PRB 02-41E

Library of Parliament
Bibliothèque du Parlement

AIRPORTS IN TRANSITION

Joseph P. Dion
Science and Technology Division

4 October 2002

PARLIAMENTARY RESEARCH BRANCH
DIRECTION DE LA RECHERCHE PARLEMENTAIRE

TABLE OF CONTENTS

Page

AIRPORTS IN TRANSITION

INTRODUCTION

Airports in Canada have been undergoing a transition from government agencies to private corporations. For the last 10 years, the federal government has been implementing a new policy whereby federally owned and operated airports have been turned over to local private corporations that operate them on a non-profit basis for the good of the community.

This is a significant change from the previous regime, dating from at least the post-World War II period, under which all major public airports were planned, built, owned and operated by the federal government. Although the change is generally regarded as positive by the industry and the public, it has many ramifications, not all of which are yet known.

Most significantly, and in contrast to the commercialization of ports and air traffic control, this change of airport management, and often ownership, was brought about without a legislative basis for the policy. The lack of legislative framework has led to some concerns about issues such as accountability and government oversight, which have been brought to the government's attention in recent policy reviews.(1) Some of these issues have also been addressed by the Auditor General.(2) The government is moving to address the lack of legislation.

(1) Transport Canada, *LAA Lease Review Consultation Report*, April 1999 (cited hereafter as "LAA Lease Review"), and the Canada Transportation Act Review, *Vision and Balance*, Public Works and Government Services Canada, Ottawa, 2001 (cited hereafter as "CTA Review").

(2) Auditor General of Canada, *Report of the Auditor General to the House of Commons for December 2000*, Public Works and Government Services Canada, Ottawa, 2000 (cited hereafter as "Auditor General's Report, 2000").

BACKGROUND

Recent and ongoing changes in airport ownership and management are the culmination of a major policy shift that reflects several important factors: the phenomenal growth in air travel in the late 1960s and the 1970s; and the broad reassessment of the role of government, and concern about budgetary deficits, that were prominent in the 1980s.

Several studies, commissions and policy statements document this evolution: Transport Canada's Task Force on Airport Management (1979); Transport Canada's Task Force on the Future of Canadian Airport Management (1986); A New Policy Concerning a Future Management Framework for Airports in Canada (1987); the agreements of the 1992 airport transfers; and the National Airports Policy of 1994.

In addition, many issues were addressed by the Royal Commission on National Passenger Transportation (1992), and more recently by the *Canada Transportation Act* Review Panel (2001).

A. The 1979 Task Force on Airport Management

The first major review of how airports were managed in Canada, and possible options for change, was carried out by Transport Canada's Task Force on Airport Management. The Task Force reported in July 1979.(3)

The report noted that Transport Canada's air administration was responsible for the ownership and operation of 169 airports (90 directly, the rest through municipalities and other agencies). This was in addition to the registration and licensing of pilots and aircraft, and the regulation of safety and air operations generally.

Revenues generated from airport operations were consolidated in the Revolving Fund, from which funds were allocated for airport operations across the system. It was, in effect, a means for cross-subsidization whereby surplus revenues generated at the large, busy airports could be transferred to smaller airports with inadequate revenues.

The rapid growth of air travel in the 1960s and early 1970s required a level of response that exceeded the capacities of a large bureaucratic structure. That growth, and the

(3) Transport Canada, Canadian Air Transportation Administration, Task Force on Airport Management, *Progress Report, Volume I and Volume II (Appendices)*, Ottawa, July 1979 (cited hereafter as "1979 Task Force").

projected future growth, resulted in the perceived need for significant additional airport capacity and a change of approach to airport development and operation.

The shortcomings of centralized airport planning were illustrated by the planning of second airports for Montréal and Toronto. Mirabel airport, near Montréal, was built but was never used to capacity; Pickering, near Toronto, was stalled at the planning stage because of widespread opposition.(4)

The 1979 Task Force recommended autonomous airport commissions at each of the principal airports in the country (virtually identical to the 26 airports in the present National Airports System [NAS], described below). In addition, there was to be a central co-ordinating Canadian Airports Authority. This authority was modelled on the Canada Ports Corporation, which was being legislated at that time under the *Canada Ports Act*.

B. The 1986 Task Force and the New Policy on Airport Management

Likely because of the difficulty of making a significant institutional change, little action was taken on the recommendations of the 1979 Task Force. In the 1980s, the issue of airport management was again brought to the fore by the deregulatory agenda of the new government, and was revisited by the Airports Task Force in the mid-1980s. The Task Force reported in 1986.(5)

The Task Force recommended that airports be transferred to local authorities, while responsibility for safety and security remained with Transport Canada. Air navigation was to be handled separately, and air regulation and certification of airports were to be separated from airport management.

At the time, the 1986 Task Force thought that legislation would be necessary in order to implement the policy. Its report noted that "to successfully establish airport authorities it will be necessary to proceed with the preparation of federal legislation for approving the creation of authorities. This will ensure that this major policy change is addressed by Parliament…"(6)

---

(4) Airport Inquiry Commission, Report, Ottawa, 1974; and Walter Stewart, *Paper Juggernaut*, McClelland and Stewart, Toronto, 1979.

(5) Transport Canada, Airports Task Force, *The Future of Canadian Airport Management*, 1986 (cited hereafter as "1986 Task Force").

(6) 1986 Task Force, pp. 5, 6.

