

The Treasury

Advice on Public Sector Pay Adjustment (PSPA) Information Release

March 2023

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Joint Treasury / PSC Report: Key considerations for a public sector pay adjustment

Date:	9 September 2022	Report No:	T2022/1989 2022/0198
		File Number:	SH-2-7-1

Action Sought

	Action Sought	Deadline
Prime Minister (Rt Hon Jacinda Ardern)	Noting and agree the contents of this report	Monday 12 September 2022
Minister of Finance (Hon Grant Robertson)	Noting and agree the contents of this report	Monday 12 September 2022
Minister for the Public Service (Hon Chris Hipkins)	Noting and agree the contents of this report	Monday 12 September 2022

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact	
Struan Little	Deputy Secretary, Budget and Public Services, The Treasury	[39]	[35]	✓
Alex Chadwick	Deputy Commissioner, Workforce Employment Relations, and Equity, Public Service Commission	N/A		

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

Return the signed report to Treasury and the Public Service Commission.

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Joint Treasury / PSC Report: Joint Report: Key considerations for a public sector pay adjustment

Executive Summary

1. On Friday 2 September, you requested analysis on the financial implications of a possible public sector pay adjustment (PSPA). This joint report responds to that request along with other relevant analysis and advice.
2. The current high inflation and low unemployment environment means that significant remuneration increases are likely to be common across the public sector, and hence require funding, over the next two years irrespective of the form of any agreement made with unions. However, a single deal would pull forward many of the increases and potentially deliver larger increases for some workers than would have otherwise been the case.
3. The cost estimates presented in this paper are indicative, largely based on top-down assumptions and should be treated with caution, particularly the estimates of how much agencies have already provisioned. [33], [38]
- 4.
5. Developing reliable estimates of the costings and existing provisions is difficult because much of the required information is only held by agencies. We have requested this information from Public Service agencies and more refined costings will be provided on 14 September and therefore recommend that Ministers revisit the funding aspect of the PSPA after that.
6. While this modelling excludes the funded sector and parts of the wider public sector, it is likely that the PSPA will influence wage rates beyond the agencies included in the PSPA.¹ [33], [38]

¹ See Appendix Four for implementation considerations for various entity types.

7. From a macroeconomic perspective, price and wage inflation and interest rate expectations have all increased since the Budget Update. The impact of a PSPA on inflation pressures and interest rates is likely to be limited provided:
 - a the agreed increase in wages is not out of step with current wage inflation; and
 - b operating allowances are maintained at current levels.
 8. Wage rates should be set in a medium-term context, not in response to shorter-term changes in the cost of living. This is particularly true when those changes in cost of living are driven by supply shocks that require everybody to absorb some of the pressure. A PSPA that delivered wage increases much above current market expectations would risk increasing wage pressure across the economy, risking a wage-price spiral. Similarly, funding some of the cost of the PSPA by increasing operating allowances would add to inflation pressure. Both scenarios would likely prompt the Reserve Bank to raise the Official Cash Rate by more than they currently expect, likely leading to a larger increase in unemployment from later in 2023.
 9. If the Government wishes to proceed, these negotiations will be complex and it is important that all parties understand the need for allowing sufficient time to deliver an acceptable outcome.
 10. As seen in previous union/employer engagements, the wider the coverage of an agreement, the less likely consensus can be reached. Therefore, the wider the coverage, the more likely ratification would not be achieved given the complexity and increasingly competing interests. Examples of this complexity include what different parties prioritise and value (rather than the dollar value of a pay rate) such as allowances over pay, and the inclusion or exclusion of pay progress.
 11. There are opportunities available to both Government and employing agencies in reaching a one-off public sector pay deal in the current environment. These include the ability for employers to potentially offer, within the parameters of any settlement, a tailored approach to sections of their workforce which have experienced the most prolonged period of wage stagnation. The deferring of any other bargaining for the term of any settlement would also free up capacity to deliver on the Government's work programme and reduce the risk of disruption to public services from industrial action. There is also an opportunity to enhance the consistency of remuneration approaches across the sector.
 12. There are also associated risks, the most material of which are:
 - a Bargaining risks: should the proposal proceed to bargaining, further hurdles would still need to be successfully navigated once terms of settlement are agreed. A proposed pay adjustment may fail to achieve sufficient endorsement from participating unions, or sufficient support within each membership. A deal may fail to be ratified or bargaining on the terms of settlement may become protracted by irreconcilable differences among the parties.
 - b Implementation and distribution risks: assuming bargaining risks do not materialise or are managed, the administrative complexity and time required to deliver pay adjustments to potentially very large workforces may risk the successful achievement the intended agreement. Should this risk be realised other risks are likely to be increased (such as adverse stakeholder relations).
- C [36]

