

Leigh|Fisher

Aviation Policy, Taxes and the FAA's Future

TRB Executive Committee

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FAA Management Advisory Council

Membership that served three-year terms between 2011 and 2013

Management Advisory Council (MAC)

Public Law 104-264, The Federal Aviation Reauthorization Act of 1996, Sec 230, mandated the Council. The law was further amended by PL 106-181, Sec. 300.

The MAC provides the FAA Administrator general advice from a broad spectrum of aviation interests. The council functions as an oversight resource for management, policy, spending and regulatory matters.

- Juan J. Alonso, Stanford University
- David J. Bronczek, FedEx Express
- Lynn Brubaker, Consultant
- Russell A. (Chip) Childs, Skywest Airlines
- Gina Marie Lindsey, LAX
- James C. Little, TWU
- Jack J. Pelton, Cessna
- Steven Pennington, USDOD*
- John D. Porcari, USDOT*
- Steven Predmore, jetBlue (to 2012)
- Ramon Ricondo, Ricondo Assoc. (Chair)
- Paul Rinaldi, NATCA
- Stephen D. Van Beek, LeighFisher

** Note that public members do not advocate*

Recent Budget Woes: FAA

It has been a rough four years...

1. **Partial Shutdown (FY 2011):** FAA Authority lapses, 4,000 FAA employees furloughed, \$400 million in lost revenue for the Airport and Airway Trust Fund (AATF).
2. **FAA Reauthorization (FY 2012):** H.R. 658 passes after 23 temporary extensions of authority. Status quo bill does little to resolve long-term funding issues and policy developments for the FAA.
3. **Sequestration (FY 2013):** A week of furloughs, including controllers for one day per pay-period, resulting in a loss of capacity at towers. \$253 million transferred from “protected” AIP account to fund operations.
4. **Sequestration (FY 2014 – FY2021):** Budget deal and easing of discretionary spending targets appears to head-off sequestration cuts for FY2014 and FY 2015.

Budgetary problems fall so heavily on aviation due to the expansive roles played by the FAA

The USDOT/FAA and Aviation Policy in the USA

FAA is regulator, operator and funder of the aviation system

- **National Aviation System:** Extensive, cross-subsidized and publicly supported. Airports, rural access and general aviation all prioritized in unique ways.
- **Air Traffic:** Largest national system in the world (e.g., > 500 towers), which support extensive domestic and international commercial and general aviation operations.
- **Airports:** System of airports supported by Airport Improvement Program and ATC operations. USA program unprecedented in providing support to >2000 airports annually, favoring smaller airports. Infrastructure supported by tax-exempt debt, which together with FAA grant assurances provide the basis for extensive regulation and limited use of private capital.
- **Certification:** Responsibility to certify commercial and private aircraft.

Background

Aviation Policy Reform and FAA Reauthorization

The current authorization expires September 30, 2015

- **Policy:** Notwithstanding the dramatic changes in aviation over the past 15 years (i.e., airline consolidation, globalization, more efficient aircraft), the basic policy framework has changed little. We need a modern policy regime and a reinvigorated FAA to support the system, not burden it.
- **Funding Capacity:** There is insufficient AATF revenues to support FAA needs. The effect is to make the system more reliant on unpredictable taxpayer money. This reality has contributed to furloughs, loss of system capacity and inadequate investment (for programs such as NextGen and airport capacity).
- **Taxes and Fees:** The tax system underlying aviation is a mess. A myriad of fees for FAA – as well as for homeland security and customs -- are confusing, weigh down the industry, and in many areas provide insufficient capital. We need to (1) rebuild the policy architecture and (2) insulate it from day-to-day politics and budget pressures.