Based on the Task Force recommendations, a new policy concerning a future management framework for airports in Canada was announced by the Minister of Transport in April 1987. This policy was based on the view that local management (rather than a central administration) would be more efficient and responsive to the community that it served. The policy stated in essence that: (1) the government would be prepared to receive proposals for transfer of ownership and/or operation of federal airports (organizations accepting a transfer could include provinces, municipalities, local authorities or the private sector); and (2) the government envisaged a new business-like approach to airport management for those airports not transferred.

Although no legislation was introduced to give a legislative basis to this new policy, Bill C-15, the Airport Transfer (Miscellaneous Matters) Act, was passed in 1991 to address human resource and official language issues prior to the creation of any local authorities.

C. First Local Airport Authorities Established

With the authority of the policy statement on the management of Canadian airports, Transport Canada officials undertook negotiations to transfer major airports, starting with those in the five cities (see below) that account for the majority of air traffic in the country. Departmental officials negotiated with local representative corporations formed for that purpose.

In 1992, the government concluded negotiations and established four private, not-for-profit local airport authorities in Vancouver, Calgary, Edmonton and Montréal (comprising Dorval and Mirabel airports). Each transfer was authorized by a transfer agreement, a legal contract between the government and the local body that had been formed, in accordance with federal guidelines, to manage the airport.

The transfer agreements were complex, lengthy documents. Key clauses for these first NAS airports were: (1) the agreements were leases, meaning that ownership was to remain with the government; and (2) the leases were to be in effect for a period of 60 years. Another key clause was the amount of rent to be paid to the government by the local authority; this amount varied by airport.

The airport authority in Toronto was born amid some controversy a few years later. Negotiations on its establishment were initially concluded in 1993. Following a change of government, however, the Government of Canada revisited the terms of the proposed agreement and disallowed it. The present Toronto airport authority was subsequently created under Bill C-28, the Pearson International Airport Agreements Act, in 1996.

THE NATIONAL AIRPORTS POLICY OF 1994

The new airports policy, first articulated in 1987, was fine-tuned in 1994, two years after the first four major airports had been transferred. The 1994 policy was consistent with the federal approach to other categories of transportation infrastructure, notably the commercialization of seaports and air traffic control (transferred to Nav Canada), and the privatization of Air Canada and Canadian National Railways. The key difference, as noted, was that all the changes concerning infrastructure other than airports were made under the authority of specific statutes.

The National Airports Policy of 1994 is summarized by Transport Canada as follows.

- In 1992, the first four local airport authorities were created when community-based groups in Vancouver, Calgary, Edmonton and Montreal expressed an interest in operating their local airports. Subsequent negotiations resulted in transfers to not-for-profit entities knows as Local Airport Authorities.

- As one of the conditions for approving the 1992 transfers, the Government of Canada required that a major review of local airport authority leases be carried out after these four airports had been operating for at least five years.

- In 1994, the national airports policy clarified the commercialization of designated Canadian airports to be divested to not-for-profit, community-based entities. The primary intention of the national airports policy divestiture policy was to enable the not-for-profit airport authorities to fully develop the potential of their airports, reduce costs, tailor levels of service to local demand, and attract new and different types of business.

- This policy encouraged airport authorities to be financially self-sufficient and gave them freedom to determine how to fund their operations.(7)

---

(7) Transport Canada web site (edited): http://www.tc.gc.ca.

The National Airports Policy set up three primary categories of airport for transfer: (1) airports in the National Airports System, to be leased and not sold; (2) regional and local airports; and (3) small airports. Airports in the latter two categories were to be sold or otherwise transferred to local parties, public or private. Two additional categories were: (4) remote airports, which were not to be transferred; and (5) Arctic airports, which were to be offered to the territorial governments.

The National Airports Policy implied that, with regard to smaller airports, market forces would dictate the size and level of operations appropriate to the passenger demand. The policy did not rule out abandoning smaller airports if no one wanted them.

A. The "Population" of Airports in Canada

As in other countries, the total number of airports in Canada is surprisingly large. For the year 2001, Transport Canada lists 354 airports certified by Transport Canada, plus an additional 746 airports that are merely registered and presumably rudimentary. Airports with scheduled passenger service are listed at 264, but the level of scheduled service is not indicated.(8)

Many of the airports are small, have always been privately or municipally owned, and serve a limited clientele. Many in the registered category could be little more than unpaved air fields. More than 90% of air traffic is handled by the 26 NAS airports (see below), and 60% of all traffic is handled by just the top three airports: Toronto, Vancouver and Montréal (Aéroports de Montréal).

B. National Airports System Airports

The National Airports System is composed of 26 airports deemed essential to Canada's air transportation system. These airports handle approximately 94% of all passenger traffic in Canada. By definition, they must have year-round, regularly scheduled passenger service with a minimum of 200,000 passengers annually and/or be located in a provincial or territorial capital.

---

(8) Transport Canada, *Transportation in Canada 2001: Annual Report*, Ottawa, Public Works and Government Services Canada, 2002, p. 88.

The National Airports Policy allows for the long-term lease (60 years plus a 20-year renewal option) of NAS airports to Canadian Airport Authorities,[9] not-for-profit corporations headed by locally constituted Boards of Directors with representation from organizations such as Chambers of Commerce, Boards of Trade, consumer, labour and professional groups, and federal, provincial and municipal governments.

