

AIRPORT AND AIRWAY TRUST FUND TAXES

HEARING
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED FIFTH CONGRESS
FIRST SESSION

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FEBRUARY 4, 1997
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AIRPORT AND AIRWAY TRUST FUND TAXES

TUESDAY, FEBRUARY 4, 1997

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:45 a.m., in room SD-215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Chafee, Grassley, D'Amato, Gramm, Moynihan, Baucus, Breaux, Conrad, Moseley-Braun, Graham, Bryan, and Kerrey.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please come to order. This morning we will open an important hearing concerning the Airport and Airway Trust Fund taxes. This is an important trust fund that helps pay for FAA operations, such as air traffic controllers and airport improvements.

Currently, there is considerable controversy over the appropriate way to support the Airport Trust Fund. Between the Administration, Congress, and the airline industry itself there are several ideas, and a commission has been established, in part, to evaluate the best way to coordinate funding sources. Its final report is due to the Congress in October of this year.

There is no doubt that the long-term financing of the trust fund must be addressed. The trust fund must be supported in a manner that allows it to carry out its mission. At the same time, the necessary revenue should be raised in a way that is fair to the passengers and to the companies competing in the commercial air transportation industry.

In our hearing today we want to explore the various positions. We will hear from the Treasury Department, the Department of Transportation, the General Accounting Office, and representatives from the airline industry. We will also hear from our distinguished colleague and chairman of the Senate Commerce Committee, Senator John McCain.

One of the items that I would like the Treasury and the DOT to address concerns a technical problem discovered while preparing for this hearing. It has come to our attention that the Treasury erroneously credited money to the Airport Trust Fund that, in fact, has not yet been deposited.

What this means, is that the trust fund is much smaller than previously thought, and the fact that the airlines are to deposit most of the ticket taxes on February 28 does not help.

That is because the authority for these funds to be transferred to the trust fund when they are deposited died last year, with the expiration of the tax.

Since the testimony of the DOT and the Treasury which is to be given this morning confirms the emergency nature of the recently discovered trust fund shortfall, I plan to bring legislation before this committee, possibly as early as tomorrow.

At this time I would like to call on my distinguished friend and chairman, Senator McCain.

STATEMENT OF HON. JOHN McCAIN, A U.S. SENATOR FROM ARIZONA

Senator MCCAIN. Thank you very much, Mr. Chairman and members of the committee. I have a full statement that I would ask be made part of the record, and I will be very brief, as I know the committee's time is limited.

Mr. Chairman, as chairman of the Commerce, Science and Transportation Committee, I have oversight responsibilities of aviation, amongst other responsibilities in that committee.

We are now in a situation where much-needed funding for the modernization of the air traffic control system, airport grant payments, and others is in jeopardy. Most critically and most vitally, Mr. Chairman, the programs to improve airport safety and aviation safety that were enacted as part of the law in the last part of last year's session are now in jeopardy.

We have no greater responsibility than to take whatever measures necessary to ensure the safety of the flying public. As we speak, that is in danger. To allow this ticket tax to lapse twice, as it did last year, in my view is an abrogation of our responsibilities of incredible proportions.

I strongly urge this committee to re-authorize the ticket tax immediately so that we can provide this much-needed funding, and I strongly urge that this be done in a fashion that it does not run out again this year.

As we know, as a result of legislation passed last year, there will be recommendations coming forward from a commission as to how we can best and most fairly apportion the costs associated with funding aviation in this Nation.

I thank the Chairman, and I thank the committee.

[The prepared statement of Senator McCain appears in the appendix.]

The CHAIRMAN. Thank you, Senator McCain.

Before I call upon you, Senator Moynihan, and I appreciate your waiting until now to make your opening remarks, I would point out that the committee was advised that the trust funds were adequate until next July. It is this recent error that has created a situation that we all agree should be addressed immediately, in a bipartisan fashion.

Senator Moynihan.

**OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN,
A U.S. SENATOR FROM NEW YORK**

Senator MOYNIHAN. Mr. Chairman, I wholly concur in your observation. I hope we can do this promptly and on a nonpartisan basis. There is nothing in the least partisan about this issue. It is urgent.

It will require, I think, that the committee, both here and in the House—but we are the ones that have the greater difficulty—ask that this tax bill, which it is, go to the floor and be enacted as it is sent, and not made a target of opportunity for anything anyone else has in mind. It certainly will be our effort, on our side, to cooperate with you completely.

I have a statement I would like to place in the record, and proceed. I am looking forward to hearing Donald Lubick, who will, perhaps, explain some of this. I find it both compelling and confusing.

[The prepared statement of Senator Moynihan appears in the appendix.]

The CHAIRMAN. Senator Moynihan, I have just received a letter from the Secretary of the Treasury, asking for our assistance in securing an immediate extension of the Treasury Department's authority to transfer receipts of aviation excise taxes from the general fund to the Airport and Airway Trust Fund, as well as a short-term reinstatement of the taxes dedicated to the trust fund. As I indicated, and as you have also stated, we intend to do this as expeditiously as possible in a unanimous fashion, hopefully without amendment.

Senator MOYNIHAN. Exactly so, sir.

The CHAIRMAN. At this time I would like to call upon Hon. Donald C. Lubick, Acting Assistant Secretary, Tax Policy, Department of the Treasury, and Ms. Louise Stoll, Assistant Secretary for Budget and Programs, and Chief Financial Officer, Department of Transportation, Washington, DC, if you please would come forward.

Senator CHAFEE. Mr. Chairman, while they are coming to the table I would like to join in the welcoming back of Don Lubick. He was here in the early 1980's. I guess it was 1981, was it, Don, you were here?

Mr. LUBICK. That is when I left, Senator.

Senator CHAFEE. You left in 1981, and came in the late 1970's.

Mr. LUBICK. Right.

Senator CHAFEE. So we have had the experience and pleasure of working with Mr. Lubick in exactly the same position that he is now acting in. I hope whatever we can do to confirm you will take place quickly. But, in any event, we are glad to see you back.

Mr. LUBICK. Thank you very much.

Senator MOYNIHAN. Mr. Chairman, may I join in that remark, and say we would particularly welcome receiving his nomination from the President. He has been working at the job for 6 months, at least.

Mr. LUBICK. It has been a pleasure, Senator, not work.

The CHAIRMAN. Well, it is a pleasure to welcome both of you here. Mr. Acting Assistant Secretary, would you begin with your testimony.

STATEMENT OF HON. DONALD C. LUBICK, ACTING ASSISTANT SECRETARY (TAX POLICY), DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. LUBICK. Mr. Chairman and members of the committee, thank you for inviting me here to represent the Treasury Department on issues involving the Airport and Airways Trust Fund.

In your letter of invitation you requested our views on several aspects of the aviation excise taxes, including their structure, the revenues raised, administrative problems, and proposals for alternative systems.

These issues we have addressed in our written testimony for the record and, with your permission, I would like to focus my oral testimony on the two important issues that have been raised by Senator Moynihan and Senator McCain, and to associate the Department and the Administration with the recommendations that they have made.

The first of these issues, is the fixing of the technical excise tax defect in law that denies us authority to pay to the trust fund amounts of tax that we have collected for the trust fund, or are about to collect, on account of travel during the period for which the tax applied, but which will not have been received until after the lapse of the tax.

We have the money. If we do not get the authority, it will have to remain in the general fund and will not be useable for the purpose for which it was assessed and paid. It appears at the present time that our disability to match collections with the purpose of collection is about \$1.2 billion.

The second question I would like to address is the question of renewal of the lapsed taxes temporarily through late September so that the operations, funding, and planning of improvements of the airway and airways system can continue as planned for the balance of this fiscal year. In the meantime, we would hope to work with you to plan appropriate long-range funding of these activities.

Let me deal, first, with the first question. The aviation excise taxes lapsed at the end of December, 1996, more than a year ago. They were renewed temporarily, from late August 1996 until the end of 1996, when they lapsed again.

The tax liabilities imposed for the renewal period, the last third of 1996, include about \$1.4 billion, which the Treasury Department paid over to the trust fund during 1996 on an estimated basis.

Excise taxes are deposited in a total pool from many, many different excise taxes, the highway taxes, as well as the aviation taxes and others. Our estimators at the Treasury Department try to guess, on the basis of experience, what portion of those deposits should be paid over to the trust fund and payments are authorized to be made on that basis.

Now, unbeknownst to the Treasury, the airlines were not paying over \$1.2 billion of their collections to the IRS as they were being collected in 1996. Instead, they were relying upon a regulation procedure that allowed them to make current payments based upon their experience-related liability in the second previous calendar quarter. Then a final reckoning is made after the close of the quarter.

Because the taxes lapsed after 1996, during the first two quarters of 1996 the base period for current payment gave the airlines a zero base, practically, for current payment.

The airlines consulted with the Internal Revenue Service attorneys on the reading of the regulation and received confirmation of their interpretation that their requirement to pay currently was essentially zero.

Unfortunately, no one communicated the fact that no current payments were being made to higher authorities in the IRS or to us so that we could have considered an amended procedure so that at least some, but not all, of the \$1.2 billion could have been required to have been paid currently.

The receipts from excise taxes other than the aviation taxes turned out to be higher than we had forecast, so while the aviation receipts were not coming in, the shortfall was masked by the fact that other excise taxes swelled the pool to a range that was within our normal expectations. So we had no way to notice this shortfall in the current payments.

We are, therefore, required to reverse the \$1.2 billion which we authorized because it was based upon no collection at all, and, therefore, we have taken steps to recapture from the trust fund the \$1.2 billion which was paid over.

Now the airlines are depositing the \$1.2 billion, and because of the technical glitch in the statute terminating our authority to restore it to the trust fund because the tax has lapsed, we cannot place those funds in the situation that they were designed to be. So, our first request is to give us that authority.

I might note that this glitch exists, not only with respect to aviation taxes, but with respect to the Highway Trust Fund too. But, with respect to the more recent trust funds, Congress has done it correctly and has authorized the payment of after-collected taxes, even in the case of lapsed taxes, to their respective trust funds.

Now, the second question. That involves the state of finances of the FAA, generally. My colleague, of course, from the Department of Transportation can speak to the details of the finances available.

In general, however, the funds are sufficient to continue operations—security, controllers, other personnel—to keep the airport system functioning for the balance of fiscal 1997. But to do so will require an earlier termination of capital programs that are designed to improve airports and the airway systems in every part of the country.

These programs are vital to the safety and efficiency of the airways system. They include such items as replacing antiquated radar, de-icing facilities, state-of-the-art explosive detection systems, and wind shear detection equipment. If we are not authorized to pay the \$1.2 billion back to the trust fund, money which we have sitting in the general fund, these programs will cease in March.

But that is not the worst of it. Notifications to terminate projects under way will have to commence virtually immediately under various contract notification requirements which the FAA can address.

If the \$1.2 billion is restored, the end day will be averted for some time. I am not sure precisely what time, certainly until summer, and with reduced expenditures, perhaps somewhat longer.

But, in any event, planning will still be thrown into damaging uncertainty with extra costs as a result of that.

We do want to work with you to achieve a permanent and fair financing of the airways and airports of the country. To do so is going to require time. The FAA Reauthorization Act of 1996 creates a National Civil Aviation Review Commission to study how best to finance the FAA in light of funding needs and systems costs.

In addition, by October of this year the Secretary of Transportation, after consultation with the Treasury Department, is required to provide Congress with the Administration's recommendations for funding the aviation system through 2002.

In the meantime, we think that it is important for prudent progress of the improvement of the airway system that there be a temporary reinstatement of the lapsed system until late September so that the safety and efficient operation of the system can proceed as planned, while these discussions continue without the need for undue haste because of the threat of breakdown.

I believe that addresses the two principal questions of immediate concern, and I will be happy to answer any questions that you may have.

[The prepared statement of Assistant Secretary Lubick appears in the appendix.]

The CHAIRMAN. I think, first, we will hear from Ms. Stoll. Then we will question both of you.

Ms. Stoll.

STATEMENT OF HON. LOUISE STOLL, ASSISTANT SECRETARY FOR BUDGET AND PROGRAMS AND CHIEF FINANCIAL OFFICER, DEPARTMENT OF TRANSPORTATION, WASHINGTON, DC; ACCOMPANIED BY MONTE R. BELGER, ACTING DEPUTY ADMINISTRATOR, FEDERAL AVIATION ADMINISTRATION

Ms. STOLL. I thank you, Mr. Chairman. I would like to thank Mr. Lubick for laying out, in a very precise and direct fashion, the problem, much as we see it as well.

I welcome the opportunity to appear before you today. You had asked us to discuss three issues, in your letter: the Airport and Airway Trust Fund balance; the Federal Aviation Administration cost allocation; and the long-term funding mechanisms for the FAA.

Joining me today is Monte Belger, the Acting Deputy Administrator of the FAA. We very much appreciate your timely decision to hold this hearing because, as you have already heard and I am sure you already know, it is essential that Congress does act promptly to renew the aviation excise taxes in order to prevent an unacceptable funding condition in aviation, which we all know is one of the country's most significant industries.

For nearly three decades, the FAA has been funded largely by aviation excise taxes through the Aviation Trust Fund. These include partial funding for the FAA operations and full funding for the facilities and equipment, airport grants, and research.

Those taxes, as you know, lapsed on the 31st of December last year. We are asking this committee to support full-term renewal as promptly as possible and to include the authority necessary to transfer the taxes that will be paid in January and February into the trust fund.

Every day that taxes are not collected results in a loss of approximately \$20 million in revenue to the trust fund, close to \$600 million a month.

We had previously projected that at the current rate of spending the uncommitted balance in the trust fund would have been depleted around the 1st of July. However, having recently learned that the revenue collected through December 1996 will not be transferred to the trust fund without the change in legislative authority, we have a problem.

At this time, the uncommitted balance in the trust fund is just under \$2 billion, \$1.9 billion. That is what we have left for the remainder of the fiscal year 1997. Funds for the FAA capital programs will be depleted in March at the current obligation rates.

Unless we act promptly to reinstate the taxes, the impact on the FAA and, as Mr. Lubick has said, particularly its capital programs, will be imminent and severe. In light of the situation, it obviously is incumbent upon us to carefully consider our options with the goal of moving forward in a manner that is both prudent and responsible.

Let me elaborate. \$5.3 billion of FAA's fiscal year 1997 appropriation of the \$8.6 billion was to come from the trust fund and the remainder from the general fund. The uncommitted trust fund balance for fiscal year 1997 was \$3 billion, and \$1.1 billion had been obligated by January 31st of this year, leaving, as I said earlier, an uncommitted balance of \$1.9 billion in the trust fund.

If we are to live within the trust fund limits and retain our air traffic controllers, its regulatory, safety, and security staffs through the end of the fiscal year absent the reinstatement of the ticket tax, we do have to begin to take action in the near future to curtail other expenditures.

We have decided to dedicate the remaining uncommitted funds to pay for these essential operations of running the air traffic control system until the fiscal year end, and to drastically reduce the agency's capital accounts in order to make that possible.

Dedicating funds for the regulatory, safety, and security staffs leaves only \$500 million available for the FAA capital programs for the remainder of the year, such things as airport safety and security improvement grants, safety and security equipment purchases, and research efforts.

The amounts which programs normally obligate in 2 months is all that we have to carry us through to the end of the fiscal year, and that means severe limitations on new obligations, airport improvement grants would be halted, and existing contracts all need to be reviewed to determine whether work stop notices must be issued.

We are aware that the results of this option are painful, but because our operational functions are a first priority we have no choice but to begin to plan in this direction. We would have to prepare to take some steps almost immediately. Interrupting the funding of FAA's capital programs, of course, also has repercussions beyond the FAA, much like a ripple effect.

Direct benefits provide for millions of people who rely on air travel each year. That would be interrupted. But so will aviation and related industries, which contribute almost 6 percent of our

gross domestic product and employ nearly nine million people in this country.

So we are here today to underscore the case. My role was to let you know how difficult it would be were we to have to continue. In my written testimony submitted to you for the record, we have covered the question of long-term user fees and cost allocations, which are not the subject directly before us today.

I thank you.

[The prepared statement of Assistant Secretary Stoll appears in the appendix.]

The CHAIRMAN. Well, thank you, Ms. Stoll. Let me welcome Mr. Belger, who is the Acting Deputy Administrator of the FAA. It is a pleasure to have you here as well.

As I indicated earlier, we were, of course, advised last year that the extension would provide adequate funds until July. What you are saying today, is the sooner action can be taken, from your standpoint, the better, because of the error that was made.

I do not have to tell you, Mr. Lubick, how difficult it is to get a clean bill through the Senate, but I think that is something we are going to have to attempt to do. My question, both to you, Mr. Lubick, and to you, Ms. Stoll, is we will need yours and the Administration's very active support in helping us to get this legislation through promptly on a unanimous consent basis.

Mr. LUBICK. We do support that, Mr. Chairman. Of course, I note that there is very likely to be other opportunities for tax legislation this year.

Mr. STOLL. I concur.

The CHAIRMAN. Let me turn, now, to what the basic purpose of this hearing is today, to consider where we go in the long-term financing of the Airport Trust Fund.

Both of you, I know, are familiar with the so-called coalition's proposal to replace the ticket tax with a multiple tax system. Would you please comment on the proposal, both from the standpoint of its content, from the standpoint of its administration, and what kind of impact you see it having on domestic competition.

Mr. STOLL. I would just like to begin by saying that the Congress established a commission, the Civil Aviation Review Commission, and the purpose of that commission is to examine the full range of financial requirements for the FAA and to propose, based on independent study—which is in the process of getting done now—a proposal for the long-term funding of the Federal Aviation Administration and the air traffic control system.

As a consequence of that, we are concerned at this time in trying to jump in and preempt what the results of that might be, or where it ought to go. We know that there will be public hearings, we know there will be great consultation with you, there will be consultation also with the Department of Transportation with this commission.

We expect a report to us by, I guess, 6 months after the independent study is reviewed, and the Secretary will be reviewing that and sending his recommendations as well to the Congress by the end of the fiscal year.

We believe we need a stable, and reliable, and long-term means of funding the FAA, and that there are alternative means of doing

this, of which the coalition was just one. We were concerned that there be equity in the industry, and that, for the FAA, it is a stable source of funding to meet the growing needs.

The CHAIRMAN. Do you have any comment as to the coalition's proposal on competition?

Mr. STOLL. We are concerned that competition be maintained, but we have not taken a position, per se, on it.

The CHAIRMAN. Now, I am aware that the FAA contracted with GRA, Incorporated, to conduct a cost allocation study which has never been publicly released. I am also aware that this study was made available to Coopers & Lybrand, the accounting firm that is conducting the independent assessment of the FAA costs, as required by the FAA Reauthorization Act of last year.

Does either of these studies provide the information necessary to assist Congress in determining if the ticket tax fairly allocates system costs among the coalition airlines and their low-cost competition, such as Southwest?

Mr. STOLL. The initial GRA cost allocation study never came to conclusion. The material that had been developed went to Coopers & Lybrand. The report from Coopers & Lybrand is due at the end of this month, and we have not seen drafts of it at this time. So I am afraid, Mr. Chairman, I cannot answer the question.

The CHAIRMAN. You are asking for a short-term extension, until September 30. The commission's report is not due until October. It is questionable how fast we will be able to get Congress to act. Do you have any suggestions for the interim period between now and when Congress does act?

Mr. STOLL. I think this would depend on when Congress would act. We have the funds at this point, assuming that transferability into the trust fund is approved, to carry forward as we had proposed the air traffic control operations of the Government, and some portion of the capital program to move forward.

If the taxes are extended as well, this would result in a balance in the trust fund which would be sufficient for us to complete this fiscal year, and have some balance to move into the coming fiscal year.

Mr. LUBICK. Mr. Chairman, we urge an extension through late September, and then we should consider where we are as to continuance after the budget reconciliation process emerges more clearly.

The CHAIRMAN. In other words, if we take prompt action on extending the ticket tax until the end of the fiscal year, September 30, plus giving the authority to transfer from the general funds to the trust fund, that will make you whole again.

Mr. LUBICK. That should allow us to proceed for a considerable period, because if the taxes are collected basically through the third quarter of this calendar year—

The CHAIRMAN. And really put into the trust fund.

Mr. LUBICK. Yes. I would suggest, while you were at it, if you made the provisions for authorizing payment of dedicated funds over on the same basis as you have in the later trust funds, that is, regardless of whether a tax happens to lapse or not, that this sort of situation could not recur.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, on the basis of what we have heard from our respected Assistant Secretary and Ms. Stoll, I think, even so, this is quite a tale you tell. If this were a court, I think the IRS would be sentenced for the remainder of this fiscal year to be especially nice to other taxpayers. [Laughter.]

Mr. LUBICK. The IRS is always trying to be nice to all taxpayers, Senator.

Senator MOYNIHAN. They certainly were nice to the airlines. They told them, do not bother to pay this tax; we will not notice if we do not get it.

Mr. LUBICK. Well, that is not quite true. The taxes are due and payable, and they have been, or are about to be, paid. Unfortunately, we cannot move them to the spot where they can be used.

Senator MOYNIHAN. Just to note, there would have been a windfall to the airlines, would there not?

Mr. LUBICK. There is a relatively inconsequential amount of float involved in this situation. If we were creating—

Senator MOYNIHAN. Inconsequential to an organization that can mislay \$1.4 billion.

Mr. LUBICK. It is roughly in the neighborhood of \$10 million to \$20 million.

Senator MOYNIHAN. Oh, I see.

Mr. LUBICK. On the other hand, if we had known about this situation we would have hastily rectified the lacunae in the regulations that did not deal with a situation of a lapse.

Senator MOYNIHAN. Right. Could I just as you, sir, and Ms. Stoll—and Mr. Belger, if you wish—as a matter of tax policy, as against, perhaps, transportation policy, is a user fee preferable to the current ticket tax, which is certainly a direct and simple affair? Do you have a view, sir?

Mr. LUBICK. We do believe that the costs associated with the running of the tax system should be borne by those who use the tax system. That is a more equitable way of handling it. I would expect that we are going to, as we have in the past, urge turning to a method of financing that bears a much closer relationship to actual use.

At the same time, as we have both stated, the FAA does need a stable and predictable source of revenues to finance its services. It is a very complex issue to measure use and benefit. I am somewhat reminded, when we talk about whether we should have a tax or a user fee, of Humpty Dumpty and Through the Looking Glass: words mean what the user of the word chooses them to mean.

Senator MOYNIHAN. But when I use a word it means exactly what I intend it to mean, no more and no less.

Mr. LUBICK. No more and no less.

Senator MOYNIHAN. Well, that is magnificently evasive, I must say. [Laughter.]

Even for a man of your distinction. I cannot cope with this, Mr. Chairman. I thank you all, and I yield the floor.

The CHAIRMAN. Thank you, Senator Moynihan.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Lubick, if we do the transfer, that does not get us into constitutional problems with the House regarding taxes. In other

words, all we are doing is voting a transfer from the general fund into the trust fund, so we can go first on that, clearly, right?

Mr. LUBICK. I believe it is a tax bill, Senator Chafee.

Senator CHAFEE. I would not see why. I am just talking about the transfer. The transfer is just saying, X billion dollars, whatever it is, that have gone into the general fund should have gone into a trust fund, and we are voting to make the transfer.

Mr. LUBICK. I am not sure that the House would concur with that interpretation. They are having a hearing on the subject tomorrow, and I would hope we would avoid constitutional questions.

Senator CHAFEE. Well, I am all for avoiding constitutional questions. That gets me to my next question. I suppose it is pretty clear that reinstatement of the tax, the House would have to go first.

Mr. LUBICK. Yes, I think that is quite clear.

Senator CHAFEE. Now, I must say, I am not going to let you off so easily on this inadvertency. It is my understanding that 87 percent of the trust fund comes from the excise tax.

So it is pretty hard, I would think, to have 87 percent made up by the gasoline tax coming in at a higher rate, or I think there are a couple of other things that contribute to the trust fund as well. When you have the others only representing 13 percent coming in higher than you expected, they have a long ways to go to make up for 87 percent.

Mr. LUBICK. No, I, perhaps, did not make my point clear. The deposits are deposits of all the excise taxes, the gasoline taxes for the highway fund, so the pool that the estimators were looking at was not just the aviation excise taxes, it was the total excise taxes that were deposited by all those that are liable for excise taxes.

Actually, the excise tax collections in the last quarter of 1996 were well in excess of \$13 billion, so it is a pool of that magnitude, where the receipts from the non-aviation taxes exceeded the forecast, that masked the \$1.2 billion shortfall.

Senator CHAFEE. All right.

Mr. Chairman, let me just say, I am looking forward to the balance of the testimony. But I start off being unenthusiastic about the suggestion from the Coalition to make this transfer, because what happens under it is that a substantial portion of their costs move to the lower-fare airlines.

I believe the lower-cost, lower-fare airlines have been a tremendous boon to many parts of this country, and particularly to my State, where Southwest is now coming in and has contributed to a surge of passenger traffic at our principal airport.

So, No. 1, I believe we ought to make the transfer; No. 2, we ought to reinstate the existing ticket tax as soon as possible; and No. 3, we ought to look with some skepticism on the proposals from the Coalition airlines that we switch to this so-called user fee and move away from the 10 percent excise tax on tickets. Therefore, if you buy a lower fare ticket, you pay less. That seems to me pretty reasonable.

Mr. LUBICK. I think the immediate question, Senator Chafee, is to address the first two points which you have made.

Senator CHAFEE. Absolutely. No one is getting around that.

Mr. LUBICK. I think we all should agree on that.

Senator CHAFEE. I presume, Mr. Chairman, based on what Ms. Stoll said, that the heavy debate on what to do, if anything will occur when we address the long-term funding for the FAA. For the record, I do not want to change from the ticket tax. But, nonetheless, you have a report that is coming, you indicated, when, the end of October?

Ms. Stoll. Yes, that is right.

Senator CHAFEE. So I presume we will wait for that report.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Chafee.

Senator Gramm.

Senator GRAMM. I wanted to get a clarification on one point, and that point is, we authorized a commission to look at a permanent funding mechanism for the trust fund. So, as far as I am aware, unless I missed something, we had not appointed but one person to that commission. That commission is supposed to report in September.

Obviously, we have got to read what they say, debate it, get input on it. There is no possibility that we could do anything in September. You are proposing that we extend the tax only through the end of the fiscal year, which would guarantee that this extension would expire before we adopt a permanent solution.

I do not understand why you are not proposing that we extend this temporary tax, at least through the end of the year, to give us an opportunity to come up with a permanent solution without the tax expiring.

Now, I understand with the transfer authority that you can transfer the money, but unless your objective in doing this, unless somebody from OMB told you, look, we want to count this \$2.9 billion gross, \$2.7 billion net as part of the budget so we can cut taxes, or we do not have to cut spending, unless this is some kind of a budget gimmick, I do not understand what you are doing.

Mr. LUBICK. Senator, there is a budget problem. If the tax is in effect on October 1, it becomes part of the baseline and I think it is going to give everybody, both at our end of Pennsylvania Avenue and your end of Pennsylvania Avenue, problems in arriving at budget balance.

Senator GRAMM. So let me be sure I am clear. So what you are saying is, let the tax expire so that it will help us in writing the budget. I do not understand, when FAA and the Treasury are here making political arguments related to the budget instead of proposing policy to produce a secure trust fund.

I am just kind of stunned that, when we are hearing your testimony, when we are hearing the testimony of FAA, I assume that we are hearing prudent fiscal policy and safe and efficient airline testimony. Yet, what you are telling me is exactly what I suspected, that the whole reason for letting this tax expire is a budget gimmick. It seems to me that we ought to let politicians do the gimmicks; after all, we have to have some purpose. [Laughter.]

You ought to let us do the gimmicks, and you ought to come here and tell us what is good for the trust fund and for the traveling public. You ought to come and tell us what is good in terms of fiscal policy.

I just think it shows how far we have let this whole process go. Every issue is a political issue. I am going to vote to extend through the end of the year. There is no reason to let this tax expire. There is no reason to have to go through this process again. We ought to have enough time to come up with a permanent solution.

I do not understand how, in at least establishing in the public's mind that you are here representing the FAA and the Treasury Department, that you are letting your arguments be basically made gimmicks by OMB and by the Congress.

Let me give you an opportunity to respond to all that.

Mr. LUBICK. Thank you, Senator. I think, as a matter of policy, it is important, as you stated, that there be a continuous source of funding to finance the airways and improvements to the system. There is no question about that.

We would hope that, before the end of the year, you and the Administration will have arrived at an agreed upon budget reconciliation package that will set the method of operation on a continuing, permanent, if not immutable, basis. I do not think there are any politics involved.

What we are trying to do is to keep open the options to make appropriate decisions to deal with some of your overriding concerns, which are to arrive at budget balance by 2002, and not to, because of technical scoring requirements, make things more difficult in doing the budget accounting which is required by other statutes. We certainly agree with the underlying policy that you have stated, that there must be a continuous source of funding. At the present time, the only source of funding are these excise taxes.

Senator GRAMM. Before your light turns red, let me just say that if we had not let this expire we would not have had the ability to claim this money in savings. I mean, this whole process is simply being driven by politics, to my mind.

Mr. LUBICK. There is no savings on the \$1.2 billion, Senator. That money is due and is being paid. It is a question of where that money sits. We think it should go to the source that it was dedicated to, namely financing the capital improvements. So I do not think that is a very difficult question. It is a technical question, but I do not see any problem of policy.

Then at the same time, until one can arrive at the solution to a very complex problem—which is how you are going to finance on a permanent basis the aviation system—we ought to at least continue that which we have.

On the other hand, we are going to have very extensive negotiations over the funding of this system, which we hope will be resolved in the budget reconciliation package. It seems to us that a continuation to late September will give us time to see exactly how it is coming out.

In no case are we suggesting that there should be a lapse in the furnishing of the lifeblood of the financing of the airways and improvements to the system. As a matter of policy, I absolutely agree with you. We cannot let the source of inflows to the funding of the system abate.

The CHAIRMAN. But I would have to point out that what you are asking for is an extension until the end of September. When the

end of September comes, we will not yet have the final report on the FAA. So, inherently, it means that either there is going to be a gap, or there is going to have to be another interim extension.

Mr. LUBICK. I would expect there would have to be another interim extension.

The CHAIRMAN. Now, let me ask you, what about extending the taxes until the end of the year?

Mr. LUBICK. The calendar year?

The CHAIRMAN. The calendar year, yes.

Mr. LUBICK. Well, then we are going to run into a technical problem that may cause you difficulty in reckoning your calculations on what can be counted for scoring purposes under the budget.

Senator MOYNIHAN. Mr. Chairman, could I say that, in all truth, the scoring purposes for the budget ought not to be our principal concern. We are dealing here with aviation and aviation safety, and we have a very unimpressive record of this tax going on, and going off, and being collected, and not being collected. I think we should follow Mr. Gramm's suggestion and put it through to the end of the year.

The CHAIRMAN. The observation I was going to make, Senator Moynihan, is that we extended it until the end of the last calendar year, and the same could be done this year.

Mr. LUBICK. I might point out, Senator, that having it expire at the end of a calendar year, when Congress is not around, perhaps leads to some of these difficulties.

The CHAIRMAN. All right.

Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman. Let me say by way of a prefacing comment, I fully intend to support the request for the transfer authority and the extension that you are requesting for the trust fund.

I must say as a new member that is unencumbered by the practices of the past, I think the Senator from Texas and the Ranking Member make a point here. It strikes me that our debate this morning is really about CBO and scoring rather than aviation policy, and to some extent we find ourselves in this dilemma this morning hoisted on our own petard because of what we did in the last year, eliminating the extension so that, for purposes of the scoring, we would be able to claim these savings in any future actions that we have taken. I must say, that is a terrible way to run an airline safety fund.

Let me ask you two quick questions, if I may. You have indicated what will occur if we fail to take the appropriate action. And March, I guess, for lack of a better term, is the drop-dead date in terms of the capital improvements. You have got to get the letter of cancellation out almost immediately under the terms of the contract.

There is one category of funding that may or may not be affected by that, and I seek your answer to that. As you are all aware, there are letters of intent that authorize airline improvements to be bonded over a period of years, the amortization or payments of those bonds being projected based upon future payments being made available to the airport authority for the purpose of retiring those funds.

Would those moneys, under the letter of intent—namely the bonding of airport improvements—be impacted as well?

Ms. Stoll. Those funds which are not all obligated, yes. We are going to review every one of them at this point and see where we stand in the process.

Senator BRYAN. When you use the term obligated, I am not as technically versed as you. The bonds have been issued. They are funded in terms of the airport improvement and the airport has the obligation to pay those bonds over whatever the period of time required to amortize the debt.

As you know, future revenues are being projected based upon the letter of intent. I guess my question is, very bluntly, is there a possibility that an airport might default on those bonds based upon those calculations?

Mr. BELGER. Mr. Bryan, if I could answer that.

Senator BRYAN. Yes, please, Mr. Belger. If my question is not clear, I will try to clarify it.

Mr. BELGER. No, sir. I understand the question.

We obviously do not want to impact those types of grants. It is not our desire to do that, we do not want to do that, and that would be the last thing that we would do.

However, because of the situation that we are in, if in some of those situations the funds have actually not been obligated by the FAA—

Senator BRYAN. Draw that distinction because, in terms of the airport, they have issued the bonds. They are certainly obligated, in a legal sense. Their liability is not contingent upon receiving the funds, but their payment is, however.

Mr. BELGER. I absolutely understand that, sir. We do not want to put any airport into that situation. But, even in looking at those types of grants, I believe it would be prudent for us to prioritize them. Some that are safety or security types of projects will clearly have a priority, should we get to the point where we have to make these drastic decisions, over some other types of grants. So, I mean, the only way that I could positively tell you that none of those types of grants would be negatively impacted would be to ensure that the taxes are reinstated.

Senator BRYAN. Well, I agree. I do not quarrel with the proposition that it needs to be reinstated, that transfer authority needs to be improved. I have got that. But I am still having difficulty, as we are going through this minuet, Mr. Belger.

My question is, is there the potential of a default on the part of an airport authority that has issued bonds based upon the letter of intent that projects over whatever the intervening period, 5, 10 years, that moneys will be paid out of the airport trust funds to those airports for the purposes of paying the bonds?

Mr. BELGER. I believe the answer is yes, there is that possibility. Now, obviously, we do not want that to happen.

Senator BRYAN. I thank you.

I would yield back the balance of my time, and thank the Chair.

Mr. LUBICK. Mr. Chairman, could I add just one thing. I want to make it clear to Senator Gramm, Senator Moynihan, Senator Chafee, and Senator Bryan, and all of you, that one thing that we share in common with you is that we want to have a permanent,

seamless source of financing for the airways and airport safety. We want to work with you to achieve that objective, and we will share with you any technical concerns that we may have in the way in which that is done.

The CHAIRMAN. Let me ask one additional question that has come to my attention. As has been pointed out, the FAA Reauthorization Act of 1996 created the National Civil Aviation Review Commission and provided a schedule for it to report its findings. It is, I believe we said, the end of October.

We are told that, to date, only one of the 21 members has been appointed. That seems, in view of the importance of the issue of airport safety and modernization, frankly, very shocking. I wonder why only one has been appointed, and when this commission will be complete and go to work.

Ms. Stoll. During his confirmation hearing, Mr. Rodney Slater, the Secretary-designate, was asked this very question. He has gone on the record as saying this is his top priority, to get that committee appointed, part of it. I believe we have 13 appointments that we need to make, and I believe Congress has eight that it needs to make. This committee needs to get going.

The CHAIRMAN. Well, I could not agree more with you. I think it is important that they be appointed so that the report will not be late in coming out.

Next, I will call on Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

I would like to go, briefly, back to the discussion that we just had relative to the extension of the tax. The assumption in all of the proposals is that the extension will be to a date certain, whether it is the 30th of September or the 31st of December.

What is the argument against reimposing this tax on a permanent basis, recognizing that there are differences of opinion as to whether the tax is fundamentally fair or not? The fact that we have extended it on a permanent basis does not preclude us from continuously reviewing the tax, and, if we determine that it is inappropriate, modifying it.

But to continue to have this uncertainty, and it is not only uncertainty, it is uncertainty buttressed by our own actions of the failure to extend the tax and all the problems that that has created, it seems to me that the best option would be to reenact on a permanent basis.

Mr. LUBICK. Well, one of our hopes, Senator Graham, was that, as the Chairman stated, originally he hoped to get a very clean, non-controversial, unanimous-consent bill through, and I will leave it to you all. But I would think that that objective would be much more assured with a less than permanent extension. A permanent extension, I am sure, would be regarded as a major piece of tax legislation.

Senator GRAHAM. Well, I think that is a political judgment that we have to go make. But I believe what we ought to be asking you is, what are the implications to the commercial and the civilian aviation systems of America of having this constant instability in the basic financing of its operations?

Mr. LUBICK. In terms of absolute logic in a pure world, I do not think anyone can dispute that a permanent tax subject to amend-

ment which changes even a year after it is enacted is the same thing as a year's extension followed by a reenactment of another thing.

Senator GRAHAM. Because the consequences of non-action, as we are experiencing today, is the tax lapses. In the other example, the consequence of non-action is the status quo continues in place.

Mr. LUBICK. I do not think that is a controvertible statement.

Senator GRAHAM. Let me move to the other issue I wanted to discuss. That is, this apparent provision in the regulations that says that airlines will go back two quarters to the amount collected during that two quarters as their safe harbor tax payment amount. Is that a summary?

Mr. LUBICK. That is correct. That is a correct statement of it.

Senator GRAHAM. Now, you indicated this was costing the Treasury between \$10-\$20 million to not have the tax paid on a timely basis, but rather in accordance with that provision of the regulation? Could you give us the numbers; what are we talking about here? How much money was collected during the last 3 months of 1996, and, under the regulation, how much has been and will be remitted, and at what point in time?

Mr. LUBICK. One point four billion dollars was collected and transferred from the general fund to the trust fund. Two hundred million dollars of that represented actual deposits of tax. The \$1.2 billion that we are talking about represented a transfer that we estimated was being deposited, but it turns out, after the facts are discovered, that that \$1.2 billion was being retained by the airlines. So, therefore, the float loss is based upon \$1.2 billion.

Now, I am going to try to do this very quickly. But if you assume the \$1.2 billion was out during the quarter an average of half the time, then you have got \$600 million. If it was invested at 6 percent interest, that is—I have to get the right number of zeros, which is the difficult problem. Thirty-six million dollars. I am sorry. It is not 6 percent, 6 percent is the year's interest. So we have a quarter's interest, so I have to divide that by four. Four into thirty-six is nine. Nine million dollars.

The CHAIRMAN. Is this how we keep our books? [Laughter.]

Mr. LUBICK. No, Senator. Mr. Chairman, you are fortunate, I do not have anything to do with the keeping of the books. I do not even make out my own tax return.

Senator GRAHAM. Well, let me ask, for most Americans it is not an insignificant amount of money. Are there any other examples in regulation where we have created this kind of an anomaly that, because of some unintended event, we then have this unintended consequence that money that has been collected, in this case from the aviation customers, and belongs to the public but is not being remitted to the public in a timely basis? Are there any other examples of regulations that have that potential, and if so, what is the Treasury going to do about them?

Mr. LUBICK. Well, there certainly are examples where withholding agents, as the airlines are in this situation, have a period of time to pay over money and the float, but they are not unintended.

Senator GRAHAM. Yes. The unintended aspect is, when that regulation was written, it was not expected that there would be a quarter in which the tax would be uncollected and, therefore, create a

void so that two quarters later when the tax was imposed you could comply by remitting close to zero.

Mr. LUBICK. You are absolutely right.

Senator GRAHAM. My question is, are you taking steps to rectify that regulation, and are there any other regulations like it that should be remediated?

Mr. LUBICK. We have ordered a lock for the barn door, and we are undertaking steps to rewrite the regulation so that, in this particular situation, which I expect would not be likely to recur—

Senator GRAHAM. Well, the question I asked is that, plus, are there any other examples of regulations that have a similar potential.

Mr. LUBICK. The regulation, incidentally, that we are writing applies to all the excise taxes. But I do not know of others where something exactly analogous would take place. We will search around, however, now that we are alerted to this possibility.

The CHAIRMAN. Thank you, Senator Graham.

Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman. Thank the witnesses for their testimony.

I have just got to ask the question again, and maybe it was asked before I got here. How did it happen that in the Treasury Department somebody—some person, I take it, not a machine—was paying money out of the general revenues into the Airport Trust Fund to the tune of \$1.2 billion, and apparently never noticed that the money had not come in? I mean, the average person out there must wonder, how did that possibly happen?

Mr. LUBICK. We collect the excise taxes, Senator Breaux, in one large pool, about \$13 billion a quarter, is the amount for the last quarter of 1996.

In order to keep the trust fund receiving a steady source of inflows, our estimators determined to the best of their ability what part of that pool—which is otherwise unidentified as to source, until the actual filing of the returns after the close of the quarter—represents aviation trust funds, what part represents Highway Trust Funds, what part of deposits represents withheld taxes, what goes into Social Security. All of these things are done on an estimated basis.

In the normal situation—

Senator BREAUX. Well, if he is estimating because he does not know what is coming in, I mean, would a red light not have gone off to say that zero had come in? It is not an estimate, that is an actual fact that nothing had come in.

Mr. LUBICK. But the problem, Senator, is that this is one large pool. By, perhaps, a bizarre state of circumstances, the revenues from the other excise taxes that came in exceeded the forecast of the estimators, so that they were actually taking in more from the other excise taxes.

In one sense, they were not paying enough of the other excise taxes, but that masked the shortfall in the aviation taxes. So they were not alerted to the fact that there was a shortfall of \$1.2 billion. The actual receipts that came into the pool was well within their normal range of forecasting.

Senator BREAUX. But not from the airlines. It was zero.

Mr. LUBICK. But they are not designated from airlines when they come in. In other words, they come in from all these sources in one big pool that the IRS receives.

Senator BREAUX. Well, what are we doing to ensure that that does not happen again? Could it happen with the Highway Trust Fund, that we make an estimate and it does not get paid? What are we going to ensure that this kind of a colossal mistake does not occur again?

Mr. LUBICK. Well, as far as the Highway Trust Fund is concerned, as I indicated to you, the Highway Trust Fund receipts presumably came in higher than were forecast so that an adjustment is to be made following the close of the quarter to make up that amount to the Highway Trust Fund. In all cases, adjustments are made when the actual facts are known.

Senator BREAUX. Well, why is it that somebody cannot just check to see how much came in from the various excise taxes? I mean, zero came in from the airline. It is not an insignificant amount. If zero came in, it seems like a light could have gone off somewhere.

Mr. LUBICK. There is no designation as to the source. Now, we could require payment and returns on a semi-monthly basis.

Senator BREAUX. The airlines snookered us, did they not?

Mr. LUBICK. Pardon me?

Senator BREAUX. The airline snookered us.

Mr. LUBICK. I do not think it is fair to say that they snookered us. They came in, they disclosed the situation.

Senator BREAUX. Did they disclose it when they were doing it?

Mr. LUBICK. Yes.

Senator BREAUX. Why, when an airline sends a letter saying we are not paying this, did somebody not say, good Lord, they are not paying it, we had better not pay it out?

Mr. LUBICK. They were reading the regulation requiring deposits. It was a plausible, although not a preferred, interpretation of the regulation. If the airlines had come to me with this interpretation, I guess I would have said we had better change that regulation, pronto.

Senator BREAUX. Did they go to anybody at Treasury with that?

Mr. LUBICK. No, sir.

Senator BREAUX. The just did not tell anybody.

Mr. LUBICK. Well, the normal place for them to come is to the Internal Revenue Service, which administers the laws. They went to the section of the Internal Revenue Service and said, here is what the regulation says and here is what seems to apply in our situation.

Senator BREAUX. But somebody in Treasury knew beforehand that they were not paying?

Mr. LUBICK. There were lawyers that issued guidance to the airlines industry that approved their interpretation.

Senator BREAUX. But the other part of Treasury did not know about that.

Mr. LUBICK. No, sir.

The CHAIRMAN. I have to say that what I hear this morning is deeply worrisome. We read in the paper that the computer operation has collapsed in the IRS. It sounds to me like they are keep-

ing their records on the back of an envelope. I am not sure that we do not need a commission to study the IRS.

I call on, next, Senator Grassley.

Senator GRASSLEY. Well, we have a commission to study the IRS, and I am on it.

The CHAIRMAN. What are you doing? [Laughter.]

Senator GRASSLEY. We were instructed not to deal with tax policy. I have come to the conclusion that we will never be able to have the intimidation of the IRS reduced until we make the Tax Code so simple that the taxpayer understands it, as well as the auditor of the IRS understands it. It is because of the complication of the Tax Code that that intimidation is present. A faceless bureaucrat can make the Tax Code almost anything they want it to be.

Anyway, in regard to the issue of who pays what tax—and Ms. Stoll, I do not want to get into this bit of the large airlines versus small airlines. My question is where does general aviation fit into any change of contribution; is it being considered at all? If it is being considered, is the Administration recommending any change in how general aviation contributes to the fund, which now is the fuel tax fund?

Mr. STOLL. The entire question of cost allocation is an important part of the studies that are currently under way. Coopers & Lybrand is doing an assessment now that is focused on the financial requirements of the FAA and is using as a basis for its work a GRA study done last year on cost allocation, a study that was not completed, but the basic data of it is in Coopers & Lybrand's bailiwick at this point.

In addition to that, the National Civil Aviation Review Commission, which was established by Congress, will review in two committees, once it is established and under way, two major areas; one deals with funding and one with safety and security of the airlines.

So the question of the role that general aviation has with respect to the contribution to the support of the aviation system are issues that are being discussed, will be discussed, and hopefully decided when the results of that report and the deliberations with the Congress have occurred.

Senator GRASSLEY. All right. So, general aviation is part of the equation that could be changed, including the method of funding the fuel tax could be changed?

Mr. STOLL. All issues are on the table with respect to finding a reliable, and long-term, and stable means of supporting this growing industry.

Senator GRASSLEY. Also, in your answer then, is the inference that since this is being studied outside the Administration by a private sector organization for the Government that the Administration is not making recommendations, or is the Administration involved in making recommendations?

Mr. STOLL. The Administration will be involved in making recommendations in that the results of these studies are coming to us. The first report of the commission, which, as I indicated earlier, has, I believe, 21 members, 13 of which need to be appointed by the Administration, by the Secretary of the Department of Trans-

portation, eight by the Congress, the results of that will come to us in September.

The recommendations of the Secretary will be added to it and will come to you. Any changes that occur will be accomplished by actions which you take. So this is something that you will have in front of you at some point toward the end of the year.

Senator GRASSLEY. Is it fair to say, since the Administration will be waiting for that study but also being involved with it, that it is putting suggestions on the table. Those suggestions could involve changing general aviation, the way they finance.

Mr. STOLL. I think that the deliberations of the commission when it is appointed will not have specific recommendations coming from the Administration to it. What it will have, is the collection of studies, thoughts, ideas, that have already been accumulated and which are basically in the public domain.

We will see the results of that aviation commission and put our own recommendation to it before that document comes to you.

Senator GRASSLEY. All right. On another point, the OMB pass-back instructed the FAA to fund \$500 million for its fiscal year 1998-budget through new user fees. What are you considering increasing in the way of new user fees for the 1998 budget?

Mr. STOLL. Well, sir, the 1998 budget will be rolled out on Thursday and, as is a longstanding tradition, I am not permitted to discuss what is in it. There are user fees, however, in the current year's budget, which you know, and they are resolving themselves into over-flight fees for users of our aviation system from outside the country.

Senator GRASSLEY. There will be new user fees, even though you cannot be specific what they are?

Mr. STOLL. There may be.

Senator GRASSLEY. Thank you.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Lubick and panelists, I think anybody watching this would think this is a pretty sorry state of affairs. Obviously, Congress has been very derelict, resorting to budget gimmickry. That is why we did not permanently, or at least for a longer period of time, extend the airline ticket tax. I mean, different members of Congress are looking for gimmickry ways to get money to pay for their pet projects, and so forth.

I remember at the time last year when we did not extend the ticket tax thinking, this is just dumb. There is no way in the world Congress is going to get this thing reenacted as it should, quickly, in the next year, 1997. I just deeply regret, myself, that I did not make a bigger stink about this at the time. It was just dumb for us in the Congress not to continue to extend the ticket tax.

Now, having said that, frankly, to some degree we are fiddling while Rome is burning. We are not getting the job done. It just seems to me that the solution is very obvious; it is just a matter of whether this Congress has the willpower and the discipline, along with the Administration, to get the job done.

No. 1, to very quickly extend the tax, I think, on its current basis, whether it's the end of this fiscal year or the calendar year, I think, is pretty irrelevant, because I am not sure the commission

is going to get the job done to recommend the proper formula by September 30 anyway. So it does not make much difference to me whether it is September 30 or the end of the calendar year, we have just got to get the job done.

No. 2, we have to transfer the funds that have not been transferred, just make sure that authority is provided for that. Finally, get on with this commission. I do not know how long it has been since Congress authorized this commission. I understand only 1 person is appointed out of, what, 21? In the Congress, the leadership on both sides, both Houses, is very derelict, in my judgment, for not making those appointments. The Administration is derelict for not making its appointments. I just, Mr. Chairman, strongly urge that the other body get the job done. Not a very short-term extension to play games, but rather meaningful extension. For me, meaningful is, again, the fiscal year, end of the calendar year, while the commission works to get the job done.

In answer to, I think, Senator Conrad's question to you, Mr. Lubick, or I guess it was Senator Breaux, how did this mistake occur, and you said there is no identification as to source of funds going into the trust fund, that cannot be right. Each of us who pays taxes has an IRS identification number. Anybody knows what the source is.

Probably the correct answer is, everybody is out of it. I mean, you do not go back and check to be sure everybody has paid every year, but obviously anybody who pays or does not pay has a taxpayer's identification number.

Mr. LUBICK. Well, Senator, obviously we know ultimately who pays what tax. In the ordinary course of events, there are no problems. People make deposits on a pay-as-you-go basis. They do not file a return, they simply make a deposit. The deposit comes in from an airline or—

Senator BAUCUS. No. But on that deposit is the name of the payee.

Mr. LUBICK. The payor.

Senator BAUCUS. The payor.

Mr. LUBICK. The payee is the Internal Revenue Service. Right.

Senator BAUCUS. The payor. On that check is the name of the payor. There is probably some kind of identification number, if it's a major company.

Mr. LUBICK. Yes. But we do not know the nature of the tax. There is simply a deposit made of the excise tax liability, of the withholding liability. What happens, Senator, is that transfers are made on an estimated basis with respect to the funds received, and at the end of the quarter, the returns are gone through and adjustments are made.

In the ordinary situation, this works very smoothly. It is designed to provide the maximum simplicity for taxpayers. They make their deposits, we make the appropriate estimates, and payments are directed to the appropriate sources. Adjustments are made at the end of the quarter, and usually they are relatively minor.

