

# Cabinet Policy Committee

MOT  
POL (05) 84

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<b>Title</b>	<b>Passenger Clearance Services at International Airports: Allocation of Aviation Security Services Across Airports</b>
<b>Purpose</b>	The paper seeks a decision about the allocation of the aviation security charge across airports, and asks POL to reconsider decisions made in 2004 on funding Passenger Clearance Services.
<b>Previous Consideration</b>	On 8 December 2004 POL directed officials from Ministry of Transport (lead), Customs, Ministry of Agriculture and Forestry, Treasury and Ministry of Tourism to report to the Cabinet Policy Committee by 31 March 2005 with progress on consultation with industry on how the Avsec charge is to be allocated across airports and options for the collection mechanism for government charges [POL Min (04) 30/2].
<b>Summary</b>	<p>The activities at international airports of Customs, MAF and Avsec in respect of passenger movements are collectively termed Passenger Clearance Services (PCS). The costs of present and anticipated PCS are projected to be approximately \$110 million per annum. A review of the funding of present PCS activities has highlighted the piecemeal manner in which the funding has previously evolved.</p> <p><b>Avsec Funding</b></p> <p>The Ministerial Committee (Ministers of Finance, Biosecurity, Customs, Transport and Tourism) has identified four alternatives for recovering Avsec costs from industry. These are set out on <b>page 3</b>. The Ministerial Committee took the view that partial location-specific charging could balance regional development needs with the need to send a price signal about the true costs of providing an international service. Some stakeholders prefer an average national charge, while others support a two-tier charge. Crown Law advises that discriminating in the application of public funds between similar classes of airports should be avoided and barring specific named airports from receiving government funding is undesirable. It is recommended that passenger volume be used to distinguish among airports.</p>

### **Customs and MAF part-charging**

The paper recommends that POL review decisions taken in December 2004 to part-charge some airports for Customs and MAF services and instead agree to fully-fund these services. The part-charging formula distorts the "primary beneficiary" model of PCS funding agreed to by industry and the government, which identifies Customs and MAF services as primarily public goods.

### **New airports**

It is also recommended that the December decision that new airports (ie additional to the current seven international airports) meet the full cost of government services be reviewed and instead that new airports self-fund PCS services for one year after which they will qualify for PCS funding at the appropriate level.

### **Collection mechanism for government charges**

The Ministerial Committee believes that the costs of Avsec, Customs, Customs and CAA services should be paid as a single item. It is recommended that Avsec undertake the collection of revenue from industry in respect of the passenger cost recovery policy.

#### **Baseline Implications**

If the decision is taken to fully fund the costs of MAF and Customs activities at medium and high volume international airports and charge for these services on a location-specific basis at low volume international airports, additional funding for Vote Customs of \$0.198 million will be required for 2005/06 and \$0.244 million for outyears.

#### **Legislative Implications**

See page 7-8 for comment on legislative requirements depending on which options are approved.

#### **Timing Issues**

Because airlines are already selling tickets for travel after 1 October 2005, there is some urgency to reaching decisions on PCS.

#### **Announcement**

A media statement has been prepared for release by the Minister of Finance.

Media communications will be needed around the 1 October start date of the new funding regime.

#### **Consultation**

Customs, MAF, CLO, Treasury, MoT, Tourism.

CAA, Avsec, airports, Local Government NZ, and industry were also consulted.

The Minister of Transport indicates that the paper will require consultation with the Labour caucus and does not need consultation with other parliamentary parties.

**The Minister of Transport recommends that the Committee:**

- 1 agree that, for the purpose of determining Passenger Clearance Services (PCS) charges, the distinction between 'new airports', 'regional airports' and 'metropolitan airports' be dispensed with and instead the following categories be established:
  - 1.1 'low-volume international airports' being those international airports processing fewer than nine thousand international departing passengers per annum;
  - 1.2 'medium volume international airports' being those international airports processing between nine thousand and two hundred thousand international departing passengers per annum;
  - 1.3 'high volume international airports' being those international airports processing more than two hundred thousand international departing passengers per annum;

**Allocation of Avsec charge across airports:**

**EITHER**

- 2 agree that the costs of the Aviation Security Service's international activities:
  - 2.1 be charged to air operators operating into New Zealand's medium and high volume international airports on the basis of a two-tier system (Option B, Table 1, page 3 of the paper under POL (05) 84) whereby:
    - 2.1.1 medium volume airports are charged at the per passenger rate of the cheapest medium volume airport and
    - 2.1.2 high volume airports are charged the average per passenger cost of all high volume airports plus the remaining costs of medium volume airports;
  - 2.2 be charged on a location-specific basis at low volume international airports;

**OR**

- 3 agree that the costs of the Aviation Security Service's international activities:
  - 3.1 be charged to air operators operating into New Zealand's medium and high volume international airports on the basis of an average national charge for those airports;
  - 3.2 be charged on a location-specific basis at low volume international airports;

- 4 note the implications of the proposals set out in paragraphs 2 and 3 for existing airports - set out in the table below:

