Defining social investment, Kiwi-style

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Authorship

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Key points

The current New Zealand Government is following a "social investment" approach to improving the lives of disadvantaged New Zealanders.

The background to this approach is widespread agreement that for a small proportion of New Zealanders, improved economic performance has not been reflected in improved living standards and life chances, despite years of active policy interventions and considerable social spending. Further, there is limited evidence about the impact of current programmes.

Social investment, Kiwi-style, represents an internationally unique approach in designing and implementing social policy.

Investment is applying resources today in the expectation of earning a return tomorrow. We define social investment as "a programme funded by the Government that entails applying resources today in the expectation that a measurable improvement in a dimension of policy interest will result at some point in the future".

New Zealand isn't the only country using a social investment approach but while many approaches to social investment have been developed, social investment as practiced in Europe (where it is most predominant) presents some consistent themes. In general, it is applied very widely across the government's activities, encompassing issues and themes such as gender equality, knowledge economy, youth unemployment and income redistribution.

Since the early 1930s, successive New Zealand governments have based social policy on the idea that the state could provide for the basic needs of families through uniform approaches. Basic needs could be met with universal programmes. This approach has however not proven successful in addressing the needs of and providing equality of opportunities for New Zealand's most vulnerable.

The New Zealand social investment approach can be best described by its three innovative features which work intimately together.

The first is **client segmentation**: identifying groups and individuals with very specific needs by using administrative data more effectively. This is a move away from the uniform approach to policy of the past.

The second is **intervention innovation**: tailoring interventions to better address the specific needs identified through client segmentation, setting very clear expectations about the returns sought from the intervention and measuring those returns. There is a clear shift in focus away from broad programmes covering large groups of people (e.g. the unemployed, single mothers, the injured, the disabled, etc.) to designing interventions that are focusing on specific clients with specific characteristics.

The final and perhaps most novel but least developed feature of the social investment approach is a new mode of **governance**. Client segmentation and intervention innovation are respectively the demand and supply side of the social investment approach, but without a structure which allows for and rewards risk taking in investing and learning what works, the social investment approach is merely a continuation of the past supplemented by better access to data. The governance and institutional change made possible by client segmentation and intervention innovation is necessary for the full implementation of the social investment approach in New Zealand. What institutional changes are required is still uncertain and needs significant attention from policymakers for this policy to succeed.

Some aspects of the New Zealand social investment approach are not new and largely are a re-labelling of existing polices. There are, however some new, and internationally unique aspects, together with a clear intention to address long-term policy problems using new analytical and measurement tools to both define target populations and test results.

Contents

Figures

Tables

"When I use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean—neither more nor less."
Lewis Carrol
Through the Looking Glass

1. Introduction

The New Zealand Government has named its current approach to social policy “social investment”. A name is label that identifies something. When that thing is a social policy, what it does and how it affects peoples’ lives, rather than what it is called, is what matters. However, especially at the early stage of a change in policy approach, being clear about what a proposal means is important, if we are to avoid confusion and, worse, not proceed with a worthwhile change because of a misunderstanding about the meaning of words. Knowing whether a new name has simply been attached to old policies will provide insights into the likelihood of success of that policy.

1.1. Theories, actions and rhetoric

Government is hard, and there are rarely clear-cut, simple solutions to easy-to-identify problems. The craft of public policy has evolved to help governments make good decisions, first by defining what “good” means and then developing techniques to test alternatives.

Having a clear analytical framework – a way of thinking about the world – is part of good policy analysis. Theories built on a solid analytical base that seek to articulate an approach to thinking about and solving policy problems are but one part of the **political** process of policy- and law-making. While it is often possible to point to linkages between policies, laws and practices and ideas from the academic literature, in many cases those linkages can be tenuous and might be the result of ex-post rationalisation.

While governments often have preferences for certain modes of thinking about issues and acting, claims that any government is always consistently applying a clear analytical framework that was carefully and systematically developed and applied rigorously across a wide range of activities are likely to be overblown. Even in small countries like New Zealand, with a single layer of sovereign government and a unicameral parliament that is traditionally dominated by the executive, policy consistency is never absolute.

Governments do, however, frequently apply broad labels to their approaches as a way of both communicating with voters and justifying what they are doing by appealing to objective science and rational analysis. While ideas like “protecting property rights”, “respecting the rule of law”, “a hand-up, not a hand-out”, “board-base, low rate tax systems” and the ever popular “what works” are very useful guides to narrowing the range of options to be considered, they are not a complete policy solution in their own right.

1.2. The current government's social investment approach

In a series of speeches in 2015, the (then) Minister of Finance[1], the Hon Bill English and his Associate, the Hon Paula Bennett said that the New Zealand government is applying a "social investment" approach to welfare: "Our goal is to shift from social spending to social investment".[2] A "Social Investment Unit" has been established, a website launched[3] and staff appointed. The Treasury's website also has a section on social investment[4] and its latest Statement on the Long-term Fiscal Position[5] was accompanied by the release of a paper on social investment.[6] In her role as Minister of Social Development, Ms Bennett launched an "Investing in Services for Outcomes" programme within her portfolio June 2012, which has been carried on by her successor and has been renamed the "Community Investment Strategy".[7]

In a speech delivered in September 2000, the then Minister of Social Services and Employment, the Hon Steve Maharey, also laid claim to using a social investment approach: "Ours is a social investment model. It involves community, strong institutions and a dynamic market economy. It is about extending economic opportunity. And it is built on security not fear."[8]

Despite Cabinet specifically stating what it considers the social investment approach to be[9], there is no shared understanding within the New Zealand policy community about what the 2015 version of social investment involves (as we note below, there is also a limited consensus in the literature about what precisely the term means[10]). After interviewing stakeholders from politics, the public service, social service delivery, academia and business, NZIER and Deloitte earlier this year observed that: "Over the course of this research we found there was no consensus on the definition of a social investment approach".[11]

In part, this lack of a clear understanding comes from the very diverse set of goals that Ministers have said that they are seeking to achieve through a "social investment" approach. For example, in a speech in Melbourne in 2015, the (then) Minister said that

1 Since we started writing this paper, Mr English has assumed the office of Prime Minister, with Ms Bennet as his deputy. In his first press conference on being elected leader of the National Party, however, Mr English explicitly stated that the government he leads will give priority to advancing the social investment approach and he has appointed the Hon Amy Adams as Minister Responsible for Social Investment.

2 English (2015b).

3 www.siu.govt.nz.

4 http://www.treasury.govt.nz/statesector/socialinvestment

5 Treasury (2016).

6 Burton et. al. (2016).

7 See https://www.msd.govt.nz/about-msd-and-our-work/work-programmes/investing-in-services-for-outcomes/ for details.

8 https://www.beehive.govt.nz/speech/social-welfare-new-zealand, accessed 17 October 2016.

9 Following submission of a paper by the Ministers of Finance and State Services in December 2015, Cabinet agreed the following statement of what the social investment approach would be:

> *Social Investment puts the needs of people who rely on public services at the centre of decisions on planning, programmes and resourcing, by: a) Setting clear, measurable goals for helping those people. b) Using information and technology to better understand the needs of people who rely on social services and what services they are currently receiving. c) Systematically measuring the effectiveness of services, so we know what works well and for whom, and then feeding these learnings back into the decision-making process. d) Purchasing results rather than specific inputs, and moving funding to the most effective services irrespective of whether they are provided by government or non-government agencies.*

See the Social Investment Unit's website at: https://www.siu.govt.nz/about-us/the-social-investment-unit .
Compare this with the following statement from Treasury staff (Burton et al 2016):

> *"social investment" denotes the variety of policies that improve outcomes by applying evidence-based investment practices to social spending to improve the fiscal and non-fiscal returns from government's investment in social services*

10 See Jensen (2009) for a review.

11 Deloitte and NZIER (2016), p.15.

the government was seeking: greater 'social mobility', more 'resilience' for 'vulnerable people', 'fewer customers' and less 'demand for public services', 'fewer dysfunctional families', 'fewer people who commit crime' and 'reductions in recidivism', less welfare dependence, a greater ability for those on benefits 'to make choices', a broader 'range of organisations and providers', a more accountable welfare state and 'smaller government' (English, 2015a).[12]

For some, an investment approach that genuinely involves applying resources now to achieve a return in the future is new and innovative and has much to recommend it:

> *[social investment involves] 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.*[13]

Others are less complimentary:

> *[t]he "Investment Approach" being taken by the Ministry of Social Development (MSD) is a narrow and flawed one. It fails to take a balanced investment view. It is better viewed as a one-dimensional performance indicator rather than a systemic approach to policy and evaluation.*[14]

Our motivation is to describe what the government is proposing in New Zealand today and them compare it with the sorts of policies usually called a "social investment approach" in the literature and with the "social investment" approaches other countries are following to see if there is anything new in what the government is proposing. If it isn't new, then it is unlikely to be any more effective than the status quo.

1.3. Outline

We begin by defining some terms, like "investment", "social" "return on investment" and discussing how the rate of return thus defined can be measured, using the lens of economics.

We review the theory and concept of social investment contained in the literature and locate the New Zealand approach within this theory.

New Zealand is not the only country to say that it is using social investment as an approach to social welfare. We examine the approaches used in other countries and compare them to both the developing New Zealand social investment approach and the traditional New Zealand welfare state.

Next, we briefly scan of the development of social policy in New Zealand, to put the current discussion in context. We then outline what the New Zealand government has said represents a "social investment" approach to social policy and its core components. We conclude with an initial assessment of whether social investment, as proposed by the New Zealand government, represents a new approach.

12 We thank Jonathan Boston for identifying these different objectives.

13 James (2016). James is also sceptical about whether what the New Zealand Government is proposing is actually an investment approach. See James (2015).

14 Rosenberg (2015).

2. Defining some terms

In this section, we discuss and define some terms that will appear frequently in the remainder of this paper.

