LSF and economics

Introductory IPANZ course

12 April 2022

Outline

- LSF: What and why

- LSF and the history of (economic) ideas
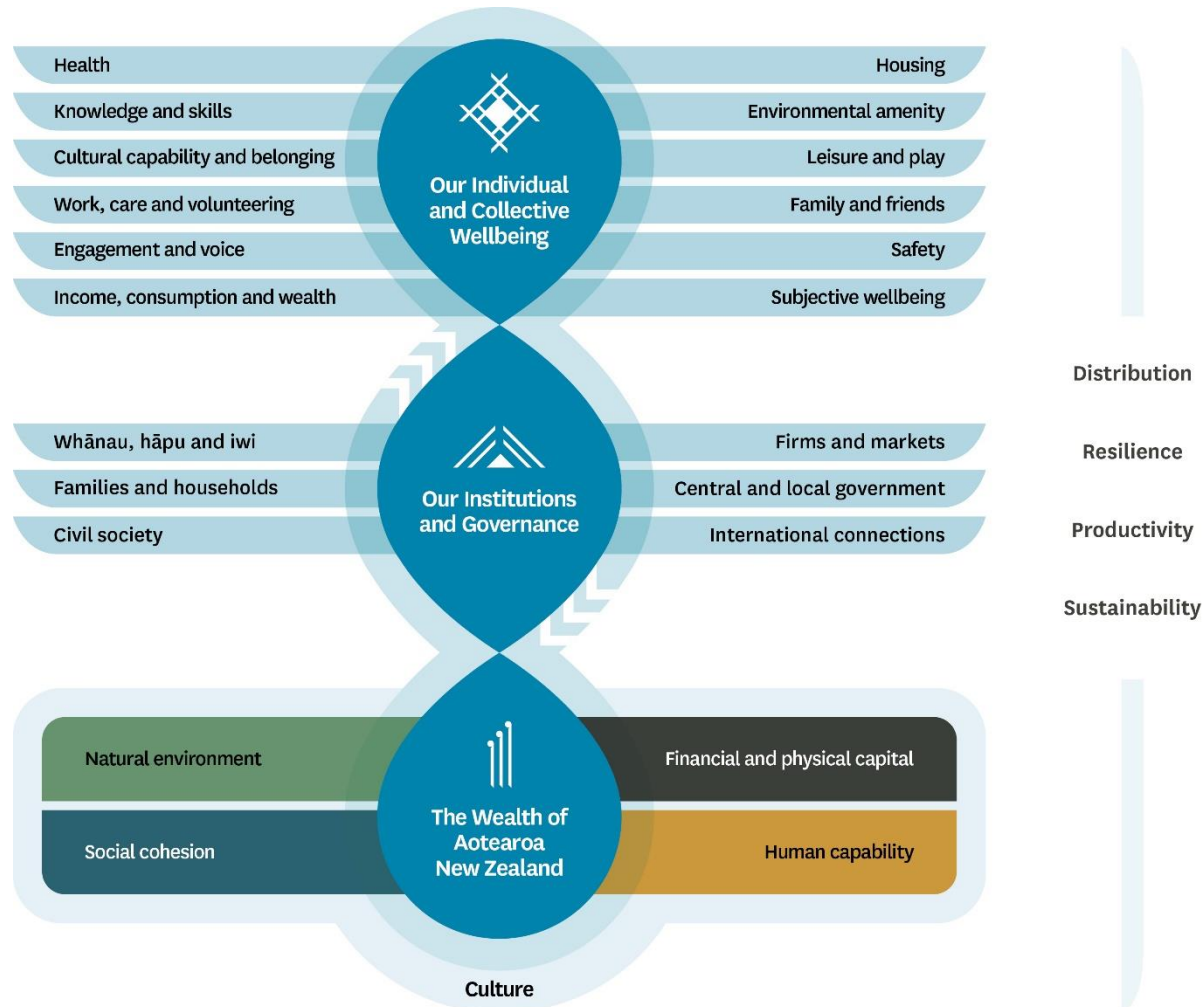
- Q+A

LSF: What and why

Higher living standards

- Treasury is the government's lead economic and fiscal advisor

- Since at least 1999, Treasury's vision has been lifting living standards for all New Zealanders.

- The LSF outlines Treasury's high level view of:
  - what living standards are
  - how living standards relate to wellbeing
  - how living standards may be lifted and sustained

- Ultimately it helps us define what a 'good' economy looks like

Applying the LSF

- The LSF is the thread that runs through efforts across the organisation

  - fiscal and economic strategy

  - vote analysis

  - primary and secondary research about living standards

  - stewardship reporting

- The current Government makes use of the LSF to support their wellbeing agenda, including their wellbeing budgeting approach

  - However, the LSF is independent of this Government and we will keep using it across successive governments.

Three levels, four prompts

Health
Knowledge and skills
Cultural capability and belonging
Work, care and volunteering
Engagement and voice
Income, consumption and wealth

Housing
Environmental amenity
Leisure and play
Family and friends
Safety
Subjective wellbeing

Our Individual and Collective Wellbeing

Whānau, hāpu and iwi
Families and households
Civil society

Firms and markets
Central and local government
International connections

Our Institutions and Governance

Natural environment
Social cohesion

Financial and physical capital
Human capability

The Wealth of Aotearoa New Zealand

Culture

Distribution

Resilience

Productivity

Sustainability

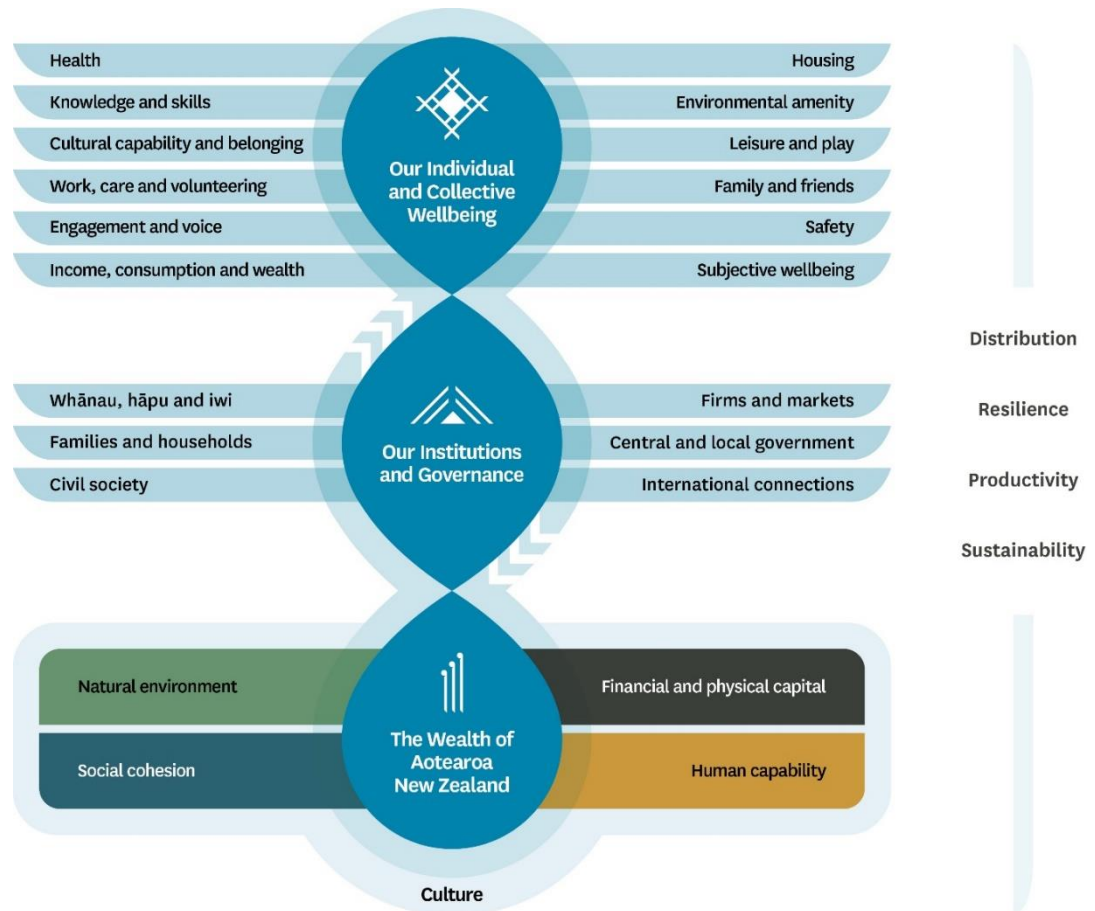# Economics all the way down

- ## Microeconomics
  - – Wellbeing economics

- ## Microeconomics
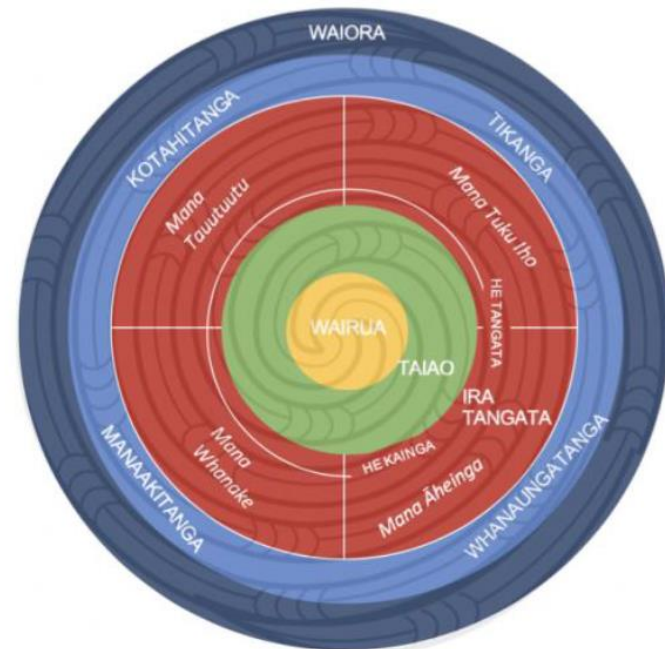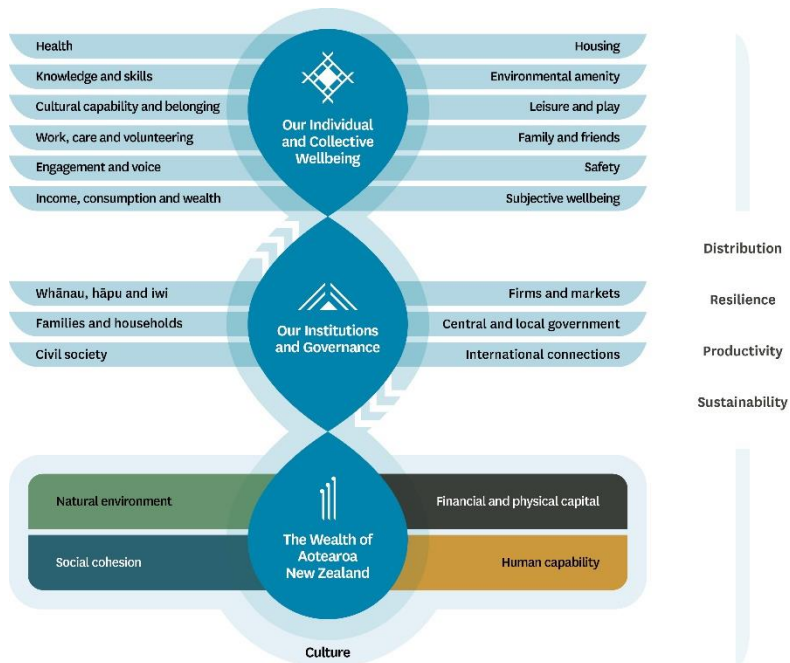 - – Institutional economics

- ## Macroeconomics
  - – Growth accounting

Two conceptual frameworks

- **LSF (2011, 2018, 2021)**
- He Ara Waiora (2018, 2020)

LSF and the history of economic ideas

The teaching of economics

CHAPTER 1

CONSUMER THEORY

In the first two chapters of this volume, we will explore the essential features of modern consumer theory – a bedrock foundation on which so many theoretical structures in economics are built. Some time later in your study of economics, you will begin to notice just how central this theory is to the economist's way of thinking. Time and time again you will hear the echoes of consumer theory in virtually every branch of the discipline – how it is conceived, how it is constructed, and how it is applied.

ASSUMPTION 1.1 *Properties of the Consumption Set, X*

The minimal requirements on the consumption set are

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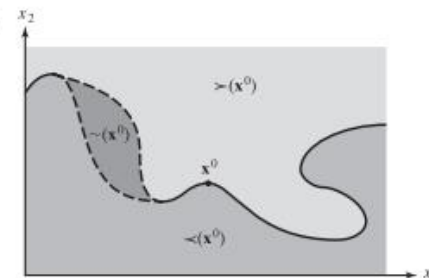
DEFINITION 1.4   **Sets in X Derived from the Preference Relation**

Let $\mathbf{x}^0$ be any point in the consumption set, X. Relative to any such point, we can define the following subsets of X:

1. $\succsim(\mathbf{x}^0) \equiv \{\mathbf{x} \mid \mathbf{x} \in X, \mathbf{x} \succsim \mathbf{x}^0\}$, *called the 'at least as good as' set.*
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A hypothetical set of preferences satisfying Axioms 1 and 2 has been sketched in Fig. 1.1 for $X = \mathbb{R}^2_+$. Any point in the consumption set, such as $\mathbf{x}^0 = (x^0_1, x^0_2)$, represents a consumption plan consisting of a certain amount x^0_1 of commodity 1, together with a certain amount x^0_2 of commodity 2. Under Axiom 1, the consumer is able to compare $\mathbf{x}^0$ with any and every other plan in X and decide whether the other is at least as good as $\mathbf{x}^0$ or whether $\mathbf{x}^0$ is at least as good as the other. Given our definitions of the various sets relative to $\mathbf{x}^0$, Axioms 1 and 2 tell us that the consumer must place *every* point in X into

Figure 1.1. Hypothetical preferences satisfying Axioms 1 and 2.

