

Banking the benefits

Better aligning budget process rules with Measuring What Matters



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Executive Summary

The Budget Process Operational Rules (BPORs) detail how federal decisions about policy proposals are made, who can make the decisions, and what information must be included as part of the decision-making process. These rules currently state that: “Only first round effects will be considered in costings.” This decision to only consider first round effects is likely borne out of a desire for precision and reliability of costings – but the inability to consider second round fiscal effects (SRFEs) can act as a barrier to policy proposals that have significant, long-term benefits for society.

CPD’s research on aligning government decision-making with the long-term wellbeing of people and the environment has underscored the need for a more holistic perspective and highlighted the importance of considering the impact of policies beyond traditional, short-term horizons. The Measuring What Matters framework, alongside recent investments in improving the evidence base for policy decision-making, marks an opportunity for the Commonwealth Government to shift towards policies that better meet the needs of current and future Australians. However, the existing BPORs limit the potential for policy and expenditure to fully align with wellbeing objectives.

Where a proposal is likely to have second round fiscal consequences, and those consequences can be determined (and secured) with a high degree of confidence, these should be included in formal budget costings. By SRFEs we are referring to the costs or savings for government due to increased or decreased demand for government services (such as improved health translating into less demand for health services) – not decreases or increases in general economic activity.

Permitting the incorporation of SRFEs in policy costings would incentivise the development of proposals that focus on early intervention and prevention, which often lead to better wellbeing outcomes and fiscal

savings. For instance, policies that reduce the need for long-term unemployment support not only improve the wellbeing of those who would have interacted with the system directly, they also represent long-term fiscal savings that under current rules would not be counted. Incorporating SRFEs will also encourage a more holistic approach and help facilitate 'joined-up' decision-making, recognising the impact that decisions made within one portfolio can have across other portfolios. This approach would enable more comprehensive evaluations of policy impacts across a range of areas.

CPD also recommends in some cases extending the timeframe for costing policy proposals to up to 25 years, to better capture their long-term impacts. This change will allow for a more accurate representation of the true costs and benefits of policies.

Improving government decision-making to align with long-term wellbeing requires better representation of the long-term costs and benefits of policies. The proposed BPORs amendments would contribute to the embedding of the government’s Measuring What Matters framework by encouraging the development of transformative policies with real fiscal impact, even if the benefits are realised over an extended period. These changes will support a cultural shift towards preventative and evidence-based policy proposals, ultimately promoting the long-term wellbeing and flourishing of Australian society.

Summary of Recommendations

1. Inclusion of SRFEs in Policy Costings

Cost assessments of new policy proposals should include SRFEs in cases where:

- a. Best evidence shows a high likelihood of SRFEs that would follow directly from the intervention;
- b. These effects are expected to represent a materially significant and direct cost or saving to government that can be estimated reliably and, ideally, tracked;
- c. Any fiscal benefits are to arise from a decrease in demand for government services, and any fiscal costs are to arise from an increase in demand for government services (for example, increased demand for health services due to a decline in health outcomes).

2. Extended Timeframe for Costing Proposals

Costing policy proposals should consider impacts up to 25 years in cases where:

- a. The best evidence suggests a high likelihood that long-term benefits (or costs) would emerge directly as a result of the intervention;
- b. These long-term fiscal impacts would be materially significant in the analysis of the policy proposal.

3. High Standards of Rigour in Assessing SRFEs

Ensure rigorous calculation and application of SRFEs through:

- a. Ensuring SRFEs are not conflated with second round economic effects which are much more challenging to estimate. SRFEs refer to direct increases or decreases in demand for government services, not in increases or decreases to economic activity;
- b. Building government capability to develop the evidence, skills and processes to confidently calculate SRFEs;
- c. The tracking of outcomes to ensure that banked savings are realised.