2.1. Investment

"Investment is capital formation – acquisition or creation of resources to be used in production".[15]

While capital originally was restricted to the idea of physical capital – machines – we now apply this label to a wide range of concepts: intangible capital (ideas, knowledge, patents); human capital (the skills and attributes people possess), social capital (trust, reciprocity, information, and cooperation associated with social networks) and natural capital (renewable resources like water and fish and ecosystem services – the ability of the environment to support life) are examples. These types of capital share the same core concepts: they can be used (often in combination with labour, other intermediate inputs and each other) to produce goods and services of value.

Capital is enduring: it lasts more than a single period of time and its use does not lead to its disappearance.[16] Here, the contradistinction is with a consumption good, something that provides benefits in a single period and is fully consumed during use. Using some goods involves a mixture of both consumption and investment. This is especially the case with many social policy interventions. Receiving counselling is an example: it can provide immediate benefits, as well as helping people to live better after they have left the counsellor's office. Even food can be a mixed good: being well nourished can lead to other experiences, like education, providing more enduring benefits. Consumption can also be enduring from the point of view of gratification: fond memories can linger for years.

Capital can be formed through investment: putting resources that could be used today towards future benefits. Investment is costly – resources that could otherwise be consumed have to be directed into building capital.

2.2. Interventions as investments

As we will see in the section on the history of social policy in New Zealand, many early government social interventions were designed to address immediate needs and were in the nature of consumption goods, reflecting Colin James' observation, cited above, that *"spending is palliative and in the moment".* They were designed to give people the material wherewithal to carry out their daily lives, focusing on curing some defect in the market (insufficient employment, low wages, poor quality housing, expensive education), rather than correcting a deficiency in human or social capital.[17] The focus was very much on now: addressing a pressing need for immediate assistance, often in

15 Coen and Eisner (2008).

16 Capital can, however, depreciate – through use, it wears out and there is a minimum amount of investment – determined by the rate of depreciation – that has to be applied to maintain the productive capacity of a stock of capital.

17 To be fair, ideas like human and social capital are of recent origin. Human Capital was developed in the 1950s and 1960s by economists Theodore Schultz and Gary Becker. See Schultz (1961) for a discussion of his early work. Becker (1962) is one of his early contributions and it appears in a special edition of the *Journal of Political Economy* devoted to the idea of "investing in human beings". The idea of social capital is even more recent, having been developed in the 1990s: see Adler and Kwon (2002) for a review.

the form of transfer payments (cash). Implicit in this is the belief that people could lead a life of value if only they had sufficient financial means.

The shift from seeing social policy interventions as solely addressing immediate needs to providing enduring benefits that would offset long-term costs was a progressive one and it is beyond the scope of this essay to trace that development fully, although we note some of the key developments in New Zealand below.

2.3. Social

The dictionary says that "social" is an adjective meaning "of or relating to society or its organisation".[18]

2.3.1. Social investment

"Social investment" often uses the adjective "social" to describe investments in people that are financed or implemented or co-ordinated by government agencies. It also expresses the idea that the investments, while beneficial to those being invested in also benefit "society as a whole". As Weber noted in 1922, it is common, but in his view wrong, to talk about "social collectives, such as states, associations, business corporations, foundations, as if they were individual persons"[19]. Thus, in this context, the collective – all of us – are said to benefit from social investments in an individual.

This is not however, an approach that meets with widespread acceptance within economics. The focus of modern mainstream economics is on the consequences of outcomes for individuals, as opposed to groups.[20] "Social" is often used in contradistinction to "private", with distinctions made between private costs and benefits and social costs and benefits, especially in discussions about market failures like externalities. Here, "social" means the sum of all private costs or benefits and does not connote the idea that there are some benefits additional to those received by individuals; nor are "social costs" costs that are additional to those incurred by individuals. Thus, "society as a whole" does not receive or spend anything additional to that received or spent by individuals. Rather, the idea is that not all of the costs or benefits of a transaction accrue fully to the parties to the transaction. Some fall to others.[21]

2.3.2. Social welfare, social security, social services and the welfare state

The terms social welfare, social security, social services and the welfare state appear frequently in the literature and in popular discourse and are often used

18 *Concise Oxford Dictionary* (10th Edition), 2001.

19 Webber (1922).

20 See Hausman and McPherson (2008) and Little (2010).

21 This is not quite the same thing as Margaret Thatcher saying that "there is no such thing as society". In an interview with *Women's Own* magazine in October 1987, the then British Prime Minister said: "I think we have gone through a period when too many children and people have been given to understand 'I have a problem, it is the Government's job to cope with it!' or 'I have a problem, I will go and get a grant to cope with it!' or 'I am homeless, the Government must house me!' and so they are casting their problems on society and who is society? There is no such thing! There are individual men and women and there are families and no government can do anything except through people and people look to themselves first. … There is a living tapestry of men and women and people and the beauty of that tapestry and the quality of our lives will depend upon how much each of us is prepared to take responsibility for ourselves and each of us prepared to turn round and help by our own efforts those who are unfortunate." Thatcher (1987).

interchangeable, especially when used to describe government organisations.[22] Margaret McClure, in her history of income support in New Zealand,[23] states that by focusing on cash-based income support, the domain of her history is "social security rather than the wider field of social welfare or the welfare state". The Universal Declaration of Human Rights, in Article 22, guarantees everyone "the right to social security", which while not defined, seems to reflect McClure's idea of cash transfers.[24] Social welfare and social services normally include the direct provision of goods and services, like health and education, counselling and child protection by state agencies. The New Zealand Productivity Commission defines "social services" as: "services dedicated to enhancing people's economic and social wellbeing by helping them lead more stable, healthy, self-sufficient and fulfilling lives"; notes that a mix of government, for-profit and not-for-profit providers, delivers social services in New Zealand; and estimated that in 2014/15, the Government expenditure of social services **excluding** benefits and transfer payments as $34 billion.[25] Benefits and transfer payments were an additional $18 billion.[26]

2.3.3. Corporate social responsibility and social impact investment

Concern about social outcomes is not just the province of government. Internationally, there is a large and active corporate social responsibility movement, where companies seek to focus on more than their profits. This use of social is outside the scope of this essay.

Social impact investment, sometimes termed social investment, is "the provision of finance to organisations with the explicit expectation of a social, as well as financial, return."[27] This type of financing has been championed by the UK Government (especially under the premiership of David Cameron)[28], the G7[29] and the OECD.[30] This variant of social investment is also outside the scope of this essay.

2.3.4. Conclusion: what the "social" in social investment means in New Zealand

Some aspects of the current New Zealand government's "social investment" approach involve much more than reform of cash transfers and are focussed on social services, and not necessarily those provided by the government. Thus, in the context of the New Zealand government's "social investment approach", we take "social" to mean any policy intervention that is funded by the government.

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22 Over the years, New Zealand has variously had an Old Age Pensions Department, a Social Security Department, a Department of Work and Income, a Department of Social Welfare, a Ministry of Social Policy and a Ministry of Social Development which have all undertaken similar functions.

23 McClure (1998).

24 In the United States, "social security" means an age-pension.

25 New Zealand Productivity Commission (2015).

26 See Treasury (2014).

27 Wilson (2014).

28 See https://www.gov.uk/government/policies/social-investment

29 See: http://www.socialimpactinvestment.org/index.php

30 See http://www.oecd.org/social/social-impact-investment.htm

2.4. Returns and measuring returns

Investments – using resources to increase capital is, as we noted above, costly, because the resources thus used have alternative uses. The purpose of the investment is to put aside resources today in order to produce more in the future. But how do we know that the investment is worth doing?

The answer lies in the idea of return. The return on an investment is simply the resulting future production above what would have happened without the investment.[31] If the return is greater than the cost (the opportunity given up by undertaking the investment), then it is worthwhile.

This idea of comparing the total gains and losses from a policy change as a way of deciding whether to proceed or not is a key element of cost benefit analysis (CBA) and is frequently used in social policy.[32] Dreze and Stern (1987) define the purpose of CBA as being to "provide a consistent procedure for evaluating decisions in terms of their consequences".

Conceptually, CBA involves three separate steps: converting the costs and benefits of a project into monetary values that can be compared; converting streams of costs and benefits that accrue through time into a single value (discounting) and then comparing the costs and benefits thus converted to find the "best" project, which is the one with the highest ratio of benefits to costs. Each of these steps is not without controversy and difficulty and we will discuss each of these steps in turn.

2.4.1. Monetary values

CBA uses money as the sole measure of both costs and benefits.

On the cost side, the approach initially looked at the financial resources used in the project under review, measured in market prices. Today, these are referred to as "accounting prices" and involve what the person or organisation undertaking the project would need to spend to buy the inputs into the project. Accounting prices have the great advantage of being relatively easy to calculate: you simply look to the relevant market and find the going rate for what you will need.

Working in the late 1960s, the distinguished economist Ian Little made significant advances in the method of cost benefit analysis, in particular on the cost side, when he introduced the idea of using what have become known as "shadow prices", which reflect the full economic costs of all the resources used in a project.[33] Importantly, shadow prices can also include non-market costs like environmental impacts and the effects of projects on income distribution into the analysis.[34] The efficiency costs of taxes can also be included within shadow prices.[35] While shadow prices are important

[31] Note that is a "with and without" question, not "before and after". Implicitly, it involves a counterfactual, which, as we will note below in relation to measurement, might not always be easy to describe.

[32] Cost-benefit analysis, as a technique in public investment appraisal, can be traced back to the work of Dupuit in the 1840s and it was codified in the United States in the early 1900s as part of the decision-making criteria adopted to decide which federally-funded navigation projects would proceed (see Prest and Turvey (1965) for a history).
Many governments have published guidelines for how CBA should be undertaken within their jurisdictions. See, for example: Treasury (2015b), Australian Department of Finance (2006), HM Treasury (2003) and US Office of Management and Budget (1992).

[33] Little's initial insight, gained while examining a heavy industrial plant in Bhopal, India, was that projects should be evaluated using world prices for inputs and outputs, since these represent the true economic cost of the project. His work on cost benefit analysis is included in two books he co-wrote: Little, Scitovsky and Scott (1970) and Little and Mirrlees (1969), later published as Little and Mirrlees (1974). For a discussion of his work on cost benefit analysis see Little and Mirrlees (1991).

