## Introduction: The Importance of the Canadian Airline Industry

In today's highly advanced and globalized society, the Canadian airline industry is crucial to the country's economy. Although Canada's largest trade and business partner and, perhaps, vacation destination is the United States, which can often be accessed by car, truck, or train, the airline industry remains vital to Canadian business operations as they continue to expand in order to reach more locations and to exploit the competitive advantages that other countries have to offer. Airlines encourage economic growth and development by providing a quick, efficient means of transportation across the vast country and around the world. For many years, Canada's airline industry was led by the federal government on behalf of the Canadian people. Routes, performance standards, and airfares were controlled by a government agency to ensure that Canadians enjoyed safe and fair-priced air travel. The purpose of regulation was to avoid wasteful and destructive competition among companies, to help the aviation industry grow, and to provide a broad range of national airline services to consumers at the best possible price. However, like all airlines around the world, Canada's carriers eventually faced numerous problems caused by high fuel prices (Appendix 1), worldwide recessions, and decreased demand. Furthermore, government control seemed to foster the stagnation of the industry, which did not have to be creative or innovative in order to remain competitive. Following the example of the United States, the Canadian government decided to deregulate the industry. Although the goal of deregulation was to achieve cheaper airfares, greater frequency of flights, and better service, it has resulted in serious problems, including overcapacity and destructive competition. Since the Canadian airline industry, an integral part of the Canadian economy, has experienced serious problems in a regulated market as well as under deregulation, only a collaborative effort by the government, airline executives, investors, and consumers can stimulate the industry and improve profitability.

**Background: The Birth of Canada's Airline Industry**

Actual air travel in Canada began in 1919, after the First World War. Pilots were eager to continue flying and demanded government intervention in the airline industry. James Richardson, who "was convinced that airline transportation would enable the development of then-untapped mineral resources at least twenty years sooner than would otherwise have been possible because planes could fly year-round" (Goldenberg 2), formed Western Canada Airways (WCA) in 1926. By the early 1930's, the Canadian airline industry was dominated by smaller, regional bush airlines, which flew through Canada's unpopulated northern forestlands. These airlines included Canadian Pacific Airlines (CP Air), WCA, and Pacific Western Airlines (PWA). Air travel was considered an essential link between Western and Eastern Canada because it created a more convenient way of traveling and would, therefore, stimulate the development of the Canadian economy. In fact, some carriers already provided services between western and eastern communities, with a smaller base in the North. However, Canada's lack of financial resources due to the Great Depression and its sparse population made it extremely difficult for the government to launch its own airline at that time.

Federally run Trans-Canada Airlines (TCA) began operations in 1937 under the direction of Clarence Decatur Howe, whose "business experience, intelligence, energy and toughness all helped him in the challenging task of developing a national airline" (Goldenberg 4). Howe wanted both the government and private enterprise to control the airline, especially for investment purposes. Richardson, on the other hand, was vying for private ownership of airline companies. Thus, the stage was set for the battle between a regulated industry and one in which all carriers had equal access to routes. This battle would rage for many years.

Another important development in the airline industry occurred in 1942, when Canadian Pacific asked the government for permission to merge Canadian Airways with TCA. The

government, led by William Lion Mackenzie King, refused the proposal and later announced that TCA was the government's chosen company to operate international air services and all transcontinental flights (Johnson 1). This meant that the Canadian airline industry would begin its development without intense competition. On one hand, TCA could operate without any fear of intense rivalry in the airlines market. On the other hand, decreased competition led to a number of serious problems in later years.

In the meantime, CP Air was growing under the control of Grant McConachie, who was "a dynamic personality …[and] one of the most remarkable figures in Canadian aviation" (Goldenberg, 10). Under McConachie's direction, the company underwent more intense restructuring in the 1940s. Over the course of McConachie's twenty-year tenure as the head of CP Air, his constant argument with the government concerned restricted competition in the air market. Even though the airline was considered to be less prominent than TCA, McConachie was able to make CP Air an international airline by securing flights to Australia, Hong Kong, and Amsterdam. Furthermore, between 1942 and 1964, McConachie was able to raise the revenues at CP Air from $3 million to $61 million (Goldenberg 10).

In 1948, TCA selected a new president, Gordon McGregor, to replace Clarence Howe. During McGregor's era, the airline did exceptionally well, experiencing losses for only five years (Goldenberg 13). McGregor emphasized the fact that TCA had faced competition well before CP Air was given transcontinental rights because the airline "had been more than holding [its] own for years against the tough competition of the U.S. services on trans-border routes, and numerous other trans-Atlantic carriers" (Goldenberg 13). However, TCA had the monopoly on all domestic transcontinental routes between 1937 and 1959 (Sinha 57). In 1965, under McGregor's presidency, the name Trans-Canada Airlines was changed to Air Canada to demonstrate that the airline no longer operated exclusively within Canada.