1. Second round fiscal effects and wellbeing

One of the ultimate aims of the departments of Treasury and Finance should be the consistency of public expenditure with the wellbeing of the Australian people. Governments spend money to achieve outcomes. Wellbeing-informed budgeting seeks to optimise those outcomes by stressing the importance of:

- *Holistic decision-making*: taking a 'joined-up' approach to government, encouraging multi-agency policy development, and avoiding 'siloed' decision making. This includes recognising the broader impacts of policy proposals beyond portfolio areas, and the interconnected nature of many of the problems the government seeks to address;
- *Long-term decision-making*: decision-making that has a focus on the longer-term impacts of policy proposals including consideration of future generations, and which recognises that policies that deliver more sustainable wellbeing benefits may have higher upfront costs but lower costs over their lifespan.

We use the term “second round fiscal effects” (SRFEs) to refer to the behaviour or outcomes, directly attributable to a policy, that represent an increase or decrease in government expenditure due to a change in demand for government services. Policies that reduce the need for support for long-term unemployed people, or the need for funding through Medicare for mental health/psychological distress, for example, represent not just a wellbeing improvement but a potential fiscal saving to government. These effects are important components to consider in holistic and long-term decision-making.

When demand relates to services that treat or alleviate wellbeing deficits from factors such as ill-health, housing insecurity, or environmental damage, SRFEs can be a useful fiscal proxy for wellbeing outcomes. In ideal circumstances spending on these services would go down because there would be less demand, indicating a population with a higher level of wellbeing. This leaves more money in the budget to meet a higher proportion of need, to spend on other areas that further increase wellbeing, to reduce the deficit, and/or to decrease the need for tax revenue. Note that SRFEs do not include second round economic effects (see §3.1).

A rigorous process that includes costing of the projected increase or decrease in demand for government services attributable to a particular intervention not only contributes to accurate and sustainable fiscal calculations, but does so in a way that can further the government’s Measuring What Matters objectives. When this rule is appropriately formulated, the consideration of SRFEs in costings would address one of the less obvious barriers to government decision-making more effectively promoting the long-term wellbeing of the Australian people.

Not permitting SRFEs to be represented in costings:

- 1) Acts as a barrier to line agencies developing and proposing programs that have higher upfront costs but lower costs over their lifespan (for example, those that focus on early intervention or prevention);
- 2) Discourages line agencies from working together on cross-portfolio budget bids, particularly where the benefits from a policy enacted in one department would mostly accrue outside that department; and
- 3) Under-represents the long-term costs to government of some policy proposals, particularly where the costs generated by a policy enacted

in one department would mostly accrue outside that department.

The inclusion of SRFEs in policy proposal costings provides an incentive for departments to develop proposals that increase expected positive SRFEs and, by extension, have a positive impact on MWM domains. In some cases, two proposals that may otherwise look indistinguishable in terms of projected first round outcomes may have very different projected second round outcomes.

It is not the case that including SRFEs in costings should be required for all policy proposals – it will not be relevant for many policies at the commonwealth level. However, CPD’s research shows that the combination of these types of small barriers in the system have a cumulative impact that reduces the effectiveness of efforts to improve practice and outcomes within the public service.

1.1 Removing a barrier to early intervention and prevention

Early intervention and prevention not only represent potential savings for government, but importantly these approaches provide better wellbeing outcomes than can be achieved by only treating demand when it has already arisen or become acute. However, the potential downstream savings of early intervention and preventative policies typically fall into the category of second round fiscal savings. Policies that are cost-neutral or close to it, as defined by the BPORs, are much more likely to make it through the obstacle course of the bureaucracy and be sent to a final decision-maker (such as Cabinet), and are more likely to be approved once they get there. Without counting SRFEs in policy costings, early intervention and preventative policies can be unfairly deprioritised, even if they would represent a very low cost or even an overall saving to government when these effects are taken into account. Further, without being

able to bank future fiscal savings, these bids directly compete with current departmental budget expenditure. This can act as a disincentive for early intervention and prevention to be prioritised over addressing current need, even if investment in such policies would reduce future need.

1.2 Removing a barrier to ‘joined-up’ decision making

Improving the wellbeing of the Australian people requires holistic decision-making that recognises the impact that decisions made within one portfolio can have across other portfolios. In health, for example, it is estimated that from a third to over half of the difference in health outcomes is due to factors that lie outside of the healthcare sector - factors including housing, socioeconomic status, education, social support networks, and transportation.

