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Public Policies as Investments

Michael Mintrom, Monash University and ANZSOG

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The Australia and New Zealand School of Government and the State Services Authority are collaborating on a partnership that draws together a broad network of policy-makers, practitioners and leading academics.

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The current paper builds on Professor Mintrom's Inaugural Lecture, presented in February 2012 at the Old Treasury Building, Melbourne. It relates to a broader book project being completed for Oxford University Press. His previous books include: *Contemporary Policy Analysis* (Oxford University Press, 2011), *People Skills for Policy Analysts* (Georgetown University Press, 2003), and *Policy Entrepreneurs and School Choice* (Georgetown University Press, 2003). He also co-edited *Political Leadership in New Zealand* (Auckland University Press, 2006) and co-authored *Public Entrepreneurs: Agents for Change in American Government* (Princeton University Press, 1995).

Public Policies as Investments

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Many governments around the world are currently experiencing financial stress. Due to changed economic circumstances, tax revenues have fallen while pressures on expenditures have increased. In response, governments have been engaging in more deficit spending. Longer term, however, deficits must be eliminated and ways must be found to run surpluses so that government debt can be sustainably managed. Despite improved government abilities to manage their financial position in the face of changing economic circumstances, we can expect periods of fiscal stress to recur from time to time. During these periods, governments inevitably look for ways to reduce their expenditures. How should spending be cut? This is what we know: Usually spending cuts are imposed across the board. Agency staff members are expected to exercise discretion in determining how to meet savings targets. In practice, this can mean imposing expenditure cuts uniformly across a range of programs. Sometimes, particular programs are targeted and eliminated because they do not enjoy strong political support. Others – like professional development programs for staff members – are viewed as 'nice to have' but as 'luxuries'. Spending for them is cut with the intention that, when the fiscal situation improves, spending on them will begin again.

In 2010 I was appointed by the New Zealand Government to chair a taskforce on early childhood education. From November 2010 through to April 2011, I worked with a group of eight other experts to review the current situation in that sector and suggest future policy directions. There was an occasion when I met with Treasury officials to discuss our work. By that point, I was familiar enough with the evidence base to know that funding high-quality, effectively-targeted early childhood education programs was one of the best investments that governments could make. In the conversation with Treasury officials, I was briefed on the difficult fiscal situation the government faced. I was reminded that the taskforce was to consider ways to improve outcomes without increasing spending. And it was suggested to me that the Treasury viewed early childhood education as an area where spending had been increasing too fast and where there appeared to be a lot of room for making cuts. My response was to ask about the logic underlying budgetary decision-making in the Treasury. It became clear from that conversation that the 'logic' involved looking to make cuts wherever it was politically viable. When I asked about comparison of marginal returns on expenditures, I was met with quizzical stares. Ultimately, the taskforce I chaired argued strongly for improved targeting in early childhood education spending, and for promoting of higher quality service provision. We also argued that this area should be made a top expenditure priority for government spending and that, as more funding became available, increased expenditure in the area would be merited.

This paper is an initial step in my effort to build on and broaden the logic that led me to believe the New Zealand Government should give high priority to funding high-quality, effectively-targeted early childhood education programs. Currently, I am working to amass existing evidence about the positive returns that societies can enjoy when governments make well-chosen public policy investments across many areas, not just education. I intend to show that effective use of evidence is essential to the making of good public policy choices, but that too often such evidence is ignored. Further, I intend to establish the foundations for an on-going research agenda that will ultimately promote more theory-driven, evidence-based decision-making in government than is presently observed.

This paper has one key message. Public policy choices should be informed by investment analysis. Often, they are not. But investment models are starting to be used more systematically to guide government decision-making (see, e.g., Aos et al 2011). Consequently, an opportunity now exists for extending the logic of investment decision-making to most government spending choices.

Treating Public Policies as Investments

Since its inception, public policy education has lacked conceptual coherence in the ways that students are introduced to various substantive public policy issues. This reinforces the view that policymaking within specific areas occurs without reference to the broader portfolio of governmental interests and activities. Over the past few decades, government expenditures have become more commonly construed as investments. In the realm of policy practice, the investment approach to public policy is appearing in discussion papers produced by policy advisors in and around government. For example, recent reports produced in Australia, Canada, New Zealand, the United Kingdom and the United States have explicitly portrayed and discussed a range of public policies as investments (see the list below). Recognising the shift towards greater accountability for government spending, the United States National Aeronautics and Space Administration (NASA) has included the following statement on one of its library web pages:

Government agencies are among the major drivers in the American economy. It behoves them to demonstrate that their programs will benefit the citizens. However, some programs will have it easier than others: A program to fix storm-damaged lighthouses will have an easier time demonstrating its usefulness than a program for installing sculptures in city parks. Often, the intangible benefit to society from programs such as the latter is termed social return on investment (NASA 2010).

NASA followed this statement with a list of citations providing advice on how to measure the return of investment in government programs.

