ACTION

DOMESTIC COUNCIL

FROM:

SECRETARY COLEMAN VIA HOPE

SUBJECT:

Transmittal to President on Aviation Noise Policy

Date: 11/26/76

COMMENTS:

Coleman sent large package to President (see transmittal memo at Tab C).

Judy prepared a cover memo from you to the President outlining the highlights of the Coleman package.

I recommend you sign ~~it~~.

A.M.

Judy - why do we need to send this to the President.

ACTION:

Date:

INFORMATION
AJ Noise

THE WHITE HOUSE

WASHINGTON

December 2, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON Jim

SUBJECT: Aviation Noise Abatement Policy

I attach for your information the final copy of the Department of Transportation's Aviation Noise Abatement Policy, (Tab A); a statement of the issues for the public hearing on financing aircraft noise reduction requirements, scheduled for December 1, 1976, (Tab B); and Bill Coleman's letter of November 19, 1976, forwarding these documents to you (Tab C).

The Aviation Noise Abatement Policy implements your directive of October 21, 1976, that DOT and FAA promulgate a noise regulation on or before January 1, 1977, to require the domestic air carrier fleet to meet certain phased-in noise standards within 8 years. The stated policy will achieve compliance for most aircraft during the next 4 to 6 years:

- 747's within 6 years, with 1/2 to be completed within 4 years;
- 727's, 737's, DC-9's, and BAC 1-11s within 6 years, with 1/2 to be completed within 4 years;
- 720's, 707's, DC-8's, and CV-990's within 8 years, with 1/4 to be completed within 4 years and 1/2 to be completed within 6 years.

On the issue of whether there is a need for additional financing, Secretary Coleman has completed his hearing and will have his recommendations to you by the end of next week.

Av Noise

THE WHITE HOUSE

WASHINGTON

1976 NOV 29 AM 7 26

November 26, 1976

MEMORANDUM FOR: JIM CANNON

FROM: JUDITH RICHARDS HOPE

SUBJECT: Aviation Noise Abatement Policy

I attach a final copy of the joint DOT-FAA Aviation Noise Abatement Policy which Secretary Coleman transmitted to the President by letter dated November 19, 1976, attached. I also attach a draft cover memorandum from you to the President transmitting this information.

Attachment

cc: Leach
Hope
Aviation Noise

THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

1976 NOV 30 PM 3 36

November 30, 1976

Honorable James Cannon
Executive Director
Domestic Council
The White House
Washington, D. C. 20500

Dear Jim:

I am enclosing herewith a document which sets forth the companies and persons who will testify at the Public Hearing on Financing of Aircraft Noise Reduction Requirements which, as you know, I am conducting tomorrow.

Sincerely,

Bill

William T. Coleman, Jr.

Attachment

113018

DEPARTMENT OF TRANSPORTATION

PUBLIC HEARING

on

Financing of Aircraft Noise Reduction Requirements

December 1, 1976

AGENDA

Morning Session	10:00 a.m. to 12:30 p.m.
Intermission	
Afternoon Session	2:00 p.m. to 4:00 p.m.
Adjournment	

Each scheduled speaker has been allotted a specified amount of time for his or her presentation. The speaker will be given a warning light signal one minute before the end of his or her allotted time and must yield the floor within the minute following.

Written presentation by any interested person, including those who may not have sufficient time to express their full views at this hearing, will be accepted if received no later than December 16, 1976, at the following address:

Secretary of Transportation
Noise Financing
400 Seventh Street, S.W.
Washington, D.C. 20590

HEARING SCHEDULE

Morning Session

PANEL	10:00	ATA	(Ignatius)
"	10:10	TWA	(Tillinghast)
"	10:20	United	(Ferris)
"	10:30	Allegheny	(Colodny)
	10:40	IATA	(Shaw)
	10:50	NBAA	(Winant)
	11:00	NOISE	(Tyler)
	11:10	ACAP	(Cutler)
	11:20	MAPNAC	(Apsell)
PANEL	11:30	Metro	(Lewis)
"	11:40	SST	(Marus)
PANEL	11:50	Boeing	(Boullioun)
"	12:00	Lockheed	(Haack)
"	12:10	Douglas	(Brizendine)
	12:20	DL&J	(Shen)