What happened in this case was caused by the situation that you stated, which was that the tax had been allowed to lapse and, therefore, there was a zero liability for that key quarter on which

safe harbors are permitted. Safe harbors are permitted for a very good reason.

Senator BAUCUS. My time is about out. I am not going to quibble with you, but it just seems to me that the right hand did not tell the left hand what is going on here. That is, the law changed and there was an interim period where there was no tax collected.

It just seems to me that somebody over at IRS should have known that and a little red flag would have come up to alert the other folks over there who dispense with the receipts that go into this trust fund, deposit it, as to what they should do.

I know my time has expired, but very quickly here, I just see little things happening which indicate to me that the IRS's computer system, the bookkeeping system, is perhaps a little unstable. It is like a computer that becomes unstable, it kind of crashes sometimes when things get too overworked and not in sync.

Another example to me is the Treasury and the Department of Transportation's error on the Highway Trust Fund of \$1.2 billion, just an accounting error. Somebody did not push the right button and it created a huge problem for us in the Congress and the States that did not get their correct allocation of highway trust funds. Then we hear about all the computer problems that the IRS is having.

I am just suggesting that somebody had better get a handle on all of this. I do not want to be too hard on you, but I just see little things coming up now that indicate to me some warning signals and little red flags that you, the Administration, are not getting a proper handle on the IRS, and particularly the bookkeeping side.

Thank you.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. Thank you. First of all, as a former tax administrator I must say I am somewhat mystified by what I have heard here this morning. It strikes me, there is a system failure of some sort. I do not know what other conclusion one could come to.

When I hear you describing the deposit of these funds and that these funds are grouped and there is not a separate designation as to what is the purpose of the check or the payment, if that is really going on, then that is a real system problem.

I cannot imagine running a revenue department and not having a clear designation for every dime received as to the purpose of that payment. If you are going to run an audit operation, and you must audit both internally and externally anytime you run a revenue department, you absolutely must have a chain that can be followed.

If money is coming in that is not designated as to the tax type for which it is in payment, it seems to me you lose audit trail. I do not want to spend a lot of time on that. I am just saying, as a former tax administrator myself, I hear things that trouble me. If that is really going on, then as a system matter we need to address that.

I wanted to talk about something else. That is, the assertion that I have heard from some of my colleagues that this 10 percent tax on tickets is fair. It is not fair. It has absolutely nothing to do with the cost of the service that is being financed.

The whole reason for the tax is to pay for FAA operations, air traffic control. A 10 percent tax on the amount of a ticket bears absolutely no relationship to the cost.

Let me give you an example. You fly from Bismarck, ND, to Washington, DC. You pay a relatively high fare because there is a lack of competition. The demands and requirements on the air traffic control system are minimal because, for the most part, you are flying over rural areas.

You juxtapose that with flying from Boston, MA, to Miami. No. 1, a much lower fare because it is a highly competitive route. No. 2, heavy demands on air traffic control because you are flying over the most populous part of the country.

Yet, that passenger flying from Bismarck to Washington, or Bismarck to Los Angeles, is paying far more for air traffic control than the passenger flying from Boston to Miami. That is not fair. We are not going to accept an extension or a long-term extension of what is clearly an unfair tax.

A second unfairness. You are on a plane. You bought your ticket 1 day before because, for example, it is a family emergency. If you are flying from Bismarck, ND, or Washington, DC and you buy a ticket under those circumstances, you pay \$1,000 for round trip. All right. Ten percent of that is \$100.

You have somebody else that bought 4 weeks in advance when the airline had a special ticket sale, and he is flying for \$300. They are paying \$30 for air traffic control. You have somebody else that is flying frequent flyer, he is paying nothing, he is not paying any tax, not paying anything for air traffic control.

So on that same plane, perhaps seated next to each other, is one person paying \$100, one person paying \$30, and one person paying nothing for precisely the same services. That is not fair. So when we talk about a solution to this problem, clearly we need to have a transfer of the funds. We need to provide for that. Clearly, we need to extend the tax for a time.

But we need to solve the unfairness in the underlying funding mechanism, and some of us are just not going to roll over and accept our people paying much more than others for less. That is not going to be an acceptable solution.

I think there is probably not much of a question in any of that. I just would say to you, this commission, we have got to get the commission up and running and get a response so that we can fashion a fair system of paying for what is a service that is clearly required by the entire traveling public. I thank you very much for having the patience to listen.

Mr. LUBICK. I do want to say one thing to you, as a tax administrator, to assure you that there is no lack of audit trail here. The deposit system is made by wire transfer or electronically.

It is only for purposes of making the initial preliminary estimates. Everything is reconciled each quarter and it is convenient to get the money in earlier and then do the record matching, but a complete record match is made quarterly.

Senator CONRAD. Well, I am encouraged by that. Still, I am left with the conclusion, we have a system failure of some type because the information that was needed in order to appropriately account

for the funds as they were received was not available or was not used.

Clearly something has gone awry here. I do not know enough about the system that is in place to diagnose the problem or provide a solution, but I think all of us are troubled, listening to this, that a red flag did not go up somewhere.

Senator GRASSLEY. Does the Senator support extension until the end of the fiscal year?

Senator CONRAD. I would prefer a shorter extension to keep the pressure on finding an alternative system. This system just is not fair and I really do not think anybody can make much of a case that it is.

The CHAIRMAN. We have two more panels, so I am anxious to move on. I want to thank our witnesses. I think you—at least I hope—you understand the real concern that is being expressed on both sides of the aisle has to do with the performance of IRS's system, or lack of system, which may be a more adequate description.

I cannot emphasize too much, that we have several committees that are supposed to be making studies, and the one that is supposed to be making recommendations by October, as I understand it, only one member has been appointed to it.

Now, eight of the members of the Commission are appointed by the leadership of the Congress. Senator Moynihan and I will be writing them, as well as the Administration, as to the critical importance of getting members appointed and this study under way so that we can address some of these long-term problems. Thank you very much for being here today.

Mr. LUBICK. Thank you, Mr. Chairman.

Mr. STOLL. Thank you, Mr. Chairman.

Senator BRYAN. Mr. Chairman, could I ask unanimous consent that a letter from one of the airlines that serves my State be made a part of the record in this proceeding?

The CHAIRMAN. Yes. I am glad you raised that, because I also want to include the letter from the Secretary of the Treasury asking us to extend the taxes and allow the taxes to be transferred from the general funds to the Airport Trust Fund. So, without objection, both will be admitted.

[The letters appear in the appendix.]

Senator BRYAN. I thank the Chair.

The CHAIRMAN. I now would like to call Mr. John H. Anderson, Jr., who is the Director of Transportation Issues, U.S. General Accounting Office, Washington, DC. Mr. Anderson, it is a pleasure to welcome you here. We would ask you to proceed with your statement. Your full statement, as all the full statements, will be included as if read. We would appreciate you summarizing it.

Welcome, gentlemen. Would you introduce those that are accompanying you.

STATEMENT OF JOHN H. ANDERSON, JR., DIRECTOR, TRANSPORTATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC, ACCOMPANIED BY TIM HANNEGAN, ASSISTANT DIRECTOR, AVIATION ISSUES, AND CHARLES CHAMBERS, SENIOR EVALUATOR

Mr. ANDERSON. Yes, I will, Mr. Chairman. Thank you very much. I appreciate the opportunity to testify today on financing FAA. With me are Tim Hannegan and Charles Chambers, and I will summarize my statement.

On December 31, 1996, the Government's authority to collect the taxes that financed the Airport and Airway Trust Fund lapsed. Historically, the fund has provided about three-quarters of FAA's budget.

On December 9, 1996, we reported to you, Mr. Chairman, and other members of the Senate and House, on the status of the fund and on a proposal by a coalition of the Nation's largest airlines to replace the 10 percent tax on domestic airline tickets with user fees.

The coalition airlines developed their proposal because they believe that the ticket tax unfairly subsidizes their low-fare competitors.

Concerning the trust fund, we have heard an awful lot about what is available in there this morning. As recently as December, Treasury and FAA estimated that, with the lapse of the authority to collect the aviation excise taxes, the trust fund would fall about \$1 billion short of funding its share of FAA's 1997 budget.

Now it appears that the Treasury miscalculated; the shortfall is more like \$2 billion. This means that the Congress would need to act sooner than originally thought.

Moving now to the coalition airlines' proposal. We believe that the commercial users of the Nation's air space and airports should, to the extent possible, pay their fair share of the cost. The ticket tax is not based on factors that relate to the user's share of the system's costs and may not fairly allocate the cost among users.

Nevertheless, comparing the relative share of airlines' payments under the ticket tax to some common measures of system usage does not provide conclusive evidence that the ticket tax is unfair.

As the chart before you shows, the coalition airlines accounted for almost 80 percent of the 1995 ticket tax payments. Their percentage of system use was lower than this for some common indicators, such as domestic departures, passenger enplanements, and miles flown. However, the coalition airlines accounted for 81 percent of the fuel consumed by commercial airlines in 1995, another indicator of system usage.

Airlines that compete with the coalition airlines, such as Southwest and America West, accounted for about 17 percent of the payments made under the ticket tax in 1995, but their system use indicators were higher than this for departures and enplanements.

On the other hand, their share of miles flown and fuel consumed was the same as their share of ticket tax payments. Reaching definitive conclusions based on these comparisons is further complicated when the impact on commuter airlines is considered. The major commuters are owned by, or affiliated with, one of the coalition airlines.

Currently, FAA does not have sufficient cost information to show whether the ticket tax, or any other system usage indicators, would be good proxies for fairly allocating FAA's costs among its commercial users.

Hopefully, when the work of the national commission that we have heard a lot about here this morning is done and the Administration and the Congress have a chance to assess it, a clearer picture of FAA's costs and the options for financing it will emerge.

However, the Congress will have to act before then to meet FAA's fiscal year 1997 funding needs. While the coalition airlines' proposal is one alternative that could be implemented, we believe it could have serious competitive ramifications.

Under the coalition's proposal, instead of a ticket tax the airlines would pay for domestic operations under a formula that is based on three factors. By using two factors in particular, originating passengers and non-stop passenger miles, the formula favors the larger airlines which operate hub-and-spoke systems at the expense of the low-fare and small airlines, which tend to operate point-to-point systems.

For example, consider two possible routings between St. Louis and Orlando. As shown on the chart that is now before you, the hubbing airlines would first take the passenger to a hub, such as Chicago O'Hare, to connect to another flight to Orlando. The point-to-point carrier would take the St. Louis passenger non-stop to Orlando.

The airline that lands at O'Hare to transfer the passenger to another flight to Orlando has twice as many take-offs and landings as the airline that flies non-stop. However, under the coalition's proposal, by charging \$4.50 per originating passenger, the hubbing airline would pay the same amount as the non-stop airline, even though, in this particular example, the hubbing airline imposes a greater cost on the system.

In addition, by charging one-half cent per non-stop passenger mile, or the straight-line distance as the crow flies between the points of origin and destination, the coalition's formula does not charge the hubbing airlines for the circuitous routings that are common to their hub-and-spoke operations.

Because the coalition airlines operate hub-and-spoke systems and low-fare and smaller airlines tend to operate point-to-point systems, the coalition's proposal would shift the fees for using the system away from them and onto their competitors.

For example, based on DOT's traffic data for 1995, if the ticket tax were replaced by the proposal the cost to the coalition airlines would have decreased by nearly \$550 million. At the same time, the cost to the low-fare and other small airlines would have increased by nearly \$500 million. This could have substantial competitive impacts.

The coalition has raised legitimate questions about the fairness of the ticket tax. However, determining how best to finance FAA is a complex problem that requires careful study and good cost data. FAA's costs vary depending on the amount, type, and timing of various airline operations.

Hubbing operations at congested airports increase the peak service demands on the system and increase FAA's costs. However, this

cost has not yet been quantified, and neither the 10 percent ticket tax, nor the large airlines' proposal accounts for these costs. Hopefully, the cost study currently being performed for FAA will shed some light in this area.

A financing system that does not take such factors into consideration could also result in costs not being fairly allocated among system users. Taxing one or more of the indicators of system use, such as departures or passenger enplanements, could be used instead of the ticket tax to finance FAA.

However, the potential competitive impact of using these indicators as a basis for allocating FAA's costs varies greatly, depending on which indicator is used. The impact of the financing options also varies among airlines within the coalition competing and commuter groupings.

For example, under a system that taxed both fuel use and passenger enplanements, the amount paid by four coalition airlines would decrease, but it would increase for three coalition members.

The various financing options for FAA also present trade-offs concerning their ease of administration, impact on the airport and airways system's efficiency, and the ability to produce an equitable system in which users pay their fair share.

For example, a formula that combines several of the common system usage indicators might provide the best proxies to ensure that users pay their fair share of costs. However, such a formula may also be complex and difficult to administer.

Similarly, taxing airlines for their use of the most congested airports may result in a more efficient use of the Nation's air space. However, because the coalition airlines are the primary users of these airports, this approach may not produce the most equitable result, from their point of view.

The advantages and disadvantages and the potential competitive impacts of a new financing system for FAA will need to be carefully studied over the coming months by the national commission and the Secretary of Transportation.

The financing alternative that is finally selected should be relatively easy to administer and help ensure that, in the long-term, FAA has a secure funding source, the Nation's airports and airways are used as efficiently as possible, commercial users of the system pay their fair share, and a strong, competitive airline industry continues to exist. Ultimately, this is going to be a policy to call for the Congress on how to best balance these goals.

This concludes my statement. We would be glad to answer any questions.

[The prepared statement of Mr. Anderson appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Anderson. Last December, you reported that, based on estimates provided by FAA and Treasury, the money available in the trust fund would finance new commitments until July 1997. Now, recent information reveals that the balance in the Airport Trust Fund is much less than originally expected. Can you please discuss the ramifications of this shortfall?

Mr. ANDERSON. I think those ramifications are very serious, Mr. Chairman. What we have here, I guess because of a technical

glitch, as it has been referred to this morning, is the shortfall about doubled. And, while it was looking to us based upon information that FAA and the Treasury had provided in December that it was going to be about \$1 billion, it is going to be about \$2 billion. The ramifications of this are that capital improvements funds are going to have to start to be cut off as early as March as opposed to July, which we were originally thinking about.

FAA, I think, is making the changes to juggle the funds around so they can be assured of paying their workforce salaries and make sure that the air traffic controllers and inspectors continue to be paid. But it will require short-circuiting, cutting the amount of funds that will be expended for things like air traffic control modernization, and that sort of thing.

The CHAIRMAN. In other words, it is critically important that Congress act as promptly as possible and that if we act by March 1—sooner, in my opinion; as I said, I would like to act as soon as tomorrow, if that were practical—in any event, that would take care of the situation.

Mr. ANDERSON. Yes, depending upon what you do. I have heard about various alternatives being talked about this morning. If you just acted to correct the technical problem that occurred and allowed you to transfer the funds, that would take care of the problem until about July. Then you would still be in the same problem for the rest of the fiscal year, in terms of funding the capital improvements.

The CHAIRMAN. You heard the discussions about IRS and the problems, or lack of system. Would you care to comment on what you know from your auditing, what is the situation over there? Do we have other situations that face the same problem?

Mr. ANDERSON. I am not responsible, myself, for reviews of the IRS or the Treasury Department, so I really cannot comment on that.

The CHAIRMAN. Could I ask you to find someone who is?

Mr. ANDERSON. Yes, we can do that. I can say that, clearly, something as significant as this, looking back in 20/20 hindsight, you would have hoped that there would have been a little better coordination between the IRS and the Treasury on this matter before that regulatory interpretation was made.

The CHAIRMAN. But I would like a definitive report from GAO for both sides, because I think this is a critically important problem.

Mr. ANDERSON. All right.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I find myself a little baffled and surprised by what I have been hearing today. I have a fairly close involvement with the surface transportation, and have handled that legislation for years now in the Committee on Environment and Public Works, and the Highway Trust Fund, which comes through here. We have never come across anything. I mean, you went on, then you went off, you deposited, you did not get credited. You establish a big, 21-person commission, and the following year only one member has been appointed. Is there something dysfunctional about all this?

Mr. ANDERSON. It certainly would appear to the casual observer that there is. I think the uniqueness here, and maybe you would

remember more than me, Senator, I believe that having these taxes lapse like they have, I do not think that has typically happened with the Highway Trust Fund in the past. I think that creates some unique situations here, where they lapse, they are reinstated, and then they lapsed again.

Senator MOYNIHAN. I just want to say again how much I agree, and support the Chairman in saying, let us get something done quickly. It is not our committee, sir, but if I were the Commerce Committee I would be wondering what is going on.

I mean, these are airplanes. They go up in the air, and if they do not come down right then all sorts of trouble happens. If you are slow in building the 19th lane of an interstate highway between Miami and Orlando, in the main, life goes on. But it is surprising and disturbing.

You expect a very high order of accountability and alertness in an area where there is nothing inherently—I remember 50 years ago in the Navy they would say, there is nothing inherently dangerous about flight, saying that it is fiercely unforgiving of carelessness. Here, I see a lot of what looks like carelessness to me. I was going to ask you a much more personal question, which is, why does it cost more to fly to Albany than to Paris? This puts personal strain on us all.

Think about these things. But I will not ask for a written statement on that, Mr. Anderson. Thank you. We have got very bizarre pricing systems which may respond to certain economic rationality, but they are hard to see. I mean, you can fly thousands of miles. Now, the great cost in air travel is getting up there. Once you are up there, it does not cost very much to keep going. Everyone understands that. Even so, it is bizarre. But that is not your problem right now.

Thank you for your testimony. I would appreciate it, with the Chairman, your statement about—I mean, savings banks in little towns manage to have 20,000 accounts, and they keep them separate. There are only about five trust funds, and the IRS cannot distinguish one from the other. I heard a lot of things this morning I would just as soon not have heard. Thank you, sir.

Mr. ANDERSON. Thank you.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. Pat, I assume it is because New Yorkers fly to Paris more often than they do Albany.

Senator MOYNIHAN. You learn too much, Senator.

Senator GRASSLEY. I have not read your study, so I do not know to what extent you dealt with this issue of fairness or not. But I want to ask a lot of questions that you should not answer until I get to the main question I want to ask.

If you looked at the income status of passengers, is there a risk that the Big 7 user fee plan could shift the tax burden away from more high-income passengers to low-income air travelers?

Did your study make a comparison—and you can use any words you want to here—the luxury of service provided in the price of a Big 7 ticket versus the luxury status provided in the price of a smaller airline ticket? Do smaller airlines offer the same type and level of first-class tickets as the Big 7 do?

This brings me then to my point.

But, just generally speaking, if the smaller airlines offer a more frugal service and their cost-effective service is reflected in the lower prices and we switched to a user fee system, how would it be fair for their low-cost-conscious passengers to pick up the taxes formerly paid by the luxury passengers of some of the bigger airlines?

Mr. ANDERSON. I think the question you are raising, Senator, is a good one. This is why we concluded in our study that the competitive implications of the proposal by the coalition were potentially very serious. Clearly, a lot of the passengers that fly on the low-cost carriers are those that might be more price-sensitive, and if there are changes in fares you might cause some drop in passengers and that sort of thing. So that is one of the things that is clearly a potential problem.

Senator GRASSLEY. So you kind of looked at some of these things that I mentioned in the first part of my questions.

Mr. ANDERSON. Yes. That is correct.

Senator GRASSLEY. All right.

Mr. ANDERSON. Of course, the argument can be made that the carrier that goes through and cuts costs and is able to charge less for a ticket and everything, why should the passengers not be able to take that into account?

Clearly, just on the surface it looks like taxing something based upon the price of a ticket will not necessarily give you equity, but when you look at some of the other indicators of system usage, there are no clear-cut answers on what might be equitable. The amount of fuel consumed is pretty close to what the ticket tax would generate if you would, say, charge 42 cents a gallon for the fuel.

That would get you about the same thing and would not result in much of a shift in terms of which airlines pay what amounts. So you have to look at it overall, and clearly, in the highway area, fuel tax is the main source of revenue there.

Senator GRASSLEY. Within your institution did you have a data base and a knowledge base on which your study took off to conduct the specific issues we are dealing with in your latest report, or did you have to start from scratch?

Mr. ANDERSON. We had a knowledge base. What we did, in terms of just taking a look at the potential competitive impacts, we use some common data bases that the Department of Transportation maintains they regularly collect information on, enplanements, departures, and fuel consumed.

What we did, was we wanted to see what would happen if we wanted to try to generate the same amount of revenue, about \$5 billion, that the ticket taxes generated, and we looked at that to see what would happen if you substitute and say, well, less tax enplanements, or less tax fuel, or less tax departures. What you see, is you see the airlines that would have to pay shifting significantly.

The coalition's proposal, the way they came up with their various factors, just seems to favor all of the coalition members and most of the commuter airlines. But if you get away from that proposal and look at other alternatives, there is a wide mix.

Senator GRASSLEY. What is the compliance cost for airlines of the ticket tax system as compared to the compliance cost for airlines with a user fee proposed by the Big 7?

Mr. ANDERSON. I am not sure what you mean by compliance costs.

Senator GRASSLEY. Administrative costs of the company, collecting and paying.

Mr. ANDERSON. All right. I do not know for sure, but I think that all indications are this ticket tax has been in place since 1970's. It is computed right on the ticket, and I think it is relatively easy to administer now. I am told that the coalition airlines also think that their proposal would be fairly easy to administer, too. We have not actually looked closely at that.

Senator GRASSLEY. Could you make a general statement, if this committee is—and it should be, if it is not—interested, and the complexities of the Tax Code, would the new system be more complex from the standpoint of consumer understanding of it, and also from an administering point within the current system? How does the current system compare in complexity with the proposed system? I did not ask my question right.

Mr. ANDERSON. In my judgment, I believe the current system is relatively easy to understand. I think we all can relate to a sales tax, and that is sort of what it seems like. When you talk about a three-part system that is partly going to be based upon the number of passengers, partly based upon the mileage as the crow flies, and partly based upon—what is the other element?

Mr. HANNEGAN. Non-stop passenger miles and seats.

Mr. ANDERSON. The non-stop passenger miles and seats. It gets a little harder to understand.

Mr. HANNEGAN. And I think, Senator, part of our concern on the administrability of the proposal is that you have such a competitive airline industry, where there airlines are basically at each other's throats, especially in this circumstance, Southwest and America West and the coalition airlines, that you need some common understanding of the terminology and what is being taxed to make sure it is administratively feasible.

I am not sure we have that agreement right now. I think the coalition airlines strongly feel that their proposal is easy to administer, but I think if you ask Mr. Kelleher later today, he would probably differ on that.

The CHAIRMAN. We have several more questions, but I think we will ask them in writing because the hour is growing late. We thank you for being here today, and ask that you keep up with the developments, because we will want to draw on your experience and background in the future.

Mr. ANDERSON. Sure will. Thank you.

The CHAIRMAN. Thank you.

I would now like to call forward Mr. Steve A. Alterman, who is president of the Air Freight Association, Washington, DC; Mr. Edward M. Bolen, president, General Aviation Manufacturers Association; Washington, DC; Mr. Geoffrey T. Crowley, chairman, president, and CEO of Wisconsin Airlines Corporation, Appleton, Wisconsin; Mr. Herbert D. Kelleher, chairman, president, and CEO of Southwest Airlines, Dallas, Texas; and finally, Mr. Michael E. Le-

vine, executive vice president, Marketing and International, Northwest Airlines, Incorporated.

Gentlemen, it is a pleasure to welcome each and every one of you. We will include your full statement in the record as if read. We would ask that you keep your comments as brief as possible. We will start with Mr. Alterman.

**STATEMENT OF STEVE A. ALTERMAN, PRESIDENT, AIR
FREIGHT ASSOCIATION, WASHINGTON, DC**

Mr. ALTERMAN. Thank you, Mr. Chairman. My name is Steve Alterman. I am the president of the Air Freight Association. Our association represents the All-Cargo Airlines of the United States. We appreciate the opportunity to submit our initial comments on this important issue today.

We pledge to work with both the Congress and the Administration in an attempt to establish a fair system of taxation that meets the needs of the shipping and traveling public, as well as the aviation community.

As we have heard this morning, historically excise taxes on passenger tickets and cargo waybills have funded upwards of 80 percent of the moneys needed for FAA expenses and airport improvements.

The remainder of the necessary funding has come from the general treasury to compensate for military and other government use of the system. This method of payment for the services provided has now been called into question. The excise tax, as everyone knows, expired last December and a divisive battle over the future of funding is now taking place.

We feel that central to the discussion today are several important points. First, in the past the industry has simply taken for granted both the nature and the cost of FAA services.

Today, both of these aspects of FAA activity are being questioned. Therefore, before even discussing the allocation of the funding universe it is necessary to understand both the precise role the FAA will play, and the cost of this role.

As we have heard, a study is presently being conducted by the consulting firm of Coopers & Lybrand, and they are examining these issues. Its report will be presented to the National Civil Aviation Review Commission established by Congress.

A second issue, is will the Federal Government continue to fund any portion of the system, or will the aviation community be expected to bear 100 percent of the identified costs?

Third, within the aviation community will commercial aviation continue to subsidize private usage or will all segments be expected to pay a fair share, whatever that is?

Finally, the big issue, will we continue the excise tax system or will go to a user fee system?

Faced with these issues, the Air Freight Association submits the following comments. As the debate over cost and funding needs of the FAA continues, we ask that you recognize that any decisions will affect, possibly in the extreme, the All-Cargo Air Transportation industry. This is a unique industry, with unique employees, needs, characteristics, and contributions to our economy.

For example, our cargo carriers operate a large majority of their flights during nighttime hours, traditionally off-peak, thereby placing less stress on the system than the daytime operations.

Similarly, because of the nature of all-cargo operations these carriers rely to a much lesser extent on airport facilities and security than do other industries.

In addition, moreover, any new tax that we need to impose should carefully be crafted so as not to significantly alter the amount of taxes or fees the All-Cargo industry pays in comparison to other transportation industry segments.

This element is critical to ensure that any new tax or user fee system not unintentionally disadvantage all-cargo companies, thereby affecting the entire economy serviced by our members.

The all-cargo industry was invented in the United States by U.S. companies, with U.S. employees and capital investments in U.S. community support.

The United States is still the world leader in the all-cargo marketplace. Whatever actions are taken with respect to the development of new excise taxes or user fees should carefully protect this leadership and avoid other highly-adverse consequences.

Now, does this mean that the industry wants a free ride from the American taxpayer? Of course not. The industry has always been willing to pay its fair share of the system cost, and continues to do so.

Indeed, we have never objected to paying the traditional amounts assessed, even though they amounted to well over 100 percent of our fully allocated costs, based on the most recently available cost allocation study which I believe was 1991. We never got the most recent one because it was turned over to the Coopers & Lybrand study and we are still awaiting those numbers.

At the same time, we should not be expected to subsidize other segments of the marketplace. If the Federal Government does not continue to pay its traditional percentage of the system, the difference should be made up by those who do not now pay their fair share, not by those who already pay over 100 percent of their fair share.

Now, we think, as mentioned earlier, it is a little too early to determine whether a user fee system should be substituted for the traditional excise tax system, but, if a user fee system is instituted, it should be simple, fair, and reflect system use. Because the cargo system is significantly different from the passenger carrier business, any tax on the cargo system should reflect these differences.

Finally, since questions have been asked about it already this morning, it is clear that there are no easy answers to the problems being discussed today. We believe that the issues will continue to be discussed well into this year.

Therefore, in order to ensure that moneys again flow into the system, the excise taxes in existence prior to the first of this year should be reinstated on a short-term basis to get money flowing into the system.

I would be happy to answer any questions. That completes my oral statement.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Alterman appears in the appendix.]

The CHAIRMAN. Mr. Bolen.

STATEMENT OF EDWARD M. BOLEN, PRESIDENT, GENERAL AVIATION MANUFACTURERS ASSOCIATION, WASHINGTON, DC

Mr. BOLEN. Thank you, Mr. Chairman. My name is Ed Bolen, and I am president of the General Aviation Manufacturers Association. GAMA represents 52 manufacturers of general aviation aircraft, engines, component parts, and avionics. Our products range from the smallest part on a general aviation four-seat airplane, to large, entire business jets. Our customers are anyone who flies in, or operates, or utilizes general aviation.

General aviation is a vital link in our Nation's air transportation system. We are the primary training ground for the professionals that ultimately go into commercial service. We serve over 10 times the number of airports that scheduled airlines serve, and we provide a number of well-paying, high-tech manufacturing jobs in the United States.

The point that I am trying to make, is that we have a very vested interest in how well we fund our air transportation system. It is vital that we fund it adequately.

The general aviation community, in its entirety, supports the premise that it should contribute to those costs. I think the manner in which we contribute is important, however.

We feel very strongly in the general aviation community that the taxes should be reinstated as soon as possible, and frankly I agree with Senator Graham, who said they should be reinstated permanently. If we decide to modify the system at some later point, that can be done. But going through a periodic crisis does not seem to make sense.

Senator MOYNIHAN. Sir, I think it was Senator Bryan who said permanently. Mr. Graham said until December 31.

Mr. BOLEN. I stand corrected, Senator.

If we reinstate the taxes, it is clearly not going to cause a disruption in our current competitive market. Every entity that is in the market today has based its long-term projections under the current financing system. So, I do not think we are going to create a crisis by reinstating the tax.

I also think the taxes that we have had in place have been very efficient taxes, both for the taxpayer to pay and for the Government to collect, particularly from a general aviation standpoint. General aviation pays a fuel tax, a per-gallon fuel tax. Aviation gasoline pays one tax, jet fuel is taxed at a little higher rate. The combination is the fuel tax. The reasons I think this is a particularly positive tax are three-fold. No. 1, it very closely approximates use of the system. The more a person flies, the more fuel they burn. So it does a very good job of determining who is a heavy user of the system.

It is also simple to pay and simple to collect. We pay when we buy the fuel. There are no returns to file, there is no record keeping, there is no paperwork associated with it. So it is easy for us, and from the Government's point of view, you simply collect from a handful of fuel companies as opposed to a large number of pilots.

No. 3, and I think this is an important point, is that, unlike user fees which we have seen in foreign countries, the fuel tax does not discourage safe practices.

In a number of foreign countries where they have user fees there are charges for various activities, and that includes filing a flight plan, getting a weather briefing, talking to control towers. When you put charges on those things, you tend to discourage their use.

I think that that runs contrary to the safe practices that we want to encourage in the United States. I do not think it is an accident that the United States has, by far, the safest air transportation system in the world, and the safest general aviation system in the world. So, for those reasons, I think we have a very positive tax. Again, I would urge that we reinstate them.

I would make a comment. There was a question asked earlier of the GAO panel regarding whether or not the President is planning on proposing user fees, or if there will be an effort made to change the method in which general aviation pays.

I certainly have not seen the President's budget, but we do know that the President last year proposed a per-flight tax on business aircraft that would fund a number of education initiatives.

Frankly, the tax that he proposed would be a huge tax increase on that segment of the market and one that I think ultimately would yield less money to the Federal Government than the fuel tax is currently yielding.

I thank the committee for the opportunity to testify today, and I look forward to answering your questions.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Bolen appears in the appendix.]

The CHAIRMAN. Mr. Crowley.

STATEMENT OF GEOFFREY T. CROWLEY, CHAIRMAN, PRESIDENT AND CEO OF AIR WISCONSIN AIRLINES CORP., APPLETON, WI

Mr. CROWLEY. Good morning, Mr. Chairman. I am Geoff Crowley, president of Air Wisconsin Airlines Corporation, and I am also currently serving as the chairman of the Regional Airline Association. I appreciate the opportunity to testify today before your committee to share with you the importance of obtaining a stable, predictable, and fair funding mechanism for the FAA.

I am here today, both as the CEO of Air Wisconsin, which is a large regional airline, and as spokesman for the 65 U.S. airline members and 350 associate members of the Regional Airline Association.

In 1996, the RAA member airlines flew over 60 million passengers to over 700 U.S. airports. In the 48 contiguous States, regional airlines serve over 500 airports. Of those 500, over 300 are served exclusively by regional airlines. There are millions of passengers on regional airlines who depend upon regional airlines for access to the National Air Transportation System by connecting small- and medium-sized communities to large cities and hubs.

As background, I would like to add to your understanding the code-sharing arrangements among the regional and major carriers. This is important because these relationships are not all the same. There are approximately 45 code-sharing arrangements among the

U.S. major carriers and U.S. regional airlines. Eleven of the regional airlines are wholly owned by a major airline.

Major airlines hold a minority interest in four regional carriers, and the balance exists as agreements between independently-owned airlines and a major airline. My airline is in that latter category. We operate as a United Express carrier and, in doing so, are able to provide additional convenience to passengers connecting to or from United Airlines.

However, Air Wisconsin is an independent corporation which must deliver a service level to passengers and shippers in order to compete successfully, and we must be profitable in order to make current and future capital investments which are critical due to the capital-intensive nature of our business.

The U.S. airways infrastructure is, of course, maintained and operated by the FAA. Mr. Chairman, you and the members of your committee are aware that commercial airlines are among the very few large private enterprises that must rely so completely on the resources and capabilities of a Federal agency.

The productivity and efficiency of an airline are dependent, in great measure, on an FAA with the necessary resources to perform its responsibilities and on a well-designed and efficient air traffic control system that has the equipment and staffing to meet the needs of the users.

The RAA has long been in support of identifying and establishing a predictable and stable source of funding for the FAA. As the demand for air travel continues to expand, the need for air traffic services also increases.

Over 95 percent of regional airline passengers travel on regional airlines which have code-sharing arrangements with a major U.S. airline. A very high percentage of this passenger population expects to connect to or from the major airline partner at connecting hubs. The characteristics of this service provided by regional airlines create even a greater need for an efficient and up-to-date air traffic control system.

Delays due to the limitations of the air traffic control system disrupt the passenger connection process. An ATC system which cannot demand of the users is an ATC system which diminishes the productivity capacity of the aircraft in the regional fleet.

Each passenger regional aircraft makes 6 to 8 landings a day, with some aircraft making 10-12 landings every day. To meet the needs and expectations of air travelers, we must have a technologically-advanced ATC system, and to achieve that we must provide the FAA with a stable funding system which will permit the FAA to obtain the resources it needs today and plan for the future needs of the users.

The excise tax mechanism, which utilizes a 10 percent tax on passenger tickets, has provided funds for operating the FAA and for the Aviation Trust Fund for many years. While the funding source has been adequate, the application of a flat percentage to the cost of a ticket is not an equitable method to pay for the aviation services that are provided by the FAA.

It is not equitable because the ticket price, not the services being provided, is determining the funding contribution. Last summer, the RAA board of directors announced its support for an alternative

funding mechanism provided by the seven major airlines. That specific funding proposal is not linked to the cost of a ticket, but to the characteristics of travel, including flight segments and distance travel.

On most of the routes served by regional carriers, this funding mechanism would result in a lower cost than the ticket tax. This could benefit travelers who travel between smaller city pairs which may have fares that are higher when compared to fares for travel between major urban areas that are served by several competing carriers.

The ticket tax only serves to artificially inflate the higher fares that reflect the higher costs of operating smaller aircraft on thinner routes. Our thinly-populated markets cannot sustain point-to-point service. Without the spokes that we serve connecting to the hubs of major carriers, a large portion of America would suffer from greatly diminished, if not eradicated, air service.

The RAA believes that aviation users must identify a fair and equitable method to fund the FAA. We also believe that any changes to the current funding system must contain three elements: (1) any new or amended funding mechanism must provide the same amount of funds available to the FAA and the Aviation Trust Fund as provided by the now-expired ticket tax; (2) a portion of the cost of the aviation infrastructure must come from the U.S. general fund, as it does today; (3) an amended funding mechanism must impose no greater cost to administer than the expired excise tax.

The important consideration for U.S. regional airlines is that we must identify a funding mechanism that will not increase the cost of regional airline travel.

Regional airline travel is, by definition, short haul, with an average trip length of slightly over 200 miles. Regional airlines often compete with automobile travel on many routes. Increases in the cost of air travel may result in potential passengers electing for travel by private auto or the bus, directly impacting the economic viability of regional airlines.

Thank you.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Crowley appears in the appendix.]

The CHAIRMAN. Mr. Kelleher.

STATEMENT OF HERBERT D. KELLEHER, CHAIRMAN, PRESIDENT AND CEO OF SOUTHWEST AIRLINES CO., DALLAS, TX

Mr. KELLEHER. Thank you, Mr. Chairman, Senator Moynihan. My name is Herb Kelleher, and I am a co-founder, chairman, president, and chief executive officer of Southwest Airlines.

Although my testimony focuses on Southwest Airlines this morning, Southwest is also a member of the Alliance for Safe and Efficient Air Transportation, which opposes so-called user fees. The alliance is probably the largest and most diverse group of aviation interests ever assembled to address aviation policy issues.

It consists of 2,400 member groups, including pilot organizations, manufacturers of commercial and general aviation aircraft and equipment, fixed-base operators, State transportation departments,

organizations utilizing business aircraft, business travel corporations, and 34 commercial airlines.

In essence, the alliance comprises all of aviation except the seven largest commercial air carriers, and some of the regional commuters which feed passengers to them. The Regional Commuter Association was a founding member of the alliance, but changed sides when the seven largest carriers revised their user fee proposal to the tax advantage of the regional commuters.

The so-called user fee proposed by the Big 7 carriers is a destructive idea. Why? For 10 basic reasons. No. 1, the American people will abhor it. Why would they not? The most price-sensitive segment of the air travel market would be hit with a highly regressive new tax, an 11.4 percent increase in tax, resulting in a total Federal tax on their airline fares of 21.4 percent.

No. 2, fewer people will fly, 26 million fewer per year. It is simple: higher fares means fewer passengers, just as lower fares means more passengers.

No. 3, communities will get hurt. Fares up, passengers down. Some people and some places are going to lose service.

No. 4, it is still a tax. The Big 7 scheme is dressed up as a fee, but we all know it is still a tax. So, what is the point?

No. 5, it does not pass the stench test. As the GAO and DOT have revealed in their reports, the Big 7 plan is simply a trick. It makes those of us who, by and large, do not use their congested, inefficient, burdensome hubs pay for them. That stinks.

No. 6, nice guys should not finish last. In a 1993 report, DOT stated Southwest is the "principal driving force behind dramatic, fundamental change in the U.S. airline industry." In a 1996 report, DOT stated that Southwest had "provided a blueprint for successfully competing with large network carriers, like the Big 7." That blueprint was low costs.

DOT also stated that low-cost carriers were responsible for all of the increases in U.S. passenger traffic in recent years, and for \$6.3 billion in savings a year to American air travelers. So why go along with a plot to penalize the good guys?

No. 7, if the Big 7 are subsidizing our group of 34 carriers, why are they so rich? The Big 7 do not want to talk tax efficiency or tax administrability. But, if they do seriously want to talk about equity, which is their pretense, or fairness, which is a word they frequently use, let us talk fairness.

Let us talk about their huge hubs, imposing an enormous burden on the airport improvement program, as well as the air traffic control system. Let us talk about the profusion of slots that they own that they got free from the Federal Government at the slot-controlled airports.

Let us talk about them evading taxes on the domestic portion of international journeys. Let us talk about the control of the computer reservation systems throughout the United States. Let us talk about their payment of travel agent overrides. Let us talk about their long-term, exclusive use of gate leases.

If the issue is fairness, why limit the discussion? We are ready to talk about all facets of it.

No. 8, so-called user fee incentives run the wrong way. Let us have a test. Assume that the Department of Energy is, by law, the sole source provider of electricity in this country.

Assuming further that the Department can establish its own budget and charge user fees to cover its self-budgeted costs. Is your electric bill going to go up or is your electric bill going to go down? I move on.

No. 9, the excise tax system works. You would not be discussing all the problems that we have this morning if the excise tax had simply been allowed to continue. The excise tax system raises all the money as needed, plus a surplus, without voter complaint.

Contrary to the representations of the Big 7 in their letter to Congress of May 29, 1996, restoration of the excise tax did not hurt them. As we all know, the fourth quarter of 1996, after the tax came back, was financially the best fourth quarter in history for most of the Big 7.

No. 10, it just ain't right. It must have taken seven Cray supercomputers operating in parallel to come up with this formula which produces for the original Big 3 an 8 percent tax, uniform, for later members a nine percent tax, and for everybody else, anywhere from 15, 16, to 25 percent tax on the fares that they pay. But we are a symbol of freedom for 50 million passengers a year in the United States of America. We are also America's low-fare policeman.

The reason you do not have low fares in some of the markets you are talking about is because we are not there. The Big 7, in effect, want to kill the cop on the beat. I ask you to support law and order by saying no to the Big 7 and their anti-competitive, anti-consumer proposal to this Congress.

Thank you.

Senator MOYNIHAN. Mr. Chairman, do you not wish that Mr. Kelleher could make up his mind?

[The prepared statement of Mr. Kelleher appears in the appendix.]

The CHAIRMAN. Well, what do you have to say, Mr. Levine?

Mr. LEVINE. Herb has overwhelmed me. I am speechless.

Mr. KELLEHER. Good. Why do you not say anything? [Laughter.]

STATEMENT OF MICHAEL E. LEVINE, EXECUTIVE VICE PRESIDENT, MARKETING AND INTERNATIONAL, NORTHWEST AIRLINES, INCORPORATED, EAGAN, MN

Mr. LEVINE. My name is Michael E. Levine. I am executive vice president for marketing and international at Northwest Airlines. I am here, and I thank the committee for its invitation for us to testify, on behalf of a coalition involving American, Continental, Delta, Northwest, TWA, United, and U.S. Air, along with the Regional Airlines Association. We form the Coalition for Fair FAA Funding.

I would like to take a moment, if I may, to give you a little bit of my own background. I am unusual in my experience. I came to the airline industry after a fairly long apprenticeship as a scholar at Cal-Tech, USC, and Yale, teaching law, economics and management, and focusing mainly on the regulation of the airline industry.

The CHAIRMAN. We will not hold that against you. [Laughter.]

Mr. LEVINE. Try not to, sir. I also was heavily involved in de-regulation of the airlines as the chief of staff of the CAB during the Carter administration.

I actually spent a fair amount of my life trying to make it possible for airlines like Mr. Kelleher's to exist and to offer their services to the public.

I ought to say also that the coalition is completely committed to raising the money it takes to run the FAA and ATC. What we are discussing today is not whether adequate funds should be raised for that purpose, but only how they should be raised, and from whom.

My problem with the tax, which has been described as fair by Mr. Kelleher, is that it is inefficient. It is inefficient, in part, because it is outmoded, and it is unfair because it is outmoded. It is the grandson of a war excise tax that was put on in 1941 to discourage civilian use of transportation resources.

It has been recycled a number of times and exists today as the established fact simply because no one ever put it out of its misery. It has just been here. It was never designed to be a financing mechanism for the air transportation system.

It was put on with a group of taxes—telephone excise taxes, movie ticket taxes, taxes on matches, a host of others—in order to raise money for the war effort. It was bumped up several times during the war from, I think, 5 percent, to finally, 10 percent in order to achieve its purposes.

Senator MOYNIHAN. Now, sir, you first said that it was used to discourage travel, now you said it was used to raise revenues.

Mr. LEVINE. Oh, you can do both, Senator, as you well know. If you tax something, you raise revenue. If you also want less of it to happen, you can make that happen by taxing it heavily. I think, during the war, there were both purposes involved. There is no question about that.

It is inefficient for the obvious reasons that it bears absolutely no relationship to the use of the system made by the passengers who pay it. It is outmoded, for the obvious reason I was describing.

It is unfair, for reasons that I can go into clearly and simply. Let us take three users of the airline system, each on an approximately 350-mile trip. If you go from Garden City, KS to Kansas City on a regional airline, you will pay between \$27 and \$40 in ticket sales tax.

By the way, you use hardly any ATC services. Garden City does not even have a control tower. If you go from Milwaukee to Des Moines, you will get jet service and some control towers, but you will go between two uncongested airports in uncongested air space.

You will pay, in ticket sales tax, between \$27 and \$40 in the Garden City, KS case, between 21 and 46 in the case I am describing. Then you go from Orlando to Atlanta on ValuJet, between two heavily congested airports and in heavily congested air space, and you pay \$3.90 in tax to use those ATC services.

It is not simply, or even mainly, that there is more competition in those markets. What is going on, is that in the Orlando-Atlanta example, the airline has specialized in carrying passengers between two airports that depend on other airlines for their connections to the worldwide network.

The seven network carriers and their regional partners are basically connecting everybody in America to the world, in fact, using less resources than you would otherwise have to use because of the hub-and-spoke systems, and are simply looking for a mechanism that reflects their use of the system in paying for it.

I ought to be very clear. We admire what Southwest Airlines and Herb Kelleher have done. We are sure that, just as the PFC (passenger facility charge) did not put Southwest Airlines out of business or halve its passenger traffic, a tax which will be less for Southwest than is the PFC will not have that effect on Southwest.

In fact, Southwest's traffic grew after the PFC was imposed. We would urge you to move as quickly as possible to get away from a tax which we believe is about as badly constructed a one as you could imagine, if you were looking for a source of FAA funding. I will be happy to expand on that, if you will ask me some questions.

[The prepared statement of Mr. Levine appears in the appendix.]

The CHAIRMAN. Would you think a fuel tax would be better?

Mr. LEVINE. No, I do not think a fuel tax would be better, Senator. The fuel tax you pay is a function of whether you have decided to service your passengers by buying airplane that burn less fuel but cost you more per month in mortgage payments, or whether you have decided to pay less in mortgage payments and buy airplanes that burn more fuel. It doesn't measure your use of the system.

The reason why the fuel tax is so popular as a highway tax—it has been criticized some by economists—is that you have millions and millions of payors and it is relatively difficult to collect from them, whereas, in this case, you have relatively few airline users and an easy ability to get payments.

I might add, by the way, that we do not propose altering the general aviation fuel tax or the freight taxes; we are simply discussing airline passenger taxes.

The CHAIRMAN. You heard the testimony of the General Accounting Office. They said that the proposal by the coalition to replace the ticket tax only incorporates factors that would substantially increase the taxes paid by low-fare and small airlines and decrease the taxes paid by the seven coalition airlines.

It goes on to say, in their testimony, that your proposal does not take into account certain subsidies, that some or all the coalition members receive, such as control of nearly all the take-off and landing slots at the four slot-controlled airports. What do you have to say in answer to this?

Mr. LEVINE. Well, quite a lot. It would depend on how much time you would like to give me. But I will keep myself as brief as possible. I am a little surprised at the GAO's position on that. First of all, two of the three factors we have chosen do not penalize, but, in fact favor, the typical low-fare operator.

We have proposed that the number of passenger seats put into service on each flight be a factor. They use smaller airplanes, on average, than the members of the coalition do. For the members of the Regional Airlines Association, we have tried to accommodate their service to small communities by differentiating the seat charge.

We have also used other measures that, as the GAO themselves concede, are not measures that penalize those airlines. Actually, if you look at all the different ways you could finance the system, the sorts of things the GAO was talking about, you will find that only a fuel tax and the ticket tax do not produce higher charges on some of the airlines who have been getting a free ride from the current system, and that is because almost every other measure of use shows that they are using the system more than they are paying for it.

We support their right to exist, but no one is suggesting that they be subsidized in the purchase of aircraft, the purchase of fuel, or the purchase of anything else. We do not see why they should be subsidized for ATC service.

The CHAIRMAN. I am going to ask you one more question, then I will let you respond, Mr. Kelleher, and anyone else that may want to.

If we adopt the coalition plan, what do you think that will do to competition; what impact will it have on the low-cost airlines?

Mr. LEVINE. I think it will have little net impact on competition. The PFC charge which was enacted by the Congress in order to allow airports to collect charges for airport use actually had a bigger impact on them than the proposed change in funding that we have offered, and those airlines have absorbed the PFC tax and continued to grow.

Those airlines themselves put in fare increases when market conditions warrant that are larger than the increase in tax we are talking about here, and they grow and prosper despite that. Southwest and others have done that. And we do not object to their ability to adjust fares, but we think it is sort of scare-mongering to talk about putting them out of business.

The CHAIRMAN. You do not think the shifting of roughly \$500 million in costs will have a competitive impact?

Mr. LEVINE. Well, actually, the coalition's proposal shifts less than that, and we have repeatedly indicated that we are prepared to be flexible on just what the amount of shifting is. The fact is, we are not proposing a perfectly efficient, perfectly fair mechanism.

We are taking the worst possible mechanism and moving it in the direction of more efficiency and more fairness, and we are absolutely willing to discuss adjustments that need to be made along the way to accommodate the realities of life. We have never suggested otherwise, and we offer here to do so.

The CHAIRMAN. Mr. Kelleher, do you agree with Mr. Levine?

Mr. KELLEHER. Mr. Chairman and Senator Moynihan, I do not know whether I am capable of summoning a response to Mr. Levine because my heart is overborne by sadness and my lips are, perhaps, sealed by grief.

He has been an idol of mine for many years because of his favoring competition in the airline industry prior to the time he went on Northwest Airlines' payroll. It is like seeing a statute of your favorite hero perhaps begrimed and besmirched by verdigris and pigeon poop. [Laughter.]

So I will try to stumble through some responses, Mr. Chairman, but understand the laborious handicap under which I labor emotionally in this respect.

I read a DOT report and it talked about some airlines saving the American consumer \$6.3 billion a year in air fares. I may have been neglectful, but I did not see Northwest Airlines mentioned as one of those.

I saw a winners and losers analysis by the General Accounting Office of the cities throughout the United States where fares had gone down more than 20 percent as opposed to cities where they had gone up more than 20 percent. The ones that were winners, that was a map of Southwest Airlines' route system, but the losers were two of Northwest Airlines' hubs; one of them was Minneapolis, the other one was Memphis, TN.

I think, really, this Congress and this committee are engaged in policy deliberations, not in the pettifogging examples of individual flights. It is impossible to determining what the costs are in a system as complex as the air traffic control system.

If you subtracted Southwest Airlines from Love Field in Dallas, TX, you would not save the FAA a dime. If you subtracted American Airlines from DFW Airport in Dallas, TX, you would probably save the FAA \$1 billion a year.

So if we really want to get into things like that, you are going to find out that the large carriers impose more of a burden on the system than we do flying from Amarillo to Albuquerque, even at a congested hour. But that is not the point. There is no way to do that. It is not ascertainable.

Cost is not a platonic, absolute, cast on the wall of a cave by a fire. Cost is a variable, and nobody can ascertain it in this type of system. They have not bothered to ascertain it. They have simply come up with a formula, again, and I have it right here, where the original members—I guess the founding fathers of the cartel—each come out with a tax of 8 percent on their fares.

Then we have the colonies that joined the founding fathers of the cartel a little later, and they each come out with 9 percent, when you heard GAO say that any variation in any one of these things would radically affect what the consequences were.

So this is a tailor-made suit. Let me tell you some of the tailoring that was done to this suit. This is fine needle work. This is nine stitches to an inch, I will guarantee you.

