

The Treasury

Budget 2017 Information Release

Release Document July 2017

www.treasury.govt.nz/publications/informationreleases/budget/2017

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
[4]	to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial	6(c)
[11]	to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.	6(e)(vi)
[23]	to protect the privacy of natural persons, including deceased people	9(2)(a)
[25]	to protect the commercial position of the person who supplied the information or who is the subject of the information	9(2)(b)(ii)
[26]	to prevent prejudice to the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied	9(2)(ba)(i)
[27]	to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information - would be likely otherwise to damage the public interest	9(2)(ba)(ii)
[29]	to avoid prejudice to the substantial economic interests of New Zealand	9(2)(d)
[31]	to maintain the current constitutional conventions protecting collective and individual ministerial responsibility	9(2)(f)(ii)
[33]	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials	9(2)(f)(iv)
[34]	to maintain the effective conduct of public affairs through the free and frank expression of opinions	9(2)(g)(i)
[36]	to maintain legal professional privilege	9(2)(h)
[37]	to enable the Crown to carry out commercial activities without disadvantages or prejudice	9(2)(i)
[38]	to enable the Crown to negotiate without disadvantage or prejudice	9(2)(j)
[39]	to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)
[40]	Not in scope	

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Treasury Report: Terranova: proposed settlement

Date:	11 November 2016	Report No:	T2016/2190
		File Number:	SH-1-6-3

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Agree the approach and table additional recommendation at Cabinet on Monday, 14 November.	Monday, 14 November.
Associate Minister of Finance (Hon Steven Joyce)	Agree the approach.	Monday, 14 November.
Associate Minister of Finance (Hon Paula Bennett)	Agree the approach.	Monday, 14 November.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
John Marney	Principal Advisor [39]	N/A (mob)	✓
Ben McBride	Manager, Health [39]	[39] [23]	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Terranova: proposed settlement

Executive Summary

This note provides further information on the implications of the proposed settlement for the care and support workforce discussed at SEC on Wednesday, and makes recommendations about how to manage the impacts for the Crown.

Estimated impacts for the Crown

The Minister of Health is seeking a five-year fiscal envelope of \$1.879 billion. The Ministry has committed to manage all costs of implementing the settlement within this amount, and to ensure that the out-year cost does not exceed \$507.25 million. Those numbers are net of assumed “business as usual” (BAU) cost growth, which is estimated to add a further ^[38] billion over five years ^[38] million per annum by year 5). This brings the total Crown cost to ^[38] billion over five years ^[38] billion per annum by year 5).

The OBEGAL impact depends on decisions about ACC funding. For the purposes of this note, we assume that ACC will increase levies to recover costs in accordance with the funding policy. This reduces the OBEGAL impact but transfers costs to levy payers. Numbers will change once we have ACC’s formal modelling.

The impact on the Crown accounts also depends on the extent to which costs are managed inside Budget allowances. We recommend managing BAU wage growth inside the operating allowance, with the net cost of the settlement being picked up in the HYEFU forecasts. The estimated implications of this approach for OBEGAL, net debt and the Budget operating allowance are summarised below. We suggest that you table recommendations at Cabinet on Monday to confirm this approach (see appendix).

Estimated impact on fiscal indicators if BAU costs managed inside allowance

	2017/18	2018/19	2019/20	2020/21	2021/22	5 year total
Total impact on OBEGAL for HYEFU forecasts	183	237	295	361	433	1,509
Total impact on net debt for HYEFU forecasts	367	421	479	435	507	2,209

Note: Assumes ACC raises levies to recover costs. Numbers will change once we have ACC’s formal modelling.

Estimated impact on operating allowance if BAU costs managed inside allowance

	B17	B18	B19	B20	B21
Budget operating allowance	1,500	1,500	1,500	1,500	1,500
less BAU wage growth (annual change)	^[38]				
less funding of OCL impact (non-earners)	83	-	-	-	-
Unused operating allowance	^[38]				

Estimated impacts for private individuals

A settlement will impose costs on people who pay for aged-residential care. It will also impose costs on levy payers if ACC increases levies to recover costs (as assumed for the purposes of the table above). The aggregate impacts are summarised in the body of this report.