[34] For a discussion of using non-market values in environmental analysis, see Baker and Ruting (2014).

[35] The New Zealand's Treasury recommends that 20% be added to the cost of projects funded out of general revenue to account for the deadweight costs of taxes.

conceptually, they have the disadvantage of often not being directly observable: the analyst often has to estimate non-markets costs, which can be a source of uncertainty and controversy. That said, provided the cost estimates are made transparent and applied consistently, they will significantly increase the richness of the analysis.

Another controversial aspect of CBA, especially on the benefit side, is the need to put into monetary terms things that many people regard as unquantifiable. The most obvious is that of a human life. The philosophical issues involved in the valuation of human lives for cost benefit analysis are well beyond the scope of this essay. For now, we will simply observe that it is possible, by references to things like life-time earnings and surveys of how much people would be willing to pay for safety-improve roadworks that reduce the road toll, to calculate the "'value of statistical life".[36] The New Zealand Treasury's current *Guide to Social Costs Benefit Analysis*[37] puts the statistical value of a life at $3.85 million.

2.4.2. From whose perspective

In many instances, the costs and benefits measured in a CBA accrue to the same person or group of people, at least to a first approximation. For example, in analysing whether to build a road, the benefits go to 'representative user' who can also be assumed with not too much of a stretch to be the 'representative taxpayer' who will meet the costs. With social spending, the two groups – those who benefit and those who meet the costs – are different and may have different perspectives. Consider the example of a person who is a long-term welfare recipient, who has lost confidence in her work skills, lost work habits, and is scared about redundancy and loss of access to emergency benefits if she takes a job. She might regard a shift to work as a negative benefit. But what if the person doing the CBA takes the more paternalistic view, from the point of view of the funder, that once she has made a successful transition to paid employment she will change her view – and uses that optimistic valuation into the CBA? Or is the concept that of a disinterested observer who weights up the donor's view and the recipient views and somehow balances them out?
Again, these are difficult questions to answer. In the context of social investment, what is important is transparency: the perspectives used in measuring costs and benefits should be made clear.

2.4.3. Discounting

As the old saying goes, time is money. Many projects involve expenditure and benefits that occur over many years. While it is possible to simply add up all the costs on one side and all the benefits on the other, and compare the results, this would give a misleading picture, since things that happen in the future are less valuable than things that happen today. Discounting is the technique used to address this problem. There are, however, many different types of discounting used for different purposes, which unfortunately, can use common terms to mean different things.[38]

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36 The term "statistical life" is used because we are talking in the abstract about the value of a notional person, not a real individual. Experience suggests that societies are often prepared to expend more than the "statistical value of a life" to rescue or save a known person.

37 Treasury. (2015b).

38 See Frederick, Loewenstein and O'Donoghue (2002) for a discussion of discounting in the context of intertemporal decision-making of individuals; Heal (2007) for review of discounting in welfare economics and Arrow et. Al. (1996), Nordhaus (2007) and Dasgupta (2008) regarding the role of discounting in climate change.

The simplest example of discounting is the "net present value" or NVP method used in financial analysis. NVP is often used by business to test whether an investment that involves expenditures and revenues over multiple periods should proceed.[39] NVP compares the present value of cash flows received over time to the initial costs of an investment. If the NVP is positive, then the project is worthwhile.[40] The discount rate used in NVP calculations at the firm level is often either the firm's cost of funds[41] or a target rate of return on investments set internally. For our purposes, the important point is that the discount rate is solely being used to reflect the financial opportunity cost of the investment. Thus, market rates are an appropriate benchmark, which will include an element of compensation for risk.

In welfare economics, discounting is different. Welfare economics is concerned with comparing different social outcomes and deciding which is the best.[42] What is being compared is not financial opportunity costs, but the weight to be given to different actors, including those separated by time, usually in the form of utility. Climate change gives a clear example. In his report to the UK Government on Climate Change[43], Nicholas Stern concluded that early and significant action to address climate change was justified. To come to this conclusion, he used a sophisticated form of cost benefit analysis (called an Integrated Assessment Model) which gave very similar weights to the welfare of current and future generations, but more weight to the welfare of the poor over the rich.[44]

The rate at which future benefits are discounted and the period over which that discounting is applied are critical in the assessment of whether a proposal should proceed. Figure 1 below shows the effects of discounting at three rates of interest: 2% (the current official cash rate), 5% (the bank deposit rate) and 10% (the small business lending rate). One key point to note is that over lifetimes (60 years plus), discounting at even moderate rates means that future benefits have a very low current value (at 10%, the current value of a future benefit received in 60 years is essentially zero).

39 See Gallo (2014) for a description of the basis of NVP analysis.

40 In NVP calculations, outgoings (costs) are conventionally recorded as negative and income as positive. When summed, a positive result means that the discounted benefits are greater than the costs. A project with an NVP of zero is just worthwhile: the benefits exactly equal the costs.

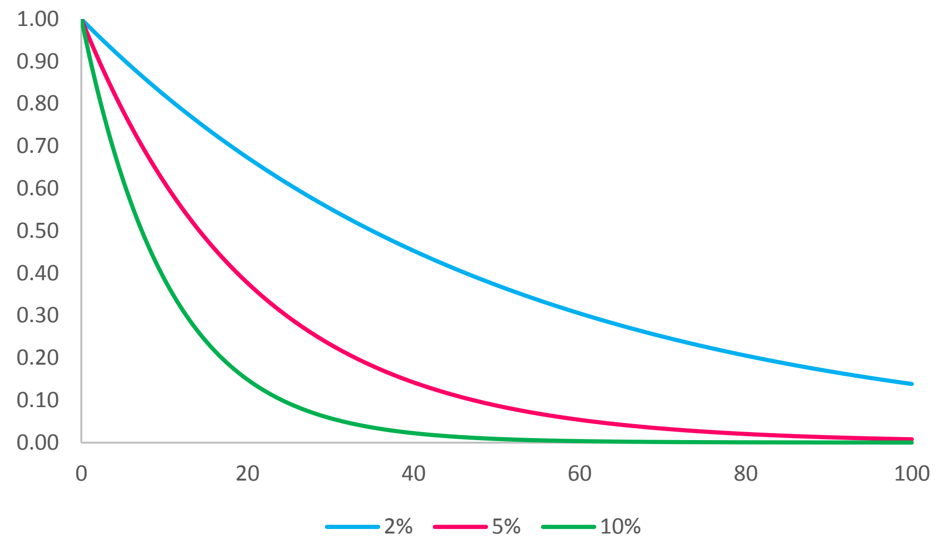
41 Either the firm's cost of borrowing for small projects, or its cost of capital for large projects that might require a capital subscription from owners. The latter is commonly referred to as the WACC, or weighted average cost of capital, which calculated by reference to the required shareholder return, the cost of borrowed funds and the debt/equity ratio of the firms.

42 "The purpose of welfare economics is to provide orderings of alternative economic policies". Jorgenson (1985).

43 Stern (2007).

44 The discount rate in the model that Stern used can be represented by the following formula:
$\rho = \eta g + \delta$,
where ρ is the discount rate, η is an inequality aversion factor – how much we care about the relative welfare of the rich and poor – g is the rate of economic growth and δ is the "pure rate of time preference", or how much weight we give to the welfare of different generations only because they are separated by time. In his initial report, Stern used values of δ = 0.1, η= 1 and g = 1.3%. The result was a discount rate ρ = 1.4%. Conceptually, Stern thought that δ should be set at zero: each generation should have the same weight. He decided, however, to give it a small positive value to account for the fact that there is a small probability the earth might be destroyed in some cosmic catastrophe. See Weisbach and Sunstein (2009).

Figure 1 The effect of different discount rates



Source: NZIER

In the context of social investment, it is important to be clear what discounting is trying to do. If it is simply an exercise of financial analysis, then a financial rate of return used in a NVP test is appropriate and since we are using "social" to mean government funded, then the government's cost of funds would be the appropriate rate.[45] However, if discounting is being used to compare welfare between different groups separated by time, then financial rates might not be appropriate. Whatever the motivation, the effects of discount rates on the assessment should be transparent.

2.4.4. Alternative to cost benefit analysis

An alternative to cost benefit analysis that does not reduce all values to a single monetary unit is multi-criteria decision-analysis (MCDA), which is sometimes called multiple criteria decision making. In MCDA, options are compared based on a range of criteria and then a weighting is applied to each criterion, which are scored, often on a 1 - 10 scale. The option with the highest weighted score is then selected. While this approach avoids the difficulty of converting all relevant factors into monetary units, the criteria, the scoring and the weighting of score all have a subjective element that can vary considerably with who is making the decision.[46]

A less demanding decision tool than cost-benefit analysis that still uses money metrics on the cost side is cost-effectiveness analysis, which seeks to determine the least cost approach to achieving a given target. An example would be what is the least-cost way of reducing heart attacks. This approach still requires investigation of the links between the intervention being analysed and welfare, since it asks the question what level of intervention will lead to the required outcome. The drawback of this approach is that it often assumes what the appropriate target should be and there is no

45 See Slemrod and Yitzhaki (2001) for a discussion of the concept of a government's cost of funds.

46 For a description on the technique, see Department for Communities and Local Government (2009). A short history of the technique can be found on the website of the International Society on Multiple Criteria Decision Making at http://www.mcdmsociety.org/content/short-mcdm-history-0.

guarantee that any one selected target will result in the highest available improvement in welfare.

An even simpler approach is to use cost-utility analysis, which seeks to find the least-cost way of achieving a given input, rather than on outcome. Extending the heart treatment analogy, a cost-utility analysis could be used to determine the least cost way of undertaking a particular type of heart surgery. As well as all the risks involved in cost-effectiveness analysis, cost-utility analysis risks the chosen input being investigated is not the best way of achieving any increase in welfare.