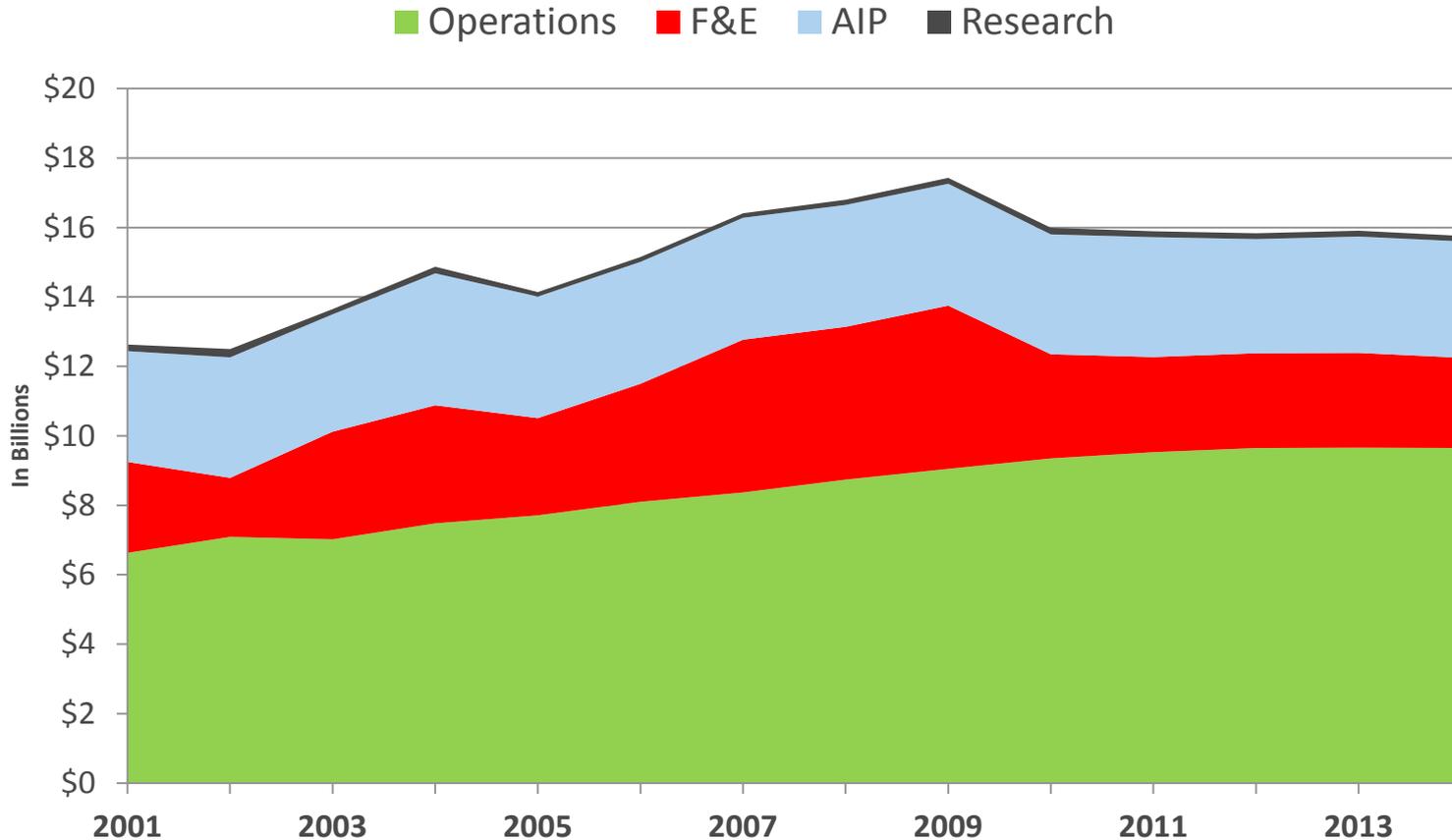
The Funding Dilemma: The FAA & Airport and Airway Trust Fund

The AATF was similar in design and intent to the Highway Trust Fund

- ***The Airport and Airway Trust Fund*** was created over 40 years ago to provide a stable source of funding for FAA capital needs and airport infrastructure with the remainder supporting FAA operations (together with the general fund).
- For decades this effectively dealt with a system funded by annual appropriations and one where those in charge lack both a capital budget and access to the financial markets.
- As long as industry revenues kept pace with system needs (principally through system growth)-- **and taxpayer funds were available annually to fund the difference between FAA needs and industry revenues** -- the FAA could effectively operate, plan and invest.
- Changes in the aviation industry coupled with the continuing pressures on the federal budget mean that this “funding system” no longer meets its original intent of providing stable funding.

