

Wellbeing, well what?

A look at wellbeing and the Living Standards Framework

Anne Boniface, Senior Economist +64 9 336 5669

- This week the Government reveals its much vaunted Wellbeing Budget. In addition to updating the fiscal accounts and economic outlook, the Budget will report on a broader range of indicators than in the past.
- To assist the Government with developing this new approach to the Budget and policymaking, the Treasury has developed its Living Standards Framework. This tool aims to provide a wider lens for preparing policy advice and assessing the outcomes of Government decisions.
- We support this development. Policy should focus on improving the things that matter for New Zealanders and that includes things that are not well measured by standard financial statistics.
- However, the new approach is no panacea. Policymaking will continue to be a tough job. A new framework for considering policies won't necessarily make choices between alternatives any easier, and producing a framework which can measure the wide variety of things that matter to New Zealanders is a complex task.
- But just because something is difficult, and solutions are imperfect, this doesn't mean it's not worth the effort. A successful focus on wellbeing should improve the quality of advice provided to governments and lead to a more thorough and comprehensive analysis of policy trade-offs and outcomes.

Well – what?

Wellbeing has become the buzzword for politicians and policymakers since the Labour-led Government took office. Next week the rubber will hit the road with the release of the first Wellbeing Budget. In it, the Government has committed to improving the wide variety of things that matter for the lives of New Zealanders and, critically, it has committed to reporting on them. In doing so, it will make greater use of the Treasury's Living Standards Framework. This framework evaluates the wellbeing of New Zealanders across economic, social and environmental spheres. It also considers distributional aspects of outcomes and the stock of capital available for contributing to the future wellbeing of New Zealanders.

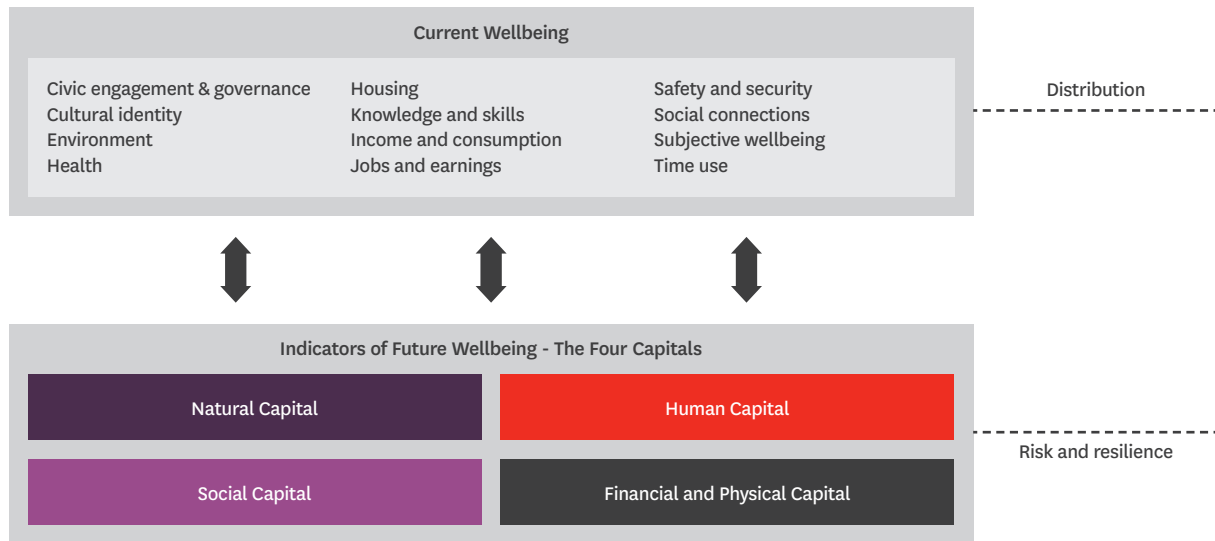
We're supportive of this development. Complementing traditional indicators of success with a more systematic consideration of a broader range of indicators of things that matter for New Zealanders makes good sense. However, there are challenges and the new approach is no panacea, as we detail in this Bulletin. But just because something is difficult doesn't mean it's not worth trying to do. Broadening the focus of governments and policymakers will take time, and needs to come in addition to (rather than instead of) some of the more traditional economic and financial metrics. But if successfully implemented, this approach should be a step in the right direction of providing a more comprehensive analysis of policy alternatives.

What is the Living Standards Framework?

The Living Standards Framework has been developed by Treasury over several years to measure and track changes in a range of indicators that impact on the living standards of New Zealanders. The first iteration of the framework was developed in 2011 drawing heavily on the OECD's "How's life" analysis. But the work has gained increasing momentum and prominence under the new Government.

In the current version, indicators of current wellbeing are split into 12 groups (outlined in figure 1). In addition, there are four types of capital identified as being the stock of resources that may be available to influence wellbeing in the future. Finally, the Living Standards Framework also considers the distribution of wellbeing across various groups in society and sees a role for risk and resilience of New Zealanders to impact on wellbeing.

