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THE WHITE HOUSE
WASHINGTON

INFORMATION

December 22, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON *Jim*
SUBJECT: Financing Aviation Noise Standards

Secretary Coleman has completed hearings on whether additional financing might be necessary to enable airlines to meet the new FAA noise regulations. (Tab A).

In brief, Secretary Coleman recommends:

1. Enactment of your Aviation Regulatory Reform proposals;
2. Reducing by 2 percent the existing federal tax on air passenger tickets and freight bills;
3. Proposing that CAB simultaneously impose a 2 percent environmental surcharge on air passenger tickets and freight bills; and
4. Depositing the revenues from the 2 percent environmental surcharge into a fund to finance replacement aircraft.

*Preliminary go
Staff to Pres by Tues.*





THE SECRETARY OF TRANSPORTATION

WASHINGTON, D.C. 20590

MEMORANDUM FOR THE PRESIDENT

SUBJECT: Financing for Replacement of Noisy Aircraft

On October 21, you asked me to hold a public hearing on whether, assuming responsible action on aviation regulatory reform, there is a need for a special financing arrangement to ensure timely and economically efficient compliance with the new FAA rule that you approved to quiet the existing aircraft fleets. Should a financing proposal be determined necessary, you further directed me to recommend what kind of special financing arrangement would be appropriate. I held that hearing on December 1 and am reporting the results to you with my determination that limited additional financing arrangements will be necessary and my recommendation for a financing program. Although the expeditious enactment of aviation regulatory reform will bring about the kind of economic environment over the long term that will enable compliance with environmental requirements, we are faced with an immediate timing problem if the air carriers are to comply with the schedule set forth in the noise rule in the most effective way. A summary of the principal points made at my public hearing is enclosed with this memorandum.

Witnesses at the hearing generally supported the need for a special financing program. The clear consensus of opinion and the great weight of the testimony I received strongly support the conclusion that retrofitting many of the older four-engine aircraft simply would be undesirable. The noise regulation therefore will force the retirement of most of these aircraft. At present, the airline industry is financially incapable of placing a sufficient number of orders to permit the manufacturers to develop a new generation aircraft and deliver it in time



to replace these noisy aircraft. Such new generation aircraft would not only be much quieter than existing planes (even if they are retrofitted) but would also be substantially more fuel efficient, thus contributing to our national goal of fuel conservation. An early start on new aircraft development also would contribute to other important national goals such as higher employment, increased exports, and continued world leadership in aviation technology.

Witnesses who addressed the subject also gave firm support to the type of financing approach I recommended to you last August, and I therefore have concluded that I should again recommend it, or a variation thereof, as a feasible and fiscally sound way for achieving the objectives of our aircraft noise program. The basic plan has the following main features:

1. CAB would impose a 2% environmental surcharge on air passenger tickets and waybills for a period of up to 10 years; at the same time, the present ticket and waybill taxes would be reduced by an offsetting 2 percentage points. Thus the cost to the users of air transportation would remain the same.
2. The revenues from the 2% surcharge, which would amount to some \$3 billion over 10 years, would be deposited in a fund managed by an escrow agent either designated by the airlines under an intercarrier agreement approved by the CAB or created by statute. Every effort should be made to keep this fund in the private sector to minimize government involvement in the management of the financing program.
3. The revenues accumulated in the fund would be distributed either in accordance with the intercarrier agreement, or pursuant to statute, in a way that would give relatively more aid to those carriers that must incur the heaviest expense in replacing noisy aircraft. The distribution of funds would be based upon the revenue produced by each of the carriers participating in the agreement, and would be designed to take into consideration the need for assuring the support of the financial community, which will provide most of the required financing.



4. Amounts distributed to the carriers from the fund would provide approximately one-third of the cost of new quieter aircraft to replace the noisy four-engine planes now in the fleet.
5. Funds remaining after airlines have received their appropriate entitlements would be transferred to the Airport and Airway Trust Fund and applied to airport noise reduction projects.
6. Funds from the existing balances in the Airport and Airway Trust Fund would be used for financing the cost of retrofitting two and three engine aircraft.

In reaching this position, I also considered a number of other types of financing arrangements, including direct payment to carriers out of uncommitted balances in the Airport and Airway Trust Fund, government loan guarantees, and pollution taxes. Each of these approaches fell short in one respect or another, i. e. , they did not ensure the success of the replacement program, or they called for excessive government involvement in the management of the financing mechanisms, etc. At the hearing, two members of the financial community proposed a plan similar to the one I favor, but they would use the fund created by the 2% surcharge to help borrow money at very favorable interest rates which, in turn, would be loaned by the fund to the carriers. I believe this approach might provide more help than is necessary for an effective financing program. Nevertheless, this type of proposal promises to provide a net surplus over the life of the program that could be repaid to the Treasury. Thus, it may present an opportunity to provide a mechanism that not only would encourage an economically sound noise abatement program, but which could also have a favorable budgetary impact. Therefore, I have not ruled out the possibility of endorsing such a proposal.

