

Title: Transfer of aviation security regulation and compliance functions from DfT to the Civil Aviation Authority. IA No: DFT00037 Lead department or agency: Department for Transport Other departments or agencies:	Impact Assessment (IA)		
	Date: 12/11/2011		
	Stage: Final		
	Source of intervention: Domestic		
	Type of measure: Primary legislation		
Contact for enquiries: matt.coleman@dft.gsi.gov.uk			
Summary: Intervention and Options			RPC: AMBER

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, One-Out?	Measure qualifies as
£-4.3m	£0	£0	No	NA

What is the problem under consideration? Why is government intervention necessary?

Aviation security regulation (i.e. rule-writing) and the inspection and enforcement of international, European and domestic regulations (i.e. compliance) are currently undertaken by the DfT, with the cost being met by the taxpayer. As a result, the costs of aviation security regulation and compliance are not reflected in the price the passenger pays. This is in contrast to aviation safety regulation and compliance, as well as economic regulation, which is undertaken by the Civil Aviation Authority (CAA), and funded by industry, who subsequently pass on the costs to passengers. Government intervention is necessary to bring forward the necessary legislation to transfer the delivery of the regulatory and compliance functions away from the DfT.

What are the policy objectives and the intended effects?

1. Reduce the costs to the taxpayer in line with SR commitments by introducing the user pays principle.
2. Remove price distortions associated with aviation security regulation and compliance being funded via general taxation. Making passengers pay for these costs should help ensure prices better reflect the costs of air travel. It should remove any distortions created from funding this through general taxation.
3. Offer efficiency savings for industry by having a single organisation responsible for aviation security, safety and economic regulation, for example synergies could result in joint inspections, thereby reducing industry resources deployed to working with compliance visits.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 0 (Do nothing): Aviation security compliance and regulation functions continue to be provided by DfT and funded through general taxation.

Option 1: Transfer aviation security regulation and compliance functions to the CAA. This is the preferred option because it meets the Comprehensive Spending Review and DfT's business plan commitments, should cost less than option 2 yet deliver at least the same level of (if not more) benefits than option 2.

Option 2: Create a new arms-length government agency to undertake aviation security regulation and compliance functions, with the powers to recover costs from industry.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 10/2014

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro No	< 20 No	Small No	Medium No	Large No
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: Nil		Non-traded: Nil

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY:  Date: 12/11/2011

Summary: Analysis & Evidence

Policy Option 1

Description: Preferred option: Transfer aviation security regulation and compliance functions to the CAA through primary legislation.

FULL ECONOMIC ASSESSMENT

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -4.8	High: -3.8	Best Estimate: -4.3

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	2.36	4.8	28.4
High	1.36	6.6	39.2
Best Estimate	1.54	4.8	28.9

Description and scale of key monetised costs by 'main affected groups'

There are transitional costs of £1.54m to transfer the compliance and regulation functions from DfT to CAA. These relate to upgrading the CAA's IT system, £1.5m, and office costs incurred in physical relocation of £0.037m.

There are average annual costs of £4.8m (running costs that will be incurred by the CAA in taking on these functions).

Other key non-monetised costs by 'main affected groups'

None.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	4.3	24.6
High	0	6.1	34.5
Best Estimate	0	4.3	24.6

Description and scale of key monetised benefits by 'main affected groups'

The benefits relate to savings to the taxpayer from no longer funding the aviation security regulation and compliance functions, which are currently provided free to airports and airlines. The benefits to DfT match the costs incurred, excluding the employer's liability and third party liability insurance cost brought about by the CAA taking on additional members of staff and transition costs.

Other key non-monetised benefits by 'main affected groups'

One body responsible for aviation safety and security regulation. Initial discussions with industry suggest that some industry operators could restructure accordingly, leading to savings, as they would be able to combine certain members of staff who currently have similar safety and security roles. The CAA may be able to make efficiency savings through synergies of aviation security and safety regulation and compliance, such as joint inspections.

Key assumptions/sensitivities/risks	Discount rate (%)
<p>ASSUMPTIONS: That the posts transferred will be subject to the current terms and conditions. That the cost of upgrading the security of the CAA's IT system falls to this project. That this transfer will take place in April 2014 in line with legislative timetables.</p> <p>SENSITIVITIES: That the number of posts transferred will change prior to the transfer, although we do not expect any significant changes.</p> <p>RISK: That CAA lacks sufficient security expertise, although DfT and the CAA are working to mitigate this.</p>	3.5

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:	In scope of OIOO?	Measure qualifies as
Costs: NA	No	NA
Benefits: NA		
Net: NA		

Summary: Analysis & Evidence

Policy Option 2

Description: Use primary legislation to create an arms length organisation to undertake aviation security able to recover costs from industry.

FULL ECONOMIC ASSESSMENT

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -4.8	High: -3.8	Best Estimate: -4.3

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	2.36	0	4.8	28.4
High	1.36		6.6	39.2
Best Estimate	1.54		4.8	28.9

Description and scale of key monetised costs by 'main affected groups'

There would be at least annual costs of £5.0m. There would be transitional costs of at least £1.537m to transfer the functions from the DfT to the new body. These relate to ensuring that the new organisation's IT system operates at the required security level totalling at least £1.5m, and office costs incurred in physical relocation of at least £0.037m. It is likely that the transition costs incurred in creating a new body to undertake aviation security functions will exceed those in option 1.

