DATE: April 12, 1994
TO: Bruce Reed
FROM: Mike Schmidt
RE: Principals Meeting on the Restructuring of Air Traffic Control Services

As you know, there will be a Principals meeting tomorrow afternoon from 5:00 – 6:00 in the Vice President's Ceremonial Office to discuss the Administration's legislative position on the restructuring of air traffic control (ATC) services (the infamous "FAA" issue). I have attached a copy of an briefing paper on the options for restructuring ATC services that will be the focus of tomorrow's meeting. The VPOTUS will be chairing the meeting, and it will be attended by Secretaries Pena, Bentsen, Reich, and Brown, as well as a number of WH Principals (Panetta, Rubin, Tyson, etc.). Carol cannot attend the meeting, and asked me to see if you could attend in her place. If you can attend, I will schedule some time this afternoon or tomorrow to give you some more information on the issue and on the meeting itself (I will also attend the meeting with you). If you can't attend, Carol has asked me to attend as an observer and recorder only (since it is a full-blown Principal's meeting), and DPC will not have a voice on the final decisions made on this issue.

The paper that I have attached is an excellent and easy-to-understand summary of the issues that surround the restructuring of ATC services. It lays out the four options that will be considered at the meeting tomorrow afternoon:

- Option 1: Promulgate More Flexible Personnel and Procurement Rules for ATC.

- Option 2: Create a Government Corporation Financed by a Mandatory Revolving Fund but Without Borrowing Authority.

- Option 3: Create a Government Corporation with Borrowing Authority.

- Option 4: Create a Non-Government Corporation with Government Oversight.

They are, for the most part, the same issues I discussed with you several weeks ago when I gave you a briefing on this issue. At tomorrow's meeting, final decisions will be made on which of the four options the Administration will support and on political and timing issues surrounding our introduction of an ATC restructuring bill. The Vice President is chairing the meeting because the NPR recommended the creation of a Government Corporation to provide ATC services.

Other items of interest about the meeting:

- The consensus at the staff level seems to be that Option 3 is the closest thing to the letter of the NPR recommendation (NPR called for a Government Corporation with borrowing authority), but that Option 4 is closer to the spirit of the recommendation.

- Secretary Pena will be pushing hard for Option 3, as well as for quick legislative action. Rubin and Tyson will likely be leaning toward Option 4, but the feeling seems to be that we will end up at Option 3 in the end.

- WH Leg Affairs and OMB will probably be pushing for some delay in the timing of any legislative action, given our full legislative plate this spring. Given the political sensitivity surrounding these options, that may not be a bad idea.

- The key policy issues that the options revolve around are: (1) the extent to which we want to open up the Budget Enforcement Act (BEA), and (2) the extent to which ATC users (airlines, customers) are involved in a new ATC entity. The political difficulty regarding the BEA is most prevalent in Options 3 and 4, while at the same time these two options provide the most user involvement.

If you are able to attend, let me know and we can schedule some time to sit down and discuss all of this in more detail. I think there are a number of issues still up in the air on this one, and that the meeting tomorrow will be quite lively and important.

OPTIONS FOR RESTRUCTURING AIR TRAFFIC CONTROL SERVICES

The President's *Civil Aviation Initiative* and the National Performance Review proposed that the Federal Aviation Administration (FAA) be restructured so that air traffic control (ATC) services could be modernized and managed more efficiently. This memorandum explains the arguments for restructuring; outlines the substantive and political merits of various options; and lists legislative strategies for achieving the Administration's goals.

The need for restructuring. Current law provides the FAA with neither the incentives nor the freedom to modernize the ATC system in a manner that is not only safe, but also cost-effective.

Budget constraints. The efficient modernization of ATC services requires that capital spending be "lumpy," i.e., large initial outlays followed for some years by much lower levels investment. Under the annual appropriations process, however, large capital spending programs are more likely to change slowly over time than to fluctuate as sharply as needed for the most cost-effective investment in a new generation of air traffic control facilities.

Agencies are uncertain about the extent to which the ATC modernization effort has been underfunded. In recent months, the FAA has identified \$3-\$5 billion in additional capital expenditures that the agency would undertake over the next ten years if sufficient funding were available. Some agencies find this conclusion credible, and argue that an independent review of the FAA's capital program might identify substantial further investments that would be cost-effective; these agencies believe that the FAA, as currently structured, cannot ascertain the needed investments. These agencies also argue that it is difficult to implement a lumpy investment plan through the Congressional appropriations process.

Whatever the need for increased funding of ATC modernization, the Congress might be hard pressed to find additional resources within the discretionary caps set out under the BEA. For this reason, the NPR and some agencies recommend that ATC modernization be financed with borrowing that is unrestricted by the current budget rules. The resulting long-term debt would be repaid through user charges on airlines.

