SUBMISSION TO THE PRODUCTIVITY COMMISSION REGULATORY INSTITUTIONS AND PRACTICES

INTRODUCTION

The Civil Aviation Authority welcomes the opportunity to comment on the Commission's draft report: Regulatory Institutions and Practices. The Commission has made a number of findings, recommendations and posed a number of questions in its draft report. The Authority's response is structured to align to those questions and recommendations posed in the draft report that it has a particular interest in.

GENERAL OBSERVATIONS

The CAA thinks there are many useful and constructive findings and recommendations contained in the Commission's draft report. In reviewing the report, the CAA is of the view the Commission needs to consider some additional issues, as follows:

- The Commission makes a number of findings and recommendations which are essentially focussed on performance monitoring of regulatory agencies being improved in order to drive improvements in regulatory performance and practice. In a sense, this means that the monitoring ministries and departments use their role to influence the behaviour of the regulatory agencies (whether within departments/ministries or as Crown entities). In-effect, those monitoring agencies are exercising a form of regulatory oversight over the regulatory agencies.

  It would be helpful if the Commission commented on the behaviours that the 'monitors' need to exhibit in order to: (a) encourage regulators to be more adaptive, learning and performance focussed; and (b) demonstrate that they are equally responsive to the changing nature of regulatory practice and/or regulatory environments.

- Part of New Zealand's credibility with respect to international trade in aviation services and products is dependent on the reputation it has for effective regulatory practice. While there is some reference to this issue in the draft report, for some sectors (for example aviation or biosecurity), further insight on how to strike the balance between international expectations and domestic regulatory preferences would be helpful, as these are not always aligned.

- Evaluating the effectiveness of a regulatory regimes is difficult, especially given the focus of a regime is often on long-term achievement. Development of guidance (by central agencies) that enables regulators to identify methods for evaluation of achievement would be very helpful, providing it is practicable and recognises the limitations of ascribing cause and effect to any specific action. Such guidance would also help determine ways of determining the efficiency of a regime and/or a regulatory entity.

- The Commission observes that monitoring agencies would benefit from deep sectoral understanding. The CAA is of the view that monitoring agencies would benefit from deep understanding of the regulatory scheme that the regulatory agencies it oversights are responsible for. Knowledge of a sector is useful, but unhelpful if that knowledge is used for 'second guessing' regulatory decisions as opposed to addressing questions of effectiveness.

- The CAA strongly supports the idea of communities of practice designed to build capability through the sharing of knowledge and experience. However, the CAA is mindful for such communities to work effectively they must not be monitored in such a way that turns them into compliance exercises. Forums (or whatever device is used to enable practice to be shared) need to be sufficiently 'safe' to enable regulatory practitioners to openly discuss the issues each faces (including with monitoring agencies).

- The CAA notes the role of the Treasury in monitoring a number of aspects about both the effectiveness of regulatory regimes, and their efficiency. However, the CAA is mindful that the Treasury will need to ensure it understands what each regulatory scheme is designed to achieve, and would encourage it to engage directly, on occasion, with the regulatory agencies to gain some first-hand insight as to what they do, how they do it and why. That will also help the Treasury assess whether monitoring agencies are performing their roles effectively, as well as whether the regime is actually working in terms of its intended design (not just economic analysis).

- The CAA notes the discussion about institutional form of regulators with interest. There are clear pros and cons for any institutional form. However, when considering the work of Black and others, ensuring that both regulations (their style and form) and the institutional form have a medium- to long-term focus seem to be critical factors to consider (and has parallels to the construct of fiscal responsibility).

Chapter 3 — Understanding the Regulatory System

The Commission has identified that a lack of regular and detailed reporting on the state of New Zealand regulators and regulation is a key gap in the current regulatory management system. It argues that the comparative lack of detailed information, viz say financial reporting, creates barriers to:

- Identifying and making systematic improvements in regulatory practice;

- Identifying trends with respect to the implementation of regulation and the performance of regulators;

- Helping identify better practice; and

- Helping designers of regulation compare and contrast regulatory approaches.