**Charging implication of paragraphs 2 and 3 on present airports (March 2005 figures):**

<b>Airport</b>	<b>Designation</b>	<b>Two-tier Option B (paragraph 2)</b>	<b>National average (paragraph 3)</b>
Auckland	High volume	\$7.87	\$8.31
Hamilton	Medium volume	\$19.80	\$8.31
Rotorua (potential new airport)	Low volume	Fully self-fund	Fully self-fund
Palm. North	Medium volume	\$19.80	\$8.31
Wellington	High volume	\$7.87	\$8.31
Christchurch	High volume	\$7.87	\$8.31
Dunedin	Medium volume	\$19.80	\$8.31
Invercargill (potential new airport)	Low volume	Fully self-fund	Fully self-fund
Queenstown	Medium volume	\$19.80	\$8.31

- 5 note that:

5.1 the Passenger Clearance Funding Bill on the 2005 Legislation Programme has a priority of 2 – must be passed in 2005;

5.2 the required amendments to the Civil Aviation Act 1990 could be made through this Bill;

- 6 note that although a two-tier Avsec charge would technically require no amendment to the Civil Aviation Act 1990 if it is cast in terms that conform with the differential charging powers in ss.38(2) and 100(2) of that Act, it is desirable to eliminate any litigation risk by amending the Act to explicitly allow for two-tier charging;

- 7 note that in December 2004 the Cabinet Policy Committee agreed that all government charges should be recovered from airlines [POL Min (04) 30/2];

- 8 invite the Minister of Transport to issue instructions to PCO:

8.1 to draft amendments (including any consequential amendments required) to the Civil Aviation Act 1990, the Civil Aviation Charges Regulations 1991 (No 2), and the Civil Aviation (Safety) Levies Order 2002 in order to implement the recommended charges and recovery mechanism for Avsec's international security activities, and the one dollar Civil Aviation Authority safety levy currently collected from airports;

- 8.2 to draft amendments (including any consequential amendments required) to the Civil Aviation Charges Regulations 1991 (No 2) in order to implement the required charges for Avsec's domestic security activities;
- 9 note that further financial risks to the Crown, of approximately \$1.254 million per month, exist in 2005/2006 and outyears if Avsec international fees are not implemented by 1 October 2005;

### Collection Mechanism for Government Charges:

- 10 note that, in light of the proposal that Customs be fully Crown funded, Avsec has been selected as the agency responsible for the calculation, invoicing, collection and distribution of the charges for Passenger Clearance Services levied on international airlines;

### Customs and MAF Funding:

- 11 note that on 8 December 2004 POL:
- 11.1 agreed that the Crown should partially fund Biosecurity and Customs services at existing regional international airports (Hamilton, Palmerston North, Dunedin and Queenstown);
- 11.2 agreed that Crown funding be set at full funding up to the per passenger rate of the third cheapest airport; and for costs beyond that 50% of per passenger costs above the rate of the third cheapest airport;
- 11.3 agreed that the maximum Customs and Biosecurity charges for regional airports would be capped at the per passenger rate of the second most expensive airport with the Crown meeting the costs above that level [POL Min (04) 30/2];
- 12 rescind the decisions referred to in paragraph 11; and instead
- 13 agree to fully fund the costs of MAF and Customs activities at medium and high volume international airports and charge for these services on a location-specific basis at low volume international airports;
- 14 approve the following changes to appropriations, contingent on the decision in paragraph 13 to fully fund MAF and Customs, to make up for loss of anticipated revenue from partial cost recovery at medium volume international airports:

	Increase/decrease					
	2005/06	2006/07	2007/08	2008/09	2009/10	
<b>Customs:</b>						
Departmental Output Class: Clearance of International Passengers, Crew and Craft (funded by revenue Crown)	0.198	0.244	0.244	0.244	0.244	Incl.
Departmental Output Class: Clearance of International Passengers, Crew and Craft (funded by revenue other)	(0.198)	(0.244)	(0.244)	(0.244)	(0.244)	Incl.

- 15 note that an amendment to the Biosecurity Act will be required regardless of the funding option chose and that a forthcoming paper to POL will address this requirement in detail;

### **New Airports**

- 16 note that on 8 December 2004 the Cabinet Policy Committee agreed that any new airport would meet the full cost of government services [POL Min (04) 30/2];
- 17 rescind the decision referred to in paragraph 15; and instead
- 18 agree that airports commencing international services undergo a PCS self-funding period of one year from the commencement of international regular public transport flights after which they will qualify for ongoing PCS funding at the level appropriate to the passenger volumes they have achieved;
- 19 note that a suitable way to implement this one-year self-funding period is to link it to a passenger volume requirement. This would obviate the need to amend legislation each time airports qualify for PCS funding, and provide a simple, certain and transparent formula for new international airports;

### **General**

- 20 direct officials to report to POL in early 2008 with a review of the first two years of the funding regime;
- 21 note that stakeholders and government agencies are all in agreement that prompt decisions on PCS funding issues will facilitate an ordered transition to the new funding regime;
- 22 note that the Minister of Transport indicates that the paper will be the subject of consultation with the Labour caucus and does not require consultation with other parliamentary parties.

