Treasury's Wellbeing Framework

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In undertaking its mission Treasury takes a broad view of wellbeing as primarily reflecting a person's substantive freedom to lead a life they have reason to value. Treasury has long had an understanding of welfare or wellbeing that extends beyond narrow measures of living standards, and a formal wellbeing framework since the early 2000s. That framework, as revised in 2011, is discussed.

1 The authors are from Macroeconomic Group, the Australian Treasury. This article has benefited from comments and suggestions provided by Christine Carmody, Harry Greenwell, David Gruen, Simon Nash, Martin Parkinson, Kate Phipps, Spiro Premetis, Daniel Royal, Duncan Spender and Barry Sterland. A draft of this article was provided at the Wellbeing and Public Policy Conference, Wellington, June 2012, and benefited from comments by the discussant, Nick Carroll. The views in this article are those of the authors.

Introduction

As a central policy agency providing advice to the Australian Government, the Treasury is expected to anticipate and analyse a wide range of public policy issues from a whole of-economy and a whole-of-society perspective, understand Government priorities and stakeholder circumstances, and respond rapidly to changing events and directions.

The breadth of this role is reflected in Treasury's mission statement, that states our objective is 'to improve the wellbeing of the Australian people by providing sound and timely advice to the Government, based on objective and thorough analysis of options, and by assisting the Treasury ministers in the administration of their responsibilities and the implementation of government decisions'.

While Treasury has had long standing and ongoing interest in wellbeing, since the early 2000s Treasury has also had a 'wellbeing framework' that sets out a conceptual approach for understanding wellbeing and provides high-level guidance to staff as to what needs to be considered in providing an objective and thorough analysis of options in advice to the Government of the day.

The original framework can be found in Treasury (2004), and was revised in 2011 following further internal discussions. It now forms part of the Treasury's Strategic Framework document (Treasury 2011) and is set out in full in Box 1.

Our goals in this paper are to provide historical context around the framework's development, and to flesh out the concepts and concerns underlying the framework. While we draw heavily on the thoughts and ideas of others expressed internally over many years, and in particular the views of former Secretary to the Treasury, Dr Ken Henry AC — under whose leadership the framework was originally developed — the views expressed remain very much our own.

Treasury's changing role and the development of a wellbeing framework

Over its history Treasury has evolved beyond its original role of balancing the Government's ledgers to having a central role in the broader policy debate in government. The role of Treasury with which we are familiar today is attributable in particular to the influence of Sir Roland Wilson, Secretary from 1951 to 1966, who sought to transform Treasury from its traditional accounting and budgetary role to an institution with the chief responsibility of providing economic advice to government.

Box 1: The wellbeing of the Australian people — the wellbeing framework

'In undertaking its mission Treasury takes a broad view of wellbeing as primarily reflecting a person's substantive freedom to lead a life they have reason to value.

This view encompasses more than is directly captured by commonly used measures of economic activity. It gives prominence to respecting the informed preferences of individuals, while allowing scope for broader social actions and choices. It is open to both subjective and objective notions of wellbeing, and to concerns for outcomes and consequences as well as for rights and liberties.

Treasury brings a whole-of-economy approach to providing advice to government based on an objective and thorough analysis of options. To facilitate that analysis, we have identified five dimensions that directly or indirectly have important implications for wellbeing and are particularly relevant to Treasury. These dimensions are:

- The *set of opportunities* available to people. This includes not only the level of goods and services that can be consumed, but good health and environmental amenity, leisure and intangibles such as personal and social activities, community participation and political rights and freedoms.
- The *distribution* of those opportunities across the Australian people. In particular, that all Australians have the opportunity to lead a fulfilling life and participate meaningfully in society.
- The *sustainability* of those opportunities available over time. In particular, consideration of whether the productive base needed to generate opportunities (the total stock of capital, including human, physical, social and natural assets) is maintained or enhanced for current and future generations.
- The overall level and allocation of *risk* borne by individuals and the community. This includes a concern for the ability, and inability, of individuals to manage the level and nature of the risks they face.
- The *complexity* of the choices facing individuals and the community. Our concerns include the costs of dealing with unwanted complexity, the transparency of government and the ability of individuals and the community to make choices and trade-offs that better match their preferences.

These dimensions reinforce our conviction that trade-offs matter deeply, both between and within dimensions. The dimensions do not provide a simple checklist: rather their consideration provides the broad context for the use of the best available economic and other analytical frameworks, evidence and measures.' (Treasury 2011)

When Sir Roland moved to Treasury from the Commonwealth Bureau of Census and Statistics in 1951, he set about building up the economic policy skills within Treasury. Prior to Sir Roland, Secretaries to the Treasury had come armed with accounting backgrounds; Sir Roland was the first economics-trained Secretary. The *Launceston*

Examiner described Wilson's appointment as 'the first Australian experiment of this kind', and correctly predicted that all his successors would be economists too (Cornish 2001).

As a consequence, during the 1950s and 1960s Treasury was transformed into an agency that sought to achieve greater consistency between policy objectives within a market economy, bringing what today is described as a whole-of-government, whole-of-economy perspective to policy analysis and advice.

Early interest in wellbeing

Along with this economic focus came an unsurprising interest in wellbeing, for the 'ultimate purpose of economics … is to understand and promote the enhancement of well-being' (Bernanke 2012). Doing so requires a concern for more than, for example, the fiscal position, material consumption or GDP alone. Two early works demonstrating this broad understanding of the objectives of public policy are noteworthy and are an historical link with Treasury's current understanding of wellbeing.

First, the November 1964 Supplement to the Treasury Information Bulletin, *The Meaning and Measurement of Economic Growth*, explored the nature of economic growth and its connection to wellbeing (Treasury 1964). Among other things, the paper explained that measures of trends in the market value of output, whether adjusted for price effects or not, cannot be taken as comprehensive and unambiguous measures of changes in total welfare.

Second, the Treasury Economic Paper, *Economic Growth: Is it Worth Having?* explored the broader wellbeing impacts of policy (Treasury 1973). The paper, written partly in response to the apocalyptic claims of the *Limits to Growth* study commissioned by the Club of Rome, examined the costs and benefits of economic growth with a focus on non-pecuniary outcomes, such as those in the natural environment. Precursors to the wellbeing framework can be glimpsed throughout the paper.

Why have a framework

Despite these antecedents, prior to the early 2000s there had been no explicit articulation of what wellbeing meant, and in particular, how an institution such as the Treasury should be incorporating consideration of wellbeing in its policy advice.

Treasury's mission statement prior to the current one focused on improving living standards, and emphasised economic policies and developments. The mission statement changed to its current form in October 1997, containing for the first time a direct reference to wellbeing as the primary objective. But with divergent internal views as to how to interpret wellbeing, the Department initiated a process of internal discussion and debate on its meaning and application to policy analysis and advice.

The wellbeing framework developed as a consequence has the goal of setting out a broad understanding of wellbeing and related dimensions of particular relevance to Treasury. By providing an ongoing reminder to staff of the underlying objectives of their work it is one of the common threads that help tie the Treasury's work together. More specifically, the framework can be seen as having a number of roles, including:

- educating staff as to the objectives of public policy to motivate their analytical work, including understanding the underlying trade-offs that often need to be grappled with;
- signalling to those outside of the Treasury — individuals, organisations, other government agencies, and the Government — that our approach to public policy does not conform to simplistic stereotypes about Treasury;
- assisting staff in engaging with external parties and influencing the policy debate, not only through the signalling function but also by improving our ability to appreciate external viewpoints;
- influencing internal resource allocation by affecting, over time, internal decisions as to what is important in the context of the Government's priorities; and
- providing a common language for staff that assists in the communication or raising of issues and ideas internally.

