NACC CNLA

National Airlines Council of Canada

Conseil national des lignes aériennes du Canada

Market Study on Canada's Airline Industry

Brief to the Competition Bureau of Canada

August 2024

The National Airlines Council of Canada (NACC) welcomes the opportunity to share its perspectives with the Competition Bureau of Canada on the competitiveness of the Canadian air travel system and the industry which supports it. NACC represents Canada's largest passenger air carriers: Air Canada, Air Transat, Jazz Aviation LP and WestJet. We promote safe, accessible, sustainable, and competitive air travel through the development of policies, regulations and legislation that foster a world-class transportation system.

In NACC's response to the Bureau's consultation on the Terms of Reference for this market study, NACC recommended that the Bureau focus the scope on the competitiveness of the overall air travel system. In hearings held by the Standing Committee on Transport, Infrastructure and Communities focused on air travel in spring 2024, there was near unanimous agreement that Canada's unique "user pay" model and the myriad of fees and charges imposed on passengers, airports and airlines in Canada, is correlated to inefficiencies and negatively impacting industry competitiveness in comparison to similar jurisdictions around the world.

In its Terms of Reference, the Competition Bureau stated that one of the key purposes of this study is to examine "***how governments across Canada can improve competition for the benefit of domestic air passengers as well as the workers and entrepreneurs who enable these services***.". We welcome this focus; however, it is not possible for this objective to be realized without a thorough understanding and review of the system as a whole. Any proposed recommendations emerging from the market study should have the goal of benefitting Canadians and be useful and effective to improve the air travel industry in Canada. As a result, NACC will be devoting the bulk of this submission to identifying the key elements of the current system that act as barriers to a more competitive system for all airlines in Canada, and proposing recommendations that would strengthen Canadian domestic air travel for the benefit of passengers and the overall industry.

Context

NACC member airlines welcome further competition in the Canadian airline sector. A competitive air travel system is one in which all airlines, large and small, can operate in an environment that provides equal opportunity to succeed. However, there are a number of challenges which must be addressed to help foster competition in the Canadian context. Some of Canada's challenges are inherent to the geographical and demographic realities of our country, including:

- Providing service to the second largest landmass in the world
- A population of only 40 million, with one of the lowest population densities in the world
- A significant number of regional, remote and northern communities
- Challenging geographic and climatic conditions, including harsh winters and unpredictable summer weather – a situation that is becoming more pronounced with climate change.

Minister Champagne reiterated these challenges in his letter to the Bureau sent May 23, 2024 when he stated "*Notably, as you are well aware, competition in this sector is shaped by our country's particular geography, with low population density and many remote locations…".*

Despite these challenges, NACC member airlines have provided consistent air travel to Canadians for well over 80 years, and in so doing, have become a world leader in civil aviation practices - a fact underscored by the fact that both the International Civil Aviation Organization (ICAO) and the International Air Transport Association (IATA) are headquartered in Canada.

In fact, NACC members serve nearly 150 unique city pairs in Canada across the country and connect Canada to over 160 destinations around the world. This level of connectivity is a key driver of Canada's economy – supporting hundreds of thousands of jobs across the country, contributing over $68 billion to Canada's GDP and supporting tourism, trade, foreign investment all while contributing to Canada's strategic objectives, such as immigration.

However, there are also significant challenges to competitiveness in the air travel system that are a function of the policy environment in which airlines operate in Canada. These challenges inhibit the growth of the air travel sector and increase the cost of air travel in Canada.

This fact is increasingly being recognized by the rest of the world. According to Airlines for America, there has been a near 40% reduction in the capacity by US carriers to Canadian non-hub airports versus pre-pandemic levels due to higher costs and regulations in the Canadian market. El Al, the Israeli air carrier, personally informed NACC that it did not resume its regular direct flights to Toronto Pearson post-pandemic citing the exorbitant costs. If new regulations such as overly punitive Air Passenger Protection Regulations are implemented, other foreign carriers have stated they will rethink whether they choose to provide service to the Canadian market.

