WESTERN CANADIAN AVIATION FORUM

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Thank you very much, Deb for inviting me to speak at this conference. The topic of renewing Canada's airport policy is an important one, and frankly, becomes more important as the evidence mounts to support the contention that the current airport funding and economic models are broken.

The evidence that the airport system is broken is well known to most of you. In June 2012, the Standing Senate Committee on Transport and Communications produced a report on the future growth and global competitiveness of Canada's airports and asked a simple question: Is the Canadian air travel system, and particularly, the airports, a toll booth for government revenues or a sparkplug for the development of the Canadian economy?

In April 2013, the same Committee produced a report entitled, "One Size Doesn't Fit All: The Future growth and Competitiveness of Canadian Air Travel".

In October 2012, The Conference Board produced a report entitled, "Driven Away: Why More Canadians Are Choosing Cross-Border Airports". All of these reports argued for a fundamental review of Canada's policy relating to airports, airport fees and charges, and airport rents. If things have gone so wrong to the degree suggested in these reports, who's responsible for reviewing the problem and who is responsible for responding to the problem and fixing it? The short answer to both questions is – everyone in this room. We will talk a little bit about that later.

When we started out in the late 1980's and early 1990's there was a glimmer of hope that ultimately turned into a reality. Transport Canada proposed to turn over the control of a number of major airports to local airport authorities. These authorities would be comprised of citizens bringing differing sets of expertise into the authority with a view to improving the economic success of their community through increases in air services and connectivity within Canada and the world.

In April 1995, a conference was held in Edmonton entitled, "Establishing a Canadian Airport Authority". Peter Watson, the Chairman of the Canadian Airports Council brimmed with enthusiasm. Here are some of his remarks:

“Airport authorities are a part of a major transformation in the transportation and specifically, the air transportation industry that presents significant opportunities. The transformation is the deregulation, decentralization, commercialization, and in some cases, privatization of the industry.

The opportunity is to take control of at least one element of that system – the airports – for your benefit. Deregulation, decentralization and privatization is global in its reach, multi-modal and multi-industry in scope. It is a fact, and there is little, if any point in arguing its costs and benefits any longer, it is happening and you either take advantage of it to make things happen for your own benefit, or simply watch what happened – or maybe even wonder what happened”.

Let me continue with Peter Watson’s vision. A local authority with local decision-making can adopt a strong customer focus orientation based on surveys to identify customer priorities. New standards for customer check-in, baggage delivery, passenger security screening, improvements in parking, taxi and other services which touch the customer directly, and corporate restructuring to meet that customer focus”.

The vision of the future benefits that airports in local hands would create, has proved to be admirable – what has happened to cause this success to seriously falter?

Some may argue that perhaps things weren't as bad with the status quo in the late 1980's with airports owned owned, controlled and managed by Transport Canada as a department of the Federal Government. If one were a film buff, one might take a page out of the great film-maker, Frank Capra's book and ask "What might have happened if Doug Young had not become Minister of Transport and aggressively set off the chain of consultations and ultimate legislation leading to the transfer of airports in Canada to local authorities. In our film, of course, we will be asking Jimmy Stewart to play Doug Young. So let's imagine what our airports would be today if they were still run by Transport Canada and funded by the Canadian taxpayer? Some of you might say I'm getting fact and fiction mixed up, which I have been accused of doing on numerous occasions. In fact, you would argue, the airports are still owned by Transport Canada and in many ways, the lease pursuant to which local authorities operate the airport are so all encompassing, that in fact, airports are still controlled by Transport Canada.

Let me offer in support of that contention, i.e. that airports are still controlled by Transport Canada, a quote from a presentation at the same Edmonton Conference by Ron Odynski, an extremely competent and seasoned aviation lawyer. Odynski's topic at the conference was "Community and government relations – a complex environment". In his remarks, he refers to a twilight zone, which he argues is "the environment in which the LAA's and CAA's must operate, for they are neither government nor private sector". Odynski continues "I've heard former Transport Canada officials like Garth Atkinson from Calgary, be asked "what's it like to be in the real world". His answer was, "I don't know; I live in a 2,350 pages of lease world".

"That's right", concludes Odynski, – "2,350 pages (mostly legal size) of finely crafted legalese". The twilight zone permeates over almost every aspect of an LAA or CAA's operations. Neither fish nor fowl, one simply cannot assume that anything about the authority is conventional or straight up. Some of the lease terms are impediments to reasonably prudent commercial decisions…".