Once the airports are transferred, these local entities become responsible for their management, development and operation. Notable exceptions were the three Arctic NAS airports, which were devolved to the territorial governments.[10]

In 1997, the Government of Canada renegotiated the leases of three of the original four airport authorities, Vancouver, Calgary and Edmonton, to make them more consistent with the 1994 policy. These renegotiations drew a critical response from the Auditor General (see below, Reviews of the Policy).

At the time of writing, 25 of the 26 NAS airports had been transferred, and the transfer of the remaining one (Prince George) was under negotiation.[11]

C. Regional and Local Airports

The 71 regional and local airports serve scheduled passenger traffic but handle fewer than 200,000 passengers each year. Under the National Airports Policy, these airports were to be divested outright to provincial and local governments, not-for-profit airport commissions, private businesses and other interests. These entities were required to operate such airports for a minimum of 10 years.

Sixty-one of the regional and local airports have been divested, with 10 airports in four provinces currently still operated by Transport Canada.

D. Small Airports

Transport Canada also owned and operated 31 small airports, primarily defined as airports without regularly scheduled passenger service, handling fewer than 1,000 passengers

(9) This term superseded the earlier "local airport authority." This paper uses "local airport authority" or simply "airport authority."

(10) Transport Canada web site.

(11) *Ibid.*

annually, and mainly used for recreational flying. These airports were to be divested to local interests and be operated according to community needs for a minimum of 10 years. Of this total, 28 small airports have been divested.

At the time of writing, 114 of the 128 airports identified in the three primary categories under the National Airports Policy had been transferred, primarily to not-for-profit community-based entities.

E. Remote Airports and Arctic Airports

Under the National Airports Policy, Transport Canada continues to own, operate and financially support 13 remote airports,(12) as they are the only reliable means of year-round transportation to isolated communities. The government intends to review its long-term role with regard to remote airports.

The Arctic airports have been transferred to the territorial governments.

REVIEWS OF THE POLICY

A. Local Airport Authority Lease Review, 1999

As part of the establishment of the first four local airport authorities, the government required the Minister to conduct a major review of the local airport authority leases after five years of operation. This was done, and the LAA Lease Review report was made public in April 1999. The background consultants' reports are not public.

Generally, the review concluded that the transfers were a good decision, that the airport authorities are successful and that safety has not been compromised. However, it noted the need for a more comprehensive policy and stronger checks on governance, and also the need for more economic oversight, transparency and representation of user interests.

The review also raised other important issues: whether the level of rent was appropriate; the creation by airport authorities of for-profit subsidiaries; and airport authorities'

---

(12) These remote airports are mostly in Quebec, according to Mary R. Brooks and Barry Prentice, *Airport Devolution: The Canadian Experience*, May 2001, unpublished (hereafter cited as "Brooks and Prentice (2001)").

extensive use of "airport improvement fees" charged primarily to departing passengers using the terminals.

The department intended to consult for a further 18 months and then deal with the issues.

B. Auditor General's Report, 2000

The 1999 review concluded that the policy is working; the Auditor General's Report, 2000, asks, "At what price?" Chapter 10 of the report is entirely devoted to airport transfers. In essence, the Auditor General was most concerned that the Crown had not received adequate remuneration for the assets transferred.

The report was quite critical, noting "many significant weaknesses in management practices" such as the following:

- Before it started the lease negotiations for each airport transferred in the second round, and any renegotiations, Transport Canada did not determine the fair market value of the airport assets and business opportunities it was transferring….
- The Department has renegotiated four leases, at a cost to the government of about $474 million in forgone rent ($342 million net present value)….
- As a result of renegotiations, the government has, in effect, agreed to a reduction of future revenues of the Crown and to the funding of significant capital projects….
- From 1992 to 1999, the government continued to provide financial support to most of the transferred airports. It provided to the airport authorities a total of $360 million, including $118 million in rental credits at Lester B. Pearson International Airport toward a number of renovation projects.(13)

It must be remembered that there was political pressure to complete the transfers, both at the time of the original four (1992) and at the time of the subsequent transfers (1994 and later). Departmental officials involved in the negotiating process may have seen benefits in forgoing some revenue if that would ensure the successful completion of a transfer.

(13) Auditor General's Report, 2000, chapter 10, p. 10-5.

Less easy to explain is Transport Canada's lack of policy response to issues arising at the time of implementation and after. The Auditor General raised this point as the overarching concern in regard to airport transfers:

> We are concerned that eight years into the transfer process, Transport Canada has yet to clearly define its role as landlord and overseer of the National Airports System. Its handling of key emerging issues such as those related to airport improvement fees, subsidiaries and sole-source contracting has generally been inadequate and, until 1997, was virtually non-existent.[14]

C. The *Canada Transportation Act* Review Panel

The *Canada Transportation Act* Review Panel conducted a five-year statutory review of the Act and reported in July 2001.[15] A chapter of the report is devoted to the governance of newly commercialized infrastructure providers.

As the panel held its hearings in 2000 to 2001, the points it makes in regard to airports largely reflect the conclusions of the LAA Lease Review report released in 1999. The Panel highlighted the need to be able to generate revenue for new investment while avoiding the abuse of monopoly power.

It is assumed that, at least to some degree, the draft airports legislation and a separate parallel government study of the rent issues (both announced by the Minister in June 2001) are the department's response to the above reviews.

