

Comments submitted to the Competition Bureau on the Market Study of Competition in
Canada's airline industry

Submitted by: Emma A. Neale
PhD Candidate, School of Public Policy and Administration, Carleton University

Thank you for the opportunity to provide comments regarding the market study on airline competition in Canada. I am a PhD Candidate at Carleton University in the School of Public Policy and Administration focusing on challenges to aviation policy in Canada.

Research Overview

Many objectives are necessary to enable an effective air transportation system, such as safety, security, competition, efficiency, accessibility and connectivity, as outlined in Section 5 of the *Canada Transportation Act*. Challenges affecting the industry such as competitive disadvantages stemming from the organizational structure of the industry (ex. the “user-pay” system) or exogenous shocks (ex. COVID-19) influence the ability to meet these objectives. My research aims to systematically analyze the provision of air travel in Canada as well as to provide insight into the best policy alternatives and feasibility of implementation based on stakeholder preferences.

Many of the current challenges in Canadian aviation create competitive consequences. I will focus this commentary mainly on two areas of the terms of reference: creating greater airline competition and barriers to entry.

How can we achieve greater airline competition? What are the benefits for Canadians?

1. Understand that airlines do not operate in a vacuum. They support an ecosystem made of several independent aviation entities, which have a trickle-down impact on the competitiveness and viability of airlines (and vice versa).

- The Canadian aviation industry has a rich history and is structured uniquely compared to other nations due to a heavy reliance on user fees. Following the deregulation of airlines in the 1980s, a series of policies and acts took place that structured the organization of the industry that we see today. This included the commercialization of airports, privatizing Canada's air navigation service provider (ANSP) and slowly limiting the government's economic oversight of the industry and its ability to ensure coherence of commercial decisions among its various entities, as illustrated by the chaotic operations of the summer of 2022. Canadian aviation entities are a mix of private, non-for-profit, crown corporation and government organizations that need to work together to enable an efficient provision of air travel.
- The process of privatization and commercialization led to the establishment of different user charges being imposed on air travel. As the government no longer operated different entities in the aviation industry, the services needed to be funded by alternative methods. Today, several user charges are imposed by different entities to fund aviation infrastructure and services.

- The COVID-19 pandemic highlighted a major flaw with this system: the difficulty of covering operational expenditures in an industry characterized by high fixed costs when the number of users varies significantly. The aviation value chain has many fixed costs, such as airport leases, infrastructure upkeep and expensive equipment. As such, when there are no users, different aviation entities are left with inadequate revenues to cover high operating costs. The revenue shortfall leads these entities to impose higher user charges, take on more debt or a combination of both, in the long run, to ensure their continued operations are viable.
- The requirement for ANSPs and airports to operate as a not-for-profit entity limits their ability to financially absorb exogenous shocks due to the nature of not-for-profit balance sheets. The upstream firms (Airports and ANSPs) end up increasing their costs and pass on the cost to the downstream supplier (Airlines), who then pass it on to the passengers (Tretheway & Markhvida, 2014). The pass on of upstream costs to the downstream value chain impacts the financial stability of airlines (Tretheway & Markhvida, 2014).
- Below is a table of select user-charges and how they increased during and after the pandemic. In addition to the fees mentioned below, there are other indirect charges such as airport rent and fuel taxes.

Table 1. Increase in User-Fees Post Onset of COVID-19 Pandemic

		Fee Pre-Covid	Fee Post-Covid	Percent Change	Source	Notes
ATSC		[7.12-25.42]	[9.46-33.77]	33%	(Government of Canada, 2023)	The fee depends on whether it is a domestic or international flight and is therefore indicated as a range.
AIF	YYZ	25	35	40%	(Toronto Airport Authority, 2022)	These are some of the increasing AIF's but this is not a comprehensive list of all airports which have increased their fees.
	YYT	35	42	20%	(St. John's Airport Authority, 2020)	
	YUL	30	35	17%	(Montreal Airport Authority, 2020)	
	YWG	25	38	52%	(Winnipeg Airport Authority, 2020)	
NAV CANADA	Terminal Charge	24.36	31.86	31%	(NAV CANADA, 2020)	NAV CANADA charging principles are complex, based on weight of the aircraft, distance travelled and a number of other criteria such as specific rates for different use cases. The charging increase shown here is just to indicate rates have increased, and on average approximately 30% across the board.
	North Atlantic Tracks	155.03	230.22	48%	(NAV CANADA, 2020)	

Airports in the National Airport System (NAS) are not-for-profit entities and as such are free to set their Airport Improvement Fees (AIF) as they see fit. Airports in the NAS are responsible for paying rent to the federal government for operating on government land. The federal government sets the Air Traveller Security Charge (ATSC) in the federal budget and charges a per-passenger rate to primarily fund CATSA. NAV CANADA sets fees in consultation with its users (i.e., airlines) and has to provide notice for any increase.

