

[In Confidence]

Office of the Minister of Transport
Chair, Cabinet Economic Development Committee

CAA pricing review 2020 – discussion document

Proposal

1. I seek the Committee's agreement for the Civil Aviation Authority (CAA) to release the attached discussion document, *Review of aviation fees, levies and charges*, which includes proposals that will affect aviation levies, fees and charges.

Executive Summary

2. The CAA undertakes a funding review every three years, alternating between comprehensive reviews which consider the policy basis and mechanisms of cost recovery, and mid-point pricing reviews. The mid-point pricing review considers whether, given passenger numbers and inflation, there is sufficient funding for the regulator to effectively and efficiently carry out its role. The review is not intended to significantly revisit existing cost methodologies. Instead, it is an opportunity to see whether there is anything urgent that has come up in the previous three years that would require funding to address.
3. As part of the mid-point pricing review, I am recommending the release of the CAA discussion document to stakeholders, proposing changes to aviation levies, fees and charges over the 2020-2023 triennium, and inviting feedback.
4. Based on the CAA's forecast expenditure, it would accrue a deficit of \$9.6 million for the next three years if aviation levies, fees and charges remain at their current rates, impeding the ability of the CAA to perform its regulatory role effectively. The expected cost increase is made up of inflationary pressures, changes necessary to support regulatory improvements, and three significant additional cost pressures.
 - a) The need to replace the CAA's obsolete regulatory technology platform, which is at increasing risk of failure, will soon be unsupported, and which prevents the CAA from improving its levels of service or how it carries out its regulatory role.
 - b) Additional staff to maintain and increase regulatory oversight of a sector that has grown since the last funding review, and to improve capability.
 - c) Funding the CAA's functions under the Hazardous Substances and New Organisms Act 1996 (HSNO), which have been funded by the Crown for the last two years and for which funding ends in June 2020. At the time the changes to HSNO came into effect, giving the CAA new enforcement responsibilities, Crown funding was provided with the understanding that the current review would consider whether it should continue, or whether the HSNO activities should be funded from levies.
5. To recover the inflationary and technology costs, the CAA proposes to apply a blanket increase of 6.5 percent across all regulatory levies, fees and charges for the triennium. The pricing changes proposed in the discussion document are based on the most expensive scenario of a capital injection to pay for the technology upgrade. Such funding has a high cost

because it would attract a capital charge¹ across the net Crown assets of the CAA, not just the incremental funding stream of \$12 million.

6. Alternatively, if Cabinet agrees to me pursuing a Crown loan for the CAA's new technology system, a lower increase of 5.3 percent will be required across all regulatory levies, fees and charges. This reflects a lower finance cost of \$11.1 million over 10 years. I would like certainty from Cabinet that a Crown loan rather than capital injection should be pursued. This would avoid the CAA going out for consultation on an increase that is the worst possible scenario for levy payers. If Cabinet agrees to pursuing a Crown loan, I will proceed through an out-of-cycle bid or as part of Budget 2020 to seek joint Ministers and Cabinet approval for a Crown Loan of \$12 million.
7. The CAA also proposes to apportion 90 percent of the HSNO enforcement costs to the Agricultural Operations Safety Levy and the remaining 10 percent across all other levies, fees and charges. This cost allocation recognises that it is mainly agricultural operators who create the hazardous substance risks and should pay for the relevant enforcement activity by the CAA. The Agricultural Operations Safety Levy is currently no more than \$1.00 per tonne of product dispersed, so this addition would result in a seemingly dramatic 82 percent increase. However, the resulting levy would still be less than \$2.00 per tonne, and a relatively small component of the price of having agricultural products dispersed by aircraft. In 2016, such products cost \$316.00–\$1,460.00 per tonne (depending on the product), and a further \$85.00 per tonne to apply. An agricultural aviation operator who dropped 10,000 tonnes of fertiliser would see their annual levy increase from \$7,300 to \$13,286 (excluding GST). Most operators drop less than this, with a few large operators dropping much greater amounts.
8. The proposed increase in the Agricultural Operations Safety levy is likely to be unpopular with the agriculture sector. Other options could be explored. Crown funding for the work could be continued via a budget bid in Budget 2020. The other option is to share the cost across all levies, fees and charges. Spreading the cost of hazardous substance enforcement across levies, fees and charges would result in a 7.6 percent increase, rather than the proposed 6.5 percent. However, this would go against funding guidance from the Treasury and Office of the Auditor General, and Transport funding principles, which recommend against cross-subsidisation unless a good case can be made, and is also inconsistent with the cost allocation methodology established in the last CAA funding review. Changing the cost allocation model in this way could lead to a broader debate and calls to change the CAA levy cost allocation models, which are not in the scope of this pricing review, and it would also be likely to get pushback from other aviation sector participants.
9. The discussion document also outlines a review of the activity-based Agricultural Operations Safety Levy. Following feedback from the agricultural aviation sector, the CAA undertook to re-examine alternatives to calculating the levy based on the amount of agricultural product dispersed. The CAA's review confirmed that tonnes of product dispersed remains the best proxy for activity to use to calculate the levy.
10. Finally, the discussion document also proposes changes to the prices of Airport Identity Cards, to incorporate the cost of an upgraded computer system, and to Regulated Air Cargo Agent charges, to reflect an anticipated increase in applications.
11. The CAA has undertaken work to ensure that the cost increases are reasonable and commensurate with the costs of similar regulators.

