United States General Accounting Office

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Report to Congressional Requesters

December 1996

AIRPORT AND AIRWAY TRUST FUND

Issues Raised by Proposal to Replace the Airline Ticket Tax

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Resources, Community, and
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Congressional Requesters

In fiscal year 1996, nearly three-quarters of the Federal Aviation Administration's (FAA) funding came from the Airport and Airway Trust Fund, and the balance came from the General Fund of the U.S. Treasury. Since its creation in 1970, the Trust Fund's primary source of revenue has been a tax on domestic airline tickets. Currently, the tax is 10 percent of the fares paid. While relatively easy to administer, the ticket tax has been challenged by the nation's largest airlines as unfair in a deregulated environment where other competing airlines often charge much lower fares. The government's authority to collect the ticket tax lapsed on December 31, 1995. In May 1996, a coalition of the seven largest U.S. airlines proposed replacing the tax with user fees, which they believe would more accurately charge each airline for the costs that its operations impose on the airport and airway system.[1]

In August 1996, the Congress reinstated the ticket tax through December 31, 1996, when it will lapse again. FAA estimates that the money available in the Trust Fund at the end of the year will be sufficient to finance the Trust Fund's portion of FAA's budget until early July 1997.[2] You asked us to examine the issues raised by the coalition's proposal, including (1) whether the ticket tax should be replaced by a different fee system, (2) what the potential competitive impacts of the fees proposed by the coalition airlines would be, and (3) what factors need to be considered if a new fee system were to be developed. Also, at your request, we have updated our April 1996 report on the status of the Trust Fund,[3] including the implications on FAA's budget of reinstating or not reinstating the taxes that finance the Trust Fund. (See app. I.)

[1]In this report, we use the term "user fee" in a general sense to describe either a fee or tax designed to charge users for the costs of government services they consume. Whether the monies are classified as a tax or a user fee affects the congressional committees that have jurisdiction over them. We are not suggesting how the monies collected should be treated for budgetary purposes. It is more appropriate for the Congress to make such determinations.

[2]According to a recent report prepared by the Joint Committee on Taxation (Present Law and Background Information on Federal Transportation Excise Taxes and Trust Fund Expenditure Programs, Nov. 14, 1996), the Trust Fund's cash balance will reach $0 early in fiscal year 1998. This estimate does not distinguish between the cash balance available to pay outstanding commitments and the cash balance available to make new commitments. In contrast, FAA's estimates distinguish between these cash balances. According to FAA, under current law, the Trust Fund cash balance available to make new commitments will reach $0 by early July 1997. Trust Fund money would be available to meet all unpaid commitments made by early July 1997.

[3]Airport and Airway Trust Fund: Effects of the Trust Fund Taxes' Lapsing on FAA's Budget (GAO/RCED-96-130, Apr. 15, 1996).

Results in Brief

As constraints on federal spending grow, the concept of directly charging users for the costs of the government services that they consume is increasingly attractive. Over the past several years, we have noted that commercial users of the nation's airspace should pay their fair share of the costs that they impose on the system, and we have identified some areas, such as the certification of new airlines, where additional fees could be justified. Because the ticket tax is based on the fares paid by travelers and not an allocation of FAA's actual costs, it may not fairly allocate the system's costs among the users.

The coalition airlines' proposal to replace the ticket tax with user fees, however, only incorporates factors that would substantially increase the fees paid by low-fare and small airlines and decrease the fees paid by the seven coalition airlines. As a result, the proposal would dramatically redistribute the cost burden among airlines and could have substantial implications for domestic competition.

If the Congress decides to replace the ticket tax with a different fee system, such a system would need to account for the wide range of costs incurred by FAA in managing the airport and airway system, which vary greatly by the amount, type, and timing of various airline operations. In addition, the views of all affected parties—not just any particular group of airlines—would need to be included in assessing the mechanisms for financing the airport and airway system. Recognizing this, the Congress in October 1996 established a 21-member commission to study how best to meet FAA's financing needs.[4] Such a broad-based study will help ensure that, in the long-term, FAA has a secure funding source; 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 have come from a tax on domestic airline tickets. The remainder of the Trust Fund is 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

[4]The commission was created by the Federal Aviation Reauthorization Act of 1996 (P.L. 104-264).

gasoline, and a 17.5-cents-per-gallon charge on purchases of noncommercial jet fuel.

