United States General Accounting Office

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Report to Congressional Requesters

September 2003

AIRPORT AND AIRWAY TRUST FUND

Financial Outlook Is Positive, but the Trust Fund's Balance Would Be Affected If Taxes Were Suspended

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GAO-03-979

September 2003

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Highlights

Highlights of GAO-03-979, a report to the Senate Committee on Commerce, Science, and Transportation and its Subcommittee on Aviation

Why GAO Did This Study

The multibillion dollar Airport and Airway Trust Fund (Trust Fund) provides most of the funding for the Federal Aviation Administration (FAA). The Trust Fund relies on revenue from 10 taxes, including passenger ticket, fuel, and cargo taxes. Concerns about the financial outlook of the Trust Fund have emerged recently given the downturn in passenger air travel, requests from the airlines to suspend some of the Trust Fund taxes, and the need to reauthorize FAA's major programs in 2003. GAO was asked to determine (1) the projected financial outlook of the Trust Fund and (2) how a 1-year suspension of various taxes accruing to the Trust Fund (i.e., a tax holiday), would affect its financial status. We were asked to assess five potential tax holidays that would have begun on April 1, 2003, and ended on April 1, 2004.

GAO used a model developed by FAA that made financial projections for the Trust Fund using expenditure assumptions that were based on (1) the Senate Committee on Commerce, Science, and Transportation's May 2, 2003, and the House Subcommittee on Aviation's May 15, 2003, reauthorization proposals authorizing over $34 billion and (2) the President's proposal authorizing almost $38 billion from the Trust Fund. For each of these proposals, GAO asked FAA to model the effects of five different tax holidays.

www.gao.gov/cgi-bin/getrpt?GAO-03-979.

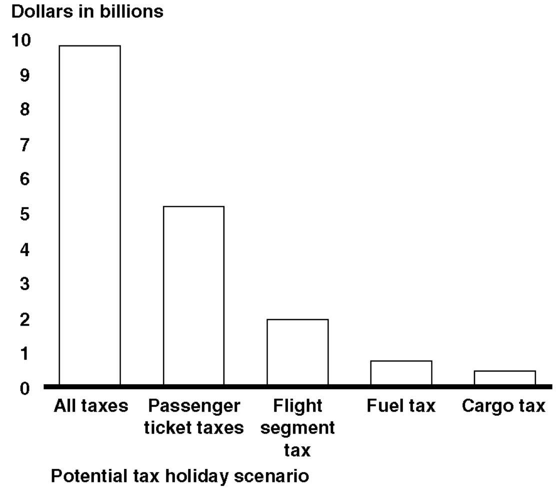
To view the full product, including the scope and methodology, click on the link above. For more information, contact Gerald Dillingham at (202) 512-2834 or dillinghamg@gao.gov.

What GAO Found

Over the next 3 years, with no change in tax rates and assuming that FAA's passenger traffic and airfare projections are valid, the Trust Fund is expected to continue to have sufficient revenue to cover authorized spending and end each year with a surplus, or an "uncommitted balance" as it is usually called, under each of the three expenditure scenarios we analyzed. For fiscal years 2004 through 2006, the potential uncommitted balances would range from over $4.4 billion (if Congress adopted either the House or the Senate proposal) to $1 billion, if the President's proposal were adopted.

Suspending some or all of the taxes that accrue to the Trust Fund for 1 year would reduce or eliminate the Trust Fund's uncommitted balance. As depicted below, if all taxes accruing to the Trust Fund were suspended, effective April 1, 2003, almost $10 billion in tax revenue would be forgone and the uncommitted balance would be eliminated by October 2003. The status of the Trust Fund would also differ according to the reauthorization proposal adopted and the taxes suspended. For example, suspending the passenger ticket tax and adopting either the House or Senate proposal would reduce the uncommitted balance to $1.8 billion and $2 billion, respectively, in 2006. However, suspending the same tax and adopting the President's proposal would eliminate the uncommitted balance by October 2003. The budgetary consequences of the remaining potential tax holidays would vary substantially. FAA officials stated that under the President's proposal, a passenger ticket tax holiday might require spending cuts to its capital programs, while a cargo tax holiday would require few if any spending cuts to its programs. In its comments on a draft of this report, FAA agreed with the report's findings and provided some clarifying comments that we incorporated where appropriate.

Amount of Forgone Tax Revenues under Five Potential Tax Holiday Scenarios, April 1, 2003, through April 1, 2004



Source: FAA.

United States General Accounting Office

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Abbreviations

AIP	Airport Improvement Program
AIR-21	Wendell H. Ford Aviation Investment and Reform Act for the 21st Century
FAA	Federal Aviation Administration
F&E	Facilities and Equipment
RED	Research, Engineering, and Development

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United States General Accounting Office
Washington, D.C. 20548

September 15, 2003

The Honorable John McCain
Chairman
The Honorable Ernest F. Hollings
Ranking Minority Member
Committee on Commerce, Science, and Transportation
United States Senate

The Honorable Trent Lott
Chairman
The Honorable John D. Rockefeller, IV
Ranking Minority Member
Subcommittee on Aviation
Committee on Commerce, Science, and Transportation
United States Senate

The multibillion dollar Airport and Airway Trust Fund (hereafter called the Trust Fund) provides all of the funding for three out of four of the Federal Aviation Administration's (FAA) major accounts—Airport Improvement Program; Facilities and Equipment; and Research, Engineering, and Development—and a majority of support for the fourth account, Operations. The Trust Fund relies on a number of taxes for its revenue, including passenger ticket, fuel, and cargo taxes that are paid by passengers and airlines.

In fiscal year 2002, the Trust Fund received about $10 billion in revenue and had expenditures of about $12 billion. Although expenditures exceeded revenues in fiscal year 2002, since its creation in 1970, Trust Fund revenues have generally exceeded expenditures—resulting in a 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 forgone revenue when Trust Fund taxes lapsed in 1996 and to fund new airport security requirements resulting from the September 11, 2001, terrorist attacks.