The framework has also influenced and provided a means for engaging with other institutions, domestically or overseas, who have developed frameworks of their own (for example, see New Zealand Treasury (2011)).

The current wellbeing framework

The current wellbeing framework is set out in Box 1. It is effectively made up of three parts. First, a generalised expression of what we think constitutes wellbeing. Second, a set of dimensions that affect or are related to wellbeing and that are relevant to Treasury's responsibilities and to providing thorough and objective advice. Third, there is a statement on how the framework should be used. These parts are discussed in turn.

Wellbeing: a life you have reason to value

In pursuing its mission Treasury interprets wellbeing as primarily reflecting **a person's substantive freedom to lead a life they have reason to value**. Such an interpretation seeks to avoid being too narrow or prescriptive in understanding wellbeing while still making some important substantive claims that are discussed further below: in particular, that it is individuals who count and what they value in life that matters.

The language used borrows from Amartya Sen, the Nobel prize winning economist and philosopher, whose 'capabilities' approach is concerned with providing individuals with the substantive freedom to lead a life they value: where a person's substantive freedom depends not only on their rights and liberties but also on their own abilities and characteristics, and the economic, social and natural environment around them.[2]

The interpretation also reflects major schools of thought concerning wellbeing or related ideas that have influenced economic thought. To the extent that people value the exercise of their liberties and rights, then what is valued begins to align with libertarian ideas. Whereas to the extent people also value the substantive outcomes achieved, such as happiness, then what is valued aligns with utilitarian and consequentialist perspectives.

Consequently, the interpretation reflects Treasury's intellectual heritage. It also shares much with the views on wellbeing adopted by other policy orientated agencies and institutions. For example, the OECD's view that 'most experts and ordinary people around the world would agree that it [wellbeing] requires meeting various human needs … as well as the ability to pursue one's goals, to thrive and feel satisfied with [one's] life' (OECD 2011).

It is individuals that count

Under Treasury's approach to understanding wellbeing it is individuals, and the things that matter to them, that are the ultimate concern. From this perspective, families, friends, a sense of the community and the like, and other aspects of life such as the natural environment, matter as they are of value to individuals, and assist individuals in achieving other things they value, but are not themselves ascribed independent value in assessing wellbeing.[3]

A focus on individuals or households is consistent with the conceptual underpinnings of domestic and overseas approaches to measuring progress or wellbeing, including the Australian Bureau of Statistic's *Measures of Australia's Progress* (ABS 2001), the OECD's *How's Life?* publication (OECD 2011) and the Stiglitz-Sen-Fitoussi

2 For example, see Sen (1999) chapter 3 and Sen (2009) Part III. While the language used is similar, not all of Sen's ideas or views should be taken as reflected in the framework.

3 None of this is to say that what an individual values arises independently of others and of those gone before them, or that the ideas of households, families, community, society, culture and the like are not useful ways of understanding these interdependencies and considering public policy issues — as reflected in the dimensions discussed below.

Commission's report on the measurement of economic performance and social progress (Stiglitz et al 2009).

It also accords with the approach in economics of choosing between alternative states of the world by reference to a social welfare function, that is an aggregate measure or ranking of the overall welfare of the individuals in a relevant population based on those individuals' utilities alone. While, as discussed below, the meaningfulness of utility, a concern for utility alone, and the use of social welfare functions can be questioned, the underlying focus on individuals is similar.

What is of value to individuals matters

In thinking about individuals, particular emphasis should be given to what it is that each individual values, with reason, in their life. Such an emphasis does not preclude government or other social or collective actions, but does provide a basis for evaluating such actions.

The emphasis on what individual's value is again consistent with the approach that underlies much economic analysis, where utility is interpreted as preference-satisfaction. But a focus on what a person values or prefers is also broadly consistent with alternative, more traditional, interpretations of utility as happiness or the like. An individual's preferences or happiness will also typically reflect a concern for others — selfishness is not presupposed.

Adopting this viewpoint supports respecting (though not necessarily rewarding or subsidising) unusual preferences. Prima facie a person who can have a high pay and status job but chooses to live otherwise should be seen as better off than if they took the high pay job. Measures of wellbeing often struggle to reflect such individual valuations.

The weight placed on individual preferences is, however, conditioned in the wellbeing framework by reference to what individuals have reason to value. Viewed positively, the attention placed on having (good) reason reflects the importance attached to people having the education, skills and information necessary to make informed choices about their lives.

The challenges of paternalism…

Viewed negatively, the concern with reason is recognition that what we choose to do may not always be consistent with our own underlying preferences. This is not a blanket claim that what people 'really' value or should value is best decided by a social planner or by government, but acknowledgement that public policy must invariably grapple with issues of paternalism. The case for paternalism is most obvious, and least contentious, for children and the mentally incapacitated.

More contentious is how government policy should respond to self-control problems (including various personal addictions) and other innate behavioural and decision making biases and limitations identified by psychologists and in the behavioural economics literature. The concern here is seemingly irrational preferences or otherwise mistaken choices, rather than unusual preferences. For example, where the choices of an individual appear internally inconsistent or are inconsistent over time, and seem likely to lead to outcomes that the person would sensibly not prefer.

The dividing line between irrational and unusual preferences is, however, not always clear (Kroft 2011): governments' lack information, and competing models of behaviour can be used to explain particular actions. It is also a simple step towards a paternalistic viewpoint to confuse or conflate irrational with unusual or simply different preferences. For example, take Ng's (1997) statement of 'my definition of irrational preference as preferring something that decreases one's own happiness or welfare, neither due to ignorance nor to a concern for the welfare of others.'

There is no simple answer as to when paternalism is appropriate or not, or how in practice policy advisers should consider these issues (Box 2).

…and ignored preferences

Separate from consideration of paternalism, which can be seen as imposing or correcting the exercise of preferences, is whether some preferences — particularly those that reflect dislikes about others' conduct or lives — should be disregarded in formulating public policy, as economics often does by assuming self-centred preferences. For example, in general we have little hesitation in disregarding or heavily discounting preferences for gender or racial discrimination or disregarding pleasure from causing hurt to others.[4]

Box 2: approaches to paternalism

There are a variety of ways of categorising paternalism, such as in terms of strong versus weak, new versus old, soft versus hard, pure versus impure (Thomas & Buckmaster 2010). At one level, we can categorise policies based on how they relate to the preferences of individuals, and how they operate to affect those preferences.

Non-paternalistic policies respect individuals' revealed preferences: the choices people actually make. In contrast, strong forms of paternalism will impose others' views as to appropriate preferences, possibly reflecting moral or ideological positions, or distributional objectives such improving a poor person's health or housing but not their unfettered consumption per se (Currie and Gahvari 2008).

Weaker forms of paternalism concern those incapable of forming preferences (the seriously mentally disabled), or seek to respect individual's underlying preferences

[4] On the latter example, see Sen (1981).

Box 2: approaches to paternalism (continued)

while correcting for their incompetent pursuit (from lack of self-control or bounded rationality). Underlying preferences may be ascertained by reference to usual preferences, stated preferences (from surveys), experienced preferences (reflecting subjective wellbeing measures) or evidence of irrational decisions (from psychology).

Acting to address negative externalities —harm to other persons not taken into account by those acting — is not usually seen as paternalistic. But then, arguably, addressing 'internalities' — when a person's current-self acts to the detriment of their future-self (for example, by smoking) — is also not paternalistic, with intrapersonal conflicts sharing some conceptual similarities to interpersonal conflicts (Congdon et al 2011).

Paternalistic policies can also be implemented in a variety of ways. They can aim to improve the outcomes for the population at large, trading off the gains from a paternalistic policy for individuals otherwise making sub optimal decisions with the costs to those who are otherwise making a choice that provides them a net benefit, or it can try to be more targeted (Congdon et al 2011).