FAA Finances: Major Program Functions 2001-2014

Overall Budget levels and FAA Operations growth has squeezed FAA's capital accounts

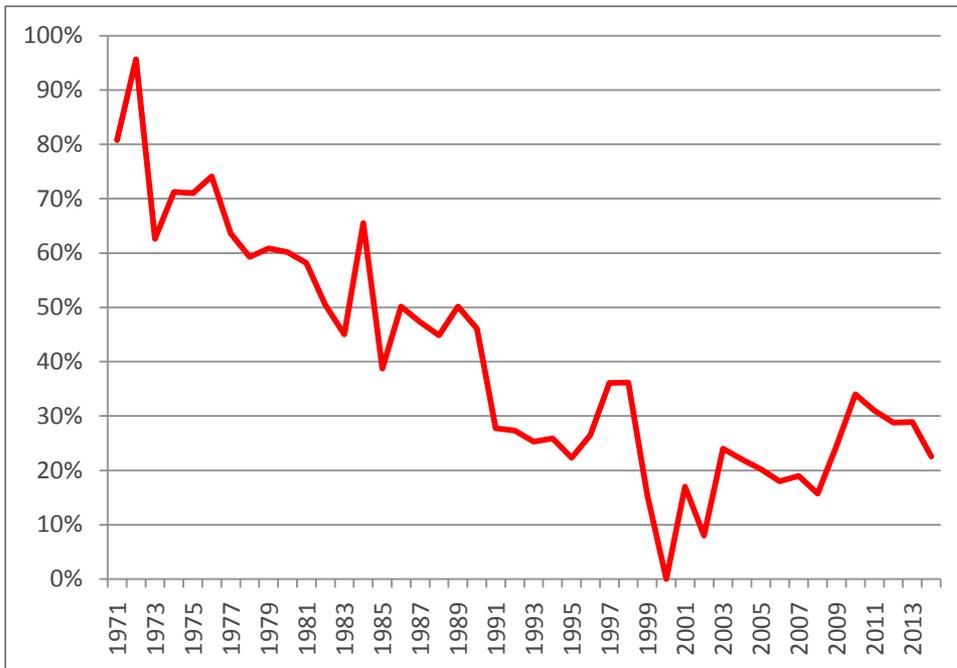


FY2014 spending levels are from the Omnibus Appropriations bill being voted on today.