Figure 1: Living Standards Framework



Source: The Treasury

GDP – the devil you know

One reason for broadening the focus of Government decision making and policy advice has been the perception that standard measures of success have been too narrowly focused on traditional financial and economic metrics. While the extent to which this is true is a point of debate, one indicator that has been firmly in the Government’s firing line is Gross Domestic Product (GDP).

For those looking to make cross country comparisons, GDP per person is often at the top of the list. It is clearly-defined, well understood and consistently measured. Independent statisticians around the world spend thousands of hours, following a well-articulated set of rules to come up with estimates of GDP for each country.

Yet while often quoted, GDP was never created as a measure of wellbeing and has certainly never been the final word on how well a country is faring. Most first year economics students will be able to recite a list of the measure’s shortcomings as a measure of welfare. These include that it only takes into account measured market activity. Not only does that mean it excludes black market activity, it also doesn’t account for activity that occurs outside the market. This means, for example, that the activity of cleaning up your own house is excluded from measured GDP. However, if you employ a cleaner to do the same job it will add to GDP.

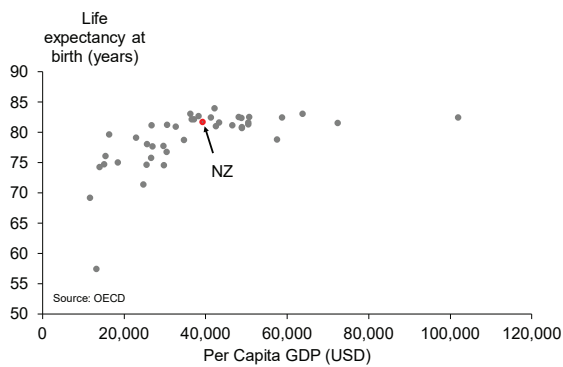
There are also other pitfalls in GDP data. GDP also doesn’t account for inequality in the distribution of activity or inequality in outcomes. There’s no negative value assigned to the likes of pollution with ‘good’ activity counted in the same way as ‘bad’. For example, the pollution generated by a factory’s operation doesn’t subtract from GDP, but the output produced by that factory adds to GDP. As an

estimate of activity in the economy, GDP can struggle to keep up with technological change. New innovations which add value to an economy in a non-traditional ways can catch on very quickly, but it often takes time for these developments to be fully accounted for in official GDP statistics. For example the framework can struggle to capture the added value generated by the switch away from traditional landline calling to video calling via Skype or FaceTime, or the switch away from using printed map books to Google Maps on a smart phone.

But perhaps one of the biggest downfalls of GDP that it is a measure of flow activity in the economy, not the stock of resources in an economy. The flow of activity over a certain period of time (as measured by GDP) can add or subtract to the stock of resources available at some point further down the track. This stock of resources can then influence living standards in the future. For example, the destruction of buildings in an earthquake has no impact on GDP but reduces the stock of resources available in the economy. In contrast, rebuilding activity following the earthquake will add to GDP for a time.

So with such significant and widely understood shortcomings, why does GDP still get such a high profile? It’s partly because GDP (per capita) is often strongly correlated to things that we care about. For example, countries with higher GDP per capita often have longer life expectancy and lower infant mortality rates. Nominal GDP is also closely related to tax revenue. This matters from the Government’s perspective because it is effectively a budget constraint on spending. It’s also relatively straightforward to measure, with measurement usually being done by independent statistical agencies so can’t be manipulated by politicians attempting to influence printed statistics.

Figure 2: Life expectancy and GDP per capita



Neither the Government nor the Treasury is planning on completely ditching all reference to GDP or other traditional financial metrics. Instead, the stated ambition is to complement these measures with additional indicators of how New Zealanders' current wellbeing is tracking and how the stock of resources is changing.

The solution?

The Treasury has developed a dashboard approach to developing a practical tool for measuring wellbeing. Launched late last year, the Living Standards Framework Dashboard collates the wide range of available data which measures some of the many components of the Living Standards Framework. This publicly available tool allows users to drill down into indicators of current wellbeing as well as the four capitals, and where possible, it also provides a cross country comparison. Although the dashboard represents a significant step forward for the Treasury in terms of providing a practical resource for policymakers, it has also been marketed as a work in progress, with an update expected to be provided in 2021. Areas highlighted for further development include child wellbeing, Te Ao Māori and Pasifika wellbeing, NZ cultural identity and risk and resilience.

Perhaps the area where the new regime has the biggest opportunity to improve the quality of public sector decision

making is by increased focus on the intergenerational consequences of policy choices. Clearly, the temptation for politicians operating in a three-year election cycle is to focus on the outcomes of today's voters, rather than the consequences of those policies in the future (the debate around Superannuation eligibility being a case in point). But decisions made today have consequences for tomorrow. Some decisions will reduce the availability of future capital (for example, felling Kauri forests to export the wood shrinks natural capital), while others may add to the stock of capital (for example, increasing the number of young people going into training may increase human capital).