Policies may also override or otherwise punish particular preferences, whether by the use of regulation, the imposition of taxes or the loss of benefits (for example, where job search or training requirements are not met). Alternatively, libertarian paternalism — exemplified by Thaler and Sunstein (2008) — involves 'nudges' to correct for the negative effects of inherent behavioural tendencies or lack of information, while still allowing (or even encouraging) individuals to ultimately make their own choices. Such approaches are now attempting to be explicitly implemented in some jurisdictions.

But there can be a fine line between what's a nudge and what's a push. For example, Thaler and Sunstein's 'nudge' of having businesses report certain information so that they risk bad publicity and being targeted by activists is more a non financial tax than a nudge. Similarly, while the public provision of information would generally not be seen as paternalistic, information presented in a way that attaches stigma to certain choices may.

There are also a number of arguments against state paternalism. States may not know what is in a person's best interests: they lack information as they are too far removed and so rely on crude proxies. There are often unintended consequences, such as increased dependency on others. In practice government imposed preferences can be faulty, not least because policy makers and voters exhibit similar behavioural failings without the same incentives to correct behaviour (Glaeser 2005). And as governments do not always act with the best motives, it can be argued that the allowable justifications for government actions are best constrained.

But in some instances things are less clear cut. For example, as to what is the appropriate level of enforcement of social norms concerning public dress and language. And whereas some see evidence that one person by increasing their own (relative) income reduces the happiness of others as an argument in favour of a greater redistribution of income by government (to correct for a negative externality), others categorise redistribution as the politics of envy and argue such concerns should be disregarded.

Disregarding what are seen as objectionable preferences can be justified on instrumental grounds: ignoring them may be a sensible approach to reducing the long run prevalence and cost of such preferences: Ng (1981); Kaplow (2008).[5] But for most of us the reason for disregarding such preferences would be a moral concern, that goes beyond a concern for observable consequences. Indeed, one of Sen's objections to policy making based solely on utility is that such moral concerns are disregarded (Sen 1979).

It is Australians we are directly concerned with

Treasury's mission is to improve the wellbeing of the Australian people. While the wellbeing framework does not directly address the issue of who are the Australian people, the Australian people can be seen largely as consisting of Australian citizens and residents, present and future.

Two related questions often arise for Treasury staff. On what ethical basis do Australians count while non-Australians do not? And if only Australians count, what should be Treasury's approach in advising on foreign aid and other policies that affect people in other countries.

Looking at the first of these, mainstream philosophical and economic thought would not consider that the wellbeing of individuals of a particular nation is more valuable than that of others by reason of nationality or residence alone. However, our mission statement expresses Treasury's objective in a way that reflects Treasury's function as an instrument of the Australian Government. That Australia's government should take particular care of its own people, and other countries' governments of their own, is not necessarily inconsistent with a concern for all individuals. Arguably it will better achieve that than every agency in the world seeking to improve world wellbeing.

For the second question, one answer is that Australians ultimately benefit materially or otherwise from assisting other nations and peoples. For example, we in part depend on the goodwill and favour of other countries, and also as there may be positive outcomes such as improved regional security or enhanced opportunities for mutually beneficial trade or people to people links. Perhaps more importantly for many, it is also the case that Australians place a positive value on the wellbeing of people other than themselves, and so value assistance provided to others. That is, the national interest

5 Kahneman (2011), at page 169, provides an example of this viewpoint, arguing that 'the social norm against stereotyping, including the opposition to profiling, has been highly beneficial in creating a more civilized and more equal society'.

does not preclude an interest in others, in the same way that individual self-interest does not preclude an interest in the wellbeing of other Australians.

If individuals count can they be added up?

Even if it is individuals alone that count, policy advisers and makers cannot avoid considering the impacts of policies on individuals in aggregate, whether in respect of their liberties or material outcomes or some other thing of value. That is, looking at the overall effects on the community or society of a change. However, levels or changes in individual wellbeing cannot always easily be added up or indexed.

Pareto rules — that support policy choices where either everyone benefits (utility increases) relative to the alternative or at least one person benefits and no one loses — offer one way of choosing between policies that does not require adding people up. In practice, though, Pareto improvements can be difficult to find, even more so if relative outcomes matter to people.[6]

Welfare economics uses social welfare functions to aggregate and order different states of the world by reference to the 'utilities' of the relevant population of individuals. The use of such functions is appealing as it provides a means of ranking different policy choices in cases where Pareto-type rules do not provide an answer. They are a common tool of economic analysis that has in turn directly affected policy advice and ultimately decisions across countries. For example, the optimal income taxation literature, which provides a systematic means of taking efficiency and distributional concerns into account together, has influenced policy outcomes in some areas.

However, social welfare functions have their problems. There is no agreement on the appropriate form of a social welfare function, in part reflecting differences of view over distributional issues (see below). Social welfare functions, for reasons of tractability, also usually make strong assumptions about how to measure individual utility, such as that individuals are all alike and that one individual's utility is not dependent on another person's utility or circumstances.

This lack of agreement also reflects a lack of clarity over what utility is meant to be. If utility is simply an ordinal ranking of a person's preferences (Varian 2010), the addition of utilities is strictly meaningless. If utility is equated with happiness, then even accepting its cardinal nature and the possibility of its approximate measurement (Ng 1997), it is unclear why it is happiness alone that matters in determining or ranking social welfare — see the discussion of opportunities below.

6 Another approach is provided by the theory of fair allocations literature, that looks for outcomes where no individual would prefer another individual's consumption bundle, and where they are indifferent between their bundle and an equal share of a reference bundle (Fleurbaey 2009).

Another difficulty is who to count over time. Where policy choices can affect the size of the population of individuals of concern (for example, by affecting fertility or mortality rates), should the goal be to maximise the aggregate utility of the population, or the average utility per person per moment of time or per life lived?

Dimensions of particular relevance to wellbeing

While Treasury's concern is to improve the wellbeing of the Australian people, we seek to do so primarily by bringing a whole-of-economy and whole-of-system approach to providing advice to the Government based on an objective and thorough analysis of options.

To assist in that task, the wellbeing framework identifies five dimensions that directly or indirectly relate to wellbeing and are particularly relevant to Treasury. They cover the ground of what are key determinants or elements of wellbeing, and their distribution currently and across generations, while also giving explicit attention to risk and complexity given the relevance of these concepts to Treasury's responsibilities around macroeconomic policy, well-functioning markets and taxation.

The set of opportunities available to people

The set of opportunities — what it is that people can achieve in their life — is central to people's ability to lead a life they have reason to value.

In practice, an important subset of opportunities for people are opportunities to consume goods and services, as reflected in common measures of living standards such as household income or consumption, as well as in-kind benefits received or produced and the use of owner-occupied homes, or in cruder measures such as GDP per capita.

But opportunities in regard to other things that affect the quality of life are also important; though access to material goods and services can clearly help improve some of them. People value good health and a long life, the natural environment as experienced, and cultural, social and political relationships and engagement.

In this context then, the idea of opportunities is not limited to legal and social rights that permit you to achieve certain things if you are able. Your real or substantive opportunities are also affected by your natural talents, health, education, family circumstances, luck and the broader economic, social and environmental context.

Importantly, the focus in the framework is on the *set* of opportunities available, not just on the outcomes achieved. Reference to a set emphasises the importance of respecting individual preferences, and that the value of the outcomes achieved is dependent on how they accord with personal, rather than uniform, preferences and needs.