[36]

- d Fiscal risks: principally, the risk of creating a higher starting position for bargaining (i.e., effectively a pay adjustment acting as a bargaining floor on which further costs accrue for employers). Given the core objective of collective negotiation is to protect the position of the weakest party, scaling collective bargaining up by an order of magnitude further elevates the risk of elevating the floor on existing labour costs.
13. The Minister for the Public Service, in his initial response to the NZCTU's letter of 27 May, flagged his focus on the existing inequities in pay for the lowest paid. A flat-rate pay adjustment would demonstrably target closing pay gaps for the lowest paid relative to the highest paid workforces within scope of any settlement, noting that any settlement would likely include detail regarding the treatment of settled collectives, phasing of any future agreements, and the handling of contractually committed pay progression.

Process going forward

14. No further engagement between the NZCTU and officials is planned. Officials have agreed with the NZCTU that they will pause discussions to allow the necessary Cabinet process to take place.
15. Should Ministers wish to proceed to bargaining, officials could develop advice to be considered by the GOV Committee on 29 September, and full Cabinet on 3 October. Officials will provide supplementary advice to the Minister of Finance and the Minister for the Public Service next week and the Minister for the Public Service will provide Cabinet with a further verbal update next Monday, 19 September.
16. Public service agencies and Ministers would be consulted over a compressed timeline, facilitated by input to date from public service chief executives during feasibility discussions with unions.
17. Should Cabinet, at the 3 October meeting, endorse the proposal proceeding to bargaining, officials will bring further advice to Cabinet on the outcome of bargaining [38]
18. This is a very tight timeline considering the breadth and complexity of the proposal. Allowing more time would enable more accurate costing work, ensure more risks are mitigated and enable consideration of the proposal to occur alongside consideration of the broader Budget strategy.

Recommended Action

We recommend that you:

- a **note** the update provided on the progress of exploratory discussions regarding the proposal by the NZCTU that there be a centralised mechanism for setting pay across the public sector.

Noted

- b **note** the significant uncertainty around the financial estimates presented in this report and they will be updated on 14 September 2022.

Noted

- c **agree** to wait for that update before deciding whether to commit to further pursuing discussions on the PSPA with the NZCTU.

Agree/not agreed.

- d **note** the risks that would need to be managed in negotiating and implementing a PSPA.

Noted

- e **agree** for the Public Service Commission to seek legal advice from Crown Law on the PSPA

Agree/not agreed.

- f **note** the Minister for the Public Service will report back to Cabinet following further, more detailed advice from Treasury and Public Service Commission officials next week.

Noted

- g **note** the Minister for the Public Service will bring a full report to Cabinet on 3 October, seeking decisions regarding proceeding to bargaining, and parameters and funding for any bargaining.

Noted

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**Deputy Commissioner, Workforce,
Employment relations and Equity
Public Service Commission**

Struan Little
**Deputy Secretary,
Budget and Public Services
The Treasury**

Rt Hon Jacinda Ardern
Prime Minister

Hon Grant Robinson
Minister of Finance

Hon Chris Hipkins
Minister for the Public Service

Joint Treasury / PSC Report: Joint Report: Key considerations for a public sector pay adjustment

Purpose of Report

19. This report presents analysis and advice to support decisions on if and how to progress discussions on the PSPA proposal put forward by the NZCTU. The report includes current high-level estimates of the potential gross and net costs. We recommend waiting for more accurate estimates, which will be available on 14 September, before deciding whether to progress negotiations.

State of play

20. On 27 May, the NZCTU wrote to the Minister of Finance and the Minister for the Public Service proposing a centralised approach to public sector pay via an across-the-board PSPA.
21. On 9 June, Treasury and Public Service Commission officials jointly provided initial advice to the Minister of Finance and the Minister for the Public Service on the NZCTU's proposal.
22. A detailed outline of interactions since that date is included in Appendix Two.
23. [36]
- 24.
- 25.

Analysis

Costing

26. [33], [38]

[33], [38]

27. [33], [38]

This includes flow-on costs such as ACC, KiwiSaver, and overtime costs as well as the impact of the increased base salaries on subsequent existing progression commitments. While there is some uncertainty around the total cost figure due to incomplete or potentially out-dated FTE estimates, we have a reasonable degree of confidence in the aggregate gross cost of the modelled PSPA. [33], [38]

Table 1: [33], [38]

[33], [38]

[33], [38]

28. To determine the net additional cost of the PSPA, we need to estimate what allowance, if any, agencies have made in their budgets for increased personnel costs over the forecast period. In the timeframes available to prepare this advice, we have had to make some very large assumptions based on limited information. Therefore, there is significant uncertainty around these estimates. [33], [38]

We have requested additional information from most agencies that will help refine this estimate, which we will provide in our updated advice on

Wednesday 14 September; even then considerable uncertainty around the estimate will remain.

