Social investment: chance for a mentality shift

Revisiting a 2015 working paper

Colin James, Treasury seminar, 7 March 2016

This is not an ex-cathedra pronouncement from high academia. It is a my exploration as a journalist. It updates my June 2015 Institute for Governance and Policy Studies working paper [James 2015] in the light of subsequent policy and commentary. Constructive comments are welcome.

Making a road is an investment. The return on that investment is the use people make of it personally and for earning income. Building water supply, waste water and sewage disposal systems are investments which deliver returns to people in various ways, including irrigation, manufacturing and energy and people's sustenance and health. Likewise the electricity generating and distribution system.

Roads and water and electricity systems are capital. We invest in and maintain them because we get a return on the capital invested.

Likewise, ecosystems are capital. They provide food, water and atmospheric services that are critical to our wellbeing – indeed, our existence. Logic suggests strongly that we should invest in and maintain the ecosystems on which we depend to ensure the services they provide continue.

Well built, well-maintained roads, water, electricity and ecosystems are positive for the economy as well as for the society that operates that economy. They are infrastructure, social and economic. We have at times learnt that there is an economic and social cost if we do not maintain that infrastructure and expand it commensurately with population growth and activities. The government has required subnational governments and, more recently, itself to plan ahead for 30 years to counter the put-it-off-for-another-year syndrome that afflicts revenue-constrained councils and governments and amounts to a transfer between cohorts and even generations. Proper national, regional and local balance sheets require that investment and maintenance are accurately accounted for. The same goes for a proper government balance sheet, which I understand the government is now aiming for.

We have been slower to recognise that ecosystems are social and economic infrastructure. Consequently we have been slow to recognise the value and necessity of accounting properly for maintaining and, where necessary, restoring ecosystems – that is, maintaining our stock of natural capital. We have only fairly recently begun to realise the actual and potential future cost of not maintaining this natural infrastructure. But that is now on the agenda, not at cabinet level, where the presumption is still "the economy or the environment" but increasingly among the public and even increasingly in business. There is a nascent, growing recognition that individuals and firms which degrade or exploit ecosystems without maintaining them are in effect charging an economic rent, which Adam Smith correctly deplored.
We are now also beginning to learn that there is a cost in social fragmentation and division. This cost is political and, as a consequence, economic.

The political form of the cost is populism, evident across Europe and North America where politicians and parties have been mining frustration, resentment, fear, stress and anger. Complacent commentators trapped in decaying orthodoxies told us Donald Trump would in time succumb to Republican party supporters' rational calculations and the party establishment's management. But the Tea Party tapeworm in the

Republican party's gut has consumed nearly all its nutritious moderate conservatism. The Republicans used to settle for 70% of their wishes, as the sainted Ronald Reagan did, but now insist on 99%, epitomised in Ted Cruz. The immoderate Trumpet calls to ex-middle-Americans or still-just-middle-Americans are in harmony with their grumping that their country has been stolen by the elites, illegal Mexican migrants, Chinese exporters, panderers to blacks, gays and worse and much else. Similar sets of gripes have given Britain the Jeremy Corbyn Labour party and the United Kingdom Independence party, France the National Front, Spain Podemos, Greece Syriza, Poland the Law and Justice party, Scandinavia rightwing rejectionists and many other anti-parties. These have a core of believers in their widely varied ideologies but they have grown fat on frustration, resentment, fear, stress and anger.

The social cost of such populist "against-ism" is irreconcilable division. The economic cost comes by way of erratic policies, which in time constrain economic growth – growth already constrained, some research, including by the OECD [*OECD 2015*], suggests, by three decades of rising inequalities of income and wealth. That in turn suggests there is economic value in policy which reduces societal divisions – in addition to the obvious social value in personal and group wellbeing.

If there is economic and social value in social cohesion, should the nation logically invest in building and maintaining it? That is, are not the structural forces for cohesion in a society infrastructure? If so, do not the same principles apply as for roads, water, electricity and ecosystems?

Social cohesion does not imply sameness. Individual humans are physically, genetically, attitudinally, aspirationally, emotionally, culturally and ethnically different. Promoting social cohesion involves reducing inequalities that are the result of a society's omissions or commissions, so that there are no arbitrary, human-made obstacles to all individuals playing as full a part as they choose in society and, logically, the economy. Arbitrary obstacles may include a bad start in life because of defective parenting, an accident or illness not of a person's making, a catastrophic economic, natural, criminal or military event or policy settings that work against some people. I wrote about this in 2012. It is on my website. [*James 2012*]

This is what the term "social investment" implies, on my reading. That reading implies a shift in policymakers' mentality. "Spending" is palliative and in the moment. It eases the symptoms and both physician and patient get remission. "Investment" is constructive and for the future. The investor gets a return and the person invested in gets the durable asset of a more nearly whole life.