2.5. A suggested definition

Pulling this discussion about terms together, we can provide what might be called a "dictionary definition" of social investment – what the everyday meaning of the term involves. Such a definition would be:

> *Social investment means a programme funded by the Government that entails applying resources today in the expectation that a measurable improvement in a dimension of policy interest will result at some point in the future.*

3. The political economy of social investment

We now present a brief review of the literature and practice of social investment. Social investment, as it is used in the social policy literature, is an elastic term and it is often very country specific. It is alternatively described as a:

- conceptual or analytical framework for assessing policy options
- paradigm, orientation or organising principle for the overall design of social policy
- set of policy interventions
- set of policy tools
- set of funding models or mechanisms
- an ideologically or politically-driven framing device or mode of discourse (e.g. to enhance the political attractiveness of particular policy interventions).

Social investment as an idea is not particularly recent despite the renewed interest and application of its principles to social policy across some OECD nations (to a greater or lesser degree). The proposition that (some) social spending can be regarded as an investment (rather than a cost) is an idea that can be traced back the Swedish economist Gunnar Myrdal writing in the 1930s.[47]

3.1. The social investment perspective

To put it simply, the idea underlying social investment commonly found in the literature is that the state should not merely protect the social positions of particular "at risk" groups in a reactive manner (such as by granting cash benefits), but should rather build "human capital" or "social capital" by investing in individuals.

3.2. The three worlds of social policy

Gøsta Esping-Andersen in his highly influential book *Three World of Welfare Capitalism*[48] outlines a typology and assessment of welfare capitalism, in which contemporary western welfare states are said to belong to one of three "worlds": liberal, conservative/corporatist and socio-democrat.[49] Before going on to describe his three worlds, we note that he was writing in 1990 and much has happened in the world of social policy since then. Some of his descriptions and examples seem dated. That said, his taxonomy is still frequently cited in the literature, especially in the context of discussions of social investment.

In the liberal welfare state, means-tested benefits, modest universal transfers and modest social insurance schemes predominate. The focus is on low-income groups and incentives to work are given special attention. Work is the main vehicle by which

47 Palme and Cronert, (2015).

48 Esping-Andersen (1990).

49 Although he acknowledges that his three worlds are abstractions and no single country adheres strictly to any one world.

people provide for their needs and there is less focus on rights. This model is associated with the Anglo-Saxon world.

The conservative/corporatist world[50] is associated with western Europe: France, Germany, Italy and Austria. While social rights are accepted, they are associated with class and status. Social insurance and pensions are used as vehicles for protecting rights, but contributions and benefits are income-based and there is a limited focus on redistribution. Benefit structures tend to favour non-working mothers. The principle of "subsidiarity" applies and the state will only interfere where the family does not have the capacity to serve the needs of its members. The church was a heavy provider of social service, especially in areas like education and health. While some of these services where charitable and targeted at the poor, many middle-class families used church-based providers.

In Esping-Andersen's socio-democrat world, principles of universalism and de-commodification of labour prevail.[51] Equality, especially between the working class and the middle class is the aim (although in practice, some social programmes are income-based). This model essentially crowds-out the market and, at least according Esping-Andersen a "universal solidarity in favour of the welfare state is created", in which "all benefit; all are dependent; and all will presumably feel obliged to pay." This socio-democrat world is, naturally, associated with the Nordic states.[52]

3.3. Social investment in the three worlds

The modern social investment approach does not sit well within Esping-Andersen's three worlds model: we can see it being applied in countries that have based their welfare system on different objectives and approaches. That said, a social investment approach has frequently been advocated either as an alternative to, or as a way to supplement, liberal approaches to social policy. It seeks to move away from a narrow focus on meeting minimum standards and build human and social capital to allow people to lead better lives.

Giddens (1999) sees the social investment perspective as part of a separate model of the state, and he goes so far so to define it as "third way social democracy". Giddens explains that the new priorities and measures of the social investment approach in social democracies calls for the restructuring of welfare regimes derive from the visions and concepts of an "activating social policy".

More recent work by Morel, Palier, and Palme (2012) focuses on the what is needed to develop a social investment welfare state. Morel *et. al.* compares the social investment perspective with what they see as two ideas of the welfare state: Keynesian and neo-liberal.[53] They see the Keynesian approach as being based on the here and now:

> *[t]he here-and-now was the most important time-frame and social citizenship focused on inequalities, inequities and challenges of the present that would be addressed in the present. The countercyclical economic instruments obviously supported such a notion of time.*

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50 Often called the Bismarckian approach, after the German Chancellor Otto von Bismarck, an early developer of corporatist social systems.

51 "De-commodification occurs when a service is provided as a matter of right, and when a person can maintain a livelihood without reliance on the market".

52 It is perhaps not surprising that Gøsta Esping-Andersen, a Dane, has a favourable view of the socio-democrat model.

53 They take a more historical perspective to discussing the development of the welfare state than Esping-Andersen.

Social policy was passive and responded to the need to create aggregate demand.

The neoliberal era after 1974 saw social policies became portrayed as a cost rather than a stimulator of economic growth or a promoter of political and social stability.[54] Social policy was increasingly seen through the lens of economic efficiency. Less emphasis was placed on providing income security and more focus was placed on providing incentives to return to the labour market.

Morel *et. al.* focus on the three distinctive elements of welfare states:

- responsibility mix of the citizenship regime
- social rights and duties
- governance dimension of social citizenship.

3.3.1. Responsibility mix of the citizenship regime

The responsibility mix is the fundamental ideology of a welfare state. It sets out the role of the different actors and what can reasonably be expected of them. The social investment perspective's macro-economic analysis retains some of the logic that neoliberalism instituted.

While the social investment perspective acknowledges that the state plays a larger role than from a neoliberal perspective, it is enthusiastic about the market, where it is course natural to speak of investments.

Therefore, the overarching idea is that activities are organised according to market principles, individuals and their families are called on 'to invest in their own human capital' so as to succeed in the labour market. When families or the market cannot sufficiently provide for all, the state has a role to play under social investment but within the framework of market principles. The idea that social investment incorporates market ideology into the welfare state is possibly strongest in the current UK social impact investment approach.

[54] See Arjona, Ladaique and Pearson (2002) and the references they cite, for a survey.,

Table 1 Three perspectives on the responsibility mix of the citizenship regime

	Keynesian perspective	Neoliberal perspective	Social investment perspective
Responsibility mix principally involves	Market, state, family	Market, family, community	Market, family, state, community
Market	Can provide wellbeing for all, with a few exceptions	Should provide wellbeing for all	May not provide sufficiently for all
Family	Children are the responsibility of the family	Families need to take responsibility and make choices for themselves	Families have primary responsibility for children, but the state has responsibility too
State	Should spend to provide protection against social risks	Spending should be limited, because the state can create the risk of dependency	Spending should be investments, such as in human capital to support labour market participation in the future as well as the present or to confront new social risks and poverty
Community	Represents citizens and advocates. Provides services in the shadow of the welfare state	May serve as a cushion to spending cutbacks and market failure	Potential partner in the provision of services, and source of local as well as expert knowledge

Source: Morel, Palier and Palme (2012)

3.3.2. Social rights and duties

Social right and duties implicitly reveal what the objectives are of different welfare state; what is their inherent objective.

The social investment perspective alters thinking about social citizenship and social rights in two ways, and these intersect to shape spending patterns. The first is increasing attention to children. If the young are future citizens, by middle childhood and the teen years, children have gained new rights and have become a focus of citizenship discourse (Jenson 2001). The second alteration introduces a new risk analysis into visions of social citizenship.

In other words, the social investment perspective refines the focus of the welfare state to address specific needs, largely at earlier ages but also refines the focus towards specific risks to be covered. There is an impetus to increase the sophistication of the welfare state imbedded in the social investment perspective as preventing becomes the central idea.

Table 2 Three perspectives on social rights and duties

	Keynesian perspective	Neoliberal perspective	Social investment perspective
Social goals	Provide social protection	Avoid policy instruments that foster dependency; promote autonomy	Invest in prevention and human and social capital, in order to ensure growth and prosperity
Vision of equality	Equality of condition and equal opportunities	Inequality is inherent in markets and is necessary to motivate economic actors	Equality of opportunity
Risks to be covered by social and labour market policies	Unemployment, disability and sickness, extra costs of children, loss of income due to retirement or absence of a male breadwinner	Disability, sickness, threat of crime and social disorder, ageing	Family breakdown, low wage work or unstable work, challenge of balancing earning with social care, demography

Source: Morel, Palier and Palme (2012)

3.3.3. Governance dimension of social citizenship

The governance dimension of the different types of welfare state reveal mostly how their respective models tend to be implemented. There are three key central themes which the social investment breaks from the two other perspectives.

The first is the longer time horizon, the second is the idea of devolution of power to community and social services and the third is the use of outcomes or result based evaluation.

Table 3 Three perspectives on the governance dimension of social citizenship

	Keynesian perspective	Neoliberal perspective	Social investment perspective
Time horizon in governance	Present, so as to avoid the past	Present, so as not to hobble the future	Future, which requires action in the present
Preferred forms of governance	Weberian hierarchical/ bureaucratic	Corporate models plus privatisation	Networking and partnerships
Ideal form of intergovernmental relations	State-building via conditionality	Unilateralism and downloading	Asymmetrical collaboration via results-based coordination
Focus for evaluation of success	Inputs (spending)	Bottom line (costs)	Outcomes (cost benefit)

Source: Morel, Palier and Palme (2012)

3.4. Which policies belong to social investment?

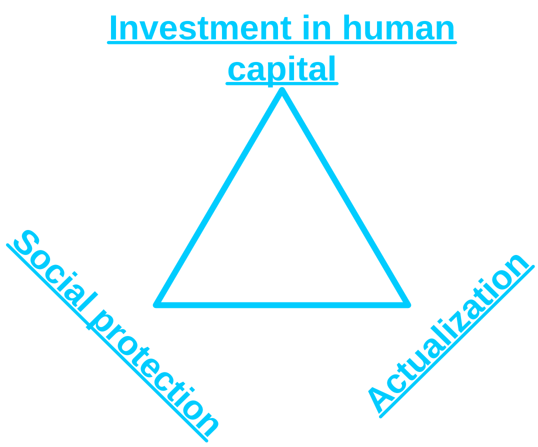
What kind of policies, then, can be said to underpin the social investment perspective?

