

The Aviation Trust Fund: *Revenue Growth at a Time of Shifting Policy*



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Airport and Airway Trust Fund
Revenue Growth at a Time of Shifting Policy

Executive Summary:

Over thirty years ago the Airport and Airway Trust Fund was established to ensure adequate capital investment in the nation's aviation infrastructure. Since its inception, the U.S. has used the Trust Fund to make capital improvements: investing in airports, air traffic control facilities & equipment, and research & development.

The structure Congress set up for the Trust Fund permitted surpluses to build over time to allow for capital spending. Over the years, this revenue stream provided consistent growth with few exceptions—those exceptions or fluctuations in revenues can be attributed to external factors, such as economic or policy decisions. This surplus, or “uncommitted balance,” has allowed the Trust Fund to provide stable funding through those brief periods of revenue decline. This policy choice to invest in our nation's aviation infrastructure has resulted in the most accessible, affordable and efficient aviation system in the world.

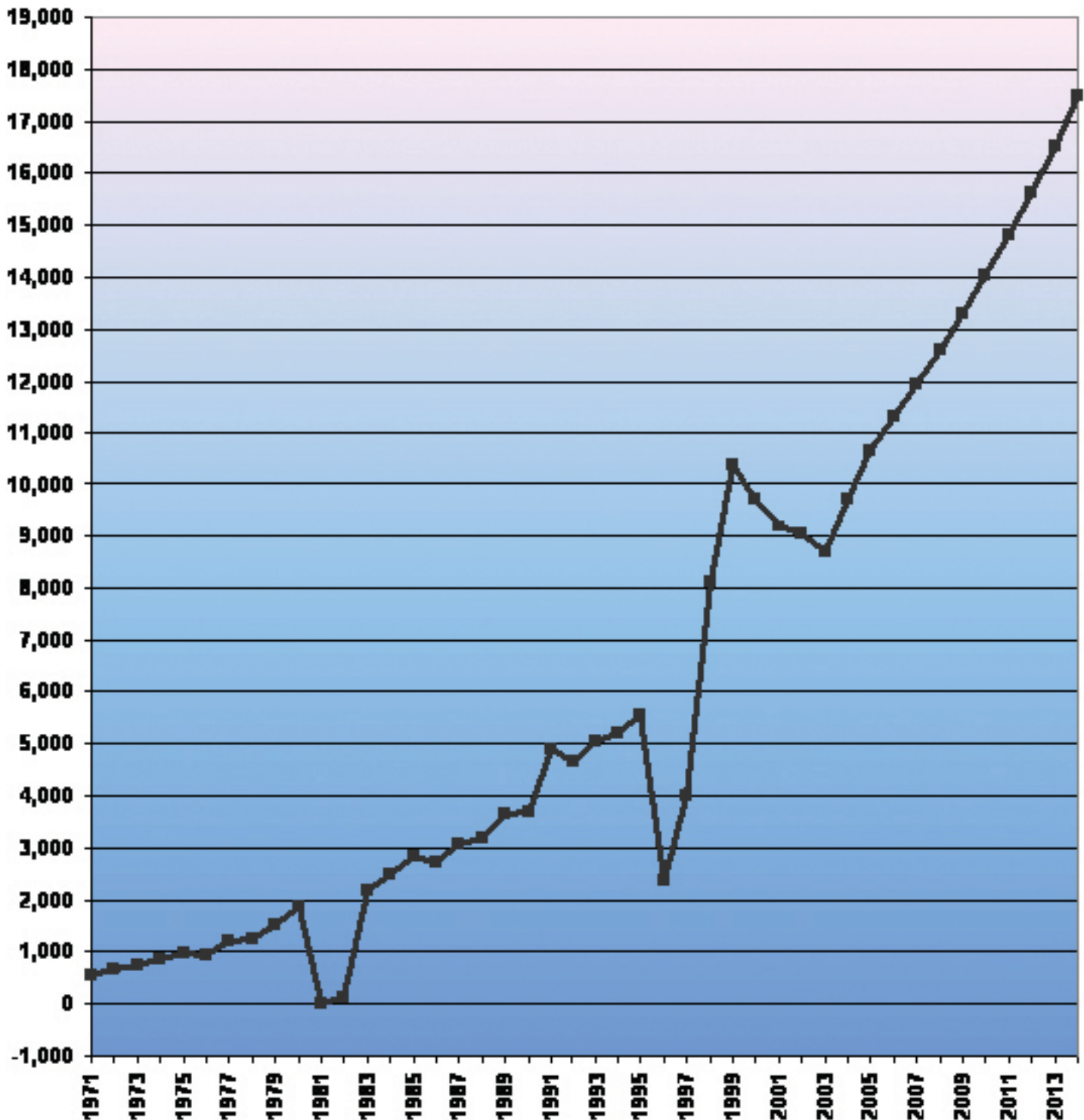
Recently, Administration and Congressional officials have stated publicly that Trust Fund revenues are declining and will probably continue to decline over the foreseeable future. In short, their view is that the Trust Fund cannot meet aviation's demands of the future. The swift acceptance of these positions of the Trust Fund as an inadequate, long-term funding mechanism has led to discussion of other possible models to fund the FAA.