A third company, Pacific Western Airline (PWA), was also emerging as a powerful rival. Russ Baker, another successful pilot, had founded the airline, as Central British Columbia Airlines (CBCA), in 1946 and, when Alcan started constructing an aluminum smelter in Kitimat, B.C. in 1949, CBCA was responsible for most of the airlift required to build the site (Goldenberg 17). That business allowed Baker to rapidly expand the airline. Over the next decade, Baker acquired eight small B.C. based airlines and, in 1953, the group of companies took on the name Pacific Western Airlines. In the late 1950s, PWA and CP Air were concerned about TCA's monopoly in the transcontinental market. In return for CP Air's Mackenzie River route through northern Alberta to the Northwest Territories, Baker supported CP Air's bid to acquire a transcontinental route (Goldenberg 18). This move by Baker was somewhat successful because CP Air was awarded one flight per day from Vancouver to Montreal. As a result, TCA's monopoly on transcontinental flights was broken and the other airlines, including PWA, were in a better position to compete.

**Impact of Regulation of the Airline Industry**

Although the Canadian government had exercised some control over aviation since 1919, widespread regulation of the airline industry did not begin until 1938, with the passing of the Transport Act (Sinha 56). Several factors led to this move. Air travel was considered essential for economic development and, with national and regional integration, an adequate air transportation system could be provided to serve the public as effectively as possible (Lazar 25). It was also believed that the lack of outside competition would facilitate the development of Canada's airline industry, which was in its infant stages. Furthermore, social concerns over safety standards contributed to the decision to regulate the industry. The fear was that, when revenues in an unregulated industry were low, safety standards would be relaxed and problems

would occur (Button 55). The failure of specific markets to produce and allocate goods efficiently provided another reason to regulate the industry. A regulated airline industry was expected to be the most effective way to run airline operations (Williams 105). A final argument for regulation was that, in a regulated market, airline companies would not need to spend money on preventing competition or entry into the market by foreign carriers. Money could, therefore, be spent on providing better service. All of these reasons had led to the creation of federally-run Trans-Canada Airlines, which would see its fares controlled by cabinet until the 1980s (Williams 94).

TCA exercised a monopoly over domestic flights and the carrier controlled transcontinental flights for years until Canadian Pacific Airlines entered the market in 1942 (Goldenberg 149). When CP Air received carrier rights in the Pacific, a two airline international system was born. Regional markets served by different carriers were created in 1966, but were not allowed to compete against the two major airlines (Williams 94). This unique system appeared to be quite effective in Canada. There was financial, scheduling, and service stability. Overcapacity, the result of excess flights on the same route, was minimal. The regulated industry seemed to provide fine services and minimized head-to-head competition (Skene 16).

Although regulation of the airline industry was originally considered to be a positive move, it posed serious problems. Studies conducted by researchers in the United States in 1965 and 1970 revealed that, on average, fares were higher in a regulated market than in a market that was deregulated (Williams 107). This led advocates of deregulation to argue that competition could prevent market exploitation, allow for greater efficiency, and improve airline performance (Button 55). Competition would force airline companies to become more efficient or face extinction. Increased efficiency would then improve airline performance and consumers would ultimately benefit. There was less incentive for efficiency in a regulated industry and chosen

carriers could afford to sit on a virtual monopoly because lack of competition meant that there was less need to streamline operations. Consequently, there were few savings to pass on to consumers. Regulation was also supposed to provide better access from small towns to larger markets. However, by 1984, only four communities of less than twenty-five thousand people were serviced by Air Canada (Goldenberg 46). Furthermore, in Canada's regulated market, prices were controlled by the government and took a lot longer to be changed than would have been the case in a deregulated market, where individual airlines would have been free to set whatever prices they wished. Aware of the discount fares offered in the deregulated American market in the late 1970s, Canadians believed that increased competition would have similar results in Canada. The number of airline carriers available to consumers was also a lot lower in a regulated market (Sinha 58). This prevented overcapacity, but it also meant less competition. A more recent argument against regulation is that it does not allow much foreign ownership in airlines and prevents foreign companies from providing domestic flights. For example, United Airlines, an American carrier, is not allowed to conduct flights from Toronto to Vancouver (Corcoran 1). Once again, this results in less competition on that route and prices remain high.

