

The Treasury

Potential Impacts of Welfare Reform Information Release

19 December 2012

Release Document

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MINISTRY OF
SOCIAL DEVELOPMENT
Te Manatū Whakahiato Ora



THE TREASURY
Kaitohutohu Kaupapa Rawa

Joint MSD/ Treasury Report: Impacts of Welfare Reform

Date:	14 June 2012	Report No:	Treasury report number: T2012/1179 MSD report number: REP/12/06/545
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Forward a copy of this report to the Minister for Employment, for his information	Thursday 14 th June 2012
Minister for Social Development (Hon Paula Bennett)	Note	Thursday 14 th June 2012

Contact for Telephone Discussion (if required)

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<i>Withheld under s(9)(2)(a)</i>			✓

Enclosure: No

Joint MSD/Treasury Report: Impacts of Welfare Reform

Purpose

- 1 This paper provides a revised estimate of the potential impacts of the Government's welfare reform package. It updates the preliminary estimates provided in late 2011, to account for developments in the policy platform, changes in the economic outlook and improvements in the evidence base and modelling methodology. This report was prepared jointly by the Treasury and the Ministry of Social Development (MSD).

Overview

- 2 This paper updates earlier modelling of the potential impacts of the Government's welfare reform package. This work has been carried out jointly by MSD and Treasury and represents our best professional judgement of the range of likely impacts of welfare reform.
- 3 The estimates in this paper cover:
 - the youth package and youth pipeline initiatives
 - changes to work obligations, which are to be introduced from October 2012
 - changes to the design of benefits, obligations, and settings, to be introduced through the second welfare reform Bill and implemented in July 2013
 - the move to a long-term investment approach to welfare
 - the less tangible, but vital, impacts of messaging, organisational drive and implementation.
- 4 Overall our estimate is that the welfare reform package could result in a reduction in the number of benefit recipients of between 28,000 and 44,000 by 2016/17, and an additional 3,000 – 6,000 beneficiaries in part-time employment. This is in addition to the reduction in working age beneficiary numbers of approximately 25,000 forecast in BEFU 2012, prior to policy decisions being explicitly built in (the baseline forecast).

	2012/13	2013/14	2014/15	2015/16	2016/17
Reduction in benefit numbers Low impact (difference from baseline estimate)	2,000	8,000	16,000	22,000	28,000
Reduction in benefit numbers High impact (difference from baseline estimate)	4,000	14,000	25,000	35,000	44,000

- 5 Based on our modelling, if this is achieved it will result in savings to Vote: Social Development of between \$0.992 and \$1.609 billion over the four years to 2016/17.

	\$m - increase (decrease)					
	2012/13	2013/14	2014/15	2015/16	2016/17 and out years	Four years to 2016/17
Net fiscal change, Low impact scenario	(12.914)	(80.997)	(195.670)	(312.324)	(403.370)	(992.361)
Net fiscal change, High impact scenario	(36.099)	(148.160)	(322.020)	(500.430)	(638.182)	(1,608.792)

- 6 These impacts have two main components:
- **“policy impacts”** – estimates of the impacts of implementation of each of the most significant policy changes, and
 - **“package impacts”** - estimates of the less tangible, but vital, impacts of messaging, organisational drive and implementation.
- 7 Estimates of the policy impacts are based on the best international and New Zealand evidence we have about the effects of similar programmes. In the case of the high impact scenario, these impacts would represent exceptional success. The policy impacts represent around one-third of the total impact.
- 8 The *package impacts* are estimated in addition to the policy impacts, and recognise that there could also be significant gains to be had from a new and evolving approach to service delivery over time. These changes will be based on an investment approach that improves how Work and Income works with beneficiaries over time, and a strong operational focus on achieving lower benefit numbers. They also pick up any impacts arising as a result of public messaging of the changes to welfare, the level of public acceptance and the political and organisational momentum behind the reforms. The ‘package impact’ represents around two-thirds of the total impact.
- 9 There is uncertainty around both the policy and package impacts because they depend on implementation, changes to delivery, and the eventual design details of the investment approach (which is being developed jointly with the Board). The package impacts are particularly difficult to estimate, because they are about driving better performance through improved understanding over time and shifting from lower to higher quality investments.
- 10 The results presented are in line with our previous estimate of \$1 billion in savings over four years and a 28,000 – 46,000 reduction in beneficiary numbers, but they relate to a later time period, and reflect a slower phase-in of the anticipated benefits of welfare reform.
- 11 The number of people on welfare is dependent on the underlying economic assumptions (regardless of whether welfare reform is undertaken or not), which are based on the BEFU 2012 forecasts. Analysis from Treasury has highlighted that the impact of the underlying economic and historical trend assumptions could be as great as the impact of welfare reform over the period. So, for example, a more delayed return to the economic and labour market conditions we saw before the global financial crisis, could result in the baseline estimate of beneficiary numbers being 25,000 higher than if there were an