First of all, you are a big hub-and-spoke carrier and you want fairness and equity, right? Right. Everybody knows that the big carriers have always wanted fairness and equity. That is, indeed, the salubrious principle by which they attempt to lead their lives.

So they exempt from the taxes passengers that fly into their hubs. They say they do not pay a mileage fee. Now, that is really fair. They say the reason they do not do that, that would penalize them for the circuitous routing. That is a ho-ho. They use more traffic control systems, but they should not be penalized for it because this is a cost-based system.

Then the regional commuters are opponents of theirs, so what do they do? They take this magical system which is designed to approximate equity and fairness and they say, hey, the regional commuters are all on the other side. They are supposed to be our vassals, but they are opposing us. We had better do something about that. So they take the seat fee, which is \$2, and reduce it to \$1 per seat for the regional commuters to get them to switch sides.

Again, the equity/fairness principle in action, real attention to costs.

Actually, this has nothing to do with all of those things. The excise tax system has worked beautifully for 25 years. I doubt that anyone in the Congress has ever received a complaint from any passenger about paying the tax. It costs nothing to collect. You see what a stealth tax it is: people do not even know when it is coming in or not, it is that unburdensome.

The CHAIRMAN. I think we get the picture, Mr. Kelleher. Time is running out.

Mr. KELLEHER. Oh, excuse me. I was also running out of thoughts. [Laughter.]

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. I think of that line of Hilare Biloc, who said, "The question is very much too wide, and much too deep, and much too hollow, and learned men on either side use arguments I cannot follow." [Laughter.]

I think we have been introduced to a complexity which we had not been aware of in the committee. I certainly had not, sir. We are going to have to learn a lot more. We have learned a lot this morning. I am very grateful to the panel and I am very happy that Mr. Anderson and his colleagues are over there to help us. We are going to need a lot of advice.

Unfortunately, sir, I have the duty to tell you that your caucus and our caucus commences in 4 minutes, this being the State of the Union day. But I thank you very much for these hearings, and I am sure we can get a unanimous decision out of this committee to go to the floor and say, this time we are just asking for a clean bill, and hold it at the desk, get the House to come over. That has to be done, and you are our leader.

The CHAIRMAN. Mr. Ranking Member, that certainly is my intent. But I would say to Treasury that there is a possibility that we might move tomorrow. I just want to put them on notice. Anyway, we are going to move as expeditiously as possible.

Gentlemen, thank you very much for being with us today. We will have a lot more questions later.

Mr. KELLEHER. And I do have a doctorate, Mr. Chairman.

The CHAIRMAN. The committee is adjourned.

[Whereupon, at 12:25 p.m., the hearing was concluded.]



APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF STEPHEN A. ALTERMAN

FUNDING AVIATION INFRASTRUCTURE—THE ALL-CARGO AIR CARRIER PERSPECTIVE

On behalf of the members of the Air Freight Association (membership list attached), we appreciate the opportunity to submit our initial comments on the future of aviation infrastructure funding. Moreover, we pledge to work with both Congress and the Administration in an attempt to establish a fair system of taxation that meets the needs of the shipping and traveling public as well as the aviation community.

Historically excise taxes on passenger tickets and cargo waybills have funded upwards of 80% of the monies needed for FAA expenses and airport improvements. The remainder of the necessary funding has come from the general treasury to compensate for military and other government use of the system. This method of payment for the services provided has now been called into question—the excise taxes expired on December 31, 1996; there is no indication of when these taxes will be reinstated; and a divisive debate over the future of aviation funding is now taking place. Central to this discussion are several important issues:

- First, in the past, the industry has simply taken for granted both the nature and cost of FAA services. Today both of these aspects of FAA activity are being questioned. Therefore, before even discussing the allocation of the funding universe, it is necessary to understand both the precise role the FAA will play and the cost of this role. A study presently being conducted by the consulting firm of Coopers & Lybrand is examining these issues and its report will be presented to the National Civil Aviation Review Commission established by Congress as part of the FAA Reauthorization Act of 1996.
- Second, will the Federal Government continue to fund any portion of the system, or will the aviation community be expected to bear 100% of the identified costs?
- Third, within the aviation community, will commercial aviation continue to subsidize private usage, or will all segments be expected to pay a "fair share"?
- Finally, will the aviation system continue to be funded by excise taxes or will a new user fee system be instituted? If a user fee system is favored, how will it be structured?

Faced with these issues, the Air Freight Association submits the following comments:

The all-cargo air carrier industry represented by the Air Freight Association is a significantly different segment of the air transportation marketplace from the passenger side of the business. For example, all-cargo carriers operate a large majority of their flights during nighttime (traditionally off-peak) hours, thereby placing less stress on the system than daytime operators. In addition, while passenger carriers historically have operated their aircraft in excess of ten hours each day, the all-cargo carriers operate their equipment approximately four hours daily, with proportionately fewer takeoffs and landings per aircraft and per day. Moreover, because of the character of all-cargo operations, these carriers do not make the same use of airport facilities (such as the passenger terminals) as the passenger carriers.

These facts have been recognized by prior Congresses when they established the cargo waybill tax at a percentage less than the tax on passenger tickets. When they expired in December 1996, these taxes were 6.25% and 10%, respectively. Even with this differential, however, the most recently available FAA Cost Allocation Study (1991) shows that the all-cargo industry pays significantly more than 100% of its

fully allocated costs. Therefore, any system of funding enacted must continue to recognize these differences.

With respect to specific issues under consideration, we feel that it is premature to discuss specific funding mechanisms until the Coopers & Lybrand study is complete and conclusions on future FAA operations and costs have been established. While the merits of an excise tax versus a user fee system can be debated, as a practical matter it is virtually impossible to assess the impact of any user fee system until the future system and its needs are established.

Second, we feel strongly that the United States Government should continue to fund a portion of the aviation infrastructure system. Quite apart from the fact that the military and other government users use the system extensively, our national air transportation system benefits every citizen and business in the country. Whether or not they ever actually get on, or ship on, an aircraft. The ability to move passengers and freight across the country and internationally, is a national asset which deserves a measure of federal funding.

Does this fact mean that the industry wants a "free ride" from the American taxpayer? Of course not. The industry has always been willing to pay its fair share of system costs and continues to do so. Indeed, we have never objected to paying the traditional amounts assessed, even though they amounted to well over 100% of our fully allocated costs. At the same time, we should not be expected to subsidize other segments of the marketplace. Therefore, if the Federal Government does not continue to pay its traditional percentage of the system, the difference should be made up by those who do not now pay their fair share—not by those who already pay over 100% of their fully allocated costs.

While, as noted above, it is too early to determine whether a user fee system should be substituted for the traditional excise tax system, if a user fee system is instituted, it should be simple, fair and reflect system use. And because the cargo system is significantly different from the passenger carrier business, any tax on the cargo system should reflect these differences. Accordingly, it is the position of the Air Freight Association that the following general principles be used if a user fee is established for air cargo transportation:

- As noted above, the first step in the process must be to determine the scope of FAA operations and the projected costs of the services provided.
- After this annual budget is set, a percentage (based upon the historical percentage obtained from the cargo airway bill tax) to be provided from cargo services should be established.
- The amount needed from cargo operations should then be allocated among users by a formula best reflecting system use. However, we are not yet prepared to even suggest what this allocation method should be.

Finally, since it is clear that there are no easy answers to the problems raised in the aviation funding debate, we believe that the issues will continue to be discussed well into this year. Therefore, in order to ensure that monies again flow into the system, the excise taxes in existence prior to December 31, 1996, should be re-instituted on a short term basis.

Thank you very much for the opportunity to present these comments; I would be happy to answer any questions.

MEMBERSHIP LIST

ALL-CARGO AIRLINES

* Airborne Express	Seattle, WA
* Burlington Air Express	Toledo, OH
* Emery Worldwide	Redwood City, CA
* Federal Express	Memphis, TN
* Southern Air Transport	Columbus, OH
* United Parcel Service	Louisville, KY
American International Airways	Ypsilanti, MI
Arrow Airways	Miami, FL
Express One International	Dallas, TX
Kitty Hawk Group	Dallas, TX
Northern Air Cargo	Anchorage, AK
Ryan International Airlines	Wichita, KS

OTHER ASSOCIATE MEMBERS

Air Cargo Management Group	Seattle, WA
Air Courier Conference of America	Washington, DC
Alaska International Airport System	Anchorage, AK
Alcalde & Fay	Arlington, VA
Columbia Metropolitan Airport	Columbia, SC
Dayton International Airport	Dayton, OH
FIDC/Fairbanks International Airport	Fairbanks, AK
Harrow & Co.	New Canaan, CT
Integrated Airline Services, Inc.	Denver, CO
Keiser & Associates	Oakland, CA
Metropolitan Washington Airports	Washington, DC
Oakland International Airport	Oakland, CA
The Campbell Aviation Group	Alexandria, VA

* Member, Board of Directors

PREPARED STATEMENT OF JOHN H. ANDERSON, JR.

Mr. Chairman and Members of the Committee: We appreciate the opportunity to testify on issues related to the financing of the Federal Aviation Administration (FAA). On December 31, 1996, the government's authority to collect the taxes that finance the Airport and Airway Trust Fund, which has historically provided about three-quarters of FAA's funding, lapsed. In December 1996, we reported to you, Mr. Chairman, and other members of the Senate and House on the status of the Trust Fund and on a proposal by a coalition of the nation's largest airlines to replace the tax on domestic airline tickets, which has been the Trust Fund's primary source of revenue, with fees on domestic operations.[1] The coalition airlines[2] contend that they pay for more than their fair share of the costs incurred by FAA in running the airport and airway system and that competing low-fare airlines underpay.

Our testimony today discusses the (1) status of the Trust Fund, (2) issues raised by the coalition's proposal, (3) potential effects of the coalition's proposal on domestic competition, and (4) potential competitive impacts of alternative options for financing FAA. Our main points are as follows:

- On December 9, 1996, we reported that, based on estimates provided by FAA and the U.S. Treasury, the money available in the Trust Fund to finance new commitments would reach zero by July 1997, unless the taxes were reinstated or another financing mechanism adopted. The estimates by FAA and Treasury assumed that airlines would pay most of the taxes that they owed for the last several months of 1996 by the end of the year. However, when making these estimates, FAA and the Treasury were unaware of a regulatory interpretation provided to the airlines by the Internal Revenue Service (IRS) that allowed airlines to delay these payments. When the taxes are paid, they cannot be transferred from the General Fund to the Trust Fund because the authority to do so also lapsed at the end of 1996. While FAA and Treasury are still trying to determine when the Trust Fund would run out of money, based on FAA and Treasury data, FAA may have to stop making new capital commitments as early as March 1997 in order to ensure that the agency can pay its workforces through the end of the fiscal year. To prevent this, the Congress would need to grant the authority to transfer the tax payments by March, which would allow FAA to fund new capital commitments to late July 1997. If the Congress reinstates the taxes or some other alternative by July, the Trust Fund should be able to fully finance its portion of FAA's fiscal year 1997 budget.
- To the extent possible, commercial users of the nation's airspace should pay a fair, cost-based share of the total costs of the nation's airport and airway system. As our December 1996 report indicated, because the airline ticket tax is computed based on the fares paid and not on factors that relate to FAA's costs for providing service, the extent to which the tax fairly allocates costs among system users is open to question. Recognizing the need for better cost data, the Congress in October 1996 directed that (1) an independent assessment of FAA's funding needs and the costs imposed on the system by each segment of the aviation industry be completed by February 1997, (2) we assess how air traffic control costs are allocated between FAA and the Department of Defense (DOD), with a report due to the Congress by April 1997, and (3) a national commission study how best to finance FAA in light of these assessments, with a report due to the Secretary of Transportation by August 1997.[3] These studies will be critical pieces in determining if the ticket tax fairly allocates system costs among users and in designing a new fee system if the Congress decides to replace the ticket tax.
- While many factors drive FAA's costs, such as the number of aircraft departures and aircraft miles flown, we found that the coalition airlines' proposal only incorporates factors that would substantially increase the taxes paid by low-fare and small airlines and decrease the taxes paid by the seven coalition airlines. As a result, the proposal would dramatically redistribute the taxes among airlines and could have substantial implications for domestic competition.[4]
- If the Congress decides to replace the ticket tax with a different financing mechanism, numerous options exist, including a tax on such common usage indicators as aircraft departures or passenger enplanements. Such options entail tradeoffs between their ease of administration, effect on how efficiently the nation's airports and airways are used, and ability to produce an equitable system in which commercial users pay their fair share of the costs. Similarly, the potential competitive impacts of these options vary widely. Examining potential financing alternatives will require careful consideration of these factors to ensure that, in the long term, FAA has a secure funding source; the nation's airports and airspace are used as efficiently as possible; commercial users of the

system pay their fair share; and a strong, competitive airline industry continues to exist.

BACKGROUND

The Airport and Airway Trust Fund was established by the Airport and Airway Revenue Act of 1970 (P.L. 91-258) to finance FAA's investments in the airport and airway system, such as construction and safety improvements at airports and technological upgrades to the air traffic control system. Historically, about 87 percent of the tax revenues for the Trust Fund has come from a tax on domestic airline tickets. Before it lapsed at the end of 1996, the tax was 10 percent of the fares paid. The remainder of the Trust Fund was financed by a \$6 per passenger charge on flights departing the United States for international destinations, a 6.25 percent charge on the amount paid to transport domestic cargo by air, a 15-cents-per-gallon charge on purchases of noncommercial aviation gasoline, and a 17.5-cents-per-gallon charge on purchases of noncommercial jet fuel.

STATUS OF THE TRUST FUND

In fiscal year 1997, under current law, the Trust Fund is to provide \$5.3 billion (62 percent) of FAA's budget of \$8.6 billion.^[5] FAA and the Treasury originally estimated that if the taxes that finance the Trust Fund lapsed on December 31, 1996, the Trust Fund would be about \$1 billion short of the funding needed to finance its portion of FAA's budget. However, in late January 1997, the Treasury acknowledged that it had miscalculated the balance of the Trust Fund because the agency incorrectly assumed that airlines would pay most of the taxes that they owed for the last several months of 1996 by the end of the year. However, under a regulatory interpretation provided to the airlines by IRS, they do not have to make most of those payments until late February 1997, and most airlines have not as yet paid. When these taxes are paid, they cannot be transferred from the General Fund to the Trust Fund because the authority to do so lapsed at the end of 1996. As a result, the Trust Fund may be about \$2 billion short of the funding needed to finance its portion of FAA's fiscal year 1997 budget.

FAA and Treasury officials are still attempting to determine the precise amount of the shortfall. However, based on FAA and Treasury data, a shortfall of \$2 billion would mean that in order to pay its workforces through the end of fiscal year 1997, FAA would have to stop making new capital commitments about March 1997. Reinstating the authority to move tax receipts from the General Fund to the Trust Fund by March would provide FAA with money to fund new capital commitments to late July 1997. If the Congress reinstates the taxes (or some other financing mechanism) by July, the Trust Fund should be able to fully finance its portion of FAA's fiscal year 1997 budget.

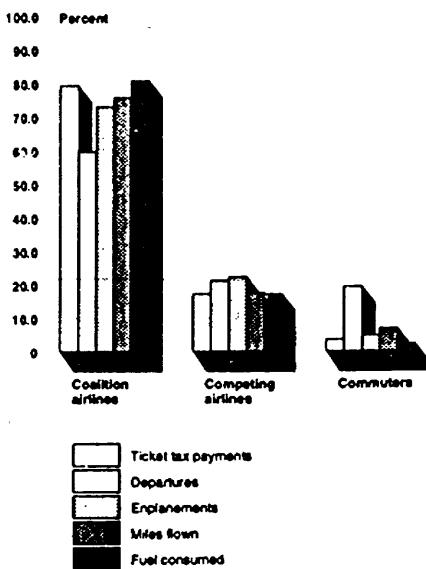
WHETHER TICKET TAX RESULTS IN USERS PAYING THEIR FAIR SHARE OF THE SYSTEM'S COSTS IS UNCERTAIN

FAA is responsible for a wide range of functions, from certifying new aircraft to inspecting the existing fleet to providing air traffic services, such as controlling takeoffs and landings and managing the flow of aircraft between airports. Over the past decade, the growth of domestic and international air travel has greatly increased the demand for FAA's services. At the same time, FAA must operate in an environment of increasingly tight federal resources. In this context, we have generally supported FAA's consideration of charging commercial users for its services and believe that the various commercial users of the nation's airspace and airports should pay their fair share of the costs that they impose on the system.^[6] In particular, we have previously suggested that FAA examine the feasibility of charging fees to new airlines for the agency's certification activities and to foreign airlines for flights that pass through our nation's airspace. In addition, to ensure full cost recovery, we have suggested that FAA consider raising the fees that it charges for the certification and surveillance of foreign repair stations.

Because the airline ticket tax is based on the fares paid by travellers and not on factors that relate to system costs, it may not fairly allocate costs among the users of the airport and airway system. For example, two airlines flying the same number of passengers on the same type of aircraft from Minneapolis to Des Moines at the same time of day will impose the same costs on the airport and air traffic control system. However, because the ticket tax is based on the fares paid, the airline that charges the lower fares will pay less for the system's use. Citing such examples, the coalition airlines contend that they pay for more than their fair share of the system's costs and that competing low-fare airlines underpay.

However, comparing the relative share of airlines' payments under the ticket tax to some common measures of domestic system usage does not provide conclusive evidence that the ticket tax is unfair. As figure 1 shows, the coalition airlines accounted for almost 80 percent of the total payments made under the ticket tax in 1995. Their percentage of system use was lower than this for some common indicators of system use such as domestic departures, passenger enplanements, and miles flown. However, the coalition airlines accounted for 81 percent of the fuel consumed by commercial airlines in domestic operations in 1995, another indicator of system usage. Airlines that compete with the coalition airlines, such as Southwest Airlines and America West, accounted for about 17 percent of the payments made under the ticket tax in 1995 but accounted for 21 percent of all domestic departures and 22 percent of enplanements. On the other hand, their share of miles flown and fuel used was the same as their share of ticket tax payments. Reaching definitive conclusions based on these comparisons is further complicated by the fact that most major commuter carriers are owned by or affiliated with one of the coalition airlines.

Figure 1: Comparison of the Relative Share Paid Under the Ticket Tax Compared With the Relative Share of Common Domestic System Usage Indicators, 1995



Source: GAO's analysis of DOT's data.

Currently, FAA has insufficient cost information to show whether the ticket tax or any of the system usage indicators shown in figure 1 would be good proxies for fairly allocating FAA's costs among commercial users. The Congress in October 1996 directed that, among other things, an independent assessment of FAA's costs be completed by February 1997 and that a national commission recommend to the Secretary of Transportation by August 1997 how best to finance FAA in light of the independent assessment.[7] Additionally, the Congress required that we assess how costs are allocated between FAA and DOD and that we report to the Congress by April 1997. Because about 18 percent of DOD services are provided to civilian users, according to DOD, information regarding DOD's costs may also be relevant in assessing financing alternatives for FAA. As a result, better information should be available later this year on FAA's costs that will allow for an evaluation of the ticket tax and potential alternative options for financing FAA.

PROPOSAL BY LARGER AIRLINES WOULD INCREASE THE SHARE PAID BY OTHER AIRLINES
AND COULD HAVE SUBSTANTIAL COMPETITIVE IMPACTS

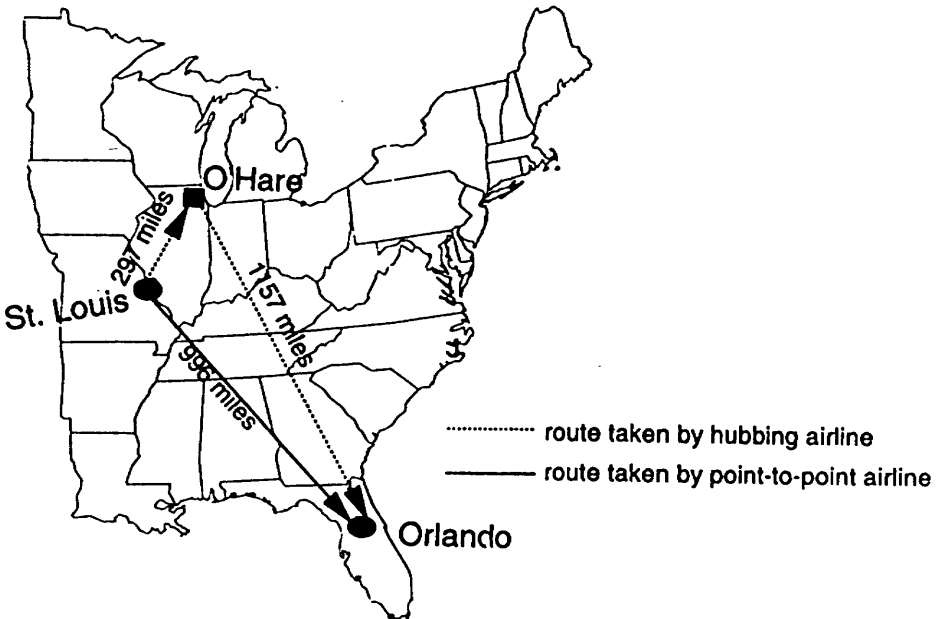
Motivated by their belief that the ticket tax unfairly subsidizes their low-fare competitors, the coalition airlines in May 1996 proposed that the ticket tax be replaced by user fees on domestic operations. Under the proposal, airlines would pay fees for domestic operations according to the following three-part formula: (1) \$4.50 per originating passenger; (2) \$2.00 per jet seat on aircraft with 71 or more seats and \$1.00 per seat on jets and turboprop aircraft with 70 or fewer seats; and (3) \$0.005 per nonstop passenger mile.[8]

By using two factors in particular—originating passengers and nonstop passenger miles—the formula tends to favor the larger airlines, which operate hub-and-spoke systems, at the expense of the low-fare and small airlines, which tend to operate point-to-point systems. This relationship can best be shown by example. Consider the two possible routings between St. Louis and Orlando shown in figure 2. The hubbing airline first takes the passenger from St. Louis to a hub, such as Chicago's O'Hare Airport, to connect to another flight to Orlando. The point-to-point carrier takes the St. Louis passenger nonstop to Orlando.

ENDNOTES

- [1]: Airport and Airway Trust Fund: Issues Raised by Proposal to Replace the Airline Ticket Tax (GAO/RCED-97-23, Dec. 9, 1996).
- [2]: The coalition comprises the seven largest airlines—American Airlines, Continental Airlines, Delta Air Lines, Northwest Airlines, Trans World Airlines, United Airlines, and USAir.
- [3]: The Federal Aviation Reauthorization Act of 1996 (P.L. 104-264). On November 18, 1996, FAA contracted with Coopers & Lybrand to conduct the independent cost assessment. As of late January 1997, the national commission had not yet been formed.
- [4]: The extent to which airlines were able to shift some or all of the costs associated with the ticket tax to consumers depended on consumers' sensitivity to changes in airfares. Prior studies have shown that consumers' sensitivity to fare changes varies and that in some cases small fluctuations in fares can have a large impact on an airline's ridership. Thus, redistributing taxes among airlines could have substantial competitive impacts depending on the subsequent effects on fares and ridership.
- [5]: Department of Transportation's Appropriations Act for Fiscal Year 1997 (P.L. 104-205).
- [6]: Certification of New Airlines: Department of Transportation Has Taken Action to Improve Its Certification Process (GAO/RCED-96-8, Jan. 11, 1996), and Management Reform: Implementation of the National Performance Review's Recommendations (GAO/OCG-95-1, Dec. 5, 1994).
- [7]: Under the Federal Aviation Reauthorization Act of 1996, after receiving the national commission's report, the Secretary of Transportation is required to consult with the Secretary of Treasury and report to the Congress by October 1997 on the administration's recommendations on how best to finance FAA.
- [8]: Air Traffic Control User Fees: A Proposal by the Coalition for Fair FAA Funding, revised June 7, 1996. The proposal defines originating passenger based on the beginning point of the trip, irrespective of the number of take-offs and landings made during the journey.

Figure 2: Comparison of Potential Hubbing and Point-to-Point Service Options Between St. Louis and Orlando



The airline that picks up a passenger in St. Louis and then lands at O'Hare to transfer the passenger to another flight to Orlando has twice as many takeoffs and landings as the airline that flies nonstop between St. Louis and Orlando. As a result, the costs imposed by the hubbing airline on the air traffic control system are greater. However, by charging \$4.50 per "originating" passenger the airline that flies the passenger from St. Louis to Orlando via Chicago O'Hare would pay the same amount as an airline that flies the passenger nonstop between St. Louis and Orlando, even though the hubbing carrier puts a greater burden on the system.

In addition, by charging \$0.005 per "nonstop passenger mile"—or the straight-line distance between the points of origin and destination—the formula does not charge the hubbing airlines for the circuitous routings that are common to their hub-and-spoke operations. As a result, the airline transporting a passenger 297 miles from St. Louis to O'Hare and then flying that passenger 1,157 miles to Orlando would be charged the same as an airline flying a passenger nonstop from St. Louis to Orlando, even though the hubbing carrier placed a greater burden on the air traffic control system.

Because the seven largest airlines operate hub-and-spoke systems and most low-fare and small airlines operate point-to-point systems, the proposed user fee would shift the fees for using the system away from the larger airlines and onto their competitors. As shown in appendix I, for example, if this proposal had been in place in 1995 instead of the ticket tax, the cost to the nation's seven largest airlines would have been nearly \$550 million less while the cost to Southwest Airlines, America West, and other low-fare and small airlines would have been about \$500 million more. In addition, the coalition's proposal would charge commuter carriers \$1.00 per seat while charging airlines \$2.00 per seat. Because most major commuter carriers are owned by or affiliated with one of the coalition airlines, the proposal would thereby provide an additional benefit to the coalition airlines by charging commuter carriers less per seat.

Implementing a proposal that would shift about \$500 million in costs from one segment of the industry to another could have substantial competitive impacts. For Southwest Airlines, for example, the increased amount paid would represent about 7 percent of the airline's total passenger revenue. According to the Department of

Transportation (DOT), competition from low-fare airlines such as Southwest influences airfares in markets that account for about 40 percent of domestic passengers. In addition, according to DOT, these passengers tend to be the most price sensitive. As a result, such a substantial increase in costs would likely force Southwest and the other low-fare and smaller airlines to raise their fares and could result in a reduction in passenger demand in those markets, which tend to be in the West and Southwest. To the extent that these airlines stopped serving markets that were no longer profitable, competition would be reduced. On the other hand, consumers in the East and upper Midwest, who have not experienced the entry of low-fare airlines to the same extent, could pay relatively less than they did under the ticket tax and may benefit from an increase in airline competition that may result from any increase in passenger demand, if the larger airlines passed their reduced tax payments onto consumers by reducing ticket prices.

While the ticket tax might provide a competitive advantage for low-fare airlines, other public policies favor some large carriers. For example, a few large airlines control nearly all the takeoff and landing slots at the four slot-controlled airports[9], which give them an advantage over their competitors. Simply eliminating the potential "subsidy" to low-fare airlines created by the ticket tax, while leaving the other policies in place that provide a competitive advantage to some large airlines, might result in higher fares and a reduction in service options for consumers.

ENDNOTES

[9]: To minimize flight delays, FAA limits the number of operations (takeoffs and landings) that can occur during certain periods of the day at four key congested airports—Chicago O'Hare, Washington National, New York Kennedy, and LaGuardia. The authority to conduct a single operation during these periods is commonly referred to as a "slot."

IMPACTS AND TRADEOFFS ASSOCIATED WITH THE NUMEROUS ALTERNATIVE OPTIONS AVAILABLE FOR FINANCING FAA VARY

Determining how best to finance FAA is a complex problem that requires careful study and good cost data. FAA's costs vary depending on the amount, type, and timing of various airline operations.[10] For example, hubbing operations at congested airports increase the peak service demands on the system and increase FAA's costs. However, this cost has not yet been quantified and neither the 10-percent ticket tax nor the large airlines' proposal accounts for these costs. A financing system that doesn't take such factors into consideration could result in costs not being fairly allocated among system users. As a result, any potential financing mechanism for FAA should be assessed from the standpoint of the data currently being developed on FAA's actual costs.

If the Congress ultimately decides to replace the ticket tax with a different fee system, numerous financing options are available for it to consider. Possible options include taxing one or more of the common indicators of system use, such as departures, passenger enplanements, seats flown, fuel consumed, or a combination of these indicators. However, the potential competitive impact of using these indicators as a basis for allocating FAA's costs varies greatly depending on which indicator is used. For example, if a tax on passenger enplanements were adopted and designed to generate about the same amount of revenue as the ticket tax, the amount paid by the coalition airlines would decline by about \$251 million while the amount paid by the competing airlines would increase by \$269 million and commuter carriers by \$61 million.[11] (See app. II.) In contrast, a fuel tax would keep the amount paid by each airline group about the same as each paid under the ticket tax. (See app. III.)

The impact of the financing options also varies among airlines within the coalition and competing airline groupings. For example, under a system that taxed both fuel use and passenger enplanements, the amount paid by four coalition airlines would decrease but would increase for the other three coalition members. Similarly, under a financing system that taxed departures and aircraft miles, the amount paid by Southwest Airlines would increase by about \$135 million but would decrease by about \$7 million for the other airlines in the competing airlines grouping. In general, such variances result from differences between airlines in operating factors, such as type of operation, average age of their aircraft fleet, and average distance of their flights.

The various financing options for FAA also present tradeoffs between their ease of administration, impact on how efficiently the airport and airway system is used, and ability to produce an equitable system in which users pay their fair share. For example, a formula that combines several of the common system usage indicators

might provide the most exact method to ensure that all users pay their fair share of system costs. However, such a formula may also be so complex that it would be difficult to administer. Similarly, taxing airlines for their use of the most congested airports may result in a more efficient use of the nation's airspace. However, because the coalition airlines are the primary users of these airports, this approach may not produce the most equitable result from their point of view.

Such tradeoffs and the potential competitive impacts of a new fee system will need to be carefully studied over the next year by the national commission and the Secretary of Transportation. The financing alternative that is finally selected should be relatively easy to administer and help ensure that, in the long term, FAA has a secure funding source, the nation's airports and airways are used as efficiently as possible, commercial users of the system pay their fair share, and a strong, competitive airline industry continues to exist. Ultimately, it will be a policy call for the Congress to decide on how to achieve these goals.

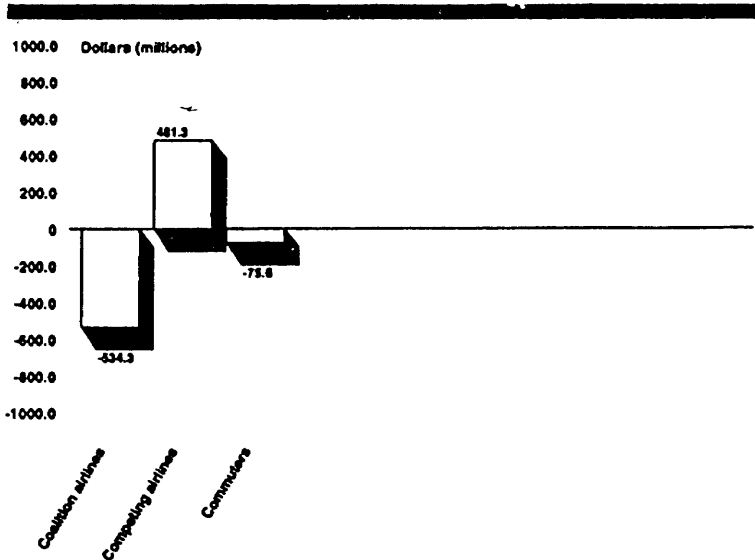
Mr. Chairman, this concludes our prepared statement. We would be glad to respond to any questions that you or any member of the Committee may have.

ENDNOTES

- [10]: The issue of how various users of air traffic and other FAA services impose costs on the system is complex. Past studies of FAA's costs have found that the nature of how air traffic and associated services are produced entails many costs that are "common"—that is they cannot be allocated to any one type of user. As a result, a full allocation of system costs may require a mechanism for assigning these common costs.
- [11]: A tax of \$10 per enplanement would generate about \$79 million more than was generated under the ticket tax in 1995.

APPENDIX I

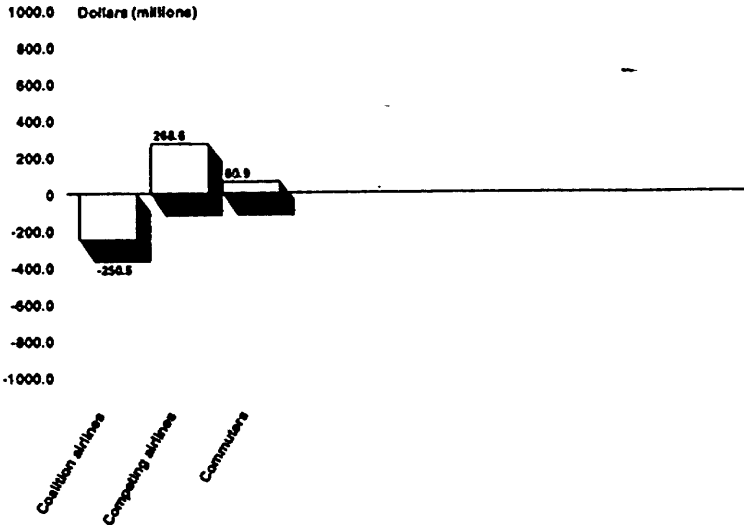
CHANGE IN THE AMOUNT PAID BY GROUPING UNDER
THE COALITION'S PROPOSAL COMPARED
WITH THE TICKET TAX, 1995



1. Charge is \$4.50 per embarkment, \$2 per jet seat, \$1 per turboprop seat, and \$0.005 per nonstop passenger mile.

2. Proposal would generate about \$128.6 million less than was generated by the ticket tax in 1995.

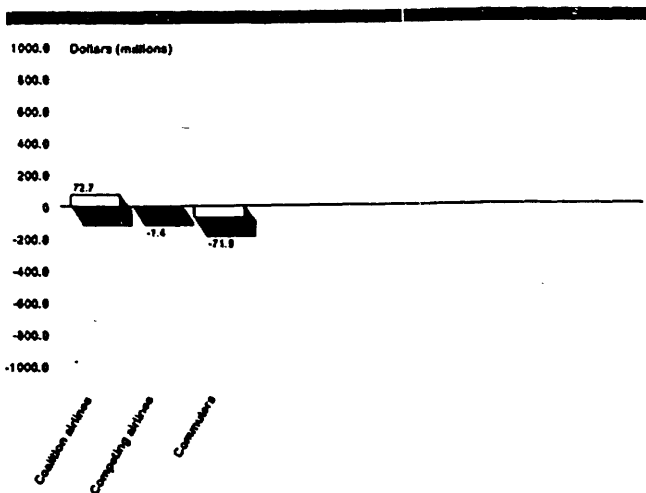
APPENDIX II

CHANGE IN THE AMOUNT PAID BY GROUPING UNDER A \$10 TAX PER ENPLANEMENT COMPARED WITH THE TICKET TAX, 1995

1. Charge is \$10 per enplanement.
2. Option #1 would generate about \$79 million more than was generated by the ticket tax in 1995.
3. Data based on total domestic enplanements by each grouping in calendar year 1995.

APPENDIX III

CHANGE IN THE AMOUNT PAID BY GROUPING UNDER A \$0.42 TAX PER GALLON
COMPARED WITH THE TICKET TAX, 1995



1. Charge is 42 cents per gallon.
2. Option #2 would generate about \$1 million less than was generated by the ticket tax in 1995.
3. Data based on total gallons consumed by each grouping in domestic operations in calendar year 1995.

PREPARED STATEMENT OF EDWARD M. BOLEN

Mr. Chairman, Senator Moynihan, and members of the Finance Committee, my name is Edward M. Bolen, and I am President of the General Aviation Manufacturers Association (GAMA).

GAMA represents 51 general aviation aircraft, engine, avionics and component parts manufacturers throughout the United States. Our members make aircraft ranging from small single-engine planes to mid-size turboprops to business jets capable of seating 19 passengers. We supply most of the aircraft flown in the United States by private pilots and the business aviation community.

Today's hearing is very timely and I appreciate the opportunity to testify. It is my hope that Congress will reinstate the aviation excise taxes, which, until January first, supplied the revenues for the Airport and Airways Trust Fund. Our nation's air transportation system is too important to our economy and our well-being to allow it to go underfunded. The recently expired fuel taxes and transportation ticket taxes have provided a very efficient, effective, fair and understandable means of generating revenues for the system. They should be reinstated as soon as possible for as long as possible.

GENERAL AVIATION

As this subcommittee has demonstrated by inviting today's panel, general aviation is an important link in our national air transportation system, and one that should not be overlooked in the FAA funding debate.

With the recent decline in military training, general aviation has become, to an even greater extent than before, the training ground for the entire aviation industry. Today, most of the pilots, technicians and other professionals in commercial aviation come directly from the ranks of general aviation. As commercial travel continues to grow, demand for these professionals will also increase.

General aviation is a major employer in the United States, with hundreds of thousands of people involved in manufacturing, marketing, operations, finance, training, and publication. It is also an industry that contributes positively to our nation's balance of trade, fosters commerce and brings economic development to thousands of rural and small communities not served by commercial airlines.

FAA SHOULD BE FUNDED THROUGH A COMBINATION OF TAXES AND GENERAL FUND CONTRIBUTIONS

The general aviation industry strongly supports the premise that it should pay to use the national air transportation system. That is why general aviation was instrumental in the creation of the Airport/Airways Trust Fund, and has supported every increase in the fuel tax except one. (The industry opposed the 1993 increase in the fuel tax only because the revenues it generated were not dedicated to the Airport/Airways Trust Fund).

Funding the Federal Aviation Administration (FAA) through a combination of the four specific aviation excise taxes and a contribution of General Fund revenues has worked well in the past. GAMA believes this combination should continue to be used to fund the agency in the future.

THE AVIATION EXCISE TAXES

Although some have disparaged the aviation excise taxes during the FAA funding debate, there are compelling reasons for keeping this funding system:

1. It has worked. Our aviation industry has grown tremendously under the aviation excise tax system. The U.S. has by far the safest, largest, most diverse and most sophisticated air transportation system anywhere in the world. Based on the success of aviation in the U.S. it seems clear that the taxes have not been a drag on the industry.

2. It has generated significant sums of money. In fact, even the FAA's own projections show that reinstatement of the expired taxes could generate all of the revenue necessary to fund the FAA through the year 2002.

3. Members of the aviation community have based their long-term business projections on the recently expired system of excise taxes. This means that reinstating the taxes would not change the current competitive balance, drive any company or industry segment out of the marketplace, or have any other unintended consequences.

GENERAL AVIATION FUEL TAX

Prior to the expiration of the aviation excise taxes, most general aviation flights were subject to the fuel tax either at 19.4 cents per gallon for aviation gasoline or 21.9 cents per gallon for jet fuel. Among other things, these fuel taxes are:

1. Directly related to one's use of the system. Since the more a plane flies the more fuel it burns, the fuel tax is an outstanding way to distinguish between light and heavy users of the system. Also, because of the differential between the tax on aviation gasoline and jet fuel, a distinction is made between high performance planes and those that are less sophisticated.

2. Easy for the government to administer. Unlike fees, the fuel tax does not require a large number of collectors, auditors and accountants. The federal government deals with a relatively small number of fuel companies rather than every individual pilot in the United States.

3. Simple to pay. The fuel tax requires no complicated record keeping. Pilots simply pay at the pump.

4. Not an impediment to safety. The fuel tax does not encourage pilots to avoid talking to towers, filing flight plans or getting weather briefings.

Perhaps the only negative aspect of the recently expired fuel tax is that 4.3 cents of the per gallon tax is used for deficit reduction rather than aviation. It is our hope that this can be changed when the taxes are reinstated so that all revenues from the fuel taxes can be used for aviation purposes.

GENERAL FUND CONTRIBUTION

The government's philosophy for using General Fund revenues to pay for a portion of the FAA's operating costs was that all Americans benefit in some measure from a strong air transportation system regardless of whether or not they ever get on an airplane. Cab drivers, hotel employees, and shop workers who manufacture goods destined for the global economy are clear examples of people who benefit from the air transportation system without getting on a plane. But the fact is that all Americans benefit to some extent from an air system that facilitates transportation and trade, and prevents airplanes from falling out of the sky.

As aviation manufacturers, GAMA's members are reminded daily of the services the FAA performs on behalf of the general public. Since 1926, the federal government has required the FAA (or one of its predecessors) to certify all aviation products manufactured in the United States. The entire purpose of this certification process is to ensure that aviation products do not pose an unreasonable safety risk to the general public.

USER FEES

GAMA's strong support for the aviation excise taxes and the General Fund contribution stands in stark contrast to its opposition to user fees. This opposition is not based on fuzzy philosophy or abstract theory. Rather, it comes from our actual experience with user fees in several foreign countries. What we have learned abroad is that user fees:

1. Restrict the growth of general aviation. The foreign countries that have user fees do not have a robust general aviation industry. Our members have publicly stated that sales in Europe have been weak and projections of future growth have been flat because of the European system of user fees. They are paperwork intensive, confusing, annoying and they leave the impression that one is being "nickel and dimed to death."

2. Create safety problems. In order for our air transportation system to be safe, we should encourage safe practices such as the filing of flight plans, obtaining weather briefings, talking to air traffic control towers and practicing takeoffs and landings. But if we attach fees to each of these activities, some people will inevitably try to avoid paying the fees, and the result will be a decrease in aviation safety.

Last year, at GAMA's Industry Outlook Conference, the President of Jeppesen, Horst Bergmann, related one of his recent experiences in Germany. Mr. Bergmann was flying with a young general aviation pilot who announced that she wanted to practice her takeoffs and landings. Mr. Bergmann said the airplane descended to just a couple of feet above the runway and then began to ascend. Miffed, Mr. Bergmann asked the pilot why she did not touch down. She responded, "in Germany, there is a 12-mark charge if your wheels hit the ground, so people don't really touch down when practicing takeoffs and landings."

If the United States is interested in safety, we should continue to require pilots to put their wheels on the ground. "Virtual" takeoffs and landings are not in the best interest of safety.

3. Are subject to bureaucratic manipulation. In some foreign countries, the civil aviation authorities charge for their services with a per person and/or a per hour fee. When this happens, it is not unusual for the government to send more people than necessary and take longer than necessary to complete the task.

4. Rise faster than inflation. In some countries, user fees are done on a flat fee per service. However, we have learned that those fees are subject to frequent increases often well beyond the government's cost of providing the service.

Last year, the International Air Transport Association, in its annual report, stated that user fees in Europe were rising much faster than the rate of inflation and that user fees were the second largest expense for transport operators, behind fuel. Those fees have been used to build plush new headquarters for the collection agency, Eurocontrol.

5. Are a disincentive for streamlining. Allowing a natural monopoly like the FAA to charge their captive customers for services creates a disincentive for efficiency. After all, why should a government agency downsize, outsource, delegate or eliminate unnecessary programs if doing so does not produce an economic benefit? What incentive is there for the government agency to find a better and less expensive way to accomplish their mission?

THE ALLIANCE

Because of GAMA's support for the existing excise taxes and our negative experience with user fees, GAMA is a member of the Alliance for Safe and Efficient Air Transportation. The Alliance, which represents the largest group of aviation interests ever formed to address aviation policy issues, is committed to adequately funding the FAA through innovative financing methods that maximize the revenues generated by the existing aviation excise taxes.

GAMA OPPOSES PRESIDENT'S PER FLIGHT FEE

Last August, President Clinton proposed placing a \$225 per-flight fee on all turbine-powered aircraft and using the revenue from the fee to fund new educational initiatives. GAMA is opposed to the President's proposal because it is:

1. Regressive. The per-flight fee is not related to the length of the flight or government services consumed.

2. Paperwork intensive. Presumably this proposal will require invoices, record keeping, audits, collection agents, and a brand new bureaucracy to administer.

3. Detrimental to business aviation. Because it will significantly increase the cost of a typical business flight, surveys of users show that this type of fee will dramatically decrease business aviation activity. As a result, the federal government could actually lose revenue, as well as many good aviation jobs.

4. Violates the principal that aviation revenue should be used for aviation purposes. This principal is the very foundation of the Airport/Airways Trust Fund, and is a matter of great importance in the aviation community. Offsetting non aviation expenditures with aviation revenues is wrong, and should be avoided.

CONCLUSION

GAMA applauds the subcommittee for holding this hearing and strongly supports a properly funded FAA. For decades, the fuel, ticket, cargo and international departure taxes have combined with the general fund contribution to provide adequate funding for the strongest, safest, most diverse and most sophisticated air transportation system in the world. As a matter of policy, why change a system that works for an untested system that could well be anti-growth and anti-safety? Instead of scrapping the aviation tax system that has served us so well, GAMA believes Congress should reinstate the taxes as soon as possible for a minimum of five years, and look for ways to maximize the revenues these taxes generate.

PREPARED STATEMENT OF GEOFFREY T. CROWLEY

Good morning/afternoon Mr. Chairman. I am Geoffrey Crowley, President, Chairman and CEO of Air Wisconsin Airlines Corporation. I am also currently serving as Chairman of the Regional Airline Association. Thank you for the opportunity to

testify before your committee to share with you the importance of obtaining a stable, predictable and fair funding mechanism for the Federal Aviation Administration.

I am here today both as the Chief Executive Officer of Air Wisconsin, which is a large regional airline, and as spokesman for the 65 U.S. airline members and 350 associate members of the Regional Airline Association. In 1996, the RAA member airlines flew over 60 million passengers to over 700 U.S. airports. In the 48 contiguous states, regional airlines serve over 500 airports. Of those 500, over 300 are served exclusively by regional airlines. There are millions of passengers who depend on regional airlines for access to the national air transportation system by connecting small and medium sized communities to large cities and hubs.

As background, I would like to add to your understanding of the code-sharing arrangements among the regional and major carriers. This is important because these relationships are not all the same. There are approximately 45 code-sharing arrangements among the U.S. major carriers and U.S. regional airlines. Eleven of the regional airlines are wholly owned by a major airline. Major airlines hold a minority interest in four regional carriers and the balance exist as agreements between independently owned airlines and a major airline. My airline is in the latter category. We operate as a United Express carrier and in so doing are able to provide additional convenience to passengers connecting to or from United Airlines. However, Air Wisconsin, is an independent corporation which must deliver a service level to passengers and shippers in order to compete successfully and we must be profitable in order to make current and future capital investments which are critical due to the capital intensive nature of commercial airlines.

The U.S. airways infrastructure is, of course, maintained and operated by the Federal Aviation Administration. Mr. Chairman, you and the members of your committee are aware that commercial airlines are among the very few large private enterprises that must rely so completely on the resources and capabilities of a federal agency. In addition to the oversight responsibilities of the Federal Aviation Administration for maintaining and operating our aircraft, airlines must also receive permission from FAA air traffic personnel for their aircraft to taxi, takeoff, turn, climb or perform any other flight function. The productivity and efficiency of an airline are dependent, in great measure, on an FAA with the necessary resources to perform its responsibilities and on a well designed and efficient air traffic control system that has the equipment and staffing to meet the needs of the users.

The Regional Airline Association has long been in support of identifying and establishing, a predictable and stable source of funding for the Federal Aviation Administration. As the demand for air travel continues to expand, the need for air traffic services also increases.

Over 95 percent of regional airline passengers travel on regional airlines which have code-sharing arrangements with a major U.S. airline. A very high percentage of this passenger population expects to connect to or from the major airline partner at connecting hubs. The characteristics of the service provided by regional airlines create even a greater need for an efficient and up to date air traffic control system. Delays due to the limitations of the air traffic control system disrupt the passenger connection process. An ATC system which cannot respond to the demand of the users is an ATC system which diminishes the productive capacity of the aircraft in the regional fleet. Each passenger regional aircraft makes 6 to 8 landings a day, with some aircraft making 10 to 12 landings every day. To meet the needs and expectations of air travelers, we must have a technologically advanced ATC system and to achieve that, we must provide the FAA with a stable funding system which will permit the FAA to obtain the resources it needs today and plan for the future needs of its users.

The excise tax mechanism which utilizes a 10 percent tax on passenger tickets, has provided funds for operating the FAA and for the Aviation Trust Fund for many years. While this funding source has been adequate, the application of a flat percentage to the cost of a ticket is not an equitable method to pay for the aviation services that are provided by the FAA. It is not equitable because the ticket price not the service being provided is determining the funding contribution.

Last summer, the RAA Board of Directors announced its support for an alternative funding mechanism proposed by the seven major airlines (see attached Press Release: "RAA Supports Alternative Funding System"). That specific funding proposal is not linked to the cost of a ticket but to the characteristics of the travel including flight segments and distance traveled. On most of the routes served by regional carriers, this funding mechanism would result in a lower cost than the ticket tax. This could benefit travelers who travel between smaller city pairs which may have fares that are higher when compared to fares for travel between major urban areas served by several competing carriers. The ticket tax only serves to artificially inflate the higher fares that reflect the higher costs of operating smaller aircraft on

"thinner" routes. Thin routes are defined as segments between less populated market areas. Our thinly populated markets cannot sustain point to point service. Without the spokes that we serve connecting to the hubs of the major carriers, a large portion of America would suffer from greatly diminished, if not eradicated, air service.

RAA believes the aviation users must identify a fair and equitable method to fund the FAA. We also believe that any changes to the current funding system must contain three elements:

1. Any new or amended funding mechanism must provide the same amount of funds available to the FAA and the Aviation Trust Fund as provided by the now expired ticket tax.

2. A portion of the cost of the aviation infrastructure must come from the U.S. General Fund, as it does today.

3. An amended funding mechanism must impose no greater costs to administer than the expired ticket tax.

The most important consideration for U.S. regional airlines is that we must identify a funding mechanism that will not increase the cost of regional airline travel. Regional airline travel is, by definition, short haul with an average trip length of slightly over 200 miles. Regional airlines often compete with automobile travel on many routes. Increases in the cost of air travel may result in potential passengers electing to travel by private auto or the bus, directly impacting the economic viability of regional airlines.



Regional Airline Association
1200 19th Street, NW • Suite 300 • Washington, DC 20036-2401 • 202-857-1170 • FAX 202-429-5113 • ARIAC WASRAAD

FOR IMMEDIATE RELEASE
Thursday, June 6, 1996

Contact: Debby McElroy
202-857-1170

RAA SUPPORTS ALTERNATE FAA FUNDING SYSTEM

The Board of Directors of the Regional Airline Association (RAA) today elected to support a FAA funding mechanism which is intended to provide for continued growth and high-frequency service to the hundreds of U.S. communities that receive scheduled airline service from regional and commuter airlines.

The funding mechanism would replace the ten percent passenger ticket tax and is based on a program developed by the seven major U.S. airlines, with some modification. The funding mechanism approved by the RAA would establish a \$4.50 per passenger charge, a charge per passenger per segment based on a ratio of 2:1 of major airline to regional airline (regardless of load factor) and a one-half cent per passenger per mile charge computed on great circle statute miles. In addition RAA noted the necessity of regional airlines participating in all decisions regarding changes to the formula. For most of the regional airlines, application of this formula would provide a benefit to the traveling public compared to the 10 percent passenger ticket tax.