The Commission makes three recommendations, summarised here as:

1. Standardised reporting requirements for agency annual reports;

2. Treasury analysis of reporting data leading to a public report on trends/key features; and

3. Agencies not currently 'captured' by either the Public Finance or Crown Entity acts being engaged such that they each provide the standardised information.

The CAA is supportive of reporting frameworks that contain information and analysis that enable transparent disclosure about an organisations' performance with respect to its mission or task. However, we are cautious about the benefits of standardised measures or indicators which focus on little more than 'counts' of various types of transaction. In particular, we are of the view that the comparability of data that purports to reflect performance across the different types of regulators may be of little direct benefit and may cause regulatory agencies to focus on a narrow subset of performance measures rather than outcomes the regulatory scheme is designed to achieve.

The rationale for the CAA's position is as follows:

1. The indicators or measures selected need to be driven by the nature of the regulatory task the agency is established to perform, and in particular the intervention logic that is applied by the agency with respect to its regulatory task[1];

2. There is a reasonable body of evidence to support the construct that the best organisational results are often achieved by indirect means[2] meaning that the focus of performance reporting needs to support and reinforce the core business of the regulatory agency;

3. The indicators suggested by the Commission on pages 56 and 57 of the draft report, in particular with regard to effectiveness, responsiveness and burden of activity on regulated parties are unlikely to enable useful comparative analysis, as they are divorced from the nature of the regulatory task performed by an agency.

4. Existing reporting requirements appear to address many of the areas canvassed in the tables on pages 56 and 57 (if not in an agency's annual report, then in its Statement of Intent) — for example through the descriptive and quality, quantity and timeliness measures associated with the outputs and sub-outputs the agency delivers.

One example of the 3rd bullet point above relates to licences/approvals issued by different agencies. The data may enable some comparison of the volume of regulatory task (e.g., number of driver licences issued versus number and type of pilot licence). However, the volume regardless of type provides little information about effectiveness — that is whether the licensing regime ensures that those that are licenced exercise the privileges a licence confers to an acceptable standard. Focusing on 'count' data enables analysis that focusses on transactional characteristics as opposed to regulatory effectiveness and associated efficiency characteristics.

Another example relates to the burden of activity issue. In civil aviation, there are many rules for an aviator to follow. Those rules largely reflect the complexity of the task associated with various flying activities — and in some cases are very prescriptive. While that creates a burden on the regulated party, the question which cannot be adequately addressed by such a measure as the 'quantity of regulation' is whether that burden is reasonable given the risks associated with the nature of the activity being regulated. Another way of expressing the CAA's concern is this: unless consideration is taken of the 'complexity' being regulated (or the acceptable level of failure) simple measures of 'burden' are unlikely to yield useful comparative analysis.

Thus, to enable effective comparative analysis the CAA is of the view that information collected from regulatory agencies needs to be carefully contextualised, and that any subsequent analysis needs to adequately reflect the nature of the regulatory regime and its design (including the actual practice of the regulator). The CAA is also of the view that there needs to be a greater focus on understanding regulatory practice of the individual regulatory agencies rather than focussing on a series of measures that reflect regulatory transactions. The CAA is concerned, as stated elsewhere in the draft report (see page 113 with respect to some Executive Agencies in the United Kingdom), that common performance indicators could lead to the assessment of a regulatory agency's performance becoming focussed on narrow performance targets rather than the question of systemic effectiveness.

[1] (see Hatry, H.P., Performance Measurement: Getting Results, The Urban Institute, 1999)

[2] (see Kay, J., Obliquity: Why Our Best Results are Best Achieved Indirectly, Profile Books, 2010)

Chapter 4 — Role Clarity

The CAA agrees with the Commission's findings — in particular in relation to "deemed-to-comply" regimes and keeping the focus of a regulator clear and well defined.

The CAA is less convinced about the merits of separating rule-making from rule enforcement, particularly in regimes which become technologically more complex and diverse with rapid pace of change. We note the Commission's comments at finding F4.6 — that there are other options that may provide equivalent benefits with respect to lower/minimised costs and disruption.