What individuals value can be expressed in many ways

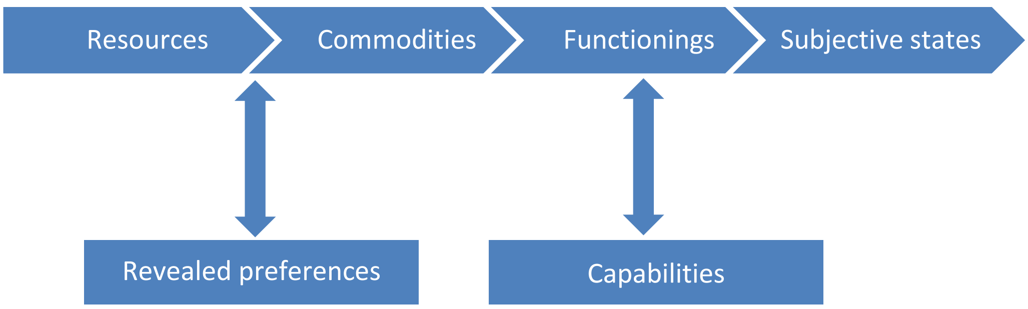
There is no definitive unchanging answer to the question of what individuals' value and hence of what opportunities matter. While there is much commonality in the things that people can be seen as valuing, as reflected in various measurement frameworks, preferences differ between individuals, and they can change over time and with circumstances.

A useful distinction to draw in considering what people value is between instrumental and constitutive things or goals. The end goals, or what an individual ultimately values, can be seen as *constitutive* of their wellbeing. However, an individual may value or aim for certain things not because they value them for their own sake, but because they are a means or *instrument* to achieve the desired ends.

Some things, such as work, may have both instrumental value (work provides income that allows material desires to be satisfied and provides a degree of independence from others) and constitutive value (work, or an occupation or doing something useful with some of one's time, is valuable to most people in its own right).

However, what is the appropriate level or way to express what is constitutive of or instrumentally relevant to wellbeing, or related ideas, is not clear and there is no common approach. A schema of some of the more prevalent approaches is at Figure 1.

Figure 1: alternative perspectives on opportunities



Wellbeing can be expressed by relation to the *resources* available to an individual. Most obviously this includes production or income, and financial and non-financial wealth. Less obviously, and at a stretch, resources can be seen as including your human resources — your physical and mental capacities — and non-market external resources such as your legal rights, social norms and social networks and the surrounding physical environment.

Commodities are closely related to resources, but focus more on what resources allow you to consume: market goods and services, public goods such as roads and emergency and police services, the use of your own home, leisure and other non-work activities, and even your experiences of nature.

Welfare economists typically take individuals' preferences between different bundles of resources or commodities as providing a rank ordering of what individuals value, and the satisfaction of such preferences as revealed by actual choices made as a more reliable indicator of utility, understood even as happiness, than measures such as self-reported happiness.

The idea of *functionings* — 'the various things a person may value doing or being' (Sen 1999) further extends commodities, by looking at what commodities give you: material satisfaction; interesting work and activities; knowledge; a good family life and friendships; social and political engagement; and safety. Looking at functionings explicitly factors in your ability to convert resources or commodities into desired ends, and takes into account factors or constraints such as ill-health or disability, climatic conditions, family arrangements, and social and political risks and prohibitions.

Sen distinguishes functionings from *capabilities*. Capabilities are the set of different functionings that it is open to you to achieve. Sen places value on people having the practical ability to choose between alternative sets of functionings, and hence on their capabilities. This mirrors the emphasis he places on the value of freedom in people's lives. Economists would generally accord higher value to the set of commodities or functionings that a person chooses, and the ability to exercise choice can also be seen as a valuable good or functioning in itself.

So far, each move from left to right in Figure 1 can be seen as broadening the range of factors seen as important for wellbeing, or getting closer to describing what is actually constitutive. Though, as noted, what you see as resources or commodities can be stretched to have a meaning much the same as functionings or capabilities.

Subjective wellbeing: multiple concepts

Similarly, *subjective states* can also be seen as part of the continuum that gets ever closer to what is constitutive and less instrumental, where the concern now moves from objective things that can be obtained (resources/commodities) or achieved (functionings/capabilities) to the resulting subjective states such as 'happiness' that are argued by some to better represent the opportunities constitutive of wellbeing.

Happiness in particular has been claimed to be the thing (in its many different forms) in particular that constitutes wellbeing and that should be the goal of public policy. It has also been suggested that even if happiness is not seen as the end goal, it can be used to weight or place values on non-market costs and benefits (Graham 2011);

though in principle this seems an equivalently strong claim. Richard Layard is one of the best known proponents of the primacy of happiness:[7]

> 'I think there is one simple test of what is the ultimate good for humans — that we find it self-evidently good. So we can list all the goods we consider important: freedom, health, achievement, income, happiness and so on. We can then ask of each, Why is it good? If we ask, for example, why freedom is good, people will say slavery makes people miserable. So does ill-health, and so on. But if we ask, why does it matter if people are miserable or happy, no reason can be given. It is self evident.' (Layard 2009)

However, equating wellbeing with subjective states is seen by others as representing a narrowing of the concept of wellbeing, and often an unconscionable narrowing, with wellbeing no longer necessarily a function of capabilities or resources or commodities and not part of a continuum in the way Figure 1 suggests.

Sen (1999), for example, points to the possibility of a slave, or a woman in a society where men are accorded preference by custom, being relatively happy with their lot by means of adaption or mental conditioning. It can also be asked whether anyone would choose a world with less resources or commodities or capabilities, even if they would still remain as happy (Fleurbaey 2009).[8]

However, it is not the case that people always adapt completely to changes in circumstances (Stiglitz et al 2009). Perhaps more importantly, many of the concerns over the use of subjective wellbeing concepts to describe wellbeing reflect in part too simplistic the equating — by proponents as well as opponents — of subjective wellbeing with happiness understood simply as mood happiness/unhappiness experienced across time.

Rather, subjective wellbeing covers a range of subjective states: 'hedonic' experiences over time, such as feeling happiness, sadness, anger, joy, tiredness or pain (Stiglitz et al 2009); remembered happiness;[9] life satisfaction, that moves beyond immediate feelings to reflective evaluations of life; 'eudemonic' states such as 'autonomy, competence, personal growth, positive relationships, self-acceptance, engagement, and meaning'

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7 See also Ng (1997). Layard (2009) makes his argument in favour of the primacy of happiness by reference to what appears more akin to mood happiness or affect, but then incongruously suggests life satisfaction is the appropriate measure for public policy to target.

8 The Easterlin paradox — that, above a certain point, average national income or production is not correlated with higher average national (self-reported) happiness, while for individuals within a country higher income is positively correlated — has also been questioned; see Stevenson and Wolfers (2008). The paradox may also reflect people's concern for relative incomes rather than just adaption per se, see Clark et al (2008).

9 See Kahneman (2011) chapter 35 for a discussion of the remembered self.

(Clark et al 2008); and narrower categories such as feelings of physical or economic insecurity (OECD 2011).

It seems unlikely that people's underlying preferences can be reducible to a desire to achieve any single one of these.

In a study of underlying objectives, Benjamin et al (2012) found that subjective wellbeing (mood happiness or life satisfaction) was a uniquely important motive underlying individuals' choices, with life satisfaction the best predictor. However, other factors were also found to matter in their own right: a sense of purpose and control over life, family happiness and social status. Experienced happiness and life satisfaction were also relatively weaker explanators of choices seen by individuals as representative of important decisions in their lives, while people would deliberately choose more money in preference to greater subjective wellbeing.

When such other states or preferences are taken into account, concerns like those over 'happy slaves' are less compelling. Life satisfaction or other life evaluations, which can be seen as subjective reflections of the 'capabilities' concept, appear to suffer less from adaption (Fleurbaey 2009). And motives such as autonomy and a sense of purpose and control over life, which reflect the importance attached by Sen to agency and freedom, are also likely to be affected differently.

Other concerns about the use of subjective wellbeing are less conceptual or philosophical than practical. These include concerns about the practical ability to measure subjective states (and the value, reliability, and comparability of self-reported measures in particular), and that whatever it's conceptual merits it may not be a sensible explicit objective for public policy given a possible lack of community support.