Afternoon Session

	2:00	Scheuer	(D. -N. Y.)
	2:10	COWPS	(Lilley)
	2:20	AOCI	(Moore)
	2:30	Los Angeles, Cal.	
PANEL	2:35	Schiller Park, Ill.	(Dalbis)
"		Des Plaines, Ill.	(Abrams)
PANEL	2:50	Mass. DOT	(Salvucci)
"	3:00	Mass. Port Authority	(Mooney)
PANEL	3:10	Salomon Bros.	(Maldutis)
"	3:20	Bankers Trust	(Bliven)
"	3:30	White Weld	(Tierney)
"	3:40	Equitible Life	(McCurdy)
	3:50	N. Y. Clearinghouse	(Dewey)

WITNESS LIST

Mr. Paul R. Ignatius
President and Chief Executive Officer
Air Transport Association

Mr. Charles C. Tillinghast, Jr.
Chairman of the Board and Chief Executive Officer
Trans World Airlines

Mr. Richard J. Ferris
President and Chief Executive Officer
United Airlines

Mr. Edward I. Colodny
President and Chief Executive Officer
Allegheny Airlines

Dr. R.R. Shaw
Assistant Director General - Technical
International Air Transport Association

Mr. John H. Winant
President
National Business Aircraft Association

Mr. John M. Tyler
Consultant
National Organization to Insure
Sound-Control Environment

Ms. Mimi Cutler
Director
Aviation Consumer Action Project

Mr. Sheldon Apsell
Technical Advisor
Massachusetts Air Pollution
and Noise Abatement Committee

Mr. Joseph R. Lewis
President
Metro Suburban Aircraft Noise Association

Mr. John Marus
Chairman
Noise Monitoring Committee of the
Emergency Coalition to Stop the SST

Mr. E. H. Boullioun
President
Boeing Commercial Airplane Company

Mr. Robert W. Haack
Chairman of the Board
Lockheed Aircraft Corporation

Mr. John C. Brizendine
President and Chief Executive Officer
Douglas Aircraft Company

Mr. Theodore P. Shen
Vice President for Stockbrokerage
Donaldson, Lufkin and Jenrette

WITNESS LIST

Honorable James H. Scheuer
U.S. House of Representatives
Eleventh District, New York

Mr. William Lilley, III
Acting Director
Council on Wage and Price Stability

Mr. Clifton Moore
President
Airport Operators Council International

A Representative
From the City of
Los Angeles, California

Mr. John J. Dalbis
Village Trustee
Schiller Park, Illinois

Mr. Alan M. Abrams
City Alderman
Des Plaines, Illinois

Honorable Frederick Salvucci
Secretary of Transportation
Commonwealth of Massachusetts

Mr. Richard E. Mooney
Director of Aviation
Massachusetts Port Authority

Mr. Julius Maldutis, Jr.
Vice President, Transportation Group
Salomon Brothers

Mr. John S. Bliven
1st Vice President
Bankers Trust Company

Mr. Paul E. Tierney
1st Vice President, Transportation Financing
White Weld & Company

Mr. William A. McCurdy
Vice President
Equitible Life Assurance Society
of the United States

Mr. John W. Dewey
Vice President
First National City Bank, Representing
New York Clearinghouse Association

Av. Noise

Judy – OK. Thanks Jim

THE WHITE HOUSE

WASHINGTON

December 2, 1976

976 DEC 3 AM 7 22

MEMORANDUM FOR: JIM CANNON

FROM: JUDITH RICHARDS HOPE

SUBJECT: Aviation Noise Hearings.

I attended the Aviation Noise Financing hearings chaired by Secretary Coleman today. Testimony, both written and oral, was received from a broad spectrum of witnesses: airline presidents, aircraft manufacturers, environmentalists, representatives of the financial community and private citizens. The various interests represented took the positions you would expect: the airline industry regretted the rules which were set forth by the FAA, particularly those covering the 2 and 3 engine aircraft since it is their contention that these will be expensive to comply with, and will not result in perceived noise improvements. They further urged that the already troubled industry could not carry the financial burden of complying with the new noise standards. They suggested basically the original Air Transport Association-Coleman proposal: a surcharge on the users of aviation to be turned over to the industry either directly, through an ATA-administered fund, or in some other way not involving excess government intervention. This fund would be used to finance new equipment.

Representatives of Boeing, McDonnell Douglas, and Lockheed urged that the noise requirements be met by replacement rather than by retrofit, that they be paid for through a government surcharge on passengers and freight, or from the surplus in the airport trust fund, or both.

The environmentalists felt that the noise regulations did not go far enough. They urged, (and Secretary Coleman concurred), enactment of aviation regulatory reform as a key to the health of the industry and to the meeting of the financial requirements for aviation noise reduction. Several of these groups also stated strongly that the 8 year phase-in was too long, that the noise standards were too lax, and that the delays in implementation were too great.

Trans.

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.

