NATIONAL AVIATION POLICY FOR THE UNITED STATES

A PRO-COMPETITION, PRO-GROWTH AND PRO-TRAVELER PROPOSAL

U.S. TRAVEL ASSOCIATION

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NATIONAL AVIATION POLICY

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IMPORTANCE OF AIR TRAVEL

Air travel is essential for facilitating commerce, growing America's economy and enhancing our quality of life.

By connecting thousands of domestic markets both within the U.S. and around the world, air travel helps American businesses thrive across national and global boundaries, and keeps people connected to family, friends and destinations wherever they might be.

The Federal Aviation Administration estimates that in 2012, the commercial aviation industry generated $504 billion in real primary output directly supported 11.2 million American jobs. Travel expenditures account for nearly 50 percent of the direct economic output in commercial aviation.[1] In the next decade, air travel is forecast to grow from 776 million enplanements per year to almost 927 million, which could add $224 billion in annual travel spending and support three quarters of a million new American jobs.

Federal Aviation Administration Reauthorization

The Federal Aviation Administration (FAA) reauthorization bill provides the foundational policies and funding levels for the operations, safety, maintenance and modernization of the national aviation system.

On September 30, 2015, the Congressional authorization for the federal aviation programs will expire, and Congress must pass a multi-year reauthorization or short-term extension in order to keep the nation's air travel system functioning.

Members of the House Committee on Transportation and Infrastructure (T&I), and Senate Committee on Commerce, Science and Transportation are currently weighing potential policy changes, gathering viewpoints from aviation stakeholders and drafting the bill's legislative language.

The U.S. Travel Association believes that this FAA reauthorization cycle provides a historic opportunity for policymakers to authorize, in the words of House Transportation and Infrastructure Committee Chairman Bill Shuster, a "transformational bill" that will result in improvements in the ways we operate, invest in and provide services to the traveling public and to the many businesses that rely on the industry.

Key Problems in Aviation

The future growth and competitiveness of air travel in America is threatened by a core set of problems that must be addressed. These problems include:

- **Aging airport infrastructure:** The American Society of Civil Engineers rated airport infrastructure a D+ and not one U.S. airport ranks among the world's top 25. Without significant airport infrastructure improvement, capacity constraints will limit the travel industry's growth, costing the U.S. economy billions in travel spending and hampering our nation's global competitiveness. Failure to increase capacity at John F. Kennedy International Airport (JFK) and Newark Liberty International Airport (EWR) alone will cost the U.S. economy $6 billion annually by 2016 and $48 billion annually by 2034.[2]
- **Growing congestion:** Inadequate airport infrastructure and an outdated air traffic control system are leading to record levels of congestion. In 2014, one in five flights in the U.S. was either delayed or cancelled; flight delays have reached their highest levels since 2008, and flights cancellations have reached their highest levels since 2000.[3]
- **Declining airline competition:** Due to airline consolidation and inadequate airport capacity, airline competition is stagnant, driving up airfares and pricing some travelers out of the market. Just four airlines control almost 80% of all available capacity, and 75% of the all airline routes are dominated by a single carrier with at least 50% of the market share. On international routes, the U.S. legacy carriers and their global alliance dominate the marketplace. Over the North Atlantic market, the U.S. legacy carriers and their global alliance partners control more than 75% of the capacity.[4]

[1] https://www.faa.gov/air_traffic/publications/media/2014-economic-impact-report.pdf

[2] http://www.ustravel.org/sites/default/files/page/2013/08/USTravel_Eno.pdf

[3] http://www.transtats.bts.gov/homedrillchart.asp

[4] http://www.gao.gov/assets/670/664060.pdf

NATIONAL AVIATION POLICY (CONTINUED)

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Key Problems in Aviation (CONTINUED)

- **Dwindling air service:** Airline consolidation has significantly reduced air service to small and medium-sized communities. From 2007-2013, air service at medium-sized airports dropped by 25% and air service at small hubs declined by 20%. Since 2008, 77 of the top 100 U.S. airports have lost seat capacity.[5]
- **Higher travel frustrations:** Flying hassles are dampening air travel demand and costing the travel industry billions of dollars each year. According to a U.S. Travel survey, air travelers' top three frustrations are flight delays and cancellations, the overall cost of flying, and airline fees. In 2013, Americans avoided 38 million trips because of air travel hassles, which lowered demand by an astonishing 8% and cost travel businesses $27.2 billion in spending.[6]
- **Inadequate funding and poor management of NextGen:** NextGen has experienced unstable federal funding, causing implementation issues and increasing costs to the U.S. economy. Like other federal agencies, the FAA is also subject to federal procurement rules, which create additional challenges when it comes to managing large-scale, technologically intensive projects such as NextGen. The inability of federal agencies to issue bonds, or any other form of long-term financing, only exacerbates these challenges.