Other agencies argue that the need for borrowing has not been established. First, these agencies regard the shortfall in ATC funding as largely unproven: these agencies believe that the FAA has offered no credible evidence for their underfunding estimates; moreover, studies by GAO, CBO and the Office of the Inspector General cite poor management, not a lack of funding, as the primary reason for delays in the modernization of ATC services. Second, past Congressional actions suggest that funds <u>can</u> be found for priority infrastructure projects: Congress increased the highway budget, for example, by more than \$2 billion in 1994; similarly, Congress more than doubled FAA's capital budget between 1987 and 1993. Finally, the Administration could accelerate somewhat the pace at which budget authority for ATC is obligated by exempting the FAA from a general budget policy: the FAA now follows the general practice of requesting appropriations for the full cost of the project in its first year; instead, the FAA could include in their annual budget requests only the amount that they expect to obligate in that given year. Accelerating ATC obligations would not, however, ease the overall outlay constraints imposed by the BEA; budgetary offsets would have to be found for any increase in outlays.

Congressional Micromanagement. The current budget process not only limits the *aggregate* amount of funding available for ATC modernization, it also encourages Congressional micromanagement of that funding. The FAA receives annual appropriations through five separate accounts involving numerous line items. This multiplicity of accounts and line items encourages Congressional micromanagement of modernization efforts, and reduces the FAA's ability to meet changing needs by reallocating funds.

Insufficient User Control. All agencies agree that ATC customers -- commercial airlines, general aviation, and the travelling public -- do not have sufficient input into the FAA's investment plan. Greater user input could make ATC services more responsive to user needs. In addition, paying for ATC services through user fees rather than taxes would give ATC users a greater economic incentive to monitor the cost-effectiveness of the ATC modernization program.

Personnel and Procurement Rules. All agencies agree that current personnel and procurement rules unreasonably constrain ATC management and strategic planning.

Options. All of the options listed below would reform personnel and procurement rules. The options differ principally in the degree to which the ATC corporation is freed from budget constraints, and the extent and manner in which users and the government are able to exercise control over spending for ATC services.

OPTION 1. REFORM WITHIN FAA

Under this option, more flexible rules would be promulgated to govern the FAA's personnel and procurement spending for ATC services. In addition, an "Advisory Board" of ATC customers (commercial airlines, cargo carriers, general aviation, etc.) would be established to inform the investment decisions made by the Secretary of Transportation. Some acceleration in capital spending would be possible through *administrative* changes to the budget process, but ATC spending would remain subject to all of the *statutory* constraints of the annual appropriations process.

Effect on the Provision of ATC Services

- ATC spending would be made more cost-effective by the procurement and personnel reforms, by the input from the Advisory Board, and the acceleration in capital spending that would follow the budget policy changes.

- ATC modernization could not be financed through borrowing and spending outside of the usual appropriations process. Differing views on the importance of borrowing authority are noted above.

- The Advisory Board would have less control over ATC spending than would the "Board of Directors" proposed under Options 2, 3 and 4; ATC spending therefore would not be as responsive to user concerns as it would be under Options 2, 3 and 4.

Political Considerations

- This option would encounter the least Congressional opposition. Indeed, the Chairs of the authorizing committees probably would support this proposal, and may credit the Administration with recommending useful reforms. Since ATC programs would remain within the existing FAA, however, even the support of the authorizing committees may not be sufficient to persuade the Government Operations committees to pass personnel and procurement rules that are significantly different from the rules governing other government agencies and programs.

- The airlines and controllers may be largely indifferent about these reforms; they would prefer that the Administration did not pursue Option 3.

- Because no amendment to the BEA would be sought, critics could not use this proposal to question the Administration's commitment to the budget disciplines of that statute.

- The NPR report called for an ATC corporation with borrowing authority; this option would not meet that goal.

OPTION 2: A GOVERNMENT CORPORATION FINANCED BY A MANDATORY REVOLVING FUND BUT WITHOUT BORROWING AUTHORITY

A government corporation would be established within DOT. As in Option 1, ATC spending would be subject to new, more flexible personnel and procurement rules. Option 2 would differ from option 1 in two important regards:

- *Governance*. The corporation would be governed by a Board of Directors, appointed by the President, that included ATC customers, the Secretaries of Transportation and Defense, and an ex-officio member to assure federal financial oversight. The Board would set fees for use of the ATC system.

- *Budget Constraints*. To provide some measure of added budget flexibility, corporation spending would be financed by a new mandatory "revolving fund," and annual ATC outlays would be limited only by each year's receipts; outlays would not be subject to the annual appropriations process. To establish the revolving fund, ATC outlays would be shifted from the discretionary to the mandatory side of the budget. This shift would require either budget offsets of more than $5 billion annually, or Congressional approval of a "technical" amendment to the BEA (the amendment would be "technical" in the sense that it would not increase the deficit -- the PAYGO spending increase would exactly equal the reduction in discretionary outlays.)

Effect on the Provision of ATC Services

- Procurement and personnel reforms would make ATC spending more efficient.

