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**Air Transport Association of Canada
Submission to the Competition Review
Panel:
Sharpening Canada's Competitive Edge in
Commercial Aviation**

January 2008

Executive Summary

The Government of Canada has identified the need to improve the international competitiveness of Canadian businesses as a central aim of its broad policy objectives across a number of governmental initiatives, including the mandate of the Competition Policy Review Panel. For Canada's commercial aviation sector this review is particularly timely, in light of a number of broader policy initiatives of the federal government to aggressively pursue Open Skies arrangements with foreign governments.

Canada's commercial aviation sector welcomes international competition but unfortunately we operate in a fiscal policy and taxation environment which is not internationally competitive. With this perspective in mind, the Air Transport Association of Canada (ATAC) proposes a series of tax reform measures to improve the prosperity of Canada's aviation sector and the opportunities for thousands of Canadians who work in our sector.

Fiscal Policy

The government of Canada has been pursuing a fundamentally flawed set of fiscal policies in the commercial aviation sector which run diametrically counter to the stated objective of this Panel's consultation exercise; to identify the kind of tax system this country needs for a prosperous future.

Instead of this progressive, strategic vision for leveraging tax policy as an instrument of creating prosperity for Canadians, a series of input taxes in our business serve to stifle growth, investment and prosperity. Collectively, the airport rent regime, the aviation Fuel Excise Tax and the Air Travellers' Security Charge contribute approximately half a billion dollars annually to federal treasury at the expense of sustainable, competitive air service levels and the potential for a world leading aviation industry.

Notably, these industry-specific taxes and charges are either unique to Canada or significantly higher than similar rates applied in competitor jurisdictions.

A number of respected independent institutions and observers have identified these tax policy measures as punitive and in need of immediate redress including the Montreal Economic Institute, the CD Howe Institute, and Dr. Fred Lazar of the Schulich School of Business.

The punitive effect of these taxes and charges on the investment climate in commercial aviation in Canada has been well-documented this past year alone, as Canada lost two scheduled air carriers from the competitive marketplace as a direct result of the inflated cost pressures of doing business in this sector in Canada. Both Canjet and HMY airlines ceased regularly scheduled service this past year, opting instead to focus on the piece-meal charter business.

It is ATAC's strong recommendation, therefore, that this Panel should recommend the elimination of all industry-specific input taxes, fees and charges, which serve to stifle investment, opportunity and prosperity and to limit taxation measures instead to the outputs of business activity; profits and wages.

Trade Policy

The drive for increased prosperity requires a strategic approach across a wide range of policy platforms to ensure international competitiveness and success for Canada.

As such, it is ATAC's view that this Panel should recommend that Canada benchmark and address its tax policy competitiveness in all trade negotiations including, but not limited to, bilateral and multilateral air policy negotiations, to ensure the maximum opportunity for success for Canadians abroad. Indeed, to ignore the competitive taxation and cost environment in jurisdictions with which Canada is pursuing open trade arrangements would be to undermine the government's mandate to this Panel and its own stated policy objectives to improve the international competitiveness of Canadian businesses.

Other Policy / Regulatory Initiatives

It is only through an integrated set of policy measures, which collectively seek to maximize the Canadian advantage that we can hope to maximize the prosperity for Canadians.

This submission also addresses the need to ensure that other governmental policy and regulatory initiatives not serve to undermine the strategic taxation policy measures that this Panel is seeking to identify in order to grow prosperity for Canadians. Indeed, regulatory creep, in particular, serves to undermine many efficiency gains achieved by commercial air carriers in the last few years.

It is ATAC's recommendation that this Panel recommend in its report that all regulatory and policy initiatives of the government of Canada be examined through the international competitiveness perspective.

Only a fully integrated approach policy development can deliver the maximum sustainable levels of prosperity enhancement for Canadians as envisioned by this Panel's pre-budget consultation exercise.

Introduction

The Air Transport Association of Canada (ATAC) represents over 200 air service providers and affiliated companies in Canada. Collectively, our member companies account for over 95% of commercial aviation revenues in Canada.

The historical challenges in our industry are well known to government:

- a highly cyclical and seasonal business model;
- intrinsic inability to control infrastructure and fuel costs;
- high susceptibility to unpredictable geo-political shocks; and,
- A low-yield, highly competitive marketplace (i.e. inability to pass on costs).