The construction of economics

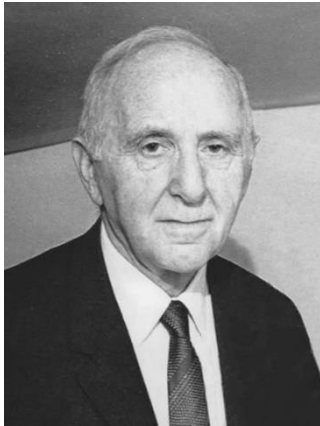Elinor Ostrom

Paul Samuelson

Partha Dasgupta

Kate Raworth

Daniel Kahnemann

Daron Acemoglu

The situation in 1940

Simon Kuznets

The situation in 1940
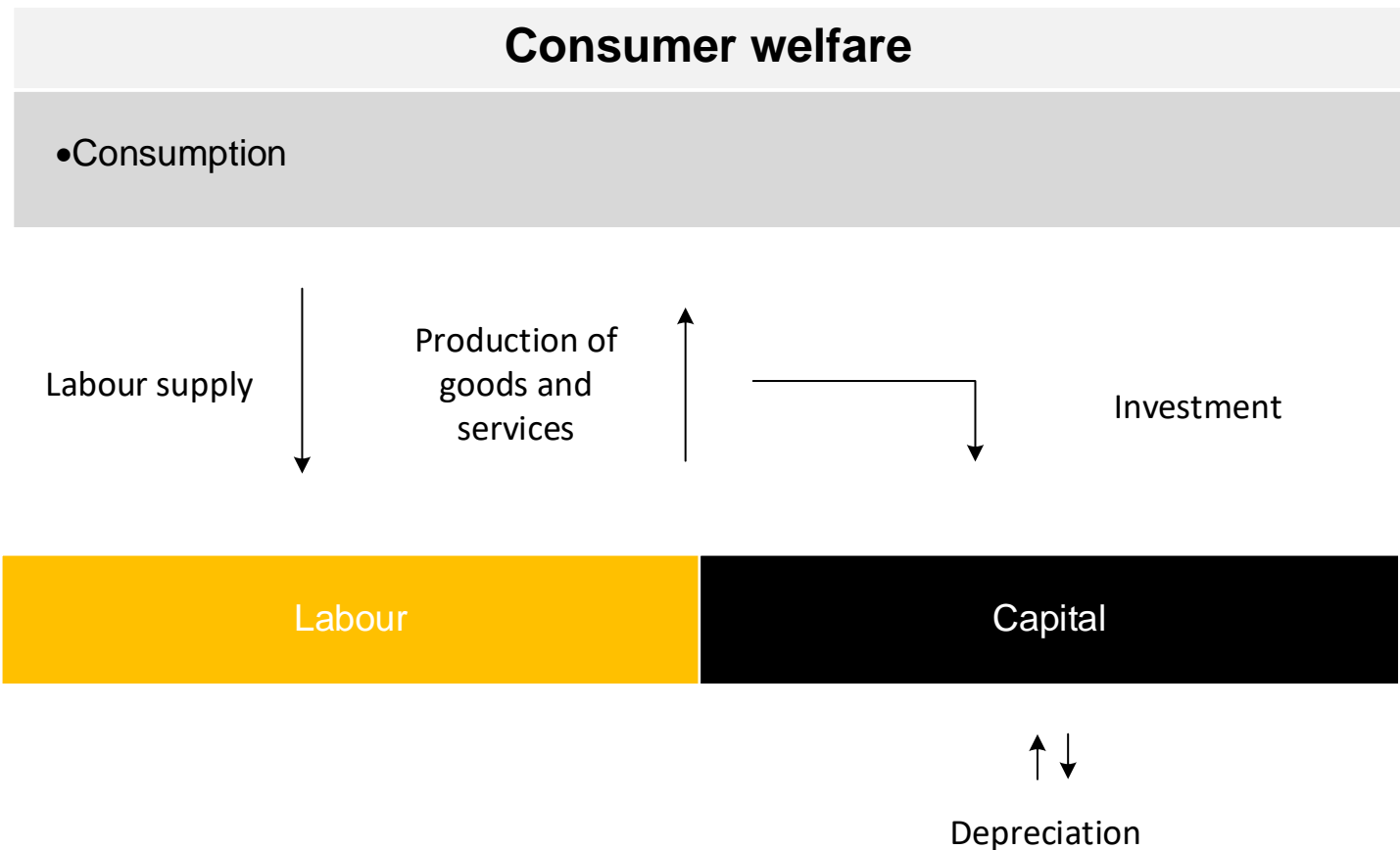
GDP per capita, $USD2011 at PPPs

	United States	Egypt	New Zealand
1940	$13,800	$1,700	$11,600
2021	$63,500	$12,000	$42,900

Population (m)

	United States	Egypt	New Zealand
1940	139	16	1.6
2021	333	104	5

Source: gapminder.org

Raising living standards, 1940s-style

Consumer welfare

• Consumption

Labour supply

Production of goods and services

Investment

Labour	Capital

Depreciation

More income and consumption

Income per person (GDP/capita, PPP$ inflation-adjusted)
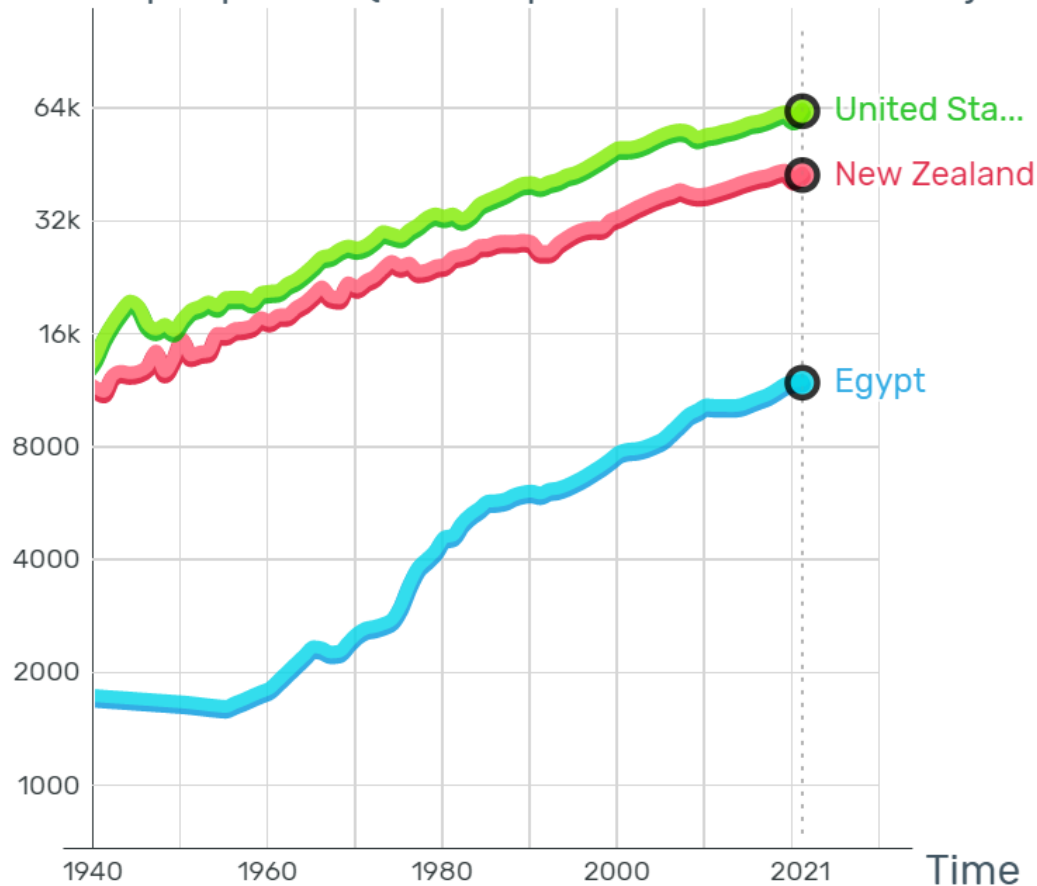
Source: gapminder.org

The situation in 1960

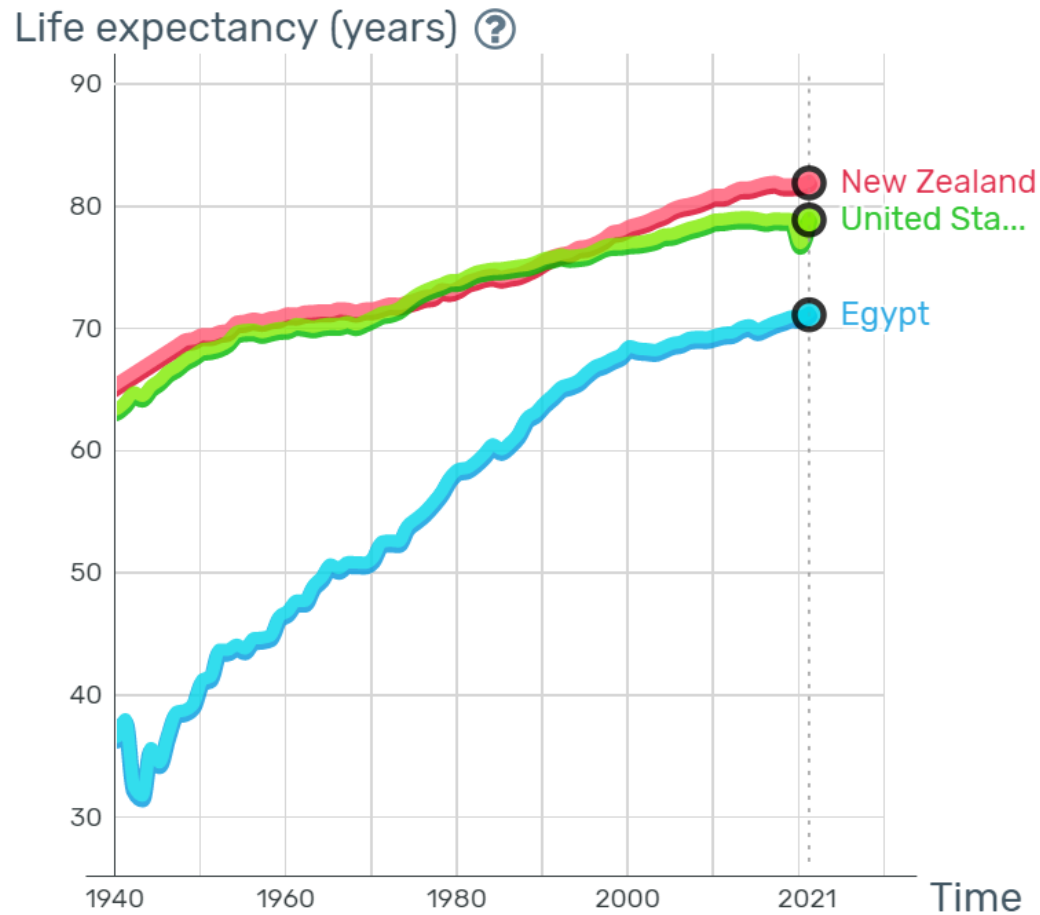Kenneth Arrow

Raising living standards, 1960s-style

Consumer welfare
•Consumption

Production of
goods and services

Investment

Investment

Human Capital	Physical Capital

↑ ↓

Depreciation

Longer, healthier lives

Life expectancy (years) ⑦

New Zealand
United Sta...
Egypt
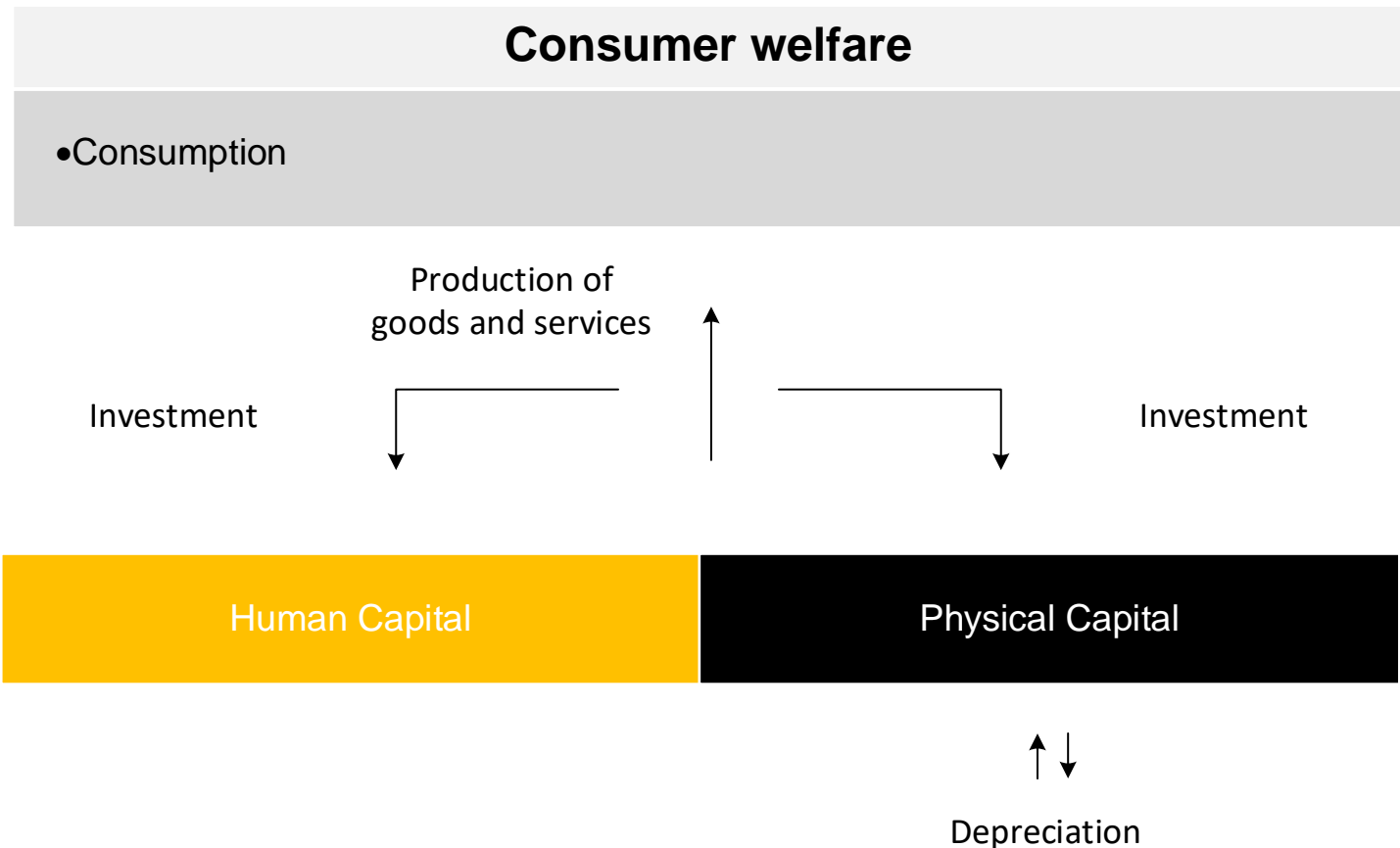
Source: gapminder.org