THE WHITE HOUSE

WASHINGTON

December 20, 1976

1976 DEC 21 AM 11 12

MEMORANDUM FOR: JIM CANNON

FROM: JUDITH RICHARDS HOPE JRH

SUBJECT: Secretary Coleman's Financing Recommendation for the Administration's Aviation Noise Policy

In accordance with your request, I attach a draft memorandum summarizing Secretary Coleman's financing recommendation's, based on the public hearings he held December 1.

THE WHITE HOUSE

WASHINGTON

Information

December 20, 1976

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON

SUBJECT: Financing for Replacement of Noisy Aircraft

On October 21, you directed Secretary Coleman to begin public hearings to determine whether financing arrangements might be necessary to enable the airline industry to comply with new FAA regulations governing aircraft noise. That hearing was held December 1. Testimony, both oral and written, was received from representatives of the airline industry, the aerospace industry, airport operators, environmentalists, and concerned citizens.

Based on that hearing, Secretary Coleman is now recommending to you limited additional financing arrangements to enable the industry to meet the new noise standards on time. His memorandum is attached at Tab A.

A summary of the principal points made at the public hearings is attached to his memorandum, at Tab A-1.

Secretary Coleman stresses the need for the expeditious enactment of aviation regulatory reform to furnish the economic environment which will permit the airlines to purchase new aircraft over the long term. He finds, however, that there is a serious timing problem because the noise regulations begin to become effective January 1.

Witnesses at the December 1 hearing supported the type of financing approach Secretary Coleman recommended to you last August. He is again recommending that approach or a variation of it as both feasible and fiscally sound. He seeks approval to submit implementing legislation in early January, as follows:

1. Ammend the Federal Aviation Act to authorize CAB approval of intercarrier agreements to achieve noise control objectives, including the establishment of an aircraft replacement fund to be managed by the private sector.

airlines

2. Amend the Internal Revenue Code to reduce existing air passenger ticket and way bill taxes by 2% as soon as (A) the CAB certifies to the Secretary of the Treasury that it has approved intercarrier agreement, or a non-profit organization to receive the 2% surcharge; and (B) the CAB approves the imposition of a special 2% environmental surcharge on tickets and way bills.

3. Amend the Airport/Airway Act to authorize appropritions for the purpose of financing the retrofit of 2 and 3 engine aircraft so that they can also meet new FAA noise standards.

Secretary Coleman states that the budget impact of these proposals is mitigated by the following factors:

1. He projects that Congress will reduce the passenger ticket tax by 2% within the next year in any case;

2. He believes that the draft legislation which he has transmitted to OMB on waterway user charges will, if enacted, produce $80 million a year in new revenues; (amounts that have not yet been reflected in the current FY-78 budget totals); and

3. The anticipated $8 billion in new aircraft sales over the next 10 years will produce a significant increase in revenues with as much as $1 billion in increased federal corporation tax revenues.

cc: Leach
Hope

THE DEPUTY SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

976 DEC 20 AM 7 29

MEMORANDUM FOR: Honorable James M. Cannon
Domestic Council

Subject: Financing for Replacement of Noisy Aircraft

On December 1, as directed by President Ford, I held a hearing on the need for special financing arrangements to enable the airlines to meet, in a timely and economically efficient manner, the new noise rule he had approved on October 21. I have carefully evaluated the material presented to me at that hearing and have finalized my recommendations to the President concerning the need for special financing as well as the general outlines of the financing mechanism I favor. You will find a copy of my memorandum to the President enclosed.

I would like to stress my unqualified support for regulatory reform. The financing environment in which the airlines now operate would be drastically and favorably altered if our proposals for regulatory reform are adopted. The improvement, over time, would probably be sufficient to enable the carriers to generate the capital they need to replace obsolescent aircraft and provide capacity for traffic growth. The problem is that the financial benefits that will accrue from reform will be achieved only gradually, since we envision a phased program designed to minimize any disruptive consequence of reform. Thus, while the benefits of regulatory reform will help the airlines pay for new aircraft over the long term, these positive consequences will not be realized soon enough to enable the airlines to order a new generation aircraft within the next twelve to eighteen months. Despite the favorable prospects for regulatory reform, we are faced with a serious timing problem. The air carriers and the aircraft industry cannot afford, unaided, to undertake a program of new aircraft development. And if the carriers are to meet the new noise requirements through replacement with new generation aircraft, they must commit themselves very soon.

