CAA FUNDING REVIEW

Summary

We believe:

- The CAA Act Review should inform the Funding Review. Separation of both reviews is not good business practice.

- The refusal to reconsider government funding of the CAA and the importance of public good has compromised the integrity of the review.

- CAA costs to industry have increased by much more than inflation in recent years and the expectation that cost increases well above CPI will continue over the next three years is unreasonable.

- There is neither openness nor transparency in the operational and cost structures of the CAA regulatory function as articulated in the consultation document. Treasury and Office of the Auditor-General guidelines on Government cost recovery have not been followed.

- The CAA approach contrasts with that of Airways NZ which intends making cost increases at about CPI over the next 3 years and to deliver articulated and quantifiable benefits to the aviation sector.

- **The status quo should be maintained while the CAA works through with ACAG and industry what it really will deliver, what it needs and how these needs can most equitably be funded.**

1 SEPARATING THE ACT AND FUNDING REVIEWS

We made submissions on the first phase of both reviews but the separation means that a review of what CAA does and how (an efficiency review) is not being considered in conjunction with a finance review. The opportunity to determine what a modern regulator should do in a modern economy has also been overlooked.

2 THE FUNDING REVIEW

According to its website, the CAA monitors safety and security performance throughout the aviation community so that it can direct its safety efforts where they are needed most.

CAA believes this review will achieve better equity between participants, better alignment between sectors and improve the interaction between CAA personnel and the industry.

The introspective review then outlines what CAA needs, not what industry needs from an aviation regulator. The review is short on detail, places more of the financial burden on fewer companies with exemplary safety records, removes the financial incentives to improve safety, **contains no real**

examples of the impact of the various provisions on individual operators, is confusing and fails to address burgeoning CAA expenses.

There is no cost benefit analysis in the funding review; no comparison with e.g. CASA, FAA or EASA; and no best practice comparisons with recent actions in the US and UK.

In our view, the status quo should be maintained while the CAA works through with ACAG and industry what it really will deliver, what it needs and how these needs can most equitably be funded.