Conditions of a settlement

We are comfortable with the settlement conditions proposed in the Cabinet paper.

We think formal acceptance by all parties that an agreement constitutes full and final settlement of pay equity claims needs to be a red-line issue for the Crown. This would not prevent care and support workers from ever making a new pay equity claim. It does mean that the unions need to accept that a settlement fully resolves historic discrimination.

We are agnostic about whether the settlement should also include a five-year moratorium on new claims. However, we would be concerned if the Crown were to accept a moratorium as an alternative to full and final settlement [38]

We would also be concerned if the settlement linked future wage increases to the nurses MECA (or to any other workforce). [38]

Recommended Action

We recommend that you:

- a **agree** to manage “business as usual” wage growth for the care and support sector inside the operating allowance, with the net cost of a settlement being picked up in the HYEPU forecasts, and

Agree/disagree.

Minister of Finance

Agree/disagree.

Associate Minister of Finance

Agree/disagree.

Associate Minister of Finance

- b **table** recommendations at Cabinet on Monday to confirm this approach (see appendix).

Yes/No

Minister of Finance

Ben McBride
Manager, Health

Hon Bill English
Minister of Finance

Hon Steven Joyce
Associate Minister of Finance

Hon Paula Bennett
Associate Minister of Finance

Treasury Report: Terranova: proposed settlement

Purpose of Report

1. At SEC on Wednesday, Ministers indicated that they were minded to approve the negotiating parameters proposed by the Minister of Health, with an envelope of \$1.879 billion over five years. This report:
 - summarises the implications for the Crown accounts and seeks your views about how to manage these;
 - describes aggregate impacts for private individuals;
 - discusses the conditions that should (and shouldn't) form part a settlement.

2. Some caveats. All numbers are subject to previous advice about the robustness of the costings and our understanding of the modelling and implementation strategy, and the risk of relatively claims post settlement (T2016/2162 refers). The estimated cost of a settlement reflects forecast demand growth as well as wage inflation and can be expected to move around around over time. ACC has provided estimates of the impacts for the non-earner and levy-payer accounts, but has not yet formally modelled the OBEGAL impacts. And we have made some assumptions about funding and levy decisions in respect of ACC.

Proposed settlement

3. Our understanding is that the proposed settlement would increase wage rates to the levels proposed in table 1, based on wage rates for mental health assistants (plus the monetised value of their workforce conditions). The increase in wage rates over time reflects the expectation that a settlement will be phased in over five years, together with a further ^[38] assumed annual wage growth.

Table 1: Proposed wage rates

\$/hr	Year 1 FY18	Year 2 FY19	Year 3 FY20	Year 4 FY21	Year 5 FY22
No qualification	[38]				
Level 2 qualification					
Level 3 qualification					
Level 4+ qualification					
Weighted average rate					

4. The monetisation calculation justifying these wage rates takes place outside the main costing model, and we have not been able to review it. We think it works as follows (focusing on weekend penal rates, which is the largest component):
 - Step 1: Take the existing weekend penal rate for a care and support worker.
 - Step 2: Take the (higher) weekend penal rate for a mental health assistant.
 - Step 3: Calculate the difference and multiply the amount by the number of weekend hours worked by care and support workers.

- Step 4: Average this amount across all care and support workers, to uplift base rates irrespective of whether a worker actually works weekends.
- Step 5: Assume that existing weekend penal rates continue to apply to care and support workers who do work weekends (the lower rates referred to in step 1).

5. [38]

6. [38]

Impacts for the Crown

7. The impact of a settlement on the Crown accounts depends on whether or not the costs are managed within Budget operating allowances. Table 2 shows the gross impacts. This is what the impacts would look like if a settlement was managed entirely outside Budget allowances.