We should recall that under the old Transport Canada regime, airports were governed under the departmental structure. This meant, for example, that any air carrier that wished to increase its operations at airport X would have to make a case to the airport General Manager, who in turn, would take that case for additional funding for facilities and infrastructure to his regional superiors. His superiors, in turn would pass that request for funding through to Ottawa to become part of the budget process requiring approval by the Air Administrator up to the Deputy Minister and ultimately to the Minister. In this discussion we should probably add the complexity of which carrier was making the request for additional funding at airport X, because it could arguably play a role in Transport Canada's decision-making process. On top of all of those layers of complexity there were certainly some political considerations such as whose riding the airport was located in…. Well, you get the picture.

Would the old Transport Canada system be sustainable today? Frankly, I don't think anyone has ever done the analysis. The "Future of Canadian travel: Toll Booth or Spark Plug?" report deals pretty quickly with this question on page 1entitled, "Context". This report simply states that "airports owned and operated by the Federal Government were inefficient and insufficiently responsive to local and regional needs".

So our film does have a happy ending. Doug Young (played by Jimmy Stewart) does become Minister of Transport and pushes forward with a national airports policy, which in 1995, at the Edmonton conference, could be best described as "It's a Wonderful Life".

But it hasn't quite turned out that way, so we need to ask, what are the basic issues that need to be confronted? Firstly, do we have the right structure? Was transferring control of the airports to local authorities that answer? Is the lease for the airports as described by Ron Odynski a “twilight zone”? It is arguable that Transport Canada officials, while recognizing that they could no longer afford, as a government, to fund all of the airport infrastructure development required across Canada, they could still influence, to a very high degree, the direction that the airport authorities must take through the control of a very substantive lease agreement.

When the airports were transferred, each party to the negotiation knew that there would be a system of rent payments under the lease and these rent payments would escalate. In response to a letter from the Air Transport Association of Canada, in December 2001, Minister David Collenette indicated, “the reasons that rents are increasing were known at the time of transfer to the airport authorities and thus represent scheduled rent increases as opposed to new charges to users. Rents are also tied to the growth and revenue-base of airport authorities. The Growth of airport infrastructure was clearly anticipated as part of the commercialization initiative of the Federal Government”.

Airports in Canada have been extremely successful in building their business and their infrastructure to support that growth. The rent formula however, has resulted in the Federal Government receiving well over $4 billion in airport rent since the airports were transferred. By the end of 2011, Canadian airport authorities had invested over $16 billion in facilities and equipment. At the large airports, the rent represents 11% of the total airport revenues. When is enough – enough?

As far back as May 2005, a House of Commons Standing Committee on Transport, in its report stated, “Air Liberalization of the Canadian Airport System called for a rent freeze”.

The House Committee Report made a number of recommendations that are today echoed in the Senate Reports of 2012 and 2013. In 2005, the Standing Committee recommended that the Federal Government immediately reduce rents by at least 75%, and that rents received by Transport Canada be reinvested in the Canadian airport system, and for airports with less than two million passengers, no rent should be paid.

The House of Common Committee also recommended that the Government ensure that airport rental revenues received by Transport Canada, be used to increase funding for the ACAP, and observed that this funding would be long-term and stable, and that the process for applying for the ACAP program would be simplified and less costly”.

It’s also interesting to note that in 2005, the House of Commons Standing Committee also recommended that the Government eliminate the air transportation security passenger fee, and pay for this service through the consolidated revenue fund.

The imposition of airport rents clearly adds a level of cost to the business of air travel in this country. Let me again quote Garth Atkinson from his presentation to the Senate Transportation Committee in February of 2012.

“At these levels, it is clear to any informed observer that federal airport rent is a tax, not a return on investment or even a ‘commission’. The differentiating factor about rent is that it does not buy steel and concrete or pay wages; it is simply a tax that flows into general federal revenues. The most disturbing aspect of the federal rent formula is that rent is assessed on revenues which are derived 100% from airport users to pay for new infrastructure which the Government played no role in creating”.

Should the Federal Government have sold the airport authorities outright to the local authorities? By reference, in the United States, privatization as a means of transferring power over to an airport has received considerable attention. The Transportation Research Board, in a paper dated August 2009, addressed the legal aspects of airport programs, and concluded that although this was a common practice internationally, privatization has not taken hold in the United States.