Ticket Tax May Not Fairly Allocate the System's Costs Among Its Users

FAA is responsible for a wide range of functions, which range 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 the agency's services. 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.[5] 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. 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.[6]

Because the various taxes that make up the Trust Fund are not based on factors that directly relate to the system's costs, the extent to which the current financing system charges users according to their demand on the system is open to question. For example, two airlines flying the same number of passengers on the same type of aircraft from Minneapolis, Minnesota, to Des Moines, Iowa, 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 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.

[5]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).

[6]In 1996, the Congress authorized FAA to collect $100 million in user fees for (1) air traffic control and related services to nongovernmental aircraft that fly over but do not takeoff or land in the United States and (2) any other services provided to a foreign government. FAA must use up to $75 million of the overflight fees for its fiscal year 1997 budget. Any overflight fees collected above this level must be used for the Essential Air Service Program.

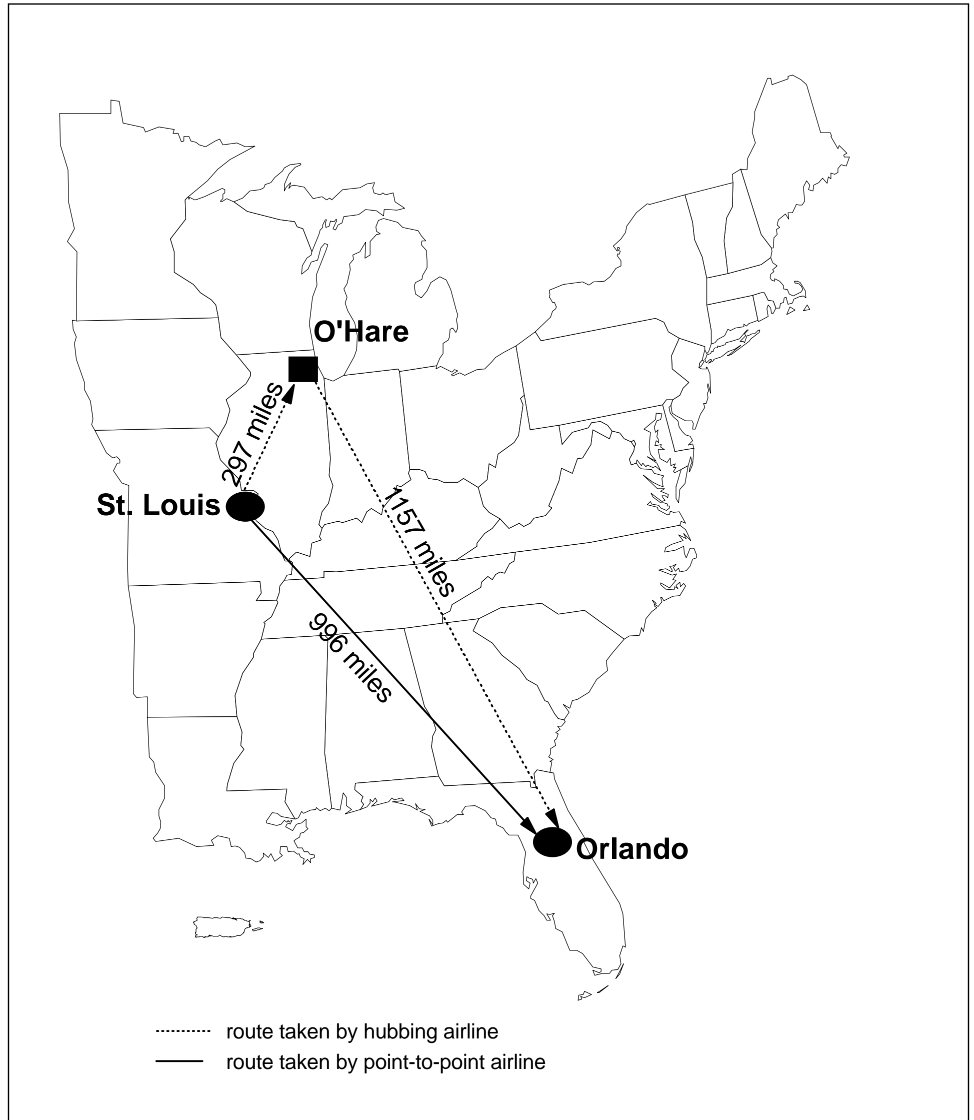
Proposal by Larger Airlines Would Increase the Share Paid by Other Airlines and Have Substantial Competitive Impacts