The uncompetitive nature of the Canadian system compared to other systems globally was recognized in the 2016 report entitled "Pathways: Connecting Canada's Transportation System to the World" - a report Chaired by former Cabinet Minister David Emerson. One of the report's observations is as follows: "***Other countries see the increasing importance of air transport for global competitiveness. Some, such as the U.S., Singapore, and the Persian Gulf states, actively subsidize their air sectors; others with user-pay models that promote self-sufficiency, such as countries in the European Union, still support their air sectors in other ways and minimize further tax burdens on the sector. Canada is unique among its competitors in charging onerous rents and taxes that undermine competitiveness"[1].*** Although this statement was made in 2016, it remains applicable today.

[1] "Pathways: Connecting Canada's Transportation System to the World, 2016, p. 190.

We specify below a number of the most uncompetitive elements of the Canadian air travel system, followed by recommendations on how they can be addressed.

Systemic Challenges to Canada's Air Travel Sector

Expensive Third-Party Fees and Charges: As recognized by the Emerson Report cited above, Canada is one of the only countries with a system based predominantly on the principle of "user pay". Although NACC member airlines are not opposed to user pay in principle, a system in which user pay is the predominant principle is one that results in a plethora of fees, charges, and taxes that passengers and airlines must pay, which when added together has made Canada one of the highest cost jurisdictions in the world. Canada has some of the highest mandatory third-party fees and taxes on air travel in the world – many of these fees have increased significantly since the pandemic. As an example, mandatory NAV CANADA fees increased by 29.5% in 2022. These fees are impacting affordability and negatively impacting all carriers. In fact, many of the fees and charges collected are not fully returned to the aviation system, and instead flow into general revenues.

On the other hand, in other jurisdictions, such as the United States for instance, excise taxes are pooled and used to reinvest in the air travel system, including for things like domestic navigation services, airport infrastructure and other system-level investments.

Meanwhile in Canada, passengers pay airport improvement fees, the Air Travellers Security Charge (ATSC), and applicable taxes. These various fees can represent a significant proportion of the cost of an airline ticket. As one example, a round-trip flight booked in August 2024 on a major Canadian airline for travel in mid-October between Toronto Pearson Airport and Calgary International Airport had a base fare of $353. However, the additional taxes, charges, and fees totalled $113.28, or the equivalent of over 32 per cent of the base fare. These additional charges do not include the service fees airlines pay to NAV CANADA, and fuel taxes on aviation fuel. These various taxes, charges and fees lead to a higher cost of air travel in Canada versus other jurisdictions.

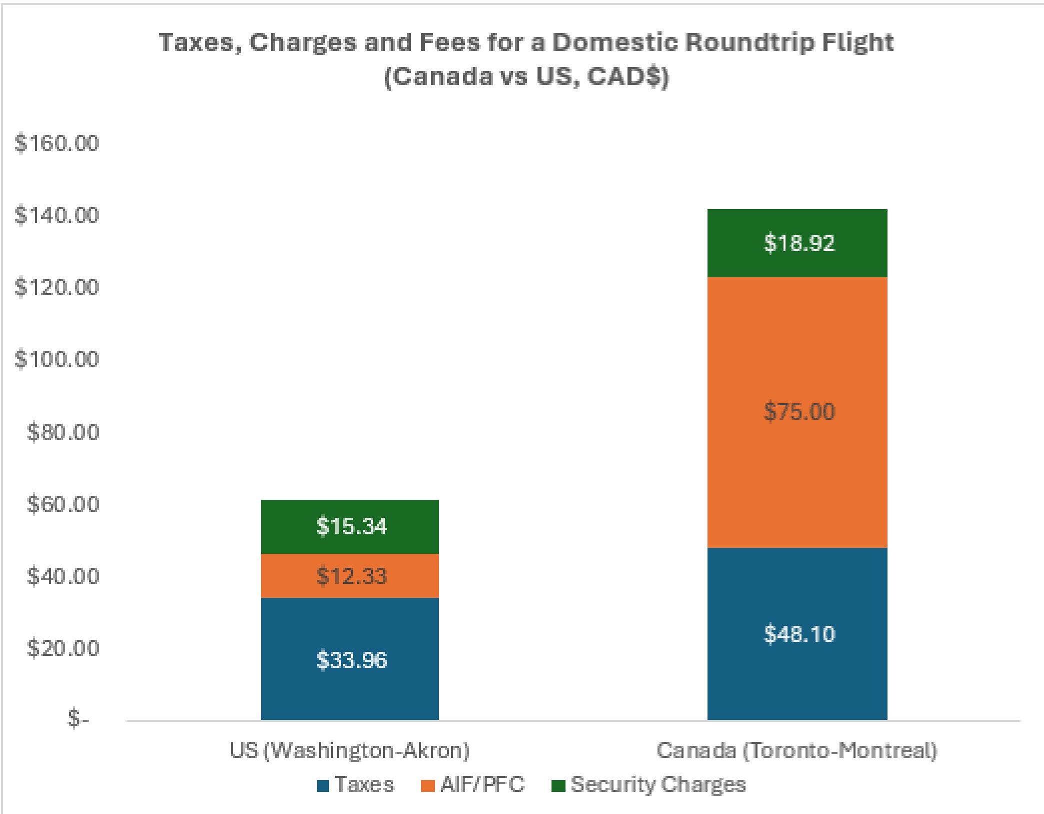
Aside from the fact that many of these fees are set without consultation, there is often a lack of transparency as to how or why fees are set at the rate they are - the announcement in the 2023 federal Budget that the ATSC would be increased by approximately 33% is a good example.