The Historic and Future Role of Taxpayers in Funding the FAA

Other than through the Obama Stimulus Program, General Fund Trending Down

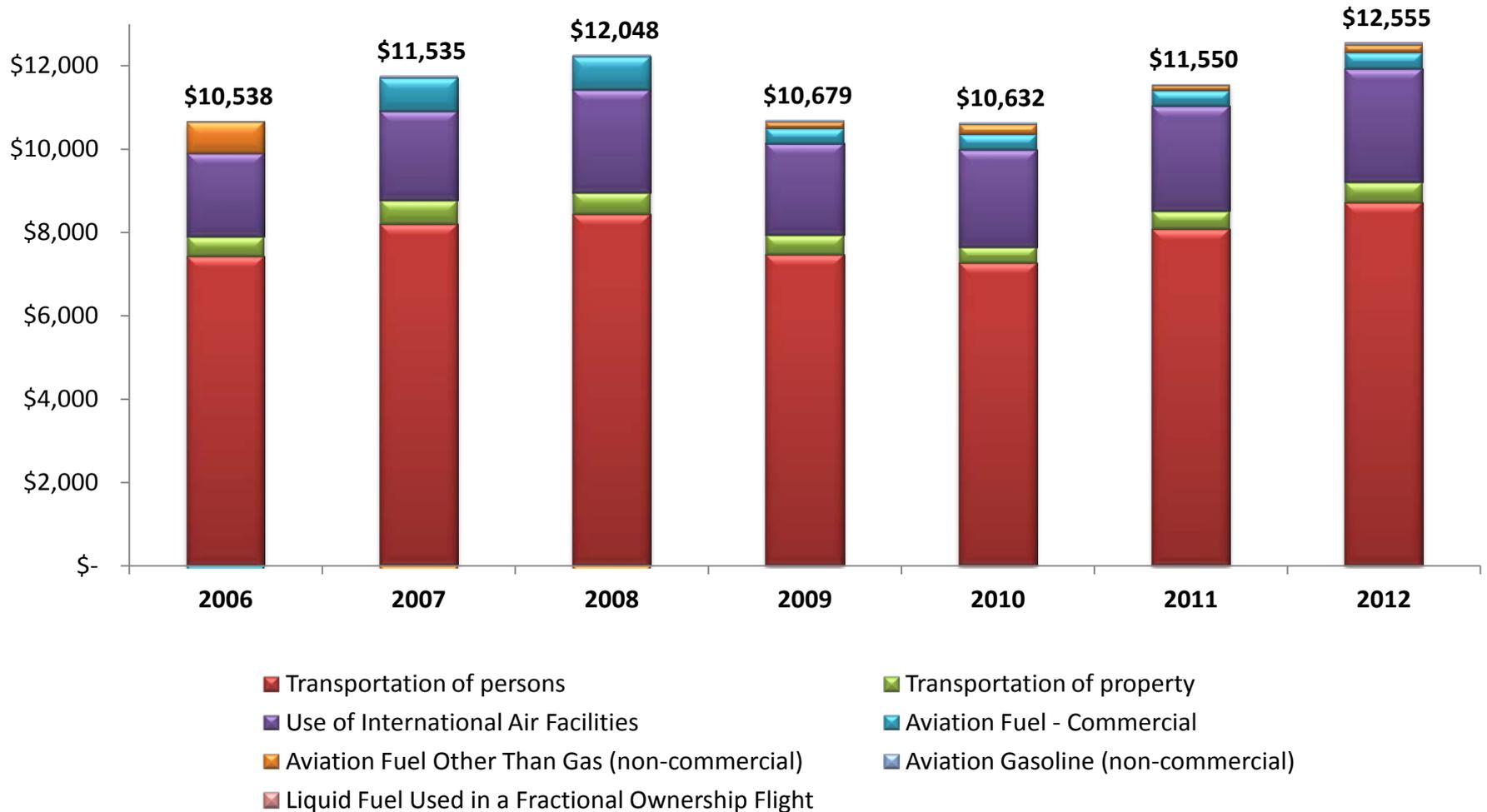
Taxpayers' Share of FAA Budget (1971-2014)



Pressures on Taxpayer Spending 2014 - ?

- Large budget deficit and national debt
- Politics right now favoring “shared sacrifice” or across-the-board cuts
- PAYGO (Senate) and CUTGO (House) rules enforce discipline and pressure spending
- With Trust Fund financial issues, infrastructure spending now widely perceived as “discretionary”
- Other transportation priorities including highways, transit and rail all lack sufficient dedicated revenues (or dedicated revenues at all), requiring taxpayer funding if they are to be continued