Motivated by their belief that the current system unfairly subsidizes their low-fare competitors, the nation's seven largest airlines have 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 per seat on jet aircraft with 71 or more seats and $1 per seat on jets and turboprop aircraft with 70 or fewer seats, and (3) $0.005 per nonstop passenger mile.[7]

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, Missouri, and Orlando, Florida, shown in figure 1. The "hubbing" airline first takes the passenger 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.

[7]Air Traffic Control User Fees: A Proposal by the Coalition for Fair FAA Funding, Revised June 7, 1996. The coalition comprises the seven largest airlines—American Airlines, Continental Airlines, Delta Air Lines, Northwest Airlines, Trans World Airlines, United Airlines, and USAir. According to the proposal, the originating passenger is determined on the basis of the beginning point of the trip, irrespective of the number of takeoffs and landings made during the journey.

Figure 1: Comparison of Potential Hubbing and Point-To-Point Service Options Between St. Louis and Orlando



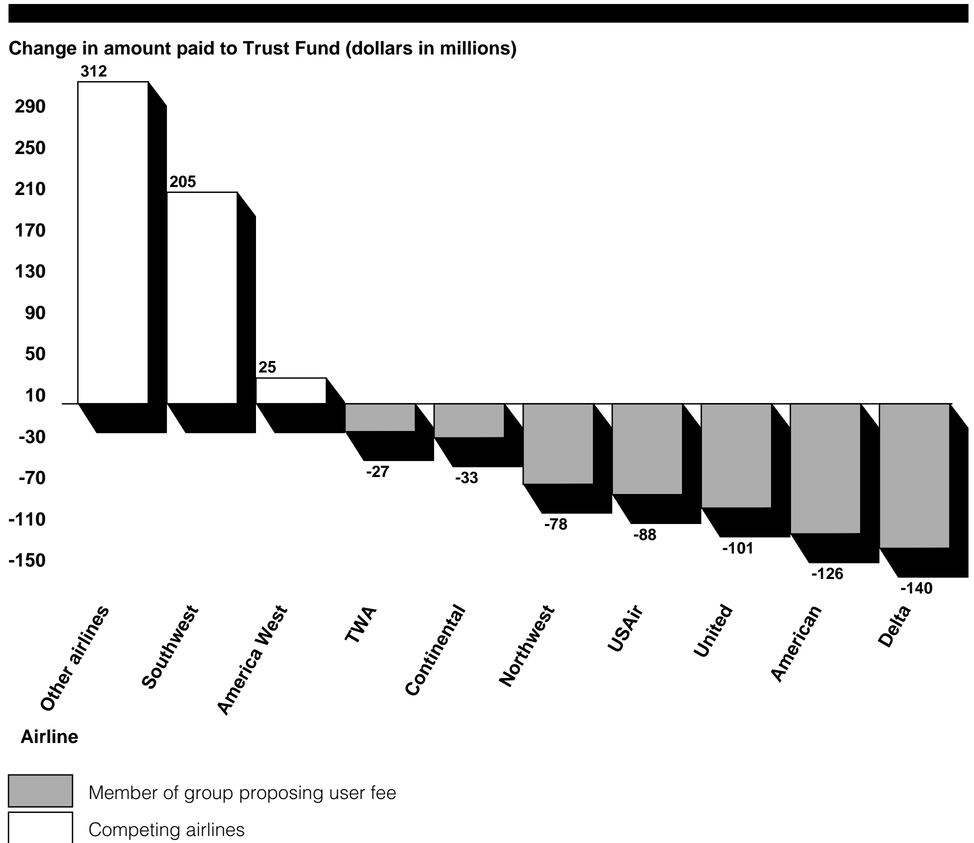
The airline that lands at O'Hare to transfer the passenger to another flight to Orlando has twice as many takeoffs and landings as the airline that flies nonstop between St. Louis and Orlando. As a result, the costs imposed by the hubbing airline on the air traffic control system are greater. However, by charging $4.50 per "originating" passenger, the airline that flies the passenger from St. Louis to Orlando via O'Hare would pay the same amount as the 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 fee system would shift the financial burden away from the larger airlines and onto their competitors. For example, as figure 2 shows, on the basis of FAA’s traffic forecasts for fiscal year 1997, if the ticket tax were replaced by this proposal, the cost to the nation’s seven largest airlines would decrease by nearly $600 million, while the cost to Southwest Airlines, America West, and other low-fare and small airlines would increase by nearly $550 million.

