

The Treasury

Budget 2012 Information Release

Release Document

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THE TREASURY

Kaitohutohu Kaupapa Rawa

Date: 7 May 2012

To: Minister of Finance

Aide Memoire: Incorporating Welfare Reform into Benefit Forecasts for Budget 2012

Purpose

This aide memoire explains how welfare reform changes have been incorporated into benefit forecasts in Budget 2012 and at the 2012 Half-Year Update. In particular we note that savings flowing through into the Budget forecasts from Bill One are \$70 million lower than the early scenario modelling previously provided to Cabinet, impacting the near zero Budget for 2012.

Background

You will shortly receive revised five-year forecasts of Benefit expenditure for Vote Social Development. These have been updated to reflect the Treasury's new economic forecasts, the most current information on benefit recipient numbers, and changes to policy and service delivery.

The Bill One welfare reform changes have been agreed by Cabinet and will therefore be reflected in benefit forecasts for Budget 2012 where there is reasonable certainty about the level of costs or savings. Previous scenario modelling had indicated that welfare reform Bill One (including Youth Package and Youth Pipeline) could deliver approximately \$205 million in savings over a four-year period (comprised of both direct policy impacts and behavioural impacts).

BEFU 2012 Benefit Forecasts

The reforms affecting working-age beneficiaries (i.e. changes to work-test requirements for many Domestic Purposes and Widows benefit recipients, changes to work test rules for some beneficiary spouses, and new activation policies), will be reflected in the Budget 2012 forecasts for all fiscal years from 2012/13 onwards. The "low impact" scenario for the impact of changes to work-testing and activation for working-age benefits will be incorporated, consistent with previous scenario modelling.

The difference between previous scenario modelling and the BEFU forecasts lies in the youth component of Bill One:

- Youth Payment: MSD is taking a conservative approach, given the current evidence base and that many of the contracted services associated with this are yet to be put in place. The direct impact of transferring people from the Independent Youth Benefit and Emergency Maintenance Allowance has been

incorporated but, reflecting uncertainties; no benefit savings from possible behavioural changes have been included¹.

- **Youth Pipeline:** Behavioural savings associated with assumptions around how successful implementation of the Youth Pipeline could reduce the eventual inflow of at-risk youth who are not engaged in employment, education or training into working-age benefits accounted for around half of the scenario modelling for savings associated with the Youth Package. These savings have not been incorporated into the Budget forecasts, because the initial estimate was based on scenarios and the services associated with the Pipeline that are not yet fully in place.

The Youth Package and Youth Pipeline service delivery and payment costs are reflected in the BEFU forecasts.

The combination of revised Youth Package and Youth Pipeline forecast savings results in a \$70 million difference between BEFU forecasts and those previously modelled:

Table 1: Forecast Benefit Expenditure Impact from Bill One changes

	Previous Scenario Modelling (4 year impacts)	BEFU Forecasts (4 year forecasts)
Welfare Reform changes (i.e. DPB, WB, UB etc)	Benefit Savings: \$122 million - \$272 million <i>This range reflects the low and high impact scenarios forecast in the Cabinet paper</i>	Benefit Savings: \$135 million ²
Youth Package and Youth Pipeline³	Benefit Savings: approx \$83 million <i>This figure was an upper estimate that included scenario modelling around assumed behavioural changes. We note that the figure is not net of service delivery costs.</i>	No behavioural savings have been incorporated. <i>Higher costs associated with the Youth Payment (e.g. incentive payments and childcare) mean that a benefit expenditure net cost of \$50.3 million over four years was incorporated in the Budget forecasts.</i>
Total Welfare Reform Bill One Savings	\$205 million⁴	\$135 million

¹ In the scenario modelling undertaken, these behavioural savings correspond to around \$40 million over four years.

² Based on the low-impact scenario from previous modelling, updated to account for CPI changes and several other small changes

³ Further scenario modelling was undertaken since these estimates which show higher savings from the Youth Package. However the \$83 million is the most frequently referenced number so was used for clarity in this instance.

⁴ Low-impact welfare reform scenario plus Youth Package and Youth Pipeline savings.

The lower than anticipated savings impact on the government's near-zero Budget for 2012. As a result of these changes, the total impact of Budget 2012 is net spending of \$26.0 million across the period 2011/12 to 2015/16.

Youth Package and Youth Pipeline savings were not incorporated into Treasury's final fiscal forecasts, and so do not have an additional impact on the government's overall return to surplus in 2014/15. The latest benefit numbers for the final BEFU forecasts show a further decrease in total benefit expenditure of \$179 million and these more than compensate for the absence of Youth Package and Youth Pipeline savings in the BEFU forecasts.

Treasury supports the BEFU forecasts. They represent a conservative estimate of the benefit savings associated with welfare reform Bill One. We agree that Youth Package and Youth Pipeline savings estimated last year were based on a preliminary scenario and that further work is required before their behavioural impact is included in forecasts.

While the Youth Package and Youth Pipeline savings may be reflected in HYEUFU when there is more certainty about their possible magnitude, the downward revision does highlight the risk associated with using forecast savings to pay for welfare reform.

HYEFU 2012 Benefit Forecasts

There will be a general update of the 2012 Budget forecasts in November. This will incorporate all information that is available at the time these forecasts are prepared, including any impact that the Youth Package and Youth Pipeline are having on benefit recipient numbers.

Welfare reform Bill Two decisions will also be agreed before the half year update, and some level of savings will therefore be reflected in the forecasts. Service delivery changes, a key component of the impact of welfare reform, will likely be reflected over a longer timeframe. This is because these savings are more uncertain and will therefore be included in forecasts as MSD achieves reductions in benefit numbers and a reduction in the forward liability.

Welfare Reform Evaluation

As part of the evaluation of welfare reform, MSD will evaluate the Youth Package and Youth Pipeline for NEET changes. MSD will estimate the impact of the changes including any fiscal savings that may result from these changes, and expects to have interim impact results 18 months after the July 2012 implementation.

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