In this challenging business environment it is particularly crucial that the government of Canada pursue tax policies which encourage investment in order to support the broader public policy goals of ensuring a safe, competitive, affordable and sustainable commercial air travel industry in Canada.

Instead, a series of highly punitive taxes and fees serve the exact opposite purpose. Collectively, the fiscal policy measures of the airport rent regime, the aviation Fuel Excise Tax and the Air Travellers' Security Charge drain almost half a billion dollars annually from the industry and our passengers; destabilizing service levels and undermining our international competitiveness.

ATAC proposes that the Government of Canada pursue an integrated policy framework for commercial aviation which fundamentally reverses course on the current approach of limiting prosperity through the imposition of these input taxes and fees as well as examining a wide range of policy frameworks which limit this same objective and undermine the tax policy reform we are proposing.

Third Party Validation

The need to reverse course on Canada's approach to taxation in the aviation sector has been validated by a number of independent observers; all of whom have issued reports critical of the impact that these measures have on the international competitiveness of Canada's commercial aviation sector.

In a report released in November of last year, the Montreal Economic Institute called upon the federal government to dramatically reform its taxation policies in the field of commercial aviation to address its international competitiveness:

“With today's increasing liberalization of airline markets, the tax load that weighs down the Canadian airline industry is threatening the competitive position of companies in this sector and should be lightened, says an Economic Note published today by the Montreal Economic Institute.

Economist Stéphanie Giaume, author of the document, says the airline sector's specific payments to the federal treasury (excluding federal taxes that apply to all companies) rose on average by 19.6% a year between 2000 and 2005, reaching \$793 million in 2004-05.

Federal revenues collected from the air transport sector come mainly from airport rents (38%), the air travellers security charge introduced in 2002 (37%) and the excise tax on aviation fuel (16%).”¹

A similar perspective was published shortly thereafter by the CD Howe Institute in a report entitled; “Excess Baggage: Measuring Air Transportation’s Fiscal Burden”, which was issued in February of 2007. In the report, authors Ben Cherniavsky and Benjamin Dachis argue that the current taxation regime in commercial aviation serves to undermine our sector’s competitiveness and industry efforts to keep costs low for Canadians:

“The federal government should ensure that Canada’s air transportation industry is taxed on a level playing field with other modes of travel, such as bus or rail, and with its international counterparts. The result would be a more internationally competitive airline sector, able to serve Canadian air travellers more efficiently and cheaply.”²

Academic voices, as well, have commented recently on the need for fundamental reform in the area of taxation policy as it affects commercial aviation. In a report commissioned by ATAC examining the impact of the federal rent regime on Pearson Airport, in particular (which also examined the case for Fuel Excise Tax reductions), Dr. Fred Lazar of York University’s Schulich School of Business clearly identified the choice faced by public policy makers:

“The Federal Government will have to choose between two courses of action. Either it can develop an air transportation policy that will provide the framework for Canadian carriers to thrive globally, the Blue Sky policy being part of this framework. Or it can continue to pursue the path of the past 25 years thus ensuring that there will be no international Canadian airline, or Canadian airport among the major hub airports in the global network. Canadians will still be connected to global networks – via foreign airlines and via hubs such as Chicago, Dallas, Los Angeles, Miami, Minneapolis-St. Paul, New York, London, Frankfurt, Paris, Hong Kong or Dubai. But it will take longer, be less convenient and be more expensive.”

Lazar’s characterization of this issue as an element of Canada’s broader international competitiveness goals for commercial aviation is particularly stark and astute and was based in part on Minister Cannon’s own, definitive, statement regarding the need to address taxation and fiscal policies impacting commercial aviation in Canada.