The distribution of opportunities[10]

The distribution, and not just the aggregate level, of opportunities matters. Indeed, three of the five dimensions identified in the framework concern distributional issues: distribution within a generation (and over that generation's lifetime); across generations (sustainability) and between contingent states (risk).

Implicit in most discussions of distributional issues are normative judgements about: among *whom* it is that we're concerned about distribution, such as households within Australia; *what* it is that is of distributional concern, such as financial income or wealth, or of rights; and what is the appropriate *distributive rule* or concern, whether providing a minimum or safety-net or achieving equal positions.

10 The discussion of distribution in this article, including Appendix One, draws on Gruen et al (2011).

Choices along any of these dimensions can be controversial, and also biased by the data sets available in practice to analyse them. And even where the state of play on distribution can sensibly be described, identifying the underlying determinants and suitable policy instruments to affect a distribution can be difficult.

Without being overly prescriptive, the framework makes the following points:

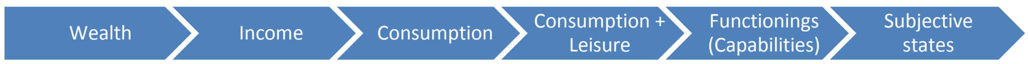
- most obviously, that Treasury staff should be concerned with distributional issues in advising the government of the day on policy;
- the distribution of substantive opportunities matters, not just of income and goods and services. So, for example, the distribution of productive capacity, of rights and freedoms, and of environmental goods are also relevant; and
- a concern for distributional issues can start with a concern for the least well-off in society and addressing the limited opportunities they face, separate from seeking equality for all for its own sake.

The distribution of opportunities among Australians — the distribution of 'what'

Discussion of distributional issues often focusses on measures of inequality or of poverty in respect of wealth (both financial and land and other property) and of financial income (either in respect of wages; or wages and other financial income before taxes and transfers, or after taxes and transfers). This reflects the ready availability of poverty and inequality measures and of data; analogous to the factors that have driven the use of GDP as a proxy measure of community welfare.

However, in the same way that the set of opportunities or living standards can reflect narrow or broad concepts, so can discussion of distributional issues. Figure 2 sets outs a spectrum of 'what' may be the focus of distributional concern. A goal of equal distribution at one point along the spectrum shown, or of particular subsets such as rights and liberty, must inevitably entail acceptance of the failure of that equality goal measured against other points or sets.

Figure 2: Alternative focuses of distributional concern



As you move from left to right in Figure 2, from narrow to arguably broader concepts, we can expect inequality for a given population to fall but without ever becoming equal. Taking a life time view, or adjusting for risks knowingly taken would also narrow differences.[11] The ranking of particular individuals or households, or measures of their relative position, could also change and sometimes significantly (for example, retirees would be seen as more advantaged looking at financial wealth than income or consumption).

The perspective the wellbeing framework takes is that it is the substantive opportunities open to people that matter overall. Taking again the example of the person who forsakes a high paying job, such a choice should not be of concern simply because it can be categorised as leading to someone falling below a poverty benchmark. Choices involving risk taking can, however, be problematic: an individual living in dire poverty as a result of a risk deliberately taken in the past is hard to pass by even if, ex ante, his or her opportunities were the same as others.

Why do we care about distribution?

While most people would agree that distribution matters, and concern over distribution between contingent states and over a lifetime is reflected (however imperfectly) in peoples' attitudes to risk and in saving to smooth consumption, exactly why it matters, and what is an appropriate distributional rule or objective for public policy, are more contentious.

In economics a more equal distribution of income or consumption — everything else unchanged — is usually seen as improving social welfare. This arises from the unremarkable observation that in general a poor person will likely derive more utility or satisfaction than a rich person from spending an additional dollar. That is, there is diminishing marginal utility from consumption.[12]

A *utilitarian approach* therefore typically favours a more equal distribution of resources or commodities for instrumental reasons.[13] Concerns over the prevalence of positional goods and evidence that individuals' self-assessment of happiness or life satisfaction

11 As individuals take a life time view and so, to some extent at least, consumption is smoothed out over time; measures of consumption inequality tend to be less than those of income inequality and better related to poor substantive outcomes or having fewer opportunities; see Meyer and Sullivan (2011). On risk, lotteries, for example, generate ex post inequality even if, ex ante, players start off equal and have an equal chance of winning.

12 There may of course be exceptions to this general rule, see Frankfurt (1987).

13 Social welfare functions often embody an additional bias in favour of a more equal distribution of income or the like, though the ethical basis for doing so is typically assumed rather than justified.

can depend on how much they have relative to others may add a further instrumental argument for caring about distribution.[14]

Utilitarian approaches do not, however, aim per se for equality between individuals of their capabilities or of individual total utility. Were individuals alike, equalising individuals' marginal utilities would equalise individuals' total utilities. But as individuals are not alike it will not. Hence Sen's criticism that utilitarianism would leave a cripple with a low level of utility (and capabilities) and justify taking resources from them if they were less able to convert a marginal dollar into utility (Sen 1979).

It is also the case that in practice everything else will not be unchanged. Achieving a more equal distribution — whether directly via the tax-transfer system or indirectly via more regulated labour markets — may reduce the aggregate level of consumption, or efficiency, by adversely affecting behaviour and given the related administrative and compliance costs. Hence, there will often be a trade-off between redistribution and efficiency.

Another common motivation for caring about distribution is that more unequal distributions, or distributions of a particular character (for example, of groups suffering extreme poverty or enjoying extreme wealth), will cause *social and political conflict or instability*.[15] Distribution viewed along ethnic, age, geographic, social and religious lines typically also align with this concern.

Individuals' disquiet and concern for the poverty they observe may also provide a reason for reducing (apparent) poverty, and if distributional outcomes directly affect individuals' utility or welfare then those outcomes can be seen as a form of *public good* (Leigh 2012).

A different approach again is that of John Rawls, who constructed a thought experiment — as to the institutions we would choose if we started behind a veil of ignorance as to where we would individually end up if we were born into society today — to argue that fairness, or justice, requires the equality of rights and liberties, and subject to that equality, that we choose those institutions that maximise the resources (primary goods) available to those with the least.

14 See Ng (1997) and Clark et al (2008). Redistribution in these circumstances is intended to reduce the incentives for what is essentially wasteful competition between individuals. But how the utilitarian calculus is affected by individuals' perceptions of how a given distribution is achieved, which may argue against mandated redistribution, seems to have been explored less.

15 Stability is usually assumed to be a good thing, but where a government is repressive instability may of course be preferred.

Under a *Rawlsian type approach* only the conditions of those who would otherwise be at the bottom are relevant, and the rest of the distribution can be ignored: in principle at least a more unequal distribution (other than of rights and liberties) may sometimes be preferable.

Unlike the other motivations discussed above, the reasoning in this approach is not instrumental: it is argued on the basis of *fairness*. Whatever the merits of Rawlsian type approaches, it is undoubtedly true that what is an appropriate distribution is often seen as essentially a question of fairness. Unsurprisingly then, in considering distributional issues policy advisers and decision makers must inevitably grapple with the issue of what is fair (Appendix One).

The sustainability of opportunities over time[16]

The wellbeing framework gives particular attention to the sustainability of opportunities available over time. In particular, consideration of whether the productive base needed to generate opportunities (the total stock of society's capital, including human, physical, social and natural assets) is maintained or enhanced for current and future generations. It relates to ideas of intergenerational equity or distribution, though one with a potential positive bias towards future generations.

Each generation can be seen as having the challenge of making choices about the use of their stock of resources without knowing what knowledge and technological advancements will be available to future generations, or how those generations will make use of their endowments. Whether an economy is sustainable or not therefore is best seen as a question of whether the economy's productive base is being maintained or enhanced, or is contracting (Dasgupta 2007a; 2007b).

