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AIRPORT AND AIRWAY TRUST FUND

Preliminary Observations on Past, Present, and Future

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Preliminary Observations on Past, Present, and Future

GAO Highlights

Highlights of GAO-05-657T, a report to Subcommittee on Aviation, House Committee on Transportation and Infrastructure

Why GAO Did This Study

The Airport and Airway Trust Fund (Trust Fund) was established in 1970 to help fund the development of a nationwide airport and airway system and to fund investments in air traffic control facilities. It provides all of the funding for FAA's accounts such as the Airport Improvement Program (AIP), which provides grants for construction and safety projects at airports, the Facilities and Equipment (F&E),which funds technological improvements to the air traffic control system, and the Research, Engineering, and Development (RE&D). In addition, the Trust Fund provides some funding for FAA's operations account. To fund these accounts, the Trust Fund relies on a number of taxes for revenue, including passenger ticket, fuel, and cargo taxes that are paid by passengers and airlines. Since 1970, revenues have generally exceeded expenditures —resulting in a surplus or an uncommitted balance. In 2004, the Trust Fund's year end uncommitted balance was about $2 billion.

A number of structural changes in the aviation industry and external events have affected revenues flowing into and out of the Fund and have caused some aviation stakeholders to speculate about the Fund's financial condition. The various taxes that accrue to the Trust Fund are scheduled to expire in 2007. GAO was asked to provide information and analysis about the financial outlook of the Trust Fund.

www.gao.gov/cgi-bin/getrpt?GAO-05-657T.

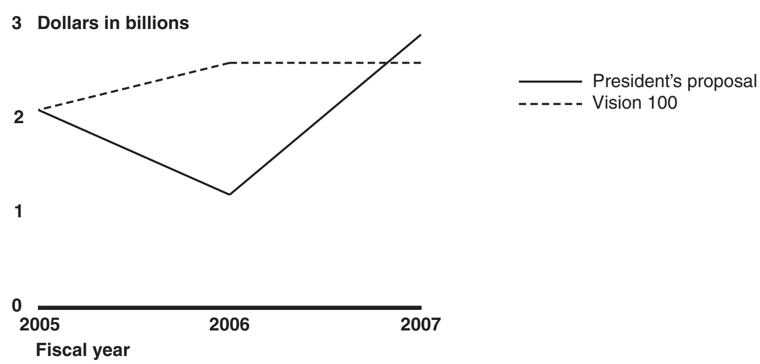
To view the full product, including the scope and methodology, click on the link above. For more information, contact Gerald Dillingham at (202) 512-2834 or dillinghamg@gao.gov.

What GAO Found

With the exception of its first four years, the Trust Fund has ended each year with an uncommitted balance; however, the amount of the uncommitted balance has fluctuated and is currently trending downward. In 1991 and 1999, the Trust Fund's uncommitted balance totaled over $7 billion—its highest level. However, in several years, the Trust Fund's balance experienced dramatic decreases resulting in a lower uncommitted balance, in part, because of lapses in the taxes that accrue to the Fund or reductions in demand for air travel. The Trust Fund's uncommitted balance decreased from $7.3 billion in 2001 to $4.8 billion in 2002 and has continued to decrease by about $1 billion each year since. This declining uncommitted balance has been caused by a number of underlying factors, such as reductions in the demand for air travel.

Over the next 3 years, the Trust Fund is projected to have sufficient revenue to fund authorized spending and end each year with an uncommitted balance under the current law, referred to as Vision 100, and the President's 2006 budget proposal, as shown below. However, this financial outlook depends on the realization of FAA's forecasted commercial passenger traffic levels and airfares. If revenues are 5 percent lower than projected, as they were in 2001, the Trust Fund's uncommitted balance would be $1.5 billion or lower under both Vision 100 and the President's budget proposal in 2006 and 2007. If the revenues were 10 percent lower than projected, as they were in 2004, the uncommitted balance would reach zero in 2006 under the President's proposal and in 2007 under Vision 100. FAA officials told GAO that if the uncommitted balance reached zero, FAA would still fund air traffic control services but would have to suspend some AIP and F&E activities.

