

Canadian-EU Bilateral Air Service Agreements

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CANADIAN-EU BILATERAL AIR SERVICE AGREEMENTS

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“No scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization.”

Chicago Convention, Art. VI¹

INTRODUCTION

The basic legal, economic, and institutional framework for international air transport was established in 1944 at the Convention on International Civil Aviation. During the conference that produced the Chicago Convention, the United States, the world’s leading aviation power, advocated a free-market approach that would have permitted generally unrestricted traffic rights on international routes.² As an alternative, other nations such as the United Kingdom and Canada proposed the establishment of an international body to regulate international route rights and to determine capacity, frequency, and fares.³

A compromise, however, could not be reached on the competing positions. Although the International Civil Aviation Organization (ICAO) was established to regulate many technical aspects of international civil aviation, it was not given any authority over economic traffic rights. Rather, member states were required to trade air transport service rights such as routes, service levels, and pricing flexibility on a bilateral, *quid pro quo* basis.

Canada has since subscribed to the principles of the Chicago Convention and the bilateral arrangements that have evolved from this Convention; in fact, Canada’s international air services are largely governed by more than 70 bilateral agreements with other countries. However, Canada’s air transport policy has been outpaced by recent dramatic changes in the aviation industry. Global instability, SARS, and the tragedy of September 11 have had a significant impact on Canada’s international traffic. At home, the demise of Canada 3000 and Jetsgo, the merger of Air Canada and Canadian Airlines, and Air Canada’s

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¹ Chicago Convention (Art. 6). *Annals of Air and Space Law*. Montreal: McGill University, 1993 at 9.

² Paul S. Dempsey and Laurence E. Gesell. *Air Commerce and the Law*. Chandler, AZ: Coastal Aire Publications, 2004, at 751. “In Chicago, the United States promoted the position that airlines of all nations should have relatively unrestricted operating rights on international rights.”

³ Christer Jonsson. *International Aviation and the Politics of Regime Change*. New York: St. Martin’s Press, 1987, at 98.



restructuring has led to a significant reduction in seat capacity despite high load factors.⁴ Coupled with a valuable but partial open skies policy with the U.S. and current protectionist and high taxation policies, Canada's current air transport policies are arguably ineffective.⁵

Furthermore, on November 5, 2002 the ECJ pronounced its judgment in cases brought by the Commission against eight Member States regarding their bilateral service agreements with the U.S., as previously discussed in Chapter 8.⁶ The judgment by the European Court of Justice makes it essential that EU Member States also amend their bilateral aviation agreements with Canada, their second largest trading partner. This is necessary in order to reflect the development of Community legislation and the need to open the traffic rights available under bilateral agreements to all Community air carriers on a non-discriminatory basis. The Community and Canada will need to consider how these adjustments can be made and to what extent such reform of their transport services should be used as an opportunity to progress towards a more open and integrated transatlantic market. To date, the bilateral agreements between EU Member States and Canada have not been the object of any litigation in the EU or any international negotiations. However, since the logic of the decisions of the ECJ also applies to Canadian-EU bilaterals as well, a call from EU Member States or from the European Commission to negotiate existing bilaterals or create a single new agreement can soon be expected.

This chapter will examine current Canadian air service agreements with the EU and the possible strategies that Canada might adopt in response to new developments in international air transport regulation and especially to pressures from the EU. Many important questions will need to be asked and resolved. For example, should Canada try to reach an agreement with the U.S. for further liberalisation before agreeing to open EU-U.S. negotiations? On the other hand, should Canada seek negotiations with the EU, or its members individually, before Canada-U.S. negotiations go much further? Moreover, should Canada seek to revive the concept of a North Atlantic Aviation Area with the EU?

It seems inevitable that the EU, or possibly its individual EU Member States, will approach Canada in the relatively near future at least to reopen the existing bilaterals in order to add the EC's horizontal clause concerning ownership and control, as the EU is currently doing with the U.S. and other states. It is also quite possible that the EU will propose negotiations on the same basis as proposed to the United States with respect to open skies including cabotage rights and relaxation of ownership and control limitations.

How should Canada prepare for this and how should it respond to the different hypotheses? What would be the advantages and the disadvantages of Canada's possible strategies? Considering the implications of a particular strategy on Canada's stake-

⁴ BC Air Industry Monitoring Consortium (AIM BC). "Wings of Change: Air Policies for a Competitive Canada." 25 Feb. 2005. <<http://www.cotabc.com/>> (visited 28/3/05).

⁵ Ibid. For example, "Canada's major airports currently pay over \$250 million a year in rent, a figure that is expected to rise to \$450 million by 2010.

