

The Treasury

Budget 2022 Information Release

August 2022

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- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
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Treasury Report: Wages and workforce insights in Budget 2022

Date:	Friday 4 February 2022	Report No:	T2022/54
		File Number:	BM-2-14-2022

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Discuss the contents of this report at your Weekly Agency Meeting with the Treasury.	Tuesday 8 February 2022

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Gabrielle Barratt	Senior Analyst, Budget Management	[39]	N/A (mob) ✓
Simon Duncan	Manager, Budget Management	[35]	

Minister of Finance's Office actions (if required)

<p>Return the signed report to Treasury.</p> <p>Refer this report to the Minister for the Public Service for his information</p>
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Note any feedback on the quality of the report

Enclosure: No

Executive Summary

The size of the public sector (both the core public service and Crown entities) has increased in recent years, in order to deliver on significant reform programmes and establish new functions agreed by the Government. This strong demand for additional workforce to deliver on Government priorities has been a key feature of recent Budgets. This trend continues in Budget 2022, with 7,887 additional FTE and contractors being sought through Budget 2022 initiatives submitted by Ministers. In-demand areas of expertise from previous budgets continue to be sought in Budget 2022, including for policy, ICT, data capability, Māori capability, and climate change expertise.

This demand is occurring in the context of several wider constraints:

- a tight labour market across the New Zealand economy
- growing wage inflation pressures
- the Government Workforce Policy statement, and
- domestic border restrictions (which will soon ease for people with Skilled Migrant visas).

A key trade-off Budget Ministers will need to consider is balancing funding the additional workforce to support the delivery of key priorities, with overall deliverability of the Budget package. To support this, the Treasury recommends using a workforce constraint alongside the fiscal constraint (budget allowances) when developing the Budget 2022 package.

Recommended Action

We recommend that you:

- discuss** with Treasury officials at the Weekly Agency Meeting on 8 February 2022 the initial insights from wage and workforce initiatives in Budget 2022, including the proposal to use a workforce constraint in Budget 2022 to support prioritisation
- discuss** FTE growth implications from Budget 2022 at the MOGSSER Ministerial meeting on 9 February 2022, and
- refer** this report to the Minister for the Public Service for his information.

Refer/not referred.

Simon Duncan
Manager, Budget Management

Hon Grant Robertson
Minister of Finance

Treasury Report: Wages and workforce insights in Budget 2022

Purpose of Report

1. You have indicated that wage and workforce initiatives are a key focus for you in Budget 2022. You have also requested that the Treasury and Te Kawa Mataaho Public Service Commission provide advice to you and the Minister for the Public Services on workforce implications associated with the Budget process, including any shifts in the numbers of public servants expected from Budget 2022 and pressure areas due to skill shortages.
2. This report outlines initial themes and insights in Budget 2022 about wage and workforce funding pressures.

Analysis

The size of the public service has increased notably in recent years in order to deliver significant reform programmes

3. The size of the public service has notably increased over recent years.
 - a. As at 30 June 2021, the core Public Service workforce was 61,097 FTE. It has grown by 15,202 FTE, or 33.1%, over the past five years. The wider workforce, including Crown entities, was 114,987 FTE, and has grown by 20,811 FTE, or 22.1%, over the past five years.
 - b. The Public Service workforce grew by an average of 4.1% per year over the last 10 years.
4. Some agencies and Crown entities' baseline workforce has increased significantly in recent years. For example, in 2020/21 the Civil Aviation Authority, the Ministry of Health, the Ministry for Pacific Peoples, the Ministry for the Environment, the National Emergency Management Agency, the Serious Fraud Office, and Stats NZ grew by more than 20%.
5. Recent Budgets funded this growth in the public service workforce to support the delivery of significant reform programmes across many portfolios, including large new functions which have been established. Demand has been particularly strong in areas like policy, ICT, data and Māori capability. Hard data is not available on the quantum of additional FTEs and contractors funded in previous Budgets, or in-demand occupations or areas. The Treasury intends to collect this data from Budget 2022 to improve analytical capability on workforce matters in future Budgets.

Strong workforce demands continue in Budget 2022

6. A significant number of additional workers (FTE and contractors) are being sought through Budget 2022.
7. Funding is being sought for 7,887 new FTE and contractors (2,628 of which are sought for clusters). 225 of the approximately 500 submitted initiatives are seeking new FTE and/or contractors.
8. If all sought additional workers were funded and delivered, the core public sector workforce would grow by 7.2% compared to an average growth rate of 4.6% over the

past six years.¹ Similarly, the public sector workforce combined with Crown entities would grow by 6.7% compared to an average growth rate of 3.9% over the past six years.