¹ A capital charge is a cost levied on each department or Crown Entity, reflecting the cost to the Crown of its investment in a department or Crown Entity where this exceeds \$15 million.

Background

12. The CAA is a Crown Entity, established under the Civil Aviation Act 1990, that oversees aviation safety and the Civil Aviation rules. The CAA also includes, as a separate division, the Aviation Security Service (Avsec).
13. The CAA is funded almost entirely by levies, fees, and charges collected from participants in the aviation sector, including airlines, pilots, and aviation organisations.
14. The CAA undertakes a funding review every three years, alternating between comprehensive reviews which consider the policy basis and mechanisms of cost recovery, and mid-point pricing reviews. The mid-point pricing review is focussed on testing whether, given passenger numbers and inflation, there is sufficient funding for the regulator to effectively and efficiently carry out its role. It is not intended to significantly revisit existing cost methodologies. The review is also the opportunity to see whether there is anything urgent that has come up in the previous three years that would require funding to address. The last comprehensive funding review was completed and its recommendations implemented in 2017.

The 2017 Funding Review

15. The focus of the 2017 review was on re-balancing the CAA's sources of revenue to better reflect its risk-based regulatory oversight of different sectors. It looked at whether cost recovery mechanisms were consistent with the intent of the activities being funded, and whether costs were recovered equitably.
16. The major changes from the 2017 funding review were:
 - 16.1 the replacement of an hourly charge for routine compliance monitoring with funding from levies, to reflect that all aviation system participants and users benefit from the safe aviation system that is provided as a result of the CAA's regulatory activity
 - 16.2 the introduction of activity-based levies for commercial aviation organisations, to increase the relative contribution made by this sector to better match the level of oversight it requires (large passenger airline services were already paying 'per passenger' safety levies).
17. The 2017 funding changes reduced the CAA's total revenue over the 2017/18 to 2019/20 period by \$2.191 million compared to what it would have received without any change.
18. In June 2019, the CAA began a mid-point pricing review to determine the prices of its levies, fees and charges for the period 2020 to 2023.

2020–2023 Pricing proposals

19. I am proposing that the CAA release the discussion document, *Changes to the Funding Arrangements for the CAA's Regulatory Functions – 2020–23, Review of aviation fees, levies and charges*, which proposes pricing changes.
20. The CAA anticipates that at current rates of levies, fees and charges, revenue over the next three years would fall short by \$9.1 million.

