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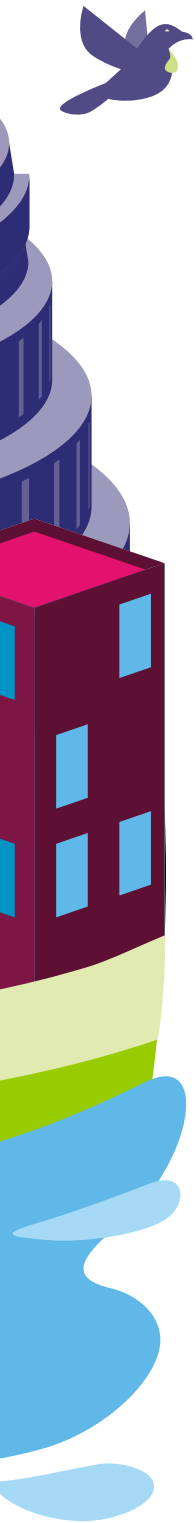
NEW ZEALAND INSTITUTE OF ECONOMIC RESEARCH

State of the State New Zealand 2016

Social investment for our future

Summary Report

Foreword



We believe New Zealand is the best place in the world to live, work and play. Over the years, successive governments have played a significant role in making New Zealand the great place it is today. Our government's finances are in good shape, despite the global financial crisis and the Canterbury earthquakes, and our research shows they are even better when you compare us to other developed nations.

But we cannot rest. New Zealand shares the challenges of an ageing population, low productivity and revenue growth, and the need to reduce government debt, with many other nations. We must tackle these challenges today to maintain our way of life in the future.

More importantly, new data shows that for some of us, life in New Zealand today is not that good at all. There is compelling evidence that too many people in our society are experiencing poor life outcomes, and too many of their children are at risk of following them. If left unchecked, many may be trapped in cycles of disadvantage, creating divisions in our community and placing substantial financial burden on the next generation of New Zealanders.

This new evidence drove us to focus our first *State of the State* report on New Zealanders with poor life outcomes.

As such, we welcome the government's moves to widen the use of the investment approach in social services, including in the recently announced reforms to Child, Youth and Family. It is only by making an impact on the lives of those most at risk of poor outcomes – not just children but across all social services – that we can ensure we maintain all that is good about New Zealand. A long term view is exactly what we need.

The challenges to the wider implementation of social investment are not trivial. Some run into the very culture and fabric of the way our public sector is run and managed. Success requires the government to start taking more calculated risks to push the envelope on the positive difference we can make in people's lives. The key is to ensure lessons are learned from failures as well as successes.

In the six months of research for this report, we spoke to some of the most senior and influential leaders in the public, non-government and private sectors, all of whom provided a unique perspective on social investment. We hope our State of the State report provides you with valuable insights into the financial health of government, and furthers the development and practice of social investment in New Zealand.

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For the full report please visit: www.deloitte.com/nz/stateofthestate

Why social investment?

The population of New Zealand is rapidly ageing

16%

32%

By 2068 the 65+ population will have increased from 16% in 2014 to 32%

2014

2068

A longer living, larger ageing population means increasing health and NZ superannuation

47% GDP

What should we do?

Left unchecked, government spending could reach 47% of GDP by 2060

Spending to rise

Three options

1

Increase taxes

May make working less attractive and encourage tax avoidance

2

Increase debt

Debt could reach 200% of GDP by 2060

3

Find a new way

Move away from spending vs cutting

Social investment

Improve the quality of spending to address fiscal and social problems by improving life outcomes

Crown finances

The government's books are in relatively good shape. But our ageing population will put Crown finances under significant pressure. Social investment may prove valuable in managing this pressure while supporting better outcomes for Kiwis.

Setting the scene for social investment

The New Zealand government's books are in relatively good shape – at least for now. The governments target of returning to operating surplus was achieved in June 2015, the first surplus in seven years. This is an admirable outcome given recent events including the global financial crisis (GFC), the Canterbury earthquakes and the severe drought of 2012-13.

Underpinned by increasing tax revenue from rising employment, wages, labour force participation and net positive migration, government revenue has grown at a compound annual growth rate (CAGR) of 4.0% over the last five years. During this same period, a focus on fiscal restraint has seen overall government spending increase by a CAGR of 0.6%. This relatively modest increase in government spending has mainly been driven by increases in social expenditure such as social welfare, education and health.

Since 2008, New Zealand's net core Crown debt has risen rapidly to around $61 billion or 25% of GDP. In response, government has made reducing debt a priority with a target of bringing it down to 20% of GDP by 2020.