We note that the submission by Aviation NZ observes that the clarity of role associated with the Civil Aviation Act may not be as clear as desirable; indeed that objective/purpose was eroded by amendments made in 2004. We are mindful that the Civil Aviation Act embodies several regulatory regimes: safety and security regulation, and economic regulation; and attempts to provide an overarching statement of what those regimes are designed to contribute to and achieve.

With respect to the purpose and function of the Civil Aviation Authority and the regulatory regime the Authority is responsible for, we are of the view that purpose is clear and unambiguous.

From the "outside looking in" the separation of roles between the economic regulator (the Ministry of Transport) and safety and security regulator (the CAA) may be less than obvious — especially when a safety regulatory activity has clear economic impacts (and vice-a-versa). The inter-relationship between regulatory regimes can become complex, making the "collective purpose of a set of regimes" more difficult to describe. Specifically, the way in which safety and security outcomes contribute to the overarching Act purpose/goal may be obscure in the minds of some. That does not mean that the roles of the regulatory agencies are confused or poorly defined — rather, it places an obligation on the agencies to articulate their respective roles and paint a picture as to how the parts fit together and in turn contribute to outcomes (either for the regulated parties or with respect to the whole regulatory regime).

The Commission makes two recommendations. The CAA is supportive of both.

Chapter 5 — Regulatory Independence and Institutional Form

The CAA agrees with the majority of the Commission's findings.

With respect to the Commission's recommendations, the CAA is broadly supportive of the recommendations, in so far as a Crown Agency can comment on the issues discussed in the Commission's draft report.

Chapter 6 — Governance and Decision Rights

The CAA notes the Commission's comments on the potential benefits of mixed-member decision-making models in comparison to single decision-maker models. In some cases, where technically complex decisions need to be made, the CAA can see advantages in single member decision-making. For the sake of clarity, the CAA is using the phrase 'technically complex' to describe things which are either technologically based or system focussed.

In support of the CAA's view that in some cases, a single decision-maker is better placed to make decisions we note the advice of Sir Kenneth Keith in a report he made to Cabinet in 1991. He highlighted the following when reporting on the constitutional aspects of civil aviation authorities:

1. The Authority has an independent function that must always be seen to be implemented in an independent manner;

2. Several of the Authority's functions involve judgements about particular people, things and situations;

3. Such functions are normally exercised by independent experts who are not subject to any specific control by Ministers or others who are ordinarily superior to them in an administrative hierarchy;

4. The power [associated with the functions] should be exercised following proper process and independently by the responsible person, and subject to rights of appeal; and

5. There need to be appropriate arrangements deployed to maintain public confidence in the decision-making process [used by the independent expert].

In the context of the current Civil Aviation Act, the Director has a number of functions vested in him/her. These functions are independent and exercised on a case-by-case basis.

The Director is also the Chief Executive of the Authority. Through this role, the Chief Executive is accountable to the Authority (the Board) for the management of the organisation. The Board has the ability to set direction and policy and to hold the Chief Executive to account for adherence to both.

With respect to the Director's independent functions and powers, the Board cannot interfere in the case-by-case decision-making associated with the exercise of those powers. The Board can, however, determine policy and procedure that the Director must give effect to when exercising his/her independent powers and functions. However, in setting policy and procedure, the Board needs to be mindful that it cannot set either in such a way that could be seen to interfere or constrain the Directors independent decision-making. The focus of policy is thus on elements of 'how' decisions are made and assurance that policy is being followed.

The CAA also accepts that there are clear merits with mixed-member decision-making processes, but suggests that the critical issue to consider is the nature of the decisions being made. Where those decisions are dependent on technical understanding (e.g. of technology or complex systems, etc.), then there is merit in using single-member decision-making models with appropriate accountability and governance frameworks.

Chapter 7 — Regulator Culture and Leadership

The CAA has, over recent years, been undertaking a 'change programme' to address a number of issues identified by the Office of the Auditor General about its performance and capability and capacity. Central to that programme is work focussed on the behaviours of its people, and thus the nature of its regulatory practice. Critically, the Board of the CAA initiated the change programme — it has been led from the top of the organisation. With this experience in mind, the CAA is in strong agreement with finding F7.3 — analysis of the cultural and/or institutional factors that impact on an organisations' performance is crucial for it evolve.