More than 60 million passengers depend on the safe, efficient and cost-effective service provided by regional airlines. The industry serves more than 700 U.S. cities, 72 percent of which depend exclusively on regional carriers for their access to the national air transportation system.

"It is important that we identify and put in place a stable and predictable funding system to permit the FAA accomplish their tasks including increasing the efficiency of the Air Traffic Control System," said Walt Coleman, RAA president. "This funding mechanism appears to provide a practical approach, while protecting the traveling public in smaller communities throughout the United States."

The Regional Airline Association is a trade association which represents U.S. regional airlines and the providers of the products and services that support the industry, before the U.S. Congress, Federal Aviation Administration, Department of Transportation and other federal agencies. Founded in 1974, RAA also provides technical and promotional services to member airlines. RAA's member airlines transported 93 percent of total regional airline industry passengers in 1995.

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PREPARED STATEMENT OF HON. ALFONSE M. D'AMATO

Mr. Chairman, I am pleased to welcome our esteemed colleague, Senator McCain, Chairman of the Commerce, Science, and Transportation Committee, and our other distinguished witnesses to today's hearing.

Just four days ago we learned from Treasury Department and the FAA that we have an urgent problem with the Airport and Airway Trust Fund. How fortunate that you had scheduled today's hearing.

The original forecast was that the Trust Fund would be sufficient to pay for FAA operations, including air traffic controllers, until September 30, 1997, the end of the fiscal year. Now we are informed that because of a "safe harbor" provision allowed by law, ticket taxes collected by the airlines prior to their expiration on December 31, 1996, will not be paid until February 28, 1997. This delay in payment will cause the Trust Fund to be depleted much sooner than expected, which will likely stop funding for new contracts for airport repairs and improvements some time in March or April.

The original purpose of today's hearing was to consider an alternative to the existing excise taxes that has been proposed by the seven largest U.S. carriers—the *Coalition for Fair FAA Funding*. However, in light of this new information, we must also determine how severe the situation is, and whether an immediate reinstatement of the ticket tax is necessary and for what length of time.

Mr. Chairman, as we begin to consider other funding solutions, it is essential to keep in mind that it not be a short-term fix, but a permanent one. And it must be fair and equitable to all concerned, especially the American public who will ultimately pay whatever fee Congress enacts into law. Most importantly, we must maintain the safety and security of the traveling public. As such, we should expect nothing less than the best, safest and most efficient air traffic control system possible. Therefore, any change to the existing form of funding must be considered thoroughly.

Again, I welcome our distinguished panel to this important hearing and look forward to an open and frank discussion of the issues.

Thank you Mr. Chairman.

 PREPARED STATEMENT OF HON. CHARLES E. GRASSLEY

Mr. Chairman, thank you for calling this important hearing. The public needs to know that the Finance Committee is committed to the continued safety and service of air travel of the ticket I support the extension tax. I also support the transfer of the 4th quarter 1996 ticket tax revenue to their proper place in the FAA trust fund. We should act with legislation as soon as possible.

A corollary to the present FAA trust fund crisis is the question of how to fund it for the future. Today, their will be testimony on how best to finance air travel safety and service. Many of the panelists will spend a good deal of time talking about "fairness." Some will talk about how the financial burdens of supporting the FAA may not be "fairly" distributed. However, it is important to keep a few things in mind.

First, the Congress gets to decide what is fair. Then, the President gets his opinion, and then ultimately the courts may rule differently on the matter if they choose. However, no one could disagree that the word "fair" is a very subjective term. What is fair for some is not always fair for all.

Also, we should keep in mind that a *fair* distribution does not necessarily mean an *equal* distribution. Fairness does not necessarily mean a distribution that is pro rata by the use of FAA services. For example, take our progressive income tax system. The wealthy pay more than the poor. That is a policy decision. Some wealthy may not like it, is the policy. It is fair because our national values lead us to believe that the poor need a little extra help, and the rich have a little extra help to give.

Similarly, Congress may decide that the current distribution of the burden of funding the FAA is "fair." In written testimony the GAO refers to 2 hypothetical airplanes. The planes are of the same make and model, and carry the same number of passengers. The two planes fly from Minneapolis to Des Moines on the same day. The passengers with the cheaper tickets, on either airline, pay less tax than the holders of more expensive tickets.

The tax burden is unequal, even though the two flights of the two planes probably deplete the FAA similar resources.

Other testimony today will explain how the Big 7 airlines think that this is unfair. The Big seven think this is "unfair" because they almost never have the cheap-

er tickets. In lieu of making their tickets cheaper, they want to make everyone else's tickets more expensive.

If they cannot defeat their competitors at the ticket offices, they want to defeat them here in the Finance Committee. This does seem inconsistent with our national values. And, this seems inconsistent with the idea of a market economy.

And how about the passengers on those two planes flying to Des Moines? In our market economy, all of the passengers on the cheaper airline made the conscious decision to buy the cheaper ticket. This might mean that they get less frills with the service. But, they still get from Minneapolis to Des Moines, which is where they are going. They freely made the decision about their carrier. That decision includes the decision to pay the lesser tax.

Of course, it is possible that many passengers could not afford the more expensive ticket, even if they wanted it. This is where I have a "fairness" concern. If the Big 7 airlines have their way, and we shift more of the FAA financing costs onto the smaller, more cost effective airlines, then maybe Congress will price some lower income people out of the air travel market.

People make a decision to pay the lesser tax on a lesser ticket. Some want to. Others have to. Everyone needs to travel for variety of reasons. Congress will error if it follows the Big 7 slogan that "fair" is "equal" when it comes to paying taxes on travel. This gets me to my bottom line. The Big 7 talk about the taxes that they pay. I say that they pay no taxes whatsoever. The passengers pay the taxes. If the passengers want, or need, to pay lesser taxes on cheaper airline tickets, then it is fair to let them continue to do so. If the Big 7 want their passengers to pay less taxes, then they might find a way to offer them cheaper tickets. Ours is a market economy. And, in a market economy, the current system is fair.

PREPARED STATEMENT OF HERBERT D. KELLEHER

TEN REASONS WHY A "USER FEE" IS A DESTRUCTIVE IDEA

My name is Herb Kelleher. I am a cofounder of Southwest Airlines, where our 24,000 Employees and thousands of Shareholders permit me to work. I am here today to offer ten reasons why an aviation "user fee" is a destructive idea. My comments concern the proposal advanced by the seven biggest airlines to substitute a three part tax for the present excise (sales) tax.

Reason #1: People Will Not Like It

The contrivance concocted by the "Big 7" airlines is a sky-high tax on the American consumer. The majority of all Americans flying in 1995 paid less than \$100 per airline coupon for a one-way journey: 53% of them to be precise. On Southwest, the average was much lower, less than \$70 per person. For these people, the Big 7 anti-competitive plan is a huge tax increase. How much? Well, it's hard to say exactly. Taking aim on the Big 7 schemes is like shooting at a fast-moving target. We can't keep pace with their constant changes. Anyway, let's assume the Big 7's deal works out to \$12 per passenger. Their own numbers actually show it to be \$13.58 on average (per their June 14, 1996, version)[1], so our assumption is conservative. At \$12 per passenger, the Big 7 tax represents an 11.4% fare increase on those people (53% of all air travelers) paying low fares (less than \$100 each way). That is 11.4% over and above what people paid in 1995 inclusive of the 10% federal excise tax. A new, highly-regressive federal tax: 21.4% in total. Just what every consumer needs and wants from the Congress.

Reason #2: Fewer People Will Fly

We have all heard the term "price elasticity." I'm told this means that if you raise the price of corn, people will buy less corn or switch to lower-priced beans. I think I get it. We asked an outside consultant, specifically John Eichner of the firm Simat, Helliesen, and Eichner, to tell us what would happen if a new tax raised airfares on 53% of the traveling public by 11.4%. Mr. Eichner told us it would produce a net loss of 26.2 million passengers nationwide. Sure, under the Big 7 anti-competition proposal, the guys in first class theoretically might get a tax cut—if the Big 7 don't convert it to profit instead (want to bet?). But more people, those who are most price-sensitive, will get hurt.

Reason #3: Communities Will Get Hurt

We asked Mr. Eichner to tell us WHERE these losses in traffic were likely to occur. He examined the annual impact in 383 domestic markets. 382 of them lost business, 62 by more than 100,000 passengers each. A table showing the losses state-by-state is attached. (Attachment A)

A few examples for your consideration are: Nevada down 10.8%; Rhode Island down 6.6%; Chicago's Midway Airport loses 9.3% of its passengers, or 211,000 people; Florida loses over a million passengers; Oklahoma busted for 12.4%; and Mississippi a loser by 8.3%. With losses of this magnitude, medium and smaller size markets are in jeopardy of losing air service altogether, particularly in shorthaul markets, thereby forcing people to return to their cars. But, every state loses.

Reason #4: It's A Plain Old Tax

The Big 7 dress up their scheme as a "user fee." We have studied their "fees." At first it seemed confusing. But it is really simple. In fact, it's as easy as 1-2-3.

One—Step on an airplane and pay a tax of \$4.50

Two—Sit down on an airplane and pay another tax of \$2.00.

Three—Fly a mile. Pay a tax. (Just think of it as a TAX-I meter in the sky.)

(Actually, the "seat tax" of \$2.00, as opposed to the "head tax" of \$4.50, mutates into a real tax of \$3.07 for non-stop flights; \$6.13 for one-stops; and \$9.20 for two stops; if you can follow the Big 7 schematic flow. They lost me on that one, so I'll leave it to the Big 7 to explain. They have more accountants—which we will all need under their formulas!)

I asked another expert, namely Lawrence B. Gibbs, former Commissioner of the IRS, to explain the difference between a "user fee" and a tax to finance the FAA. Gibbs reply: no difference. Call it what you will, a tax is a tax. Gibbs' legal opinion letter is attached (Attachment B) for your review. It raises some rather interesting public policy reasons why a user fee is a bad idea, based on Mr. Gibbs' experience administering the tax laws of the United States of America.

Reason #5: It Doesn't Pass The Smell Test

The Big 7 Formula is complex in order to hide the truth. This is all you need to know about their "formula": the Big 7 want a tax exemption for their connecting passengers at major hub airports, otherwise known in FAA parlance as the "congested" hub airports. They remind us of Willie Sutton, who, when asked why he robbed banks, told us that to steal money you have to go where the money is. Hub airports are the "banks" of the airline world. The Big 7 anti-competitive scheme tends to give "hypocrisy" a bad name. In short, they say the passengers of those airlines who impose the absolute greatest burden on the national aviation infrastructure should pay the least. And for sheer boldness and baldness, 'ya gotta love this. The Big 7 say this tax exemption is justified so their hub/spoke connecting passengers will not be "penalized for a circuitous routing."^[2] That is, a routing requiring more ATC services!

Reason #6: Nice Guys Shouldn't Finish Last

It's clear by now, as it was to DOT based on their comments on the Big 7 plan (Attachment C), that the Big 7's artifice is a thinly veiled assault on Southwest Airlines. According to their own numbers, their taxes go way down and Southwest's go way up—an incredible 67% or \$195,243,060.00 per year! What did we do to make the Big Seven so mad? History may hold the answer.

My professional life with Southwest Airlines covers almost 30 years. I filed the Articles of Incorporation for the company in 1967, but spent four years fighting the plots of the entrenched airlines which tried to prevent the birth of Southwest by erecting every legal, administrative, and political barrier they could construct. They were indicted—and they lost. In the process, they also spent as much as it would take to start a new airline. On June 18, 1971, Southwest started flying as America's new experiment in low-cost, high-frequency, shorthaul air travel. Our goal was to convert air travel from a luxury into an unsubsidized commuter transit system. We succeeded.

Twenty-six years later we are America's largest low-cost, low-fare airline. We can still offer low fares on every flight every day because our highly productive Employees work very hard, give great Customer service, and have become rather devoted, as proud parents tend to be, to their "baby." Our People have accomplished wondrous things:

1. We have created 24,000 jobs, BUT we have never furloughed an Employee.

2. We were the first airline to offer Employees an ownership interest via a profit sharing plan. We instituted that plan in 1973 and have made bountiful contributions to the plan each year since 1973. Every permanent Employee is a shareholder.

3. Southwest has one of the most highly unionized work forces in the American airline industry (84%) and has some of the most generous pay/benefits contracts of any major carrier. At the same time, Southwest enjoys low unit costs. It's not magic; it's People.

4. The authors Robert Levering and Milton Moscowitz in their book, *The Best Companies to Work for in America*, chose Southwest as one of the ten best places to work.

5. Based on number of flights operated and passengers carried without fatality, Southwest has the best safety record in the world.

6. Southwest has been the "launch" customer for three different Boeing airplanes, creating and/or maintaining thousands of jobs in the aerospace industry. Southwest today operates an all-Boeing fleet of 243 airplanes and has orders and options for approximately 20 new airplanes each year for the rest of this decade and beyond.

7. Southwest carried almost 50 million people in 1996 at the lowest average airfares in America. The combination of low fares and frequent flights caused the U.S. DOT in a 1993 report to describe Southwest as the "principal driving force behind dramatic fundamental changes" in the U.S. airline industry.[3]

8. Southwest is the only carrier that has ever won a DOT "Triple Crown" for having the best ontime performance; the fewest mishandled bags; and the fewest Customer complaints. Southwest has won 31 monthly and four consecutive annual Triple Crowns!

9. For two of the last three years, Southwest has won the top spot in the Wichita State University/University of Nebraska's Airline Quality Rating study, an annual consumer index using performance-based data.[4]

To succeed in this harshly competitive business, new entrants and smaller carriers must offer low fares in order to overcome the inherent advantages of the mega carriers. The giant airlines, by sheer strength of longevity, size, global linkages, dominant computerized reservation systems, slots at controlled airports, travel agent overrides, and frequent flyer programs, can crush new competition unless that competition can provide the consumer a good service at a lower price. Profitable low fares are dependent, totally, on having low costs.

As stated in an April, 1996, DOT Report:

"As it turns out, in addition to its own direct competitive effects, Southwest had another important effect. It provided a blueprint for successfully competing with large network carriers. The linchpin to this success is low costs. While a number of new entrant carriers today have differing business concepts, many of the more successful have one thing in common that allows them to compete effectively. This common denominator is very low operating costs." (Emphasis added.)[5]

The Big 7's "user fee" proposal is an attempt to burn this "blueprint"—and, thus, to destroy competition, forever.

Initially, just three airlines joined together (American, Delta, and Northwest) in an expedient scheme. I'm sure it is a mere coincidence, but, if one works through their numbers, it just so happens that their proposed "user fee" works out to be a tax of exactly 8.4% for them, while Southwest's tax is 16%. So, our low-fare passengers pay double the tax rate that their high fare passengers pay. What's not to like?

Recently, the GAO did a study[6] of airline competition. Its conclusion: cities served by Southwest got more service at lower fares. Cities not served by Southwest usually did not.

Reason #7: If They Are "Subsidizing" Us, Why Are They So Rich?

Okay, by now probably you have all heard the Big 7 corporate refrain: "Southwest is subsidized because we pay higher per capita taxes into the trust fund." This is the equivalent of the minor on trial for murdering his parents begging the court for leniency on the grounds he is an orphan. They can cut our so-called "subsidy" by cutting their fares. It is true, however, that the Big 7 are experts on federal subsidies. They should be—they have all of them. If they are offended by subsidies, here are some suggestions they might make:

- a. Pay the government the fair market value each year for their slots at the slot controlled airports.
- b. Pay the fully allocated cost of running the FAA all night long, 24 hours a day. They are the ones using it, not us.
- c. Pay the true cost of servicing their "international" passengers, instead of the miserly \$6 they paid before the excise taxes lapsed altogether. A typical passenger flying Dallas-Houston paid more tax than someone flying from Sacramento to Amsterdam on Northwest Airlines, connecting through Minneapolis, who was treated as an international passenger while traversing the breadth of the U.S., thereby evading any excise tax at all.

d. Pay hub congestion fees to cover the true costs of the ATC expenses and ATC delays they impose on the rest of us, not to mention the huge amount of AIP funds that their gigantic, overworked airports require.

And what of the argument that low-fare, high-frequency airlines like Southwest don't pay a fair share? After all, the Big 7 say, we "use" the system more, relative to the taxes we generate with our low fares. Their joint submission to Congress, dated May 29, 1996, contains the following refutation of their own position:

"Most of the expenses of the air traffic control system are fixed and do not vary with the volume of traffic. Thus, as the volume of traffic increases over time, the FAA's unit costs should decline."^[7]

And where is all of the growth coming from? From the low-cost, low-fare airlines and new entrants, according to the U. S. Government. In its report of April, 1996, DOT found that 100% of the growth in air travel in recent years is attributable to airlines like Southwest and our "progeny."^[8]

Conversely, if Southwest grounded every one of our 2,200 daily flights, the FAA's fixed costs would not decline a penny. Most of the fixed costs are in place to support the inefficient (from an ATC perspective) hub/spoke system conjured up by—guess who? By design, Southwest chooses less congested routes and airports. Compare Love Field to DFW; Midway to O'Hare; Oakland to San Francisco; Birmingham to Atlanta. Ask yourselves, as those charged with developing the Nation's tax policy, where has all the money gone and for whose benefit? Which airlines impose the greatest burdens on the system and the Treasury? Why, the very ones asking you for a tax cut today.

Reason #8: User Fee Incentives Run the Wrong Way

Believe it or not, some people have actually said that user fees will create incentives for greater productivity and lower ATC costs. Let's test that one a little bit. Assume that the Department of Energy is, by law, the sole source provider of electricity in this country. Assume further that DOE can establish its own budget and charge "user fees" to cover its self-budgeted costs. Is your electric bill going up or down? Can we move on now?

Reason #9: The Excise Tax System Works

No one has ever found a method for collecting money from users which works more easily, more efficiently, or more painlessly than the aviation excise taxes imposed for decades without complaint from passenger or shipper users. Money is not the issue. The excise tax has produced consistent surpluses.

The Big 7 would have you believe that the excise tax is a destroyer of passenger traffic. In their May 29, 1996, letter to Congress, the Big 7 said:

"By the time a new ticket tax is imposed, it will universally be perceived as a new and substantial tax increase, causing many travelers to stay home rather than travel. Nearly five months have passed since consumers were required to pay the 10% tax and the dramatic increase in air travel that has resulted is a testament to how powerfully the tax cut has stimulated economic activity."

That was then. This is now. When the excise tax was restored in a fiscally responsible manner in August, 1996, the Big 7 moved to jack up prices. According to the Wall Street Journal on August 19, 1996, (Attachment D), the carriers justified passing the tax on to consumers because "they said demand had been running so strong that they thought the market could bear the increase."

The Journal article went on to report:

"We're seeing really excellent demand in the industry," said a Continental spokesman in Houston. "There's a very healthy supply-and-demand relationship right now, and under those conditions, a price increase is justified."

Even more recently, the Big 7 raised fares again, over and above the 10% excise tax, justifying it on the basis of "widespread, strong demand" according to the September 9, 1996, Wall Street Journal: (Attachment E)

"Airlines raised most domestic fares 2.5% over the weekend as demand for airplane seats continues strong, even after a 10% boost in ticket prices just three weeks ago." (emphasis added)

I doubt this is the first time industry has told Congress one thing and Wall Street another. Airline traffic is solid because the economy is solid. It may not last. The industry is cyclical. When the economy turns, as it always does, fares will decline. At that time, the mega carriers tax contributions will also decline. That is all good. It encourages lower fares for the consumer and greater efficiency by the airlines. I may be economically illiterate, but to me it seems that the incentives of an excise tax work the right way. User fees for services rendered by a natural pure monopoly like the FAA encourage profligate spending. A tax as a percentage of the price paid by the consumer encourages greater efficiency. Of course, what goes unstated here

by the Big 7 is the hidden agenda. If the FAA looks to the airlines as its customers instead of the passengers, the FAA naturally will tend to gravitate toward its largest customers. The "user fee" scheme is a quiet, subtle attempt to maneuver a "hostile takeover" of a federal safety agency by those whom it is supposed to regulate.

Reason #10: It Just Ain't Right

For 25 years, Southwest Airlines has been America's Low-Fare Policeman. Under the protection of the Supreme Court's Noerr-Pennington Doctrine, these seven large corporations may be able to combine forces to try to lobby Congress to do what they could not do on their own: force us to raise our fares and/or reduce competitive service. They are trying to remove the cop on the beat. Wouldn't that be a crime?

As the St. Louis Post Dispatch just editorialized (Attachment F) on January 9, 1997, Congress should renew the ticket tax as is.

Thank you for your time, patience, and good humor.

ENDNOTES

- [1]: "Comments on the DOT Staff Review of the Coalition's Air Traffic Control User Fee Proposal, June 14, 1996," Roberts, Roach & Associates, Inc
- [2]: "Air Traffic Control User Fees, A Proposal by the Seven Largest U.S. Airlines," May 29, 1996, Roberts, Roach & Associates, Inc. p.21.
- [3]: Bennett and Craun, "The Airline Deregulation Evolution Continues: The Southwest Effect," Office of Aviation Analysis, U.S. DOT, (May, 1993.)
- [4]: "Airline Quality Rating Study," Wichita State University and University of Nebraska at Omaha, April 15, 1996.
- [5]: Bennett and Craun, "The Low Cost Airline Service Revolution," Office of Aviation and International Economics, U. S. DOT, (April, 1996), p.5.
- [6]: "Airline Deregulation: Changes in Airfares, Service, and Safety at Small, Medium, and Large Communities," General Accounting Office. (GAO/RCED-96-79, April, 1996.)
- [7]: "Air Traffic Control User Fees, A Proposal by the Seven Largest U.S. Airlines," May 29, 1996, Roberts, Roach & Associates, Inc. p. 12.
- [8]: "The Low Cost Airline Service Revolution," U.S. Department of Transportation, Office of Aviation and International Economics, April, 1996, p.11.

STATE BY STATE PASSENGER LOSS DUE		
TO \$24 ROUNDTRIP FEDERAL HEAD TAX OR USER FEE		
STATE	PASSENGER LOSS/ YEAR	PERCENT OF TOTAL
Alaska	90,180	-8.8%
Alabama	208,736	-12.4%
Arizona	145,540	-13.0%
Arkansas	899,640	-9.6%
California	2,159,764	-5.6%
Colorado	615,916	-4.7%
Connecticut	91,752	-4.5%
Washington DC	388,736	-4.7%
Florida	1,152,308	-5.2%
Georgia	1,326,456	-6.2%
Hawaii	426,060	-19.3%
Iowa	183,552	-15.7%
Idaho	137,652	-12.7%
Illinois	1,427,500	-5.8%
Indiana	410,076	-12.7%
Kansas	52,852	-9.3%
Kentucky	239,768	-14.7%
Louisiana	263,756	-7.8%
Massachusetts	400,908	-4.9%
Maryland	423,392	-9.0%
Maine	80,064	-11.2%
Michigan	1,154,672	-10.3%
Minnesota	648,744	-6.3%
Missouri	1,258,332	-9.5%
Mississippi	44,684	-8.3%
Montana	71,164	-7.1%
North Carolina	1,363,108	-10.3%
North Dakota	66,008	-15.3%
Nebraska	149,056	-10.2%
New Hampshire	41,448	-11.0%
New Jersey	288,960	-3.4%
New Mexico	132,228	-7.7%
Nevada	887,892	-10.8%
New York	756,348	-4.9%
Ohio	1,140,572	-9.0%

STATE	PASSENGER LOSS/ YEAR	PERCENT OF TOTAL
Oklahoma	259,200	-12.4%
Oregon	307,004	-6.6%
Pennsylvania	1,174,228	-7.5%
Rhode Island	55,040	-6.6%
South Carolina	338,988	-17.9%
South Dakota	59,180	-12.9%
Tennessee	656,944	-8.9%
Texas	2,673,788	-7.7%
Utah	339,856	-5.3%
Virginia	195,272	-8.0%
Vermont	32,016	-10.9%
Washington	502,624	-5.2%
Wisconsin	424,428	-14.8%
West Virginia	46,992	-17.0%
Wyoming	48,516	-17.2%
United States	26,247,900	-7.3%

MILLER & CHEVALIER
ATTORNEYS

June 18, 1996

MEMORANDUM

TO: Herbert D. Kelleher
Chairman of the Board
President & Chief Executive Officer
Southwest Airlines Co.

FROM: Lawrence B. Gibbs *Lawrence Gibbs*

You have asked for my views on whether the user fees proposed in S. 1239, the Airport Traffic Management System Performance Improvement Act of 1996, are taxes and whether the processes provided by that legislation for raising and spending fee revenues constitute sound tax and budget policy. My position on these matters is provided in a letter I have sent you dated today. Essentially, I have concluded that the fees are taxes and that the processes are ill-advised.

This memorandum is to advise you of a United States Supreme Court case, Massachusetts v. United States, 435 U.S. 444 (1978), that relates specifically to taxes/user fees to fund FAA but does not affect the conclusions of my letter. I think you should be aware of the decision, nonetheless, since those who disagree with my position could argue that the decision conflicts with the letter's conclusions. As will be discussed, I believe that any such argument is unpersuasive.

Massachusetts addressed the issue of whether the imposition of a federal aircraft registration tax on a helicopter used by Massachusetts in its police function violated intergovernmental tax immunity. The tax in question, which applied to all aircraft that fly in U.S. airspace, was part of the original group of excise taxes used to fund the Airport and Airway Trust Fund. The Court determined that a tax that operated as a nondiscriminatory user fee would not violate intergovernmental tax immunity, since any such tax would not seriously impair the appropriate exercise of functions by state governments subject to the tax.

The argument that could be raised is that since the decision treats taxes that fund FAA services as user fees, it follows that the fees of S. 1239 are user fees and not taxes. My position, however, is that user fees and taxes should not be viewed as "either or" alternatives. In my view, the charges proposed by S. 1239 are both taxes and user fees. A Court decision to the effect that certain charges similar to those of S. 1239 are both taxes and user fees is thus in no sense inconsistent with the position I have taken.

ATTACHMENT B

Mr. Herbert D. Kelleher
 June 18, 1996
 Page 3

taxes. In a later case, Skinner v. Mid-America Pipeline Co., 490 U.S. 212 (1989), the Court reaffirmed the public benefit test for determining when a user fee is a tax. While deciding that the taxing power constitutionally could be delegated by the Congress, it specifically endorsed its earlier view that a user fee that benefits the public in general is a tax.

The factors described above demonstrate to my satisfaction that user fees imposed for the purpose of funding the FAA are taxes. First and foremost, there is no doubt that the services funded significantly benefit the general public, not just those who make direct use of our air transport system. A number of public benefits can be readily identified. It is indisputable that, in this day and age, an efficient system of air transportation is vital to a sound economy. Any lessening of our ability to transport people and goods efficiently would have a profound negative impact on every sector of the economy, every region of the country. In addition, the crucial safety functions performed by the FAA benefit not only those in the air, but those on the ground as well.

In addition to the benefits the FAA provides the public, the other factors point equally clearly to the conclusion that the fees in question are taxes. The amounts of revenue to be raised are substantial, amounting to billions of dollars a year. The revenues are to be used to finance a number of sizable programs, amounting to the bulk of the FAA annual operating budget. Finally, since a significant part of the value of the services financed by the fees will accrue to the public generally, it follows that the fees paid by the airlines will exceed the value the airlines receive. In short, what is being suggested is a far cry from a system of tolls charged to finance the construction of a road or a series of charges for visits to a national park. Rather, the proposed fees are designed to fund large government programs -- and a large government agency's annual operating budget -- for the benefit not only of those charged the fees, but of the public generally. Those fees, accordingly, are taxes.

III. The Proposed Procedures For Raising And Spending Fee Revenues Are Unsound.

As taxes, the proposed user fees should be governed by the processes and procedures normally applicable to taxes.

Mr. Herbert D. Kelleher
 June 18, 1996
 Page 4

That is not simply because the fees should appropriately bear the label of taxes. Rather, the very reasons they are taxes -- i.e., their size, the magnitude of the programs they fund, and the benefits they provide for the general public -- are the reasons that the normal processes for raising taxes and spending tax revenues should apply to them. In particular, these are reasons that the Congress itself, and not the FAA, should make the major decisions regarding the raising and spending of fee revenues. The provisions of S. 1239 that would transfer those decisions from Congress to the FAA constitute the bill's most serious weakness.

The representatives of the people as a whole are best able to make the political judgments involved in deciding such issues as who should pay, how much they should pay, and how much programs competing for a finite amount of money should receive. The FAA is institutionally ill-equipped to make such judgments. Moreover, the agency would bring a strong institutional bias to the decision-making process, a bias that might well result in an increase in taxes. Since the FAA would be allowed to spend whatever revenues it raised, it would be motivated to impose whatever taxes were necessary to fund the programs it considered most desirable.

As the former head of a federal agency, I can understand the appeal to the FAA of proposals like S. 1239. Yet that appeal is precisely what makes such proposals so dangerous. If any such proposal is enacted, I believe it is inevitable that other federal agencies will make similar attempts to assess taxes themselves and to transfer their annual operating costs beyond the controls of the budget and appropriations processes. It is critically important to avoid such inroads into the unified budget process that has served us so well.

Sincerely yours,


 Lawrence B. Gibbs

**COMPARISON OF PROPOSED USER CHARGES SYSTEM
VS. 10 PERCENT TICKET TAX COLLECTED (BASED ON CY 1995 DATA)
FOR DOMESTIC OPERATIONS OF THE MAJOR, NATIONAL, REGIONAL, AND COMMUTER AIRLINES**

ATTACHMENT C

CARRIER MAJORS	SEATS		\$2 PER LG A/C		O&D PASSENGERS	\$4.50 PER O&D PASSENGER	NONSTOP REV-PAX-MILES	.005 CENTS PER NONSTOP RPM	ESTIMATED USER CHARGE (\$000's)	EXCISE 10% TICKET TAX (\$000's)/2	CHANGE IN USER FEES TO CARRIER (\$000's)
	LARGE AIRCRAFT 1/	SMALL AIRCRAFT 1/	BEAT SMAC BEAT	BEAT AND \$1 PER PASSENGERS							
ALASKA AIRLINES, INC.	12,758,434		\$ 25,516,868	7,887,730	\$ 35,484,785	5,123,910,420	\$ 25,819,552	\$ 86,631,205	\$ 131,104,700	\$ (44,473,495)	
AMERICA WEST AIRLINES, INC.	26,540,096		\$ 53,082,192	12,080,320	\$ 54,261,440	12,011,874,750	\$ 60,059,374	\$ 187,501,006	\$ 159,919,704	\$ 27,587,302	
AMERICAN AIRLINES, INC.	91,073,121		\$ 182,146,242	43,707,540	\$ 188,683,830	51,203,908,170	\$ 258,029,531	\$ 634,856,703	\$ 735,624,163	\$ (100,964,460)	
CONTINENTAL AIR LINES, INC.	53,827,934		\$ 107,655,868	24,486,480	\$ 110,189,180	25,183,002,370	\$ 125,915,912	\$ 343,960,040	\$ 368,416,166	\$ (24,456,126)	
DELTA AIR LINES, INC.	134,824,183		\$ 269,248,366	51,804,360	\$ 223,569,710	50,587,239,330	\$ 252,836,197	\$ 756,854,273	\$ 831,884,230	\$ (76,029,957)	
NORTHWEST AIRLINES, INC.	64,678,356		\$ 129,356,712	29,638,070	\$ 188,771,840	29,756,337,140	\$ 148,781,686	\$ 411,509,713	\$ 448,435,618	\$ (36,925,905)	
SOUTHWEST AIRLINES, CO.	90,128,688		\$ 180,257,376	44,171,320	\$ 133,371,315	21,896,763,210	\$ 109,763,818	\$ 468,813,052	\$ 293,369,992	\$ 195,243,060	
TRANS WORLD AIRLINES, INC.	31,684,089	955,008	\$ 64,683,148	13,417,860	\$ 60,380,820	15,002,759,920	\$ 75,013,800	\$ 200,077,786	\$ 217,483,892	\$ (17,406,106)	
UNITED AIR LINES, INC.	98,333,431		\$ 196,666,862	48,472,460	\$ 209,129,070	82,454,448,520	\$ 262,272,233	\$ 668,065,165	\$ 739,444,467	\$ (71,379,302)	
USAIR	86,818,209	2,708,231	\$ 180,348,648	40,207,080	\$ 180,831,860	33,074,191,450	\$ 165,370,957	\$ 528,648,468	\$ 554,143,283	\$ (27,485,817)	
TOTAL MAJORS	692,747,531		\$ 1,369,158,301	313,973,540	\$ 1,412,886,930		\$ 1,481,682,158	\$ 4,283,721,387	\$ 4,480,020,215	\$ (178,298,828)	
<u>NATIONALS AND REGIONALS</u>											
AIR 21		8,052	\$ 8,052	0	\$ 0	0	\$ 0	\$ 0	\$ 8,052	\$ -	\$ -
AIR SOUTH, INC.	2,705,838		\$ 5,411,676	564,390	\$ 2,539,755	189,807,710	\$ 949,689	\$ 6,901,120	\$ 6,442,968	\$ 2,456,152	
AIR WISCONSIN AIRLINES CORP	3,299,082		\$ 6,598,124	1,388,150	\$ 6,246,875	423,878,990	\$ 2,118,395	\$ 14,964,194	\$ 11,886,394	\$ 3,274,800	
AIRTRAN AIRWAYS CORPORATION	413,981		\$ 827,962	745,280	\$ 3,353,760	663,077,160	\$ 3,315,368	\$ 7,497,108	\$ -	\$ -	
AMERICAN TRANS AIR, INC.	4,668,897		\$ 9,337,794	2,581,470	\$ 11,816,615	3,110,814,630	\$ 15,554,073	\$ 36,508,482	\$ 31,290,072	\$ 5,218,410	
ATLANTIC SOUTHEAST AIRLINES	78,464	6,883,068	\$ 7,041,996	50	\$ 225	11,760	\$ 59	\$ 7,042,260	\$ 31,836,015	\$ (24,793,735)	
BUSINESS EXPRESS	35,280	3,815,449	\$ 3,886,009	445,280	\$ 2,003,760	87,153,550	\$ 485,768	\$ 6,373,537	\$ 17,903,657	\$ (11,526,120)	
CARNIVAL AIR LINES, INC.	1,736,622		\$ 3,473,244	1,127,580	\$ 5,074,110	1,514,334,700	\$ 7,571,674	\$ 16,119,028	\$ -	\$ -	
CASINO EXPRESS	308,950		\$ 613,909	206,000	\$ 940,860	216,878,140	\$ 1,084,681	\$ 2,636,641	\$ -	\$ -	
CONTINENTAL EXPRESS AIRLINE		7,891,563	\$ 7,891,563	140	\$ 630	72,170	\$ 361	\$ 7,892,554	\$ 23,500,000	\$ (16,607,448)	
CONTINENTAL MICRONESIA	278		\$ 556	10	\$ 45	24,530	\$ 123	\$ 724	\$ -	\$ -	
EAGLE AIRLINES	931		\$ 1,862	0	\$ 0	0	\$ 0	\$ 1,862	\$ -	\$ -	
EASTWIND AIRLINES, INC.	117,600		\$ 235,200	35,680	\$ 160,560	14,300,320	\$ 71,502	\$ 467,264	\$ -	\$ -	
EVERGREEN INTL, INC.	459		\$ 918	0	\$ 0	0	\$ 0	\$ 918	\$ -	\$ -	
EXECUTIVE AIRLINES		513,937	\$ 513,937	0	\$ 0	0	\$ 0	\$ 513,937	\$ 2,513,956	\$ (2,000,019)	
EXPRESS ONE INTERNATIONAL			\$ -	22,870	\$ 102,915	29,731,000	\$ 148,655	\$ 251,570	\$ -	\$ -	
FRONTIER AIRLINES, INC.	1,586,434		\$ 3,172,868	552,360	\$ 2,485,620	336,758,640	\$ 1,663,785	\$ 7,342,273	\$ -	\$ -	
GRAND AIRWAYS, INC.	243,552		\$ 491,104	178,310	\$ 788,895	192,664,080	\$ 963,470	\$ 2,243,469	\$ -	\$ -	
GREAT AMERICAN AIRWAYS	266		\$ 532	0	\$ 0	0	\$ 0	\$ 532	\$ -	\$ -	
HAWAIIAN AIRLINES, INC.	152,463		\$ 304,926	21,440	\$ 88,730	5,438,950	\$ 27,195	\$ 430,851	\$ 27,805,824	\$ (27,374,873)	
HORIZON AIR		6,551,608	\$ 6,551,608	200	\$ 900	47,080	\$ 235	\$ 6,552,741	\$ 26,484,300	\$ (18,911,559)	
KMI INTERNATIONAL	3,182,965		\$ 6,365,930	1,479,890	\$ 6,859,855	1,054,858,520	\$ 5,213,296	\$ 18,296,583	\$ 15,877,472	\$ 2,821,111	
MARKAIR, INC.	1,649,140		\$ 3,298,280	543,110	\$ 2,443,895	468,442,380	\$ 2,332,212	\$ 8,074,487	\$ -	\$ -	
MESA AIRLINES, INC.	128,326	4,842,077	\$ 4,894,729	0	\$ 0	0	\$ 0	\$ 4,894,729	\$ -	\$ -	
MGM GRAND AIR, INC.		175	\$ 175	10	\$ 45	24,530	\$ 123	\$ 343	\$ -	\$ -	
MIDWAY AIRLINES, INC.	2,852,280		\$ 5,704,560	977,560	\$ 4,399,110	628,313,370	\$ 3,146,567	\$ 12,850,237	\$ -	\$ -	
MIDWEST EXPRESS AIRLINES	1,633,184	822,920	\$ 4,089,288	964,860	\$ 4,340,700	843,877,870	\$ 4,229,390	\$ 12,658,378	\$ 20,511,866	\$ (7,852,618)	
NATIONS AIR EXPRESS, INC.	415,821		\$ 833,642	222,450	\$ 1,001,026	65,717,680	\$ 328,588	\$ 2,163,256	\$ -	\$ -	
PARADISE AIRWAYS			\$ 2,952	0	\$ 0	0	\$ 0	\$ 2,952	\$ -	\$ -	
RENO AIR, INC.	6,430,270		\$ 12,860,540	3,305,280	\$ 14,973,760	1,877,837,680	\$ 9,369,189	\$ 36,123,489	\$ 25,841,828	\$ 10,281,661	

**COMPARISON OF PROPOSED USER CHARGES SYSTEM
VS. 10 PERCENT TICKET TAX COLLECTED (BASED ON CY 1995 DATA)
FOR DOMESTIC OPERATIONS OF THE MAJOR, NATIONAL, REGIONAL, AND COMMUTER AIRLINES**

CARRIER MAJORS	SEATS		\$2 PER LG A/C	O&D PASSENGERS	\$4.50 PER O&D	NONSTOP REV-PAX-MILES	.005 CENTS PER NONSTOP RPM	ESTIMATED USER CHARGE (\$000's)	EXCISE 10% TICKET TAX (\$000's) 2/	CHANGE IN USER FEES TO CARRIER (\$000's)
	LARGE AIRCRAFT 1/	SMALL AIRCRAFT 1/	SEAT AND 51 PER SM A/C SEAT		\$4.50 PER O&D PASSENGER					
RICH INTERNATIONAL AIRWAYS	26,040		\$ 52,080	0 \$	-	0 \$	-	\$ 52,080	-	
RYAN INTERNATIONAL AIRLINES	13,060		\$ 26,120	0 \$	-	0 \$	-	\$ 26,120	-	
SIMMONS AIRLINES		9,342,646	\$ 9,342,646	0 \$	-	0 \$	-	\$ 9,342,646	\$ 32,052,560	\$ (22,709,914)
SPIRIT AIR LINES	750,156		\$ 1,510,312	554,280	\$ 2,494,305	492,314,090	\$ 2,461,575	\$ 6,474,192	-	
SPORTSFLIGHT AIRWAYS, INC.	519		\$ 1,036	0 \$	-	0 \$	-	\$ 1,036	-	
TOWER AIR, INC.	896,369		\$ 1,792,738	479,520	\$ 2,157,840	858,543,750	\$ 4,292,719	\$ 8,243,337	-	
TRANS STATES AIRLINES		3,615,580	\$ 3,615,580	513,470	\$ 2,310,615	110,863,480	\$ 563,467	\$ 6,478,662	\$ 13,613,897	\$ (7,134,035)
TRISTAR AIRLINES, INC.	227,800		\$ 455,600	0 \$	-	0 \$	-	\$ 455,600	-	
UPS, INC.		1,478,208	\$ 1,478,208	546,930	\$ 2,456,665	85,876,480	\$ 429,362	\$ 4,364,275	-	
USAIR SHUTTLE	3,382,625		\$ 6,765,250	1,296,440	\$ 5,847,480	262,967,560	\$ 1,314,936	\$ 13,927,666	\$ 6,495,312	\$ 7,432,356
VALUJET AIRLINES, INC.	7,644,894		\$ 15,289,788	4,144,000	\$ 18,648,000	2,530,431,030	\$ 12,652,155	\$ 46,569,943	\$ 39,780,484	\$ 6,809,459
VANGUARD AIR EXPRESS, INC.	1,512,934	4,722	\$ 3,030,590	525,790	\$ 2,366,056	228,696,660	\$ 1,133,478	\$ 6,530,123	-	
VISCOUNT AIR SERVICE, INC.	2,699	270	\$ 5,668	0 \$	-	0 \$	-	\$ 5,668	-	
WESTERN PACIFIC AIRLINES	1,182,047		\$ 2,364,094	594,340	\$ 2,674,530	474,247,760	\$ 2,371,259	\$ 7,429,863	-	
WORLD AIRWAYS, INC.	11,500		\$ 23,000	0 \$	-	0 \$	-	\$ 23,000	-	
UNIDENTIFIED CARRIERS			\$ -	208,010	\$ 940,545	143,134,100	\$ 715,671	\$ 1,866,216	-	
<u>OTHER AIRLINES 3/</u>									\$ 66,817,588	
TOTAL NATIONAL AND REGIONALS	47,111,802	45,068,273	\$ 139,762,077	24,228,600	\$ 106,028,700		\$ 63,600,236	\$ 332,421,016	\$ 422,237,104	\$ (89,816,066)
TOTAL 296-C/ OTHER COMMUTERS		69,268,833	\$ 69,268,833	3,336,448	\$ 15,014,015	56,787,075	\$ 283,835	\$ 84,568,863	\$ 203,141,673	\$ (116,574,860)

NET RESULTS **\$ 4,700,708,286** **\$ 5,085,366,862** **\$ (384,658,576)**

ASSUMPTIONS	LARGE AIRCRAFT SEAT CHARGE \$	2 00
	SMALL AIRCRAFT SEAT CHARGE \$	1 00
	PASSENGER FEE \$	4 50
	CENTS PER NONSTOP RPM	0.0050
	ALTERING THESE ASSUMPTIONS WILL CHANGE THE SPREADSHEET OUTPUT	

1/ LARGE AIRCRAFT ARE DEFINED AS THOSE WITH 71 OR MORE SEATS, SMALL AIRCRAFT HAVE 70 SEATS OR LESS.

2/ 1995 EXCISE TICKET TAX PAYMENTS OBTAINED FROM "AIR TRAFFIC CONTROL USER FEES" A PROPOSAL BY THE SEVEN LARGEST US AIRLINES.

TABLE 12. PASSENGER REVENUE EXCISE TAX @ 10%, PAGE 11

3/ THESE AIRLINES WERE NOT IDENTIFIED IN THE AIR TRAFFIC USER FEE PROPOSAL.

* THE AIR TRAFFIC USER FEE PROPOSAL DID NOT PROVIDE 1995 10% TICKET TAXES PAID BY THESE AIR CARRIERS

SOURCE: U.S. DEPARTMENT OF TRANSPORTATION, BTS OFFICE OF AIRLINE INFORMATION, T-100, ORIGIN & DESTINATION DB4, 296-C COMMUTER DATA

Wall Street Journal, August 19, 1996

Domestic Fares Increased 10% At Big Airlines

By SCOTT MCCARTNEY

Staff Reporter of THE WALL STREET JOURNAL

Airlines quietly raised domestic fares 10% late last week, citing very strong demand, higher security costs and the looming return of a 10% excise tax on tickets.

The increase, initiated by Continental Airlines, covers unrestricted coach fares, which business travelers often pay, and structural advance-purchase fares. The increase doesn't apply to existing sale fares and special promotions, nor does it cover international fares.

Continental raised its fares Thursday; all major carriers except Northwest Airlines matched the rise by Friday. Northwest matched the fare increase over the weekend, officials said.

Carriers have been experiencing strong demand for seats. And despite some recent seasonal sales, which have had limited availability, air fares have generally been increasing. Airlines enjoyed a windfall from the Dec. 31 lapse of the 10% tax on air fares, which allowed them to raise fares 5% to 6% without increasing the overall cost of a ticket.

But the 10% tax will soon be re-enacted when President Clinton signs into law a minimum wage bill that includes the tax. The bill is expected to be signed tomorrow, and the 10% excise tax will take effect seven days later.

Airlines have indicated they hope to pass on the tax to consumers, even though the carriers took advantage of its lapse to raise fares. But if one carrier should decide to absorb the tax, others would have to follow suit.

Last week's increase thus gives the industry some insurance: Airlines have the option of absorbing the 10% tax without eroding their fare structures, or passing on the tax along with the recent 10% fare increase.

Carriers said increased security measures ordered by the Federal Aviation Administration also caused them to consider a fare increase. They said demand had been running so strong that they thought the market could bear the increase. While demand has risen, increases in the number of flights has been small. Load factors—the percentage of seats filled—ran over 80% industrywide in early August, one carrier said.

"We're seeing really excellent demand in the industry," said a Continental spokesman in Houston. "There's a very healthy supply-and-demand relationship right now; and under those conditions, a price increase is justified."

Airlines are facing enormous earnings pressure this fall, trying to improve strong results posted last fall. While carriers have enjoyed record earnings this summer, there has been concern on Wall Street that the earnings cycle may have peaked, especially since the 10% tax is returning and airline stocks have declined since the end of the second quarter.

Though the increase doesn't apply to existing sale fares, it could quickly show up in future sales. Airlines routinely offer large discounts off "structural" fares—seven-day, 14-day or 21-day advance-purchase fares.

ATTACHMENT D

Wall Street Journal, September 9, 1996

Airlines Boost Most Domestic Fares 2.5% As Widespread Strong Demand Persists

By SCOTT MCCARTNEY

Staff Reporter of THE WALL STREET JOURNAL

Airlines raised most domestic fares 2.5% over the weekend as demand for airplane seats continues strong, even after a 10% boost in ticket prices just three weeks ago.

Carriers said the increase applies to most domestic markets, except where they compete with short-haul carrier Southwest Airlines, which didn't go along with the price increase.

Continental Airlines initiated the fare boost Thursday night. By yesterday afternoon, most major airlines had matched the new prices, and the increase appeared to hold, a Continental spokesman said.

Airlines had been trying unsuccessfully to raise fares since Aug. 27, the day a 10% federal excise tax on tickets was reinstated. The tax, which is incorporated into ticket prices, led airlines to post fare increases of between 2.5% and 10% several times during the past two weeks, but not all airlines matched, causing carriers to pull

back.

This time, the 2.5% increase held. Carriers say there is growing concern about fuel prices as a result of events in the Middle East, although Continental, for one, has hedged fuel prices into 1997. In addition, airlines are concerned that new safety measures recommended by Vice President Al Gore's commission will increase costs.

The biggest reason for the price boost, however, is that demand is so robust that travelers will pay higher prices. A 10% increase in mid-August, the week before the tax was reinstated, didn't dampen demand, carriers say. In addition, seats may be hard to come by this fall because an early round of fare sales, with some tickets as low as \$25, generated heavy bookings. With fewer seats left to sell, airlines are increasing prices.

"There's continued strong demand in the marketplace," said a spokesman for Continental, which also initiated the 10% increase in mid-August.

ATTACHMENT E

BEST AVAILABLE COPY

ST. LOUIS POST-DISPATCH

THURSDAY, JANUARY 9, 1897

THE POST-DISPATCH PLATFORM

I KNOW THAT MY RETIREMENT WILL MAKE NO DIFFERENCE IN ITS CARDINAL PRINCIPLES. THAT IT WILL ALWAYS FIGHT FOR PROGRESS AND REFORM, NEVER TOLERATE INJUSTICE OR CORRUPTION, ALWAYS FIGHT DEMAGOGUES OF ALL PARTIES, NEVER BELONG TO ANY PARTY, ALWAYS OPPOSE PRIVILEGED CLASSES AND PUBLIC PLUNDERERS, NEVER LACK SYMPATHY WITH THE POOR, ALWAYS REMAIN DEVOTED TO THE PUBLIC WELFARE, NEVER BE SATISFIED WITH MERELY PRINTING NEWS, ALWAYS BE DRASTICALLY INDEPENDENT, NEVER BE AFRAID TO ATTACK WRONG, WHETHER BY PREDATORY PLUTOCRACY OR PREDATORY POVERTY.

April 10, 1907

JOSEPH PULITZER

Founded by JOSEPH PULITZER
December 12, 1878

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EDITORIALS**Renew The Airline Ticket Tax As Is**

The 10 percent federal airline ticket tax levied on each passenger to pay for the nation's air traffic control system and airport capital improvements expired on Dec. 31 and needs to be renewed or reformed. The big carriers have a major reform in mind — but it would benefit themselves unduly at the expense of small carriers.

The big seven carriers — American, Continental, Delta, Northwest, Trans World, United and USAir — want a system that shifts as much as \$550 million in annual fees to smaller discount carriers. The majors argue that the recently expired flat 10 percent per passenger tax causes them to overpay for their use of the system and that small carriers now pay less. That isn't really true.

The big seven propose to levy a \$4.50 charge per originating passenger, plus a \$2 per seat fee on all planes with more than 71 seats and \$1 per seat on smaller planes, as well as another half-a-cent per nonstop passenger mile. The fee is designed to reduce the current costs the major carriers must pass on to their passengers on top of their ticket prices.

But it ignores the many connecting flights the majors operate through their hub-and-spoke systems. For instance, a St. Louis passenger flying to Miami by way of Chicago would be charged only for a flight between St. Louis and Florida, ignoring the costs imposed on the air traffic and airport system by the stop in Chicago. The big airlines also ignore the fact that they benefit from other public policies — such as their virtual monopoly on takeoff and landing slots at airports whose total capacity is restricted. Smaller carriers have no such advantage.