3 CAA PERFORMANCE

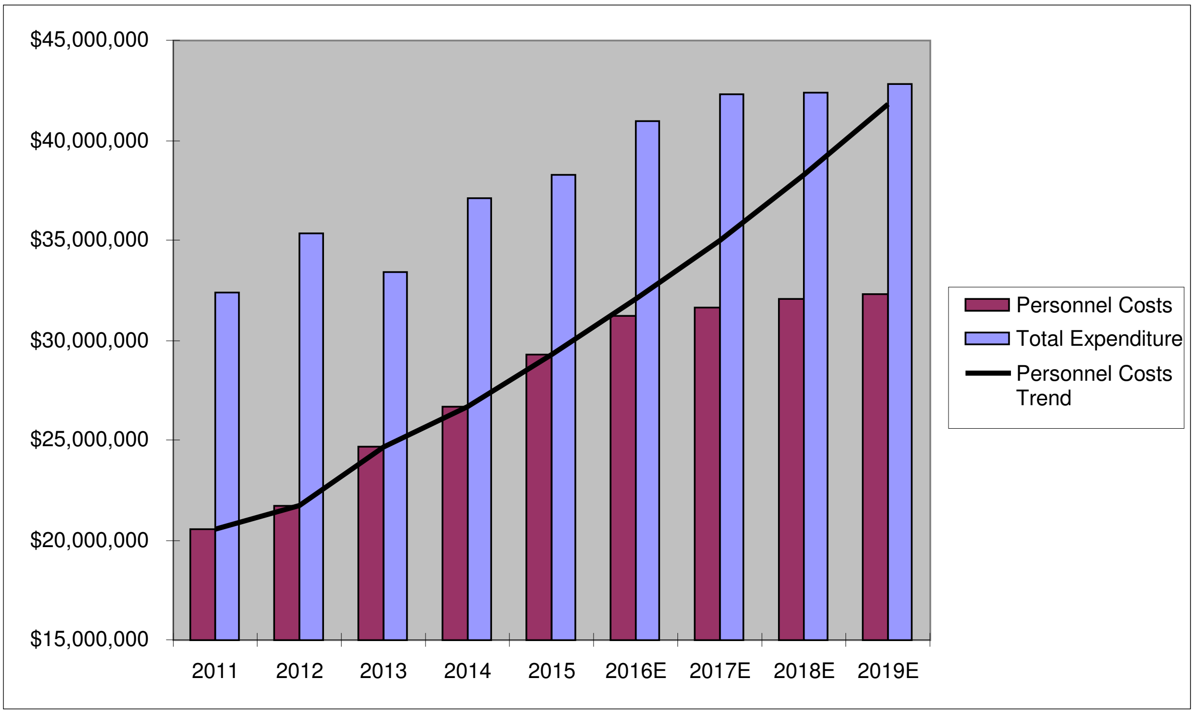
3.1 CAA Financial Performance

CAA has grown costs and head count at a comparatively high rate over the last 4 years and predicts that the rate of increase will slow through 2017 - 2019

We are concerned by the:

- current level of expenditure in the regulatory area;
- rate of increase (especially in personnel expenses) over the 4 years ended June 2015; and a total expenditure increase of 18.2% over the 4 years compared with a CPI increase of 3.7%;
- expectation that expenditure will continue to increase well above CPI rates to 2019 but that personnel expenses will only grow modestly; and
- assumption that even more money can be extracted from industry.

CAA Regulatory Costs 2011 - 2019
2011 – 2015 Actuals from Annual Reports; Estimates from Funding Review Document



Staff costs have increased by 43% between 2011 and 2015 and the average salary has increased from $109,914 to $122,582. Staff costs have also accounted for an increasingly large proportion of CAA costs. The Consultation Document predicts a small increase in salaries from 2016 to 2019 but there must be significant doubt about this given the historic increases (The trend line shows Aviation New Zealand estimates of likely personnel costs given historic trends).

Regulatory actuals for years ended June, $m

	2012	2013	2014	2015	Total % change
Revenue	30.4	33.8	37.2	38.7	27.3
Expenses	35.3	33.4	37.1	38.3	8.5

Regulatory estimates for years ended June from consultation doc, $m

	2016	2017	2018	2019	Total % change
Revenue	39.7	39.8	41.2	43.4	9.3
Expenses	41.0	42.3	42.4	42.8	4.3

Staff number actuals for years ended June, 2016 not available

	2012	2013	2014	2015	2016
Regulatory	200	217	217	239	?

According to CAA Safety Reports, accident rates are down to 4.4 accidents/100,000 hours flown, most reported aircraft incident rates are down and most reported 3 year moving averages are moving in the right direction. Individual operator safety performance is improving. Given this performance, it seems anomalous that CAA intends further increasing its costs to industry – there is some justification for CAA costs to actually decline.

The Funding Review states that CAA needs additional funding to support its involvement in the Aeronautical Information Service, New Southern Skies, Safety Management Systems (SMS) and the Regulatory Craft Programme (RCP). No budgets (indicative costs) are given and there is no indication that costs will be amortised over a period of years (i.e. be cost neutral). We would also expect that the SMS and RCP would be funded from existing budgets with operational efficiencies reducing ongoing funding needs.

CAA also suggests that its revenue from the GA sector needs to be increased while the dependence on the airline sector should be reduced. However, 42% of CAA costs come from ‘other’ including oversight of Airports, Airways, MetService, policy and regulatory strategy etc which are excluded from consideration in this review.

3.2 CAA Service Performance

The CAA Statement of Performance for 2015/16, in the areas of direct interest to industry including Rules Development, Outreach, Certification and Licensing, Surveillance and Audit performance basically contain activity measures with the only quality measurement being adherence to CAA procedures.

Industry has been keen to engage with CAA to help determine what it should do, how it should be done and a move towards outcome measures. These overtures have been ignored.

3.3 Government Funding

The question of changing the method of direct Government funding of the Authority was not canvassed in the latest consultation document, despite being raised in our earlier submission - it was considered to be ‘out of scope’. This document makes it very clear that no further government funding will be provided to support CAA growth. The integrity of a robust funding review has therefore, been compromised by the refusal of the Government to meet its fair share of costs.

Figures show the government contribution to CAA (Crown funding and Ministry of Transport contract revenue) increasing from $4,.1m in 1998 to $3,.90m in 2015; a 5% decrease, while expenditure has increased from $15.9m in 1998 to $38.2m in 2015; a 140% increase. Government is publically committed to encourage economic productivity and supporting a healthy business environment. The government contribution does not meet these objectives.