In order to move toward the creation of an effective financing mechanism, I ask your approval to submit the necessary implementing legislation to the new Congress early in January. Basically this legislation would do the following:

1. Amend the Federal Aviation Act to authorize CAB to approve intercarrier agreements to achieve noise control objectives



including the establishment of an aircraft replacement fund, to be managed in the private sector.

2. Amend the Internal Revenue Code to reduce existing air passenger ticket and waybill taxes by 2 percentage points at such time that CAB certifies to the Secretary of the Treasury that (1) it has approved an intercarrier agreement containing the provisions referred to above necessary to assure success of the program or, to authorize a nonprofit trust or coproration to be created to receive the 2% surcharge and use it for the replacement or retrofit of noisy aircraft, and that (2) the Board will approve the imposition of a special 2% environmental surcharge on tickets and waybills on a date certain, but not earlier than October 1, 1977.
3. Amend the Airport/Airway Act to authorize appropriations for the purpose of financing the retrofit of two and three engine aircraft to meet existing Federal noise standards.

With this legislation before the Congress, this Administration will have advanced a complete program to deal with the aircraft noise program. As you know, pursuant to your direction, by January 1 the Federal Aviation Administrator will have issued a final regulation requiring existing aircraft to meet more stringent noise standards. The legislation and financing plan I am proposing will permit the requirements of that regulation to be met in a timely fashion, minimizing the burden on the industry and the users of air transportation, while achieving the broader national objectives I have discussed earlier.

I appreciate, at the same time, your continuing concern about the impact which this or any financing scheme might have on the Federal budget. As I have indicated to you before, it is my firm conviction that the next Congress will reduce, in any event, the passenger ticket tax by at least 2 percentage points, based on the industry's valid claims that this reduction is justified by the Trust Fund surpluses (now \$1.4 billion and growing) and the fact that DOT studies show that airlines are now paying more than their fair share of the costs of operating the airways. Nevertheless, any proposal to reduce tax revenues by some \$300 million per year without offsetting adjustments must be a



matter of concern. In this regard, however, I do wish to bring the following mitigating factors to your attention:

1. I have just transmitted to the OMB draft legislation which would impose for the first time a system of waterway user charges. As you know, you approved such legislation last year but Congress did not act on it. The bill I am now proposing and which I urge you to submit to the Congress, would produce \$80 million per year in new revenues. As I understand it, these amounts have not been reflected in current FY 1978 budget totals by OMB.
2. Our analysis indicates that the aircraft replacement program which I am recommending would generate some \$8 billion or more in sales by the aircraft and engine manufacturers over a 10-year period. We estimate that this significant increase in revenues to the affected industries will yield as much as \$1 billion in added Federal corporation tax revenues. In addition, we estimate that nearly \$500 million in added personal income revenues will result from the increased employment the program will generate. While added Federal income will not begin to flow in the early years of the program, we believe that beginning in the third year the amounts will be significant, becoming a major offset to the air user tax loss.

In summary, I believe that after a full, exhaustive, and public search for the best way to accomplish our aircraft noise control objectives, we have reached a remarkably broad consensus on the basic outlines of a sound approach.

I urge that you approve my proposal to submit to the Congress legislation that would authorize the financing program I have set forth here. Without such legislation the airlines would be compelled to curtail service or resort to inefficient means to comply with the new noise requirements you directed in October. By submitting my legislative proposal, your Administration will have taken all the necessary actions to assure that aircraft noise reduction objectives



will be achieved on a timely and efficient basis and in a way which will yield the other important national benefits I have outlined to you.


William T. Coleman, Jr.

Enclosure



Department of Transportation

SUMMARY ANALYSIS OF ISSUES RAISED AT THE
PUBLIC HEARING OF DECEMBER 1, 1976 CONCERNING
FINANCING AIRCRAFT NOISE REDUCTION REQUIREMENTS

On December 1, 1976, a public hearing was conducted on the financing of the aircraft noise reduction requirements to be promulgated as an amendment to the Federal Aviation Regulations, 14 CFR Part 36. In anticipation of this hearing the Department of Transportation published a Statement of Issues listing the issues it hoped would be addressed by witnesses. This paper summarizes and analyzes the testimony and other materials submitted in connection with this hearing, following, in general, the original Statement of Issues. Certain other matters raised by various witnesses are also addressed.

- A. Would it, from the standpoint of the national interest, be more advantageous to meet the new noise standards by replacing some or all of the 707s and DC-8s with new generation aircraft rather than by modifying them?