I was first brought to the entrance to this track a decade and a-half back by Peter Hughes, and his minister at the time, Steve Maharey. Hughes was then chief executive of the Ministry of Social Development (MSD) – in itself an ambitious title for a government agency, implying making something, not just ministering to ills. Maharey was a minister who liked ideas. Hughes was trying to get the Treasury to think differently but at the time thinking differently was not a core Treasury performance objective. I mentioned to Helen Clark that I had been talking to Maharey about this and she frowned and stomped off down the corridor. "Investment" was a word capitalists used. Clark was accommodating her liberal-left preferences to the necessity of capitalists to produce the wherewithal for her redistributive ambitions. But she preferred her social policy to have nobler terminology, though every and then she did use the word for early childhood education and the like. Maharey rang me later to say she had been on the phone to him asking what on earth he was doing. Hughes' idea was anaesthetised.

It took a small-time capitalist – if that is what farmer Bill English can be called and I accept that is debatable – to give the idea ministerial momentum. Welfare Working Group Paula Rebstock (not yet a Dame), alerted me early in 2011 to the impending inclusion in the group's report of an actuarially-based investment approach for beneficiaries, where I duly found it. The first cabinet application of this import from accident compensation insurance was announced at the National party conference in June, aimed at 16-and-17-year-old teenagers at risk of starting adult life unemployed and staying that way.

This "forward liability investment approach" is well known to policy analysts. The fiscal cost of a lifetime on a benefit is actuarially calculated and the avoidance of that future cost is the return from investing in intensive case management to get the beneficiary into work and keep her/him in work. It has since been widely applied to beneficiaries and is to be applied elsewhere in the support system, including, for example, to address recidivism in those discharged after prison sentences.
The Australian firm of Taylor Fry, which did the original actuarial calculations has assessed future lifetime net savings of $12 billion as a result of the first four years of application of the approach. As Bill English put it in a speech on 25 February, "this equates to welfare customers spending 900,000 fewer years on benefits over their working lifetimes compared with pre-reform expectations. That's the equivalent of 60,000 people each spending 15 fewer years on a benefit". [*English 2016*] Among the potential and claimed benefits other than fiscal savings have been: staff feeling better about their work when they stop someone's benefit-work-benefit door from revolving; the personal boost to the wellbeing of those worked with in this way (assuming, of course, the net-of-costs income from their work are at least equal to their income as beneficiaries and there are not other costs like too little time with children); and, down the track, potentially better adjusted children of those helped who can get educated, get a job and set up a virtuous circle.

The approach and its application were described by Damian Edwards, who manages its application in MSD, and Eric Judd in November 2014. [*Edwards 2014*] I summarised that in my July 2015 IGPS working paper [*James 2015*]. Very briefly, Edwards and Judd said the approach: gave MSD the ability to disaggregate impact of action and policy changes from wider economic impact; had enhanced decisions on which case management service to stream clients to and which additional services and supports they should get and prompted trials to find better ways; and had inspired a deliberate shift from a primary focus on efficiency to effectiveness. But they said it would be far more powerful if coordinated across all key agencies that interact with the family, including health and corrections. Others said some agencies were at that time not providing enough data to do that.

A prominent critic of the forward liability investment approach has been and is Simon Chapple, a former MSD chief economist. I summarised his May 2013 critique [*Chapple 2013*] in my IGPS working paper. Among his many and detailed points were: that a cost-benefit approach would value each reduction in welfare benefits at 20 cents (the deadweight cost of taxation) and each dollar of earnings at a dollar whereas the forward liability approach valued the asset at zero; that income redistributed from the better off people to beneficiaries would have a higher utility value because beneficiaries had a greater need for the income; and that there was a utility value to citizens from living in a society they perceived as more socially just.

Another critic last year was by Bill Rosenberg, in a paper issued by the Council of Trade Unions, of which he is the policy director, and in a brief article for *Public Sector*. [*Rosenberg 2015a and 2015b*] Rosenberg found a "fundamental flaw … it looks only at costs to the government and at nothing else". "It fails to take a balanced investment view." He added: "Being employed is not always the best outcome for beneficiaries." Examples of such suboptimal outcomes he gave included: a sole parent pressured to put her children into care and take a job; not all jobs being equal; and the "exit rate is a poor measure of quality" because staying on a benefit could enable acquisition of higher skills, so better employment later (and, Rosenberg didn't add, higher tax payments). Rosenberg said there were limitations in assessing the forward liability, among them modelling errors and confusion of correlation with causation, that they were based on past experience and that "social welfare and many other public services are inherently long-term. It takes many years to see the effects of policies and policy changes." And, he said, "it treats citizens as liabilities unless they are employed and even then they are not regarded as assets."

