



# **The New Zealand Treasury's Living Standards Framework –**

**Concept, Purpose, Measurement, Theory, Policy Applications**

May 2015

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- Purpose – what is it used for?
- Theory and Stylised Model
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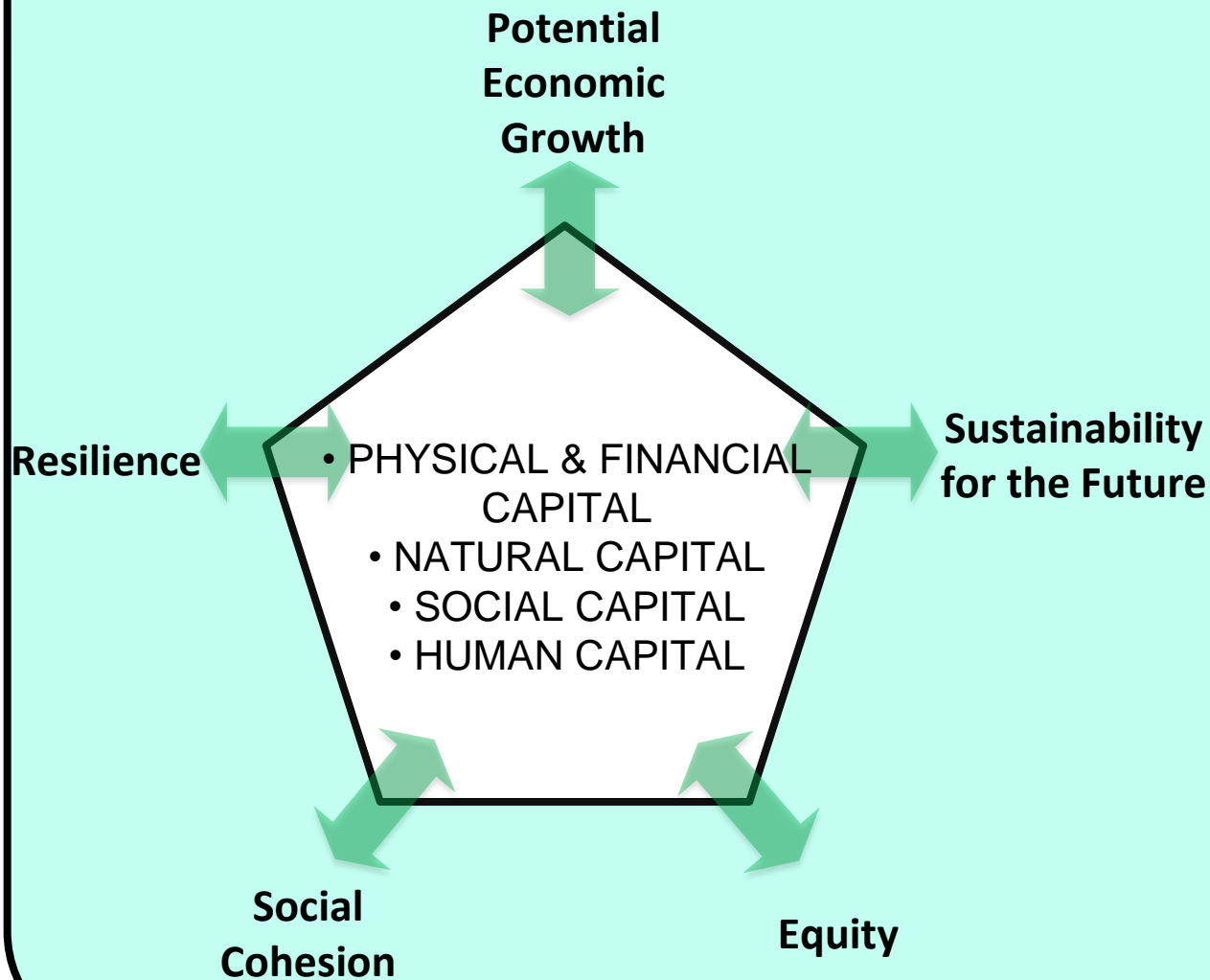
# PURPOSE

# Purpose

- Enhance the quality of policy advice ...
- ... towards increasing collective wellbeing on a sustainable basis
- Integrated economic, environmental and social policy advice
- Collaborative / joined-up advice across government agencies
- Encourage focus on complementarities, instead of tradeoffs

# LIVING STANDARDS: THE HEART OF OUR POLICY ADVICE

Assess the impact of policy across key living standards dimensions



## Potential Economic Growth

- Does this improve the opportunities or incentives for higher incomes or greater economic growth?
- Does this remove obstacles that hinder resources moving to their most efficient use, or enhance the ability of people to take up new opportunities?

## Sustainability for the Future

- Does this impact on the capital stocks for future use (e.g. physical capital, human capital, or the sustainability of the environment)?

## Equity

- Does this impact on the distribution across society (both intra and intergenerational)?
- Does this improve opportunities for people to improve their position?

## Social Cohesion

- Does this impact on core institutions that underpin our society (e.g. trust in the rule of law, democracy, Crown-Māori relationship, cultural identity)?
- Does this impact on the trust and connections between people?

## Resilience

- Does this impact on NZ's ability to withstand unexpected systemic shocks?