Table 1: Estimated Expenditure over the Pricing Review Period (2020/21 – 2022/23)

Estimated Expenses	Budget	Pricing Review Period		
	2019/20 \$000s	2020/21 \$000	2021/22 \$ 000	2022/23 \$000
Personnel Costs	40,633	41,795	41,907	42,664
Depreciation & amortisation	727	792	825	1,465
Finance Costs		460	1,080	1,380
Other expenses	8,494	8,671	8,824	7,220
Total Expenses	49,854	51,718	52,636	52,729

21. The main drivers of the increased costs, outlined in more detail below, are:
- 21.1 replacement the obsolete CAA regulatory technology platform
 - 21.2 hiring additional staff and improving capability
 - 21.3 recovering the cost of enforcing requirements relating to the use of hazardous agricultural chemicals.
22. Wage inflation for this review was set at levels in line with Treasury’s economic forecast update information (Budget Economic Forecast Update, Issue 30 May 2019).
23. The CAA proposes to recover these costs by increasing all levies, fees and charges by 6.5 percent, and by further increasing the Agricultural Operations Safety Levy (see below)

Table 2: Financial projections based on recommended 6.5% price increase plus HSNO levy

	Budgeted 19/20 \$000	Projected 20/21 \$000	Projected 21/22 \$000	Projected 22/23 \$000
Total Revenue	49,127	51,971	52,397	53,174
Total Expenses	49,854	51,718	52,636	52,729
Total Surplus/(Deficit)	(727)	253	(239)	445

Replacement of the CAA’s Regulatory Technology Platform

24. The biggest contributor to the increased total expenditure estimated by the pricing review is the replacement of the CAA’s obsolete regulatory technology platform – that is, the computer system required to support its core regulatory activities.
25. The CAA’s bespoke regulatory business application, developed in-house, is now over thirty years old. The system has been reliant on a single person for its ongoing maintenance and support. From January 2020 the underlying operating system will no longer be supported by Microsoft. The CAA identifies significant system failure and security risks, among others if it continues to depend on the current platform. These risks leave no option but to replace the current platform to mitigate system and safety implications.

- **A heightened risk of system failure** – as the current platform ages, it has needed significant new functional and security patches that potentially compromise its stability. When support ceases, any further necessary modifications will be even less reliable.
 - **Considerable IT security risk** – security patches will no longer be provided for the operating system from January 2020.
 - **Significant business risk** – the software functionality was last updated in 2000–2003, addressing the business needs at the time. It is no longer able to accommodate changing regulatory requirements or to provide the intelligence and information analysis needed by the CAA and aviation operators to improve safety performance. Nor can the software code be modified to support changes in business processes. Important software elements are based on applications from now-defunct vendors.
 - **Performance risk** – the functional constraints of the system are undermining the CAA's regulatory effectiveness.
 - **Operational risk** – the lack of digital interfaces places a significant administrative burden on participants in the aviation system when they interact with the CAA.
26. Initial work to replace the system commenced in 2014, which may appear to have been a long time. This was needed to ensure prudent due diligence process was followed. As can be expected of such due diligence process, the CAA has done some extensive staging and pilot work, including trialling errors, before deciding on the EMPIC system.
 27. To manage the complexity and risks associated with changing the platform, the CAA Board decided in 2014 to proceed in two stages: firstly focusing on the implementation of a core information management platform, and then moving onto the replacement of the core regulatory platform.
 28. The first stage focussed on the implementation of an all-of-government common capability application for an information management platform. This was successfully implemented in 2017, with the intention to use the same application to replace the regulatory platform.
 29. The second stage, to replace the regulatory functionality, commenced in 2017, as soon as the core information management platform 'InfoHub' was in place in 2017. The CAA started off by reviewing a number of product options, then started a pilot on the preferred product OpenText Process Suite (DecisionHub), a parallel product to the InfoHub information management platform. However, the CAA had to stop considering this option, as the pilot identified a number of risks and issues with proceeding. The risks include uncertainty around the cost, duration, and the appropriateness of proceeding with a completely bespoke solution.
 30. The CAA then conducted further research and analysis, including mitigating the critical business risks that the existing platform poses. The CAA has determined that the preferred solution would be a commercial-off-the-shelf (COTS) regulatory aviation-specific system. This would mitigate key risks and issues experienced in previous attempts to replace the obsolete system as well as provide the enhancements necessary to drive improved regulatory practice and performance.
 31. Having compared many alternatives, on 26 March 2019, the CAA Board approved an indicative \$16.4 million investment in the EMPIC Digital Regulatory Technology Platform project (EMPIC-EAP) provided by EMPIC GmbH, based in Germany as the most suitable replacement system. This product is a purpose-built aviation regulation technology platform used by more than 25 other international aviation agencies, including the Civil Aviation Safety Authority of Australia (CASA).
 32. As it is an off-the-shelf solution specifically designed for aviation safety oversight and regulation, which will greatly reduce the risks often associated with large-scale IT

implementation projects. The CAA has engaged closely with CASA to learn from its experience of implementing EMPIC.