¹ http://www.iedm.org/main/show_mediareleases_en.php?mediareleases_id=130

² http://www.cdhowe.org/pdf/commentary_242.pdf

Finally, in a report prepared for ATAC and a number of sponsoring airports, InterVistas Consulting identified the often conflicting nature of fiscal and economic policy goals:

*Canada's policy to use gateway and corridor strategies to enhance the competitiveness of the national economy is being undermined by fiscal policies which impose fiscal burdens on Canadian aviation. Canada's aviation sector has taxation and other fiscal burdens imposed by government which are a net drain of resources to the general treasure from this critical sector. This is in direct contrast to the U.S. where airports, air carriers and air navigation services all receive fiscal support to enable them to fulfil the strategic role they place in the U.S. economy and social connectivity.*³

This discrepancy between the approaches taken by Canada and its largest trading partners regarding matters of fiscal policy applied to commercial aviation is fundamental to the international competitive challenge faced by Canadian carriers. It is particularly acute when considered in the context of Canada's drive to open aviation markets.

During his announcement launching Canada's new international air policy framework, 'Blue Sky', Minister Cannon acknowledged the need to deal with these fiscal challenges while seeking new international opportunities:

*"I understand that Canadian airlines remain concerned about federal fees and costs affecting their industry. I recognize both the legitimacy of these concerns and the need to ensure that these costs do not impede the air industry's ability to compete."*⁴

There is no further debate on this matter. Canada is imposing a set of punitive input taxes in the field of commercial aviation which are harming our industry's international competitiveness and undermining Canada's broader policy objectives for this sector; to provide a safe, affordable, competitive and sustainable commercial aviation industry in Canada.

ATAC recommends that this Panel propose a permanent reversal of the current policy framework by recommending that the Minister of Finance eliminate industry-specific input taxes and fees and limit taxation measures to the outputs of commercial activity; profits and wages.

³ Intervistas Consulting. The Role of Government Policy in the Cost Competitiveness of Canadian Aviation, 2007

⁴ <http://www.tc.gc.ca/mediaroom/speeches/2006/2006-11-27.htm>

Fiscal Policy Reform

Specific fiscal policy measures, as identified previously, remain those identified in previous years.

1. Airport Rents

The airport rents regime is a well-known albatross around the industry's neck. Established in the mid-nineties in conjunction with the devolution of airports, this fee contributes approximately \$300 million annually (\$2 billion since its inception) to general government coffers. The total contribution has already exceeded the net worth of those facilities at the time of their transfer to local authorities and ignores the fact that few of those facilities exist any longer as they have been replaced by more modern user-financed facilities, which are owned by – and will be returned to – the Crown at the end of their lease.

Indeed, it is a misnomer to label these payments as rent. Since they are remitted to the federal government with no commensurate service received in return, the airport rent regime can only be categorized as a simple but brutal tax on investment.

The airport rent reform of the previous government, which primarily capped the rate of future growth, did not address the fundamental competitive challenge posed by airport rents; the fact is that Canada is alone with Peru and Ecuador as the only two developed countries with an airport rent policy.

Indeed, on the very day that Canada announced its airport rent reform in 2005 to limit future increases, the United States government made an announcement as part of its own – fundamentally different – approach to airport policy; an *investment* of \$300 million to improve runways at Chicago's O'Hare airport.

While the government of the United States – along with most governments throughout the world – treats their airports as important tools for economic development, which require investment and support, Canada views its own airports as sources of tax revenue. In policy terms; ours is an approach lacking any strategic vision.

The need to address this glaring international competitiveness gap for Canada is particularly acute in light of Minister Flaherty's own words from last year's budget about the importance of infrastructure in Canada's broader international competitiveness agenda:

“An Infrastructure Advantage for Canada

Canada needs modern, world-class infrastructure to make our country a world leader for today and future generations...⁵”

⁵ <http://www.budget.gc.ca/2007/bp/bpc5be.html>

ATAC couldn't agree more and are left to wonder why this noble principle of supporting our transportation infrastructure is applied to every other sector in Canada, *except airports*. Indeed, how can the Minister speak of creating an Infrastructure Advantage for Canada when – in the field of commercial aviation – he is, in fact, perpetuating an infrastructure disadvantage for Canada?

ATAC calls upon the Panel to immediately provide significant – and equitable – savings in airport rent payments to all airports on a level commensurate with their passenger volumes and to commit the government to putting airport rents on a permanent downward trend towards zero.

2. Aviation Fuel Excise Tax

Similarly challenging to our sector is the impact of the federal aviation Fuel Excise Tax (FET). The revenue collected through this tax has jumped from just over \$40 million in 2001-2002 to almost \$100 million in this last fiscal year. This is a particularly punitive tax, insofar as it serves to exacerbate the impact of high fuel prices on our sector.