DOT invited views of interested persons on the issue of whether the national interest would be better served by replacement rather than modification of the 707s and DC-8s, and outlined the major considerations bearing on the issue, as well as its current position on each. These were:

- The cost of replacement versus the cost of modification. In terms of capital outlay only, retrofit which will provide compliance with Part 36 standards is the least costly and possibly quickest means of attaining the required noise reduction. However, when other aspects of the replacement versus retrofit question are considered, replacement becomes clearly preferable to retrofit for certain aircraft, particularly when looking at the long run economic and social



ramifications of the program. The noisiest aircraft in the fleet (narrow-body four-engine jets equipped with JT3D or JT4A engines) are also the oldest and are becoming economically obsolescent. Retrofitting these planes would impose an operating cost penalty and would not extend their physical lives and would be quite expensive (\$1.2 to \$2.6 million or more for each aircraft).

- The noise reduction achievable by modification compared to that achievable by replacement. New generation replacement aircraft would be quieter than the quietest aircraft in operation now, and far quieter than retrofitted aircraft.

- Significant ancilliary benefits would accrue from a replacement program. Replacement would mean greater fuel efficiency, the application of advanced concepts in a new technology aircraft and thus a safer, more efficient operation, increased employment, a stronger aerospace industry, and technologically advanced aviation products for export.

In general, there was overwhelming agreement with the Department's view as to the merits of a replacement program for 707s and DC-8s. Most of the testimony both substantiated and elaborated on the tentative evaluation made by the Department in the Statement of Issues summarized above. The representative of the air carrier industry indicated that major aerospace manufacturers were developing new engines that would be quieter, more fuel efficient and available in time to carry out the proposed replacement program. The impact of replacement on employment was also detailed in his testimony. It was estimated that "... each billion dollars in aircraft sales generates 60,000 job years; thus, a \$6 billion replacement program would create 360,000 job years. "



One airline executive claimed that much of the retrofit cost would be wasted since it would hasten the economic obsolescence of the planes involved by making them less fuel efficient. He argues that his company might have to ground its 707s rather than incur the costs of retrofitting them, and that would result in a significant reduction in his airline's capacity.

Other airline executives pointed out that a retrofit kit for DC-8s has not yet been developed, and said it is not known how long the development, testing and installation of the kits would take. The representative of one airline stated that 90 percent of its fleet would come under retrofit requirements at a cost of at least \$22 million, an expenditure which, in its view, would not add to the productivity or longevity of its aircraft. It was further asserted that in addition to providing greater noise reduction benefits and greater economic efficiency, a replacement program offered the potential for significantly reducing traffic congestion through the use of newer, widebody aircraft combined with reductions in flight frequency.

Two witnesses did bring forward proposals for re-enginning (as opposed to retrofitting) newer 707s and DC-8s. Such a program would in their view present significant cost savings while extending the lives of the aircraft. The Department agrees that this alternative is certainly worthy of consideration if the engines can be developed and certificated in time to meet the deadlines of the carriers. However, in the final analysis the choice among retrofitting, re-enginning or replacement should be left to the best business judgment of the airlines.

Witnesses who can be characterized as representing environmental or consumer groups were divided in their support for, or opposition to, a replacement program as compared to retrofit. It should be noted, however, that the arguments raised in favor of a retrofit program dealt not with any perceived superiority of that alternative, but stemmed from the expectation that it could be accomplished faster than a replacement program and thereby provide at least modest noise relief sooner.



In summary, the overwhelming majority of the testimony on the need for financing was in substantial agreement with the Department's view that from the standpoint of an economic and public policy, replacement of the older DC-8s and 707s has substantial advantage over retrofit.

B. Assuming that replacement of some aircraft is preferable from the national interest standpoint, is there a need for special financing provisions to enable aircraft operators to meet the deadlines stipulated in the new standards?

Although the various witnesses provided a number of rationales for their positions, virtually all of them agreed with the Department's conclusion that the airline industry is financially incapable of implementing a replacement program within the deadlines in the new noise regulations, and that a special financing arrangement is vital.

The Department's own financial analysis had identified several factors which argued for such a special arrangement:

1. The weakness of the airline industry's financial situation. The poor profit performance of many major carriers over the past ten years, exacerbated by the recent economic downturn, prevents them from ordering the new aircraft they need to replace economically obsolete equipment.
2. Even without the noise requirements, the airlines face some difficulty in meeting their estimated capital requirements between 1976 and 1985. In the early 1980's the industry will need to order a substantial number of new aircraft for replacement and traffic growth, thus creating a heavy demand for capital even without considering the effect of the new noise regulations. Meeting the noise requirements with a reasonable mix of retrofit and replacement will add from \$6 to \$8 billion to the estimated \$32 billion in capital needs of the trunk carriers between now



and 1985. The carriers will no doubt find it difficult to meet their normal needs, not to mention the added burden that the new noise regulations will create.