immediate return to pre-2007 conditions (regardless of whether welfare reform is undertaken or not).

- 12 The reforms are also expected to encourage more people to actively look for employment, which will increase the labour force participation rate and temporarily raise the unemployment rate. The Treasury has estimated a temporary increase in the unemployment rate of around 0.4%. This impact is similar to the existing margin of error in unemployment rate estimates from the Household Labour Force Survey.
- 13 Around \$135 million of forecast savings resulting from changes in Bill 1 were included in Budget 2012. We are working through the method for including the Bill 2 savings associated with specific policy interventions into future forecasts.

Recommended Action

It is recommended that you:

- a **note** the final estimates of the impacts of welfare reform contained in this paper, and
- b **forward** a copy of this report to the Minister for Employment, for his information.

Fiona Carter-Giddings
Team Leader
The Treasury

Sue Mackwell
Deputy Chief Executive
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Ministry of Social
Development

Hon Bill English
Minister of Finance

Hon Paula Bennett
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Joint MSD/Treasury Report: Impacts of Welfare Reform

Introduction

- 14 The experience of welfare reform in New Zealand, Australia, the US and the UK is that reform can result in significant reductions in the number of welfare recipients, particularly when it includes changes to expectations, incentives and delivery and it occurs during periods of solid economic growth.
- 15 This paper estimates the potential impacts of the Government's welfare reform package, including:
 - the youth package and youth pipeline initiatives
 - changes to work obligations, which are to be introduced from October 2012
 - changes to the design of benefits, obligations, and settings, to be introduced through the second welfare reform Bill and implemented in July 2013
 - the move to a long-term investment approach to welfare, and
 - the less tangible, but vital, impacts of messaging, organisational drive and implementation.
- 16 This work builds on officials' initial estimates of the impacts of welfare reform in November 2011 and subsequent estimates of the impacts of Bill 1 policy changes which have been included in BEFU 2012.
- 17 The estimates in this paper use updated macroeconomic assumptions, an improved evidence base, improved modelling methods and the most up-to-date information available about the final policy package and service delivery model.
- 18 The estimates are of fiscal savings and off-benefit outcomes. We have not estimated the wider economic and social benefits that may accrue from these reforms, such as improved health status associated with being in work or possible reductions in child poverty.

How we have modelled the impacts of welfare reform

The overall approach

- 19 Modelling the aggregate impacts of a package of reform as complex and wide ranging as the Government's welfare reform agenda is challenging. We have approached this task in a systematic and evidence based manner, but both New Zealand, and the welfare reform package, are unique in many ways, and the available evidence and experience often does not directly match the changes being modelled. This has meant that the informed use of judgement has been necessary.
- 20 The most important factors that will drive the outcomes of welfare reform include the nature of policy change, the economy and the way reform is delivered (including the level of resourcing). Also, while these are hard to isolate, factors like the impact of messaging on beneficiaries, the degree of public acceptance, organisational focus and drive, are also important.