Trust Fund's Projected Year End Uncommitted Balance Under Vision 100 and President's 2006 Budget Proposal



Source: FAA.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the financial condition of the Airport and Airway Trust Fund (Trust Fund). The Trust Fund was established by the Airport and Airway Revenue Act of 1970 (P.L. 91-258) to help fund the development of a nationwide airport and airway system and to fund investments in air traffic control facilities. It provides all or some of the funding for FAA's accounts which include the

- Airport Improvement Program (AIP), that provides grants for construction and safety projects at airports,
- Facilities and Equipment (F&E) account that funds technological improvements to the air traffic control system,
- the Research, Engineering, and Development (RE&D) account, and
- Operations account.

To fund these accounts, the Trust Fund relies on a number of taxes for revenue, including passenger ticket, fuel, and cargo taxes, that are paid by passengers and airlines. In fiscal year 2004, the Trust Fund received $9.7 billion in revenue and had expenditures of $10.4 billion.[1] Although Trust Fund expenditures exceeded revenues in 2004, since its creation in 1970, revenues have generally exceeded expenditures —resulting in a surplus or an uncommitted balance.[2] At the end of 2004, the Trust Fund's uncommitted balance was about $2.4 billion, a decrease of about 67 percent since 2001.[3]

A number of structural changes in the aviation industry and external events have affected revenues flowing into and out of the Trust Fund and have caused some aviation stakeholders to speculate about the Fund's financial condition. For example, some aviation stakeholders believe that there is a reason to be concerned about the financial condition of the Trust

[1]For purposes of this report, we are using the expenditure amount rather than the appropriated amount. The expenditure amount includes the amount of funding spent on AIP, F&E, RE&D, and operations and does not include commitments.

[2]The Trust Fund's uncommitted balance represents money against which there is no outstanding budget commitment or authority to spend.

[3] All dollar amounts in this testimony are in nominal dollars.

Fund because revenues have not recently kept pace with expenditures. In contrast, other aviation stakeholders state that the Trust Fund is healthy because revenues are expected to continue increasing. The various taxes that accrue to the Trust Fund are scheduled to expire in 2007.

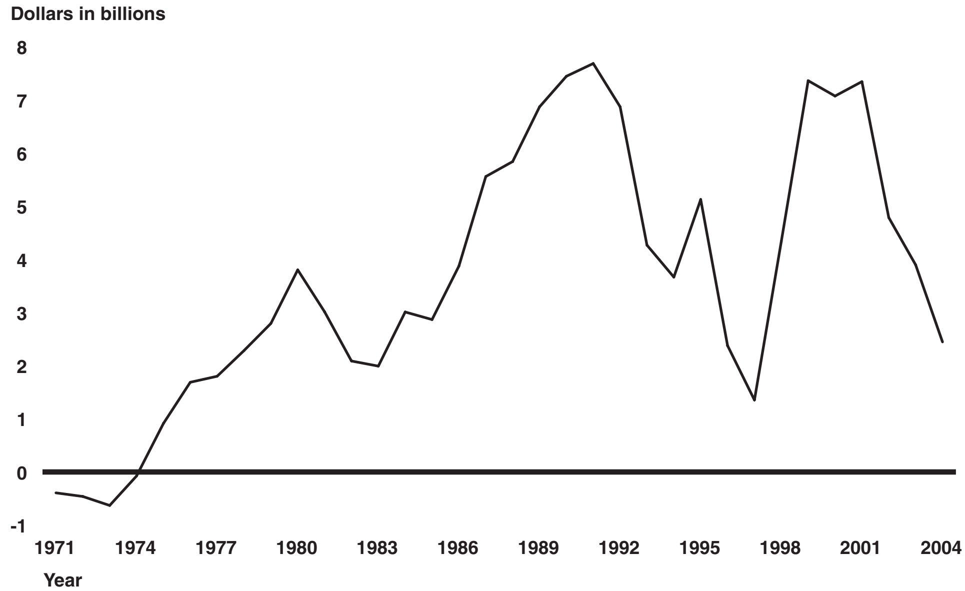
My statement today is based on our ongoing work on the Trust Fund and discusses our preliminary observations on the past, present, and future financial outlook of the Trust Fund. We plan to issue a final report to this Subcommittee later this year.