33. In addition to addressing the current critical risks, adopting the new platform will deliver benefits including improved regulatory performance, and a reduced regulatory and administrative burden on aviation system participants.
34. Implementation of the new system will require a significant capital investment and ongoing operating costs in the form of software licensing and maintenance fees. The CAA estimated that approximately \$16.3 million(excluding contingencies) will be capital expenditure, which will be partially met from the CAA's existing cash reserves in addition to \$12 million of Crown capital funding. The estimated operating and capital expenditure for EMPIC-EAP is \$26.8 million over a ten-year period.
35. The implementation and operating costs of the new EMPIC–EAP investment are provided in the operating expenditure projections for the three years from February 2020 as per Table 1 above. Costs include personnel costs, depreciation and amortisation costs, and finance costs.
36. EMPIC-EAP is a cloud hosted 'Software as a Service' product. Therefore, future upgrades are expected to be funded by levies, fees and charges, rather than further capital funding. The CAA projected the ongoing operating costs of \$1.1 million per annum for licensing and maintenance once the system is fully implemented from 2023/24 onwards. Table 3 shows the costs of EMPIC, assuming a February 2020 start, and going live during the 2022/23 year.

Table 3: Estimated costs of the EMPIC regulatory technology platform

EMPIC costs	Current SOPE	Pricing Review	Pricing Review	Pricing Review	
	2019/20	2020/21	2021/22	2022/23	2023/24
Operating Costs	146	485	862	906	1,100
Depreciation ²				819	1,639
Finance Costs		460	1,080	1,380	1,440
Total	146	945	1,942	3,105	4,179

Funding the new regulatory technology platform

37. The CAA would prefer the \$12 million capital expenditure for the new system to be funded by a Crown loan, and seeks Cabinet's agreement to this approach. However, the proposed discussion document instead sets out the levy and fee increases that would be necessary to fund the upgrade with a capital injection. These assume a capital charge at 6 percent on all Crown equity funding held by the CAA, which would increase levies and fees and charges.
38. In recommending a Crown loan, the CAA has worked with the Ministry of Transport to consider four funding options for this project:
 - Crown capital injection
 - repayable Crown capital injection
 - Crown loan

² Based on 10 year straight-line depreciation

- commercial third party loan³.

39. The CAA evaluated the funding options against the following criteria.

- Cost to the aviation sector and stakeholders.
- Match with the substantive nature of the asset being purchased.
- Complexity of financing arrangements

Table 4: Comparison of potential funding options

Key Criteria	Crown Finance		
	Capital Injection	Repayable Capital Injection	Crown Loan
Lower cost	□	□□	□□
Match to the substantive nature of the asset being purchased	□	□	□
Complexity of financing arrangements	□	□	□
Total Finance Cost Over 10 Year Life	\$14.4 million	\$3.3 million⁴	\$3.3 million

40. A Crown Loan has been assessed as the preferred option because:

- The nature of the investment – cloud-based software-as-a-service – means that temporary debt funding to meet the one-off project design and implementation costs is more appropriate than a permanent capital injection by the Crown. Future upgrades are expected to be funded through operating costs rather than requiring further capital investment.
- If this investment were funded by a capital injection, the capital charge on Crown-funded net assets that exceed \$15 million would motivate the CAA to reduce its assets to below this threshold. It could do this either by setting its pricing so it did not recover the depreciation expense of the initial investment, or by recovering this depreciation and returning the surplus cash to the Crown. Either approach would have the effect that a permanent capital injection would behave like a form of temporary financing, which further suggests that a loan is the more appropriate funding instrument for this type of investment.
- It would entail the lowest cost to the aviation sector. A Crown loan would require an increase of 5.3 percent to all the CAA's levies, fees and charges. By contrast, a permanent Crown capital injection would require an additional increase of 1.2 percent, for an overall increase of 6.5 percent.
- The additional cost of a permanent capital injection is due to the capital charge incurred by exceeding \$15 million net Crown assets, which amounts to \$11.1 million over the 10-year financing period. This capital injection option is more expensive than other funding

³ Treasury does not support the CAA accessing funding from an external provider. This option is not analysed further.