It is evident, therefore, that regulation of the Canadian airline industry had mixed results. There was a considerable degree of financial stability since losses were only experienced in 1982 and 1985, which were recession years when all industries were adversely affected (Goldenberg 68). In fact, in 1980, Air Canada had a record profit of $57 million (Won 1). Overcapacity was also kept to a minimum. Fare prices remained competitive with those of the United States until that market became deregulated. Nevertheless, not all the outcomes of Canada's regulated market were positive. Regulation did not result in better service for citizens of smaller communities. The lack of discount fares also meant that Canadian consumers were not offered the lower prices enjoyed by their American counterparts. Since regional carriers were subject to

government regulation and could not compete with the major airlines, fewer carriers offered services to Canadians. These carriers only remained in business due to the complementary services they provided to larger airlines (Williams 95). Although regulation had numerous advantages, the government was under great pressure to deregulate the industry. Consequently, in 1988, the National Transportation Act deregulated government route and price controls (Goldenberg 151).

**Impact of Deregulation of the Airline Industry**

The government originally regulated the airline industry because it was an integral part of an efficient transportation system that was essential to the economic development of a country as vast as Canada. The number of firms was controlled, as were the prices they charged, and the ways in which they were allowed to compete (Lazar 13). However, the sharp rise in fuel prices triggered by the Organization of Petroleum Exporting Countries (OPEC) in late 1973, several recessions, and levelling off of passenger traffic growth all contributed to the destruction of the relative stability the industry had enjoyed for many decades (Skene 18). The American Congress reacted to the problems by introducing the Airline Deregulation Act in 1978 (Skene 42). The goal of deregulation in the United States was to make the airline industry more efficient and profitable and to give the travelling customer a price break (Skene 43). Hoping to enjoy the deeply discounted fares available in the United States, the Canadian public urged the government to deregulate the airline industry. At first the government responded by encouraging the airlines to offer discounts of up to 35 percent (Goldenberg). However, these seats were limited and required much in-advance booking. The Canadian government deregulated the industry a decade after the U.S. in response to the belief that a perpetual monopoly for the government-owned carrier, Air Canada, was unacceptable (Skene 18).

Advocates of deregulation assume that competition is viable in the airline industry and that competitive markets are inherently stable (Lazar 14). The Economic Council and the Department of Consumer and Corporate Affairs put forth three main arguments for deregulation. First of all, since there are no economies of scale in the Canadian airline industry, entry barriers are minimal. Secondly, competition creates the necessary pressures for efficiency and lower overall costs and fares. Finally, competition increases the number of fare/quality options in the marketplace (Lazar 133). An integral part of deregulation is free entry. Allowing free entry into the market will drive existing firms to price competitively and offer the types of price service options consumers desire, as dissatisfied consumers are a cause for new entrants into the market. Entry need not actually occur for its threat to be an effective incentive (Lazar 28).

The initiative toward deregulation was called "Freedom to Move". Airline employees strongly opposed "Freedom to Move", citing cases in the United States to illustrate that deregulation leads to further concentration of the industry, job losses, bankruptcies and instability (Goldenberg 53). However, advocates of deregulation dismissed arguments relating to network imbalances and market chaos, believing that the economic performance of the airline industry would improve in the absence of regulatory constraints. In spite of the arguments raised by economists and airline employees, and regardless of the example of the United States, the Canadian government still supported deregulation. Liberalization of the Canadian airline industry began in May 1984, when the government deregulated the airlines in the densely populated south, but not in the sparsely populated north (Sinha 58). Although the National Transportation Act introduced almost total deregulation in Southern Canada in 1988, entry into the Canadian markets and aspects of rates and fares remained under the control of the Air Transport Committee (Sinha 58).

"Deregulation, particularly of Canada's airlines, made as much sense as holding the Stanley Cup playoffs without referees. Like them or not, referees were there, as were government regulators, to keep the players from mutilating and maiming each other" (Skene 20). In the case of the airline industry, the mutilation was the result of overcapacity and destructive competition. During the 1980's, the Canadian airline industry was transformed through a series of mergers and acquisitions. Canadian Pacific Air acquired Eastern Provincial Airways, Nordair, and Quebecair, and was then bought by Pacific Western Airlines (PWA). PWA went on to buy out Wardair, which catapulted it to Canada's second largest airline and put it in direct competition with Air Canada, resulting in a duopoly such as the one with which the decade had begun (Goldenberg 43).

