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Reference: T2016/2162 SH-1-6-3

Date: 8 November 2016

To: Minister of Finance (Hon Bill English)
Associate Minister of Finance (Hon Steven Joyce)
Associate Minister of Finance (Hon Paula Bennett)

Deadline: Ahead of SEC on Wednesday, 9 November.

Aide Memoire: Terranova: state of play

This note summarises the state of play on financial and negotiating parameters for the care and support workforce (Terranova). We understand that the Minister of Health intends to lodge a paper for discussion at SEC this week. We have made clear at official level that we do not think sufficient progress has been made to ask Cabinet to sign off the proposed approach. Key points (discussed below) are as follows:

- Costings are still moving around and are not clearly represented in the paper. (See the appendix to this note for our summary of the latest numbers.)

- Costs will depend on how a settlement is implemented, and there has been limited progress here. No work has been done to translate the proposed wage rates into price increases for providers. And there is no clarity about how a qualifications-based pay structure will work in practice. Both points are directly relevant to the estimated cost of a settlement.

- Monetisation of employment conditions is the largest single element of the proposed settlement. We do not have a good understanding of (and cannot verify) the costing methodology on this point. [38]

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Costings

A new set of costings was included in the draft Cabinet paper circulated late yesterday (Monday evening). Two points are worth noting:

- Costs are presented net of "business as usual" (BAU) wage pressures (based on assumptions about demand growth and wage inflation). This means that the Cabinet paper only shows the incremental cost of a settlement. This is reasonable if the starting point is that BAU cost growth would be funded anyway – which is almost certainly true up to a point. Nevertheless, the full cost of a five-year wage settlement will be substantially higher than the incremental figures presented in the Cabinet paper. (There is a choice about whether BAU costs are assumed to be funded from within the operating allowance, or allowed to flow through to the HYEFU forecasts along with incremental costs.)

- Costs are also presented net of assumed phasing. This reduces the cost of of a five-year settlement in years 1 to 4. [38]

The appendix to this note provides a more complete picture of the costs associated with a settlement (based on the Monday-evening iteration from the Ministry). There continue to be material uncertainties about likely fiscal costs and other impacts, as discussed below.

Implementation issue 1: pricing

The Joint Agency report of 1 September (T2016/1671) indicated that firmed up costings would include clarity on price increases for providers (and funding increases for district health boards). However, analysis to date continues to focus only on wage rates. There has been limited discussion about how a settlement would be implemented through prices; and no costings work has been done on that basis. Given that these are tripartite negotiations where the cost to the Crown will be determined by the prices eventually negotiated with providers, this seems like a significant omission.

The latest draft paper that we have seen includes some high-level discussion about how wage increases will be translated into prices. This is helpful as far as it goes, but it mainly serves to illustrate that the detailed work remains to be done; and that there haven't been any substantive discussions with providers. As we understand it, the Ministry's view is that this work is best undertaken sequentially: negotiate wage rates first, then negotiation prices with providers. That may now be unavoidable if Ministers want an early settlement.

To be clear: the costings only relate to wage rates. We do not know how the Ministry proposes to translate the new wage rates into price increases, how much that would cost, or whether it will be acceptable to providers.

Implementation issue 2: qualifications

The proposal is to introduce a qualification-based pay structure (with significant increments between wage levels). The costing is therefore sensitive to the assumed distribution of qualifications across the workforce: more workers with qualifications means a higher cost. The costs presented in the paper assume that the distribution of qualifications under the new wage structure is broadly similar to the current situation (most workers with no qualification; only a few workers with the highest qualification). It is not clear that this is a reasonable assumption.

The proposed settlement would tie wage increases directly to qualifications, so more workers can be expected to pursue them. On the other hand, providers will have an incentive to limit the growth in qualifications as this would increase their costs. We have no idea (and neither do the Ministry) about the extent to which these two factors will cancel each other out. At the very least, we would like to see some sensitivity analysis showing costs under different scenarios. If we end up with a similar distribution of workers across wage levels as we have currently (rather than across qualification levels), this could increase costs by almost a third.

A better sense of how a qualifications-based regime will be implemented might provide more confidence about the robustness of the costings. However, this work has not yet been done. Ideally, we would like to know the answer to some key questions before the Crown commits to qualifications-based wage rates in negotiations. First, what is the policy objective: what is the distribution of qualifications that the government considers appropriate for this workforce? Second, is there a mechanism for achieving that objective, or will it just be left to the push and pull of the incentives noted above? Third, how will expectations about qualifications be reflected in prices paid to providers?