Sue Sharp  
for Secretary of the Cabinet

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#### **Copies to:**

Cabinet Policy Committee  
Chief Executive, DPMC  
Director PAG, DPMC  
Secretary to the Treasury  
Solicitor-General  
Director-General, Ministry of Agriculture and Forestry (Biosecurity)  
State Services Commissioner  
Secretary for Transport  
Minister of Tourism  
General Manager, Ministry of Tourism  
Minister of Local Government  
Secretary for Internal Affairs (Local Government)  
Minister of Customs  
Comptroller of Custom

Chair  
Cabinet Policy Committee

## **PASSENGER CLEARANCE SERVICES (PCS) AT INTERNATIONAL AIRPORTS: ALLOCATION OF AVIATION SECURITY CHARGE ACROSS AIRPORTS**

### **Proposal**

1. This paper meets a requirement to "...report to the Cabinet Policy Committee by 31 March 2005 with progress on consultation with industry on how the Avsec charge is to be allocated across airports and options for the collection mechanism for government charges". [POL Min (04) 30/2].

### **Executive summary**

2. On 13 December 2004 Cabinet agreed that Avsec services should be fully industry funded and that MAF and Customs services should be fully Crown funded at Auckland, Wellington and Christchurch. In order to send a pricing signal for lower volume airports it was decided that MAF and Customs services should be only partially funded at Hamilton, Palmerston North, Dunedin and Queenstown [POL Min (04) 30/2].
3. Cabinet also made decisions on several collateral Passenger Clearance Services (PCS) funding issues. In particular, any new international airports should meet the full cost of all government services, and all charges should be recovered from airlines.
4. The outstanding decision still to be made is how to apportion Avsec costs between locations. It is recommended that a two-tier funding regime be implemented whereby air operators to lower volume international airports pay a higher Avsec charge per passenger than air operators to higher volume airports. Furthermore, it is recommended that the distinctions between the funding tiers be made in terms of passenger volume and not by naming particular airports.
5. It is recommended that Cabinet review two of its previous decisions on funding PCS. First, it is recommended that new airports be subjected to a minimum probationary period of one year, after which they will qualify for PCS funding, so long as they have reached a passenger volume threshold. Second, it is recommended that the partial recovery of Custom and MAF costs from Hamilton, Palmerston North, Dunedin and Queenstown be amended in favour of full Crown funding.

### **Background**

6. The activities at international airports of the New Zealand Customs Service (Customs), the Ministry of Agriculture and Forestry (MAF) and the Aviation Security Service (Avsec) in respect of passenger movements are collectively termed *Passenger Clearance Services* (PCS). The costs of present and anticipated PCS are projected to be

approximately \$110 million per annum. A review of the funding of present PCS activities highlighted the piecemeal manner in which the funding had hitherto evolved.

7. Avsec activities are broadly divided into domestic and international. Charging international airports a standard \$4.00 per departing international passenger currently funds Avsec's international security activities. The airports have adopted the methodology of incorporating this amount, along with the Civil Aviation Authority (CAA) cost recovery of \$1.00 per departing international passenger, into their own departing passenger charge as part of the \$25 international departure fee.
8. A review in August 2003 of the domestic aviation security levy found that this charge was being under-recovered. Cabinet decided to defer raising the level of this charge [POL Min (04) 13/9] until completion of consultation on the international PCS funding review, of which Avsec's international levy is a part. The correct setting of the domestic levy is of equally critical funding importance to Avsec as that of its international levy. With consultation on both the international and domestic components of Avsec's costs now completed the resetting of the domestic levy will now progress by separate process as an amendment to the Civil Aviation Charges Regulations 1991 (No 2).
9. All consultation participants commented on the need for prompt decisions on PCS funding.
10. The Ministerial Committee gained agreement with industry that funding on the basis of identifying the primary beneficiary of a service was a pragmatic way to proceed. This led to the government decision to fund the bulk of MAF and Customs costs and to industry agreeing to pay fully for aviation security. It was decided to part charge for MAF at Hamilton, Palmerston North, Dunedin and Queenstown as a pricing signal to airports with relatively cost-inefficient passenger volumes.
11. Charging formulae that have been put forward over the course of PCS industry consultations have made a distinction between metropolitan airports (named as Auckland, Wellington, Christchurch) and regional airports (named as Hamilton, Palmerston North, Dunedin and Queenstown).

## **Comment**

### **Avsec Funding**

12. The Ministerial Committee identified four alternatives for recovering Avsec costs from industry, tabulated below. These alternatives formed part of the discussion document supplied to industry prior to consultation held on February 8 2005. No significant variations to these alternatives were subsequently suggested by industry. The more than doubling of the national average charge, from the present \$4.00 to \$8.31, largely reflects the costs of introducing Hold Baggage Screening from 1 October 2005.



**Table 1: Avsec cost-recovery alternatives (10 March 2005 figures)**

Airport	Options for the Avsec charge \$ (GST inclusive)			
	Average national charge	Metro/Regional two-tier Charge		Location specific charge
		Option A	Option B	
Auckland	8.31	7.52	7.87	6.28
Wellington	8.31	7.52	7.87	12.38
Christchurch	8.31	7.52	7.87	10.96
Palmerston North	8.31	29.09	19.80	27.99
Hamilton	8.31	29.09	19.80	28.59
Dunedin	8.31	29.09	19.80	19.80
Queenstown	8.31	29.09	19.80	69.59

Note: *Two-tier Option A* averages costs within the two airport groups  
*Two-tier Option B* caps all regional airports at the cost of the cheapest member of that group, with the metropolitan airports absorbing the shortfall within the average of their group.