At the end of 1991, Canada's two major airlines carried a debt totalling $4.5 billion, and their debt-equity ratio was a staggering 3.65:1 (Skene 23). Furthermore, while other major carriers around the world were unloading expensive commitments, the Canadian carriers still had over $3.1 billion in future aircraft contracts (Skene 23). This is an example of overcapacity caused by companies that order too many new planes and do not have enough routes to use them all. Overcapacity also occurs when airline companies have too many carriers or too many seats given the demand. When the industry was regulated, the government set the number of flights per day, thereby limiting capacity. Under deregulation, market forces determine the number of flights and types of planes used. Since Canadian carriers often fly to the same destinations at the same times, the planes are seldom full and profits are either marginal or non-existent. In 1992, as the worldwide industry lost U.S.$4.8 billion, the two Canadian carriers lost more than 11 percent of the world's total, even though they represented less than 3 percent of the global airline business (Skene 22). The airlines would have benefited by avoiding price-cuts. However, they fell victim to destructive competition, which is another serious problem caused by deregulation.

Destructive competition caused the operations of the companies involved to be driven by one-upmanship rather than demand (Verburg b 73). Thus, many Canadians were traveling on discount fares less than cost as the two major Canadian carriers had locked themselves into a travel war by cutting fares. The situation continued to deteriorate to the point where the combined debt of the airlines was in excess of $7 billion with a debt-equity ratio of 15:1 (Skene 34). To this day, Air Canada has maintained its market-share mentality, copying “virtually every route, frequency and fare offered by Calgary-based Westjet Airlines Ltd. (WJA), [and] losing hundreds of millions of dollars in the process” (Verburg b 73).

As it became more apparent that Canadian Airlines International was heading toward insolvency, a proposed merger with the ailing Air Canada sparked fear in the industry. Although it seemed like the logical solution, the merger would leave the entire domestic industry in the hands of one company and make a mockery of deregulation in Canada because the country would once again be heading toward a single, national carrier. The merger also meant that Canadians faced the prospect of higher fares, less service, and no one to whom they could complain. Furthermore, employees of the airline industry feared large job cuts. The country had started with one transcontinental air carrier dominating the market, and now it had one private carrier doing the same. Air Canada’s monopoly position permitted it to tell Canadians where they could fly and for how much (Skene 32). Deregulation promised more airlines competing for business, cheaper air fares, greater frequency of flights, better service, and a stronger airline industry. However, what Canadians actually received was very different. The results of deregulation included fewer competing airlines, unaffected fares, less service on most major routes, and a domestic industry on the verge of collapse (Skene 19).

**Current Situation in Canada's Airline Industry**

The Canadian airline industry has experienced several problems throughout its history, but the worst undoubtedly have occurred in the last few years. A combination of internal and external factors have led Canada's largest airline, Air Canada, to file for bankruptcy protection. Therefore, the current troubles do not exist in isolation but are the cumulative result of all the factors that have influenced the industry over the years. These factors include competition, decreasing demand, rising costs, and external forces.

Historically, Air Canada has dominated the domestic market. When Air Canada acquired its largest competitor, Canadian Airlines, there were concerns that Canadian consumers would not benefit from the effects of healthy competition, which would have produced higher quality and lower prices (Von Finckenstein 1). Thus, the options for Canadian travelers would be significantly reduced. Although this was initially the case, competition has increased considerably in recent years. The emergence and growth of other domestic airlines have forced Air Canada to give up forty-two peak hour slots at Pearson International (Von Finckenstein 1). In addition, Canada's leading discount airline, WestJet, has received access to Hamilton's airport in order to enter markets on the East Coast. Although Air Canada remains the dominant company in terms of size, it is facing increasing competition from WestJet and other carriers such as JetsGo and CanJet (Appendix 2). In the last year alone, WestJet has increased the number of flights and destinations and has expanded to the West Coast. The company now has access to all major Canadian cities. As Westjet expands, its growth will naturally decline and it is expected that operating costs and competition will challenge its bottom line (Paddon 1). Nevertheless, the carrier's profitability bodes well for the domestic industry.

The success of Air Canada's domestic rivals has partly been achieved at Air Canada's expense. However, the problems that Air Canada is facing today go beyond the effects of

competition. After merging with Canadian Airlines, Air Canada had to prevent a hostile takeover attempt by the Onex Corporation. Following that, there was a sudden collapse in business travel as major customers, such as Nortel Networks, had to cut back on traveling in response to a weak economy (Paddon 2). Another problem has been the fact that the airline industry has been highly protected since foreign airlines have been kept out of the domestic market and foreigners are prevented from gaining control over Canadian airlines (Paddon 2). There are a limited number of take-off and landing slots at certain airlines. Furthrmore there are tight rules regarding the size a foreign market must be in order for a second Canadian carrier to serve it. These factors have all contributed to the lack of efficiency within Air Canada.