Table 1: Votes seeking the greatest number of additional workers through submitted initiatives in Budget 2022²

Vote	Total number of additional workers sought (FTE and contractors)
Labour Market	1,404
Police	840
Transport	805
Justice	612
Corrections	542

9. In the cluster process, the Natural Resources cluster high package is seeking funding for approximately 670 new FTE by 2025/26.³ The Natural Resources cluster positions are split across multiple initiatives, which are seeking resources in similar areas (eg, Māori capability in agencies).
10. The Justice cluster high package is seeking funding for approximately 1,755 new FTE and 203 contractors by 2025/26. Many of the Justice cluster positions are for regional frontline staff at Corrections, Justice and Police, however, there is also funding sought for Justice policy staff and a significant number for the Arms Safety and Control work programme at Police.
11. The drivers for additional workforce in Budget 2022 are the same as previous Budgets; significant reform programmes and new functions being established have created public service workloads that exceed business as usual delivery for many agencies. The growth in public service FTEs over the past few years, and the proposed additional FTEs in Budget 2022, can be observed in the graph below:⁴

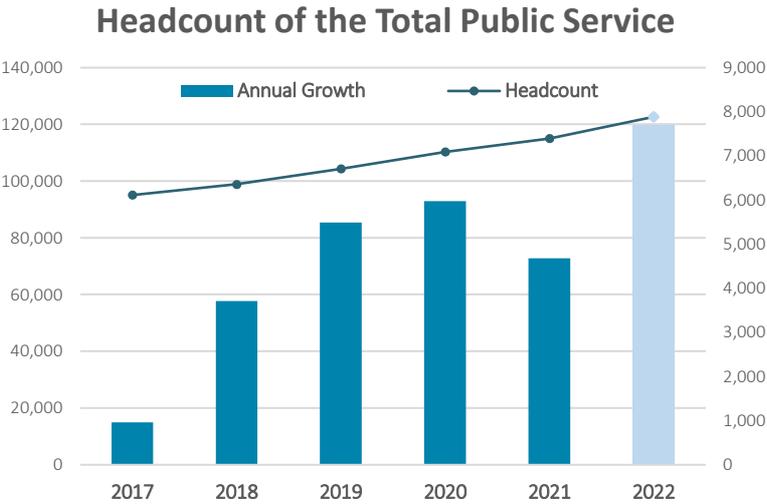
¹ This is a simplification of proposed additional workers; in Budget 2022 and previous budgets, while many funded workers are hired in year 1, some are hired across the forecast period. Years run from 1 July to 30 June.

² This includes cluster initiatives which are over a three-year Budget term, and can therefore be generally expected to be higher than non-cluster proposals. Initiatives may cover a range of agencies and Crown entities regardless of the vote they were submitted within.

³ Cluster numbers are cumulative over the forecast period and reflect a multi-year funding path.

⁴ This is a simplification of additional FTEs similar to footnote 1, given some proposed additional FTE are not intended to be hired in Year 1.

Figure 1: Growth of public service workers



12. In-demand skills and expertise are similar to previous Budgets too. Occupations with the highest demand include ICT and policy. 567 additional policy FTE and 226.5 additional ICT FTE are sought in Budget 2022. Compared to the current public service workforce in these areas (3,542 policy FTE and 2,352 ICT FTE as at 30 June 2021 in the core public service), the quantum of proposed additional workers in these areas is significant.⁵

13. Specialist skills and expertise in areas like Māori capability, data capability and climate change are also in demand. Māori capability demand is driven by demand for both Māori policy advisors and to build internal Māori capability within agencies. Demand for climate change expertise reflects the recent significant growth in large-scale reform in this area.

14. ^[33]

15.

16.

17.

⁵ Specific growth percentages are not possible as occupational data for Crown entities is not available, and occupational data was not submitted for all workforce bids in Budget 2022.

