STATEMENT OF MARION C. BLAKEY, ADMINISTRATOR OF THE FEDERAL AVIATION ADMINISTRATION, BEFORE THE AVIATION SUBCOMMITTEE OF THE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE, U.S. HOUSE OF REPRESENTATIVES, ON THE FINANCIAL CONDITION OF THE AIRPORT AND AIRWAY TRUST FUND

MAY 4, 2005

Chairman Mica, Mr. Costello, and Members of the Subcommittee, thank you for the opportunity to discuss a topic of great importance to the Federal Aviation Administration (FAA) and to the United States of America. The financial health of the Airport and Airway Trust Fund (aviation trust fund) is critical to the stability of the airline industry and in no small part to the U.S. economy. Today I would like to provide the Committee with an overview of FAA's funding structure, which, as you know, is heavily dependent upon the aviation trust fund. I also will address the challenges that this funding structure presents and the implications for the FAA's future financial health. Without question, there is a critical need to establish a more stable funding stream for the FAA, especially in light of the turbulent business environment in which aviation finds itself.

I do not have a solution in hand today. Under Secretary Mineta's leadership, we have opened a dialogue on the future of the trust fund. At a forum between government and industry convened just last week to discuss the trust fund, the Secretary said, "We are beginning the process now, more than two years before the current authorization expires, because it is important to take the time to get the financing piece right." And therefore, I commend the Committee for holding this hearing today so that we in Government can have the benefit of a wide range of expert views and lay the foundation for change.

As this committee well knows, the FAA operates 24 hours a day, 7 days a week, 365 days a year. We run a multi-billion dollar air traffic control system that in FY 2004 served 688 million passengers and 35.1 billion cargo revenue ton miles of freight. There are FAA-operated or contract towers at 489 airports, and we are also responsible for inspection and certification of about 220,000 aircraft and 620,000 pilots. We have some 43,000 dedicated government employees working to serve the traveling public and the businesses that depend on the air transportation system. We operate and maintain a system comprised of more than 70,000 facilities and pieces of equipment. Our mission is to provide the safest, most efficient air transportation in the world, and that is what we do.

The FAA is funded by annual appropriations drawn from taxes, fees and revenue from the aviation trust fund and the General Fund. There's been a long history of funding a portion of the FAA's operating costs out of the General Fund due to recognition that aviation provides benefits to the non-traveling public and to our economy as a whole. The ratio of General Fund versus aviation trust fund financing has varied over the years. The General Fund share of total FAA appropriations has been as high as 59 percent (in FY 1984) and as low as zero (in FY 2000). The trend, however, is not in question. On average over the last 15 years, the portion of operating costs coming from the General Fund has declined steadily. In FY 2005, about 20 percent of the FAA's total budget is coming from the General Fund and 80 percent from the trust fund. Looking at the Operations account only, 63 percent of the FY 2005 appropriation is from the trust fund. In recent years, trust fund appropriations have been funded not only from the annual revenue and interest posted to the trust fund, but also from drawing down the AATF's balance, which was over $7 billion as recently as 2001.

It might be helpful to provide a little background about the aviation trust fund. It was created in 1970 to provide a dedicated source of funding for the aviation system. Before there was a trust fund, a 5% tax on passenger airline tickets, a general aviation fuel tax, and a tire and tube tax were deposited in the General Fund. Today trust fund revenues are generated by a combination of taxes that were last authorized in 1997: a domestic passenger ticket tax of 7.5% of the price of a ticket, a domestic flight segment fee of $3.20 per segment per passenger, an international departure/arrival tax of $14.10 per international passenger, a 6.25% waybill tax on domestic cargo and mail, a general aviation (GA) jet fuel tax of 21.8 cents per gallon, a GA aviation gasoline tax of 19.3 cents per gallon, and a commercial fuel tax of 4.3 cents per gallon. The segment fee and international departure/arrival tax rates are indexed to the Consumer Price Index and have increased each year, but the airline ticket tax is a fixed percentage of the ticket price, so it is dependent on changes in airline ticket prices rather than general inflation. These taxes and fees are scheduled to expire in 2007, which also coincides with the end of the current authorization for FAA programs under Vision 100.

The problem that we faced is that the status of the aviation trust fund is inextricably tied to the fortunes of the aviation industry. The vast majority of the trust fund revenue (72%) currently comes from domestic airline passengers (with the largest portion coming from the 7.5% tax on domestic airline tickets), while the sources for the remainder break down as follows: international departure/arrival fees (15%); commercial fuel taxes (6%); cargo waybill taxes (5%); and general aviation fuel taxes (2%). A graphic illustration of these revenue sources is shown in the attached pie chart depicting FY2004 Trust Fund Receipts. These taxes and fees are also invested by the Treasury Department in government securities and generate interest revenue for the trust fund.