In addition to the internal problems plaguing Air Canada and the rest of the industry, there have been a number of external forces, such as the terrorist attacks of September 11, 2001 and the outbreak of SARS in 2003, that have contributed to its weakened state. Consumer demand for air travel decreased after September 11, 2001, since passengers no longer felt safe. Within days of the attacks, Air Canada revenues were down 60% and bookings for future flights were down 30% (Verburg b 73). This led to significant losses that did not end in 2001 (Appendix 3). In order to restore consumer confidence and prevent another tragedy from occurring, airlines have put into place a number of security procedures, with the emphasis on more intense passenger screening. Consequently, the industry has faced a pattern of falling demands and rising costs, which have created large financial losses. In fact, Air Canada has lost $2 billion since 2001, in addition to billions in losses that built up during its years of competition with Canadian Airlines (Canadian Auto Workers Union 1). Air Canada was particularly affected by the SARS outbreak because its flights extend both to Hawaii and to Asia. Consequently, Air Canada's Pacific business fell off, and people stopped traveling to Toronto during the outbreak. In fact, the airline incurred an operating loss of $400,000 a day, down from $5 million a day

(McArthur a 1). Like the terrorist attacks, SARS created psychological effects that instilled panic and hesitation in flight passengers, leading to a decrease in bookings and revenue.

Besides reduced demand, airline companies faced excessive hidden costs and taxation. These fees are increasingly difficult to pass along to customers who are traveling less and are already fed up with high travel costs. Some of the major hidden charges include airport rents, the Air Traveler's Security Taxes, and the Federal Excise Tax on fuel. Airport rents have increased by 430% in seven years according to the Canadian Airports Council (Milliken 1). Although these fees are passed along to travelers through airfares, they represent straight cash generators for the government, since they are not reinvested into the air transportation sector. Airline security in Canada has recently been enhanced with the use of strengthened cockpit doors, armed sky marshals, as well as more intense policing at airports. However, these additions have resulted in taxes that are among the world's highest. Finally, the Federal Excise Tax on fuel represents a devastating blow to the airline industry because it extracts between $70 and $90 million each year from the system (Milliken 1).

As a result of the significant losses and challenges faced by the Canadian airline industry, Air Canada has filed for and been granted bankruptcy protection from its creditors. The company is determined to do all in its power in order to restructure itself and to evolve into a profitable and internationally competitive airline. However, the profitability of one or two companies is not enough to carry the success of the entire industry. Steps must be taken and policies must be put into place in order to restore the airline industry to the lofty place it deserves in the Canadian economy.

**Possible Alternatives**

The Canadian airline industry has experienced serious problems in a regulated market as well as under deregulation. Given the industry's importance to the country's economy, the government must consider the possible alternatives for the future in order to choose the one that will solve the greatest number of problems while keeping the disadvantages to a minimum. The first and easiest alternative would be to leave things as they are. This involves continuing to promote competition, limiting foreign ownership, and encouraging user fees rather than providing government bailouts. As a result, Air Canada and its competitors would have to be more creative and efficient, while making cost-effective business decisions. In fact, limited government bailouts have already forced Air Canada to seek bankruptcy protection as it attempts to "restructure its debt and go through an extensive and fundamental overhaul" (Ward 12). Although this alternative would appear to save the government money, the user-pay approach means increased airline fees, such as security and fuel taxes, which decrease demand and reduce profitability. The industry suffers further losses and the economy is subjected to more pressure. Consequently, the government is seeking ways to alleviate the burden placed on customers. In 2003, for example, the government implemented a forty-two percent reduction of the air travel security tax for flights within Canada (McArthur b B7). Nevertheless, since the industry is still having difficulty stimulating air travel with low fares, further government involvement in the Canadian airline industry is necessary.