Although the Trust Fund's uncommitted balance totaled almost $5 billion at the end of fiscal year 2002, a number of recent developments have raised congressional concerns about its financial outlook. First, domestic passenger traffic has declined over 12 percent over the last 3 years, in part because of a sluggish economy and the public's reluctance to travel. Second, the airline industry is experiencing significant financial problems, and the airlines have asked Congress for tax relief, such as suspending the taxes that support the Trust Fund, which is known as a "tax holiday." According to Air Transport Association officials, such relief could lower airline operational costs, generate additional passenger traffic through lower fares, or improve yields realized on existing traffic. Third, given that the current authority—the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century—for funding FAA's major programs and activities expires at the end of fiscal year 2003, Congress will have to decide what level of expenditures from the Trust Fund is appropriate to authorize for fiscal year 2004 and beyond. Recently, the Senate Committee on Commerce, Science, and Transportation; the House Committee on Transportation and Infrastructure's Subcommittee on Aviation; and the President presented reauthorization proposals for FAA. The three proposals differ regarding the amounts authorized from the Trust Fund, the number of years authorized, and how much would be used to support FAA programs. In light of these developments, we were asked to address the following questions:

1. What is the projected financial outlook of the Trust Fund?

2. How would the suspension (i.e., a tax holiday) of various taxes accruing to the Trust Fund affect its financial status?

To answer these questions, we requested Trust Fund financial projections from FAA using the expenditure scenarios included in the following three proposals: (1) the Senate Commerce, Science, and Transportation Committee's reauthorization proposal, known as the Aviation Investment and Revitalization Vision Act (S. 824, May 2, 2003, version, hereafter called the Senate); (2) the House Transportation and Infrastructure Committee, the Aviation Subcommittee's reauthorization proposal, known as Flight 100—Century of Aviation Reauthorization Act (H.R. 2115, May 15, 2003, version, hereafter called the House); and (3) the President's reauthorization proposal, known as the Aviation Authorization Act of 2003. Because there is a difference in the number of years that the three expenditure scenarios would authorize funding for FAA's accounts, our analysis compares proposed authorizations for fiscal years 2004 through 2006, which were included in each scenario. For each of these three proposals, we asked FAA to model the effects of the following five different tax holidays: a cargo tax holiday, a fuel tax holiday, a flight segment tax holiday, a passenger ticket tax holiday,[1] and an "all" tax holiday that would include the four taxes previously mentioned and the international departure/arrival taxes. We selected these five holidays because they represent a range of different tax holiday scenarios. At your request, our analysis was based on a tax holiday hypothetically beginning on April 1, 2003, and lasting 1 year until April 1, 2004. Although our analysis is based on hypothetical tax holidays during this period, the results of our analysis would remain valid if Congress were to decide to implement the tax holidays retroactive to April 1, 2003, or would be similar if Congress were to grant a tax holiday at a later time. The information and analysis presented in this report are based on FAA's most recently published aviation forecasts, which were made in November 2002. Appendix I provides additional details on our scope and methodology.

We performed our work from February through August 2003 in accordance with generally accepted government auditing standards.

[1]The passenger ticket tax holiday scenario includes the taxes on domestic airline tickets, rural airport tickets, and frequent flyer awards.

Results in Brief

With no change in tax rates and assuming FAA's passenger traffic and airfare projections are valid, the Trust Fund is expected to continue to have sufficient revenue to cover authorized spending and end each year through fiscal year 2006, with a surplus (or an "uncommitted balance") under each of the three expenditure proposals we analyzed. For example, if Congress were to adopt the Senate's or House's reauthorization proposal, which would authorize over $34 billion from the Trust Fund, the Fund's uncommitted balances are projected to be over $4.4 billion each year from 2004 through 2006. In comparison, if the President's reauthorization proposal to authorize $38 billion from the Trust Fund were to be adopted, the Fund's uncommitted balance is projected to decline from $4.8 billion in 2002 to $1 billion in 2006 because it authorizes a higher amount of Fund revenue for FAA's Operations. However, if passenger traffic and airfares[2] through 2006 are below the levels projected in FAA's November 2002 forecast, Trust Fund revenues may not be sufficient to cover planned expenditures beginning in 2005. According to FAA officials, as of May 2003, passenger traffic levels and airfares are lower than the projections made in November 2002.

The suspension of some or all of the taxes that accrue to the Trust Fund for 1 year would reduce or eliminate the uncommitted balance of the Trust Fund. As shown in table 1, for example, suspending all taxes accruing to the Trust Fund for 1 year, starting on April 1, 2003, would cause the Trust Fund's uncommitted balance to reach zero by October 2003, no matter which legislative proposal were adopted.

[2]For forecasting Trust Fund revenues, FAA uses airfares to calculate yields that measure the average amount of revenue per passenger mile.

Table 1: Projected Trust Fund Uncommitted Balances at the End of Fiscal Year 2006, by Tax Holiday and Reauthorization Proposal

Dollars in millions

Tax holiday scenarios	Senate's proposal	House's proposal	President's proposal
All taxes	Eliminated as of October 2003	Eliminated as of October 2003	Eliminated as of October 2003
Passenger ticket taxes	$1,957	$1,772	Eliminated as of October 2003
Flight segment tax	3,608	3,424	Eliminated as of April 2004
Fuel tax	4,237	4,053	$135
Cargo tax	4,412	4,228	495

Source: FAA.

Notes:

At the end of fiscal year 2002, the Trust Fund's uncommitted balance was $4.8 billion.

The Senate's reauthorization proposal is the version of S. 824 passed by the Senate Commerce, Science, and Transportation Committee on May 2, 2003, and the House's reauthorization proposal is the version of H.R. 2115 passed by the House Transportation and Infrastructure Committee's Aviation Subcommittee on May 15, 2003.

Under an all tax holiday, all taxes accruing to the Trust Fund are suspended. A passenger ticket tax holiday would suspend the passenger ticket tax, the rural airport tax, and the frequent flyer tax. A flight segment tax holiday would suspend the segment tax. A fuel tax holiday would suspend the commercial aviation, general aviation gasoline, and general aviation jet fuel taxes. A cargo tax holiday would suspend the cargo waybill taxes.