This distinction between current wellbeing (a flow concept) and sustainability (a stock concept) is important, and was highlighted by the Stiglitz-Sen-Fitoussi commission, who made a case for the separate measurement of current wellbeing and sustainability (Stiglitz et al 2009). The OECD has adopted a similar perspective (OECD 2011), as did the 2010 Intergenerational Report, which also considered the sustainability of the environment and aspects of human and social capital (Commonwealth of Australia 2010b).

The two concepts remain closely linked, however, as the wellbeing of the current generation may be affected by intergenerational considerations. Current wellbeing is affected by the way in which resources are used at present, including the creation of

16 This discussion of sustainability draws heavily on Gorecki et al (2011). Carmody (2012) provides a more comprehensive discussion of sustainability and its implications for wellbeing and public policy.

stocks bequeathed to children and future generations, whereas sustainability is affected if the stock of resources itself is affected (Gorecki et al 2011).

While the idea of sustainability is often given an environmental focus, natural capital is not the only source of wellbeing. An economy's productive base includes not only its capital assets (stocks of manufactured and human capital) but also its natural capital (stock of environmental capital) and its institutions (or stock of social capital, see Box 3). These are often referred to as the three pillars of sustainability — economic, environmental and social capital.

Other dimensions of policy that Treasury is concerned with also reflect a concern for sustainability. The global financial crisis and subsequent events have illustrated the importance of fiscal sustainability. And the successful microeconomic and macroeconomic reform agendas that began in the 1980s and continued into this century improved Australia's institutional settings and can be seen as a created endowment for future generations (Parkinson 2012).

Weak versus strong sustainability

Arguments regarding sustainability are often framed in terms of weak or strong sustainability — each presenting a different perspective of sustainability by giving priority to assets in general or particular classes of assets, most typically environmental ones. The key difference between both perspectives relates to the degree of substitutability between different forms of capital.

Weak sustainability allows trade-offs between the different forms of capital, so long as the total capital stock is not declining. The concept was developed through a body of work undertaken in the mid-1970s in response to the debate surrounding the *Limits to Growth* publication. These approaches extended standard neo-classical growth theories, in which output is determined by technology and available quantities of labour and capital, by introducing natural resources as an additional factor of production (Stiglitz et al 2009).

In these models, natural resources are finite, non-renewable, and essential to production, and human-made capital is indefinitely substitutable for natural capital (Pezzey and Toman 2002). So long as natural and human made capital are substitutes, output can grow indefinitely even in the presence of scarce resources, and the current generation can draw on the finite pool of resources so long as they add to the stock of reproducible capital (Gutés 1996).

Box 3: Social capital

The World Bank (1998) defines social capital as including 'the institutions, the relationships, the attitudes and values that govern interactions among people and contribute to economic and social development … It includes the shared values and rules for social conduct expressed in personal relationships, trust, and a common sense of 'civic' responsibility, that makes society more than a collection of individuals'.

In any coordinated activity, participants can achieve more with whatever sources of capital resources they draw on if they are able to coordinate activities and credibly commit to a sequence of future actions that produces a better joint outcome (Ostrom 2000). Social capital can reduce transaction costs in exchanges if the parties can legitimately expect each other to be non-exploitative should an uncovered contingency arise (Solow 2000).

When individuals trust each other transaction costs in economic activities are reduced, through generating expectations, informal rules and common understandings, people are able to conduct personal interactions and business dealings more efficiently (Alesina and La Ferrara 2002). It is of course possible to achieve coordinated activities by drawing up contracts relying more on monitoring, negotiating, litigating and enforcing agreements. But these will almost always be incomplete, and tend to be inflexible and costly to enforce, undermining their effectiveness.

Another way of considering social capital is as a product of iterated prisoner's dilemma games. If individuals interact with each other repeatedly over time, they develop reputations which affect the outcomes of the interactions, and so it is in their interest to develop a reputation for honesty or reliability to maximise payoffs from interactions (Fukuyama 2000).

Public policy and social capital

Social capital is often a by-product of factors that lie outside the direct control of government such as religion, cultural traditions, and shared historical experiences. Yet many existing policies aim to build up or support social capital — education, family support, funding for sports and cultural and national events. This likely reflects not only a concern for more efficient markets, but also to improve daily life and social opportunities. Low social capital in depressed communities can also reinforce existing inequalities (Productivity Commission 2003).

Government can indirectly foster social capital through the efficient provision of public goods, particularly property rights and public safety (Fukuyama 2000). Educational institutions, in addition to developing human capital, can generate social capital through teaching social rules and norms.

On the other hand, policies can inadvertently reduce social capital. For example, public liability laws can make it harder for community groups to form and prosper. Social capital can be reduced where public policy crowds out activities best left to private individuals (Green and Cromwell 1984). If unused, social capital deteriorates. An over-reliance on the state can lead to the loss of habit and experience by individuals, and the loss of the ability to spontaneously work together without external prompting.

The normative basis for weak sustainability is that the current generation owes its successors generalised productive capacity, or, access to a certain standard of living or wellbeing. But how this productive capacity is transmitted across generations is a matter of efficiency rather than equity. So whether for example it is more efficient to transfer mineral deposits or capital equipment or technological knowledge is a question of efficient resource allocation, and not of justice (Solow 1986). Provided that each generation ensures that the expected welfare of its offspring is no less than its own perceived wellbeing, it is justified in pursuing its preferences (Howarth 1995).

Strong sustainability does not allow for substitution (as normative value is attached to protecting the environment for its own sake) or alternatively sees practical limits in the scope for trade-offs between the environment and any competing economic and social goals. Proponents of strong sustainability argue that substitution possibilities between forms of capital necessarily face physical limits, and so impose a constraint of a non-declining natural capital stock in volume terms. A variant is that levels of most natural resources must be maintained sufficiently to keep reasonable levels of environmental resilience; that is, the capacity of eco-systems to regenerate and return to equilibrium aftershocks (Stiglitz et al 2009).

Differences between weak and strong sustainability are best seen as resting on different positive claims (which can be tested) as to the degree of substitutability between different capital stocks and the risks attached to assuming that such substitutions will continue to be available.

The overall level and allocation of risk[17]

Risk refers to the intrinsic uncertainty in possible outcomes regarding the future that is also present in almost all decisions. In this broadest conceptual sense, risk impacts on all individuals, and is everywhere in the economy and in society (Treasury 2004). Risks arise across the range of opportunities of interest to people, including financial, physical and environmental.

Risk is marked for particular attention in the wellbeing framework because of its value as a concept in analysing and understanding a range of public policy issues and how those issues relate to overall wellbeing. It also reflects an awareness of the difficult challenges involved in factoring consideration of risk and uncertainty into advice, whether policy advice or forecasts or projections, and the danger that that difficulty may see risk being ignored.

17 This section draws heavily on, without completely following, Banerjee and Ewing (2004) who provide a more extensive discussion of risk and its connection to wellbeing.

People have different preferences regarding risk, depending on factors such as their relative financial security, their aspirations for the future, or in some cases a desire for risk as a good in its own right.

Under a conventional approach, it can be expected that wellbeing would be improved if there is a better match between people's risk preferences and the risk borne. Risk itself (or alternatively, positive goods such as security or certainty) can be seen as part of the set of opportunities in which individuals make trade-offs or choices, with people generally willing to trade-off other things to reduce risk. As for other goods, the ability to do so depends on the existence and efficiency of relevant markets.
A general disposition against risk can, as often assumed in economics, be seen as a consequence of diminishing marginal utility of consumption, which favours a more even distribution of outcomes.