Summary of the main impacts

8. The negotiating envelope of \$1.879 billion sought by the Minister of Health relates to the incremental Crown cost. The total Crown cost is [38] billion over five years. The estimated OBEGAL impact over 5 years is [38] billion. The difference between these numbers arises because:

- The Ministry of Health figures net out assumed “business as usual” (BAU) wage growth in the care and support sector [38] billion over five years). This BAU cost is not factored into baselines, and therefore needs to be funded.
- OBEGAL will also be affected by decisions about ACC funding and levies. We have assumed that levies increase, with a positive impact on OBEGAL.¹ This implies a corresponding (negative) impact on levy payers.

9. You asked specifically about the reduction in the Ministry’s estimate of the net cost from \$2.227 billion over five years to \$1.879 billion. (This equates to a reduction in the year 5 cost from \$610 million to \$507 million.) This reflects the exclusion of costs relating to ACC’s levy-payer accounts. Those costs still impact OBEGAL, but they do not affect net debt.

¹ This is why the estimated 5-year OBEGAL impact ([38] billion) is lower than the figure mentioned at fiscal issues on Wednesday [38] billion).

Table 2: Impact on Crown accounts (if managed outside Budget allowances)

	2017/18	2018/19	2019/20	2020/21	2021/22	5 year total
Affects OBEGAL and net debt:						
Net costs for MOH/DHB	232	281	335	395	461	1,703
ACC (non-earners account) *	25	30	35	40	46	176
Net Crown cost	257	311	369	435	507	1,879
Assumed BAU wage growth (MOH/DHB)	[38]					
Total Crown Cost						
Affects OBEGAL but not net debt:						
ACC (levy-payer accounts): borne by levy payers *	56	67	77	90	103	393
Recovery of ACC costs (levy payers) *	(56)	(67)	(77)	(90)	(103)	(393)
Recovery of OCL impact (levy payers) **	(74)	(74)	(74)	(74)	(74)	(370)
Total OBEGAL impact	[38]					
Affects operating balance:						
Outstanding claims Liability (OCL) increase **	1,067	-	-	-	-	1,067
Total Operating balance impact	[38]					
Affects Net debt:						
Total Crown Cost (from above)	[38]					
Funding of OCL impact (non-earners) **	110	110	110	-	-	330
Total net debt impact	[38]					

* These numbers relate to the impact of higher wage costs on new ACC claims.

** These numbers relate to the impact of higher wage cost on ACC's outstanding claims liability.

ACC impacts

10. The treatment of ACC impacts is complicated.
11. Higher wages will increase the cost of new ACC claims (marked with a single asterisk in table 2). This will negatively affect OBEGAL. However, the final impact on OBEGAL and net debt will depend on future funding decisions about how these costs are managed through appropriations and levy increases. Table 2 assumes that those decisions will be consistent with the current ACC funding policy. Specifically:
 - Costs relating to non-earners will be funded through appropriations. In that case, there will be a negative impact on net debt, corresponding to the OBEGAL impact.
 - Costs relating to levy payers will be funded through levy increases. In that case, the additional revenue should in principle mean that there is neutral impact on OBEGAL over time. Table 2 assumes that the two effects wash out each year. It may not be this clean in practice.
12. Higher wages will also increase the lifetime cost of outstanding claims for ACC (marked with a double asterisk in table 2). This will have a negative impact on the outstanding claims liability (OCL) in 2017/18, estimated at \$1.067 billion. This affects the operating balance but is below the line for OBEGAL. Again, the final impact on the Crown accounts depends on funding decisions. Consistent with the current funding policy, table 2 assumes that the OCL impact will be recovered by ACC:

- For the non-earners account, through appropriations over three years. This affects net debt by \$110 million a year until 2019/20. (The funding policy may change to spread the impact over ten years instead of three.)
 - For the levy-payer accounts, through levies over ten years. This would have a positive impact on OBEGAL of \$74 million a year.
13. There are likely to be other OBEGAL impacts that are not reflected in table 2. We expect OBEGAL to be unfavourably affected by the initial OCL impact unwinding over time. There may also be a minor positive impact on OBEGAL from investment income, due to increased funding. We will have a better sense of the OBEGAL impacts once these have been formally modelled by ACC, but we will not have a definitive view until funding decisions are made.