# THEORY

# Key Planks

- Object of interest: intergenerational collective wellbeing
- Source of wellbeing: comprehensive consumption
- Source of comprehensive consumption: comprehensive wealth
- Raison d'être for public policy: existence of negative and positive externalities that have not been fully internalised
- Domain of public policy: to expand the “wellbeing frontier” by internalising key externalities
- Choice of key externalities are informed by domains of wellbeing identified by OECD, NZ MSD, ...
- Dynamic optimisation of the intertemporal wellbeing function suggests opportunities for wellbeing-enhancing policies
- Whether these opportunities can be realised depends on the degree of effectiveness and efficiency of policy implementation

# Comparing the Better Life Initiative to NZ Treasury 'Living Standards Framework'

## OECD well-being dimensions

### Individual well-being

- Income and wealth
- Jobs and earnings
- Housing
- Health status
- Work and life balance
- Education and skills
- Social connections
- Civic engagement and governance
- Environmental quality
- Personal security
- Subjective well-being

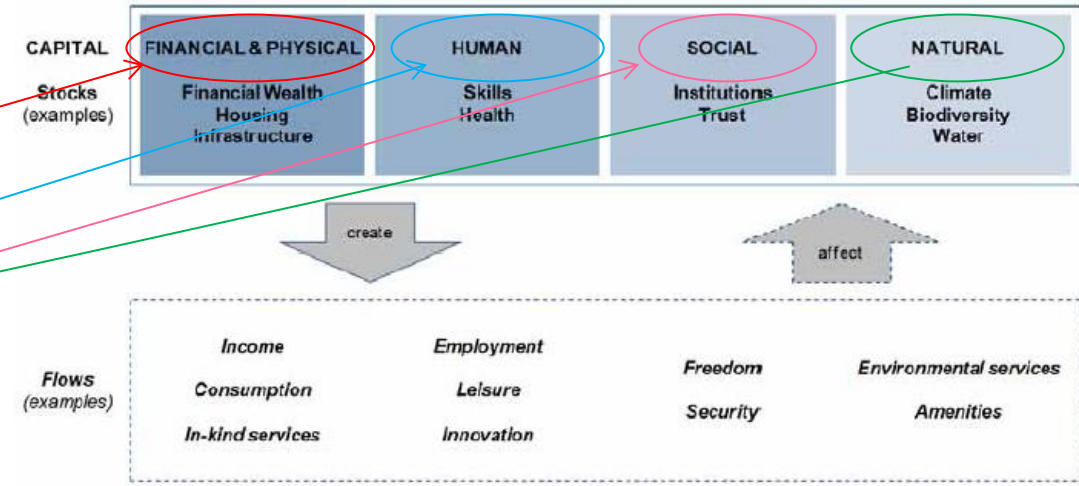
## NZL Treasury's Indicators for Measuring Living Standards

- Income
- Wealth
- Employment
- Leisure
- Education/Skills
- Health
- Trust
- Security
- Environment
- Subjective well-being

## Sustainability of well-being over time

- Natural capital
- Economic capital
- Human capital
- Social capital

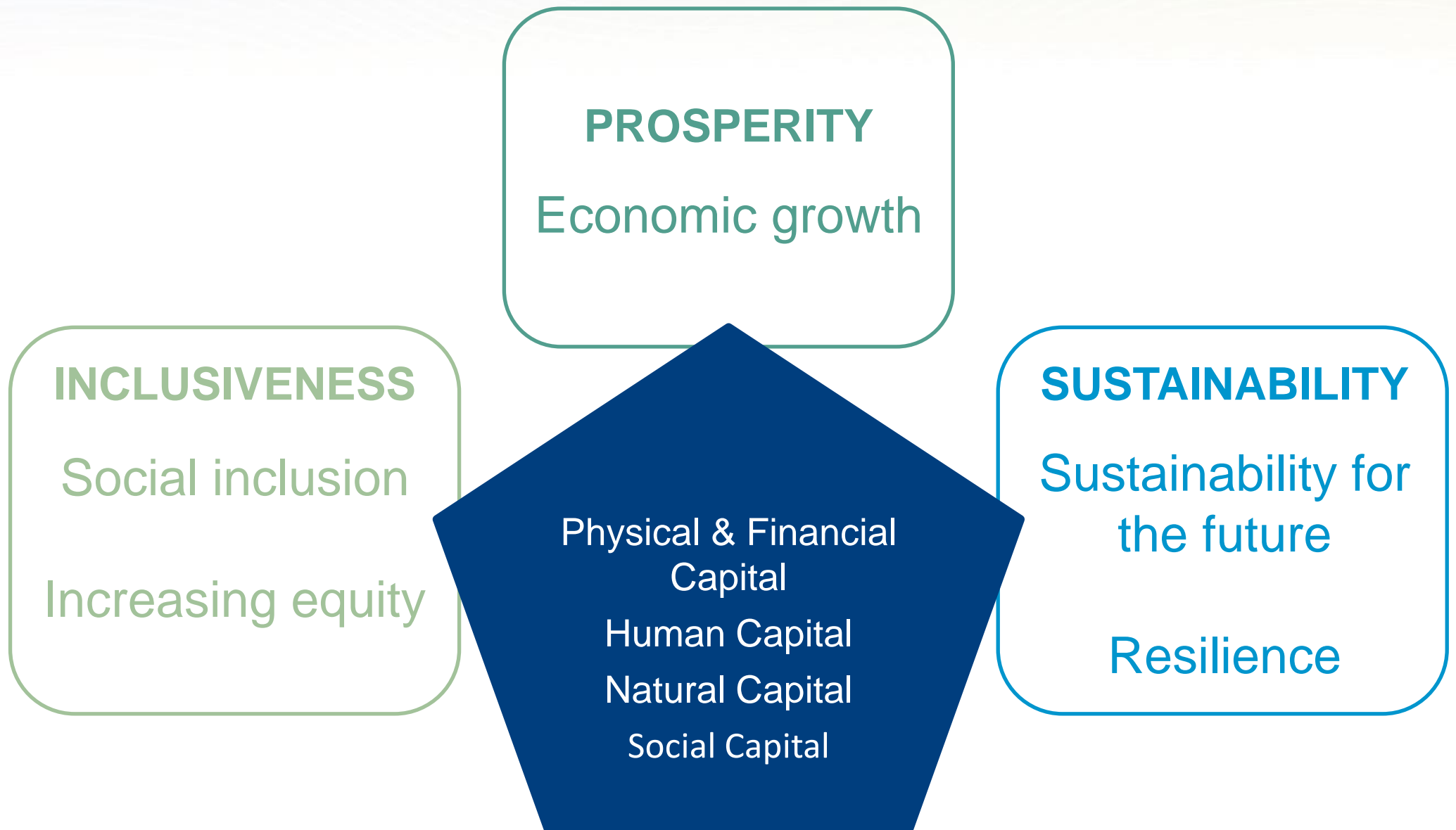
### Treasury's Living Standards Framework



# **ALIGNMENT WITH OUR CURRENT POLICY ADVICE**

# Policy Implications

- Policy levers are imbedded in the equations of motion for both the various capital assets that comprise comprehensive wealth, and for the externalities that affect general wellbeing.
- A particularly promising policy package aimed at increasing collective wellbeing on a sustainable basis includes:
  - Incentivising clean-technology research and penalising the use of dirty technology with a view to switching production towards clean technology - supported by subsidising skilling and education, as well as the immigration of skilled labour and scientists.
  - These policies would have the positive effects of raising both the rate and the quality of sustainable growth (by reducing the negative effects of production on the environment and on health).
  - A reduction in inequity would follow as the relative weight of skilled labour and scientists (that are both wealthier and better paid than unskilled labour) increases in the working population.
  - This package would need to be enhanced by poverty-reducing and community-building investments to ensure that social cohesion and resilience to systemic shocks are increased.