13. Adherence to strict location-specific charging has the potential to produce high per-passenger costs at some airports. In recognition of this the Ministerial Committee stated that partial location-specific charging could balance regional development needs with the need to send a price signal about the true costs of providing an international service. Auckland Airport, with its below average per-passenger cost, is the sole advocate of strict location-specific charging. Auckland Airport disputes the regional airports' view that the \$2.03 extra that a national charge would add to each of Auckland's passengers is not material.
14. Other stakeholders are in two camps. The regional airports all advocate a continuation of the national average charge, as do the local government bodies that made submissions subsequent to the February 8 2005 consultation. Wellington Airport also supports a national average charge, possibly reflecting the position of part-owner Infratil who would see this as the preferable charging option if their ambitions for a Whenuapai international airport come to fruition. The Aviation Industry Association (AIA) supports a national average charge, but is comfortable with two-tier Option B if favoured by the government.
15. Two-tier Option B is supported by airlines, including Air New Zealand.
16. Recent Crown Law advice suggests that as a matter of general principle, and of equality before the law, discriminating in the application of public funds between similar classes of (international) airport should be avoided. Likewise, barring specific named airports ('new airports', see paragraph 20) from receiving government funds is undesirable.
17. It is recommended that a more objective distinction, based on passenger volume, be substituted for 'metropolitan' and 'regional'. It is recommended that 'high volume international airports' be defined as those international airports processing two hundred thousand or more international departing passengers per annum and 'medium volume international airports' be defined as those international airports processing between nine

thousand and two hundred thousand international departing passengers per annum. These passenger volume groupings would correspond to the present metropolitan and regional groups. For the avoidance of doubt, 'passengers' referred to under this recommendation are chargeable passengers in terms of Customs' and Avsec's harmonised exemptions list (e.g. excluding children under two years of age).

18. A further category of 'low volume international airports' is recommended, to be defined as those international airports processing less than nine thousand international departing passengers per annum. These are airports that do not reach the threshold passenger volume to qualify for PCS funding. 'New airports' (see paragraph 20 below) fall into this group. Airports corresponding to these recommended designations are tabulated below.

<b>Airport</b>	<b>Present designation</b>	<b>Recommended designation (passenger volume pa)</b>
Auckland	Metro	High volume (200k +)
Hamilton	Regional	Medium volume (9k - 200k)
Rotorua	Potential new airport	Low volume (0 – 9k)
Palm. North	Regional	Medium volume (9k - 200k)
Wellington	Metro	High volume (200k +)
Christchurch	Metro	High volume (200k +)
Dunedin	Regional	Medium volume (9k - 200k)
Invercargill	Potential new airport	Low volume (0 – 9k)
Queenstown	Regional	Medium volume (9k - 200k)

### **Customs and MAF part-charging**

19. It is recommended that Cabinet review its previous decision to part-charge medium volume international airports (currently Hamilton, Palmerston North, Dunedin and Queenstown) for Customs and MAF services, and instead agree to fully fund these services. In support of this recommendation:

- i. The latest formula for the part charging of MAF and Customs costs shows that this would raise \$0.538 million, representing 1.4% of the total costs spent on Customs and MAF passenger services at international airports. The mild pricing signal this would send would be overshadowed by the strong pricing signal that could be sent by a two-tier Avsec charge. There is a relatively small fiscal cost in fully Crown funding these services.
- ii. The part-charging formula distorts the 'primary beneficiary' model of PCS funding, agreed to by industry and government, which identifies Customs and MAF as primarily public goods.

- iii. The Crown Law Office has advised that as a technical matter the existing cost recovery provisions for MAF and Customs in the Biosecurity Act 1993 and Customs and Excise Act 1996 respectively could be amended so as to implement the previous decision to part charge medium volume international airports. Nevertheless this regime is not without its complexities and uncertainties. The drafting of clauses to give effect to such a system could give rise to legislation which may appear unusual, unduly complicated, unfair and may be controversial. It is therefore considered better avoided if possible.
- iv. Administrative ease, stakeholder acceptance, and the longevity of the funding regime would all be promoted by adhering fully to the simple funding split suggested by the 'primary beneficiary' model.

