CAMP

Connecting Canadians

Submission to the Competition Bureau's study of competition in Canada's airline industry

About CAMP

The Canadian Anti-Monopoly Project (CAMP) is a think tank dedicated to addressing the issue of monopoly power in Canada and around the world. CAMP produces research and advocates for policy to make the Canadian economy more fair, free, and democratic.

Executive Summary

Canada is a country built on the movement of people, goods and ideas across great distances. As one of the most geographically vast and least densely populated countries, Canada has unique needs when it comes to transportation, and air transportation is no different.

The future of Canada's economy depends in part on an air transportation sector connects Canadians and their economic and social lives. Canada's transportation sector is served a tall order: to knit together a relatively small and geographically dispersed society in support of a flourishing economy. In creating an air transportation system that serves Canadians, industry and policy makers are solving a multi-dimensional problem. Canadians need an air transportation system that provides access to communities that is safe, affordable, and reliable.

But the current state of air transportation is not serving Canadians well. Despite the ongoing growth of the country, the total available seat kilometres has not yet returned to pre-pandemic levels. The market is dominated by two players increasingly dividing the country between themselves rather than competing. Routes between even relatively large population centres are drying up, reducing Canadians' mobility. When routes are available the cost of accessing this limited supply can be prohibitive. Those that can afford to travel, including international travelers, are often left unsatisfied by the level of service provided by Canada's major carriers. While new entrants have made and continue to make important contributions to the state of competition in the market, the long-term position of these players remains tenuous.

Solving the problem begins with realizing that markets alone will not address the problems of Canada's air transportation sector. The economic structure of the industry means that not all communities deserving of and reliant on air transportation will have access to it. To ignore the role that policy must play in this sector would make communities increasingly cut off from one another, unable to benefit from the social and economic benefits that a more mobile population creates. There is and will continue to be a role for policy in delivering a well-functioning air transportation market in Canada.

While we face unique challenges, Canada can learn from international peers like the U.S., whose even larger and denser market has followed a similar trajectory since deregulation, and Australia, with even more intense geographic challenges to overcome.

There is an opportunity today to change the trajectory of the Canadian air transportation market. By reconfiguring rather than retreating from its role, public policy can support a vibrant market that serves Canadians despite the physical constraints of our geography. To do so, Canada should:

- Dedicate resources within the Competition Bureau to provide ongoing monitoring for anticompetitive behaviour in the air transportation sector
- Improve the economics of low-cost carrier (LCC) and ultra low-cost carrier (ULCC) models by reducing the reliance on user fees for airport operations and investment
- Explore alternate models for maintaining affordable and reliable access to Canada's smaller and more remote communities such as the "Draft Pick" or "Regional Conference" systems
- Invest in addressing the record backlog of consumer complaints at the Canadian Transportation Agency (CTA)
- Except in cases of reciprocity or investment, maintain international cabotage restrictions to preserve competition for regional routes

The physical dimensions of the country create a unique set of challenges for providing safe, affordable and reliable air transportation in Canada. But rather than a reason to accept the current state, those challenges call for thoughtful policy that blurs the boundary between regulation and supposedly free markets.

What's at stake?

A common refrain is that Canada is a relatively small population spread across one of the world's largest geographies. What's more, most of that relatively small population is located in an effectively linear strip along our border with the United States, along with communities of all sizes sometimes hundreds of kilometres to the north. These factors make geography an unavoidable fact in the challenge of connecting those communities, no matter the method of transportation.

But the challenge is worth the reward. On the economic side of the ledger, the benefit of safe, affordable and reliable travel between Canada's far-flung communities should not be underestimated. This kind of connectivity supports not only economic activity through internal tourism, but also the mobility of workers to pursue new opportunities and the agglomeration of resources and talent across the country. Whether visiting a new city, moving to a new job, or connecting with colleagues, accessible air transportation has several positive spillover effects.

The ability to easily traverse our country also has an important social aspect as well. From the founding, what Canada could accomplish was fundamentally a function of the physical networks that brought us together. A solely economic view misses the fact that safe, affordable and reliable air transportation brings Canadians literally closer to one another, with important implications for the future of our shared identity.

