

## **Treasury Report: Funding Options for Passenger Clearance Services**

|                        |               |                           |             |
|------------------------|---------------|---------------------------|-------------|
| <b>Date:</b>           | 21 July 2004  | <b>Treasury Priority:</b> | <b>High</b> |
| <b>Security Level:</b> | IN-CONFIDENCE | <b>Report No:</b>         | T2004/1314  |

### **Action Sought**

|   | <b>Action Sought</b>                          | <b>Deadline</b>     |
|---|---|---------------------|
| Minister of Finance                                   | Circulate to Border Funding Ministerial Group | As soon as possible |
| Associate Minister of Finance<br>(Hon Trevor Mallard) | For your information                          | None                |
| Associate Minister of Finance<br>(Hon David Cunliffe) | For your information                          | None                |

### **Contact for Telephone Discussion (if required)**

| <b>Name</b> | <b>Position</b>                          | <b>Telephone</b> | <b>1st Contact</b> |
|-------------|--|------------------|--------------------|
|             |  |                  | ✓                  |
| David Galt  | Manager, Environment & Natural Resources |                  |                    |

**Enclosure: No**

21 July 2004

SH-12-7-1

## **Treasury Report: Funding Options for Passenger Clearance Services**

Following consultation with industry four main options for the funding of passenger clearance services have emerged. These options are:

| Option   | Total fiscal cost (\$ m) | Total 3 <sup>rd</sup> party costs (\$ m) | Average charge per passenger | Option allows location specific Pricing |
|--|--------------------------|--|------------------------------|---|
| 1 Extending status quo (current funder meets cost of related new services)                             | 41.84                    | 41.91                                    | \$12.20                      | Possible but not recommended            |
| 2 Industry preferred position (industry funds aviation security, Crown funds customs and biosecurity)  | 49.00                    | 34.73                                    | \$10.10                      | Split views within industry             |
| 3 Crown funds non-location specific costs, recovers location specific costs for all clearance services | 24.69                    | 59.03                                    | \$17.20                      | Yes                                     |
| 4 Crown funds all services at level of the lowest cost airport (Auckland)                              | 73.47                    | 10.24                                    | \$3.00                       | Yes                                     |

The fiscal cost by Crown agency would be:

| Option  | Aviation Security (\$ m) | Customs (\$ m) | MAF (\$ m) | Immigration (\$ m) |
|---|--------------------------|----------------|------------|--------------------|
| 1 Extending status quo  | 0                        | 19.31          | 18.62      | 3.91               |
| 2 Industry preferred position   | 0                        | 26.47          | 18.62      | 3.91               |
| 3 Crown funds non-location specific costs, recovers location specific costs           | 1.91                     | 14.65          | 3.5        | 4.63               |
| 4 Crown funds all airport services at the level of the lowest cost airport (Auckland) | 24.94                    | 24.3           | 18.4       | 5.83               |

Notes:

- Existing Crown funding – Aviation Security \$0 m, Customs \$14.34 m, MAF \$18.62 m, Immigration \$3.23 m.
- All figures are based on 02/03 financial and passenger numbers. Financial numbers have been adjusted for recent decisions on hold stow baggage screening and increased rates of Customs' interaction with passengers
- Exclude all unresolved issues (identified below).
- Customs secondary processing of 'people of interest' is treated as non-location specific for the purposes of option 3.

### **Comment**

Industry's preferred position is a pragmatic cost sharing approach that recognises the public benefits provided by passenger clearance services. In particular this approach avoids the need to make subjective judgements on apportioning costs. Implementing and running

Industry's proposed option would also be relatively quick, cheap and uncontroversial as it uses an existing collection mechanism (the charges would be collected through airline tickets rather than by airports).

The industry estimate their option would see industry funding increasing by approximately \$32m (including costs directly absorbed by industry) and Crown funding by approximately \$14m (including paying for after hour's services).