Derek Gill, who wrote an article for *Public Sector* alongside Rosenberg's, took a positive view. He did note limitations: "It can only tell you who to interact with, not what to do or how to do it. It can't provide insight into the receptivity to change of the target group." But Gill said the "early results are encouraging", the "potential gains from adopting a longer-term view are considerable," "with big data we can discover which services work for whom" and the approach made it "possible to measure the marginal added value". Gill argued that it "is clearly much better than a simple transactional efficiency measure" as a proxy for things society cares about. [*Gill 2015*]

The Productivity Commission, in its report on social services in September 2015 also found promise. The net fiscal benefit measure "differs from a full measure of social and economic costs and benefits, yet it is a legitimate measure for governments to focus on" and a reduction in future fiscal liability "can often be taken as a (somewhat conservative) measure for future social benefits" and "is a significant improvement on traditional approaches". The commission saw scope for wider application and recommended the Treasury pursue work it had begun to "apply an investment approach across agencies and to appraise budget proposals for social services". It backed contracting out to "some organisations that are better placed than (the) government to manage and reduce those (financial) risks". [*Productivity Commission 2015*] Contracting out was one of Rosenberg's fears.

A couple of months after the Productivity Commission report Tony Burton posted a Treasury working paper in November. [*Burton 2015*] He categorised the forward liability investment approach as "a financial measure of primarily non-financial outcomes, not an attempt to replace the non-financial objectives of the welfare system", as, he said, some critics thought. Burton said the actuarial approach "provides transparency and accountability, not a mechanism to replace political decision-making" – that is, it is a tool, not an end in itself. The accountability and feedback and the data the feedback provided could be used at all organisational levels to refine and improve interventions. These were not covered in usual cost-benefit evaluations. Burton drew a parallel with "active, usually 'Nordic' models of welfare" by contrast with "passive 'Anglo-Saxon' models".

Burton did acknowledge one of the risks many critics have focused on: that staff might focus on the easy wins, the beneficiaries most likely to get and keep jobs. And he acknowledged a risk identified by Chapple, of focusing on the fiscal "proxy" instead of the outcome that is being proxied.

All of those commentaries focused on the "forward liability investment approach". But is that really "investment"? Is the government being unambitious?

Well, in 2014 Bill English changed the terminology. He started calling it "social investment". The Treasury developed a section on its website under that name and Nick Carroll heads a social inclusion team.

But is all this still just a fiscal exercise? Or is it investment as a capitalist or a householder would understand the word?

I asked an eminent academic economist for a definition of investment. It was: "the reservation of resources from production for current consumption in order to generate greater consumption in the future". This generates assets, which are the "accumulation of investments less depreciation".

A practising mainstream economist put it more simply: "the procurement of an asset with the expectation of a return." A research economist was even simpler: "something you do today that will have a payoff tomorrow."

Apply these various formulations to a firm. A firm sets aside some of its current profits – or draws on others' accumulated profits or assets in the form of loans or equity – to invest in assets (equipment or a licence and so on) which enable it to lift output and make more profits. The accumulated assets and profits make up its capital. A householder who takes out a mortgage forgoes some material consumption to pay down the mortgage and gradually acquires more of the house (though mortgage payments can also be said to be consumption in the form of accommodation, that is, in effect rent). When the mortgage is fully paid back, the householder ends up with the whole of the asset.

The mortgage and the investing firm's loans or equity are funds brought in from outside. Forgone consumption or reinvested profits are internally generated.

So far the "forward liability investment approach" – Bill English's "social investment" – has been funded entirely or very nearly entirely out of forgone consumption, that is, by using funds which had previously gone on some other activities.

This is in keeping with English's drive for "more with less". Funds going into activities which produce outcomes judged to be of lesser value are diverted into activities which produce outcomes judged to be of greater value. In numerous recent speeches, most recently in his annual speech to the Institute of Public Administration, he sees mining increasingly fine-grained and voluminous data as a particularly useful way to find out who are the "most vulnerable", from whom the greatest return will be obtained if they are rescued from their vulnerability. Intervention should focus on those people.