Policymakers need to know that a gap that exists between our revenue and expenses, and this gap is quickly eroding the Trust Fund. From fiscal year 2001 to fiscal year 2004, the uncommitted balance of the Trust Fund dropped dramatically from $7.3 billion to $2.4 billion, as trust fund receipts were lower than predicted due to lower airline ticket prices and lower aviation demand (as a result of 9/11 and other events). In fiscal year 2006, the President's budget projects that the uncommitted balance in the trust fund will dip to approximately $1.2 billion--the lowest level in its history. This estimate is based on projected 2006 tax and interest revenue of $11.8 billion with $12.1 billion being appropriated for FAA programs. Unfortunately, over the past 4 years, our revenue projections proved to have been overly optimistic, due to the impacts of 9/11 and the unprecedented change in the structure of the airline industry. The FY2006 projected level of the uncommitted balance is sobering because it leaves only a small "cushion" in the trust fund balance. In addition, our ability to rely on an increased General Fund contribution to bridge any gap is in question due to competing budget pressures as well as the effort to reduce the federal deficit.

As we look to the future, we see a complicated and somewhat worrisome picture. We are projecting that passenger demand, which dipped severely in the wake of 9/11, will return to pre-9/11 levels by the end of this year, reaching 718 million passengers. In FY 2004, commercial operations at 17 of our 35 major airports were above pre-9/11 levels. We project that by 2006, an additional 8 will be added to that list, with some airports like Salt Lake City and Fort Lauderdale showing very high growth, in excess of 40 percent over year 2000 levels. We forecast that travel demand will continue to increase to where we could serve over 1 billion passengers by 2015.

It is very good news for the aviation industry that demand is back, but it is back in different ways than before. Domestic fares have continued to fall as a result of the growth of low-fare/low-cost airlines, changes in ticket distribution methods due primarily to the Internet, and increasing business traveler price sensitivity. It is these low fares that have helped traffic levels rebound to pre-9/11 levels. While low fares are good news for the passenger, they spell trouble for the trust fund with its heavy reliance on the ticket tax as its primary source of revenue.

Industry changes also have implications for the FAA's workload. The airlines are trying to control costs by using increasing numbers of smaller aircraft. This trend adds to the workload of air traffic controllers without increasing tax revenue commensurately. Regional jets normally carry fewer passengers than the larger airliners, so the movement toward smaller passenger aircraft contributes to the decline in the trust fund revenue per flight. If an airline carries a given number of passengers (paying the same fares) on two regional jets instead of one larger jet, ticket tax revenue does not change, but controller workload approximately doubles. Our latest forecasts indicate that the growth in the number of smaller aircraft is expected to continue and become more pronounced. Plainly, our revenue is not tied in any way to the cost of the service, which means that there is no nexus between actual workload and how it's paid for.

Increased air traffic operations are not the only source of increased workload for the FAA. In recent years the industry has also seen more new entrant carriers. While this is good news for competition, it also has workload implications for our agency. Right now, there are 16 applications in the queue awaiting review and certification by our safety staff, and each of these new operators will bring additional pilots and crew into the system. Also, with regard to our airport grant program, Vision 100's increase in funding for the Airport Improvement Program (AIP) coupled with a new entitlement formula apportionment for non-primary airports increased our workload in processing grant applications by fifty percent.

As our workload increases and our resources are strained, we have been forced—like the industry we serve—to make changes, become more efficient and continually work hard to control our costs. As this committee has heard in previous testimony, our Air Traffic Organization (ATO) has reduced costs through productivity gains and attrition. The ATO has reduced management layers, with executive ranks reduced by 20 percent, and has consolidated a number of redundant functions, thereby reducing overhead. One example of these cost savings is that the FAA's average cost of controlling a single

Instrument Flight Rule (IFR) flight fell by 3.6% in 2004 as compared to 2003. On its own that may seem like a small figure but with more than 16 million annual IFR flights the savings add up over time. In addition, we used the competitive sourcing opportunity outlined in the President's Management Agenda, more commonly referred to as the A-76 process, for the delivery of services now provided by our Automated Flight Service Stations. This is the largest public/private competition in U.S. history. As a result, we will save the taxpayer more than $2 billion over the next ten years. Also, we are implementing a cost accounting system throughout FAA that will provide our managers and executives with the information they need to identify and eliminate wasteful spending, hold or reduce operating costs, and better link financial performance to mission objectives. Our efforts are being recognized. This month we won our second straight C.E.A.R. Award—Certificate of Excellence in Accountability Reporting. In recognition of our efforts to enhance financial management, the GAO removed the agency from its "High Risk" list.

Controlling our costs will be a major focus but we face numerous challenges in that arena. Negotiations with our major unions will begin in earnest this spring and summer. The contract with our largest union, the National Air Traffic Controllers Association, is due to expire this coming September. My goal for these negotiations with our unions is to reach new contracts that enable the agency to meet the aviation system's needs, be fair to employees and provide the flexibility that we need to operate the system. I have said before that I will not sign a contract that the agency cannot afford and I want to underscore that again here today.