- Because the corporation would have a permanent appropriation, its outlays would be limited only by receipts to the revolving fund; Congressional micromanagement would be discouraged. Just as under current law, however, budgetary offsets would have to be found for any increase in outlays; moreover, the corporation could not borrow and spend outside of BEA constraints.

- ATC customers would have more influence over ATC investments through the Board of Directors than they would through the "Advisory Board" of Option 1.

- Because the corporation would be "governmental", and because the government -- through its representatives on the Board -- could influence the corporation's decision-making, the corporation may not be sufficiently independent of the Executive Branch and the Congress to make truly "business-like" investment decisions, even with a Board of Directors dominated by private sector interests.

Political Considerations

- The Chairs of the authorizing committees openly oppose this option. The Chairs of the appropriations committees, however, have expressed support "in principle" for establishing a corporation, while reserving final judgment until they can examine a specific proposal.

- Setting ATC services in a separate government corporation might give the Administration a better chance at persuading the Government Operations committees to pass personnel and procurement rules that are flexible enough to allow the corporation to achieve significant efficiencies in the provision of ATC services.

- Although the airlines and controllers are likely to support these reforms, they would be disappointed that the Administration did not pursue Option 3.

- Compared to the amendment needed for Option 3, this "technical" amendment is less likely to be interpreted as an attempt to evade the budget discipline imposed by that statute. On the other hand, the amendment still would open up the BEA (with all the attendant political complications that implies) and still would require 60 votes on the Senate floor to overcome a point of order. Moreover, this option would set a precedent for using a reduction in the discretionary caps as a PAYGO offset on the mandatory side, and may thereby encourage those in Congress who would like to use a reduction in the discretionary caps as an offset for a reduction in income taxes.

- Would not meet the NPR goal of allowing ATC modernization to be financed through borrowing.

OPTION 3: GOVERNMENT CORPORATION WITH BORROWING AUTHORITY

A government corporation would be established within DOT. As in Options 1 and 2, the corporation would be subject to more flexible procurement and personnel rules. As in Option 2, the corporation would be governed by a Board of Directors, appointed by the President.

Option 3 differs from Option 2 only in the budgetary freedom given the corporation: the Administration would seek **a BEA waiver that allowed the corporation to borrow and spend funds without regard to BEA constraints; in addition, the corporation's spending would be excluded from calculations of the budget deficit.**

Effect on the Provision of ATC Services. Same as for Option 2, with the following exception:

- The ability to borrow and spend funds without any BEA constraints would free the corporation from the spending restrictions that are a normal part of the federal budget process.

Political Considerations. Same as Option 2 with the following exceptions:

- Airlines and controllers both support the creation of a governmental corporation with borrowing authority.

- This option would exempt a single government activity from the constraints of the BEA. Because this option would create pressure to exempt other government activities from BEA constraints (e.g., some might seek the creation of the Inland Waterways Development Corporation, in which a federal corporation builds, maintains and operates the inland waterway system that is now the responsibility of the Corps of Engineers), critics are likely to call into question our commitment to deficit reduction. In addition, this option would set the further precedent of effectively allowing capital budgeting for a single federal entity. For all of these reasons, the needed BEA amendment might be more difficult to achieve than the "technical" amendment needed under option 2 or 4.

- This option most closely resembles the NPR recommendation.

OPTION 4: NON-GOVERNMENT CORPORATION WITH GOVERNMENT OVERSIGHT

The government would charter a nongovernmental, non-profit corporation governed by a Board of Directors or Trustees. The charter would specify mechanisms by which ATC users would elect representatives to the Board (under Options 2 and 3, the President would appoint the Board). The federal government would exercise control over the corporation only through regulatory oversight, either through the administrative powers of the DOT or through a new regulatory commission. As a nongovernmental entity, the corporation would be freed from all government personnel and procurement rules, and would be free to incur long-term debt in private capital markets and to raise revenue through fees for the use of the ATC system (existing ATC assets would be transferred to the corporation).

Establishing the corporation may require only a "technical" amendment to the BEA: the discretionary caps would be reduced by an amount equal to the reduction in the government's ATC outlays; the reduction in the caps would be used as PAYGO savings to offset a corresponding reduction in aviation excise taxes (the taxes would no longer be needed since the corporation could assess user fees). CBO may contend, however, that the corporation is inherently "governmental," thereby complicating Administration efforts to argue that the desired BEA amendment was merely "technical."

Effect on the Provision of ATC Services

- Of all the options considered here, a nongovernmental corporation would be most responsive to its customers, and would have the greatest institutional freedom to pursue cost-effective ATC investments. In addition, the discipline of private capital markets would encourage the corporation to manage its investments efficiently.

- Critics will argue that a nongovernment corporation would jeopardize either safety or national security. All agencies agree, however, that these fears are without merit -- all public interests could be safeguarded through strict regulatory oversight.

Political Considerations

- The authorizing committees, and especially the committee Chairs, are likely to cite safety as their reason for opposing this option more strongly than any other. A few Republican members have expressed a philosophical preference for true privatization, but none have yet openly supported this option.