Managing these Crown impacts

14. You have some options for managing the costs of a settlement through allowances and forecasts. Most obviously:
- Managing BAU wage growth inside the allowance, with the net cost of the settlement being picked up in the HYEFU forecasts. This is the approach we recommend.
 - Managing all costs outside the operating allowance, allowing the full cost to be picked up in the HYEFU forecasts.
 - Managing all costs inside the operating allowance.

Managing BAU wage growth inside the allowance (recommended)

15. The costs of specific wage settlements for the health workforce are not normally funded directly. Instead, they are one consideration when deciding the annual Vote Health baseline uplift each Budget. The uplift counts against the operating allowance for the relevant year. We recommend retaining this approach for BAU wage growth in the care and support sector. Table 3 summarises the implications for the Crown accounts under this approach. Table 4 shows the estimated impact on the operating allowance.

Table 3: Impact on Crown accounts (if BAU wage growth managed inside the allowance)

	2017/18	2018/19	2019/20	2020/21	2021/22	5 year total
Total OBEGAL impact	[38]					
Less BAU cost growth						
Total impact on OBEGAL for HYEFU forecasts	183	237	295	361	433	1,509
Total net debt impact	[38]					
Less BAU wage growth						
Total impact on net debt for HYEFU forecasts	367	421	479	435	507	2,209

Table 4: Impact on the operating allowance (if BAU wage growth managed inside the allowance)

	B17	B18	B19	B20	B21
Operating allowance	1,500	1,500	1,500	1,500	1,500
less BAU wage growth (annual change)	[38]				
less funding of OCL impact (non-earners)	83	-	-	-	-
Unused operating allowance	[38]				

16. In practice, this approach means that:
- The net increase in wages resulting from the settlement (\$1.879 billion over five years) is managed outside the allowance. This would be reflected in the HYEFU forecasts as an increase in government expenditure.
 - BAU wage growth ^[38] billion over five years) is managed inside the operating allowance. The Ministry of Health would have to bid for this amount as a cost pressure each year, in accordance with usual Budget processes. This should help to maintain an on-going discipline for the Ministry to manage cost growth, and give Budget Ministers some flexibility to make trade-offs between different sectors from year to year.
17. ACC operates on the basis of full-funding for future costs, which already includes assumptions about BAU wage growth. So only the net increase in wages is relevant to the ACC numbers. For consistency, we suggest managing these impacts outside Budget allowances. In that case, we would reflect those impacts in HYEFU.
18. We suggest adding recommendations to the Cabinet paper to confirm this approach. See the appendix for draft recommendations that you could table at Cabinet on Monday. These recommendations reflect commitments made at SEC by the Ministry of Health to manage all (net) costs of implementing the settlement within their proposed fiscal envelope of \$1.879 billion and to keep the (net) out-year cost at or below \$507.25 million. We have adjusted those numbers to exclude costs to the ACC non-earners account, which the Ministry of Health does not control.
19. We will group the additional expense with other tagged contingencies in HYEFU so that it is not too visible and does not undercut the Crown's negotiating position.

Managing all costs outside the allowance

20. An alternative approach would be to manage the full cost of the settlement outside allowances. In that case, the estimated impact on the Crown accounts would be as shown in table 2. In principle, this would leave the full Budget operating allowance (currently \$1.5 billion a year) available for items other than care and support wage costs. In practice, the Ministry of Health might still seek some additional Budget funding for wage costs associated with adverse variations in forecast demand growth.

Managing all costs inside the allowance

21. Or you could try to manage the full costs of the settlement inside the allowance (with the annual change counting against the allowance each Budget). Table 5 shows the impact on the Crown accounts under this approach. The settlement would not affect net debt, but there would still be some impact on OBEGAL (and the operating balance) due to costs for ACC. Table 6 shows how the Budget operating allowance would be affected.