Figure 2: Projected Change in the Amount Paid by Selected Airlines Under Large Airlines' User Fee Proposal Compared With the Ticket Tax, Fiscal Year 1997



Source: GAO's analysis of data contained in the coalition airlines' user fee proposal.

In addition, the coalition's proposal would charge commuter carriers $1 per seat while charging airlines $2 per seat. Most major commuter carriers are owned by or affiliated with one of the coalition airlines; Continental Express, for example, is a wholly-owned subsidiary of Continental Airlines. As a result, by charging commuter carriers less per seat, the proposal would provide the coalition airlines with an additional benefit.

Implementing a proposal that would shift nearly $600 million in costs from one segment of the industry to another could have substantial competitive impacts and needs to be studied first. While the ticket tax might provide low-fare airlines with a competitive advantage, 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,[8] 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 some large airlines with a competitive advantage, might result in higher fares and a reduction in service options for consumers.

In addition, the proposal as written could have a dramatic shift in costs that could affect regions differently. On the one hand, consumers in regions such as the West and Southwest that have benefitted from the entry of low-fare airlines could pay more than they do under the ticket tax. 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.

Nevertheless, 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. In 1995, for example, Southwest accounted for 6.3 percent of the airlines' payments under the ticket tax. In that year, Southwest accounted for 10 percent of the industry's departures and 7 percent of the aircraft miles flown. However, if only these two measures were considered, Southwest's share would not increase to the same extent as under the large airlines' proposal. Under the coalition's proposal, Southwest's share of the industry's contribution to the Trust Fund would increase to 10.3 percent.

A more precise fee system, however, would account for those costs incurred by FAA in managing the airport and airway system, which vary greatly by the amount, type, and timing of various airline operations. For example, the air traffic control costs imposed by a flight arriving at 5 p.m. at New York's congested LaGuardia Airport—regardless if that flight involves a large jet or commuter aircraft—are much greater than those imposed by a flight arriving at noon at the noncongested airport in Des Moines. Likewise, hubbing operations at the nation's largest airports increase the peak service demands on the airway system and increase FAA's operating and staffing costs. Neither the 10-percent ticket tax nor the largest airlines' proposal accounts for these factors.

[8]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's O'Hare, Washington National, and New York's Kennedy and LaGuardia. The authority to conduct a single operation during these periods is commonly referred to as a "slot."

Further Study With Broader Input Needed to Determine How Best to Finance FAA

Determining how best to finance FAA involves complex issues, requiring careful examination. In addition, an evaluation of alternative financing for FAA would need to involve the Department of Transportation's (DOT) Office of Aviation and International Affairs. This office is responsible for evaluating the potential competitive implications of any changes to our aviation system. By changing what each airline pays, any new funding mechanism will have ramifications for airline competition that DOT would be better positioned to examine for the Congress than FAA. Likewise, DOT may also be better positioned than FAA to determine the extent to which a new financing mechanism might otherwise affect the aviation system.

Recognizing the complexities associated with determining how best to finance FAA, the Congress recently directed that the issues involved be studied further. Specifically, the Federal Aviation Reauthorization Act (P.L. 104-264), enacted in October 1996, requires FAA to contract with an independent firm to assess the agency's funding needs and the costs occasioned by each segment of the aviation industry on the airport and airway system.[9] This assessment, which the contractor is required to complete by February 1997, will be a critical piece in designing a new fee system if the Congress ultimately decides to replace the ticket tax.

