



**CANADA-EUROPE TRANSATLANTIC DIALOGUE:**

**SEEKING TRANSNATIONAL SOLUTIONS TO 21<sup>ST</sup> CENTURY PROBLEMS**

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## **Sky-high: Charges on Canadian Air Services through the Gold-plated Roof**

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Canada has committed to a ground-breaking progressive dismantling of all government regulation of market access in the Canada-EU transatlantic air services market.<sup>1</sup> The underlying principle is that there will be reciprocal social benefits from the more competitive economic framework, as air services act as a generator for activity in the broader economy. However in order for this policy to reap such benefits, air carriers must be able to charge prices inclusive of taxes and charges for the operation of services which generate sufficient demand to allow operators to breach the break-even load factor. Moreover, European airlines must discern that serving Canadian gateways will prove more profitable than directing capacity to other destinations including the United States to which they also have unrestricted access.<sup>2</sup> In light of this, it is necessary to ponder whether Canadian policy on air passenger user fees does not act as an impediment to growth of the EU-Canada market.

Additional charges levied on passengers over and above the base fare perhaps disproportionately affect the market for passengers departing from the EU. This is because EU regulations require that when marketing air transportation leaving from points within the EU, all mandatory taxes and charges must be included in the advertised price.<sup>3</sup> This means that headline prices for return travel to Canada from the EU will always have to include these charges which are significantly greater than those applicable on return transportation to alternative destinations including the United States. This paper will explore the nature of two of the charges paid by passengers which have already been increased in 2010; Airport Improvement Fees and the Air Travellers Security Charge. In the second of these cases, we will underscore how the charge is unfairly structured discriminating against European-bound passengers.

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## **I. Airport Improvement Fees**

Canadian airports were government run and subsidized until 1992 when four of Canada's leading airports (Calgary, Edmonton, Montreal, and Vancouver) were transferred to Local Airport Authorities (LAAs) under the Airport Transfer Act.<sup>4</sup> The LAAs were non-profit corporations which were bound to pay rents to the federal government to cover the value of the infrastructure transferred to them. In 1994, this policy was extended as the Federal government announced it would no longer subsidize or run any airport and obliged communities to establish Canadian Airport Authorities (CAAs) with slightly modified corporate structures from the LAAs.<sup>5</sup>

At the time when the airports were handed over to the LAAs and CAAs, Canada's airports were in a poor state of repair and required heavy infrastructure investment.<sup>6</sup> Furthermore, as not for profit corporations, the airport authorities had no equity and thus user fees had to be increased to not only cover the shift from government subsidy to lease payments to the government, but also to fund future improvements to airport infrastructure since financing was not available on a pure debt basis.<sup>7</sup> Almost two decades later, the value of the infrastructure transferred to the LAAs and CAAs under the Airport Transfer Act has been more than repaid to the federal government. However -- despite a rent reduction agreement in 2005<sup>8</sup> -- the government currently continues to raise \$390 million in airport lease payments per year<sup>9</sup> which go to the central treasury and act as an indirect tax on all air passengers, which with respect to international passengers runs contrary to the spirit of the policies of the International Civil Aviation Organization which calls for restraint of Contracting States from taxation of international flights.<sup>10</sup>

The airport authorities raise funds through fees levied on retail outlets and parking etc. However, two mandatory sources of funding imposed respectively indirectly and directly on passengers are aircraft landing fees and passenger user fees. Landing fees are levied by aircraft movement irrespective of loads -- these are payable by the airline and thus are factored into costs and covered in the base airfare charged. However, user fees are levied by the airline on a per passenger basis, but the airline is merely acting as handling agent for the respective airport authority which receives these fees.

Landing fees were initially the primary source of income for the airport authorities. However criticism in 2007, by which time landing fees at Toronto Airport had risen to the second highest in the world behind Narita, led to cuts in landing fees.<sup>11</sup> However the focus has shifted to increasing passenger user fees. Pursuant to the Canada Airports Act 2006, although the airports are obliged to undertake public consultation in the establishment of their fees, they are free upon satisfaction of the procedural requirements to establish charges without interference or review from the federal government. Passenger fees are an especially blunt charging technique since passengers have very little lobbying power, and unlike landing fees charged to airlines, there is no opportunity to try to offset the increased expense by cost cutting elsewhere.