- 21 Our modelling seeks to account for each of these factors by grouping them into two types:
- **“policy impacts”** – estimates of the impacts of each of the most significant policy changes, and
 - **“package impacts”** - estimates of the less tangible, but vital, impacts of messaging, organisational drive and implementation.
- 22 The *policy impacts* represent our best estimate of what each of the specific policies, initiatives and proposals could reasonably be expected to deliver in terms of reduced benefit numbers and lower fiscal costs over time.
- 23 The *package impacts* are estimated in addition to the policy impacts, and recognise that there could also be significant gains to be had from a new and evolving approach to service delivery over time. These changes will be based on an investment approach that improves how Work and Income works with beneficiaries over time, and a strong operational focus on achieving lower benefit numbers. They also pick up any impacts arising as a result of public messaging of the changes to welfare, the level of public acceptance and the political and organisational momentum behind the reforms. We have drawn on evidence from a range of programmes in modelling the package impacts:
- New Zealand’s welfare reforms in 1998-99 and Australian Welfare to Work changes for sole parents, to model the impact of changes in the number of sole parents on a benefit.
 - The experience of a range of targeted programmes used by Work and Income (for example the Job Search Service and Future Focus changes).
 - The experience of ACC in the late 2000s and Work and Income’s focus on Unemployment Beneficiaries in the early 2000s.
- 24 The package impacts account for approximately two-thirds of the total estimated impacts of welfare reform. The estimate is therefore inherently uncertain as it depends on implementation and relies on the shape of an evolving model of delivery based on the investment approach. It is particularly difficult to estimate the additional impact this approach will have with precision at this stage as it is fundamentally about developing understanding over time, using feedback loops and trials, and shifting from lower to higher quality investments. This model will be developed over the next few years jointly with the Board and Ministers.
- 25 Due to the level of uncertainty involved, and the varying degrees of impact estimated in the available evidence, in each of these cases we have estimated a range, from low to high. All the estimates represent challenging targets. The high estimates involve a considerable degree of aspiration, and should be recognised as an exceptional result, if achieved.
- 26 More detail about the modelling assumptions used is provided in the Appendix.

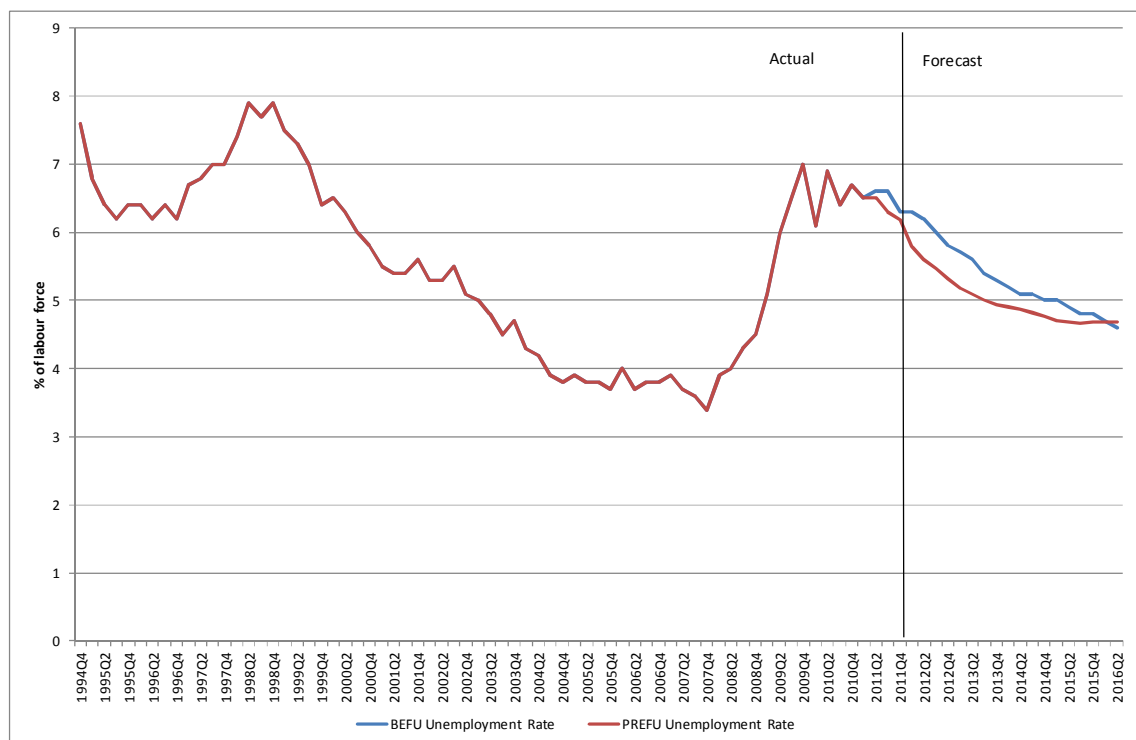
Accounting for the economy and labour market