Historically, Trust Fund Has Generally Had an Uncommitted Balance but Recently the Balance Has Started to Trend Downward

As shown in figure 1, with the exception of its first four years, the Trust Fund has ended each year with an uncommitted balance; however, the amount of the uncommitted balance has fluctuated and is currently trending downward. In 1991 and 1999, the Trust Fund's uncommitted balance totaled over $7 billion, which represented its highest amount.[4] However, in several years, the Trust Fund's experienced dramatic decreases resulting in a lower uncommitted balance. For example, in 1982, the end of year uncommitted balance was $2.1 billion, and in 1997 it was $1.4 billion because of a lapse in the taxes that accrue to the Trust Fund. The Trust Fund's uncommitted balance also decreased from $7.3 billion in 2001 to $4.8 billion in 2002 and has continued to decrease by about $1 billion each year since. There are a number of reasons for this downward trend, including changes in the amount of revenue flowing into and out of the Trust Fund.

[4] Because of price level increases that reduced the value of a dollar over time, in terms of purchasing power, the Trust Fund was larger in 1991 than in 1999.

Figure 1: Trust Fund's Uncommitted Balance Has Recently Started to Trend Downward

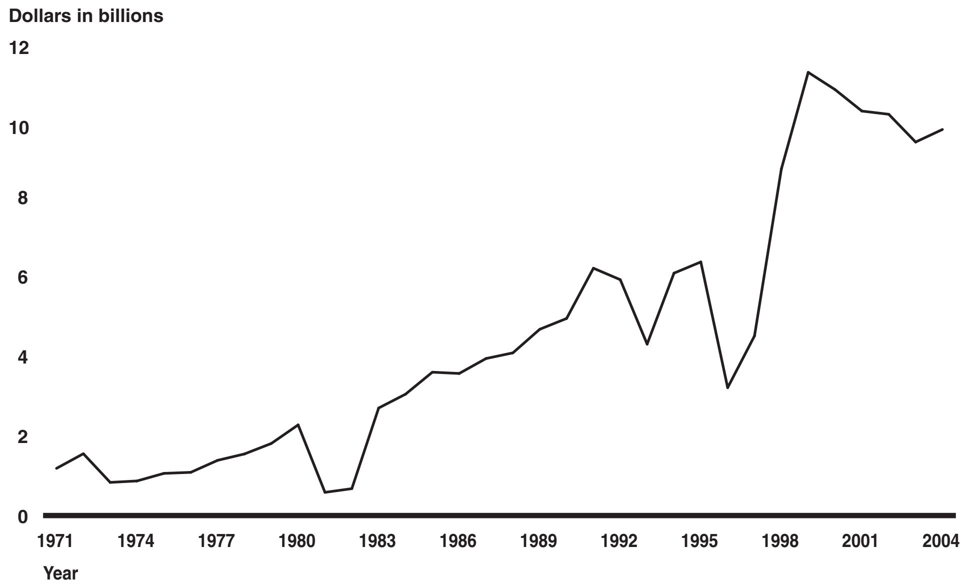


Source: Congressional Budget Office and FAA budgets.

Revenues Have Generally Increased With Some Fluctuations

The amount of revenues flowing into the Trust Fund has fluctuated from year to year but has generally trended upward, as shown in figure 2. The Trust Fund relies on a number of taxes for revenue, including passenger ticket, fuel, and cargo taxes that are paid by passengers and airlines. During 1981 and 1982 the amount of revenues including interest flowing into the Trust Fund averaged $629 million which was the lowest amount in its history because of a lapse in the collection of aviation taxes. In contrast, in 1999, revenue flowing into the Trust Fund totaled $11.1 billion, which was the largest amount in its history.

Figure 2: Trust Fund Revenues Have Fluctuated but Generally Increased



Source: Congressional Budget Office and FAA budgets.