Further, given the CAA's experience to date with its change programme, the following observations are made in relation to culture and leadership issues.

The Commission comments on the risk adversity of many regulators (finding F7.6). In the CAA's view, this is hardly surprising. Most regulators exist to prevent some form of harm. An effective mechanism for mitigating harm is the careful, sometimes slavish, management of risk. Keeping that cultural norm in mind and thinking within a broader government context, the benefits of a proposed change to a regulation need to clearly outweigh the costs and be worth the risk. Thus, the government environment regulators work within reinforces the very characteristic that regulators generally rely on to mitigate/manage harms irrespective of whether they display a learning culture or not.

Further, political or public appetite for regulatory failure is extremely low as the consequences are often simply not tolerable. A learning culture goes someway to helping a regulatory agency evolve and change (and hopefully avoid regulatory failure). However, meaningful change will only be introduced and sustained if there is a high degree of internal and external confidence that the proposed change is likely to result in a positive outcome. To this end, the CAA based on its experience, concurs with the Commission's finding F7.7.

The Commission also comments that many front-line staff in regulatory agencies are critical of poor communication from senior managers about an agency's mission. In some cases the CAA would suggest this is because most workers in regulatory organisations are vocationally driven — they believe in a cause. Alignment of the individuals cause to the organisations mission may not always be as strong as desired. The internal communication within the regulator may be appropriate and may also challenge the employee's view of the 'mission' — and may well result in disgruntlement or weak alignment. If an organisation is going through significant change to re-align itself in some way, no matter how clearly the messages are communicated, the willingness to listen may be constrained. None of this takes away from the need for open and clear communication.

Monitoring agencies play an important role with respect to how cultures within regulatory agencies develop and evolve. To help encourage constructive cultures within regulatory agencies monitoring/oversight agencies need a deep understanding of the purpose, design and operation of the regulatory system that is in place (or is being put in place). If their understanding is insufficient, they can undermine those constructive cultures through the most innocent of actions.

Chapter 10 — Decision Review

The CAA agrees with the Commission's recommendations, in particular R10.2.

Chapter 11 — Regulator Practice

The CAA generally agrees with the Commission's findings about the challenges of putting in place new regulatory regimes, or implementing new regulatory styles or practice (e.g., risk-based regulation).

Our experience, to date, with respect to examining forms of risk-based regulation for civil aviation is that many of the biggest challenges associated with implementation sit within the regulator in the first instance. In summary, those challenges are that the regulator:

1. Needs to equip itself to be able to understand operational risk; then
2. Identify those operational risks that are least acceptable; then
3. Target resources on addressing the things that give rise to the identified risks; then
4. Evaluate whether its actions have mitigated or managed the risk; and
5. Apply what it has learnt to changing its systems and processes.

In other words, risk-based regulation requires a regulator to become a dynamic entity that not only learns, but actively changes. And while doing that, it also needs to be able to engage with the regulated parties to encourage and support them to develop and implement systems that reflect the regulatory regime.

The catch with rapidly changing forms of regulatory practice is that regulators are not expected to fail. Failure may result in death, injury or serious loss — none of which is publicly or politically acceptable. Yet, introducing new regulatory paradigms carries with it a fundamental risk, and that is that an issue or problem will not be identified and a resulting harm will occur (or get close to occurring) — and this is despite all systems and processes being designed to minimise the probability of that occurring.

More specifically, risk-based regulation is one means of targeting resources. It is also a means of dealing with increasing complexity. It requires a significant change in the type of resources used by a regulator (e.g., more analytical capability, more information accessibility). The need to develop new types of capability brings with it risk of regulatory failure during the transition from one approach to another. Yet, often risk-based regulation is considered predominantly as a means of enhancing regulatory efficiencies on the premise that resources can be rationally targeted to most pressing problem.

