THE TREASURY
Kaitohutohu Kaupapa Rawa

Living Standards Framework

Grace Campbell-Macdonald
Director, Living Standards Framework Implementation Programme
New Zealand Treasury

9 November 2018

The diversity of New Zealanders

New Zealanders are diverse and this is reflected in the breadth of their interests, values and activities, and the government activity to support them.

About the Treasury

- The Treasury is the Government's lead economic and financial adviser.
- We also manage state sector and public finances and are the steward of the public sector financial management and regulatory systems.
- Our vision is to be a **world-leading Treasury** working towards **higher living standards for New Zealanders**.

Why we are developing the Living Standards Framework (LSF)

- The Treasury wants to grow wellbeing through improving New Zealand's human, social, natural, and physical/ financial capital. This thinking is at the heart of our LSF.

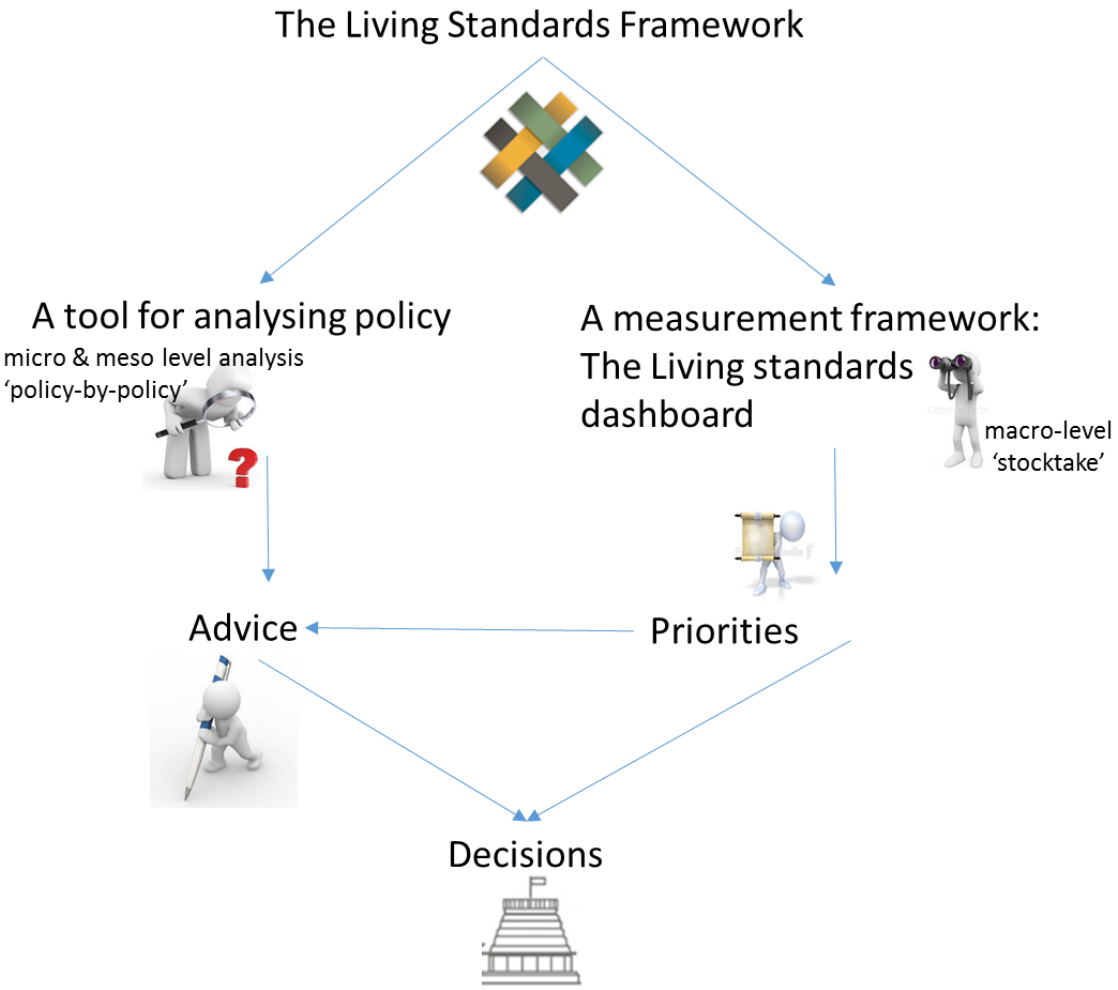
- There are three major gaps driving our work:
  - the measurement and monitoring of living standards;
  - the coherence of policy development to support Ministerial decision-making; and
  - collective action by delivery agencies in the pursuit of wellbeing.