D. The Public Accounts Committee Response to the Auditor General's Report, 2000

The House of Commons Standing Committee on Public Accounts examined the Auditor General's Report, 2000, in regard to airport transfers, and reported in May 2002.[16]

The Committee heard from a number of witnesses from Transport Canada and the Office of the Auditor General. By and large, it supported the Auditor General's assessment of

---

(14) *Ibid.*

(15) For a detailed study of the report, see Joseph P. Dion, *The Report of the Canada Transportation Act Review*, PRB 01-12E, Parliamentary Research Branch, Library of Parliament, Ottawa, October 2001.

(16) House of Commons Standing Committee on Public Accounts, *Twenty-First Report*, May 2002 (cited hereafter as "Public Accounts (May 2002)").

the airport transfer process. The Committee made 10 recommendations that reiterated concerns raised by the Auditor General, and requested that Transport Canada inform the Committee of the department's plans to implement the recommendations contained in the Auditor General's Report, 2000.

ISSUES

The commercialization of Canada's airports was a major policy shift that had to be implemented with due regard for safety, human resources considerations and the financially appropriate disposition of significant publicly owned assets.

Generally speaking, the transfers have been successfully completed. Questions can be raised, however, as to whether they were completed at the right price and whether many important ramifications were properly considered. There has been some controversy, both in relation to individual airports and in regard to certain issues, arising from the manner in which the policy was implemented.

A. Issues Relative to Specific Airports: Toronto and Montréal

Several factors have conspired to create unique situations at the airports in Canada's two largest cities.

1. Toronto

Pearson International Airport in Toronto has benefited from many factors. First, there are the "system effects" that naturally result in more traffic passing through larger nodes in a system. Second, those system effects were accentuated by airlines' development of "hub and spoke" traffic patterns after deregulation. Third, the Canada-U.S. "Open Skies" Agreement of 1995 generally boosted trans-border traffic – much of which gets funnelled through Toronto, for the above reasons. Finally, all these transportation-related developments took place against the backdrop of the overall shift of economic activity from Montréal to Toronto during the 1960s and 1970s.

As the key airport in the country and the one with the greatest potential for revenue generation, Toronto's airport became a very attractive operation to be involved with.

Several private-sector companies made offers, and the government's choice of which entity and individuals would be responsible for this significant operation became a political issue that was hotly debated in the 1993 election.(17) A transfer agreement was entered into between what became the outgoing government and a local Toronto group chosen by that government. The incoming government cancelled the agreement. A new authority came into being and finalized an agreement with the new government. The new deal was legislated by Bill C-22 (later renumbered C-28), the Pearson International Airport Agreements Act, which was passed in 1996.

Toronto remains so preponderant, both in the amount and type of traffic handled and its central hub status for Canada's major airline, that airports in Canada can almost be classed as Toronto and all the rest. At present, Toronto alone handles approximately a third of the country's passenger traffic.(18)

2. Montréal

Montréal, on the other hand, has suffered doubly. First, as noted, there was a significant loss of traffic as economic activity shifted to Toronto. A 1986 study shows that the difference between the number of passengers at Montréal and Toronto grew from 27% in 1969 to 116% in 1983,(19) while the difference in the number of passengers transferring airplanes in Toronto grew from 14% more than Montréal in 1971 to 165% more than Montréal in 1983.(20)

Second, while air traffic was dropping considerably in Montréal, the city was acquiring significantly more capacity with the construction of Mirabel airport. However, this capacity was located relatively far from the city, which worked against economies of scale and, in fact, made the situation worse. Montréal has been struggling ever since with this double-edged problem of declining traffic and an over-supply of airport infrastructure split between two locations.

---

(17) Mollie Dunsmuir, *Bill C-28: Pearson International Airport Agreements Act*, LS-253E, Parliamentary Research Branch, Library of Parliament, Ottawa, April 1996.

(18) CTA Review, p. 150.

(19) Le Conseil consultatif des aéroports de Montréal, *Recommandation d'une structure de gestion locale pour les aéroports de Montréal et l'avenir des aéroports de Montréal*, September 1986, Annexe C II, pp. 9, 11.

(20) *Ibid.*

Montréal airport (i.e., Aéroports de Montréal, comprising Dorval and Mirabel) is at present the third-busiest in the country in terms of number of passengers, after Toronto and Vancouver (a much smaller city by population and commercial and industrial activity), and only just ahead of Calgary. Recently all scheduled passenger traffic was moved to Dorval, originally a 1950s facility, while the mid-1970s facility at Mirabel has been relegated to handling air cargo.

Thus, important issues remain for airports in Canada's two largest cities. For Toronto, there is the question of whether its rent reflects, or should reflect, the additional benefits that it receives as unofficial national hub and national gateway to the United States.(21) The Montréal airport authority, with two airports and not enough passengers, continues to try to respond to a difficult situation.

B. Issues Common to All Transferred Airports

The concerns most often raised(22) in regard to airport authorities tend to focus on the following: government control over airport management to avoid abuse of power; the revenue raised by airport authorities and the rent paid by the leased airports to government; what can be done for airports that are not economically self-sustaining; and how the national interest is addressed by a conglomeration of separate independent entities. Also of interest is the changing transportation context within which the airport transition has been taking place. There are also questions about the number of airports to be considered for inclusion in the national airport system.

1. Monopoly Power and Governance

Generally speaking, an airport has monopoly power in its market. As a result, in the absence of government regulation of what the airport does and how much it charges, there is a potential for abuse as there is with any other monopoly. For instance, as an unregulated monopoly and in the absence of competition, an airport can increase its revenue merely by increasing the charges it levies for its services; the users of those services have no choice but to

---

(21) See Section 2, below. The Toronto airport authority collects "airport improvement fees" on connecting as well as departing passengers.