Wage rates and monetisation

The paper states that the cost of a negotiated settlement has increased because the comparator changed from health care assistants (mainly female) to mental health assistants (mainly male). This is not correct. What has driven the escalation in costs is the inclusion of employment conditions (higher rates for weekends and nights, overtime rates, long-service leave, etc.).

The proposal is to "monetise" these employment conditions into basic wage rates for the care and support workforce. This accounts for over 60% of the cost of the proposed settlement. It has the effect of increasing the proposed wage rates significantly above the base rates for mental health assistants, bringing them closer to the wage rates proposed by the unions (based on corrections officers).

The costing is obviously very sensitive to wage rates, so it is also very sensitive to assumptions and estimates used in the monetisation calculations (which we are not able to independently verify). [38]

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Full and final settlement of pay equity claims

The Crown's counter-offer will include a requirement that all parties accept the agreement as full and final settlement of pay equity claims for this workforce. [38]

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Settlement versus litigation

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John Marney, Principal Advisor, Health, [39]
Ben McBride, Manager, Health, Health, [39]

APPENDIX: SUMMARY OF THE IMPACTS

Annual costs ($m), excluding OCL impact		2017/18	2018/19	2019/20	2020/21	2021/22	5 year total
Baseline exependiture (2016/17)		**1,236**	**1,236**	**1,236**	**1,236**	**1,236**	**6,178**
No phasing							
Crown costs *							
Incremental cost for MOH/DHB		386	402	420	440	461	2,110
ACC (non-earners account)		42	42	43	45	46	219
Incremental Crown cost		428	445	463	485	507	2,329
Assumed BAU cost growth (MOH/DHBs)	[38]						
Total Crown costs							
Other costs							
Incremental costs borne privately by aged-care residents		58	61	64	67	70	320
ACC (other accounts): borne by levy payers **		94	95	97	100	103	488
Incremental other costs		152	156	161	167	173	809
Assumed BAU cost growth born privately by aged-care residents***	[38]						
Total other costs							
Crown costs plus other costs							
Total incremental costs		580	601	624	652	680	3,137
Assumed BAU cost growth	[38]						
Total Crown and other costs							
With phasing							
Crown costs *							
Incremental cost for MOH/DHB		232	281	335	395	461	1,703
ACC (non-earners account)		25	30	35	40	46	176
Incremental Crown cost (*Crown cost presented in Cabinet Paper*)		257	311	369	435	507	1,879
Assumed BAU cost growth (MOH/DHBs)	[38]						
Total Crown costs							
Other costs							
Incremental costs borne privately by aged-care residents		36	43	51	60	70	261
ACC (other accounts): borne by levy payers **		56	66	77	90	103	392
Incremental other costs (*Private cost presened in Cabinet paper*)		92	110	129	150	173	653
Assumed BAU cost growth born privately by aged-care residents ***	[38]						
Total other costs							
Crown costs plus other costs							
Total incremental costs		349	420	498	585	680	2,532
Assumed BAU cost growth	[38]						
Total Crown and other costs							

* Crown costs will affect OBEGAL and net debt to the extent they are managed outside the operating allowance.
** Costs affectding ACC levies will also affect OBEGAL but will not affect net debt.
*** Treasury estimate (pro rata)

OCL impact ($m) *	2017/18	2018/19	2019/20	2020/21	2021/22	5 year total
No phasing						
Funding adjustment ACC Appropriations (non-earners)	118	118	118			354
Funding adjustment ACC levy payer accounts	79	79	79	79	79	395
With phasing						
Funding adjustment ACC Appropriations (non-earners)	110	110	110			330
Funding adjustment ACC levy payer accounts	74	74	74	74	74	370

* Policy is that OCL impacts are recovered over 3 years (for Appropriations) or 10 years (for levies). This is what is shown here.
(Note: Funding policy for non-earners (Appropriations) may change to spread funding over 10 years rather than 3 years.)
These impacts affect the operating balance but do not affect OBEGAL.
Funding adjustments for Appropriations (non-earners) will affect net debt. Other funding adjustments do not affect net debt.