The main disadvantage of industry's position is that charges are not location specific, and industry receives no direct price incentives to minimise costs on Customs or biosecurity services. There would be ongoing risks to the Crown in terms of potentially having to provide increased funding to match growth in passenger arrivals and/or new airports or let risk management or processing time standards slip. This option therefore produces poor incentives on industry for economic efficiency and means the Government bears all volume and cost increases for Customs or biosecurity services. This is somewhat offset by strong incentives on Government to minimise the cost of services.

By comparison, option 3 provides strong efficiency incentives on industry and reduces future fiscal costs by having industry meet the costs of the bulk of changes in passenger numbers. The trade-off is greater complexity and the need to establish new collection mechanisms through legislation.

The main potential disadvantages of option 3 are that it may be seen as being fiscally driven, and the potential efficiency gains are difficult to quantify. While a high level of industry funding will place strong incentives on industry to act efficiently, the size of the resulting efficiency benefits will be dependent upon the extent to which industry can change its behaviour to minimise these costs.

### **Future cost increases and new costs**

All options require future Crown funding to be responsive to forecast increases in passengers. However, growing tourism export earnings and the resultant GST returns to the government (\$487 million in 2003) will offset this risk.

Industry's option allocates full responsibility for growth in demand in Customs or Biosecurity services to government. The option does not provide guidance for allocating the cost of any new services. Under option 3, the majority of passenger driven cost increases would be location specific and recovered from industry. Allocation of new costs would be determined by whether they were location specific.

### **Unresolved issues (potential bargaining points)**

The following concessions are also sought by industry. Where officials have a unanimous position, this is identified below.

#### ***Removal of gazetted hours and after-hours charges (fiscal cost \$6 million p.a. in Vote Customs)***

If agreed increased funding for out of hours passengers would be met by the Crown under options 2 and 4 or primarily by increased cost recovery under options 1 and 3. This option exposes the Crown to potentially significant increases in industry demands for after-hours services. Officials tentatively support this proposal provided there are adequate controls on industry's demands in terms of after-hours services and funding issues are resolved. Without such controls the Crown would bear all the risk in terms of having to meet the additional costs of airports and airlines changing their commercial practices in respect of flight scheduling.

***Allowing charging for Aviation Security, Customs and MAF space at airports  
(fiscal cost \$2.05 million p.a.)***

If agreed these costs would mainly fall on the Crown under options 2 and 4, and be primarily cost recovered under options 1 and 3. There are good economic efficiency reasons for allowing charging for airport space. This would also have precedent effects for MAF and Customs' space at seaports and for the space at airports required for Aviation Security's domestic screening activities.

***Payment for required airline services (fiscal cost \$2.75 million p.a.)***

Airlines have requested refunding of the cost of providing the Government with information for advanced passenger screening and information (fiscal cost \$2.25 million p.a.) as well as for aircraft disinsection (bug spraying) (\$0.5 million p.a.). Officials recommend that this request be declined as the Crown would have no control over these costs and they represent a legitimate cost of doing business.

***Meeting of ICAO recommended processing times (cost not quantified)***

Industry propose that the processing times be set at recommended ICAO times. A separate work stream is currently engaging with industry on target passenger processing times.

***New international airports (cost not quantified)***

Industry is divided on whether charges should be location specific. Applying location specific charges would discourage the creation of new international airports but would not prohibit them. If Ministers are concerned about airports seeking international status not facing the full cost of their decisions then options are to:

1. grandparent cost sharing for existing airports only and have new airports meet the full costs of services, and/or
2. require new international airports to be specifically approved.

## Recommended Action

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We recommend that you:

- a **circulate** this report to members of the Ministerial Committee on Border Funding (Ministers of Biosecurity, Tourism, Transport, Customs and Immigration);
- b **indicate** if you require a briefing on the attached report; and
- c **note** that the full report will be distributed to Ministerial Committee members on Thursday 22 July for the committee's meeting at 9:15 am on Monday 26 July.

**Bruce Arnold**

Senior Analyst, Environment & Natural Resources  
for Secretary to the Treasury

**Hon Dr Michael Cullen**  
Minister of Finance