As well, the impact on competition as a result of the new fees would be severe. Last year, Southwest Airlines, the nation's most successful discount carrier, earned \$182.6 million in profits. Under the proposed fee system, it would face \$200 million in additional fees, not all of which could be passed on to passengers without virtually eliminating the airline's ability to remain a discount carrier. That would reduce consumer choice by raising prices for all. It is both fairer and better for consumers for Congress to renew the current 26-year-old flat 10 percent airline ticket tax.

ATTACHMENT F

PREPARED STATEMENT OF MICHAEL E. LEVINE

My name is Michael E. Levine. I am Executive Vice President, Northwest Airlines, Inc. Prior to joining Northwest, I served as Dean of Yale University's School of Management. For most of my professional life, I have been involved in the world of air transportation and its regulation, not only as a senior airline executive, but as a government official and an academic. I am pleased to be here today to discuss with members of the Senate Finance Committee the merits of alternative financing proposals to fund the Federal Aviation Administration, and most importantly, the FAA's air traffic control (ATC) function.

I appear before the Committee on behalf of Northwest, of course, but also on behalf of a coalition of the seven largest network airlines—American, Continental, Delta, Northwest, TWA, United and USAir—all of whom along with the Regional Airline Association have joined to form the Coalition for Fair FAA Funding. Our Coalition advocates that Congress scrap the inefficient, outmoded and unfair 10% ticket sales tax and substitute a usage based funding mechanism that bases payments by users of the federal ATC system on the services they actually use.

In this statement, I will develop the following points:

- The ticket sales tax offends important public policy interests and should not be reinstated.
- A usage based system along the lines proposed by the Coalition should be adopted.
- The Coalition's proposal is reasonable and meets all major public policy objectives.

We recognize this is a complex subject, and we are prepared to work with the Congress to further develop our proposal as more information becomes available.

For the past 50 years, there has been an airline ticket sales tax, and for the past 35 years, the 50 year old ticket sales tax has been used to fund the US air traffic control system. Since 1990, the tax has been set at 10%. At the end of 1995, the ticket sales tax lapsed and was not reinstated until August of last year. The ticket sales tax was reinstated only through the end of 1996, however, and it has, by its terms, again lapsed. Thus, at this critical juncture in the future of air traffic control reform, the Congress is operating on a clean slate. The Congress can and should approach the task of restoring a stable and reliable funding source for FAA activities with no preconceived notion of what the best system would be. This Committee is in the enviable position of being able to reflect on what a more optimal funding mechanism would be and to adopt it. Our Coalition does not believe that a ticket sales tax should even be considered by this Committee if sound public policy is to be the guidepost to your decision.

One point deserves emphasis. Our Coalition is committed to raising with its usage-based formula the same amount of revenue raised by the ticket sales tax. We are aware that the Congress will apply its revenue models to our proposal to assess whether we have achieved revenue parity with the ticket sales tax. To the extent that our proposal falls short of generating the same amount of revenue for the federal treasury as the ticket sales tax, we will modify it to make up the shortfall.

I. THE TICKET SALES TAX OFFENDS IMPORTANT PUBLIC POLICY INTERESTS AND SHOULD NOT BE REINSTATED.

A. The Ticket Sales Tax Is Inefficient.

Users who operate in heavily traveled airspace, to and from congested metropolitan areas where ATC costs are greatest, usually pay less for those services than users who operate in lightly traveled air space, to and from relatively uncongested smaller cities and towns where the costs are the lowest. Three real-world examples illustrate this phenomenon. (See Appendix A for detail.) In the 339-mile Garden City, KS-Kansas City regionally served market, a traveler must pay between \$40.64 and \$27.20 in ticket sales tax, depending on the price of his or her ticket, but the traveler receives very little in the way of ATC services in return. The air space is relatively uncongested, and Garden City does not even have a control tower. In the 313 mile Milwaukee-Des Moines market, the facts differ somewhat, since the service is a jet service, and the airports that serve both cities have control towers, but the airspace in this market appears to be relatively uncongested. Accordingly, the amount of air traffic control services used in this air corridor is likely to be minimal. Nevertheless, the customer is obligated to pay between \$46.70 and \$20.90 for ATC service.

Let's compare these examples to the 397-mile Orlando-Atlanta market. Both of these cities have congested airports and air space and the Atlanta-Florida corridor is one of the busiest in the country. Large amounts of air traffic control services are deployed to control a ValuJet flight between Orlando and Atlanta, yet a ValuJet

customer pays as little as \$3.90 for the substantial labor and equipment employed to assure him or her of the safe flight experience we take for granted in this country.

Any system that yields such illogical and irrational results necessarily promotes inefficient use and allocation of ATC resources. Demand is made artificially high for scarce ATC services in congested corridors and airports, and is suppressed in markets whose costs are, in fact, low. Airlines offer more service in smaller and emptier aircraft in congested ATC corridors than they could afford if ATC charges were related to the true cost of providing ATC services. On the other hand, in thin uncongested markets, where few ATC services are utilized, and more aircraft operations could be accommodated with little additional expense, additional service is deterred by high ticket sales taxes that bear an artificially inverse relationship to the ATC services received.

In this system, it is hard to determine the true demand for ATC services since false price signals are created that must be ignored. And it is hard to find the funds to accommodate the false demand created. For example, the high ATC charge for service between Garden City and Kansas City artificially penalizes and discourages customers and airlines using this already underused service, yet appears to signal that ATC capacity is scarce and more might be required. That of course is not true, and this price signal is false. Similarly, in the Orlando-Atlanta corridor, demand is artificially stimulated but funds are not made available by the ticket sales tax to accommodate it. Instead, the system requires the transfer of money from users of already underused service, discouraging uses of underused facilities and discouraging further investment in over-used facilities.

For all of these reasons, the ticket sales tax should be scrapped. It distorts user decisions, and it camouflages the price signal necessary to make sound resource allocation decisions. In a budget-constrained era, the waste that necessarily flows from such inefficiencies are particularly damaging.

B. The Ticket Sales Tax Is Outmoded.

Given its demonstrable inefficiencies, one is led to ponder how it came to pass that Congress made the initial choice to implement a ticket sales tax to finance the ATC system. In fact, it appears that Congress backed into this form of taxation as a result of non-aviation wartime needs during World War II to raise revenue and discourage civilian usage of transportation resources that were needed for the wartime effort.

The tax on commercial passenger air travel was first enacted in 1941 as a 5 percent tax on the base fare for transportation of persons. The tax applied to virtually all commercial travel, including rail, motor vehicle, water and air, and was intended to discourage travel in order to protect capacity for military uses during World War II. Moreover, because commercial travel was then considered a luxury, the tax on transportation was enacted, and later increased, simultaneously with other luxury taxes, such as those on jewelry and furs. The transportation tax was twice raised to increase revenue for the ongoing war effort—to 10 percent in 1942 and 15 percent in 1943.

Having reached such high levels during World War II, transportation excise taxes became a significant source of federal revenue. By 1955, transportation excise taxes accounted for more than 40% of total excise tax receipts. Attracted by the revenue, Congress postponed reductions in subsequent years in order to finance other national defense efforts, such as the Korean War. Nonetheless, the transportation tax was reduced to its original level of 5 percent in 1959, and in 1962 the tax was amended to apply only to the transportation of persons by air, effectively exempting all other commercial travel.

In 1965, when most wartime taxes were reduced or repealed, the airline ticket sales tax was instead made "permanent" at the 5 percent level and was re-rationalized for the first time as a "user tax" for aviation services. Then, in 1970, Congress created the Airport and Airway Trust Fund and a system of excise taxes to support it. The airline ticket sales tax was increased to 8 percent of domestic passenger airfares, and again justified as a user tax, to finance airport development and capital improvements in air navigation and traffic control systems.

In the Omnibus Budget Reconciliation Act of 1990, Congress increased the domestic tax from 8 percent to 10 percent but dedicated the 25 percent increase to the General Fund of the Treasury, rather than the Airport and Airway Trust Fund, for fiscal years 1991 and 1992 for federal deficit reduction funding. (See Appendix B for a synopsis of the aforementioned history.) One will search this history in vain for any principled justification of the ticket sales tax as an efficient, or a fair way to finance the federal air traffic control system. It is an outmoded relic that has outlived by 50 years its original purpose. It was not designed to finance ATC infrastruc-

ture or capital investment, and it undermines sound ATC resource allocation decision-making.

C. The Ticket Sales Tax Is Unfair.

Even though the ticket sales tax has always been inefficient, prior to deregulation it had a certain element of fairness as between different consumers because the CAB dictated that on a per mile basis, fares in all markets were the same. Applying a percentage sales tax to uniform ticket prices produced roughly proportionate sharing by all passengers in financing air traffic control service.

After deregulation, however, governmentally enforced ticket price equality disappeared, and with it whatever fairness the ticket sales tax might have had. Today, airline ticket prices vary widely, even on the same flight—and even on the flights of discount airlines like Southwest, the chief opponent of a usage based FAA financing system. Under a ticket sales tax, therefore, all passengers on a flight receive identical ATC services but they pay wildly varying amounts for these services. This is simply unfair. It harms those consumers who pay too much for ATC services, and where a hub-and-spoke system serves many origins and destinations on the same flight, it harms the communities where taxes are higher, many of which are rural or medium size towns and villages.

To elaborate, on every scheduled airline flight, passengers pay a variety of ticket prices for air travel. Business people who place a premium on flexibility pay more for this flexibility. Leisure travelers who typically plan their trips well in advance of departure, and who can travel on lightly traveled days, typically pay less for their travel. Travelers connecting from or to lower-density markets pay higher fares to cover the higher airline costs of serving these markets. While passengers on any particular flight place markedly different demands on an airline for access to that airline's seats, and thus are charged different prices, they place identical demands on the federal government for air traffic control services and should be charged the same price. All passengers should pay according to their use of this service, since they receive equal service of equal value. It makes no sense—and it is extremely unfair—for the federal government to compel one passenger to pay more for this service than another.

Americans who live in small towns and rural communities are particularly hard hit by this inequity. In thinly traveled markets, there are fewer passengers over whom an airline can spread its costs. This usually means that residents of small towns must pay more for their air travel than those who live in dense urban areas because it simply costs more to serve thinly traveled routes. But why should the federal government exacerbate this cost disadvantage and obligate these Americans to pay more for their air traffic control services than their fellow citizens in large cities? One of the enduring challenges of the post-deregulation period has been to devise a national policy to retain and promote air service to small cities, towns and villages. While the Essential Air Service program has been moderately successful, I find it ironic that at the same time the Congress has been spending millions to subsidize EAS service to rural areas, the ticket sales tax unwittingly has been artificially inflating the cost of rural air service with excessive and unfair ATC taxes. I do not believe Congress ever knowingly made the choice both to subsidize and penalize the same activity, but that is the inevitable result of the ticket sales tax. It is difficult to imagine that Congress, when presented with this choice in 1997, will opt to continue such a perverse system. Put another way, if this Committee succeeds in identifying a funding mechanism that provides that every American pays for the ATC services he or she actually uses, I do not believe that the Congress will choose to intervene and redistribute the burden to penalize Americans in small and rural towns.

II. A USAGE BASED SYSTEM ALONG THE LINES PROPOSED BY THE COALITION SHOULD BE ADOPTED.

A usage-based system should generally reflect costs. ATC costs are complicated to determine and allocate and a complete study to better understand them is now underway. While this comprehensive study of FAA costs is conducted, Congress should replace the inefficient, outmoded and unfair ticket sales tax with a usage-based tax that would generate the same revenue as the ticket sales tax and that would be more efficient and much more fair to all users. Rather than applying a tax on the price of an airline ticket, Congress should enact a usage based tax on three primary indicators of system usage—aircraft size, passengers flown, and distance traveled. Under our proposal, for each one-way domestic flight, air carriers would pay—

- \$4.50 per passenger
- \$.005 per "Great Circle" revenue passenger mile

- \$2.00 per airplane seat for noncommuter planes (jet aircraft with 71 seats or more) or \$1.00 per airplane seat for commuter planes (jet aircraft with 70 seats or less and all turbo prop aircraft).

The Coalition proposal makes no change in the excise tax structure for general aviation or cargo operators. General aviation would continue to pay the same non-commercial aviation fuel taxes they now pay, which is what we understand to be the preference of most GA groups.

We do not claim that this system correlates precisely or elegantly to the actual costs of providing ATC services. In fact, we acknowledge that it does not. Neither we nor the ATC managers at the FAA know what those costs are, and it would be impossible for anyone to construct a true cost-based user fee system today in the absence of the necessary cost allocation studies. That study process, which Congress launched last year in the FAA Reauthorization Act, is likely to take far more time than is available to the Congress now, as it seeks promptly to restore a funding stream for the Aviation Trust Fund.

We nonetheless are confident that our formula is a vast improvement over the ticket sales tax. We know there is room for debate regarding the details, and we are anxious to have that debate and to work with the Congress to make the necessary adjustments. Moreover, at least speaking for Northwest, we are strongly in favor of privatization of the ATC system, and the introduction of true cost-based user fees in conjunction with privatization. But in the meantime, our formula is demonstrably more efficient and more fair than the ticket sales tax, and it deserves this Committee's serious consideration.

Under the Coalition's new, more principled approach to FAA funding, a few carriers whose use of the system was subsidized under the ticket sales tax scheme will pay somewhat more per passenger than they did in the past. However, the estimated average increase amounts to only \$1.64 per passenger for ValuJet, \$2.09 for America West, \$3.19 for Reno Air, and \$4.25 for Southwest. These amounts are significantly less than the one-way PFC maximum of \$6.00 per passenger which was adopted in 1990 to no apparent competitive disadvantage. Despite the dire predictions at the time of some low fare carriers that PFCs would sound the death knell for low fare operators and low fare service, the only consistently profitable carrier in America for the last seven years, a time when most of the industry was mired in a fearful depression, was Southwest. Southwest also was the fastest growing carrier in the country during this period.

In its effort to preserve the ticket sales tax, Southwest has been claiming that the usage based formula we have promoted would destroy its business. Specifically, Southwest recently told the Minneapolis Star Tribune that an 11.4% increase in its fares that would occur as a result of a \$12 per passenger user charge (a formula we studied, but never proposed) would "drive away 26 million of Southwest's 50 million passengers." Southwest claims it has economic studies that prove this, but it refuses to make them public. Studies it has submitted to the DOT have been withheld from public scrutiny. Our FOIA attempt to examine these studies has been denied by the DOT in response to Southwest's objections. Our appeal of that ruling is pending. Southwest has maintained its objection to any disclosure of the information it has provided the Administration.

Southwest's claim of 26 million lost passengers from a 11.4% increase in its fares is false. First, as mentioned previously, the Coalition's formula would raise Southwest's average fare by approximately \$4.25, a 6.8% increase in Southwest's 1996 average fare of \$62. In 1996, Southwest raised its fares 8% over its entire system, and experienced a growth of 6% in passengers. (See Appendix C.) It raised its fares 12% in markets of less than 300 miles and its passengers increased by 4% in those markets. In markets of 300-499 miles, it also raised its fares 12%, and its passengers there increased 7%. In only one market segment, that of routes of between 500 and 700 miles, did Southwest's passenger count decrease (by 3%) but that was in response to an average fare increase of 17%. Based on its 1996 performance, Southwest should suffer little or no traffic loss from introduction of the Coalition's formula. Indeed, in most markets, it should be able to continue to enjoy healthy traffic growth.

As the GAO found in its December, 1996 Report on this subject, cost shifting to low fare carriers is inevitable under any usage based system. This should not be surprising. After all, it is those carriers who are subsidized by the aviation ticket sales tax. The GAO nevertheless strongly advocated a usage based system to replace the ticket sales tax largely for the same reasons described in this paper:

- "We have generally supported FAA's consideration of charging commercial users for the agency's services."

- "Similarly, we have reported our view that the various commercial users of the nation's airspace and airports should pay their fair share of the costs that they impose on the system."
- "The Ticket Tax may not fairly allocate the system's costs among its users . . . because the ticket tax is based on the fares paid [and] the airline that charges the lower fares in this example will pay less for the system's use, even though both airlines had the same number of takeoffs and landings and flew the same number of passengers, the same type of aircraft, and the same distance."
- "Under any fee system that incorporated common measures of the system's usage, such as departures and aircraft miles flown, it is likely that the relative share paid by low-fare airlines would increase compared with what they pay now under the ticket tax."

GAO Report on "Issues Raised by Proposal to Replace the Airline Ticket Tax," December 9, 1996 at 3, 8.

Thus, it begs the question to state that the Coalition's formula shifts costs to certain carriers who today do not pay their fair share. The material question is not whether costs get shifted; it is rather whether the formula by its terms is fair, reasonably related to legitimate air carrier activities that drive costs, and easy to administer. Our formula satisfies these tests.

III. THE COALITION'S PROPOSAL IS REASONABLE AND MEETS ALL MAJOR PUBLIC POLICY OBJECTIVES.

A. Ease of Administration. The Coalition's proposal is easy to administer. Some have suggested that because the tax owed is based on three calculations (seats, miles and passengers) rather than one (10%), that makes our proposal three times as complicated, and difficult for the IRS to administer. Actually, the opposite is the case. The ticket sales tax is not computed by reference to one number; rather it is computed ticket by ticket, applying 10% to thousands and thousands of numbers—ticket prices—and these numbers are always changing.

The incidence of the ticket sales tax is on the consumer. This is an important factor, because millions of ticketed transactions every year are rewritten, many times after the tax has been calculated and collected from the passenger, and perhaps even after the moneys have been remitted to the Treasury with a bi-weekly disbursement from the carrier. That obligates the airline to recompute the tax and recompute the amount of tax actually to be remitted to the Treasury, creating millions of altered transactions that undoubtedly complicate the lives of all concerned with verifying the actual amount of tax obligation.

In contrast, the incidence of the Coalition's usage based tax is on the airline, not the consumer. Under our proposal, when we embark a passenger, put a seat in service, and fly a mile, we will owe the Treasury a check for that activity. Changes in fares, travel dates, and so on, all of which can change the tax owed under the existing system, will be irrelevant to calculating the amount owed. Moreover, the three species of airline activities measured and taxed in the Coalition's proposal—seats, miles and passengers—all are available, easily observed and verifiable. Indeed, the airlines already capture these data and report them on a regular basis to the DOT and FAA.

B. Stable Funding Source. ATC finance now is tied to the price of airline tickets. When ticket prices fall for any reason, recession or fare war, for example, FAA revenues fall without regard to ATC usage or ATC needs. In fact, in a fare war scenario, prices go down, ATC revenues go down, while ATC usage goes up, the worst possible financial result for the ATC system, and a result incompatible with the need to create a stable, reliable revenue stream for ATC modernization and capital investment. The underwriters for the Nav Canada privatization have advised us that the cost of bonds for Nav Canada would have been considerably higher if the revenue stream backing the bonds had been a ticket sales tax rather than user fees, because of the added instability and uncertainty inherent in a revenue stream tied to ticket prices.

In contrast, our proposed formula raises revenue in direct proportion to use of the system. As use increases, revenue increases without regard to what the airlines may be charging for tickets.

C. The Coalition's Proposal Does Not Unfairly Favor the Hub-and-Spoke Carriers.

Southwest Airlines argues that hub-and-spoke operators impose a disproportionate amount of costs on the ATC system, and that hub-and-spoke carriers should pay more as a result. It is by no means clear, however, that hub-and-spoke operators impose a disproportionate share of costs on the ATC system. We do not yet have the ATC cost allocation study we need to identify just where the costs are, and while FAA-retained consultants are hard at work on this project, we are not likely to have useful cost information for a while. Of greatest importance, however, is the Coali-

tion's position, which we reaffirm here, that we are willing to pay our fair share of the ATC costs we generate, whatever they are determined to be by objective outside analysis. Southwest has refused to make the same commitment. If Southwest is so sure that hub-and-spoke operators generate a disproportionate amount of total ATC costs, why is it not eager to move to a cost-based system? Southwest instead has aggressively resisted moving to a cost based system, and this must be because, as the GAO has found, any usage based system would obligate Southwest to pay more than it pays now. Boiled down to its essence, Southwest's position is that for years, it has not paid its fair share of ATC costs under the ticket sales tax, and this corporate welfare should be enshrined in the tax code as a permanent entitlement for Southwest.

By their very nature, network operations in many ways reduce the overall demand for ATC services. Hub-and-spoke operations minimize the total number of aircraft movements necessary to serve low density, dispersed traffic flows. If it were not for hub-and-spoke operations, there would be thousands more flights per day (in smaller aircraft) from virtually every city in the country to provide the array of services offered today in the thousands of city-pair markets served by the network carriers. Properly understood, hub-and-spoke operations reduce overall demand for ATC services, and thus save billions of dollars. Point-to-point operators like Southwest serve only a tiny fraction of the city-pair markets served by the network carriers, and thus do not meet the nation's demand for travel from virtually any city or town in the country to any other.

In any event, our proposal is consistent in its impact on hub-and-spoke versus point-to-point operators. Two of the three elements of the Coalition's formula actually favor short-haul, point-to-point operators like Southwest. Specifically, the half penny per mile component of the formula favors Southwest, since it operates shorter segments than the network carriers. The seat charge, which is a way to impose a greater tax burden on large aircraft, which derive greater total value from the system, favors Southwest since on average, it operates smaller planes than do most network carriers.

The GAO has suggested that two aspects of our formula—use of originating passengers and nonstop passenger miles—tend to favor the established carriers who operate hub-and-spoke systems at the expense of new-entrant low fare and small airlines which tend to operate point-to-point systems. Let me respond:

First, most low fare new entrants are hub-and-spoke operators, not point-to-point operators. The three I mentioned previously—America West, ValuJet and Reno Air—all are hub-and-spoke operators. Second, we made the early observation in this exercise that one of the greatest harms inflicted by the ticket sales tax was the cost shift it imposed on small towns and rural areas, which already necessarily experience lower service levels and higher fares than do dense urban markets due to thinner traffic densities. We believed that if a new formula failed to significantly relieve this injustice, or worse, if it were to exacerbate it, it would be politically unacceptable. Regional carriers have an extreme mix of connecting and point-to-point passengers, approximately 90% connecting to only 10% "local." We concluded that our new funding formula had to be responsive to this phenomenon. The Regional Airline Association, whose members serve these small and rural markets, has joined our Coalition and our effort, so we are confident we are on the right track. In this regard, the Committee should keep in mind that to the extent it makes adjustments in the formula to favor point-to-point service, it necessarily increases the costs for the regionals and the people they serve.

Third, the seat fee is computed on a segment basis. It is imposed for each segment operated, and this factor penalizes hub-and-spoke connecting services, and favors point-to-point operators. Finally, we made an honest effort to keep the cost shift to Southwest and other point-to-point operators to a minimum. When we commenced the effort to identify a substitute for the ticket sales tax, we believed that one desirable attribute would be simplicity. So, we considered the possibility of a federal "PFC," a federal per passenger charge of approximately \$15.00. When we did the math on that, however, we discovered that Southwest's tax liability would have increased by more than \$350,000,000 over what it remitted in ticket taxes in 1995. We concluded that a cost shift of such magnitude was impractical, so we dropped it, and came up with the three-part formula we have placed before you. It improved the result for Southwest by approximately \$150 million from the \$15 per passenger formula.

I'd like to add a personal note: There is no motivation here to punish Southwest. Southwest is a fine and highly successful airline that all of us respect greatly. As an early supporter of deregulation, I have stated publicly on many occasions my personal admiration for what Herb Kelleher and Southwest Airlines have achieved. Southwest has deftly filled a public need and it will continue to do so for a long

time. It is a very valuable part of our national aviation system. But none of this excuses Southwest from paying its fair share of our national ATC bill. Southwest is no more entitled to a break for its ATC obligations than for its aircraft or its fuel. It's just part of the price of doing business as an air carrier.

The Coalition's usage-based formula raises approximately 1/3 of the total \$5 billion raised from each of the three elements. Two of those elements favor Southwest. Using miles as a basis for raising revenue favors Southwest since that carrier flies on average much shorter stage lengths than do the network carriers. Moreover, substituting "segment" miles for "nonstop" miles would not benefit Southwest, contrary to the implication in the GAO Report. Rather, Southwest's costs actually would increase by approximately \$6 million over what they are under our formula if we changed to segment miles.

In addition, using seats to raise one third of the money favors Southwest, since taxing seats favors operators of smaller aircraft, and Southwest operates only B737s. The network operators, by contrast, operate many domestic aircraft that are significantly larger than the 737.

One criticism which is particularly misguided is the suggestion that in applying a \$1 dollar seat charge to regional operations, but a \$2 dollar seat charge to large jet operations, the network carriers have feathered their own nests since they own the regionals, and are thus the direct beneficiaries of this price break. The price break has been included to effectuate a declared congressional preference for maintaining service to smaller communities, most of which is provided by regional carriers. Of the 69 regional carriers in the RAA, only 33 are affiliated with the Coalition's seven network carriers and 21 have no equity relationship of any kind with the network carriers. The network carriers own minority stakes in 4 of the affiliated regionals, and own 100% of the remaining eight. (See Appendix D.) Much of the regional airline industry is independently owned, and all of it, independent or not, has as its principal mission linking smaller communities to the worldwide network. We stand by our decision to favor a national tax policy that eliminates the tax penalty that penalized air service to these communities for so long.

The final criticism directed at our formula has to do with our selection of passenger embarkments, not enplanements, as the basis for raising 1/3 of the revenue. Using enplanements, however, would hit the regionals particularly hard, since over 90% of their business is connecting. Using embarkments insures that the regional operators will be protected under this new regime.

While I believe we can easily defend our formula against the criticisms that have been raised, it is important to conclude with this observation: We are anxious to address all reasonable concerns, and are willing to continue to refine this proposal. The issues are complex, the data incomplete and no perfect solution is possible. But we can make a change which will make major improvements in efficiency and fairness of the system, and we should not let this opportunity slip through our fingers. A few weeks ago, the Chairman of our Coalition directed a letter to Southwest inviting Southwest to sit down with us at the negotiating table and iron out a compromise that a united industry can present to Congress. Southwest never responded to our invitation. So, while we remain eager to refine this proposal further, no one is offering to discuss it with us. It is our sincere hope that we can get on with this as soon as possible.

In summary, I would like to leave the Committee with three thoughts.

First, passengers deserve equal tax treatment for funding the FAA and the air traffic control system.

Second, given today's competitive industry structure, the 10% ticket sales tax is inherently inefficient, outmoded and unfair and should be replaced with a usage based system which charges passengers only for the services they use, no more and no less.

Third, we recognize the complexity of the problem and are flexible about details, but we do not want to lose the opportunity to make major improvements in the way we fund ATC by eliminating the ticket sales tax.

I appreciate the opportunity to present Northwest's and the Coalition's views, and I would be pleased to respond to your questions.

**COMPARISON OF SELECTED CITY-PAIRS
WITH FAA TOWERED AIRPORTS VERSUS NON-TOWERED AIRPORTS**

Category	City-Pair	Miles	Airline	Aircraft		Published One-Way Fare			10% excise tax		User Fee	Difference	
						Economy/coach (Y)		Advance	Full Y	Lowest Discount		Full Y	Lowest Discount
						Full	Disc.	Purchase					
1	Garden City, KS* - Kansas City	339	USAir Express	BE1	fare	\$447.00	\$199.00	\$ -	\$ 44.70	\$ 19.90	\$ 8.18	\$ 36.53	\$ 11.73
1	Presque Isle, ME* - Boston	335	USAir Express	BE1	fare	\$510.00	\$199.00	\$ -	\$ 51.00	\$ 19.90	\$ 8.16	\$ 42.85	\$ 11.75
2	Milwaukee - Des Moines	313	Midwest Express	D9S	fare	\$467.00	\$ -	\$ 209.00	\$ 46.70	\$ 20.90	\$ 9.10	\$ 37.61	\$ 11.81
3	Atlanta - Orlando	397	ValueJet	D9S	fare	\$131.00	\$ -	\$ 41.00	\$ 13.10	\$ 4.10	\$ 9.52	\$ 3.59	\$ (5.42)

- Category 1 Commuter -- low density market, uncongested airspace, small city to big city, no control tower at small city.
 2 Jet -- medium density market, uncongested airspace, control tower at both airports.
 3 Low fare jet -- high density market, congested airspace, control tower at both airports.

* No FAA control tower

Source: FAA Terminal Area Forecasts, September 1994
 Official Airline Guide, February 1997

LEGISLATIVE HISTORY OF THE AIRLINE TICKET TAX	
1941-1953	<p>The excise tax on the transportation of persons was instituted in 1941 at 5% of the base fare of commercial transportation by rail, motor vehicle, water, or air, within or without the United States. Revenue Act of 1941, Title V, Sept. 20, 1941, I.R.C. § 3469(a). The tax was used, together with a broad range of other tax increases, to finance military needs during World War II and was intended in part to discourage commercial air travel to reserve planes for the war effort.</p> <p>The excise tax was increased to 10% in 1942 and to 15% in 1943. Revenue Act of 1943.</p>
1954	<p>The Excise Tax Reduction Act of 1954 reduced the tax on transportation of persons to 10% of the base fare. Mar. 31, 1954, ch. 126, P.L. 324, 68 Stat. 37.</p> <p>[Note: 1954 amendments to the Internal Revenue Code renumbered I.R.C. § 3469(a) as I.R.C. §§ 4261, 4262, which remains in effect today.]</p>
1959	<p>The Tax Rate Extension Act of 1959 lowered the tax on transportation of persons from 10% to 5%, effective July 1, 1960. P.L. 86-75, June 30, 1959, 73 Stat. 157.</p>
1961-1964	<p>Annual extensions of the transportation excise tax were enacted in 1961, 1962, 1963, and 1964. Tax Rate Extension Act of 1961, P.L. 87-72, June 30, 1961, 75 Stat. 193; Tax Rate Extension Act of 1962, P.L. 87-508, June 28, 1962, 76 Stat. 114; Tax Rate Extension Act of 1963, P.L. 88-52, June 29, 1963, 77 Stat. 72; Excise-Tax Rate Extension Act of 1964, P.L. 88-348, June 30, 1964, 78 Stat. 237.</p> <p>In the Tax Rate Extension Act of 1962, the tax was amended to apply only to the transportation of persons by air, effectively exempting commercial travel by rail, motor vehicle or water. P.L. 87-508, June 28, 1962, 76 Stat. 114.</p>
1965	<p>The Excise Tax Reduction Act of 1965 made permanent the 5% tax on the transportation of persons by air. P.L. 89-44, June 21, 1965, 79 Stat. 136.</p>
1970	<p>Congress created the Airport and Airway Trust Fund and a system of aviation excise taxes in the Airport and Airway Development and Revenue Acts. P.L. 91-258, Title 1, May 21, 1970, 84 Stat. 219. The Acts established a long-term federal role in airport development and financial support for capital investments in air traffic management and other aviation programs.</p> <p>Aviation excise taxes were authorized from June 30, 1970, through June 30, 1980, as follows: (i) an 8% airline ticket tax (a 3% increase); (ii) a \$3 international departure tax; (iii) a 5% cargo waybill tax; (iv) a \$0.07 per gallon tax on noncommercial aviation gasoline (a \$0.02 increase); and (v) a \$0.07 per gallon tax on other noncommercial aviation fuels.</p>
1971	<p>The Airport and Airway Development Amendment of 1971 effectively prohibited use of Trust Fund expenditures for FAA operations and extended trust fund spending from June 30, 1980 through September 30, 1980. P.L. 92-174 § 1-5(a), Nov. 27, 1971, 85 Stat. 491.</p>
1976	<p>The Airport and Airway Development Act Amendments of 1976 reversed the 1971 amendment prohibiting the use of Trust Fund expenditures for FAA operations. P.L. 94-353, July 12, 1976, 90 Stat. 871.</p>

LEGISLATIVE HISTORY OF THE AIRLINE TICKET TAX	
1980	The statutory authorization for aviation excise taxes expired on September 30, 1980, causing the tax levels to revert to their pre-1970 levels (e.g., 5% on the base fare of domestic passenger tickets).
1982	Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982, which reinstated the aviation excise taxes at their prior levels through the end of calendar year 1987, increasing the airline ticket tax to 8%. P.L. 97-248, Title II, Sept. 3, 1982, 96 Stat. 324. [Note: the Airport and Airway Improvement Act of 1982 is Title V of the Tax Equity and Fiscal Responsibility Act; revenue provisions are contained in Title II.]
1987	The Airport and Airway Safety and Capacity Expansion Act of 1987 extended aviation excise taxes through 1990. P.L. 100-223, Dec. 30, 1987, 101 Stat. 1486.
1990	The Omnibus Budget Reconciliation Act of 1990 (OBRA) increased the airline ticket tax from 8% to 10% but provided for the increase to remit to the General Fund of the Treasury to pay for deficit reduction for fiscal years 1991 and 1992. OBRA 1990 also increased the cargo waybill tax from 5% to 6.25%, increased the international departure fee from \$3 to \$6 per person, and authorized the agricultural products inspection fee. P.L. 101-508, §§ 11211, 11213, Nov. 5, 1990, 104 Stat. 1388. Also in OBRA 1990, Congress authorized local airport authorities to impose passenger facility charges of \$3 per airport or \$12 per round-trip flight. Id. At § 9110. PFCs constituted an exception to the "reasonableness" requirement of the Anti-Head Tax of 1973. P.L. 93-44, June 18, 1973, 87 Stat. 90.
1995	Due to an impasse in the federal budget process, authorization for aviation excise taxes contributing to the Airport and Airway Trust Fund expired on December 31, 1995.
1996	The Small Business Job Protection Act of 1996 reimposed the aviation excise taxes through December 31, 1996. P.L. 104-188, Aug. 20, 1996, 110 Stat. 1755.

Winston & Strawn
December 1996

[In addition to the primary sources cited above, secondary sources include: *Taxes and Fees*, Air Transport Association, January 1996; *Reassessing the U.S. Airline Industry's Federal Excise Tax Structure*, R. Barnes and J. Heimlich, M.P.P. Candidates, John F. Kennedy School of Government, Harvard University, April 9, 1996; *Effects of the Trust Fund Taxes' Lapsing on FAA's Budget*, U.S. Government Accounting Office, GAO/RCED-96-130, April 15, 1996; *The Status of the Airport and Airway Trust Fund*, Congressional Budget Office, December 1988.]

Top Southwest 1995 Markets

Summary

Nonstop Miles Traveled:	Passengers			Average Fare		
	1995	1996	Change	1995	1996	Change
Less than 300 Miles	5,247,080	5,457,160	4%	\$48	\$53	12%
300-499 Miles	8,101,550	8,668,770	7%	\$50	\$56	12%
500-700 Miles	2,967,600	2,892,770	-3%	\$63	\$74	17%
Greater than 700 Miles	1,659,430	2,036,300	23%	\$98	\$99	1%
Grand Total	17,975,660	19,055,000	6%	\$58	\$62	8%

Source: O&D Plus-Origin & Destination Survey of Airline Passenger Traffic, First Six Months, 1995 and 1996.

Top Southwest 1995 Markets Less than 300 Miles

1995 Rank	Origin	Destination	Nonstop Miles	Passengers			Average Fare		
				1995	1996	Change	1995	1996	Change
1	DAL	HOU	239	618,740	638,360	3%	\$57	\$61	7%
2	LAS	LAX	236	418,580	477,400	14%	\$44	\$46	5%
3	LAS	PHX	256	338,830	370,870	9%	\$42	\$46	10%
4	BUR	LAS	223	328,460	336,150	2%	\$46	\$50	9%
5	DAL	SAT	248	288,180	298,320	4%	\$53	\$60	13%
6	LAS	SAN	258	285,060	299,630	5%	\$45	\$50	11%
7	AUS	DAL	183	259,870	260,740	0%	\$57	\$65	14%
8	DTW	MDW	229	233,200	212,910	-9%	\$50	\$57	14%
9	MDW	STL	251	214,040	222,320	4%	\$48	\$54	13%
10	BUR	SJC	296	201,520	211,610	5%	\$49	\$57	16%
11	AUS	HOU	152	159,800	147,450	-8%	\$58	\$66	14%
12	LAS	ONT	197	158,840	180,930	14%	\$45	\$50	11%
13	DAL	LBB	293	157,270	150,480	-4%	\$49	\$57	16%
14	HOU	SAT	192	149,840	148,450	-2%	\$56	\$63	13%
15	DAL	LIT	296	141,500	151,190	7%	\$48	\$53	10%
16	DAL	TUL	237	137,850	148,090	7%	\$52	\$59	13%
17	GEG	SEA	224	128,810	161,540	25%	\$38	\$39	3%
18	MDW	SDF	271	126,540	113,930	-10%	\$38	\$51	34%
19	HOU	HRL	278	123,740	119,620	-3%	\$48	\$56	17%
20	MCI	STL	238	113,780	106,120	-7%	\$42	\$44	5%
21	OAK	RNO	180	109,960	118,540	8%	\$50	\$47	18%
22	DAL	IAH	217	108,510	122,540	13%	\$57	\$65	14%
23	CMH	MDW	284	107,810	95,720	-11%	\$38	\$52	37%
24	DAL	OKC	181	103,940	110,820	7%	\$54	\$62	15%
25	CRP	HOU	187	77,800	75,470	-3%	\$56	\$64	14%
26	RNO	SJC	188	76,080	98,250	29%	\$37	\$40	8%
27	IND	MDW	162	67,900	75,880	12%	\$40	\$42	5%
28	GEG	POX	279	60,460	77,660	28%	\$36	\$39	8%
29	ABQ	ELP	223	58,560	55,320	-6%	\$52	\$54	4%
30	BOI	SLC	291	52,660	44,130	-16%	\$35	\$38	9%
31	HRL	SAT	253	50,450	48,440	-4%	\$52	\$58	12%
32	LIT	STL	256	50,000	50,550	1%	\$48	\$50	4%
33	MCI	TUL	223	48,340	46,300	0%	\$50	\$58	16%
34	IND	STL	229	46,070	35,810	-22%	\$47	\$55	17%
35	AUS	MAF	293	41,830	37,480	-10%	\$57	\$67	18%
36	SDF	STL	254	38,430	32,590	-15%	\$36	\$45	25%
37	AUS	HRL	280	35,110	37,530	7%	\$51	\$56	10%
38	ELP	LBB	295	25,710	24,710	-4%	\$52	\$60	13%
39	ELP	MAF	246	22,670	20,190	-11%	\$52	\$61	17%
40	ABQ	LBB	289	18,870	18,630	-1%	\$53	\$59	11%
41	BOI	GEG	287	15,730	44,260	181%	\$44	\$39	-11%
42	BHM	BNA	177	15,490	20,830	34%	\$39	\$47	21%
43	ABQ	AMA	277	15,300	15,710	3%	\$56	\$63	13%
44	MAF	SAT	277	12,040	12,090	0%	\$63	\$91	10%
45	DTW	IND	231	6,950	6,730	-3%	\$63	\$67	6%
46	AUS	CRP	175	6,320	5,860	-7%	\$55	\$66	20%
47	LBB	OKC	269	5,060	4,950	-2%	\$86	\$100	16%
48	CLE	IND	281	3,550	2,500	-30%	\$58	\$68	17%
49	AMA	OKC	233	1,770	1,920	8%	\$98	\$109	11%
Totals				5,247,080	5,457,160	4%	\$48	\$53	10%

Source: O&O Plus-Origin & Destination Survey of Airline Passenger Traffic, First Six Months, 1995 and 1996.

Top Southwest 1995 Markets

300-499 Miles

1995 Rank	Origin	Destination	Nonstop Miles	Passengers			Average Fare		
				1995	1996	Change	1995	1996	Change
1	LAX	OAK	337	528,000	562,490	7%	\$44	\$57	30%
2	LAX	PHX	370	375,810	428,590	14%	\$44	\$45	2%
3	BUR	OAK	325	341,970	417,780	22%	\$46	\$54	17%
4	OAK	SAN	446	303,400	311,390	3%	\$49	\$56	14%
5	PHX	SAN	304	299,410	310,010	4%	\$45	\$47	4%
6	BUR	SMF	358	297,590	294,490	-1%	\$48	\$51	6%
7	OAK	ONT	361	292,600	298,470	2%	\$45	\$51	13%
8	LAX	SJC	308	287,500	311,330	8%	\$45	\$52	16%
9	ONT	SMF	389	283,860	288,090	1%	\$48	\$51	6%
10	SAN	SFO	447	264,650	236,220	-11%	\$45	\$51	13%
11	HOU	MSY	303	240,340	246,190	2%	\$62	\$70	13%
12	ABQ	PHX	328	225,760	233,070	3%	\$48	\$53	10%
13	SAN	SMF	480	217,750	275,020	26%	\$47	\$55	17%
14	OAK	SNA	371	208,730	192,910	-8%	\$54	\$64	19%
15	ONT	PHX	325	208,430	215,800	4%	\$46	\$51	11%
16	MCI	MDW	405	196,960	205,640	4%	\$57	\$60	5%
17	SJC	SNA	342	191,010	161,310	-16%	\$53	\$62	17%
18	ONT	SJC	333	171,490	171,830	0%	\$46	\$53	15%
19	LAX	SMF	373	166,480	181,650	9%	\$46	\$51	11%
20	LAS	OAK	407	159,080	249,790	57%	\$50	\$49	-2%
21	LAS	SJC	386	152,110	178,900	18%	\$50	\$46	-21%
22	LAS	SLC	368	141,610	145,300	3%	\$58	\$78	17%
23	DAL	MSY	437	139,760	145,960	4%	\$65	\$78	17%
24	BUR	PHX	369	137,250	141,370	3%	\$47	\$51	9%
25	SAN	SJC	417	131,060	179,690	37%	\$46	\$55	20%
26	LAS	RNO	345	129,560	177,390	37%	\$44	\$50	14%
27	DAL	MAF	319	127,670	123,340	-3%	\$50	\$57	14%
28	CLE	MDW	307	126,200	144,700	15%	\$43	\$51	19%
29	LAS	SMF	397	120,800	146,130	21%	\$58	\$54	-7%
30	AMA	DAL	324	119,460	115,490	-3%	\$48	\$56	17%
31	LAX	TUS	451	116,560	110,380	-5%	\$41	\$45	10%
32	BWI	CLE	314	115,000	103,750	-10%	\$32	\$47	47%
33	ELP	PHX	347	114,080	112,710	-1%	\$46	\$55	20%
34	ABQ	LAS	487	105,800	117,450	11%	\$75	\$73	-3%
35	HOU	TUL	453	89,110	89,390	0%	\$81	\$94	16%
36	BNA	MDW	395	87,150	94,450	8%	\$56	\$68	21%
37	DTW	STL	440	78,830	70,140	-11%	\$53	\$58	9%
38	MCI	OKC	312	77,220	78,710	1%	\$48	\$55	15%
39	CRP	DAL	362	68,150	63,670	-7%	\$65	\$72	31%
40	BHM	MSY	321	67,780	77,860	15%	\$57	\$57	0%
41	PDX	SMF	479	66,190	93,640	41%	\$53	\$56	6%
42	ELP	SAT	486	66,060	67,390	2%	\$78	\$85	9%
43	SAN	TUS	367	64,300	68,930	7%	\$43	\$49	14%
44	BWI	SDF	495	62,110	65,960	6%	\$39	\$53	36%
45	HOU	MAF	441	60,390	62,560	4%	\$79	\$85	8%
46	HOU	OKC	419	59,460	60,050	1%	\$78	\$91	17%
47	DAL	HLR	458	57,170	61,070	7%	\$75	\$92	23%
48	BOI	PDX	344	56,630	73,030	29%	\$43	\$45	5%
49	AUS	LBB	335	54,140	51,040	-6%	\$64	\$70	9%
50	LAS	TUS	365	49,290	58,250	18%	\$37	\$41	11%
Totals				8,101,550	8,668,770	7%	\$50	\$56	12%

Source: O&D Plus-Origin & Destination Survey of Airline Passenger Traffic, First Six Months, 1995 and 1996.

Top Southwest 1995 Markets
500-700 Miles

1995 R#M	Origin	Destination	Nonstop Miles	Passengers			Revenues			Average Fare		
				1995	1996	Change	1995	1996	Change	1995	1996	Change
1	BWI	MDW	611	195,880	178,820	-10%	\$9,961,530	\$11,595,420	16%	\$51	\$66	29%
2	LAX	SLC	590	175,200	136,050	-22%	\$7,923,060	\$6,289,540	-5%	\$45	\$46	2%
3	ABQ	LAX	677	151,250	138,140	-9%	\$12,868,870	\$10,964,500	-15%	\$85	\$80	-7%
4	PHX	SLC	507	143,150	144,070	1%	\$6,612,170	\$8,118,610	26%	\$46	\$53	17%
5	DAL	ELP	562	136,610	148,090	9%	\$9,929,490	\$12,176,670	22%	\$72	\$83	16%
6	ABQ	DAL	580	129,870	153,940	18%	\$9,078,370	\$12,249,570	35%	\$70	\$80	14%
7	OAK	PHX	646	119,330	105,450	-12%	\$6,825,540	\$7,725,460	13%	\$57	\$73	28%
8	OAK	SLC	566	117,130	88,190	-25%	\$5,482,200	\$5,302,720	0%	\$47	\$61	30%
9	PHX	SFO	851	102,490	100,150	-2%	\$5,896,500	\$7,125,560	21%	\$58	\$71	21%
10	OAK	SEA	671	97,970	114,680	17%	\$4,725,170	\$5,991,780	27%	\$48	\$52	8%
11	PHX	SJC	621	97,570	96,870	-1%	\$5,640,200	\$7,081,060	19%	\$61	\$73	20%
12	SEA	SLC	689	92,400	66,350	-28%	\$4,534,510	\$4,280,620	-6%	\$49	\$65	31%
13	SAN	SLC	626	83,250	57,080	-31%	\$3,597,800	\$3,222,800	-10%	\$43	\$56	31%
14	HOU	STL	687	78,290	78,370	0%	\$6,236,580	\$7,200,030	15%	\$80	\$92	15%
15	BNA	HOU	670	87,190	70,810	-6%	\$5,294,780	\$7,063,610	34%	\$79	\$100	27%
16	AUS	ELP	525	66,320	66,040	0%	\$5,353,040	\$5,866,980	10%	\$81	\$89	10%
17	OAK	POX	543	64,730	77,630	20%	\$3,239,840	\$4,257,910	31%	\$50	\$55	10%
18	PHX	SMF	647	64,170	72,950	14%	\$4,262,560	\$5,237,610	22%	\$67	\$72	8%
19	ABQ	SAN	626	61,870	64,450	4%	\$5,026,160	\$5,329,280	6%	\$81	\$83	2%
20	BHM	HOU	570	61,600	48,190	-22%	\$5,526,510	\$4,718,870	-15%	\$90	\$88	-2%
21	PDX	SLC	630	59,530	37,840	-36%	\$2,835,160	\$2,395,110	-16%	\$48	\$63	33%
22	ELP	LAS	584	57,830	58,400	1%	\$4,100,940	\$4,687,140	9%	\$71	\$78	8%
23	ELP	HOU	677	51,980	51,730	-1%	\$5,158,500	\$5,739,610	11%	\$99	\$111	12%
24	BHM	BWI	682	47,250	46,420	-2%	\$2,696,800	\$3,485,500	29%	\$57	\$75	31%
25	BHM	MDW	570	43,270	44,340	2%	\$3,309,870	\$4,094,990	24%	\$76	\$92	21%
26	SLC	SMF	532	41,910	24,970	-40%	\$1,790,720	\$1,450,560	-19%	\$45	\$58	28%
27	HOU	MCI	666	39,940	38,080	-5%	\$1,896,880	\$4,245,980	124%	\$69	\$112	25%
28	SEA	SMF	605	39,060	53,800	38%	\$3,587,150	\$2,763,680	-23%	\$54	\$51	-5%
29	ELP	SAN	636	38,770	35,860	-7%	\$2,114,060	\$3,327,480	57%	\$60	\$83	38%
30	PHX	RNO	601	35,260	47,830	36%	\$3,096,760	\$3,213,230	4%	\$54	\$67	23%
31	AMA	HOU	538	34,520	20,480	-41%	\$1,920,820	\$2,941,620	53%	\$65	\$97	48%
32	RNO	SEA	564	31,910	49,860	56%	\$2,924,980	\$2,183,980	-25%	\$48	\$44	-8%
33	ABQ	ONT	631	31,610	28,190	-11%	\$1,517,800	\$2,232,640	47%	\$75	\$79	5%
34	LIT	MDW	544	29,200	33,440	15%	\$2,378,790	\$3,137,420	32%	\$62	\$94	51%
35	GEY	SLC	547	24,860	18,580	-25%	\$2,390,950	\$1,148,050	-52%	\$46	\$62	35%
36	ONT	MCI	630	22,260	23,080	4%	\$1,137,390	\$1,827,120	61%	\$70	\$79	13%
37	ONT	SLC	558	22,180	17,140	-23%	\$1,563,500	\$1,355,500	-13%	\$54	\$66	22%
38	PHX	ONT	670	21,870	20,250	-7%	\$1,207,710	\$1,944,800	61%	\$62	\$96	56%
39	ABQ	SAT	800	21,170	24,780	17%	\$1,767,730	\$2,520,610	43%	\$68	\$102	48%
40	MDW	TUL	583	20,440	18,770	-8%	\$2,071,870	\$2,201,140	6%	\$69	\$117	50%
41	GEY	RNO	572	19,830	31,770	60%	\$2,016,770	\$1,779,680	-12%	\$53	\$56	6%
42	ABQ	AUS	613	17,810	19,250	8%	\$1,049,520	\$2,013,980	92%	\$98	\$105	7%
43	LIT	SAT	511	16,480	16,480	0%	\$1,748,080	\$1,414,000	-19%	\$76	\$66	-14%
44	MSY	OKC	587	15,860	17,720	12%	\$1,240,470	\$1,542,800	24%	\$78	\$87	15%
45	CMH	MCI	633	15,840	15,700	-1%	\$1,198,740	\$1,318,280	10%	\$72	\$84	16%
46	LBX	PHX	588	15,480	13,720	-11%	\$1,143,430	\$1,291,090	13%	\$77	\$94	22%
47	SEA	SJC	687	14,970	46,220	209%	\$1,190,900	\$2,258,980	90%	\$44	\$49	12%
48	AMA	PHX	601	14,310	12,710	-11%	\$652,300	\$1,141,720	75%	\$76	\$90	18%
49	MAF	PHX	580	14,010	13,130	-6%	\$1,065,140	\$1,185,520	9%	\$74	\$80	21%
Totals				2,967,800	2,892,770	-3%	\$1,043,510	\$15,440,080	20546%	\$63	\$74	17%

Source: OAG Post-Flight & Destination Survey of Airline Passenger Traffic, First Six Months, 1996 and 1995

Top Southwest 1995 Markets
Greater than 700 Miles

1995 Rank	Origin	Destination	Nonstop Miles	Passengers			Average Fare		
				1995	1996	Change	1995	1996	Change
1	ELP	LAX	714	91,530	81,460	-11%	\$86	\$98	14%
2	BWI	STL	737	81,100	77,530	-4%	\$56	\$78	39%
3	LAS	SAT	1,069	68,830	88,850	29%	\$96	\$97	1%
4	LAS	MCI	1,139	65,580	67,180	2%	\$94	\$93	-1%
5	MCI	PHX	1,043	60,190	91,320	52%	\$96	\$76	-20%
6	MDW	PHX	1,444	59,120	66,380	12%	\$112	\$112	0%
7	ABQ	SFO	896	54,700	59,710	9%	\$113	\$102	-10%
8	HOU	LAX	1,390	54,200	61,860	14%	\$143	\$148	4%
9	HOU	MDW	937	50,930	65,970	30%	\$116	\$108	-7%
10	HOU	PHX	1,020	47,390	56,020	18%	\$122	\$132	9%
11	PHX	STL	1,262	46,930	56,500	20%	\$105	\$120	15%
12	AUS	PHX	868	46,110	49,930	8%	\$83	\$101	9%
13	PHX	SAT	843	46,040	52,290	14%	\$104	\$100	-4%
14	HOU	LAS	1,235	44,350	86,290	95%	\$66	\$90	6%
15	PHX	SEA	1,107	43,570	58,330	34%	\$89	\$79	-12%
16	GEG	OAK	723	41,660	37,840	-9%	\$57	\$64	13%
17	PHX	TUL	935	33,650	39,010	16%	\$112	\$105	-6%
18	OKC	PHX	833	33,060	42,450	28%	\$116	\$107	-7%
19	LAS	MDW	1,521	30,930	43,780	42%	\$110	\$112	2%
20	AUS	LAS	1,085	30,890	55,510	80%	\$83	\$83	-1%
21	SLC	STL	1,156	28,590	20,940	-27%	\$66	\$95	44%
22	PDX	PHX	1,009	26,540	29,590	11%	\$84	\$81	-4%
23	LAS	SEA	866	26,220	64,110	145%	\$59	\$58	-1%
24	LAX	MDW	1,750	24,690	31,230	26%	\$133	\$125	-6%
25	ABQ	HOU	759	24,660	33,680	37%	\$82	\$93	1%
26	BWI	HOU	1,246	24,380	30,890	27%	\$105	\$130	24%
27	LAX	SAT	1,210	24,290	36,570	51%	\$117	\$119	1%
28	MDW	MSY	825	24,060	36,100	50%	\$89	\$101	13%
29	ABQ	OAK	869	23,480	21,150	-10%	\$105	\$105	0%
30	LAX	SEA	954	22,490	48,280	115%	\$88	\$73	-16%
31	DTW	PHX	1,671	22,410	19,150	-15%	\$127	\$149	17%
32	LAS	LBB	775	21,770	23,720	9%	\$79	\$89	13%
33	MDW	SAN	1,728	21,400	18,500	-14%	\$128	\$134	5%
34	OMA	PHX	1,037	21,170	35,560	68%	\$94	\$78	-18%
35	HOU	IND	862	21,080	18,860	-20%	\$94	\$111	18%
36	LAS	MAF	796	20,300	22,480	11%	\$79	\$89	11%
37	ABQ	SJC	870	20,080	15,300	-24%	\$100	\$107	8%
38	BNA	PHX	1,448	19,880	30,210	52%	\$152	\$144	-5%
39	LAS	PDX	762	19,640	56,650	188%	\$59	\$61	3%
40	SAT	STL	786	19,010	15,860	-17%	\$87	\$100	15%
41	HOU	SAN	1,312	18,840	22,730	21%	\$133	\$136	3%
42	ABQ	MCI	717	18,550	20,170	9%	\$109	\$103	-6%
43	AUS	LAX	1,238	18,510	19,490	5%	\$108	\$120	12%
44	MDW	SLC	1,258	18,120	16,250	-10%	\$107	\$111	4%
45	LAS	OMA	1,069	17,270	29,010	68%	\$89	\$89	0%
46	SAN	SAT	1,129	16,620	15,740	-5%	\$129	\$130	1%
47	AMA	LAS	758	16,290	17,260	6%	\$83	\$90	9%
48	GEG	PHX	1,020	16,290	14,520	-11%	\$68	\$82	-6%
49	BNA	LAX	1,797	16,040	15,840	-1%	\$96	\$134	40%
50	BWI	MCI	967	16,020	20,250	26%	\$80	\$95	20%
Totals				1,659,430	2,036,300	23%	\$96	\$99	1%

Source: O&D Plus-Origin & Destination Survey of Airline Passenger Traffic, First Six Months, 1995 and 1996

Major-Regional Affiliations
(ownership, if any, is indicated)

1. Northwest

Business Express
Mesaba (30%)
Express 1
Horizon
Trans States

2. United

Atlantic Coast
Mountain West
Great Lakes
Westair
Air Wisconsin
United Feeder Service

3. Delta

Atlantic Southeast (24%)
Business Express
Comair (23%)
Sky West (18%)

4. TWA

Trans States

5. USAir

Air Midwest
Allegheny (100%)
CCAir
Chautauque
CommutAir
FloridaGulf
Liberty Express
PSA (100%)
Piedmont (100%)
Trans States

6. American

Executive (100%)
Flagship (100%)
Simmons (100%)
Wings West (100%)

7. Continental

Continental Express (100%)
Gulfstream
Skywest

PREPARED STATEMENT OF DONALD C. LUBICK

Mr. Chairman and Members of the Committee:

I am pleased to present the views of the Treasury Department on the measures necessary to assure the continued solvency of the Airport and Airway Trust Fund (Trust Fund). Your invitation asked us to focus our testimony on the Trust Fund excise taxes, including their structure, the revenue raised from the taxes, the administrative problems with the taxes, and proposals to modify the domestic passenger ticket tax or substitute an alternative funding system. I will address these matters, but first I would like to bring to your attention a much more pressing issue.

