

# The Treasury

## Advice on Public Sector Pay Adjustment (PSPA) Information Release

March 2023

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Date: 21 September 2022

To: Minister of Finance (Hon Grant Robertson)

CC: Prime Minister (Rt Hon Jacinda Ardern)

Minister for the Public Service (Hon Chris Hipkins)

## **Aide Memoire: Update on Key Considerations for PSPA**

On Monday 12 September you requested a new set of costings for the proposed Public Sector Pay Adjustment (**PSPA**) proposal, building on our advice from 9 September (T2022-1989). This note outlines our updated costings and also provides a high-level assessment on how a PSPA could interact with Budget 2023.

This new set of costings includes a further refinement of our estimates for flow-on costs, progression commitments and provisioned funding - whether from baselines or tagged contingencies. 'Provisioned funding' for the core public service is now based on detailed agency-level information and we have also made high level adjustments where it is unlikely excess funds from one sector will be available to be used to cross-subsidise other sectors. The model still applies some top-down assumptions, particularly for the Public Service and Crown agent's progression commitments, but these assumptions have been better informed by data from agencies.

In addition to this Aide Memoire, today you are also receiving:

- A Treasury Aide Memoire outlining the macroeconomic consequences for various public sector wage inflation outcomes. While that advice is relevant to a possible PSPA, the insights are applicable whether or not a PSPA is pursued.
- A Public Service Commission Aide Memoire covering a range of issues relevant to a PSPA, including legal advice and advice on the scope of the PSPA

### **Revised costings of PSPA deal**

Table 1 below presents updated estimated costs for alternative PSPA constructs, [38]

[38]

[38]

**Table 1: Costings for alternative increases**

*Four year totals to 2025/26*

[38]

**Adjustments to reflect available funding**

This section outlines the new adjustments we have made to arrive at the 'revised shortfall' (see Appendix 1 for further detail).

**Table 2: Adjustments to determine available funding**

*Four year totals to 2025/26*

[38]

***Existing core public service provision that is likely unavailable***

There are three areas where in our judgement funding may not be available:

[38]

**The impact of existing progression commitments on costings is variable**

Many agencies have pre-existing commitments to increase the salaries of their employees in pre-determined steps within their salary bands on their appointment anniversary. While this progression steadily lifts the salaries of individual employees, in aggregate the net cost is zero provided employees who depart at the top of the band are replaced by new employees entering near the bottom of the band. Our updated information from agencies is that this is an appropriate assumption for employees in Health, Education, Police and Defence.

However, many core public service agencies are increasingly hiring new employees further up the salary band to attract staff in the current tight labour market even though

the quality of the employees has not improved. Average salaries also increase when new progression systems, or additional progression steps, are added as the changes take time to reach a new salary cost equilibrium. [38]

[38]

**Table 3:** [38]

[38]

## **Sectors we have not costed**

### ***Wider public sector***

Consistent with your request, the above scenarios exclude large parts of the wider public sector, including Tertiary Education Institutions, Autonomous Crown Entities, Independent Crown Entities, State Owned Enterprises, and other smaller organisations.

Our high-level estimate is that the wider public sector not included in this costing accounts for approximately 132,000 FTE. Even if these entities are excluded from the PSPA, there could be spill-over costs as employees in those entities try to benchmark their wages to the PSPA. [38]

### ***Funded and contracted sectors***

The PSC advice discusses the difficulties of implementing a PSPA for the funded and contracted sectors. However, as with the wider public sector, there could be spill-over from the PSPA to the funded and contracted sectors. [38]

### **The link to the budget process / fiscal strategy advice**

[33]

We understand you are considering taking a Cabinet paper on 3 October to seek in-principle agreement to funding a PSPA, to allow bargaining to begin. We expect the paper would:

- outline the parameters of the adjustment (scale, scope, etc...),
- outline the total cost, and
- [33], [38]

A detailed timeline of decisions and implications is included as **Appendix 3**, but in summary, a 3 October decision would allow time for PSPA decisions to be incorporated into setting Budget 2023 cost pressure envelopes and the Fiscal Strategy, both of which will be set in late October. [38]

There also may be time to provide you (but not the Cabinet paper) an initial view of the scale of wage pressures relative to other cost pressures agencies are experiencing.

### ***Impact of any later changes to mandate (increase in quantum)***

It may be that further changes to the bargaining mandate are sought towards the end of negotiations, for example towards the end of 2022. At this point the cost pressure fiscal envelopes for agencies will have been set, but we would still recommend any additional funding required are met from within allowances. Seeking funding outside allowances would impact the Government's ability to meet your fiscal targets (including your OBEGAL surplus target for 2024/25), as well as having wider macroeconomic effects by increasing government spending.

**David Harrison**, Senior Analyst, Communities Learning and Work, [39]

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## **Appendix 1: Detailed explanation of modelling changes**

[33], [38]

[33], [38]



[33], [38]

## Appendix 2

[38]

## **Appendix 3 – PSPA implications on Budget and Fiscal Strategy Processes**

[33], [38]