The focus on investing in human capital is perhaps the policy domain which gathers the greatest consensus amongst social investment proponents. The policy recommendation to invest heavily in human capital is also based on the observation of a causal structure where education has been shown to be the central driving variable for GDP growth in Europe.[55]

Bonoli (2009) identifies education and full-time training the only purely social investment policies, as proposed by Esping-Andersen in 2002. Knijn and Smit (2009) describe these policies as belonging to the transition labour model and to them, social investment policies are about good-quality public childcare and parental leave – showing a specific commitment to gender equality (Antonucci, 2010). A third view is represented by "flexicurity" policies. Labour market policies inspired by flexicurity have been oriented towards increasing labour market flexibility, while also guaranteeing security of income and employment.

Drawing this discussion together in the framework of Morel *et. al*, we can arrange policies which are relevant to describing the social investment perspective into three different pillars.

Figure 2 The three pillars of the social investment approach



Source: Morel, Palier and Palme (2012)

Investment in human capital – The policy recommendation is to invest heavily in human capital. Skill acquisition during the different stages of education is realised through policies that promote high enrolment and quality instruction.

Social protection – relates to the relation between the productive and the reproductive spheres, and hinges on policies that help parents combine work and family life. Here the aim is both to increase labour supply by supporting mothers' employment in order to foster economic growth and ensure the long-term fiscal

55 Institute for Future Studies (2006).

sustainability of welfare systems, but also to make families less exposed to the risk of poverty. Policies put forward typically include benefits, childcare services and parental leave schemes.

Actualisation – activating political strategies are aimed at integrating the entire population into the labour market, and thus attempt to increase the rate of the “productive” as compared to “unproductive” parts of the population.

4. International approaches to social investment

European countries, where social investment policies are most visible, face a number of common challenges related to environmental concerns and the threats of climate change, deregulated financial markets, mobile global capital, ageing populations and de-industrialisation.

During the Lisbon Summit in 2000, the European Union adopted a new approach to meet the future challenges of ageing populations and the shift towards a knowledge-based and service economy. Those are two very recurrent themes in the European social investment approach.

The investment approach gained further momentum following the GFC at the launch of the 'Social Investment Package for Growth and Social Cohesion' by the European Commission in early 2013, largely in the face of enduring high structural unemployment particularly among younger generations.

The European 'Social Investment Package' makes a strong case for social investment no longer being dismissed as 'fair weather' policy when times get rough. The overall message boils down to not allowing human capital to go to waste through inactivity, as was the case in the 1980s and 1990s in many continental European welfare systems.[56]

Very few countries have enforced a pure social investment perspective to their welfare state. The clear break between social investment, Keynesian and Neoliberal perspectives is really only true in theory.

4.1. Different approaches by country

Based on the three pillars of human capital, social protection and actualization and work from the European Union, we can divide different countries into different groups depending on how strongly their policy settings match with the concept of social investment.

If social investment is to be the defining feature of the new welfare state, then one should certainly differentiate between 'varieties of social investment'.

For each pillar, we have reviewed the member states of the EU to determine the extent to which social investment ideology forms the basis or has influenced the pillar based on the three elements of the social investment perspective (responsibility mix, rights and duties, and governance).

Broadly speaking, neither Southern European countries (Italy, Spain, Greece and Portugal) nor Eastern European countries have really entered the social investment era. The continental European countries remain typically "traditional compensatory welfare systems" (Keynesian), with few attempts to activate the social investment turn. The countries that seem to have gone the furthest are the Nordic countries, the Netherlands and some English-speaking countries.

[56] Hemerijck (2014).

Thirteen countries (row 1 in Table 4) have well-established social investment approach to many social policies. These countries tend to preserve and further develop good institutional linkages between different policy areas, especially when they are addressing key social challenges. However, many experts comment that while such an approach is evident there is often no explicit reference made to “social investment” in national policy strategies.

Nine countries (row 2 in Table 4) while still to develop an explicit or predominant social investment approach, show some increasing awareness of social investment and have begun to apply elements of a social investment approach in a few specific policy areas.

Finally, there are eighteen countries (row 3 in Table 4) where a social investment approach has not so far made many significant inroads into the overall policy agenda though some seem to have started moving slightly in a social investment direction in a few policy areas.

Table 4 Implementation of the social investment approach is not uniform

Cluster	Countries
Well-established social investment approach	AT, BE, CH, DE, DK, FI, FR, IS, LI, NL, NO, SE, SI
Still to develop an explicit or predominant social investment approach with some partial application	CY, ES, HU, IE, LU, MT, PL, PT, UK
Social investment approach is not in the overall policy agenda but there are signals of moving towards social investment	BG, CZ, EE, EL, HR, IT, LT, LV, MK, RO, RS, SK, TR, EE, HR, LT, LV, RO

Source: Bouget at al., 2015

There are significant differences in the focus by different countries in their social investment approaches. The investment in human capital pillar is split into two policy sets.

If one distinguishes between compensatory social spending (old age, early exit and unemployment compensation) and investment (expenditures for families, active labour market policies, education), one sees that only a few countries have taken a social investment approach.

While policies geared towards preventing human capital depletion seem to have gone out of fashion, countries tend to emphasise either training or policies aiming at removing obstacles to labour market participation.

The main orientation of employment policy today is a mix of negative and positive incentives for jobless people to enter mostly low skill employment in the services sector and therefore activation makes up the bulk of social investment approaches or policies observable in welfare states around the world.

Table 5 Features of the social investment approach in Europe

Pillars	Policies	Countries
Investment in human capital	Childcare, early childhood health and development, and child poverty strategies	ES, PT, RO, SK
	Education and lifelong learning	FI, FR, MT, PL
Social protection	Income support	AT, CY, LU, MT

Source: Bouget at al., 2015

5. The development of social policy in New Zealand

The "social investment approach" is but the latest in a long series of social welfare policies and practices in New Zealand. In this section, we briefly sketch the history of that policy development.

5.1. Colonial times

Like many other outposts of Britain, New Zealand's early approaches to the issue of poverty can be traced back to the early poor laws of England, especially the Elizabethan Act for the Relief of the Poor 1601. Relieving poverty was a local matter and different treatment was prescribed for different classes of pauper. But individuals were primarily responsible for supporting themselves and their family. The approach was recognisably liberal.

As Susan St John puts it:

> *When the largely young and hardy immigrants from the old country came to New Zealand they sought to reinforce with even greater vigour the strong anti-welfare mood becoming apparent in 19th century Britain. The dominant ideology was that individuals should be self-reliant and that families should care for their own.*[57]

The Destitute Persons Act 1846, New Zealand's first foray into what would become social policy, placed the responsibility to care for a "destitute person not able to support himself" on their family. If a "respectable householder" laid information on oath before two Justices of the Peace that a person was destitute and unable to support himself by his own labour, but had a father or other near relative in New Zealand who was of sufficient means to support them, then after a hearing, the Justices could make an order requiring the relative to make payment not exceeding twenty shillings per week to the person for their support. This was a continuation of the English practice from the 1601 Act.[58] While re-enacted a number of times, the approach in the original Destitute Persons Act remained on the statute books in New Zealand until 1968.[59]

The Act also made provision for the care of illegitimate children (the Justices could make an order that the putative father make payment to the mother of between two and ten shillings per week). Deserting a wife or child under fourteen and leaving them

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57 St John (2004).

58 Section 7 of the 1601 Act (rendered using modern spelling) provided: "And be it further enacted, That the father and grandfather, and the mother and grandmother, and the children of every poor, old, blind, lame, and impotent person, or other poor person, not able to work, being of a sufficient ability, shall at their own charges relieve and maintain every such poor person in that manner, and according to that rate, as by the Justices of Peace of that County where such sufficient persons dwell, or the greater number of them, at their general quarter Sessions shall be assessed, upon pain that everyone them shall forfeit twenty shillings for every month which they shall fail therein." Any amount so forfeited was to be "employed to the use of the poor of the same Parish, and towards a Stock and habitation for them, and other necessary uses and relief as before in this Act are mentioned and expressed" (Section 11).

59 Discrete Destitute Persons Acts were enacted in 1894 and 1910. The operative provision of the 1910 version, section 3, provided:

> Every near relative of a destitute person, if that relative is of sufficient ability, is liable for the maintenance of that destitute person in manner hereinafter provided.

with no support was a crime punishable by a fine of up to five pounds for the first offence and ten pounds for the second or subsequent offence.[60]

Tellingly, the Act made no provision for the care of destitute people, illegitimate children or deserted wives where there was no relative or father to provide material support.

5.2. The first state pensions

In 1898, New Zealand became one of the first countries to introduce a state-funded age pension. The initial modest pension was subject to a means, assets and character test. It was non-contributory and paid for entirely out of current revenues.

Health and education were mainly local, private and charitable activities, with some central government oversight and funding. Housing was largely provided by the private market, often of low quality. Slums soon sprung-up in the major settlements.

5.3. The beginnings of the welfare state

The early 20th century saw progressive moves to extend the coverage of state pensions beyond older people. The idea of the "deserving poor", those whose straitened circumstances were regarded as no fault of their own, became a focus of attention.

