Intelligence MEMOS

From: Barry Prentice

To: Trade Observers

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Re: **Let's Let More US Airlines Into Small Canadian Centres**

The Competition Bureau's new report on the airline industry gets things mostly right.

Perfection in transportation policy is an elusive beast. Consumers want lower fares, more options and better-quality service. As the old joke says, you are welcome to choose any two.

The Bureau addresses two separate cases. The first is air transport in the highly urbanized south of Canada, home to 11 cities over 500,000 people and 10 more over 250,000. Generally speaking, people here have reasonable access to two large carriers (WestJet and Air Canada) and also, for some, Porter and Flair.

The second market, in the North, consists of 294 fly-in communities and a handful of small centres with paved runways. Residents face minimal choice and airfares that are (sorry!) sky-high.

The source of the problem is network economies. The larger the network, the more convenient to the consumer and the greater the operating efficiency. But how many airline networks can a country with Canada's geography support?

With Canada's population strung out along the US border, the air passenger networks serving the urban south overlap. The two largest carriers have evolved western and eastern hubs, with smaller players competing mainly at the major airports.

The Competition Bureau recommends opening the domestic market to more foreign investment. They would allow 100-percent foreign ownership, with a maximum of 49 percent for any single investor, and they would enable smaller local airports near large ones to offer international service, which is now restricted.

The Bureau also recommends negotiating "cabotage," which would allow foreign airlines to pick up and drop off passengers on Canadian segments of their international routes, provided Canadian airlines were allowed to do the same in these airlines' home countries. That would certainly create competition. But the only logical partner is the United States and Americans have never been interested.

Recommendations for the North are more muted. Distances are so great and population so sparse that even the limited network that exists today is endangered. At best, relaxing some regulations and leveraging infrastructure investment could reduce costs. At bottom, however, the North is only able to support what it currently has because so many fares are for public servants.

The Bureau heard consumers grumble about the higher cost of domestic service versus foreign, high airport fees, inadequate passenger protections and lack of price transparency. These complaints aren't new and can generally be traced back to regulations, fees and taxes. They also aren't likely to change.

A third market the Bureau might have looked at is the population spread out along the border in communities of 250,000 or less. At the moment, it is very hard to get from these places to cities of similar size or larger in the United States and Canada. A person living in Thunder Bay, say, who wants to get to Duluth, Minnesota, would have to fly to Winnipeg, then Minneapolis and finally Duluth. There are many such cases. Winnipeg travelers wanting to get to Fargo, North Dakota would need to fly past Fargo to Minneapolis and then back to Fargo.

Limited cabotage could solve this problem. We could allow US airlines that fly airplanes of fewer than 65 seats and less than, say, 1,000 km from the border to create efficient routes connecting small cities in Canada to their counterparts across the border. Consider Kingston and Cornwall linked to Syracuse, New York. Or Kamloops and Lethbridge linked to Spokane, Washington. Or Saint John and Sherbrooke linked to Portland, Maine. Many of these "isolated" border communities are economically depressed and losing population. Better air service would help them attract investment and tourism.

The Competition Bureau realizes that negotiating any kind of cabotage for US airlines faces hurricane-force headwinds on both sides of the border. But why don't we give it a try and be first movers? Let's grant limited cabotage to the United States unilaterally and then, whether sooner or later, encourage them to reciprocate. There could be cross-border economies both ways.

There is a precedent in trucking. When the United States deregulated its trucking industry in 1981 it allowed Canadian trucks 48-state access. It wasn't until 1987 that Canada returned the favour to U.S. truckers.

Creating a competitive environment for small regional air carriers would not threaten our large national carriers or anyone else and it would bring significant benefits to under-serviced border towns. It would be win-win-win.

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To send a comment or leave feedback, email us at blog@cdhowe.org.

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