In addition, according to FAA officials, an all tax holiday would require significant spending cuts to FAA's capital programs and could result in contract termination costs in excess of $1 billion under all three expenditure scenarios, unless Congress authorized funding from the General Fund. However, FAA officials stated that air traffic control services would be maintained if taxes were suspended and the Trust Fund's uncommitted balance reached zero because such services are considered an emergency function that involves the safety of human life. According to FAA officials, to ensure the continued safe operations of the national airspace system, the agency would use available Trust Fund revenue to first fund Operations costs, which primarily support air traffic control activities.

In commenting on a draft of this report, FAA agreed with information contained in this report and provided some clarifying and technical comments that we incorporated where appropriate.

Background

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 FAA investments in air traffic control facilities. It provides all of the funding for the Airport Improvement Program (AIP), which provides grants for construction and safety projects at airports; the Facilities and Equipment (F&E) account that funds technological improvements to the air traffic control system; and a Research, Engineering, and Development (RED) account. In fiscal year 2002, the Trust Fund provided 79 percent of the funding for FAA Operations, which represented almost 50 percent of Trust Fund expenditures.

The Trust Fund is supported by 10 dedicated excise taxes. One of the major taxes is referred to as the passenger ticket tax, which include the following 3 taxes:

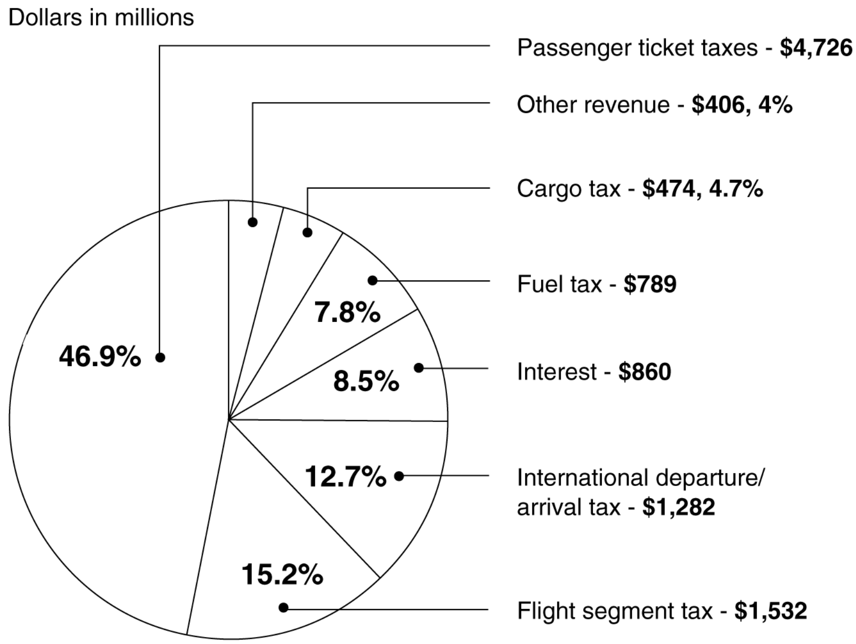
- 7.5 percent tax on the price of domestic airline tickets,
- 7.5 percent tax on the value of awards of free or reduced-rate air fares (frequent flyer awards tax), and
- 7.5 percent tax on the price of domestic airline tickets to "qualified rural airports" (flight segment fees do not apply if this tax is levied).

The remaining 7 excise taxes that finance the Trust Fund include the following:

- $3 on each flight segment, indexed to inflation starting in 2002;
- 6.25 percent tax on the price charged for transporting cargo by air;
- $0.043 per gallon tax on commercial aviation jet fuel;
- $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 inflation; and
- $13.40 tax on international departures, indexed to inflation.

In fiscal year 2002, the Trust Fund received about $10 billion in revenue from these taxes and interest.[3] As shown in figure 1, the passenger ticket tax was the largest single source of Trust Fund revenue, totaling about 47 percent of all receipts, followed by the flight segment tax at 15 percent of total receipts, and the international departure/arrival tax at about 13 percent of total receipts.

Figure 1: Trust Fund Revenues Totaled $10 Billion in Fiscal Year 2002



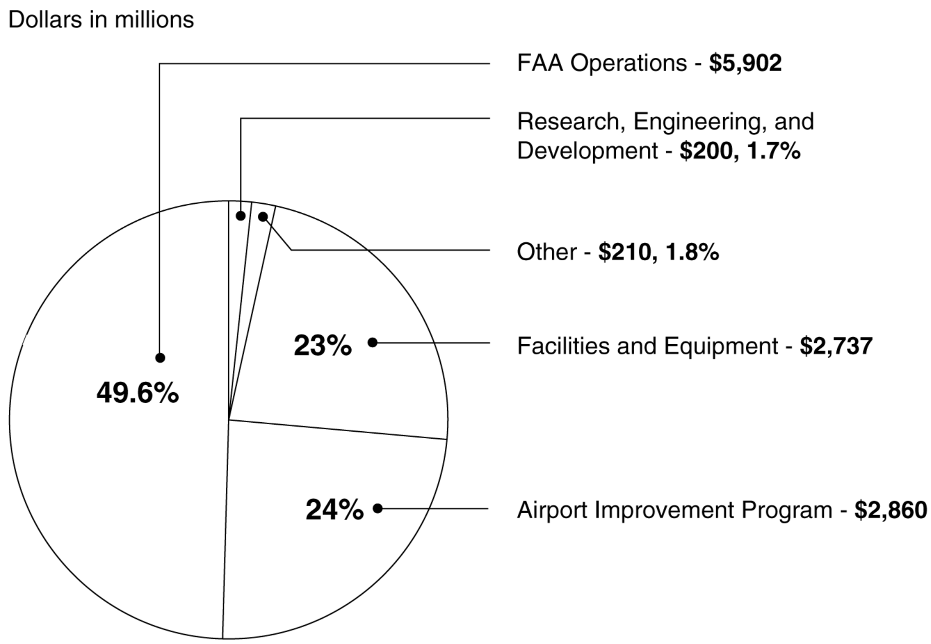
Source: Air Transport Association.