- Improving this situation is the purpose of the LSF.

- Governments can then make their judgments about which aspects of wellbeing they will prioritise.

What is the Living Standards Framework?

How will The Treasury use the LSF?



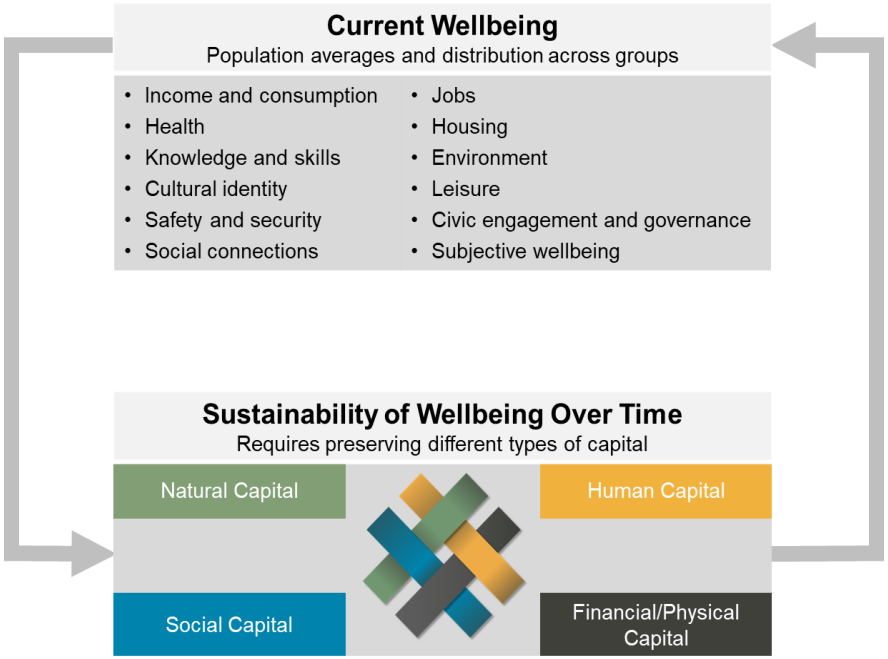
The Living Standards Framework

- The LSF is a set of organising principles that help us understand and advise on the *collective impact* of government policies on *intergenerational wellbeing.*

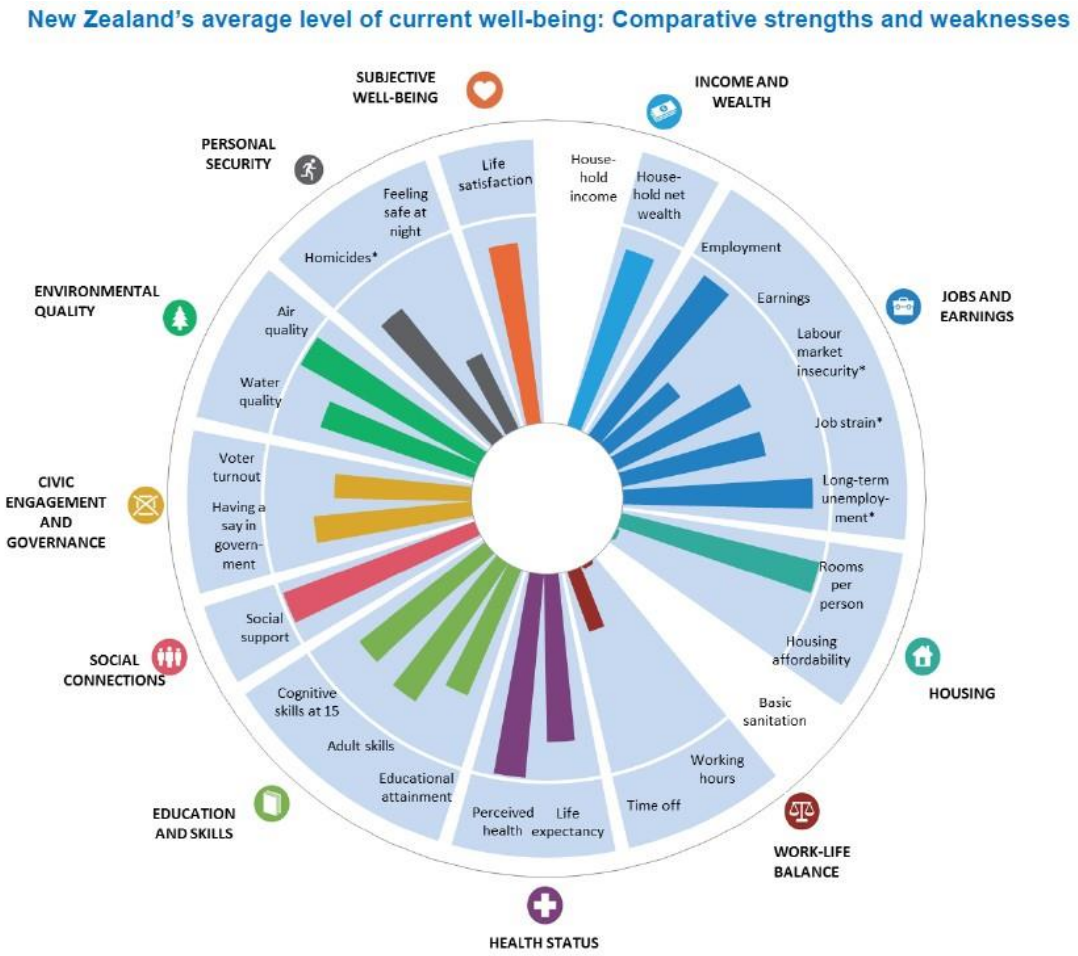
- It situates the activities of households, businesses, and the government within a “four capitals” view of the economy, showing the dynamic relationships between the sources of wellbeing and the different aspects of wellbeing.