- The main union representing air traffic controllers has cited safety in publicly opposing the creation of a nongovernmental corporation. In private, unions have also expressed concerns that this option would set a precedent by limiting the right to strike of nongovernmental employees. The airlines' view of this option is uncertain.

- Establishing a more independent corporate entity would avoid the charge that the government corporation is designed principally to keep the ATC system within the government while evading the BEA. Similarly, this option would avoid establishing a capital budget for a single federal entity. On the other hand, this "technical" amendment still would open up the BEA (with all the attendant political complications that implies) and still would require 60 votes on the Senate floor to overcome a point of order. Moreover, this option would set a precedent for using a reduction in the discretionary caps as a PAYGO offset on the mandatory side, and may thereby encourage those in Congress who would like to use a reduction in the discretionary caps as an offset for a reduction in income taxes.

- Although not the "governmental corporation" called for by the NPR report, this option — if enacted — could best achieve the broader goals sought by NPR: safe and efficient modernization of the ATC system.

<u>**Legislative Strategy**</u>. Congressional critics are seeking assurances that the Administration has considered all possible options for restructuring the FAA. All agencies agree that the Administration therefore should submit a report detailing the reasons why it believes that ATC services must be corporatized rather than simply reformed within the FAA. This leaves two issues: when to submit legislation and when and how hard to push for legislative action. Options include:

- *Seek passage this year of specific legislative proposal.*

- *Submit legislation this Spring; do not push Congress to act before January.*

- *Submit a report this Spring outlining more than one option for corporatization; restate Administration goals for restructuring; and indicate a willingness to work with the Congress on a mutually acceptable legislative proposal.*

DATE: April 5, 1994
TO: Bruce Reed
FROM: Mike Schmidt
RE: Update on the FAA Restructuring Initiative

I have attached the following packet of information on a new "compromise" option for restructuring FAA that is currently being circulated. It would create a new non-profit Government Sponsored Enterprise (GSE) to provide civilian air traffic control services. Apparently, some feel this type of enterprise would have an easier time getting the Senate to amend the BEA than would a private corporation or government corporation. However, I am still not sure how this would change the overall politics of the situation --the committee chairs still hate the idea of creating a new entity, no matter what we call it. I will be interested to hear Barbara Chow's political take on this option, but I would assume that waiting until next year to push a FAA restructuring initiative on the Hill would still be the best option. The only problems: 1) Pena wants to get this moving and get a legislative "accomplishment" under his belt; 2) VPOTUS may want to push ahead with the restructure sooner rather than later, since it is a NPR recommendation.

Anyway, please give this a look and tell me what you think. I will also run it by Weinstein, since he worked on the NPR stuff with you over the summer. Thanks!

April 4, 1994

MEMORANDUM FOR ELAINE KAMARCK
BOB STONE

FROM: Michael Deich

SUBJECT: ATC -- Option 3.5

Attached is Jon Baker's discussion draft of option 3.5. I've only skimmed it. My first impression is that the only thing that might need to be changed is to get the Secretaries of Transportation and Defense off the Board of Directors. While both Secretaries should have enough control to settle any question about the system's safety and responsiveness to national security issues, that control probably should be exercised through some kind of regulatory structure rather than by direct participation in the governance of the nominally-private corporation (through their seats on the Board). Please let me know what you think. Thanks.

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

SENIOR ECONOMIST

April 1, 1994

MEMORANDUM FOR MICHAEL DEICH (NEC)
ED MURPHY (TREASURY)
JEE RHEE (OMB)
FRANK KRUESI (DOT)

FROM: JON BAKER

SUBJECT: GSE Option for Air Traffic Control

The attached draft attempts to capture "Option 3.5"--a corporate form sufficiently private to permit us to argue in good faith that we are not evading the BEA, but sufficiently public to address concerns that a privatized system would jeopardize safety and to avoid setting the precedent of restricting the right to strike for a private firm. I picture the eventual audience for this document as congressional staff and industry representatives, although much review and rewriting will likely occur between now and then.

In writing the draft, I started from Ed's various corporate models and Jee's recent draft. Many of the choices I made were arbitrary and can be modified substantially without moving off Option 3.5; this draft is intended merely as a basis for discussion. It has not yet been reviewed by Joe Stiglitz, so it is not necessarily the position of CEA.

I will not be in the office on Friday, April 1, and I will probably not be in on Monday, April 4. I can be reached at home if you wish to talk it over or make comments before Tuesday at 301-951-1831.

cc: Joe Stiglitz
Elizabeth Schneirov

DRAFT 3/31 7pm

GOVERNMENT-SPONSORED ENTERPRISE (GSE) OPTION FOR THE AIR TRAFFIC CONTROL SYSTEM

To provide civilian air traffic control services in the United States, a non-profit government-sponsored enterprise will be established and chartered by the Federal Government. This air traffic control corporation will be subject to regulatory oversight by the Department of Transportation. It will conduct its operations in a business-like manner.