The 1996 act also created the National Civil Aviation Review Commission, which is charged with studying how best to finance FAA in light of the contractor's independent assessment of funding needs and system costs. The commission is to have 21 members—13 appointed by the Secretary of Transportation and 8 appointed by the Congress—and represent "a balanced view of the issues important to general aviation, major air carriers, air cargo carriers, regional air carriers, business aviation, airports, aircraft manufacturers, the financial community, aviation industry workers, and airline passengers."[10] The commission must report its findings and recommendations to the Secretary of Transportation within 6 months of receiving the contractor's independent assessment—in other words, by August 1997. After receiving the commission's report, the Secretary of Transportation is required to consult with the Secretary of the Treasury and report to the Congress by October 1997 on the Administration's recommendations for funding the needs of the aviation system through 2002.

[9]On November 18, 1996, FAA awarded a $900,000 contract to Coopers & Lybrand to conduct the independent assessment.

[10]The Federal Aviation Reauthorization Act of 1996 (P.L. 104-264, sec. 274(b)).

Agency Comments

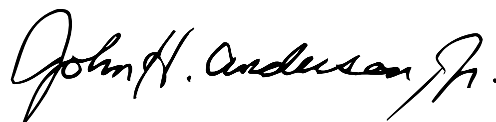
We provided DOT with a draft copy of this report for review and comment. We discussed the draft with DOT officials, including the Deputy Assistant Secretary for Aviation and International Affairs, who stated that the agency was in complete agreement with the report. DOT also provided us with two comments, which we incorporated where appropriate. First, the agency noted that the coalition's proposal also benefits the largest airlines by charging commuter carriers $1 per seat while charging airlines $2 per seat. DOT pointed out that because most of the commuter carriers are owned by or affiliated with one of the coalition airlines, this differential would provide the coalition airlines with an additional benefit. Second, in our draft report, we stated that FAA was completing work on its own cost allocation study, which the agency expected to release by the end of the year. DOT commented, however, that because of the recent congressional mandate that FAA contract with an independent firm to undertake such an assessment, FAA would likely not release its study.

Scope and Methodology

We obtained information for this report from (1) documents and data provided by DOT, FAA, and the coalition airlines and (2) our discussions with representatives of the coalition as well as the executives of several large carriers, including the CEO of American Airlines, and representatives of low-fare and other smaller airlines, including the CEO of Southwest Airlines. For our analysis of the implications of reinstating the taxes, we used the rates in effect as of November 1996. For FAA's funding levels, we used the agency's enacted fiscal year 1997 budget. We performed our review from June through November 1996 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretary of Transportation; the Acting Administrator, FAA; the Director, Office of Management and Budget; and other interested parties. We will send copies to others upon request.

If you or your staff have any questions, please call me at (202) 512-2834. Major contributors to this report are listed in appendix II.



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Status of the Airport and Airway Trust Fund and the Potential Effect on FAA's Budget of the Trust Fund's Taxes Lapsing

During fiscal years 1990 through 1996, the Airport and Airway Trust Fund financed 100 percent of three FAA accounts—Grants-in-Aid for Airports (the Airport Improvement Program); Facilities and Equipment; and Research, Engineering, and Development. Also, during this period, the Trust Fund has, with the exception of fiscal year 1990, financed about half of FAA's fourth account—Operations—and the remainder of this account was financed by the General Fund. Under FAA's fiscal year 1997 budget, as enacted, the Trust Fund would continue to finance 100 percent of three accounts and would finance one-third of the Operations account if the taxes that finance the Trust Fund are extended beyond December 31, 1996.[1] Table I.1 shows FAA's funding sources for fiscal years 1990 through 1996 and FAA's fiscal year 1997 budget as enacted.