How the LSF is organised

- The LSF draws on OECD analysis of intergenerational wellbeing, adapted for the New Zealand context.
- The starting point is answering three questions:
  - What are the current wellbeing outcomes?
  - Will these outcomes be sustained or improved in the future?
  - How resilient is the system?
- The LSF uses these three questions to frame a system of *measurement*, and a way of thinking about *policy*.



Current wellbeing outcomes



Note: This chart shows New Zealand's relative strengths and weaknesses in well-being when compared with other OECD countries. For both positive and negative indicators (such as homicides, marked with an "*"), longer bars always indicate better outcomes (i.e. higher well-being), whereas shorter bars always indicate worse outcomes (i.e. lower well-being). If data are missing for any given indicator, the relevant segment of the circle is shaded in white.

Additional information, including the data used in this country note, can be found at:

www.oecd.org/statistics/Better-Life-Initiative-2017-country-notes-data.xlsx

Current wellbeing indicators

Wellbeing indicators for New Zealand that we consulted on

Life satisfaction

- Mean life satisfaction (0-10), New Zealand General Social Survey (NZGSS)

Material standard of living

- Household net adjusted disposable income per capita
- Mean equivalised household disposable income

Housing

- Rooms per person
- Housing cost overburden
- Housing quality

Jobs and earnings

- Unemployment rate
- Employment rate
- Median hourly earnings
- Work accidents per 100,000 workers
- Job strain* (future data collection)

Health

- Life expectancy at birth
- Self-reported health status
- Limitations in daily activities
- Proportion of the population with poor mental health

Civic engagement

- Voter turnout
- Proportion of the population reporting discrimination

Social connections

- Social network support
- Loneliness
- Time spent in positive social activities* (additional factor)

Environmental quality

- Air quality (PM10 concentrations per cubic metre)
- Air quality (PM2.5 concentrations per cubic metre)
- Satisfaction with water qualtiy
- Natural space footprint within a 1km radius of dwelling (additional inidcator)

Self and aspirations

- Proportion of the population expecting future wellbeing to be higher than the present
- Proportion of the population reporting a high level of control over their own life* (additional indicator)

Knowledge and skills

- Educational attainment of the adult population (upper secondary)
- Educational attainment of the adult population (tertiary)
- Cognitive skills at age 15

Leisure and recreation

- Proportion of the population working long hours
- Time in leisure and personal care
- Satisfaction with free time* (additional indicator)