⁴ Based on an assumed interest rate equivalent to Crown loan rather than capital charge. Treasury notes that a repayable capital injection is treated substantially the same as a Crown loan, but a Crown loan is preferable.

options because the CAA would have to pay a capital charge on its existing net assets, in addition to the 2 percent higher finance rate on the funds sought. For the other options, the finance rate is lower and only applies to the incremental funds advanced to the CAA and only until they are repaid.

- It would allow the replacement of the current computer system to start with the urgency required given the growing technology risk. It would also let the commercial and contractual negotiations to be completed as early as possible.
41. From the Crown's perspective, a repayable Crown loan that is repaid within ten years of initial drawdown has no impact on the capital allowances for Budget 2020. There will be an initial impact on Crown loan debt, but it is fiscally neutral over the ten year period.
 42. The proposed discussion document sets out the levy, fee and charge increases that would be necessary to fund the CAA's computer upgrade with a capital injection. However, if Cabinet agrees to me pursuing a Crown loan, the CAA could consult on the cheaper option for levy and fee and charge payers.
 43. If the Cabinet supports a Crown loan as the preferred funding option, I will either seek Cabinet approval for an out-of-cycle bid (based on urgency) or include a bid as part of part of Budget 2020. A Cabinet paper requesting a Crown loan for EMPIC-EAP, supported by the finalised EMPIC-EAP business case, will be submitted in the near future.

Additional staff and improved capability

44. The CAA expects increased costs for personnel and capability due in part to more certification and surveillance activity from increases between 2016 to 2019 in:
 - registered aircraft numbers (from 4700 to 4843 – a 3 percent increase)
 - air operator certificates (from 1009 to 1064 – a 6 percent increase); and
 - certified drone operators (from 31 in 2016 to 105 – a 239 percent increase).
45. The CAA expects the commercial use of drones in New Zealand to continue to grow – consistent with the Government's encouragement of their potential. Demands on the CAA have also increased as it has operationalised the introduction of Safety Management Systems (SMS) across aviation organisations to improve risk management and safety oversight. Additional capability will also address concerns that have been raised by some in the sector about gaps in delivery, and about the way that the CAA interacts and engages with the sector.
46. The increased costs comprise the following.
 - 46.1 It is proposed to hire 4 additional permanent regulatory FTE in the 2020/2021 financial year, and a further 4 permanent regulatory FTE in the following year. This will cost \$0.7 million for the 2020/21 financial year and \$1.5 million in 2021/22 and 2022/23. The additional personnel will enable the CAA to undertake more regular oversight and surveillance activities across a wider range of operators, according to risk, and is aligned with the recent organisational design changes implemented to drive regulatory performance improvement.
 - 46.2 The CAA intends to build additional capability to support ongoing improvement in the CAA's regulatory practice and performance, and in measurement of that performance. It proposes additional staff, comprising 1.5 permanent operational policy, practice and guidance FTE in the 2020/2021 financial year, and a further 1 permanent operational policy, practice and guidance FTE and 1 permanent sector education and engagement FTE in the following year. This will cost \$0.2 million for the 2020/21 financial year and \$0.5 million in 2021/22 and 2022/23. Performance will be improved through the

ongoing development of tools and guidance for regulatory staff, and information and education initiatives for industry.

47. These changes will ensure that CAA continues to have the capability to ensure the safety of New Zealand's civil aviation system by conducting the required certification and surveillance of the individuals, organisations and aircraft participating in it. They will also provide for improved reporting to allow better measurement of performance, so that the CAA can better target its activities according to risk.
48. The CAA also proposes an increase of \$0.08 million per annum to Board members' and Medical Convenor fees, subject to approval by the Cabinet Appointments and Honours Committee, and Cabinet.