National Aviation Policy

For almost a century, Congress and the Executive Branch have played a leading role in the development and operation of the U.S. commercial aviation system. In 1925, President Calvin Coolidge called for the creation of a "national aviation policy," which led to the establishment of a government-regulated commercial aviation industry. Since that time, America's commercial aviation system has been leading the global race in aviation by embracing deregulation and free market principles.

Unfortunately, the aviation industry and travelers alike have experienced a challenging 21st century because of repeated shocks (e.g., the 9/11 terrorist attacks, the SARS health crisis, the severe economic recession); because of bankruptcies, mergers and consolidation of U.S. airlines; and because of aviation's unique vulnerability to the all-too-common budgetary and policy stalemates in Washington. Notwithstanding these myriad challenges, there has not been a significant reform of aviation policy in at least 25 years.

To counteract these trends and to design a National Aviation Policy that is pro-competition, pro-consumer, and pro-growth, U.S. Travel offers a comprehensive framework to modernize air travel in America. U.S. Travel believes this National Aviation Policy should inform the FAA reauthorization effort and include the following elements:

1. Reduce federal aviation taxes imposed on travelers as part of the reform effort to overhaul how the U.S. funds, provides and manages air traffic control.

- **Eliminate Five Airport and Airway Trust Fund Taxes:**
  - Domestic Passenger Ticket Tax: (7.5% excise tax on tickets). According to the U.S. Department of Transportation's Bureau of Transportation Statistics the average domestic fare was $393 (4Q 2014). This would reduce the tax an estimated $25.50 on the average domestic ticket.
  - Tax on International Arrivals and Departures: Currently set at $17.70 per passenger (indexed to the Consumer Price Index (CPI)).
  - Tax on Flights Between the Continental U.S. and Alaska and Hawaii (or Between Alaska and Hawaii): $8.90 per person (indexed to CPI)
  - Domestic Commercial Fuel Tax: 4.3 cents per gallon.
  - Tax on Mileage Awards: 7.5% of value of miles

The net effect on the amount of average federal taxes and fees on a domestic airline ticket would be a reduction of between $9.50 and $25.50, based on a base average round-trip airfare of $340, according to U.S. Travel's calculations.[7]

[5] http://gao.gov/products/GAO-14-454T

[6] https://www.ustravel.org/news/press-releases/survey-flying-hassles-keep-travelers-home

[7] See Appendix I

NATIONAL AVIATION POLICY (CONTINUED)

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National Aviation Policy (CONTINUED)

- **Reform the Funding of Air Traffic Control:** As part of the current Congressional discussions on air traffic control, passenger taxes would be replaced by a new user-fee system designed by a revamped and independent provider of air traffic control services. Airlines and other users would pay directly for air traffic operations and the capital needs of the system, including NextGen. This business-to-business (B2B) payment model, consistent with recommendations from the International Civil Aviation Organization (ICAO), would align airlines' air traffic costs with the services they actually use. Airlines would pay ATC user-fees directly to a new air traffic organization (ATO). This would:
  - Provide a stable and predictable source of funding for air traffic control;
  - Encourage airlines to use ATC service more efficiently;
  - Accelerate the implementation of NextGen by stopping the on-again, off-again uncertainties of the appropriations process and permit the new ATO to leverage its fees to accelerate deployment of NextGen capital needs.
- **Reform the Organization and Management of Air Traffic Control:** Congress should reform the organization of air traffic control by removing it from the FAA and creating a non-profit, commercial provider of services. This new air traffic organization would maintain an "arms-length" relationship with the safety regulator as recommended by ICAO. Today's FAA Air Traffic Organization's management structure would be replaced with a board of directors made up of air traffic users and aviation interests. This would:
  - Reduce operational costs of the ATC system through efficiency gains;
  - Align ATO capabilities with user needs and expectations;
  - Enable the faster deployment of upgraded ATO infrastructure to airports of all sizes.