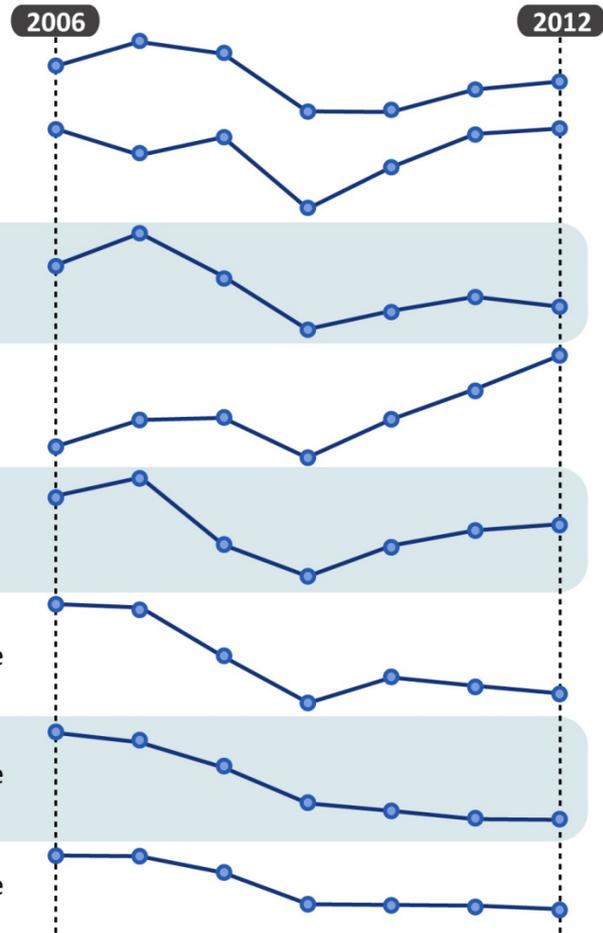
Gross AATF Revenues by Fiscal Year (millions)