# A snapshot of Treasury's strategic policy advice

Good outcomes are not just about economic growth.

We want New Zealand to be prosperous – but we want that prosperity to be sustainable and inclusive.

We have identified a priority strategic challenge for each of these dimensions of performance.

## **Inclusiveness:**

This is about enabling all New Zealanders to participate in the economy and society.

The state sector has a particular role in helping the most disadvantaged overcome barriers to economic and social participation.

## **Prosperity:**

New Zealand's small size and distance make it difficult to connect internationally but imperative that we do.

International connections are the key to lifting New Zealand's productivity and economic growth

## **Sustainability:**

Does this impact on the capital stocks for future use (e.g. physical capital, human capital, or the sustainability of the environment).

Also relevant is sustainable fiscal policy.

Equally relevant is building resilience to major shocks.



# Summary of our advice on policy priorities

Short-term

Medium-term

Long-term

**Inclusion:**  
lifting  
outcomes for  
disadvantaged  
New  
Zealanders

**Reducing child poverty and supporting inclusion: expanding smart social sector investment and helping those on the lowest incomes.**

A continued shift towards investment in effective social sector interventions that improve long-term outcomes, reduce long-term economic, social and fiscal costs and focus on those most in need.

**Sustainability:**  
moving to  
export and  
investment-  
led growth

**Sustaining economic performance**

Managing pressure on interest and exchange rates in the upswing through fiscal restraint.

**Microeconomic and state sector reform**

Increasing the responsiveness of housing supply, improving natural resource management and lifting state sector effectiveness.

**Environmental and fiscal challenges**

Managing the risks and costs to New Zealand of climate change and demographic fiscal pressures.

**Prosperity:**  
boosting  
productivity  
and  
international  
connections

**Internationally-competitive business environment**

Continued strengthening of international connections and 'behind the border' policy settings.

**Long-term productivity**

Tertiary education and infrastructure are two key priorities for long-term productivity performance.

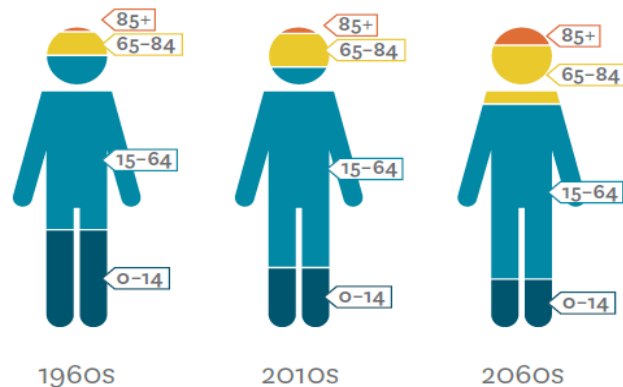
# **USES IN POLICY ADVICE**

# FRAMING OUR POLICY ADVICE



## Long Term Fiscal Statement

**Figure 1** Getting older: New Zealand's changing population structure, 1960s–2060s



# The Living Standards Framework in Action: How have we been using the Living Standards Framework?

## 1. As a way to organise and expand our thinking about how various areas contribute to living standards...

### Example: Tertiary Education

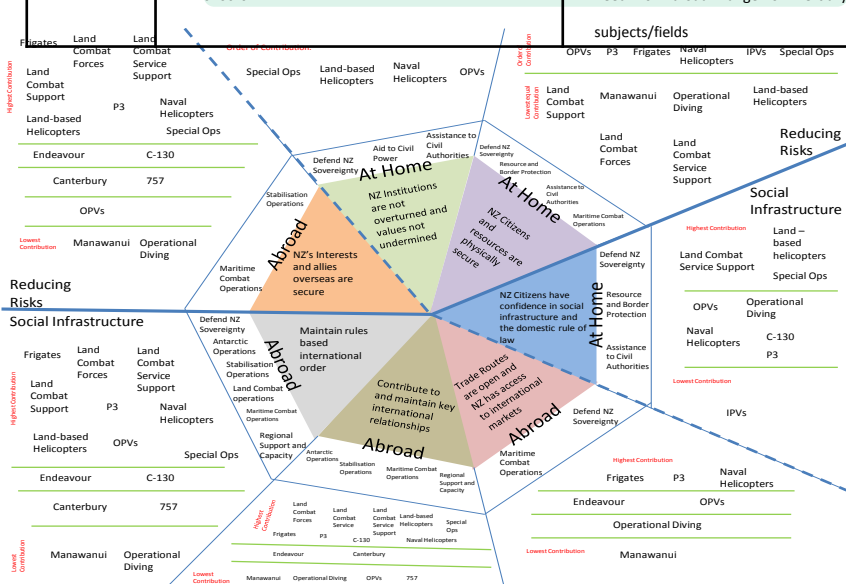
Dimension	Role of Tertiary Education	Treasury's consideration
<b>Sustainability for the Future</b>	Early investment in education provides the basis for lifelong learning  Intra and intergenerational effect	Maximise Tertiary Education outcomes and value for money within fiscal constraints  Balance between quality and access and sustainable funding  Ability to respond to skill needs in the economy
<b>Increasing Equity</b>	All students have access to Tertiary Education regardless of the Social Economic Status (SES) and the opportunity to develop their potential	Tertiary Education settings around access and funding (i.e. financial and non-financial barriers)  How to mitigate the effect of SES on achievement
<b>Social Infrastructure</b>	Tertiary Education strengthens social institutions, i.e. trust, democracy, cultural identity, openness to other perspectives  Benefits for children whose parents have the opportunity to have a Tertiary Education	Good quality Tertiary Education system with broad range of subjects providing a sound basis as well as scope for specialisation
<b>Managing Risks</b>	Tertiary Education contributes to a more highly educated/flexible and adaptive population which enables New Zealand to withstand unexpected shocks	Fiscal sustainability of Tertiary Education (impact on Crown's balance sheet)  Difficulty forecasting demand for skills implies the need for broad range of Tertiary Education subjects/fields