Note: Other revenues to the Trust Fund include the rural airport tax, the frequent flyer tax, and the collection of fees from other activities.

Trust Fund expenditures totaled almost $12 billion in fiscal year 2002. As shown in figure 2, FAA Operations accounted for nearly half of Trust Fund expenditures, followed by AIP grant funding at 24 percent, F&E at 23 percent, and RED at almost 2 percent.

[3] Interest refers to the amount of money earned on the Trust Fund's cash balance.

Figure 2: Trust Fund Expenditures Totaled $12 Billion in Fiscal Year 2002



Source: Air Transport Association.

Note: Other expenditures include offsetting collections from the program accounts to the Trust Fund and appropriations to the Payments to Air Carriers Program managed by the Department of Transportation.

FAA's current authorization expires on September 30, 2003, and Congress is considering three proposals that would reauthorize funding for FAA. In the May 2, 2003, version of S. 824, the Senate proposes to authorize $43.4 billion from 2004 through 2006 for FAA programs, of which $34.4 billion would be funded from the Trust Fund, with the balance of $9.1 billion covered by the General Fund. In the May 15, 2003, version of H.R. 2115, the House Subcommittee on Aviation proposes to authorize $60 billion from 2004 through 2007 for FAA programs, of which $47.2 billion would be funded from the Trust Fund, with the balance of $12.8 billion covered by the General Fund. The President's proposal authorizes $57.3 billion from 2004 through 2007 for FAA programs, of which $50.8 billion would be funded from the Trust Fund and the remaining $6.6 billion would be funded from the General Fund.

Table 2 breaks down the distribution of the funding among FAA programs for each of the three expenditure scenarios through 2006.[4] Under each proposal, the Trust Fund provides all of the funding for the AIP, F&E, and RED programs and funds between 58 and 79 percent of FAA Operations. The balance of FAA Operations is funded through the General Fund and not reflected in table 2.

[4]Although the House's and President's reauthorization proposals authorize funding through 2007, for comparative purposes, our analysis includes authorizations for fiscal years 2004 through 2006, which were included in all three proposals.

Table 2: Expenditures Scenarios Showing Proposal Authorizations from the Trust Fund for FAA

Dollars in millions

	Fiscal year			
	2004	2005	2006	Total
Airport Improvement Program				
Senate's proposal	$3,400	$3,500	$3,600	**$10,500**
House's proposal	3,400	3,600	3,800	**10,800**
President's proposal	3,400	3,400	3,400	**10,200**
Facilities and Equipment				
Senate's proposal	2,916	2,971	3,030	**8,917**
House's proposal	2,938	2,993	3,053	**8,984**
President's proposal	2,916	2,971	3,031	**8,918**
Research, Engineering, and Development				
Senate's proposal	289	204	317	**810**
House's proposal	366	410	462	**1,238**
President's proposal	100	102	104	**306**
Operations				
Senate's proposal	4,124	4,808	5,210	**14,142**
House's proposal	4,025	4,480	4,842	**13,347**
President's proposal	6,000	6,112	6,236	**18,348**
Other				
Senate's proposal	0	0	0	**0**
House's proposal	5	7	5	**16**
President's proposal	4	5	5	**13**
Total authorizations				
Senate's proposal	$10,729	$11,483	$12,157	**$34,369**
House's proposal	10,734	11,490	12,162	**34,385**
President's proposal	12,420	12,590	12,776	**37,785**

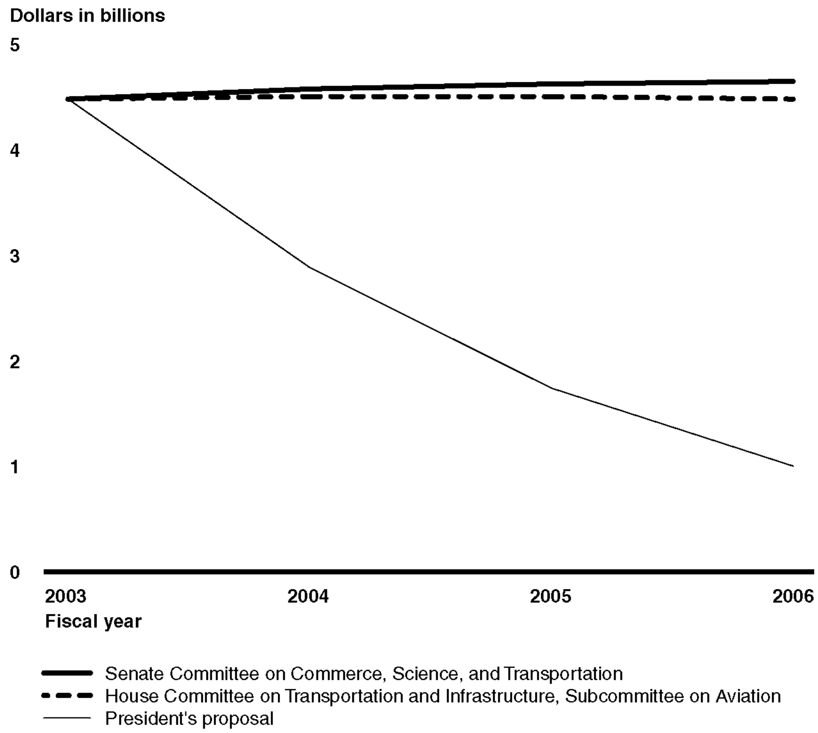
Source: S. 824 (May 2, 2003, version), H.R. 2115 (May 15, 2003, version), H.R. 586, and the President's reauthorization proposal.

Note: "Other" includes funding for an airline data and analysis program, and a climate change program, but does not include payments to air carriers funding. In some cases, the numbers do not add to reported totals due to rounding.

