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Backgrounder
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CLINTON'S WELCOME PLAN TO IMPROVE AIR TRAVEL

(Updating *Backgrounder* No. 958, "The Airline Commission's Boost for Deregulation," September 29, 1993.)

The Clinton Administration's initiative to implement most of the recommendations of the 1993 National Commission to Ensure a Strong Competitive Airline Industry is generally welcome, and will both strengthen the airline industry and improve the air traffic control system. The initiative would, among other positive steps, extend the multilateral rules of international trade to air services, restructure the air traffic control system as an independent corporation, and rein in federal regulators. Unfortunately, the initiative also would increase government subsidies to commercial aeronautic research and production, which is well beyond any recommendation by the Airline Commission, and it is silent on much-needed tax relief for airlines as well as on how to pay for a reorganized air traffic control system.

The document on the initiative, issued by Transportation Secretary Federico Peña on January 6, 1994, indicates that legislation will be introduced in April.

RESTRUCTURING THE FAA

The Administration wisely endorses the Airline Commission's proposal to restructure the Federal Aviation Administration (FAA), separating the safety regulation function from the air traffic control system. The air traffic control system would become a government corporation, which could be a step toward establishing the system as a private corporation. Reform of this kind is long overdue. The FAA has experienced severe delays and cost overruns in modernizing the air traffic control system and in its plan to make use of the Global Positioning System (a network of orbital satellite radio beacons developed for U.S. military use, but now available for general navigation). These bureaucratic problems have reinforced the consensus that air traffic control must be placed on a more businesslike footing and freed of the government's costly and time-consuming procurement and personnel restrictions. Unfortunately, the Administration's sensible proposal will encounter resistance on Capitol Hill. Some key Congressmen already have expressed reservations about the proposed change, among them Senate aviation subcommittee chairman Senator Wendell Ford (D-KY) and Representative James Oberstar (D-MN), who will have jurisdiction over the proposal in the House.

The Administration's initiative is silent on the question of how the proposed air traffic control corporation would be funded, although *The New York Times* reports that the Administration plans to use a tax on airline tickets.[1] But in the same article, Jim Landry, who is president of the Air Transport Association, said the financing mechanism has not been worked out. Currently, one-third of the FAA's $9.5 billion budget comes from the Air-

1 Martin Tolchin, "Let New Corporation Control Air Traffic, U.S. Says," *The New York Times*, January 6, 1994, p. A16.

port and Airway Trust Fund, which is funded by a ticket tax. Other costs, such as the salaries of flight controllers, are paid from general revenues. Shifting the entire cost of the system to the trust fund has been proposed by recent Republican Administrations. The Clinton Administration may purposely link the trust fund tax issue with modernization of the air traffic control system, which would raise revenue and release general funds for spending in other areas. If air traffic control operations are paid from the trust fund, and removed from general taxpayer financing, the Congress would be free to divert the general taxes to other spending programs. It seems likely, however, that the costs of safety regulation, and other FAA functions that would not be entrusted to the corporation, would continue to be paid from general tax funds.

FURTHER DEREGULATION AND REFORM

The Administration's initiative generally follows the Airline Commission's recommendations on bankruptcy reform, and effectively sidesteps the Commission's idea of a presidentially appointed financial advisory committee for airlines. Without mentioning the financial committee idea, the initiative affirms that "Secretary Peña has directed Department of Transportation staff to monitor more closely and report to him regularly" on industry financial conditions. The Airline Commission noted that the Secretary already has authority to issue regulations to protect against financial irresponsibility by an airline, and so the initiative proposes no new financial regulations.

The initiative announces there will be an annual cost-benefit report to Congress on FAA regulations. This is welcome because, as the Airline Commission noted, "Neither Congress nor federal agencies know the magnitude of the total costs they impose on airlines and, indirectly, to travelers." The Administration's initiative follows the Airline Commission's recommendation that the FAA include data collection from the industry early in the rule-making process and monitor the costs of compliance, with actual data on benefits.

Unfortunately, the Administration's initiative is completely silent on one of the Airline Commission's most innovative regulatory reform proposals: that "FAA subject regulations to an annual regulatory cost budget—except for emergency safety regulations needed to address a direct and immediate threat to the traveling public." A regulatory budget would, in effect, set a total permissible cost of federal regulations on the economy, or an industry. Once the budget had been posted, a new regulation could be introduced if one with at least the same associated cost were to be discarded. Such a budget, therefore, would force regulators to look at the cost of complying with their rules in the same way a manager has to look at his operating costs. At a minimum, a regulatory budget would require the FAA to consider how costly rules could be phased in (or phased out) over time. Today, regulations often are triggered by news events, such as a spectacular disaster, and put into effect hastily without a proper evaluation of their costs and benefits, or a full consideration of the alternatives. A regulatory cost budget would force the FAA to think first about the cost imposed on airlines by each new rule.

ADVANCING TOWARD A MULTILATERAL SYSTEM

The Administration's initiative fully endorses the Airline Commission's call for "building a modern, liberal, and multinational regime for international aviation. Such a regime would provide greater access to foreign airports for U.S. carriers, more travel options for passengers, and enhanced competition that lowers fares." The Administration's airline initiative details a number of alternative negotiating strategies, including what would in effect be an aviation-specific free trade area: "the formation of a global coalition of like-minded free market-oriented nations that recognize the benefits of expanded air travel to citizens and national economies." There has already been some progress toward this goal, thanks to the recent European Union acceptance of a U.S. proposal to establish a working group to explore the creation of a fully unrestricted North Atlantic air cargo market.

