Submission

By

THE NEW ZEALAND INITIATIVE

to the Treasury

on

Embedding wellbeing in the Public Finance Act 1989

28 September 2018

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1. SUMMARY

The New Zealand Initiative is pleased to submit this response to the Treasury's Discussion Document: "Embedding wellbeing in the Public Finance Act 1989".

In our view the proposed changes to the Public Finance Act (PFA) undesirably confuse its role.

We recommend against including any goals in the PFA that are unrelated to matters of fiscal control and reporting.

The fundamental problem with the Treasury's Living Standard Framework (LSF) is that it provides no basis for reaching a decision. An 'ought' cannot be deduced solely from an 'is'. Resources are scarce, choices must be made. The LSF provides no framework for making them.

The document does not demonstrate how the proposed changes to the PFA might improve transparency, accountability, the quality of policy advice, or government decisions. Since wellbeing indicators will be published regardless, amendments to the PFA do not make decision makers any better informed. There is little accountability because wellbeing outcomes are affected by many factors outside government's control. Currently the LSF offers no framework for assessing trade-offs.

We recommend against the Secretary to the Treasury being made responsible for defining wellbeing or selecting preferred indicators. These tasks are fundamentally political.

We recommend that changes to the PFA be abandoned, or at least deferred until the LSF has been developed to the point it can help make decisions about trade-offs between contending wellbeing considerations. In its current form, the LSF is plainly not capable of doing this.

Given the problematic nature of the top-down approach being pursued, we recommend a bottom-up approach using evaluation technologies and expertise developed in agencies over the past two years. This approach can give meaningful effect to the Government's commendable goal of improving wellbeing.

2. INTRODUCTION

The New Zealand Initiative is pleased to submit this response to the Treasury's Discussion Document: "Embedding wellbeing in the Public Finance Act 1989".

This submission does not comment on the other changes to the PFA listed on page 9 of the Treasury document.[1]

3. THE PROPOSAL IN RELATION TO THE PFA'S PURPOSE

The document proposes that Parliament amend the PFA to:

- Require the Government to set out how its wellbeing objectives will guide its Budget decisions alongside fiscal objectives, and
- Require the Treasury to report on wellbeing indicators. These will be "aggregate, national-level movement[s], and long-term trends in wellbeing" to be used by the Government to identify areas that may need attention.

In our view this undermines the purpose of the PFA, as set out in section 1A. It is to provide a framework for parliamentary scrutiny of government expenditure decisions – and financial

[1] The New Zealand Initiative is submitting separately on the proposed independent fiscal institution.

management more generally. It is not about using the PFA to prescribe the pursuit of non-fiscal objectives that may be largely outside the government's control and unrelated to fiscal discipline.

We recommend against including any goals in the PFA that are unrelated to matters of fiscal control and reporting.

However, since the Government intends to include all manner of non-fiscal goals in the PFA ,[2] we offer the following comments taking the Government's commitment as given.

The fundamental problem with the Treasury's LSF is that it provides no guidance for making choices. An 'ought' cannot be validly deduced from an 'is'. Any decision might be 'justified' by arbitrarily pointing to any subset of the dozens of indicators.

4. REQUIREMENT TO REPORT WELLBEING INDICATORS

Relevant data assists analysis. Outcomes measures can assist policy advice and decision-making in two ways:

- Bottom-up: revealing relative spending effectiveness of different programs with respect to outcomes, allowing spending to target areas that make the greatest difference
- Top-down: governments can set targets based on aggregate measures as a source of sustained pressure for results from spending.

Under either channel, the pathway from measurement to decision-making is clear: the first can improve the quality of decisions-; the second can drive political demands for spending effectiveness.

The Treasury's proposal contributes to neither path. Nor would the pursuit of either path require amending the PFA.

When there is no clear link between fiscal decisions and wellbeing outcomes, there can be little or no accountability for the efficacy of actions.

It is not even clear the proposal will improve transparency or priority setting if once every year Treasury is obliged to do no more than assemble existing measures in a new section of an existing report.

5. REQUIREMENT TO DECLARE HOW WELLBEING GUIDES BUDGET DECISIONS

The proposed changes to the PFA would require future governments to declare their wellbeing objectives. This obligation will not support any of the Treasury's or Minister's objectives as stated at the front of the document because:

- The Treasury's proposal gives neither the public, the Government, departments nor Parliament any way of assessing whether a government's fiscal policy actually gives effect to the declaration or represents a responsible use of taxpayers' money.
- Under the proposal, governments will be free to define wellbeing in any way, or to leave it undefined, making compliance all but trivial.
- The proposal does not provide a framework for addressing conflicts between fiscal and wellbeing objectives, or between short- and long-term wellbeing effects, let alone suggest a resolution.

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[2] We note that the document states on page 11 that requirements to report on child poverty are to be included.

Conflicts between wellbeing objectives and fiscal discipline put the latter at risk in the short-term and the former in the longer-term.

The potential dilution of fiscal discipline could have significant consequences. The document's reference to re-introducing the four wellbeings to the local authorities is telling: The four wellbeings were removed from local government legislation in 2012 in part to guard against council overreach and a loss of fiscal discipline in some councils.

Accountability for many objectives with no clarity about priorities is accountability for none.