Other key non-monetised costs by 'main affected groups'

Whilst this has at least the same monetised costs as option 1, there are significant other costs (e.g. management and support) that have not been monetised that would be incurred by creating an arms length organisation to take on aviation security regulation and compliance functions. Due to the scale of such an undertaking it is very difficult to monetise such costs with any degree of accuracy.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	n/a	0	4.3	24.6
High	n/a		6.1	34.5
Best Estimate			4.3	24.6

Description and scale of key monetised benefits by 'main affected groups'

The benefits relate to savings to the taxpayer from no longer funding the security functions (regulation and compliance) which are currently provided free to airports and airlines. The benefits to DfT match the costs incurred, excluding the employer's liability and third party liability insurance cost and transition costs.

Other key non-monetised benefits by 'main affected groups'

None.

Key assumptions/sensitivities/risks	Discount rate (%)
Same as for option 1.	

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: n/a	Benefits: n/a	Net: n/a	No	NA

Evidence Base (for summary sheets)

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	Better Regulation for Aviation Security IA
2	Better Regulation for Aviation Security Consultation
3	http://www.parliament.uk/business/news/2010/10/strategic-defence-and-security-review/
4	http://www.fas.org/irp/crs/RL31617.pdf).
5	http://research.dwp.gov.uk/asd/asd5/WP86.pdf

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs	0.0	0.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Annual recurring cost	0.0	0.0	0.0	4.0	5.0	5.0	5.0	5.0	5.0	5.0
Total annual costs	0.0	0.0	1.5	4.1	5.0	5.0	5.0	5.0	5.0	5.0
Transition benefits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Annual recurring benefits	0.0	0.0	0.0	3.5	4.5	4.5	4.5	4.5	4.5	4.5
Total annual benefits	0.0	0.0	0.0	3.5	4.5	4.5	4.5	4.5	4.5	4.5

* For non-monetised benefits please see summary pages and main evidence base section



Microsoft Office
Excel Worksheet

Issue

1. Aviation is subject to two different regulators: the CAA for safety, economic and consumer protection regulation¹ and the DfT for security regulation. We believe that there are efficiencies to be gained through having a single regulator for all aviation specific issues. Currently, the industry pays for safety, economic and consumer protection regulation, in line with the user pays principle, as the costs are passed to passengers². Inconsistently, aviation security regulation functions - (i.e. rule-writing) and the inspection and enforcement of international, European and domestic aviation security regulations (i.e. compliance) - are currently undertaken by the DfT, with the cost being met through general taxation. As a result the costs of aviation security regulation are not reflected in the price the passenger pays. Government intervention is necessary to bring forward the necessary legislation to transfer the delivery of the regulatory and compliance functions away from DfT.

Rationale for intervention

2. The government is committed to deficit reduction, and the proposed transfer of aviation security functions to the CAA, which is funded by the aviation industry, forms part of the Government's wider deficit reduction plans. The transfer of aviation security regulation and compliance functions is expected to deliver savings to the taxpayer estimated at £24.6m in present value terms over the appraisal period (analysis of the monetised costs and benefits can be found from paragraph 24). This cost will be transferred to the passenger at approximately £0.02 per passenger movement.³
3. The demand for aviation security is derived from the demand for air travel. The regulation of aviation security provides both private benefits to passengers (reduced risk of a terrorist attack) but will also benefit wider society. For example, the regulation of aviation security means there is a lower risk of a terrorist attack and hence the costs to society associated with an attack (such as reduced trade, less investment and physical harm on non-passengers). Because of these 'positive externalities' – i.e. the wider benefits to society of aviation security, the market left to its own would under-provide aviation security. The degree of under-provision would depend on the size of the positive externality. The aim of this policy is not to address this market failure (i.e. the policy does not look to change the level of aviation security or seek to achieve a socially optimal level of aviation security) the aim of the policy is to address the question of who should pay for aviation security.
4. The question of who should pay for aviation, in economic theory, depends on who should own the property rights for a secure society. The group who own the property rights could be either the users of air travel or wider society. For the former, this would require wider society compensating passengers for aviation security (this is what occurs currently as taxpayers compensate passengers by paying for aviation security) or for the latter, this would require passengers compensating wider society (passengers should pay for aviation security – the policy proposal). However, the government believes that because the need for aviation security is derived from the demand for air travel that, in line with the 'user pays' principle⁴, there should be a better balance between the costs that fall on taxpayers and those that fall on the users who benefit most directly. There will be aviation security costs remaining on taxpayers in respect of threat assessment, policy making, international engagement and oversight of the regulator. Given the costs per passenger are small (£0.02 per passenger) these are clearly going to be outweighed by the private benefits realised by the passenger (for example a lower risk of loss of their life) from the reduced risk of a terrorist attack due to the regulation of aviation security.

¹ Within the aviation sector certain airports are subject to economic regulation. Airspace is also subject to economic regulation.

² We refer to passengers as a short hand for all end users of air transport services (including users of cargo which is shipped via air).

³ This is based on dividing the best estimate annual average cost (£4.8m) by the total number of passenger movements per annum based on 2010 figures (210,000,000).