(22) See: LAA Lease Review; Auditor General's Report, 2000; CTA Review; Brooks and Prentice (2001); and J. A. A. Lovink, "Improving the Governance of Airport Authorities," *Policy Options*, 6 April 2001 (cited hereafter as "Lovink (2001)").

pay. This is unfair to the users and inefficient for the economy. The Royal Commission on National Passenger Transportation explicitly warned of such a possibility when it reviewed the new and evolving airport policy of commercialization.(23)

Similarly, there are no controls on executive compensation or adventurous business offerings. For example, some airport authorities have set up for-profit subsidiary companies that are doing consulting work in various parts of the world. There is no government review of these subsidiaries' activities and no assessment of whether they serve the interests of airport users or the airport's owner, the government.

Airport management could also become over-ambitious and expand facilities in the hope of growth. This is especially risky if several competing locations are counting on the same customer base to fund their growth. It is very easy, especially playing to a local audience, to be promotional and growth-oriented and to make the entrepreneurial case for being a region's airport hub. The airport can then build to meet – and, it is often hoped, generate – future demand. However, if the projected demand does not materialize, it is ultimately the government and taxpayers who are liable.

There may be insufficient control over how the airport authority defines its mandate. Management could decide, for example that the best way to serve its community would be through revenue maximization with the goal of growth. This could have the effect of promoting north-south traffic to the United States at the expense of Canadian east-west traffic. Revenue maximization could also result in a focus on commercial ventures not central to the core business of the airport, such as the subsidiaries referred to above.

It is hoped that legislation will give government the control it needs to provide checks and prevent abuse.

2. Revenue, the Role of Airport Improvement Fees, and Rent

a. Revenue

Before the 1992 commercialization of airports, the primary charges at government-owned and -operated airports in Canada were landing fees and other terminal fees charged to airlines using the facilities. These fees were set on a system-wide basis and varied little from airport to airport.(24) A federal Air Transportation Tax was charged to passengers,

---

(23) Royal Commission on National Passenger Transportation, *Directions*, Minister of Supply and Services, Ottawa, 1992, pp. 121-126 (cited hereafter as "Royal Commission").

(24) Royal Commission, Vol. 1, p. 94.

primarily to cover air traffic control costs. Some revenues from airport concessions (much less extensive at that time) covered some airport costs.(25) Revenue collected went into what was called the Revolving Fund, which was then allocated to airports throughout the system.(26)

Many foreign airports levied "passenger facility charges" also known as "passenger service charges," often in the case of international passengers. Traditionally, the International Civil Aviation Organization (ICAO), which works to ensure an equitable and competitive air transport sector, has not opposed passenger facility charges. Its main concern was that they not be collected separately, which could physically slow down the movement of passengers within and through the airport facility. ICAO appears to be changing its view of passenger facility charges, however. Increasingly, it is concerned about over-charging and the anti-competitive aspects of passenger facility charges.(27)

The United States introduced legislation in 1992 to allow for the collection of a passenger facility charge from all passengers to fund some aspects of airport operations. However, there were restrictions. It was generally kept to $3 and was overseen by the Federal Air Administration. This policy was reviewed in 1999.(28)

Moving from a regime of system-wide charges that can be juggled and re-allocated, as was the case with the Revolving Fund, to a regime requiring each airport to pay its own way likely does promote certain efficiencies. However, it also has disadvantages. It places pressure on each airport to ensure it generates sufficient revenue to cover expenses even when passenger traffic declines – possibly encouraging the introduction of inappropriate and ultimately inefficient charges. It fails to take into account the system benefits that favour the hubs. Moreover, some efficiencies can be achieved only on a system-wide basis, as the following analysis indicates:

> If only one airport existed, no network benefits would exist. The links created by each additional airport increase geometrically as the number of airports increases linearly. If all airports' costs were

---

(25) *Ibid.*

(26) 1979 Task Force, Vol. 1, p. 19.

(27) See: International Civil Aviation Organization, *Airport Economics Manual*, 1991, and *Report of the Conference on the Economics of Airports and Air Navigation Service: Air Transport Infrastructure for the 21st Century*, Montréal, 2000.

(28) United States, General Accounting Office, *Passenger Facility Charges: Program Implementation and the Potential Effects of Proposed Change*, Washington, May 1999.

> pooled, as they once were under Transport Canada, new airports would be added until the marginal costs of the last entrant equalled the marginal benefits to the network. When the network benefits are ignored, and each airport must cover its full costs, the system is likely to be sub-optimized.[(29)]

It has been suggested that, under the current policy, the government does not take sufficient measures to require that airport operators allocate their costs appropriately among airport users.[(30)] This situation is seen as leading to inequitable charges among user groups and as being contrary to the letter and spirit of recommendations developed by ICAO to avoid inequitable and inappropriate user charges.

b. Airport Improvement Fees

In order to minimize their costs, especially if passenger traffic is declining, airlines can be expected to lobby to reduce the amount they must pay to use an airport. This, in turn, could lead airports to consider generating revenues from individual passengers who are not, under monopoly conditions, in a position to refuse to pay such charges.

While few airports in Canada identify such fees as passenger facility charges, many or most charge what they call airport improvement fees. These are substantial, most often $10, and they are rising; the Ottawa airport, for example, has announced that it will charge $15 in 2003. The fees may be charged separately or added to the air ticket.

