TE TAI ŌHANGA
THE TREASURY

Opening Address for the Government Economics Network Conference 2019

Speech delivered by Caralee McLiesh,
Secretary to the Treasury

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Tēnā ōoutou Katoa. Ko Caralee McLiesh toku ingoa. Na Te Tai Ōhanga.

I have been in the role of Secretary to the Treasury since mid-September, so I haven't had the pleasure of meeting some of you yet. But it's fair to say I feel right at home in a gathering like this.

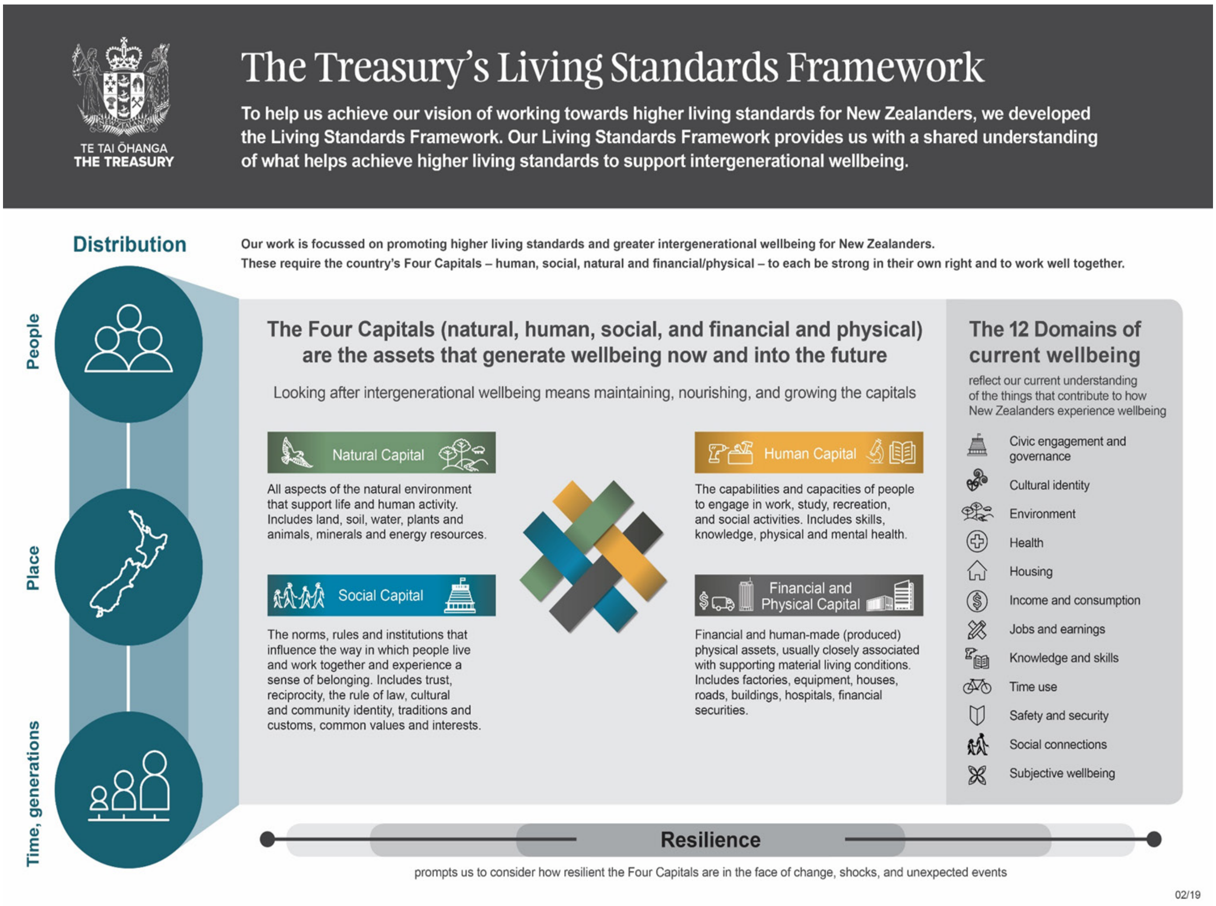
My background is economics and finance. I've always been drawn by how the discipline of economics opens up ways to think broadly and deeply about issues that range in scale from the global to the personal. It has given me a rewarding career in the public sector, business sector, and international institutions, in different places around the world, including now – I'm happy to say – in Wellington. So it's great to join others in government, academia and elsewhere who share an interest in the application of economics, and an appreciation of its importance in public policy.