Although I refer you to the enclosed memorandum for the specifics of my proposal, I want to emphasize that replacement, rather than retrofit of narrow-body four-engine aircraft is the preferable course of action. Compliance with the new rule solely through retrofit would be a significant waste of resources. Existing narrow-body four-engine aircraft are becoming economically obsolete and would be replaced now if the carriers had sufficient resources. Moreover, retrofit would be expensive (in the range of \$1.2 million to \$2.6 million per year) and would add nothing to the aircrafts' useful life. Indeed, retrofit would actually raise operating costs. By contrast, if the carriers could finance the replacement of noisy aircraft with new generation equipment, their fleets would be much quieter than if they simply retrofitted their 707s and DC-8s. Moreover, new aircraft would yield significant fuel savings and lower overall operating costs. An early start on a new generation aircraft would also bring the added benefits of increased employment, and would help maintain U.S. aerospace leadership in world markets.

I very much hope that we can work closely together to complete by January 20th, this final, essential part of the Administration's comprehensive noise policy that the President so wisely directed.

William T. Coleman, Jr.

William T. Coleman, Jr.

Enclosure

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. <u>If special financing arrangements are found to be necessary, what specific approach should be taken?</u>

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.

<u>Source of Funds</u>

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.

Aircraft Noise

THE WHITE HOUSE

WASHINGTON

December 29, 1976

MEMORANDUM TO: ALAN GREENSPAN
JOHN MARSH
JAMES LYNN
ED SCHMULTS
MAX FRIEDERSDORF
L. WILLIAM SEIDMAN

FROM: JIM CANNON Art Quern

SUBJECT: Secretary Coleman's Proposal Re Financing Aircraft Retrofit and Replacement

Attached is a copy of Secretary Coleman's memorandum to the President regarding financing for replacement of noisy aircraft.

I would appreciate having your comments on this paper and whatever recommendations you have in this regard by 5:00 p.m. Monday, January 3rd.

Attachment

Comments ~~attached~~

cc: Leach
Hope

THE DEPUTY SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

976 DEC 20 AM 7 29

MEMORANDUM FOR: Honorable James M. Cannon
Domestic Council

Subject: Financing for Replacement of Noisy Aircraft

On December 1, as directed by President Ford, I held a hearing on the need for special financing arrangements to enable the airlines to meet, in a timely and economically efficient manner, the new noise rule he had approved on October 21. I have carefully evaluated the material presented to me at that hearing and have finalized my recommendations to the President concerning the need for special financing as well as the general outlines of the financing mechanism I favor. You will find a copy of my memorandum to the President enclosed.

I would like to stress my unqualified support for regulatory reform. The financing environment in which the airlines now operate would be drastically and favorably altered if our proposals for regulatory reform are adopted. The improvement, over time, would probably be sufficient to enable the carriers to generate the capital they need to replace obsolescent aircraft and provide capacity for traffic growth. The problem is that the financial benefits that will accrue from reform will be achieved only gradually, since we envision a phased program designed to minimize any disruptive consequence of reform. Thus, while the benefits of regulatory reform will help the airlines pay for new aircraft over the long term, these positive consequences will not be realized soon enough to enable the airlines to order a new generation aircraft within the next twelve to eighteen months. Despite the favorable prospects for regulatory reform, we are faced with a serious timing problem. The air carriers and the aircraft industry cannot afford, unaided, to undertake a program of new aircraft development. And if the carriers are to meet the new noise requirements through replacement with new generation aircraft, they must commit themselves very soon.

Although I refer you to the enclosed memorandum for the specifics of my proposal, I want to emphasize that replacement, rather than retrofit of narrow-body four-engine aircraft is the preferable course of action. Compliance with the new rule solely through retrofit would be a significant waste of resources. Existing narrow-body four-engine aircraft are becoming economically obsolete and would be replaced now if the carriers had sufficient resources. Moreover, retrofit would be expensive (in the range of \$1.2 million to \$2.6 million per year) and would add nothing to the aircrafts' useful life. Indeed, retrofit would actually raise operating costs. By contrast, if the carriers could finance the replacement of noisy aircraft with new generation equipment, their fleets would be much quieter than if they simply retrofitted their 707s and DC-8s. Moreover, new aircraft would yield significant fuel savings and lower overall operating costs. An early start on a new generation aircraft would also bring the added benefits of increased employment, and would help maintain U.S. aerospace leadership in world markets.

I very much hope that we can work closely together to complete by January 20th, this final, essential part of the Administration's comprehensive noise policy that the President so wisely directed.

William T. Coleman, Jr.

William T. Coleman, Jr.