⁴ The user pays principle is equivalent to the more commonly used 'polluter pays' principle. The polluter pays principle is used in environmental economics to justify society owning the property rights to a clean environment and hence the polluter is required to compensate society.

5. Furthermore, the current method of funding aviation security regulation and compliance - via general taxation – is also likely to create distortions which should be addressed if industry (and therefore passengers) were to fund these functions instead. Currently, the taxpayer meets the costs of aviation security regulation and compliance, so these costs are not reflected in the price the passenger pays. This could lead to inefficiencies in the air travel market and an over-consumption of air travel⁵. In addition to this the proposed transfer should also remove any distortions created from funding aviation security regulation and compliance through general taxation⁶. Aviation security regulatory activity has had to grow relatively quickly in response to attacks/attempted attacks. This activity has fallen to central government as it has the resources and knowledge to be able to respond quickly. All regulatory activity is founded on threat assessments and now that the machinery for producing security threat assessments for the various sectors (through the Joint Terrorism Analysis Centre) is well established, it is possible to site the regulation functions closer to the relevant sector, and therefore address the aforementioned market distortions, whereas previously this would not have been possible.

Background

6. The UK is legally obliged as a contracting state of the International Civil Aviation Organisation, and a Member State of the EU, to ensure that security measures are in place to protect civil aviation against acts of unlawful interference that jeopardise the security of civil aviation. Unlike some EU countries and the US, aviation security in the UK is delivered by the aviation industry, not the state. In the US for example, aviation security is delivered by a Government Agency – the Transport Security Administration. In the UK the Secretary of State is responsible for regulating aviation security in the UK, as set out in Part 2 of the Aviation Security Act 1982.
7. A thriving aviation industry is an integral part of the UK economy. In 2010, UK airports handled 211 million passengers and served nearly 400 international destinations. The air transport sector's turnover in 2009 was around £26 billion and the sector directly generated around £9 billion of economic output. It provides about 150,000 jobs in the UK and supports many more indirectly. Goods worth £95 billion were shipped by air freight between the UK and non-EU countries, representing 38 per cent of the UK's extra-EU trade by value⁷.
8. However, the UK faces a continuing threat from international and domestic terrorism. The Government's recent strategic review of defence and security set out its proposals for securing Britain in an age of uncertainty⁸ and included a commitment to improve aviation security. The aviation industry carries millions of business and leisure passengers each year, directly employing tens of thousands of people, and carries over two million tonnes of freight, including fresh food, medical supplies, business mail and consumer goods. The consequences of an incident occurring, both in terms of potential loss of life and the economic cost, have been deemed by successive governments as sufficiently serious to warrant security (and safety) regulation.
9. It is difficult to quantify the benefits to industry that security provides. There is no simple way to measure the effectiveness of aviation security other than through covert testing and disrupting terrorist attacks, but this only covers a small portion of the aviation security effort. It is impossible to know how many attacks have been deterred by the presence of aviation security measures. Estimates can be made on the impact that a terrorist attack on aviation would have. 9/11 demonstrated that when aviation security measures are insufficient to mitigate the risk posed by terrorist methodologies, the consequences can be on a par with a major natural disaster. This conclusion was reached in the Congressional Research Service in *The Economic Effects of 9/11: A Retrospective Assessment*.⁹

⁵ Although given the scale of this distortion (£0.02 on average per passenger movement) we expect this efficiency to be small.

⁶ This concept is known as the social cost of exchequer finance (SOCEF). For further information on SOCEF see section 3.4 of "The Department for Work and Pensions Social Cost-Benefit Analysis framework" available at <http://research.dwp.gov.uk/asd/asd5/WP86.pdf>

⁷ <http://www2.dft.gov.uk/consultations/open/2011-09/consultationdocument.pdf>

⁸ <http://www.parliament.uk/business/news/2010/10/strategic-defence-and-security-review/>

⁹ (<http://www.fas.org/irp/crs/RL31617.pdf>).

The aviation security functions - currently

10. Aviation security policy is set by the Secretary of State for Transport. Policy is developed from first principles or in response to events and trends, to give direction to security activities and inform priorities. The policy function is also responsible for conducting negotiations to influence the international framework that dictates some of the security priorities, and liaises with the other agencies such as the Home office, security service and police.
11. The regulation function develops and maintains the rules that are applied in practice, amending them in line with policy requirements or in response to events. This is given effect through directions made by the Secretary of State on reliance of his powers under the Aviation Security Act 1982 (ASA1982). The regulation function communicates the requirements to the regulated industries and, where necessary, provides advice and assistance on meeting their regulatory responsibilities.
12. The compliance team consists of the posts of the 'authorised persons' (as per Part 2 of the ASA1982), who, in practice, are referred to as inspectors. A team of administrative and management staff support the work of the inspectors. The inspectors monitor the UK airports, airlines, cargo installations and in-flight suppliers to ensure that they are complying with basic security procedures as specified in both directly applicable EU legislation and UK directions. Where an authorised person is of the opinion that any person has failed to comply with their regulatory requirements he may serve on that person an Enforcement Notice, specifying the remedial action to be taken. Failure to comply with an Enforcement Notice is an offence punishable by a fine. Inspectors may also provide advice and assistance to the industry on meeting their regulatory responsibilities.
13. The DfT also operates a National Security Vetting function which processes, and makes decisions on, applications for vetting clearance from staff engaged in front-line security activities, such as industry staff controlling access at UK airports. The policy on vetting is set by DfT and the regulations give effect to the policy i.e. that persons undertaking listed duties shall hold vetting clearance to counter-terrorist check (CTC) level and shall make an application to the DfT. Delivery of the regulatory requirements is achieved when the DfT processes, and makes the decision, on the application for CTC clearance. If a decision is made to refuse, withdraw or restrict vetting clearance the application may appeal, initially to a higher authority in DfT, then to an independent panel.
14. The DfT supports the Governors of the Overseas Territories (OTs) in the discharge of their aviation security responsibilities (arising from the UK's obligations from its signature of the Chicago Convention in 1947). This is currently delivered by an adviser working under the terms of a contract. This function provides a guidance and support service to Governors and Directors of Civil Aviation on aviation security issues.