GOVERNANCE

- The corporation will be governed by a 9-member Board of Directors. The Secretaries of Transportation and Defense will fill two of the 9 seats. The remaining 7 directors will be appointed by the President.

- The President shall select a specified number of directors from each of a certain designated groups of air traffic control system users (e.g. passenger carriers, air freight carriers, general aviation).

- Directors will serve staggered seven year terms.

- An Advisory Panel of users will be designated by the corporation's chief executive officer. Each member of the panel must be approved by the Board of Directors.

- The Board of Directors will hire (and have the power to remove) the corporation's Chief Executive Officer, and will approve significant corporate decisions after receiving the advice of the Advisory Panel (as discussed below in connection with oversight).

- The incumbent Board of Directors and the Advisory Panel shall each nominate candidates for vacancies on the Board, although the President will not be required to select from either list. Nominations to the President need not be made public.

CORPORATE POWERS

- The corporation will have the power to enter contracts with suppliers and customers, and provide services for any users. It will not be subject to rules governing procurement by government agencies.

- The corporation will own the current civilian air traffic control assets (transferred without charge from the government) when it commences operation. It will have the power to acquire or lease additional assets, or reconfigure or sell assets.

- The corporation will have the authority to set its own budget, borrow funds, hire or dismiss employees, and determine the compensation of employees, directors, and officers. It will not be subject to government personnel rules.

- The corporation will have the power to set fees, terms, and conditions for users of airspace by contract with users. It will have the power to specify charges for violations of those terms and conditions (through contractual liquidated damages provisions), and the power to refuse to deal with users that intentionally or recklessly violate its terms and conditions.

RESTRICTIONS

Corporate Actions

- The corporation will be non-profit entity, precluded from paying dividends or rebating fees to users.

- The corporation may not adopt fees or policies that discriminate among similarly-situated users, disadvantage new entrants, harm competition among users, lead to excessive fees for air service, endanger safety, endanger national security, or impair the financial viability of the corporation. These restrictions will be enforced by the Department of Transportation through the oversight authority discussed below and will not give rise to a private right of action.

- The corporation may not violate any law or any international obligation of the United States.

- During periods of war, or national emergency declared by the President, the Board and the corporation must carry out such policies or actions as the President may direct.

- The corporation must keep financial records in accordance with generally accepted accounting procedures, and have those records audited annually by a certified public accountant. Audited financial statements shall be submitted to the Department of Transportation and made public.

Legal Obligations

- The corporation shall not be liable for tort claims involving the operation of the air traffic control system arising out of corporate policies (such as the generation of radar equipment employed, staffing levels, or procedures for using equipment). A successful plaintiff with a tort claim involving the operation of the air traffic control system shall be precluded from receiving prejudgment interest or punitive damages. The total tort liability of the corporation arising out of a single event (e.g. plane crash) shall not exceed $100 million. A suit seeking tort damages from the corporation in excess of $100,000 shall not be tried before a jury.

- Employees will have the right to bargain collectively and have the right to strike. Upon the commencement of a strike by any collective bargaining unit, the President shall have the power to take any or all of the following actions upon a determination that national security or public welfare will be enhanced: order work to continue for 30-days and extend the 30-day cooling off period once, appoint a mediator, and appoint a fact-finding commission to assist a mediator. At the end of a cooling off period that has been extended, the President may order work to continue, appoint an arbiter and require compulsory arbitration.

- Outside of the exceptions noted above, the corporation will be subject to all applicable laws of the United States, or any state or other jurisdiction within the U.S., including the antitrust laws.

OVERSIGHT

- The residual FAA, operating as an agency within DOT, will promulgate safety rules. The corporation and users of the airways must operate within the constraint of those rules.

- Significant corporate decisions shall be defined as: fees for the use of the airways, general policies governing the terms and conditions for the use of airspace that the corporation will negotiate with users, services offered by the corporation, collective bargaining agreements, the compensation of directors and officers, and major changes in the corporation's strategic plan. Significant corporate decisions must be approved by the Board of Directors.

- Before the Board of Directors approves significant corporate decisions other than collective bargaining agreements or the compensation of directors and officers, it must receive the advice of the Advisory Panel. The Advisory Panel must transmit its advice within fourteen days of receiving notice that the Board

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will consider a significant corporate decision.

- Significant corporate decisions will not take effect until the Department of Transportation announces that it will not institute a proceeding to disapprove the decision. If DOT wishes to commence a disapproval proceeding, it must do so within 30 days of transmission of the decision from the Board. DOT shall conduct such disapproval proceedings as informal adjudications (notice and comment, without trial-type hearings). A significant corporate decision will not take effect if the decision is disapproved, and will not take effect so long as a disapproval proceeding is underway. The corporation may withdraw a significant decision at any time; doing so will end an ongoing disapproval proceeding.