3. Front end capital must be available promptly if more quiet aircraft are to be available in time to meet noise deadlines. A lead time of four to five years is necessary in the development of new generation aircraft, which means an almost immediate start is necessary if the new aircraft are to replace noisy aircraft by the compliance deadlines. Manufacturers require a large number of firm orders with front end capital (\$500 to \$1 billion) before they can start production of a new aircraft. The airlines cannot at this time place sufficient orders for new aircraft because of their poor financial situation.

4. A special financing arrangement for a replacement program is in the national interest. Development of new quieter aircraft will have positive impacts on U.S. employment and export levels. U.S. aerospace industry employed some 942 thousand people in 1975 and exported almost \$2.5 billion worth of civil aircraft.

5. The financial benefits that will accrue from regulatory reform will not be available soon enough to finance a replacement program. Were the airlines operating in an environment that would be created by the regulatory reform bill, they would be able to generate the capital needed to bring their fleets in compliance with FAA noise standards. Under the present circumstances, the period between enactment and implementation of the legislation will not allow for the aircraft developmental lead-time needed to develop new generation aircraft before the deadlines in the noise regulations.

In reacting to the Department's tentative conclusions in the Statement of Issues, the representative of the Air Transport Association (ATA) and senior airline executives confirmed my understanding that virtually none of the carriers who would be most affected by the noise regulations is in a position to make the capital expenditures required to comply with them through replacement. Indeed, it was pointed out that most of



these carriers were already at their debt limits and, without significant and sustained profit improvement, had no hope of obtaining equipment financing from their traditional lenders in the near future without some special financing mechanism.

As a group, witnesses from the financial community (banks, insurance companies, and Wall Street analysts) provided testimony highlighting the high proportion of debt in airline capital structures. A witness from the insurance industry summarized the general view of the lenders by noting that the recent financial performance of the industry had significantly lowered investor confidence in the airlines. Moreover, the airlines already have about \$6 billion of debt coming due between now and 1985. In summary, the financial community recognizes the desirability of an accelerated aircraft replacement program but is unwilling, and in some cases unable, to risk further financial exposure in the air carrier industry without a special financing program.

Another argument in favor of a special financing program was advanced by the Salomon Brothers' representative. His analysis showed that a financing program which encouraged the timely development of new generation aircraft could have a significant impact on future airline profitability by producing overall airline productivity gains (similar to those achieved when jets were introduced) which would relieve to some degree the pressure of the cost escalation spiral which has plagued the air carrier industry over the recent past.

While there was some disagreement among the representatives of aerospace manufacturers as to whether long-term noise goals could best be accomplished by replacement using derivatives of existing aircraft models or an aircraft involving new development programs, there was no disagreement with the Department's judgment that both financial and timing considerations required a special financing arrangement if an aircraft replacement program were to be activated in time to meet the regulatory deadlines. While competitive considerations are involved in these differing viewpoints, the sound course would appear to favor a financing arrangement that would permit the broadest possible discretion to the air



carriers in choosing whether to go for a completely new technology aircraft or to purchase a derivative model.

With regard to questions about financing and timing, the Boeing Aircraft representative pointed out that development of a completely new aircraft would take about four years, and that the company would require firm orders for 50 aircraft before it could go ahead with the program. This would represent an airline commitment of about \$1 billion, and 30 percent would be required in down payments. The Douglas Aircraft representative suggested that a lower cost alternative to replacement of the DC-8s and 707s might be to refit them with new high bypass engines.

The representative of the Council on Wage and Price Stability, while not directly disputing the Department's view that a special financing arrangement would be needed, argued that it could possibly constitute a dangerous precedent in terms of Government intervention in the private marketplace. The witness did not recommend any alternative solution other than to suggest the imposition of a pollution tax (and possibly an increase in fares) or doing nothing and relying on market forces.

Delta Airlines, in a letter to the Department for inclusion in the hearing record, argued that "...the need for financing outside the normal rate-making function of the Civil Aeronautics Board is non-existent." Delta believes that because international aircraft are exempt (international carriers, Pan Am and TWA in particular, have many four-engine jets in their fleet) there would be no inequities. Delta also argues that a special financing arrangement would be inequitable to carriers that have expended significant funds to modify their fleets without government assistance.

In summary, the overwhelming consensus of the testimony discussed above, as well as that of witnesses representing airport operators, consumers, and others, constitutes a reaffirmation of the need for and special benefits to be derived from a special financing arrangement for replacing four-engine aircraft as part of the overall aircraft noise reduction program. Further, ample support was provided for the view that such an arrangement would be in the public interest. Delta's argument that no inequity would exist if carriers were to



simply recoup costs through fare and rate increases is not immediately cogent. United Airlines (which has no international operations) and American Airlines also have large numbers of four-engine jets that will be affected by the noise rule, and it is not clear that the international exemption removes the inequity.