Table I.1: FAA Funding, Fiscal Years 1990-97

Dollars in millions

	Fiscal year							
FAA account	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997[a]**
Operations	$3,824	$4,036	$4,360	$4,530	$4,580	$4,572	$4,643	$4,955
(General Fund)	(3,017)	(2,033)	(2,250)	(2,251)	(2,285)	(2,122)	(2,420)	(3,255)[b]
(Trust Fund)	(807)	(2,003)	(2,110)	(2,279)	(2,295)	(2,450)	(2,223)	(1,700)
Percentage from the Trust Fund	21%	50%	48%	50%	50%	54%	48%	34%
Airport Improvement Program (Obligation Limitation)	$1,425	$1,800	$1,900	$1,800	$1,690	$1,450	$1,450	$1,460
Facilities and Equipment	$1,721	$2,095	$2,409	$2,302	$2,055	$1,960	$1,866	$1,938
Research, Engineering, and Development	$170	$205	$218	$230	$254	$252	$186	$208
Total	**$7,140**	**$8,136**	**$8,887**	**$8,862**	**$8,579**	**$8,234**	**$8,145**	**$8,561**
(General Fund)	(3,017)	(2,033)	(2,250)	(2,251)	(2,285)	(2,122)	(2,420)	(3,255)[b]
(Trust Fund)	(4,123)	(6,103)	(6,637)	(6,611)	(6,294)	(6,112)	(5,725)	(5,306)
Percentage from the Trust Fund	58%	75%	75%	75%	73%	74%	70%	62%

Note: Figures represent budget authority adjusted for obligation limitations and rescissions.

[a]FAA's fiscal year 1997 budget as enacted.

[b]Under Public Law 104-205, FAA must use up to $75 million in user fees charged for air traffic control and related services to nongovernmental aircraft that fly over but do not takeoff or land in the United States in lieu of General Fund financing.

Source: FAA.

[1]The Trust Fund is financed from taxes on domestic airline tickets, international air travel from the United States, domestic cargo transported by air, and noncommercial aviation fuels.

If the taxes that finance the Trust Fund are not extended beyond December 31, 1996, the Trust Fund's balance available (referred to as the uncommitted balance) will be below the level needed to finance FAA's fiscal year 1997 budget as enacted. Specifically, the Trust Fund will be about $1 billion short of the funding needed to finance its portion of FAA's fiscal year 1997 budget. Therefore, the total funding commitments that FAA can make are reduced by this amount.

According to FAA's estimates, the Trust Fund could provide about $4.28 billion for FAA's budget and $65 million for non-FAA expenditures, thereby bringing the Trust Fund's total contribution to about $4.35 billion. However, FAA's budget as enacted calls for $5.31 billion from the Trust Fund and $3.26 billion from the General Fund. FAA also estimates that, under current law, the Trust Fund balance available will be $0 by early July 1997 if the taxes are not reinstated (or the tax on airline tickets is not replaced by user fees).[2] Table I.2 shows the Trust Fund's enacted share of FAA and non-FAA budgets and the potential funding shortfall for fiscal year 1997.

[2]According to the Joint Committee on Taxation, the Trust Fund's cash balance will reach $0 early in fiscal year 1998. This estimate does not distinguish between the cash balance available to pay outstanding commitments and the cash balance available to make new commitments. In contrast, FAA's estimates, which are used in our analysis, distinguish between these cash balances.

Table I.2: Trust Fund's Enacted Share of FAA and Non-FAA Fiscal Year 1997 Budgets and Its Potential Shortfall

Dollars in billions

Trust Fund's share of FAA's fiscal year 1997 budget	$5.306
Trust Fund's share of non-FAA expenditures in the Department of Transportation's fiscal year 1997 budget	0.065
Total of Trust Fund's enacted share of fiscal year 1997 budgets	**5.371**
Trust Fund's uncommitted balance at the end of fiscal year 1996	2.366
Enacted fiscal year 1997 rescission of contract authority for fiscal year 1996	0.050
Estimated taxes through December 1996 placed in the Trust Fund before 1997	1.371
Estimated interest on the Trust Fund's balance	0.560
Trust Fund money available to fund FAA and non-FAA programs in fiscal year 1997	**4.347**
Potential shortfall under current law[a]	**$1.024**

Note: FAA's estimates are based on preliminary data for the end of fiscal year 1996.

[a]This shortfall does not include $820 million in unobligated contract authority for the Airport Improvement Program. This amount is the difference between the Airport Improvement Program's fiscal year 1997 obligation limitation level of $1.46 billion and contract authority level of $2.28 billion.

Source: FAA.