- While market structure, market share and behavioural practices of airlines are integral to analyzing the competitive nature of the industry, the structure of the value chain cannot be overlooked.
- When a firm decides to enter a market, it must determine that its marginal revenue will exceed marginal cost. If the Canadian airline market structure price-inelastic consumers is well served and at the point of saturation, new entrants will not be looking to enter this market, rather the elastic market.
- The business model of low-cost airlines is to attract passengers who have not travelled by air or travel infrequently. They try to stimulate the price-elastic air travel demand with low fares.
- The Canadian aviation fee system acts as a barrier to entry for low-cost carriers, as the number of fees which must be added to the base fare of a ticket will preclude the fare from being in the category of a low-cost ticket. As such, the low-cost consumer market (the elastic market) will not be feasible to attract. This means new entrants, should they decide to enter, will be operating at a loss, or will end up competing for consumers with inelastic demand. This ultimately leads to market exit or underrepresented market share for the elastic consumers.
- The above case has been demonstrated with Lynx Air (Gangcuangco, 2024) and most recently Canada Jetlines (AviTrader, 2024). Additionally, Flair Airlines one of the remaining prominent low-cost carriers in Canada is financially struggling (Seal, 2024).
- When additional regulatory costs are added to the system such as the Air Passenger Protection Regulations (APPR), the future cost of mitigating CO₂ and non-CO₂ emissions (e.g., ICAO's CORSIA, higher costs for sustainable aviation fuels and new technologies), the financial burden on airlines will put upward pressure on airfares, which will further dampen demand for air travel.

To achieve greater airline competition, it is necessary to restructure the current user-fee system to promote the entry of low-cost carriers and the long-term viability of all airlines. There are many ways which may influence this, such as:

- Light-handed regulation on fees, such as the credible threat of price cap regulated based on whether fees exceed a condition of reasonableness
- Airport ownership or governance changes
- Elimination or capping government fees such as the ATSC or airport rent
- Reinvestment of fees collected by the federal government into aviation infrastructure

Benefits to Canadians include more affordable fares, increased choices through the viability of low-cost carriers, and enhanced connectivity throughout Canada brought through additional carriers in the market.

2. The public policy paradox must be addressed to ensure the best interest of Canadian air travellers

- The government cannot advocate for a competitive aviation industry, while simultaneously be contributing to the anti-competitive nature of the industry structure by putting upward pressure on airfares through an ever-increasing regulatory burden (e.g., passenger rights regulations, lack of support for energy transition in aviation) and continued heavier reliance on the user-pay principle than in other countries.
- The government collects the Air Traveller Security Charge which goes into the general revenue fund and then sets the amount of money allocated to CATSA.
- While the recuperation of costs for airport security is integral to a safe and secure system, there should be transparency in the collection of fees and operating expenses. It is worth noting that the general concept of aviation security is to ensure national security (Prentice, 2015) as such it should be treated as a public good and funded through general taxation.
- The International Civil Aviation Organization (ICAO) established a guideline for airport and air navigation charges (Doc 9082), which also outlines a framework for security charges (ICAO, 2012).
- On page II-4 of Doc 9082, the following is recommended: “Any charges for, or transfers of, security costs to providers, aircraft operators and/or end-users should be directly related to the costs of providing the security services concerned and should be designed to recover no more than the relevant costs involved.” Additionally, “No discrimination should be exercised between the various categories of users when charging for the level of security provided.” (ICAO, 2012).
- Up until the COVID-19 pandemic, the revenue collected from the ATSC was significantly higher than the amount of money allocated to CATSA (NACC, 2018). For example, the 2019 Public Accounts of Canada shows 871 million dollars collected by the government from the ATSC, whereas CATSA was provided 723 million dollars of government allocated funds (Government of Canada, 2019). This is a 148-million-dollar surplus to the government from the ATSC.
- In 2023, the ATSC was increased by roughly 30% by the federal government (Government of Canada, 2023).
- The operating expenses of CATSA remained relatively constant throughout the pandemic with limited passengers to screen, minimizing the ATSC revenue collected.
- The ATSC should not be treated as a “user-fee” and increase over time as it adds additional burden onto the cost of air travel contributing to the competitive disadvantage to the Canadian market.
- There are also discriminatory fees between domestic and international passengers, which do not require different security screening. Trans-Border security may have different associated costs as security must follow CBP and TSA standards.
- In addition to the security fees, the government collects ground rent from airports in the National Airport System as a percentage of airport authority revenue.
- This collection of revenue is not necessarily reinvested back into the industry. While reinvestment into the industry is a wide debate, airports effectively charge the AIF to recuperate part of the ground rent.

- Because airports are not-for-profit entities in Canada, their charges are not regulated and possibly distortionary (Not to mention Airports are not under any formal Act).
- There are many acts and regulations, which contribute to the fee structure of the industry. The primary ones are:
 - o National Airports Policy
 - o *Airport Transfer (Miscellaneous Matters) Act*
 - o *Canadian Air Transport Security Authority Act*
 - o *Civil Air Navigation Services Commercialization Act*
 - o Air Passenger Protection Regulations
- Other policy documents which are integral to the analysis of the system but may not have a direct contribution to the fee structure are as follows
 - o *Canada Transportation Act*
 - o Blue Sky Policy
 - o *Aeronautics Act*
 - o *Air Canada Public Participation Act*
- An analysis of these acts, the integration of the system and the effects on the competitiveness in the airline industry should be conducted to determine improvements to airline competition in Canada.