C. If special financing arrangements are found to be necessary, what specific approach should be taken?

For the purpose of exposition, this issue can be divided into three aspects: the source of funds, the financing vehicle, and the basis for entitlement and disbursement.

Source of Funds

Alternative sources of funds considered were the uncommitted balance of the Airport and Airway Trust Fund, a surcharge on passenger tickets and waybills, a pollution tax on carriers, the use of general Government revenues, Government loan guarantees, and traditional private sector sources. All but a few witnesses supported a surcharge on tickets and cargo waybills as the preferred source of funding, to be accompanied by an equivalent reduction in current user tax rates.

Several witnesses, including Congressmen James H. Scheuer and Norman Mineta, support use of the Trust Fund to finance a noise abatement program. The Los Angeles Airport Commission supported this notion on the condition that the Airport and Airway Trust Fund not be handicapped in the future and urged that general tax sources be considered to supplement the Fund. The Airport Operators Council International supported special financing to enable the carriers to meet or beat the deadline, but expressed opposition to diverting too much money from the Airport and Airway Trust Fund so that it could not accomplish its historical objectives.

At the hearing, the Council on Wage and Price Stability supported a pollution tax as a promising approach employing a financial incentive and noted that the Department did not pursue a pollution tax as a means of financing replacement because it would place further burden on an industry that is already in poor financial condition. In a subsequent written submission, the Council made it clear that it considered the pollution tax as an alternative to the noise rule itself. The pollution tax would generate about \$146 million a year. The Council did not elaborate on its thought that the tax could be structured so that carriers in weak financial condition would not be harmed. In a written submission,



IATA opposed the pollution tax approach. Northwest Airlines, in a written statement, strongly favored a set per ticket or per passenger charge rather than one that is a percentage of the ticket or waybill price. In Northwest's view, the percentage surcharge discriminates against long-distance passengers since noise is a problem at take-off and landing and is not a factor in high-altitude, long-range flight.

The National Business Aircraft Association suggested that tax credit might be a more workable and practical method for consideration in the private sector, but its main concern was that the financing aid should provide for equitable treatment of commercial and non-commercial operators.

The Department continues to favor a surcharge because it can be neatly matched with an equivalent reduction in user charges and thus avoid any change in user transportation costs. Payment of retrofit costs only (an estimated \$350 million to retrofit the newer 2- and 3-engine planes) from the Airport and Airway Trust Fund is a reasonable course, and I consider it preferable in order to involve the Congress closely in the question of retrofitting the newer 2- and 3-engine planes. However, payment of these costs from the Fund generated by the surcharge would avoid legislative controversy. The Department agrees that the Fund should not be depleted and recommends that its use be limited to the costs of retrofit.

The pollution tax advocated by the Council on Wage and Price Stability, since it is proposed as an alternative to the rule, need not be considered as a financing arrangement supplementary to the rule. Also, it is less desirable than the surcharge since it would heavily involve the Government in the collection and disbursement of funds, and the funds to be generated would not be sufficient to allow carriers to replace noisy aircraft with new generation aircraft by the noise rule deadline.

The Department supports a reduction in the user taxes in an equivalent amount to the surcharge. Such a reduction has been proposed as part of a bill aimed at aircraft noise reduction introduced by Congressman Norman Mineta of California and co-sponsored by fifty other Congressmen. Also, a reduction was previously proposed by the Department outside the context of the noise financing problem to reduce the existing uncommitted balance in the Trust Fund.



Financing Vehicle

The widest support of a financing vehicle was for a private and independent third party such as an escrow agent that would collect and disburse the funds. Two proposals that would use surcharge revenues to obtain additional funds through issuance of debt were presented as superior to the escrow concept. Donaldson, Lufkin, and Jenrette Securities Corporation proposed creation of a separate non-profit corporation that would borrow \$1 billion from the Airport and Airway Trust Fund and use revenues from the surcharge to obtain funds by issuing bonds and loaning funds to the airlines at a favorable interest rate. ^{1/} White, Weld and Company proposed formation of an Aircraft Replacement Cooperative with shares owned by the airlines. The Cooperative would provide downpayment financing in exchange for a claim on the eventual residual value of the aircraft, and the balance of the financing would be accomplished through the purchase or guarantee of preference stock of member airlines. In both of these plans the financing vehicle would stay in existence to collect loan payments until near the end of the century.

At the present time the Department continues to favor the escrow concept. Creation of a loan pool for the airlines is probably excessive in terms of the need for replacement funds related to noise regulations, and the long-term existence of the financing entity is less desirable than a plan which would terminate the special financing arrangement by mid-1985. There are some advantages to this type of concept, however, such as flexibility as to equity and loan payments and the possibility of recovering all the surcharge revenues and interest paid on them (through loan repayments) for eventual return to the Airport and Airway Trust Fund.