The situation in 1990

Robert Putnam

Herman Daly

Raising living standards, 1990s-style

Consumer welfare
•Consumption

Ecosystem services → Production of goods and services ⇅ Investment

Earth system processes ⇄

Human Capital	Physical Capital
Natural Capital	Social Capital

Creation and destruction

Depreciation
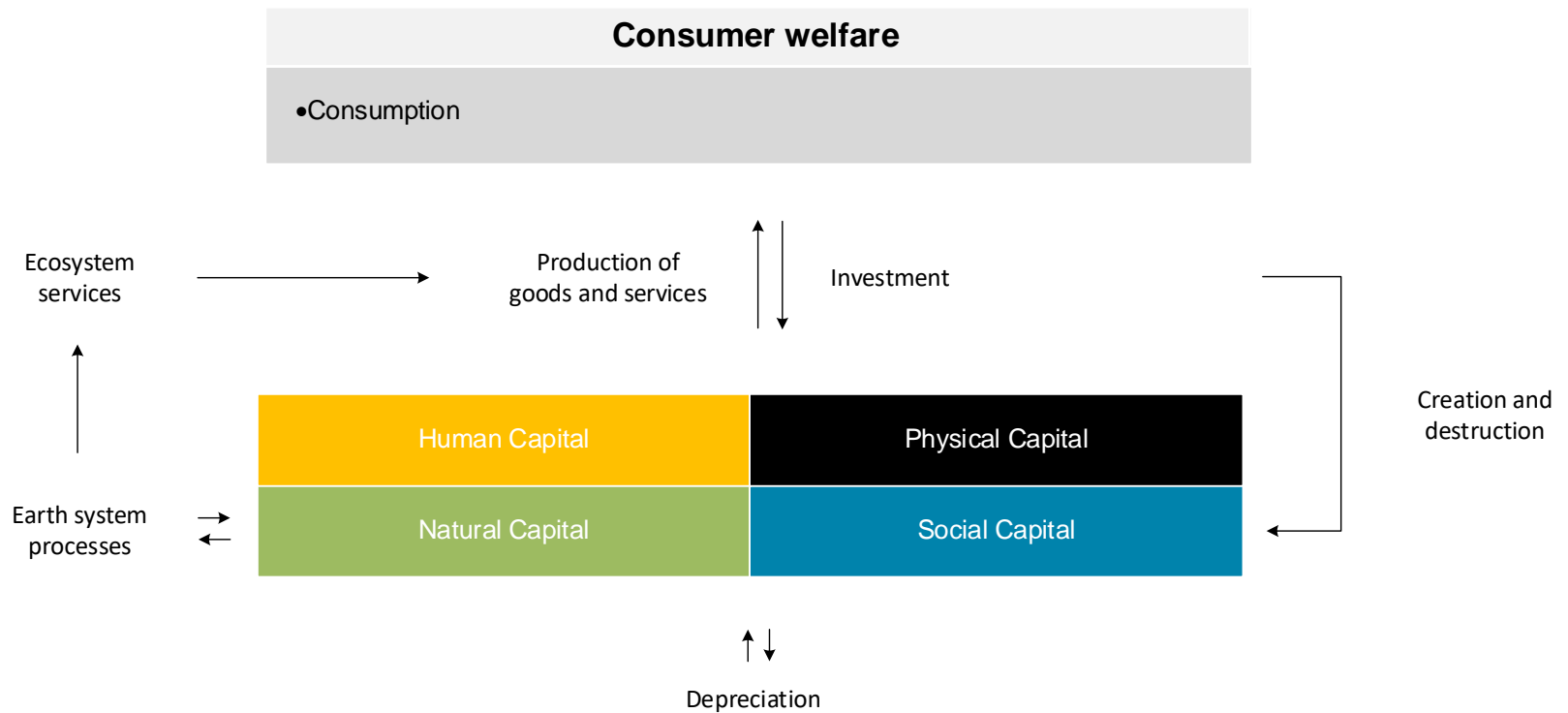
The World according to the World Bank
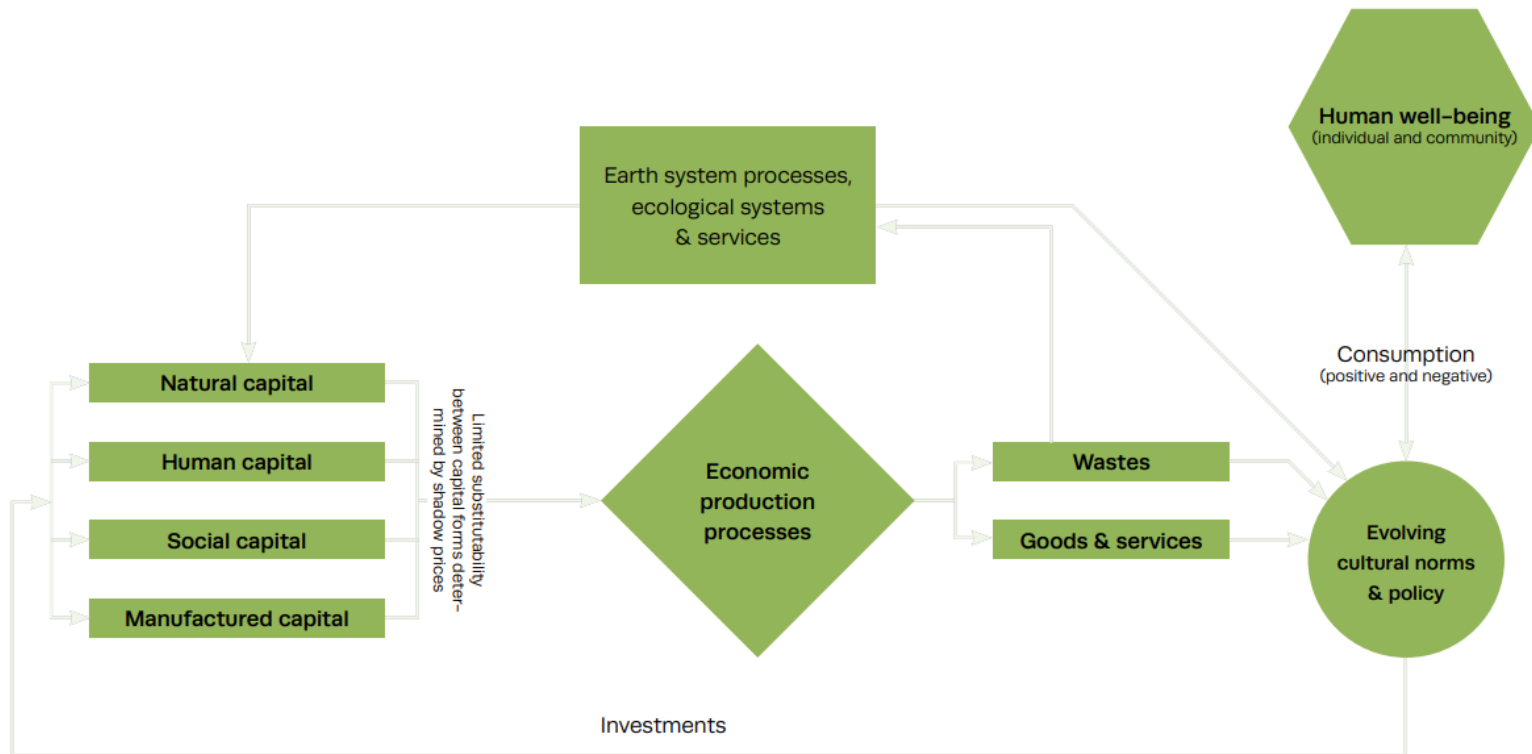
Source: World Bank

Declining trust (in the USA, at least)

Figure 1: Trust has declined sharply in the United States
share of working-age population responding that most people can be trusted

Actual: actual share of working-age population responding that most people can be trusted
Adjusted: composition-adjusted share of working-age population responding that most people can be trusted
Source: General Social Survey, 1972-2012
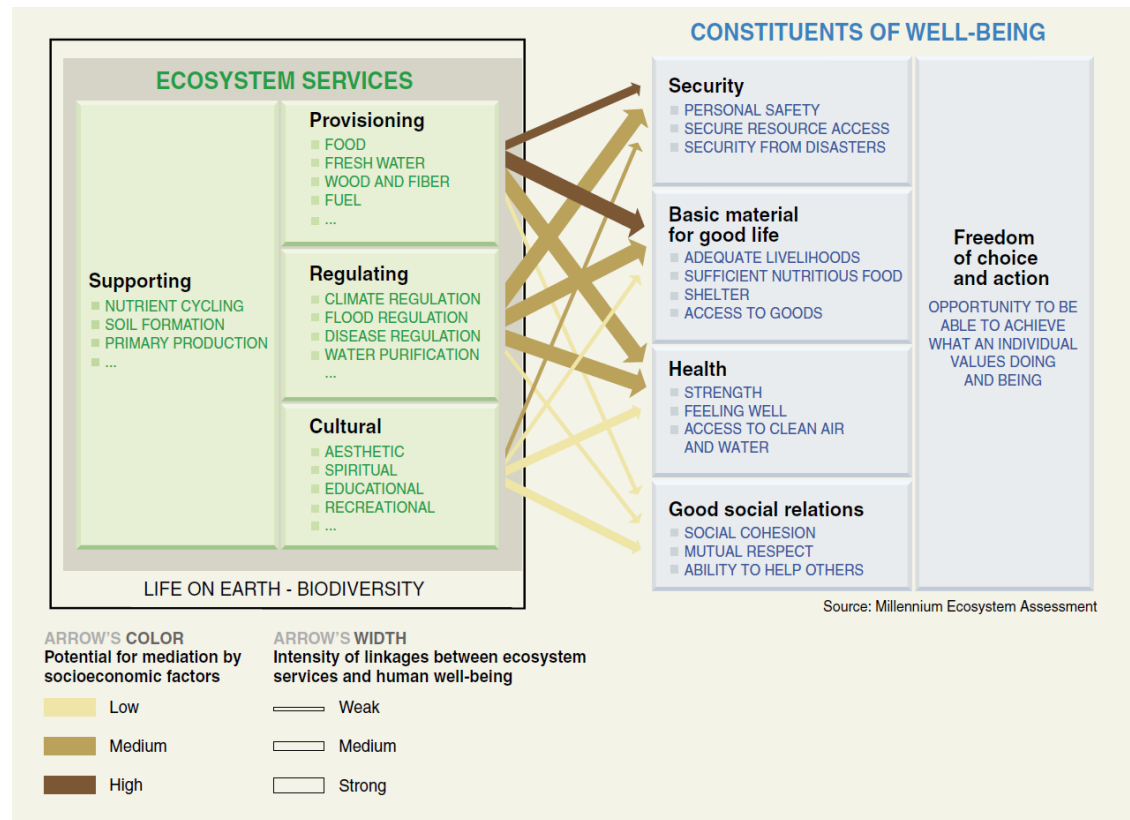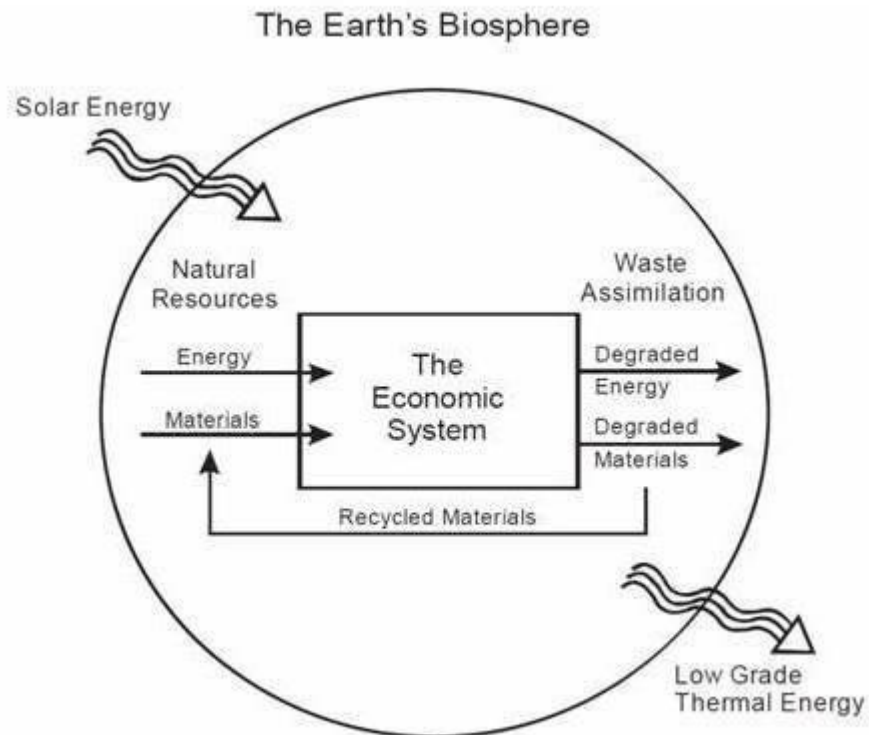
Source: IMF