Our findings indicate that contrary to some assumptions that have been stated on the record, the Trust Fund revenues are not declining. While the Trust Fund revenue did experience a temporary period of decline from 2000 through 2003, revenues rebounded in 2004. Indications are that the Trust Fund revenues are increasing and growth is projected to continue.

The stated issue of declining Trust Fund balances seems to be one of policy rather than revenue. The funding mechanism was designed to include FAA operations funding from the general treasury as recognition that there is a significant national interest in maintaining and operating our air traffic control system. The Administration's recent budget submission to Congress for FY06 has projected the percentage of funding from the general treasury is limited to 13% of operations, which represent historically low levels. A shift to increase the percentage of the costs from the general treasury to the Trust Fund is a substantial change in policy that will reduce the Trust Fund's uncommitted balance even though Trust Fund revenues are increasing. Any policy decision of this magnitude should be the topic of free and open debate. This policy change should not be presented under the pretence of a revenue shortfall.

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Aviation Trust Fund Revenues (in Millions)



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Statutory Overview

The Airport and Airway Revenue Act of 1970 established the Airport and Airway Trust Fund for the purpose of funding the development of a nationwide airport and airway system and to fund investments in air traffic control facilities¹ in order to meet the current and future projected growth in aviation. The Act allowed aviation related excise taxes to be deposited in a trust fund for aviation activities. The primary taxes on passenger tickets and aviation gasoline were already in existence (since 1941 and 1932 respectively) and were previously deposited into the general fund. The Act created three new taxes on international tickets, air-freight waybills, and aircraft registration.

The Airport and Airway Trust Fund expired on October 9, 1980 at which point aviation-related excise taxes could no longer be deposited into the fund leaving only the accumulated surplus from previous years. The Airport Improvement Act of 1982 re-established the Airport and Airway Trust Fund and deposited \$134 million into the fund.

The Omnibus Reconciliation Act of 1990 increased the passenger ticket tax from 8% to 10% of the fare, increased the cargo tax from 5% to 6.5%, and increased the rate for noncommercial jet fuel from 14 cents to 17.5 cents per gallon.²

In 1994 and 1996, a series of short-term reauthorizations extended the expenditure authority from the Trust Fund until January 1, 1997 when the authority lapsed and was not reinstated until October 1, 1997, with the passage of the Taxpayers Relief Act of 1997. This Act reinstated the aviation excise taxes for ten years and set rates for taxes, gradually reducing domestic passenger tax rate to 7.5% by 1999 while increasing flight segment fee to \$3.00 by 2002 and indexing for inflation starting in 2003. The act also set

¹ Government Accounting Office, *Airport and Airway Trust Fund*, (Washington, DC: GPO, 2003).

² Henry, Eric, *Excise Taxes and the Airport and Airway Trust Fund 1970-2002*, (Washington, DC: Statistics of Income Bulletin, 2003).

rates and indexing for the international passenger ticket tax, rural passenger taxes, special taxes for flight to Hawaii and Alaska, added other miscellaneous aviation related excise taxes and shifted the 4.3-cent per gallon aviation fuel from the general fund to the Trust Fund.

The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, enacted in April of 2000, substantially increased the annual funding for the Airport Improvement Program (AIP). It was intended to ensure that all revenue from aviation related taxes was spent on aviation programs through 2003. It allowed airports to raise passenger facility charges up to \$4.50 and increased both the minimum and maximum annual funding available to large airports as well as raising the state apportionment and guaranteeing funding to general aviation airports for the first time.