The aviation security functions - after the proposed transfer

15. The proposal is that the policy making function will remain with the Secretary of State therefore responsibility for the overall security policy framework, together with risk and threat analysis and international representation, will remain with the Secretary of State.
16. The regulation function would be undertaken by the CAA or new body, who will make recommendations to the Secretary of State for new or revised directions under the ASA1982 to give effect to his policy priorities. In practical terms, this means that the CAA or new body will develop and draft directions, but the Secretary of State will sign and issue all directions, retaining responsibility for them at all times. Once a new direction is made by the Secretary of State, application and enforcement would be solely for the CAA or new body.

17. Delivery of the compliance function, along with all inspectors and support staff, would transfer to the CAA or new body. The processing of National Security Vetting applications and the making of clearance decisions would be undertaken by the CAA or new body. Likewise the function of providing advice and support to Overseas Territory governments would be undertaken by the CAA or new body.

Policy objectives

18. The overall policy objectives are:
- To exploit any synergies resulting from a single body (the CAA) developing and enforcing security, safety and economic regulations.
 - To reduce the costs to the taxpayer in line with Comprehensive Spending Review commitments and the DfT's business plan.
 - To remove price distortions associated with aviation security regulation and compliance being funded via general taxation. Making industry (and therefore passengers) pay for aviation security regulation and compliance should help ensure prices better reflect the costs of air travel.
19. The proposed transfer of aviation security regulation and compliance functions from DfT to CAA would also bring aviation security regulation into line with the approach taken to aviation safety and economic regulation.

Description of options considered

Option 0: Do nothing

20. Business as usual will see the aviation security regulation and compliance functions remain with the DfT. The taxpayer will continue to meet the cost of aviation security, estimated at £24.6m in present value. This option meets none of the policy objectives set out in paragraph 16 above.

Option 1: Transfer aviation security regulation and compliance functions to the CAA.

21. The staff, assets, and functions of the aviation security compliance and regulation teams will be transferred from the Secretary of State to the CAA. This will be done by a transfer scheme made by the Secretary of State, enabled by primary legislation, which is the only way to enable a transfer.
22. The total benefits (both monetised and non monetised) associated with option 1 are expected to outweigh the total costs; as a result option 1 is preferred to option 0 (do nothing). In addition option 1 will cost less than option 2 and is expected to deliver at least the same level (if not more) of benefits. As a result **option 1 is the preferred option**.

Option 2: Create a new body to undertake the role of aviation security regulator with the powers to recover costs from industry.

23. This option is the same as option 1 except for the fact that the aviation security functions would be transferred to a new non-departmental public body (NDPB) rather than to the CAA. The monetised costs and benefits of this option are the same as option 1, as the same functions, would be transferred. However there would be additional (non monetised) costs associated with setting up an entirely new body (e.g. additional fixed costs associated with overheads which are spread over a much smaller workforce). In addition it is likely that a certain level of recruitment would be necessary when setting up a new NDPB, that would not be necessary in option 1. Some of the non monetised benefits associated with option 1 would also not be realised under this option. For example this option would prevent the industry from creating efficiencies brought about by having one combined safety and security regulator.

Options appraisal

OPTION 0 (DO NOTHING)

This the option against which all other options are assessed. As a result there are no costs or benefits associated with this option.

OPTION 1 (TRANSFER AVIATION SECURITY REGULATION AND COMPLIANCE FUNCTIONS TO CAA)

Costs

24. In total we estimate CAA will incur costs of £5.0m per annum to take on the required aviation security functions. This is the combined cost of Staff (£3.577m), employer's liability and third party liability insurance (£0.500m), office costs (£0.214m), vetting costs (£0.315), travel and subsistence costs for the 47 inspectors (£0.235m) and supporting of the Governors of the Overseas Territories (£0.128m). We also estimate that CAA will incur a one-off cost of around £1.54m to transfer the compliance and regulation functions from DfT to CAA. The detailed assumptions underpinning these estimates are explained in the following paragraphs. All costs detailed within this Impact Assessment have been discussed with the CAA.

Staff costs

25. Under Option 1 we estimate that 84 posts would be transferred from the DfT to the CAA, under a transfer scheme. The post holders would become employees of the CAA, who would be responsible for salaries and all associated staff costs. The DfT has recently finished a restructuring process and the new departmental structure has clearly identified the posts that will be subject to transfer.