However, more recently, 'prospect theory' has made clear that actual behaviour often contradicts the conventional assumptions of well-ordered risk preferences. Some of this reflects bounded decision making, such as biases in the way probability is assessed. In these cases people's risk preferences if acted on may limit their ability to achieve what they value.

But prospect theory also suggests that actual behaviour can also reflect the value of each outcome being measured relative to a reference point which is dependent on how the prospect has been framed. Such behaviour arguably reflects underlying preferences. There is, consequently, a challenge for public policy in distinguishing between behaviour that is inconsistent with underlying preferences and behaviour that reflects a person's real concerns for the path they have followed and other context.

Government actions and the level and allocation of risk

Importantly, almost all government actions have impacts on risk, whether or not the original intent of the action is risk-related. One useful distinction for the impact of government actions on risk is between those which affect the *level of overall risk* in society, and those which *reallocate risk* between groups in society.

Government actions which seek to affect the level of risk in society are generally aimed at reducing overall risk, though they will generally affect its allocation as well. Examples include providing a system of enforceable and consistent property rights, prudential regulation, monetary and fiscal policies that minimise the likelihood and consequence of economic shocks, meteorological services, and specific regulations which prohibit or constrain risky activities like driving without a seatbelt.

While the presence of government tends to reduce overall risk, some government actions can also add to the level of risk at the margin. For example, while national defence spending can provide insurance against and reduce the risk of uncertain (even if remote) future threats and natural disasters, defence capabilities acquired to obtain influence over other countries may sometimes increase the risk of conflict.

Government actions can also affect the distribution of risks between groups in society. Such risk reallocation may shift risk from one group to another, or spread the risk across a large number of groups (which by itself may reduce overall risk through diversification). The redistribution achieved by the overall tax-transfer system can be seen as in part shifting resources from those who are lucky (whether in investments they make or by avoiding accidents or illness) to those who are not.

The case for government action to affect private decisions concerning risk or the trading of risk typically reflect a concern over information problems, contractual problems (the difficulty of contracting for all possible circumstances), and the existence of externalities.

As in other areas of public policy, government intervention will often involve a trade off with other things of value. Defence spending, for example, has an opportunity cost of higher taxes (and hence reduced private consumption), or reduced spending in other areas of public benefit. Redistribution achieved by the tax-transfer system, and other fiscal decisions, typically has an efficiency cost. And financial market regulation can involve a trade-off between stability and competition.

The complexity of the choices facing people and the community

Like risk, complexity can also be seen as a dimension of the set of opportunities available to people. We all make choices between simple or more complex things based on our personal preferences. In the choices we make concerning work, and leisure, can be seen a preference for a degree of complexity rather than the simplest possible outcome: routine repetitive work is shunned by many, and leisure activities are not enjoyable if too simple.

At the same time we also organise ourselves and make choices to manage and reduce complexity, such as through specialisation. Complex things when mastered become simpler. Specialisation together with the ability to take advantage of it via markets and organisations can be seen as the basis for current high living standards (Hausmann et al 2011).

But people not only make choices about the desired degree of complexity given their preferences and trade-offs with other objectives or other opportunities, they also make choices or decisions that are complex. As noted in the discussion of paternalism above, the evidence suggests that there are some decisions that people find inherently difficult to make.

Complexity in this context can impose costs on people. There are the direct costs of dealing with complexity (of time, effort or cost of expert advice). There also the costs of making the wrong decisions, reducing the resources available to people or their ability to convert them into functionings or desired subjective states. Consumer law, for example, reflects a concern for these issues.

Complexity imposed by government

Complexity is also explicitly highlighted because of a concern over unwanted complexity. That is, complexity imposed by governments including through the taxation system and various market regulations for which Treasury has policy advising responsibility.

Even in that context, a degree of complexity is likely to be optimal. As noted in Treasury (2004), 'Increasing complexity usually brings benefits both through a better targeting of rules and through the provision of greater certainty. However, it may also impose significant costs through increasing resources devoted to verification and compliance'. There are trade-offs to be made.

Reference to complexity in this context should however also be seen as reference to distinct, though related, issues that are often conflated with complexity or a goal of simplicity.

Most obviously there is a concern to reduce *compliance and administration costs*. These costs include not only the cost of advice, but also of lost leisure and any psychic costs, and the negative effects of any uncertainty created. Even if typically such costs and complexity go together, they are distinct: a relatively simple tax such as a broadly based single rate value-added tax can still have high compliance costs because of the volume of transactions to which it applies, and a complex system coupled with a good user interface may have relatively low compliance costs.

We are also separately concerned with *complexity facing advisers and decision makers*. This is not just the complexity of the legal constructs and rules, but also of understanding the system as a whole and its economic consequences. For those who advise on the tax-transfer system, and for agencies, governments and parliaments who ultimately make decisions as to its administration and design, its sheer complexity (and the complexity of the world to which it applies) is challenging to say the least.

Related to this is a concern for *transparency*. Voters are the ultimate decision makers, but the complexity of the system as a whole may limit or bias community debate and choices by reducing transparency as to what the choices actually are. Some design choices that reduce or otherwise do not affect complexity per se may still reduce transparency. For example, indirect taxes may be less apparent to voters, while some have expressed concern that systems that largely remove the need for individuals to lodge their own income tax return may also reduce transparency.

The wellbeing framework and day to day policy advising

A common question within Treasury has been whether the wellbeing framework can be used — or be refined to be used — as an analytical tool that staff can use to work through specific policy issues. The answer is clearly 'no'.

The framework's role is, as discussed above, to provide broad context and direction for policy advice, and cannot replace the vast body of economic, social and analytical frameworks, statistical and other evidence, and relevant measures available to staff. As such, it cannot be used as a simple checklist to provide easy answers to complex problems.

When considering a specific issue, the framework does serve as a useful high level reminder of things to be concerned about in undertaking the 'thorough and objective analysis' asked for in Treasury's mission statement. But appropriate analytical frameworks must be employed to work out what the problem is, or is not, that may justify government action, or inaction, and assess the policy instruments available.

The framework is, however, not divorced conceptually from the more common analytical frameworks that are used in providing policy advice.

The framework's primary concern with individuals, and their own choices as to what they value in their lives, fits with the general approach in Treasury of viewing government interventions in society and the economy as needing to be motivated by market and other failures that have the consequence that individuals' choices left to themselves lead to sub-optimal outcomes.

So the wellbeing framework reinforces the need for staff in providing policy advice to correctly identify the problem or issue of concern, by reference to such things as the presence of public goods and the like; negative or positive externalities; information failures and asymmetries, including principal/agent failures; systematic failures in personal decision making; and short-run macroeconomic variability.

The presence of such failures does not of itself make the case for government action, as government may not be able to rectify or counteract the market failure, or such action may not achieve benefits, relative to what would arise through private and community action, that outweigh the costs of intervention. In assessing the costs and benefits of policy options, where possible the full range of costs and benefits should be taken into account, as should their sustainability, using valuations reflecting as far as possible the underlying preferences of the people concerned.

Similarly, tax and transfer system policy advice, in its concern for efficiency, will generally favour settings that minimise distorting personal choices, such as those around work and leisure and the timing of consumption, unless itself being used as an instrument to correct market failures.

Treasury's approach to distributional issues

Separate from concerns over market or other failures, concern over the distribution of opportunities may also merit government action, as reflected in the current tax-transfer system. At the same time, the distributional impact of changes — and the potential for winners and losers — can act as a constraint over changes to policy settings. Taking these concerns into account in providing policy advice can be particularly challenging.

Treasury's approach to doing so is typically cautious given what is often a lack of clear community agreement as to an appropriate distributional rule, to 'what' that rule is to be applied to in particular circumstance, and as to what is fair. In taxation policy, axioms such as vertical and horizontal equity are often referred to even if they are not always conceptually well grounded (Kaplow 2008).