Disbursement

The hearings generated comments about a wide range of alternatives for disbursement. Many witnesses addressed the disbursement question in the context of the extent to which replacement should be supported by any special financing arrangement. The Air Transport Association took the position that the system of entitlement to such financing should provide incentives for carriers to replace older aircraft. The details of this plan as presented in the ATA's letter of May 14, 1976, were as follows:

^{1/} Alternatively, a portion of the funds could be dispersed in cash and the remainder held as security for debt.



- (a) "Carriers would receive total entitlements calculated by apportioning all the above collections on the basis of each carrier's actual passenger and cargo system revenue.
- (b) "Each carrier flying B-707s and DC-8s (and a limited number of B-747s) would be entitled to draw an amount equivalent to the cost of retrofitting the aircraft.
- (c) "To provide an incentive for replacement rather than retrofit, each carrier would receive a replacement entitlement which would be based on that carrier's total entitlement less his retrofit entitlement. This entitlement, along with the retrofit entitlement, would be available for new aircraft purchases. "

Two carriers dissented from the ATA approach. Delta, as noted above, believes that any cross subsidy or Federal subsidy is inequitable. Northwest dissented from the ATA's percentage surcharge in favor of a \$1.00 surcharge per passenger. They also advocated that carriers collect the funds, retain them, and return any funds to the Treasury not used for either retrofit or replacement. Congressman Mineta (in a written submission) strongly argued that any payments be limited to retrofit costs.

In written submissions, the Airport Operators Council International and EPA suggested an incentive scheme which would pay the airlines more for quieter aircraft. AOCI also suggested setting the payment schedule to provide more aid in earlier years to induce carriers to quiet their fleets as early as possible.

The Secretary of Transportation of Massachusetts urged judicious use of any special funding. He agreed that funding should probably cover the direct costs of retrofit, and if the Government wishes to encourage replacement, the development of a new aircraft could be funded or payments could be made in amounts equivalent to retrofit costs or on the basis of a unit of noise reduction to encourage introduction of quieter aircraft.

While the Department is open on the question of disbursement formulas, the need for some redistribution of funds in favor of the carriers with the greatest need to replace noisy equipment still seems evident. Otherwise, the goal of achieving quick production of a new technology aircraft would not be realized, as major carriers could not order it. Any formula which recognizes carrier need and keeps cross-subsidy within reasonable bounds would be acceptable. Basing the disbursement on system revenue

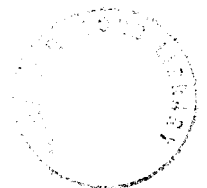
appears in general to be a reasonable approach. The proposal to limit replacement payments to retrofit costs would prevent the program from generating a sufficient amount of funds to start production of a new aircraft, since the difference between the cost of retrofitting all noisy aircraft and the total payments for those that are actually retrofitted would be too small. Basing payments to carriers on unit of noise reduction seems impractical, and paying more for quieter aircraft may result in degradation of the carriers' efficiency, because a larger (e. g. DC-10) aircraft could be preferable to the new generation aircraft for operational reasons. Also, the large size could mean fewer operations and less noise overall.

D. How should foreign flag carriers be treated under any financing plan?

The application of noise regulations to aircraft in international service is deferred to allow for the development of an international agreement on noise control standards. It is the intention of the Department, however, to require compliance of these aircraft within eight years and it will institute a rulemaking procedure to achieve such compliance if ICAO has not acted after three years. Those witnesses speaking to this issue generally felt that it would be necessary to initiate any collections of taxes or surcharges from international passengers simultaneously with initiation of domestic collections.

The International Air Transport Association (IATA) representative urged that funds collected from international passengers be put in some form of escrow account pending establishment of international noise regulations. IATA "would strongly oppose any . . . suggestion to use such funds for domestic noise abatement." Eventual use of the funds should "be applied on some reasonable and non-discriminating basis to both U.S. flag and foreign flag carriers." IATA's preferred way of providing capital would be to "reduce the current \$3.00 tax on international tickets to \$2.00 . . . and to retain the extra dollars" for a Government administered fund.

Trans World Airlines, while not commenting in detail on the issue of the treatment of foreign carriers, did urge "recognition of the need to avoid placing U.S. international carriers at a competitive disadvantage."



McDonnell Douglas supported use of a portion of the international departure tax and proposed that "the tax be increased, if necessary, to assure equitable treatment for U.S. international carriers." It was suggested that the Export-Import Bank "... provide greater financing assistance for foreign flag carriers purchasing "quiet" U.S. equipment under the program."