Two years ago, the Van Horne Institute, in partnership with the School of Public Policy at the University of Calgary, brought international transportation experts together in Calgary to make recommendations on transportation initiatives that the Government of Canada should consider when it carries out its review of transportation policy in the year 2014/2015. We commissioned Brian Flemming to develop a White Paper based on discussions at the Roundtable, and last February we took this White Paper to six cities across Canada to receive feedback from stakeholders, firstly, on the contents of the White Paper and secondly on other policy initiatives that the Government should consider in its upcoming review.

The White Paper, in particular, focused on infrastructure financing and the methods by which the Government of Canada could fund infrastructure in this country in addition to the policies already announced. The development of an infrastructure bank was proposed, and more work has been commissioned to develop this concept within a Canadian context. The White Paper suggests that the Government of Canada might wish to consider creating a pool of funds for the infrastructure bank through the sale of infrastructure assets, which it currently owns, such as airport authorities, to a large financial institution such as McQuarrie Bank. Part of the financial undertaking by the purchaser would be to reduce the rental payments under the lease agreement that it has assumed over a period of time to make the airports, and therefore the aviation industry, more competitive.

While this initiative might have the benefit of funding a national infrastructure bank, one might expect the airport authorities to have mixed reactions over changing one landlord for another. Airport authorities would also like to “own the dirt”. Garth Atkinson, in his testimony to the Senate Committee, recommended that rent could be capped, scaled-back and eliminated over a period of time. He suggested 20 years.

So here is where we are. Scott Clements, at the Fort McMurray Airport Authority would call this a SITREP.

1. We know that the airport model for which we held such high hopes in the early 90’s is broken and needs fixing.
2. Going back to a pre-transfer scenario won’t work.
3. Transport Canada has received, on behalf of the Canadian public, an extraordinarily positive return through rental payments on assets that they transferred to local authorities.

4. We know that Canadians like all consumers, are price and value conscious. We know that consumers have the capability to search for comparative pricing for routes from Canada to the United States and overseas.
5. We know that the total cost to Canadian consumers for air travel from Canada to the United States and elsewhere, as reflected on their ticket, is expensive and consumers have other options available to them.
6. A significant portion of the price components in a Canadian airfare reflect either directly or indirectly, fees and charges initiated by the Federal Government.
7. The higher level of costs imposed on Canadian airports and the Canadian air transport system makes Canada uncompetitive.

The last point must be understood and addressed. Let's look first at air cargo with margins that can be best described as thin. There are a number of costs imposed on the aviation system that are significantly greater than those imposed on the U.S. system, which is the home base of our industry's largest and most formidable competitors. We have gone on at some length about federal rent. In addition, airlines face a federal fuel tax, and in some provinces, a provincial fuel tax. Airlines also face NAV Canada fees and high landing fees, which in turn, are a reflection of the higher costs experienced by Canadian airports.

In the cargo world, these higher costs are driving freight consolidators to truck cargo from points in Canada into the United States for connections to freighters operating to Europe or to Asia. It is cheaper to take cargo from Calgary to Huntsville, Alabama, by truck to be placed on a European air carrier that it is to place that cargo on a European-bound aircraft from Calgary. Another example would be cargo transported by truck from Pearson Airport to Chicago rather than using existing freighter capacity out of Pearson.

Additional costs will be experienced by the air cargo industry when the new requirement for a 100% screening of cargo at Canadian airports comes fully into force. Either the airport or the air carrier will pay the costs of that screening with such costs forming part of the ultimate cost to the shipper. There continues to be a legitimate argument that security screening of both passengers and cargo should be provided at the cost of the state, since national security is a state matter. As we know, this is a practice in the United States, and any charge to the passenger for security is substantially less than in Canada.

Is the carriage of cargo important to an air carrier? Cargo revenues comprise 12% and 16% of the revenue on any given routing. Cargo revenues are extremely important when an air carrier determines whether or not a route will be operated.

With respect to passenger operations, the same additional costs imposed on the air transportation system apply. Air Canada and WestJet compete on the transborder with some very large U.S. carriers, and Air Canada also competes with these same carriers on an international scale. It is estimated that the additional costs imposed on the airports and airlines in Canada, create a price differential of approximately $200 a passenger, when comparing the cost of travel from Toronto as opposed to Buffalo. The same differential will probably apply to Vancouver and Montreal. This is not the case in Calgary or Edmonton, since a passenger wishing to access flights at the closest U.S. point of departure will have to undertake a long drive to that airport in the United States.

For a family of four, this differential of $200 adds ups quickly. A drive from Toronto to Buffalo of 1 ½ hours probably makes sense if the family will experience a total cost differential of $1,000 to their holiday budget.