Importantly, the Living Standards Framework takes a broad approach to measuring New Zealand's capital stock. The four capitals identified by the Treasury are:

- **Natural Capital**
Parts of the environment that is used to support human life and activity. It includes things like land, water, minerals, animals and biodiversity.
- **Financial/Physical Capital**
These include the financial and physical things that help generate incomes. For example, buildings, roads, machines and equipment. It also includes financial assets of households and governments.
- **Human Capital**
People's skills, knowledge physical and mental health that allow them to fully participate in work and society more generally.
- **Social Capital**
Arguably the most difficult of the four capitals to describe, it includes the values that underpin society such as the rule of law, cultural identity and the connections between people and communities.

From the Government's perspective, it also aims to enshrine its wellbeing focus in legislation. Planned amendments to the Public Finance Act will require future Governments to report on their wellbeing objectives. Treasury will also be obliged to report every four years on both current and future wellbeing.

Figure 3: The Four Capitals

Natural Capital	Human Capital
All aspects of the natural environment that support life and human activity. Includes land, soil, water, plants and animals, minerals and energy resources.	The capabilities and capacities of people to engage in work, study, recreation, and social activities. Includes skills, knowledge, physical and mental health.
Social Capital	Financial and Physical Capital
The norms, rules and institutions that influence the way in which people live and work together and experience a sense of belonging. Includes trust, reciprocity, the rule of law, cultural and community identity, traditions and customs, common values and interests.	Financial and human-made (produced) physical assets, usually closely associated with supporting material living conditions. Includes factories, equipment, houses, roads, buildings, hospitals, financial securities.

Source: The Treasury

Our take

We're supportive of the principles underlying the focus on wellbeing and the concept of the Living Standard Framework. In particular, it makes a lot of sense to think about the impact on New Zealand's capital stock of policy changes and to measure that capital stock as comprehensively as possible. Considering New Zealand's Natural, Social and Human capital in addition to the country's Financial/Physical capital appears an eminently sensible approach.

In many ways, the new approach is a practical step forward. And both the Treasury and the Government are at pains to point out the wellbeing approach and the Living Standards Framework are both works in progress. The types of indicators used to measure wellbeing will evolve as understanding of the topic grows and new data becomes available. Presumably, advice to Ministers from government departments will also develop as policymakers become more familiar with the approach and tools available.

The dashboard approach to measuring living standards also deliberately steers away from boiling wellbeing down into a single aggregate index. While intentional, this still means its comparing alternative policies remains complex and open to interpretation. Beyond the dashboard, Treasury research has demonstrated the potential to construct an aggregate wellbeing score and compare how this measure varies across groups in society.¹ The Treasury's latest version of its traditional cost benefit analysis tool also attaches a monetary value to some of the factors that influence wellbeing.

Inevitably, choosing which policies will best improve the outcomes for New Zealanders within a budget constraint will remain challenging, even with the aid of the Living Standards Framework. By opting to take a dashboard approach, comparisons between alternative policies will continue to rely in part on judgement (albeit hopefully more well informed judgement than previously).

For example, the Living Standards Framework dashboard won't necessarily stop people emphasising one measure over another in order to advocate for pet projects. Someone strongly in favour of spending on education may still downweight other indicators of wellbeing in their analysis, even though the dashboard approach requires both to be considered. Similarly, financial/physical capital may be emphasised at the peak of the economic cycle but be

downplayed at the trough. However, a structure which consistently reports on as many components of wellbeing as possible may make this more difficult to do than in the past.

There's also the risk that 'what gets measured gets done'. While there are an impressive range of indicators in the Treasury's Living Standards Framework dashboard, it is certainly not a complete list of everything that impacts on the living standards of every New Zealander. Some things are simply more difficult to measure than others. For example, while it's relatively easy to count the number of university graduates, it's challenging to assess the increase in skills of the workforce from increased on the job training. Measuring one but not the other, risks investing too heavily in things that improve outcomes that are measured, and not enough on things that are just as important but harder to survey.

There's also the risk of confusing correlation with causation. The dashboard focuses on measuring outcomes and shows how they are correlated with components of wellbeing. However, correlation is not the same as causation. And the focus on outcomes means there's a risk of missing other things that influence outcomes such as the structure of markets or the role of incentives.

The Government and Treasury also can't afford to drop the ball on the more traditional aspects of their respective roles. The Government's Budget constraint will still effectively be determined by Treasury's forecasts of how the economy will perform and the consequences of this for the fiscal accounts. Holders of NZ Government bonds will still need to be confident that they will be repaid.

At the end of the day, the proof will be in the pudding. Next week's "Wellbeing Budget" certainly won't be the final comment on the matter and will probably be incrementally different from its predecessors rather than a radical departure. However, we think the broader focus of the Government and Treasury is a step in the right direction. Focussing on wellbeing may not give us all the answers, and certainly won't make tough choices any easier. But we expect the approach will help politicians and policymakers get better at asking the right questions. Over time, this should lead a more thorough and comprehensive analysis of policy trade-offs and outcomes.

Anne Boniface
Senior Economist

¹ Our People – Multidimensional wellbeing in New Zealand, <https://treasury.govt.nz/publications/ap/ap-18-04>

Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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