6. THE GOVERNMENT, NOT THE SECRETARY, SHOULD APPROVE INDICATORS

The document proposes the Secretary will have the authority to approve a suite of wellbeing indicators (p. 14), emphasising the exercise of professional judgment in fulfilment of this role.

However, the task of determining indicators and wellbeing is fundamentally political. Judgment is more a matter of values than of expertise and professionalism. There is no objective basis for deciding what measures to include or exclude when people differ. Environmentalists, Maori, Pacifika, women, children, the elderly, health and education providers, socialists and capitalists can all be expected to have different views about the relative importance of contending indicators. Choosing a preferred measure of spiritual wellbeing, for example, is likely to be contentious. Treasury is not the appropriate home for this role. We note that the same considerations apply to the Government Statistician. Her position should not be politicised either in this respect.

The suite of indicators a government cares about is going to depend on what its political priories are as between the contending factions. This is a job for politicians, not public servants. As such, authority appropriately sits with the Government. In practice, the Government would be supported in its decision with advice from department officials.

We are strongly of the view that this authority should sit with the Government rather than the Treasury Secretary.

7. THE DOCUMENT FAILS TO CONNECT THE FOUR CAPITALS TO FUTURE WELLBEING

In his foreword, the Secretary to the Treasury says:

> Traditionally, economists have focused their thinking around the factors of production, like land and labour, and how they are combined to create goods and services. The Treasury's Living Standards Framework is an adaptation of this notion: the four capitals – natural, human, social and financial/physical – are the stocks that combine to generate flows of wellbeing.

This is one technocratic aspect of economics. It is more associated with Ricardo and Marx than Adam Smith. Issues of incentive structures, opportunity cost, the gains from trade, comparative advantage, specialisation and exploiting economics of scale are a more pervasive focus in economics.

A defining feature of neoclassical microeconomics is the technical production function for a known technology, and the decision-maker's preference set – the utility function – for a single decision-maker. These functions permit trade-offs to be assessed. Much of formal microeconomics is derived from the analysis of trade-offs using these functions and concepts: profit maximisation, cost minimisation, utility maximisation, choice, demand and supply, consumer and producer surplus, analysis of monopoly, oligopoly and perfect competition, welfare, public goods, externalities, and optimisation.

To postulate a single aggregate production function for the entire economy, and a single utility function, is much more contentious exercise. But robust links between policy levers, Treasury's capital stock measures and future wellbeing outcomes need to be established. Otherwise the relevance of these stocks to decisions is not known. The Treasury's LSF currently supplies no such links, not even an articulated production or utility function. This is one reason why the LSF provides no guidance concerning trade-offs, and therefore no basis for making choices.

There is a deeper difficulty. Stock accumulation production functions do not model the well-being growth process. They do not tell us if the environment is conducive to conservation, innovation, investment and entrepreneurship. They do not model the formation of expectations. They take the incentives built into existing institutional structures as given. Yet such omitted, or at best mechanistically accommodated, aspects are vital for future outcomes. Too many resource rich countries are poor because their institutional safeguards are weak.

Expressed differently, it is not the level of stocks that count, it is how well they will be used, and that depends on secure property rights and the quality of incentives, amongst others.

The alternative, and indeed mainstream, approach is to use cost-benefit analysis to make decisions. A competent analysis will make credible links between alternative policy actions and likely outcomes. Currently the LSF offers no substitute for this approach.

Our purpose in raising this matter is to re-state a fundamental objection to the LSF. Lacking any basis for evaluating trade-offs, the LSF is structurally incapable of justifying decisions.

The government's commendable desire to improve wellbeing does not obviate the fact that choices between competing uses of funds must be made in pursuit of that goal. The LSF does not help government agencies to decide how to trade-off competing considerations.

The Treasury has been aware of these difficulties for the decade it has been developing its LSF. To date, it has not demonstrated that it is close to resolving them. Until it does, it is premature and risky to assume it will be able to.

A wellbeing approach can be meaningfully pursued through the above bottom-up approach using the technology developed in other agencies. Over the last two years, agencies have built systems that can measure the actual effectiveness of services and which offer a plausible and coherent pathway to improved wellbeing for people.

8. CONCLUSION AND RECOMMENDATIONS

Without significant changes, Budget 2019 risks being indistinguishable from previous budgets in substance, rhetoric aside. Ministers will have to make decisions about matters such as housing affordability, material hardship, water quality, roads and poor productivity growth with little or no better information about trade-offs than they would have had otherwise.

The fundamental problem is that the document does not explain how the proposed changes can improve policy advice and government decisions concerning trade-offs. It merely asserts this improvement, implausibly.

We do not see even in principle how the proposed changes as they stand can help achieve the Minister of Finance's goals in the document of improved living standards and wellbeing.

The New Zealand Initiative recommends that:

- The proposed changes to the PFA be abandoned, or at least deferred until a framework for making it useful for decision-making is developed.
- Treasury commission the Social Investment Agency, or one or more social sector departments, to undertake for Budget 2019 bottom-up evaluations of, say, five baseline spending programs or Budget 2019 initiatives using the evaluation technology they have developed. Evaluations would measure the effects of selected spending on the wellbeing of service recipients.