29. [33], [38]

Costs not included

30. Although the above modelling excludes the funded sector and the wider public sector, such as Autonomous and Independent Crown Entities, it is likely that the PSPA will influence wage rates beyond the agencies included in the PSPA.

[33], [38]

31. [33], [38]

Funding

32. [38]

Budget Update implied a 9.4 percent decline in real per capita government operating expenditure between the end of 2022 and mid-2025 (which would leave it 10.4 percent above pre-pandemic levels). [38]

The

33. As outlined below, if a decision is taken on the PSPA in the next month, Ministers will need to consider how this interacts with the existing cost pressure process for Budget 2023 and what changes may be required. [38]

34. Funding some or all the shortfall by increasing government spending beyond existing operating allowances would add to inflation pressures and hence require the Reserve Bank to have higher interest rates than otherwise.

Macroeconomic impacts

35. The labour market remains tight and although there was a slight increase in unemployment in the June quarter, the most prominent feature in the June data

was the pick-up in wage inflation, with annual wage growth of 6.4 percent compared to the 4.7 percent increase forecast in the Budget Update.

36. Relative to the Budget Update forecasts, our interim update sees a continuation of earlier and more rapid interest rate tightening, with a weaker outlook for activity as the economy adapts to higher interest rates including via lower house prices and weaker consumption and investment and an earlier and more rapid increase in unemployment, although its peak (at 4.9 percent) remains modest by historical standards. We now expect annual economy-wide wage inflation of 6.2 percent in 2022/23 and 5.4 percent in 2023/24.
37. While it is important that wages reflect the tight demand conditions, beyond some point they may risk prolonging the current bout of inflation. As part of preparing the interim economic forecast update, which was provided to Minister of Finance in August (TR T2022/1816 refers), we considered a scenario where wage pressures were more elevated than in the updated baseline. This scenario assumed that annual wage inflation was around 1.5 percentage points higher over the year to June 2023. With the public sector accounting for around 20 percent of total employment, this would approximate an effective increase in public sector pay of around 7.5 percent, assuming private sector wage growth was unchanged.
38. This wage increase contributes to increased inflationary pressure through a combination of increased consumer spending (demand pull) and firms needing to increase prices (cost push). This requires additional monetary policy tightening to keep inflation in check, with interest rates rising around 1 percentage point higher than otherwise forecast. The impact of higher interest rates on demand flows through to lower activity and higher unemployment, with the unemployment rate peaking around 0.5 percentage points higher than in the baseline.
39. The labour market pressures are being experienced across multiple skill categories, sectors and regions, but particularly strong in the private sector and at the low skilled end of the labour market.
40. While the public and private sector labour markets are distinct in many ways (do not compete directly in many areas), there will be overlaps in some sectors/ occupations/ regions whereby public sector wage setting may influence or spill-over into private sector wage pressure e.g., the Wellington region is currently experiencing extensive skill shortages and has a lower than average unemployment rate of 2.7 percent; it is the region most dominated by public sector employment with 30 percent of total employment (even though more public sector employees are in Auckland by total number). Other examples where wage spill-over impacts may occur include health sub-sectors such as disability services and aged care; education; other general and transferable skills like ICT and corporate services (HR, Finance, Legal, and to some extent, Management).
41. In some cases, a combination of specialisation (e.g., psychologists) and/or geography (e.g., regions vs urban centres) can create conditions where competition (and, therefore, wage pressures) occurs for a given type of workforce (e.g., psychologists or corporate services functions) operating in a wider market than the public sector. In some cases, the core business of an entity also creates these conditions. These agency-level and workforce cluster dynamics are also considerations within the context of wage pressures across the economy.

Feasibility progress

42. [33], [38]

43.

Implementation and scope

44. The ability to direct an agreed rate of pay adjustment differs by entity type. Relationship, and proximity, to the Crown directly impacts the ability of Government to deliver any agreed settlement. Officials are developing detailed analysis on various implementation mechanisms.

45. [38]

46. Appendix Four summarises the key challenges and implementation considerations for the various sectors over which the NZCTU has claimed and reaches some possible conclusions about scope feasibility based on these factors (note that these factors do not include cost).

Limitations of progressing to negotiating a pay-only deal

47. While a negotiated settlement for a pay adjustment is tied to cost-of-living concerns, a pay deal alone cannot address the range of other concerns raised in the NZCTU's 27 May letter.

48. To address the full breath of concerns articulated by unions, a more strategic and systemic approach is needed that coordinates both employer and union engagement across multiple avenues.