Declining natural capital
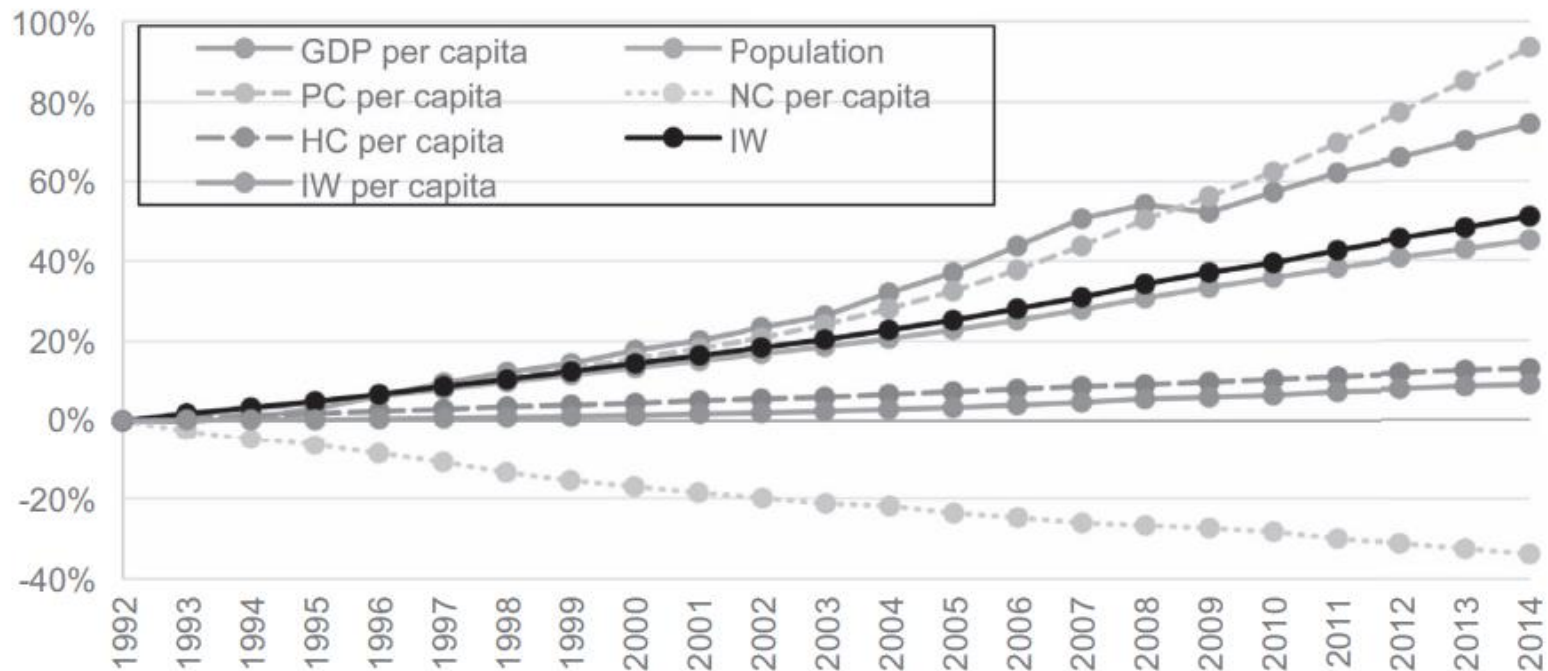
Figure 1.7 Changes in worldwide inclusive wealth per capita and other indicators for 1992–2014

Source: World Bank
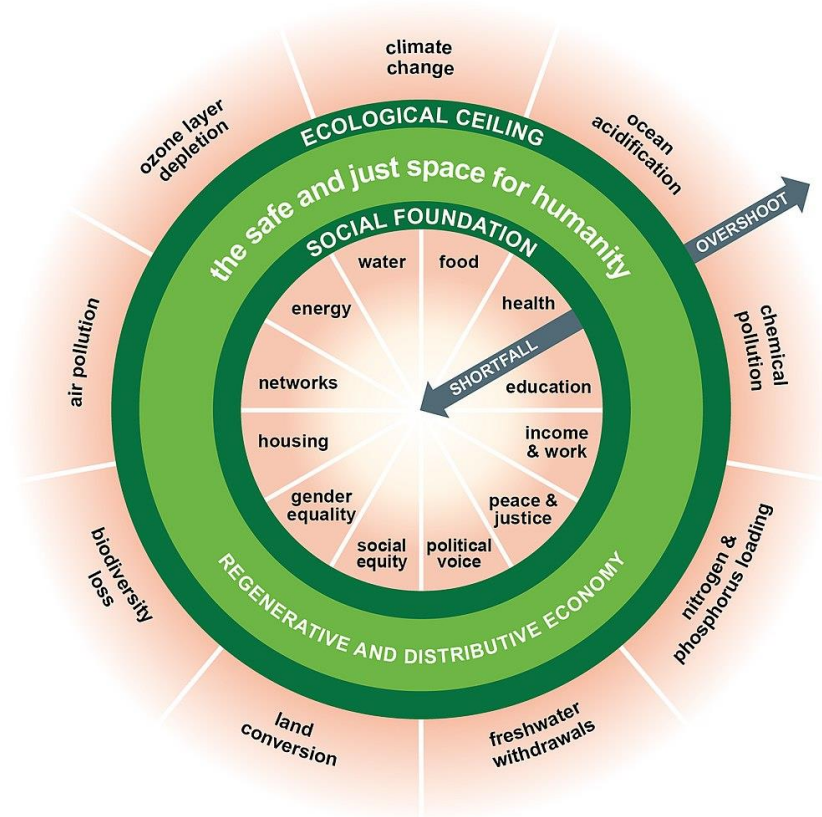
Ecoystem services (The World according to the UN)

Source: Millennium Ecosystem Assessment
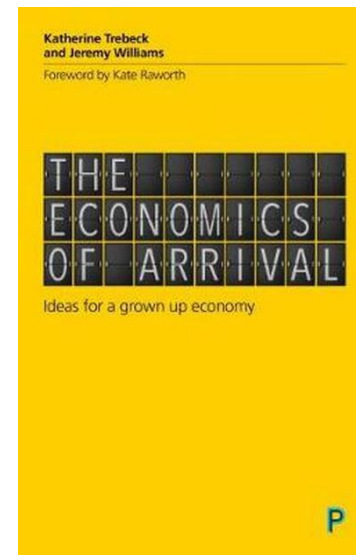
Ecological economics
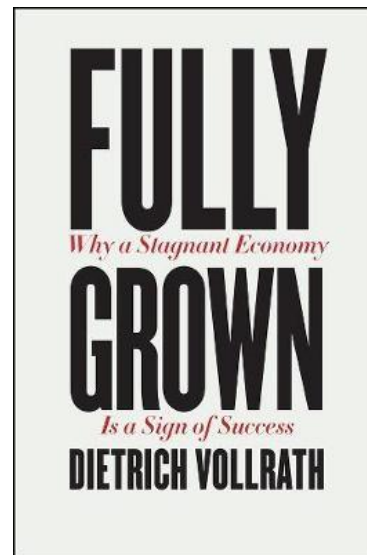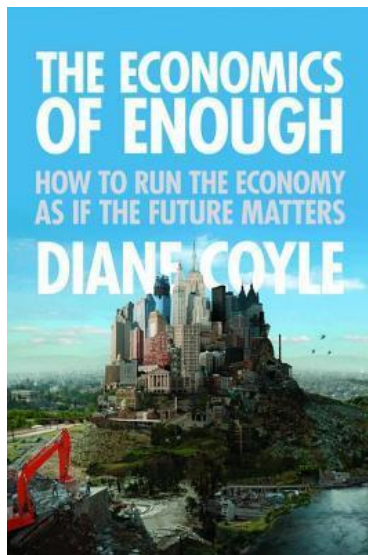

The Earth's Biosphere

Doughnut economics

Kate Raworth

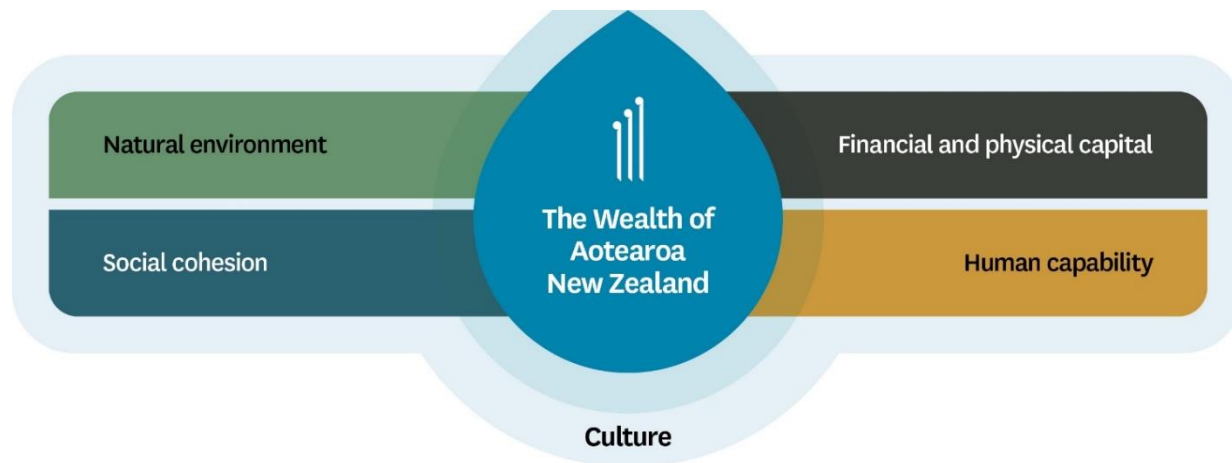# How much is enough?

Keynes: *"The difficulty lies, not in the new ideas, but in escaping from the old ones".*

Wealth in the LSF

Consumption = wellbeing?

Consumption = wellbeing?

Consumer welfare
•Consumption

Ecosystem services → Production of goods and services

Investment

Creation and destruction

Human Capital	Physical Capital
Natural Capital	Social Capital

Earth system processes

Depreciation
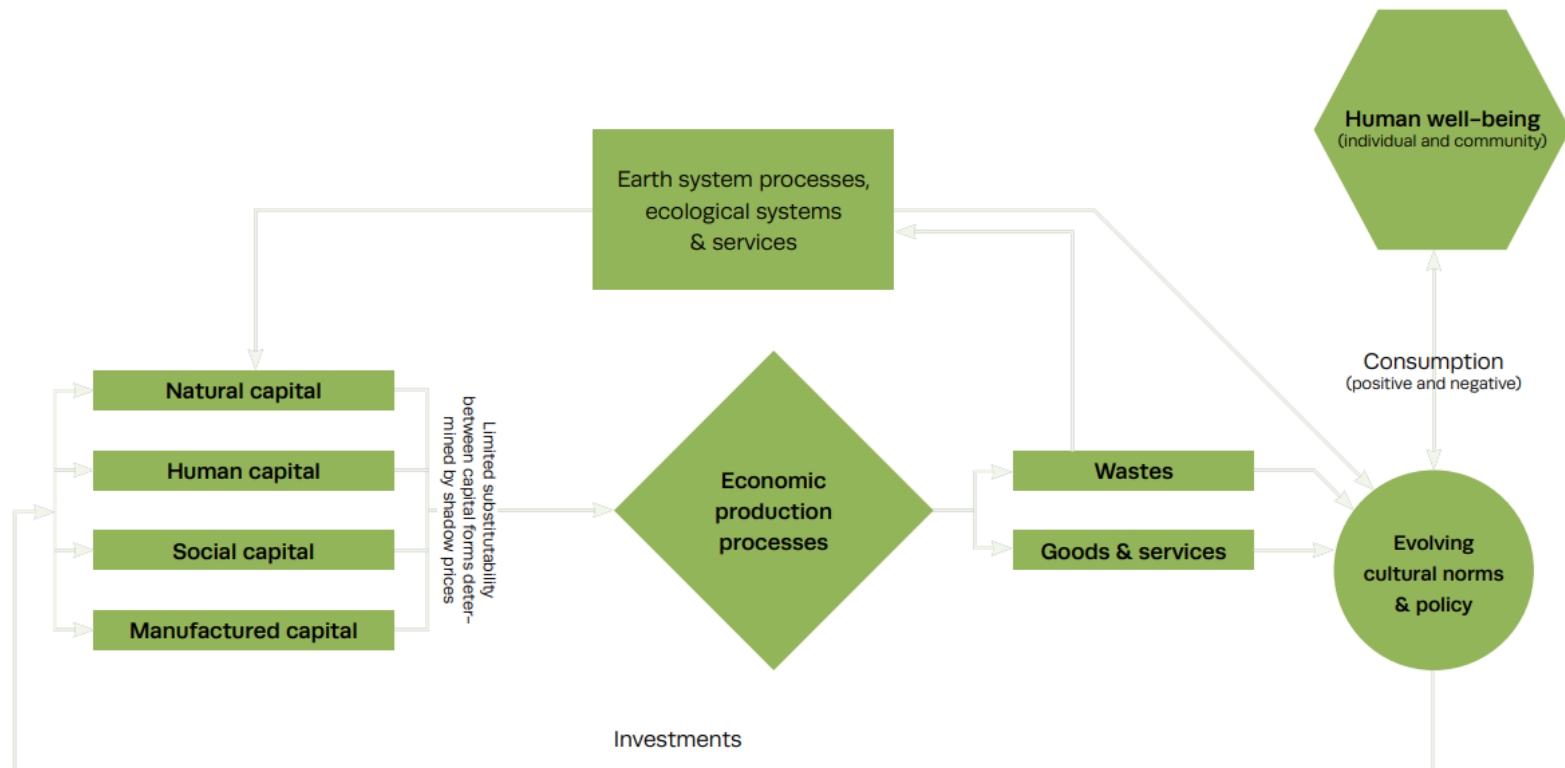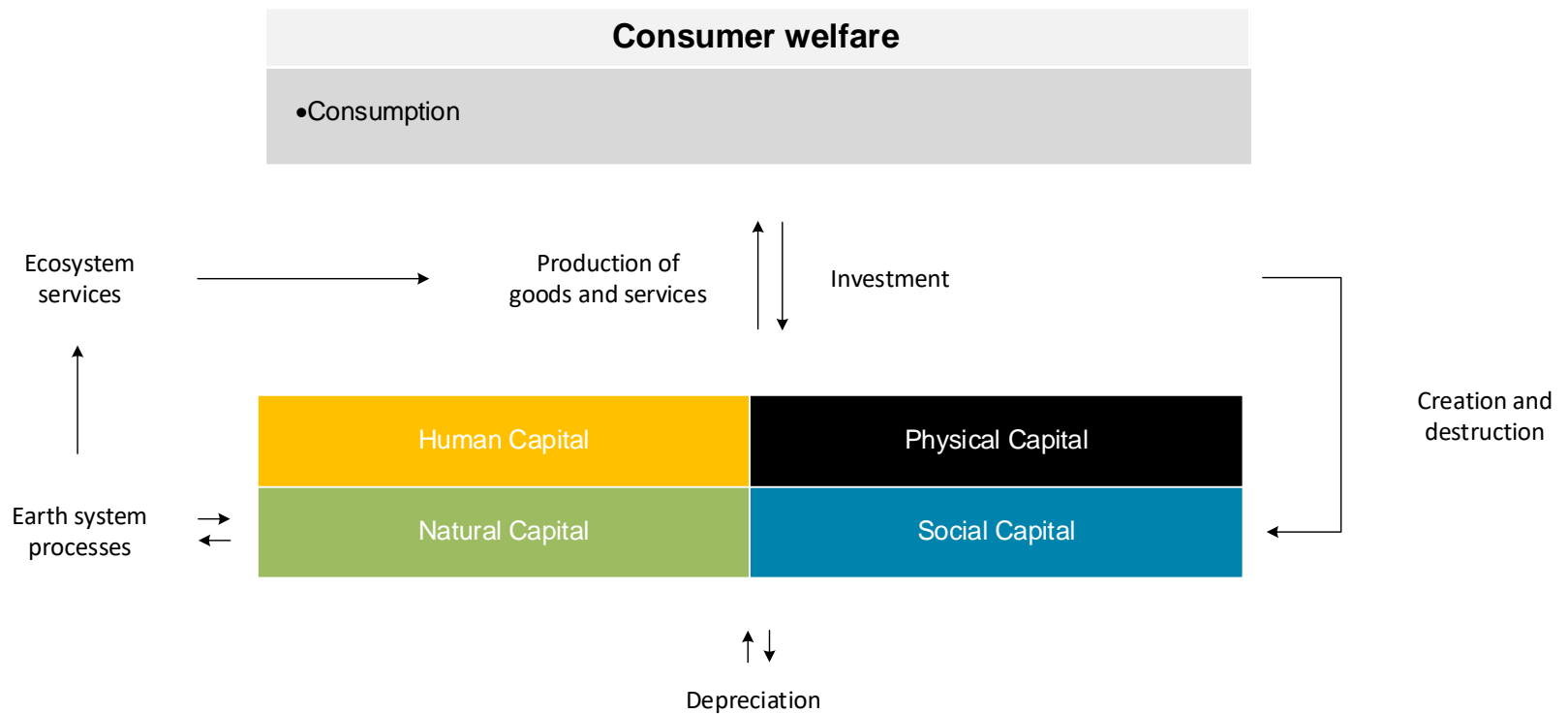
Econ701: Yes.