While policy proposals can currently be offset outside of the proposing department, the impact that policies have on demand for government services that goes beyond a department’s portfolio area are almost always realised in second round effects. This means that most cross-departmental fiscal savings cannot currently be represented as an offset. Without SRFEs counting towards costings, the allocation of offsets for cross-departmental policies is complex and can unfairly penalise proponents of cost-effective policies. Counting SRFEs towards costings, however, would remove some of the disincentive to pursue cross-portfolio work.

1.3 Accurately representing long-term costs of policies

Allowing for the inclusion of SRFEs in costings can better capture the broader fiscal impact of policies that, in addressing one problem, may generate negative wellbeing impacts in other portfolio areas. Where rigorously applied, this has the potential to reduce risks of unforeseen or under-weighted and uncosted second round fiscal outcomes.

Examples can include measures that appear to be cost savings, such as tightening means testing for a benefit or centralising service delivery. Such measures may result in direct savings for that area of expenditure but also result in cost increases in other areas that offset the savings and reduce wellbeing.

2. Suggested changes to the BPORs

We are not recommending a sweeping change that is applied to all policy proposals, but rather an amendment to the rules that ensures the best chance of them being applied effectively, rigorously, and in keeping with intentions to align with the long-term wellbeing and flourishing of society. This will require supporting capability, which we discuss in the following section, and may be best approached through a pilot scheme to prove up methodologies and to enable a smooth process of scaling through the budget process.

Changing the budget rules to allow for counting SRFEs in costings will also require careful framing in line with the following principles:

1. In costing policy proposals, second round fiscal effects should be included in the case that:
 - a. Best evidence shows a high likelihood of SRFEs that would follow directly from the intervention;
 - b. They are expected to represent a materially significant direct cost or saving to government and that these can be estimated reliably and, ideally, tracked;
 - c. Any fiscal benefits are to arise from a decrease in demand for government services, and any fiscal costs are to arise from an increase in demand for government services (for example, increased demand for

health services due to a decline in health outcomes).

2. The timeframe for costing policy proposals be extended up to 25 years in cases where:
 - a. The best evidence suggests a high likelihood that long-term benefits (or costs) would emerge directly as a result of the intervention;
 - b. These long-term fiscal impacts would be materially significant in the analysis of the policy proposal.

2.1 The importance of changing the BPORs

While second-round fiscal effects can and should be represented in the business cases that accompany new policy proposals, their inclusion within business cases does not affect the “bottom line” costing by the Finance Department, and will not address the barriers highlighted above. One of the key problems that the rule change proposed here seeks to address is the understandable reluctance of departments to divert acute spending to early intervention initiatives, or to those with cross-portfolio outcomes. Further, business cases typically do not undergo the same standardisation or rigour as costings, which means that it can be hard to differentiate between the range of reported potential second round effects within a business case. This is particularly apparent where SRFEs are conflated with second round economic effects (see §3.1).

Similarly, having a ring-fenced pool of funding to encourage investment in early intervention initiatives will not have the same impact as banking SRFEs. International examples of

such funds¹ show that while they may increase the number of early intervention initiatives in the short term, without 'closing the loop' and tying funding directly to the savings that early intervention generates, they lack a mechanism that allows the fund to grow based on the savings that it generates. This can make such funds vulnerable to being ended on the grounds of their cost, without consideration of the real fiscal savings that they generate. Another strength of banking SRFEs over specific funds is that it not only increases the chances that good policies get through, but also discourages policies that have a negative overall effect on wellbeing.

2.2 Extending the timeframe for assessing proposals

The BPORs already recognise that the 4 year forward estimates published in the budget is an insufficient time horizon for decision-making, hence the requirement for new policy proposals to be costed over an additional seven years beyond the forward estimates. While this is sufficient for many types of policies and interventions, there are obvious examples – such as many of the SRFEs discussed above – that take longer than 10 years for the benefits to become fully apparent. A longer timeframe is particularly important to accurately assess the fiscal impact of interventions that build human capital (e.g. education and health), and interventions intended to break intergenerational cycles of disadvantage. These sorts of interventions, for instance those that keep children in school, deliver benefits across a whole lifetime, many of which are only fully realised once people are established in the workforce.² This is often more than 10 years after the spending. We therefore recommend that in costing policy proposals where the benefits emerge over

many years, there should be scope to include savings and costs up to 25 years in the future.