Transport Canada lists a total of 38 airports that charged an airport improvement fee in 2001. These ranged from $5 to $28, and many had increased since the previous year. The charge was collected directly at 12 airports (including Vancouver and Montréal), and through the ticket at the others. Toronto collects two different fees, both added to the ticket: $10 from departing passengers, and $7 from connecting passengers.[(31)] Notably, Thunder Bay eliminated its airport improvement fee in October 2001.

Airports claim that these fees are directed towards the development of specific new facilities. However, the fact remains that an air traveller is contributing to a facility that is not yet in operation and that he or she is therefore not using on the day of travel (and may never

---

(29) Brooks and Prentice (2001), p. 13.

(30) Lovink (2001), pp. 50-56.

(31) Transport Canada, *Transportation in Canada – 2001 Annual Report*, Public Works and Government Services Canada, Ottawa, 2001.

in the future). An airport improvement fee is, in effect, a charge levied on the passenger to use the facility as it is on that day. It is thus a passenger facility charge, albeit under another name.

While a major air carrier can use its size and importance to try negotiating some relief on its landing fees, an individual traveller cannot. Perhaps in consequence, there has been a significant shift in airport practice from charging the air carriers to charging the individual traveller. As a result, "Airport improvement fees have become a significant source of revenue for the Local Airport Authorities, surpassing each of the major aeronautical charges, landing fees and general terminal fees…"(32)

Two questions now need to be asked. Is it appropriate to make today's users pay for future facilities? Second, are the fees really put into a separate account dedicated to development of new facilities, or can they be re-allocated by management and be used to cast the airport in a more positive financial light? A review of some airports' financial statements shows that airport improvement fees are listed along with other revenue.

Dependence upon airport improvement fees – to the detriment of the traveller – is suggested by a recent report that revenues exceeded expenses at the Ottawa airport despite a drop in the number of passengers:

> Revenues exceed expenses by $6.7 million in the six-month period, with the surplus almost entirely due to the airport's $10 fee charged to all departing passengers. The fee will rise to $15 on January 1 [2003].(33)

The main issue is that there is no government control, and the airport authority is free to set passenger facility charges or airport improvement fees as it sees fit.

c. Rent

The issue of rent applies to the NAS airports, which have been leased to local authorities; not to regional and local airports, which have been sold or otherwise transferred. Leases are similar across the National Airports System, differing only in details. The amount of rent to be paid over the period of a lease was determined in the negotiations leading to the agreement, and is specified in each lease.

---

(32) LAA Lease Review, p. 30.

(33) "Fee helps airport turn a profit," *Ottawa Citizen*, 17 August 2002.

Questions have been raised as to whether rent should be charged in all cases and whether the levels that were set are appropriate. The Auditor General's Report, 2000, expresses the view that, in the second round of transfers, the department did not establish a fair market value for the airports as a basis of negotiation. The report also claims that, in renegotiating the leases of the airports transferred in the first round, the department forwent several hundreds of millions of dollars in rent.(34)

When the House of Commons Standing Committee on Public Accounts reviewed the Auditor General's report on airport transfers in the spring of 2002, it basically accepted the analysis and made several recommendations calling upon Transport Canada to implement the Auditor General's recommendations.(35)

Although the department had rejected the Auditor General's criticisms and stated that the rents were appropriate, the Minister ordered a study of the rent issue. The study is currently under way but is being undertaken separately from the proposed legislation and related issues.(36) The review will address the appropriate level of rents, and likely the Auditor General's comments.

Departmental figures on rents raise another important aspect of this issue: which airports pay rent and which do not. In regard to rent paid in 2000-2001, Transport Canada noted:

> Nine authorities paid rent totalling $236 million – Toronto, Vancouver, Calgary, Montreal, Edmonton, Ottawa, Winnipeg, Victoria and Kelowna ($1.00). *Of this total, 95 per cent was paid by the first four authorities*. (Italics added for emphasis.)(37)

It further states:

> In the same year, seven authorities paid no rent, and another *five received a total of $20 million in subsidies to cover their operating shortfalls*. (Italics added for emphasis.)

(34) Auditor General's Report, 2000, pp. 10-5, 10-37.

(35) Public Accounts 2002, pp. 3-8.

(36) Transport Canada, News Release, "Transport Minister to Develop Legislation and Review Rent Policy for Canada's Airports," and Backgrounder, "Rent Policy Review," 12 June 2001.

(37) *Ibid*.

This spectrum demonstrates that a few airports pay a lot, most pay little or nothing, and some, far from paying rent, are being subsidized. The situation appears to be similar to the cross-subsidized system under the former Revolving Fund of the 1970s and 1980s, but one carried out in an ad hoc manner and without an explicit policy.

d. Economic Viability of Low-Traffic Airports

It is uncertain whether most of the existing airports in Canada handle sufficient flights and passengers to be economically viable without external funding. It is also uncertain whether traffic will grow sufficiently in the foreseeable future to make them economically viable.

Of the 26 NAS airports, it likely that only the 8 or 10 largest (in terms of passenger traffic) are actually or potentially viable financially. It must be remembered that many of these airports are in communities with very small populations by world standards; they are often relatively close to other larger airports with more direct connections; and the vast majority of inter-city trips are made by automobile (95% of trips up to 300 km, and 82% of trips up to 800 km).[38]

Other factors also play a role. Better four-lane highways, improved for-hire ground transportation, and more costly, time-consuming airport security procedures could result in even more concentration at large airports. Also, under the terms of the acquisition of Canadian Airlines by Air Canada, some currently available air service is mandated only until December 2002. Already some services have been discontinued, and a further decrease can be expected.