Cultural identity/Ūkaipōtanga

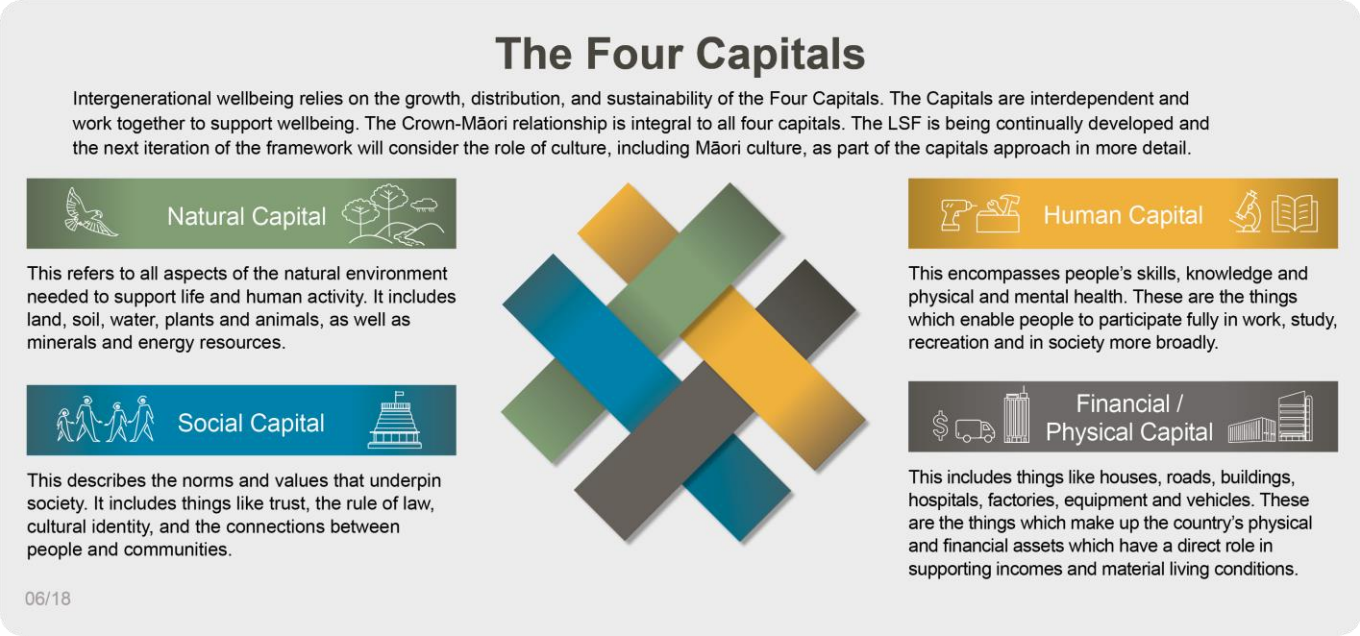
- Proportion of the population working long hours
- Time in leisure and personal care
- Satisfaction with free time* (additional indicator)

Safety

- Intentional homicide rate per 100,00
- Self-reported victimisation
- Feelings of safety

The four capitals

- At the core of the framework, sustainable intergenerational wellbeing is organised into four capital stocks – Natural Capital, Social Capital, Human Capital and Financial/Physical Capital.



Current work on the Living Standards Framework

Implementing the LSF: Our programme

We have organised our work on the LSF into four major workstreams:

1. Technical development of the LSF

2. Equipping the Treasury to lead and apply the LSF

3. Applying a wellbeing approach to the public finance system (including the Budget)

4. Applying the LSF to our economic and fiscal strategy

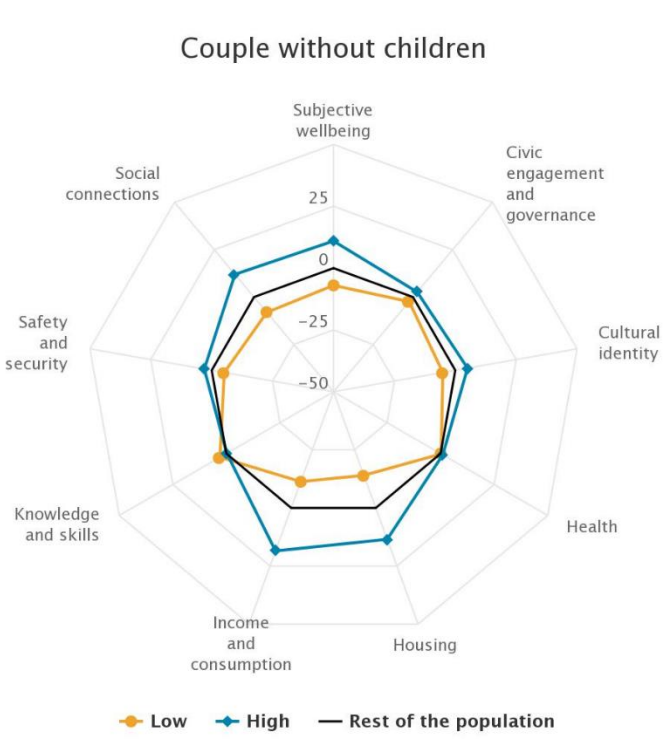
Technical development of the LSF

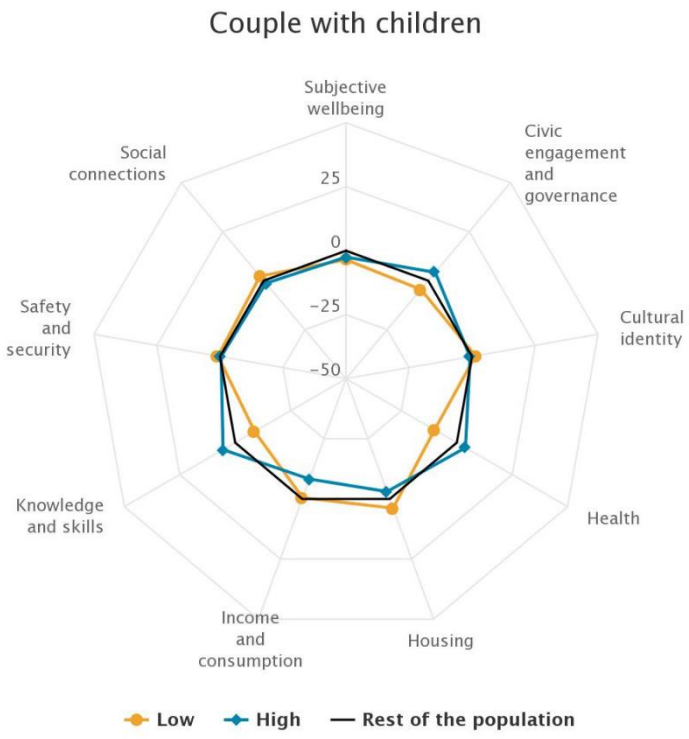
- The Treasury has been developing the LSF for several years. We are continuing with this work to ensure the framework is fit for purpose in a New Zealand context.

  - We are releasing Version 1 of the Living Standards Dashboard in December.
  - Stats NZ is developing Indicators Aotearoa New Zealand, which the Dashboard's indicators will draw from.

- We know that there are some key gaps in the data and framework, we will be working on these next year – e.g. children, Te Ao Māori.

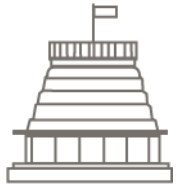
LSF Dashboard – an example





Delivering the Wellbeing Budget in 2019

- The Government has announced that Budget 2019 will be a '**Wellbeing Budget**'.



- It will introduce the Government's wellbeing approach in the strategic, decision-making, and production phases of the Budget, including in setting priorities.

- The Government's objectives will be anchored in its overarching wellbeing approach, and informed by the LSF.

- This means that government agencies will need to **assess Budget initiatives against broader wellbeing criteria**, such as their impact on the environment and communities.

What are the challenges?

Being at the leading edge

Modern variants of national income accounting have been in continuous development since the 1940s. 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.

Adapting current processes

The complexity of government processes means substantial time is needed to integrate new approaches.

Completing the analyses

Sensitivity of the measures

The sensitivity of the measures to real policy changes is still unclear because current measures have not been properly tested in a policy environment.

Ownership

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

Questions and thoughts for discussion

The LSF fits with broader trends that are shaking up government institutions

- The LSF will evolve as we learn more about what can (and should) be measured, and as we become better at integrating this data into the day to day work of government

- The Treasury's LSF work sits within broader trends:
  - The international organisations that helped manage the global economy have come under increasing challenges as living standards increase. This is both exciting and a little frightening!
  - Big data

What might it mean for your students

- For future analysts:
  - opportunities to help reshape world institutions more suitable for the world as it will become.
  - application of economics in the policy environment may look different from how it is taught, but the skills are no less important.
  - being numerate and being able to communicate clearly is only going to be more important

Skills, knowledge and curiosity

- What economists learned (relearned?) over the last decade is that it is not just having formal models, but understanding the concepts and their limitations that matter as much as the results themselves. This matters for students thinking about the skills they need. **("It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."** *The Big Short* attr. Mark Twain)

- There has been increased interest in history and understanding what history can tell us about current uncertainty ("**Those who fail to learn from history are condemned to repeat it**." Churchill)

- Some of the best economics in recent years has come from non-economists (Kahneman and Tvertsky, John Nash)

Background on the Four Capitals

Future wellbeing - four capitals

The Four Capitals

Intergenerational wellbeing relies on the growth, distribution, and sustainability of the Four Capitals. The Capitals are interdependent and work together to support wellbeing.

Natural Capital

This refers to all aspects of the natural environment needed to support life and human activity. It includes land, soil, water, plants and animals, as well as minerals and enegy resources.

Social Capital

This describes the norms and values that underpin society. It includes things like trust, the rule of law, the Crown-Māori relationship, cultural identity, and the connections between people and communities.

Human Capital

This encompasses people's skills, knowledge and physical and mental health. These are the things which enable people to participate fully in work, study, recreation and in society more broadly.