But the importance of accessible air transportation does not negate the challenge in delivering it. Since the birth of the air transportation sector, government policy has had a hand in shaping outcomes for Canadians. This remains the case even in the wake of the deregulatory moment in the late 1970s. Rather than returning to that previous era, Canada must understand the role policy can play in creating the foundation for an air transportation sector that serves Canadians and knits the country together.

What is the current state?

The current structure of the domestic Canadian airline market is effectively a duopoly structure with Air Canada and WestJet making up a combined 79% national market share with the remaining share split between Porter airlines, internationally focused Air Transat, and ultra-low cost carrier (ULCC) Flair, along with an array of smaller regional, local and remote community focused providers.[i] Canadian and international perceptions of the value for money on this duopoly structure do not indicate a high level of satisfaction. This past year, Air Canada and WestJet were both found to be ranking among the lowest in terms of service quality based on consumer surveys.[ii]

That duopoly service, whatever travelers may think of it, is also available on fewer and fewer routes. While adding routes in Toronto, Montreal and Vancouver, Air Canada has been removing direct flights from cities like Calgary, Regina, Saskatoon and Penticton. At the same time, WestJet has made clear its intention to reduce its focus on Ontario and Quebec in favour of focusing future growth in cities in Western Canada.

While the past decade has provided reason for optimism with the emergence and growth of competitors like Porter, Flair, Lynx Air and corresponding challenger responses like WestJet's Swoop subsidiary, recent consolidation has reset that trajectory. With the acquisition of Sunwing and folding in of Swoop by WestJet, along with the shuttering of Lynx Air in 2024, and the attempted acquisition of Air Transat, the future of competition in the Canadian air transportation market is uncertain.

Though different in their composition, competition in both the Canadian and U.S. markets has followed a similar trajectory over the past 50 years. Following a deregulatory turn to encourage greater competition in the 1970s and 80s, both countries experienced an initial surge of news entrants. What has taken place since has been disruption and dramatic consolidation of the respective air transportation markets, whether through acquisition or bankruptcy.

In both cases the expected challenge to this trend from competition and antitrust policy was effectively absent. Reflecting on the "unpleasant" surprise of the consolidation that had followed the initial entry of new competitive players, Alfred E Kahn, the father of airline deregulation in the U.S., remarked on the "lamentable failure of the administration to enforce the policies of antitrust laws."[iii] In the late 90s the Canadian federal government suspended our own competition laws to allow merger talks between Canadian Airlines and Air Canada to proceed based on the belief that Canadian Airlines would fail absent the merger.[iv] Before its folding into Air Canada, Canadian Airlines itself was the product of the rapid consolidation that the industry had undergone, comprised of Pacific Western Airlines, Canadian Pacific Airlines and its own constituent precursor carriers, and Wardair.

If the past is any indication, left to its own devices the Canadian air transportation market would likely return to the monopoly position of early 2000s when Air Canada was responsible for over 90% of air travel within the country. This is an undesirable outcome for travelers and would necessitate a much heavier regulatory hand than is likely undesirable for the airlines themselves.

In creating an air transportation market that works for Canadians, policy makers are solving for three categories of service offerings: shorter routes to and from smaller and more remote communities, longer haul flights between major domestic population centres, and flights to international destinations.

Of these categories, the first presents the most pressing policy problem for Canadians. All else being equal, the profitability of a flight is inversely related to its length, leading larger airlines to favour longer routes. This is paired with the fact that smaller communities will inherently have less demand for routes. Looking abroad, Canadians are relatively well served for international destinations because these long-haul flights benefit from competition from international players. Maintaining competitive connectivity between smaller communities is where the market continues to fall short.

But not all factors of air travel lend themselves to the underserving of regional routes to smaller communities. Because of their relative unattractiveness compared to longer-haul flights, shorter routes create space for smaller competitors with different cost bases to enter the market, often referred to as low-cost (LCC) or ultra low-cost carriers (ULCC). Canada needs a policy framework that encourages not only competition between large carriers, but a dedicated role for smaller players to make the most of that space and better serve Canadians.

