



Aviation Security Service Funding Review 2018/19

SUMMARY OF SUBMISSIONS

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Introduction

1. The purpose of the Aviation Security Service (Avsec) Funding Review 2018/19 is to ensure that Avsec is efficiently and effectively funded so that it can continue to deliver its statutory functions. This review considered who should pay, how they should pay, and how much they should pay. It did not consider Avsec's operational activities or business model.
2. A consultation document was released on 14 August 2018 which outlined the purpose and objectives of the funding review and the six associated proposals. A total of nine submissions were received. This document summarises the key elements of the submissions in relation to each of the Civil Aviation Authority's (CAA) proposals.

Who should pay for aviation security services?

Proposal A – Cost recover from airlines on a per-screened passenger basis

The Authority proposed to continue to cost recover from airlines on a per-screened passenger basis as airlines and their passengers are the primary beneficiaries of aviation security services and passengers are the main risk exacerbators.

3. This proposal was generally supported by submitters. Most submitters also agreed with the classification of beneficiaries and risk exacerbators.
4. The main concern submitters had with this proposal is that a per-passenger screened charging method does not accurately reflect the public good aspects of Avsec. Submitters highlighted how a functioning aviation security service contributes to the economy of New Zealand and the tourism industry. They also pointed out that the landside security activities carried out by Avsec benefit a broader range of people than just airlines and passengers. These submitters have requested a higher, or more proportionate, Crown contribution to Avsec. A small number of these same submitters suggested that some aspects of aviation security services would be more accurately classified as a private good. This was on the basis that passengers benefit directly from the services that they receive. These submitters advocated for a proportional attribution where the crown funds the public goods aspects and passengers pay for the private or club good aspects.
5. A small number of submissions further suggested that it could be appropriate to charge airport retailers for the specific security services they receive. If this was not possible, it was suggested that airline staff and crew receive priority at non-passenger screening lanes. The rationale for this was in relation to a proportional funding model where those receiving the benefit pay directly for the services.

Authority Response

6. The terms of reference focused on whether the current cost recovery framework was fit-for-purpose and whether the alternatives proposed remained consistent with Treasury guidelines. Passengers and airlines introduce safety and security risks to the aviation system and New Zealand, and should pay for the costs of managing those risks. Crown

contribution, or a general tax was considered as part of the analysis and it was determined that this would not be an appropriate cost recovery method for a number of reasons. These reasons included but not limited to, a mechanism for a tax on the public would be costly to establish and be administered by the Inland Revenue Department, of which the Authority has no control (economic inefficiencies), inequitable charges, and it does not align with Government cost recovery guidelines.

7. Although the Authority recognises that airports, airport leaseholders, and the New Zealand public all accrue economic and social benefits from a safe and secure aviation environment, it considers that airlines and passengers are the primary beneficiaries. It is also not considered feasible or efficient for Avsec to tax the New Zealand public. In addition to the reasons stated above, members of the public who do not use air passenger services may dispute a tax for this based on their perception that they receive no tangible benefit from aviation security services. The Authority's analysis concluded that the public good element of the Aviation Security Service is not large enough to warrant Crown funding, and therefore the costs of this service should be placed on the primary beneficiaries.
8. The Authority recommends that Avsec's costs continue to be recovered from airlines on a per-departing passenger basis as a charge on airlines, using passengers as a proxy, is still considered the fairest way to recover aviation security service costs.

Proposal B – Include transit passengers in the International Passenger Security Levy

To provide equity and transparency for all passengers, the Authority proposed to charge airlines the International Passenger Security Levy for international transit passengers.