The theme of today's conference is how well-performing regions and cities can contribute to our wellbeing and raise living standards for all. Those of you familiar with the Government's Economic Plan will know that the Government has identified 'strong and revitalised regions' as one of the key economic shifts it is working towards. And work on government's urban growth agenda and resource management reforms is well underway. So this is a significant and substantial topic for New Zealand.

I'm interested in how this conference will put a spatial lens on economic development. I think all of us are looking forward to hearing from the great range of speakers today and learning from their insights.

For my part, I want to share with you how the Treasury thinks about regional and urban economic development and some of the work we have been doing in this area. I will bring a Living Standards Framework (or LSF) lens to that topic, as we are committed at the Treasury to using the LSF to bring people and place perspectives to our analysis and advice.

Living Standards Framework



Before I turn to talking about how the Treasury views regional economic development let me talk a little about the LSF itself.

I know most of you will have heard quite a bit about the LSF from the Treasury over recent years. But in brief, the LSF includes domains of current wellbeing outcomes; the four capital stocks that support wellbeing now and into the future; and risk and resilience. Distribution across people, places and generations matters across all of these dimensions.

The Treasury developed the LSF to help us provide high quality advice by more systematically considering the broader impacts of policy, particularly those that may have been underplayed in the past – for example, robust distributional analysis, impacts on social norms, consideration of natural capital, and robust risk analysis.

The LSF guides us in what matters to citizens and, therefore, what we need to measure. It is consistent with standard economic frameworks and based on the simple concepts that:

i scarce resources are used together to produce wellbeing, and

ii the capacity of people and communities to participate in the economy influences their willingness to take risks, innovate, be creative, and therefore, be productive.

The Treasury has drawn ideas from academic literature, among other sources, that seek to confirm public policy as being ultimately about finding the best means, among many competing alternatives, to promote a broad concept of wellbeing. The work is also a practical response to critique that traditional policy approaches are unlikely to be rich enough to confront complex challenges we face today, such as rapid technological change, growing social disconnection and disparities, environmental degradation and climate change.

The basic ideas are not especially new, despite the recent interest in many countries, including New Zealand, to put them in practice in public policy. Almost a century ago, the Nobel Laureate and economist Simon Kuznets – having been one of the founders of national accounts – made clear that gross national income is not the same as a measure of national welfare. But more recently, contributions such as the Stiglitz, Sen and Fitoussi report in the late 2000s, on the Measurement of Economic Performance and Social Progress, have been influential for governments that are seeking to think in a broader and deeper way about what they are trying to achieve.

In developing the most recent version of the LSF, the Treasury chose to draw mostly on the OECD's wellbeing framework. This is because it is oriented towards policy practitioners, and enables international comparisons. The framework also needed to be broad enough to fit the priorities, values and philosophies of future governments. Among other things, this meant developing a multidimensional dashboard rather than a single aggregate measure (which would have required contestable weights on each element to be chosen). It also meant using medium-to-long term wellbeing outcomes in the dashboard measures.

