

Date: 29 April 2010

SH-13-5-2-1



To: Minister of Finance
Cc: Minister of Revenue

AIDE MEMOIRE: AIDE MEMOIRE: EXCLUDING THE IMPACT OF THE TOBACCO EXCISE INCREASE FROM CPI ADJUSTMENTS FOR GSF AND NPF PAYMENTS

Overview

This note seeks decisions on whether CPI adjustments to Government Super Fund (GSF) and National Provident Fund (NPF) payments should exclude the impact of the tobacco excise increase to be consistent with the treatment of New Zealand Superannuation (NZS), Veterans' Pensions and Working for Families tax credits (WFF).

Because GSF and NPF payments approach a contractual obligation and adjusting these payments on the basis of a tobacco-exclusive CPI track could be seen as retrospectively reducing negotiated workplace remuneration rates, on balance Treasury recommends retaining the current CPI indexation arrangements for GSF and NPF payments.

Background

Yesterday you received advice about excluding the impact of the tobacco excise increase from the annual CPI adjustment to GSF and NPF payments.

NPF

Officials advised against excluding the impact of the tobacco excise increase from the annual CPI adjustment for NPF payments, as this would require legislation to amend the trust deed's CPI provision. This would arguably reduce property rights vested under the trust deed (and advertised in the investment statement), which would be inconsistent with fundamental common law principles regarding vested rights. Accordingly, we recommend that CPI adjusted NPF payments do not exclude the CPI impact of the tobacco excise increase.

GSF

Officials undertook to further investigate whether to exclude the impact of the tobacco excise increase from the annual CPI adjustment for GSF payments and report back to you as soon as possible. This note expands on that advice.

Discussion: Removing tobacco from adjustment mechanism for GSF payments

Consistency of GSF with welfare payments

The GSF Act provides that GSF payments are adjusted by the CPI. Excluding the CPI impact of the tobacco excise increase from these payments would be consistent with the treatment of NZS, Veterans' Pensions and WFF.

However, a distinct contrast can be made with benefit payments. Rather than providing people with welfare payments for the purpose of mitigating financial hardship, GSF payments approach a contractual obligation (as part of a prior workplace obligation). That is, because GSF members have contributed directly (through employee contributions) and indirectly (as part of overall remuneration packages) to the fund,

adjusting payments on the basis of a tobacco-exclusive CPI track could be seen as retrospectively reducing negotiated workplace remuneration rates.

It should be noted that the decision to index GSF and NPF payments from 1 October 2010 for the expected 2.02% CPI impact of increasing GST, rather than 1 April 2011 as per the existing scheme, is also inconsistent with the contractual obligations of the Crown. However, because compensation for the GST change increases GSF and NPF entitlements, that change does not create property rights issues.

Health policy rationale

From a health perspective, there is no rationale for increasing payments made to smokers to compensate for Government actions to increase tobacco prices and discourage smoking. Similarly, there is no rationale in compensating non-smokers receiving these entitlements for tobacco price increases that don't affect their cost of living.

Operating balance and balance sheet impact

The operating cost of excluding tobacco products from the CPI measures applied to adjust GSF payments is expected to be immaterial and within the margin of uncertainty of the overall revenue projection for the exclusion of tobacco products from CPI adjustments. As such it is not expected that excluding tobacco products from the CPI measures applied to adjust GSF payments will have an impact on the fiscal forecasts.

The third round impact on the balance sheet of a permanent increase in future GSF payments by the amount of the tobacco-induced CPI change is also expected to be immaterial. This is because there is not expected to be a long-term CPI impact as a result of the tobacco excise increase. This is consistent with the treatment of the third round effects of the changes to GST.

Conclusion

Treasury considers the choice of whether to exclude tobacco products from the CPI measures applied to adjust GSF payments to be a choice between preserving existing property rights and equity concerns resulting from adjusting the CPI measures for universally available welfare payments such as NZS but not government subsidised defined benefit employee schemes.

On balance, Treasury recommends that the CPI adjustments made to GSF payments should not be adjusted for the impact of the tobacco excise increase on the grounds that making such an adjustment could be seen as retrospectively reduce workplace compensation.

Implementation/action points

No action is required if you agree to retain full CPI indexation for GSF payments.

If CPI adjustments to GSF payments are to exclude the impact of the tobacco excise increase, this will need to be agreed by Budget Ministers in time for amendments to be included in Budget night legislation [CAB Min (10) 12/11].

Recommendations

It is recommended that you:

NPF

- 1 **Note** that excluding the impact of the tobacco excise increase from the annual CPI adjustment for NPF payments would require legislation to amend the trust deed's CPI provision.
- 2 **Agree** to retain the current CPI indexation arrangements for NPF payments.

GSF

- 3 EITHER

Treasury's preferred option:

- (i) **Agree** to retain the current CPI indexation arrangements for GSF payments.

OR

Alternative option:

- (ii) **Agree** to exclude the impact of the tobacco excise increase from the annual CPI adjustment for GSF payments.
- 4 **Note** that, if recommendation 3(ii) is agreed to, officials will seek agreement from Budget Ministers in time for amendments to be included in Budget night legislation.

[deleted - privacy] Tax Strategy, [deleted - privacy]
Steve Cantwell, Principal Advisor, Tax Strategy, [deleted - privacy]