- The Department of Transportation may conduct, at any time and on its own motion, an oversight proceeding requiring the corporation to alter fees or policies on the ground that they discriminate among similarly situated users, disadvantage new entrants, harm competition among users, lead to excessive fees for air service, endanger safety, endanger national security, or impair the financial viability of the corporation. DOT shall have the authority to enjoin corporate actions--both at the completion of the proceeding and as interim relief.

FINANCE

- The corporation will be financed through fees paid by users of the air traffic control system, and through issuing debt.

- The air traffic control assets now operated by the FAA will be transferred to the corporation without charge.

- The corporation's debt will be secured solely by its revenues; the authorizing statute establishing the GSE will expressly disclaim any government obligation.

BUDGET SCORING

- This option will require legislation to reduce discretionary budgetary caps by an amount equal to the reduction in the government's air traffic control outlays. The cap reduction will be used as PAYGO savings to offset an identical reduction in aviation excise taxes. This "technical" amendment of the BEA would require 60 Senate votes to overcome a point of order.

DATE: March 22, 1994
TO: Bruce Reed
FROM: Mike Schmidt
RE: Restructuring the FAA

Tomorrow morning at 11:00, Bo Cutter, Chris Edley, Joe Stigletz, and Alicia Munnel (Treasury) will be meeting to discuss the attached draft decision memorandum for the Vice President on restructuring the FAA (per the NPR/Airline Commission/Civil Aviation Initiative's call for the FAA's Air Traffic Control services to be restructured as a government corporation). They have invited DPC to attend, and I think it would be a good idea for you to attend for several reasons:

- The memorandum will not be going through the normal NEC process -- instead, it will be pushed on to the Vice President for approval after tomorrow's meeting (unless any major problems are raised). Therefore, this meeting may be the last chance we have to comment on the memo before it goes up to the VP.

- According to my sources, Cutter, Stigletz and Munnel are leaning toward Option 4 -- creating a non-government corporation with limited government oversight. This option is not what the NPR recommended (it recommended creating a government corporation). As the memo points out, there are good reasons for wanting this option, but there are also some major political problems that come with it -- most notably opposition from unions and from Rep. Oberstar.

If you have any questions about the memo, I would be happy to talk with you tomorrow morning before the meeting (if you can go). If you can't go, let me know and I will try to go (although I have another meeting at that time that I am currently trying to get out of!). Sorry about the short notice on all of this -- originally, it was supposed to go through the "normal" NEC process, where deputies and principals would comment, but for some reason unknown to me a decision has been made to put this issue "on the fast track."

DRAFT March 22, 1994 high noon.

MEMORANDUM FOR THE VICE PRESIDENT

Our offices have been working with the Executive Oversight Committee at the Department of Transportation (DOT) to develop a sound legislative proposal to restructure the nation's air traffic control (ATC) system. To further these efforts, we would like your early guidance on a critically important issue whose resolution will affect many details of the proposal: what modifications, if any, should we seek in the Budget Enforcement Act (BEA)?

The President's *Civil Aviation Initiative*, the NPR, and the Airline Commission all called for the FAA's ATC services to be restructured as a government corporation. All of the proposals argued that a corporation would allow ATC services to be provided on a more "business-like" basis. The *Initiative* stressed the importance of personnel and procurement reform. The NPR and Commission proposals focused more on freeing ATC spending from the constraints imposed by the federal government's budget rules.

In our judgment, the central dilemma is this: achieving greater freedom from federal budget rules not only increases the probability that the corporation would make more efficient investment decisions, but also raises far greater hurdles for legislative success. These hurdles are of two kinds. First, proposals that limit the oversight of the Congressional authorizing committees have met strong opposition from the chairs of those committees. (In contrast, these proposals have been supported --- at least in principle --- by the appropriators.) Second, proposals that require a significant exemption from the BEA are likely to be opposed on the grounds that they undercut Administration and Congressional efforts to achieve long-term deficit reduction.

The budgetary reforms being considered by the EOC will require either finding budgetary offsets **exceeding $5 billion per year**, or modifying the BEA (which would require sixty Senate votes). All of the options listed below would reform personnel and procurement rules, and all would make ATC spending at least somewhat more responsive to customer concerns. The options differ principally in the scope of the BEA modifications that each would require.

Option 1: Partially Address Budgetary Constraints Within Current Law

Option 1 would not seek any BEA amendment. The budgetary cost of any reforms would be accomodated within existing budget rules.

Under this scenario, the EOC is likely to recommend a corporation along the following lines: The corporation would be established within DOT. The Secretary would appoint its management and would control its decisions. In addition, an Advisory Board of ATC customers (airlines, cargo carriers, general aviation, etc.) would be established to help the Secretary make more business-like investment decisions. The corporation would have special procurement and personnel rules, but would remain subject to all existing limitations on ATC spending. In the future, however, capital projects would be budgeted on an annual cost, rather than a fully-funded basis, thereby allowing some projects to proceed in parallel rather than sequentially.

