Well-being Budget skewed by its fiscal focus

Geoff Bertram

Treasury has developed a tool called the Living Standards Framework to assess policy proposals in terms of their impact on "four capitals". These "capitals" - the bases on which the future well-being of New Zealanders rests - are natural capital, human capital, social capital, and financial/physical capital.

The Government's promised "Wellbeing Budget" is supposed to put the Living Standards Framework into practice. So policies that promise good financial returns but which damage the other three "capitals" – for example, mining in a national park, or reducing poor people's living standards, or sacrificing the quality of education and healthcare - should be less likely to be approved than in the past.

There is a problem with this approach. A genuine wellbeing strategy would prioritise and enhance New Zealanders' wellbeing, subject to relevant fiscal considerations. That would put fiscal policy in its place, as the means to an end – not the end in itself. But as the law now stands, it is difficult for this to happen, because of the language in the current Public Finance Act. The Act focuses tightly on public finance, with little or no explicit acknowledgment of the wider impact of government policies.

A responsible fiscal strategy aimed at increasing wellbeing requires that all four areas of capital – natural, human, and social, as well as financial - be sustained and enhanced over time, with policy maintaining a balance across them. The present framing of the Act prioritises narrowly-conceived financial issues, to the near-exclusion of the other capitals. The Act's reporting procedures, which are its key contribution to good government, ought to be designed and operated to facilitate the fiscal strategy – not to dictate the strategy itself.

The Act's exclusive focus on Government's financial debt, rather than on the nation's stocks of the four capitals, puts pressure on Government to pursue budget surpluses by running down public infrastructure, natural, human and social capital. But budgetary austerity that leaves inequality and poverty unchecked to destroy social and human capital is not responsible. It should not be described as responsible.

The so-called Budget Responsibility Rules adopted by the present Government rely on arbitrary numerical ratios to limit total spending and net debt. Those ratios are simply political artefacts – they have no real economic basis, and are open to manipulation by shifting definitional boundaries. Treasury's definition of "core spending", for example, is inflated by including welfare transfers, yet excludes infrastructure investment. New definitions could bring the Government's accounting framework more into line with the national accounts and the IMF's Government Finance Statistics, and new fiscal targets should reflect an explicitly chosen balance between public and private provision of goods and services.

The treatment of Crown entities as lying outside the "core" in terms both of spending and of borrowing limits is a loophole that enables Government to increase investment and net debt without breaking the letter of the Responsibility Rules, but it has the effect of increasing the cost of raising funds for programmes such as state house construction, while forcing policy debate into a distorting frame of reference. Better to treat all public debt simply as Crown debt, shifting the focus from "core Crown" to "total Crown", and to report transfers separately, given that they do not involve a Crown claim on the nation's output.

In the long run, the two essential issues in setting fiscal strategy should be first, what are our aspirations as a society; and second, what is society's willingness and ability to raise sufficient revenue to fund those aspirations? Upper and lower bounds on government spending should be based not on rigid adherence to arbitrary ratios, but on the outcome of those strategic choices, with due regard paid to the macro-economic limits which any New Zealand government has to respect: full employment (defined in a sensible way) and the balance-of-payments constraints facing a small open economy. These limits will vary in the short to medium term (with economic cycles) and in the longer run.

In allocating spending across the four capitals difficult choices have to be made, and different Governments will make different choices. But it is in transparently making and implementing those choices that real fiscal responsibility lies – not in sacrificing genuine wellbeing in the name of preconceived debt or spending ratios.

'Wellbeing Budget' skewed by its fiscal focus

Geoff Bertram
comment

Treasury has developed a tool called the Living Standards Framework to assess policy proposals in terms of their impact on "four capitals". These "capitals" – the bases on which the future wellbeing of New Zealanders rests – are natural capital, human capital, social capital, and financial/physical capital.

The Government's promised "Wellbeing Budget" is supposed to put the Living Standards Framework into practice. So policies that promise good financial returns but which damage the other three "capitals" – for example, mining in a national park, or reducing poor people's living standards, or sacrificing the quality of education and healthcare – should be less likely to be approved than in the past.

There is a problem with this approach. A genuine wellbeing strategy would prioritise and enhance New Zealanders' wellbeing, subject to relevant fiscal considerations. That would put fiscal policy in its place, as the means to an end – not the end in itself. But as the law now stands, it is difficult for this to happen, because of the language in the current Public Finance Act. The act focuses tightly on public finance, with little or no explicit acknowledgment of the wider impact of government policies.

A responsible fiscal strategy aimed at increasing wellbeing requires that all four areas of capital – natural, human, and social, as well as financial – be sustained and enhanced over time. The present framing of the act prioritises narrowly conceived financial issues, to the near-exclusion of the other capitals.

The act's exclusive focus on Government's financial debt, rather than on the nation's stocks of the four capitals, puts pressure on Government to pursue budget surpluses by running down public infrastructure, natural, human and social capital. But budgetary austerity that leaves inequality and poverty unchecked to destroy social and human capital is not responsible.

The so-called Budget Responsibility Rules adopted by the present Government rely on arbitrary numerical ratios to limit total spending and net debt. Those ratios are simply political artefacts – they have no real economic basis, and are open to manipulation by shifting definitional boundaries. Treasury's definition of "core spending", for example, is inflated by including welfare transfers, yet excludes infrastructure investment. New definitions could bring the Government's accounting framework more into line with the national accounts and the IMF's Government Finance Statistics, and new fiscal targets should reflect an explicitly chosen balance between public and private provision of goods and services.

The treatment of Crown entities as lying outside the "core" in terms both of spending and of borrowing limits is a loophole that enables the Government to increase investment and net debt without breaking the letter of the responsibility rules, but it has the effect of increasing the cost of raising funds for programmes such as state house construction, while forcing policy debate into a distorting frame of reference. Better to treat all public debt simply as Crown debt, shifting the focus from "core Crown" to "total Crown", and to report transfers separately, given that they do not involve a Crown claim on the nation's output.

In the long run, the two essential issues in setting fiscal strategy should be first, what are our aspirations as a society; and second, what is society's willingness and ability to raise sufficient revenue to fund those aspirations? Upper and lower bounds on government spending should be based on the outcome of those strategic choices, with due regard paid to the macro-economic limits which any New Zealand government has to respect: full employment (defined in a sensible way) and the balance-of-payments constraints facing a small open economy.

In allocating spending across the four capitals, difficult choices have to be made. But it is in transparently making and implementing those choices that real fiscal responsibility lies – not in sacrificing genuine wellbeing in the name of preconceived debt or spending ratios.

Geoff Bertram is Senior Associate with the Institute for Governance and Policy Studies at the Victoria University of Wellington