Compared to many other OECD countries post-GFC, the current picture of our Crown finances is a positive one. Other countries still have sizable fiscal deficits while the UK, France, Canada and the US have gross debt ratios in the range of 80-120% of GDP.

But long-term projections of our Crown finances aren't so rosy. Similar to other OECD countries, this is driven largely by our ageing population. By 2038, the number of Kiwis aged 65 and older is projected to nearly double to 1.3 million people and will account for over a quarter of the total population. This trend will continue with those 65 and over reaching 32% of the population by 2068. What's more, the number of people aged 65 and older per every 100 working aged person (aged 15-64) is currently around 22. This dependency ratio is set to rise to 48 by 2068. With relatively fewer people in the working population the income tax base will shrink, meaning there will be less government revenue to support increasing government expenditure on the non-working population.

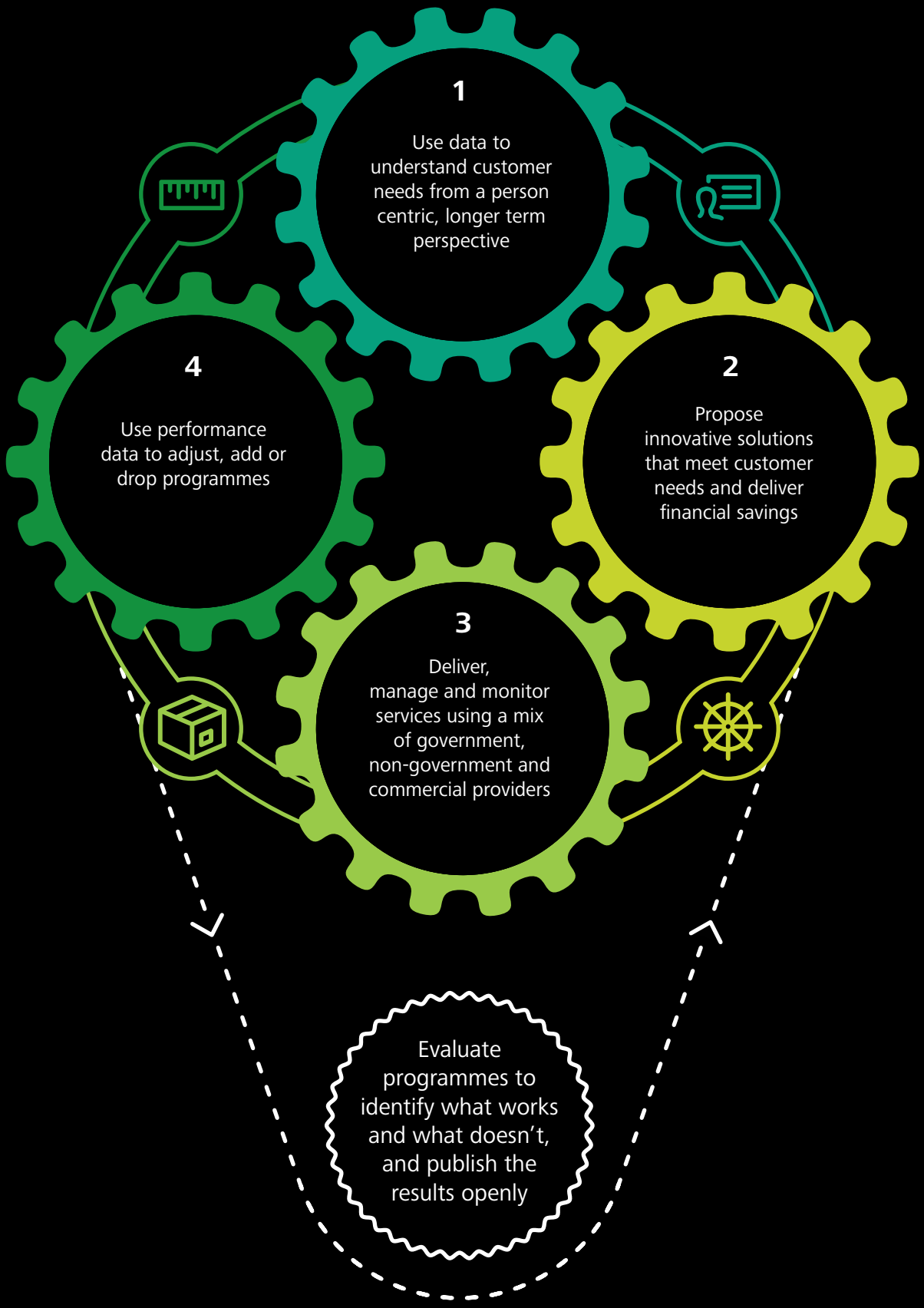
If current spending and taxation patterns were to be maintained, costs associated with the ageing population would push net debt up to as high as 200% over the next 50 years.