This leakage of Canadian passengers to U.S. airports is well covered in a number of studies. There is however, another major opportunity for Canadian carriers to expand in international market places that is seriously compromised by the higher operating costs in Canada.

Air Canada competes in international markets with major U.S. carriers such as Delta, U.S. Air and United. Each of these U.S. carriers has a major hub airport that is designed for the handling of traffic to and from all destinations whether they be domestic, transborder or international. Canada's population-base is small compared to that of the United States, and while Canada's population will grow into the future, this growth will not be sufficiently large enough to ensure the future economic prosperity of the industry

There is a significant opportunity for Air Canada and at some point in the not too distant future, for WestJet to expand its market-base dramatically by carrying connecting traffic from the United States or South America to points in Asia or Europe over a Canadian hub. If the costs of providing services over a hub such as Toronto, Montreal, Vancouver or Calgary are higher for the Canadian carrier, then the opportunity to carry this connecting traffic will be severely limited by competition from their U.S. counterparts. The carriage of connecting traffic is probably one of the greatest opportunities for Canadian carriers to increase the volume of their services and their potential for greater profitability. Let me repeat, the higher costs experienced at Canadian airports and throughout the Canadian air transportation system, will severely compromise this opportunity for growth for the Canadian aviation industry.

Let me give you an example. Air Canada could carry traffic from Narita, Japan to a Calgary, Vancouver or Toronto hub for onward connection to Las Vegas or South America. A Japanese passenger destined for Las Vegas or points in South America would also have the choice of utilizing a U.S. carrier and connecting via a U.S. hub. If the total cost to the Japanese passenger is less using the U.S. connection services, then the Canadian carrier will lose that opportunity and consequently, a loss to the Canadian economy.

If we keep with the spirit of the 2012 Senate Committee Report, we have to conclude that “the spark plug needs cleaning”.

So what does this mean? Well, if you look at the quantum of the cost differential between the Canadian and U.S. aviation systems that is currently causing leakage for both passengers and cargo, you have a base from which to work. That same cost differential between Canada and the United States must also be addressed when considering future opportunities for connecting international passenger and cargo flows over Canadian hubs. This number, whatever it is, should be the starting point for driving costs out of the Canadian aviation system and efficiencies into the system.

A cautionary note to the policy-makers. Do not consider depreciation of the loonie as a method by which to address this gap. This approach would not be construed by many as an expression of nation-building.

What are the other tools that might be available to reduce the total cost impact? I touched on airport rents and how they could be reduced by turning the lease payments into payments to own by the airport authorities, as suggested by Garth Atkinson. The sale of the airports to a major financial institution with conditions in the sale agreement, that the purchaser would reduce the rents to the authority to zero over a specific time-scale with another undertaking relating to the level of increases to the aviation industry for other fees and charges, may be an approach. This would have the benefit of creating a substantial pool of funds for the Government of Canada to in turn, develop an infrastructure bank.

A sale of the airports either to the local authorities or to a major financial investment house would immediately resolve any end of lease issues, which are predicted to cause significant disruption within the airport community, when they have to be re-negotiated with the Federal Government.

Another method of reducing costs to the aviation system would be for the Government of Canada to assume the majority of security costs for both passengers and cargo as is currently the practice in the United States.

The Federal Government would have to find those funds elsewhere, and that is a recognized concern. I would argue that the perspective of who pays for security costs for the transportation industry should be uniform and borne directly by the travelling public. Air navigation fees are another matter that needs to be addressed, and I assume that the management of NAV Canada are acutely aware of the concern and are addressing this with improvements in functionality, technology and efficiency.

How should these issues be addressed within the context of the development of a new airport/aviation policy? The Senate Committee, in its number one recommendation, suggests that Transport Canada, together with the Department of Finance, bring all relevant stakeholders to the table to establish a national air travel strategy to increase and facilitate air travel in Canada. It's on the table.

Who should attend these meetings:

1. Transport Canada/Privy Council/Finance
2. Airports
3. Freight-forwarders
4. NAV Canada

The timing of when these critical issues would be addressed was touched upon at the Roundtables held by the Van Horne Institute across Canada in February. Can we wait for the policy review slated for 2014/15? Arguably, that would be the ideal forum in which to have these issues fully aired, but frankly, this is a bridge too far. Any review started in 2014 will probably report out at the end of 2015, and due to the election cycle, any recommendations would not be considered until 2016.

I hope that this conference will add its voice to support the recommendation of the Senate Committee that a national travel strategy be undertaken. The recommendations from this meeting should be considered as the platform upon which this strategy is based.

Thank you for your attention.