Table 5: Impact on Crown accounts (if managed inside the allowance)

	2017/18	2018/19	2019/20	2020/21	2021/22	5 year total
Affects OBEGAL but not net debt:						
ACC (levy-payer accounts): borne by levy payers *	56	67	77	90	103	393
Recovery of ACC costs (levy payers) *	(56)	(67)	(77)	(90)	(103)	(393)
Recovery of OCL impact (levy payers) **	(74)	(74)	(74)	(74)	(74)	(370)
Total OBEGAL impact	(74)	(74)	(74)	(74)	(74)	(370)
Affects operating balance:						
Outstanding claims Liability (OCL) increase **	1,067	-	-	-	-	1,067
Total Operating balance impact	993	(74)	(74)	(74)	(74)	697

Table 6: Impact on the operating allowance (if managed inside the allowance)

	B17	B18	B19	B20	B21
Operating allowance	1,500	1,500	1,500	1,500	1,500
less net cost for MOH/DHBs (annual change)	232	49	54	60	66
less BAU wage growth (annual change)	[38]				
less ACC non-earners (annual change)	25	4	5	6	6
less funding of OCL impact (non-earners)	83	-	-	-	1
Unused operating allowance	[38]				

Impacts for private individuals

22. A settlement would also involve some impacts for private individuals, namely ACC levy payers and aged care residents who meet their costs privately. Those impacts are summarised at an aggregate level in table 7.

- The impacts shown for ACC levy payers assume that costs are recovered in accordance with the current funding policy. To the extent this did not happen, there would be a negative impact on OBEGAL compared to the figures presented earlier.
- The Cabinet paper floats the possibility of mitigating the impact on aged care residents via a policy change that shifts the cost onto district health boards. [38]

Table 7: Impacts for private individuals

	2017/18	2018/19	2019/20	2020/21	2021/22	5 year total
Costs borne privately by aged-care residents						
Net (incremental) costs of the settlement	36	43	51	60	70	261
BAU wage growth (Treasury estimate)	[38]					
Total impact on aged-care residents						
Costs borne by ACC levy payers						
Recovery of ACC costs for new claims	56	67	77	90	103	393
Recovery of OCL impact	74	74	74	74	74	370
Total impact on levy payers	130	141	151	164	177	763

Conditions of a settlement

23. There was some discussion at SEC on Wednesday about conditions that the Crown might want to attach to a settlement. We are comfortable with the proposals in the Cabinet paper. The following comments provide some background to the issues raised by Ministers.

Full and final settlement of historic discrimination

24. Ministers questioned the practicality of asking the unions to agree that the settlement represents full and final settlement of pay equity claims. They noted the possibility that wages may diverge again in future, giving rise to legitimate discrimination claims. We do not think it is necessary to ask the parties to forever forswear any future pay equity claim. That would obviously be unreasonable.
25. However, we do think it is appropriate to ask the unions to accept that a negotiated agreement constitutes full and final settlement of all pay equity claims relating to historic discrimination. In other words, the settlement agreement should make clear that all parties consider that wage relativities are have been reset appropriately at the time the agreement is made. This would not prohibit future pay equity claims under the new law if wage rates were to diverge again in ways that could not be justified.
26. [38]

Five year moratorium

27. As long as the settlement is accepted by all parties as full and final settlement of historic discrimination, we are agnostic about whether there should also be a five-year moratorium on claims for newly arising discrimination. [38]

Linking future wage adjustments to the Nurses MECA

28. We would also be opposed to an agreement that provided for future adjustments to wage rates in line with the Nurses MECA. (This is not a feature of the proposed settlement; but it is something the unions want.) [38]

Suggested recommendations to table at Cabinet

note that the cost of a settlement to the Crown of \$1.879 billion over five years is net of assumed business-as-usual wage growth in the care and support sector (estimated at ^[38] billion over five years), and includes certain costs relating to the ACC non-earners account;

agree that Ministry of Health will manage the implementation of the settlement within a five-year envelope of \$1.703 billion, with an on-going annual cost (from 2021/22 onwards) that does not exceed \$461 million, exclusive of costs to the ACC non-earners account;

agree that the net cost, inclusive of ACC, of \$1.879 billion over five years will be managed outside Budget allowances and will be reflected in forecasts in the half year economic and fiscal update 2016 along with other impacts on the Crown accounts;

agree that business-as-usual wage growth will continue to be managed inside annual Budget operating allowances, and will remain subject to the usual Budget processes and disciplines.