The Commission observes that regulators are perceived as not being attentive to learning from mistakes and successes, being inflexible, not taking the opportunity to improve performance, etc.. The CAA, based on its

past experience, is perhaps an example of a regulator that did not easily or willingly adapt to change nor learn from its mistakes, nor examine/evaluate its performance. None of these things are easy to when your focus is largely on the day-to-day business of being a regulator — and in particular when various of the monitoring agencies are perceived to focussed on your day-to-day regulatory practice. Further, to willingly acknowledge were things are not working as well as they might requires an environment that is open and supportive. If a regulator is to become a learning entity, then the monitoring agencies need to allow it to learn. Put simply, if a regulator identifies something that it needs to change, there needs to be sufficient open-mindedness from the monitoring agencies to enable the regulator to have that discussion safely. Likewise, regulators need to be open to learning from the insights of others. Indeed, Braithwaite's nine heuristics[3] apply equally to monitoring departments and ministries (as well as regulators) when seeking to create a learning environment for regulatory agencies, and encouraging agencies to adapt to changing environments and expectations.

In principle, the CAA supports the Commission recommendation R11.1. However, forums and networks will not achieve the desired results if they have too strong an element of compliance attached to them (e.g., monitoring of attendance). Monitoring attendance creates a risk of the community of practice degenerating into a compliance exercise. The CAA is of the view that monitoring agencies ought to turn their minds to how to encourage Crown entities to actively engage. Simply measuring presence may stifle the benefits of open and active discussion between all agencies (including the monitoring departments or ministries who need to build deep knowledge and understanding).

The CAA is supportive of recommendation R11.2, as guidance material which has relevance and practical application for regulators would be useful. However, the CAA is equally mindful that the utility value of such material is highly dependent on it having relevance to the regulatory domain a regulatory agency is responsible for. To this end, forums (as suggested in R11.1) and making overseas experts available to all regulatory agencies (ministries, departments and Crown agents) when they are in country may have significantly greater value and benefit. Our perception is at the moment that Crown agencies are often included (unless at the last minute) in various of the Departmental and Ministry forums that are used.

Chapter 12 — Workforce Capability

The CAA agrees with the findings F12.1 to F12.3. Regulators need a mix of competencies and know-how allied with technical knowledge and regulatory practice to effectively discharge their functions. These competencies are dynamic — they will change as the regulated sector and as regulatory practice evolve

The Common Compliance Framework has gone some way to codify elements of the core or common competencies one might expect to find in staff holding regulatory roles. However, the CAA is also mindful that aspects of regulatory practice are rapidly evolving (e.g., the moves to risk-based regulatory systems). Competencies that are rooted in older systems and approaches will have increasingly less relevance in the future. Thus forums, which enable ideas and approaches to be shared, are strongly supported by the CAA. Such forums though should not simply be confined to those who 'regulate'. Forums need to include those who oversight the regulators and allow new ideas to be introduced, new expectations to be outlined, and the impacts assessed and better understood. This type of comprehensive approach may assist in identifying and preparing for new regulatory competencies required in the future.

The CAA is of the view that the Compliance Common Capability Programme (CCCP) has merits. However, the CAA is concerned that a significant number of regulatory agencies are not engaged with the CCCP, and that it may be unable to provide support in a way that is suitably nuanced to individual regulators needs and requirements. To that end, the CAA is strongly supports recommendation R12.2, and suggests that the CCCP

[3] Braithwaite, J: Fasken Lecture: The Essence of Responsive Regulation (delivered 21 September 2010), University of British Columbia Law Review, Vol 44:3, page 479, 2011

needs to actively engage with as many regulatory agencies as practicable. However, there needs to be some care taken that the CCCP does not take on the responsibilities and accountabilities of each regulatory agency with respect to ensuring that that the agency's people are appropriately skilled to discharge their roles, or the agency's preferred means of "filling competency gaps" in a way that reinforces desired organisational culture.