The comprehensive list of the impacts that tertiary education has on living standards ensure that we consider tertiary education policy from a broad perspective  
This comprehensive list of how the health system impacts on all the different LSF dimensions ensures all aspects of living standards are considered when thinking about health policy

### Example: Health System

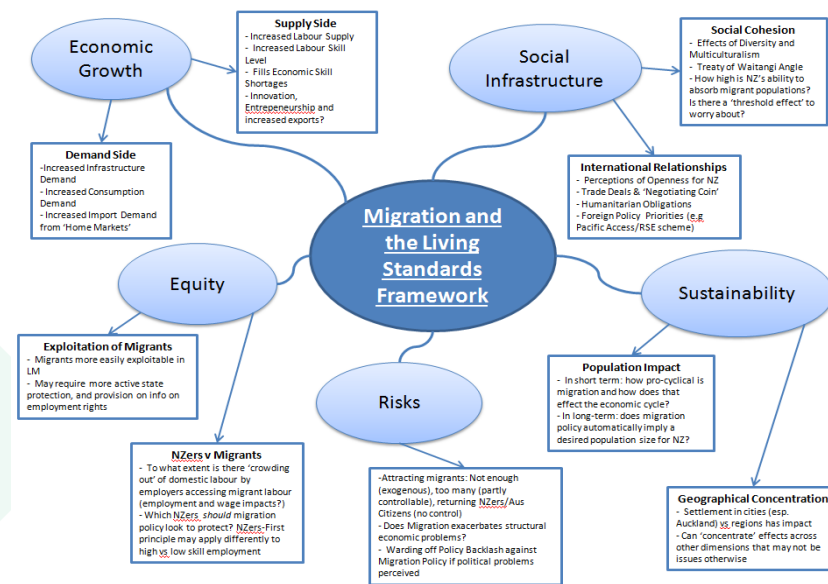
Dimension	Application to the health system
<b>Economic growth</b>	A healthy population supports economic growth by enabling greater rates of participation in the labour market and higher productivity.  Health spending represents a significant proportion of total government expenditure. As such, the size of the public health system has implications for economic growth through taxation and associated deadweight economic costs.  The productivity of the health sector is also important for economic growth, since if government is providing a significant share of goods and services in an economy and has lower productivity growth than the private sector, it will tend to drag down overall economic growth.
<b>Sustainability for the future</b>	The level of growth in publicly-financed health spending has implications for fiscal sustainability.  In the health context, this dimension also raises questions about the sustainability of the health workforce e.g. clinical sustainability.
<b>Managing risks</b>	At an individual level, public health services and private health insurance provide mechanisms for risk sharing in the face of uncertain health care needs and costs.  At a national level, the health system provides capacity to respond to health emergencies such as flu pandemics.  The size of the health system contributes to New Zealand's ability to withstand macroeconomic shocks, since the level of public spending on health impacts the fiscal position.
<b>Increasing equity</b>	The health system can increase equity through redistribution of resources based on factors such as ability to benefit (rather than ability to pay) and age.
<b>Social infrastructure</b>	New Zealand's public health system is a major institution and is relied upon by all New Zealanders to varying degrees.

### Example: Migration



The Treasury Security Framework was developed to understand how NZDF contributes to living standards and to provide the Justice and Security Team with a practical tool with which to analyse policy.

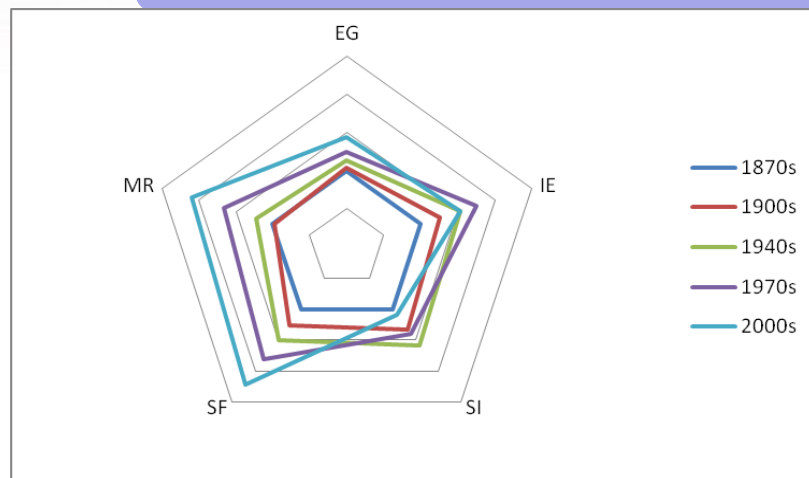
The impacts on living standards of migration policy have been mapped out, so one can clearly see how changes to migration might impact on all NZers.