The treatment of public policies as investments is implicit in cost-benefit analysis, which is now used routinely by advisors in government as they seek to clarify the impacts of policy choices. A key aspect of cost-benefit analysis involves calculating expected returns on investments. While all public finance textbooks and most public policy textbooks discuss how cost-benefit analysis can be performed, those textbooks rarely include any sustained discussion of public policies as investments. David Hyman's (2010) *Public Finance* is an exception, where a chapter is devoted to portraying cost-benefit analysis as a tool for assessing government investments. Patricia Pulliam Phillips and Jack J. Phillips' edited volume, *Measuring ROI in the Public Sector* (2002), a specialist text, offers an interesting contrast to the current set of public finance and public policy textbooks. Phillips and Phillips present a series of case studies that build on the common theme of applying investment analysis to calculating the benefits of government-sponsored training programs.

It would be easy for an exploration of public policies that treats them as investments to become a narrow, technical exercise. That should be avoided. While indicating the tools for treating policies as financial investments and measuring their return on investment, I seek to emphasise the importance of broadening the investment metaphor. Thus, among other things, I am interested in how well-designed public policies can serve as effective platforms for the on-going development of programs and practices that, over periods of time, add high value to the lives of citizens. In taking this approach to treating public policies as investments, I wish to avoid being both technically narrow and intellectually blinkered.

The investment perspective is normative. It is based on the view that all government programs should be treated as investments whereby current expenditures serve to promote better social outcomes for the future. The approach deserves careful scrutiny, because the normative implications – especially when public policy investments are construed narrowly – can be unpleasant. In a relevant commentary published in *The Guardian Weekly*, Madeleine Bunting noted that '[c]aring for others cannot be toted up according to a calculus of costs and returns'. Bunting went on to state:

Care for children fits into a marketized understanding of relationships: we talk of "investing" in our children. The state sees children as important because of their future worth to the economy as labor. But in this marketized mindset, the elderly have no economic value; they are perceived as a burden. The only values ascribed to the elderly are found … in silver-haired celebrities still working… (Bunting 2011).

Bunting's critique is not of the investment perspective so much as of the narrowness with which people apply it when discussing policy choices of governments or the day-to-day choices of citizens and family members. In contrast, I take the view that good public policy analysis should first begin by considering what social values governments wish to promote through public policy. It should then indicate an effective strategy – a model of investment – for increasing the likelihood that those values will be promoted, rather than being inadvertently displaced or ignored. Indeed, an assumption underlying this approach is that explicit and thorough analysis of government choices is the best way to move society in the direction of generating the greatest good for the greatest number of people.

In short, the investment perspective can be applied in a manner that is consistent with the deeply compassionate goal of maximising human flourishing throughout the life-course. Next, I note two examples of its application.

Case 1

Each of us benefits from education. Further, we all benefit from having educated people around us. That is why education is often thought of as a good that has both private benefits for the individual receiving it and public benefits. Education is also a post-experience good. That is to say, we often do not appreciate the full value of attending school or university until long after we have completed our diplomas or degrees. When we are young, we need other people to act in our best interests. Within the field of education, early childhood education continues to be commonly viewed as less important than what happens to people at school or in higher education. This helps to explain why attending school is compulsory in many countries; in contrast, no country requires children to attend early childhood education services. However, important evidence has begun to show that attendance in high-quality early childhood education services can have major and sustained benefits for individuals, especially those coming from families with less-educated parents and lower household incomes.

This evidence is based on longitudinal studies (principally conducted in the United States) that conformed to the model of randomised field trials, where early childhood education was considered the treatment. Through randomised allocation, some children received the treatment while others did not. Analysis of data collected in these studies has demonstrated that the individuals involved and society as a whole gain greatly from investments made in people's early education. The magnitude of the return on investment fluctuates across studies and is sensitive to how narrowly or broadly benefits are construed. However, the pattern of findings can be summarised as follows.

These studies have revealed that, compared with matched peers who did not receive the treatment, children from poor families who attended high-quality early childhood education services were more likely to perform better at school, stay in school for longer, attend university, obtain and remain in steady employment, refrain from criminal behaviour, get married and stay married, and have children of their own. They were also found to experience better physical and mental health later in their lives. Given this evidence, targeted subsidisation of poor children into high quality early childhood education services represents a very good use of government funding.[1] The evidence base supporting this kind of public policy was largely established in the United States. Ironically, that country lags behind many others in the provision of targeted, high-quality early childhood services.[2]

Case 2

For adolescents and young adults, spending extensive time outside of training or any form of gainful employment can have detrimental long-term effects. Economists refer to this as 'scarring' (Arulampalam, Gregg and Gregory 2001). Scarring can take a variety of forms. Those who have been inactive as adolescents and young adults are more likely than others to experience future bouts of unemployment. Often, they find a mismatch between their skills or their work preferences and the jobs they are able to acquire. There is a tendency for these people to have lower income streams over the life course than others who have had stable employment. Some studies have noted a greater tendency toward psychological problems and family dissolution in cases where one or more of the adults is unemployed (Thomas, Benzeval and Stansfeld 2005). It is also the case that people – predominantly women – who take extensive spells outside of the paid workforce to perform care duties in their families can have difficulty returning to paid employment. The jobs that women enter after spells of full-time care-giving are often unsatisfying to them, as well as poorly matched to their skills. Evidence suggests a tendency for such women to retire from the labour force earlier than men and earlier than other women who did not lose touch with the workforce during their careers (Abhayaratna and Lattimore 2006).