The current labour market and broader economic context places additional constraints on agencies when hiring workers

The labour market is very constrained, making it difficult to fill current vacancies as well as additional roles

18. Labour supply constraints mean it is not possible to deliver the total additional workforce sought in Budget 2022. With relatively less movement across New Zealand's borders and a tight employment market, employers are finding it difficult to fill existing vacancies and there is evidence of churn in the public sector. Funding additional roles in Budget 2022 would add to this demand and put significant pressure on deliverability, and could crowd out the private sector.
19. Unemployment recently fell to 3.2% (December 2021 quarter), the lowest since modern records began in 1986, and the underutilisation rate also remains low at 9.2% (Stats NZ). The in-demand areas identified above are examples of where there is a limited pool of skilled labour to hire from, and agencies are struggling to hire and retain workers for either BAU vacancies or recently funded Budget initiatives.
20. A 2021 survey of government agencies by the Government Chief Digital Officer (GCDO) demonstrates the difficulty agencies are facing to hire and staff in in-demand areas:
 - a 82% of respondents felt that they were unable to offer the right level of remuneration to attract and retain senior digital personnel.
 - b 92% of respondents noted that "better remuneration" was the primary driver of staff turnover.
 - c Of those who left their job, the survey revealed that most staff left for other roles in the public sector, with slightly fewer leaving for work in the private sector or for contracting work.

The New Zealand economy is experiencing significant inflationary pressure that is expected to remain for the year ahead

21. Annual consumer price inflation rose to a 30-year high of 5.9% in the December 2021 quarter, following a 4.9% increase in the September 2021 quarter. This reflects continued resilience in demand, and elevated cost pressures as a result of capacity constraints and labour shortages. These inflationary pressures are likely to persist over the year ahead.
22. Labour shortages have inevitably led to increasing wage pressures. In the *Half Year Economic and Fiscal Update (HYEFU) 2021* the Treasury expected hourly wages to rise 4.0%. The Treasury is continuing to forecast hourly wage growth in the 4% range over the forecast period:

Table 2: Hourly wages actual and forecast in HYEPU 2021:

Year ending June	2021 actual	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast	2026 Forecast
Hourly wages (annual % change)	4.0	4.1	4.5	4.6	4.4	4.2

23. Wage inflation puts pressure on agencies for both hiring and retention of FTEs. Several Ministers have submitted remuneration pressure initiatives to try and meet this challenge. Payroll data collected by Te Kawa Mataaho shows that as at 31 June 2021, the average Public Service wage had increased 3.7% over the past 12 months. This followed an increase of 4.0% in 2020, and 4.4% in 2019.⁶
24. Wage inflation in the broader economy should also be considered when determining how many additional FTE should be funded in Budget 2022. Given the tight labour market, adding demand for large numbers of additional roles could also increase wage inflation pressure.
25. [38]

The Government Workforce Policy Statement is a further influence on agencies in the current employment market

26. In June 2021, the Minister for the Public Service issued the Government Workforce Policy Statement on the Government's expectations for employment relations in the public sector (the Workforce Policy). In giving effect, or having regard, to the Workforce Policy, agencies need to consider the Government priorities to pay people fairly and equitably, and ensuring the Government's employment relations goals are achieved within the fiscal context of the Government.
27. Supply constraints combined with the constrained ability to increase salaries to retain staff may pressure agencies to offer higher starting salaries to secure new staff. Some agencies have submitted costings for hiring additional FTEs at above-market rates as an attraction and retention tool. Given supply constraints, it is not clear that offering above-market rates to secure FTE would increase the total number of FTE available for the Public Service to hire, and such proposals may not be consistent with the Workforce Policy. These decisions may have unanticipated flow-on effects for the Public Service workforce, for example creating uneven salaries between similar roles and employees at agencies depending on when workers were hired.
28. Nine initiatives have been submitted to address remuneration pressures. It is standard practice for Te Kawa Mataaho to ensure that changes to remuneration systems are affordable and sustainable from within baselines, although select agencies have sought Ministerial approval for remuneration initiatives. Agencies may seek to increase their baselines to provide leeway to offer increases in upcoming bargaining.

More movement across New Zealand's borders in 2022 may alleviate some labour market capacity constraints

29. New Zealand's borders have been relatively closed over the past two years due to the COVID-19 pandemic, significantly affecting net migration. This barrier to skilled and unskilled workers being able to enter New Zealand contributes to the current tight

⁶ Data on public service wage growth past 31 June 2021 is not yet available.
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employment market. Results from Te Taunaki, the first public service census run last year, found that 3.3% of respondents were recent migrants (less than five years); 8.3% of ICT professionals were recent migrants.

30. In December 2021, Cabinet agreed to a border class exception for up to 600 specialist tech workers to come to New Zealand [CAB-21-MIN-0517 refers]. Step 2 of Reconnecting NZ will commence on Sunday 13 March 2022, and enable skilled workers earning at least 1.5 times the median wage to enter New Zealand. This could mean for some additional FTE initiatives, there will be somewhat improved labour market capacity compared to the past couple of years.