Source: FAA

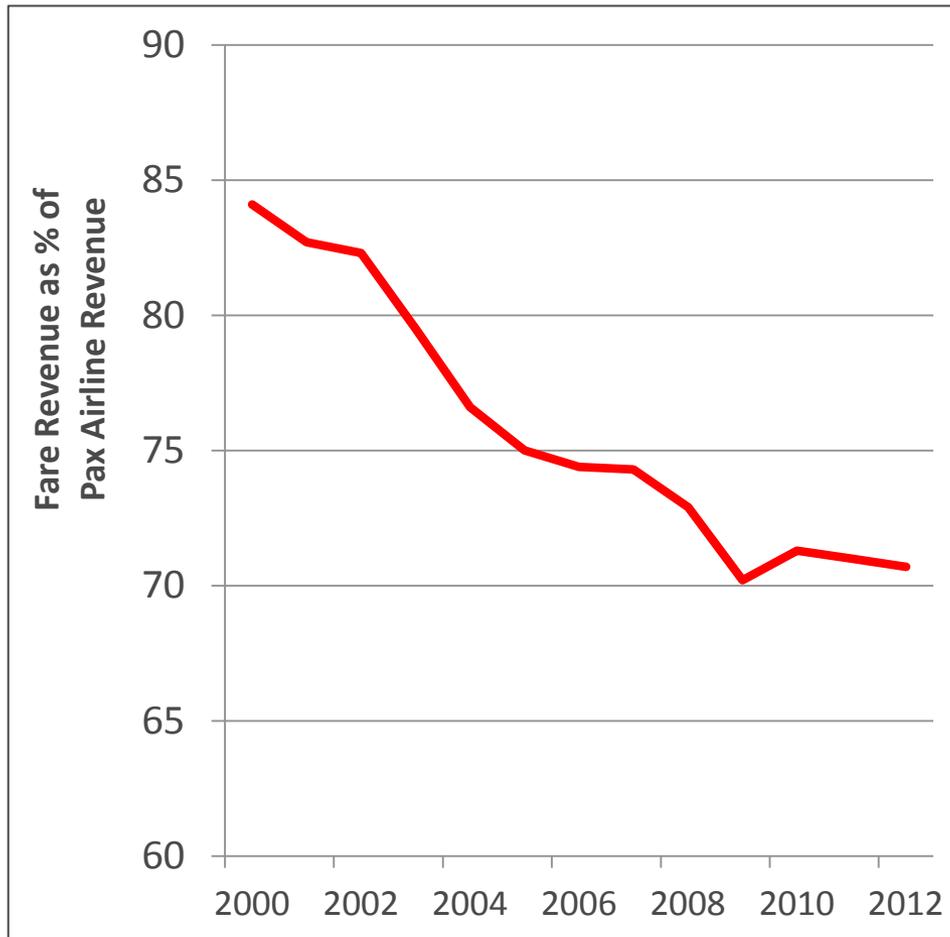
AATF Ticket Taxes: Structure and Trends

| Tax | Description | Adjusted? | Driver | 7 Year Trend (absolute values) |
|---------------------------------|--|------------|--------------------------------------|--|
| Domestic Passenger Ticket Tax | 7.5% of ticket price | Ad Valorem | Enplanements and Fare Price |  Flat |
| | | | Average Airfare Price (2013 Dollars) |  Flat |
| Domestic Flight Segment Tax | \$3.90 per segment | CPI | Domestic Segments |  Flat |
| Int'l Arrival and Departure Tax | \$17.20 | CPI | International Passengers |  Growth |
| CONUS to/from Alaska or Hawaii | \$8.60 | CPI | Enplanements to/from AK/HI to CONUS |  Flat |
| Domestic Cargo | 6.25% of Freight Value | Ad Valorem | Cargo Value and Volume |  Decrease |
| GA Fuel Tax | Avgas: \$0.193/gallon Jet: \$0.218/gallon | No | Operations |  Decrease |
| Commercial Fuel Tax | \$0.043/gallon | No | Operations |  Decrease |



Airline ticketing practices constraining FAA revenue collections: Fares as a Percentage of Airline Revenue (2000-2012, BTS)

Drop in taxed proportion of airline revenues further jeopardizes the Trust Fund



- Ancillary fees growing at >15% per year.
- The drop in taxed airline revenue costing the NAS >\$500m annually
- Airline ticketing practices, rather than system use, increasingly determining how much airlines provide for NAS capital needs, AIP and other needs.
- Airlines such as Southwest and jetBlue which have more of their tickets taxed are discriminated against by existing policy.
- Even with modest system growth, AATF revenues will grow more slowly due to the relative decline of fare revenue.

Stop Air Tax Now

... Think about what you buy—milk, electronics, clothing, etc. None of these goods is taxed at a rate of 20 percent... Airlines are taxed as a sin, at a higher rate than alcohol, tobacco and firearms. Yet we are not a sin ...

(Jeff Smisek, President and CEO, United Airlines, *Hemispheres*, November 2011)

Confusing 'Sin' Taxes and Fixed Costs

... The federal ticket tax and segment fee go almost entirely to running the FAA and the air traffic control system, the airlines' equivalent of other industries' "production line" ... If the airlines built and operated their own airports and air traffic control system and still paid 21% in special taxes that went into the U.S. Treasury and local governments' general funds, they would have a point, but they don't ...

(Chip Barclay, President AAAE, *Aviation Daily*, May 27, 2010)

User Fee Example: EUROCONTROL Enroute Charge January 2011 Brussels to Copenhagen (A-319)

Cost of collection 0.3%, Recovery at 99% +

| Sector | Distance Factor | | Weight Factor | | Rate 2010 | = | Charge (Euro) |
|-----------------------|-----------------|---|---------------|---|-----------|---|-----------------|
| Belgium | 0.29 | X | 1,18 | X | € 76.59 | = | € 26.21 |
| Netherlands | 3.03 | X | 1,18 | X | € 65.81 | = | € 235.30 |
| Germany | 2.19 | X | 1,18 | X | € 71.99 | = | € 186.04 |
| Denmark | 2.14 | X | 1,18 | X | € 67.90 | = | € 171.46 |
| Total Charge = | | | | | | | € 619.01 |

Unit charges available at:

http://www.eurocontrol.int/crco/public/standard_page/information_circulars.html

The Work of the FAA MAC

FAA Policy: MAC Criteria to Analyze Tax and Funding System

Factors to consider given past efforts at reform

1. Funding Sufficiency/Sustainability:

Does the system enable long-term capital planning and provide the \$\$ to operate and upgrade the system? **No. Draconian choices have limited operations and investment and pushed the problem into the future.**

2. Tax Incidence:

How does the burden of taxes and fees fall upon the users of the system (i.e. airlines with different business models, general aviation users)? **Unfairly. System is not equitable even for similarly situated users (and getting worse).**

3. Market Signals:

Does the method of revenue collection provide the “proper” incentives for the system to operate effectively (e.g., efficiency, maximize capacity, equity)? **No. Market signals not used.**