Projected Financial Outlook for the Trust Fund 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 each of the three expenditure proposals. This positive financial outlook depends on the realization of FAA's forecasted passenger traffic levels and airfares. As shown in figure 3, under the Senate's and House's proposals, the Trust Fund's year-end uncommitted balance is projected to be over $4.4 billion over the next 3 years. Under the President's proposal, the Trust Fund's year-end uncommitted balance is projected to range between $2.9 billion in 2004 and $1 billion in 2006.

Figure 3: Projected Uncommitted Balances of the Trust Fund, Fiscal Years 2003 through 2006



Source: FAA.

The primary reason that the Trust Fund's uncommitted balance would be higher under the Senate's and House's proposals is that they use 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 and RED in a given year equal to projected Trust Fund revenues (as specified in the President's budget) minus the authorizations for the capital accounts (AIP and F&E) in that year. Thus, under the Senate's proposal, the Trust Fund is projected to support $14.1 billion, or 61 percent of FAA Operations from 2004 through 2006. Under the House's proposal, the Trust Fund is projected to support $13.3 billion, or 58 percent of FAA Operations from 2004 through 2006.[5] 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 $18.3 billion for FAA Operations from 2004 through 2006, or about 79 percent of its total estimated costs for Operations.

Although the Trust Fund is projected to have a surplus over the next several years under each of the expenditure proposals, this projection depends to a significant extent on the realization of forecasted commercial passenger traffic levels and airfares. If passenger traffic or yields fall below the levels that FAA projected in November 2002, the Trust Fund may not have sufficient revenues to fund projected expenditures. For example, table 3 presents the projected Trust Fund balances under each expenditure proposal and shows the impact if revenues were 5 percent or 10 percent less than currently projected. The Trust Fund could absorb these revenue shortfalls while retaining a positive balance under the Senate's and House's proposals because the AIR-21 formula would limit appropriations from the Trust Fund for FAA Operations. In contrast, if revenues were 5 percent lower than projected, the uncommitted balance of the Trust Fund would reach zero during 2006 under the President's proposal; if the revenues were 10 percent lower than projected the uncommitted balance would reach zero in 2005.

[5] Although the House and Senate use the same formulas to determine how much funding of FAA Operations should come from the Trust Fund, the total amount of funding in the two proposals differ.

Table 3: Sensitivity Analysis of the Trust Fund's Uncommitted Balance to Revenue Shortfalls

Dollars in millions

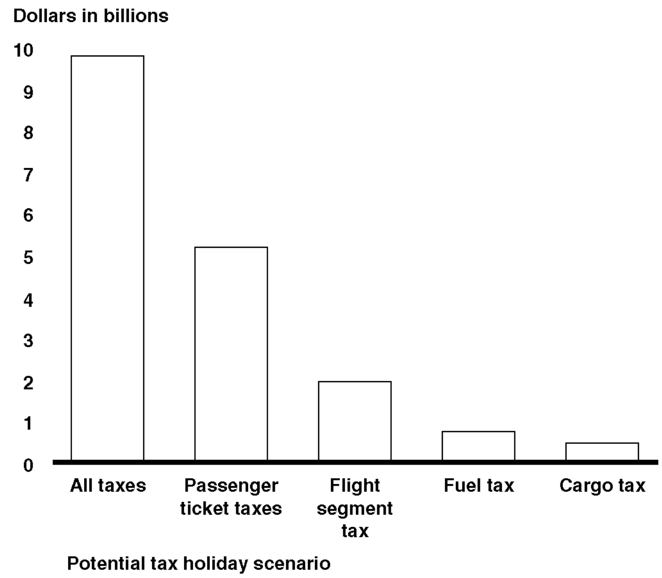
		Fiscal year		
Revenue scenario	**Proposal**	**2004**	**2005**	**2006**
Baseline projections as of November 2002.	Senate	$4,565	$4,630	$4,651
	House	4,500	4,502	4,467
	President	2,878	1,744	1,003
If revenues are 5 percent less than projected.	Senate	4,098	4,167	4,195
	House	4,033	4,039	4,010
	President	1,874	143	0
If revenues are 10 percent less than projected.	Senate	3,631	3,704	3,738
	House	3,566	3,576	3,553
	President	871	0	0

Source: FAA.

Suspending Some or All Taxes Accruing to the Trust Fund Would Reduce or Eliminate the Trust Fund's Uncommitted Balance

Billions of Trust Fund revenue would be forgone if all taxes accruing to the Trust Fund were suspended for 1 year. As shown in figure 4, suspending all taxes would result in almost $10 billion in forgone Trust Fund revenues. The amount of Trust Fund revenues forgone under the other tax holiday scenarios would range from approximately $447 million if the cargo tax were suspended to nearly $5.2 billion if the passenger ticket taxes were suspended.

Figure 4: The Amount of Forgone Tax Revenues under the Five Potential Tax Holiday Scenarios, April 1, 2003, through April 1, 2004

