

TREASURY'S LIVING STANDARDS FRAMEWORK

By Bryce Wilkinson

The New Zealand Treasury has a vision. It is to be “a world-class Treasury working for higher living standards for New Zealanders”.¹

In the pursuit of this vision it published a “Living Standards Framework” in May 2011.² It now describes this framework as comprising “The Heart of Our Policy Advice”.³

Personally, I am not a fan of vision statements for government agencies. Public servants are paid to serve their elected ministers in the wider public interest and perform their delegated authorities impartially, honestly and competently. Visions can embody agendas. For example, does Treasury's vision see it as working for higher living standards for New Zealanders who want to achieve them at someone else's expense? Some would hope that Treasury would oppose rent-seeking and privilege.

Nevertheless, it would be good to see Treasury excelling in its delegated roles of guardian of the public purse and of the quality of regulatory analysis. Its own analyses should set a high standard. It should encourage and support other public agencies to reach the same standard. It should always seek to protect and enhance the disciplines embodied in our fiscal and regulatory ‘constitutions’.

Yet high quality fiscal and regulatory analysis is difficult. For a start, politically powerful or influential spending and regulatory advocates might not welcome it. It is also difficult technically. The mainstream technique for analysing both regulatory and fiscal proposals is cost-benefit analysis.⁴ Treasury is the custodian of that methodology in the public service.⁵

Given these gatekeeper roles Treasury can't expect to be widely liked, but it should aspire to be respected. It should not confuse the two.

Yet the Living Standards Framework does appear to want to be all things to all people. It proposes evaluating spending and regulatory proposals from five ad hoc perspectives—their contributions to economic growth, equity, sustainability, reducing risk and enhancing social infrastructure.

The framework apparently leaves it open to spending and regulatory interests to cherry-pick amongst the five pillars and within them, deciding for themselves which pillar best serves their purposes in a particular case. It gives no disciplined guidance to Treasury officers or anyone else as to how to choose between, say, competing concepts of equity, or how to assess trade-offs between the pillars.⁶ Nor is there an international literature to look to for guidance.

In contrast to this five pillar approach, cost-benefit analysis, for all its well-known weaknesses, provides an internationally mainstream framework for assessing whether the self-evaluated benefits to the New Zealand public from a fiscal or regulatory proposal are likely to exceed the self-evaluated costs. Some may choose to distinguish

between economic, social and environmental costs and benefits, but the technique itself transcends such inchoate distinctions.

The framework accommodates risk⁷ and can accommodate equity considerations, albeit not uncontentiously.⁸ Sustainability considerations are captured in the estimates of future costs and benefits.

Since the assessment of benefits and costs is familiar practice in private decision-making, commercial or otherwise, conclusions reached using this framework should be reasonably predictable and defensible to those being regulated or liable for paying the taxes. That is an important virtue.⁹

Nevertheless, while cost-benefit analysis provides a disciplined framework for evaluating competing considerations, the outcome even from a high quality analysis does not necessarily dictate the recommendation. Policy advice is more of an art than a science. Unintended consequences are rife. Assessing which recommendation might best meet the disparate needs of the democratically elected government and the public interest commonly requires wisdom and judgement in the face of many unknowns and conflicting considerations.

So what is the relationship between Treasury's Living Standards Framework and its guidance manuals on cost-benefit analysis?

In June 2012, Treasury published a second working paper that aimed to present the details of a practical living standards tool designed to assist policy analysts to consider the key elements of the living standards framework “in their day-to-day work”.¹⁰ Treasury's chief economist, Girol Karacaoglu, presented the framework to the annual conference of this Association in 2012.¹¹

Curiously, this document made no reference to cost-benefit analysis. It did not even include Treasury's guidance documents in the bibliography.

With respect to equity, the paper and the conference speech endorsed Amartya Sen's capability approach.¹² As articulated by Karacaoglu in an NBR article in 2010,¹³ it means that everyone “has the right to the freedoms and capabilities that will give them the opportunity to pursue their individual purpose(s) in life. ... In a just society, these freedoms and capabilities would be equally distributed, which is what we often refer to as ‘distributional justice’”.

As articulated, whether an accurate synopsis of Sen or not, this seems to be an elitist and visionary assertion of an entitlement to the fruits of someone else's labour. More to the point, how can this vision be practicable? People are born with markedly different capabilities (not just different IQ's). What does it mean to propose that a Newton, Mozart and Pele should have equal capabilities - with each other and everyone else?

1 See <http://www.treasury.govt.nz/abouttreasury>

2 Working Towards Higher Living Standards for New Zealanders, New Zealand Treasury Paper 11/02, May 2011.

3 See <http://www.treasury.govt.nz/abouttreasury/higherlivingstandards/sp-livingstandards-advice-oct14.pdf>

4 But constitutional principles, and the rule of law must also be given much weight, as in CabGuide's endorsement of the Legislation Design and Advisory Committee's guidelines.

5 See <http://www.treasury.govt.nz/publications/guidance/planning/costbenefitanalysis/guide> and <http://www.treasury.govt.nz/regulation/regulatoryproposal/ria/handbook>

6 In January 2013, The Treasury published six short papers elaborating on the pillars. See <http://www.treasury.govt.nz/abouttreasury/higherlivingstandards>. A similar number of complementary background notes have also been published and are accessible on the same website page.

7 See the section on risk and uncertainty in Part 2 of Treasury's guide.

8 The section on equity in Part 2 of Treasury's guide recommends separate consideration of equity aspects but notes that the UK Treasury Green Book recommends the inclusion of distributional weights.