- 27 The modelled impacts are attributable to the welfare reform changes, and are in addition to any reduction in benefit numbers that are expected from existing service delivery and economic growth (a reduction of 25,000 working age beneficiaries over the forecast horizon). However, the additional reduction due to welfare reform will depend, in part, on the state of the economy and labour market. While measures to increase the

movement of people into work, through combinations of incentives, service delivery and changed obligations are expected to have an impact irrespective of the economic cycle, this impact may be higher when the labour market is in expansion than when it is stagnant or in contraction.

- 28 Since the PREFU 2011 forecasts, when the initial impact work was carried out, the outlook for the unemployment rate has deteriorated and it is now expected to drop below 5.5% one year later than previously anticipated (see figure 1 below). This potentially means that the labour market will be more constrained in its ability to provide jobs. We have explicitly accounted for the latest economic growth and unemployment forecasts by introducing more gradual sequencing of impacts (see Appendix), which now sees the full impacts of the reforms in place only from June 2015.
- 29 Analysis from Treasury has highlighted that the impact of the underlying economic and historical trend assumptions could be as great as the impact of welfare reform over the period. A more delayed return to the economic and labour market conditions we saw before the global financial crisis, could result in beneficiary numbers being 25,000 higher than if there were an immediate return to pre-crisis conditions – an impact in the same order of magnitude as our low-end welfare reform projections.
- 30 If economic growth and job creation is weaker than currently forecast, this would also mean that the initial impact of welfare reform would be toward the lower end (or below) the estimates in this paper, (particularly in the short term) and the achievement of the impacts estimated in the paper would take longer to be realised. Conversely, stronger than forecast economic growth may boost the impact of the package.

Figure 1: Pre-Election Economic and Fiscal Update (PREFU) vs Budget Economic and Fiscal Update (BEFU) unemployment rate forecasts



Accounting for the implementation model

- 31 The implementation of welfare reform is critical if the impacts estimated in this paper are to be achieved. We have accounted for the implementation of welfare reform in two ways:
- the policy impacts assume a base level of implementation, backed by an appropriate level of resourcing (for instance, the estimate of impacts arising from the work tests for sole parents assumes that resources are available to administer work testing and provide associated support, and
 - the package impacts include an element of ‘aspiration’ and implicitly assume the ability to lower case loads for groups of beneficiaries through a more active model for more beneficiaries delivered by Work and Income or through contracted services.
- 32 The results in this paper are not intended to provide a detailed cost-benefit analysis of specific provisions or service delivery approaches being proposed. However, if an appropriate level of resources (either additional funding or from within existing resources) to administer the work tests and other policy changes, including for case management and systems changes and services is not available, we expect that the estimated impacts may be toward the lower end (or below) the estimates in this paper.
- 33 A key element of the delivery model that impacts on the off-benefit outcomes is a more active approach to people receiving the new Jobseeker Support benefit. This more active delivery model is assumed to include a pre-assessment and triage process prior to benefit receipt and an early focus on work for some people and a more intensive reassessment process for more people.
- 34 The investment approach is an important contributor to the “package effect.” This will mean developing new approaches for groups with high life-time benefit costs (such as sole parents with younger children and people on the Supported Living Payment). For this approach to be successful, funding and other resources will need to be moved from less successful programmes and transferred to more successful employment programmes, services and assessments. A critical first step for success is that there is an ongoing assessment of the relative effectiveness of programmes and approaches that feeds into decision-making about where to invest resources within current baselines.
- 35 Similarly, to reach the upper end of our estimates will require cross-government effort, with resources and effort applied in support of the objectives of welfare reform, particularly in the health and education sectors.