White, Weld & Co. proposed an approach which would:

1. Subject all foreign aircraft which land in the U.S. to the same noise standards as U.S. aircraft;
2. Allow foreign carriers to utilize the investment and loan guarantee program of the Aircraft Replacement Cooperative;
3. Restrict the use of entitlement funds for downpayment financing (e. g. , 25%) to U.S. airlines only and require foreign airlines to self-finance this portion;
4. Work closely with the Export-Import Bank to extend its guarantees from 10 years to a term of 12 to 15 years on new jet aircraft.

In the Statement of Issues for the hearing, the Department solicited views on whether foreign flag carriers should be made eligible for inclusion in any financing provision, now or when the standards become applicable. The witnesses did not treat this issue in much depth, and not much light was shed on the problems of how to deal equitably with the foreign carriers. A surcharge put on international passengers by IATA agreement may be a workable mechanism. The Department agrees that U.S. and foreign carriers should be treated equally, and prefers to leave the question of financing the noise costs for international operations for resolution at a later date.

- E. Other non-financing issues raised at the hearing include:
- (1) the timing of the implementation of the noise standard;
 - (2) the coverage of the noise regulations (i. e. , whether the two and three-engine aircraft should have to meet the standard);
 - (3) the rationale for the Government's involvement in helping create a special financing arrangement; and (4) the budgetary impact of a special financing arrangement.



Several witnesses took the opportunity to raise matters connected with the noise reduction program that generally fell outside the scope of financing.

1. The Timing of the Implementation of the Noise Standard. The ATA representatives argued that implementation of the regulation should be deferred until the matter of financing arrangements had been settled and it was clear to all how the program was going to be accomplished. Congressman Scheuer and certain citizens' groups expressed the hope that the noise regulations could be phased in faster and a concern that implementation might, in fact, be delayed if certain interests had their way. One witness expressed the belief that the implementation schedule should be slipped so that the DC-8s and 707s could be replaced by aircraft even quieter than what will be required by the new noise standard.

The question of the timing of the implementation of the noise standard has been exhaustively explored by the Department, and addressed all of the above arguments. The schedule finally approved represents, in the Department's judgment, the most judicious balance of all the several, sometimes conflicting considerations involved, and no retreat from this timetable should be made.

2. Should the New Regulations Cover Two and Three-Engine Aircraft? A number of witnesses (primarily those representing airlines, manufacturers, or lenders) took the opportunity to restate their opposition to retrofit of two- and three-engine aircraft.

While the Administration has already considered all the arguments and decided retrofit of these aircraft is in the public interest, these parties will obviously continue to make it an issue. They contend that the case against the two- and three-engine aircraft is based on the cumulative effect of operations, any one of which violates the noise standard by an amount so small that the ear cannot detect the violation. They



dispute the validity of the cumulative measure, and argue that people will not be able to notice any benefit from the retrofit program. However, expert opinion to the contrary is nearly unanimous.

3. The Rationale for Government Involvement in Helping Create a Special Financing Arrangement to Assist the Airline Industry. Another matter raised at the hearing concerned the appropriateness of the Federal Government involving itself in establishing special financing arrangements to help the airlines meet environmental standards when, it was implied, comparable assistance is not afforded other industries similarly impacted by Governmental regulation. Actually, the only monetary aid contemplated for special financing of noise costs is the use of the uncommitted balance in the Airport and Airway Trust Fund for the costs of retrofitting the newer planes. Otherwise, any "aid" is limited to the enabling legislation or regulatory authorization that would permit carriers to develop and implement a plan to impose a surcharge and redistribute the revenues among themselves. In any case, there is ample precedent for government aid to help industries meet pollution control costs, and a special financing program would not be inconsistent with Federal Government policy.

As a matter of fact, the Federal Government does currently provide both direct and indirect financial assistance to private industry in order to enable compliance with environmental standards. Direct aid is provided in the form of grants to private industry to encourage development of pollution control technology and equipment. Such grants are authorized by the major pollution control statutes (see, e. g., Federal Water Pollution Control Act--33 U.S.C. §1156, and Clean Air Act--42 U.S.C. §1857b). In addition, numerous Government agencies are engaged in the development of new pollution control technologies, which are made available to private industry without charge. For example, EPA has numerous research projects in this area, and, in the aircraft noise area,



NASA has several projects aimed at the development of quiet engines and aircraft. These programs use federal funds to develop pollution control equipment for private industry.

As important as the direct assistance programs are, they probably shrink to relative insignificance when compared to the indirect financial assistance rendered through the federal tax laws. The Internal Revenue Code explicitly authorizes greatly accelerated (i. e., five-year) depreciation of pollution control equipment (26 U.S.C. §169). The investment tax credit is also specifically available for pollution control facilities for which accelerated depreciation is not taken (26 U.S.C. §46, 48(h)(12)). Both of these provisions provide for the financing of pollution control facilities out of what would otherwise have been federal revenue.