These various third-party fees are typically significantly higher in Canada than they are in the US, which contributes to the price disparity often found between air travel in Canada versus the US. A few examples of these disparities:

- The excise tax on aviation fuel is 158% higher in Canada than the US.
- With the recent increase in the ATSC, the Canadian security fee will be significantly higher than the equivalent fee in the US (up to C$34.42 compared to C$7.65 in the US).

- Airport Improvement Fees (AIF) are generally much lower at US airports. At 19 Canadian airports, these fees are between 2.5 and 7.5 times the US national average, which translates to approximately C$15.00-$45.00 per passenger versus C$6.14 per passenger in the US.

The below example compares a roundtrip fare for a comparably distanced domestic route in Canada and the US, with a similar base fare. This example illustrates the impact of high taxes and fees in Canada, which, in this example, are more than double vs the US:



In short, the high cost of third-party fees and charges represents a significant cost drain for air travel to, from and within Canada, which increases costs, and reduces the ability to invest, thereby impacting the competitiveness of the sector.

Airport Rent Not Reinvested in Airport Infrastructure: Since 1992, the federal government has charged "ground rent" to Canada's largest airports. Between 2013 and 2023, Canada's airports paid over $3 billion in rent to the federal government, which included a year where rent payments were suspended due to the pandemic. In 2022-23, airports paid over $419 million in rent, a 42% increase in 10 years[2]. Airport rents can represent up to 12% of an airport's overall revenue.

[2] "Wing Heavy: The Fees that Undermine the Competitiveness of the Airline Sector"; Gabriel Giguere, Montreal Economic Institute, December 2023.

At the same time, the federal government invests only a small portion of these rent payments back into airport infrastructure. Between 2013 and 2020, an average of $32 million per year was invested in airports via the Airports Capital Assistance Program (ACAP), which represents approximately 9% of the rents collected by the federal government in the same period.

By contrast, the US government has invested massively in its airports. Since 2020, the US government has invested over US$40 billion in American airports. Furthermore, American airports are not required to pay any sort of rent for land to American governments. This is a clear competitive disadvantage for Canada.

Because airport rents are so high, and the return so little, airports must charge Airport Improvement Fees that are considerably higher than the equivalent fees in the US in order to modernize infrastructure and pursue their growth. All of this puts Canadian airports, and therefore the Canadian air travel system, at a competitive disadvantage compared to US and other international counterparts.

Canada's Regulatory Framework: Civil aviation is a highly regulated sector in any jurisdiction in the world. An efficient and modern regulatory framework is a critical tool to ensure that air travel maintains its excellent safety rating, and that the overall system is efficient and viable. However, Canada's regulatory framework is in need of an overhaul, as its current structure is putting Canada and Canadian airlines at a significantly competitive disadvantage. Concerns with the regulatory framework include the following:

- *Outdated regulations that do not reflect the modern aviation system:* Change is constant in civil aviation, and airlines need a resourced and modern regulator to be able to compete with domestic and global competitors. The International Civil Aviation Organization continually drafts new and updated Standards and Recommended Practices (SARPs) for their 193 contracting States to implement. However, in Canada, it can take up to 5-7 years (in a best-case scenario), for the aviation regulator to promulgate these into regulation. Also, the overarching legislation, the Aeronautics Act (AA), has not been amended since the 1980s, which prevents some of the ICAO safety provisions being enabled in Canada.