These 84 posts consist of 68 Compliance posts and the associated staff costs:

Note: these figures are an average cost for the role.

• 1 Aviation security compliance lead	£84,000
• 1 Head of airports security compliance	£78,675
• 1 Airlines, cargo & inflight supplies	£78,675
• 1 Compliance improvement	£78,675
• 1 Training	£47,856
• 7 Senior inspectors	£334,992
• 47 Inspectors	£1,878,120
• 1 Aviation security compliance data mgt	£47,856
• 2 Compliance support	£79,920
• 3 Compliance support	£100,920
• 3 Compliance support	£82,906
68 Compliance posts total:	£2,892,595

Included in the 84 posts are also 14 regulation posts and associated staff costs:

• 1 Regulation	£84,000
• 2 Regulation	£78,675
• 2 Airports and airlines	£95,712
• 2 Airports and airlines	£79,920
• 1 Airports and airlines	£33,640
• 1 Training and personnel	£47,856
• 1 Training and personnel	£39,960
• 1 Training and personnel	£27,635
• 1 Cargo and IFS	£47,856
• 1 Cargo and IFS	£39,960
• 1 Regulatory Improvement	£47,856
14 Regulation posts total:	£623,070

There are also two vetting posts being transferred:

• Vetting Function Overseer	£27,635
• Vetting Function Overseer	£33,640
2 Vetting posts total:	£61,275

Total cost of Aviation Compliance, Regulation and vetting posts: £3,576,940

26. The estimates for the associated staff costs are the DfT HR Department's recommended figures for estimated pay and non-pay costs for the relevant pay grades for staff. These costs are estimated at £3,576,942.

Employer's liability and third party liability insurance

27. After discussions with the CAA they have calculated that there will be further costs to the CAA of extending their employer's liability and third party liability insurance to cover the additional 84 staff and the transferred functions. This is estimated to be approximately £0.5m per annum, and is calculated at £5,952 per inspector.

Office costs

28. The CAA will require office space in order to accommodate the extra members of staff. This is estimated to be £0.209m, based on current estimates for price and office space. These costs have been estimated by calculating the costs of office space per person, at the current location (where the posts are currently based) and then multiplying that to cover all the posts that will be transferred. The DfT's transport security operation occupies 1,487sqm of the 5th floor at Southside on Victoria Street. This represents 65.88% of the total 5th floor area of 2,257m². There are 185 workstations so the space occupied per person is approximately 8m². The rental cost for the 5th floor in total is £1,336,749 (inc VAT) so the DfT's security share of this would be £880,650. The service charge cost for the 5th floor in total (which includes the provision of

utilities) is £251,755 of which the DfT's security operations would be £165,856. This creates a total of £1,046,569 for the office space which is occupied by 185 members of staff. In order to work out a cost per person for this office space we can divide these figures (£1,046,569 ÷ 185) to give us a figure of £5,657 per member of staff. We can then multiply this figure by the number of posts to be transferred in order to establish the ongoing costs the CAA will incur in office space. We assume that the posts would be relocated to the CAA's safety division based near Gatwick airport, so it is likely that a similar, or lower, rent will be paid and hence for the purposes of this impact assessment we assume the same rental costs. Whilst these posts were within the DfT, only 37 were provided with permanent desk space (this is because the inspectors spend a considerable amount of time away from the office due to the nature of the role). It is our working assumption that the same number of posts will still require desk space and we have calculated it accordingly:

$$£5,657 \times 37 = £209,313$$

Total cost of office space that will be incurred by the CAA: £209,313

Vetting Costs

29. There will also be annual costs to CAA of the transferred national security vetting function. This assumes the introduction of the shared vetting service in January 2012 and is based on current known costs. Although use of the shared service provider is not the current means by which the service is provided, it will be from early 2012 due to Cabinet Office requirements. It therefore forms the appropriate basis for assessing costs. Assuming a similar vetting demand for aviation security clearances of 6,560 (the figure for year 2010) the monetised cost of paying the shared vetting service at the current fee charged by the operator of £48, inclusive of VAT, is £314,880

Cost per year of undertaking the Vetting function: £314,880

Travel and subsistence costs

30. There will be a cost incurred in providing travel and subsistence allowances to the 47 inspectors that are envisaged to be transferred. These costs relate to the necessity for inspectors to be accommodated overnight and the amount of travelling inherent within their roles. This cost has been calculated as totalling £5000 per inspector. This is an average based on current costs.

$$£5000 \times 47 = £235,000$$

Cost per year of travel and subsistence costs for the inspectors: £235,000

Advice and assistance to Overseas Territory (OT) Governments

31. There will be annual costs to the CAA or new body for undertaking the function of providing aviation security advice and assistance to the OT Governments. The current cost (of the contract signed in 2010) is £128,000. Air Safety Support International (ASSI) is a not-for-profit wholly owned subsidiary company of the CAA. ASSI currently provides aviation *safety* advice and assistance under the terms of a Direction from the Secretary of State, and the costs of ASSI's services are reimbursed by OT Governments. If the role of ASSI were extended so that it could also provide aviation *security* advice and assistance under Direction to OT Governments on a repayment basis, it is anticipated that the cost to ASSI of providing *security* advice and assistance will be the same as the current £128k per annum, and the cost could possibly be less given the potential efficiencies of delivering *safety* and *security* advice through a single organisation. It is assumed that the costs would be at least the same if the function was transferred to a new organisation under option 2, and there are likely to be other costs under this option that are very difficult to monetise with any accuracy.