Enclosure

TO: Jim Cannon

From: MAX Friedersdorf

THE WHITE HOUSE

WASHINGTON

December 29, 1976

MEMORANDUM TO: ALAN GREENSPAN
JOHN MARSH
JAMES LYNN
ED SCHMULTS
MAX FRIEDERSDORF
L. WILLIAM SEIDMAN

FROM: JIM CANNON

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Attachment

I am concerned this will be publicly perceived as a bail-out for the industry by asking for a new tax on the public for air-fare. Perhaps the President should predicate his recommendation upon a requirement that Congress reduce passenger ticket tax by 2%. Coleman's plan has merit and provides an equitable financing plan to a critical industry. I recommend approval of the proposal if we emphasize Congressional responsibility to lower taxes to avoid ticket cost increase, Hope

DEC 30 REC'D

THE WHITE HOUSE

WASHINGTON

December 29, 1976

MEMORANDUM TO: ALAN GREENSPAN
JOHN MARSH
JAMES LYNN
ED SCHMULTS
MAX FRIEDERSDORF
L. WILLIAM SEIDMAN

FROM: JIM CANNON

SUBJECT: Secretary Coleman's Proposal Re Financing Aircraft Retrofit and Replacement

Attached is a copy of Secretary Coleman's memorandum to the President regarding financing for replacement of noisy aircraft.

I would appreciate having your comments on this paper and whatever recommendations you have in this regard by 5:00 p.m. Monday, January 3rd.

Attachment

I favor approval of Sec Colemans proposal

LWS

ACTION

THE WHITE HOUSE

WASHINGTON

January 4, 1977

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON Jim

SUBJECT: Financing for Replacement of Noisy Aircraft

The purpose of this memorandum is to seek your decision on whether to recommend legislation to implement Secretary Coleman's proposed financing for aviation noise reduction.

BACKGROUND

On October 21, 1976, you directed that current noise standards be extended to all existing commercial aircraft, to be phased in over an 8 year period. These standards began to go into effect January 1, 1977. You further alerted Congress that your aviation regulatory reform proposal, which will strengthen the airline industry's financial condition, would be on their doorstep in January. On December 1, in accordance with your further direction, Secretary Coleman held a public hearing to determine whether additional financing arrangements were needed to enable the airline industry to meet the new noise rules in a timely and economically efficient manner. Secretary Coleman's recommendations to you are set forth at Tab A. A summary of the issues raised at the December 1 hearing are attached at Tab A(1).

FINANCING ISSUES

At the public hearing, on December 1:

- The aviation industry recommended replacement for 707's and DC-8's rather than modification or retrofit.

- Financial data submitted indicated that the airline's financial situation is weak, although improving, and that, even without the noise requirements, the airlines will have difficulty in meeting their estimated capital requirements between now and 1985.

- Witnesses from the financial community indicated an unwillingness to risk further financial exposure in the aviation industry without a special financing program.

- Both Delta and Northwest Airlines, however, stated that there was no need for financing outside the normal rate-making function of the CAB, and that special financing arrangements would be inequitable to carriers which have already expended large amounts to modify their fleets without any government assistance.

- The Council on Wage and Price Stability (COWPS) believes federal financing may set a dangerous precedent for government intervention.

SUMMARY OF FINANCING PROPOSAL

Secretary Coleman recommends transmittal of a legislative package which would:

1. Urge enactment of your Aviation Regulatory Reform Proposal.

2. Reduce by 2% the existing federal tax on air passenger tickets freight bills;

3. Propose that the CAB simultaneously impose a 2% environmental surcharge on air passenger and freight bills;

4. Deposit the revenues from the 2% environmental surcharge into a fund to finance aircraft replacement;

5. Open a portion of the existing balance in the Airport and Airway Trust Fund for financing the retrofit of 2 and 3-engine aircraft only.

OPTIONS

1. Do not submit a financing proposal; urge enactment of Aviation Regulatory Reform only.

2. Direct Secretary Coleman to prepare immediately the legislation outlined above.

BUDGET IMPACT

OMB projects that this proposal would increase the budget defecit each year by the following amounts:

	($ in millions) 1978	1979	1980
Loss of receipts (tickets and waybill tax reduction)	250	270	290
Trust fund expenditures for retrofit	10	50	60
Effect of deficit	260	320	350

STAFF RECOMMENDATIONS

Alan Greenspan believes that special treatment for the airline industry is unnecessary, inequitable, and creates dangerous precedents for future environmental regulations. Further, he states that a Federal financing pool complicates the Administration's aviation reform efforts. (Tab B)

Jim Lynn opposes the DOT proposal on both budgetary and philosophical grounds: it would increase the deficit, and run counter to the policy of requiring the private sector to reflect the cost of meeting environmental standards through product pricing. (Tab C)

Ed Schmults believes the DOT financing proposal is premature, and would establish an undesirable Federal precedent, and is contrary to aviation regulatory reform. (Tab D)

Max Freidersdorf, while expressing concern that the proposal may look like a bail-out, recommends its approval so long as we emphasize Congressional responsibility to lower taxes, thus avoiding a ticket cost increase.