2. Modernize airport infrastructure.

- **Improve U.S. Airport Infrastructure through Cost-Recovery, Locally Set User Fees:** Congress should give local airport authorities the option to recover their infrastructure costs through passenger facilities charges (PFCs). These PFCs fund airport improvements and enhance airline competition.
  - Airports would have the option to assess a PFC of up to $8.50 (adjusted for inflation), an increase from today's maximum of $4.50;
  - Consistent with today's practice, the fees would be only for federally authorized capital projects, requiring airline consultation before they are imposed;
  - Airports would continue to pay the airlines 11 cents per PFC (for their cost of administering them on the ticket).
- **Allow Large Hub Airports to be Self-funded by Eliminating their Federal Airport Improvement Program (AIP) Entitlements:** With a PFC increase, the top 30 large hub airports (handling 72% of all enplanements), would forego over $1.5 billion in federal AIP grants over 10 years. This would enable a significant portion of the tax reduction advocated in (1) above.
- **Target Existing $4.00 FAA Flight Segment Fee to Smaller Community Airports:** Recognizing that smaller community airports require industry assistance to meet their capital needs, especially in light of airline consolidation, dedicate FAA's flight segment fee to AIP, thereby providing a sustainable flow of revenue, replacing today's series of AATF taxes. With the elimination of AIP for larger hub airports, a $4.00 segment fee pegged to inflation and imposed on all domestic and international enplanements would provide a sufficient base of capital to support airport infrastructure and other FAA functions including safety. Under this proposal, AIP funding would be provided through a dedicated trust fund, and grants for small and medium-sized airports would not be reduced below current levels.

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3. Enhance airline competition.

- **Protect All Existing Open Skies Agreements and Expand to New Countries:** Prior to the first Open Skies agreement adopted in the 1992, the U.S. government—not free market principles—determined which international air carriers and routes could fly to and from the United States. Under Open Skies the airlines of each state are given unrestricted market access to fly between the two countries. These agreements eliminate government control over routing, frequency and pricing, and allow free market competition. We now have more than 100 Open Skies agreements in place with countries around the world.

  Open Skies agreements:

  - Deliver Competition: Open Skies is the foundation of airline competition, delivering new access and choices for travelers.
  - Lower Fares for Travelers: Economists have noted that fares have fallen 32% on routes subject to Open Skies agreements compared to markets that remained regulated.
  - Provide Access to More Flights: Before Open Skies, cities like Dallas, Detroit, Las Vegas, Memphis, Minneapolis, Portland, and Salt Lake City had very few or no direct international air connections. Adding services means more jobs because each overseas visitor spends on average $4,500 when they visit the U.S. (2012).

  This proposal strongly recommends that the U.S. government protect all existing Open Skies agreements and should continue to prioritize their expansion to other countries wherever possible.

- **Give Communities the Option to Adjust the PFC for Competition-Enhancing Projects:** Airports today raise capital from three principal sources: AIP, their users, and from the current $4.50 PFC. This proposal would better target AIP and create more opportunities for airports to become self-reliant and expand competition.

  Many gateway airports, including Atlanta, Chicago, Minneapolis-St. Paul, San Francisco, Washington and others, have long-term contractual agreements with the airlines that allow the airlines serving the airports to block significant capital projects they disagree with, even if they are required to improve efficiency, expand capacity, and/or enable the new entry or expanded services of competitors. These "Majority-in-Interest" clauses were a major factor in precipitating Congress to create the PFC in 1990 as a way of promoting competition.

  Because Congress has not authorized a PFC increase for 15 years, the value of PFCs has dropped by more than 50% just due to the effects of inflation. This has significantly reduced the financial capacity of airports—a principal reason why many U.S. airports have not been modernized. In addition, it has forced many airports to commit their existing PFCs for the foreseeable future, limiting their ability to add capacity and renew their infrastructure over the next decades.

  A PFC increase would "turn on" a source of revenue for airports thereby prohibiting today's post-consolidation network airlines (Delta, United and American) from blocking airport projects—many of which will have significant pro-competitive effects.