It is simply not feasible to let debt as a percentage of GDP rise this high. Doing so would place an intolerable burden on future generations to repay the debt, and the risk associated with the New Zealand economy would depress the currency and push up borrowing costs.

Over the coming decades, this pressure on government resources will require a change in the approach to public spending. In particular, improving the quality of social expenditure will need to be a priority.

Social investment may prove valuable in managing this pressure while supporting better outcomes for Kiwis.

How does social investment work?



A focus on social investment

What is the social investment approach?

The investment approach can be thought of as government activity undertaken on the basis of a return-on-investment justification. Using the investment approach, funding is made available on the basis of:

a) Data quantifying the issue or challenge

b) The likelihood of the proposed interventions to address the issue or challenge

c) Measurement and reporting back to decision-makers on the outcomes achieved by the interventions to enable calculation of the benefits.

The term *social* investment relates to the application of this approach to the social sector.

If there is no change in the way we approach social spending – expenditure on things like welfare, health, education, justice and other social services – government expenditure in the social sector will continue to grow at a rate greater than revenue growth.

The current approach to social spending is largely about funding outputs like more hospital procedures or more prison beds. And previous attempts at fiscal restraint have asked agencies to deliver savings while continuing to provide the same number of, or in some cases even slightly more, of these outputs.

But a new focus on reducing *avoidable* spending asks agencies to go further. The task is not to deliver the next 100 prison beds for the same cost as the previous 50 for example; it is to remove the need for those new prison beds altogether.

The only way to meet this kind of challenge is to consider root causes and prevent the need for these services in the first place.

The evolution of social investment in New Zealand

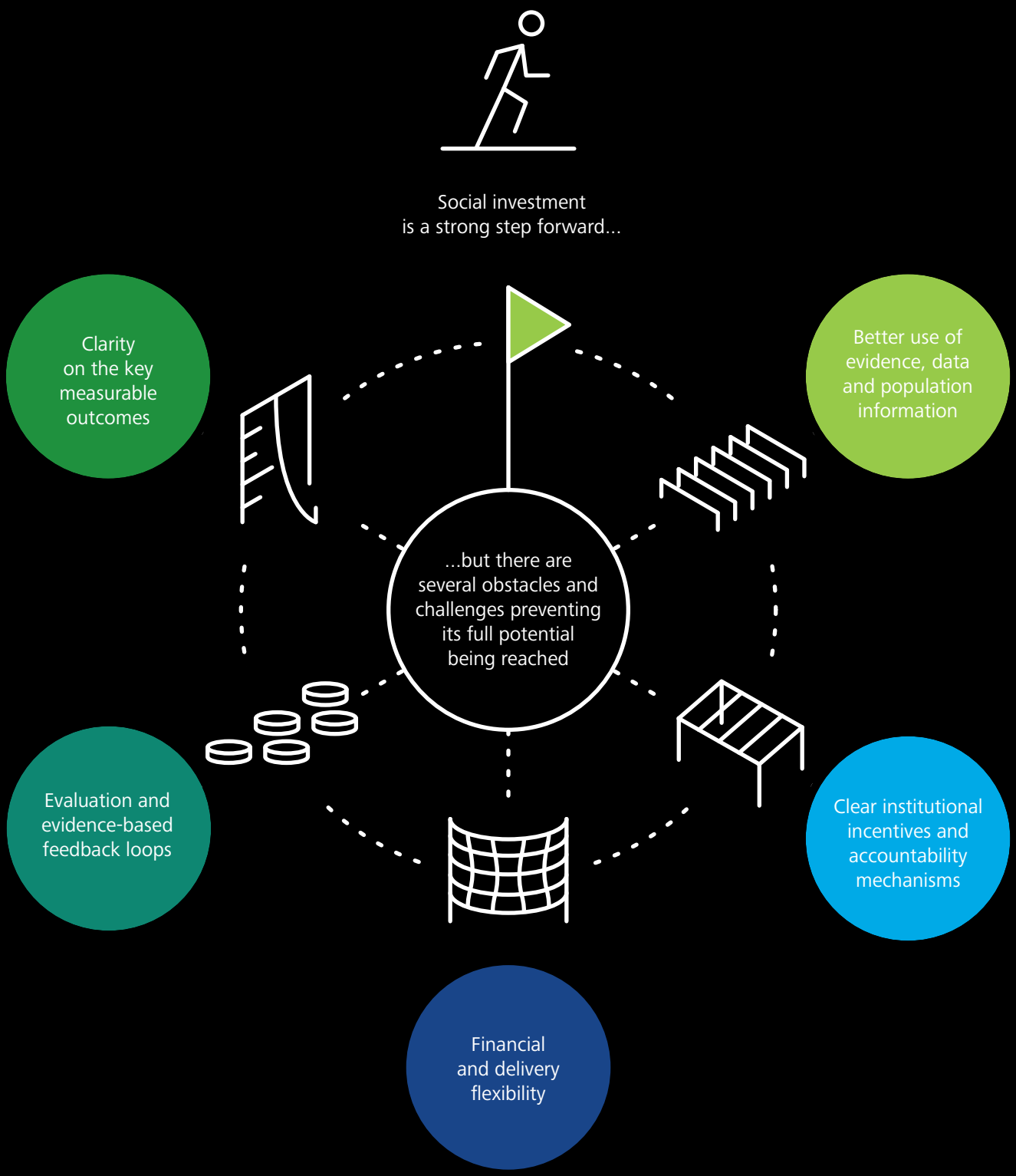
The concept of social investment is not a new one. It was first raised in New Zealand nearly 20 years ago at the Beyond Dependency Conference. More recently, in 2011 the Welfare Working Group recommended an investment-based approach. That same year the government carried out an actuarial assessment of adopting a long-term investment approach which served as the basis of reform.