# The Living Standards Framework in Action: How have we been using the Living Standards Framework?

## 2. As a measurement tool to better understand New Zealand's living standards...

### Example [DRAFT]: Where we've come from



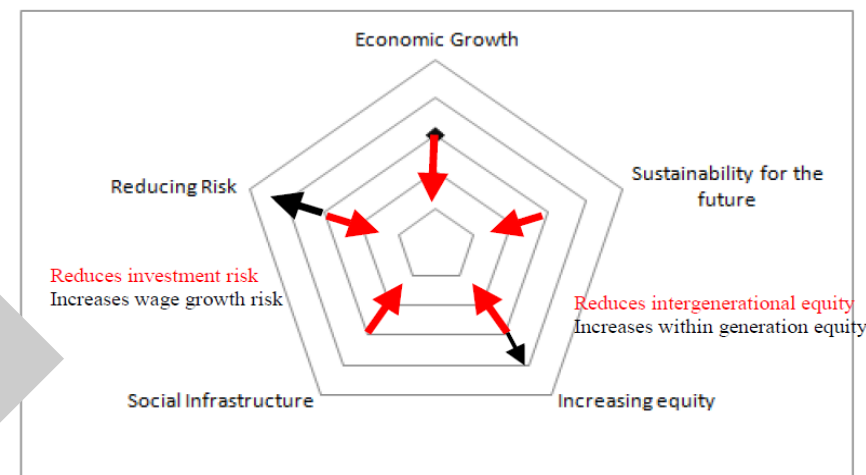
We can compare how NZ living standards have changed overtime and can think about where we want NZ living standards to fit on the pentagram in the future

A number of different retirement income policies was assessed over the five dimensions of the living standards framework.

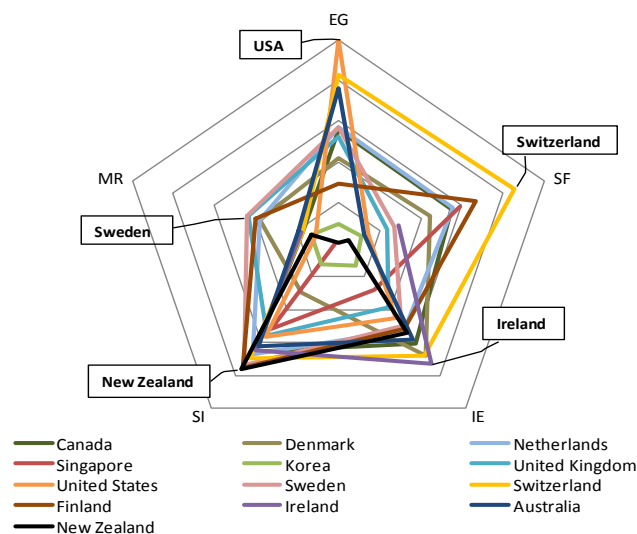
## 3. As a policy assessment tool to highlight the implications and tradeoffs over the various dimensions of living standards...

### Example: Retirement Income Policies

Figure 8: Effect of a PAYGO-funded expansion of New Zealand Superannuation



### Example [DRAFT]: How we compare with other countries



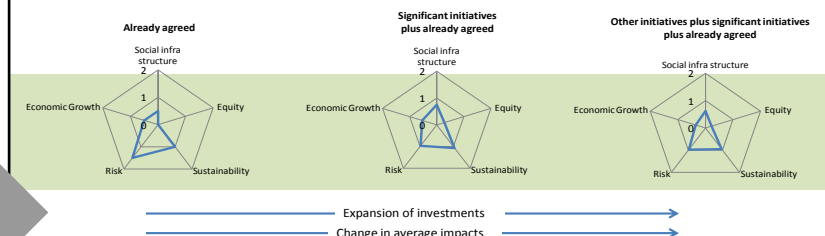
Cross country comparisons can be useful to see where we could be looking to find policy and advice to expand the corners of the living standards pentagon

Used at Budget 2013 and 2014 to inform Ministers about the impacts of packages of capital initiatives on the different dimensions of living standards.

### Example: Understand the impact of different portfolios of Capital investment

#### Living Standards Framework results in Budget 2013 capital advice

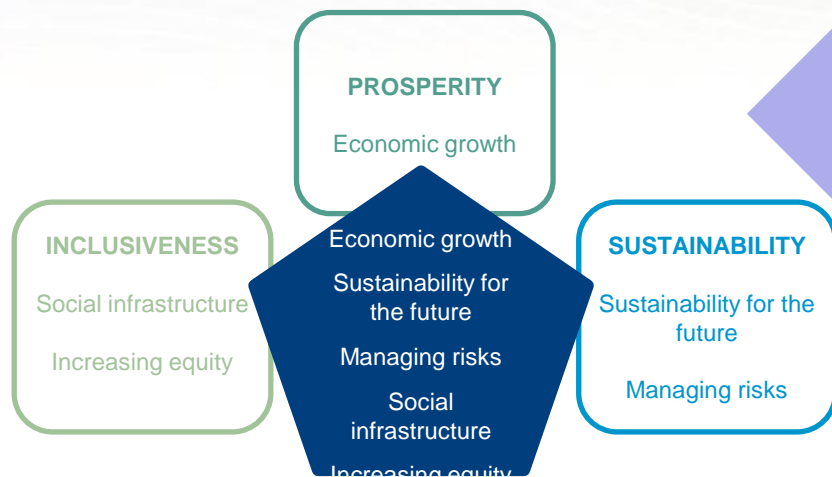
Spider diagrams to depict aggregate impacts across different investment packages, for example...



# The Living Standards Framework in Action: How have we been using the Living Standards Framework?

## 4. As a *strategic framework* for advising on New Zealand's economic performance

### Example: Treasury's *Holding On and Letting Go*



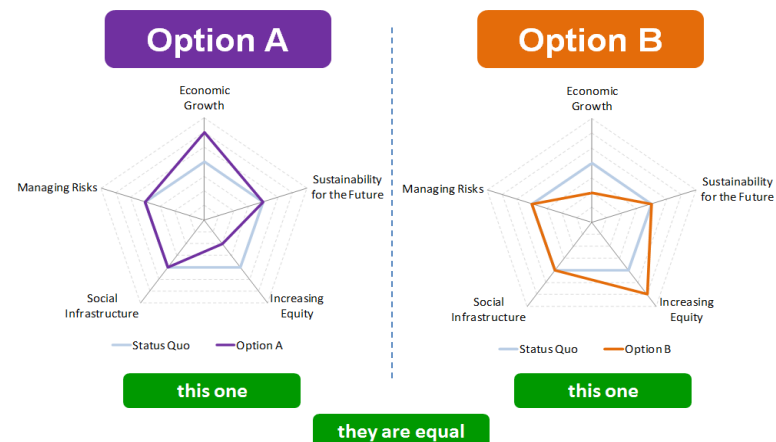
We used the living standards framework to inform our strategic advice on economic performance in our Holding On and Letting Go paper and Briefing to the Incoming Minister of

We conducted focus groups with members of the public and ran a survey to try quantify and reveal people's preferences over the various dimensions of well-being.