Widows were clearly a deserving group – at least those with children – and were provided for under the means tested Widows Pension Act 1911. A pension scheme for miners suffering lung damage was established in 1915.[61]

Early in the First World War, a pension scheme for war widows and soldiers disabled on service in the New Zealand Expeditionary Forces was established.[62]

The mass unemployment of the 1930s Depression led to a rethink of State support. Poverty was widely experienced and gained public recognition. Long queues forming outside charitable aid offices and city mission halls were a visible reminder of a failure to adequately support the poor. The Unemployment Act 1930 established an Unemployment Board, charged with making arrangements with employers for the employment of the unemployed, promoting the growth of primary and secondary industries in New Zealand, and administering a new contributory scheme of sustenance payments to those who were out of work.[63]

The First Labour Government, elected in 1935 with Michael Joseph Savage as Prime Minister, took major steps to introduce what would become known as "the welfare state". The Social Security Act 1938 extended the range and increased the rate of social assistance as well as introducing a new social security tax of 7.5% to finance benefits. The aim of the Act was to end poverty in New Zealand and was based on the principle that that every citizen had a right to a reasonable standard of living and that it was a

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60 Presumably, deserting a wife the second time, not deserting a second wife.

61 The Miner's Phthisis Act 1915. Phthisis, also referred to as pneumoconiosis in the Act, is a restrictive lung disease caused by the inhalation of dust. Depending upon the type of dust, the disease is given different names: including black lung or anthracnosis, from coal dust; asbestosis, from asbestos and silicosis (also known as "grinder's disease" or Potter's rot), from inhaling silica.

62 War Pensions Act 1915.

63 The benefit was paid at a rate of 21 shillings per week, with an additional seventeen shillings and sixpence a week payable in respect of the wife of married unemployed man, and further four shillings for each child.

community responsibility to ensure that its members were safeguarded against the economic ills from which they could not protect themselves. This was a deliberate move away for the family responsibility of the Poor Laws of England.

The new welfare state was based, in part, on the idea that the state could provide for the basic needs of families – food, shelter, education and healthcare – using uniform approaches. The basic needs were all the same and thus could be met with universal programmes.

Government provision of housing was a major plank of the new approach to welfare. The Government embarked on a programme of building high quality, comfortable houses for working people. The photograph of the Prime Minister moving furniture in to the first state house in 1937 is an icon of New Zealand politics.

While this system of benefits was extensive, employment was still seen as the major cure for social evils. Thus, full employment was the main strategy the government followed to ensure prosperity. As Belgrave puts it:

> *The most significant aspect of Labour's new welfare state was not its social security system, which to some extent merely consolidated existing benefits with added provision for unemployment and health care and old age, it was the introduction of economic stabilisation in 1938. This measure created a highly protected economy aiming to promote and then preserve full employment. Although the introduction of stabilisation was prompted by the demands of the British government and British financiers to tone down Labour's social experiments, its impact reinforced the long tradition in New Zealand's social policy, of placing employment above pensions. Once introduced, protection would be retained until the 1980s.*[64]

A Royal Commission on Security in 1972 proposed that the state should "ensure … that everyone is able to enjoy a standard of living much like that of the rest of the community and thus is able to feel a sense of participation and belonging to the community". This shifted the focus from meeting basic needs to ensuring that the proceeds of economic growth where shared more evenly. Successive governments accepted this approach and an expansion of the range and generosity of benefits and grants followed. A domestic purpose (sole parents) benefit was established in 1974. Supplementation benefits followed. A universal pension at age 60 at more than twice the previous level was introduced in 1976 (subsequently the age went to 65 and the payments were cut). Tertiary student grants and subsidies were expanded and benefits for special circumstances and special needs were added over time.

5.4. Economic reform

By the early 1980s, the economic situation of New Zealand was deteriorating. The policies used to promote full employment – heavy tariff protection of industry, subsidies, major infrastructure projects and extensive state employment – were no longer working (unemployment, which had stood at under 1% for most of the post WWII period, reached the unheard of and alarming level of 5% in the first quarter of 1984) and were leading to slow economic growth and rising government debt.

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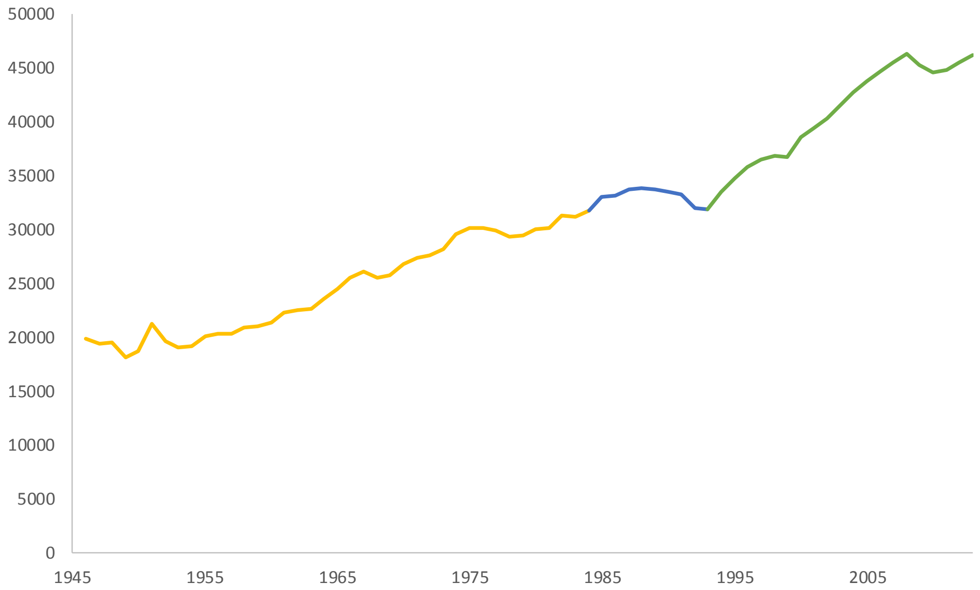
[64] Belgrave (2012).

The newly elected Labour Government started a wide-scale programme of economic reforms, directed at removing what it saw as government-imposed inefficiencies. Its successor continued with reforms, especially in areas of welfare, health and education. Fiscal retrenchment was pursued vigorously. There followed ten years of little growth in real GDP per head and large-scale redundancies, especially in government trading departments and entities[65] and in regional centres that were reliant on protected industries. Figure 3 shows three broad phases of economic growth in New Zealand; the long post-World War II expansion, the ten-year period of limited growth after 1984[66] and then a resumption of growth at a higher level, with the dip due to the Global Financial Crisis at the end.

Figure 3 Three phases of growth

Real GDP/head



Source: NZIER

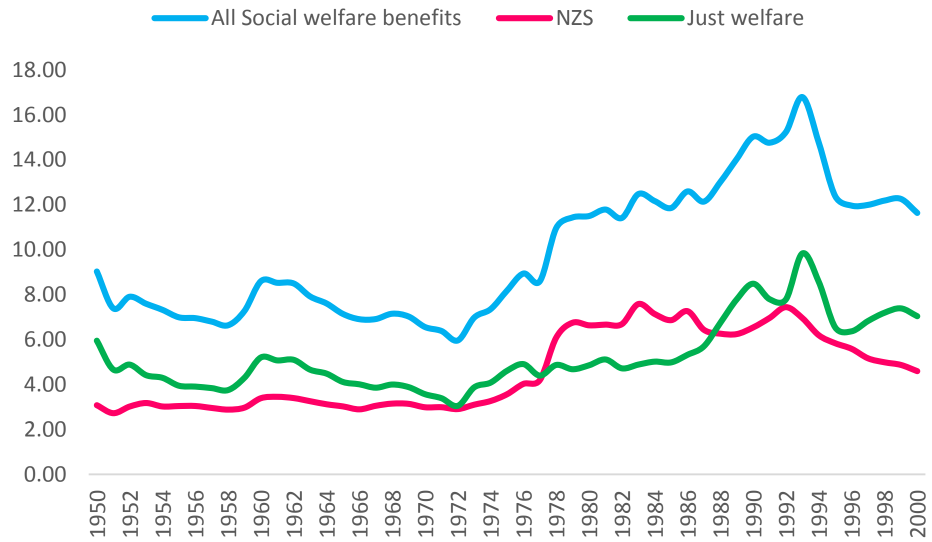
The social welfare system strained under the numbers of newly unemployed and the effects of the post-Royal Commission increases in entitlements. Social welfare spending, as a proportion of GDP, which had been falling since 1950, started to climb in 1972, reaching a peak of 16.8% in 1993.

[65] In 1984, the Government owned the postal and telecommunications systems, multiple financial institutions, the electricity generation and transmission systems, large forests, many farms, an unprofitable railway network, a domestic and international airline and a shipping fleet. The private sector was highly regulated. Regional development polices had seen both the public and private sectors establishing operations in provincial towns. For an analysis of the impact of these reforms across a number of metrics, see Gemmell and Gill (2016).

[66] When comparing the pre- and post-1984 economic performance, it is important to think about the counterfactual. Successive governments from 1984 were clearly of the view that the economic situation was unsustainable and that if economic policy was not adjusted, outcomes would deteriorate even further than they did.

Figure 4 Spending on social welfare peaked in the early 1990s

As a percentage of GDP



Source: Treasury

The perception of the role of state changed over time, with a return, at least at the official level, of attitudes closer to those of colonial times: individual responsibility became a guiding principle, with the state's role being reduced to helping out during what were expected to be short periods of need.

5.5. The resumption of growth and the persistence of disadvantage

The New Zealand economy started to grow in around 1993 and the trajectory has largely been upwards since, with global economic shocks like the late 1990s Asian financial crisis and the late 2000s global financial crisis being the major determinants of local economic outcomes.