Combined with the inclusion of SRFEs in costings, allowing savings and costs beyond 10 years would support a broader culture shift towards early intervention and evidence-based policy proposals. The budget rules make it easier for agencies and ministers to bring forward policies that are offset by savings. However, if only medium-term savings are counted, it creates a cultural bias towards bringing forward policies that have immediate impact (e.g. acute services), even if the evidence suggests other policies would have a greater impact over the long term (e.g. early intervention). We understand that this process would be resource intensive, so recommend that it only be applied in cases that have the approval of the Treasurer or Finance Minister.

3. Ensuring a high level of rigour in calculating and applying SRFEs

There are two key reasons why the BPORs do not currently permit the inclusion of SRFEs in costings. First, SRFEs are often conceptually combined with second round economic effects which, by their nature, can rarely be calculated with a high level of confidence. Second, to have a sufficient level of confidence to bank SRFEs would require a significant investment in government capability. We address these concerns below, and highlight Victoria as a jurisdiction that banks SRFEs in a way that not only maintains, but has actually improved budget rigour.

¹ For example, Children, Young People and Families Early Intervention and Adult Learning and Empowering Communities Fund (Scotland) – Scottish Government. (2019). [Children, Young People and Families Early Intervention and Adult Learning and Empowering Communities Fund evaluation: final report.](#)

² OECD. (2015). [Universal Basic Skills: What Countries Stand to Gain.](#)

3.1 Second round fiscal effects should not be conflated with second round economic effects

When second round effects are discussed there is often little distinction made between costs or savings to government due to increase or decrease in demand for services (second round *fiscal* effects) and costs or benefits to the economy of reduced or increased economic activity (second round *economic* effects). However, these two types of effects are not equivalent. Typically, second round *economic* effects are challenging to robustly estimate, represent a high degree of uncertainty, and present a risk of double counting.³

Second round economic effects can result in fiscal effects (for example increased economic activity can lead to lower unemployment that reduces transfer payments). However, the limitations on accurately modelling these effects and the inability to track the causal impact an intervention has on levels of economic activity mean such effects are not good candidates to include in budget process rules. SRFEs do not include second round economic effects.

In contrast, the potential savings for government associated with the direct impact of a program on a decrease in demand for acute government services (or the costs associated with an increase in demand) can, in some cases, be modelled with a high level of accuracy. Where linked data and/or data on comparisons with control cohorts is available these savings can be effectively tracked. Unlike with second round economic costs and savings, it is possible to bank second round fiscal costs and savings in a robust way, as has been achieved in other jurisdictions.

3.2 Case study: Banking second round fiscal effects via the Victorian Early Intervention Investment Framework

Including SRFEs in budget costings is an approach taken by the Victorian Department of Treasury and Finance (DTF) in the use of their Early Intervention Investment Framework (EIIIF). EIIIF is a policy proposal assessment framework that is used to calculate and ‘bank’ not just upfront costs and expected outcomes but also an “estimate of the avoided cost to the Government from the reduction in the use of acute services”.⁴

For example, the Journey to Social Inclusion initiative (J2SI) funded through EIIIF was shown to reduce homelessness by 90%, and also reduce hospital bed stays by 60% in the intervention group.⁵ It has been assessed by the Victorian DTF that this intervention is cost-negative - this assessment assisted in making funding available for scaling up the J2SI for a second time.