The Greater Toronto Airport Authorities (GTAA) stated on introduction of an Airport Improvement Fee in March 2001 that the measure would be temporary to cover developmental costs,<sup>12</sup> however, the charge has risen 150% in nine years. Users now pay \$25 to the airport authority upon departure from Toronto Pearson Airport. In February 2010, Aéroports de Montréal increased their user charge by \$5 to match the \$25 charged by the GTAA for Pearson. This marked an increase of over 66% in a little over two years. The fee had been \$15 until January 4, 2008. Furthermore, the Airport Improvement Fee is subject to federal sales tax, and potentially provincial tax. This is levied in Quebec but not in Ontario.

Canadian airport charges are excessive and discourage air travel. The situation is exacerbated when it is taken into consideration that US airport authorities do not pay anything more than nominal lease payments, and are often subsidized under the U.S. federal grants program. Further increases to mandatory user fees can only serve to either stifle demand for air services, or provide a further inducement to drive passengers to border airports in the United States. Efforts to attract new air services from European airlines, as promoted by the Open Skies Agreement, will be hampered by the extravagant fees charged by Canadian airports to fund lavish refurbishments, a process which has often been referred to as the “gold-plating” of Canadian airports.

In light of the above it is recommended that the federal government review its airports policy:

- To consider the abolition or progressive reduction of airport lease charges payable by airport authorities, which represent an indirect taxation of passenger taxation. Lease charges at Toronto and Vancouver airports are projected to increase by over 30 and 35 per cent respectively in the next five years, and these increases are likely to be off-set by further user fee increases.
  
- To provide for some legal oversight or review of substantive decisions made by airport authorities. In light of the detrimental implications for the air transport sector and the broader Canadian economy, the gold-plating of Canadian airports should be under federal supervision. Moreover sales tax should be excluded from airport improvement fees (these can be perceived as taxes on a tax), most particularly for international air passengers.
  
- To prevent air carriers from advertising airfares exclusive of mandatory taxes and charges. This makes increases to airport and other charges non-transparent to travellers since they are excluded from misleading headline tariffs which in Canada exclude taxes and charges.

## **II. Air Travellers Security Charge**

On 27 March, 2002, the Canadian Parliament passed the Air Travellers Security Charge Act.<sup>13</sup> The Act introduced passenger user fees for security facilities at Canadian airports. After the events of 9 September 2001, the federal government assumed responsibility for security at airports and established the Canadian Air Transport Security Authority (CATSA). To fund this new State agency, charges were levied at \$12 for one way domestic flights, \$12 for a transborder flight and \$24 for an international flight.

Pursuant to the review policy included in the Act, as revenue exceeded costs, the charge was progressively decreased, and from 2008 the charges stood at \$4.90, \$8.34, and \$17.00 for domestic, transborder and international emplanements respectively. The diminution of the charge was however sharply reversed in 2010. Subsequent to the attempted terrorist attack on Christmas Day 2009 on board a jet flying from Amsterdam to Detroit, Canada has elected to further boost security checks at its airports. To fund this, the Transportation Minister announced on February 25, 2010 that the Air Travellers Security

Charges would rise by \$2.50, \$4.37, and \$8.91 respectively for domestic, transborder and international emplanements.<sup>14</sup> This came into effect April 1, 2010. Thus, any passenger now departing from a Canadian airport to Europe, or any other international destination, will now pay \$25.91.<sup>15</sup> This charge is applicable whether the flight is direct to Europe, or is a connecting service via the United States. This prevents a competitive distortion against direct services to international destinations from Canada.

Transport Canada has underlined that the increase will be revenue neutral, allowing CATSA to operate with a balanced budget from 2010 through 2015 with the fee increase covering increased personnel and security infrastructure.<sup>16</sup> This raises a longstanding international debate over whether airport security costs should be assumed by users, or the wider public, since aviation security is in the broader interest of the general public. This is underpinned by the fact that aircraft security incidents can have even more catastrophic effects on the surface than on board, as highlighted by 9/11, and that assaults on aviation security are always effectively an attack on a State and its policies rather than the airline or its travellers. Without entering into this philosophical debate, we can still criticize the charge imposed on European and other international bound passengers as constituting a disguised luxury tax, and subsidizing domestic and transborder operations.

The justification for increased charges is the necessity of new security measures, since the most recent security breach on 25 December, 2009. The principal changes to date however have been new verification obligations imposed on passengers destined for the United States, and full body scanners, which have been installed initially at transborder terminals. These additional expenses thus have been directed towards the transborder market, yet are being disproportionately funded by international passengers.