What can we learn from other countries?

In terms of our geographic make up, Canada has a unique problem to solve when it comes to air transportation. But this does not negate the lessons learned by other countries from their own struggles to maintain an air transportation market that serves their citizens. Engaging in a similar deregulatory move in the 1970s, the trajectory of the U.S. air market is worth consideration. Facing similar geographic dispersion and isolation, Australia's efforts to foster a competitive airline sector are also valuable touchstones for Canadian policy makers.

Deregulation to Consolidation in the United States

While a much larger and denser market than Canada, all is not well with the U.S. air transportation market. As colleagues at the American Economic Liberties Project (AELP) have pointed out, the decades since the deregulation of the American air transportation market have exhibited several troubling trends.

While the regulated system in place before the 1980s was not perfect, unlike Canada's regulated monopoly approach it supported a diverse market of 12 major airlines, reliable service to both small and large communities, and an absence of the bankruptcies and bailouts that have characterized both the U.S. and Canadian markets since both countries embarked on airline deregulation. Rather than a call to return the regulatory models of yesterday, the current state and potential paths forward in the U.S. are a reminder that there is a role for policy in fostering fair competition that serves customers and society even in markets that may seem vibrant in comparison.

After waves of consolidation, those 12 major airlines have consolidated down to four major carriers – Delta, American, Southwest and United – which make up 67% of the national market.[v] Today the consequences of that consolidation for air travelers are clear. Several indicators suggest that the quality of airline service has deteriorated with canceled flights, average wait times on outsourced call centers and consumer complaints at all-time highs.[vi] From Consumer Reports in 2017, "[a] lack of competition and consumer choice allows carriers to disregard the interest and concerns of their passengers in ways that would have been unthinkable when there were 12 or even 8 major airlines in the United States competing for customers."[vii] At the same time even midsized cities that dwarf their Canadian counterparts are losing air service to the detriment of their local economies and connection to the rest of the nation.

The experience in the U.S. is a reminder that even a much larger and denser market with a greater number of players requires policy intervention to maintain fair competition and the protection of air travelers. While even the concept of the Big 3 would be welcome in Canada, that increased competition would not negate the need for policy to ensure the air transportation sector works for travelers. The U.S. experience shows that, left to its own devices, there is a tendency towards not only consolidation of competitors but also a focus on more profitable routes absent a strong policy effort to balance the underlying economics of the industry in favour of safe, affordable and reliable air service for all.

Policy to Overcome Geography in Australia

At a total population of 27 million and even more intense geographic dispersion and isolation, Australia provides an excellent case study for Canadian policy makers. The structure of Australia's airline market exhibits an even more extreme duopoly structure than Canada's, with the Qantas Group controlling 62% and Virgin Australia 33% for a total of 95% of the Australian domestic market.[viii]

Outcomes in the Australian market follow a familiar pattern, with routes between major centres showing positive competitive outcomes while regional routes are characterized by less access, less competition and higher prices. Australia also appears to be undergoing a similar segmentation of the market, with major airlines moving away from head-to-head competition towards filling different niches in the domestic market, with the Australian Competition and Consumer Commission (ACCC) noting that the market has been delivering underwhelming results for travelers.[ix]

Australia recognizes that the challenge of their unique geography creates an important role for policy to support a competitive air transportation market. Compared to Canada, Australia is taking a much more concerted approach to protecting travelers and competition in its own air transportation market. In 2023 the Australian government released the Aviation Green Paper, seeking to set the policy direction for the sector for the next three decades.[x] The piece kicks off a detailed consultation with industry and civil society on a range of issues, and at time of writing the Aviation White Paper sketching out that final vision is set to be released before the end of 2024.