9. The submitters generally agreed to the principle of charging transit passengers, as it improves the equity of charging users of the service. Another reason submitters supported this proposal was that the International Passenger Security Levy would be increased to make up the shortfall if this proposal was rejected, to ensure sufficient cost recovery.
10. A small number of submitters believe the proposal is too simplistic as there are different security checks for different transit passengers. These submitters have encouraged the Authority to consider proportionate levies for different types of international transit passengers. They have raised the point that not all transit passengers are subject to the same screening as departing international passengers, and thus should not be charged for the services they do not receive.
11. We asked airlines if they would have the ability to report on transit numbers. They have said they do have this ability, however, this will involve administrative costs. One submitter stated that introducing a levy on transit passengers would have a large impact on their operations, however, this potential impact was not explained any further.

Authority Response

12. All international passengers gain the same security outcome, regardless of the differences in the way some transit passengers are treated. The Authority has proposed

to monitor the issue of differences in transit passengers and if appropriate, the issue will be reconsidered at the next funding review.

13. However, the Authority is proceeding with the recommendation to recover its costs for screening transit passengers. With the growing number of international travellers departing New Zealand, not recovering transit passenger screening costs is not equitable.

How should they pay?

Proposal C – Maintain separate cost recovery for domestic and international activity

Due to the substantial cost differences arising from the different security requirements for international and domestic air travel, the Authority proposed to maintain separate cost recovery for domestic & international activity.

14. All submitters who responded to this question agreed that maintaining the status quo by having separate cost recovery for domestic and international passengers is appropriate. The main reason for support is the recognition of the additional security requirements imposed on Avsec for international travellers.

Authority Response

15. As there were no issues raised with this proposal, the Authority will proceed with it as planned.

Proposal D – Change from a charge to a levy

The Authority has re-classified Avsec services as a club good due to it being excludable and non-rivalrous. The Authority proposed to change from a security charge to a security levy as levies are a more appropriate way of charging for a club good and can be used to fund a range of security activities.

16. Most submitters substantially agreed to this proposal, with a small number only partially agreeing. Some submitters again raised the issue of some of Avsec's services being more appropriately classified as public goods. These submitters suggested that the levy should not be used to fund those aspects of Avsec.
17. Several concerns were also raised around the allocation of funds from the levy collection where submitters did not want the funds applied to other activities, such as immigration, or landside protections.
18. Other concerns were focused on the potential for a lack of discipline and a reduced focus on efficiency from Avsec, due to the weakened link between income and expenditure. This is on the basis that levy funds cover a range of activities. There is a concern that the transparency of Avsec's costs may be lost.

Authority Response

19. As mentioned above, the Authority considers that it will be economically inefficient and inequitable to tax the New Zealand public for the benefits they receive from Avsec services. While the Authority recognises the general public do receive some benefits from Avsec, these are less direct than those of passengers, airlines, and airports; and therefore we do not think it would be appropriate to tax people who do not have a direct benefit or introduce risk into the aviation system. It would also be too difficult to quantify the proportional benefit the general public do receive from Avsec. As such, the Authority considers the reclassification of aviation security services to a club good to be appropriate.
20. There are a number of controls in place to ensure appropriate levy allocation, these include: public accountability documents; and oversight from the Ministry of Transport, Authority Board, and the Minister of Transport. The Authority must adhere to the Crown Entities Act, and is regularly audited through Audit NZ. The Authority considers that these controls are sufficient to ensure that levy funds will be appropriately allocated and the process for allocation will be transparent.
21. The Authority has recommended that, to reflect the club good nature of the aviation security services, the passenger security charges are changed to passenger security levies.

How much should they pay?

Proposal E – Create a regulated, stepped pricing structure with inbuilt flexibility

Due to the volatile nature of the security environment that Avsec operates in, the Authority proposed to create a regulated stepped pricing structure with flexibility.

22. Most submitters saw the benefits of a stepped pricing structure and appreciated the difficulties in forward planning for capital investment and changing security requirements.
23. In relation to the flexibility proposal, there were some reservations in regards to lead times and justifications for what would trigger an increase. While some submitters agreed that six months was sufficient, others suggested that a full consultation process should be carried out in order to assess the need and impact of any changes.
24. Generally, this proposal was met with support by submitters who commented on the innovation in approach. Submitters also recognised the benefits a stepped and flexible structure has over an averaged price.