4. Public vs. Private Roles and Benefits:

How are the public benefits of aviation captured in the funding model? Should they be captured with a public contribution knowing that this will insert Congress into at least parts of the FAA’s business? **Taxpayers (sometimes) pay the difference between FAA’s budget request and AATF revenues--no rationale for public contribution.**

5. Governance Reform:

Is it necessary and/or advisable to link funding reform with the possible FAA reform? **According to users it is the only way.**

FAA MAC: Four Reform Principles for Aviation Policy

Industry Members of the FAA MAC Unanimously Agree on this Future Path

- 1. *Create a sustainable financial future for the FAA:*** The most important goal is to establish a funding system that provides dedicated and sufficient user-based revenues to pay for FAA obligations. MAC members believe that general fund support for the aviation industry should be phased out as soon as possible in order to insulate the agency and the provision of user services from day-to-day politics.
- 2. *Separate a new commercialized Air Traffic Organization (ATO) from the FAA:*** Modeled after other Air Navigation Service Providers (such as NAV CANADA), separate the service-oriented ATO from the FAA and appoint a board consisting of users and aviation stakeholders to oversee its work. MAC members strongly believe that ***ATO reform must be accompanied by overall aviation policy reform*** due to the links between policy and funding decisions.
- 3. *Assess and codify FAA Authorities and programs:*** Simplify statutes, regulations and policy by reviewing existing rules and procedures and eliminating redundant regulatory oversight. MAC members believe that this process will result in significant savings to the FAA and will obviate the need for a near-term increase in user revenues after the phase-out of general fund support.
- 4. *Reform the tax structure:*** Eliminate the current mix of AATF taxes and fees and replace it with transparent schedules of cost-based fees that provide sufficient funding for services such as air traffic control and aircraft certification. MAC members believe that new schedules should be (1) “revenue neutral” and (2) flexible in their administration in order to gain the confidence of stakeholders and facilitate the transition to a new system.

Organizational Models for ATO/FAA Reform

The variety of ANSP models offer examples for the constituent elements of reform

| Nation | Air Navigation Service Provider | Ownership | Funding (Charges) | Access to Markets | Comments |
|-----------------------|---|--|-------------------|-------------------|--|
| Australia (1995) | Airservices Australia | Government Corporation | User Fees | yes | Minister of Transport appoints board |
| Canada (1996) | NAV CANADA | Private, non-profit, non-share corporation | User Fees | yes | Unions appoint 2 board members, balance by airlines, airports, government |
| France (2005) | Direction des services de la navigation aerienn | Government Department | User Fees | yes | Most like the FAA, only user fees and access to markets really distinguish |
| Germany (2007) | Deutsche Flugsicherung GmbH | Government Corporation | User Fees | yes | Uses ICAO principles of cost recovery for fees |
| Netherlands (1993) | Luchtverkeersleiding Nederland | Independent Government Agency | User Fees | yes | Receives some government support for services exempt from fees |
| United Kingdom (2001) | National Air Traffic Services, Ltd. | Public private partnership | User Fees | yes | Government owns 49%, balance owned by airlines, airports, employees |
| United States (2004) | FAA Air Traffic Organization | Government Department | Taxes | no | Uncertain funding results in inability to confidently invest |

The Birth of NAV CANADA: An Example for South of the Border?

From “Air Traffic Control Commercialization Policy: Has It Been Effective” mbs ottawa, inc. (2006)

In 1991, Canada associations representing airlines, business aviation, pilots and air traffic petitioned the government to change the organizational arrangements for air navigation services:

“... the present air traffic control system is not serving the interests of the traveling public, pilots, the aviation industry and is creating a progressively higher level of frustration in employees working the system who wish to perform a professional service.... We believe that these issues reflect fundamental deficiencies in Canada’s current organizational arrangements for air navigation. Stress on the system would be reduced in an environment where managers had greater operational freedom and access to revenue that allowed them to respond to changing requirements.”

Over the last two years, FAA MAC members, representing a similar cross section of the USA industry, have come to believe that similar reforms are necessary here.