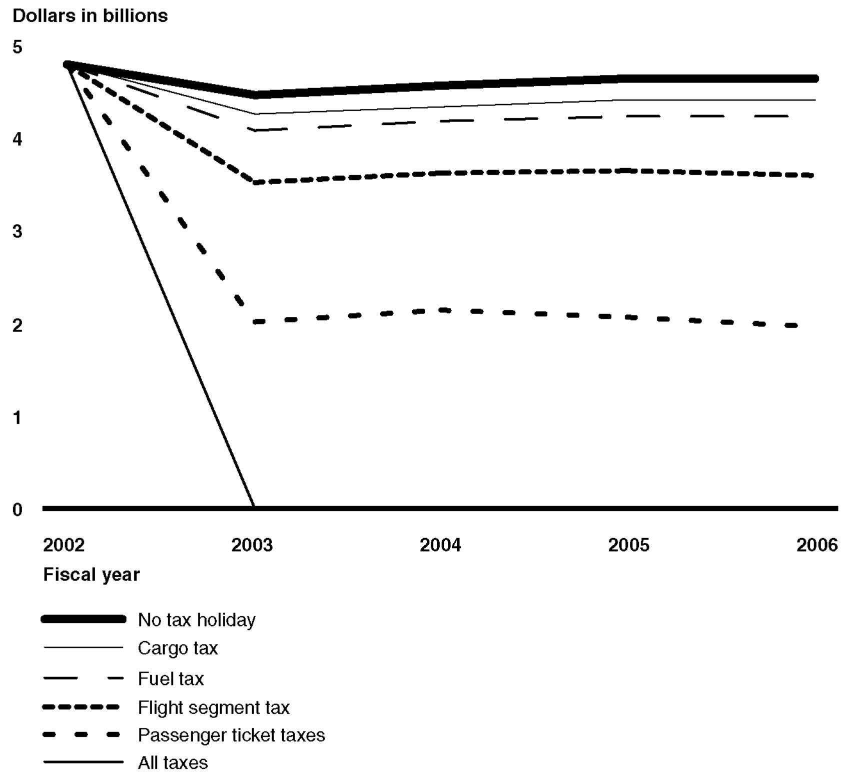


Source: FAA.

Note: This figure does not include the amount of Trust Fund interest that would be forgone.

Under an all tax holiday, the Trust Fund's uncommitted balance would reach zero by October 2003, no matter which expenditure proposal were adopted, as shown in figures 5 through 7. However, the other four tax holiday scenarios would affect the Trust Fund's uncommitted balance in different ways under each of the three expenditure proposals. Figure 5 shows the effects of several tax holidays under the Senate's proposal. Although the Trust Fund's uncommitted balance would decrease under the other four tax holiday scenarios, it would not reach zero. For example, a passenger ticket tax holiday would decrease the Trust Fund's uncommitted balance from $4.8 billion in 2002 to $2 billion in 2003 and to $2.1 billion in 2004, while a fuel tax holiday would reduce it to $4.1 billion in 2003 and to $4.2 billion in 2004.

Figure 5: Trust Fund's Projected Uncommitted Balances Based on Tax Holidays, under the Senate Committee on Commerce, Science, and Transportation's Proposal



Source: FAA.

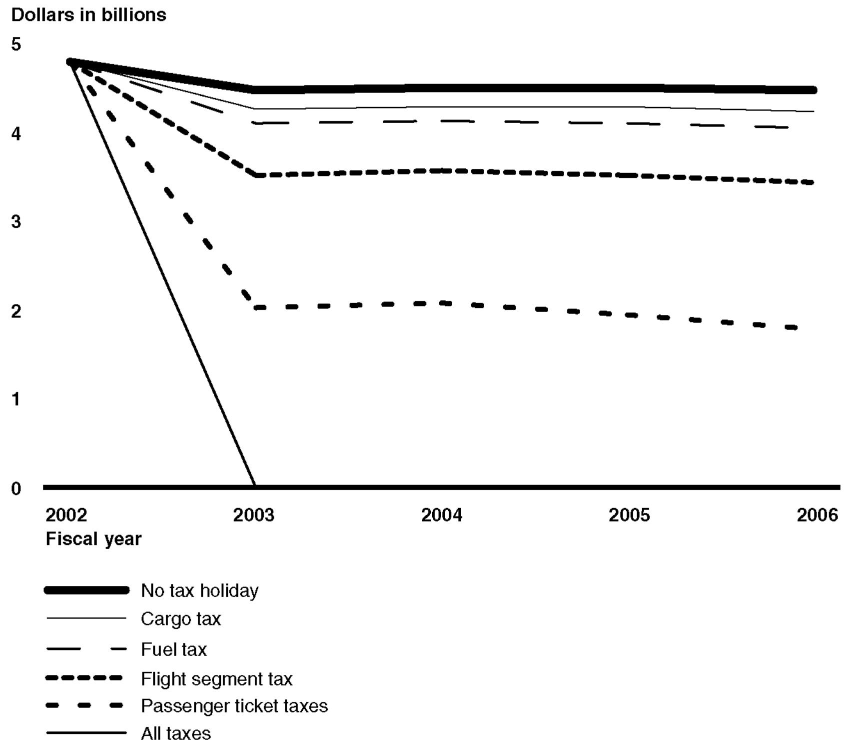
Notes:

This figure includes fiscal years 2002 and 2003 and reflects expenditures according to AIR-21, which expires on September 30, 2003. It also includes fiscal years 2004 through 2006, which reflects the Senate's reauthorization proposal.

The baseline represents FAA's projections of the Trust Fund's uncommitted balance under the Senate's proposal with no tax holiday. Under an all tax holiday, all taxes accruing to the Trust Fund are suspended. A passenger ticket tax holiday would suspend the passenger ticket tax, the rural airport tax, and the frequent flyer tax. A flight segment tax holiday would suspend the segment fee. A fuel tax holiday would suspend the commercial aviation, general aviation gasoline, and general aviation jet fuel taxes. A cargo tax holiday would suspend the cargo waybill taxes.

Similarly, as shown in figure 6, under the House's proposal, the Trust Fund's uncommitted balance would also decrease under the other four tax holiday scenarios, but it would not reach zero. For example, a flight segment fee tax holiday would decrease the Trust Fund's uncommitted balance from $4.8 billion in 2002 to $3.5 billion in 2003 and to $3.6 billion in 2004, while a cargo tax holiday would reduce it to $4.3 billion in 2003 and to $4.3 billion in 2004.

Figure 6: Trust Fund's Projected Uncommitted Balances Based on Tax Holidays, under the House Committee on Transportation and Infrastructure, Subcommittee on Aviation's Proposal



Source: FAA.