As you know, when Congress extended the aviation excise taxes through December 31, 1996, it similarly extended our authority to transfer to the Trust Fund only those taxes that were actually received by the IRS by the end of 1996. Thus, we are not permitted to transfer to the Trust Fund taxes that are received in 1997, even if those taxes relate to air transportation that occurred in 1996.

This lack of extended authority is greatly exacerbated by the recent revelation that the airlines did not deposit until 1997 the vast majority of the taxes imposed in 1996. As a consequence, we have concluded that approximately \$1.2 billion transferred to the Trust Fund based on initial estimates should have remained in the General Fund and thus must be withdrawn. Given that the level of funding for the Trust Fund was already of serious concern, this adjustment to the Trust Fund forces us to focus immediately on ways to ensure the continued high standards for aviation safety. For the reasons I will discuss briefly below, the Administration urges an immediate extension of the Treasury Department's authority to transfer to the Trust Fund all of the revenues collected from these taxes, regardless of when they are received, together with an immediate reinstatement, through late September 1997, of the taxes dedicated to the Trust Fund.

The excess transfers to the Trust Fund occurred because the Treasury office responsible for authorizing transfers to the Trust Fund did not know that the airlines (relying on IRS advice) were not making anticipated deposits.[1] Thus, our estimates, and our transfers to the Trust Fund, were much higher than actual deposits.

We have concluded that it is necessary to correct this error by transferring the \$1.2 billion excess back to the General Fund. But not that the actual tax payments by the airlines have been or are about to be made, we lack authority to transfer the monies from the General Fund to the Trust Fund.

Parenthetically, you may wonder why the airlines did not make full deposits in 1996 of taxes collected in that year. In large part it was because of reliance on the administrative procedure set up in the regulation governing deposits, which allowed payment under a safe harbor measured by the taxpayer's liabilities in the second previous quarter. IRS attorneys in the excise tax branch agreed with the airline industry's position that the regulation should be construed to permit current deposits based upon zero actual liability for the second previous quarter when the tax had lapsed. They were not aware of the inability to transfer post year-end receipts to the Trust Fund, since that was not an IRS function. Had top officials of the IRS and the Treasury been advised that the airlines were largely deferring payment of tax collections, we might have been able to alter that outcome, including, if necessary, by revising the deposit regulation quickly to require earlier deposit of much, but not all, of the 1996 tax liabilities.[2]

The second aspect of the problem is the urgency of extension of the lapsed taxes. Even with the renewal of authority to transfer after-collected taxes, some Federal aviation capital programs will, absent a reinstatement of these aviation excise taxes, run out of money in the near future. Such programs include the replacement of antiquated radar systems and airport grants. Although the ability to continue such programs will end in March 1997, or a few months later if the technical correction described above is made, earlier notices to contractors, in many cases almost immediately, will be necessary to avoid liability on projects where funds will run out without extension of the lapsed taxes. The FAA will be able to explain to you their exact financial situation.

We therefore urge, in addition to the technical modification to the Treasury Department's authority to make transfers of aviation excise taxes to the Trust Fund, the immediate short-term reinstatement of those taxes through late September of this year, while the Administration works with Congress to devise a long-term solution.

STRUCTURE OF TAXES

The Airport and Airway Trust Fund was created in 1970 to finance Federal aviation programs, including services provided by the FAA and grants for airport im-

provement. Since its creation, the Trust Fund has been supported, in large part, by Federal excise taxes on commercial air passenger and air freight transportation and on noncommercial aviation fuel. These taxes expired on December 31, 1995. The Small Business Job Protection Act of 1996 reinstated the taxes beginning on August 27, 1996, but the taxes expired again on December 31, 1996.

Before the expiration of these taxes at the end of last year, the tax on domestic air passenger transportation was 10 percent of the amount paid for the transportation, the tax on international air passenger departures was \$6 per person, and the tax on domestic air freight transportation was 6.25 percent of the amount paid for the transportation. The tax on noncommercial aviation fuel, to the extent dedicated to the Trust Fund, was 15 cents per gallon in the case of gasoline and 17.5 cents per gallon in the case of fuel other than gasoline.[3]

REVENUES FROM TAXES

The table below shows total liabilities and the composition of those liabilities for the taxes that fund the Airport and Airway Trust Fund for FY 1993 through FY 1996.[4] The table shows that liabilities from the aviation excise taxes increased from \$4.9 billion in FY 1993 to \$5.7 billion in FY 1995, and then decreased to \$1.8 billion in FY 1996. The reduction in liabilities reflects the lapse in the aviation excise taxes from January 1, 1996 through August 26, 1996.

The table also shows that the tax on domestic air transportation accounts for most of the liabilities from the aviation excise taxes (87.5 percent). The other aviation excise taxes account for 12.5 percent of total liabilities, as follows: the tax on domestic air freight transportation (5.8 percent), international air passenger departures (4.5 percent), aviation fuels other than gasoline (2.0 percent), and gasoline (0.2 percent).[5]

LIABILITIES FROM EXCISE TAXES THAT FINANCE THE AIRPORT AND AIRWAYS TRUST FUND: FY 1993-1996 (\$ MILLIONS)

	FY 1993	FY 1994	FY 1995	FY 1996
Domestic air transportation	4,316	4,747	4,928	1,557
Domestic air freight	238	330	335	126
International air passenger departures	224	225	256	87
Aviation fuels (other than gasoline)[6]	101	118	139	5
Gasoline[7]	6	21	8	1
Total	4,885	5,441	5,666	1,776

ADMINISTRATIVE PROBLEMS WITH TAXES

The IRS has identified various administrative problems with the current tax. Some of these problems are attributable to the fact that the taxes on air transportation are imposed on the person purchasing the transportation rather than the transportation provider. Although the transportation provider is required to collect the tax and remit the amounts collected to the Treasury, the IRS may have no effective remedy when the transportation provider does not collect and remit the tax. In those cases, the IRS must either establish that the transportation provider's failure was willful or attempt to collect a small amount of tax from each of the persons to whom transportation was provided. Additional difficulties arise when the tax expires or is reinstated. For example, the expiration of the tax at the end of 1995 resulted in numerous small refund claims from individual passengers who purchased tickets in 1995 for travel during 1996.

The differing tax treatment of commercial and noncommercial aviation is also a source of difficulty. When the same aircraft is used to transport passengers or property for hire and to transport employees or property of the owner (or the affiliated group to which the owner belongs), the tax that applies is determined on a flight-by-flight basis. In the case of flights that transport passengers or property for hire, tax is imposed on the amount paid for the transportation, but the fuel used is exempt from tax (other than the 4.3 cent general fund tax). Dual-use aircraft, however, are likely to use fuel that has already been taxed at the full rate, necessitating a claim for refund. In addition to the administrative burden of filing and processing refund claims, the rules relating to dual-use aircraft can result in inappropriate revenue losses because a flight is treated as commercial aviation (and not subject to the Trust Fund fuel tax) if it carries a single fare-paying passenger. In other words, a substantial fuel tax can be avoided by paying a relatively small tax on a single passenger's fare.

The administrative problems discussed above do not result in significant revenue losses. We would, nevertheless, be pleased to work with Congress to develop legislation that would address the IRS concerns.

We also note that the air transportation taxes may lead to allocation disputes. This occurs because express delivery services generally involve a combination of air transportation and ground services. In such cases, only the amount paid for the air transportation is subject to tax, and it is therefore necessary to determine the extent to which the total amount paid is allocable to air transportation. The IRS believes that some taxpayers are taking advantage of these rules by allocating an inflated amount to ground services to avoid the tax. This problem is inherent in a tax imposed on amounts paid for taxable services that are commonly bundled with other services. The IRS believes, however, that its concerns can be minimized by appropriate changes to its regulations and is currently studying this issue.

PROPOSALS TO MODIFY TAXES OR SUBSTITUTE AN ALTERNATIVE FUNDING SYSTEM

The Administration is also represented at this hearing by Louise Frankel Stoll of the Department of Transportation. Her testimony will discuss in greater detail the allocation and funding issues as they affect the FAA's programs and operations. As you know, Congress has directed further study of the issues relating to FAA financing. The Federal Aviation Reauthorization Act of 1996 (P.L. 104-264) requires an assessment by an independent contractor of FAA's funding needs and the costs imposed by each segment of the aviation industry on the airport and airway system. This assessment, which is due later this month, should provide a useful starting point for efforts to develop a secure funding source for Federal aviation programs. The Reauthorization Act also creates a National Civil Aviation Review Commission to study how best to finance the FAA in light of this assessment of funding needs and system costs. The Commission is scheduled to report its findings and conclusions to the Secretary of Transportation by August 1997. In addition, by October 1997, the Secretary of Transportation, after consultation with the Treasury Department, is required to provide Congress with the Administration's recommendations for funding the needs of the aviation system through 2002.

We believe it would be inappropriate to propose a specific system of new fees or taxes without the benefit of the Commission's recommendations. The Administration will, of course, be pleased to work with this Committee to develop a long-term financing solution when the study is complete and the Secretary of Transportation has reported his recommendations to Congress.

Mr. Chairman, this concludes my written testimony. I will be pleased to answer any questions you or other members of the Committee may have.

ENDNOTES

- [1]: Initial information regarding excise tax collections is available only in aggregate form. No information is available with respect to liability or collections for a particular excise tax source until quarterly returns are filed and completely processed by IRS, usually 6 to 9 months after a taxable quarter has closed. During October-November 1996, total excise tax collections, which were in excess of \$13 billion, were below forecast level by an amount that was well within the range of normal and acceptable forecasting error. It would appear that, in aggregate, deposits of all other excise taxes exceeded Treasury estimates, thus offsetting and masking the \$1.2 billion shortfall in Airport and Airway Trust Fund taxes.
- [2]: The Treasury Department intends to modify the regulatory safe-harbor provision on which the airlines relied to provide that when a new tax is imposed, or an expired tax is reinstated, taxpayers must deposit liabilities attributable to the new or reinstated tax on a current basis.
- [3]: The Omnibus Budget Reconciliation Act of 1993 imposed an additional tax of 4.3 cents per gallon on both commercial and noncommercial aviation fuel. Revenues from this tax, which remains in effect and is not scheduled to expire, are retained in the General Fund.
- [4]: Liabilities incurred for a given year may differ from net receipts to the Trust Fund, due to adjustments made during that year which relate to prior periods.
- [5]: Net receipts from the additional 4.3-cents-per-gallon tax on commercial and non-commercial aviation fuels were \$28 million in FY 1993, \$38 million in FY 1994, \$41 million in FY 1995, and \$568 million in FY 1996. Deposits received relating to these taxes remain in the General Fund. The application of the 4.3-cents-per-gallon rate to fuel used in commercial aviation began in FY 1996.
- [6/7]: These liabilities are net of refunds for exempt uses and certain adjustments.

PREPARED STATEMENT OF HON. JOHN MCCAIN

Mr Chairman, thank you for the opportunity to testify at your hearing to examine the Airport and Airway Trust Fund taxes. Mr. Chairman, the American people demand that we make good on the aviation safety and security improvements Congress enacted last year. We must take immediate action to reinstate the current aviation excise taxes as quickly as possible. I was recently told by former Acting FAA Administrator Linda Daschle that FAA safety programs would be at risk if we do not move immediately to restore funding for the aviation trust fund.

It is unconscionable to sit by and allow the trust fund's available balance to dwindle to zero as we dicker over inside-the-beltway issues, such as how these revenues should be scored in the congressional budget process, and who should pay what to support the aviation system in the long term. For every day that Congress fails to act on a tax reinstatement, the aviation trust fund loses as much as \$20 million dollars in revenue and interest foregone.

The aviation excise taxes lapsed at the end of last year. The main reason they were allowed to lapse is so that Congress can use the revenues to offset tax cuts or increased spending elsewhere when they are reinstated. This sort of budget gimmickry is deplorable. The reality is that even if the revenues are deposited in the trust fund, deficit pressures will reduce incentives to spend these funds for their dedicated purpose—aviation safety and capacity improvements.

On a side note, I am dismayed by reports that several airlines increased fares to match the lapse in the 10 percent passenger ticket tax. The aviation investments we are discussing today benefit the airlines along with other system users.

The need for action has increased dramatically in recent days. We just learned that the Treasury Department mistakenly credited the aviation trust fund with approximately \$1.2 billion. Unless Congress takes immediate action, the FAA will run out of funds to obligate to capital programs by the end of March of this year. These recent discoveries prompted me, along with the rest of the bipartisan aviation leadership on the Commerce Committee, to introduce legislation last week to reinstate the trust fund taxes on a short-term basis, in the hopes that you would take it up quickly.

The FAA capital programs—the Airport Improvement Program, the Facilities and Equipment program, and the Research, Engineering & Development program—are 100 percent trust fund financed. These are the programs that will be jeopardized without a renewed revenue stream.

The Facilities and Equipment account is the principal means for modernizing and improving the air traffic control system and other airway facilities. We may not know yet exactly how the funding shortfall will affect specific programs. Even so, it appears that within 60 days, the FAA will have to move to terminate major projects, such as the terminal and en route automation programs, and improved aircraft navigation and precision approach systems. I also question whether the FAA will be able to meet its commitments on enhanced weather detection programs, as well as advanced baggage screening equipment.

Lack of aviation trust funds will also cripple the Airport Improvement Program, which provides airport grants for critical safety, capacity and noise projects. The FAA will have to terminate certain grant payments, as well as new commitments, in the near future.

Sufficient trust fund revenues are critical to support the aviation safety and security reforms contained in the Federal Aviation Reauthorization Act of 1996, which we enacted at the close of the last session. Many of my colleagues from the Senate, including members from the Finance Committee, spoke at that time about the vital nature of the safety and security improvements contained in the FAA legislation. Yet, the FAA legislation is only as effective as the ability to fund its improvements.

Again, I urge that the committee move as soon as possible to extend the current aviation excise taxes. The tax lapse jeopardizes safety-related capital improvements and shakes the public confidence in the government's ability to safeguard the nation's air travelers. Thank you, Mr. Chairman, for the opportunity to speak to the committee on this issue today.

PREPARED STATEMENT OF HON. DANIEL PATRICK MOYNIHAN

Mr. Chairman, we are here today to learn about the Airport and Airway Trust Fund, and about the excise taxes levied to fund the Trust Fund. These taxes largely support the operations of our Federal Aviation Administration, our Nation's air traffic control system, civil aviation security research, and weather reporting services.

These taxes also fund our airport improvement program, providing grant money for important equipment and infrastructure improvements at our Nation's airports.

The aviation infrastructure that we, as a Nation, public and private sectors, have built is the envy of the world. And we have the safest airways in the world.

All of us here fly our domestic commercial airlines—repeatedly—to and from cities large and small, near and far, foreign and domestic. It is a remarkable thing, and we have the luxury of taking this for granted. And it something of inestimable value to our economy.

Our first concern has been, and will continue to be, airline safety. As I stated, we have the safest airways in the world. Major air disasters, such as the TWA Flight 800 tragedy, are a rarity. This is part of the reason why they touch us so deeply, and are so closely followed by the National press. But they are, thankfully, quite rare.

Our safety record is not some fluke. Our Government, through the FAA, works with aircraft manufacturers, certifies aircraft, licenses pilots, requires annual medical certificates for pilots, and works with airport contractors in design, construction, maintenance and repair. We inspect aircraft, and impose rigorous safety requirements on aircraft design, manufacture, maintenance, repair and operation. We have created a National Weather Service to gather and timely report weather conditions and forecasts. We provide air traffic control services to all aircraft in our airways, which is made possible by our dedicated air traffic controllers, the radar, communications and other equipment we provide them with, and the system of rules and regulations we have created. And, when disaster occurs, we investigate to determine what happened and how to prevent a recurrence. As we know from the Flight 800 tragedy, our investigations are painstaking and they are exhaustive.

And, as mundane as it may seem, the Airport and Airway Trust Fund excise taxes are what fund the lion's share of these activities.

We are here today because these taxes have expired. We are no longer collecting the \$500 million or so each month that we should to fund the Trust Fund. Why? Our budget scoring rules can occasionally provide us with perverse incentives. Had the taxes been extended through April 15, as the Senate voted to do in last year's Small Business act, we would be in a much better position. Instead, because the taxes expired December 31, 1996, a reinstatement of the Trust Fund taxes now will be scored as if they were new taxes. This revenue—even though dedicated to a trust fund—will be spent for some tax cut, despite our need to reduce the deficit. We could not have done this under the Senate's version of last year's Small Business bill. And, of a sudden, it becomes very clear why we are here today.

As we hear testimony today from our distinguished panel of witnesses, let us keep in mind that we must ensure not only that our air traffic control services continue to be financed without disruption; we must also ensure that our ability to finance airport and airway infrastructure improvements for the 21st century.

PREPARED STATEMENT OF LOUISE FRANKEL STOLL

Mr. Chairman and Members of the Committee:

I welcome the opportunity to appear before you to discuss the three issues you raised in your letter: the Airport and Airway Trust Fund balance, Federal Aviation Administration (FAA) cost allocation; and long-term funding mechanisms for the FAA. Joining me today is Monte Belger, Acting Deputy Administrator of the FAA. We appreciate the Committee's timely decision to hold this hearing. It is essential that Congress act quickly to renew the aviation excise taxes in order to prevent unacceptable funding conditions in aviation, one of the nation's most significant industries.

AVIATION AND AIRWAY TRUST FUND BALANCE

For nearly three decades the FAA has been funded largely by aviation excise taxes through the Aviation Trust Fund. These include partial funding for FAA operations and full funding for facilities and equipment, airport grants and research. Those taxes lapsed on December 31 of last year. We urge this Committee to support their short-term renewal as promptly as possible, and to include the authority necessary to transfer taxes that will be paid in February. Every day that the taxes are not collected results in a loss of approximately \$20 million in revenue to the Trust Fund.

We had previously projected that at the current rate of spending, the uncommitted balance of the Trust Fund would be depleted around July 1 of this year. However, we have recently learned that revenue collected through December 1996 will not be transferred to the Aviation Trust Fund without a change in legislative au-

thority. So the uncommitted balance in the Trust Fund, \$1.9 billion, is all we have left for the remainder of fiscal year (FY) 1997. Funds for FAA capital programs will be depleted in March at current obligation rates. Thus the need for Congressional action is even more urgent. Unless Congress acts promptly to reinstate the taxes, the impact on the FAA, particularly its Capital Programs will be imminent and severe.

In light of these recent developments I have described above, we have carefully considered our options with the goal of moving forward in a manner that is both prudent and responsible.

Let me provide a complete explanation: \$5.3 billion of FAA's FY 1997 appropriation of \$8.6 billion was to come from the Trust Fund, and the remainder from the General Fund. The uncommitted Trust Fund balance available for FY 1997 was \$3 billion, and \$1.1 billion had been obligated as of January 31, leaving an uncommitted balance of \$1.9 billion in the Trust Fund. If the FAA is to live within Trust Fund limits and retain all its air traffic controllers and its regulatory, safety, and security staffs through the end of the fiscal year, action must be taken absent the reinstatement of the Ticket Tax. We have decided to dedicate the remaining uncommitted funds to pay for these essential operations until the fiscal year end, and to reduce drastically the agency's capital accounts to make that possible. Dedicating funds for the regulatory, safety and security staffs would leave only \$500 million available for FAA capital programs, such as airport safety and security improvement grants, safety and security equipment purchases, and research efforts. The amount such programs normally obligate in 2 months, would be the total available for the rest of the fiscal year. That means that no new obligations will be incurred, Airport Improvement Program (AIP) grants will be halted, and existing contracts will be reviewed to determine whether stop work notices must be issued.

We are very aware that the results of this option are painful, but because our operational functions are our first priority, if the taxes are not restored we have no choice. The FAA will have to prepare to take steps almost immediately. Actions such as interrupting funding of FAA's capital programs could have repercussions beyond the FAA. The importance of aviation as a vital part of our nation's economy is clear. This is true not only in terms of the direct benefits provided for the millions of people who rely on air travel each year, but also in terms of the indirect benefits aviation provides. It has been estimated that aviation and related industries contributed almost six percent of our gross domestic product, and employed 8.8 million people in 1993. No one would deny the impact that aviation has on the efficiency and productivity of many businesses, in all sectors of the economy, that depend on the rapid and reliable service provided by the national air transportation system.

The results of the anticipated shortfall in funding if the taxes are not restored will not be just a temporary cessation of work, but will instead have a "ripple effect." This ripple effect can perhaps best be understood in the context of airport grants. If Trust Fund revenues are not restored, the delay in issuing AIP grants could cause airport sponsors, especially in the northern part of the country, to miss some or all of the 1997 construction season. The loss of the construction season would lead to increased costs for these projects and disruptions of existing construction schedules for phased projects. We urge reinstatement of the taxes until September 15 of the current fiscal year in order to permit the agency to continue carrying out its capital programs.

LONG TERM USER FEES AND COST ALLOCATION

The President's Budget, which is scheduled to be released on February 6, will address long-term mechanisms for financing the FAA. This is also the object of the study in the Independent Financial Assessment and the National Civil Aviation Review Commission established under the Federal Aviation Reauthorization Act of 1996. I know these issues are of great interest to this Committee, and the Administration looks forward to working with you on them after release of the President's Budget.

The Department of Transportation and the FAA worked with the last Congress on aviation financing issues, and these efforts culminated in enactment of the Federal Aviation Reauthorization Act of 1996, which provided the framework for achieving financial reform for the agency. Subtitle C of the "FAA Reform" Title of the Act requires, first of all, that an independent assessment of the FAA's financing needs be conducted. The legislation specifies factors to be taken into account, such as anticipated air traffic forecasts, and includes a requirement for a cost allocation study. The FAA has awarded Coopers and Lybrand (C&L) a contract for this assessment and cost allocation study, which is to be completed later this month. FAA had earlier contracted with Gellman Research Associates (GRA), Incorporated for a cost al-

location study. The work undertaken pursuant to that effort, however, was not finalized by the FAA, given the recent statutory direction for the independent financial analysis and cost allocation study. C&L has been provided the data earlier compiled under the GRA contract, but we will not see their final product until later this month. How costs are ultimately allocated depends, in part, on assumptions that are made during the course of such a study, on matters such as how to allocate fixed or common costs among various users. We should note that, in general, types of information of interest to the Committee, such as costs imposed on the FAA by regional breakdown or by rural versus urban users, were not developed or considered during the GRA work, nor do we expect that it will be by C&L. Traditionally, costs have been allocated by class of users (e.g., general aviation, commercial aviation, public users). We will assure that this Committee receives a copy of the C&L work, once it has been completed.

The financial assessment and cost allocation study will, in turn, form the basis for the deliberations of the National Civil Aviation Review Commission, also called for by the Reauthorization Act. The Commission is to review aviation funding and safety issues. Among other topics, Congress directed the Commission's aviation funding task force to conduct a comprehensive study of FAA's costs, and evaluate financing alternatives to the aviation excise tax system. The Commission is to consider the full array of possibilities, including supporting the FAA's financial needs through user fees, taxes, or some combination of these revenue sources.

Before closing, Mr. Chairman, let me note that we are here today to urge quick action to reinstate the aviation excise taxes, not to advance a particular legislative solution for FAA's long-term financing needs. Aviation is a dynamic industry, and virtually all indicators suggest that it will continue to grow. Failure to restore the aviation excise taxes would have severe consequences for the nation's air travelers, causing delays in bringing on line much-needed modernization programs that will enhance the system's overall safety, efficiency and capacity. An immediate renewal of the authority for the Department of the Treasury to transfer receipts into the Trust Fund, and a short-term extension of the taxes to carry us through this period of deliberations and studies of long-term financing solutions for the FAA, would be the best way to avoid costly and disruptive interruptions to FAA and the aviation industry.

That concludes my prepared statement. I would be pleased to respond to any questions you may have at this time.

[SUBMITTED BY SENATOR ROTH]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

February 3, 1997

The Honorable William V. Roth
Chairman, Committee on Finance
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I am writing to request your assistance in securing an immediate extension of the Treasury Department's authority to transfer receipts of aviation excise taxes from the General Fund into the Airport and Airway Trust Fund and short-term reinstatement of the taxes dedicated to the Trust Fund.

As you know, when Congress extended the tax through December 31, 1996, it extended our authority to transfer the taxes to the Trust Fund only through the end of 1996. Thus, we were permitted to transfer taxes that were deposited in 1996, but not taxes that are received after December 31, 1996 even if the taxes relate to air transportation that occurred in 1996. We have recently discovered that approximately \$1.2 billion of transfers to the Trust Fund of aviation excise taxes were authorized based upon preliminary estimates that they were being deposited by the airlines in 1996. In fact, those revenues were received, or are shortly to be received, in calendar year 1997, and hence the transfers to the Trust Fund with respect to those revenues should have remained in the General Fund.

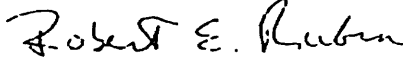
In general, transfers to the Trust Fund are based on Treasury estimates of tax deposits. Because the Treasury office responsible for authorizing transfers to the Trust Fund did not know that the airlines (relying on IRS advice) were not making normal deposits, our estimates, and our transfers to the Trust Fund, were much higher than actual deposits. We have concluded that it is necessary to correct this error by transferring the excess back to the General Fund.

We have also concluded that the only way to make aviation taxes received in 1997 on account of 1996 liabilities available for the purpose Congress intended is to extend Treasury's authority to transfer those excise taxes to the Trust Fund. The extension of Treasury's authority to transfer the receipts into the Trust Fund does not involve the expenditure or appropriation of any new money. Rather, it is simply a technical modification required to ensure that certain aviation taxes already received, or shortly to be received, are appropriately deposited in the Trust Fund.

In addition, some Federal aviation capital programs will, absent a reinstatement of these aviation excise taxes, totally run out of money in the near future. Such programs include the replacement of antiquated radar systems and airport grants. Although the ability to continue such programs will end in March 1997, earlier notices to contractors will be necessary to avoid liability on projects where funds will run out without extension of the lapsed taxes. In many cases these notices will need to go out almost immediately. We therefore also urge the immediate short-term reinstatement of those taxes through late September of this year, while the Administration works with Congress to devise a long-term financing solution for the FAA.

Thank you for your attention to this urgent issue.

Sincerely,

A handwritten signature in black ink that reads "Robert E. Rubin". The signature is written in a cursive style with a large, prominent "R" at the beginning.

Robert E. Rubin

COMMUNICATIONS

STATEMENT OF AOPA LEGISLATIVE ACTION (SUBMITTED BY PHIL BOYER, PRESIDENT)

Mr. Chairman, my name is Phil Boyer, and I am President of AOPA Legislative Action.

AOPA Legislative Action enjoys the financial support of 340,000 dues paying members. Together with our affiliated organization, the Aircraft Owners and Pilots Association, we promote the interests of those who contribute to our economy by taking advantage of general aviation aircraft to fulfill their business and personal transportation needs. There are more than 650,000 general aviation pilots nationwide.

AOPA Legislative Action strongly supports efforts to reinstate the aviation ticket tax and the other excise taxes, including those paid by general aviation, on a multi-year basis. For the past 27 years, these taxes have adequately funded the world's busiest, most complex, and safest aviation system. We are confident the current tax structure can fund the modernization of the air traffic control system and improve the nation's aviation infrastructure even as, over the next five years, we balance the federal budget. The reforms adopted by Congress last year will allow the agency to immediately stretch its dollar, and the National Civil Aviation Review Commission will soon focus on FAA funding issues beginning with the audit of FAA currently being undertaken by the accounting firm Coopers & Lybrand.

If Congress eventually concludes a new funding mechanism is necessary, alternatives exist beyond the Administration's simplistic user fee proposal — alternatives that, unlike user fees, would not diminish the participation of Congress in aviation safety and capacity matters. For example, AOPA Legislative Action has developed Linked Financing, a proposal which would continue to fund the air transportation system with the excise taxes, meet future funding needs, and preserve the involvement of Congress in the funding allocation process. However, until a consensus develops on FAA's future funding needs and mechanisms, we urge Congress to reinstate the existing excise taxes and put FAA back on a firm financial footing.

As we all know, the users of the airway system, including the hundreds of thousands of general aviation pilots who pay taxes on fuel, pay for the bulk of the system. The excise taxes that airline passengers and pilots pay is, in the broad sense of the word, a user fee. The system is already user-funded. It has worked just fine for 27 years — including two decades into the era of airline deregulation. We need to put the current system of user charges back into place by reinstating the excise taxes.

The users we are talking about today include the travelers who enjoy the benefits of both a free market in airline travel and the best aviation infrastructure in the world. Members of our association count themselves among those who pay for the system and benefit from it.

Mr. Chairman, the costs to our members of flying in the ATC system do not end with the payment of the excise taxes. We each make a substantial personal investment in modernization by upgrading to new avionics equipment for navigation, communication and surveillance. This represents our direct cost of modernization, and modernization cannot proceed without it.

Management Reforms

Last year, Congress adopted several meaningful reforms of the FAA's management environment. First, we were pleased to work with Congress on proposals to free the FAA from most federal personnel and acquisition rules, allowing the agency to develop its own flexible rules. Personnel and acquisition reform will save the FAA time and money and allow the agency to transform itself into a more efficient and effective agency. Other important reforms include making the FAA more autonomous of the Department of Transportation, establishing a Management Advisory Committee to give the FAA access to the management expertise of its customers in the aviation community, significant rulemaking reforms, requiring an independent assessment of FAA's funding needs, and creating a commission to examine financing alternatives.

I'd like to thank this Committee for its vital role in bringing these reforms, especially the Management Advisory Committee, to fruition. Although appointment of MAC members is behind schedule, when it is finally up and running it will provide priceless guidance to the FAA. I would also like to thank this Committee for creating the National Civil Aviation Review Commission. Though the spotlight right now is on the Gore Commission, the Review Commission holds the most promise for meaningful financing reform.

On another front, an FAA working group has completed version two of the proposed National Airway System Architecture. This roadmap to modernization is intended to take advantage of new technology in a forward-thinking way which will place the FAA in line with technological possibilities and customer needs. While we think this version of the system architecture proposal still needs adjustments, such as changes to the technology transition timetables, overall, much of the proposal is sound.

The Next Step: Financing Reform

With these significant advances in place, the debate concerning airway modernization has shifted from "how to do it" to "how to pay for it." This shift in debate is premature, though. The bureaucratic reforms put into place late last year have only just begun to transform the FAA and allow it to use its resources more wisely. However, dictated by the goal of balancing the federal budget, the FAA, Congressional leaders, and the industry have struggled with the financing issue. To the extent funding will be a problem in the future, what is needed are innovative approaches, not risky schemes.

While we were able to reach a consensus last year on many FAA reform issues, neither the very controversial idea of user fees nor a reshuffling of the excise tax structure were a part of that consensus. And the so-called user fees which the seven largest U.S. airlines have proposed have absolutely nothing to do with reforming the FAA, nor helping it meet any perceived funding shortfall. The one and only goal of the Group of Seven's tax proposal is to shift their tax burden. The high-fare airlines are interested in increasing their profits at the expense of their competitors. That's a perfectly natural impulse, but it hardly amounts to reforming the FAA.

In fact, a DOT staff review of the Group of Seven proposal concludes that their plan "would have produced \$248 million less in revenue for the Trust Fund for FY 1995 than was estimated by the Group of Seven carriers for the 10 percent excise tax approach." In other words, their plan not only fails to generate additional revenue, it would only exacerbate any out year funding problem the FAA may eventually confront.

This discussion of equity demonstrates that it is impossible to accurately distribute the cost the FAA incurs by serving each user or segment of the aviation industry. We are very wary of any attempt to do that. It is well-known that a "Cost Allocation Study" was recently completed for the FAA. The information in this study could certainly be of use in this debate; perhaps this Committee could request access to it. In a broader context, let us take a moment to examine how user fees emerged in the reform debate.

In July of 1995, the FAA claimed that it would need \$59 billion in the following seven years — \$12 billion more than the Administration assumed the FAA would receive under the budget

resolution Congress adopted for FY96. The Administration hoped to make up the shortfall by charging user fees for air traffic control and other services.

With further scrutiny, however, FAA's projections reveal many flaws.

First, FAA is assuming an average annual growth in the operating budget of 5.9%. This is almost 80% higher than the rate experienced over the past five years, and it is twice the expected annual rate of inflation. We question the credibility of FAA's projected rate of growth in the operating budget. This unrealistic assumption appears to be intended solely to help justify the projected funding crisis.

Further, we have received the Office of Management and Budget passback document sent to the Department of Transportation in response to its budget request. In the passback, OMB estimates significantly lower out-year funding for FAA for the same five year period in which FAA estimates that its funding will reach a crisis level. When the Administration itself is revising the estimates downward, it casts further doubt on the reliability of the FAA's projections.

We also understand that controller productivity has remained relatively flat or has decreased over the past few years, and that FAA's analysis assumes no new productivity gains between now and 2002. This lack of increased productivity is also reflected in the most recent version of FAA's proposed airway system architecture. If controller productivity is not going to improve in the coming years, what benefit will be derived from the installation of new air traffic control equipment? How will delays be reduced or system efficiency enhanced without increased controller productivity?

The credibility of FAA's projected funding crisis depends heavily on the accuracy of the agency's long-range estimates of growth in air traffic. However, data available to us indicates that the farther out in time the FAA makes its projections, the more inaccurate it is. This is not surprising, but what is significant is that the FAA's projections are almost always overly optimistic, projecting considerably higher rates of traffic growth than eventually occur.

For example, in the category "IFR aircraft handled," FAA historically overestimates by 6.2% when it guesses five years ahead of time. This error goes down to 1.7% in the year before the actual traffic count. So in 1989, FAA projected that 41.9 million IFR aircraft would be handled in 1994. This obviously drove their estimates at that time for staffing requirements in 1994. However, the

actual figure for 1994 was 38.9 million IFR aircraft handled, which is seven percent below the 1989 projection.

The impact of these substantial overestimates are magnified when combined with other overly optimistic growth estimates within FAA's analysis of the funding crisis. This surely accounts for a significant proportion of the projected funding shortfall.

The FAA estimated it could cut its procurement costs by 20 percent under the procurement reforms initiated last year. Based on FY96 numbers, this means that FAA could save \$390 million annually in F&E costs, or nearly \$2.5 billion dollars by the year 2002! This doesn't include the substantial savings which we assume that personnel reform will also yield.

Finally, the FAA assumes that Congress will reduce funding for transportation functions as a whole, and it will reduce FAA's share of that funding by the same rate. Neither is a fair assumption. Surely the FAA does not expect Congress to allow funding for a government function so vital to our economy and public safety to drop to dangerously low levels. The Administration chooses to ignore the fact that 57 Senators recently wrote to the chairman of the Budget Committee advocating an increase in transportation funding.

All these areas of potential savings and shaky assumptions cast serious doubt on FAA's assertion that it will experience a funding crisis that only user fees can relieve. Even if additional revenue is necessary, user fees would bring with them substantial liabilities. Any system of direct charges to users is sure to require a large and costly bureaucracy to collect, a politicized system for setting the fees, and possible threats to safety because of the unavoidable disincentive raised by imposing user fees.

Action Needed Now on the Excise Taxes

In August, the excise taxes that supply revenue to the Airport and Airway Trust Fund, which had expired at the beginning of this year, were reinstated in time to stop the FAA's steady and dependable source of revenue from drying up. That was a wise move. The excise taxes have served as a stable and reliable source of funds for decades.

The issue of FAA financing is being discussed in several forums. The White House Commission on Aviation Safety and Security, known as the Gore Commission, will issue recommendations soon. The National Civil Aviation Review Commission will convene this year to consider the financing

issue specifically. The Review Commission will use the independent assessment of FAA conducted by Coopers & Lybrand. And, of course, many Members of Congress are considering the issue.

Since a consensus on the financing issue has yet to develop, we recommend that Congress reinstate the excise taxes that provide revenue to the Airport and Airway Trust Fund as soon as possible. The FAA must have a firm financial footing and the full confidence of the flying public. Unless and until a consensus arises on a better way to finance the FAA, the agency should not be denied the stable and reliable source of revenue that has served it well for 27 years.

We, the users of the aviation system, have paid these taxes for many years. We come before you today to ask you to continue to levy these taxes on us for the good of the nation's aviation system. It's not often that taxpayers come to Congress to ask for taxes to be reinstated. We hope this fact alone demonstrates the importance we attach to reinstating the taxes.

Funding Alternatives

In the meantime, we concede that the FAA could face a funding problem — not a crisis, but a problem. But the revenue collection mechanism, the excise tax, is not the problem. The Airport and Airway Trust Fund until recently was in surplus by several billion dollars year after year. The problem is with the delivery mechanism — the practical and political pressure to balance the budget, and the Congressional rules and procedures that impose limits on spending.

We certainly don't advocate abandoning the effort to balance the budget. But consistent with the goal of a balanced budget, we think there are constructive and honest ways to deal with the problem. One promising idea that we have developed is rooted in the fact that the FAA and the air traffic control system is an essential government function for which users pay the bulk of the expenses. We call our idea "Linked Financing."

The idea is complex, so I won't go into the details today. But the objectives of Linked Financing are as follows:

- excise taxes, rather than user fees, remain the mechanism for generating revenue to fund the needs of the air transportation system,
- any new revenues generated under the plan will be available for use as additional resources to fund the air transportation system, without reducing the amounts made available to other modes of transportation or other discretionary programs, and

- the involvement of Congress in the allocation process is preserved.

A number of aviation and finance experts in and out of government have expressed interest in the concept of Linked Financing, and we are encouraged by the comments we have received. If it works for the FAA, as we believe it would, Linked Financing could offer a bold new way for other government agencies funded by users to maintain adequate levels of funding without disrupting the goal of fiscal responsibility within the federal government as a whole. We have developed an innovative alternative for FAA financing. This is the kind of thinking we need from the entire aviation industry, not just from those with an obvious vested interest in tinkering with the current tax structure solely for their benefit.

We have been happy to work closely with Congress to achieve groundbreaking changes in the way the FAA operates. The new management environment the FAA now enjoys is a testament to what Congress and a united aviation industry can achieve when we work together. I hope that this Committee will support our efforts to reinstate the aviation excise taxes as soon as possible to put the FAA back on a firm financial footing unless and until a better financing alternative is developed.

Mr. Chairman, this concludes my comments. Thank you again for the opportunity to present our views.

+ + +

W. A. FRANKE
 Chairman of the Board
 President
 and
 Chief Executive Officer



4000 E Sky Harbor Blvd Phoenix, AZ 85034 • (602) 693-5512 FAX (602) 693-5517

February 3, 1997

The Honorable William V. Roth, Jr.
 Chairman
 Committee on Finance
 United States Senate
 SD-219
 Washington, D.C. 20510

Dear Senator Roth:

The purpose of this letter is to comment on the hearing to be held by the Senate Finance Committee Tuesday, February 4 regarding airline excise taxes. I would appreciate it if this letter would be made a part of the hearing record.

America West Airlines supports reenactment of the airline ticket tax. Failure to reenact the ticket tax in a timely manner concerns us for two reasons. First, it could delay needed improvements to our nation's air traffic control system as well as needed capacity at our nation's airports. Secondly, the perception by the public of a funding crisis affecting our nation's aviation system could have an unwarranted negative impact on air travel.

Last fall Congress passed, and the President signed into law, a measure creating a commission to study all aspects of aviation financing, including allocation among and within the various user groups. At the time this measure was on the floor of the Senate, its primary authors, Senators McCain and Ford, stated the ticket tax should be reauthorized while the process called for in the legislation moved forward. This should be done. It does not make sense to us for the Congress to readjust the tax formula in the absence of any facts, precisely when those facts are being established.

Many economic decisions have been made based on the existing tax structure. If there are any adjustments to be made in the relative tax burdens between competing companies, they should be made only once and based in fact. To do otherwise risks the injection of instability into the entire industry which is not good for our company, our industry or the economy. In our view, the most prudent course of action is to leave the existing structure in place until such time as a new funding structure is devised to replace it.

Thank you for your time and attention.

Sincerely,

A handwritten signature in dark ink, appearing to read 'W.A. Franke', written in a cursive style.

W.A. Franke

STATEMENT OF KAY HARRISON

My name is Kay Harrison and I am a member of the Fort Smith, Arkansas, City Board of Directors, our city's governing board. I also have worked extensively with the Fort Smith Regional Airport and other airports in northwest Arkansas.

I live in a medium-sized city, where I increasingly have become aware of the crucial role that aviation plays in improving local economies. Like many consumers, I fly all airlines. And, I am not ashamed to say, I shop around for the absolute best fares I can find.

My city's story is typical. It could just as well be told by someone from Gulf Port/Biloxi or Bloomington . . . or Chico or Chattanooga.

But let me detail exactly how this plays out in northwest Arkansas when you compare the cost of the expired ticket tax versus a usage-based system. If you took all the passengers in and out of the three airports in northwest Arkansas, we pay \$4.2 million more in aviation taxes than we should. I repeat: \$4.2 million dollars!

Now, \$4.2 million may be just a rounding error in Washington. But it's a huge sum for the individuals in Arkansas—and everywhere else in America—who have to reach into their wallets and ante up.

These numbers are based on U.S. Department of Transportation data from the year ending last June, the latest figures available.

The usage-based formula for this particular calculation was proposed by the Coalition for Fair FAA Funding—the only formula that has been made public. I am not wedded to that formula, but it gave me an opportunity to move beyond anecdotal evidence to real economic outcomes. I'm sure that scores of possible formulas exist. Most of all, I am positive that numerous formulas can be developed that are fairer than the 10 percent excise tax.

The DOT figures show that Fort Smith generates 173,820 one-way passengers a year, with an average one-way fare of \$186. The most traveled route—28,780 passengers—is Dallas-Ft. Worth, Texas. On the other end of the scale, there are ten lucky souls a year who travel to St. Croix, Virgin Islands.

By exploring the Dallas statistics, you will understand my frustration. The average fare between Fort Smith and Dallas is \$99. Under the 10 percent tax system, the tax was \$10. That means travelers between the two cities paid \$285,843 in taxes.

But under a usage-based system, which is meant to be revenue neutral, the tax would be \$7. It's simple—multiply it out. A \$7 tax means a savings of \$79,922—a savings of 28 percent. Overall, a usage-based system would save Fort Smith passengers alone \$1 million a year.

To put it another way, travelers in northwest Arkansas are forced by the U.S. government to subsidize travelers in other cities. Travelers in northwest Arkansas, like travelers in many other regions, shoulder an unfair burden and end up subsidizing travelers in urban areas.

Mr. Chairman, that undeniably is just plain unfair.

In 1978, Congress deregulated the airline industry so that airlines could compete for business on merit. Now, one airline says it needs the ticket tax subsidy to remain competitive. That sounds like corporate welfare to me.

In the next few weeks, the debate in Congress should be about what is best for consumers and passengers.

As you know, Mr. Chairman, the United States currently does not have an airline ticket tax. We are faced with a decision on how to enact a new tax to provide steady reliable financing to maintain a safe, efficient air traffic system.

The way to meet these needs—and to meet these needs fairly—is a usage-based system. I am not committed to any specific formula, but I am committed to a fair formula.

At bottom, this is an issue about consumers and passengers, not airlines.

Along those lines, I was stunned to read the General Accounting Office report in December about this issue. GAO simply ignored consumers and passengers and the impact on communities like Fort Smith.

I was stunned equally by the news that money collected from passengers last year, but awaiting deposit this year, is being deposited in the general treasury fund instead of the FAA trust fund.

We have taken money from passengers to pay for our aviation system, but are diverting it to pay for who-knows-what. I appeal to Congress to set right this wrong.

The real question is, however, where do we go from here?

In my view, it would be a mistake to go backwards to a percentage tax based on fares. Under that system, too many travelers are asked to pay too much—especially travelers in smaller cities who fly less popular routes and generally are forced to pay higher fares.

A 10 percent federal sales tax on tickets is higher than any state sales tax. And, it unmistakably is unfair to consumers who buy tickets with a wide range of prices. Thus, the debate must focus on how a new tax should be structured.

Air travelers should pay the government only for the air travel services they actually receive. Two passengers on the same plane should pay the same tax for upkeep and improvements of the air traffic control system, because they place the same demands on the system.

Congress should adopt a usage-based tax that will provide the funds needed for FAA and air traffic control improvements. A usage-based tax will distribute costs fairly and evenly among all travelers and will be fair to areas like northwest Arkansas.

I am working to form a coalition called Fair Share, which will speak for those hit hardest by the 10 percent excise tax. Our voice will grow during this debate. We plan to speak for all air travelers to make sure all are treated alike.

STATEMENT OF THE NATIONAL BUSINESS AIRCRAFT ASSOCIATION, INC.
(SUBMITTED BY JOHN W. OLCOTT, PRESIDENT)

Introduction

On behalf of the more than 4,500 Member Companies of the National Business Aircraft Association, Inc., I commend Chairman Roth and Senator Moynihan for holding this important hearing on the solvency of the Airport and Airway Trust Fund. Ensuring adequate funding for the operation of the FAA and the nation's air traffic control system is critical to our Members and the entire nation. In light of that fact, NBAA urges this committee to act as soon as possible to reinstate the expired aviation excise taxes for as long as possible.

NBAA Member Companies are the world's most active users of general aviation for business transportation as well as extensive users of the airlines, purchasing more than \$11 billion in tickets annually. NBAA Member Companies rely heavily on safe and efficient transportation to service customers, expand markets and facilitate the ebb and flow of commerce to thousands of communities in the United States and abroad. They are a critical part of the economic fabric of our nation, generating more than \$3 trillion in annual revenues and employing millions.