At the top of the list of concerns in the Green Paper is competition and airline concentration and whether Australia should follow the EU in introducing specific consumer protections. But the Green Paper is not the only source of focus on competition in Australia's airline sector. The country's Treasury Department is embarking on a two-year review of the country's entire competition policy framework, including sector specific regulation of air transportation.[xi]

Unlike Canada, the regulation of regional air transportation is split between the federal and state and territory governments. The Australian government currently offers both a Remote Air Services Subsidy Scheme and Enroute Charge Payment Scheme that subsidizes service to remote and regional routes that would otherwise go underserved.[xii] These programs are complemented by those of state and territorial governments focused on similar goals including additional subsidies and regulation of consumer fares.[xiii]

One policy point noted as beneficial for competition is investment cabotage, where foreign investors are able to serve the domestic market so long as they establish a domestic subsidiary and pass foreign investment review processes. This contrasts with a more liberal definition of cabotage which introduces reliance on foreign regulators for oversight of airline safety as well as worker compensation and regulation. Australia has only entered reciprocal cabotage with a single country, New Zealand, whose airlines to date have not made use of the freedom.

Australia's competition law enforcer, the Australian Competition and Consumer Commission (ACCC) has a much wider regulatory remit compared to Canada's Competition Bureau. Beyond authority over the country's competition law, the ACCC also has formal regulatory powers over sectors such as telecommunications and utilities. While this regulatory authority does not extend to the air transportation sector, the ACCC has been tasked with an additional monitoring role to track and regularly communicate to the public the state of competition and the behaviour of market participants. The ACCC has also been actively involved in the regulation of competition in the air transportation sector, with recent investigations against Qantas for anti-competitive conduct and opposition to Qantas' acquisition of Alliance Airlines and joint ventures between Virgin Australia and Alliance Airlines.

Potential Paths Forward

Canada's air transportation sector, marked by a history of consolidation, bankruptcy and global headwinds, is headed in the wrong direction. Still recovering from the COVID-19 pandemic, promising signs of increased competition and customer service are proving temporary as established players carve up their respective shares of the market. To reverse this trend, Canada needs to recognize the role policy can play in supporting an air transportation sector that serves Canadians despite the inherent challenges of our geography.

Dedicate Competition Bureau resources to monitoring the sector and increase transparency

The Competition Bureau, with roughly 400 staff, is responsible for investigating and litigating competition law issues in every sector of the Canadian economy. For both emerging and mature markets, this entails a learning curve that adds time to the currently multi-year process of assessing competition issues. Most recently, after over five years, the Competition Bureau's investigation of WestJet subsidiary Swoop outlasted the airline itself when it was folded into its parent company.[xiv]

Air transportation is too important and volatile a market to allow anti-competitive conduct to quash emerging and expanding entrants. While the Competition Bureau has experience investigating the space, its expertise cannot be based on institutional memory alone and contend with the requirements of monitoring other sectors of the economy. Following a model akin to the ACCC in Australia, the Competition Bureau should, in partnership with Transport Canada, dedicate resources to the monitoring of Canada's air transportation market. Transport Canada and the Competition Bureau should also partner to produce more public information and analysis on the state of airline competition in Canada, following the lead of the ACCC and U.S. Department of Transportation.[xv]

Reduce reliance on user fees to enable low-cost carrier models

As previously discussed, the economics of air transportation favour longer haul flights with limited turnarounds, borne out by recent trends in both Canadian and U.S. markets. To make shorter haul routes more profitable and to compete where larger carriers are increasingly uninterested, new entrant carriers need to bring a lower-cost operating model to bear. It is these LCC and ULCC models that offer the most promise in enhancing competition for smaller and more remote communities. While the user fee approach to funding airport operations and investment in Canada aligns utilization with contribution, these costs have an outsized effect on carriers attempting to differentiate with lower cost operating models.

The government should realign its approach to funding needed airport investment and operation, reducing the bias against new entrant and low-cost carriers. The federal government should cease collecting rent from airport authorities and instead raise those funds through general taxation to remove a source of financial pressure on airports that represents over $400 million annually and up to 12% of their total revenues.[xvi] In exchange, the government should require a reduction in the airport improvement fees (AIFs) that airports levy on airlines and their passengers. The federal government should also explore how other airport fees such as landing, terminal, and security fees could be better aligned with supporting regional routes relying on smaller aircraft, reflecting the ability of larger airlines to spread costs over larger aircraft.