## 5. As a *tool to spark other ideas* on how we can apply a living standards framework to policy...

### Example: Retirement Income Policies

ALIGNING PUBLIC POLICY WITH THE WAY NEW ZEALANDERS WANT TO LIVE: HOW MUCH WEIGHT DO WE GIVE TO EACH OF THE DIMENSIONS OF THE LIVING STANDARDS FRAMEWORK?



### Example: Māori Living Standards Framework

A Māori Living Standards Framework has also been developed to encourage consideration of Māori perspectives when providing policy advice

#### Economic Growth

- NZ economic growth is critical to Māori living standards and vice versa.
- Young Māori population can play a critical role for growth.
- Māori aspirations to participate fully in New Zealand economy.
- Māori aspirations for Māori led economic growth.

#### Managing Risks

- Māori historically disproportionately impacted by macro-economic shocks.
- Māori state dependence can be reduced through greater social and human capital.
- Implications for New Zealand's social fabric need to be considered.

#### Social Infrastructure

- Whānau and Iwi form an important part of social infrastructure for many Māori.
- Adaptability of Iwi/Māori institutions to respond to changing Māori needs and demographics, and mainstream institutions to adapt to Māori.
- Low levels of Māori trust, access to, and participation in key institutions can reduce representation and therefore make those institutions less effective.