  Regulations in Canada also do not keep pace with technological advances and other changes. As an example, Canada's regulations require manual verification of passenger documents during the boarding and screening process, despite the fact that new modern biometrics and facial recognition technology exist and are leveraged in other jurisdictions, to facilitate and speed up the boarding process. Other countries have already put in place the regulatory framework to allow use of biometrics; Canada's regulations have not been modernized. Another example is the Canadian Air Carrier Protective Program (CACPP), which was established in the wake of the Sept. 11, 2001, terrorist attacks, but has not been fundamentally changed nor comprehensively reviewed since that time.

- *Regulatory support or service from the federal government is lacking*: Many regulations require service from Transport Canada to be implemented. For instance, Transport Canada provides medical certifications for pilots, and issues Restricted Area Identity Cards (RAICs) for staff working in secure locations. However, over the past several years, there have been many instances of delays in the issuance of RAICs and medical certifications; delays that have contributed to system disruptions, which inhibit performance of Canada's airlines.
- *Unnecessary or burdensome regulations*: There are many examples of regulations that are overly burdensome or costly when compared to other jurisdictions. A very recent example is the proposed regulatory framework for the Air Passenger Protection Regulations (APPR) unveiled by the Canadian Transportation Agency (CTA) in July 2023. Although NACC is not opposed to a reasonable passenger protection regime, if the proposals as presented in July 2023 are adopted, Canada would have one of the most punitive passenger rights regimes in the world, which would drive up costs and threaten regional connectivity. The associated 'cost recovery' component of the APPR regime is another such example – no such 'cost recovery' system, whereby airlines pay a levy for appeals launched by the passenger, is in place anywhere in the world. A number of foreign airlines have suggested that if adopted, the APPR regime would force them to rethink their service to Canadian markets, and many stakeholders, including provincial premiers, have expressed strong concerns over the impact that these costly APPR regulations could have on regional service in Canada.

Proximity to US Airports: Approximately three quarters of Canada's population live within 160 kms of the US border, and many significant Canadian population centers lie within close proximity to US airports. For instance, Toronto and Buffalo; Vancouver and Bellingham or Seattle; Montreal and Plattsburgh or Burlington; and so forth.

As we discussed above, the fees and charges in the US air travel system are significantly less than the Canadian system; as a result, overall air travel costs for passengers flying out of the US can be much cheaper. Given the short distance to access a US airport, the Canadian Airport Council (CAC) conducted an analysis several years ago demonstrating that over 5 million travellers per year cross the border to fly out of a US airport. This is a significant loss of opportunity for Canadian airlines and airports.

Intermodal Inequity: Whereas the federal government has talked of the importance of a multi-modal transportation system, it appears to treat air travel in a less equitable manner when compared to other modes of transport in Canada – especially in consideration that no other mode of transport operates on the same strict user pay model as aviation. Some specific examples:

- At a time when the federal government is actively pushing for cost recovery in air services, the Minister of Transport issued a public statement on "X" on July 4, 2024 confirming that cost recovery for Marine Atlantic would be eliminated: "*Marine Atlantic is an essential service for Newfoundlanders. With Budget 2024, we're investing in Marine Atlantic to keep services affordable. And we're eliminating the overall cost recovery policy because that's what's fair*."

- No other mode of transport has compensable passenger requirements such as APPR, even though the CEO of Via Rail called for a rail passenger bill of rights in October 2023.
- Bill C-52, which has currently passed second reading, would require port authorities to follow certain principles when setting port fees to enhance transparency and accountability; principles not contained in legislation for all air travel ecosystem partners.

If the Competition Bureau wants to enhance the domestic air travel system for the benefit of passengers, NACC would encourage the Bureau to raise the issue of intermodal inequity with the federal government as a barrier to enhanced competition within the air travel mode.