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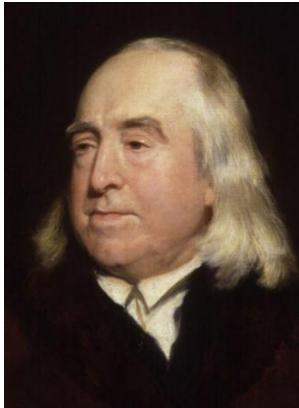
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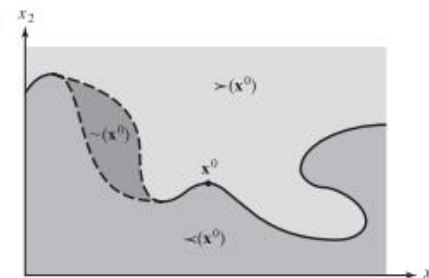
From classical to neoclassical economics…

Jeremy Bentham

1780

- Father of utilitarianism
- Utility is the sum of pleasure over pain
- Utils = Hedons-Dolors

1938

- Utility = realisation of preferences
- Preferences inferred from behaviour (revealed preference)
- Internal experiences unknown
- No interpersonal comparisons
- Ordinal, not cardinal

Paul Samuelson

…to wellbeing economics (1990s-2020s)

Wellbeing =

- **Satisfaction with one's life**

- Sense of meaning and purpose

- Emotions (positive and negative affect)
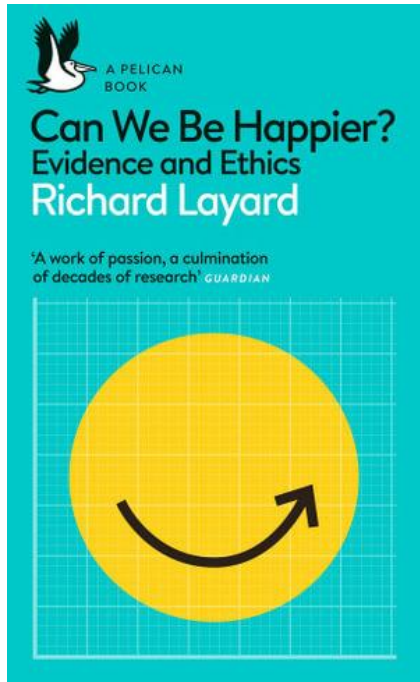
Martin Seligman

Richard Layard

Ed Diener

Daniel Kahnemann

Neo-utilitarianism and the WELLBY/WALY

Richard Layard

Raising wellbeing, 2010s style

Personal wellbeing

- Civic engagement and governance
- Cultural identity
- Environment
- Health
- Housing
- Knowledge and skills

- Income and consumption
- Jobs and earnings
- Safety
- Social connections
- Subjective wellbeing
- Time use

Ecosystem services

Production of goods and services

Investment

Creation and destruction

Earth system processes

Human Capital	Physical Capital
Natural Capital	Social Capital

Depreciation

The World according to the OECD

CURRENT WELL-BEING
[Populations averages and differences across groups]

Quality of Life
- Health status
- Work-life balance
- Education and skills
- Social connections
- Civic engagement and governance
- Environmental quality
- Personal security
- Subjective well-being

Material Conditions
- Income and wealth
- Jobs and earnings
- Housing

RESOURCES FOR FUTURE WELL-BEING
Sustaining well-being over time through preserving:
- Natural capital
- Economic capital
- Human capital
- Social capital

LSF2018

On average, we are very happy

Rank (2020)	Country	Average life satisfaction (out of 10)
1	Finland	7.9
2	Iceland	7.6
3	Denmark	7.5
…		
9	Norway	7.3
10	New Zealand	7.3
11	Austria	7.2
…		
147	Rwanda	3.4
148	Zimbabwe	3.1
149	Afghanistan	2.5

Source: World Happiness Report

But not all of us are

Distribution of life satisfaction scores across NZ population aged 15+
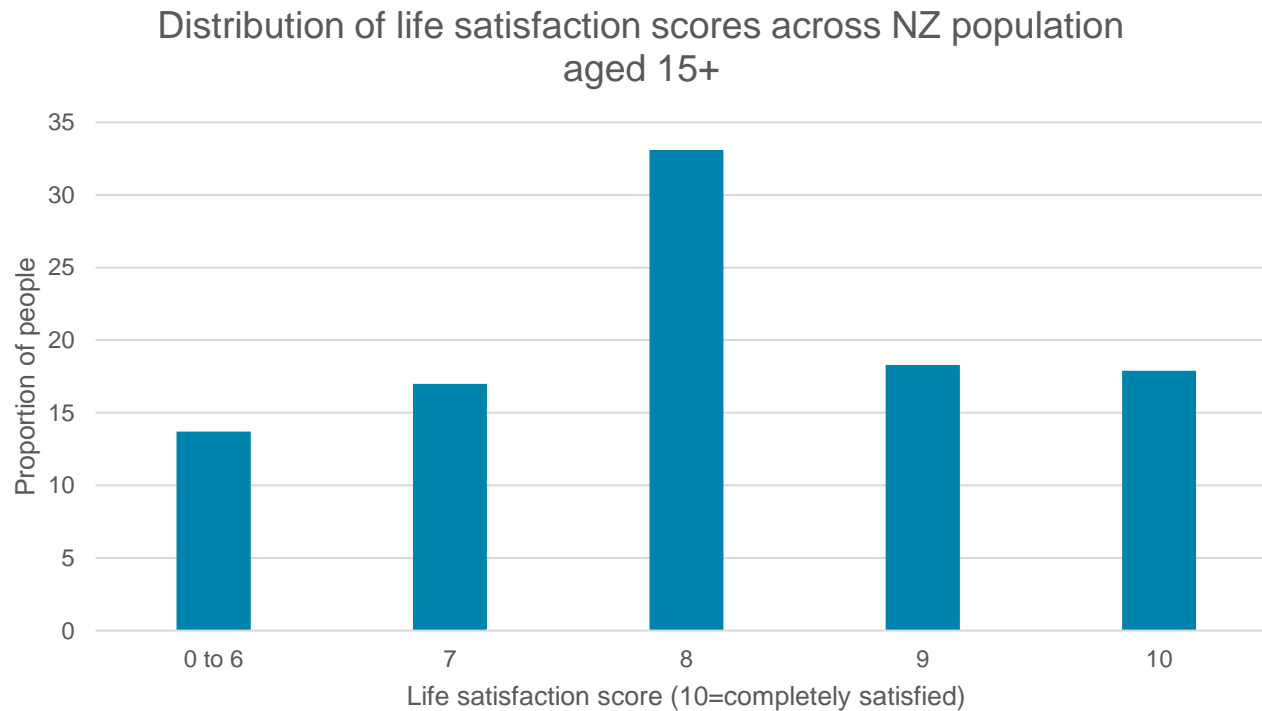
Source: General Social Survey

But not all of us are

% of people who rated their life satisfaction highly, by disability status
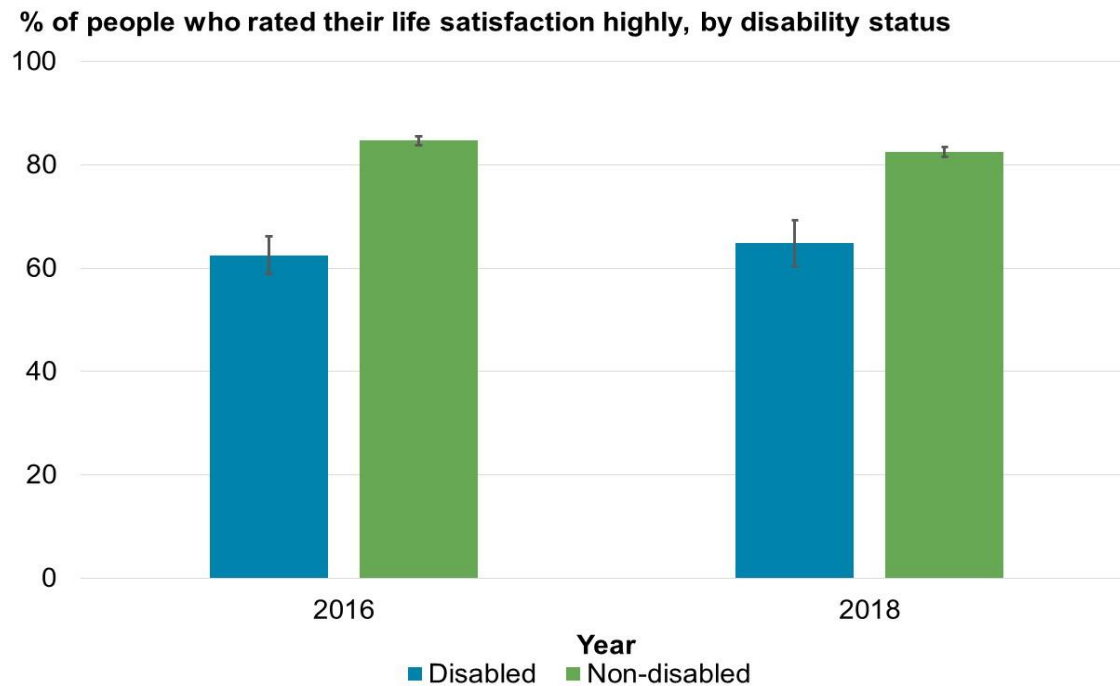
Source: General Social Survey

And not much has changed over time

Average life satisfaction score, World Values Survey
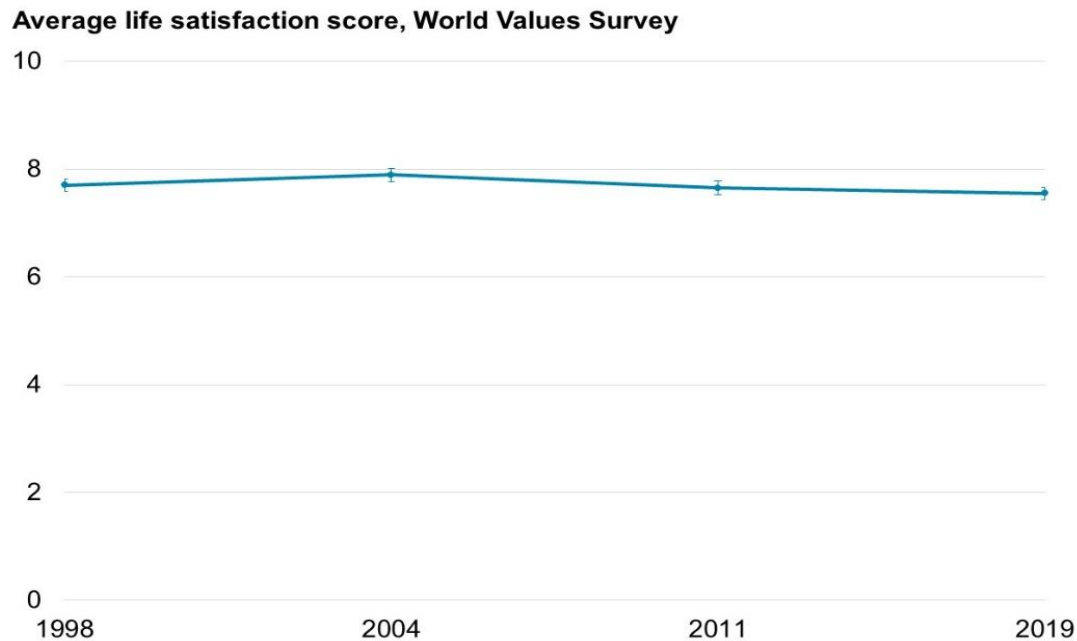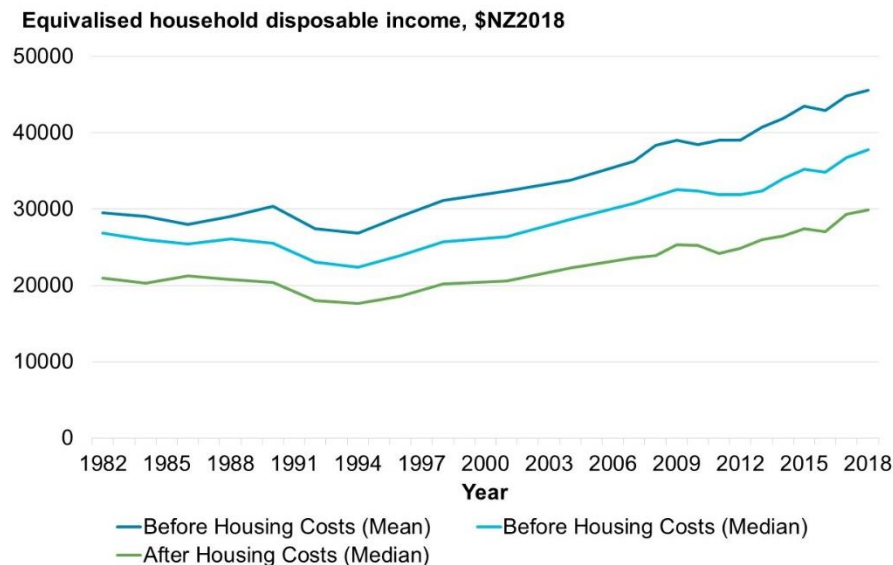

Source: World Values Survey

Even as we have continued to get richer

- Relates to 'Diminishing marginal utility of income'
- The richer we get, the more important other drivers of wellbeing become and the more that lifting wellbeing is about the bottom of the distribution

Equivalised household disposable income, $NZ2018

Source: MSD

Wellbeing, or wellbeing freedom?