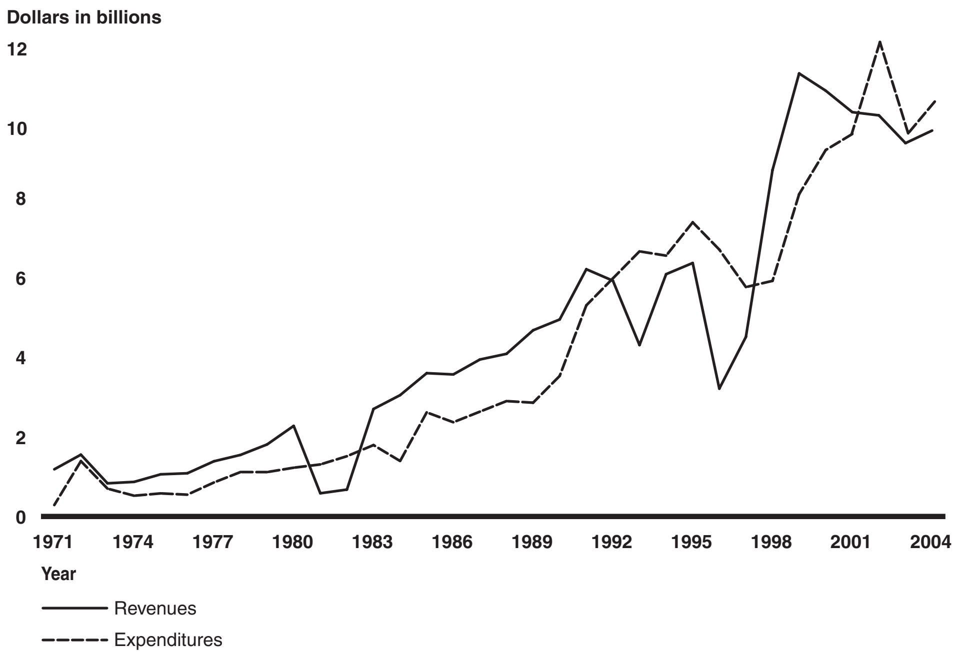
However, after revenues peaked in 1999, the amount of revenue flowing into the Trust Fund started to trend downward, totaling $9.7 billion in 2004. A number of factors may have contributed to this decrease. For example, within the airline industry, the growth of the Internet as a means to sell and distribute tickets, the growth of the low cost airlines, and fare reductions by legacy carriers all transformed the industry and led to lower average fares. These lower fares may have resulted in lower ticket taxes and less revenue into the Trust Fund.[5] In addition, a series of largely unforeseen events, including the September 11 terrorist attacks, war in Iraq and associated security concerns, the Severe Acute Respiratory Syndrome (SARS), global recessions, and a steep decline in business travel seriously reduced the demand for air travel resulting in a sharp decrease in airline industry revenue.

[5] Increased traffic from these lower fares may have offset some of the decline in tax revenue.

Trust Fund Expenditures Have Also Increased and Exceeded Revenue in Some Years

The amount of funds flowing out of the Trust Fund also has generally increased since the Fund's inception and has also exceeded revenues in some years. For example, as shown in figure 3, from 2002 through 2004, expenditures exceeded revenues by an average of about $938 million, or about 9 percent.

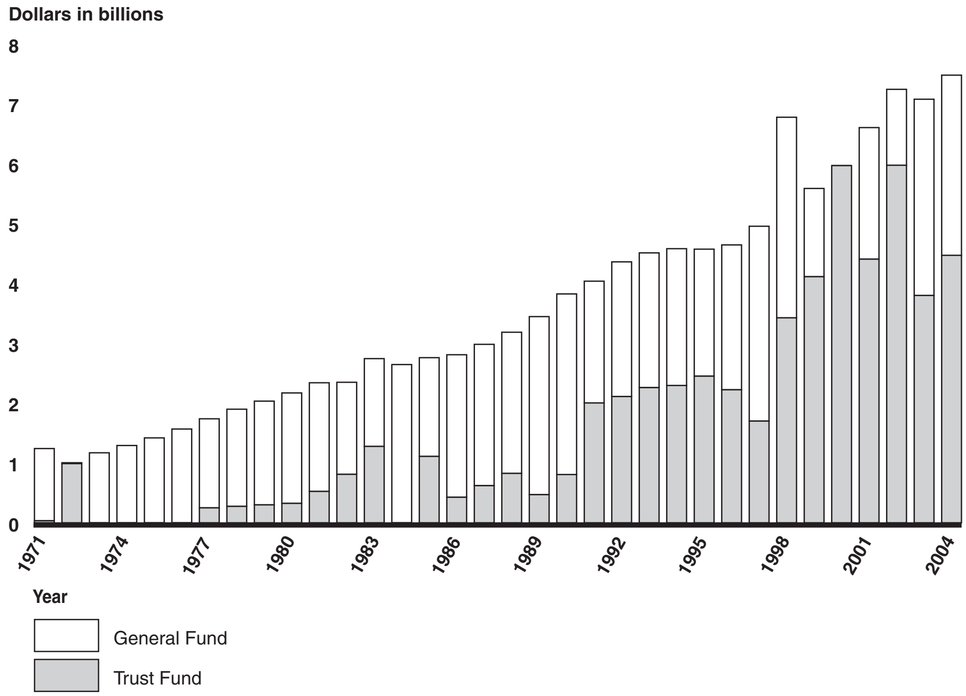
Figure 3: Expenditures Exceeded Revenues in Some Years