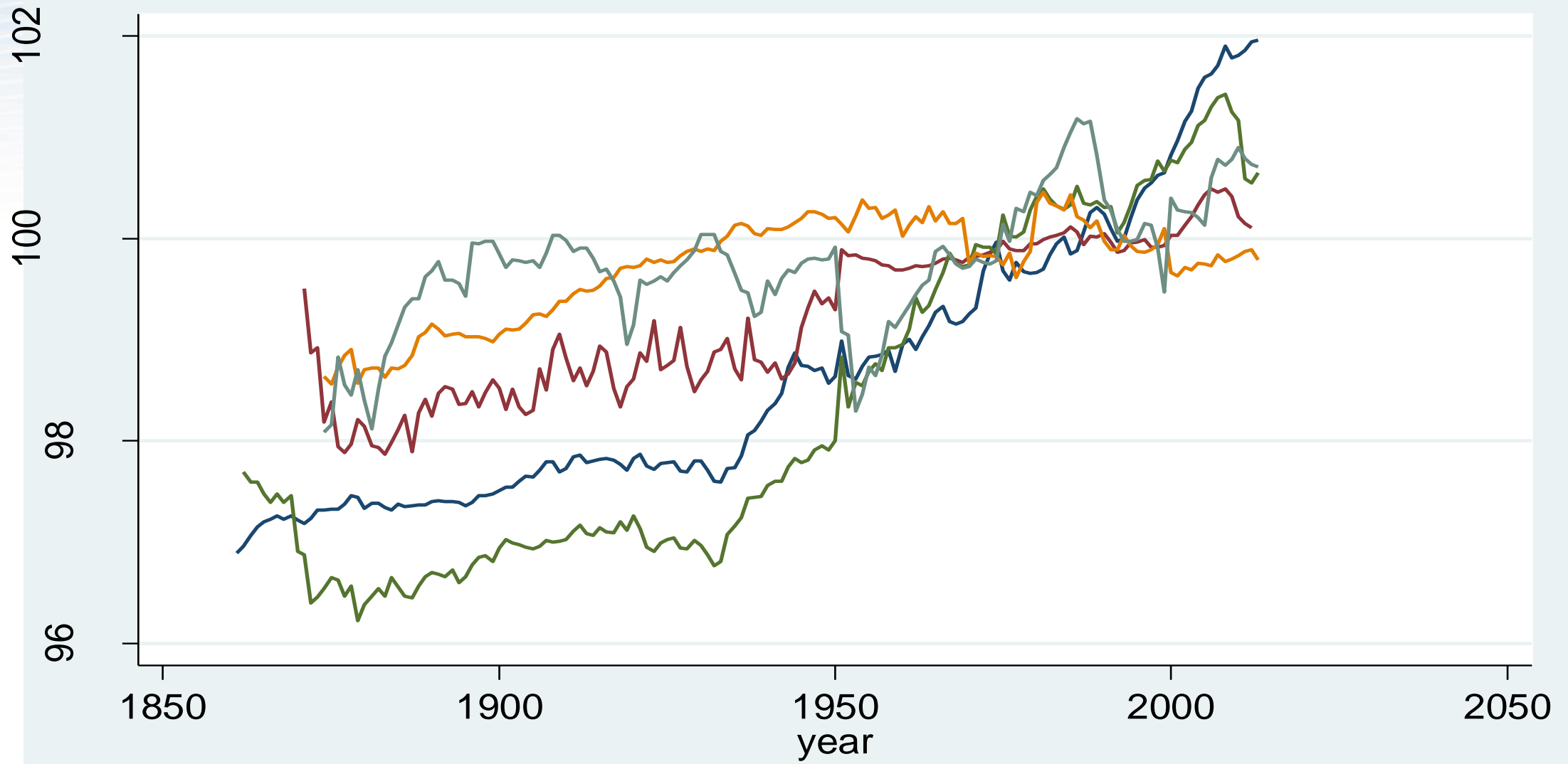
#### Sustainability for the Future

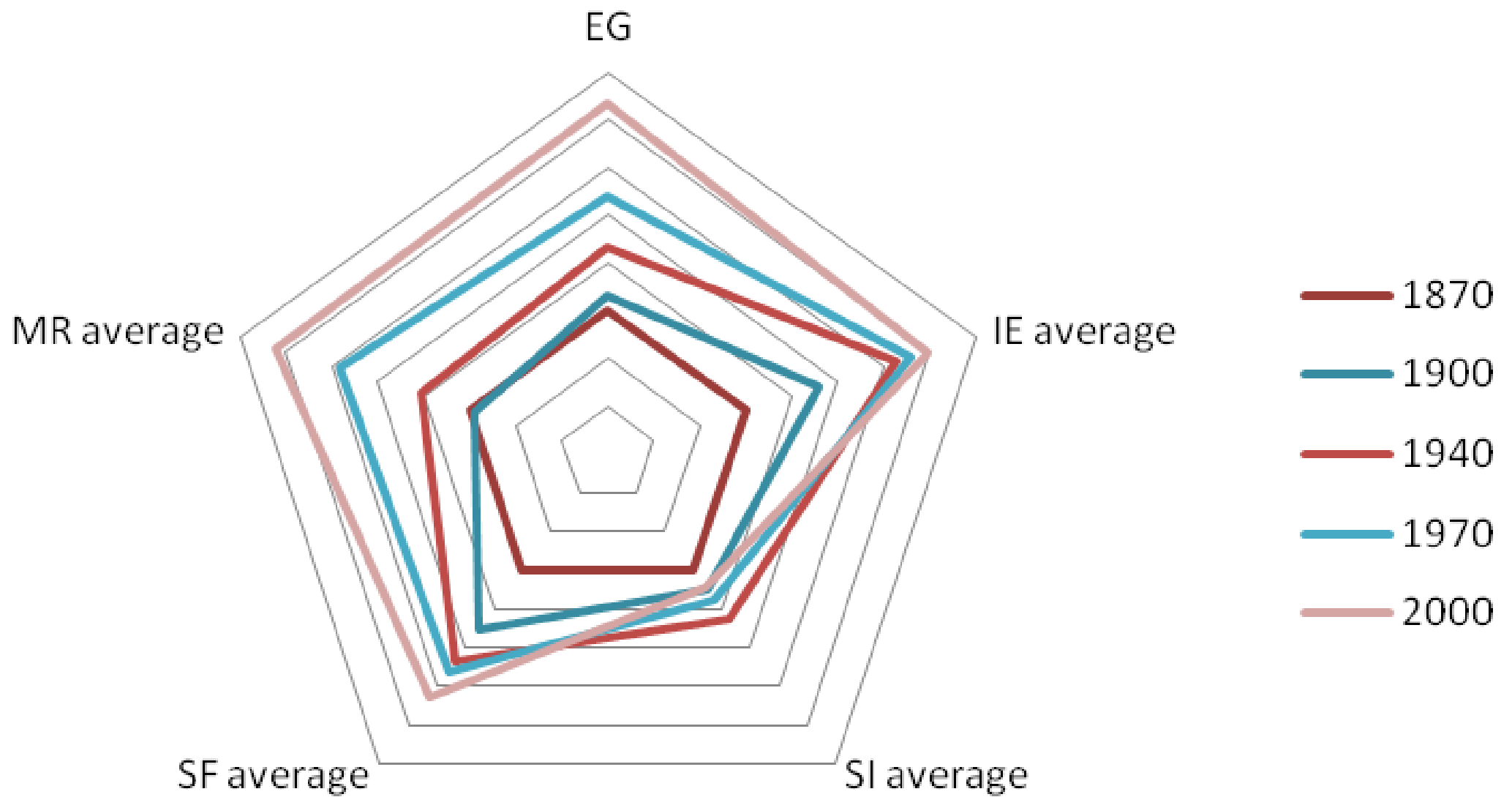
- Māori aspiration that the environment is able to provide for cultural attachment and values.
- Māori emphasis on protecting resources for future generations.
- Sustainability of cultural participation and knowledge, such as Te Reo, is important.

#### Equity

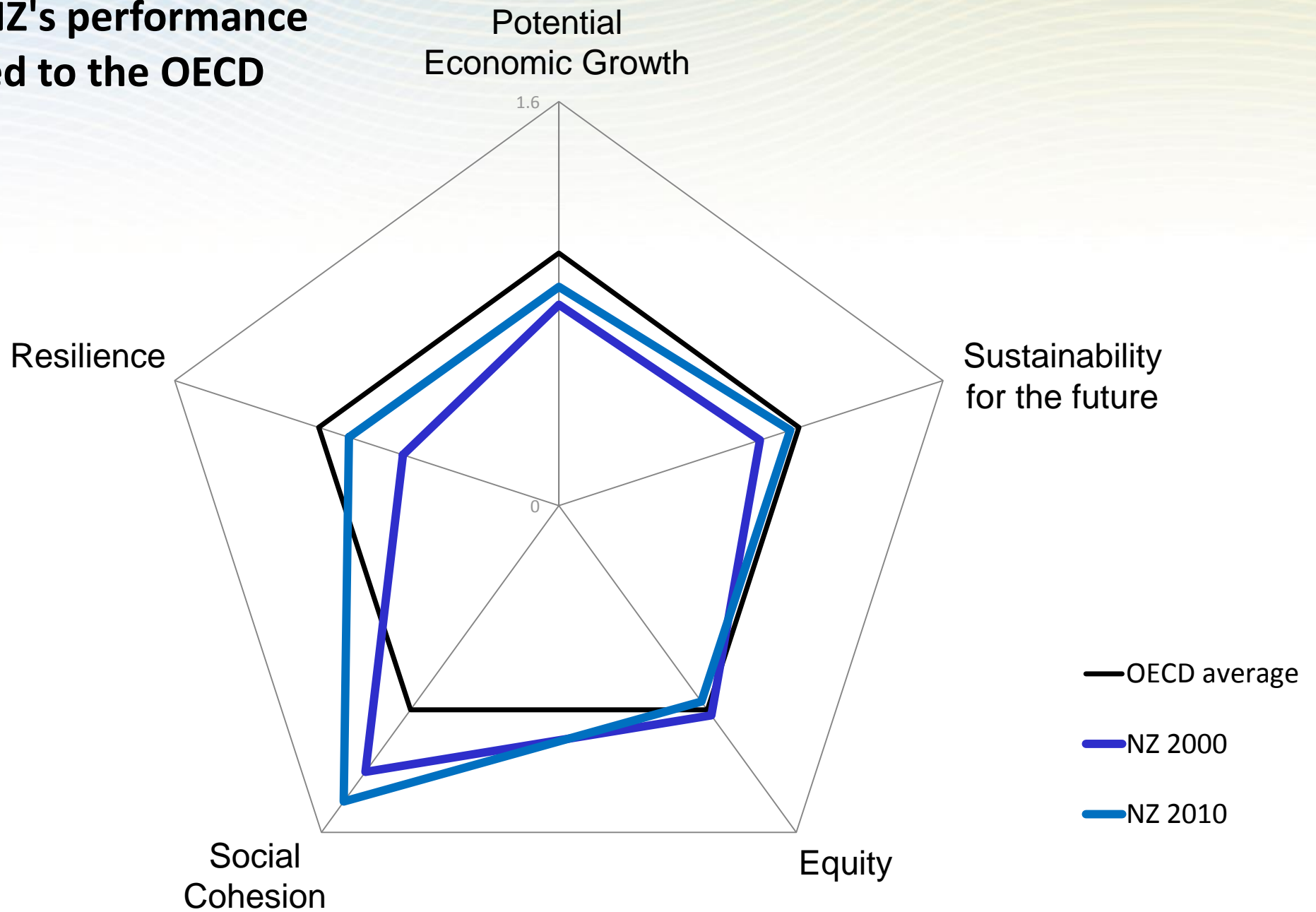
- Age and geographical demographics of Māori can lead to different policy impacts.
- Lower skill levels contribute to higher rates of poverty for Māori.
- The levels that benefits are set or way services are provided can have significant impacts on the outcomes of Māori communities.