Results

- 36 The results presented here are in line with our previous estimate of \$1 billion in savings over four years and a reduction in the number of benefit recipients of 28,000 – 46,000. They do, however, relate to a later time period, and reflect a slower phase-in of the anticipated benefits. Approximately two thirds of these impacts are “package impacts” with the remainder directly attributable to the policy changes.

- 37 The potential impacts relate only to impacts directly on Vote: Social Development, and do not account for increases in spending on Working for Families tax credits, or corresponding increases in income tax revenue.

Potential Reductions in beneficiary numbers

- 38 Our estimate is that the welfare reform package could result in a reduction in the number of benefit recipients of between 28,000 and 44,000 by 2016/17, and an additional 3,000 – 6,000 beneficiaries in part-time employment.
- 39 The impacts by year are shown in Table 1 below, and are in addition to the reduction in working age beneficiary numbers of approximately 25,000 forecast in BEFU 2012 (the baseline estimate).

Table 1: Potential reductions in benefit numbers

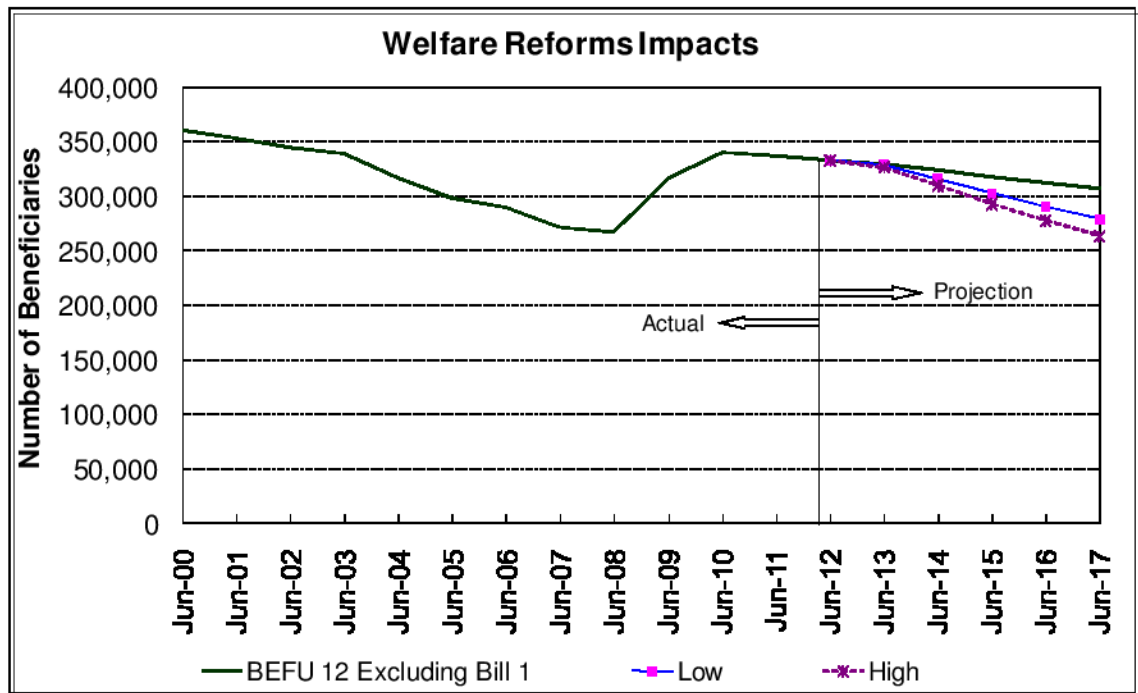
	2012/13	2013/14	2014/15	2015/16	2016/17
Reduction in benefit numbers Low impact (difference from baseline)	2,000	8,000	16,000	22,000	28,000
Reduction in benefit numbers High impact (difference from baseline)	4,000	14,000	25,000	35,000	44,000