Cost recovery of Regulatory Functions under the Hazardous Substances and New Organisms Act 1996 (HSNO)

49. The CAA enforces the Hazardous Substances and New Organisms Act 1996 with respect to spray drift and the misapplication of products dropped from aircraft, which is almost entirely attributable to agricultural operations. The CAA was given this responsibility in December 2017, and received Crown funding⁵ for two years to carry it out and establish its capability. That is, up until the current funding review, in which it was to be decided whether Crown funding should continue, or the cost be recovered through a levy.
50. The CAA proposes to recover the cost of its oversight of the discharge of hazardous substances from aircraft from the Agricultural Operations Safety Levy. This is the biggest percentage increase in a levy proposed in the discussion document. The additional cost of the HSNO work is estimated at around \$600,000 per year. This is close to the current revenue from the Agricultural Operations Safety Levy, so seeking to recover it from the 105 aircraft operators providing agricultural services, as would be appropriate, would almost double that levy.
51. The CAA's discussion document presents the alternative option of spreading the HSNO cost over all levy payers, but proposes that most of it should be paid by agricultural operators. It suggests that 90 percent be added to the Agricultural Operations Safety Levy, and 10 percent be added to the other levies, fees and charges. The latter share recognises that some risk is introduced by other parts of the aviation sector, such as by aircraft jettisoning fuel. The increase, along with the other proposed increases, will raise the Agricultural Operations Safety Levy by 82 percent.
52. The scale of this increase places an additional burden on agricultural operators, which may threaten the viability of businesses if it is difficult to pass it on to their customers, and is bound to provoke opposition. Of the 105 agricultural operators, more than 90 drop less than 10,000 tonnes each (identified as small in Table 5). This option may also have impacts on the wider agricultural and forestry industries.

⁵ The CAA received \$0.55 million in Crown funding in 2018/19 and \$0.52 million in 2019/20.

Table 5: Examples of the effect of the proposed levy increase (all excluding GST)

Size of operator	Tonnes dispersed per annum	Current rate per tonne	Proposed rate (82% increase)	Annual levy based on current rates	Annual levy based on 82% increase
Small (within the 0-10,000 tonnes per annum levy bracket)	2,500	\$0.87	\$1.58	\$2,175	\$3,950
Medium (within the 10,000 to 50,000 tonnes per annum levy bracket)	25,000	\$0.73	\$1.33	\$18,250	\$33,250
Large (within the 50,000 + levy bracket)	80,000	\$0.65	\$1.18	\$52,000	\$94,400

53. The CAA reports that although there has been opposition to the Agricultural Operations Safety Levy since it was introduced, it has received little feedback about the actual impact of the levy on businesses. Although the proposed increase is significant, it will still be a small proportion of the price for applying agricultural products. In 2016, before the previous funding review, the cost of the products themselves was \$316–1,460 per tonne (depending on the product), while they cost about \$85 per tonne to apply. The proposed levy will be less than \$2 per tonne. However, I have no financial information about the commercial businesses involved that would enable me to further assess its impact.
54. The burden could be reduced by increasing the share paid by other operators to cross-subsidise the cost of the CAA's oversight of agricultural operations. If the whole cost were spread over all levies, fees and charges, it would be necessary to increase these by 7.6 percent (rather than 6.5 percent) to ensure full cost recovery from across the aviation sector. This option goes against funding principles which recommend against cross-subsidisation unless a good case can be made, and is also not consistent with the cost allocation methodology set up in the last CAA funding review. Changing the cost allocation model in this regard may lead to debate on the CAA levy cost allocation models more broadly, which are not in the scope of this mid-point review, and is also likely to get pushback from other aviation sector participants.
55. The discussion document and consultation process will provide a good opportunity to discuss these options further, and test the impacts of the levy increase on agricultural operations.
56. Given that the proposal will lead to a significant increase to the levy paid by aircraft operators who disperse potentially hazardous agricultural substances, the Crown may also want to consider continuing to fund this regulatory activity, through a budget bid for Crown funding.