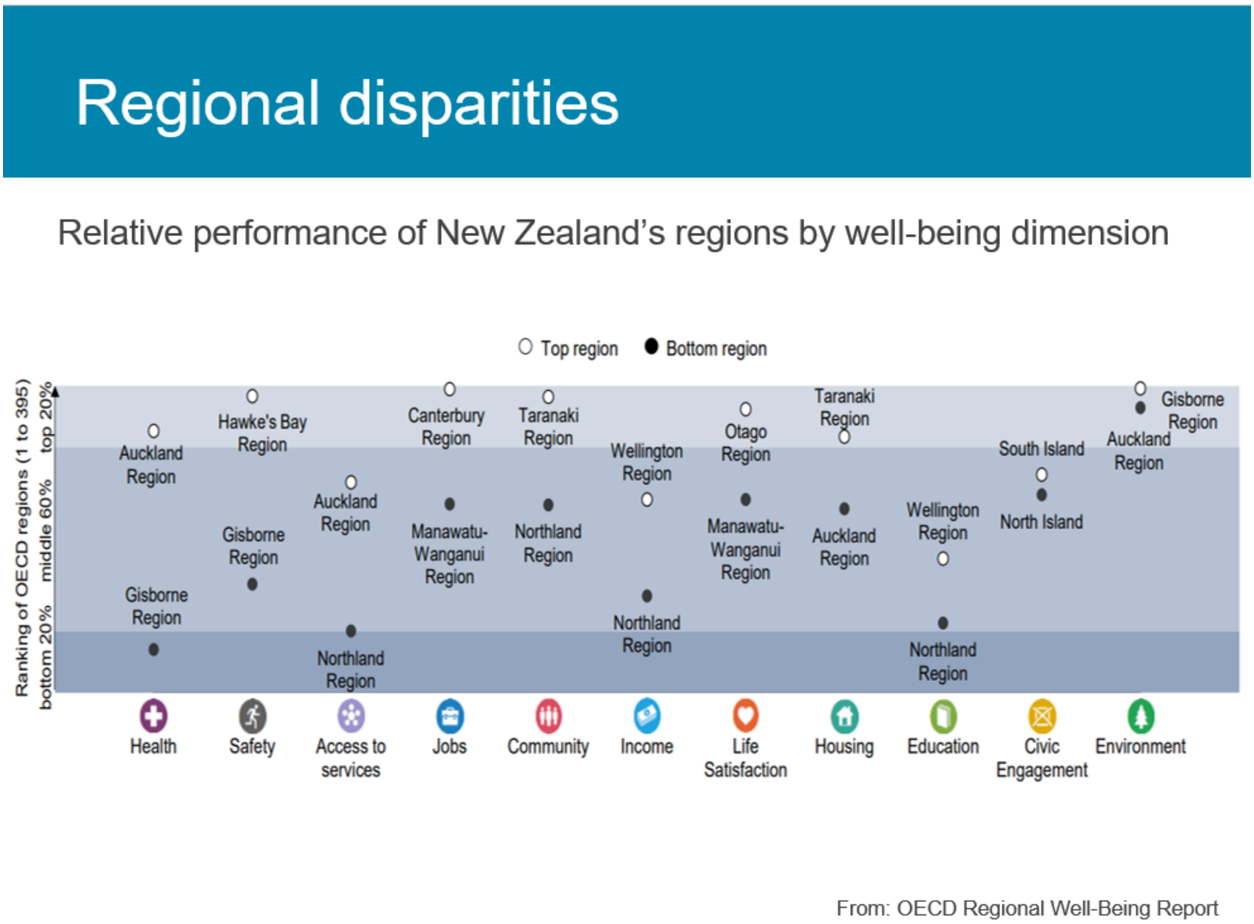
The LSF is important to both the Treasury's ministry of finance and economic stewardship roles. Some critics say "good analysts always thought like this", and that the LSF should not substitute for traditional frameworks. We absolutely agree.

In many ways, the LSF is simply doing traditional welfare economics and cost-benefit analysis thoughtfully, and thoroughly. It requires understanding the context for a potential intervention – avoiding a 'static counterfactual' – and being as comprehensive and specific as possible in identifying costs and benefits, whether they are measured in monetary terms or otherwise. This approach demands more rigorous use of evidence, quantification, and careful monetisation where useful, to understand the net impact of a potential government intervention.

The Treasury always has an important role to play in advising government on how to lift economic productivity and performance, and this remains a core part of our LSF thinking. A roomful of economists doesn't need to be told, but I will say it anyway, that high living standards depend on strong economic performance, and that markets that operate well – and I emphasise, "well" – can, and do, powerfully lift living standards. They enable people to participate in labour markets, earn higher incomes, and apply those incomes towards whatever wellbeing means for them. The story of development is basically a story about investment in the institutions and mechanisms that enable people to flourish in deep and complex markets – that is, to grow.