Authority Response

25. The Authority will engage with stakeholders on any change to the stepped annual levies. It considers 6 months a reasonable timeframe to advise stakeholders of any changes. The Authority does not support the request for full consultation processes on any price increases using the flexibility functionality, as it would negate the intent of a flexible

pricing structure. Any changes to passenger security levies that differ from the stepped annual levies would be subject to the Authority and Minister of Transport's approval, with six months' notice for stakeholders. The range, within which a levy can be adjusted, will be capped to the minimum and maximum price annual levies over financial years 2019/20 to 2021/22.

26. The Authority recommended both a stepped and flexible pricing structure to provide both certainty and timely adaptability of the levies for Avsec and its stakeholders.

Proposal F – New rates to provide adequate funding

To adequately fund Avsec's services, the Authority proposed new levy rates as outlined in Table 6 of the Consultation document.

27. There was significant concern from submitters regarding the environment and context in which the Avsec review is happening. Several submitters referenced the other border sector funding reviews currently underway, all of which will have an impact on the cost of aviation. Submitters were concerned more generally with the rising costs of aviation for both operators and travellers. These costs include government fees, airport costs, and rising fuel costs. There was a concern that New Zealand is becoming an increasingly high-cost destination for tourists. Some submitters suggested that Avsec should carry out benchmarking and make this information available to ensure that it is providing an efficient, customer-centric, and secure model for New Zealand.
28. Most submitters noted an absence of justification of the cost increases within the public consultation document. This was considered a barrier to providing further comment on the levels of support or otherwise for the proposed rates. A number of the stakeholders requested, and were provided more detail during consultation. However they are still eager to see more justification and further breakdown of the costs and projections that produce the proposed rates.
29. Some submitters suggested that the proposed rates could be adjusted to rebuild reserves to the minimum level in the first year and then gradually rebuilt to the mid-point of the reserves policy by 2022. It was suggested that this would minimise the increase in the 2019/20 financial year.
30. The Authority was urged by submitters to confirm the final rates as soon as possible so that airlines would be able to incorporate any changes into their pricing models. This would mitigate any impacts.

Authority Response

31. Further justification for the rates was provided to stakeholders who attended the consultation meetings or provided feedback during the consultation period. A number of stakeholders (airlines and airports) were provided with more detail in relation to the proposed cost increases due to receiving separate briefings regarding implementation of the additional security requirements. It is difficult to share much more information in a public forum due to the security sensitive nature of the business plans.

32. The Authority is aware that the proposal for increased Avsec charges comes at a time of wider Border sector funding increases, however, aviation security makes up only a small percentage of Border charges. The proposed rates are what the Authority considers necessary to recover the costs of providing an effective and efficient security service.
33. The Authority will continue to target the mid-point of the reserves in the first year. The Authority considered the proposal to target the lower limit of the reserves and slowly rebuild to the mid-point by 2022, however this would result in the 2021/22 levy being higher than consulted on and require a steeper price increase in the final year to reach the mid-point in 2021/2022. Additionally, due to the removal of proposals G and H, as discussed below, the Authority considers it important to recover to the mid-point of reserves in the first year of the funding period in order to be able to absorb any costs associated with domestic airport set-up, for example the now confirmed start-up of Invercargill jet flights, or charter flights.
34. The recommended rates were adjusted post consultation to reflect a number of assumptions that changed
- The assumed Crown Loan interest rate was reduced from 6% to 4% resulting in a lower Domestic Passenger Security Levy.
 - The opening times for international screening points will increase from 90 to 120 minutes prior to flight departure (this is a result of this consultation and further explained in paragraphs 48 and 50), resulting in increased operational expenditure, and negating the savings made from a lower Crown Loan rate for the International Passenger Security Levy.
35. The final recommended rates have resulted in a reduction from those consulted on as seen in Table 1.¹