- 40 Table 2 below shows the impacts on welfare recipient numbers in the 2016/17 year, broken down by major package component:

Table 2: Breakdown of potential impacts on beneficiary numbers in the 2016/17 year

	Policy impacts	Package impacts	Total off benefit impact due to Welfare reform	Underlying change in benefit numbers excl. welfare reform	Increase in number of beneficiaries in part-time work
Low scenario	10,000	18,000	28,000	25,532	3,000
High scenario	18,000	26,000	44,000	25,532	6,000

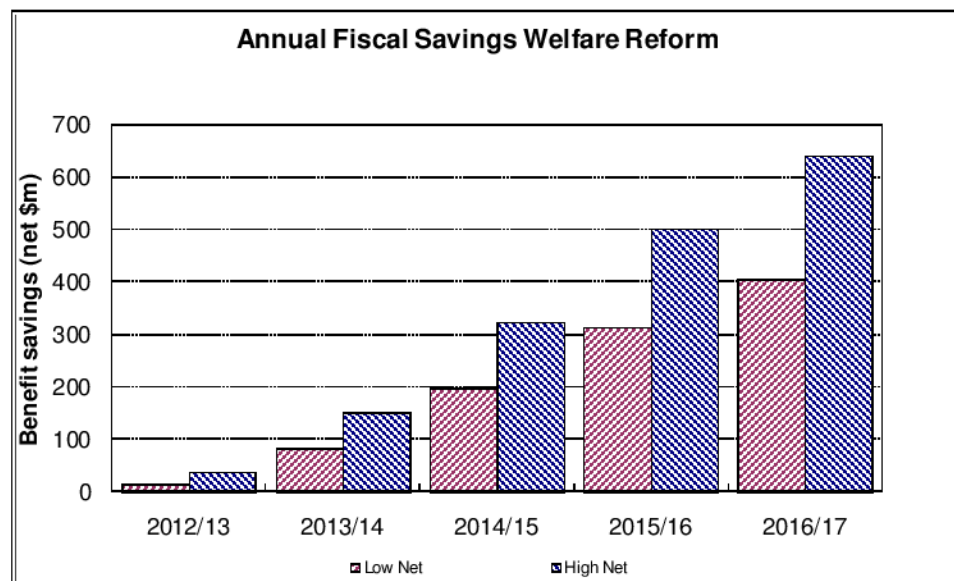
Figure 2: Potential impact on working-age benefit numbers due to Welfare Reform



Reductions in fiscal costs

- 41 The fiscal savings to the Crown from reductions in welfare costs are estimated at \$0.992 to \$1.609 billion over the four years to 2016/17. We have shown the savings over the period to 2016/17 to ensure compatibility with the Half Year Economic and Fiscal Update, where some of these savings may be reflected. The corresponding five year totals are \$1.005 to \$1.645 billion.

Figure 3: Potential Savings (net) from benefit expenditure due to Welfare Reform.