Should policymakers care about these things? From an investment perspective, the answer is clearly 'yes'. That is because appropriate support, guidance, or mentoring for people at critical decision-points in their lives would likely have three kinds of positive benefit. First, it would lead to the individuals themselves having more satisfying, productive, higher-income, and socially-engaged lives. Second, it would reduce the risk of government having to make future expenditures on these individuals in the form of benefit payments and the delivery of other forms of individual and family support services. Third, it would increase the likelihood of these people paying more tax over the course of their lives.

Governments in several countries are beginning to take an investment approach to working with people who are vulnerable to the scarring effects noted above. The United Kingdom is leading the way. For example, the Department for Work and Pensions conducted a multi-year randomised controlled trial to test the effects of policy interventions designed to help long-term unemployed people return to and remain in permanent employment. The study findings revealed strong positive returns on the investments made in individuals (Hendra *et al.* 2011). Those who were included in the program were assisted to find employment. They were then supported by Advancement Support Advisers for up to two years; these advisers were expected to help the individuals avoid some of the early pitfalls that sometimes cause new jobs to be short-lived. They were trained to help participants advance to positions of greater job security and better pay and working conditions, at either their current employer or a new one. Special cash incentives were also given to encourage people to remain in work, along with support to complete training while employed, and emergency payments were available to help people overcome short-term barriers to staying in work. A cost-benefit analysis suggested that the return on investment from this program was equivalent to £4 for every £1 spent on it.

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[1] Children from better-off families also benefit from early childhood education, but the long-term effects are less pronounced. It is also the case that better-off families are more likely than poor families to choose to place their children in early childhood education regardless of the amount of government subsidy.

[2] For a summary of the relevant evidence to support the claims made here, see Mintrom *et al*., 2011

Broader Implications

The two cases noted here indicate the gains to specific individuals and to society as a whole that can be achieved when governments take care in selecting how to invest scarce program resources. The kind of knowledge that supports effective policy choices in early childhood education and in the support of job seekers can guide both government spending and the cutting of expenditures. Just as in good fiscal times governments would be foolish to spread money around in an across-the-board fashion, it is equally foolish – but commonly observed – for governments to cut expenditures indiscriminately when belt-tightening is needed. If serious, evidence-based efforts are made to determine the likely return from the marginal expenditures in specific program areas, then the scene can be set for judicious discussions of where to spend new money and where to reduce current spending. Inevitably, governments will balance such decisions against their political calculations. That is the nature of democratic politics. However, improving the evidence base that guides government budgetary choices is highly desirable, and is likely to promote better overall social outcomes than we have achieved in the past. Note also that the approach of treating public policies as investments does not imply that all governments everywhere need to suddenly start rushing to collect and analyse vast amounts of new data. In many instances, jurisdictions can learn relevant and important lessons from observing the outcomes of policy studies performed elsewhere. Creative blending of comparative institutional analysis (Mintrom 2011) with evidence-based investment analysis holds the promise of yielding many insights for decision-makers in jurisdictions where efforts to collect and analyse relevant data have not occurred. In other words, lack of evidence in everyone's backyard is no excuse for people continuing to make poorly-informed policy choices, be they to do with spending or saving scarce public dollars.

Conclusion

I have argued here for greater use of evidence-based investment analysis in policy development. An opportunity now exists for extending the logic of investment decision-making to most government spending choices. In my current book project, I am examining how effective use of investment thinking and appropriate evidence can guide policy choices across many areas of traditional government activity. These include: public infrastructure, public safety and national security, public schooling, health care, income maintenance, criminal justice, science funding, environmental protection, and economic development. The aim is to improve public policy education and, in turn, to improve the quality of public policy design work and the choices governments make when seeking to increase or decrease their overall spending.

Treating public policies as investments is an important way of ensuring that micro-level policy choices are fully consistent with macro-level policy goals. The approach to public policy advocated here contrasts sharply with the set of mentalities and practices that produces public services that are under-funded, poorly functioning, populated by demoralised staff, and constantly criticised by citizens. When governments prioritise their activities and determine the most appropriate ways to meet specific policy goals, they open the possibility of delivering high-value public services by top-notch professionals, whose efforts are fully appreciated by citizens. This desirable state can be attained. But getting there will take resolve, and a way of approaching public policymaking that is more focused and deliberate than we have seen in the past.

Recent Reports Portraying Public Policies as Investments

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