The consultation paper states that 'MoT indicates that the CAA's funding from the Ministry for policy advice and the rules programme is comparable to that received by other transport agencies'. The MoT 2015/16 Budget Estimates show:

- **Capital Injection**

2014/15 to Maritime NZ = $6.78m, CAA = 0
2015/16 to Maritime NZ = $3.10m, CAA = 0

- **Policy Advice and Related Outputs**

2014/15 to Maritime NZ = $7.83m, CAA = $2.22m
2015/16 to Maritime NZ = $7.24m, CAA = $2.22m

Maritime NZ has a $35.9m budget, CAA a $115m budget.

3.4 Other Regulatory Authorities in Aviation.

The Airways Proposed Pricing for 2016–19 contrasts with the CAA initiative. Airways has proposed a 3.6% price increase over the three years and estimates that it will deliver an extra $84m of new benefits to industry. While any price increases are unwelcome, the ability to measure new benefits to industry improves their palatability.

4 THE MOVE TO LEVY FUNDING

4.1 Levy impact

We have no information on the $ value of costs CAA is seeking to cover, how they are allocated across the various regulatory functions, what will be done for these costs and whether they represent value for money.

CAA comments that the process behind the proposed levies has been reviewed by Castalia Strategic Advisors and that the cost of the levies to individual operators will be low ('about 1.0% for ag operators', 'not place an undue burden on other operators' etc).

There is no analysis of the impact of these levies on operator cost structures or on growth of the sector:

- the Tourism and Agriculture sectors are hit hard by the proposed CAA increases.
- the government commissioned research in 2015 on the likely impact of a proposed travel tax on international visitors. While this tax has been proposed at a much higher rate than the passenger levy increase, the research indicated that it will impact adversely on international visitor growth. This research has not been released by the government.
- the outlook for the agricultural sector over the next 3 years is not bright, the dairy sector in particular is facing falling prices and farmers are again under pressure to reduce operating costs.

Government is publicly committed to boosting economic productivity and supporting businesses to thrive. Also, the Ministry of Transport has established a cross-modal Regulatory Reform Programme that responds to the government's goals for better and less regulation. The CAA new levy proposals are not consistent with government objectives to encourage economic growth.

There is inequality in the fact that CAA is only introducing levies on some aviation activities, removing charging on others and excluding some activities from the funding review. The ‘equity’ suggested by the review is not being achieved.

4.2 Levy calculations

Domestic passenger levy: CAA estimates levy pays $17.41m by 2018/19 ($2.1m increase on 2014/15)

International passenger levy: CAA estimates levy pays $10.30m by 2018/19 ($3.6m increase)

ANZA Passenger levy: CAA estimates $3.48m by 2018/19 ($0.75 increase)

(Note that the above 3 levies generally reflect increased patronage, are charged as part of ticket prices and are ‘pass through’ payments from airlines to CAA.

Agriculture: CAA estimate new levy provides $621,356pa

Freight only: CAA estimate new levy $304,598pa

Part 115, 121, 125 and 135 operators not covered elsewhere: CAA estimates new levies $865,971

Operator Safety Levy: new levy $229,110

Therefore:

Total increase in revenue	= $8.54m
Less revenue forgone	= $2.88m
Total increase in revenue	= $5.66m

The total estimated increased revenue here of $5.66m over the four years compares with the estimate of $4.7m in table 14 of the Consultation document.

5 DETAILED RESPONSES

5.1 Proposal 4, Passenger levies

Growing rationale to reduce trigger level for levy payment from 20,000 passengers to 15,000 passengers or less.

5.2 Proposal 5, Charge out rate not to be amended.

Agreed

5.3 Proposal 6, Medical Certificates

Generally welcomed. Those who are medically fit and pass each test (at least 80%) will still be subsidising those that do not pass the test. Possibility to reduce further with those failing and incurring additional costs with CAA should pay for those costs.

5.4 Proposal 7, Participation levy where applicable and aircraft registration fee be invoiced at same time.
Makes commercial sense, but doesn't this happen already?

5.5 Proposal 9, Recovering costs when outside professionals/technical help sought
Agreed provided this need is identified early on and outside contractors have clear brief and clear fixed price contract.

5.6 Proposal 12, Agriculture
Costs CAA $621,356 to provide oversight of Ag operators. How was this cost determined, what does it cover, what benefits does the sector get?