In order to enable competition and ensure fees are not distortionary, specifically on the basis of government-imposed fees, it is recommended that Doc 9082 be reviewed and fees adjusted to reflect aviation charges' best practices.

The aviation policy ecosystem should also be reviewed to work towards a better-integrated framework, which ensures true cost recovery and non-distortionary fees.

Benefits to Canadians include lower costs to air travel through cost recovery mechanisms as recommended in Doc 9082, the possibility of enhanced service standards, and better passenger experience through a more integrated system of aviation entities. There will also be wider social benefits by increasing the air transport contribution to the Canadian economy.

3. Enable data-driven decision making which is a major contributor to competitiveness

- The inability to easily access market data acts as an inhibitor of competition, otherwise known as asymmetric information.
- Statistics Canada has improved the visualization and data availability for aviation statistics over the last few years. However, key information pertaining to the industry is missing for public use.
- While Canadians can see how many travellers have come through a particular airport, the Origin-Destination connectivity data is missing. i.e. how many travellers have taken a Toronto – Montreal flight over the past 12 months?
- When a firm has private information regarding demand, costs and service levels it will act strategically to optimize profits and capture the optimal market share.
- If the information for each firm is public, there is a greater incentive to compete on different levels.

- It is important to remember that firms compete for two items: price and quality. While Statistics Canada does publish some average airfare data, there is no data collected on quality.
- If we look at our neighbour to the south, aviation data is collected and made readily available to the public on connectivity and quality. (U.S. Department of Transportation, 2024).
- When price competition is sufficient, or where the difference in airfares is marginal, a consumer will make a choice based on some other indicator such as the airline's reputation, loyalty to a brand or quality of service.
- Making quality statistics publicly available such as flight delays, mishandled baggage, and overbooking such as what the U.S. Department of Transportation does will allow consumers to make more informed decisions.
- Publicly available quality data will also close the gap on part of the information asymmetry and therefore can create an increase airline competition.

In order to enhance competition and reduce barriers to entry, data on connectivity and quality should be made available to the public.

Benefits to Canadians include increased choice by making informed decisions on airline quality and the possibility of lower fares through enhanced competition on quality.

What are the major barriers to entry and expansion and how can policymakers lower them to stimulate competition?

As outlined in the above section, some of the main barriers to entry are structural and include the following:

- **User-charges**
 - The extent of charges added on top of the base fare, in addition to indirect charges such as navigation charges and fuel taxes, act as a barrier for low-cost carriers to enter the market and charge a low-cost fare. If a new carrier does choose to enter the market and offer low-cost services, due to the structure of the market, the carrier will end up competing with full-service carriers and be pushed out of the market.
- **Government Policy**
 - Several policies and acts have contributed towards the structure of the aviation industry in Canada and have ultimately led to the establishment of user-charges, including government-imposed charges. These policies thus indirectly contribute towards a barrier to entry.
- **Data**
 - The lack of publicly available data for the Canadian aviation industry causes information asymmetric leading to firms having limited knowledge of market conditions and consumer behaviour when making an informed decision to enter the market. In addition, the lack of quality data causes passengers to choose based on price and can inhibit consumer choice.

How can policymakers stimulate competition?

When answering this question, it is important to determine how much competition an air travel market such as Canada can sustain in the long run. Canadian airline competition will be reflected differently than the competition in larger economies with higher population density. It is thus important to ask “how much competition is enough”. The following provides a summary of recommendations to stimulate competition based on the commentary provided in this submission.

1. Better integrate the aviation system as a whole by restructuring the fee system in a manner that is more conducive to competition, further analysis must be done to determine what the best way forward is
2. Review government fee mechanisms and ensure they are in line with Doc 9082
3. Review the policy ecosystem of the aviation industry in Canada and work towards a better-integrated framework, which ensures equitable cost recovery and non-distortionary fees
4. Provide public access to aviation statistics, specifically Origin-Destination data, which may involve regulating the collection and dissemination of airline, airport, security and other entity data
5. Enable a way for quality data to be collected and reported publicly to increase consumer choice and enable further airline competition
6. Lastly, recognize that the aviation system is interconnected and that any policy change to airlines, airports, security or air navigation service providers may have competitive impacts on another aspect of the industry. These entities do not work in isolation and thus cannot be treated independently

The focus of this commentary was to provide insight into the competitive disadvantages the current structure of the aviation industry in Canada causes. Through my research on analyzing Canadian aviation policy recommendations and interviewing experts, many other competitive concerns have been identified such as international competitive disadvantages due to regulatory burdens and the lack of inter-modal competition and connectivity in Canada. My research will progress as the market study continues. As such, I welcome any questions or follow-ups pertaining to my research and remain available for further commentary.

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