Table 1. Final Passenger Security Levies

	Current	Funding Review Period		
	2018/19 GST	2019/20 GST	2020/21 GST	2021/22 GST
Consulted				
Domestic Passenger Security Levy	\$5.05 (Excl) \$5.81 (Incl)	\$6.28 (Excl) \$7.22 (Incl)	\$6.47 (Excl) \$7.44 (Incl)	\$6.64 (Excl) \$7.64 (Incl)
International Passenger Security Levy (including transit passengers)	\$8.70 (Excl) \$10.01 (Incl)	\$11.98 (Excl) \$13.78 (Incl)	\$12.59 (Excl) \$14.48 (Incl)	\$13.12 (Excl) \$15.09 (Incl)
Confirmed New Levy				
Domestic Passenger Security Levy	\$5.05 (Excl) \$5.81 (Incl)	\$6.23 (Excl) \$7.16 (Incl)	\$6.42 (Excl) \$7.38 (Incl)	\$6.57 (Excl) \$7.56 (Incl)
International Passenger Security Levy (including transit passengers)	\$8.70 (Excl) \$10.01 (Incl)	\$11.98 (Excl) \$13.78 (Incl)	\$12.59 (Excl) \$14.48 (Incl)	\$13.12 (Excl) \$15.09 (Incl)

¹ The final International Passenger Security Levy rates were adjusted twice due to significant changes to transit passenger forecasts. The ones presented in this document differ from those originally approved by Cabinet in February 2019, but accurately reflect those approved by Cabinet at a subsequent meeting in March 2019.

Cost Recovery for Set-up Costs

Proposal G – Cost recovery for establishing or re-establishing at domestic airports

The Authority proposed to establish a new mechanism to allow Avsec to recover reasonable set up costs from a domestic airport at which Avsec is required to establish, or re-establish capacity to process flights.

36. Most submitters objected to this proposal, preferring the status quo that set up costs continue to be funded from Avsec reserves. One of the main reasons that this proposal was rejected was the legislative requirements for airports to consult on pricing changes. This would make it difficult for airports to respond to any such cost recovery methods in a timely manner. Most submitters raised the point that in the past Avsec have not recovered set up costs at airports where they are establishing, re-establishing, or expanding, and claim that doing so in the future would unfairly disadvantage new airports. Submitters also stated that airports are usually not the parties making decisions which would trigger the need for Avsec services to be offered at the airport. While airports may advocate for new airlines or routes, they do not decide on the seat capacity of the aircraft. This is the deciding factor for whether Avsec is required to providing aviation security services for a domestic flight.
37. Another key concern that was raised by submitters is the potential for negative effects on regional airports and regional development. It is suggested that requiring regional airports to pay for set up costs could change the viability of flights. This would in turn impact on visitor numbers.
38. Many submitters questioned what Avsec would consider reasonable set up costs, and when set up costs would become business as usual and be covered by the Domestic Passenger Security Levy.
39. Two submitters supported this proposal, primarily, as they believe it would remove the “first mover” disadvantage if airlines were asked to fund any set up costs. They suggested that airlines funding set up costs could prevent certain routes being established in the first place. These submitters have suggested that if airports pay set up costs, they would likely pass this on to the airlines over time.
40. One submitter commented that whatever cost recovery method is used, it is important that a fair employment model is maintained at any new airport.

Authority Response

41. In response to comments received through consultation, the Authority has significant concerns about retaining the status quo, which does not allow it to recover significant setup costs. The Authority is concerned that, under the current funding model, should several airports require screening services to be established, it is exposed to a significant financial risk. Despite this concern, the Authority has not been able to identify a suitable

way of introducing a set-up cost recovery mechanism that is equitable and does not introduce the risk of significantly discouraging regional development.