Also, the authority to transfer the tax receipts from the Treasury to the Trust Fund will expire on December 31, 1996.[3] As a result, some taxes imposed late in 1996 will not be deposited in the Treasury until 1997 and, therefore, cannot be transferred to the Trust Fund. FAA estimates that this amount will total about $300 million.[4] If the Congress provides transfer authority for moving this $300 million to the Trust Fund, then FAA estimates that the Trust Fund balance available to finance FAA would not reach $0 until late July 1997 and the potential shortfall would be reduced to $724 million.

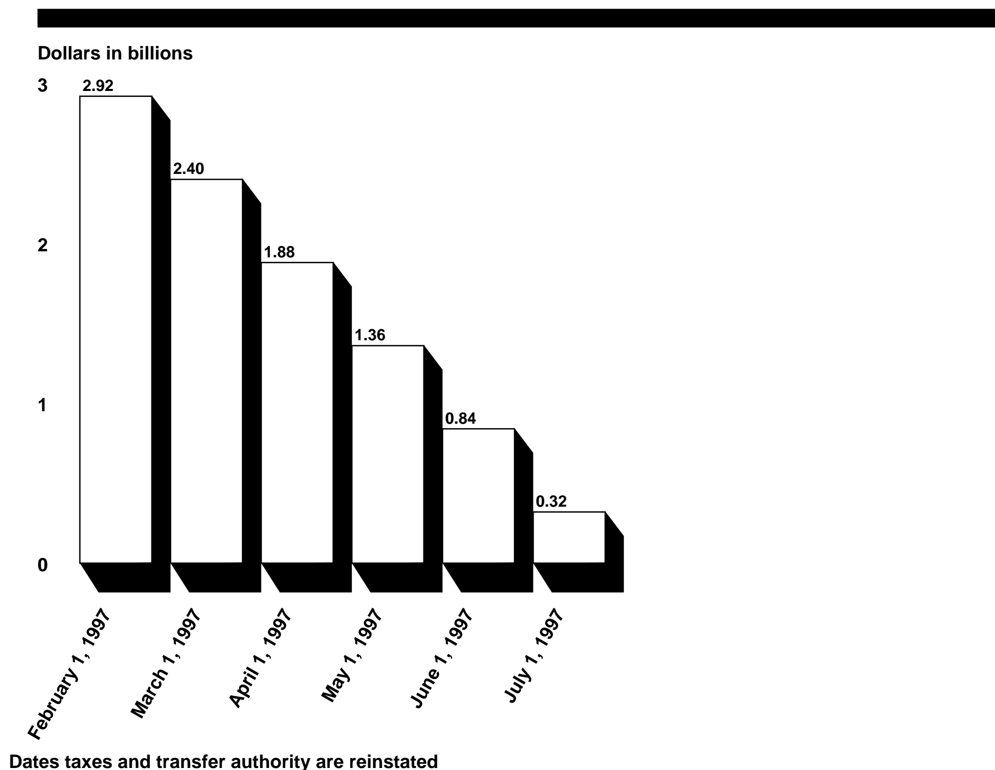
FAA officials estimate that in order for the Trust Fund to finance $5.31 billion of FAA's fiscal year 1997 budget, the taxes would need to be reinstated by July 1997. However, according to FAA officials, reinstatement

[3]Without transfer authority, the tax receipts remain in the General Fund.

[4]When the taxes and transfer authority lapsed on December 31, 1995, $205 million of the taxes imposed in late 1995 were deposited in the Treasury in 1996. This money was transferred from the Treasury to the Trust Fund after the Congress temporarily reinstated the transfer authority in August 1996.

by this date allows for almost no margin of error in the agency's estimates of tax revenue. Consequently, if revenue is less than estimated, congressional action would be required to obtain additional financing from the General Fund. Also, the Trust Fund balance available to finance FAA's fiscal year 1998 budget would depend on when the taxes and transfer authority are reinstated, as shown in figure I.1.

Figure I.1: Trust Fund's Uncommitted Balance at the End of Fiscal Year 1997 to Finance FAA If the Taxes and Transfer Authority Were Reinstated by Various Dates



Note: These balances do not reflect the $820 million in unobligated contract authority for the Airport Improvement Program. If the obligation limitation level were increased to include the $820 million, the balances would decrease by that amount. Also, these balances reflect some spending on non-FAA programs, including Essential Air Service and rent to the General Services Administration.

Source: FAA.

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