Between 1993 and 1999, the then Department of Social Welfare implemented a strategic initiative called "From Welfare to Well-being", designed in part to address concerns that economic growth (which was starting to appear after ten years of economic restructuring) would be insufficient to address the observed growth in welfare dependency. A long-term scenario developed the Department's Social Policy Agency in 1994 (referred to internally as the "grim vision") painted a picture of New Zealand divided between the beneficiaries of economic growth and the long-term benefit dependent if action was not taken to tackle benefit dependency. As the Director General of the Department, Dame Margaret Bazley put it in a speech in 1997:

> *Until that time, most New Zealanders, including Department staff thought that the economic situation would improve and that people would move into employment as followed the 1930s recession... The 10 year scenario indicated ... it was unlikely that beneficiaries would get the jobs ... that youth, women at home and the recently retired people would be more attractive to employers than beneficiaries.*

In a paper delivered at a "Beyond Dependency" conference the Department convened in 1997, Rob Brown and Helene Quilter proposed that welfare dependency should be addressed by a series of interventions seen as "investments against future costs".[67] Welfare dependency was the main problem to be addressed, with the government moving from passive benefit payment (and passive benefit receipt on the part of beneficiaries) to a more active approach of assisting people into the labour market. While Brown and Quilter's paper contains a number of elements on what is now proposed as the social investment approach (including focusing on the long-term benefit liability, an area we will return to below), their approach was on what the Ministry could do to improve its services, operating within a framework of uniform benefits.

Elements of the "grim vision" of the Ministry of Social Development came to pass. While average incomes were increasing, the gains from economic reform and the resulting economic growth were spread unevenly. Discussion of cycles and pockets of disadvantage become common.

Speaking to a National Party's conference in May 1997, the then Prime Minister, the Rt. Hon. Jim Bolger, spoke about his concerns with rising numbers of benefit-dependent families and the impact this was having on social outcomes and he outlined the aspects of a "Strengthening Families Project" which the Government was working on:

> *This effort which is in the developmental stage is spread across many departments and is designed to better co-ordinate the delivery of support and, in particular, to give people the opportunity to move to greater independence.*
>
> *The Ministers of Welfare, Health and Education are very supportive of the strategy, and the CEOs of all three departments are working together on the project.*
>
> *It makes sense to integrate this work because many of the children and families that come to one department for help also go to other agencies.*
>
> *In delivering more relevant help we must lower the barriers between agencies so that the left hand knows what the right hand is doing.*
>
> *The approach will be to try and tailor-make support for each individual family.*
>
> *The idea is to ensure better social, health and educational results for at-risk and dependent families and to break the cycles of disadvantage.*
>
> *A strength of the new approach is that it will be more community-based*

In its 1999 Briefing to the Income Government, Treasury observed:

> *Irrespective of broad distributional issues, all governments will be concerned with the most disadvantaged. Disadvantage is statistically associated with a variety of factors: income, ethnicity,*

[67] Brown and Quilter (1997).

> *health, disability, age, family status, gender, educational attainment, work experience, region – it is not simply a matter of low income. As far as possible, governments need to focus on the dynamics of persistent disadvantage, rather than temporary difficulty. The most serious disadvantage is often multi-dimensional, and often persists through time and across generations. The causes of poor outcomes are complex and poorly understood, making them difficult to resolve. There is a need to ensure a focus on effectiveness and to test interventions robustly, modifying them in the light of experience. Examples include new organisational forms (e.g. 'wrap-around services') and pilot programmes such as Family Start. A more experimental approach will require discipline and courage on the part of both ministers and officials – to acknowledge that some programmes have failed and to ditch them.*

By 2002, the Treasury staff were saying:

> *Interventions designed to improve outcomes and to enhance well-being can be considered as social investments that involve current expenditure to produce a future benefit. Viewing interventions, from legislation to targeted assistance, as investments allows the costs to be arrayed against the benefits over time, and permits choices to be made among them. It also allows a portfolio of interventions to be selected.*[68]

The ability of the welfare state, both in New Zealand and internationally, to address this issue was increasingly questioned:

> *Many states have discovered or rediscovered permanent intergenerational poverty, which provides a critique of the evolution of welfare policies. If one of the original objectives of the modern welfare state was to reach down and provide greater equality of opportunity, freedom from want, and participation in society, then the design and implementation of welfare systems have been at least partially unsuccessful.*[69]

In 2010, the government of the day established a Welfare Working Group to undertake a fundamental review of the welfare system, Chaired by Paula Rebstock. The Institute for Governance and Policy Studies at Victoria University hosted the Group's secretariat.[70] Part of the Group's work included examining whether an approach undertaken by the Accident Compensation Corporation (of which Paula Rebstock was also Chair at the time) to measure and manage its long-term liabilities could have wider application.

In its final report, the Working Group summarised its recommendations as:

> *We have presented a plan for a large scale and comprehensive reform of the welfare system to reduce long-term welfare dependency. This reform is founded on a greater work focus for more people, reciprocal obligations,* ***a long-term investment view***

68 Jacobsen e. al. (2002)

69 Carpinter (2012).

70 The background papers to the Group's work are archived at: http://igps.victoria.ac.nz/WelfareWorkingGroup/Index.html

> *(investing early to reduce the risk of poor long-term outcomes for many people), commitment to targets, better outcomes for Māori, better outcomes for children, a cross-Government approach and more effective delivery. Two key elements are the introduction of Jobseeker Support (replacing all existing benefits), and the establishment of Employment and Support New Zealand.*[71]

In a report to the Cabinet on child poverty in 2013, Treasury said that while the proportion of New Zealand children living in households with low income is close to the OECD average, "there appear to be significant issues with a large group of children spending the majority of their childhood reliant on benefits and low incomes. As a consequence, despite New Zealand having benefit levels close to the OECD average, we have high rates of material hardship".[72]

The Ministry of Social Development's 2016 *Social Report*[73] also concluded that while most New Zealanders are experiencing good and improving outcomes, the distribution of those outcomes is mixed, with some groups not doing well or not improving.

This then is the context of the government's social investment approach: a realisation that despite over 80 years of active policy and billions in spending and with real levels of national income 320% higher in 2013 than they were in 1937, for a group of the population, economic success had not been delivered. Long-term liabilities were increasing.

71 Welfare Working Group (2011), emphasis added.

72 Treasury (2013).

73 Ministry of Social Development (2016).

6. The New Zealand social investment approach

Faced with entrenched disadvantage and large forward liabilities, the government, rejecting calls for significant increase in social spending has instead said that it will use a social investment approach.

The Minister of Finance, Bill English, has described the approach as follows:

> *At core, social investment is a more rigorous and evidence-based feedback loop linking service delivery to a better understanding of people's needs and indicators of the effectiveness of social services. This needs to take account of the long term – including those benefits that might take years to be delivered. There will also be more systematic measurement of the effectiveness of services people are currently receiving. This information can then be used to do more of what works – and stop things that don't. Understanding the effectiveness of spending and doing what works are two principles with relevance to all public spending.*[74]

The New Zealand version of a social investment approach is still developing and it is thus not surprising that a perfectly clear picture of what it entails has yet to emerge. We can, however, already see some clear indicators of what the government is doing.

As we noted in the Introduction, policy consistency is never achieved in practice and for many governments (at least at the political level) is never the aim anyway. The current New Zealand government is noted for its caution, flexibility and pragmatism. It is not a government driven by a top-down ideology. Rather, it operates bottom-up, case-by-case, within some general preferences. If that means an overall picture that is hard to place within any known system of government, then so be it.

In this section, we look at both some emerging overarching themes and at some specific examples of the approach in action. Of these features, the government has specifically emphasized three differences from previous approaches to social policy: a much greater reliance on individual data; giving greater attention to evidence about policy effectiveness; and measuring rates of return on social interventions that are spread over time – potentially very long periods of time.

Looking across the whole social sector, we have seen some repeated features in the Government's initial applications of the social investment approach. In Table 1 we set out the main elements of the approach to date.

Table 6 Main elements of the New Zealand social investment approach

Element	Definition
Intertemporal	Returns on interventions are spread over time

[74] English (2015b).

	Costs and benefit should be assessed on a long-term basis
Effectiveness	Investment is to be justified on the basis of social return Outcomes matter and best way of achieving those outcomes should be used, regardless of provider Outputs should be assessed on the basis of how well they achieve outcomes.
Evidence	Doing 'what works – and stop things that don't' based on evidence Needs are assessed on an individual basis, based on granular data

Source: NZIER

We now turn to a number of specific examples of applications of the social investment approach that help cast more light on what is proposed.

6.1. Welfare forward liability

The most concrete steps undertaken towards implementing the social investment approach in New Zealand has been the development of a welfare forward liability.

The Ministry of Social Development and the Accident Compensation Corporation have both calculated the future welfare liability (i.e. in fiscal terms) of particular categories of people (e.g. different classes of beneficiaries or accident victims) via an actuarial analysis and are using such calculations to guide or inform the selection and targeting of interventions – such as active labour market policies (e.g. training programmes).

The broad aim has been to encourage agencies to select interventions and prioritise clients based on the expected reduction in the Crown's forward liability. To be effective, of course, agencies need reliable evidence not only about the respective fiscal liabilities of their various clients but also about which particular interventions are likely to be most cost-effective. Without such evidence there can be no assurance that the interventions selected will maximise net social returns. Simon Chapple is critical of the forward liability approach. He sees it as providing a one-sided metric: while there is a liability, there is no counterfactual benefits against which the liability is judged. This means, in particular, that there is a risk that all reductions in the liability, regardless of the effect of people, will be judged equally.[75]

The investment approach implemented through a forward liability has received some criticism.

[75] Chapple (2013).

In 2014, Simon Chapple said:

> *There are many problematic aspects of the forward liability investment model which is being applied in the welfare system. The problem definition surrounding welfare reform and the performance management approach of MSD has been poor, the forward liability solution has not been carefully unpicked, and reasonable alternatives to this model have not been acknowledged, let alone examined in detail.*[76]

The overall argument is that the welfare system does need much better, independent and regularly collected indicators of performance in terms of benefit take-up, underpayments and overpayments, and compliance with benefit conditions, as well as cost benefit indicators of the effectiveness of programmes in generating better employment and earnings outcomes.

6.2. Policy design

Again in part due to the government still working to fully develop its social investment approach, it is not clear at which level of operations it is intended to operate. The underlying idea is that to implement a social policy based on the principal of social investment, the government must build an environment that is conducive to an investment mind-set, where success is measured by rates of return.

At the level of programme design, we have seen three themes emerge from the early application of a social investment approach: demand factors, which we call client segmentation, a supply factor, intervention innovation, and governance factor. The end result sought is an institutional change in the market for social development in New Zealand.