The Trust Fund provides 100% of the funding for FAA airport grants (AIP), facilities and equipment, and research, engineering and development. Funding from the Trust Fund as well as an appropriation from the General Fund supports FAA Operations. The percentage of Federal Aviation Administration operations that has been funded from Trust Fund revenue has fluctuated from year to year from 0% to 100% depending on Congressional Action.³ Trust Fund revenue is currently supported by ten dedicated excise taxes:

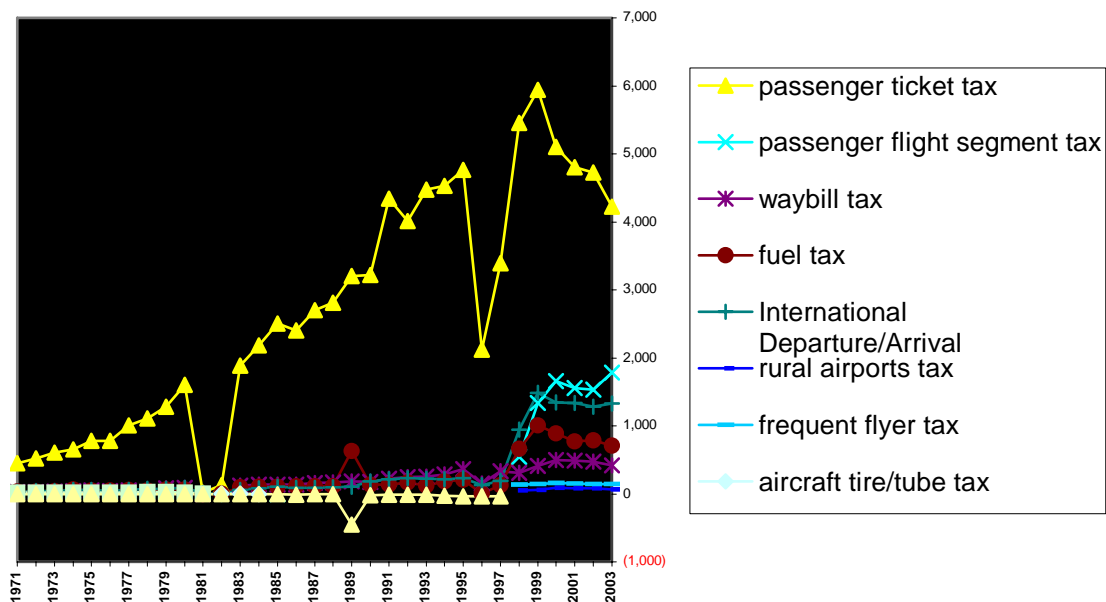
- 7.5% tax on the price of domestic airline tickets
- 7.5% tax on the value of awards of free or reduced-rate airfares (frequent flyer tickets)
- 7.5% tax on the price of domestic airline tickets to “qualified rural airports” (flight segment fees do not apply if this tax is levied)
- \$3 on each flight segment, indexed to inflation starting in 2003⁴
- 6.25% tax on the price charged for transporting cargo by air
- \$0.043 per gallon tax on commercial aviation jet fuel

³ Federal Aviation Administration, *Airport and Airway Trust Fund (AATF)*, 2004.

⁴ In 2004, the flight segment fee increased to \$3.10

- \$0.193 per gallon tax on general aviation gasoline
- \$0.218 per gallon tax on general aviation jet fuel
- \$13.40 tax on international arrivals, indexed to inflation⁵
- \$13.40 tax on international departures, indexed to inflation

Figure 1: Airport and Airway Trust Fund Revenue by Source⁶



data source: ATA Analysis of FAA Budgets in Brief

As you can see from the chart in Figure 1, since its inception, there have been fluctuations in Trust Fund revenue, minor fluctuations are likely the result of economic cycles, however, major fluctuations can be attributed to external factors including policy decisions. From 1981-1982, the Airport and Airway Redevelopment Act of 1970 expired causing the authority to transfer revenue from the excise taxes to the Trust Fund to lapse and in 1996 the ticket taxes expired awaiting congressional action on FAA reauthorization (which included the authority to collect the tax). These fluctuations are the result of policy actions, or inaction, that affected the treatment or collection of

⁵ In 2004, the International Departure and Arrival Taxes were \$13.70

⁶ There have been structural changes in the AATF since its inception, creating and eliminating certain types of taxes; all types of taxes have not necessarily been in effect every year.

revenue and not necessarily the general availability of the funding from the source. Smaller fluctuations are more likely source based rather than policy based as can be seen as a result of temporary declines in air travel, including those as a result of the 1991 Gulf War and the September 11 terrorist attacks and subsequent war in Iraq. However, as the fluctuations have been temporary in nature, the structure of the Trust Fund, permitting structural surpluses, has allowed funding for aviation programs to continue with steady funding levels.

The percentage of the FAA operations that is funded from Trust Fund revenue (and conversely the amount of Trust Fund revenue that is expended) is determined by Congress and has been subject to a number of policy and statutory restraints. From 1982 to 2000, Trust Fund based funding of operations was limited by tying it to levels of capital investment funding. Under the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR 21), specific limitations were put on distribution of Trust Fund revenues specifically requiring that the Airport Improvement Program (AIP) and Facilities and Equipment (F&E) receive Trust Fund allocations under a formula before an allocation for operations is made, and data from 2004 to 2012 (projections) are based on the FY05 President's budget. The projected percentage of funding from the general fund is limited by the President's proposal to 13% of operations, which represents historically low levels.