The CAA is of the view that recommendation R12.6 has merit. Reflecting on the CAA's own journey over the last five years, a significant issue has been (and is) ensuring that its people are sufficiently skilled and competent to discharge the breadth of their roles. Often, this means building their knowledge of regulatory practice and finding ways to combine that knowledge with the technical knowledge each brings to their role. As new regulatory approaches come in to vogue (e.g., risk based regulation), this requirement in-effect increases. Performance-improvement-framework approaches will have some benefit. However, the CAA would suggest that if monitoring agencies are discharging their role effectively, and working well with the regulatory agency, competency issues should be identified well in advance of them becoming problems. In this context, the impost of specific reviews (as suggested in R12.6) needs to be considered with care.

Chapter 13 — Funding Regulators

The CAA completed a review of its funding arrangements in 2012 which Government made a number of decisions about. The CAA recovers most of the costs of its oversight operations from direct hourly charges or from levies. As the Commission observes, the direct recovery of the cost of specific regulatory activities can and does create a number of issues that require careful management. These include the issue identified by the Commission on page 320 and 321 of the draft report and also:

- The use of interventions for which there is a direct cost recovery, in lieu of the use of other interventions that may be more appropriate, because of the regulatory agency's revenue needs;

- Lighter use of interventions for which there is a direct cost recovery because of the impost on regulated parties is perceived to be in conflict with other goals (e.g., minimisation of regulatory costs);

- Lighter use of interventions for which there is a direct cost recovery of cost because regulatory staff are asked to justify the costs being incurred by the regulated party; and

- The views of some that regulatory activities should be delivered through contestable models (e.g., multiply suppliers of regulatory services, creating price pressure on the service providers).

Accordingly, the CAA strongly supports the Commission's finding F13.2.

The CAA also agrees with the intention of F13.5. However, a strong focus on the cost of the provision of regulatory activities needs to be contextualised by the nature of the harms prevented by the regime, the public interest, and in the case of aviation the credibility of NZ's regulatory systems when assessed or evaluated by other jurisdictions. In essence, the CAA's position is that efficiency measures/indicators need to be determined in conjunction with effectiveness measures/indicators. Either evaluated in isolation will lead to perverse conclusions.

With respect to Recommendations R13.2, the CAA is of the view that the role of the monitoring agency needs to be carefully spelt out with regard to the guidelines and processes followed by crown agents when setting when setting fees, charges and levies. Without their role being clarified, the recommendation could create confusion and significant tension between the regulatory agency and the monitoring agency. Further, for those regulators who sit within ministries or departments, a different mechanism may be required to give effect to the Commission's recommendation.

Chapter 14 — Accountability and Performance Monitoring

The CAA agrees that there is a need to sharpen performance monitoring and assessment and accountability arrangements. In particular, the CAA supports the Commission's recommendation R14.3 — monitoring agencies developing and maintaining explicit and consistent statements about their monitoring roles.

However, with respect to the other recommendations made by the Commission, the CAA is less supportive. In particular, the CAA is of the view that recommendation:

- R14.1 has merit, and would be enhanced by those guidelines being available to Crown entities. However, the CAA also believes that the monitoring agency needs to demonstrate a deep understanding of the regulatory regime the Crown agency is responsible for, as much as deep sectoral knowledge in order to understand the regulators operating environment.

- R14.2 has merit, although in the CAA's view the utility and practicality of common performance measures needs testing, as simple transactional measures will not give the depth of insight the Commission appears to be driving at.

The CAA is also thinks the roles of Boards in relation to their reporting obligations to, and relationships with, accountable Minister's needs to be clarified. The risk the CAA currently sees is that there are multiple accountability and performance assessment mechanisms in place for Crown entities, all of which are seeking to provide forms of assurance or insight about actual performance. However, those mechanisms are not necessarily aligned, and consequently have the potential to drive significant compliance costs or perverse behaviours. In refining both performance measures and accountability systems, a systematic examination of how the 'parts' fit together in terms of institutional design would be helpful; in particular with respect to clarifying roles and expectations.

Chapter 15 — System-wide Regulatory Review

The CAA is in general agreement with the finding F15.1, and with the general thrust of the recommendations. However, the CAA would observe as much as competencies from an economics or legal perspective are required to achieve the recommendations, so are competencies around regulatory practice.