A second alternative would be to implement greater regulation or to return to total re-regulation. This would allow the government to reduce overcapacity by controlling ticket prices and flight destinations, thereby increasing demand. A step towards greater regulation of the industry was taken when the government tabled legislation that would force Air Canada to "interline" (McArthur c B5) passengers with smaller carriers on international routes. Interlining

refers to the seamless transfer of passengers and their cargo between airlines. Advocates of greater regulation argue that deregulation has not effectively increased competition or lowered prices for customers. In fact, when Air Canada acquired Canadian Airlines in 2000, Bill C-26 was created "to put some checks and balances in place to maintain healthy airline competition" (Cordon a 1). The desired healthy competition did not occur. However, re-regulation could reduce or eliminate the trends of mergers and downsizing that occur when airlines are exposed to market forces. Increased regulation would also indicate that the government has confidence in the industry and would, in turn, make the industry more stable and more attractive to investors. The added capital would help to cover the costs incurred by the industry that may not otherwise be affordable during periods of weakness (Ward xi). In spite of these benefits, re-regulation of the industry would entail its own problems. Since regulation increases exposure to political influence and bureaucracy, fewer entrepreneurs would be encouraged to enter the market. The industry would need more taxpayer bailouts. There would be less local control because regulators, not users, would make the decisions. Most importantly, however, it would be impossible to control only one aspect of the economy without exerting stronger control over other sectors that have been liberalized or privatized. Thus, re-regulation alone is not enough to solve all the industry's problems.

A third alternative would be to relax limits to foreign carriers. The government could create reciprocal or unilateral agreements. Reciprocal agreements would allow Canadian airlines and foreign airlines to compete freely in each other's market. Unilateral agreements, on the other hand, would allow foreign competitors access to the Canadian market but Canadians could not compete in the foreign markets (Ward 37). Both types of agreements would integrate the Canadian industry with the global industry, increasing demand and competition. Reciprocal agreements would open up a greater market for Canadian airlines that have always operated in a

country with a relatively sparse population. Carriers would compete for flights to more distant and lucrative destinations. Smaller Canadian airlines, such as WestJet, would have the incentive to expand services, resulting in more jobs, while customers would have greater choice at a lower cost. One problem posed by this alternative, however, is that users might have to travel through an American hub, which would entail security issues. Furthermore, negotiations with other countries could take years, leaving the industry with no immediate solution (Ward iii). Even if negotiations could be finalized within a reasonable time frame, the fact remains that foreign carriers might consider the Canadian market too small. Should foreign airlines decide to participate in the Canadian market, they would most likely select the most profitable routes, leaving the less profitable ones to the Canadian airlines (Cordon a 2). Finally, unilateral agreements would ultimately result in even greater overcapacity in the Canadian market as airlines fought for popular routes. Small carriers that lack sufficient capital to compete on a level playing field would be powerless against large foreign companies, and would have to cease operations.

A fourth alternative would be to establish programs to encourage investment, expansion, and growth in the industry. The government could provide loan guarantees to struggling airlines, or airlines trying to expand, in order to offer a greater number of flights or better service to small Canadian communities. The maximum amount of foreign ownership could be increased from 25% to 49% because foreign investors are less likely to invest "without having control of the boardroom" (Verburg b 77). This alternative would provide more capital, which encourages expansion in good economic times and covers expenses during recessions. Although the airlines would have a bigger safety net, operations would continue to be controlled by Canada, resulting in more jobs for Canadians. Like the other alternatives, however, this one also poses several problems. If the barriers to entry were removed, there would be more competitors and greater

overcapacity. There would also be few immediate benefits because investors would have to be convinced of the prospects for a decent return on their investment. Even if foreign investors were to increase their presence in the industry, they would most likely invest in more reputable and established carriers. Thus, smaller airlines would find it even harder to compete with larger companies that have access to more capital, and they might be forced to cease operations and lay off workers.

The government could also increase demand by lowering costs associated with offering flight service. User fees could be reduced by sharing security fees rather than passing them directly on to the users. Lower fuel taxes would improve the profitability of Canadian airlines. A reduction in the cost of renting land for airports could be passed on to consumers and would create greater demand and make the airlines more profitable and competitive on a global scale. In fact, the government has examined “a cap on the $250-million a year it makes in rent from airports” (Fitzpatrick FP6) because airlines were looking at possible double-digit increases in these rents. Of course, this alternative hinges on the assumption that any savings would be passed on to the consumers. There is no guarantee that this would happen.

The sixth alternative would be for the government to enact policies to stimulate growth in the travel industry and in the economy as a whole. Airline industry experts have argued that “a long list of tax breaks [is] needed to help the troubled industry” (McArthur b B7). Increased tax breaks, with respect to airline travel as well as to other sectors of the economy, would leave consumers with more disposable income. More income would lead to increased use of airlines for business and pleasure. This, in turn, would mean that airlines could acquire more resources while remaining profitable. A major problem with this alternative, however, is that there would be a great deal of controversy as to which sectors are deserving of tax breaks. The debate could

delay action so there would be no immediate solution. Furthermore, the Canadian economy is too complex to be stimulated by only a few policies.