49. To this end, additional options have been developed to complement (or standalone from) any pay adjustment. Officials have considered existing work programmes underway, Government priorities, and forums for engagement and joint sponsorship by employers and unions.

50. Unions have canvassed a range of non-pay issues. To a large extent these issues align with existing employer/union work programmes or forums. Unions' concerns about the lack of enterprise-level innovation or sector-wide coordination achieved through bargaining highlights that better coordination of these work programmes and forums could form part of the solution. In particular:

- a Te Takawaenga Whakamana / Accord for the Public Service

- b The PSA/PSLT Strategic Forum
- c Exemplar ER engagement
- d Common and consistent terms and conditions of employment
- e The Public Service Commissioner's 2021 Public Service Pay Guidance and 2022 supplementary advice.

51. [33], [38]

52. Officials have, during the period of feasibility discussions, explored a range of alternatives and complementary approaches to the proposed pay adjustment, particularly on non-remuneration issues. Further advice to Ministers can be provided as needed, as well as in response to the nature and shape of any evolving scope of the proposal should bargaining occur. [38]

Risks

53. Beyond the key risks flagged at paragraph 12, there are other risks to consider. The relativity of these risks will be a function of both if, and how, the proposal proceeds, if formal bargaining occurs, and the nature of any settlement reached.

Officials will continue to provide updated advice to Ministers and Cabinet on the most material risks, as relevant.

54. Examples of the wider themes of risk officials continue to evaluate include:
 - a Delivery and implementation risks – including complexity, administrative burden, timing, and scale of implementation.
 - b Media and stakeholder risks – including potential sustained, adverse coverage of the pay adjustment, and/or incorrect information shifting public interest in the proposed pay adjustment.

[33], [38]

Appendix Two – Developments to date

55. On 10 June, the Minister for the Public Service wrote back to the NZCTU indicating his openness to exploring their proposal and signalling the need to focus on four priority areas:
 - a Scope: highlighting the difficulties of extending an adjustment into workforces, such as the state-funded sector, that the Crown does not employ.
 - b Connection with non-pay bargaining: signalling initial challenges for parties being able to conclude collective agreements due to disagreement over non-pay matters.
 - c Settled collectives: the need to carefully consider how far back to extend a claim
 - d Needs of the lowest paid: flagging potential for reinforcing inequalities if the pay adjustment were to set an across-the-board percentage increase (i.e., need for continued focus on Government's commitment to closing pay gaps).
56. On 13 June, the NCZTU and the Minister for the Public Service released parallel media statements indicating the Government was open to exploring a joined up public sector pay negotiation process. The Minister for the Public Service signalled the Public Service Commission would engage with the NZCTU to establish a process to explore the proposal's feasibility.
57. From 21 June to 2 September, union, employer, and Public Service Commission representatives met each week (a total of 14 meetings) to discuss union claims and the above four priority areas.
58. Twelve unions, including NZCTU, have directly engaged in these feasibility discussions.

Appendix 3 —^{[33], [38]}

[33], [38]

Appendix 4 – Breakdown of various areas of the Public Sector

Name	Description	#'s of org
Depts and Dept. Agencies	Public Service Departments and Departmental Agencies.	37
Health sector	Health New Zealand employees (public hospital workers and HealthNZ's corporate areas) plus the Māori Health Authority.	1
Education sector	Funded school boards; compulsory schooling employees and kindergarten teachers.	2500+
Non-Public Service Depts	Non-Public Service Departments - NZ Defence Force, NZ Police, and Parliamentary Council Office.	3
Crown agents	Crown agents, excluding Health New Zealand. Examples are ACC, CAA, FENZ, Maritime NZ, NZQA, TEC, Worksafe, NZTA, NZTE, Real Estates Agents Authority, Sport and Rec NZ.	27
ACEs and ICEs	Eg Te Papa, Māori Language Commission, Public Trust, Heritage NZ, Law Commission; Electoral Commission, Productivity Commission.	36
Crown entity companies	Eg CRI's, Radio NZ and TVNZ.	11
Crown entity subsidiaries		150
Tertiary sector	Universities, Wananga, and Te Pūkenga.	13
Public Finance Act Organisations and Reserve Bank	A range of organisations including Fish and Game councils, Lottery Grants Board, Education Payroll, Predator Free 2050, Network for Learning.	59
SOEs; Mixed Ownership Model Companies		15
Legislative branch	Office of the Clerk; Parliamentary Service; Office of the Ombudsmen; OAG; Parliamentary Commissioner for the Environment.	5 plus Judiciary
Funded sector	Employers funded (partly or fully) to provide public services.	Unknown
Contracted sector	Employers contracted to provide services to the public sector.	Unknown