Financial & Physical Capital

This includes things like houses, roads, buildings, hospitals, factories, equipment and vehicles. These are the things which make up the country's physical and financial assets which have a direct role in supporting incomes and material living conditions.

Financial and physical capital

What is it?

- Financial and physical capital includes the buildings, machines and equipment and other conventional investment, including capital spending by government.
- The financial assets of households provide resilience to unexpected life events and retirement. Housing is a major contributor to current wellbeing and is the highest-valued household asset.
- Government owns physical capital stock in schools, roads, and hospitals to deliver public services. Its financial assets provide a buffer through economic fluctuations.

How will we measure it?

Many elements of financial and physical capital are measured by Statistics New Zealand (SNZ) and we are using the OECD framework (see table below) to develop measures of this capital.

Indicators relevant to both current and future well-being	Indicators of the "stock" of capital	"Flow" indicators (investment in, and depletion of, capital stocks)	Other risk factors
Net wealth of households	Net fixed assets per capita	Gross fixed capital formation	Indebtedness of the private (household) sector
Net financial wealth of households	Knowledge capital per capita	Investment in R&D	Financial net worth of general government
	Financial net worth of the total economy per capita		Leverage of the banking sector

Source: Adapted from OECD (2015) *How's Life?*

Financial and physical capital

What are the issues?

Productivity Performance

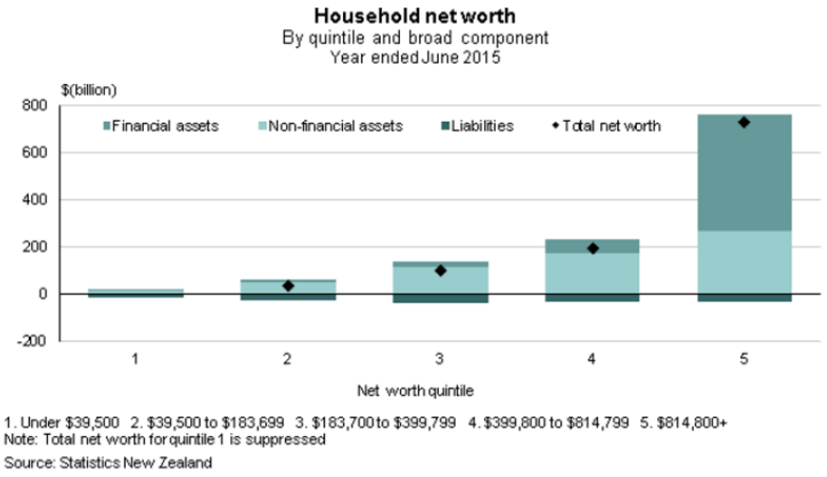
It is difficult to compare capital *stocks* across countries, but evidence suggests capital stocks are low in New Zealand by OECD standards. Investment flows continue to be weak. This is probably a contributor to New Zealand' sluggish labour productivity growth (OECD, 2017).

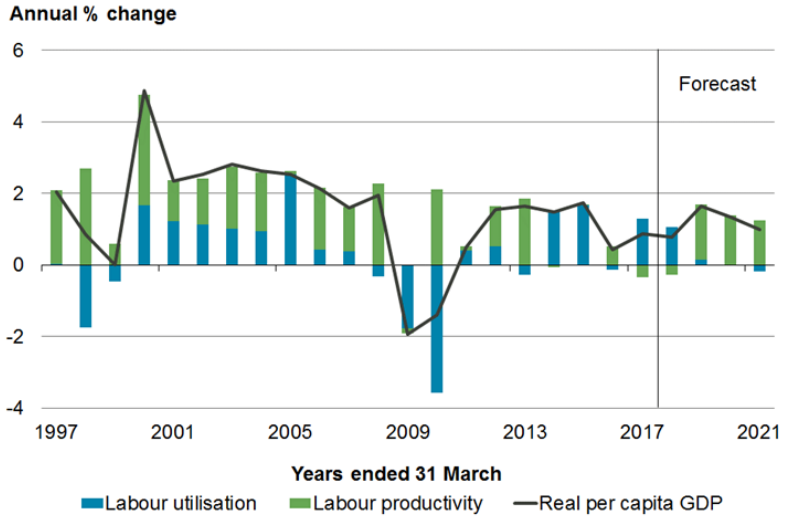
Distribution

The distribution of wealth in New Zealand is largely consistent with the OECD average. SNZ has shown the top 1% of New Zealand households had 18 percent of total net worth, compared to 13% in Australia.