- "The capability to lead a life one values and has reason to value"

Amartya Sen

Martha Nussbaum
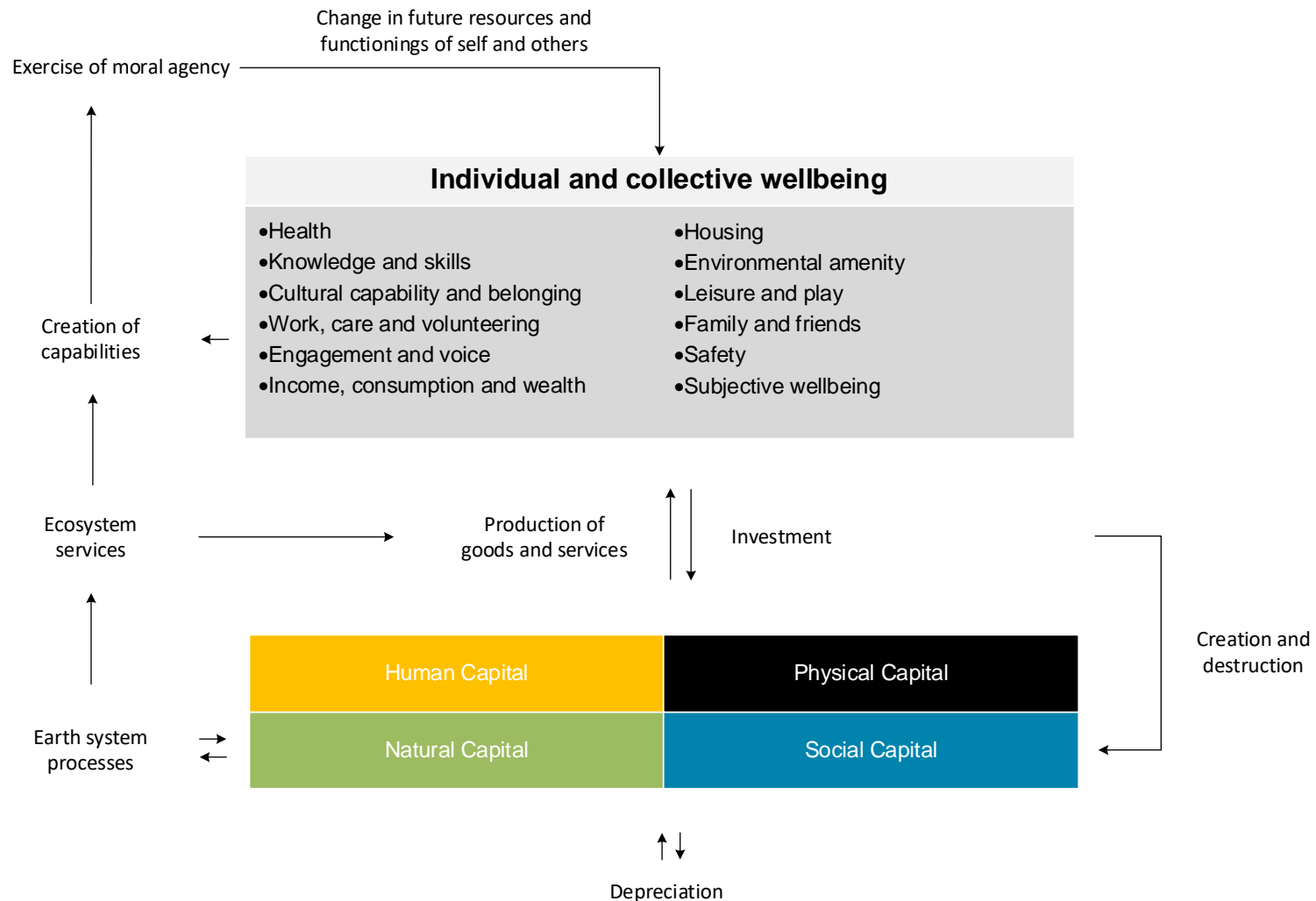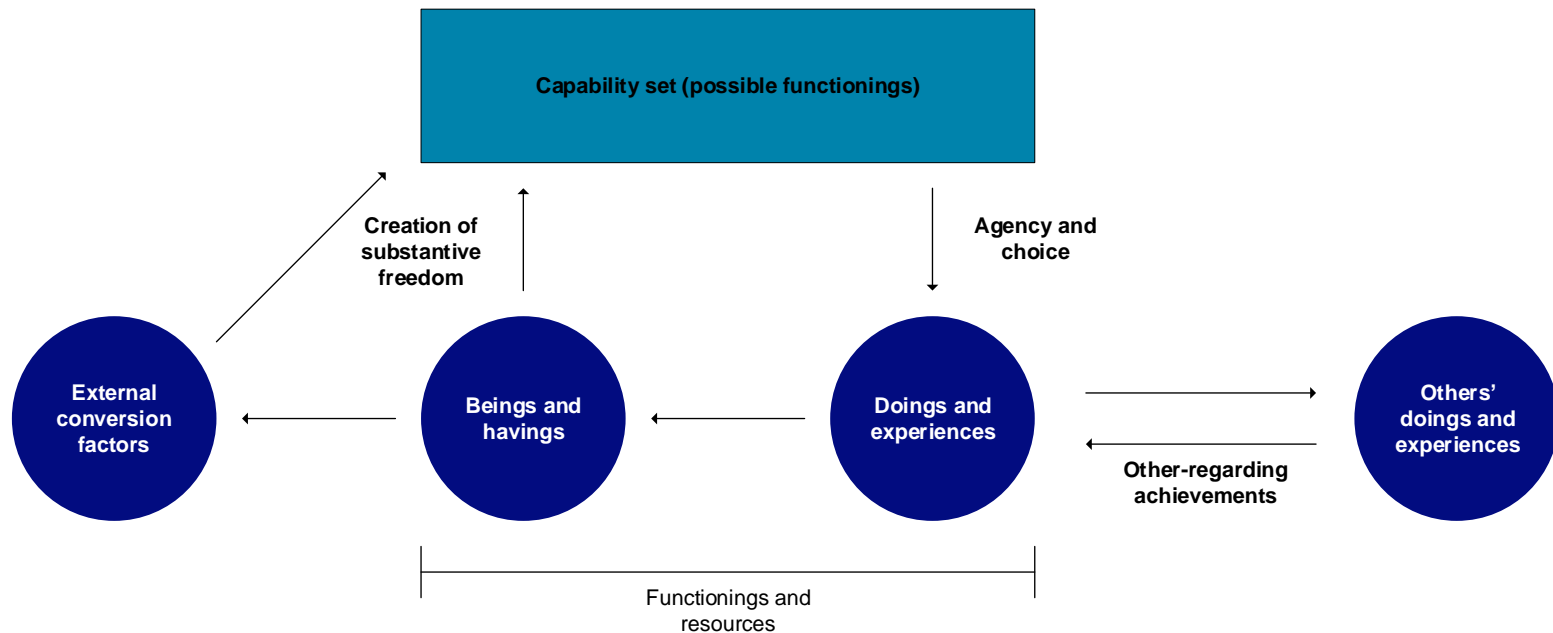
Ingrid Robeyns

Wellbeing and the capability approach

Change in future resources and functionings of self and others

Exercise of moral agency

Individual and collective wellbeing

- Health
- Knowledge and skills
- Cultural capability and belonging
- Work, care and volunteering
- Engagement and voice
- Income, consumption and wealth

- Housing
- Environmental amenity
- Leisure and play
- Family and friends
- Safety
- Subjective wellbeing

Creation of capabilities

Ecosystem services

Production of goods and services

Investment

Earth system processes

Human Capital	Physical Capital
Natural Capital	Social Capital

Creation and destruction

Depreciation

Individuals, collectives and externalities

Private vs public wellbeing

- ## One the one hand:

  – Private, individual, no one else's business

  – Not for Government to define on behalf of people

- ## On the other:

  – Often requires collective action to achieve

  – Strongly affected by each other's actions
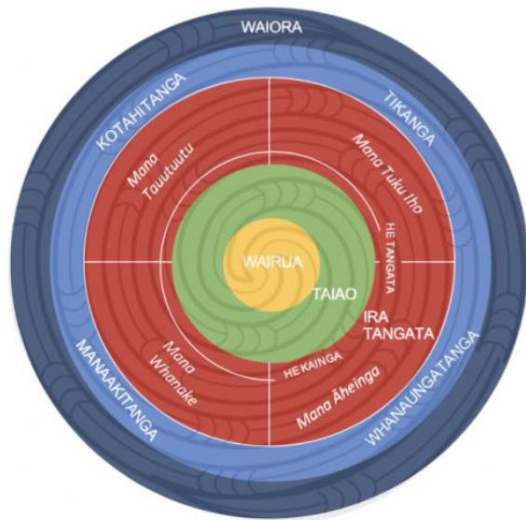
  – Something we generally want for each other

Wellbeing and the LSF

Health

Knowledge and skills

Cultural capability and belonging

Work, care and volunteering

Engagement and voice

Income, consumption and wealth

Our Individual and Collective Wellbeing

Housing

Environmental amenity

Leisure and play
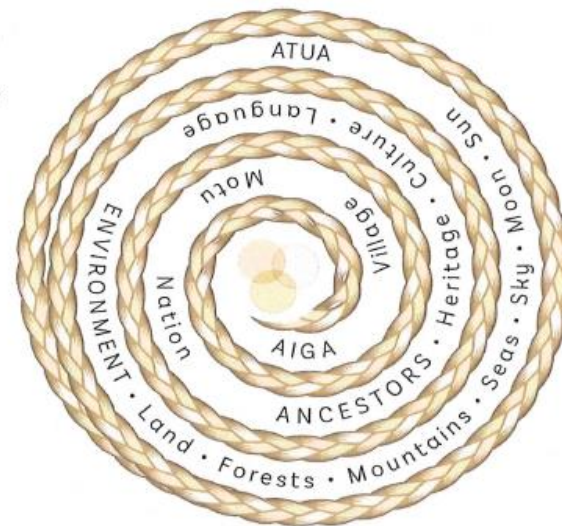
Family and friends

Safety

Subjective wellbeing

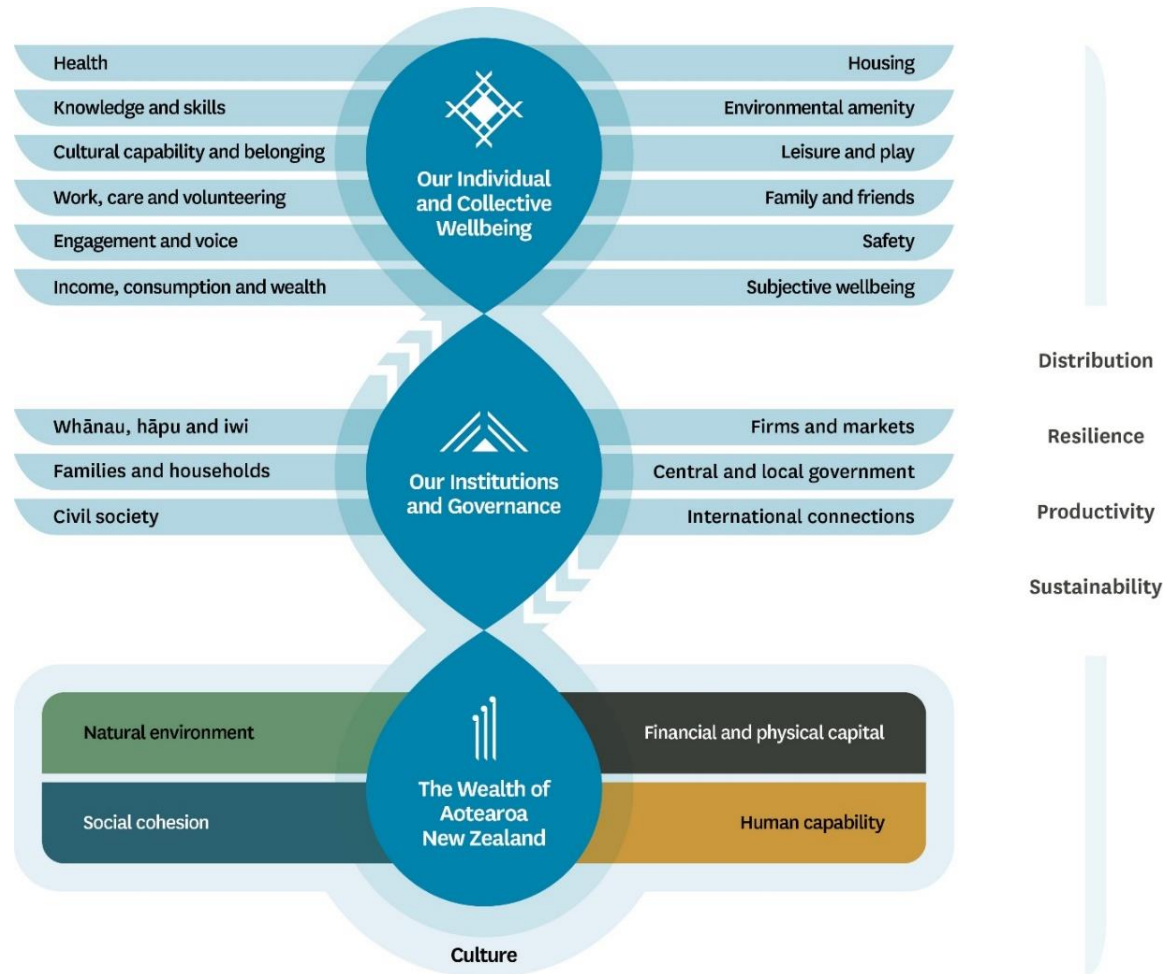**Distribution**

The world according to Aotearoa

- Collective wellbeing is particularly important for many Māori and Pacific Peoples