Business aviation provides access to economic opportunity with proven results, and our community stands ready to make even greater contributions through an improved FAA and air transportation system. To be successful in that endeavor, we must first address the immediate problem at hand caused by the expiration of the aviation excise taxes. Next, we must recognize and understand the problems at the FAA and act rationally and responsibly to address them in the most appropriate and effective manner. The House made great strides toward that end last year by passing legislation that acknowledged the need to explore innovative financing mechanisms while recognizing the importance of improved FAA management.

Reinstatement of the Aviation Excise Taxes

The revenue system the FAA has historically relied on—a combination of excise taxes and general fund contributions—has provided a steady, reliable and abundant source of funds for the agency. The FAA, over the years, has spent billions of dollars on facilities and equipment and even greater amounts on operations and maintenance. The agency, however, has not capitalized on those investments because it lacked the management structure needed to use its dollar and people resources efficiently and effectively. Now, with the enactment of personnel and procurement reforms, the FAA may finally be on the road to "reinventing" its operations from within and making better use of the many resources provided through the traditional funding system.

Unfortunately, the funding system the FAA has traditionally relied on is not in place due to the expiration of the aviation excise taxes on December 31, 1996. Recent analysis concludes that the Aviation Trust Fund surplus could be exhausted as early as March without congressional action to reinstate the taxes. NBAA strongly supports the reinstatement of aviation excise taxes as soon as possible.

NBAA also believes that the aviation excise taxes should be reinstated for as long as possible. Extending the taxes for a longer period of time will ensure that we avoid the virtual federal giveaway of \$500 million a month from the Aviation Trust Fund—a situation we now find ourselves in for the second straight year. A lengthy extension also makes sense because the traditional system works well.

Simply put, the FAA funding system we have relied on to fund the agency for more than 25 years is a useful, appropriate and efficient system that reflects the benefits that both the general public and direct users receive from its operation. It

has enabled our nation's air transportation system to thrive as the world's safest and most efficient; it is the proper system to ensure that our future needs are met.

Despite those truths, some have used the expiration of these taxes and the current funding situation to push for the adoption of a user fee system to fund the operations of the FAA. Such a system would create a series of unintended and detrimental consequences.

Benefits to the General Public and the General Fund Contribution

A relatively small portion of the revenues that fund the FAA come from the general fund of the U.S. Treasury. This system allows the federal government to fulfill its responsibility to participate in the funding of our nation's air transportation system. This is a responsibility NBAA believes is proper and essential for three fundamental reasons:

1.) Non-users benefit economically and socially from a safe, efficient and effective air transportation system. Property values and employment levels, for example, are higher in regions with access to good air transportation, yet it is not possible to charge the non-users who benefit from those economic and quality of life advantages outside of general taxes.

2.) Our nation's tax revenues are enhanced by the economic impact of a safe, efficient and effective air transportation system, since transportation drives the economy upon which taxes are paid. Imagine what the economy and thus the federal tax revenues of our nation would be if there were no air transportation. The general fund contribution spurs tremendous economic growth and tax revenues. In its study entitled, *The Economic Impact of Civil Aviation on the U.S. Economy Update 1993*, Wilbur Smith Associates estimated that the U.S. air transportation system generated \$771 billion in economic activity—5.9 percent of our nation's GNP in 1993. Assuming a modest tax rate, civil aviation contributes directly, indirectly or through induced impacts, roughly \$30 billion in federal taxes each year, an excellent return on the government's \$2 billion annual investment.

3.) For safety, efficiency and effectiveness, our nation's ATC system must be a monopoly. European ATC involves about 20 countries and about 40 discrete authorities. A study by IATA concluded that rationalizing Europe's ATC system under one authority (i.e. a monopoly) would double the number of aircraft handled in European airspace daily. Such greater efficiency would only equal the density that routinely operates each day in the Northeast Corridor of the United States. Only government, with congressional oversight, should run monopolies.

Given these important facts and benefits to the general public, it is clearly appropriate that the FAA and the ATC system be the responsibility of our national government and that some level of public funding be applied to support it.

User Fees—Unintended Consequences

In contrast, a system funded entirely by direct users will be under capitalized and under utilized, according to most economists and a recent literature search by Arthur Andersen (attached). If users are charged too much, they will be discouraged from using the services to the point of reducing potential economic growth. The result is a trade-off between efficiency and cost-recovery: full cost recovery through charges to users may result in lost productivity, lost economic growth, lost competitiveness and lost tax revenues to the federal government.

In addition, it seems unwise to give the agency responsible for regulating the aviation community responsibility for imposing fees on that community. As such, a user fee system would reduce, if not eliminate, the incentive for the FAA to operate more efficiently. After all, what incentive is there to change an operation that produces revenue even if a better system exists?

A user fee system would also create significant administrative costs and headaches that could discourage growth and require new bureaucracies. In an era of making government work better, it makes little sense to switch from a system with low administrative costs and high compliance to one that will undoubtedly require mountains of paperwork and an army of bureaucrats to review.

Furthermore, a system in which a price is placed on system use could have detrimental safety effects. Pilots could be discouraged from filing flight plans, checking the weather or contacting the tower if they are charged for doing so. The current system avoids such risks.

NBAA is especially concerned with the unintended consequences of proposals for new user fees on "business jets" or "corporate jets" or "non-commercial turbine-powered aircraft" for the following reasons:

1.) Utilization of "business aircraft" would be reduced significantly (in the order of one-third according to recent studies, attached) which would harm

many companies—small, medium, and large—also be detrimental to the nation, including thousands of rural cities and towns that now benefit from the ebb and flow of commerce facilitated by business aviation.

2.) Existing aviation policy would be affected, possibly in a way that would discourage new entrants to air transportation.

3.) "Business jets" could be subject to discrimination.

4.) There would be reduced aviation tax revenues from all sources, including lost fuel taxes and lost taxes due to reduced sales of aviation-related products and services.

NBAA has been and remains especially troubled by a proposal by President Clinton that would target our community for new and potentially damaging taxes or fees. The proposal exhibits a fundamental misunderstanding of "business aviation" and the vital role it plays in corporate productivity and taxable revenues of American corporations. And, it seems inappropriate to consider a proposal that would divert aviation revenues to other programs. It is particularly puzzling that President Clinton would move in this direction given his previous comments about the business aviation community in a September 18, 1992 letter addressed to NBAA, which states:

"As Governor of Arkansas and as a presidential candidate, I have been grateful for and dependent on every aspect of this important industry, including airplanes, helicopters, FBO's, fuelers, and others. General aviation has provided me with a flying office and conference room, a sleeping coach, and a means of covering many, many thousands of miles to carry my message of change to America."

"General aviation is critical to the health and growth of our economy. From aircraft manufacturing to business flight departments to FBOs and fuelers, general aviation contributes greatly to our economy. It provides jobs, creates high technology export products contributing to the balance of trade, and improves the efficiency and productivity of businesses through safe and efficient transportation of people and materials by air to all regions of the country and the globe. Success in rebuilding our economy depends on giving workers and businesses the tools, such as those associated with general aviation, to compete in the fast-paced world economy."

Excise Taxes—An Appropriate Use-Based System

Rather than take chances with a risky and unproven system, NBAA strongly supports the excise tax system, under which business aviation, and all general aviation, pays for its use of the air transportation system through a per-gallon tax of 19.4 cents per-gallon on aviation gasoline and 21.9 cents on jet fuel—(Note, these amounts include 4.3 cents per-gallon for deficit reduction). The NBAA believes that the fuel tax is an appropriate reflection of the use of the system. Aircraft that fly further distances burn more fuel and pay higher taxes. In addition, the jet fuel that sophisticated aircraft burn is taxed at a higher rate than the aviation gasoline that less sophisticated aircraft use.

Some have criticized the fuel tax, claiming that it does not reflect general aviation's use of the system. While some cost allocation studies that have been performed and relied upon in the past claim that business aviation is not paying its "fair share," it is important to note that those studies focus on the fully allocated costs rather than the avoidable costs of business aviation. That important distinction is critical when determining what costs of the aviation system should be borne by different segments of the aviation community.

NBAA believes that the right question to ask is: "How much more does it cost the FAA to operate because of the various elements of general aviation, including business aviation?" We observe that incremental costs are a more appropriate means for determining the business aviation communities' "fair share."

Turbine-powered business aircraft are incremental users of an air traffic control system that is designed, built and maintained for the commercial air carriers and their passengers. If a business jet or turboprop never flew again, capital and maintenance costs of our nation's ATC system would be virtually unchanged. Most of the dollars earmarked for airport improvement also would remain within the FAA budget. Only incremental costs associated with a limited percentage of controllers would be affected, and those dollars are significantly less than the fully allocated costs often attributed to business aviation.

If turbine-powered business aircraft never flew again, the real losers would be American businesses, communities, and the federal government. Loss of productivity would reduce corporate profits and federal revenues, making less money available for other worthwhile government programs. It is our hope that these facts will be borne out by the independent cost allocation analysis being performed by Coopers & Lybrand.

The Alliance for Safe and Efficient Air Transportation

NBAA is a member of and strongly supports the Alliance for Safe and Efficient Air Transportation, the largest and most diverse group of aviation interests ever formed to address aviation policy issues. The Alliance and NBAA strongly support the reinstatement of the aviation excise taxes as soon as possible for as long as possible. Further, the Alliance encourages more innovative use of traditional excise tax revenues and maintenance of a general fund contribution.

Conclusion

Immediate reinstatement of the expired aviation excise taxes and reform of the FAA and the ATC system are critical to the long-term economic stability of the business aviation community and the nation. NBAA Members Companies stand ready to work with the Committee, Congress and the Administration to ensure that our nation's air transportation system remains the safest and most efficient in the world. This is a unique opportunity to elevate the debate on this issue and to truly make significant progress. We should not and cannot, however, waste our energies focusing on switching to an unproven and risky user fee system. Instead, we should recognize the many strengths of the traditional system, and aggressively pursue changes that will enable the FAA and the entire aviation community to be more effective.

**BACKGROUND PREPARED FOR THE
NATIONAL BUSINESS AIRCRAFT ASSOCIATION
CONCERNING
FAA REFORM AND RELATED LEGISLATION**

*FEBRUARY 27, 1996
Washington, DC*

**ARTHUR
ANDERSEN**



**Economic and
Financial
Consulting
Services**

I. The Importance of Transportation in the U.S. Economy

There is general agreement among economists that transportation investment is a key ingredient in achieving or sustaining economic development. At the beginning of *The Wealth of Nations*,¹ Adam Smith describes the critical role of transportation in economic growth: simply stated, that improvements in transportation allow markets to expand, leading to specialization in labor and increased productivity.

Transportation has been called "the backbone of America's strength." Historians suggest that transportation, especially inland transportation, has played a more important role in the economic development of the United States than that of any other nation. The opening of the American interior following the War of 1812 allowed a clear demonstration of Smith's theories of specialization and economic development. More recently, investment in the Interstate Highway System and the National Airspace System has led to reductions in travel time between production, population and distribution centers across America, increasing productivity throughout the economy.

Transportation development leads to economic growth in three ways: First, falling transport costs expand markets and lead to increased specialization and productivity growth, as described by Adam Smith. Second, growth in the transport sector increases direct demand for raw materials – from iron and coal, to steel, aluminum, and now composite materials, depending on the mode of transport. Third, economic growth results from the multiplier effect generated by the overall increase in income arising from the increased demand for products and raw materials. In addition, there are secondary benefits to the economy from improvements in transportation, including lower inventory costs, improved distribution systems, changes in technology, and long term industry restructuring.

Transportation remains an important element in expanding and integrating markets globally. Investment in transportation infrastructure and services in the United States leads to lower costs and increased productivity for American businesses, helping them retain their edge in international competition. The quality and efficiency of America's transportation network is also critical in enabling the United States to attract new investment from abroad and to retain the existing economic base.

Several studies emerged in the early 1990s that supported a strong link between transportation, productivity and economic growth. David Aschauer and Alicia Munnell argued that inadequate public investment in U.S. infrastructure, including transportation, could be linked to the decline in U.S. productivity growth.² Both argued that public capital investments in infrastructure play an important role in enhancing

¹ Smith, A. (1776) *An Inquiry into the Nature and Causes of the Wealth of Nations*. Britannica Great Books of the Western World, Vol. 39, pp. 8-10 ["Wealth of Nations"].

² These studies include Aschauer, D. (1989) "Is Public Capital Productive?" *Journal of Monetary Economics*, vol. 23, pp. 177-200; Aschauer, D. (June 1991) "Why is Infrastructure Important?" in *Is There a Shortfall in Public Capital Investment?* Conference Series No. 34 (Boston: Federal Reserve Bank of Boston); Munnell, A. (Jan/Feb. 1990) "Why Has Productivity Growth Declined? Productivity and Public Investment," *New England Economic Review* (Boston: Federal Reserve Bank of Boston) pp. 3-22.

both productivity growth and in stimulating private economic activity. While these studies have been criticized by the Congressional Budget Office, the CBO also notes that the general implications of the results – that public capital increases private economic output – accords with economic theory and other empirical studies.³

II. The Role of Government in Transportation

Adam Smith argued that the expense of maintaining infrastructure “is, no doubt, beneficial to the whole society, and may, therefore, without any injustice, be defrayed by the general contribution of the whole society.” Although he favored raising revenues from the beneficiaries (the users of infrastructure and the consumers of transported products), he recognized that if these funds are insufficient, the deficiency must “be made up by the general contribution of the whole society.”⁴ This argument – that investments that benefit society are worth making even though it may not be possible to recover all costs through charges to users – is in fact reiterated several times in a Congressional Budget Office analysis of how to charge user fees.⁵

The underlying rationale for government provision of certain goods and services is that there are external benefits, such as the societal benefits described by Adam Smith, that cannot be readily captured by the market. In addition, some goods and services, called “public goods,” will not be produced by the market in efficient quantities, because it is either difficult to identify all of the beneficiaries, or inefficient to charge them a fee.⁶ It can be argued that the safety of the aviation network is a public good since communities located below flight paths benefit from the prevention of accidents.⁷

Increased productivity is one external benefit from a transportation system that has been identified, but many of the benefits are not immediately apparent. Economists who have tried to quantify the impact of transportation on economic growth have been criticized for failing to account for many of the spinoff benefits. For example, classic studies of the impact of American railroads in the 19th century failed to account for the railroad’s effect on increased mobility of the populace, technological advances in the iron industry and the international migration of labor and capital to America.⁸ External effects of federal aviation activities can include community and nationwide gains from income growth, increased population mobility and improved regional integration.

³ Congressional Budget Office (July 1991) *How Federal Spending for Infrastructure and Other Public Investments Affects the Economy*, p. 24 [“CBO 1991”]. The conclusions of Aschauer and Munnell are also cited in a September 15, 1990 speech by Transportation Secretary Samuel Skinner in which he argues the need for increased investment in transportation infrastructure to ensure economic growth.

⁴ *Wealth of Nations*, p. 357.

⁵ Congressional Budget Office (May 1992) *Prying for Highways, Airways and Waterways: How Can Users Be Charged?*, pp. xi and 9 [“CBO 1992”].

⁶ Lipsey, R., Courant, P., Purvis, D., Steiner, P. (1993) *Economics*, Tenth Edition, pp. 404, 410.

⁷ CBO 1992, p. 30.

⁸ Porter, C., ed., *Encyclopedia of American Economic History*, Volume I, p. 329.

The existence of public goods and external benefits makes the efficient pricing of federal transportation services difficult. If users are charged too much, they will be discouraged from using the service to the point of reducing potential economic growth. The result is a trade-off between efficiency and cost recovery: full cost recovery through charges to users may result in lost productivity, lost economic growth and lost competitiveness. Under these circumstances, government expenditures that benefit society may be worth making, even though it may not be possible to recover all costs through charges to users.

Economists also argue that government expenditures are only justified if the total social value of the expenditures (including external factors) are greater than those derived from alternative uses of the funds -- either consumption or private sector investment. A 1991 study by the Congressional Budget Office found that "carefully chosen federal investments in physical infrastructure such as highway and aviation projects would yield economic rates of return higher than the average return on private capital."⁹

A study recently prepared for the National Research Council, "Transportation Investment and Economic Expansion," examines the potential impact of alternative transportation investments and identifies certain strategic investments that are particularly important in supporting expanding sectors of the economy.¹⁰ Among the strategic investments listed in the report are those aimed at meeting the air transportation requirements of management/professional staffs of businesses with decentralized operations. This may be a function that business aviation is particularly well-suited to fill.

III. Conclusion

There is general agreement among economists that transportation is a key component in achieving and sustaining economic growth. There is also agreement that government funding of transportation infrastructure and services can be justified where there are net benefits to society and these exceed returns on private investment. These investments may be worth making even though costs may not be fully recoverable through charges to users.

⁹ CBO 1991, p. xv.

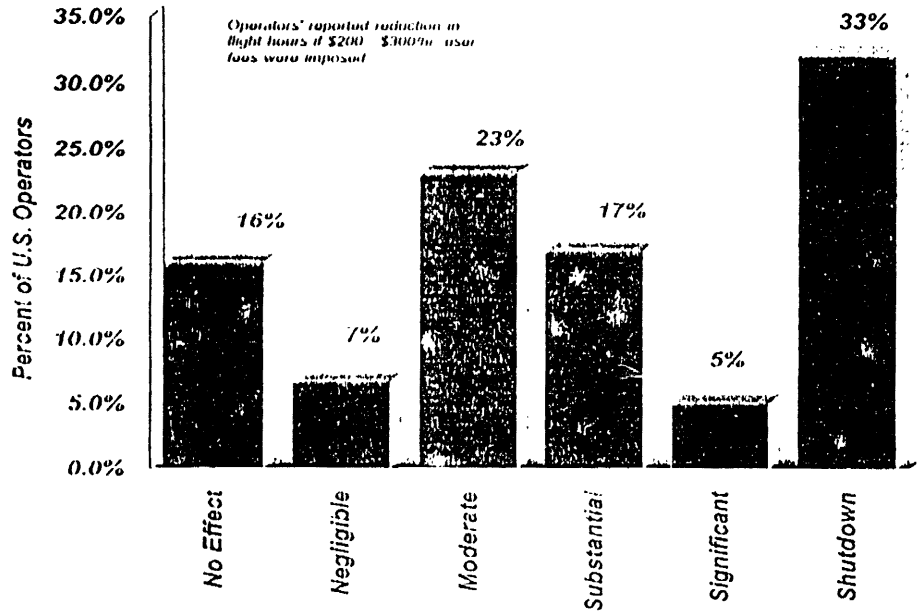
¹⁰ Louis Berger International, Inc. (October 1995) *Transportation Investment and Economic Expansion: Summary Report*, p. 52.



Business Aircraft Purchase Expectations Survey

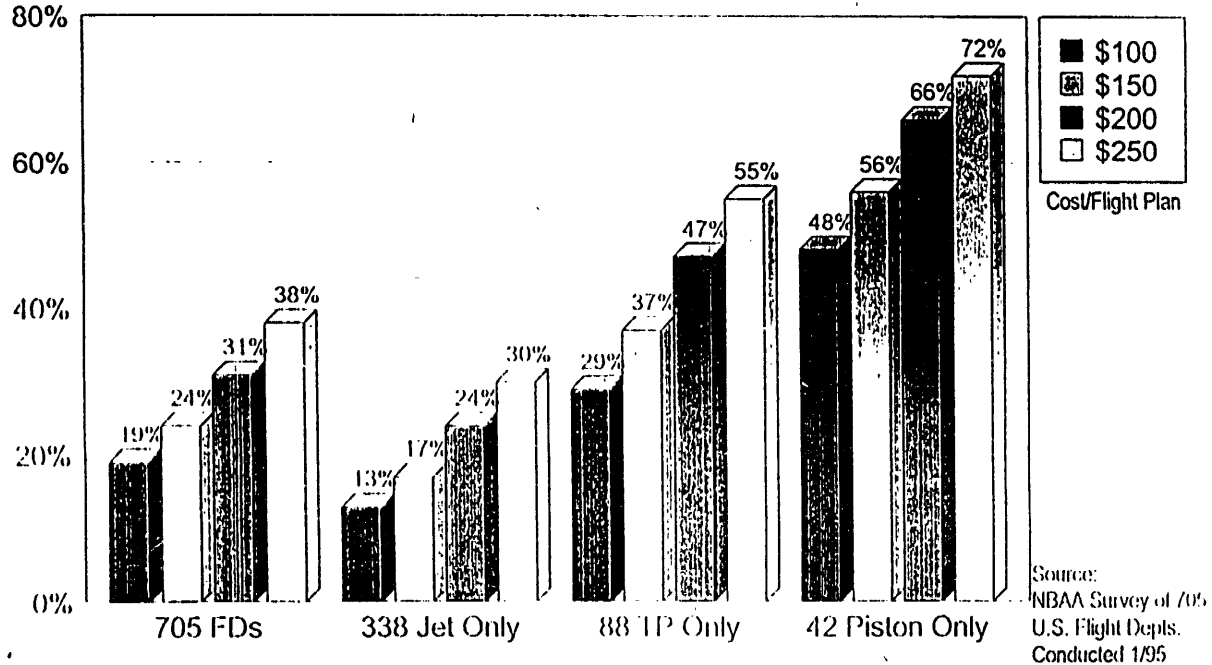
- **Telephone interviews with 1,100 business aircraft operators operating 2,200 aircraft.**
- **Survey conducted spring, 1996.**
- **Majority of respondents were chief pilots or aviation managers.**
- **Respondents were asked their future plans for each aircraft in their fleet during the next 5 years:**
 - Continue to operate (no change)
 - Replace with used aircraft
 - Replace with new aircraft (highest probability make/model)
 - Expand fleet with new aircraft (highest probability make/model)

Reported Impact of User Fees on Aircraft Utilization



Most Operators Voiced Strong Concern Whether Their Companies Would Continue To Operate Aircraft As They Currently Do If User Fees Are Instituted On Business Aircraft Operators

PERCENT REDUCTION IN FLIGHT ACTIVITY AFTER PAY-AS-YOU-GO



**BACKGROUND INFORMATION ON FEDERAL AIR TRANSPORTATION
EXCISE TAXES AND THE AIRPORT AND AIRWAY TRUST FUND**

Scheduled for a Public Hearing

Before the

SENATE COMMITTEE ON FINANCE

on February 4, 1997

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

February 3, 1997

JCX-3-97

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INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of present and prior air transportation excise taxes and information on the financial status of the Airport and Airway Trust Fund. The Senate Committee on Finance has scheduled a public hearing on this subject for February 4, 1997.

Part I of this document is an overview. Part II is a description of present and prior law with respect to Federal air transportation excise taxes. Part III is a summary description of present-law Airport and Airway Trust Fund expenditure program purposes. Part IV is a discussion of the budgetary treatment of air transportation excise taxes and the Airport and Airway Trust Fund. Part V presents information on the current and projected status of the Airport and Airway Trust Fund. Part VI presents the estimated budget effects of reimposing the Airport and Airway Trust Fund excise taxes. The Appendix presents data on the financial condition of certain U.S. commercial air carriers.

¹ This document may be cited as follows: Background Information on Federal Air Transportation Excise Taxes and the Airport and Airway Trust Fund (JCX-3-97), February 3, 1997

L. OVERVIEW

Since 1970, a majority of the revenues derived from air transportation excise taxes has been dedicated to the Airport and Airway Trust Fund (the "Airport Trust Fund"). Unlike many other tax issues, Federal excise taxes on aviation and other transportation sectors require the Committee on Finance to coordinate tax structure and rate decisions with actions of other Congressional committees that set specific rules governing the level and types of expenditures for which the tax revenues are dedicated. Because the management of, and authority to spend monies deposited in, the transportation Trust Funds generally are contained in provisions of the Internal Revenue Code (the "Code"), the Finance Committee also exercises more direct oversight of these programs than is true of many other Federal expenditure programs with respect to which primary jurisdiction lies in other committees (and which typically are financed with general revenues).

Historically, the portions of the transportation excise taxes that are dedicated to Trust Funds such as the Airport Trust Fund have been imposed on the persons judged to create at least some of the costs associated with the programs financed with the tax revenues. The tax rates and mix of taxes dedicated to Trust Fund program financing are influenced by analyses of the costs expected to be incurred by the Federal Government in providing services to different segments of the sector. The most recently released study of Federal Aviation Administration ("FAA") costs was published in 1991. The FAA completed an updated study in 1996; however, that study has not been released because of establishment of a Congressionally mandated independent commission to review FAA costs and financing in the Federal Aviation Reauthorization Act of 1996.

Air transportation excise taxes

Before January 1, 1997, excise taxes were imposed on commercial air passenger and freight transportation and on fuels used in general aviation (i.e., transportation on non-common carrier aircraft which is not for hire) to fund the Airport Trust Fund. In addition, like other transportation sectors, the air transportation sector was and is subject to a permanent 4.3-cents-per-gallon excise tax on aviation fuel, revenues from which are retained in the General Fund for deficit reduction.² The Airport Trust Fund was established in 1970 to finance a major portion of the costs of Federal Aviation Administration ("FAA") services and grant programs for airports. Before establishment of the Airport Trust Fund, Federal aviation expenditures were financed from general revenues. General Fund domestic air passenger and fuels taxes were imposed during this period. The structure of the Airport Trust Fund excise taxes has remained generally unchanged, except for rates, since 1970.

² The 4.3-cents-per-gallon transportation motor fuels excise tax was enacted by the Omnibus Budget Reconciliation Act of 1993 (the "1993 Act"). Fuels used in commercial aviation were exempt for a period of approximately two years (through September 30, 1995) when the tax initially was imposed.

Prior to 1997, the Airport Trust Fund excise taxes included three taxes on commercial air transportation:

- (1) a 10-percent excise tax on domestic air passenger transportation;
- (2) a \$6 per person international air passenger departure tax; and
- (3) a 6.25-percent domestic air freight excise tax.

During the same period, general aviation (e.g., corporate aircraft) was subject to Airport Trust Fund excise taxes on the fuels it used rather than the commercial aviation passenger ticket and freight excise taxes. The Airport Trust Fund rates for these excise taxes were 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline.

Airport Trust Fund expenditure programs

Current Airport Trust Fund program expenditure authorizations are scheduled to expire after September 30, 1998. The Airport Trust Fund expenditure purposes are included in the Code (sec. 9502) by reference to general purposes and to programs as authorized under specific aviation legislation (as periodically updated).

Budgetary treatment of air transportation excise taxes and Trust Fund expenditures

The Budget Enforcement Act of 1990 and related legislation (collectively, the "1990 Budget Act") include two provisions that are central to the operation of the Airport Trust Fund programs and Trust Fund excise taxes: a budget scorekeeping assumption that current dedicated excise taxes are imposed on a permanent basis (even if statutorily they are scheduled to expire) and classification of Trust Fund spending as discretionary spending subject to aggregate annual caps that apply to all discretionary spending (both for transportation and other programs).

The effect of these rules is that under the 1990 Budget Act, there is no budget scorekeeping link between the revenues raised by the air transportation excise taxes (and transferred to the Airport Trust Fund) and the spending from the Airport Trust Fund. The Trust Fund balances similarly have no effect in a broader budgetary sense on the amount that can be obligated for transportation program expenditures. If Trust Fund excise taxes and programs are extended and reauthorized before expiration of the taxes, there is neither a revenue nor a spending budget score from the legislation. However, if the taxes expire (as is currently true with the Airport Trust Fund excise taxes), Congressional Budget Office ("CBO") revenue baselines issued after the expiration do not include any revenue with respect to the expired taxes. Thus, if the taxes are reimposed following issuance of a new CBO revenue baseline, a revenue increase will be scored based upon the period of time for which the taxes are being reimposed. Because there is no link between Airport Trust Fund spending and dedicated revenues, the resulting revenue increases may be used under the Budget Act to offset revenue loss from enactment of other tax provisions without affecting the Trust Fund programs.

Financial status of the Airport Trust Fund

Late in 1996, the FAA and the General Accounting Office reported that the uncommitted balance of the Airport Trust Fund would be sufficient to fund all of the fiscal 1997 operational expenses of the FAA that were expected to be funded from the Trust Fund, and would allow the FAA to enter into new capital program commitments through July 1997. However, the staff of the Joint Committee on Taxation recently received new information which indicates that pursuant to certain Internal Revenue Service tax deposit rules, commercial passenger and freight air carriers have delayed significantly the time when the pre-1997 excise taxes collected by them from air passengers and freight shippers will be received by the Treasury Department. As a result of this delay, an overwhelming majority of the revenues resulting from reimposition of the Airport Trust Fund air passenger and freight excise taxes from August 27, 1996 through December 31, 1996, were not received by the Treasury Department before January 1, 1997, and therefore such revenues cannot be transferred to the Airport Trust Fund.

The Treasury Department has been crediting revenues to the Airport Trust Fund since the beginning of the 1997 fiscal year, based on estimates of receipts that were made before this information was known. As a result of the new information, the Treasury Department will be required to adjust the Airport Trust Fund balance downward. As of January 31, 1997, the amount of the anticipated adjustment is understood to be approximately \$1.2 billion. The FAA estimates that, after this adjustment is made, the uncommitted balance of the Airport Trust Fund, plus the uncommitted portion of the FAA's 1997 fiscal year appropriation from the General Fund, will be sufficient to fund all of the FAA's operations for the 1997 fiscal year, but will only permit the FAA to enter into new capital program commitments through March 1997 at the latest. However, because these numbers are only estimates and because they do not include any estimates of the costs of terminating certain multiple phase contracts, the FAA may have to stop making new commitments and begin notifying contractors of its intent to terminate multiple phase contracts on March 1, 1997, or earlier, absent legislative action.

II. PRESENT AND PRIOR FEDERAL AIR TRANSPORTATION EXCISE TAXES

A. In General

Before January 1, 1997,³ excise taxes were imposed on commercial air passenger and freight transportation and on fuels used in general aviation (i.e., transportation on non-common carrier aircraft that is not for hire) to fund the Airport Trust Fund.⁴ In addition, like other transportation sectors, the air transportation sector generally is subject to a permanent 4.3-cents-per-gallon excise tax on fuel used in aviation. Revenues from this 4.3-cents-per-gallon transportation motor fuels tax are retained in the General Fund for deficit reduction. The Airport Trust Fund was established in 1970 to finance a major portion of the costs of FAA services and grant programs for airports. Before establishment of the Airport Trust Fund, Federal aviation expenditures were financed from general revenues; General Fund domestic air passenger and fuels taxes were imposed during this period. The structure of the Airport Trust Fund excise taxes has remained generally unchanged, except for rates, since 1970.

The prior-law Airport Trust Fund excise taxes included three taxes on commercial air transportation

- (1) a 10-percent excise tax on domestic air passenger transportation;
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During the same period, general aviation (e.g., corporate aircraft) was subject to Airport Trust Fund excise taxes on the fuels it used rather than to the commercial aviation passenger ticket and freight excise taxes. The Airport Trust Fund rates for these excise taxes were 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline.

Each of these taxes is described in more detail below.

Current Airport Trust Fund program expenditure authorizations are scheduled to expire after September 30, 1998.

³ Previously, the taxes expired during the period January 1, 1996, through August 26, 1996.

⁴ Air transportation is taxable regardless of whether public or commercial airports are used in taking off or landing aircraft.

B. Airport Trust Fund Excise Taxes Imposed on Commercial Air Transportation

The three Airport Trust Fund excise taxes imposed on commercial air transportation were retail excise taxes.⁵ The structure of these excise taxes has remained unchanged since the period when airline fares were regulated by the Federal Government. That is, ultimate liability for payment of tax was imposed on the person purchasing the transportation, not on the transportation provider.⁶ Transportation providers were subject to penalties, however, if they failed to make reasonable efforts to collect the tax. Air transportation providers were required to state separately the domestic air transportation excise tax on passenger tickets.

Domestic air passenger excise tax

Imposition and tax base --The 10-percent air transportation passenger tax generally applied only to amounts paid for domestic air transportation (Code sec. 4261).⁷ In the case of domestic air transportation for which payment was made outside the United States, the tax applied only if the transportation both began and ended within the United States. Domestic transportation is defined generally to include travel between two points within the United States or travel to or from a point within the continental United States⁸ and a point within the "225 mile zone." The 225 mile zone includes the portions of Canada and Mexico which are not more than 225 miles from the nearest point in the continental United States.⁹

⁵ It is possible for specific aircraft to be used in both commercial and general aviation. For example, a private corporate aircraft is treated as engaged in commercial air transportation (and subject to the commercial passenger tax) when it transports persons for compensation, but when the same aircraft transports only employees of the owner corporation, it is treated as engaged in general aviation (and subject to the Airport Trust Fund fuels taxes, described below). A similar flight-by-flight determination regarding taxation is made with respect to aircraft owned by affiliated groups of corporations.

⁶ Structured in this manner, the excise taxes were not a factor in rates set by regulatory bodies. The only other example of a "collected" Federal excise tax is the telephone tax, which also originally was imposed only on activities subject to governmental rate regulation.

⁷ Because the tax applied to "amounts paid" for air transportation, no tax was imposed on transportation under airline frequent flyer programs for which no charge was made. Similarly, no-charge transportation provided to airline employees as a fringe benefit was not subject to tax; tax was imposed (determined by reference to actual amounts paid) for reduced-rate travel available under both frequent flyer programs and airline employee and family fringe benefit programs.

⁸ The term "continental United States" excludes Alaska and Hawaii.

⁹ The Treasury Department was authorized to enter into agreements with Canada and Mexico excluding specified areas that geographically fall within 225 miles of the United States.

Special rules applied to air transportation between the continental United States and Alaska or Hawaii and between Alaska and Hawaii. The portion of such transportation which was not within the United States (e.g., the portion over the Pacific Ocean between the continental West Coast or Alaska and Hawaii) was not subject to the 10-percent air passenger excise tax.¹⁰ The 10-percent excise tax applied in full, however, to air transportation within the States of Alaska and Hawaii.

The 10-percent air passenger transportation excise tax also did not apply to domestic United States segments of uninterrupted international air transportation. Uninterrupted international air transportation was defined to include only travel (entirely by air) that did not both begin and end in the United States (or in the 225 mile zone) and during which there was not more than a 12-hour scheduled period between arrival and departure at any point in the United States.¹¹ For example, assume that a passenger traveled from Tokyo to New York, with a four-hour stop in Seattle. The domestic segment of the flight (i.e., Seattle to New York) was not subject to the domestic air passenger transportation excise tax because that segment was a part of uninterrupted international air transportation.

The Federal Government, State and local governments, and private, non-profit organizations were subject to tax on commercial air transportation purchased by them.

Exemptions --Exemptions were provided for helicopters engaged in the exploration for, or the development or removal of, hard minerals, oil, or gas, and in timber (including logging) operations if the helicopters neither took off from nor landed at a facility eligible for Airport Trust Fund assistance or otherwise used Federal aviation services during the flight.¹² In addition, emergency medical aircraft (both fixed-wing and helicopter) were exempt from tax when the aircraft were equipped for and exclusively dedicated to emergency medical transportation. This latter exemption applied regardless of whether the Federal aviation system was used or the aircraft took off from or landed at a Federally assisted airport. A further exemption applied to transportation on aircraft having a maximum FAA certificated takeoff weight of 6,000 pounds or less, except when the aircraft was operated on an established line.

from the taxable zone if the Treasury determined that Canada or Mexico, respectively, imposed an appropriate air transportation tax on flights from such locations

¹⁰ The \$6 per passenger international air passenger departure excise tax, described below, did apply to this transportation

¹¹ A more liberal rule was provided for military personnel traveling in uniform while on leave in transportation that involves both international and domestic United States segments.

¹² In the case of flights involving multiple intermediate stops, this determination was made on a segment-by-segment basis

History of tax. --The 10-percent domestic air passenger transportation excise tax rate dates to 1990 legislation. In 1990, the tax rate was increased from 8 percent to 10 percent for a five-year period (through December 31, 1995) as part of budget reconciliation legislation, which also provided that revenues from the 2-percentage point increase would be retained in the General Fund as a deficit reduction measure for two years of the five-year period. The 10-percent tax lapsed after December 31, 1995. The Small Business Job Protection Act of 1996 (the "1996 Act") reinstated the tax for the period August 27, 1996 through December 31, 1996.

The 8-percent tax rate was imposed concurrent with establishment of the Airport Trust Fund in 1970. Except for a period between 1980 and 1982 when the rate temporarily was reduced to 5 percent as a result of a general expiration of the Airport Trust Fund excise taxes, the rate remained at 8 percent until enactment of the 1990 legislation described above. Before establishment of the Airport Trust Fund in 1970, the tax was imposed at rates varying between 5 and 15 percent, with revenues going to the General Fund. (Federal aviation expenditures were financed entirely from the General Fund before 1970.)

International air passenger departure tax

Imposition and tax base --Prior to 1997, a \$6 per passenger excise tax was imposed on international air transportation which began in the United States (sec. 4261(c)). The \$6 tax applied to all commercial air passenger transportation from the United States which was exempt from all or a part of the 10-percent domestic air passenger excise tax. Thus, transportation between the continental United States and Alaska or Hawaii and between Alaska and Hawaii was subject to this tax (because the international portion of the flight was exempt from the 10-percent tax) as was transportation from the United States to a foreign country. This tax applied regardless of whether the transportation was purchased within the United States (i.e., the tax applied to a return segment from the United States of "round trip" travel originating and ending in a foreign country even if payment occurred within the foreign country).

History of tax --The international air passenger transportation tax was first imposed, at a \$3 per passenger rate, by the 1970 legislation that established the Airport Trust Fund. Except for a period between 1980 and 1982 when the tax expired, the tax rate was not changed until 1989, when it was increased to \$6 per passenger beginning on January 1, 1990. This tax expired after December 31, 1995, and was reinstated by the 1996 Act for the period August 27, 1996, through December 31, 1996.

Domestic air freight excise tax

Imposition and tax base --Before January 1, 1997, a 6.25-percent excise tax was imposed on air transportation of freight within the United States (sec. 4271). Like the domestic air passenger excise tax, this tax applied regardless of whether payment for the transportation was made within the United States, however, the tax did not apply unless the transportation both began and ended within the United States. Transportation was treated as beginning and ending within the United States if both the point of origination and the final destination point were

within the United States (i.e., layover time outside the United States and movement of aircraft in deadhead service were treated as part of taxable transportation).

Air freight transportation between the continental United States and Alaska or Hawaii and between Alaska and Hawaii was partially exempt from this tax under special rules similar to those that applied under the domestic air passenger excise tax. Transportation of freight within either Alaska or Hawaii was fully taxable, even when a portion of the transportation occurred over international waters or Canada.

The domestic air freight excise tax base did not include charges for accessorial ground services. These services included costs of ground transportation such as movement from a downtown freight carrier drop station to the airport. Accessorial service charges were excluded only if the service could be performed by a party other than the transportation provider and if the provider maintained in its records a separate accounting for the charge.

Unlike the air passenger excise taxes, air freight transportation providers were not required to state the amount of this tax separately on customer bills.

Exemptions --The air freight excise tax did not apply to property transported by emergency medical aircraft performing qualifying medical services. The Treasury Department further ruled that the tax did not apply to amounts paid for transportation of property in cropdusting, and aerial firefighting service, or the use of helicopters in construction such as setting equipment on the roofs of buildings or installing power lines.

History of tax --The domestic air freight excise tax was first imposed by the 1970 legislation that established the Airport Trust Fund. Except for a period when the Airport Trust Fund excise taxes generally expired between 1980 and 1982, the tax rate was 5 percent of the transportation charge until 1990, when the 6.25-percent rate was enacted. Revenues attributable to the 1.25-percentage point rate increase were retained in the General Fund as a deficit reduction measure for the first two years of the original five-year period during which the 6.25-percent rate applied. The tax expired after December 31, 1995, and was reinstated by the 1996 Act for the period August 27, 1996, through December 31, 1996.

C. Airport Trust Fund Excise Taxes Imposed on Fuels Used in General Aviation

Imposition of tax and tax base

In lieu of the passenger and freight excise taxes imposed on commercial air transportation, general aviation was subject to Airport Trust Fund excise taxes on the fuels consumed (secs. 4081 and 4091) during the period when the Airport Trust Fund excise taxes were imposed. These taxes were imposed at rates of 17.5 cents per gallon on jet fuel and 15 cents per gallon on aviation gasoline. The jet fuel tax was imposed on the sale of the fuel by

producers, defined to include registered wholesale distributors.¹³ The aviation gasoline tax was imposed on the removal of the gasoline from registered terminal facilities under the same administrative rules as apply to the highway motor fuels excise taxes.

Like the Airport Trust Fund excise taxes on commercial air transportation, the fuels taxes imposed on general aviation expired after December 31, 1996. The tax on jet fuel and 1 cent per gallon of the tax on aviation gasoline expired during the period January 1, 1996, through August 26, 1996; the remaining 14 cents per gallon of the aviation gasoline excise tax continued to be collected, with revenues being deposited in the Highway Trust Fund. When the Airport Trust Fund excise taxes were reinstated in 1996, revenues from this 14-cents-per-gallon tax collected during the tax-expiration period were transferred to the Airport Trust Fund. All of the aviation fuels taxes (including the 14-cents-per-gallon tax) expired after December 31, 1996.

Exemptions

Exemptions were provided for helicopters engaged in the exploration for, or the development or removal of, hard minerals, oil, or gas, and in timber (including logging) operations if the helicopters neither took off from nor landed at a facility eligible for Airport Trust Fund assistance or otherwise used Federal aviation services during the flight.¹⁴ In addition, emergency medical aircraft (both fixed-wing and helicopter) were exempt from fuels taxes when the aircraft were equipped for and exclusively dedicated to emergency medical transportation.¹⁵ This latter exemption applied regardless of whether the Federal aviation system was used or the aircraft took off from or landed at a Federally assisted airport. A further exemption applied to fuels used by tax-exempt aircraft museums operated for the care and exhibition of World War II combat aircraft.

Fuels sold for export or for use as supplies for vessels or aircraft (generally use by the United States military and in foreign trade), by State and local governments and nonprofit educational organizations, or on a farm for farming purposes were exempt from the aviation fuels excise taxes.

¹³ The majority of this tax was imposed on wholesale distributors of jet fuel. Because most major airports have wholesale distributors on site that deliver fuel directly into aircraft, the absence of a retail intermediary effectively rendered much of the tax a retail tax.

¹⁴ In the case of flights involving multiple intermediate steps, this determination was made on a segment-by-segment basis.

¹⁵ The Airport Trust Fund exemptions for fixed-wing emergency medical aircraft were enacted in the Small Business Job Protection Act of 1996. A technical correction is needed to clarify application of the fuels tax exemptions to these aircraft.

History of tax

The aviation gasoline tax was imposed at a 2-cents-per-gallon rate before the Airport Trust Fund was established in 1970 (revenues from this tax were dedicated to the Highway Trust Fund from 1956 through 1970). The gasoline tax rate was increased to 7 cents per gallon beginning in 1970, and the tax on jet fuel was imposed at the same rate. In 1982, the aviation gasoline tax rate was increased to 12 cents per gallon, and the aviation jet fuel tax rate was increased to 14 cents per gallon. In 1990, the aviation gasoline tax rate was increased further to 15 cents per gallon and the jet fuel tax rate was increased to 17.5 cents per gallon.

D. General Fund Transportation Fuels Excise Tax**Imposition of tax and exemptions**

The 1993 Act imposed a permanent, General Fund excise tax on transportation motor fuels for deficit reduction (secs 4081 and 4091). The tax rate is 4.3 cents per gallon. The tax applies generally to motor fuels used in all transportation sectors, including aviation. Fuels used in commercial aviation were exempt during the period through September 30, 1995.

This General Fund motor fuels excise tax rate is administered as an "add-on" to existing Trust Fund excise taxes. Thus, the tax on aviation jet fuel is imposed (along with any applicable Airport Trust Fund excise tax) on the sale of the fuel by a producer (typically, a wholesale distributor), aviation gasoline is taxed upon removal of the fuel from registered terminal facilities.

Fuels used in a use that is exempt from all Trust Fund excise taxation similarly is exempt from the General Fund transportation motor fuels excise tax.¹⁶

History of tax

The Omnibus Budget Reconciliation Act of 1990 (the "1990 Act") represented the first time that transportation motor fuels excise taxes had been used for General Fund purposes since enactment of the various Federal Trust Fund programs (e.g., aviation in 1970). The 1990 General Fund "deficit reduction" tax of 2.5 cents per gallon applied only to highway and rail transportation fuels and was scheduled to expire after September 30, 1995. The 1993 Act expanded upon the 1990 Act, adding an additional 4.3-cents-per gallon to the existing General

¹⁶ The tax base established in 1993 for this tax generally paralleled that of the Leaking Underground Storage Tank ("LUST") Trust Fund fuels excise tax. The LUST tax rate of 0.1 cents per gallon applied to aviation (both commercial and general), highway, rail, inland and intracoastal waterway, and recreational motorboat (gasoline). Revenues from the LUST excise tax, which expired after December 31, 1995, were used to finance clean up of pollution from leaking underground petroleum storage tanks.

Fund tax rate, and expanding the transportation sectors subject to this additional tax rate to include aviation (commercial aviation after September 30, 1995) and inland waterway fuels. The 1993 tax is permanent.

E. Repealed Air Transportation Excise Taxes

Two additional excise taxes previously were imposed on air transportation. First, an annual civil aircraft use tax was imposed from 1970 to 1980. The tax rate was \$25 plus 3.5 cents per pound of the maximum certificated takeoff weight (turbine aircraft) or 2 cents per pound of maximum certificated takeoff weight in excess of 2,500 pounds (other aircraft).

Second, before 1984, aircraft tires and tubes were subject to tax as part of a general tire and tube excise tax that also applied to highway vehicles.

Revenues from the annual aircraft use tax and the tax on aircraft tires and tubes (after 1970) were dedicated to the Airport Trust Fund

III. AIRPORT AND AIRWAY TRUST FUND EXPENDITURE PURPOSES

The Airport Trust Fund was created in 1970 to finance a major portion of the Federal expenditures on national aviation programs. Prior to that time, these expenditures had been financed with General Fund monies. The 1996 expenditure authorization legislation, enacted on October 9, 1996, generally extended expenditure authority for these programs through September 30, 1998; conforming amendments to the Code Airport Trust Fund expenditure provisions were included in that legislation.¹⁷ The statutory provisions relating to the Airport Trust Fund were placed in the Code in 1982 (sec. 9502).

General Trust Fund expenditure purposes

The current general expenditure purposes for the Airport Trust Fund are:

(1) obligations incurred under provisions of previous aviation authorizing legislation enacted since 1970, as those provisions were in effect on the date of enactment of the FAA Act of 1996,¹⁸

(2) obligations incurred under part A of subtitle VII of Title 49, United States Code (generally, FAA programmatic provisions), which are attributable to planning, research and development, construction, or operation and maintenance of--

- (a) air traffic control,
- (b) air navigation,
- (c) communications, or
- (d) supporting services for the airway system, and

¹⁷ Federal Aviation Reauthorization Act of 1996 (the "FAA Act of 1996"), enacted on October 9, 1996 (P.L. 104-264). See also conference report on H.R. 3539 (H. Rept. 104-848). Title X of H.R. 3539 extended the authority to spend from the Airport Trust Fund through September 30, 1998.

¹⁸ The Acts (or provisions of Acts) pursuant to which Airport Trust Fund expenditures are allowed are Title I of the Airport and Airway Development Act of 1970; the Airport and Airway Development Act Amendments of 1976; the Aviation Safety and Noise Abatement Act of 1979; the Fiscal Year 1981 Airport Development Authorization Act; the Airport and Airway Improvement Act of 1982; the Airport and Airway Safety and Capacity Expansion Act of 1987; the Federal Aviation Administration Research, Engineering, and Development Authorization Act of 1990; the Aviation Safety and Capacity Expansion Act of 1990; the Airport and Airway Safety, Capacity, Noise Improvement, and Intermodal Transportation Act of 1992; the Airport Improvement Program Temporary Extension Act of 1994; the Federal Aviation Administration Authorization Act of 1994; and, the Federal Aviation Reauthorization Act of 1996.

(3) obligations incurred for administrative expenses of the Department of Transportation which are attributable to activities described in items (1) and (2).

No expenditures are permitted to be made from the Airport Trust Fund after September 30, 1998. Because the expenditure purposes are set in the law as of the date of enactment of the FAA Act of 1996 (October 9, 1996), the authorizing and appropriations committees of Congress cannot accomplish expenditure of Trust Fund monies for any new purposes without an amendment (approved by the tax-writing committees) to the Code.

Specific Airport Trust Fund expenditure programs

Authorized expenditures for the following airport and airway programs are included under the general purposes, described above

(1) Airport Improvement Program (AIP)--

(a) Airport planning--Planning for airport systems for airport master plans, also, airport noise compatibility planning for air carrier airports eligible for terminal development costs

(b) Airport construction--Construction, improvement or repair of a public airport (includes removal of airport hazards and construction of physical barriers and landscaping to diminish noise)

(c) Airport terminal facilities-- Non-revenue-producing public-use areas which are directly related to movement of passengers and baggage at certified air-carrier airports having required safety and security equipment (including baggage facilities and passenger-moving equipment), also, development of revenue-producing areas and construction of non-revenue-producing parking lots for nonhub airports (subject to certification that the grant will not defer needed development with respect to safety, security, or capacity)

(d) Land acquisition--Includes land or property interests for airport noise control purposes, also includes acquisition of land for, or work necessary to construct, pads suitable for aircraft deicing (subject to certain limitations).

(e) Airport-related equipment--Airport security equipment required by Department of Transportation regulations, snow removal equipment, noise suppressing equipment, navigation aids, and safety equipment required for airport certification, also includes construction or purchase of capital equipment necessary for compliance by an airport with the Americans with Disabilities Act, the Clean Air Act, or the Federal Water Pollution Control Act, other than capital equipment which would primarily benefit a revenue-producing area of the airport used by a nonaeronautical business

(f) Airport noise compatibility programs--Includes sound-proofing of public buildings, local governmental units are eligible for project grants as well as airports

(2) Facilities and Equipment Program (F&E) --Costs of acquiring, establishing, and improving air navigation facilities.

(3) Research, Engineering, Development, and Demonstration Program (R&D) --Projects in connection with FAA research and development activities.

(4) Operations and Maintenance Programs (O&M) --Expenses of flight checks and operations and maintenance of air navigation facilities, including air traffic control; services provided under international agreements relating to the U.S. share of joint provision of air navigation services; weather reporting services provided to the FAA by the National Oceanic and Atmospheric Administration

(5) Small Community Air Service Program --Contract authority for fiscal years 1992-1998 for payments to ensure that eligible localities receiving airline service at the time of deregulation continue to have airline service.