Bill Seidman recommends approval of the proposal.

RECOMMENDATION

I recommend that no legislation be submitted at this time except for resubmitting your revised aviation regulatory reform proposal. I further recommend that, when we resubmit the aviation reform, we include a statement that Congress should assess the financial condition of the aviation industry over the next year to ensure that the new noise standards are met on time.

DECISION:

Option 1: (Resubmit Aviation Regulatory Reform only; do not submit financing proposal.)

Recommended by: Jim Lynn, Alan Greenspan, and Ed Schmults. I also recommend this option.

Approve ________________ Disapprove ______________

I further recommend a statement to Congress urging the monitoring of the airlines' financial condition.

Approve ____________Disapprove ______________

Option 2: (Direct Secretary Coleman to draft comprehensive financing legislation for your submission to Congress.)

Recommended by: Bill Seidman, Max Friedersdorf

Approve ________________ Disapprove ______________

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 retro-fitted) 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. <u>The Budgetary Impact of a Special Financing Arrangement.</u> 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.

Judy Hope

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

January 3, 1977

Dear Mr. Cannon:

You have requested the comments and recommendations of the Council of Economic Advisers regarding the Secretary of Transportation's Memorandum for the President on the "Financing for Replacement of Noisy Aircraft."

Secretary Coleman argues that the airline industry needs Federal financing assistance to purchase new, quieter aircraft in order to meet the new noise regulations announced by the President on October 21, 1976. His conclusions and recommendations are based on the record of the December 1 public hearing on this subject attended by representatives of the airlines, the Air Transportation Association, the aircraft manufacturers, the institutions that have provided financing to the industry, the airport operators, groups representing individuals who live near airports and airline consumers. Secretary Coleman reports that there was virtually unanimous support for Federal financing aid to allow the airlines to make timely purchases of the new quieter aircraft, the one exception being the Council on Wage and Price Stability. However, we believe that a broader consideration of the public's interest, beyond the narrow interests of the airline industry, reveals that special treatment for this industry is not required, would be inequitable, and if provided would create dangerous precedents for future environmental improvement.

It has already been determined that a reduction in aircraft noise is desirable and, accordingly, rules have been promulgated. The important question at issue now is <u>how</u> the mandated noise reduction will be financed. A general economic policy of the Ford Administration has been to rely on the free-market for economic decisions unless a convincing case for government involvement can be made. In our judgment no such case has been established in this instance. It is our preference to rely on the private sector to cope with the implementation of aircraft noise reduction. If a case can be established for reducing the Federal airline ticket and way bill tax, that should be done independently of the noise reduction financing issue.

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Secretary Coleman argues that his Federal financing plan would not cost air travelers anything because the 2% environmental surcharge would be offset by a 2% reduction of the present ticket and waybill taxes. However, he also points out that DOT and the industry were recommending this reduction in any case. Thus in a lost opportunity sense, costs to airline travelers would be increased by the environmental surcharge. If a 2% tax on air transportation revenues would provide the necessary financial assistance to acquire quieter replacement aircraft, a 2% increase in airfares would do similarly. However, our concern with rising airfares should not ignore the fact that economic efficiency requires consumers to pay the full cost of providing service which, in this instance, includes the removal of excessive noise.

The original proposal by the Air Transportation Association for Federal financing aid was introduced in early 1976 after a disastrous two years during which the number of passenger-miles traveled plateaued and costs skyrocketed. In 1975, the major U. S. airlines suffered an annual loss of $100 million. However, this year profits for the industry are expected to reach $375 million. If these trends continue, coupled with the general expansion now predicted for the economy, the airline industry should find itself with sufficient expected profits to finance new aircraft immediately. Even though some of these expected profits will accrue several years in the future, they have a current capitalized value which will support the acquisition of private capital funds today.

Furthermore, as DOT studies and industry testimony reveal, the operating efficiencies of the new aircraft make them quite profitable investments regardless of who finances their purchase. Under such circumstances it is quite likely that capital funds will be forthcoming from private investors. The apparent capital shortage of the airline industry is probably symptomatic of the general capital shortage facing many industries and can best be dealt with by macro policies that encourage general capital formation.