<u>Pro</u>

- Procurement and personnel reforms, together with input from the "Advisory Board," could make ATC spending more efficient. Some acceleration in capital spending would be possible.

- Rep. Oberstar and Sen. Ford probably would support this proposal, and may credit the Administration with recommending useful reforms.

- Because no amendment to the BEA would be sought, critics could not use this proposal to question the Administration's commitment to the budget disciplines of that statute.

<u>Con</u>

- Secretary Peña has stated publicly that the corporation would ease current budget constraints in some fashion. This option would address capital constraints, but not to the degree anticipated by the Secretary.

- The corporation could not borrow. For NPR, an important virtue of corporatization is the ability to accelerate capital investments through borrowing. (We have not yet fully developed our arguments on the benefits of accelerated investment. As a result, while some of us concur that borrowing authority is essential to achieve significant improvements in ATC investments, others remain unpersuaded.)

- The corporation may not be as responsive to the "Advisory Board" as it would be to the "Board of Directors" proposed under Options 3 and 4. The corporation's investments therefore might not be as efficient as they would be under Option 3 or 4.

- Since changes to personnel and procurement rules are the focus of this option, critics may question why the Administration seeks rules only for the ATC corporation, but not other government agencies. (Steve Kelman regards this criticism as being without merit; his arguments shall follow.)

Option 2: Provide Minimal Relief from Budgetary Constraints

Option 2 would give the corporation some small measure of budget flexibility by transferring ATC outlays from the discretionary to the mandatory side of the budget. A "revolving fund" would be established, and ATC outlays would be limited only by each year's receipts. Option 2 would require either budget offsets of more than $5 billion annually, or Congressional approval of a "technical" amendment to the BEA, in which the discretionary caps are reduced and used as a PAYGO offset for the new mandatory spending. As in Option 1, future capital projects would be budgeted on an annual cost, rather than a fully-funded basis.

Under this scenario, the EOC is likely to recommend a corporation exactly like that under Option 1 (except for the added budget freedom).

Pro

- This option would secure limited freedom from current budget constraints. The corporation would have a permanent appropriation; its outlays would be limited only by receipts to the revolving fund. And as with Option 1, capital spending would be slightly accelerated through budgeting on an annual, rather than fully-funded, basis.

- If a BEA amendment were pursued, it would be only "technical" (in the sense that it would not increase the deficit — the PAYGO savings would exactly equal the reduction in the discretionary outlays). Compared to the amendment needed for Option 3, this "technical" amendment is less likely to be interpreted as an attempt to evade the budget discipline imposed by that statute.

- Procurement and personnel reforms, together with input from the "Advisory Board," could make ATC spending more efficient.

- Rep. Oberstar and Sen. Ford are far more likely to support this proposal than Options 3 and 4.

Con

- While addressing budget constraints, this option still would not allow the corporation to borrow. Moreover, just as under current law, budgetary offsets would have to be found for any increase in outlays.

- Under this option the authorizing committees would lose none of their current influence over ATC outlays. The appropriators, however, would not be able to exercise as much control over ATC spending as they now do, and might therefore oppose this option.

- The corporation may not be as responsive to the "Advisory Board" as it would be to the "Board of Directors" proposed under Options 3 and 4. The corporation's investments therefore might not be as efficient as they would be under Option 3 or 4.

- This option would set a precedent for using a reduction in the discretionary caps as a PAYGO offset on the mandatory side. This option may encourage those in Congress who would like to use a reduction in the discretionary caps as an offset for a reduction in income taxes.

- The BEA amendment would require 60 votes on the Senate floor to overcome a point of order. (The "technical" nature of the amendment, however, would make it easier to pass than the amendment that would be needed for Option 3.)

- Critics still may question why the Administration seeks rules only for the ATC corporation, but not other government agencies. (Again, Steve Kelman regards this criticism as being without merit; his arguments shall follow.)

Option 3: Government Corporation Exempt from BEA (Current EOC Proposal)

Under Option 3, the Administration would seek **a BEA waiver to allow a government corporation to borrow funds without regard to BEA constraints.**

The EOC is now recommending a corporation along the following lines: the corporation would be established within DOT. As in Options 1 and 2, the corporation would have special procurement and personnel rules. The corporation would be government by a Board of Directors that included, among others, ATC customers. While the Board would have more influence over corporate decision-making than would the "Advisory Board" of Options 1 and 2, the Secretary of Transportation would retain final decision-making authority.

<u>Pro</u>

- Other countries have demonstrated the feasibility of this approach by establishing government corporations to run their own ATC services.

- Because it could borrow funds without any BEA constraints, this corporation would face no impediments to "business-like" investment.

- A Board of Directors would push the corporation to make more efficient investments.

<u>Con</u>

- This option would set a precedent for exempting a government activity from the constraints of the BEA.

- No "governmental" corporation may be sufficiently independent of the Executive Branch and the Congress to make truly "business-like" investment decisions even with a Board of Directors controlled by private sector interests. This may be especially true where the Secretary of Transportation retains direct control over the corporation's investment and business plan.