An additional challenge in the upcoming years is a surge in controller retirements. We developed a plan last December for hiring and training new controllers. This plan lays out cost-saving mechanisms that will allow the ATO to reduce previous staffing projections by 10 percent over the next five years. Full implementation of the plan is under way and it will enable us to have the right people in the right places at the right time. We are also faced with an aging and deteriorating inventory of facilities and equipment. The average condition of the FAA's 21 en route air traffic control centers is poor and getting worse each year. As this Committee well knows, modernization of the air traffic control system is critical if the agency is to keep up with what aviation brings tomorrow. The price tag for these facilities and equipment alone is $2 billion per year in capital funds just to maintain current services. Given our recent F&E budgets of approximately $2.5 billion, that doesn't leave a lot of money for modernization. The total cost of asset replacement is $32 billion.

As you know from your recent hearing on our Joint Planning and Development Office (JPDO), we must also plan for the emergence of the next generation of the air transportation system. The next generation plan takes the system out to 2025, charting the course for satellite based navigation, handling new aircraft classes, on-demand services, and the increasing growth in air traffic. However, the move to a modern, efficient and technology-driven aviation system is going to require sustained, multi-year investments. As the recent flight service station A-76 experience has taught us, we will often need to invest some money in order to make the transition to a new system that will significantly reduce operating costs and better serve our customers in the long run.

What I have outlined above—the condition of the aviation trust fund in the context of the growth in demand and industry restructuring, and the fact that FAA's future funding requirements will significantly outpace revenue from aviation taxes--clearly highlights a couple of issues. One, the current low balance in the trust fund cannot withstand a lapse in revenues. During the most recent reauthorization cycle for the current aviation excise taxes (1996-1997), Congress allowed the authority for those taxes to expire twice, which resulted in a $5 billion loss in revenue to the trust fund. We cannot afford to let that happen again. Two, the FAA needs a stable source of funding that is based both on our costs and the services we provide so that we can meet our mission in an extremely dynamic business environment. Airline ticket prices are not related to any real measure of productivity for the FAA. Regardless of how many operations we run through the national airspace system or how quickly we can certify new aircraft products and technologies, or how we continue to drive down the already low accident rate, the primary source of trust fund receipts is linked to the price of a ticket. That approach will not sustain us into the future.

Tying fees to the cost of providing service protects both FAA and the customers who use FAA services by not subjecting our ability to provide a certain level of service to unrelated factors like ticket prices. A stable, cost-based revenue stream can also ensure funding for long-term capital needs. We also believe that a cost-based revenue structure would provide incentives to our customers to use limited resources efficiently and to the FAA to operate efficiently, as stakeholder involvement can help us ensure that we are concentrating on services that the customer wants and is willing to pay for.

I want to be clear. I am not at this point advocating user fees, or endorsing new excise taxes, or urging debt financing, or seeking a bigger share of the General Fund. There are many different ways to achieve the goal of a cost-based funding structure. I am saying that we have an opportunity in the near future for positive change and we need to begin the discussion now. Today's hearing is part of that. Also, just last week, we hosted a forum for our stakeholders to start a full debate on resource requirements and funding alternatives. We were pleased that members of your staffs were able to attend. It was a very productive conversation. As business leaders, they know that the health of the trust fund has a direct connection to the success of their industry. Our goal is to make sure that we allow for their input on this crucial issue. They responded to the opportunity with some key themes:

- *The current system is very vulnerable*. We're all aware of the uncertainties about the future shape of the aviation system – from regional jets to business jets to microjets to ticket yields. We reviewed a number of scenarios that could result in Trust Fund revenues and FAA costs continuing to diverge. To protect the system and delay the gridlock that could come as traffic increases, we need to have a funding mechanism that ensures our costs and revenues are aligned.
- While there was a clear view from stakeholders that the General Fund should continue to contribute to the FAA's budget, there was also the view that the

reality of budget deficits and increasing entitlement spending mean that *the community shouldn't see the General Fund as its salvation*.

- *Any new funding system should contain the right incentives*. The system should give the FAA strong incentives to control costs and should also give users the incentives to use our limited system resources efficiently.
- *There must be equitable treatment of stakeholders*. We realize that there are many different ideas about out there about what "equitable treatment of stakeholders" means in practice - -and the devil is, of course, in the details. However, I hope that fair treatment is a basic principle that we all share as a starting point.
- *Continued consultation with stakeholders is critical in any revenue structure*.

Mr. Chairman, we will have tough decisions to make during the upcoming reauthorization of our programs, and the funding mechanism will most likely be the hardest. At this point, I see a need for fundamental change because the mismatch between the FAA's growing budget requirements and our revenue sources will hamper our ability to meet the demand for our services. In simple terms, we can't do it all and right now we can't pay for it all. Reducing needed FAA services or delaying or limiting modernization of our facilities is not an attractive option. What the solutions will be remain to be seen—after a lot of discussion and creative thinking. One thing is certain. There needs to be equitable treatment of all stakeholders. I look forward to the debate among all segments of the industry, consumers, academia, and, of course, Members of Congress. I am sure it will be a lively one.

That concludes my testimony. I would be happy to answer any questions you may have.

The majority of Trust Fund revenue comes from a 7.5% excise tax on the price of airline tickets

FY 2004 Trust Fund Tax Receipts – Estimated Allocation