Applying the LSF

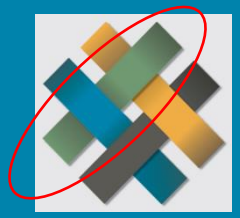
The LSF potentially adds new perspectives on the role of shocks to the future financial position, how climate change might affect physical assets, and the impact of digitalisation on capital and labour.





Sources: Statistics New Zealand, the Treasury

Natural Capital



What is it?

Natural capital are the aspects of our environment that improve intergenerational wellbeing, including land, soil, water, biodiversity, minerals, energy resources, and ecosystem services.

How will we measure it?

There are a number of international standards for estimating natural capital stocks and flows, with no single approach obviously the best for all purposes. The Treasury is developing an approach based on drawing together different international approaches, such as:

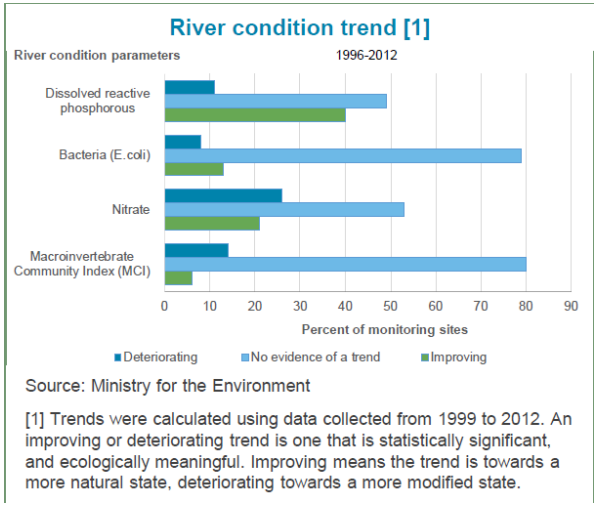
- the Total Economic Value (TEV) approach - the Total Economic Value model (TEV) estimates value based on five sources: Actual Use, Option, Existence, Altruistic and Bequest. For instance, water has an electricity and irrigation use value, an option value where it is available in rivers, lakes and so on, but not used; and an existence value from a cultural perspective
- The UN System of Environmental – Economic Accounting (SEEA) – This framework outlines the non-quality adjusted stock of natural resources over time and a monetary value provided for some of these resources
- The World Bank Genuine Savings (GS) approach – is a measure of how well a country maintains its total asset base, including natural, human and physical capital, by estimating whether or not any depletion of natural resources is used for current consumption or converted into other forms of capital for future use.

Natural Capital

What are the issues (examples)?

Fresh Water

Population growth, irrigation expansion and climate change are increasing pressure on freshwater quality, with the major risks being agricultural and urban storm water run-off.



Source: Ministry for the Environment

[1] Trends were calculated using data collected from 1999 to 2012. An improving or deteriorating trend is one that is statistically significant, and ecologically meaningful. Improving means the trend is towards a more natural state, deteriorating towards a more modified state.

Threatened Species

Presently, more than 3000 of our native species are classified as ‘threatened’ or ‘at risk’, with around 800 at risk of extinction and the remainder vulnerable to small changes in the environment. Many of these are unique to New Zealand. Threats to biodiversity have the potential to reduce social and economic capital as well as natural capital.

Climate Change

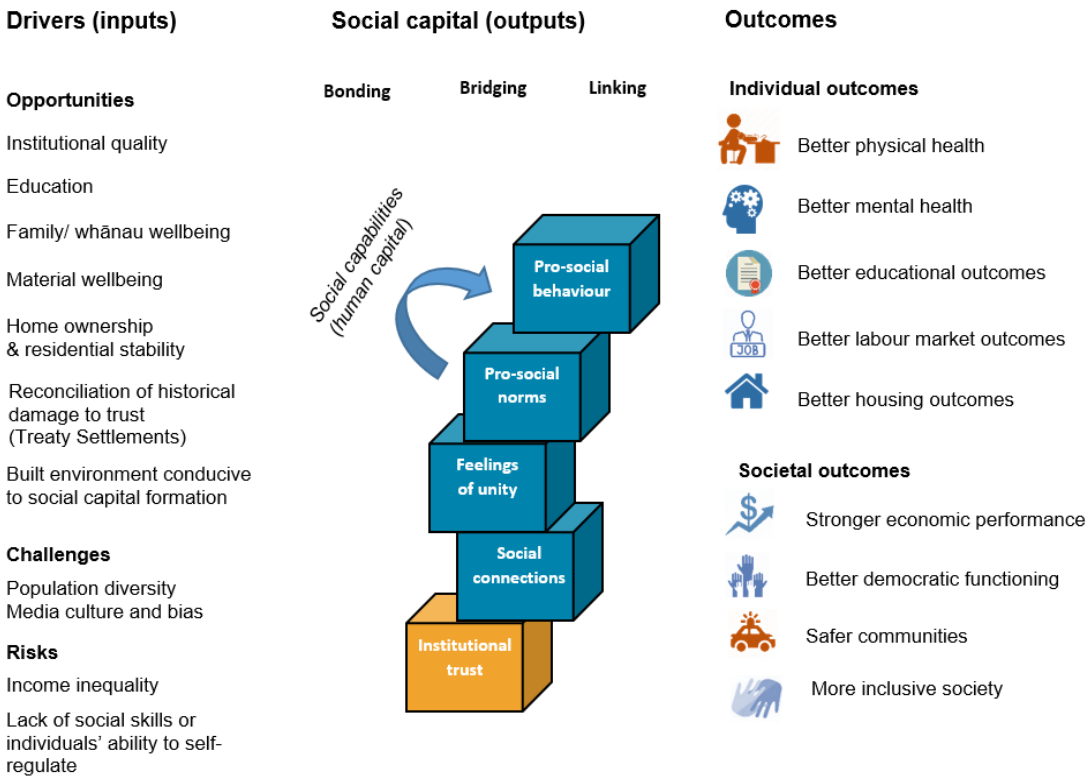
Growing the economy while meeting emission reduction ambitions requires a focus on productivity, innovation, technology uptake and better environmental management.