# MEASUREMENT



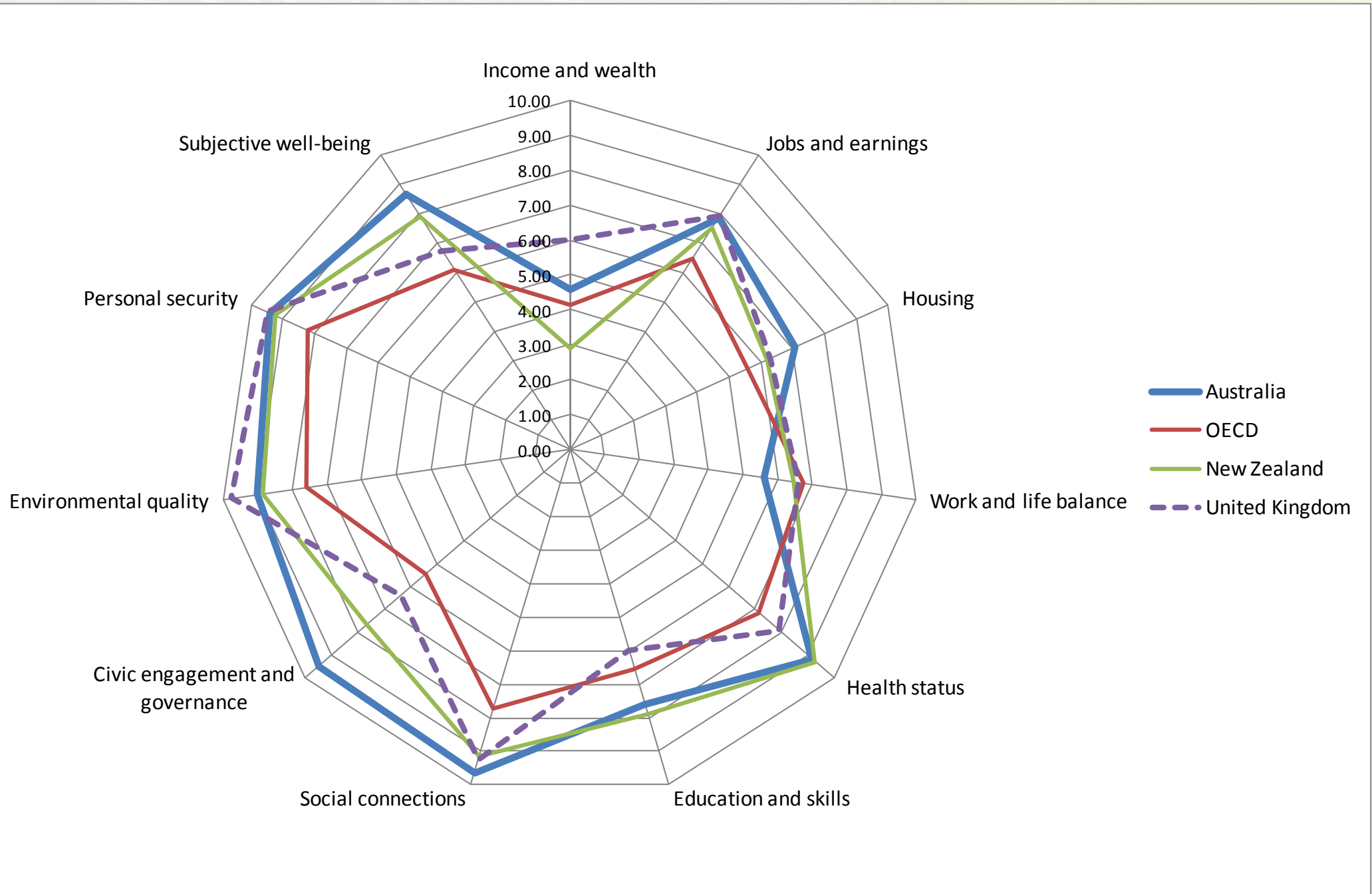


# Example: NZ's performance compared to the OECD



Note: This is only intended to indicate how the diagram may be used. The data involved and the methodology for constructing the indices needs significant further work. It does not therefore represent Treasury's view of what has happened over the ten years concerned.

# How's life for the average NZ household?



Source : OECD calculations

# NEXT STEPS

- Measurement:
  - Forward-looking indicators
  - Preferences and tradeoffs
- Policy applications: ongoing expansion
- Cost-Benefit Analysis: multi-dimensional
- Theory: keep developing
- Calibration: viability theory and calibration

# CHALLENGES

- Misconstrued as being anti-growth rather than being pro good growth
- Multi-dimensionality is seen as a disadvantage / difficulty rather than as a positive challenge
- Not much political support right now – focus on higher economic growth