Source: Congressional Budget Office and FAA budgets.

As mentioned earlier, the Trust Fund provides all the funding for AIP, F&E, and RE&D and provides some funding for operations. Trust Fund expenditures have grown because of increases in both spending for these accounts and in the amount of FAA operations funded by the Trust Fund. For example, the amount of funding provided for AIP increased from about $1.5 billion in 1998 to $3.5 billion in 2005. In addition, as shown in figure 4, since its inception the Trust Fund has funded some portion of FAA's operations. In 1972 and 2000, the Trust Fund funded 100 percent of the cost of FAA operations. In 2004, the Trust Fund funded 60 percent and it is expected to fund 63 percent in 2005.

Figure 4: FAA Operations Cost Funded By Trust Fund and General Fund

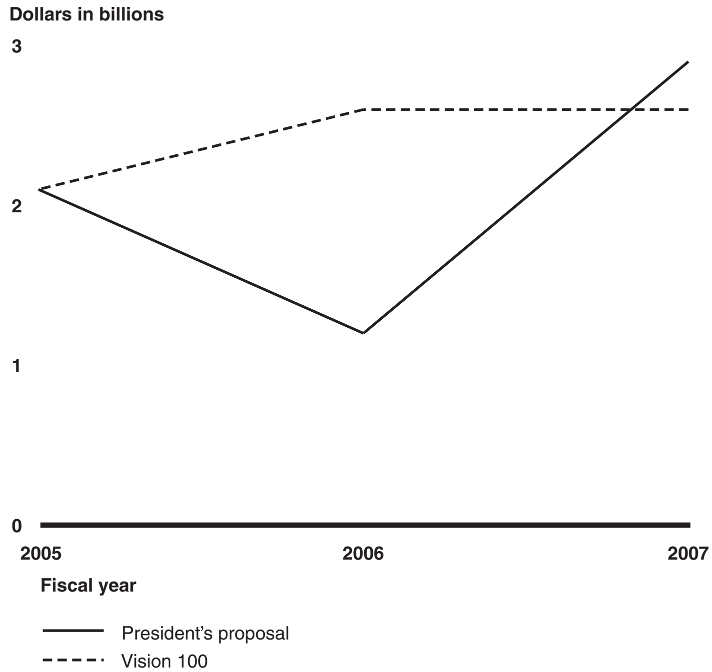


Source: FAA.

Projected Trust Fund's Uncommitted Balance Is Positive but Depends on Realization of Forecasted Passenger Traffic Levels and Airfares

Over the next 3 years, the Trust Fund is projected to have sufficient revenue to fund authorized spending and end each year with an uncommitted balance under Vision 100 and the President's 2006 budget proposal. However, this financial outlook depends on the realization of FAA's forecasted commercial passenger traffic levels and airfares. As shown in figure 5, under the current law—the Century of Aviation Reauthorization Act (Vision 100)—the Trust Fund's year-end uncommitted balance is projected to be about $2.6 billion in 2006. Under the President's proposal, it is projected to be slightly over $1 billion in 2006.