As the price of fuel increases, so too does the government's windfall. In an industry where fuel costs represent one of the largest expense items and where companies have previously announced significant job cuts due exclusively to the impact of record-high fuel costs, it simply doesn't make sense for the government to make a bad situation worse through the continuation of this policy.

The Fuel Excise Tax regime is particularly punitive from an international competitiveness perspective. The United States applies a similar tax at a rate of four cents per gallon, while Canada's rate is four cents per litre; almost four times the rate of our biggest competitor.

3. The Air Travellers' Security Charge

Also contributing to the high cost structure in our industry is the Air Travellers' Security Charge (ATSC). In the low-fare, low-yield, environment in which our industry operates, this charge serves as a significant disincentive for air travel in Canada. The security of commercial aviation is in the broader public interest and should be funded accordingly, as is that of road, rail and sea travel in Canada. For this reason, we suggest that this tax should be abolished as soon as possible.

Indeed, the impact of the ATSC has been particularly punitive to our industry when considered from an efficiency perspective. Since the inception of CATSA, the government has collected almost \$1 billion from the ATSC, yet it has only spent approximately \$650 million on the delivery of CATSA services; resulting in a productivity gap of approximately \$350 million dollars. That money is not directed towards commercial aviation security but is categorized instead as general government revenues to be used for general purposes.

As recently as this past summer, the Department of Finance released audited financial statements demonstrating a surplus of revenues over expenses from the Air Travellers' Security Charge of nearly \$80 million. The released financial statements cover the fiscal year that ended on March 31, 2005. In their statement, the Government of Canada commits that the ATSC surplus will be drawn down in future years by the higher costs of improvements to Canada's air transportation security infrastructure. Clearly a government that is focused on improving the international competitiveness of Canadian businesses ought not to be over-taxing those same businesses and justifying such surpluses on the basis that they intend to increase spending.

Trade Policy Reform

In order to support the Panel's efforts to improve the prosperity to Canadians through tax reform, it is imperative that it also examine the role of Canada's tax policy in our broader trade policy efforts.

The fiscal policy reform measures identified previously must be combined with a strategic approach to international trade policy, to ensure that Canada seek to open markets in countries with which it has competitive tax policy regime or which otherwise provide significant opportunities for success and prosperity for Canadians.

Canada should not simply grant valuable economic rights (i.e. unfettered access) to a carrier of a foreign country when that country offers no meaningful benefits in return for Canadian businesses or when that country subsidizes its own aviation industry or infrastructure.

Improving Canadian prosperity is an objective requiring an integrated policy framework. Trade policy must work in tandem with any fiscal policy reform identified by this Panel to provide a reasonable prospect of success for improving the prosperity of Canadians at home and abroad.

Efficient Policy and Regulation

Delivering upon an integrated policy framework, which supports Canada's drive to improve prosperity, requires a disciplined approach to policy and regulatory reform to ensure that all proposed measures are examined through the lens of their impact to prosperity.

The aviation industry is one of the most heavily regulated and scrutinized industries in Canada and rightly so. There is no greater responsibility that our members have than the safety and security of their passengers. We welcome government efforts to ensure our continued world-class record of safety and security.

What is needed, however, is for government to ensure that unintended economic consequences are avoided in our sector and many others in the development of ancillary regulatory and policy initiatives.

Recently, the Canadian Transportation Agency ruled that carriers have an obligation to provide free seats to attendants of qualified disabled travellers as well as complimentary second seats to the obese. The *de facto* expropriation of air carriers' inventory to serve broad social policy goals works to undermine our international competitiveness and undermine the investment climate for our industry. Clearly, social policy objectives are more appropriately addressed through general taxation.

ATAC calls upon this Panel to recommend that the government conduct an economic competitiveness impact audit of all new proposed regulations or policies as part of their development process. This is a standard applied for many other areas of priority social and environmental objectives. Why not for the sake of Canadians' economic prosperity?

Addressing Specific Issues in the Consultation Paper

Having addressed our broad perspectives as to how best improve the competitiveness of Canada's commercial aviation sector, ATAC offers feedback on specific matters addressed in the consultation paper released by the Panel.