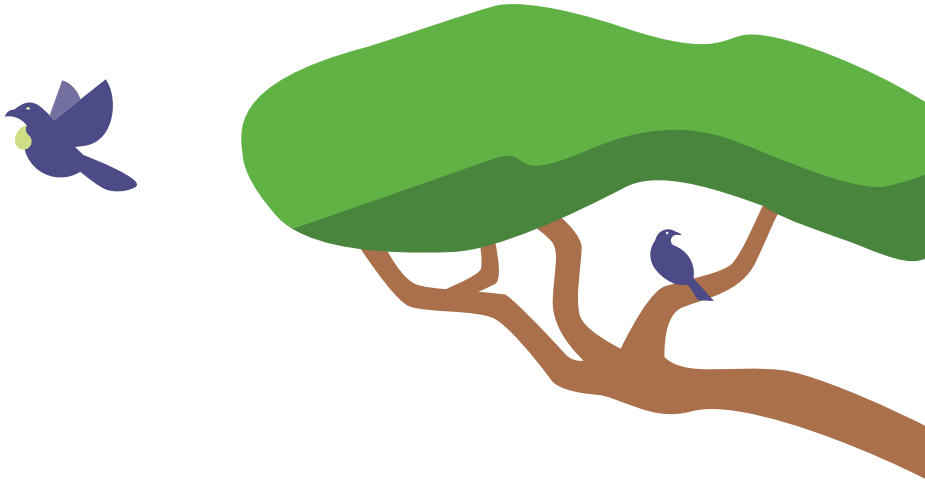
The current government appears to be throwing more weight behind social investment. Recent developments include the creation of a new Social Investment Unit charged with setting data and evaluation standards, developing methods for estimating return on investment, and enabling the safe sharing of data to support better decision-making.

More widespread use of social investment could put New Zealand back at the cutting edge of public sector reform. But more importantly, people who might otherwise be facing a life of poor outcomes and disenfranchisement may be empowered to do better for themselves and their children.

More widespread use of social investment could put New Zealand back at the cutting edge of public sector reform

The challenges to successful social investment





Why a social investment approach matters

While many New Zealanders are flourishing, an unacceptable number of our children, young people and adults experience alarmingly poor outcomes. Current social services do not always address their needs, which can lead to long-term negative impacts.

There is a pressing need to ensure New Zealanders are set up for good life outcomes and supported to be productive and healthy adults.

New Zealand's social sector government agencies each have access to a wealth of data on those they serve. This data shows us, for example, that:

- Children and young people with certain risk factors have a high chance of poor life outcomes. Left unaddressed some of them could cost taxpayers dearly in the long run, but worse still is that the potential of these young people may not be realised.
- Disadvantage often has a regional dimension. For example, while Northland is a region of promise it also has the highest dependency ratio among New Zealand's regions and its rate of youth not in employment, education or training (NEET) is nearly double that of the national rate.
- There is often an interplay of factors. A total of 60% of community-based offenders have substance abuse problems and almost half of all crimes are committed by people under the influence of drugs and alcohol.