Review of Airport Identity Card (AIC) fees

57. The CAA is replacing the computer system it uses to manage and issue identity cards for people permitted to enter secure parts of airports. The existing system is now outdated in that it is no longer supported (so security cannot be upgraded), is unreliable and involves manual processes that increase risks to privacy. The new system will improve security; however, it is more costly.
58. Based on demands on system resources, prices for an AIC are proposed to change as follows.
 - Permanent AICs – decreasing by 4.7 percent, from \$54.31 to \$51.75 (59.51 including GST)
 - Temporary AICs – increasing by 173.7 percent, from \$6.91 to \$18.91 (\$21.75 including GST)
59. Permanent AICs require security vetting and are valid for three years. In the last year, 17,666 permanent AICs were issued. Temporary AICs are valid for a week, and often a contractor will need several to complete a job. In the last year, 59,743 temporary AICs were issued.
60. It is likely that the increase in the price of temporary AICs will encourage more applicants to apply for permanent AICs instead. Since the vetting required for permanent AICs improves airport security, the CAA considered using pricing to incentivise their uptake. However, it was determined that the appropriate AICs should remain accessible, and the pricing proposed here reflects the actual costs to the system. It is expected that there will continue to be more temporary AICs issued than permanent cards.

Review of Regulated Air Cargo Agent (RACA) fee

61. All international cargo must have security controls applied to it by an airline or a Regulated Air Cargo Agent (RACA).
62. People who work for RACAs must undergo security vetting in order to be issued with an authorisation. Their Security Check Determination applications are managed by the CAA's Aviation Security Service for a fee.
63. The costs of processing RACA applications comprise primarily labour and IT, along with minor components such as the cost of Ministry of Justice vetting.
64. Based on its projections of future application numbers, the CAA is able to reduce the cost per application. The current fee for a RACA check is \$53.30 (\$61.30 including GST). It is proposed to reduce this by 58.5 percent to \$22.14 (\$25.46 including GST).

Policy issues

65. The discussion document also includes summaries of two policy reviews undertaken as part of the funding review, but which do not result in recommendations that would change the price of levies, fees or charges. The review of the Agricultural Operations Safety Levy responds to concerns raised by stakeholders. A review of drones merely signals on-going work and makes no policy or funding recommendations.

Review of the Agricultural Operations Safety Levy

66. In the 2017 funding review, the CAA introduced activity-based Operations Safety Levies, which allowed the CAA's costs for regulatory activities to be recovered more appropriately from the operators that benefit from the CAA's services, or create the need for them.

67. As a result of this change, the levies paid by aircraft operators who disperse agricultural products – fertilisers, herbicides or pesticides – were better aligned with the actual oversight costs to the CAA. The basis on which the levy for these operators is calculated was also changed from an hourly fee, plus specific charges, to a levy calculated based on the weight of product dispersed.
68. This basis was chosen as the best proxy for the extent of activity that generates the CAA's regulatory work.
69. Some agricultural aircraft operators were unhappy with the new levy, and with it being calculated based on the amount of product dispersed. The latter concern is essentially about the distribution of the levy burden. Of 105 agricultural operators in the aviation system, fewer than ten large operators distribute most of the product, and so pay most of the levy. The current levy structure recognises the potential for this to misrepresent risk, by charging a lower per tonne rate for larger operators. Nonetheless, the CAA committed to reconsider whether an alternative measure of activity should be used as the basis for the levy, and presents its conclusions in the discussion document.
70. The CAA considered four ways in which the Agricultural Operations Safety Levy might be calculated, based on data already provided by operators:
- the amount of product dispersed
 - the number of loads dispersed
 - the area over which the product is dispersed
 - total flight time.
71. The CAA's review confirms that the amount of product dispersed remains the best proxy for activity to use to calculate the levy. Of the alternatives considered, it utilises data that is more verifiable and would not create an incentive to unsafely overload aircraft.

Risk considerations

72. Operators using aircraft to provide agricultural services will face the proportionately highest proposed price increases. Some will also be disappointed that the CAA is not proposing to change the basis for calculating the Agricultural Operations Safety Levy. Some may feel that the levy increase due to the CAA's HSNO obligations will put their business at risk. These costs may also affect the farming or forestry sector, if they are passed on to customers. Officials will test the impacts on businesses through the consultation process.
73. Applicants may be concerned at a \$21.75 issuing charge for temporary airport identity cards, especially if several cards are needed to complete a job. However, for longer jobs, the price may incentivise application for a permanent identity card, which would improve airport security.
74. Passenger numbers have recently been lower than were forecast. Although the pricing changes proposed in the discussion document take account of a drop in passenger numbers consistent with the trend in the 12 months to May 2019, there is a risk that the downward trend will increase. This would further reduce the CAA's revenue over the next three years, and possibly require higher prices than are proposed in the discussion document. In that case, the lower passenger numbers will be reported to Cabinet for consideration as part of the final policy decisions on the pricing review in February.