This general caution notwithstanding, Treasury's underlying concern is that Australians should in general be able to lead a fulfilling life and participate fully in the community.[18] Such a perspective would have general community acceptance, and reflects the 'need' principle discussed in Appendix One. While it does not directly advocate more egalitarian or redistributionist policies that a government may be minded to implement, it does not preclude them either.

Such an objective is of course concerned with more than just the distribution of cash income over a defined period. And it does not neatly fit in either the absolute or relative poverty camps: it treats both senses of poverty as relevant, as what is needed in absolute terms to participate fully in a society will change as a society becomes wealthier.[19]

Distributional concerns and policy advice

To be concerned with distributional issues is not to say that policy advisers should factor such concerns into their advice on all issues. In economics there is a long tradition of trying to separate consideration of efficiency issues from those of equity or distribution. For example, the Kaldor-Hicks criterion that only requires that the losers from a change could *potentially* be compensated.[20]

18 For example, see Henry (2007).
19 See Sen (1999) at pages 72-74.
20 For a more recent attempt at a separation, see Kaplow (2008).

For policy advisers, it usually seems sensible to adopt such an approach and focus on efficiency concerns except where affecting distribution is the primary goal. So, for example, the recent review of the Australian tax system argued that (Commonwealth of Australia 2010a):

> 'The transfer system, together with progressive personal taxation, is better suited to this task, and should be the primary means through which the government influences the distribution of income in the economy…'

Government action to achieve distributional outcomes is of course not limited to using the tax-transfer system, with its focus on transfers of cash or in-kind benefits. Governments of all persuasions are aware of the potential negative consequences of transfer payments in entrenching disadvantage, and the benefits for some groups of attaching labour force participation requirements to transfers made to them, supplemented where appropriate by active labour market programs.

This is not only because of the potential improvements in the distribution of disposable income in the medium- to long-run through earlier attachment to the labour force. It is also because, in general, work can have benefits of its own beyond the income provided. Unemployment may give rise to feelings of loss of control and diminished self-worth (Bernanke 2010), and individuals may not always fully factor this and costs such as a loss of skills and future employability into account (Harrison 2008).

There is also now more awareness of the importance of human capital, of education and good physical and mental health, for the outcomes people achieve and the overall distribution of opportunities (Henry (2007)). Education is associated with improved participation in the labour market, higher lifetime incomes, and longer lives. Assistance provided through education could be subject to fewer of the adverse incentive effects of cash and like transfers.

Also of importance are the non-income benefits associated with education — that it gives people greater capacity to convert other resources or income into positive outcomes, and more sensibly choose between them. Education has been argued to improve health, reduce crime and increase political engagement (Goldin and Katz 2008).

Conclusion

Treasury's wellbeing framework is a product of its history and intellectual heritage and the mission it has been given by the Australian Government. It also reflects the need for a central policy agency of government to have an informed understanding and debate as to the objectives of public policy, how those objectives relate to its work and responsibilities, and the trade-offs that must often be faced.

The current wellbeing framework is valued within Treasury and it, and the internal discussion it has generated, has allowed Treasury to better engage with and understand a wider range of external parties and their views. It is, however, modest in its goals: it cannot and does not seek to replace the analytical and measurement frameworks available from economics and other disciplines and from statisticians.

Appendix One: What is a fair distribution?

We are all likely to have a sense of what is fair, even if most of us struggle to articulate it clearly. One way to approach the question of what is fairness is to look at the evidence as to what people see as fair. As example of this approach is Konow (2003), who looked at a range of surveys, responses to vignettes and social laboratory experiments aimed at shedding light on attitudes to fairness.

Konow claimed three principles underlay what people consider a fair distribution:

- *need*, concerning the satisfaction of basic needs;
- *equity* (or *just deserts*), concerning proportionality (for example, of income to work effort or risks deliberately taken) and individual responsibility; and
- *efficiency*, concerning maximising aggregate income, consumption or even subjective outcomes like enjoyment.

Strikingly, if perhaps unconvincingly, Konow argued that equality or egalitarianism is itself not an underlying principle, but rather a default rule that people apply when they lack information on need, equity or efficiency.[21] Reflecting the behavioural economics literature, Konow also noted that context also matters, and sets the stage for the playing out of the three competing principles. He also noted that people appear to trade off the three principles rather than giving precedence to one over the others.

One way to interpret the importance Konow attaches to proportionality over equality is that the question of what is a fair distribution depends, unsurprisingly, on what is being distributed. If we are looking at the distribution of cash income, then people naturally want to take account of individuals' effort and risk in obtaining that income. If our starting measure of income is a broader one, that factors in leisure, work amenity and adjusts for risk, then concern for equality could become prominent.

It is not hard to see the principles identified by Konow playing out in public debate. Mankiw (2010), for example, sees differences in the weights that people place on equality and just deserts as explaining major political fault lines in the United States. Angst over inequality in the United States is focussed more on those in the financial sector —seen as undeserving of their bonuses, especially in the aftermath of the financial crisis —and not people who make more obviously useful things, like Steve Jobs did.

21 But equality may be the dominant distributional principle in the context of friendships and family relations, Konow et al (2009).

A concern for equity and just desserts may also lie behind the interest in social and intergenerational mobility.

These principles, taken separately rather than together, are also reflected in the various philosophical camps: need in the views of Rawls and Sen; equity or just deserts in Robert Nozick's concerns for procedural fairness; and efficiency in the concerns of utilitarians to maximise aggregate utility.

Economics and fairness

Given Treasury's reliance on economics to underpin and give coherence to its policy advice, community notions of fairness can constitute a challenge. Economists typically give weight to efficiency, with perhaps a division between those whose conception is maximising aggregate resources or wealth (broadly understood) and those who seek to maximise aggregate utility (so that distribution is an aspect of efficiency).

Economists and policy makers are also not averse to using proxies and tags to achieve more efficient outcomes, which may sometimes run counter to community views as to what is equitable or proportional.

For example, rather than providing every one with sufficient transfers to ensure a minimum acceptable standard of living which in turn requires high tax rates, a given redistributional goal may be more efficiently achieved (that is, have less effect on labour supply and effort) by providing benefits only to certain groups who are likely to have relatively limited ability to work and are likely to be needful (Akerlof 1978). Old age and having severe disabilities are obvious examples.

Such 'tagging' is one strand of optimal tax theory, which seeks to maximise social welfare by taking account of both the efficiency and distributional consequences of tax and transfer policy settings.

A major area of debate in optimal tax theory is whether and to what extent savings should be taxed: whether the tax system should operate more like an income tax, or more like a consumption or expenditure tax. One argument for taxing savings is that individuals with higher natural ability, who are less likely to reduce labour supply and effort as taxes increase and who can earn higher incomes than others, tend to save more. Taxing savings then acts as proxy for taxing ability.

Old age and severe disability as tags, and savings as a proxy, may not clash with community ideas of fairness, but other tags — such as those based on racial or cultural identity — and proxies may.

Mankiw and Weinzierl (2010), somewhat tongue in cheek, noted that a person's height is also (like savings) positively correlated with underlying ability (and unlike savings is harder to alter) and so having taller people pay relatively more tax than others would be welfare enhancing. But while a height based tax may be 'efficient', even the most hardened public finance economists find the idea of tax based on height disagreeable: it seems strikingly unfair.[22]

22 While it would be unfair for tall people with relatively low ability, it is also the case that current non-height based arrangements are arguably unfair to low ability individuals who work harder or in unpleasant or high risk jobs, as the compensation for lost leisure, low amenity and high risk is typically subject to income tax. But as Kahneman (2011), page 229, notes for a different but analogous case, the '…rational argument is compelling, but it runs against a stubborn psychological reality: for most people, the cause of a mistake matters.'

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