To ensure rigour in fiscal assessments of policy proposals, DTF employs several safeguards. First, the evidentiary standard for new policy proposals assessed under EIIIF is significantly higher than for typical budget bids, to ensure a high level of confidence that any projected reduction in demand for government services and associated savings will be attained. Second, only 50% of the anticipated saving is then offset as a reduction in the budget of the saving department. 50% gives a wide margin for error in savings forecasting. Third, rather than being a ‘set and forget’ approach, under EIIIF, actual savings are assessed annually - if they come in lower than the amount offset the difference between the offset and the real saving is returned to the relevant department. To aid this where possible, at the

³ Parliamentary Budget Office. (2017). Including broader economic effects in policy costings.

⁴ Victorian Department of Treasury and Finance. (2022). The Early Intervention Investment Framework: A Considered and Collaborative Approach to Support Early Intervention Investment: 1.

⁵ Sacred Heart Mission. (2022). [Journey to social inclusion program outperforms its targets for the third year in a row.](#)

point of proposal, outcome measures are ideally matched with a control group of comparable individuals not participating in the intervention. This enables tracking of program effectiveness over time, and may include program data collected through the initiative (such as surveys of participating individuals) and/or linked data (such as data on correctional service demand).

EIF's success demonstrates that in a range of cases there is a strong evidence base for specific and significant SRFEs that can be used as part of robust budget calculations. To date, only one EIF bid has not achieved its anticipated savings.

3.3 Considerations for evidence-based decision-making and the counting of SRFEs

The Victorian example demonstrates how second round fiscal effects can be banked in a way consistent with a high standard of budget rigour through:

- a) High confidence that second round fiscal effects will be achieved, supported by a strong evidence base;
- b) A wide margin of error built into any offsetting (such as 50% in the case of Victoria);
- c) The tracking of outcomes to ensure that any banked costs or savings are realised.

Changing the rule to allow SRFEs to be counted in costings is needed to enable greater alignment of the budget process with Measuring What Matters, but the change would not deliver it on its own. Building the capability to include SRFEs in costings can support and expand upon recent investments in evidence-based decision-making (for example, the Australian Centre for Evaluation (ACE)) and data-informed government decision-making (through data assets such as the Life Course Data Initiative), directly linking their resources and findings to a pragmatic way of improving the

effectiveness of policy formulation and selection.

To support the rigorous calculation of relevant SRFEs, there will need to be coordination of resources and methodologies within Finance and Treasury. It will require increased capability to assess the effectiveness of policy interventions, particularly in relation to whether a projected saving has been achieved. This aligns with the work that is already being carried out by ACE.

Rigorous calculation of relevant SRFEs will also require using linked data to underpin assessments of policy interventions, ensuring that any savings banked are highly likely to be achieved, and ideally that they can be tracked once an initiative is in place. The Person Level Integrated Data Asset (PLIDA) already provides a secure data asset which gives whole-of-life insights combining information on health, education, government payments, income and taxation, employment, and population demographics over time. PLIDA is one such resource that can be used to support a rigorous level of evidence-based SRFE outcome and costing assessments. Current pilots of data-sharing and analysis between the Commonwealth, ACT and South Australian governments through the Life Course Data Initiative are another new resource that could support the kind of fiscal assessment necessary to accurately incorporate SRFEs into budgetary offset calculations.

A pilot scheme that trials a select number of potentially fruitful policy proposals, making use of existing data and evidence resources, while building the capacity to integrate them into SRFE assessments for the purpose of costings, would be valuable for proving methodologies, prior to scaling through the budget process.

3.4 Cross-jurisdictional considerations

While some SRFEs will be directly relevant to Commonwealth budgetary calculations, others cannot be considered at the

Commonwealth level alone. Many of the government services for which wellbeing-aligned SRFE savings and costs can be captured lie within the jurisdiction of the States and Territories, or fall within services that are delivered by States and Territories on behalf of the Commonwealth. To address this challenge and increase the scope and effectiveness of incorporating SRFEs into fiscal calculations as capability scales up, cross-jurisdictional arrangements might need to be explored. These could include increasing measurement and evaluation as part of National Partnership Agreements or other vehicles that manage Commonwealth-State relations from a wellbeing perspective; or piloting Commonwealth-State cross-jurisdictional agreements for savings offsetting for early intervention or prevention initiatives that deliver SRFE savings outside of the enacting department/government's jurisdiction (for example, where a state policy would likely reduce demand for unemployment benefits, or a Commonwealth policy would likely reduce law enforcement demand).

for instance, by ignoring savings/offsets that occur over a long period of time, such as when an education intervention changes lifetime outcomes.