**Best Solution**

There is no single alternative that will solve all of the problems faced by the Canadian airline industry, nor can the government alone rescue it. In order for the industry to recover, a number of changes must occur, which require the co-operation of the government, airline executives, investors, and consumers. Executives must focus more on profitability rather than market share. Employees must moderate wage and job security demands in order to avoid future job losses. Consumer confidence in airline safety must be restored so that revenues will recover. Increased security measures have already been put in place towards this end.

As a major stakeholder, the government must undertake a number of initiatives in order to create an environment for stability and profitability. The government could work with other stakeholders to identify areas of the industry with which they are unfamiliar so that they could receive appropriate information in order to make effective decisions and avoid errors in the future. The industry could remain deregulated, but the government could create safety nets to protect the industry during weak periods and to ensure that user fees do not become prohibitive. However, the safety nets must be minimal so as not to discourage independence, creativity, and efficiency. Maximum foreign ownership could be increased to 49 percent (Cordon b 2) in order to encourage greater foreign investment. In fact, Hong Kong's Victor Li has been granted a 31 percent equity stake in Air Canada for $650 million (Verburg a 11). The government must also study ways to improve service to smaller communities so that their economies could grow and become more diverse. Finally, Canada's largest air carrier, Air Canada, must continue to make drastic changes in order to pull itself out of bankruptcy protection. Some of these changes might

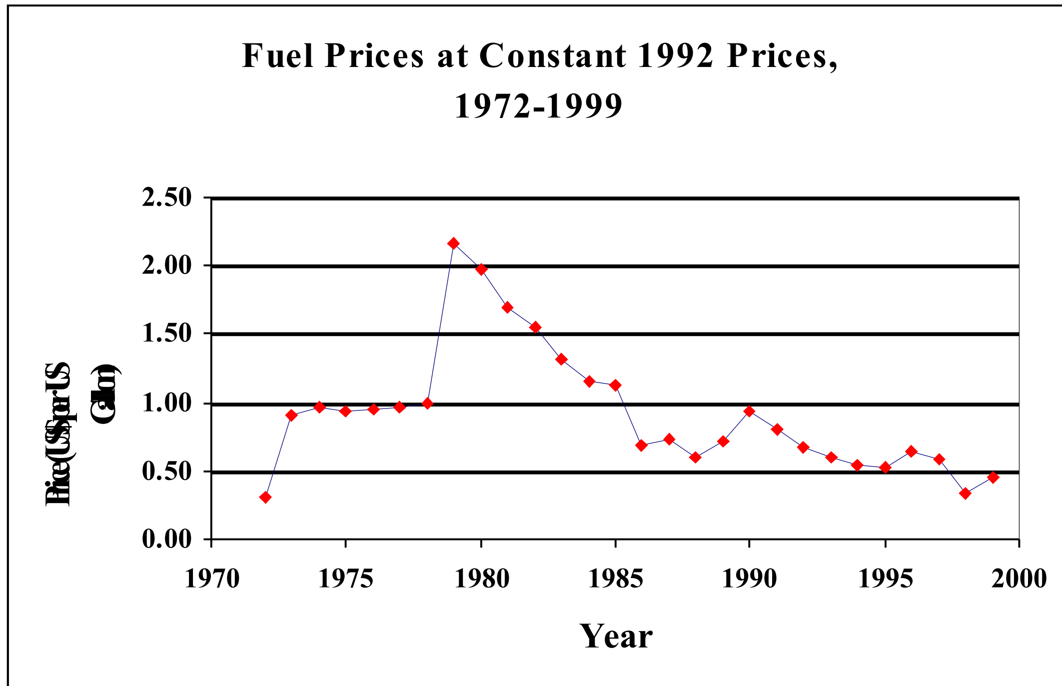
include overhauling the board and hiring new management. Mr. Li's investment is a step in this direction. By focusing on international flights, the company could also reduce domestic capacity and increase competition. Thus, the co-operation of the government, airline executives, investors, and consumers would begin to restore faith in the essential, but faltering, Canadian airline industry.