## **New Airports**

20. The government agreed on 13 December 2004 that any airports additional to the present seven internationals (that is, new airports) would meet the full cost of government services [POL Min (04) 30/2]. Invercargill and Rotorua airports are characteristic of such regional domestic airports with international aspirations. These airports expressed the desire to participate in the PCS funding regime. Invercargill Airport bases its case on the assertion that it has received international flights in the past, even though it is not currently receiving scheduled international services. Rotorua Airport argues its case from the point of view of regional development and the fostering of growth in overall passenger volumes.
21. It is expected that the sustained exclusion of new airports from the PCS funding regime would become difficult to defend if they were to develop successful international services. It is therefore proposed that any new international airport pay the full location-specific cost of government services for one year from the commencement of international regular public transport flights after which they will qualify for ongoing PCS funding at the level appropriate to the passenger volumes they have achieved. In support of this recommendation:
  - i. The one-year stand down period will encourage new airports to take the full government costs into account when they assess the business case for such a venture.
  - ii. It will also preserve and potentially enhance the Border Funding framework by providing a defined transition mechanism for new airports
  - iii. It reflects the process that existing regional airports had to go through, i.e. a period of self-funding. It provides a measure of surety to 'new' (low volume) airports on how they can become medium volume airports with access to PCS funding, a measure that the current Border Funding arrangement lacks.
22. Setting a 9000 passenger per annum qualifying threshold for PCS funding (paragraph 18) is likely to produce a de facto stand down period as a new airport increases services towards this passenger number. A single PCS funding criterion based solely on passenger volumes would obviate the need to amend legislation each time airports qualify for PCS funding, and provide a simple, certain and transparent formula for new airports.

## **Collection mechanism for government charges**

23. The government decision that all government charges should be recovered from airlines [POL Min (04) 30/2] is a reflection of the preference of the Ministerial Committee that the costs of Avsec, Customs, MAF and CAA services be paid as a single item. Recovering costs from airlines also gives effect to another government decision that, to achieve transparency, non-government airport charges would not be allowed to be aggregated within government charges [POL Min (04) 30/2].
24. Regarding the collection of revenue from industry in respect of the passenger cost recovery policy it has been agreed that Avsec should undertake this role. In reaching this decision it was noted that both Avsec and Customs had the capability to undertake this role but with the latest proposal that Customs be fully Crown funded and Avsec fully industry funded the logical decision, all other things being equal, was to agree that Avsec should undertake this role.
25. Avsec charges are sensitive to variations in passenger volumes. Industry and Avsec have debated passenger volume forecasts, and a consensus has been achieved on which to base charging figures.

## **Consultation**

26. The views of industry reflected in this paper have been extracted from written submissions received after a consultation meeting on February 8 2005 from airports (Auckland, Rotorua, Hamilton, Wellington, Invercargill), the Aviation Industry Association, Air NZ, the Board of Airline Representatives of New Zealand, Dunedin City Council, Waikato Mayoral Forum, Local Government NZ, and the Palmerston North City Council.
27. This paper has been drafted in consultation with Customs, MAF, Tourism, Avsec, CAA and the Crown Law Office. Treasury and the Minister of Finance have been kept apprised of the financial implications of the decisions recommended in this paper. Treasury has been consulted in the preparation of this paper and agrees with the recommendations made.

## **Financial implications**

28. Revenue to the government for aviation security is fiscally neutral between charging options. The same level of revenue will be raised whichever option is chosen.
29. If government adopts the recommendation to dispense with part-charging for Customs and MAF services at Hamilton, Palmerston North, Dunedin and Queenstown (medium volume international airports) it will mean an increase in the need for Crown funding for Customs of \$0.198 million in 2005/06 and \$0.244 million in 2006/07 and outyears.
30. Formal PCS industry consultation is now finished but the intervening period of under-recovery of the domestic charge, as well as start-up costs for Avsec's imminent Hold Baggage Screening system, have left Avsec in a deficit funding situation. Avsec's latest levy estimates are predicated on Cabinet's decision that the PCS funding regime should

come into effect on 1 October 2005 [POL Min (04) 30/2], coinciding with the planned introduction of Avsec's Hold Baggage Screening system. If Cabinet decisions do not allow this date to be met, Avsec will experience an ongoing monthly deficit for its international security activities of \$1.254 million (excl. GST).

31. Because airlines are already selling tickets for travel after 1 October 2005 there is some urgency to reaching Cabinet decisions on PCS that will let airlines allow for this added cost.

### **Human rights, gender and disability implications**

32. There are no implications for human rights, gender or disability in this paper.

### **Legislative implications**

33. Primary legislation was intended to put in place the Customs and MAF components of the border funding proposals. Provision was made in Customs' legislative programme for a bill that would cater for the requirements of all affected departments; Customs, MAF and Avsec. In the event of Customs and MAF part charging at medium volume airports not proceeding, their need for primary legislation is greatly reduced. However, instigation of a stand-down period for new airports would have legislative implications for MAF. MAF would need to recover all of its costs at any new airport for one year. This is inconsistent with the equity requirement in section 135 of the Biosecurity Act (as interpreted by the Privy Council). Consequently an amendment to the Biosecurity Act would still be needed.
34. There are two viable alternatives for the Avsec charging structure. The average national charge option is the structure currently in place. The two-tier option (a high volume/medium volume division) is novel.
35. If the average national charge option is chosen as the means to recover the revised Avsec charges, the only legislative change required will be to the Civil Aviation Charges Regulations 1991 (No.2). If, on the other hand, the two-tier charging option is chosen, it is prudent that an amendment to the empowering provisions in the Civil Aviation Act 1990 be made.
36. The Crown Law Office [2 March 2005, to MOT] has given an opinion that if the two-tier charging option is put in the Act it will be safe from challenge. This is based on the view that if differential cost recovery is to occur amongst the same class of airports (i.e. international) then there should be express approval for such different treatment contained in primary legislation.
37. The Civil Aviation Act (in sections 38(2) and 100(2)) allows for different rates of charges in respect of (among other factors) different classes of aerodromes, on any other differential basis, or in respect of the same class of aerodrome in different circumstances.
38. International airports constitute a class of their own in relation to domestic airports. However, that does not preclude the further classification of international airports. This should not be done on the basis of identifying airports by name, but is better done on the basis of distinguishing characteristics such as passenger volumes. Classification on that

basis would be supported by s.38(2) in differentiating between high-volume and medium-volume classes of international airports, or alternatively by s.100(2) in differentiating between international airports in their differing circumstances of passenger volumes.