Recommendations to Enhance Competitiveness

To achieve the dynamic, affordable, and accessible air travel system that Canadians deserve, the federal government must be willing to address the policies and factors that are inhibiting a truly competitive system from being realized.

But to do this, the federal government needs to refresh its vision for the role of air travel. Rather than view civil aviation as a cash cow, it is critical to rethink air travel for what it is - an indispensable link that connects Canadians to each other and to the world, a critical component of the domestic and global supply chain, and an economic enabler for a wide range of sectors such as trade and tourism.

NACC is providing the following recommendations on how to enhance competitiveness in the air travel system:

- *Immediately freeze all federal fees and taxes, and review all third-party fees and charges:* Although NACC doesn't oppose the concept of a user pay system, such a system must be balanced with the significant advantages that an affordable, accessible, and efficient air travel system brings to Canada. As a first step, we would urge the Competition Bureau to recommend an immediate freeze on all federal taxes and charges within Canada's aviation system as an immediate means to address affordability. Subsequently, a full review is required of all third-party fees and charges in the Canadian aviation system. Such a review should benchmark with foreign jurisdictions, and should identify where efficiencies could be gained and where fees should be amended - with an overall goal of reducing the cost for passengers to travel to, from and within Canada.

- *Fully reinvest airport rent back into airport infrastructure*: One of the most immediate changes the federal government could make to enhance competitiveness is to fully reinvest the rents that are paid by Canada's airports back into airport infrastructure. The Canadian Airports Council estimates this would return over $400 million into the system to enable modernized infrastructure, allow for growth to meet current and future demand, and would reduce the cost pressures on Airport Improvement Fees.

- *Conduct a Regulatory modernization review*: In a highly regulated sector such as aviation, it is imperative that government ensure that regulations are reviewed and modernized on a continuous basis to ensure that they are still relevant and reflect technological advancements. In addition, Transport Canada needs to be properly resourced to ensure that it can deliver the regulatory services and requirements for which it is responsible.

  NACC is recommending that Transport Canada launch a comprehensive regulatory modernization exercise to ensure that regulations are reflective of the current air operating environment, and that they are not putting Canada in an anti-competitive position compared to similar jurisdictions. Furthermore, Transport Canada must continue to posture itself as a regulatory authority that is a global aviation leader with a focus on safety, increasing efficiencies, and building resiliency in the current system and the aviation system of tomorrow. To do this, it must be properly resourced to provide its necessary safety and regulatory functions.

- *Implement a Robust Shared Accountability Model*: One way in which Canada could enhance its competitive position globally is by introducing a robust ‘shared accountability’ model in which all entities in the air travel system, not just airlines, are accountable to publicly reported service standards, and where those performance standards are publicly reported. Although the concept of ‘shared accountability’ has been endorsed internationally by the International Air Transport Association (IATA), there is no jurisdiction that has implemented such a robust system. Canada has the opportunity to demonstrate leadership and a competitive advantage by being one of the first countries to do so.

Transparency of Ancillary Fees

In the 2024 federal Budget, the government announced that it would “strengthen transparency of fees for optional services charged by airlines, such as for seat selection, checked and carry-on baggage, meals on board, and in-flight entertainment.” This concept of transparency and informed consumer choice was repeated by the Competition Bureau in its Terms of Reference.

NACC member airlines are fully transparent in regard to the options that consumers have when booking a flight. Our members are subject to, and adhere, to regulatory requirements in this regard, and we would expect all Canadian airlines to adhere to those same regulations. Consumers have full and complete access to information on service options when booking a flight, and NACC member airlines are fully embracing technological options to improve disclose to consumers. These options put greater control and choice directly in the hands of consumers, so that they know exactly what services they are receiving for the price they pay. In fact, there are few other industries or sectors in which consumers have as much transparent choice and options as is the case with airlines.

Conclusion

NACC thanks the Competition Bureau for reviewing these comments. Canada's airlines are an indispensable force for good in connecting Canadians to each other and to the world, they are a critical component of Canada's supply chain, they are a tool for nation building, and airlines support growth in a wide variety of related sectors. With a more competitive policy and regulatory framework, Canada's airlines can strengthen these vital roles, for the betterment of passengers, and the overall country.