Balancing deliverability with ambition of reform will be a key trade-off in decisions on wage and workforce pressures in Budget 2022

31. Based on the evidence and analysis of recent public sector workforce growth and Budget initiatives, and the current labour market, we do not think it is possible to deliver all sought additional workforce in Budget 2022 even if sufficient funding was available. Prioritisation, phasing and deferral of additional workforce will be important to ensure Budget 2022 funds delivery-ready initiatives.
32. As noted in paragraph 27, some initiatives have proposed to offer above-market rates to attract staff to mitigate delivery risk. While this approach could be used to aid delivery for a few high-priority initiatives, if such an approach is taken broadly across Budget 2022 it would likely be ineffective. The Crown could end up paying more for a relatively static labour pool as agencies compete with each other. Further, there are system risks and the potential to set a general precedent if some roles are funded at above-market rates. Such an approach could create internal inequities across similar roles at agencies, contributing to wage and workforce pressures in future Budgets.
33. The Treasury is using a range of tools in initiative assessment and package development to determine which wage and workforce initiatives represent the best investment opportunities in Budget 2022.
34. At the initiative analysis level, Treasury Vote Analysts are assessing initiatives within the context of these insights, including:
 - a Areas of high demand and large numbers of sought FTEs noted as high risk when assessing delivery as part of initiative-level Value for Money assessment.
 - b Focus on delivery when assessing initiatives, including looking at delivery of recent additional FTE initiatives, current vacancies, and exploring options for scaling and phasing.
 - c Initiatives for wage inflation adjustments may be recommended for funding, but for one year only as the following Budget is a further opportunity to review inflation pressures rather than commit to a less accurate forward forecast now. The only exception to this is the Justice and Natural Resources clusters, and the health cost pressure initiative. As the clusters are seeking funding covering the next three Budgets, any initiatives for inflationary pressures will cover a three-year period as opposed to one year only. Similarly, the health cost pressure initiative is covering a two-year period rather than a one-year period.
 - d Ensuring the initiative gives effect or has regard to the PSC Guidance on Pay Restraint as appropriate. Initiatives seeking funding for existing remuneration approaches are cross-checked with recent PSC engagement on remuneration approaches.
 - e Guidance on typical overhead rates and what overhead costs should include and exclude, to ensure moderation in overhead costs across the public sector.

35. At a package development level, a key trade-off will be between balancing the overall deliverability of additional FTEs in the package, and the total number of additional FTE funded. Funding significant numbers of additional FTE will make it more difficult across the public sector to successfully deliver them all, given the tight labour market.
36. To help ensure more confidence in deliverability of total investment in additional workforce in Budget 2022, we are proposing using a workforce constraint when developing an initial Budget package alongside the traditional fiscal constrain (budget allowances). This will set a total number of additional FTE to consider as a ceiling this Budget to aid in overall deliverability of the Budget 2022 package. This number is not intended to be a workforce cap, and Budget Ministers could choose to fund a greater number of additional workers. However, it could act as a guide for the maximum number of additional workers we think the labour market could realistically deliver.
37. The Treasury could also provide an overview of the proposed additional workers at an initiative level in the draft Budget package for the Budget Ministers 3 meeting. Options that include and exclude the Social Unemployment Insurance initiative could be developed, as well as options which focus on key Budget 2022 priorities, or greatest confidence in delivery.

Data Sources and References

38. Much of the wage and workforce information submitted in Budget 2022 has been collected for the first time. The submitted information is not complete (for example, only about 50% of workforce bids submitted occupational data) and we do not yet know how likely it is that proposals and assumptions in initiatives will track to outcomes post-Budget. We are considering options for improving the incomplete data submitted in Budget 2022 to provide further analysis for this and future budgets.
39. The definition of “contractor” that Te Kawa Mataaho uses for their data may be different to what agencies submitted, so comparisons of contractor data between Te Kawa Mataaho and Budget 2022 information may not be possible (for example, Te Kawa Mataaho’s definition excludes fixed term employees).

Next Steps

40. Treasury officials will meet with you to discuss the contents of this report at the Weekly Agency Meeting on Tuesday 8 February.
41. Te Kawa Mataaho officials will update the Minister for the Public Service on FTE growth implications arising from Budget 2022. You may wish to discuss this with MOGSSER Ministers at the meeting on Wednesday 9 February.
42. On Friday 11 February, the Treasury will provide a report on the draft Budget 2022 package ahead of the Budget Ministers 3 meeting. The development of this package will include the above wages and workforce analysis, and incorporate your feedback from this report.
43. The draft slides for Budget Ministers 3, including workforce advice, will be provided to your office on Friday 18 February.