APPENDIX I

Below is the basis for U.S. Travel's calculations that the net effect of the proposed federal aviation tax cut would be a reduction of between $9.50 and $25.50 on an average base airfare of $340. It is important to recognize that many domestic passenger tickets and international tickets have a higher, and sometimes much higher, base fare. For those tickets, the tax savings would be even greater with the elimination of the 7.5% ticket tax.

BACKGROUND

The U.S. Travel proposal would eliminate the Domestic Passenger Ticket Tax, which is currently set at 7.5% of the base airfare. According to the Government Accountability Office (GAO), federal taxes and fees average 13.7% of the average domestic airfare. As such, the average federal taxes and fees collected on a $393 airfare would be $53.84 (or 13.7% of $393). This means the base airfare (the total domestic airfare minus federal taxes and fees) would be approximately $340. Therefore, the average Domestic Passenger Ticket Tax on a $340 base airfare is $25.50.

Estimates for Federal Taxes and Fees under the Current System

Average Domestic Airfare (including federal taxes and fees)[1]	$393.00
Average Federal Taxes and Fees (13.7% of domestic airfare)[2]	$53.84
Estimated Base Airfare *(Average domestic airfare minus average federal taxes and fees)*[3]	$340.00
Estimated Domestic Passenger Ticket Tax *(7.5% of estimated base airfare)*[4]	$25.50

EXPLANATION FOR SCENARIO #1 UNDER THE U.S. TRAVEL PROPOSAL

This scenario assumes the 7.5% Domestic Passenger Ticket Tax would be eliminated and that the remaining passenger federal passenger ticket taxes and fees would remain unchanged. This would likely happen in the period immediately following Congressional authorization to increase the maximum PFC to $8.50, because each airport individually sets its PFC rate and must go through several steps before adjusting the charge. These steps include identifying an eligible project for PFC funding, submitting a PFC application to FAA for approval (which can take FAA one year or more to complete), and providing airlines with an opportunity to review and comment on the project.

Estimates for Scenario #1:

Average Domestic Airfare (including federal taxes and fees)[5]	$393.00
Estimated Federal Taxes and Fees *(Average federal taxes and fees minus estimated domestic passenger ticket tax)*[6]	$28.34
Federal Tax and Fee Reduction Compared to Current System	**-$25.50**
Percent Reduction Compared to Current System	**-47%**

[1] According to the Department of Transportation, the average domestic airfare for Q4 of 2014 was $393.

[2] According to the Government Accountability Office (GAO), federal taxes and fees are 13.7% of the average domestic airfare. *($393 x .137 = $53.84)*

[3] *$393 - $54.84 ≈ $340*

[4] $340 x .075 = $25.50

[5] According to the Department of Transportation, the average domestic airfare for Q4 of 2014 was $393.

[6] $53.84 - $25.50 = $28.34

(Continued)

APPENDIX I (CONTINUED)

EXPLANATION FOR SCENARIO #2 UNDER THE U.S. TRAVEL PROPOSAL

This scenario assumes the 7.5% Domestic Passenger Ticket Tax would be eliminated. In addition, it assumes that for a roundtrip airfare with one connecting flight each way, the passenger originates and connects through airports that charge an $8.50 PFC.

It is important to note that the vast majority of the top 100 U.S. airports currently charge a PFC of $4.50. Under this scenario, the passenger would pay an additional $4.00 per segment of their trip. However, this scenario is highly unlikely, given the fact that many airports would not charge the maximum allowable PFC or adjust their current rates in the immediate future. This is considered an "extreme scenario."

Estimates for Scenario #2:

Average Domestic Airfare (including federal taxes and fees)[7]	$393.00
Estimated Federal Taxes and Fees *(Average federal taxes and fees minus estimated domestic passenger ticket tax)*[8]	$28.34
Additional PFC Charges *($4.00 for each originating and connecting airport with a total of four segments)*	$16.00
Total Federal Taxes and Fees *(Estimated federal taxes and fees plus additional PFC charges)*	$44.34
Federal Tax and Fee Reduction Compared to Current System	**-$9.50**
Percent Reduction Compared to Current System	**-17%**

[7] According to the Department of Transportation, the average domestic airfare for Q4 of 2014 was $393.

[8] $53.84 - $25.50 = $28.34