Social capital

What is it and how will we measure it?

There is no international standard for estimating social capital and its definition is highly contested. Our approach is to draw strands of work together in a working definition that supports policy. Thus social capital is:

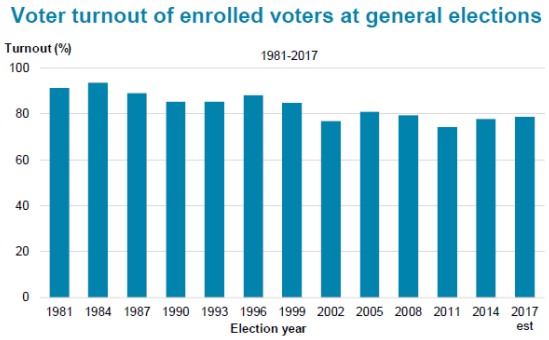
- Networks, attitudes and norms promoting coordination and collaboration between people;
- Individuals' social connections that provide emotional, instrumental and informational support.



Social Capital

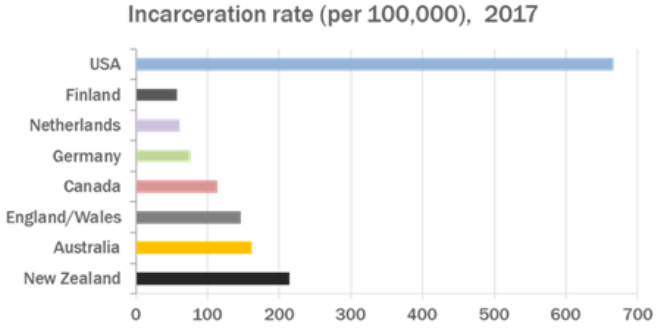
What are the issues?

Social capital has a large and well-evidenced impact on economic performance, democratic functioning, public safety, educational outcomes, labour market outcomes, and individual health and wellbeing.



Source: Electoral Commission

Source: Electoral Commission



Source: Ministry of Justice

To maintain and grow social capital through public policy, agencies across government should understand the social capital implications of different policy proposals.

Human Capital

What is it?

Human capital is an individual's skills, knowledge, mental and physical health. It enables people to participate fully in work, study, recreation and in society more broadly.

How will we measure it?

The measures are still being explored, but those under consideration include:

- students leaving school with NCEA level qualifications;
- students leaving tertiary education with an undergraduate or equivalent qualification;
- students leaving tertiary education with a post-graduate or equivalent qualification;
- the percentage of women in paid employment working part-time;
- life expectancy;
- suicide rates;
- obesity and preventable conditions.

Human Capital

What are the issues?

Potential barriers to individuals investing in and using their human capital in the formal economy include structural disadvantage and some cultural or social norms.

Education

The human capital stock is increasing (through qualifications profile, lifetime earnings and higher relative earnings of qualified people) and is high relative to physical capital. However OECD evidence suggests this human capital advantage is decreasing, as our younger workers are less skilled than their international equivalent, and our highly skilled older workers start to leave the labour market.

Unpaid work

Unequal distribution of care and domestic responsibility between genders may cause labour market participation frictions.

Health

Overall, we are living longer, but there are ethnic disparities and NZ has high suicide rates.