The way that higher return is measured is the actuarial estimate of future fiscal savings. These savings might be thought of as an asset, which might be drawn on for other good public works or invested in a sovereign wealth fund like the Cullen fund or returned to taxpayers.

But what if at some point "more with less" turns into "less with less": that programmes which produce positive results for those they help are cut in order to fund the actuarially-determined higher-priority ones and funds overall are cut. There is some reason to think that may have begun, judging by complaints by not-for-profits about funding squeezes and some other mutterings around town. In that event the fiscal savings would be illusory and hardly describable as an asset. (There might well also at some point be a populist "against-ist" reaction, described earlier, which would likely be counterproductive and might even wipe out the savings.)

In the business world a firm might mine one profitable – asset-creating – activity to put funds into a more profitable activity. More likely it would want to keep both profitable lines and borrow or raise more capital by issuing shares. The householder with the mortgage could choose to cut to the bone spending on food, clothing and treats for children but is more likely to accept a slower path to full ownership of the house asset, which would in effect be borrowing the difference.

In the real world of firms and householders there is not an overwhelming enthusiasm for less with less. (Though some greens to argue for a version of it.)

There is another "more" dimension: not more funds but more agencies. Bill English – as did Edwards and Judd back in 2014 – also argues for pooling data from different agencies to, as Edwards and Judd put it, "understand the drivers of not only welfare dependency but also of housing, education and heath needs". That just states the obvious: that meeting one need may go nowhere if other intersecting needs are not also met. Agencies need to work together and that needs not to be just at the shopfront level but in the chief executives' suites.

That takes us to "better public services" phase 2, which, as I understand it, is aimed at developing more complex "targets" or "outcomes" which can only work if there is real, actual, serious, patch-sharing cooperation at chief executive level (and their squabbling ministers). Such outcomes will also be much more difficult to measure. And who gets the bottom line credit? Right now, if the health sector contributes to someone spending less time on the dole, it is MSD that gets the credit in the form of the future fiscal savings. That will need attention.

This wish – and need – for wider integrated thinking and action opens up topics beyond the scope of this tentative exploration. But it does take us to the Treasury's living standards framework, which puts natural, social and human capital alongside financial and physical capital and balances economic growth with managing risks, sustainability for the future, social cohesion and increasing equity.

Girol Karacaoglu, chief economist at the Treasury, wrote a working paper last year on using the living standards framework in which he defined the "object of interest for public policy as intergenerational wellbeing". [*Karacaoglu 2015*] Karacaoglu described the source of wellbeing as "comprehensive consumption" which included "marketed consumption goods as well as others such as leisure, arts, health services and consumption services provided by nature". He said consumption was sourced from "comprehensive wealth, which comprises stocks of capital assets" which included economic, human, natural and social capital.

The measure of success implied in this approach is not *flows* but the *stocks* that result from the flows: whether those stocks increase or decrease and the impact of stocks changes on potential future flows. Karacaoglu said the "purpose of public policy is to ensure that the wellbeing-generating capacity of capital assets is sustained or enhanced".

If Karacaoglu is right, then the measure of "social investment" is whether it builds or runs down human and social capital. This is a much broader, more demanding and more difficult to measure than future fiscal liability, which is just about financial capital. It is to think in terms of stocks, not just flows. And that opens the opportunity to think differently about social assistance policy and to take "social investment" beyond a narrow fiscal savings focus to building assets.

In this context, recall Tony Burton's insistence in his paper that the forward liability approach is a measurement device, not an objective-setting one. Simon Chapple and Bill Rosenberg would likely disagree but let's explore it. What logically should the objective be?
Bill English's Catholic instincts have a role here. As with Catholic Jim Bolger in the 1990s, there is a part of English that bothers about deprivation and its damage to those he thinks "vulnerable". In this he has alongside him his wife, Mary.

I am less clear about whether in giving some rein to this instinct English's objective is to palliate the damage done by "vulnerability" or to invest in and build future assets. Is it genuinely "social investment" in the sense of investing in social infrastructure, in the human and social capital, to increase social cohesion by increasing the potential for all to take a full part in society and, as appropriate, in society's economic activities? I suspect that is a stretch too far for English and for most policymakers.

Education has long been thought of as investment in the individuals educated, generating a return in the form of more productive individuals, personally and socially as well as economically, and consequently a more productive society. In very general terms this is so, though it is unclear who does, or should do, how much of the investing and who gets, or should get, what in return. There is now recognised to be scope for a forward liability approach to be applied to pinpointing where additional and remedial teaching effort would produce the greatest return, especially among those who do not now get educated and end up a social support cost, not a taxpaying benefit, a liability, not an asset.