The current rules also understate the net cost of policies that achieve one goal at the expense of wellbeing outcomes that fall under different portfolios, and particularly those for which the costs may not be immediately apparent but which accrue over time. The BPORs not only set the rules for assessing proposals, they play a significant role in shaping which proposals are put forward in the first place. The BPORs amendments recommended in this paper would contribute to efforts to bring about more efficient and effective government expenditure, by encouraging proposals that both improve wellbeing outcomes *and* deliver real fiscal impact.

Conclusion

To enable government decision making that more effectively works towards the long-term wellbeing and flourishing of society, there needs to be improvement across government in the capacity to better represent the long-term costs and benefits of decisions. Aligning budget rules with the principles that underpin Measuring What Matters does not mean wellbeing-related proposals should get a free ride through the budget process. Many such policies cost a lot of money, and Cabinet needs a clear-eyed view of the fiscal impact of proposed policies in order to make informed decisions. However, the way that the "fiscal impact" of a policy is currently defined in the BPORs can work to systematically overstate the net cost of potentially transformative policies –

Appendix: Specific recommended BPORs amendments⁶

Financial offset requirements

Section 2.5

Existing clause:

“All offsets must be genuine expenditure offsets, unless the Treasurer and Minister for Finance agree that taxation revenue offsets can be brought forward. Genuine offsets are deliberate policy decisions which improve the underlying cash and fiscal balance, resulting from:

- (a) a reduction in expenditure (including capital expenditure) below the level of expenditure currently included in the budget estimates.
- (b) a discretionary reordering of priorities by a Minister.
- (c) a quantifiable increase in revenue (either taxation and/or non-taxation) from a decision to change policy settings which results in an increase of revenue above that currently included in the budget estimates.”

Recommended amendment:

We recommend the addition of the following genuine offsets:

“(d) a quantifiable second round fiscal decrease in expenditure (e.g. resulting from reduction in demand that is consistent with the themes of the government’s Measuring What Matters framework).”

Costing Policy Proposals

Section 3.3

Existing clause:

“All policy proposals which have expected costs in the medium-term beyond the forward estimates:...”

Recommended amendment:

We recommend the inclusion of an additional clause to section 3.3 of the BPORs:

“(d) Where policies are designed to improve Measuring What Matters outcomes through, for example, improving human capital, breaking cycles of disadvantage, or making early investments in systemic change, the Treasurer or Minister for Finance may allow the policy to be costed over a 25 year timeframe to fully capture the fiscal benefits.”

Section 3.35

Existing clause:

“Only first round effects will be considered in costings. However, any identifiable and material second round effects should be included in policy proposals and Cabinet submissions.”

Recommended amendment:

“In addition to first round effects, second round fiscal effects should be included in the case that:

1. Best evidence shows a high likelihood that they would follow directly from the intervention;
2. They are expected to represent a materially significant direct cost or

⁶ Note that the specific recommended BPORs changes made here refer to the version of the BPORs effective December 2022: https://www.finance.gov.au/sites/default/files/2023-05/Budget_Process_Operational_Rule_esffective_6%20December_2022.pdf

saving to government and that these can be estimated reliably;

3. Any fiscal benefits are consistent with an increase in wellbeing as captured under the themes of the Measuring What Matters framework, and any fiscal costs are consistent with a decrease in wellbeing as captured under the themes of the Measuring What Matters framework.”

Minor policy proposals

Section 5.2

Existing clause:

(a) “The Finance Minister will consider minor policy proposals (unless Rule 5.2(b) applies)... including where:”

Recommended amendment:

We recommend the inclusion of the following:

“(iv) the minor policy proposal is consistent with an increase in wellbeing as captured under the themes of the Measuring What Matters framework and is fiscally neutral or represents a net saving when including direct second-round effects under a 25 year timeframe.”



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