Figure 5: Trust Fund's Projected Uncommitted Balances Under Vision 100 and President's Budget Proposal



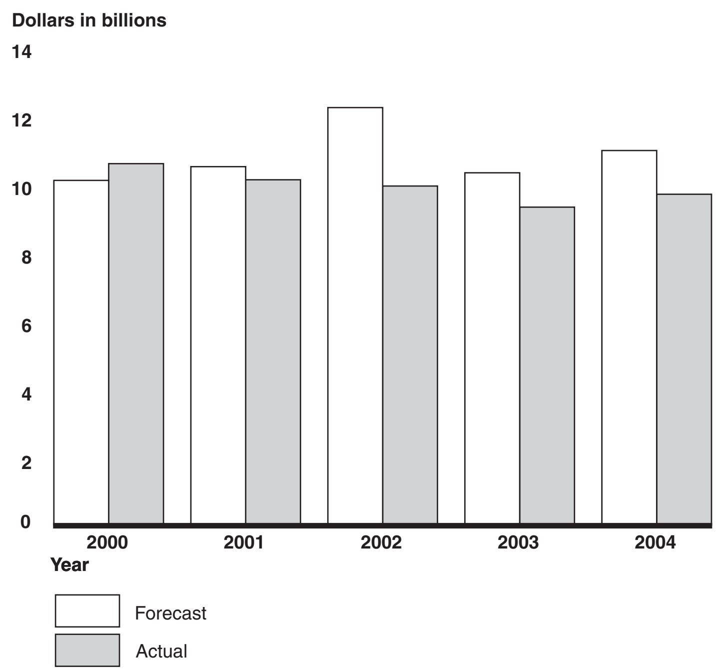
Source: FAA.

The primary reason that the Trust Fund's uncommitted balance would be higher under Vision 100 is that it uses the formula created in the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR-21) to determine how much funding for FAA Operations should come from the Trust Fund, and the President's proposal does not. Under AIR-21, the formula sets the amount of Trust Fund revenue that will be authorized for FAA Operations in a given year equal to projected Trust Fund revenues (as specified in the President's budget) minus the authorizations for AIP, F&E, and RE&D in that year. Thus, under Vision 100, the Trust Fund is projected to support almost $15 billion, or 63 percent of FAA Operations from 2005 through 2007. In contrast, the President's proposal specifies a set amount of Trust Fund revenue to be used for FAA Operations. Therefore, if Congress enacts the President's proposal, the Trust Fund would provide $17.7 billion for FAA Operations from 2005 through 2007, or about 74 percent of its total estimated costs for Operations.

In contrast to 2006, in 2007, the Trust Fund's uncommitted balance would be about $300 million higher under the President's budget proposal than under Vision 100. According to FAA officials, this is primarily because of reduced spending for AIP and F&E under the President's budget proposal.

Although the Trust Fund is projected to have a positive uncommitted balance from 2005 to 2007 under each of the expenditure proposals, this projection depends to a significant extent on achieving forecasted commercial passenger traffic levels and airfares that affect the amount of revenues flowing into the Trust Fund. We recognize that it is very difficult to anticipate future events that may significantly affect the demand for air travel and our analysis shows FAA's projected revenue forecast exceeds the actual amount of revenue received for four of the last five years as shown in figure 6. According to FAA officials, the major reasons why projected revenues were lower than actual revenues is because forecasted airline yields[6] were higher than the actual yields and aviation activity was below anticipated levels for the last several years.

Figure 6: Comparison of Forecasted Revenue with Actual Revenue Received



Source: FAA budgets.

[6]Yields are commonly measured in cents per revenue passenger mile—with revenue passenger miles being the number of miles revenue passengers are transported.

Given the difference between the forecasted revenue and actual amount of revenue received, we conducted sensitivity analyses to estimate what would happen to the Trust Fund's uncommitted balance if passenger traffic or yields fall below the levels that FAA projected in November 2004. For example, table 1 shows the projected Trust Fund balances under Vision 100 and the President's proposal and the impact if revenues are 5 percent or 10 percent less than currently projected. If revenues are 5 percent lower than projected, as they were in 2001, the Trust Fund's uncommitted balance would be $1.5 billion or lower under both Vision 100 and the President's budget proposal in 2006 and 2007. However, if the revenues are 10 percent lower than projected, as they were in 2004, the uncommitted balance would reach zero in 2006 under the President's proposal and in 2007 under Vision 100.