Health policy is now essentially geared to defeating disease and repairing damage resulting from accidents and failure of body parts. If instead there was investment in young people, particularly at-risk cohorts, to reduce accidents and avoidable physical degeneration and prevent mental deterioration, that would reduce a future liability and also build an asset.

Housing policy is essentially geared to putting a roof over the heads of those who can't afford a market rent or to buy. The part it could play, if the houses were all healthy, in building an asset in the form of taxpaying parents and educable, less-sick children does not seem yet to be a core consideration.

In forward liability terms, all this comes back to the avoidable future cost of social support, in benefits and houses, remedial education and avoidable health repair, not to mention prisons (which have become our mental asylums in these enlightened times). There is a task ahead of the forward liability programmers to allocate better the costs and returns among the government intervention streams so all chief executives see value for money.

There is also a time-of-intervention dimension. The earlier the diagnosis of vulnerability, to use Bill English's term, of deprivation and lost opportunity, the bigger the reduction in later fiscal liability. That focuses us on the first years of childhood or even, as Sir Peter Gluckman argues, the two years before birth. The Dunedin longitudinal study headed by Richie Poulton has produced evidence of coincidence so detailed that causation can be confidently inferred.

But what is the forward liability reduction then measuring? The timespans from birth to death are mind-bogglingly long, far past any reliable actuarial estimate.

That points us towards an objective of building assets – a "forward asset investment" approach, in which the assets are not co-benefits, as in Edwards and Judd's paper and the Productivity Commission report, but people with real opportunities in life and, as a likely result, a more cohesive society. Resetting the objective as building assets would amount to a fundamental change in the mentality of policy analysts and policymakers: from "spending" to "investment", from reallocating existing resources – "more with less" – to applying additional funds – "more with more". The capitalist system Bill English admires could give him some clues. So could those who borrow to buy a house.

Moreover, applied imaginatively by those on the Labour-Green side of politics, it could validate the sorts of interventions they favour. And, indeed, some on that side are opening up cautiously to this possibility. The prize for supporters of the welfare state is that it could be converted into the wellbeing state and made respectable.

Of course, there are many caveats. Are ministers good investors? Not if you look at the failure to invest in MetService and Landcorp where good returns are to be made or to borrow and invest in the well-performing Superannuation Fund (to, by the way, reduce a forward liability). The long timeframes involved raise issues of defining the right discount rate to assess net present value of future assets, of managing changing voter attitudes and of dealing with disjunctive shocks, including technological change. There would also be difficulties defining the proxies needed for hard-to-quantify and impossible-to-quantify externalities and other intangible assets.

That suggests that it would not be simple to shift the focus from avoiding a liability to building an asset – or, as Tony Burton would have it, changing the objective that forward liability actuarial estimates are expected to measure. It would be prone to mistakes and errors that undermined public confidence. So any shift of objective would first pick "low-hanging fruit", as Bill English puts it and then proceed incrementally. A speedy, and so risk-prone, shift in which things go wrong could deligitimise the asset-building and lead future politicians and policymakers to retreat to safety.

But too slow development would carry its own risk. The sceptics would continue sceptical and even build their case for a dismantling. Many would continue to see Burton's measuring stick as the actual objective: to reduce the numbers helped regardless of merit.

This leaves more questions than answers. But good policy comes from fronting complex questions with insight, imagination and a dash of daring. So with real "social investment", investment that builds a cohesive society of full participants.

The challenge is to shift from addressing deficiencies to building durable, serviceable infrastructure assets. For roads and water, that is under action. For ecosystems, the challenge is starting to be outlined. Why not social cohesion?

And if focussing on asset-building were to be built into policy thinking, that could amount to a fundamental change in policymaking mentality which could be applied in many other fields. Fundamental change is scary. But if all capitalists had been averse to change, including risky change, we would not be nearly as prosperous. Maybe there is a lesson for risk-wary public servants (including those squabbling ministers).

It is that potential for a mentality shift that I first thought I saw in Peter Hughes' investment notion a decade and a-half back and in Paula Rebstock's alert to me in 2011. Could it open a new way of thinking about and doing public business? That is the opportunity I see in "social investment". It goes a long way beyond the Treasury website's version. It promises a different set of rules at a time when technology and globalisation are taking us into a different world that will require a different set of rules. Or am I just away with the cuckoos?

Being a journalist, all I have is questions. The answers are for policymakers.

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with different socio-economic backgrounds, the gap widens in high-inequality countries as people in disadvantaged households struggle to access quality education. This implies large amounts of wasted potential and lower social mobility."

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