Cost per year of undertaking the OT government's assistance function: £128,000

Transitional costs

32. This one-off cost includes the cost of upgrading the CAA's IT system so that it is approved for handling security sensitive information, which has been estimated by CAA to cost between £1m to £2m. Our best estimate is the midpoint (£1.5m) of this range.
33. This one-off cost also includes office space costs. Of the 84 posts currently identified for the transfer, 37 posts will require permanent desk space, as these 37 posts currently require desk space and we assume that this will not change. It is our working assumption that these will be accommodated at the CAA's office at Gatwick where there is sufficient space. In order to calculate the cost of new IT equipment and other resources necessary for the new posts we have forecasted a cost of £1000 per member of staff, necessary as part of the transition. This results in a transition cost of £0.037m being incurred
34. **Transitional cost to transfer the compliance and regulation functions from DfT to CAA: £1.537m**

Benefits

Ongoing cost savings

35. The DfT would no longer be responsible for the aviation security functions that have been transferred to CAA. As a result the ongoing costs imposed on CAA estimated above (£5.0m) would be almost matched by an on-going saving to the DfT and therefore the taxpayer. Barring the employer's liability and third party liability insurance cost, which whilst this would not incur an equivalent saving for the DfT, the DfT will reduce its liability from employee and third party claims, we have not seen any evidence to suggest that the breakdown of these savings should be any different to the breakdown of costs as described in paragraphs 24 to 39 above. Therefore our best estimate is that option 1 would result in an ongoing saving to DfT of £4.5m per annum. This option will therefore reduce the costs to the taxpayer in line with Comprehensive Spending Review commitments and the DfT's business plan.

Removal of distortions

36. The current method of funding aviation security regulation and compliance functions - via general taxation – is also likely to create distortions which should be addressed if industry (and therefore passengers) were to fund these functions instead. It is not possible to estimate the scale of these potential benefits so we refer to them as non monetised benefits for the purpose of this impact assessment.
37. The need for aviation security regulation and compliance is derived from the demand for air travel. Currently, the taxpayer pays for aviation security so these costs are not reflected in the price the passenger pays. In theory this could lead to inefficiencies in the air travel market and an over-consumption of air travel. Making industry (and therefore passengers) pay for aviation security regulation and compliance should therefore help ensure prices better reflect the costs of air travel. This is in line with the user pays principle which currently applies to both aviation safety and economic regulation. Although society more generally is likely to benefit from the avoidance of an aviation-related security incident they should not be expected to pay for this as the original threat only exists because of the demand for air transport (i.e. if there was no demand for air transport then the prospect of an aviation-related security incident would not exist). Insofar as air transport leads to positive spillovers which benefit the wider economy, then it would be economically efficient for tax-payers to subsidise air transport. However this impact assessment

is concerned with the internalisation of costs associated with aviation security, not the internalisation of wider benefits associated with air transport (which are very difficult to quantify).

38. In addition, the proposed transfer should also remove any distortions created from funding aviation security regulation and compliance through general taxation. The expected reduction in economic efficiency that arises from the transfer of resources from the private to public sector (which includes the distortionary effect of most forms of taxation) is known as the social cost of exchequer funds (SOCEF). The 2010 Department for Work and Pensions Social Cost-Benefit Analysis framework¹⁰ discusses the concept of SOCEF and draws on a number of studies which have sought to estimate its value (which range from 9% to 43%). However this framework also notes that the Green Book does not include guidance on SOCEF. As a result we include the potential benefits of removing the distortionary effects (of funding aviation security via general taxation) as a qualitative benefit only.

Synergies from a single aviation regulator

39. Having a single regulator for all aviation specific issues could deliver additional benefits. Responses garnered from industry through our 'Request for Evidence' exercise on regulatory reform suggest they could restructure their organisations accordingly, leading to savings, as they would be able to combine certain members of staff who currently have disparate safety and security roles. This is obviously a difficult saving to accurately monetise. Given that there are approximately 1343 entities which will be subject to security regulation by the CAA, were 5% of these able to combine two members of staff costing £40,000 per annum this would lead to an annual saving of £2.7m which over the ten year period would ensure that monetised and non-monetised benefits exceed the costs of the transfer. Reporting and communications between the regulator and the industry could become more efficient as the industry will only have to report to one body concerning both security and safety. The CAA may be able to make efficiency savings through synergies of aviation security and safety regulation and compliance, for example by making use of joint inspections.

Risks and assumptions

40. There is a risk that the CAA currently lacks sufficient levels of security expertise, however the DfT and the CAA will work closely with each other to improve the CAA's corporate knowledge of aviation security.
41. We have assumed that the posts transferred from DfT to CAA will be subject to the same terms and conditions that they are currently. It is our working assumption that this transfer will take place in April 2014.
42. There is a sensitivity that the number of posts transferred will change prior to the transfer, resulting in an alteration to the cost estimates outlined in this IA. However we do not expect the numbers to change significantly.