Even if the revenue from the increased charge is eventually directed towards the upgrade of security checks for passengers to all destinations, it is unclear why international passengers should contribute greater sums than domestic or transborder passengers. To be considered as a charge rather than a tax, an air transportation levy should be commensurate to the cost of the provision of the service. The security check services provided by CATSA are not more than three times more rigorous for international passengers as compared to domestic passengers, and most certainly not twice as costly for international passengers as compared to transborder passengers. Indeed, the fact that the sum owed by a passenger for identical CATSA services when travelling Montreal to New York will depend on whether or not s/he has an onward flight from New York underlines the function of the charge as a disguised luxury tax, which presumes that international bound passengers are more able to afford higher charges, and have a lower price elasticity. European-bound passengers are amongst the most severely hit by these new policies. Airfares to Europe can often be cheaper than transcontinental domestic and transborder flights, and the huge majority of other international destinations. Thus, the security charge for European bound passengers will in most cases be the highest percentage of the ticket price amongst all passengers.

The overall effect of the Canadian policy on security charges is to dampen demand for transatlantic services. International passengers are being used to subsidize upgrades to security systems for domestic and transborder passengers. This wealth redistribution is unjustified and inconsistent with the goals of the Canada-EU Open Skies Agreement which is seeking to reinvigorate transatlantic services. Domestic airlines may be satisfied with the *status quo* since they may perceive that demand will be less affected on international routes than if the fully allocated costs of the program were shared equally amongst all

passengers. However the long term outcome of this policy will be to suppress international connectivity from Canada to Europe and beyond, and potentially bolster Europe-United States services.

The Canadian approach to user charges of air travel services is inconsistent with the medium and longer term interests of the national economy. Foreign connectivity stimulates international trade and exchanges. Whereas Canada is on the one hand promoting the liberalization of air services through its open skies policy, while on the other it is stifling sectoral growth by imposing excessive charges which dissuade the increase of European and beyond foreign air service.

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<sup>1</sup> Agreement on Air Transport between Canada and the European Community and its Member States, online: EU Air Transport Portal

<[http://ec.europa.eu/transport/air/international\\_aviation/country\\_index/doc/canada\\_final\\_text\\_agreement.pdf](http://ec.europa.eu/transport/air/international_aviation/country_index/doc/canada_final_text_agreement.pdf)>.

<sup>2</sup> The European Union and the United States signed an Open Skies Agreement in March 2007 which took effect from 30 March 2008. The text of the agreement is available online: EU Air Transport Portal <<http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2007:134:SOM:EN:HTML>>.

<sup>3</sup> Regulations, EC, Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community [2008] O.J. L 293/3. Art. 23 requires that all air fares from Community airports be advertized inclusive of mandatory taxes, charges and fees.

<sup>4</sup> Airport Transfer Act S.C. 1992, c. 5.

<sup>5</sup> Michael W. Tretheway & Robert Andriulaitis, "Airport Policy in Canada, Limitations of the not-for-profit Governance Model" in Clifford Winston & Gines de Rus eds., *Aviation Infrastructure Performance. A Study in Comparative Political Economy* (Washington D.C: Brookings Institute, 2008) 136.

<sup>6</sup> Ibid.

<sup>7</sup> As not for profit corporations, the LAAs and CAAs had no start up capital and thus could not find affordable debt-based financing for major regeneration. Capital had to be generated by internal profit-making through the increase of user fees for usage of substandard facilities to a level which permitted the accumulation of capital reserves to finance future improvements.

<sup>8</sup> Transport Canada, News Release, "Government of Canada Cuts Airport Rents" (9 May 2005), online: Transport Canada <<http://www.tc.gc.ca/eng/mediaroom/releases-nat-2005-05-h098e-4847.htm>>.

<sup>9</sup> See Tretheway & Andriulaitis supra note 5.

<sup>10</sup> ICAO's Policies on Taxation in the Field of International Air Transport, ICAO Doc. 8632.

<sup>11</sup> "Pearson reducing landing fees" CBC News (17 October 2007) online: CBC News <<http://www.cbc.ca/canada/toronto/story/2007/10/17/pearson-fees.html>>.

<sup>12</sup> "Pearson Airport adds \$10 fee to tickets" *The Record* (20 March 2001) B6.

<sup>13</sup> Air Travellers Security Charge Act, S.C. 2002, c. 9, s. 5.

<sup>14</sup> Transport Canada, News Release, "Government of Canada Enhances Air Traveller Security" (25 February 2009), online: Transport Canada <<http://www.tc.gc.ca/eng/mediaroom/releases-2010-h025e-5847.htm>>.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.