Table 1: Sensitivity Analysis of the Trust Fund's Uncommitted Balance to Revenue Shortfalls

Dollars in millions				
Revenue scenario	**Fiscal year uncommitted balance**			
Proposal		**2005**	**2006**	**2007**
Baseline projections as of November 2004	Vision 100	$2,103	$2,571	$2,615
	President's budget	2,103	1,195	2,937
If revenues are 5 percent less than projected	Vision 100	1,577	1,459	855
	President's budget	1,577	83	1,176
If revenues are 10 percent less than projected	Vision 100	1,051	346	0
	President's budget	1,051	0	0

Source: GAO analysis of FAA data.

A scenario in which the Trust Fund reaches zero is cause for concern. According to FAA officials, the elimination or reduction of the Trust Fund's uncommitted balance could also pose budgetary challenges. For example, if the Trust Fund's uncommitted balance reached zero in 2006 it might require FAA to make significant spending cuts to aviation programs currently supported by the Trust Fund unless additional funding were authorized and appropriated from the General Fund. According to FAA officials, they would continue to fund air traffic control services because it is considered an emergency function that involves the safety of human life. However, to fund air traffic control services, FAA officials said it would have to suspend activities for AIP, F&E, and RE&D accounts including some F&E contracts.

Regarding the long-term financial outlook of the Trust Fund, we believe that it is difficult to project beyond 2007 because the Trust Fund expires in 2007 and it is unknown if the current tax schedule will change. In addition, as mentioned earlier, forecasting aviation activity is difficult in part because of the complexities and uncertainties associated with anticipating future events that may affect the demand for air travel. Projecting the long-term financial outlook of the Trust Fund also requires some consideration of the planned spending of the programs that it finances.

According to FAA officials, over the next 4 years, there may be an $8.2 billion dollar gap between costs and revenues, which reflects a $5 billion shortfall for operations and $3.2 billion shortfall for capital development. If this projected gap is realized, our past work suggests that the cost saving initiatives that FAA has identified will not be sufficient to close this gap.[7] Consequently, additional reductions will be needed. For example, to meet air traffic controller staffing needs FAA could consider making greater use of the Air Traffic Collegiate Training Initiative Program which could save millions of dollars annually. In addition, FAA could save millions of dollars by eliminating redundant ground based navigational aids.

Concluding Observations

Deciding what changes may need to be made to the Trust Fund to help ensure a safe, efficient, and adequately funded national airspace system will require some tough choices by Congress and FAA. One of the critical questions that will need to be addressed is not only the amount of the Trust Fund's uncommitted balance but also whether the government has the fiscal capacity to fund current and future Trust Fund obligations while concurrently addressing the needs of other competing programs for scarce resources.

FAA and Congress will also have to find a way to better align FAA's costs with revenue and to better address both the cost and revenue sides of the ledger. In terms of cost savings, our past work suggests that the cost saving initiatives that FAA has identified will not be sufficient to close its

[7] U.S. Government Accountability Office, *National Airspace System: Progress and Ongoing Challenges for the Air Traffic Organization*, GAO-05-485T (Washington, D.C.: April 14, 2005).

projected 4-year cumulative $8.2 billion shortfall. On the revenue side, this decision-making will include the consideration of a number of alternatives that have been proposed by various aviation stakeholders— ranging from increasing the current taxes that accrue to the Trust Fund to adopting user fees that would be more cost related— and the trade-offs associated with each. We plan to review these alternatives as part of our ongoing review of alternative approaches for funding FAA that we are doing at the request of this Subcommittee.

This concludes my statement. I would be pleased to answer any questions that you or other members of the Subcommittee may have.

Contacts and Acknowledgments

For further information on this testimony, please contact Dr. Gerald Dillingham at (202) 512-2834 or by email at dillinghamg@gao.gov. Individuals making key contributions to this testimony include, Jay Cherlow, Tammy Conquest, Colin Fallon, David Hooper, Maren McAvoy, and Nicolas Zitelli.

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