It is disappointing that no detailed breakdown of current revenue derived from the Agricultural Aviation Sector in relation to Certification, Surveillance, Participation levy and any other income is provided

The Agricultural Aviation Risk Profile on the CAA website states: 'Evidence …. suggests that there is an oversupply of smaller operators whose pricing models are promoting unsustainable competition. In addition, with the introduction of large co-operatives, (whose) capacity for very competitive pricing can create additional financial pressure and the associated safety concerns that arise from smaller operators trying to cut corners to compete'.

Accident data – 3 years ended March 2014: Fixed wing rate has increased but is well below CAA 2014-18 interim target. Rotary accidents trending down and also well below 2014-18 interim target.

If levies are based on the ag stat returns, the current system of collecting stats will penalise the honest operators and the bottom feeders will have a competitive advantage. If CAA goes down this track industry needs to be assured they have a 100% robust system for collecting the information. Can CAA provide such an assurance?

Page 40 of the Consultation document states that advice was sought from Castalia Strategic Advisors. It is disappointing that a copy of this report was not provided.

The sector risk profile identified predatory pricing, under recording and overloading as high risks. The new funding model provides the "perfect storm" for this type of behaviour to prosper. Therefore, safety will not be improved; but an avenue has been provided for more operators to become dishonest.

Concern that small owner operators which are not captured now will remain outside the levy system. Where do the biggest risks lie?

Two examples of companies where levy will add $100,000+ to costs and another example of $40,000 - $50,000 to costs. Companies could do a lot for safety if they were to invest this on themselves. Conversely, small operators will pay less, this is where the sector profile indicates the biggest risks lie and therefore, the big companies will subsidise the small companies.

Industry already invests over $100,000 on safety. Companies have AIRCARE accreditations for up to 3 years. Again, the risks are not with these companies.

The sector would prefer the status quo to be maintained until a more consultative and agreed solution can be developed.

Federated Farmers will lodge its own submission in support.

5.7 Proposal 13, Freight

CAA estimates new levy will return $304,598 pa. How was the need for this amount developed? What benefits will be provided?

By excluding freight carried on passenger flights, those companies secure a competitive advantage.

Capturing NZ data with law change is possible but how complete will overseas registered fleet data be?

The sector would prefer the status quo to be maintained until a more consultative and agreed solution can be developed.

5.8 Proposal 14, Operations Levy on Pt 115, 121, 125 and 135 operators not covered elsewhere.

CAA estimates new levy will return:

Part 115	$202,397
Parts 121 & 125	$208,288
Part 135	$455,286.

What are their costs? What benefits will they provide? We should know this.

Accident data – 3 years ended March 2014: Fixed wing and Rotary accident rates are trending down. Sport aviation data under preparation by CAA.

Medium to larger sized operators predict costs will rise by between $10,000 and $60,000 pa.

These medium to larger operators are already AIRCARE or Qualmark certified so have independent assessments of the way they do things.

The sector would prefer the status quo to be maintained until a more consultative and agreed solution can be developed.

Tourism Industry Association will lodge its own submission in support.

5.9 Proposal 20, Penalty Provision
Rather than just penalty for late payment could look at discount for paying on normal commercial basis.

5.10 Proposal 23, Funding Framework and Frequency of Reviews
OK for framework to be set for 6 years and rates of levies to be reviewed every 3 years BUT must be with full disclosure and with industry meaningfully involved in the review process.

Question 1

- **Should the CAA introduce a 'category by class' model to apply safety levies to Other Commercial operations?**

This depends on being open and transparent and providing equitable treatment.

Question 2

- **Should the CAA develop a regressive levy structure to apply safety levies to Other Commercial operations?**

This depends on being open and transparent and providing equitable treatment.

Question 3

- **Should the CAA further develop the concept of risk based levies as:**
  - **Implementation of Safety Management Systems in the industry progresses, and**
  - **Further development of our Risk Profiling systems occurs.**

This question contradicts much of what is in the current funding proposals and appears to ignore what is being reflected in the current risk profiles! Industry achieves safety and should be rewarded for improved safety performance.

Question 4

- **Should the CAA examine the potential for charging levies on flights which transit New Zealand airspace but which do not land in New Zealand?**

Follow best international practice.

Question 5

- **Are there any other proposals you may have that you think we should consider?**

Not at this stage.

ENDS