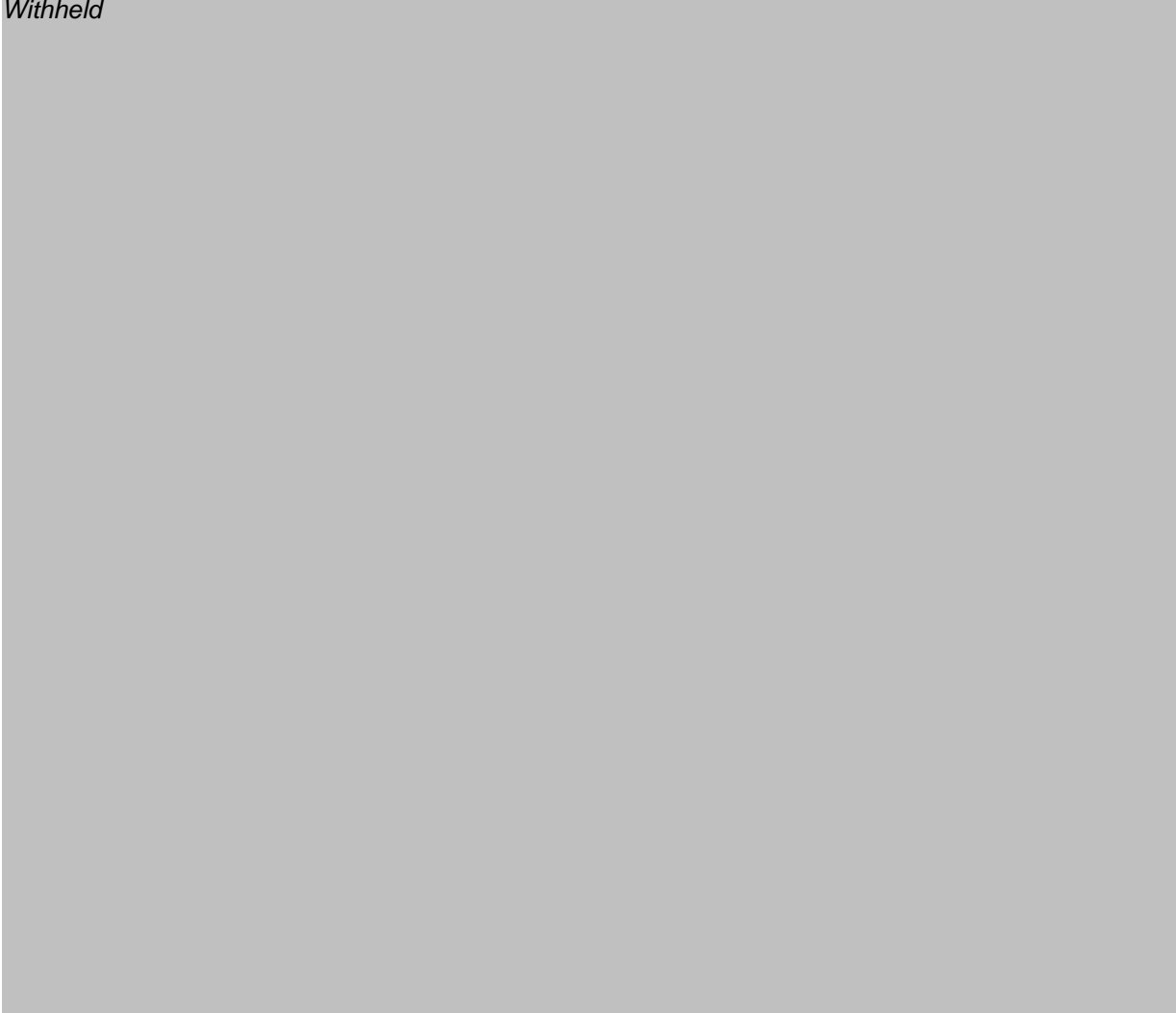
42 The overall year-by-year impacts illustrated in the graph above are shown below:

Table 3: Potential fiscal savings, net

	\$m - decrease					
	2012/13	2013/14	2014/15	2015/16	2016/17 and out years	Five Year Total
Net fiscal change, Low impact scenario	(12.914)	(80.997)	(195.670)	(312.324)	(403.370)	(1,005.275)
Net fiscal change, High impact scenario	(36.099)	(148.160)	(322.020)	(500.430)	(638.182)	(1,644.891)

43 *Withheld*

Withheld



Comparison with Welfare Working Group estimates

- 44 The Welfare Working Group (WWG) estimated that welfare reform could result in up to 100,000 fewer beneficiaries receiving benefits after 10 years, and a 25% reduction in the forward liability. These estimates were framed as aspirational goals.
- 45 The figures in this paper are not directly comparable to this estimate because:
- the WWG estimate covers a 10-year timeframe
 - they are based on a different package – the Government package does not include all of the recommendations of the WWG
 - the WWG recommended high levels of investment in services (between \$215m and \$285m per annum between 2012-13 and 2016-17), and
 - the WWG impacts were based on a scenario where there was no decline in benefit numbers in the absence of welfare reform.