In addition to the 26 NAS airports, there are 71 regional and local airports, defined as having scheduled service but handling fewer than 200,000 passengers a year. The viability of these regional and local airports is also in question.

e. Community Airports Survey

Transport Canada has acknowledged that there is a lack of basic data on the operations, financial status and passenger traffic at the smaller NAS airports and the 71 regional

---

(38) Royal Commission, Vol. 1, p. 22.

and local airports. Some data, however, have been released by the Federation of Canadian Municipalities.(39)

This study, entitled *Community Airports Survey*, was carried out with the financial assistance of the Air Transport Association of Canada and the involvement of the Canadian Airports Council. Fifty-eight completed questionnaires were received from eight provinces and one territory (Yukon), with major concentrations in Ontario, British Columbia and Alberta.

The responses yielded the following key points:

- The majority of the smaller NAS airports were not self-sufficient at the time of transfer and continued to receive declining subsidies until the date of the study. They are not eligible to receive Airport Capital Assistance Program funds (see below) and are experiencing difficulty generating sufficient revenues to support a capital program.

- The majority of airports in the study are owned (72%) and operated (58%) by municipalities. Slightly more than half were previously owned by Transport Canada, five of which belong to the National Airports System.

- Most of the airports (77%) operate with fewer than 10 employees, and handle fewer than 50,000 annual enplaned and/or deplaned passengers and fewer than 50,000 annual aircraft movements.

- For the airports surveyed, operations and maintenance costs and personnel costs account for the vast majority of expenditures.

- For some airports, revenue sources include substantial subsidies from local governments. A significant number of airports depend on fuel fees as a revenue source. Over 60% of the airports reported receiving revenue from the leasing of land, which accounts for almost 25% of their total revenues.

- Support from local governments is significant. Most often, this takes the form of an operating subsidy or capital funding, but it may also include the provision of personnel or equipment.

- Airports owned by municipalities are controlled by provincial legislation, which, in most cases, restricts the ability of governments to accumulate debt. Consequently, none of those airports reported having debt, although more than half reported an operating deficit.

(39) Federation of Canadian Municipalities, *Community Airports Survey: Final Report*, Ottawa, November 2001, Appendix D, section on Transport Canada (cited hereafter as "Community Airports Survey").

- Airline restructuring has led to the consolidation of service. This means that while the actual number of passenger seats available may not have changed, the number of flights may be reduced, entailing a loss of landing fee revenue for airports.

- Government infrastructure programs are critical to the continued operation of many of these airports.
  - Almost half of the airports responding to the survey reported that they are eligible for assistance under the Airport Capital Assistance Program.
  - Seventeen airports reported having access to other (mostly provincial) financial assistance programs.

- Changes in government safety regulations can have considerable cost implications for small airports. The Airport Emergency Intervention Service Regulations (Canadian Aviation Regulations 308) are the one of greatest concerns.

In summary: small airports appear to be surviving financially, albeit with deficits, with the help of some federal (Airport Capital Assistance Program), provincial, and a great deal of municipal assistance. Passenger facility charges are of limited help because of the small number of passengers. Land leases, along with other commercial and retail activities, are the major sources of revenue.

f. Airport Capital Assistance Program

In the short term, many airports are receiving subsidies through the Airport Capital Assistance Program. The government has provided $190 million for this program over the next five years. Although the program’s title specifies capital assistance, the criteria for project eligibility are broad, including projects related to safety as well as “asset protection and operating cost reduction.” These last two criteria appear similar to the usual definitions of operations and maintenance.

As noted above, NAS airports are not eligible for this program. It is available to other categories of airport, including those handling as few as 1,000 passengers per year, equivalent to a volume of only 20 passengers per week.

It is possible that the non-viability of many regional and local airports is not being recognized and addressed because of the short-term help being provided through the Airport Capital Assistance Program. In the longer term, this issue must be resolved. It would be helpful, as a first step, to estimate the operating subsidies necessary to support specific levels of service at regional and local airports, and consider who might pay them. These airports are often seen as contributing to regional economic development, in which case funding might be sought from appropriate sources (although regional economic development benefits remain very difficult to attribute definitively and to quantify).

3. The National Interest

The policy of turning airports over to local authorities was predicated on the assumption that a local board with both a local focus and business acumen would, by nature, develop an operation that was efficient, responsive, and designed to work in the best interests of the community. This approach certainly offered some advantages over the government's earlier centralized planning approach. However, while the withdrawal of bureaucratic involvement in day-to-day operations has been welcomed at the local level, the present "hands-off" federal approach has been seen by some as going too far in the other direction.[40] As previously noted (see the section on "Monopoly Power and Governance," above), lack of government control over airport management can have significant drawbacks.

Also important, but perhaps less often recognized, is the question of how the national interest is addressed.[41] The present policy assumes that a number of self-optimizing elements of a system will naturally lead to an optimal system. That is to say, if Toronto airport does what is best for Toronto, Montréal does the same and Vancouver likewise, the natural result will be a national airport system that is both efficient and appropriately balanced. While this approach would be unlikely to lead to an ideal result anywhere, it is extremely unlikely to work on a national scale in Canada, considering that much of the population is concentrated in a thin strip along our southern border.