The question of appropriate use of the Trust Fund is not new. From 1973 to 1976 the Trust Fund was prohibited from financing FAA operations and maintenance. In 1976, Congress capped the amount of Trust Fund revenue available for operations and maintenance and included a penalty clause, which remained in place until 1990. In 1984, the annual appropriations bill specified that only general treasury funds would be used for FAA operations. In February of 1999, the General Accounting Office responded to an inquiry from Representative Frank R. Wolf, Chairman of the Transportation and Related Agencies Subcommittee of the House Appropriations Committee, who asked the General Counsel's office to review the legislative history and advise whether the Airport and Airway Trust Fund was created solely to finance aviation infrastructure.

The GAO isolated several pertinent parts of the Act, specifically referencing section 208 (f) (1) (B) which stated that Trust Fund balances could be used for “planning, research and development, construction or operation and maintenance of – (i) air traffic control, (ii) air navigation, (iii) communications, or (iv) supporting services for the airways system.” The GAO concluded in its response to the inquiry:

The trust fund as it was enacted in 1970 was not created solely to finance aviation infrastructure. Throughout its history, it has financed some non-infrastructure expenses, such as administrative expenses incident to the administration of the airport development program and research and development. With the exception of the time period during fiscal years 1973-1976, it has also funded some costs of maintenance and operation of air navigation facilities.⁷

While earlier debates focused on whether the Trust Fund could be used to fund portions of FAA operations, more recent debates focus on whether the Trust Fund should provide the sole source of funding for FAA operations. This dramatic shift in how the Trust Fund is viewed with regard to operations funding has sparked recent debate about the long term viability of the Trust Fund.

In November of 2004, Chief Operating Officer of the FAA Air Traffic Organization Russ Chew stated that, the amount available from the aviation trust fund is falling, and increasing pressure on the General Fund means top-up money will be harder to justify.⁸ This treatment of a General Fund contribution as “top-up” or extra funding for operations illustrates a new philosophical view of how the Trust Fund is to be treated with regard to operations funding. Further evidence of this philosophical shift is seen on press coverage of FAA funding issues in late 2004. Ken Mead, Department of

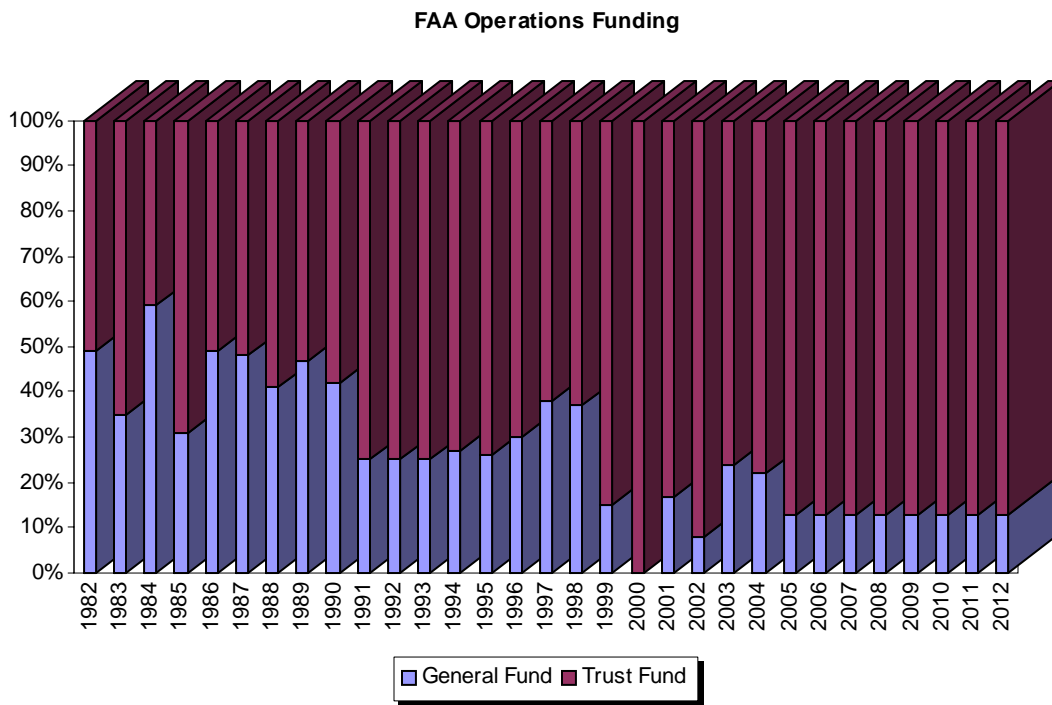
⁷ Robert P. Murphy, General Counsel, General Accounting Office, Correspondence February 12, 1999.