In addition to these provisions, it has become a fairly common practice for state and municipal authorities to issue tax-free industrial development bonds, the proceeds of which are loaned either directly to local companies for the acquisition of pollution control equipment, and subsequently repaid at the lower tax-free interest rate, or are used by the local authorities to construct facilities which are then leased to private industry. In either case, the cost of installing the equipment is reduced because the bonds' municipal status provides an exemption from federal income tax.

4. The Budgetary Impact of a Special Financing Arrangement. Witnesses advocating a special financing arrangement which involved a reduction in current user charges were invited to address the question of such a program's impact on the federal budget. Clearly, in the present fiscal environment a reduction in user charges from any source would have the effect of increasing the federal deficit.



I am very sensitive to the fiscal impact which the reduction would have on the federal budget in future years. However, I believe that the Congress is very likely to reduce the tax in any event based on the air carrier industry's contention that a two percentage point reduction is justified by the growing trust fund surplus and the fact that DOT studies show that airlines now pay more than their fair share of airway costs. Weighing all considerations, I believe that we should act to harness the pressure for a user tax reduction to the realization of the highly desirable goals of the noise reduction financing program I originally proposed, but in a way that minimizes the budgetary impact. To those ends, I propose the following approach:

Legislation would be proposed to Congress which would have these major elements:

- An amendment to the Federal Aviation Act would authorize CAB to approve intercarrier agreements and pooling of revenues from a two percent ticket and waybill surcharge in a fund which would be used for purchase of replacement aircraft by the participating airlines. The legislation would also authorize the CAB to approve a special environmental surcharge of two percent on passenger tickets and freight waybills to be effective simultaneous with the two percent reduction of present ticket taxes.
- An amendment to the Internal Revenue Code to reduce by two percentage points the present passenger ticket and waybill taxes. Imposition of the surcharge and the reduction in user charges to occur simultaneously on a date set by the CAB, provided that it had certified to the Treasury that a satisfactory intercarrier agreement had been concluded.
- An authorization to appropriate from the Airport and Airway Trust Fund monies to cover costs of retrofitting two and three engine aircraft to meet a new federal noise standard.



It is my judgment that if Congress enacts such a statute, air carriers will be in a position, based on the assured future flow of revenues, to place orders for replacement aircraft in a timely fashion. In this connection, no fiscal impact should be felt until some time in FY 1978, inasmuch as the enactment of the required legislation and the subsequent CAB actions put the likely start up date of the escrow fund some time after October 1, 1977.

In addition, however, without offsets my proposal to pay the costs of retrofitting two and three engine aircraft from the Airport and Airway Trust Fund could add as much as \$50 million in budget outlays in FY 1979. My draft legislation to authorize waterway user charges, now pending approval in OMB, if enacted, would yield revenues approximately \$65 million per year (not currently reflected in OMB's budget totals) and would more than balance the added outlays in FY 1979 for the cost of quieting two and three engine aircraft.

This proposal, in my judgment, meets much of our fiscal concerns and will permit the airport noise program to be carried forward on an effective basis.



Alternative Way to Implement Noise
Financing Surcharge to Avoid Budget Effects
in Fiscal Years 1978 and 1979

The proposed financial arrangement to enable carriers to meet the new noise regulations through replacement envisions a reduction in aviation user charges, probably after October 1, 1977. The probability that a reduction in these taxes would occur even without the noise financing program is recognized. If it is desired, however, to avoid any budget effect in fiscal year 1979 and to allow the early accrual of funds to enable carriers to replace their aircraft to meet the noise standards, the following approach could be taken.

1. Amend the Federal Aviation Act (Section 412) to permit airlines, by agreement subject to CAB approval, to establish a noise financing fund from a two percent surcharge on passenger tickets and freight waybills. Broadly, the authority granted by this amendment would be limited to intercarrier agreements whose purposes are limited to financial arrangements for the acquisition of new aircraft that will meet federal environmental standards.
2. Amend the Internal Revenue Code to authorize refunds to air carriers of revenues from two percentage points of the taxes on passenger tickets and freight waybills paid to the Treasury in FY 1978 and FY 1979. These refunds would be made no later than December 31, 1979, provided that by that date CAB certifies to the Secretary of the Treasury that the airlines have entered into an intercarrier agreement under the authority in the amendment proposed above to the Federal Aviation Act for the purpose of acquiring replacement aircraft which meet noise standards and that the refunded taxes will be deposited in the replacement fund established by the intercarrier agreement to be used for aircraft replacement only; and provided that CAB certifies that it has approved a two percent surcharge on passenger ticket taxes and waybills effective October 1, 1979.
3. Amend the Internal Revenue Code to reduce the air passenger ticket tax and waybill tax by two percentage points effective October 1, 1979.

This approach has several solid advantages:

- It avoids any revenue loss through fiscal year 1979.
- Technically no appropriations would be involved since none is required to tax refunds.