It's notable that economic growth theory is increasingly focusing on the drivers of multi-factor productivity. In particular, there is a focus on the role of investment in 'intangible' capital – especially human and social capital – alongside physical capital and natural capital. There is a growing body of evidence about the roles of culture, knowledge and effective institutions in innovation as a driver of productivity growth and development. I see it as incumbent on our profession to make the most use of this evidence in our practice.

Regional economic performance



So let's get into talking about an LSF approach to regional and urban economic development.

OECD research emphasises the risks of highly uneven spatial growth for national cohesion. We know there is a significant gap in wellbeing indicators between New Zealand's regions. For example, life expectancy in Auckland is in line with the top 15 percent of regions in the OECD. Gisborne is in the bottom 15 percent. That is a stark and unpalatable contrast. And there's a correlation in many cases between incomes and various social inclusion measures. The poorer regions tend to be less inclusive.

The regional data also glosses over lots of variation at a more local level: there is big variation within regions, such as Auckland, Bay of Plenty or Waikato.

We could focus on policies to encourage people to move to places with better economic and social indicators. This is important – for example, research by Raj Chetty shows moving kids to better neighbourhoods makes them better off as adults.

But we also know place matters to people. People value their connections to places – and their communities. It is hard to measure, but it's an important source of social capital. We know that this connection to place is particularly important to Māori.

There is an economic, as well as a social case, to focus on regional economic development. The OECD also emphasises the fiscal and economic costs of lost output of weakly performing regions.

In terms of fiscal costs, we currently spend around $2,000 more per person on services in Northland and Bay of Plenty than we do in Auckland – mostly due to higher social security and health spending.

Regions may contribute more to national economic development if we can tap unrealised economic potential. A policy approach that emphasises strengthening regional comparative advantage means we may be able to lift national economic performance rather than just shifting economic activity around the country.

There can be a role for government in helping communities to identify strengths and opportunities or strengthening local governance. There can be a role in working across agencies, local authorities, local people, and the private sector to coordinate and facilitate private investment. Or in investing in infrastructure where this directly unlocks economic opportunities. And can we do more to coordinate between social interventions and economic opportunities to ensure these approaches are complementary?

But in developing policy responses, spatial economics has highlighted that we need to be thinking about the relative performance of cities or regions. Edward Glaeser would stress that you can't understand cities or regions without understanding the bedrock concept of 'spatial equilibrium'. If a city or region grows, is it because it is providing more economic opportunities, more amenity, or because it's supplying homes when other places are not? Understanding growth and development requires thinking of how push and pull factors balance. The pull factors are wages and amenities, and the push factors are house prices and congestion.

We need to better understand spatial equilibrium and location decisions. Thankfully there has been a recent bloom of New Zealand specific research on quality of life and quality of business using spatial equilibrium, such as from Motu Economic and Public Policy Research.

More than a third of New Zealanders live in Auckland, a city with house prices vastly in excess of the marginal cost of supply.

Now, New Zealand has been urbanised for a long time. Townies have been in the majority for over a century, and for 50 years, more than 80 percent of New Zealanders have lived in urban areas. But Auckland continues to see rapid population growth despite its high costs of living. Between 2000 and 2018 our national population grew by 26 percent, but all of the above-average population growth has been from the Bay of Plenty northwards, with Auckland the fastest growing at 37 percent. Contrast that with population growth of 7 percent in Southland, 5 percent in Gisborne and 4 percent on the West Coast.

This population growth is despite the fact that Auckland's GDP has grown at only 82 percent of the national average in the 2000 to 2018 period. In contrast, GDP growth was well above the national average in every region of the South Island, while Bay of Plenty and Northland had above-average growth too.

This pattern of population and GDP growth begs the questions of both 'What's going on with Auckland - why is it growing so fast in population, when GDP is growing more slowly and housing prices are so much higher?' as well as 'Why can't other cities and regions compete with a better mix of wages, amenities and housing supply?'

Improving productivity in housing supply-constrained cities may initially benefit workers, but will ultimately benefit the owners of land, increasing wealth inequality. We need to improve productivity, amenity, and housing supply in tandem. Many government agencies and councils are working to solve the supply issues in Auckland and many other New Zealand cities through the government's Urban Growth Agenda.