Introduce alternative models for affordable and accessible service to smaller markets

Even with a cost base better geared to lower cost and regional operating models, the propensity for even a well-functioning market to underserve smaller communities will remain because of the structure of the economics of air travel. While federal and provincial governments have provided support for connectivity to remote regions, especially in the wake of the COVID-19 pandemic, an approach that changes the economics of air travel is needed to provide continuous service to smaller and more remote communities while ensuring airlines are fairly compensated. Two models proposed by U.S. airline experts Bill McGee and Ganesh Sitaraman to accomplish such a task are their “Draft Pick” and “Regional Conference” systems.[xvii]

Under the Draft Pick system, the federal government would establish criteria for draft-eligible communities and require airlines to participate in a draft in which they would choose eligible cities to serve until all cities have been selected. Airlines would then be required to serve those cities at regulated, affordable rates with daily frequency, with flexibility on destinations to complement an airline’s broader network. Under the Regional Conference system, airlines would be designated as the exclusive provider of scheduled air service to smaller communities in each region, offering service to larger population centres at regulated rates to prevent exploiting this designated monopoly. This would provide reliable “utility-like” service on lower volume routes while maintaining competition between larger cities. By allowing code-sharing between other airlines and designated regional carriers, passengers would have the flexibility to reach their intended destination with a preferred carrier.

Address backlog of customer complaints under the Air Passenger Protection Regulation

The 2019 introduction of the Air Passenger Protection Regulations and the 2022 introduction of updated refund obligations were both positive steps towards respect and fair treatment for Canadian travelers. However, a mark on that achievement has been the growing backlog of consumer complaints being handled by the Canadian Transportation Agency (CTA).

Before the introduction of the refund obligations the CTA received 12,000 – 19,000 complaints every year and had an annual backlog of approximately 13,400 – 16,500 complaints. As of the most recent CTA annual report, the annual number of complaints has tripled to 43,500 and the backlog has grown to 71,000. Trust in the effectiveness of the Air Passenger Protection Regulations depends on its ability to address the issues Canadians experience with airlines in a timely manner. To restore that trust, the government should explore the underlying factors of the backlog, streamline the process for complaints to be resolved and resource the agency appropriately.

Absent reciprocity or investment, maintain cabotage rules

A recurring discussion in air transportation policy has been the removal of cabotage restrictions to allow foreign carriers to operate domestic routes within Canada, even absent reciprocity. While opening the market to foreign competition seems like an appealing policy recommendation in several sectors, it is unlikely to address the current issues facing Canadian travelers.

First, there are no countries that currently allow foreign carriers to operate domestic routes absent reciprocity or other qualifications. Even Chile, with similar geographic and population constraints as Canada, and with the most liberal cabotage rules in the world, does not allow for full cabotage without reciprocity. Second, and more importantly, it is unlikely that foreign carriers would be interested in operating routes for underserved communities, absent other changes to the economics of flying in Canada. Returning to the example of the U.S., where foreign carriers would most likely originate, we see a similar pullback from shorter haul routes to smaller communities in favour of the longer haul flights that are already relatively well served in Canada.

Despite this shortcoming, Canada could explore more balanced avenues for bringing more foreign competition and investment into the airline sector. Chile and Australia both allow foreign carriers to create domestic subsidiaries under an investment cabotage scheme that ensures foreign players commit to domestic investments and fall within domestic regulation. Both countries have also pursued reciprocal cabotage arrangements with other countries, though as noted the Australia–New Zealand cabotage has seen relatively limited uptake. To allow for greater access to international capital for domestic airlines, Canada could also raise the limit on holdings for a single international investor from 25% to 49% while maintaining domestic ownership requirements.

Conclusion

As a large and geographically dispersed country, Canada faces unique challenges in offering safe, affordable and reliable air service. While more competition is needed in the air transportation space, that competition depends on a foundation of policy focused on creating a vibrant air transportation market despite these challenges. Recent years have demonstrated both that new models of air transportation are possible, but that the long-term success of those models remains tenuous. A productive mix of policy and markets can ensure an air transportation market that shrinks the distance between all Canadians.

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