It is our view that the stimulation to the aircraft industry that might result from the Federal financing plan is both overstated and misplaced. First, the previously established noise reduction rules will require equipment investments by air carriers regardless of their method of finance. Thus the stimulation that can be expected for the aircraft industry is properly attributed to the noise standards rather than any particular method of financing compliance with them. Any employment effects that result from the method of financing depend on the presumption that the airlines will not purchase these aircraft without Federal assistance. We do not believe that presumption is correct. Second, justifying individual government programs on the basis of their employment impacts threatens to reduce our macro-economic policy program to a piecemeal effort. Aggregate demand should be managed in a coordinated and systematic manner.

The funds are to be collected as a 2% environmental surcharge on air passenger tickets and waybills. The provision for their distribution is ambiguous. Item 3, page 2 of the Coleman memorandum states both that they would be distributed (a) "...in a way that would give relatively more aid to those carriers that must incur the heaviest expense in replacing noisy aircraft," and (b) "...based upon the revenue produced by each of the carriers participating in the agreement..." If (b) is true there is no reason for a Federal financing program since it would have the identical impact of a corresponding fare increase. If (a) is true the procedure is inequitable to airlines such as Delta and Northwest which have already purchased quieter aircraft, and inefficient in that it encourages airlines (and perhaps other firms) to delay purchase of pollution abatement equipment until a government subsidy is provided.

Secretary Coleman argues that he is not setting a dangerous precedent since Federal policy is consistent with providing aid to industry to meet pollution control costs. However, the Federal aid programs he mentions -- subsidizing pollution abatement equipment, R & D costs, accelerated depreciation, and the investment tax credit -- are general programs already utilized by the airlines. Secretary Coleman's proposal goes one step further and provides assistance to a specific industry for purchasing new equipment that also happens to provide positive environmental effects. If the airlines succeed in obtaining Federal financing support, it is likely that strong cases for Federal aid to meet pollution standards will soon be made by the automobile, steel, paper, and public utility industries, to mention a few.

Perhaps the most important disadvantage of the proposed Federal aircraft noise reduction financing plan is its potential detrimental effect on the Ford Administration's serious and laborious efforts to achieve regulatory reform in air transportation. The existence of a Federal financing pool adds an additional complication that must be addressed in drafting acceptable reform legislation. In addition, relaxing pressures on airline earnings weakens the incentive for reform.

It is our view that the airlines are, or soon will be, healthy enough to finance the purchasing of new quieter aircraft, that they would do so in any case in order to comply with the noise reduction standards and that to provide Federal assistance to the industry in general and the "neediest" airlines in particular would produce undesirable efficiency and equity consequences and precedents.

Sincerely,

Alan Greenspan

Mr. Jim Cannon
The White House
Washington, D. C.

Judy Hope

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

ACTION

MEMORANDUM FOR: MR. JAMES CANNON
THE WHITE HOUSE

FROM: James T. Lynn

SUBJECT: Financing Proposal for Replacement of Noisy Aircraft

In response to your request for OMB views on Secretary Coleman's financing aircraft retrofit and replacement memorandum, I have strong reservations about both the timing and content of the DOT proposal.

OMB Position

We continue to support the President's October 21st decision to tie the capital requirements of aircraft noise reduction measures to the enactment of aviation regulatory reform, an action which will bring about the kind of economic climate that will enable each airline to meet environmental requirements in the most economical and expeditious manner. OMB believes that an announcement of special financing arrangements will act to shift attention away from strengthening the airline earnings capability thereby weakening the immediate need for regulatory reform.

There are a number of specific concerns which the DOT proposals does not appear to address in a satisfactory manner:

- In view of the favorable 1976 earnings projected for the airline industry ($360-400 million), it is difficult to support a proposal to involve the government in special financing arrangements for the airlines. The cost of retrofitting an aircraft does not appear to be excessive, $200-250 thousand per aircraft depending upon the aircraft type. Regulatory reform in a climate of economic growth should allow the airlines individually to make capital commitments of this magnitude.

° While there is no disagreement that four engine aircraft (e.g. B707s, DC-8s) are noisy, these aircraft would probably be replaced anyway in an effort to counter rising fuel and labor costs. The improving level of industry earnings should provide an adequate base for making prudent capital investments in replacement aircraft, especially if currently manufactured models are selected by the airlines. The Secretary's proposal for a financing arrangement is based upon the premise that a yet-to-be-developed aircraft will be the primary replacement and therefore orders from airlines must be made as soon as possible. We believe that the choice of replacement aircraft should be made independently by each airline in view of its current and projected finances.