Other cities and regions may have plenty of available land. However, they will need to improve their quality of business and quality of life attributes too if they are to significantly ease pressure in Auckland. And worldwide we see that agglomeration into major cities continues despite congestion and high property prices. Clearly, both employers and employees often see better long-term prospects in these major cities, despite efforts to develop other regions.

As economists, there is an enormous opportunity to further enhance our use of spatial equilibrium concepts to understand urban and regional economic development, and to improve living standards.

Examples of wellbeing approach in local and regional government development initiatives

Working at the local and regional level

Photo credit: HLC – Porirua Development, Jo Burleigh

Central government has created more capability through urban growth functions in HUD, and appointing senior regional officials to lead engagement and coordinate government across regions.

Of course lifting wellbeing across the regions is not just up to central government, which is why we see more partnering with local government and regional economic development agencies over recent years to develop action plans.

This is reinforced by the reinstatement of the four aspects of community wellbeing – social, economic, environmental and cultural –into the Local Government Act in May.

Waikato, for example, is applying a wellbeing approach to better coordinate and guide decision-making on complex regional issues like population change, transport, water, economic development and the environment.

Back in October I had the pleasure of travelling to the Waikato to meet with business, local government, iwi and NGOs, and it was valuable to hear first-hand from them what they see as important for their local economy and people's wellbeing. I was impressed with how these groups are agreeing a shared set of wellbeing targets, which will help them to work together more effectively and leverage investment and government funds for community priorities. Getting this on-the-ground insight to their approach is really important for the Treasury in our policy work as we further develop the LSF.

Another closer-to-home example of how the LSF is being applied in regional and urban development is the regeneration of Porirua

This is a case where using the LSF for looking at regional development means using the existing tools we have transparently and thoroughly. The Treasury's better business cases (BBC) framework, for example, provides a way of surfacing different assumptions made about potential costs and benefits, and creates a framework for testing and challenging different recommendations.

A key part of the work in Porirua was building up a detailed picture of potential social impacts from the regeneration. We used a combination of Census and Stats NZ micro-data to look at indicators of low intergenerational wellbeing and establish a baseline – for example indicators of poor education, history of truancy, poor housing, people not in employment or training, the likelihood of being a victim of crime, and poor physical and mental health outcomes.

So what did the analysis find? Taking a narrow economic and fiscal approach (that might have been traditionally applied) the best option was to do nothing, and let the housing stock run down even further. But broader analysis showed that investment in housing has positive impacts on other wellbeing domains that outweigh the cost of the investment in the housing stock. It delivers not just better homes, but also better outcomes in education, employment, health and justice.

The decision has been that the Porirua regeneration project will be housing-led, but will also look to other social and economic growth opportunities. All up, this will be a $1.5 billion investment over 25 years and the biggest and most ambitious regeneration since eastern Porirua was built 60 years ago.

Closing

Kia kaha economists!

In closing, I want to acknowledge that being an economist working in public policy is incredibly rewarding, but it can also be challenging. We are a community of professionals that sometimes has to be loud to be heard. When people want the comfort of policy that is simple, certain, and swift, we can find ourselves the sometimes uncomfortable voice of technical rigour, nuance, and realism.

We need to support each other and our profession. So let me say that as someone who has been working in economics and public policy throughout my career, I see enormous value in a network like GEN. I believe strongly that economics – and more broadly analytical rigour – is essential for providing high quality advice to the government of the day and for our stewardship role of preparing for future challenges.

It is great to be part of a network that is focused on both lifting economics capability across the public sector and in strengthening the linkages between economists across the private, public and academic sectors. These will contribute to better advice to government, and ultimately policies that lift living standards.

The Treasury is on the GEN organising committee and has been since its inception, which I understand was around 9 years ago. We were here from the first conference in 2011, we are excited to be here again today, and I'm sure we will be in the thick of GEN events over the years to come. The Treasury will continue to be a strong supporter of GEN.

With that let me reiterate I am delighted to open the day today. Enjoy the rest of the proceedings and the excellent speakers coming up.