9 I am grateful to a colleague for making this point.

10 ‘Improving the Living Standards of New Zealanders: Moving from a Framework to Implementation Conference Paper’, June 2012

11 See also Girol Karacaoglu, ‘Improving the Living Standards of New Zealanders: Moving from a Framework to Implementation’, Speech to the New Zealand Association of Economists Conference, June 2012.

12 Ibid 4, 10 and 16.

13 Girol Karacaoglu, ‘Mind Share: Equality, justice and prosperity – just utopian ideas or actually achievable?’, National Business Review, 17 December 2010.

Few dispute about the role for a state safety net, along with private philanthropy in its multitude of forms. But what appears to be being advocated here could be something vastly more ambitious and problematic.

How would such 'distributional justice' be pursued while preserving individual liberty? Apparently not by James Madison/Thomas Jefferson-style checks and balances aimed at limiting the potential for the abuse of the state's coercive power. To the contrary, Sen reportedly proposes that capability equalisation be achieved, or at least approached, by "democracy", meaning imposed by political majorities following "government by discussion". That proposition, Sen's or not, smacks more than a little of Rousseau's utopian and disastrous vision of an infallible "general will" as determined by a voting majority in general assembly.

Karacaoglu's article was surely written as a private individual rather than as a Treasury officer, but Treasury's subsequent endorsement of Sen's capability approach is a concern, at least if this is how it is being interpreted. Taxpayers may be happy to pay taxes to help those in desperate or distressing circumstances, but some may not want to be taxed much beyond that in order to give other people opportunities that they squander. So exactly what is Treasury endorsing when it endorses equalising capabilities?

In 2015 a further Treasury working paper, also by Karacaoglu, presented a stylised model of the living standards framework using the familiar utility maximising framework that constitutes mainstream frictionless neo-classical welfare economics.¹⁴ All general matters relating to institutional quality, property rights, the rule of law, public choice theory and the role of the common law in addressing externality issues lie outside this framework. Political and bureaucratic decision-making is not modelled. The implicit assumption is that politicians have no interest in being re-elected. Their sole concern is altruistic—to make people better off. For example:

*We conceptualise governments as collective agents through whose activities public goods are provided or their provision is facilitated, and the associated externalities are realised. The purpose of all such collective action is to enhance (note, enhance or improve - not equalise) the opportunities and capabilities of individuals to improve their private wellbeings.*¹⁵

This statement apparently rejects the large economic literature analysing political and bureaucratic incentives. Much more dangerously, it apparently endorses the potentially totalitarian assumption that politicians are angels.

But politicians are not angels. They are elected by the same people that the model assumes act in a narrow self-interested way in situations involving externalities.

No sound public policy analysis of a government spending, tax or regulatory proposal would fail to assess possible unintended consequences due to flawed incentives and inadequate information. The proposition that governments do not respond to political incentives is one of the last things I would have expected to see from Treasury.

Since assumed benevolent government is the only means in the proposed framework of responding to any posited departure from the outcomes posited for a frictionless, static, stylised neo-classical nirvana, policy implications follow almost by default.

14 Girol Karacaoglu, 'The New Zealand Treasury's Living Standards Framework - Exploring a Stylised Model', New Zealand Treasury Working Paper 15/12, August 2015.

15 Ibid, 16.

In particular:

*A particularly promising policy package 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, engineers and scientists.*¹⁶

With respect to education, the model recognises that skilled workers earn more but contentiously assumes that their work does not complement that of unskilled workers. By assumption such unequal incomes violate the equity pillar. Education subsidies are therefore indicated. But what if the assumption is flawed and what about people who choose not to learn skills, work long hours or take on heavy work responsibilities? And how adequately has half a century of state-subsidised education dealt with the problem of the 'long-tail' of educational under-achievement?

Similarly, the case for subsidising scientific research and innovation rests heavily on a modelled departure from nirvana due to spill-over effects and the assumption that the causal connection between scientific research and innovation runs from the former to the latter rather than in reverse. However, the modelling and the recommendation do not address either Baumol's argument that the spill-over effects under capitalism have material 'efficiency' advantages or UK academic Terence Kealey's extensive historical rebuttals of the causal "linear model" presumption.¹⁷

All the indicated policy recommendations arose without consideration of likely unintended consequences, let alone a recognisable cost-benefit or law and economics analysis. Once again Treasury's cost-benefit guide is neither referred to nor referenced in the bibliography.

In short, the above-cited publications appear to be saying the mainstream cost-benefit and law and economics analyses of public policy proposals are no longer at the heart of a Treasury's officer's 'day-to-day' work. If so, who is to tell other agencies that they matter?

The critical thrust of this article is motivated in good part by the dispiriting amount of evidence of low capacity in the public service generally (notwithstanding good exceptions) to produce high quality cost-benefit and law and economics analyses. More analytical discipline is needed, not less. Yet the Living Standards Framework seems likely in practice to impose even less discipline on government agencies to justify policy interventions than before. The freedom to cherry-pick pillar priorities is the freedom to avoid responsible analysis.

Finally, despite these critical comments and concern, there is a lot of common ground. Of course government policy advisers must give due consideration to all the matters mentioned in the Living Standards Framework, and more. But good advisers always have.

16 Ibid, iv.

17 See William Baumol, 'The Free Market Innovation Machine: Analyzing the Growth Miracle of Capitalism', 2002, and, for example, with respect to Kealey, <http://www.cato-unbound.org/2013/08/05/terence-kealey/case-against-public-science> and <http://www.criticalrationalism.net/2010/10/02/summary-of-kealey-on-the-economic-laws-of-scientific-research/>