Notes:

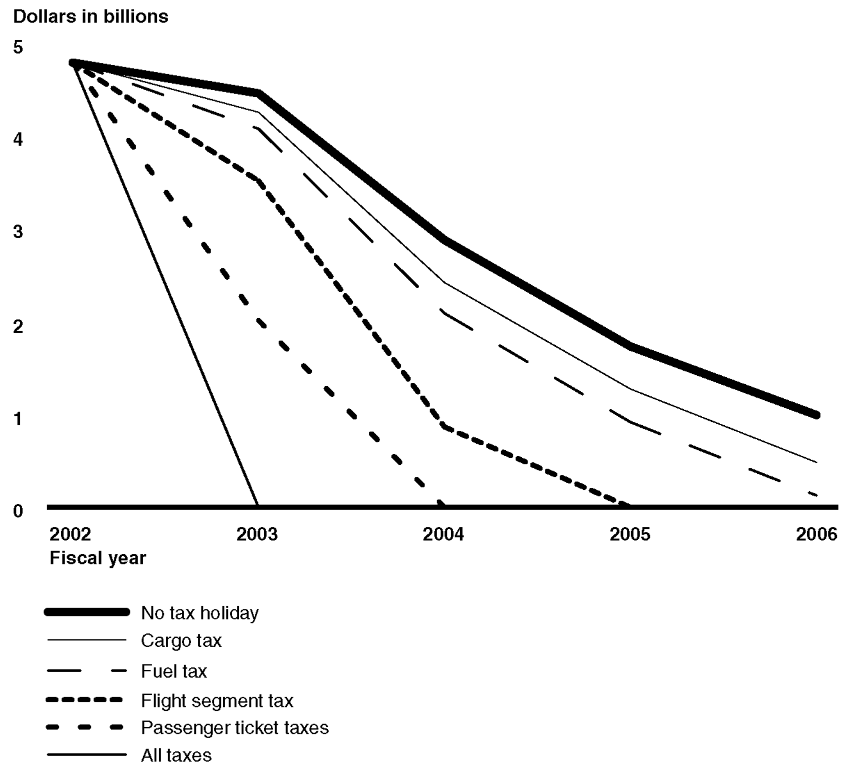
This figure includes fiscal years 2002 and 2003 and reflects AIR-21, which expires on September 30, 2003. It also includes fiscal years 2004 through 2006, which reflects the House's reauthorization proposal.

The baseline represents FAA's projections of the Trust Fund's uncommitted balance under the House's proposal with no tax holiday. Under an all tax holiday, all taxes accruing to the Trust Fund are suspended. A passenger ticket tax holiday would suspend the passenger ticket tax, the rural airport tax, and the frequent flyer tax. A flight segment tax holiday would suspend the segment fee. A fuel tax holiday would suspend the commercial aviation, general aviation gasoline, and general aviation jet fuel taxes. A cargo tax holiday would suspend the cargo waybill taxes.

In contrast, as shown in figure 7, under the President's proposal, the Trust Fund's uncommitted balance would reach zero under three of the five tax holiday scenarios by the end of 2006. For example, a passenger ticket tax holiday would cause the uncommitted balance to reach zero by October 2003. A fuel tax holiday and cargo tax holiday would be the only tax holiday scenarios in which the Trust Fund's uncommitted balance would not reach zero by 2006 under the President's proposal. Under a fuel tax holiday, the Trust Fund's uncommitted balance would decrease from $4.8 billion in 2002 to $135 million in 2006, a decrease of about $4.7 billion. Similarly, a cargo tax holiday would decrease to $495 million in 2006, a decrease of about $4.3 billion.

A tax holiday under the President's proposal would have a greater effect because that proposal would require the Trust Fund to support a larger percentage of FAA Operations compared with the Senate's and House's proposals. For example, if there were an all tax holiday and the President's proposal was adopted, the Trust Fund would support 79 percent of FAA Operations. Under the Senate's and House's proposals, the amount of funding spent on FAA Operations would be reduced in response to the amount of revenues lost from a tax holiday due to the adoption of the AIR-21 funding formula for Operations.

Figure 7: Trust Fund's Projected Uncommitted Balances Based on Tax Holidays, under the President's Proposal



Source: FAA.

Notes:

This figure includes fiscal years 2002 and 2003 and reflects AIR-21, which expires on September 30, 2003. It also includes fiscal years 2004 through 2006, which reflects the President's reauthorization proposal.

The baseline represents FAA's projections of the Trust Fund's uncommitted balance under the President's proposal with no tax holiday. Under an all tax holiday, all taxes accruing to the Trust Fund are suspended. A passenger ticket tax holiday would suspend the passenger ticket tax, the rural airport tax, and the frequent flyer tax. A flight segment tax holiday would suspend the segment fee. A fuel tax holiday would suspend the commercial aviation, general aviation gasoline, and general aviation jet fuel taxes. A cargo tax holiday would suspend the cargo waybill taxes.

In addition to forgone revenue and the elimination or reduction of the Trust Fund's uncommitted balance, granting any kind of tax holiday could pose budgetary challenges for FAA. For example, as previously noted, a 1-year all tax holiday starting in April 2003 would cause the uncommitted balance of the Trust Fund to reach zero by October 2003 and might require FAA to make significant spending cuts to the aviation programs supported by the

Trust Fund unless additional funding were authorized from the General Fund. If there were a 1-year all tax holiday, FAA officials said they would continue to maintain some FAA Operations, particularly air traffic control services because it is considered an emergency function that involves the safety of human life. However, according to FAA officials, the agency would have to suspend activities for the AIP, F&E, and RED programs until April 2004 and use the funds appropriated for these suspended capital programs to continue to first fund FAA Operations. According to FAA officials, additional support from the General Fund would also be needed to continue funding Operations during the first 6 months of fiscal year 2004.

FAA officials also stated that if a 1-year all tax holiday under all three expenditure scenarios were granted, FAA might have to delay or terminate some multimillion dollar F&E contracts, unless Congress authorized funding from the General Fund. FAA officials stated that while their contracts have clauses that limit liability, it is their experience that any remaining obligated funds for contracts in a given fiscal year that have not actually been expended would be used to offset contract termination costs. If there were a 1-year all tax holiday, FAA estimates it could incur in excess of $1 billion in contract termination costs. For example, according to FAA officials, terminating the National Aerospace System Implementation Services contract, which provides engineering support for the implementation of programs such as the Standard Terminal Automation Replacement System, would result in termination costs of $20 million. We reviewed FAA's data on the unobligated balances of outstanding F&E contracts and verified that the amount totaled $1.5 billion. However, we did not review individual FAA outstanding F&E contracts to confirm FAA's statement that on the basis of its experience, any remaining obligated funds for contracts in a given fiscal year that have not actually been expended would be used to offset contract termination costs.