It has been noted that there is a "lack of any formal means of ensuring [that] major decisions by airport management, with their purely local and regional accountabilities, do not have negative consequences for the national system of air transportation."[42] This suggests a need to be addressed in the proposed legislation.

---

(40) This assessment was noted, in a critical manner, by the Public Accounts Committee, 2002.

(41) This is raised in Lovink (2001).

(42) *Ibid.*

4. The Changing Transportation Context

The new airport policy, as we have seen, has taken 25 years to develop and implement. As the legislative basis is now about to be brought before Parliament, it would be useful to consider what has changed since the mid-1970s and how that might affect the context in which Canadian airports now operate.

Several factors, frequently raised in public and political forums, should be considered before legislating a policy framework for the coming years.

- Deregulation of the airline industry has led to greater flexibility and an increase in air travel (the only other significant inter-city option being private automobile). This suggests air travel may find markets even in small centres under new conditions that allow greater flexibility.

- Improved highways and vehicles have made more, and longer-distance, inter-city automobile travel attractive. In some areas (for example, southern Ontario), fairly elaborate systems of ground transportation serving major airports have developed. These factors have made some smaller airports redundant.

- Economic globalization has led to increased tourism and travel generally, but it has also led to international competition among major commercialized airports as hubs and transit points.

- Urbanization has continued apace in Canada, but overall the population of most Canadian communities is small when considered as a generator, or attracter, of air travel contributing to the support of a community airport.

- Air travel has significant environmental effects (emissions and noise). If users were charged for environmental costs, the additional fee would constrain growth in air travel.(43)

- There is now one dominant domestic carrier in Canada.

- The terrorist attacks of 11 September 2001 have made security a costly and time-consuming aspect of air travel. This has tempered demand for air travel, at least in the short term.

All these factors suggest that current and projected volumes and patterns of air travel cannot support, in an economically self-sufficient manner, the 71 regional and local airports in Canada. They also raise questions as to whether the 26 NAS airports can, individually, be supported by the current and projected number of air passengers.

---

(43) Royal Commission, Vol. 2, pp. 220-228.

There may be a need to address the manner in which many of the existing airports are currently supported (through a combination of municipal, provincial and federal subsidies), and whether it should be done differently. Alternately, it may be considered whether all of the current airport capacity is needed.

There may also be a need to revisit the criteria by which airports are included in the National Airports System. As noted above, the 26 NAS airports are virtually identical to those termed "principal airports" in the 1979 Task Force study.

CURRENT STATUS

The government intended to introduce airports legislation in the fall of 2002, in order to give a legislative basis to the current airports policy. The legislation was initially planned for the fall of 2001, but was delayed.

The draft legislation was not available at the time that the present paper was being written. However, the government has outlined in the following backgrounder what it intends to put in the legislation.

> **Proposed Canada Airports Act**
>
> The proposed legislation for airports builds upon Canada's National Airports Policy….The legislation is intended to clearly set out the obligations for airports in the National Airports System…and for the Government of Canada. It will address key public policy issues, such as:
>
> - clarifying the roles and responsibilities of the Government of Canada, as well as those of the airport authorities;
> - updating and strengthening the governance regime for airport authorities;
> - establishing requirements for transparency and consultations between airport authorities and interested parties;
> - establishing principles for charges imposed by airport authorities, including special provisions for airport improvement fees, and an appeal process;

- addressing competition issues, including equitable access for airlines to airport facilities and slots;

- ensuring that NAS airport activities are consistent with Canada's international obligations, including trade;

- establishing parameters for non-core activities undertaken by airport authorities; and

- establishing appropriate enforcement mechanisms.

Key objectives will be to:

- modernize NAS airport authority governance practices and principles;

- establish high standards of transparency and public accountability, including appropriate disclosure of information on costs and their relationship to charges;

- create adequate opportunity for users of airport facilities, including air carriers, the travelling public and residents of the airport region, to provide meaningful input into major airport decisions on charges and material expenditures affecting charges; and

- maintain the flexibility that currently exists in the airport divestiture model which allows airports to generate revenues necessary to achieve and maintain financial viability, while providing guidance to airports in setting airport charges.(44)

The above statement suggests that the legislation will focus on the 26 NAS airports. It does not say whether the legislation is intended to apply to the category of local and regional airports. It will be remembered that 61 of the 71 airports in this category have already been sold or otherwise transferred to local authorities.

CONCLUSION

Canada's airports have been undergoing a significant transition from government agencies to private corporations for a period of 10 years.

---

(44) Transport Canada web site, at: http://www.tc.gc.ca/mediaroom/backgrounders/b01_h074e1.htm.

This transition from public to private management and, in some cases, to private ownership is in keeping with the broad direction of federal involvement in transport operations (including both carriers and infrastructure), and also with international trends. In general, this change in airport operations has been successfully completed and offers many benefits. There have been some significant shortcomings, however, and it is planned to address these through forthcoming legislation and a rent review.

Still to be addressed is the question of how the large number of low-traffic airports, including many local and regional airports and also several NAS airports, are to be self-sufficient within the new policy framework. Alternatively, if they are not self-sufficient, there is the question of what is to be done with them. If they are to continue in operation, will they have to be subsidized; and, if so, by whom?

Discussion of many of these issues has been postponed pending the introduction of the legislation. Once that legislation has been tabled, the debate attending its passage will play an important role in determining what might be seen as the second half of the transition of airports in Canada.