OPTION 2: TRANSFER AVIATION SECURITY FUNCTIONS TO A NEW BODY

Costs

43. We expect the ongoing annual costs (£5.0m) and one-off costs (£1.54m) incurred by the CAA under option 1 would be at least those incurred by the new body.
44. However, we would also expect a new body to incur additional costs arising from the fact that a new smaller body will have to spread its fixed costs (e.g. accommodation, support staff, management) over a smaller number of employees. Evidence from the National Audit Office (NAO)¹¹ suggests that the merging of five previous regulators¹² into a single regulator – Ofcom –

¹⁰ This concept is known as the social cost of exchequer finance (SOCEF). For further information on SOCEF see section 3.4 of "The Department for Work and Pensions Social Cost-Benefit Analysis framework" available at <http://research.dwp.gov.uk/asd/asd5/WP86.pdf>

¹¹ "The creation of Ofcom: wider lessons for public sector mergers of regulatory agencies" available at http://www.nao.org.uk/publications/0506/the_creation_of_ofcom_wider_l.aspx

resulted in efficiency gains of around 13%. It is not clear whether inefficiencies similar in scale to those that would have prevailed in the absence of the Ofcom merger would arise if the aviation security functions were transferred to a new body. Furthermore a new NDPB would have to establish a charging mechanism in order to recover costs, something which the CAA already has in place. **As a result we conclude that the costs associated with option 2 are greater** than those for option 1; however the difference in the scale of the costs is very difficult to predict.

45. Creating a new Non-Departmental Public Body to take on aviation security regulation and compliance functions, is also in direct contrast to the coalition government's stated desire to limit the number of new arms length bodies.

Benefits

46. The ongoing cost savings and removal of distortions would be the same as under option 1. However any synergies resulting from having a single aviation regulator (as described in paragraph 35 above) would not be realised under this option.

Risks and assumptions

47. There is a risk that the new organisation would lack sufficient levels of security expertise, however the DfT and the new organisation would work closely with each other to improve the new body's corporate knowledge of aviation security.
48. We have assumed that the posts transferred from DfT to the new organisation will be subject to the same terms and conditions that they are currently. It is our working assumption that this transfer will take place in April 2014.
49. There is a sensitivity that the number of posts transferred will change prior to the transfer, resulting in an alteration to the cost estimates outlined in this IA. However we do not expect the numbers to change significantly.

SUMMARY

50. Option 1 (which involves transferring aviation security regulation and compliance functions, to the CAA) is estimated to result in costs of around £28.9m (present value over 10 years) and monetised benefits of around £24.6m (present value over 10 years). It is also estimated to deliver non monetised benefits resulting from the removal of distortions and potential synergies from having a single aviation regulator looking after security, safety and economic regulation. Overall the total benefits (monetised plus non monetised) associated with option 1 are expected to exceed the total costs; as a result option 1 is preferred to option 0 (do nothing).
51. The costs associated with option 2 (which involve transferring aviation security functions to a new body) are estimated to be at least as high as option 1 and it is very likely that they exceed those of option 1; however the benefits are estimated to be lower. Furthermore, option 1 meets all of our policy objectives whereas option 2 only meets the first 2 and not the objective to exploit any synergies resulting from a single body (the CAA) undertaking security, safety and economic regulation. As a result option 1 is preferred to option 2.

Therefore option 1 is the preferred option.

One-in, One-out

52. The policy is out of the scope of One-in, One-out (OIOO) because the CAA's costs incurred as a result of this policy will be through an increase in CAA's charges to industry without a change in

¹² The five previous regulators comprised the: Broadcasting Standards Commission; Independent Television Commission; Office of Telecommunications; Radio Communications Agency; and Radio Authority.

the level of regulatory activity. **It has been confirmed by the Regulatory Policy Committee that this policy is out of the scope of OIOO for this reason.**

53. The costs of aviation security will transfer from DfT to the CAA (and eventually be passed on to passengers via airports and airlines as described below).
- The CAA derives its funding from industry through charges and so will pass on all additional costs incurred as a result of the proposed transfer to airports and airlines.
 - Airports are either “designated” for economic regulation (if the airport has substantial market power and the benefits of economic regulation outweigh the costs)¹³ or where there is sufficient competition the airport is not subject to economic regulation. For the former, any increase in the airport’s costs will be reflected in an equivalent change in the airport’s price control¹⁴ set by the CAA. For the latter, there should be sufficient competition between airports such that any increase in an airport’s costs is passed on to airlines through higher charges¹⁵.
 - Given the airline sector is generally competitive, both of these costs would subsequently be passed on to the passenger or the owner of cargo¹⁶.

Therefore, we expect that the majority (if not all) of the indirect costs to business to be passed on to end users (i.e. passengers and those shipping cargo by air).

54. The bearing of the cost on ends users is considered to be in line with the ‘user pays’ principle. This principle states that it is appropriate for users (passengers and cargo owners) to pay for aviation security regulation and compliance. Currently the taxpayer pays for aviation security regulation and compliance so these costs are not reflected in the price the passenger pays for air travel. In theory this could lead to inefficiencies in the air travel market and an over-consumption of air travel. We do not attempt to quantify this inefficiency but recognise that the removal of this inefficiency is an indirect benefit.