⁸ Adrian Scofield, *Chew Says More Cost Controls Needed to Match Revenue Drop*, Aviation Daily November 5, 2004

Transportation Inspector General said, “When trust-fund revenues are less than the FAA budget, the President’s proposal and Congress’ appropriation can make up the gap with money from the general fund, allocation of trust-fund surpluses built up in previous years, or a combination of both.”⁹ Russ Chew was reported as saying that in order to match revenue predictions the ATO operating budget would have to be reduced by 21 percent by 2009.¹⁰

Throughout the Trust Fund’s history the revenues had routinely exceeded allocations from the fund, creating large surpluses causing the administrations and lawmakers to consider options available for reducing the aviation trust fund balance as reflected in GAO studies in 1988 and as recently as 2003.

Figure 2: FAA Operations Funding by Source



data source: FAA

⁹ David Bond, *Collision Course: FAA’s Trust Fund isn’t What it Used to Be, but Airlines Want Cost Reductions – Not a Fix*, Aviation Week and Space Technology, November 22, 2004

¹⁰ *Chew Says More Cost Controls Needed to Match Revenue Drop*, Aviation Week’s The Weekly of Business Aviation, November 8, 2004.

Are Revenues Declining?

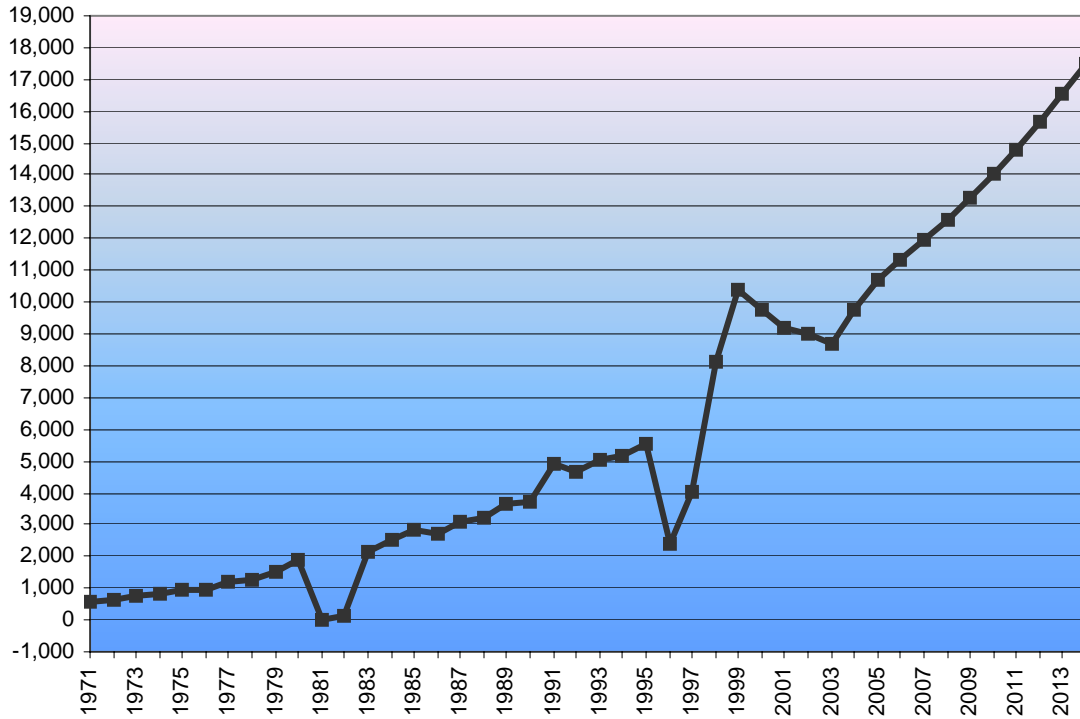
The FAA is on record saying that Trust Fund revenues are declining in press coverage of budget issues at the end of 2004 and into 2005. While it is undeniable that the Trust Fund experienced a sudden and steep decline from 2000 to 2003, it is equally clear that 2004 shows Trust Fund revenue increasing. In addition, the dramatic increases in Trust Fund revenues in 1998 and 1999 put the fund itself at record highs. One could argue that the decline in 2000, which is unrelated to the terrorist attacks, represents a correction rather than a structural decline. While there is no denying that the Trust Fund revenues suffered a decline during the post September 11 recession, there is no indication that revenues are still in decline. In contrast, FAA forecasts for revenue growth are positive and in 2003, the House, Senate and President were considering various aviation tax holiday scenarios. The Government Accountability Office reported that the financial outlook for the aviation Trust Fund is positive but suspending all taxes accruing to the Trust Fund would eliminate the Trust Fund's uncommitted balance. The GAO's analysis is based on FAA's aviation forecasts, which were published in November 2002. In its 2003 report GAO states:

Although expenditures exceeded revenues in fiscal year 2002, since its creation in 1970, Trust Fund revenues have generally exceeded expenditures – resulting in surplus (or an “uncommitted balance” as it is usually called). For example, at the end of fiscal year 2002, the Trust Fund’s uncommitted balance was nearly \$5 billion. The Trust Fund’s uncommitted balance represents money against which there is no outstanding budget commitment or authority to spend and, subject to congressional approval, is the amount available to finance FAA accounts in the future. It was also used to offset foregone revenue when the Trust Fund taxes lapsed in 1996 and to fund new airport security requirements resulting from the September 11, 2001 terrorist attacks.¹¹

¹¹ Government Accounting Office, *Airport and Airway Trust Fund*, (Washington, DC: GPO, 2003).

Figure 3: Aviation Trust Fund Revenue

Aviation Trust Fund Revenues (in Millions)



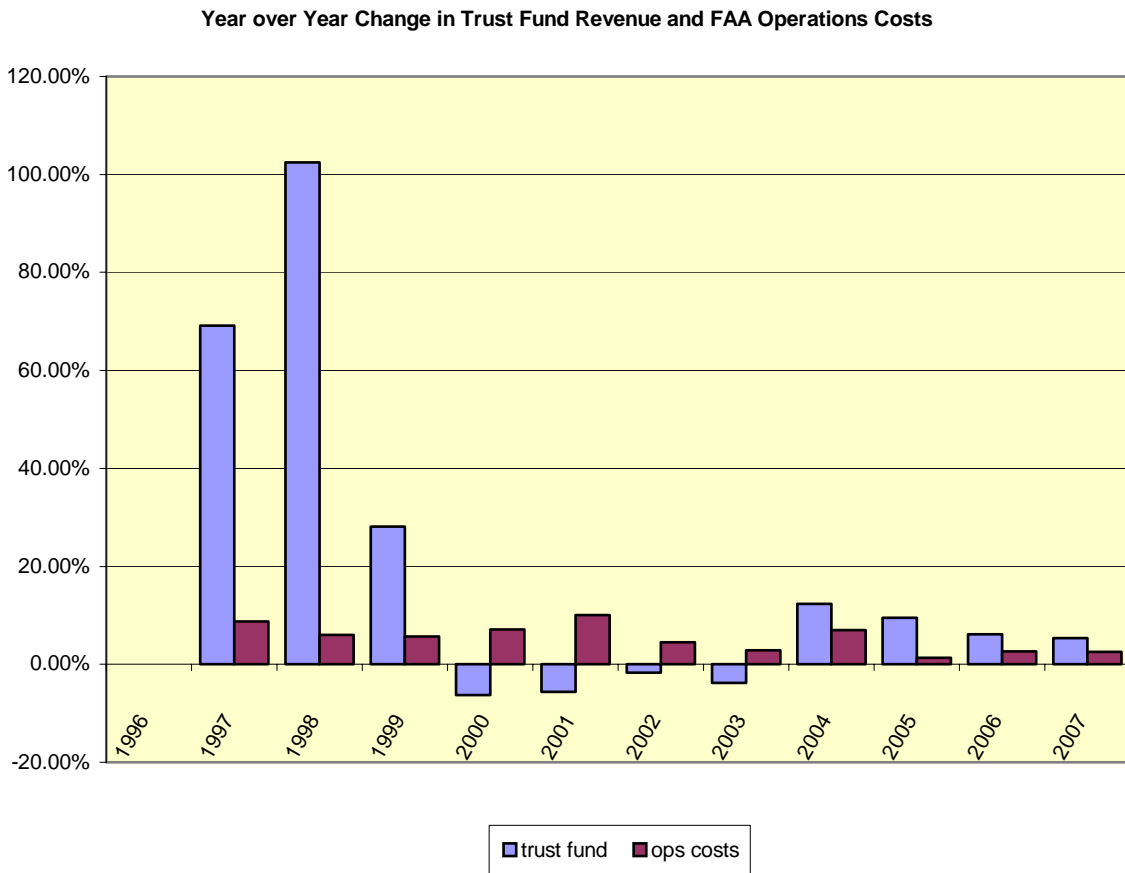
Ops Accounts Growth vs. Trust Fund Growth

Since the mid 1990’s the Department of Transportation Inspector General has been highlighting the growth in the FAA operations budget. Trust Fund revenue is the most direct indicator available of the demand placed on the system as it comes directly from the users of the system. So while periodic reviews of the growth in the operations budget have compared it to other FAA budgeted categories, so far the comparisons have not compared the budget growth to the growth in demand and corresponding revenue.