(6) Vocational Technical Institutions --Grants to up to four vocational technical institutions for the acquisition of facilities for the advanced training of maintenance technicians for air carrier aircraft

(7) Airway science curriculum grants --Grants for higher education airway science study programs, including equipment, buildings, and associated facilities.

(8) Civil aircraft security research and development --Grants relating to technologies and procedures to counteract terrorist activities against civil aviation

General Fund air transportation expenditures

Under the FAA Act of 1996, spending from the Airport Trust Fund for FAA operations and maintenance for fiscal years 1997 and 1998 may not exceed the lesser of (1) 50 percent of the amounts appropriated for airport grants, airway facilities and equipment, and research and development or (2) (a) 72.5 percent (as compared to 70 percent for fiscal years 1994-1996) of total FAA expenses minus (b) expenses under (1).¹¹ The balance of those expenses, principally a portion of FAA operations and maintenance (e.g., air traffic control expenses), is financed from general revenues

¹¹ See section 48104, 49 U.S.C.

IV. BUDGET ACT SCOREKEEPING RULES FOR TRANSPORTATION EXCISE TAXES AND TRUST FUND EXPENDITURES

The 1990 Budget Act includes two provisions that are central to the financing and operation of the Federal transportation Trust Fund programs: a budget scorekeeping assumption that dedicated excise taxes are imposed permanently (even if statutorily they are scheduled to expire) and classification of Trust Fund spending as discretionary spending, subject to aggregate annual caps that apply to all discretionary spending (both for transportation and other programs).

The effect of these rules is that under the 1990 Budget Act, there is no budget scorekeeping link between the revenues raised by the transportation excise taxes and the spending from the transportation Trust Funds. The Trust Fund balances similarly have no effect in a broader budgetary sense on the amount that can be obligated for transportation program expenditures.²⁰ If Trust Fund excise taxes and programs are extended and reauthorized before expiration of the taxes, there is neither a revenue nor a spending budget score from the legislation. However, if as is currently true with the Airport Trust Fund excise taxes, the taxes have expired and a new CBO revenue baseline has been issued, the new CBO baseline includes no revenue with respect to the expired taxes. Thus, the reimposition of the taxes would be scored as a revenue increase. Further, because Airport Trust Fund spending is not linked to dedicated revenues, the resulting revenue increases may be used under the Budget Act to offset the revenue loss from enactment of other tax or direct spending provisions without affecting Trust Fund programs.

Treatment of dedicated excise taxes under CBO revenue baseline

The 1990 Budget Act provides that excise taxes that are dedicated to Trust Funds are assumed permanent for budget scorekeeping purposes. This means that revenues from the excise taxes are automatically included each year in the CBO and Office of Management and Budget revenue baseline, even though the taxes may be scheduled to expire before the end of the baseline period. The CBO issues this annual baseline as part of its overall economic forecast in approximately January or February of each year; the forecast is used in developing the Congressional budget resolution. Both revenue and spending estimates are determined relative to that forecast (and the budget resolution) throughout the year.²¹ As a result of their inclusion in the revenue baseline, extensions of Trust Fund excise taxes generally are not scored as raising

²⁰ Unrelated to this general budgetary result, the Highway Trust Fund, but not the Airport Trust Fund, has internal anti-deficit provisions that limit amounts that can be authorized and appropriated from specific Trust Fund Accounts (Highway and Mass Transit Accounts).

²¹ The CBO typically issues an update of its forecast in August; however, because the budget resolution is based on the earlier baseline, revenue estimates continue to be determined by reference to the January or February baseline throughout the year.

revenues when the extensions are enacted. On the other hand, reductions in excise taxes (even as part of an extension of those taxes), are scored as losing revenue.

The following examples illustrate the operation of these budget scorekeeping rules.

Example (1) -- In 1995, the Airport Trust Fund excise taxes were scheduled to expire after December 31, 1995. The taxes had been imposed since before January 1, 1995. In November 1995, when Congress passed the Balanced Budget Act of 1995 extending these excise taxes, no revenue increase was scored from the extension. This occurred because the 1995 CBO revenue baseline, against which legislation was scored, assumed permanent continuation of these dedicated excise taxes (i.e., the scheduled expiration date was disregarded in forecasting future Government receipts).

Example (2) -- The Airport Trust Fund excise taxes expired after December 31, 1995. When the CBO issued its 1996 revenue baseline, projected future receipts from the Airport Trust Fund excise taxes were deleted, and deficit forecasts were adjusted accordingly. The excise taxes were reimposed by the Small Business Job Protection Act of 1996 the "Small Business Act" for the period August 27, 1996, through December 31, 1996. Because the Airport Trust Fund excise taxes had expired when the 1996 CBO revenue baseline was issued, no revenue from these excise taxes was included in the baseline, and thus, revenue increases were scored from their reinstatement in the 1996 Act, for the approximately four-month period during which the taxes actually were reimposed.

Example (3) -- The Airport Trust Fund excise taxes expired again after December 31, 1996. Because the Airport Trust Fund excise taxes expired before the January 1997 CBO revenue baseline was issued, the baseline does not include any projected receipts from them. If Congress acts to reimpose the taxes in 1997, revenue increases will be scored for the period during which the taxes are reimposed.

Trust Fund expenditures as discretionary spending

The 1990 Budget Act divides Federal Government spending into two major categories: direct spending and discretionary spending. Direct spending is spending for which no appropriation is required (e.g., entitlements such as social security old age benefits). Discretionary spending may occur only when funds are appropriated. All discretionary spending programs must compete for a fixed pool of dollars under aggregate annual caps imposed on Federal discretionary spending. As described above, spending for the Federal transportation Trust Fund programs is classified as discretionary spending. When authorizing legislation is enacted, generally, it is not considered to be an increase in Federal spending. Rather, that spending is scored when the funds are appropriated, which occurs after the competing demands of transportation and other discretionary spending programs have been reconciled within the annual caps. This spending reconciliation is independent of issues related to imposition or revenue scoring of dedicated Trust Fund excise taxes.

Concepts of "gross receipts" and "net revenues"

Under present law, the Code transfers amounts equivalent to "gross receipts" raised by the air transportation excise taxes, rather than the "net revenues" produced by those taxes, to the Airport Trust Fund. Net revenues equal approximately 75 percent of gross receipts. The concept of net revenues reflects budget scorekeeping conventions that discount excise tax revenues by the amount that income tax receipts are expected to decrease as a result of monies being removed from the private economy for payment of excise taxes.

Amounts in excess of net revenues produced by the excise taxes may be dedicated to the Airport Trust Fund without a budgetary effect because, as described above, there is no budget scorekeeping link between the amount of revenues dedicated to the Trust Fund and the level of Trust Fund expenditures. The Trust Fund is included within the unified Federal budget, and expenditures from the Trust Fund are classified by the Budget Act as discretionary spending, subject to aggregate annual caps on all such spending. If, however, expenditures from the Trust Funds were reclassified as direct spending which occurs automatically without appropriation, a budgetary shortfall could result if the amount of such direct spending was based on the gross receipts from the taxes rather than the net revenues estimated to be raised by the taxes. Similarly, if the Airport Trust Fund were removed from the unified budget, an increase in stated deficits could occur because actual outlay patterns from the Trust Fund typically lag behind excise tax collections. Under present law, receipts in excess of the amount to be spent during the current budget period (even though such funds may be obligated for future transportation expenditures) act to reduce current budget deficits.

V. CURRENT AND PROJECTED FINANCIAL STATUS OF THE AIRPORT TRUST FUND

In general

Expenditures from the Airport Trust Fund are governed by three sets of statutory provisions: authorizing Acts, annual appropriations Acts, and the Code's Trust Fund provisions. The current authorizing Act provides for expenditures through September 30, 1998 (generally by authority granted to the FAA to enter into contracts). Public Law 104-205, providing transportation appropriations for the 1997 fiscal year, limits authorized contract authority to specified dollar amounts for the various FAA programs. This appropriations Act further provides that at least a portion of the funding for each of the FAA programs is "to be derived from the Airport and Airway Trust Fund," with the balance being derived from general revenues. In general, all of the appropriations for FAA programs, except for a portion of the FAA's operating expenses, which is derived from the General Fund, are derived from the Airport Trust Fund. These programs include the FAA's operating expenses, expenditures for facilities and equipment programs, research, engineering and development program expenditures; and, the airport improvement grant program for State and local government airports. In addition to setting dollar limits on future commitments for the capital programs, the current appropriations Act generally provides that the amounts appropriated for capital expenditures may be utilized at any time through September 30, 1999.

The Code's Trust Fund provisions adopt, by cross-reference, the expenditure provisions of these authorization and appropriation Acts. In addition, the Code's Trust Fund provisions determine which revenues will be deposited into the Airport Trust Fund, and thus will be available to finance expenditures which are authorized and appropriated from that Fund. The current Code provisions transfer to the Airport Trust Fund only those receipts from the air transportation excise taxes that are received by the Treasury Department before January 1, 1997. Amounts received after December 31, 1996, are retained in the General Fund (and thus are not available for financing authorized and appropriated Airport Trust Fund expenditures) under present law. As described more fully below, the commercial air transportation excise taxes are not deposited in the Treasury immediately following their collection from consumers by commercial passenger and freight air carriers (the "air carriers"). Until recently, it was anticipated that these Code provisions would allow transfer to the Trust Fund of all receipts attributable to taxes paid by consumers when the taxes were imposed in 1996 except those paid by consumers during the month of December 1996.²²

The financial condition of the Airport Trust Fund generally is evaluated by reference to two balances: a cash balance and an uncommitted balance. The cash balance reflects all cash on

²² A similar situation arose with respect to amounts attributable to air transportation taxes paid by consumers during the month of December 1995. Those amounts were transferred to the Airport Trust Fund when the Trust Fund taxes were reimposed in the 1996 Act.

hand in the Trust Fund--both that which is required to satisfy outstanding obligations (or commitments) and funds with respect to which no commitments have been made. This balance is used to evaluate the Trust Fund's ability to pay outstanding bills as they become due. The uncommitted balance includes only funds with respect to which binding commitments have not as yet been made. This balance is used to evaluate the ability of the FAA to enter into new commitments as provided in authorization and appropriation Acts. As is true with most other transportation Trust Funds, actual disbursements from the Airport Trust Fund for capital expenditures lag significantly behind the time when commitments are made because many of the commitments are for capital projects, with respect to which payment is made only as work is completed. Thus, the cash balance typically is significantly larger than the uncommitted balance (For example, at the beginning of the 1997 fiscal year, the cash balance of the Trust Fund was estimated by the CBO to be approximately \$7.9 billion, whereas the uncommitted balance was estimated to be only \$2.4 billion.) The delay in actual disbursements produces Trust Fund cash balances that frequently are referred to as "surpluses" by persons who propose increased transportation spending. Because expenditures continued to be made from the Airport Trust Fund during the part of calendar year 1996 when no excise taxes were imposed, both the cash balance and the uncommitted balance of the Trust Fund are lower than has been true in the past.

Cash and uncommitted balances of the Airport Trust Fund (as reported in the December 1996 CBO baseline)

Tables 1 and 2, below, provide the CBO's current baseline estimate of the financial condition of the Airport Trust Fund.²³ Both of these tables were produced before receipt of new information, also described below, regarding when air passenger and freight taxes imposed on consumers during the period September 1 through November 30, 1996, were deposited by the air carriers with the Treasury Department. Therefore, the balances reflected in these tables are understood to be overstated, but the exact amount of this overstatement is unknown at the present time. The tables should be viewed only as providing an upper limit on funds available from the Trust Fund.

Table 1 shows that, looking at the cash balance, the Airport Trust Fund is projected to continue to be able to pay bills coming due with respect to previous commitments through the end of the 1997 fiscal year. The CBO projects that the Airport Trust Fund will end the 1997 fiscal year with a cash balance of \$4.2 billion.

Table 2 provides the CBO's current estimates of the fiscal condition of the Airport Trust Fund with respect to uncommitted funds. This table shows that the Trust Fund's uncommitted

²³ Table 1 is an updated version of Table 4 in Joint Committee on Taxation, Present Law and Background Information on Federal Transportation Excise Taxes and Trust Fund Expenditure Programs, JCS-10-96, November 14, 1996, p. 55. The current table reflects the CBO's December 1996 baseline. The prior table was based on the CBO's March 1996 baseline.

balance is projected to be depleted before the end of the 1997 fiscal year. Thus, absent reinstatement of the air transportation excise taxes, or dedication of either other revenue sources to the Airport Trust Fund or appropriation of additional amounts from the General Fund, the FAA would not be able to enter into new capital contracts at some point during the current fiscal year.²⁴ It should be understood, however, that because the current appropriations Act provides that appropriated amounts will remain available for spending through September 31, 1999, the constraints on current fiscal year spending resulting from the lower uncommitted Airport Trust Fund balance will not prevent the FAA from ultimately spending these appropriated amounts. Instead, those commitments could be made without further Congressional appropriations action once additional receipts are deposited in the Airport Trust Fund.

²⁴ The General Accounting Office recently has reported that, absent additional funds, the uncommitted balance of the Trust Fund would reach zero by July 1997. See, United States General Accounting Office, Airport and Airway Trust Fund: Issues Raised by Proposal to Replace the Airline Ticket Tax (GAO/RCED-97-23) December 1996, pp.12-13.

**Table 1.—Congressional Budget Office Projection of Airport and Airway Trust Fund Revenues, Outlays, and Cash Balances,
Fiscal Years 1997-2007 (in millions of dollars)
[December 1996 Baseline. Prior to Information Relating to Semi-Monthly Deposits^a]**

Trust Fund Balances	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Beginning of Year Cash Balance	7,875	4,208	-1,329	-7,254	-13,660	-21,585	-28,048	-36,160	-44,950	-54,431	-64,695
Tax Revenue	1,527	0	0	0	0	0	0	0	0	0	0
Interest Revenue	399	94	-275	-659	-1,062	-1,483	-1,926	-2,433	-2,932	-3,514	-4,147
Total Revenue	1,926	94	-275	-659	-1,062	-1,483	-1,926	-2,433	-2,932	-3,514	-4,147
Outlays	5,593	5,630	5,650	5,748	5,864	5,980	6,185	6,357	6,549	6,750	7,029
End of Year Cash Balance	4,208	-1,329	-7,254	-13,660	-20,585	-28,048	-36,160	-44,950	-54,431	-64,695	-75,871

a - Estimate of tax revenue assumes the Airport Trust Fund is credited with semi-monthly deposits during the period October 1 - December 31, 1996. The staff of the Joint Committee on Taxation recently learned that most such deposits were not made, suggesting that these December 1996 baseline estimates overstate current cash balances. The staff of the Joint Committee on Taxation understands that as much as \$1.2 billion in excise taxes were not deposited during the period of October 1 - December 31, 1996. See text for detailed explanation.

Source: Congressional Budget Office

**Table 2.--Congressional Budget Office Projection of Airport and Airways Trust Fund Uncommitted Balances,
Fiscal Years 1997-2007 (in millions of dollars)
[December 1996 Baseline, Prior to Information Relating to Semi-Monthly Deposits ^a]**

Trust Fund Balances	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Beginning of Year Unpaid Commitments ^b	5,498	6,072	6,856	7,807	8,856	9,989	11,214	12,446	13,724	15,035	16,378
New Budget Authority ^c	6,167	6,414	6,601	6,797	6,997	7,205	7,417	7,634	7,860	8,094	8,333
Outlays	5,593	5,630	5,650	5,748	5,864	5,980	6,185	6,357	6,549	6,750	7,029
End of Year Unpaid Commitments	6,072	6,856	7,807	8,856	9,989	1,214	12,446	13,724	15,035	16,378	17,862
End of Year Cash Balance ^d	4,208	-1,329	-7,254	-13,660	-20,585	-28,048	-36,160	-44,950	-54,431	-64,695	-75,871
End of Year Uncommitted Balances	0	0	0	0	0	0	0	0	0	0	0

- a - This estimate of uncommitted balances assumes the Airport Trust Fund is credited with semi-monthly deposits of air transportation excise taxes during the period October 1 through December 31, 1996. The staff of the Joint Committee on Taxation recently learned that most such deposits were not made, suggesting that these December 1996 baseline estimates overstate current uncommitted balances. The staff of the Joint Committee on Taxation understands that as much as \$1.2 billion in excise taxes were not deposited during the period of October 1 through December 31, 1996. See text for detailed explanation.
- b - Unpaid Commitments: all budget authority which has been provided but not yet expended, a combination of unobligated and obligated balances.
- c - Budget Authority: authority provided by Congress to enter into contracts committing funds.
- d - "Cash" available in Airport Trust Fund at the end of the fiscal year, see Table 1.

Source: Congressional Budget Office.

New information relating to cash and uncommitted balances of the Airport Trust Fund

Before new information was discovered during the week of January 27, 1997, the FAA and the General Accounting Office had reported that the uncommitted balance of the Airport Trust Fund would be sufficient to fund all 1997 fiscal year operational expenses of the FAA that were expected to be funded from the Trust Fund and to allow the FAA to enter into new capital program commitments (as anticipated by current authorization and appropriation Acts) until July 1997. However, the staff of the Joint Committee on Taxation recently received new information which indicates that, pursuant to certain Internal Revenue Service tax deposit rules, many commercial air transportation providers ("air carriers") have delayed significantly the time when taxes will be received in the Treasury Department. As a result of this delay, it is understood that an overwhelming majority of the revenues resulting from reimposition of the Airport Trust Fund air passenger and freight excise taxes from August 27, 1996, through December 31, 1996, were not received by the Treasury Department before January 1, 1997, and therefore cannot be transferred to the Trust Fund. Thus, the cash and uncommitted balances reported in the December 1996 CBO baseline estimates (Tables 1 and 2) are likely to be substantially overstated.

As described in Part II, the air passenger ticket and air freight excise taxes are collected from passengers and freight shippers by the commercial air carriers. The air carriers then remit the funds to the Treasury Department, however, the air carriers are not required to remit monies immediately. Excise tax returns are filed quarterly (similar to annual income tax returns) with taxes being deposited on a semi-monthly basis (similar to estimated income taxes). For air transportation sold during a semi-monthly period, air carriers may elect to treat the taxes as collected on the last day of the first week of the second following semi-monthly period.²³ Under these "deemed collected" rules, for example, the taxes on air transportation sold between October 1 and October 15, are treated as collected by the air carriers on or before November 7. These amounts generally must be deposited with the Treasury by November 10. Thus, on average, revenues from commercial air passenger and freight transportation generally are not received by the Federal Government until approximately one month after the air carrier actually sells the transportation.

Like income tax withholding and estimated tax payments, the excise taxes contain payment safe harbors for avoiding underpayment penalties.²⁴ In general, Treasury regulations provide that commercial air carriers are not subject to underpayment penalties if their semi-monthly deposits of passenger ticket and freight waybill taxes for a quarter equal at least the amount of taxes they were required to remit during the second preceding calendar quarter (the

²³ Air carriers generally make this election because it allows them to delay remitting tax beyond the date when remittance otherwise would be required.

²⁴ See, Treas. reg. secs. 40.6302(c)-1 and (c)-3.

"look back" rules). For example, air carriers generally would not be subject to underpayment penalties if their semi-monthly deposits for the fourth quarter (October 1 through December 31) equaled at least the amount they were required to remit during the second quarter (April 1 through June 30) of the same year.

During calendar year 1996, no commercial air transportation excise taxes were imposed before August 27. In a general information letter to the Air Transport Association of America, dated August 30, 1996, the Internal Revenue Service advised the air carriers that, notwithstanding that no excise taxes were required to be remitted during the second quarter of 1996, applicable Treasury Department regulations permitted the air carriers to continue to avail themselves of the look back rules in determining tax deposits for the fourth quarter. Because the Airport Trust Fund taxes had expired and therefore nothing was required to be remitted during the second quarter, the Internal Revenue Service stated that air carriers were not required to make semi-monthly deposits with respect to the fourth quarter. The staff of the Joint Committee on Taxation recently learned that, in general, the air carriers therefore chose not to make semi-monthly deposits of these taxes during the fourth quarter of 1996. Instead, the air carriers generally retained the taxes collected from their passengers on tickets sold and freight shipped during the period September 1-November 30, 1996, and intend to remit the entire amount they collected with their excise tax returns for the fourth quarter, due on February 28, 1997. (Similarly, the air carriers are expected to retain most taxes attributable to December 1996 sales until their excise returns for the first quarter of 1997 are due on May 31, 1997.)

Therefore, with the exception of receipts attributable to the period August 27, 1996 through August 31, 1996, it is understood that only relatively small amounts were received by the Treasury before January 1, 1997, as a result of the 1996 reimposition of the commercial air transportation excise taxes. Tax receipts that were received after December 31, 1996, cannot be credited to the Airport Trust Fund, absent further legislative change.

Effect on Airport Trust Fund balance and the Federal Aviation Administration budget for the 1997 fiscal year

When the Treasury Department and the FAA learned that most air carriers had not deposited passenger and freight excise taxes during the fourth quarter of 1996, the two agencies re-evaluated their projections of the Airport Trust Fund's uncommitted balance and the ability of the FAA to fund its operations and enter into new capital commitments during the 1997 fiscal year. The current FAA funding constraints do not affect the ability of the FAA to continue to make payments on commitments that have been entered previously (except for certain "incrementally accrued" contracts, described below). The cash balance of the Airport Trust Fund includes committed funds that are sufficient to finance completion of those prior commitments. Table 3, below, was submitted by the FAA on January 31, 1997, and summarizes the FAA's analysis of its financial condition as of that date. The information contained in Table 3 is very preliminary and may change before the Finance Committee's hearing on February 4, 1997.

The Treasury Department estimates that it incorrectly credited the Airport Trust Fund with approximately \$1.2 billion of receipts that were assumed to have been received before January 1, 1997, but in fact will not be received from the airlines until February 28, 1997. These receipts are attributable to excise taxes collected from consumers during the months of September, October, and November 1996, as explained above. Table 3 shows that, after this adjustment, the FAA currently estimates the Trust Fund's uncommitted balance to be \$1.9 billion. The 1997 fiscal year appropriations Act also provides \$3.3 billion in General Fund appropriations for the FAA's operations. As of January 31, 1997, the FAA estimates that it has obligated \$1.2 billion of the General Fund appropriation, thus leaving \$2.1 billion available for additional commitments in the 1997 fiscal year. When the Trust Fund's uncommitted balance and the remaining General Fund appropriation are combined, the FAA is provided with a total of approximately \$4.0 billion to finance its operations for the remaining months of the 1997 fiscal year.

As Table 3 shows, the amount needed to fund FAA operations (e.g., air traffic controller salaries) through the end of the current fiscal year is estimated to be approximately \$3.5 billion.²⁷ The remaining \$0.5 billion in available funds could then be used to enter into new capital commitments. Under normal circumstances, this \$0.5 billion would permit the FAA to continue entering into new capital program commitments at planned levels through March 1997. Because these numbers are only estimates and because of provisions of certain outstanding contracts, described below, the FAA may need to reduce capital commitments before the end of March to protect against inadvertently overcommitting available Trust Fund monies.

The FAA's contract accounting does not treat the full cost of certain contracts that are "incrementally accrued" as committed when contracts are entered. An example of such an arrangement would be a contract for a project to be completed in multiple phases, where the FAA would treat as committed only the amounts required for the current phase of the project, but the contract might provide that if the contract is terminated before all phases are completed, the contractor could receive liquidated damage payments. In some cases, these liquidated damage payments may be increased if the FAA fails to provide 30 to 60 days notice of its intent not to continue the contract. The FAA is continuing to review its outstanding contracts to determine the extent of such liquidated damage provisions. Table 3 does not include any estimates of such damages. Any liquidated damages under these contracts would reduce the \$0.5 billion otherwise available for new capital commitments during February and March 1997. Thus, absent earlier legislative action, it appears that the FAA may have to stop entering new commitments and begin notifying contractors that they will not extend contracts such as those described beginning on March 1, 1997, or earlier.

²⁷ This \$3.5 billion includes monies required to fund the salaries of approximately 2,800 FAA employees that are paid through capital accounts (primarily the facilities and equipment ("F&E") and research and experimental development ("RED") accounts).

**Table 3.--Estimated Effects of New Information on the Uncommitted Balance of the
Airport Trust Fund and the FAA Budget
(Submitted by the FAA on January 31, 1997)**

DRAFT ANALYSIS OF FAA's FY 1997 SPENDING OPTIONS
(All Sums in \$Billions)

TRUST FUND (TF) BALANCE INFORMATION		FY1997
TF uncommitted balance, beginning of year		\$2.4
Total FY 1997 Adjustments (interest, recoveries, etc.)		\$0.6
Available FY 1997 TF balance after adjustments, before obligations		\$3.0
Net obligations of FY 1997 appropriations through January 31		\$1.1
Remaining TF balance for rest of FY 1997		\$1.9
		\$1.2 available to fund Operations for 3 months
		\$0.2 available to fund F&E/RE&D workforce for 8 months
		\$0.5 remaining to fund capital programs
 GENERAL FUND BALANCE INFORMATION		
GF balance, beginning of year		\$3.3
GF obligations through January 31		\$1.2
Remaining GF balance		\$2.1 Funds Operations for 5 months

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SCENARIO: PROTECT AGENCY WORKFORCE THROUGH FISCAL YEAR
Shaded Area Indicates Months That Can Be Fully Obligated

	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.
Obligation rate per month for Operations (post 1/31)	\$0.40	\$0.41	\$0.41	\$0.41	\$0.41	\$0.41	\$0.41	\$0.41
Cumulative Remaining Operations Obligations	\$0.40	\$0.81	\$1.21	\$1.62	\$2.03	\$2.43	\$2.84	\$3.25
 Capital Programs 1/								
Obligation rate per month for F&E (post 1/31)	\$0.18	\$0.20	\$0.11	\$0.13	\$0.13	\$0.10	\$0.13	\$0.12
Obligation rate per month for RE&D (post 1/31)	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02
Obligation rate per month for AIP (post 1/31)	\$0.07	\$0.08	\$0.08	\$0.09	\$0.16	\$0.27	\$0.28	\$0.31
Total capital obligations per month (post 1/31)	\$0.27	\$0.30	\$0.21	\$0.24	\$0.30	\$0.39	\$0.42	\$0.45
Cumulative remaining capital obligations	\$0.28	\$0.58	\$0.77	\$1.01	\$1.31	\$1.70	\$2.12	\$2.57

1/ Monthly totals do not include costs associated with potential interruptions in contracts.

Table 3.—Estimated Effects of New Information on the Uncommitted Balance of the Airport Trust Fund and the FAA Budget, continued

DRAFT ANALYSIS OF FY 1997 SPENDING OPTIONS
(All Sums in \$Billions)

TRUST FUND (TF) BALANCE INFORMATION FY 1997

TF cash balance, beginning of year (not additive to table)	[57.8]
TF uncommitted balance, beginning of year	\$2.4
Adjustment for recapture of December 1995 taxes	\$0.2
Oct. to Dec. 1996 transfers by Treasury	\$1.7
Funds to be withdrawn by Treasury (subject to upward revision)	[51.2]
Available TF balance before interest on cash balance	\$2.6
Interest for FY 1997 (based on adjusted cash balance)	\$0.4
Available TF balance before obligations	\$3.0
Obligations for F&E programs through 1/31	\$0.9
Obligations for F&E from FY 1996 appropriations	[50.6]
Obligations for RE&D through 1/31	\$0.1
Obligations for AIP through 1/31	\$0.1
Obligations for Operations through 1/31	\$0.5
Obligations for OST programs (completed 1/87)	\$0.1
Net obligations of FY 1997 appropriations through January 31	\$1.1
Remaining TF balance (including interest)	\$1.9

GENERAL FUND BALANCE INFORMATION

GF appropriation, beginning of year	\$3.3
GF obligations through 1/31	\$1.2
Remaining GF balance	\$2.1

RATES OF OBLIGATION

	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Total
Obligation rate per month for Operations	\$0.39	\$0.37	\$0.55	\$0.40	\$0.40	\$0.41	\$0.41	\$0.41	\$0.41	\$0.41	\$0.41	\$0.41	\$4.85
Capital Programs 1/													
Obligations per month for F&E	\$0.05	\$0.35	\$0.19	\$0.31	\$0.18	\$0.20	\$0.11	\$0.13	\$0.13	\$0.10	\$0.13	\$0.12	\$1.88
Obligations per month for RE&D	\$0.00	\$0.03	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.21
Obligations per month for AIP	\$0.00	\$0.01	\$0.06	\$0.06	\$0.07	\$0.08	\$0.08	\$0.08	\$0.16	\$0.27	\$0.28	\$0.31	\$1.48
Total capital obligations per month	\$0.05	\$0.39	\$0.26	\$0.39	\$0.28	\$0.30	\$0.21	\$0.24	\$0.30	\$0.39	\$0.42	\$0.45	\$3.85
Total Operations and capital obligations per month	\$0.45	\$0.75	\$0.81	\$0.78	\$0.68	\$0.71	\$0.61	\$0.65	\$0.71	\$0.80	\$0.83	\$0.85	\$8.61

1/ Monthly totals do not include costs associated with potential interruptions in contracts.

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VI. ESTIMATED BUDGET EFFECTS OF REIMPOSING AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES

Table 4, below, shows the estimated budget effects of reimposing the Airport Trust Fund excise taxes (both commercial and general aviation taxes) that expired after December 31, 1996. The first line of the table shows the estimated budget effects of reimposing the excise taxes for the period March 1, 1997, through September 30, 1997. The second line shows the estimated budget effects of reimposing the excise taxes for the period March 1, 1997, through September 30, 2007.

The revenue estimates in Table 4 assume that the provisions of the Treasury Department's regulations relating to deposits of excise taxes are overridden to prevent recurrence of a delay in receipt of tax deposits such as that which has been discovered with respect to the fourth quarter of 1996. The estimates also assume that the reinstated air passenger ticket tax, international departure tax, and domestic air freight excise tax would be effective for air transportation beginning after February 28, 1997 (with respect to amounts paid after that date),²¹ and that these three excise taxes would terminate with respect to transportation purchased after the termination date. Transportation would be considered to be purchased no later than the date on which a ticket was issued (Earlier tender of payment by the consumer, whether or not processed by the air carrier in the case of checks or credit card payments, would be treated as payment.)

²¹ Payments between related parties before March 1, 1997, for transportation occurring after February 28, 1997, would not receive the benefit of this delayed effective date.

TABLE 4.—ESTIMATED REVENUE EFFECTS OF OPTIONS TO EXTEND AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES^a

Fiscal Years 1997 - 2007

[Billions of Dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997-02	1997-07
1 Extension of airport and airway trust fund excise taxes through 9/30/97	3-1-97	2.7	0.2	---	---	---	---	---	---	---	---	---	2.9	2.9
2 Extension of airport and airway trust fund excise taxes through 9/30/07	3-1-97	2.7	5.2	5.5	5.9	6.2	6.6	7.0	7.4	7.9	8.4	8.9	32.1	71.8

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

a - This table shows the net revenue effect of reimposition of the excise taxes (gross receipts less income tax revenue offset).

APPENDIX: DATA ON FINANCIAL CONDITION OF COMMERCIAL AIR CARRIERS

The following figures and tables report revenues and net income for twelve selected air passenger airlines for the period 1990 through 1995. The data are revenues and net income as reported for financial accounting purposes and were derived from the CompuStat data base.

The revenue and income data for the selected airlines are reported by two groups. The first group is comprised of American Airlines, Continental Airlines, Delta Airlines, Northwest Airlines, Trans World Airlines, United Airlines, and USAir. These seven airlines are the seven largest air passenger carriers serving the domestic market. Each of the seven airlines have had annual revenues in excess of \$3 billion throughout the period 1990 through 1995. Figure 1 and Table A 1 report annual revenues, which largely are comprised of passenger ticket sales, for each of these seven large airlines. The data show that throughout the period American, United, and Delta experienced revenue growth. Revenues for Northwest and USAir were flat, while Continental and TWA experienced revenue declines. Figures 2 and 3 and Table A.2 report net income for these airlines. Generally each airline reported losses between 1990 and 1994, while 1995 was a year of positive net income for all except TWA.

The second group of airlines is five smaller airlines: Alaska Airlines; America West Airlines, Atlantic Southeast Airlines, Comair, and Southwest Airlines. Each of these airlines had annual revenues of less than \$3 billion throughout the period 1990 through 1995. While there are other "small" airlines, these five airlines were selected because of the availability of data on revenue and net income for each year of the period 1990 through 1995. Figure 4 and Table A 3 report revenues for these airlines. Alaska Airlines, America West, Atlantic Southeast, and Comair each reported modest revenue growth for 1995 compared to 1990. Southwest Airlines reported more substantial revenue growth throughout the period. Figure 4 and Table A 5 document that these five smaller airlines generally were profitable throughout the period 1990-1995.

Reported 1996 operating results for these twelve air carriers are not yet generally available. However, financial news accounts generally characterize 1996 as a year of revenue and profit growth.²⁹

²⁹ For example, *The Value Line Investment Survey* recently wrote that "[t]he Air Transport Industry will report its highest profits ever for 1996, and next year should be good, also. Traffic has been rising and ticket prices are higher than they were a year ago." The Value Line analyst projects that total industry revenues (including freight operations) will be more than ten percent higher for 1996 than 1995 and that total industry profits will be 35 percent higher in 1996 than in 1995. *The Value Line Investment Survey*, December 20, 1996, p. 251.

Table A-1.—Sales Revenues of the Seven Domestic Passenger Airlines with Annual Revenues of \$3 Billion or Greater, 1990-1995 (\$ millions)

Year	Northwest Airlines Corp.	Trans World Airlines	United (UAL Corp)	USAir Group	American (AMR Corp)	Continental Air Lines Inc.	Delta Air Lines Inc.
1990	7,426.4	4,601.1	11,017.4	6,558.6	11,719.6	6,230.5	8,582.2
1991	7,682.9	4,651.4	11,662.5	6,514.1	12,887.0	5,551.0	9,170.6
1992	8,127.6	4,618.7	12,889.7	6,686.4	14,396.0	5,575.2	10,836.7
1993	8,648.9	4,154.4	14,511.0	7,083.2	15,701.0	5,775.3	11,996.6
1994	9,142.9	4,407.7	13,950.0	6,997.2	16,137.0	5,669.9	12,359.0
1995	9,084.9	4,316.8	14,943.0	7,474.3	16,910.0	5,825.0	12,194.0

Source: CompuStat

Table A-2.—Net Income of the Seven Domestic Passenger Airlines with Annual Revenues of \$3 Billion or Greater, 1990-1995 (\$ millions)

Year	Northwest Airlines Corp.	Trans World Airlines	United (UAL Corp)	USAir Group	American (AMR Corp)	Continental Air Lines Inc.	Delta Air Lines Inc.
1990	-302.5	-237.6	94.5	-454.4	-39.6	-2,343.8	302.8
1991	-320.2	34.6	-331.9	-305.3	-240.0	-305.7	-324.4
1992	1,079.5	-317.7	-956.8	-1,228.9	-935.0	-125.3	-506.3
1993	-115.3	623.8	-50.0	-393.1	-110.0	2,601.6	-1,001.9
1994	295.5	-435.8	51.0	-684.9	228.0	-613.3	-409.0
1995	450.9	-227.5	349.0	119.3	167.0	224.0	408.0

Source: CompuStat

Table A-3.--Sales Revenues of Five Selected Domestic Passenger Airlines with Annual Revenues Less Than \$3 Billion, 1990-1995 (\$ millions)

<u>Year</u>	<u>Alaska Airgroup Inc.</u>	<u>America West Airlines</u>	<u>Southwest Airlines</u>	<u>Atlantic Southeast Airlines</u>	<u>Comair Holdings Inc.</u>
1990	1,647.0	1,315.8	1,186.8	187.2	201.7
1991	1,104.0	1,413.9	1,313.6	221.9	217.4
1992	1,115.4	1,294.1	1,685.2	235.6	248.3
1993	1,128.3	1,325.4	2,296.7	288.5	296.6
1994	1,315.6	1,408.8	2,591.9	312.1	360.7
1995	1,417.5	1,550.6	2,872.8	328.7	463.3

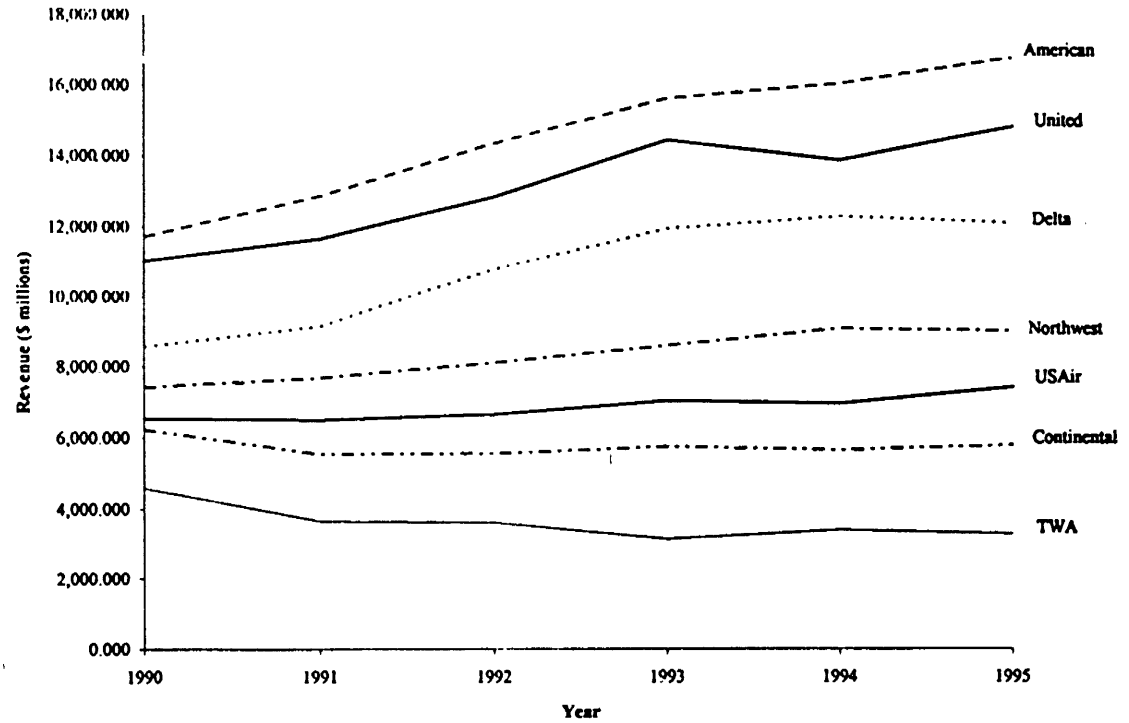
Source: CompuStat

Table A-4.--Net Income of Five Selected Domestic Passenger Airlines with Annual Revenues Less Than \$3 Billion, 1990-1995 (\$ millions)

<u>Year</u>	<u>Alaska Airgroup Inc.</u>	<u>America West Airlines</u>	<u>Southwest Airlines</u>	<u>Atlantic Southeast Airlines</u>	<u>Comair Holdings Inc.</u>
1990	17.2	-74.7	47.1	25.4	13.1
1991	10.3	-222.0	26.9	32.5	12.4
1992	-84.8	-131.8	103.6	37.1	19.3
1993	-30.9	37.2	169.5	50.5	28.5
1994	22.5	62.2	179.3	52.7	29.3
1995	17.3	53.8	182.6	51.1	60.0

Source: CompuStat

Figure 1.-- Sales Revenues of Seven Major Airlines, 1990-1995

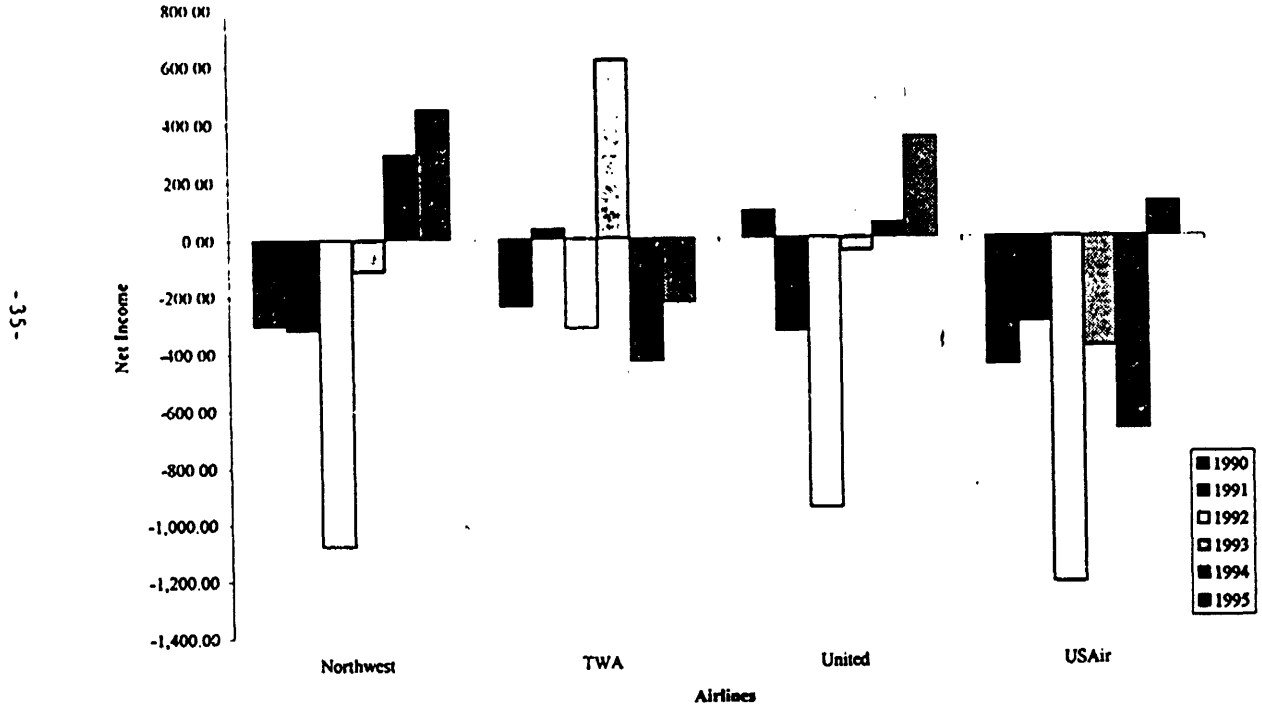


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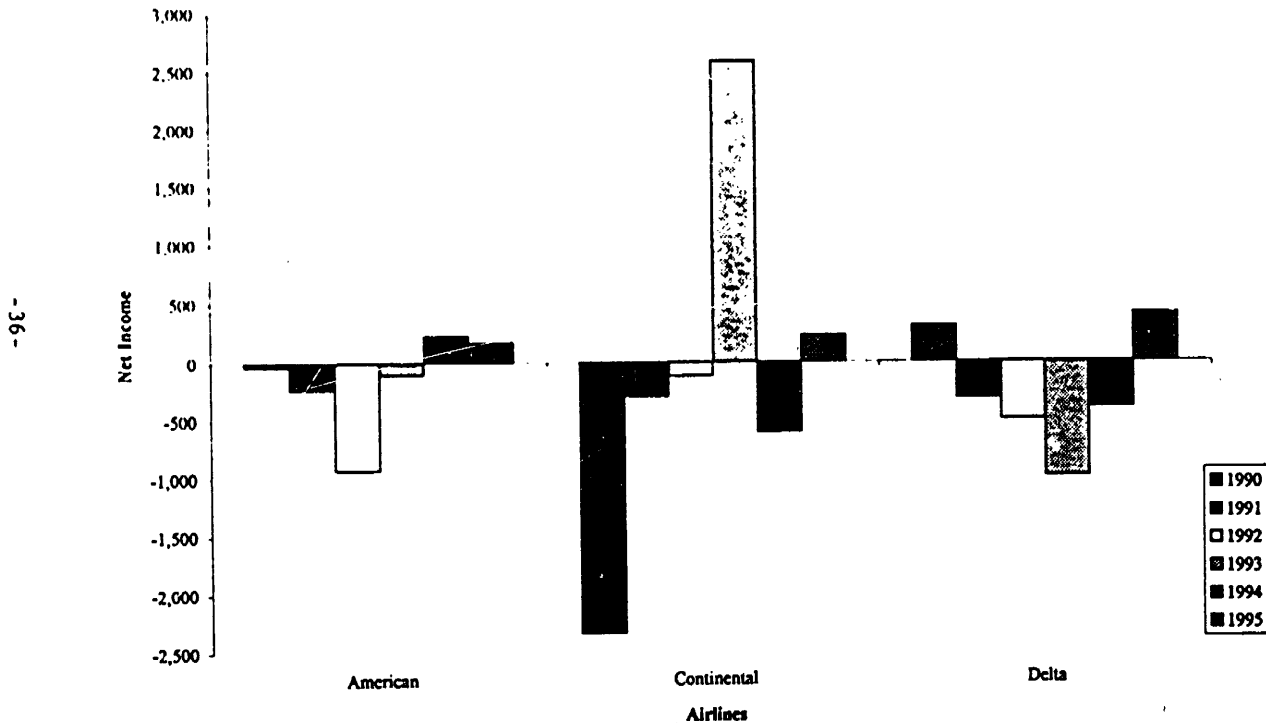
Source: CompuStat

Figure 2.--Net Income of Northwest, TWA, United, and USAir, 1990-1995



Source: CompuStat

Figure 3.--Net Income of American, Continental, and Delta, 1990-1995

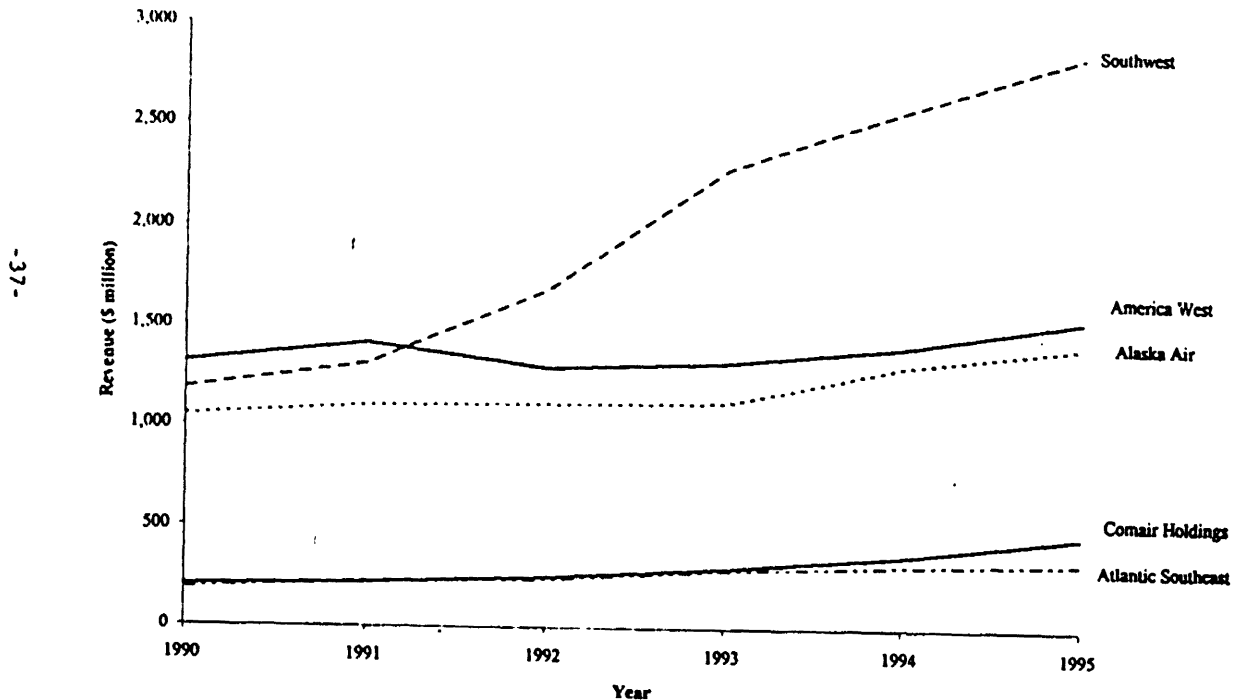


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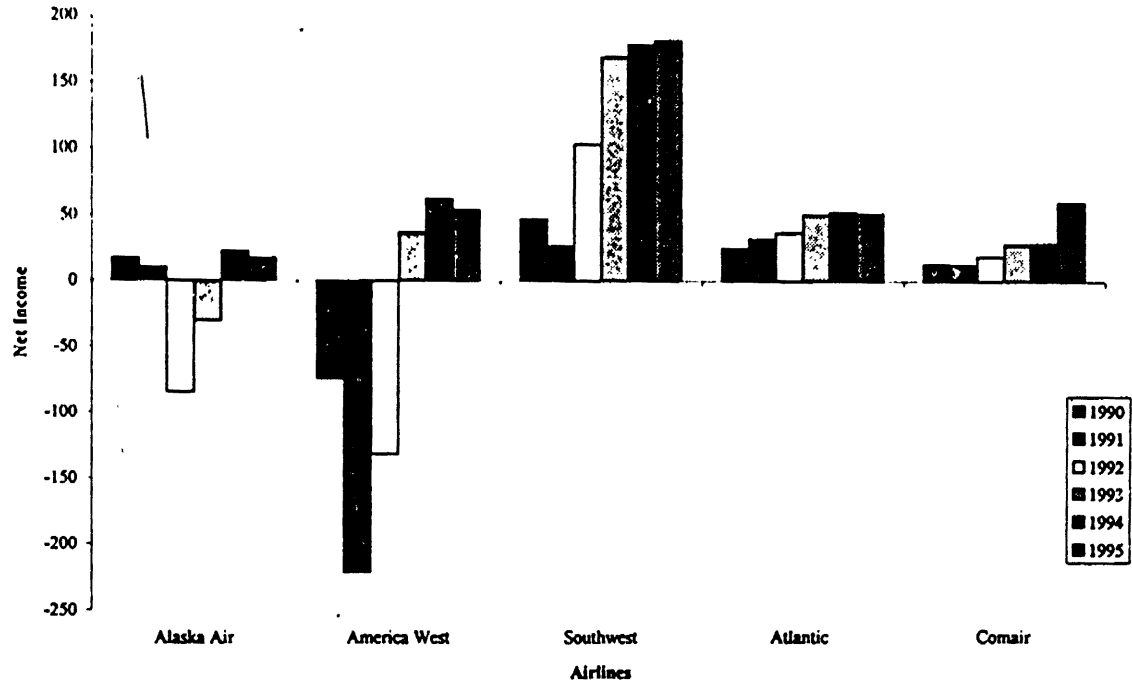
Source: CompuStat

Figure 4.--Sales Revenues of Alaska Air, America West, Southwest, Atlantic Southeast, and Comair, 1990-1995



Source: CompuStat

Figure 5.--Net Income of Alaska Air, America West, Southwest, Atlantic Southeast, and Comair, 1990-1995



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Source: CompuStat