6.3. Demand – client segmentation

The demand side of the social investment approach is about *segmentation*. It is built on an increasing understanding that the needs of individuals can vary significantly and thus what might work to address those needs also likely to different. This is a clear move from the early approach to social assistance in New Zealand, where needs were seen as uniform and thus could be relieved by uniform measures.

The objective is to build a strong understanding of the clients of the state, to divide them into groups with greater or lesser needs on which the expectations of return on investment must differentiated and therefore allows for different targeted mix of interventions. It is to gain understanding of where the returns on social investment exist by better matching unmet needs with successful interventions.

One distinctive element of the client segmentation approach is the use of individual level data, matching of data across social services and administrative datasets, the use of evidence and evaluation to learn on the characteristics of those different population, how to segment them and understand not just what works but what works for whom.

[76] Chapple, 2014.

6.4. Supply – intervention innovation

There are far-reaching consequences of client segmentation for the provision of interventions, the supply side. If customers have different needs, then they are likely to need different interventions to meet those needs.

Client segmentation through a better understanding of the needs of the customers requires a more differentiated statement of the outcome sought through intervention and the intervention itself. The New Zealand Treasury gives an example from unemployment assistance:

> *Traditionally governments have focused on getting newly unemployed people back into work, as unemployment is one of the biggest welfare costs. But analysis of lifetime costs of people who receive a benefit found that one of the most expensive groups is people who have recently returned to work from being on a benefit. This is because they are likely to slip back onto benefits. In any given month, 70 percent of people who sign up for a benefit have been on a benefit before. This indicates that the government needs to do more to help those people stay independent.*[77]

This focus on outcomes (what is achieved), as opposed to outputs (what is done) or inputs (who does it and for how much) is another element of the social investment approach in New Zealand. It is, however, not a new approach at least at the conceptual level. The Public Finance Act 1989 and the State Sector Act 1988 were part of a suite of reforms of the public sector in New Zealand that were intended to shift the focus from inputs to outputs and outcomes. In a 1989 paper, Graham Scott and Peter Gorringe,[78] two of the key architects of the reforms, wrote:

> *The distinction between outputs of goods and services an agency produces and the outcomes the government seeks to achieve is central to the reforms. … Under the new system, the performance of bureaucrats can be judged on whether they produce the outputs of services agreed to, and whether they do so efficiently. Politicians can be judged on whether they buy the right services to achieve social goals like wealth, justice and the relief of suffering. The distinction also highlights that politicians need not buy the services they require from the bureaucracy, and that the government need not be the only customer of the bureaucracy.*[79]

Writing in 2004, Anna-Louis Cook[80] concluded that while the core elements of the New Zealand Model of public administration remained sound, the state sector had yet to implement an outcomes-based approach.

The current government's focus on outcomes as part of its social investment approach can, therefore, perhaps best be seen as a further attempt to use the tools given to ministers and managers in the existing public management system, as opposed to being conceptually new.

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77 Treasury (2015).

78 Graham Scott was Secretary to the Treasury from 1986 to 1993 and is widely regarded as one of the leaders in the development of the "New Zealand Model" of public management. Peter Gorringe was a Chief Analyst in Treasury's Policy Coordination and Development Section and developed important analytical features underlying that Model.

79 Gorringe and Scott (1989).

80 Cook (2004).

Demand and supply work together, as the segmentation of the market into groups of customers becomes more and more reliable, products are to be increasingly sophisticated and designed to achieve specific outcomes.

This mechanism between demand and supply are the building blocks of the institutional change for social development that the current National government is trying to set in motion.

6.5. Governance

The final piece of the puzzle which ensures that supply responds to demand is the governance structure and regulations which determine the incentives within the market. One of the key challenge in driving the institutional change is building a new incentive and structure that leads to allocation of resources based on the two previous pillars.

All markets suffer from imperfect information which therefore implies that when information is scarce, returns on investment (in the social investment framework social investments) may not perfectly reflect the cost and benefits of a particular intervention.[81]

In the context of the social investment approach in New Zealand, incentives need to be both towards:

- funding interventions which are most effective (from a cost benefit lens) in achieving the desired outcomes
- a learning structure which ensures that information is consistently refined and the state rewards risk taking in the face of imperfect information.

The idea is to develop a governance structure and incentives that will sustain the production of information so that the information on investments is as best as possible and the state has enough information to justify taking risks in undertaking social investments.

Table 7 shows the four mains levels at which the government operates social programmes. We have seen suggestions that governance element of the social investment approach might operate at all four, although there has been more emphasis on the programme and portfolio level to date.

[81] See Stigler (1961) and Hirshleifer (1973).

Table 7 Level changes of the New Zealand social investment approach

Level	Features
Programme	Target resources within existing programmes (e.g. matching clients to programmes based on the expected effectiveness)
Portfolio	Allocate resources across a set of programmes within an agency
Whole-of-government	Allocate resources across agencies, and how to encourage cross-portfolio, multi-dimensional investment strategies, especially for assisting citizens with complex and multiple needs

Source: NZIER

6.6. Progressive implementation

The New Zealand social investment approach is still developing and the government is building what the social investment approach looks like progressively. We can, however, distinguish two phases separate phases of development. The first focused particularly on actuarial considerations and the, current, second phase places greater emphasis on building individual data capability across government and administrative data sources.

It is hard to anticipate how the approach will evolve over time. Nonetheless, the overarching idea of driving institutional change to foster intervention innovations through the combination of our three pillars which will drive the future shape of the social investment approach in practice in New Zealand.

Table 8 summarises the social policy questions that the social investment approach intends to answer differently than the current status quo. How the institutional change will arise from the combination of the three pillars is still to be fully developed by the government.

The New Zealand social investment approach is also distinctively expansive. The current social investment approach in started with injury rehabilitation (ACC) then extended to active labour market programmes (within MSD). The government is actively working on extending it to Justice, Education and Health. The New Zealand Productivity Commission Inquiry on social services report explored the recommended its extension to operate at a cross-programme and cross-agency level (R9.4, p. 236).

Table 8 The big questions on social policy

Pillar	Social policy decision	Status quo (vastly caricatured)	Social investment approach (overly optimistic)
Client segmentation	Who to spend it on?	Those meeting programme eligibility criteria (broad proxies for disadvantage)	The individuals for whom spending offers the highest net social benefit
	How to measure the difference made?	Greater spending has greater effect Subjective or qualitative programme evaluation	Aggregation of individual-level outcomes as captured by administrative data

Pillar	Social policy decision	Status quo (vastly caricatured)	Social investment approach (overly optimistic)
Intervention innovation	What to spend it on?	Existing programmes plus politically determined new initiatives	Whatever is demonstrated to have the most effect relative to its cost
	Who delivers the service?	Whomever delivered it previously -- generally a mix of public, not-for-profit and for-profit	Whomever does the "best" job, as measured quantitatively
Governance	How to allocate those funds?	Baseline is past allocations to administrative silos	Flexible allocation across administrative silos for highest net social benefit
	Who matches individual to programme?	Policy-makers, via eligibility criteria, programme design and budget allocation	Case-worker, navigator or algorithm?
	How to feed this back into public decision making?	Advocacy/lobbying	Funds should be flexibly allocated across administrative silos for highest net social benefit
	What performance measures drive organisational behaviour?	Varys across and within silos. Often a crude count of transactions.	Aggregated quantitative data at all levels
	How to maintain and build taxpayer and voter support?	Appeal to solidarity, mutual support, and intra- & inter-generational fairness	Additional appeal based on long-term efficiency and effectiveness

Source: Dave Heatley personal communication

7. New Zealand's social investment approach is unique

Both at the political economy level, as well as in the practical implementation of the social investment perspective, the similarities between the New Zealand social investment approach and the European approaches stops at the underlying organising theme (i.e. invest rather than protect).

This is partly because social policy issues in New Zealand are different from those overseas, especially in Europe. The factors driving the European welfare states toward social investment are mostly non-existent in New Zealand.

The New Zealand social investment approach is silent on reforms to the income redistribution system or education (human capital investment) which are core policies of other social investment approaches in Europe. It is also not concerned to a great degree with activation policies, in large measure due to this not being a significant problem here.

The New Zealand social investment approach also differs from other approaches by its focus on a wider range of beneficiaries (not just the long-term unemployed as in Europe). The idea of contracting non-government providers to deliver government social programmes is very different and not seen in other welfare states.

7.1. Is the New Zealand social investment approach new?

The only reason to be concerned with whether the social investment approach is new or not is that, is the concern that the social welfare system is failing a significant portion of the New Zealand population. If social investment is just a new name for policies that have not worked, we should not expect much from it.

The objectives of the approach – improving people's lives – is certainly not new. The idea that cash-based transfers will address all social ills is also not new.

That early interventions might lead to better long-term outcomes is not new.

Holding public service managers accountable to outcomes is not new in theory, but to date there have been few examples where rigorous accountability mechanisms have been applied either consistently or with measurable effect.

New Zealand has pioneered the use of forward liability estimates to implement a social investment approach.

Using administrative data to identify people at risk of poor outcomes is new, not least because the data has only recently been made available and used by government agencies in policy design.

The three themes of client segmentation, intervention innovation and governance to drive institutional change are certainly novel, as is using forward liability as a measurement tool, as an instrument for guiding interventions and as a motivating factor.

7.2. Interesting idea, with considerable promise

Social investment, especially as it is understood and practiced in the European Union, is a known term in social policy; but it describes something rather different from what the New Zealand government is proposing. However, as Humpty Dumpty says, you can use a word to mean anything. But it aids understanding if everyone uses the same words to describe the same thing.

Social investment, Kiwi-style is introducing promising new ideas to address pressing social problems. Provided people understand that the term "social investment" as it is applied in New Zealand is different in some key respects from welfare policies that have that label internationally and in the social policy literature, then they will be able to focus on the new elements of the policy and investigate the likelihood of it being successful.

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