## Conclusion

For many years, Canadian airlines have struggled to continue operating. Mergers, acquisitions and bankruptcies have become commonplace. Countless jobs are in jeopardy and small, remote communities risk losing a vital link to the rest of the country, thereby facing the death of their economy. Furthermore, the industry's problems were magnified following unforeseen events such as the terrorist attacks in New York, the onset of the war in Iraq, and the outbreak of the SARS epidemic. As a result, Canada has seen the demise of several prominent carriers. Although one of the goals of deregulation is decreased government intervention, the industry is too vital to Canada's economic future for the government to stand by and watch Canada's airlines succumb to failure. Effective and efficient solutions must be planned and implemented in order to minimize the damaging effects of the challenges faced by the airline industry. Policies must be enacted to create an environment that fosters stability and profitability. However, the government alone cannot rescue the Canadian airline industry. Airline executives, foreign and domestic investors, employees, and consumers must all co-operate. Nothing short of a major concerted effort among stakeholders, combined with a set of logical and cohesive government policies, will fully alleviate the burdens faced by the Canadian airline industry.

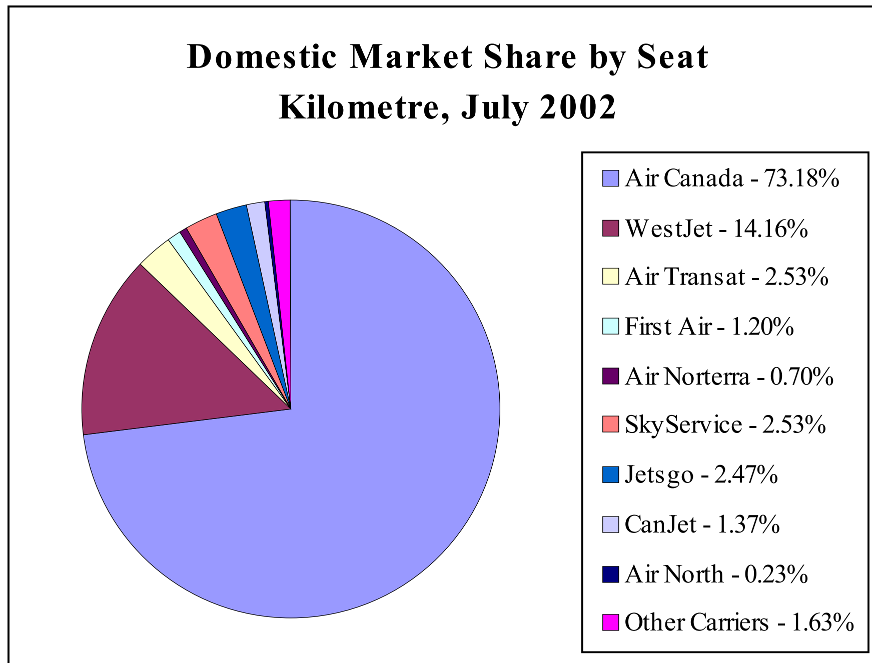
## Appendix

### Appendix 1: Fuel Prices at Constant 1992 Prices, 1972-1999



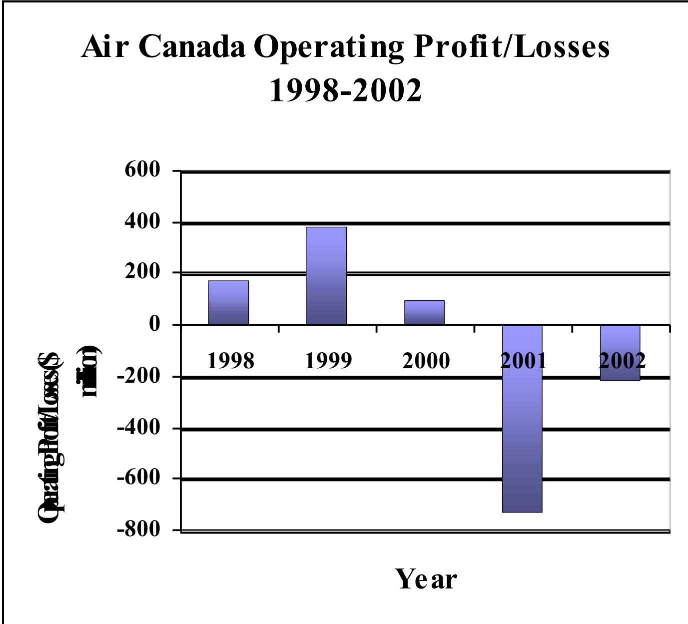

Source: (Doganis 7)

**Appendix 2: Domestic Market Share by Seat Kilometre, July 2002**




Source: ("Domestic, International and Transborder Markets" 2)

**Appendix 3: Air Canada's Revenues Compared to Profits/Losses, 1998-2002**




Source: (Bloom B5)

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