39. However, it is considered that if the two-tier charging option is chosen, an amendment to the Civil Aviation Act allowing for the setting of charges by reference to passenger volumes (as is discussed at paragraph 17) is desirable. While risk of litigation being initiated around these measures cannot be ruled out because of the sums of money involved, it is felt that distinguishing between airports on the basis of passenger volumes rather than categories of 'metropolitan' and 'regional' is more robust.

### **Regulatory impact and business compliance cost statement**

40. A Regulatory Impact Statement is attached.

### **Publicity**

41. There are two future milestones where media communications will be required. The main media interest will occur following Cabinet decisions on funding, and media communications should also accompany the 1 October 2005 start date of the new funding regime. Consideration will also be given to communications needs once airlines begin collecting the PCS charge on tickets they sell for travel post 1 October 2005.

42. A media statement has been prepared for release by the Minister of Finance should Cabinet agree to the recommendations below.

### **Recommendations**

43. I recommend that the Committee:

1. **Agree** that, for the purpose of determining PCS charges, the distinction between 'new airports', 'regional airports' and 'metropolitan airports' be dispensed with and instead the following categories be established:
  - i. 'Low-volume international airports' being those international airports processing less than nine thousand international departing passengers per annum
  - ii. 'Medium volume international airports' being those international airports processing between nine thousand and two hundred thousand international departing passengers per annum
  - iii. 'High volume international airports' being those international airports processing more than two hundred thousand international departing passengers per annum.

## Allocation of Avsec Charge Across Airports:

### Either

2. **Agree** that the costs of the Aviation Security Service's international activities be charged to air operators operating into New Zealand's medium and high volume international airports on the basis of a two-tier system (Option B, Table 1, page 3) whereby:

- i. medium volume airports are charged at the per passenger rate of the cheapest medium volume airport and
- ii. high volume airports are charged the average per passenger cost of all high volume airports plus the remaining costs of medium volume airports, and be charged on a location-specific basis at low volume international airports;

### Or

3. **Agree** that the costs of the Aviation Security Service's international activities be charged to air operators operating into New Zealand's medium and high volume international airports on the basis of an average national charge for those airports, and be charged on a location-specific basis at low volume international airports;

### Charging implication of Recs. 2 and 3 on present airports (March 2005 figures):

Airport	Designation	Two-tier Option B (Rec. 2)	National average (Rec. 3)
Auckland	High volume	\$7.87	\$8.31
Hamilton	Medium volume	\$19.80	\$8.31
Rotorua (potential new airport)	Low volume	Fully self-fund	Fully self-fund
Palm. North	Medium volume	\$19.80	\$8.31
Wellington	High volume	\$7.87	\$8.31
Christchurch	High volume	\$7.87	\$8.31
Dunedin	Medium volume	\$19.80	\$8.31
Invercargill (potential new airport)	Low volume	Fully self-fund	Fully self-fund
Queenstown	Medium volume	\$19.80	\$8.31

4. **Agree** that Transport make its required amendments to the Civil Aviation Act 1990 using the legislative slot available to Customs and MAF;
5. **Note** that although a two-tier Avsec charge would technically require no amendment to the Civil Aviation Act 1990 if it is cast in terms that conform with the differential charging powers in ss.38(2) and 100(2) of that Act, it is desirable to eliminate any litigation risk by amending the Act to explicitly allow for two-tier charging;

6. **Note** Cabinet's decision of December 2004 that all government charges should be recovered from airlines [POL Min (04) 30/2]
7. **Agree** that Transport instruct PCO to draft amendments (including any consequential amendments required) to the Civil Aviation Act 1990, the Civil Aviation Charges Regulations 1991 (No 2), and the Civil Aviation (Safety) Levies Order 2002 in order to implement the recommended charges and recovery mechanism for Avsec's international security activities, and the one dollar Civil Aviation Authority safety levy currently collected from airports;
8. **Agree** that Transport instruct PCO to draft amendments (including any consequential amendments required) to the Civil Aviation Charges Regulations 1991 (No 2) in order to implement the required charges for Avsec's domestic security activities;
9. **Note** that further financial risks to the Crown, of approximately \$1.254 million per month, exist in 2005/2006 and outyears if Avsec international fees are not implemented by 1 October 2005;

#### Collection Mechanism for Government Charges:

10. **Note** that, in light of the proposal the Customs be fully Crown funded, Avsec has been selected as the agency responsible for the calculation, invoicing, collection and distribution of the charges for Passenger Clearance Services levied on international airlines;

#### Customs and MAF Funding:

11. **Agree** to fully fund the costs of MAF and Customs activities at medium and high volume international airports and charge for these services on a location-specific basis at low volume international airports;
12. **Approve** the following changes to appropriations, contingent on the above decision to fully fund MAF and Customs, to make up for loss of anticipated revenue from partial cost recovery at medium volume international airports:

Vote Customs	\$m - Increase/(decrease)					GST
	2005/06	2006/07	2007/08	2008/09	Outyears	
Departmental Output Class: Clearance of International Passengers, Crew and Craft (funded by revenue Crown)	0.198	0.244	0.244	0.244	0.244	Incl.
Departmental Output Class: Clearance of International Passengers, Crew and Craft (funded by revenue other)	(0.198)	(0.244)	(0.244)	(0.244)	(0.244)	Incl.