° The Secretary's proposal contains a waterways user charge to offset partially the decline in government receipts from the proposed ticket and waybill tax reduction. Receipts from a waterway user charge are already reflected in the current deficit estimates, therefore the budget deficit each year will be increased by the following amounts:

	($ in millions)		
	1978	1979	1980
Loss of receipts (ticket and waybill tax reduction)	250	270	290
Trust fund expenditures for retrofit	10	50	60
Effect on deficit	260	320	350

It is inappropriate in our view to use waterway user charges receipts as an offset to the impact of the Secretary's aircraft noise proposal.

- While Secretary Coleman has offered to reduce other areas of the DOT budget (excluding UMTA programs) to offset the adverse impact on the deficit, reductions of this magnitude in other DOT programs would not be acceptable to the Congress.

° As Delta Airlines pointed out in a recent letter to DOT, the proposed financing arrangement for the replacement of aircraft would be inequitable to carriers that already have expended significant funds to modify their fleets without government assistance. Northwest Airlines has expressed concern that the DOT proposal to place a 2% replacement tax upon fares would penalize the long haul traveler since such travelers would have to pay more tax per takeoff and landing than short haul traveler.

° During the Secretary's public hearing, the Council on Wage and Price Stability (COWPS) stated that the creation of special financing arrangements for the air transport industry may well constitute a dangerous precedent in terms of government intervention in the private marketplace. We concur with the COWPS assessment.

° More information on measures to reduce the impact of aircraft noise is expected in less than a month. On January 17th the FAA will hold hearings on an Environmental Protection Agency proposal covering airport noise abatement. At present, seventeen noise abatement alternatives will be considered at these hearings.

° The impact upon the economy of the replacement aircraft aspect of the Department's proposal is speculative in that U.S. manufacturers may continue to develop working agreements with European aerospace firms with much of the work being accomplished overseas.

While many of the effects of the DOT proposal (e.g., increased employment, greater productivity) would benefit the air transport and aerospace industries and their surrounding communities, we are concerned that DOT has lost sight of the primary goal, reducing aircraft noise, and that the Secretary's proposal is aimed primarily at stimulating the air transport industries. We are confident that the Secretary's proposal, which is quite similar to the Air Transport Association's proposal announced publicly last spring, will receive full consideration through the congressional hearing process. Administration endorsement of special financing arrangements would be premature.

In conclusion we recommend that approval of the DOT proposal be withheld to preserve the momentum of the Administration's regulatory reform efforts and to continue the current policy of requiring the private sector to reflect the cost of meeting environmental standards by way of product pricing.

THE WHITE HOUSE

WASHINGTON

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January 3, 1977

MEMORANDUM FOR: JIM CANNON

FROM: ED SCHMULTS

SUBJECT: Proposed Financing for the Replacement of Noisy Aircraft

After reviewing Secretary Coleman's recent proposal for a financing program to assist airlines in meeting federal noise regulations, I continue to have serious reservations regarding both the need for such a program and the proposed mechanisms for implementation. In a September 10, 1976 memo to the President, I outlined my basic objections to the Department's proposal and, essentially, those same points apply to the latest proposal.

1. Despite the Department's claims, I believe that approval of the proposed financing program would establish an undesirable precedent. Checking informally with OMB, I am told that EPA does not make expenditures for private sector pollution abatement. The initiation of a federal program to subsidize the installation of pollution abatement equipment for the airline industry would create a serious potential for the proliferation of such expenditures to other industries, particularly as environmental standards become more stringent.

2. I am not satisfied that we are ready or that the time is ripe to undertake the technological development of a "new generation" of jet aircraft. Such a program should be attempted only after the ramifications of fuel standards, noise standards, industry needs -- both domestic and international, and traffic considerations have been fully considered and coordinated. The Department's proposal has not adequately addressed all of these factors.

3. The specific proposal regarding a distribution mechanism is not clear. If the proposal is to allow carriers to pool these special funds through the use of an inter-carrier agreement and distribute them on the basis of the greatest need to replace noisy aircraft, such an approach has serious competitive implications which should be carefully reviewed by the Justice Department. It is also contrary to the policy stated in the Administration's regulatory reform legislation which would prohibit the use of pooling agreements. In addition, it is not clear how such a distribution would provide equitable treatment for those carriers who have acted to abate aircraft noise without government assistance.

I do not believe that the full effects of this proposal, including such things as the long term cost effects beyond the aviation industry, the questions of need and equity within the industry, and the relationship of this proposal to the Administration's efforts to reform federal airline regulation have been adequately addressed. These basic issues must be resolved before serious consideration is given to approving special financing arrangements.

Attached is a copy of my September 10, 1976 memorandum to the President.