42. The Authority is not proceeding with this proposal. It would like to highlight that retaining the status quo does expose it to potential financial risk. If this risk eventuates, it would be managed through the adjustment of the domestic passenger security levy if necessary.

Proposal H – Cost recovery for charter flights

The Authority proposed to establish a new mechanism to allow Avsec to recover reasonable costs for set up of screening services for charter flights from airports where it does not have capacity to process flights.

43. Most submitters supported this proposal as they believe it to be an appropriate way to recover set up costs. Submitters generally recognised the substantial cost to Avsec and staff in providing screening services for charter flights. One submitter pointed out that airlines would need to be made aware of the actual costs in advance so that they are able to include these in charter prices. They said that it would also be possible to charge airports this cost who could then pass this on to the airline with the cost for the charter. One of the supporters for this proposal further queried whether remote screening would be a possibility in order to reduce costs.
44. Submitters who disagreed with this proposal queried whether airlines may no longer fly to regional airports if this proposal was implemented, as it would cost them more to do so. It was recognised that although the number of charter flights that would be subject to security screening would be small, it could have a significant impact on a regional economy. The example that was provided by one submitter was the confidence in regions to successfully stage significant events.
45. Two submitters questioned the 'one-size-fits-all' approach to screening all flights with a 90 seat capacity. They suggested that the current approach screening charter flights may not be applying a risk-based approach.
46. As with Proposal G, submitters wanted to know what the Authority considered reasonable set up costs.

Authority Response

47. The costs to Avsec from charter flights are not significant, and the Authority acknowledges this proposal could restrict regions from bidding for and holding events that showcase their regions. Currently, Avsec is able to absorb these costs without the risk of affecting its reserve levels, and as such, the Authority is not proceeding with this proposal. However, if the number of charter flights was to increase significantly, the Authority would seek to re-consider the proposal.
48. The requirement to screen passengers of flights with a 90-seat capacity is Government policy and as such was outside the scope of this review.

Other Comments

49. A number of comments were raised by submitters which related to the operational efficiency of Avsec. One suggestion was for Avsec to open international screening lanes 120 minutes prior to an international departure, instead of the 90 minutes prior it currently opens. This suggestion applies to Wellington, Christchurch, Queenstown, and Dunedin International Airports. Auckland Airport international screening lanes are already open 120 minutes prior to international departure.
50. A range of other suggestions raised as part of consultation included reducing passenger wait times, improved infrastructure planning, enhancing the passenger experience, and increased staffing levels. This included specific proposals for the introduction of passenger priority lanes, and priority for airline staff. It also included a proposal that Avsec consider a new business model, wherein instead of paying for a government-set passenger throughput rate, users (airlines or airports) could pay more for a higher level of service. Some submitters also requested greater involvement in Avsec planning. This would ensure that they are aware of infrastructure plans and needs earlier in order to better plan for these.

Authority Response

51. Changing the opening times of international screening lanes from 90 minutes to 120 minutes prior to departure will have a cost impact as there is a need to employ more Aviation Security Officers and Load Assistants (queue combbers). It has been costed at a total of 26.3 FTE and \$1.49million.
52. These additional costs were not reflected in the passenger security charges consulted on, but have been factored into the final proposed international passenger security charge.
53. Avsec regularly engages with its stakeholders at an operational level. With the changes brought about by the new requirements, Avsec will enhance its engagement initiatives. The Ministry of Transport also undertakes two Aviation Security Forums with industry stakeholders each year.
54. This review did not include any assessment of Avsec's operations or business model. A comprehensive review of such matters was conducted at the last triennial review.
55. Analysis suggests that a 'user pays' costing model will not deliver more fair and equitable outcomes than the status quo. Current arrangements also meet government policy on network pricing. The current charging model also supports regional services and the potential for growth.
56. As a result of requests for priority lane services, Avsec is facilitating a premium service trial with the industry starting at Auckland International Airport. The industry has agreed to meet any increased marginal costs.