- 46 Although the WWG's headline figure was for 100,000 fewer beneficiaries by 2021, their estimates for June 2016 are much closer to ours. A comparison of the WWG estimates and our own is provided in the table below.

	WWG Estimate	MSD/ Treasury Estimate	Part-Time Employment (MSD/ Treasury estimate)
Low scenario	26,000	28,000	3,000
High scenario	64,000	44,000	6,000

Other impacts of welfare reform

- 47 The purpose of welfare reform is to encourage and support more people to look for and move into employment. When fully implemented, the welfare reforms can be expected to increase the labour force participation rate and employment.
- 48 As a result of this increased participation, there may be a temporary increase in measured unemployment, reflecting more beneficiaries actively searching and being available for work.
- 49 The Treasury has undertaken some initial estimates of the likely scale of this impact, based on an assumption that the job search rate of sole parents and some Sickness Beneficiaries will rise to the same level as Jobseeker Support recipients. If this happens it could increase the labour force participation rate by 0.3 % and the unemployment rate could temporarily be around 0.4% higher than otherwise. The impact on the BEFU forecast rate of unemployment would be that instead of the unemployment rate declining to 4.6% by June 2016, it would decline to around 5%.
- 50 For comparison, according to Statistics New Zealand the Household Labour Force Survey, which the unemployment rate is calculated from, is subject to sampling errors of around 6.1%. This means that (with a 95% confidence interval) the March 2012 quarter unemployment rate of 6.7% could be as high as 7.1% or as low as 6.3% - a margin of error roughly the same size as the estimated impact of welfare reform.
- 51 This estimated impact is expected to be temporary. The OECD and others conclude that increases in the supply capacity of the economy do result in increased level of economic output and particularly that increases in the size of the labour force do result in increased employment levels.¹

Treatment of Welfare Reform savings in forecasts

- 52 MSD and Treasury advise that the Bill 2 welfare reform savings will be within scope for inclusion in forecasts after final policy decisions have been made and more information about implementation plans and funding is available. The low end estimate of \$127 million for policy initiatives in Bill 2, provided above provides a reasonable estimate of what could be achieved from reform, but further work is required to determine what is included in the HYEPU 2012 forecast.

¹ OECD (2005); OECD Employment Outlook, page 178. Schioppa, F (ed) (1991) Mismatch and Labour Mobility; Layard (2000); *Welfare to Work and the new deal*.

- 53 The remaining policy and package impacts represent the additional gains from improved operational performance, including better targeting of resources, a greater focus on supporting more people into work (within existing policy frameworks), and a greater focus on early intervention in getting people into work (“package effects”). Evidence of this improved operational performance will be observed as changes are made to implement the investment approach over the next three years, and these impacts will be included in forecasts as evidence emerges. This approach is consistent with that used in ACC, where measures of improved operational performance are only included in forecasts as evidence of improvement is observed.
- 54 Policy and implementation decisions have previously been taken on youth initiatives and the welfare reforms contained in Bill 1. Bill 1 impacts have been included in BEFU 2012 forecasts, because there was sufficient certainty about decisions taken and the implementation plans.

Impacts and monitoring the implementation of welfare reform

- 55 Over the next 6-12 months, MSD and Treasury will be developing an approach to monitoring the implementation of welfare reform. A range of measures of performance will need to be developed, including estimates of the long-term liability and the numbers (and durations) of people on benefit. The impacts presented in this paper will be used to inform the expectations of what can be achieved from welfare reform.