1. Canada in a Global Context

In a section devoted to Canada's sectoral investment regimes, the Panel addressed the matter of the current limitations on foreign investment in Canada's commercial aviation sector.

ATAC supports the current regulatory environment, which permits Cabinet to increase the foreign ownership limits to 49% from their current threshold of 25%. ATAC would not object to a move by Cabinet to undertake such an initiative but recommends that Canada pursue this issue strategically with its trading partners in the context of bilateral or multilateral negotiations so as to maximize the balance of benefits to Canadian industry.

More broadly, Canada should seek alignment with our major trading partners on matters of foreign investment and liberalizing investment regimes in commercial aviation. While ATAC makes no recommendation on the issue of the importance of national headquarters, clearly, Canadians are best served by a policy and regulatory framework that fosters the freest and most unfettered flow of investment and services in the field of commercial aviation.

2. Competition Policy

ATAC believes that Competition Policy should, not only serve to stimulate investment in Canada but also to encourage and stimulate Canadian business abroad.

At present, Canadian competition policy is narrowly focused on the domestic marketplace and does not adequately account for its impact on global business operations. Specifically, ATAC encourages the Panel to recommend that aviation-specific competition law be revisited. This is an area of law which addresses matters of broad public interest and ought to be structured accordingly.

Moreover, particular restrictions as defined within the CTA regarding mergers and acquisitions in the aviation sector as well as notice periods for route cancellations only serve to de-stimulate market entry and negatively impact the investment climate in our sector.

It is ATAC's recommendation that the aviation sector in Canada be brought under the same regime of competition policy, as is broadly applied to other sectors.

3. Investment Policies

The limitations on foreign investment in our sector are defined within the CTA Act and addressed above.

4. Promoting Canadian Direct Investment Abroad

As addressed earlier, ATAC believes that Canada should seek alignment with our major trading partners on matters of foreign investment and liberalizing investment regimes in commercial aviation. The global aviation industry has historically been a cash-intensive, low-margin business. While Canada's aviation industry has been resilient in adapting and growing in this challenging operating environment its growth is limited by restrictive foreign investment policies. Indeed, the emergence of global aviation alliances is a direct response to these artificial barriers. Airlines should be permitted and encouraged to make the necessary investments with their international partners to leverage their own strengths and grow internationally.

5. Becoming a Destination for Talent, Capital and Innovation

The most immediate and substantive method for addressing this goal in the field of commercial aviation is to eliminate the industry-specific taxation regime that exists and which has been thoroughly addressed earlier.

Put simply, unless and until Canada commits to reversing its current approach of draining capital from our sector through the taxation of business input costs, it will never become a significant center of international aviation growth.

By comparison, cities such as Amsterdam and Dubai, who have the complete and integrated policy support of their home governments, have become major centres for talent, capital and innovation in commercial aviation.

Every aspect of the development of air services in those centres, for example, has been aligned to promote growth:

- Airports are not charged rent;
- Supportive infrastructure is provided through general taxation; and
- Governments pursue strategic growth opportunities for their home-country carriers.

ATAC recommends that the Panel encourage the Government of Canada to take a similar approach to building Canada's airlines and major hub airports.

Conclusion

Air service providers in Canada directly employ over 60,000 Canadians in high paid, high skilled occupations and are one of the most important strategic sectors in supporting Canada's economy.

In short, we connect Canadians to each other and the world.

No major business decision is made without an assessment of a country or a region's air transportation system. Tourism and conventions are driven by similar assessments. That is why it is so important that Canada have an efficient, low-cost air transportation system. The very prosperity of Canadians depends upon it.

The current aviation industry-specific taxation regime, with airport rents (\$300 million this year), the fuel excise tax (over \$100 million this year), and the air travellers' security charge (over \$400 million annually), is neither efficient nor low cost and undermines the prosperity of our employees and customers, alike.

Respectfully, we conclude with our defining recommendation to this Panel; meaningful taxation reform which maximizes the prospect for improving the prosperity of Canadians. In short, government should tax the outputs of economic activity instead of the inputs, as it does with practically every other sector of the economy.

Respectfully,

A handwritten signature in blue ink, appearing to read 'S. Barone', with a horizontal line extending to the right.

Sam Barone
President and Chief Executive Officer