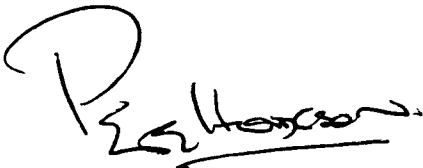


## **New Airports**

13. **Agree** that airports commencing international services undergo a PCS self-funding period of one year from the commencement of international regular public transport flights after which they will qualify for ongoing PCS funding at the level appropriate to the passenger volumes they have achieved;
14. **Note** that a suitable way to implement this one-year self-funding period is to link it to a passenger volume requirement. This would obviate the need to amend legislation each time airports qualify for PCS funding, and provide a simple, certain and transparent formula for new international airports;

## **General**

15. **Note** that this funding regime would benefit from a review after two years of operation from 1 October 2005, and
16. **Note** that stakeholders and government agencies are all in agreement that prompt decisions on PCS funding issues will facilitate an ordered transition to the new funding regime.



Hon Pete Hodgson  
**Minister of Transport**

**Regulatory Impact Statement:**  
**PCS at International Airports: Allocation of Avsec Charge Across Airports**

**Statement of the nature and the magnitude of the problem and the need for government action**

Government services at international airports comprise the activities of the New Zealand Customs Service (Customs), the Ministry of Agriculture and Forestry (MAF), and the Aviation Security Service (Avsec). All of these services have come under pressure to deploy more resource in recent years, as a result of the changed security environment over the last four years, by obligation of international treaty, and also as a result of increased traveller numbers.

The funding of these services has been subject to a review since early 2003 under the oversight of a Ministerial Committee on Funding Border Security (the Ministerial Committee). A process of industry consultation since May 2004 has produced a broad agreement of approach to the allocation of costs. On the basis that the primary beneficiary of a service should fund that service the government has agreed to largely fund the activities of Customs and MAF and the aviation industry has agreed to fund the activities of Avsec.

The per-passenger cost of these border services is greater at airports with a lower volume of travellers. This has prompted the government to seek some mechanism to send a price signal to those less efficient airports. In December 2004 Cabinet agreed to several funding measures:

- All charges to be collected as one charge on airlines **but** that the manner in which Avsec costs were allocated between airports was to be a matter for further industry consultation.
- That the Crown would fully fund Customs and MAF services at Auckland, Wellington and Christchurch airports, but only partially fund these services at the smaller and more inefficient regional international airports;
- Any new international airport should pay the full cost of all government services;

The further industry consultation on Avsec costs occurred in February 2004. Options presented to industry for the collection of Avsec costs were threefold:

- Levy a national average per-passenger charge as at present, or
- Charge for each airport the per-passenger costs associated with that particular airport; or
- Adopt a two-tier approach whereby the smaller airports pay a charge representative of their group costs and the larger airports pay a smaller charge representative of their group costs.

Industry was split on the preferred option: some segments favouring a national average charge and others favouring a two-tier or location-specific charge.

The Crown Law Office advises that the two-tier charging option for Avsec costs, specified in terms of passenger volumes, would require an amendment to the Civil Aviation Act 1990 in order to protect this novel charging structure from challenge. The Crown Law Office also advises that the initial Cabinet proposal to part-charge for Customs and MAF activities at Hamilton, Palmerston North, Dunedin and Queenstown is best avoided as the drafting of clauses to give effect to such a system could give rise to legislation which may appear unusual, unduly complicated, unfair and may be controversial.

If government confirms its decision to charge new airports for the full costs of MAF and Customs services, or modifies this decision to charge them only until such time as these airports reach a specified passenger volume (as recommended in this paper), MAF will require an amendment to the Biosecurity Act 1993 in order to allow it to conduct such differential cost-recovery measures that are contrary to indications in the present Act.

#### Statement of Public Policy Objective

To ensure that New Zealand's current and future border funding arrangements for passenger clearance services are consistent, efficient, transparent and have the agreement of Industry.

Statement of feasible options (regulatory and non-regulatory) that may constitute viable means for achieving the desired objective(s) AND Statement of the Net Benefit of the Proposal, Including the Total Regulatory Costs (Administrative, Compliance and Economic Costs) and Benefits (Including Non-Quantifiable Benefits) Of the Proposal, and Other Feasible Options

#### Non-regulatory options

Cabinet has decided that a user contribution is appropriate for those services for which a primary beneficiary is identifiable. There are no non-regulatory avenues available when setting such charges for funding of government services.