Various reports from the DOT Office of the Inspector General select 1996 as a base year for operations when examining the growth in the budget. The reason for selecting 1996 as the base year is not explicitly stated in the reports, however the year corresponds to the first year under legislation establishing a five-year term for the FAA Administrator.

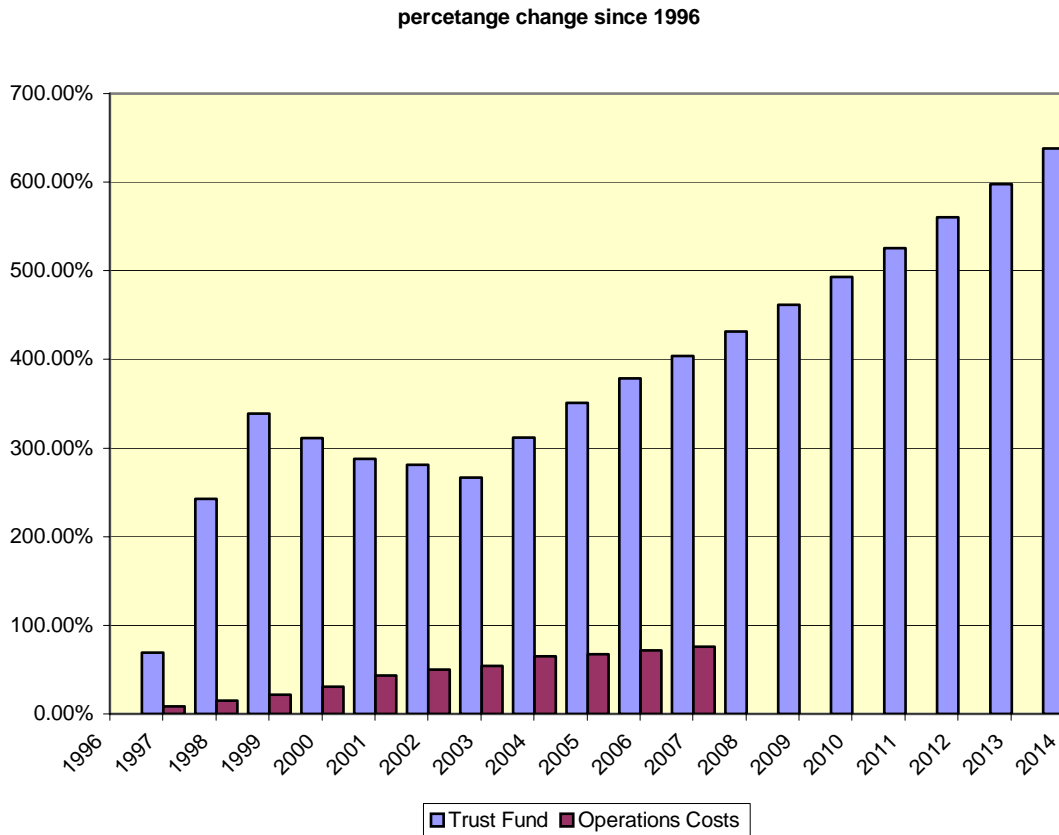
Accepting 1996 as a base year and comparing the change in the operations budget to the change in the aviation trust fund we see year over year fluctuations that, absent the 2000 correction and 2001-2003 post September 11 decline, the growth in the Trust Fund outpaces the growth in the operations account, that is forecast to continue through 2007, when the taxing authority is scheduled to expire. At that time, Congress will have to consider whether to continue the current funding system or introduce alternatives. Under the current system, both FAA and GAO data illustrates that when revenues are in a normal state (not reacting to a catastrophic event) there remains a healthy relationship between the increase in both operations costs and Trust Fund revenue.

Figure 4: Annual Changes in Trust Fund Revenue and Total FAA Operations Costs



While there are brief periods while the Trust Fund was in decline, yet operations cost increased, the overall picture is quite stable and presents an extremely favorable outlook. Rather than a year-by-year analysis, it is instructive to evaluate both costs and revenue growth over a longer term.