- The BEA amendment, which would require 60 votes on the Senate floor to overcome a point of order, may be more difficult to achieve than the "technical" amendments needed under options 2 and 4.

- The chairs of the authorizing committees strongly oppose this option.

Option 4: Non-Government Corporation with Government Oversight

Option 4 would require only a "technical" amendment to the BEA: the discretionary caps would be reduced by an amount equal to the reduction in the government's ATC outlays; the reduction in the caps would be used as PAYGO savings to offset the corresponding reduction in aviation excise taxes (the taxes would no longer be needed; the corporation would assess user fees instead).

Under this scenario, the EOC is likely to recommend the establishment of a "nongovernmental" corporation — either a non-profit firm controlled by ATC users or an investor-owned firm. User fees would replace most of the existing aviation excise taxes. We believe that a non-profit corporation is better on the merits. CBO, however, may regard a non-profit entity as a "governmental" entity for purposes of the BEA. If so, then Option 4 would require exactly the same kind of BEA amendment as Option 3. An investor-owned firm is certain to require only the "technical" BEA amendment outlined above. Concerns about safety, however, are likely to be raised more loudly about an investor-owned firm than about any other option listed in this memo.

Whatever its form, a nongovernmental corporation would be subject to regulatory oversight by the federal government, either through the administrative powers of the DOT or through a new regulatory commission. As a private firm, the corporation would have personnel, procurement, and budgetary freedom (including the ability to charge user fees and to borrow).

<u>Pro</u>

- Of all the options considered here, this corporate form would be most reponsive to its customers, and would have the greatest institutional freedom to pursue efficient ATC investments.

- Establishing a nongovernmental entity would require only technical amendments to BEA.

- Establishing a more independent corporate entity would avoid the charge that the government corporation is designed principally to keep the ATC system within the government while evading the BEA.

Con

- Secretary Peña has declared that "we are not seeking any 'privatization' of ATC services."

- Critics will argue that a nongovernment corporation would jeopardize the public interest, such as safety. (In our judgement, these fears are without merit –– safety and other public interests would be safeguarded through strict regulatory oversight.)

- The authorizing committee chairs are likely to cite safety concerns as their reason for opposing this option more strongly than they oppose any other option.

- The main union representing air traffic controllers has cited safety in publicly opposing the creation of a nongovernmental corporation (however, the controllers do support the creation of a government corporation).

- The BEA amendment would require 60 votes on the Senate floor to overcome a point of order. (The "technical" nature of the amendment, however, would make it easier to pass than the amendment that would be needed for Option 3.)

Recommendations: TBD

FAA RESTRUCTURING AND THE BUDGET ENFORCEMENT ACT

As the draft VP decision memo makes clear, the driving factor in restructuring the FAA is the Budget Enforcement Act (BEA). All options, except Option 1 which is a minimalist option, requires PAYGO offsets, and thus effect the BEA in some way.

Government-Owned Corporation (Options 2 & 3)

- A government-owned ATC corporation (as defined in Options 2 and 3) would be funded in the Budget as a mandatory revolving fund, where its fees or receipts (ie -- the current ticket tax and freight waybill tax) are "permanently" appropriated on the mandatory side of the Budget, and its outlays are moved from the discretionary to the mandatory side of the budget (Currently, 75% of FAA's receipts are on the mandatory side, but its outlays and 25% of the receipts are on the discretionary side).

- Establishing this mandatory revolving fund for a government-owned corporation would increase mandatory outlays for the corporation (as described above). This would create a need for a PAYGO offset under the BEA. Congress would have to find offsets, or modify the BEA to balance the mandatory increase with the corresponding decrease in receipts and outlays on the discretionary side (after all, we are simply moving receipts and outlays from the discretionary side to the mandatory side); this would require 60 votes in the Senate, as the memo makes clear.

Non-Government Corporation (Option 4)

- If the ATC corporation were non-governmental, it would not be part of the Federal Budget. However, this approach would call for the elimination of current receipts (ticket tax, etc) and replace them with some kind of user fee. This would reduce receipts (and spending) to the Budget and hence require PAYGO offsets under the BEA. Congress could modify the BEA to balance the tax decrease with corresponding decreases in discretionary outlays, but this would require 60 votes in the Senate.

Borrowing Authority (Options 3 (Government) and Option 4 (Non-Government))

- Issuing debt is a budget issue, because the debt finances direct spending by a government entity (in Option 3). Spending by a government corporation, financed by borrowing from the Treasury or from the public, is counted as a Federal outlay under the BEA. It could be offset by reductions in other Federal outlays, or the outlay could be exempted from the BEA. But exemption would be difficult politically.

- Borrowing by a non-government entity (Option 4) would not affect the Federal Budget. However, the CBO and the Budget Committees would look closely at any proposed non-government ATC corporation. If they considered it an extension of the government, its borrowing would be treated as agency borrowing and require an offsetting decrease elsewhere under the BEA.