#### Regulatory options

##### *Status quo option*

A national average charge of \$4 per international passenger is currently recovered from international airports for Avsec services under the Civil Aviation Charges Regulations 1990 (No. 2). In terms of funding options the status quo would be to retain this funding source, albeit amended to \$8.31 to reflect the latest costs of Avsec services. The status quo for MAF involves no cost recovery at any airports. The status quo for Customs involves after-hours charges

### *Allocation of Avsec Costs*

*Either a two-tier charge (preferred option):*

- Rec. 2 Key features: Retains an element of location-specific pricing sufficient to signal to both medium volume and low volume international airports the true cost of providing international services.
- Rec. 2 Net benefits: Government is assured of full third party funding of Avsec. Medium volume airports experience a moderation of full location-specific charging. High volume airports experience some relief from the cross-subsidy inherent in a national average charge. Travellers may experience a moderate cost differential depending on their airport of departure.

*Or a national average charge:*

- Rec. 3 Key features: All existing international airports share a single charge, while low volume international airports (new airports) experience a price signal on the true cost of providing international services.
- Rec. 3 Net Benefits: Government is assured of full third party funding of Avsec, but with no price signal to the more cost-inefficient airports. Air operators to medium volume and high volume airports experience the same charge regardless of actual costs at their location of providing the service. If air operators pass on costs travellers will experience a standard nationwide cost for Avsec services regardless of port of departure.

### *Customs/MAF charges*

- Rec. 9 Key features: Full funding of Customs and MAF activities at medium volume international airports, in addition to high volume airports.
- Rec. 9 Net Benefits: The Government's minor reduction in cost-recovery is offset by a reduction in administrative burden, stakeholder challenge, and system complexity. Air operators to medium volume airports experience a reduction in charges. If air operators pass on costs travellers will experience a reduced cost at medium volume airports.

### *New Airports*

- Rec. 12 Key features: New entrants to the international airport market are obliged to meet a performance criterion before becoming eligible for PCS funding.
- Rec. 12 Net Benefits: The Government has reduced exposure to demands for border services at marginally cost-efficient locations. Low volume airports will experience higher costs for border services while they build passenger volume. If air operators pass on costs travellers will experience costs relevant to their port of departure.

There are no significant compliance costs for business arising from this proposal.

Amendment to the Civil Aviation Charges Regulations 1991 (No 2), and to the Civil Aviation (Safety) Levies Order 2002 will be required in order that Avsec is able to collect the correct amounts from liable air operators.

#### Statement of Consultation Undertaken

The latest PCS consultation meeting, held February 8 2005, focussed on the distribution of Avsec charges amongst industry and attracted twelve submissions from industry and local government organisations.

The following government organisations were consulted on this paper: Customs, MAF, Tourism, Treasury, CAA, Avsec, MED and CLO. Their feedback on a draft Cabinet paper has been incorporated in the final paper.

## Consultation on Cabinet and Cabinet Committee Submissions

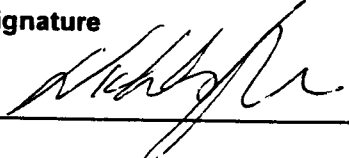
### Certification by Department

**Departments consulted:** The attached submission has implications for the following departments whose views have been sought and are accurately reflected in the submission:

CUSTOMS, MAF, CAA, AUSEC, CROWN LAW, ~~DO~~, TREASURY, ~~DO~~  
TRANSPORT, TOURISM.

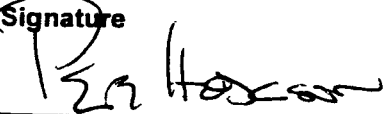
**Departments informed:** In addition, the following departments have an interest in the submission and have been informed:

**Others consulted:** Other interested groups have been consulted as follows: AIRPORTS, AIRLINES, LOCAL GOVERNMENT NZ.  
INDUSTRY CONSULTATIONS (+ WRITTEN SUBMISSIONS) 8 FEB 2005.

<b>Signature</b> 	<b>Name, Title, Department</b> PRINCIPAL ADVISOR, S + S.	<b>Date</b> 24/03/05
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### Certification by Minister

Ministers should be prepared to update and amplify the advice below when the submission is discussed at Cabinet/Cabinet committee. The attached submission:

<b>Consultation at Ministerial level</b>	<input type="checkbox"/> did not need consultation with other Ministers <input checked="" type="checkbox"/> has been the subject of consultation with the Minister of Finance <i>[required for all submissions seeking new funding]</i> <input type="checkbox"/> has been the subject of consultation with the following Minister(s) ..... 
<b>Consultation with Government MPs</b>	<input type="checkbox"/> does not need consultation with the government caucuses <input checked="" type="checkbox"/> has been or will be <i>[specify which]</i> the subject of consultation with the following government caucuses: <input checked="" type="checkbox"/> Labour caucus <input type="checkbox"/> Progressive Coalition caucus
<b>Consultation at Parliamentary level</b>	<input checked="" type="checkbox"/> does not need consultation at parliamentary level <input type="checkbox"/> has been or will be <i>[specify which]</i> the subject of consultation with the following other parties represented in Parliament: 
<b>Signature</b> 	<b>Portfolio</b> TRANSPORT  <b>Date</b> 24/3/05