Figure 5: Cumulative Trust Fund Revenue and FAA Operations Cost Changes ¹²

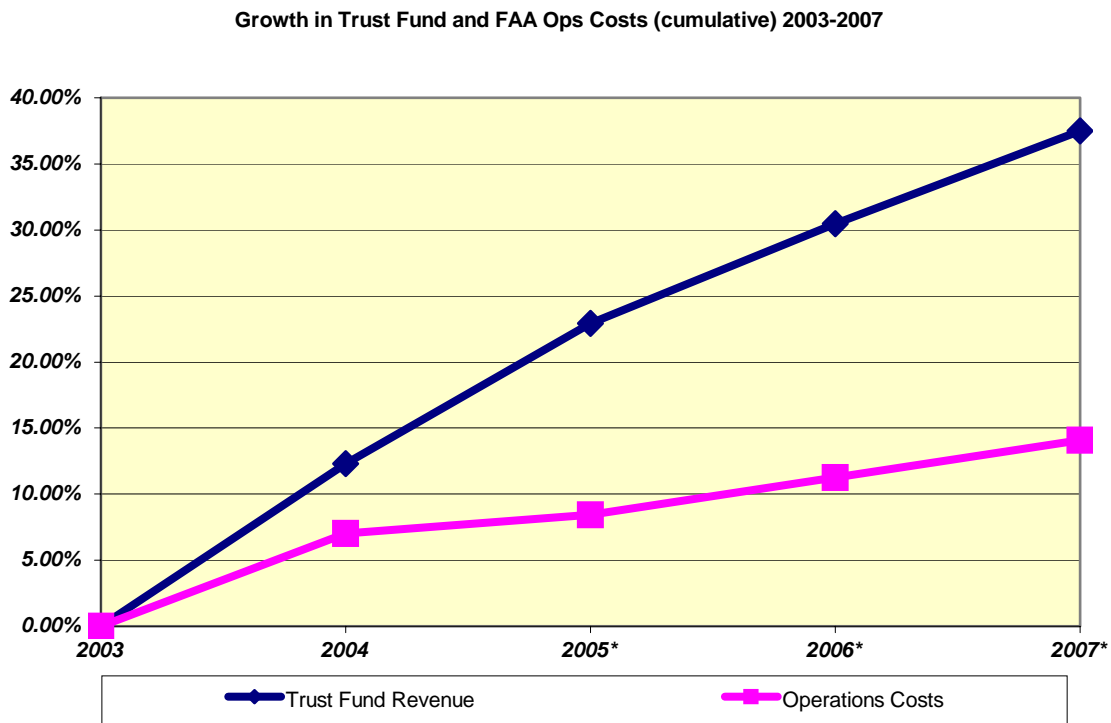


However, this approach presents three distinct challenges. First, out-year estimates (2008 and beyond) are based on an estimated percentage increase each year and it is difficult to determine the validity of the assumptions used in making the long term forecast. Second, in 1996 the authority to collect Trust Fund taxes lapsed affecting revenue in both 1996 and 1997. As the revenue levels were depressed in these two years are a result of the

¹² The Trust Fund authority expires in 2007, this chart assumes reauthorization of current excise tax and fee structure

policy decision rather than reflecting market conditions, the following year, 1998 shows a corresponding dramatic increase in revenue. It is not that the market conditions changed, but rather that it was a full year in which revenues were collected. Third, the terrorist attacks of September 11, 2001 caused an increase in operations costs to support security related activities in 2001 and 2002 until most security functions were appropriately transferred out of the FAA. These policy decisions affecting revenue in 1996 and 1997 and expenditures in 2001 and 2002 cause distortions in the model unrelated to market based fluctuations in aviation. Unfortunately, eliminating the years dramatically affected by policy changes and out years only allows for a short-term assessment.

Figure 6: Growth in Trust Fund Revenue and FAA Operations Costs 2003-2007



* projected

Conclusion

There is no escaping the facts that the expiration of the Trust Fund authority in 1996 following by the sudden decline post September 11, 2001 and the associated increase in security related spending in 2001 and 2002 has caused a reduction in the uncommitted balance of the aviation trust. It is equally true that a policy decision to require the Trust Fund to finance higher than average percentages of the FAA operations costs will place continued pressure on the uncommitted balances. In addition, treating the Aviation Trust Fund as the primary source of funding for operating expenses further reduces the funding available for capital improvements as the legislation originally intended.

FAA data illustrates that while the Airport and Airway Trust Fund suffered a brief but predictable decline as a result of the reduction in air travel post September 11, 2001. It is equally clear that as air travel is increasing, so too is the Trust Fund and continued growth is forecast by the FAA. The question of available resources for FAA operations is limited by policy choices rather than Trust Fund forecasts. The question of Trust Fund allocation and what percentage of FAA operations is appropriately funded from the general treasury vs. the Trust Fund, more so than Trust Fund revenue itself, will determine whether adequate resources are available to meet the demands placed on the system.