The initiative also endorses the Airline Commission's recommendation to change the law to permit up to 49 percent foreign control of a U.S. airline. Existing law limits foreign ownership to no more than 25 percent of an air carrier's voting stock. Legal restrictions on the ability of a company to sell its stock to willing investors of foreign nationality have forced many U.S. airlines to rely on excessive debt to finance expansion. Debt service is a cost that cannot be adjusted if profits fall, as during the 1990-1991 recession, while stock dividends can be reduced or postponed. The over-leveraged condition of too much debt has contributed to the problem of airline bankruptcies. Raising the maximum overseas ownership will permit much-needed foreign equity capital to flow into debt-laden U.S. carriers. Multilateral ownership also could contribute to greater market diversification of airlines that today are simply too small to be viable as commercial ventures and invite taxpayer subsidies. "National" airlines are too closely identified with foreign policy issues.

Unfortunately the Administration's proposal is conditional on similar provisions to be enacted by other governments on a reciprocal basis, which ironically means the Administration does not want U.S. airlines to be able to use more overseas capital to strengthen themselves unless foreign governments also allow their competitors to obtain more capital from Wall Street. This ill-considered reciprocity requirement, moreover, is inconsistent with the "national treatment" investment rules the U.S. has supported for decades as part of the Organization for Economic Cooperation and Development. National treatment grants equal rights under the law to foreigners as well as citizens. As the world's largest international trader, the United States stands to lose the most whenever this principle is compromised.

Other laudable international proposals in the Administration's aviation initiative include the harmonizing of international regulation and developing with Europe common performance-based aviation safety standards. It also calls for removing impediments to procurement and other trade barriers. These changes would permit U.S. aircraft manufacturers to compete more effectively for a growing share of the air transportation market.

AN INDUSTRIAL POLICY FOR AVIATION?

Strangely, the Administration's airline initiative cites the global nature of the aircraft market as further reasons for active U.S. government participation in the industry. But the main example cited in the initiative is the 1993 partial repeal of antitrust statutes, which is actually an example of reduction in government involvement rather than a case of government intervention.

More disturbingly, while the initiative does contain calls for deregulation, Secretary Peña's opening statement reveals an enthusiasm within the Clinton Administration for industrial policy involvement in aviation. "In short," writes the Secretary, "while eschewing any return to regulation, we have defined a role for government as an active player in aviation." One example of this philosophy in the Administration's initiative is the proposal to increase NASA's budget by 18 percent so that the agency can subsidize launches for private-sector projects. The programs to receive the bulk of this funding are the Advanced Subsonic Technology (AST) program and the High Speed Research (HSR) program, which is to further research toward "an industry-developed High Speed Civil Transport." The initiative also calls for the FAA to "work with industry in a cooperative research and development effort for new aircraft designs and manufacturing processes."

In addition, the aviation initiative endorses further Export-Import Bank aircraft export funding, which has reached the level this year of $3.3 billion, or about 22 percent of overall Eximbank activity. The Administration is seeking relaxation of some Eximbank rules to permit further subsidization of aircraft exports, with an eye on the Russian and Newly Independent States market. Rather than increasing the role of Eximbank subsidies in this industry, the Administration should initiate talks with other governments that subsidize aircraft exports to eliminate the practice.

So while the Clinton Administration urges the European Union to end subsidies to its aircraft manufacturers, the White House wants to subsidize the U.S. industry. The aviation initiative seems to reflect a Hamlet-like ambivalence toward government subsidies. While on the one hand it says the Administration "will continue to be vigilant in monitoring compliance by the Airbus partner governments" under the 1992 agreement, which imposes strict limits on government support for aircraft production, it supports a more active role for government subsidies in developing new products and manufacturing processes. Down the road, the Administration's policy is likely to cause more disputes with the Europeans under GATT. As part of the Uruguay Round of GATT, which will be signed on April 15, 1994, civil aircraft will come under the new Agreement on Subsidies and Countervailing Duties.

CONCLUSION

The Administration's aviation initiative generally is a welcome, affirmative response to the major recommendations of the Airline Commission. The Clinton Administration's support for extending the multilateral rules of international trade to air services represents by far the most important part of the aviation initiative. Also important is restructuring the air control functions of the FAA to allow the agency to perform its mission in a more rational organizational form, equipped with the most advanced technology. And requiring the FAA's safety-conscious rulemakers to explore the least costly way to raise safety standards will lower the costs of improving the quality and safety of air traffic, just as similar cost-benefit principles have improved the performance of many other sectors of the modern economy.

The method of financing the new corporation for air traffic control should have been explicitly addressed in the Administration's initiative, as well as the other tax-related recommendations of the Airline Commission. If an undisclosed increase in the tax on airline tickets is to be part of the plan, the Administration should make the tax increase revenue-neutral by permanently reducing the tax on aviation fuel, as well as relieving the air transportation industry from the alternative minimum tax, which has required air carriers to pay heavy taxes in years when they have suffered financial losses.

Congress should act quickly on the legislation the Administration will submit in April. The risk is great that revenue considerations may link modernization of the air traffic control system with an increase in taxes on airline passengers and cargo, coupled with fine rhetoric about "investment in infrastructure." Americans should be alerted to this kind of undercover tax increase, which will allow the diversion of revenues now dedicated to this vital public service to be spent elsewhere. In considering legislation to permit ownership of up to 49 percent of voting stock in airlines, Congress should seriously consider removing entirely the requirement for nationality, and place airlines on the same legal footing as American industry in general, with the rights of investors protected regardless of citizenship.

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