New Zealanders are lucky to live in a country with a stable democracy and quality of life envied by most other nations. Everyone should be able to share in the benefits but that means tackling some persistent problems affecting people throughout the country.

The data tells us what part of the problem is. That's the first step. But it doesn't solve the problem – data to help evaluate what works is quite different.

Challenges to the wider adoption of social investment

Social Investment is a strong step forward. The goal is to help people move away from being at-risk to leading happy, productive and fulfilling lives. But as alluring at it sounds, achieving that ideal is not easy.

In addition to our own research, we spoke to more than 20 leaders in politics, the public service, social service delivery, academia and business to get a sense of their thoughts, concerns and ideas on social investment. Through these conversations we identified a number of challenges to the widespread uptake of social investment. We group these challenges under each of the five principles for successful social investment laid out by Treasury in 2014:

1. **Clarity on the key measurable outcomes**
2. **Better use of evidence, data and population information**
3. **Clear institutional incentives and accountability mechanisms**
4. **Financial and delivery flexibility**
5. **Evaluation and evidence-based feedback loops**

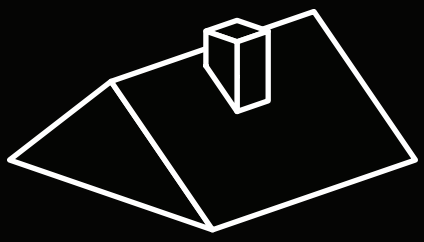
> The goal is to help people move away from being at risk to leading happy, productive and fulfilling lives

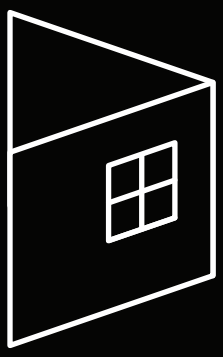
A model for social investment

1

Set the direction and targets for people with poor outcomes

Release, every four years, a government-wide statement that establishes the outcomes and targets for at-risk New Zealanders





2

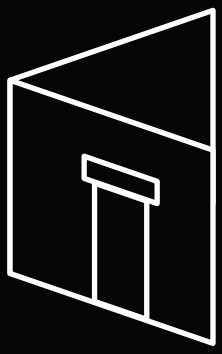
Set up a single agency to focus on people with poor life outcomes

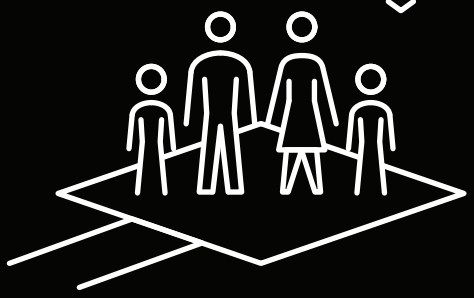
Establish a new agency to commission specialist social services for people at risk of poor life outcomes

3

Run the new agency according to social investment principles

Empower the new agency to 'own' the liability, and automatically retain a share of the savings for re-investment in new programmes





4

Enable access to data

Share information on what works and what doesn't, and link up agencies and service providers with the data they need to deliver better services

Recommendations

Today, social investment is like a start-up – a small number of people are working incredibly hard to bring a big, bold vision to life. Tomorrow, social investment needs to become a mainstream way of working.

We propose a package of reforms to realise the aspiration for social investment in New Zealand. These proposed reforms represent a clear departure from today's operating environment for the social sector. We suggest a structural reconfiguration that some will find challenging, while acknowledging we don't yet have all the answers.

Recommendation 1
Release, every four years, a government-wide statement to define the outcomes and targets for at-risk New Zealanders

Recommendation 2
Establish a new agency to commission specialist social services for people at risk of poor life outcomes

Recommendation 3
Embed the social investment approach to funding quality and sustainability in the new agency's operating model

Recommendation 4
Enable better access to government-held data and detailed evaluation reports

Find out more – access the full report

This is a summary of Deloitte and NZIER's State of the State 2016 report. To access the full report, entitled *State of the State New Zealand 2016: Social investment for our future*, go to:

www.deloitte.com/nz/stateofthestate

The full report includes more in-depth research on the social investment approach in the New Zealand context, including a supplementary section investigating additional topics around the people and place of social investment.

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