Micro-Businesses

54. The Government aims to ensure that, as far as possible, micro-businesses¹⁷ and new start-ups should be subject to no new regulation during a growth period which starts from 1st April 2011 to the 1st April 2014. As our working assumption is that this transfer will take place in April 2014, no micro businesses will be subject to new regulation during this period.

¹³ Heathrow, Gatwick and Stansted are currently designated airports. 54% of UK passengers travelled through these airports in 2009.

¹⁴ The maximum price the airport can charge the airline for using airport services.

¹⁵ In economic theory, there is 100% cost pass through when a market is perfectly competitive.

¹⁶ A report produced by Vivid Economics on behalf of Defra and DfT (see <http://www.vivideconomics.com/docs/Vivid%20Econ%20Aviation%20Tickets.pdf>) provides evidence to support that this is the case for the airline industry. In particular, the report states “When modelled, the theoretical range of cost pass-through is found to be 80–150%, with few exceptions”.

¹⁷ A micro-business is any business or civil society organisation with fewer than 10 employees (or their full time equivalents).

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

<p>Basis of the review: [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review, or there could be a political commitment to review (PIR)];</p>
<p>Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]</p>
<p>Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]</p>
<p>Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured]</p>
<p>Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]</p>
<p>Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection of monitoring information for future policy review]</p>
<p>Reasons for not planning a review: [If there is no plan to do a PIR please provide reasons here]</p> <p>We do not propose to have a formal PIR, but we propose a lessons learned exercise 6 months after the transfer of functions (Oct 2014). Following the transfer the CAA will be required to share the results of compliance inspections and other compliance data with the Department, giving an insight into the effectiveness of the transferred regime on an ongoing basis. The Department will continue to work closely with the CAA, not least by providing the latest threat and risk analysis to enable the CAA to focus their compliance function appropriately. The CAA will continue to report to the DfT on the performance of its functions.</p>

ANNEX 2

The following specific impact tests apply to both policy options.

Statutory equality duties

Race

1. The proposals relate to all passengers, therefore we do not anticipate that these reforms will lead to:
 - Different consequences according to people's racial group;
 - People being affected differently according to their racial group in terms of access to a service, or the ability to take advantage of proposed opportunities;
 - Discrimination unlawfully, directly or indirectly, against people from some racial groups;
 - Different expectations of the policy from some racial groups;
 - Harmed relations between certain racial groups, for example because it is seen as favouring a particular group or denying opportunities to another; or
 - Damaged relations between any particular racial group (or groups) and the DfT.

Disability

2. The Disability Discrimination Act (DDA) 1995 now gives rights to disabled people in the area of access to goods, facilities and services. The proposals apply equally to all passengers, and so we do not anticipate any disadvantages or discrimination for disabled people, in line with this Act.

Gender

3. The proposals will apply to all passengers. Therefore, we do not anticipate that these reforms will lead to:
 - Different consequences according to people's gender;
 - People being affected differently according to their gender in terms of access to a service, or the ability to take advantage of proposed opportunities;
 - Discrimination unlawfully, directly or indirectly, against genders; or
 - Different expectations of the policy from between genders.

Competition

4. This Impact Assessment demonstrates the costs envisioned to be transferred from the taxpayer to the end-user. Costs would be passed on proportionately.

Small firms

5. Small business that currently fall under the auspices of the National Aviation Security Programme who are currently subject to inspection will continue to be inspected. It will be for the CAA to determine and specify how they will charge airports and airlines proportionately in accordance with the regulators' compliance code¹⁸. Regulators have a duty to have a regard to the need to be proportionate in their approach.

¹⁸ <http://www.berr.gov.uk/files/file45019.pdf>

6. Costs – It would be for the CAA to ensure that industry is charged proportionately for the regulatory service provided.

Greenhouse gas assessment

7. The aviation sector already has targets and policies in place to ensure it plays its part in helping to reduce greenhouse gas emissions and thus achieve the UK's climate change targets. These proposals do not affect such policies or targets, and more generally are not expected to affect the amount of greenhouse gas producing activity in the industry. We therefore do not anticipate any direct impact of these proposals on greenhouse gas emissions.

Wider environmental issues

8. There are two wider environmental issues relevant to the aviation sector as a whole: noise pollution and air quality. None of the proposals directly influences the overall level of activity in the industry, however, and so we do not anticipate any direct impact in these areas.

Social impacts

Health and well-being

9. None of the proposals are expected to have a direct impact on health. There is no potential for any of the proposals directly to affect wider determinants of health such as income or the environment, nor is there any potential for the proposals to affect relevant lifestyle related factors such as physical activity or diet. There is no anticipated impact on the demand for health and social care services.

Human rights

10. It is not anticipated that our proposals will have any human rights impacts.

Justice system

11. The proposed transfer will not create any new criminal offences and Ministry of Justice has assessed the impact of the proposal and considers that it will have a minimal impact on the justice system.

Rural proofing

12. We do not believe that any of the proposals will have a different impact on people in rural areas because of their particular circumstances or needs.

Sustainable development

11. Sustainable development entails the current generation satisfying its basic needs and enjoying an improving quality of life without compromising the position of future generations. The proposals do not affect the resources available to future generations, and are therefore compatible with sustainable development.