- In some frameworks, the collectives include the environment and spiritual realms
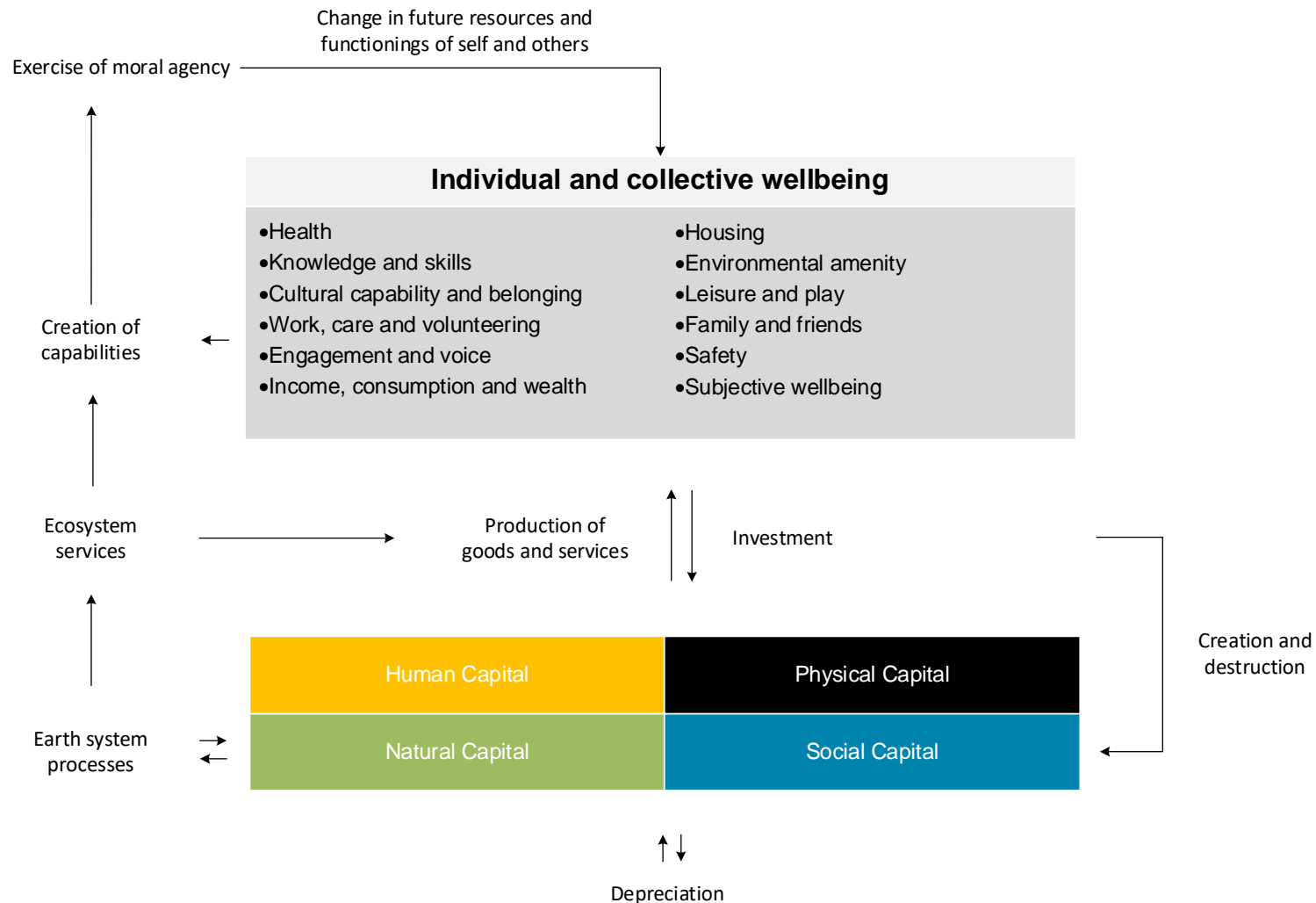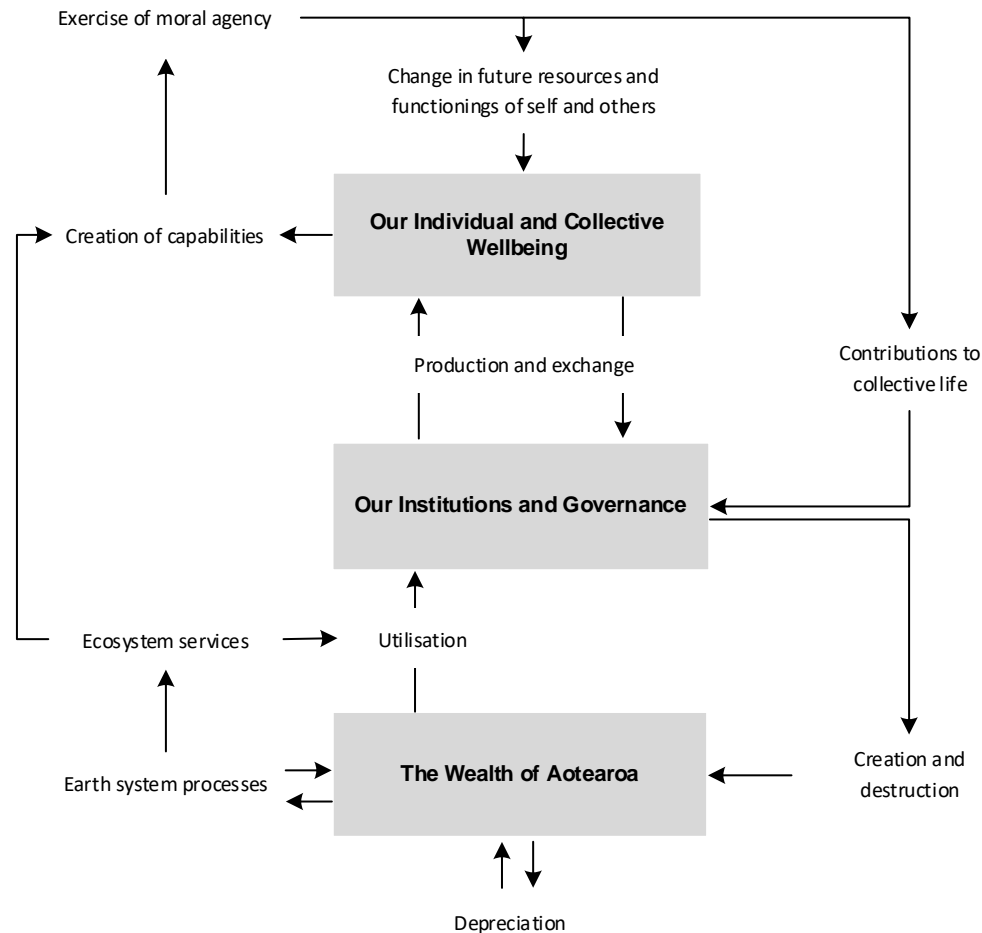
What about institutions then?

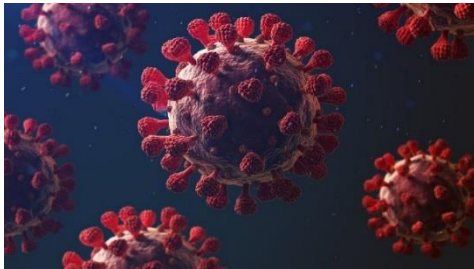# Answer 1: Institutions do the producing, investing, polluting etc.

Change in future resources and functionings of self and others

Exercise of moral agency

Individual and collective wellbeing

- Health
- Knowledge and skills
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- Work, care and volunteering
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Earth system processes

Human Capital	Physical Capital
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Creation and destruction

Depreciation

Answer 1: Institutions do the producing, investing, polluting etc.

Production doesn't just happen in markets

Whānau, hāpu and iwi
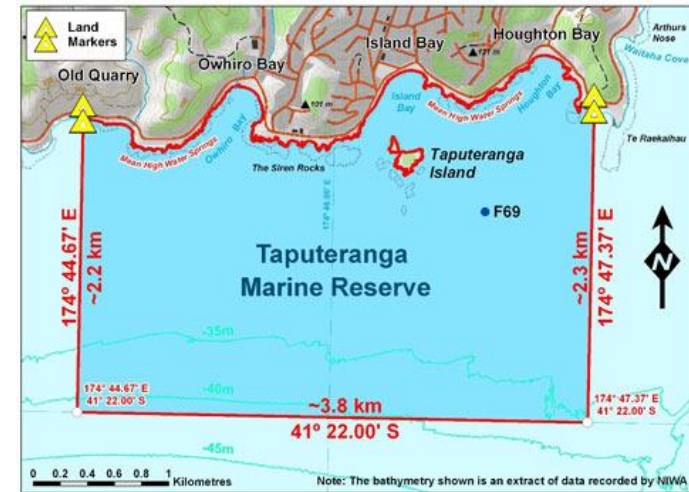
Families and households

Civil society

Our Institutions and Governance

Firms and markets

Central and local government

International connections

Productivity

Marilyn Waring

Answer 2: Institutions create resilience

Whānau, hāpu and iwi

Families and households

Civil society

Our Institutions and Governance

Firms and markets

Central and local government

International connections

Resilience

Answer 3: Institutions do the regulating

Creation of capabilities

Our Individual and Collective Wellbeing

Polycentric regulation and institutional change

Our Institutions and Governance

Guardianship

The Wealth of Aotearoa
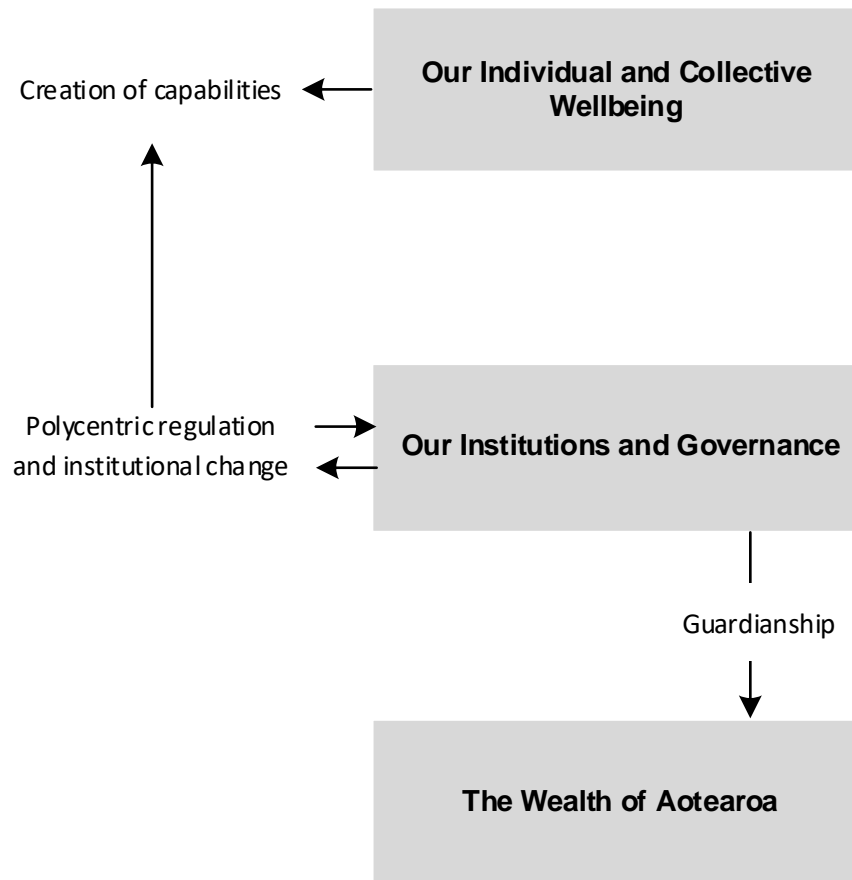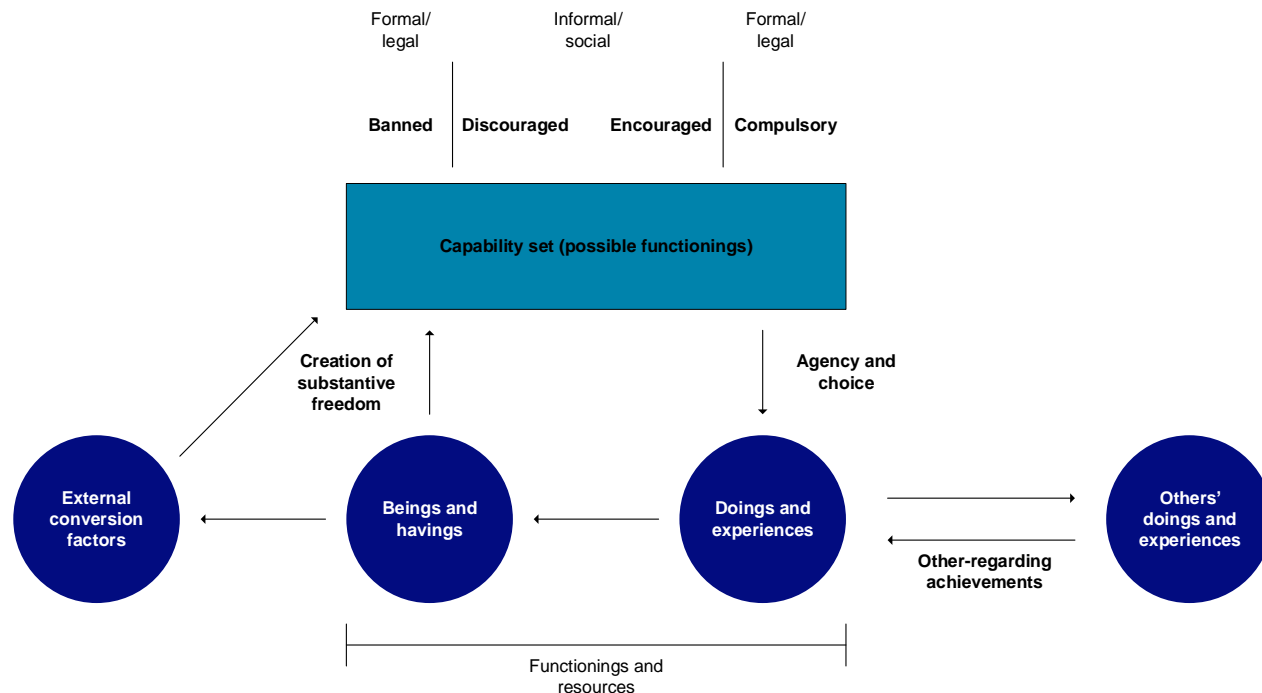
Regulation to safeguard our wealth

