brief selection of the issues that still need to be addressed.

Adapting current processes

The complexity of government processes means substantial time is needed to integrate new approaches. At this stage there is a stronger case for using the LSF in strategic decisions, which is closer to the intent of the work by international organisations, than using it on a programme-by-programme basis.

Specific impact analysis may be possible where there are material changes to large programmes with a direct link to household wellbeing (eg, tax, housing costs), but the tools for doing this in a way that works at the pace policy develops will need to be created. Barriers include the quality of information we typically receive from agencies, cross-agency standardisation, issues around attribution and the sensitivity of the measurement.

Sensitivity of the indicators

The sensitivity of the measures to real policy changes is still unclear because current measures have not been properly tested in a policy environment. What do we use when they are not sensitive enough to provide a guide for advice?

Sustainability

While the Brundtland Commission's definition of sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" [12] is widely accepted, this encompasses a variety of different criteria that will, in practice, differ by context.

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11 Bos (1992).

12 WCED (1987).

Distribution

The traditional measures of the dispersion of wellbeing use the distribution of income, but where income does not properly proxy wellbeing, it will also poorly proxy its distribution. Adding other attributes of wellbeing may lead to counter-intuitive conclusions. For example, younger people tend to have lower incomes than older people, but older people tend to have poorer health. Does this mean income inequality measures should be adjusted to account for the benefits of better health?[13]

Ownership

What is the natural, social and human capital equivalent to owning physical capital, including the individual benefits, obligations and responsibilities?

13 Compare with the debate of inequality in OECD (2017).

6 Next Steps

During 2018 the Treasury intends to develop a dashboard of indicators suitable for understanding intergenerational wellbeing in New Zealand. The dashboard of indicators will need to be robust to provide long-term advice, but also be responsive to the wide variety of short- and long-term requirements that the Treasury and other government organisations have.

As part of this development process we will be releasing further discussion papers on cultural capital, financial and physical capital, dealing with uncertainty and other topics as they emerge. As with the current tranche of papers, the Treasury welcomes comments on these papers to help bring these strands of work together.

There will be three distinct types of indicator:

- **Best evidence indicators for comparison** between New Zealand and other countries, to understand current and future trends in wellbeing.

- **New Zealand-specific indicators** of current and long-term wellbeing, particularly with respect to Treaty of Waitangi obligations and values, and other aspects of New Zealand's unique diversity.

- **Indicators for current policy priorities** that supplement the medium- to long-term focus of other indicators to support short-term focused action by government and government agencies.

How the indicators are finally presented is yet to be determined, but *Table 1* below summarises the components of the dashboard approach.

Table 1 – Components of the dashboard

Nature of work	Ownership	Description
What is the current state of wellbeing?	The Treasury/ Stats NZ	Current wellbeing indicators, international standard from OECD plus New Zealand-specific indicators.
What does wellbeing look like in the future?	The Treasury/ Stats NZ	Long-term wellbeing indicators, including those that are New Zealand-specific.
How to achieve wellbeing	Government	The stated priorities of the incumbent government.

The work will cover the following issues:

- **Data availability** – Whether the data for indicators are available, or need to be collected more often or new collections are needed. If the latter, how long it would take to change current practice.

- **Distribution of wellbeing** – How far social and demographic inequalities can be monitored.

- **Frequency of reporting** – There are practical limits to how often it is useful to report and what is reported. For instance, gross domestic product (GDP) is measured quarterly, inequality indicators are based on annual data and anything requiring census data is collected every five years. These data limits have an impact on the frequency of useful reporting.

- **Comparability** – Which indicators mean this approach provides a consistent international and inter-temporal time series to support analysis and provide historical benchmarks.

- **Indicator sensitivity** – An unanswered question is how well society-wide indicators will pick up the impact of policy initiatives, either because they have an impact on a relatively small group of people (eg, children in care) or because the impact will be gradual and any increment spread over a number of individual data points. This is particularly relevant where there is potential for policy targets.

- **Type of measurement** – While GDP is measured cardinally, using a fiscal weighting to address aggregation issues, it is unclear if this will be possible or desirable using a multi-dimensional measure of wellbeing or the capitals. The issue of how the indicators are measured will need to be addressed, including alternative approaches that are good enough for the purpose. This includes considering ordinal changes, rather than the level, assessing if the indicator shows greater/smaller, more/less and so on; or purely qualitative measures. This potentially deals with some data availability issues.

- **Compatibility with current indicators** – The practical implications of the different measures include how well they map with indicators currently used by government agencies.

- **Link between current wellbeing and the capitals** – The dashboard of indicators will be more useful the more we understand the links between current and future wellbeing. Further work is needed to deepen our understanding of these links.

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