Consultation

75. This paper and the attached discussion document have been reviewed by the Civil Aviation Authority; the Ministry of Business, Innovation and Employment; the Ministry for Primary

Industries; the Ministry of Foreign Affairs and Trade; the Department of Conservation and the Treasury. The Department of the Prime Minister and Cabinet has been informed.

Financial Implications

76. There are no financial implications from releasing the CAA's discussion document.
77. The CAA's proposals would have the following implications.
- 77.1 There would be no change in baseline Crown funding for the CAA.
 - 77.2 However, the Crown funding for the CAA's enforcement of HSNO requirements will end as scheduled.
 - 77.3 There would be an increase in revenue for the CAA from fees and levies, of \$9.1 million over 2020–2023, to match cost pressures.
 - 77.4 The Crown would be asked to provide funding of \$12 million to upgrade the CAA's regulatory technology platform. This will be provided either as a Crown loan, or as a capital injection. A loan would incur interest at 4 percent, amounting to \$3.3 million over 10 years. A permanent capital injection would incur a capital charge on all Crown equity funding held by the CAA, at 6 percent, amounting to \$14.4 million over 10 years. These costs would be recovered from aviation levies and fees.

Legislative Implications

78. The release of the discussion document would have no legislative implications. Legislative proposals may follow consultation.

Impact Analysis

79. The Treasury has confirmed that an impact statement is not required in order for Cabinet to agree to the requested consultation. A CRIS will be provided when recommendations are made to Cabinet as a result of the pricing review.

Human Rights

80. There are no human rights implications from release of the discussion document.

Gender implications and Disability perspective

81. The proposals have no gender implications, or implications for people with disabilities.

Publicity

82. With Cabinet's agreement, the CAA will publish the discussion document, along with supporting information, on its new website, and will contact stakeholders to invite submissions.
83. Consultation will involve emailing those on the CAA's regulatory system database, the CAA's website subscription list and other identified stakeholders, and providing them with options to respond to the proposals.
84. Sector engagement during the consultation will include a small number of open meetings held at venues accessible to the agricultural sector, as it is anticipated there will be high interest from agricultural operators. Targeted meetings will also be held with sector representative

groups. The consultation will also be communicated through all existing channels including social media, and the Aviation Community Advisory Group (ACAG) will be advised of the consultation before it begins.

85. Consultation is planned to run from as soon as the discussion document is revised to reflect any Government decisions about funding to the CAA, which is likely to be in the last week of November 2019 or first week of December 2019. As the timing gets close to Christmas and New Year holidays, the consultation will be extended to finish in early February 2020.

Proactive Release

86. Following Cabinet agreement to this paper I intend to release it on the Ministry of Transport website.

Recommendations

87. The Minister of Transport recommends that the Committee:

1. **agree** to the Civil Aviation Authority releasing the attached discussion document as part of its consultation with stakeholders about proposed increases to aviation levies, fees and charges for 2020/21 to 2022/23
2. **agree** that a Crown loan of \$12 million is the preferred option, in principle, to fund the capital investment required for the CAA's new regulatory technology platform

EITHER

3. **agree** that the costs of the Regulatory Functions under the Hazardous Substances and New Organisms Act 1996 (HSNO) should be levy funded mainly from the Agricultural Operations Safety Levy

OR

4. **agree** that the costs of the Regulatory Functions under the Hazardous Substances and New Organisms Act 1996 (HSNO) should be Crown funded through Budget 2020
5. **agree** that the discussion document may be revised to reflect any Government decisions about funding for the Civil Aviation Authority's Regulatory Technology Platform and/or HSNO costs, without being referred back to Cabinet
6. **note** this paper will be released following Cabinet agreement.

Authorised for lodgement
Hon Phil Twyford
Minister of Transport