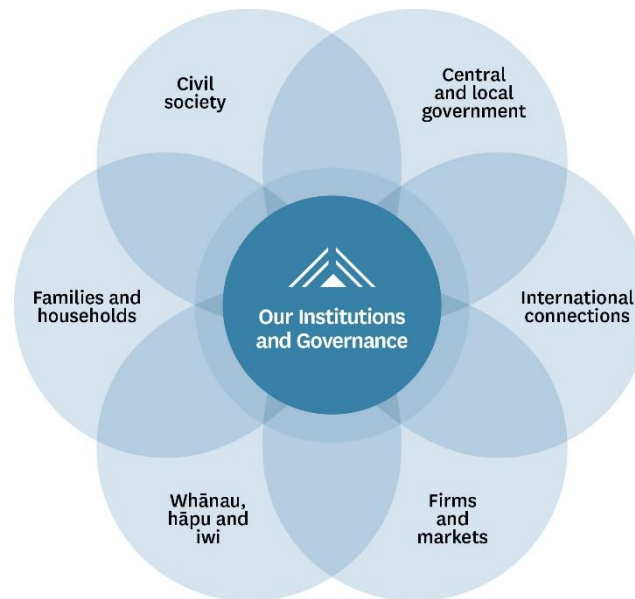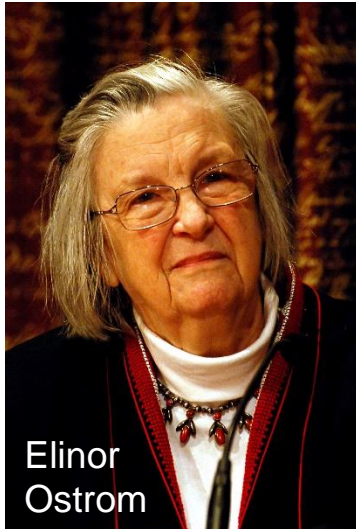# Regulation to resolve the paradox of freedom

Karl Popper
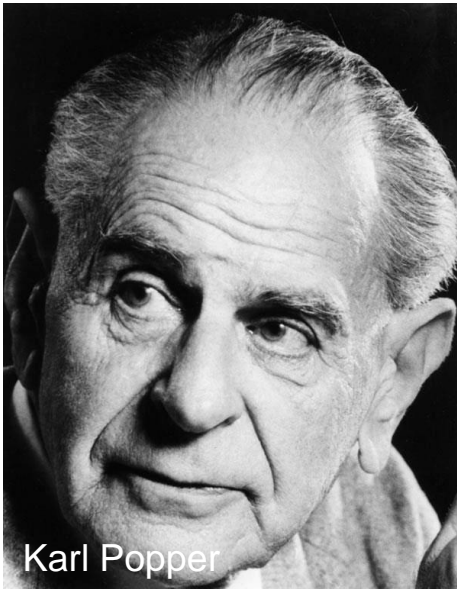
"…unlimited freedom leads to its opposite, since without its protection and restriction by law, freedom must lead to a tyranny of the strong over the weak. This paradox, vaguely restated by Rousseau, was solved by Kant, who demanded that the freedom of each man should be restricted, but not beyond what is necessary to safeguard an equal degree of freedom for all."

Regulation to resolve the paradox of freedom

- Institutions both govern and empower individuals
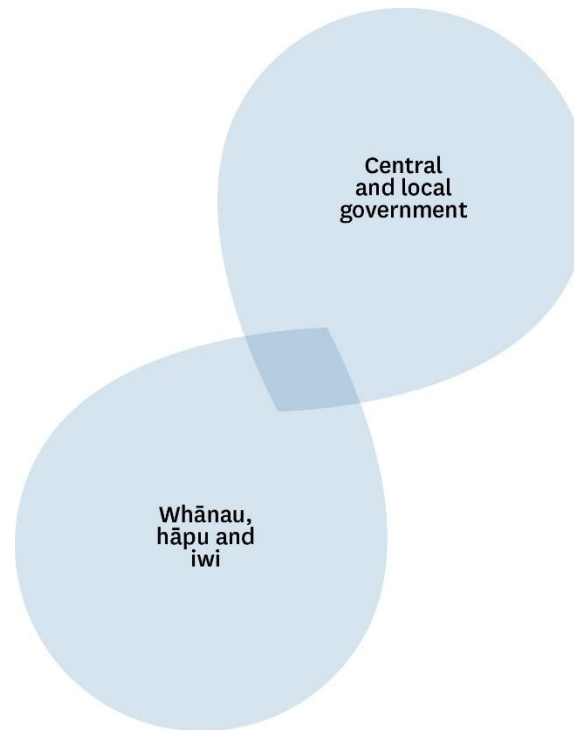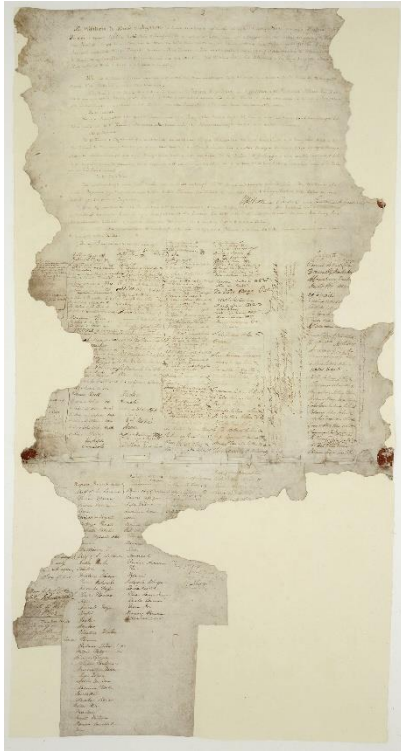
Regulation of each other (polycentric)

Elinor Ostrom

Civil society

Central and local government

Families and households

Our Institutions and Governance

International connections

Whānau, hāpu and iwi
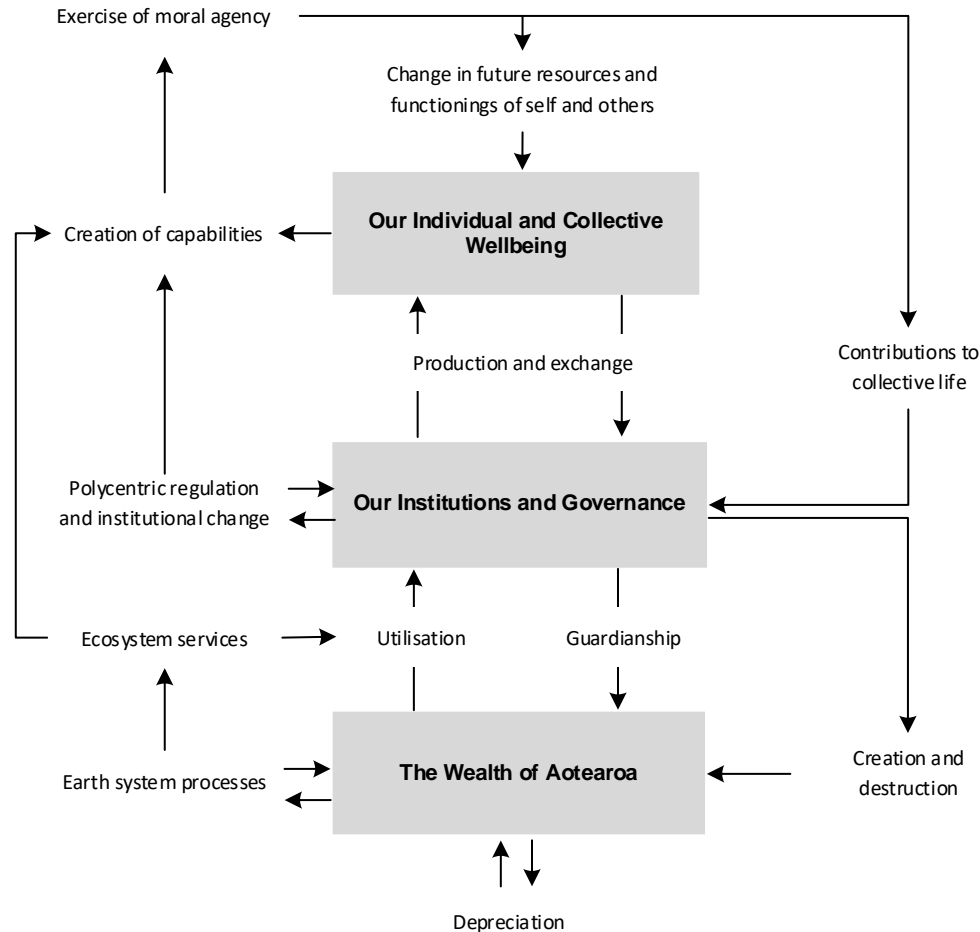
Firms and markets

Regulation=Governance

Rob Reich

"*regulation* is just a loaded word for an important thing: the actions taken by those we elect to transform our shared values into rules that serve the common interest."
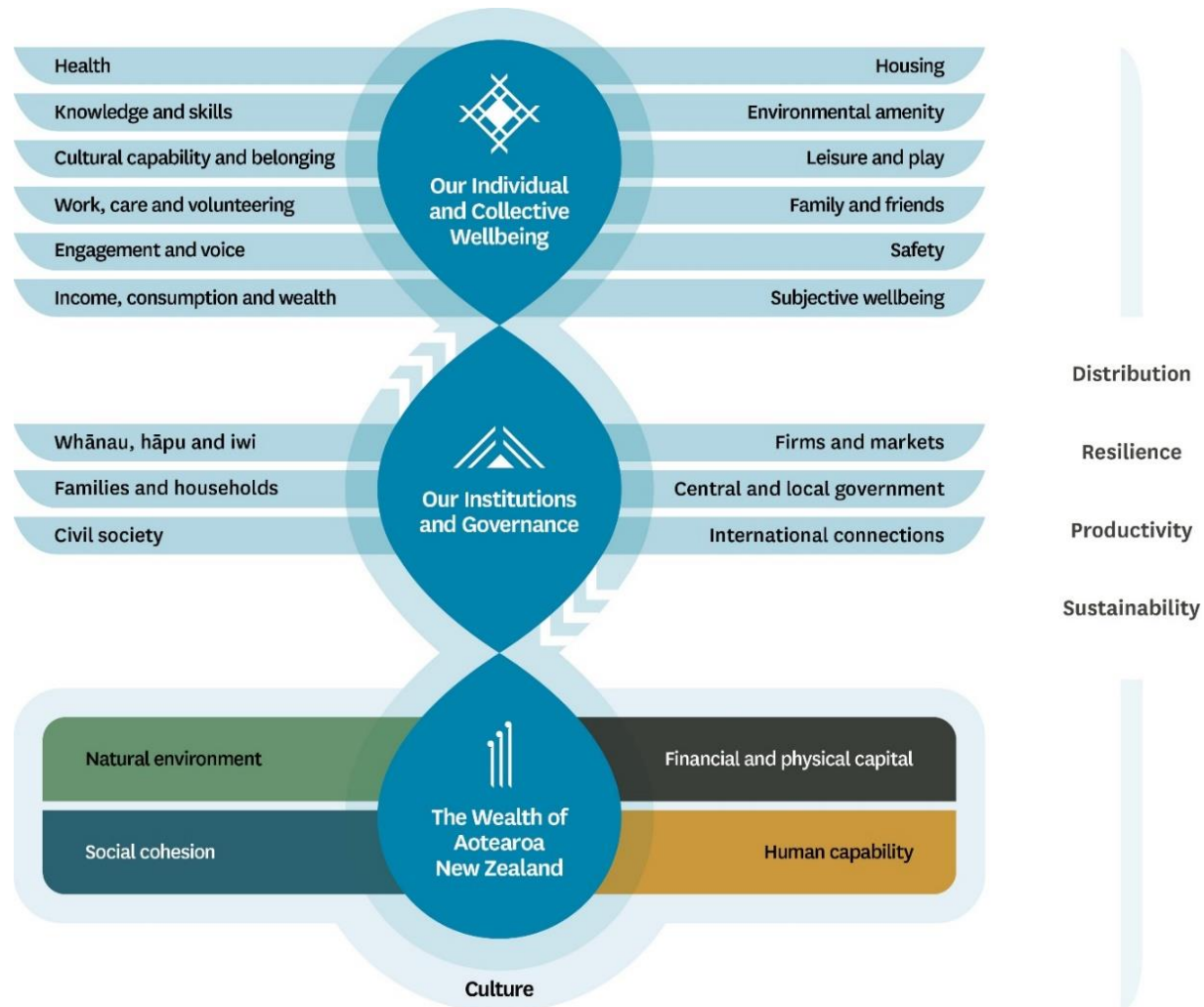
Including Treaty-based governance

Central
and local
government

Whānau,
hāpu and
iwi

Exercise of moral agency

Change in future resources and functionings of self and others

Our Individual and Collective Wellbeing

Creation of capabilities

Contributions to collective life

Production and exchange

Our Institutions and Governance

Polycentric regulation and institutional change

Ecosystem services — Utilisation — Guardianship

The Wealth of Aotearoa

Earth system processes

Creation and destruction

Depreciation

Lifting wellbeing, 2020s style

Want to learn more?

Papers, data and more

- Landing page:
    - Higher living standards (treasury.govt.nz)

- Official definition of LSF2021:
    - The Living Standards Framework (LSF) 2021 (treasury.govt.nz)

- History and discussion papers:
    - History of the LSF (treasury.govt.nz)

- LSF Dashboard
    - Measuring wellbeing: the LSF Dashboard (treasury.govt.nz)

Questions