Although FAA would not have to terminate contracts under the House's and Senate's proposals if there were a passenger ticket tax, flight segment tax, or fuel tax holiday, FAA' s ability to continue to fund its programs with Trust Fund revenue would be affected under the President's proposal if one of these holidays were granted. For example, if passenger ticket taxes were suspended for 1 year, beginning in April 2003, the uncommitted balance would reach zero by October 2003. Consequently, FAA officials stated that its AIP and F&E programs would have to be suspended from October 2003 through May 2004, if additional funds were not provided from the General Fund. However, to fully fund FAA Operations, particularly air traffic control services, Congress would have to authorize additional funding from the General Fund to offset revenue shortfalls created by these tax holidays.

Agency Comments

We provided the Department of Transportation with a draft of this report for its review and comment. FAA officials agreed with information contained in this report and provided some clarifying and technical comments that we incorporated where appropriate.

We are sending copies of this report to the appropriate congressional committees; the Secretary of Transportation; and the Administrator, FAA. We will also make copies available to others upon request. In addition, this report is also available at no charge on GAO's Web site at http://www.gao.gov.

Please contact me or Tammy Conquest at (202) 512-2834 if you have any questions. In addition, Jay Cherlow, Colin Fallon, Dave Hooper, and Richard Swayze made key contributions to this report.

Gerald L. Dillingham

Gerald Dillingham
Director, Physical Infrastructure Issues

Scope and Methodology

To determine the projected financial status of the multibillion dollar Airport and Airway Trust Fund (hereafter called the Trust Fund), we obtained from the Federal Aviation Administration (FAA) the financial projections for the Trust Fund that it had developed under the expenditure proposals included in the President's reauthorization proposal.[1] We subsequently asked FAA to develop similar projections using the expenditure scenarios in the proposals from the Senate Committee on Commerce, Science, and Transportation and the House Committee on Transportation and Infrastructure, Subcommittee on Aviation. In addition, since the realization of FAA's projections depends on passenger traffic levels and airfares, we asked FAA to develop two additional projections under each of the three expenditure proposals. Specifically, we asked FAA to project what would happen if tax revenues accruing to the Trust Fund from fiscal years 2003 through 2007 were 5 percent and 10 percent below the levels projected in FAA's November 2002 forecasts. Accordingly, our findings on the financial outlook of the Trust Fund are based on FAA's projections, rather than on any projections of our own. We reviewed the process, methodology, and sources of information used by FAA to make these projections and found them reasonable.[2] We discussed the approach and results of our analysis with FAA officials who are responsible for making the projections, representatives from the Airports Council International and the Air Transport Association, and two academic experts.

To assess the effect of various tax holidays on the financial status of the Trust Fund, we asked FAA to develop additional financial projections under various tax holiday scenarios. FAA developed these additional projections under each of the three expenditure proposals that we used in determining the financial condition of the Trust Fund. We then assessed the effect of each tax holiday scenario under each expenditure proposal by comparing the financial projection for the Trust Fund under that tax holiday scenario and expenditure proposal with FAA's baseline projection.

We used the following five tax holiday scenarios:

[1]FAA develops financial projections for the Trust Fund in conjunction with its forecasts of aviation activity.

[2]FAA uses both econometric and spreadsheet models to develop its financial projections for the Trust Fund. Although we did not do a comprehensive evaluation of FAA's models, we reviewed them to determine their appropriateness for this purpose.

- An all taxes holiday, in which all taxes that accrue to the Trust Fund are suspended.
- A passenger ticket tax holiday, in which the passenger ticket tax, the rural airport tax, and the frequent flyer tax are suspended.
- A flight segment tax holiday, in which the passenger segment tax holiday is suspended.
- A fuel tax holiday in which the commercial aviation, general aviation gasoline, and general aviation jet fuel taxes are suspended.
- A cargo tax holiday in which the cargo waybill taxes are suspended.

The following assumptions were also included in the analyses:

- As requested in March 2003, we based our analysis on hypothetical tax holidays that would have begun on April 1, 2003, and ended on April 1, 2004.
- The FAA projections presented do not account for budgetary responses by FAA to the drop in revenues resulting from a tax holiday. Unless each dollar of lost revenue resulting from a tax holiday was replaced by General Fund revenues, FAA would adjust its spending plans, which in turn would have a direct effect on FAA's projections.

In addition, in projecting the effect of any particular tax holiday on the Trust Fund's revenues, FAA set the tax rate to zero for the tax or taxes that were being suspended while keeping all other factors in its forecast model unchanged. That is, FAA's projections do not take into account changes that might cause the Trust Fund's revenues from one tax to increase when another tax was suspended (i.e., feedback effects). For example, a suspension of the passenger ticket taxes might lead to lower fares for air travelers, which in turn might cause more trips to be made, thereby increasing the Trust Fund's revenues from the flight segment tax. We discussed with FAA officials the possibility of preparing additional projections that incorporated feedback effects to more thoroughly analyze the impact of tax holidays. However, we chose not to make such a request because preliminary analysis that we and FAA officials conducted indicated that these feedback effects would likely not be large enough to change our findings. Finally, to assess the effect that tax holidays would have on FAA's ability to continue to use Trust Fund revenue to support its programs, we interviewed FAA officials. We reviewed FAA data on the outstanding Facilities and Equipment (F&E) contracts that had unobligated balances and verified that they totaled $1.5 billion. However, we did not review individual FAA outstanding F&E contracts to confirm FAA's statement that on the basis of its experience, any remaining obligated funds for contracts in a given fiscal year that have not actually been expended would be used to offset contract termination costs.

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