⁶ Judgments of the European Court of Justice. 5 Nov. 2002. Nrs. C-466/98 Commission vs. UK, C-467/98 Commission vs. Denmark, C-468/98 Commission vs. Sweden, C-469/98 Commission vs. Finland, C-471/98 Commission vs. Belgium, C-472/98 Commission vs. Luxembourg, C-475/98 Commission vs. Austria, and C-476/98 Commission vs. Germany. *Official Journal*, C 71/8-15 (13 March 1999).



holders, this chapter will also attempt to assess best- and worse-case scenarios for the forthcoming negotiations with the EU.

Canadian-EU Air Transport Policy

Canada and the EU have a good and long-standing trading relationship; the EU has for many years been Canada's second most important trading partner.⁷ The EU is also the second source of foreign investment in Canada. In fact, for over twenty-five years the "EU and Canada have been working hard, both bilaterally and in a multilateral context, to liberalise transatlantic trade."⁸

Moreover, air transport issues continue to feature high on the EU-Canada agenda, and a brief description of Canadian-EU aviation policy will reveal that many of Canada's concerns in the early days of aviation regulation continue to exist today. For example, whereas the U.S. and Britain wanted to retain national control over international aviation in Chicago in 1944, Canada "proposed an international authority to fix and allocate routes, frequencies, capacity and rates."⁹ Like the U.S., Canada was in support of competition; however, like Britain, Canada also wanted international air routes to be divided fairly and equally between member states.

Although Canada had closer relations with the U.S. geographically and commercially, Canada also had strong cultural ties with Britain. It was therefore natural for Canada to seek a compromise solution, but Canada's role, however, fell short of expectations. Canada put forward the idea of the first four freedoms and the possibility of "lifting aviation out of bilateralism altogether."¹⁰ The U.S. countered with a proposal for adding fifth freedoms, which would allow its carriers to carry traffic between third countries, but the British were not willing to grant fifth freedom rights for obvious reasons (i.e., long haul American carriers would carry most of the traffic).

Canadian studies prepared prior to the Chicago Conference warned Canada, however, about granting multilateral fifth freedom rights.¹¹ By granting these rights, Canada would have given Europe and the U.S. what they needed most, yet leaving Canada with very little bargaining power since Canada would not have a great deal of traffic to offer. Also, many international airlines were hoping to have permission to cross Canadian territory because of its geographical position between Europe and the U.S.

⁷ Commission of the European Communities. Brussels, 13 May 2003. COM (2003) 266 Final. Communication from the Commission on EU-Canada Relations.

⁸ *Id.* "Bilateral trade in goods has nearly tripled since 1980, with an increase of more than 40% between 1998 and 2001 (from 6.8 billion ECU in 1980 to 18 billion euros in 2001). Trade in services follows the same trend, with an increase of 39% between 1998 and 2000 (from €10.1 billion to €14.1 billion). Two-way investment has also experienced a strong growth and has become the most dynamic element of the transatlantic relationship. While its economic relationship with the United States easily overshadows Canada's other trading relationships, accounting for 79% of Canada's trade in 2002 (compared to 7.5% for the EU), trade and investment flows between the EU and Canada are far from negligible. The EU is currently the second investor in Canada after the US."

⁹ Christer Jonsson. *International Aviation and the Politics of Regime Change*. New York: St. Martin's Press, 1987, at 53.

¹⁰ *Id.* at 54.

¹¹ *Id.* at 54.



Due to the failure to reach a compromise in 1944, air transport services between Canada and other countries have since been governed by the provisions of a multitude of bilateral air service agreements. More recently, however, Canada has initiated a multiple designation air policy, which was issued in 2002, allowing all interested carriers to be designated to operate international services in any international market—if sufficient bilateral rights are available.

Positions of Canada’s Stakeholders

Although Canada’s unique geographical setting has posed many challenges since the early days of aviation, Canada’s air transport industry currently reports revenues of approximately \$14 billion and employment for over 73,000 Canadians.¹² It is also extremely diverse with companies ranging from global players like Air Canada to growing carriers such as WestJet and First Air, charter companies such as Air Transat and Skyservice, cargo operators such as Kelowna Flightcraft and All Canada Express, and a large number of air taxi, helicopter and flight school operations located in all parts of the country.¹³ Competition in the industry is intense in many sectors, and each sector is aggressively seeking new and expanded service and revenue opportunities. Any negotiations with the EU should take the ultimate interests of Canada’s stakeholders into consideration which should imperatively include:

- an increased share of the traffic and capacity to the EU,
- an increased number of passengers through Canada’s airports,
- an environment that continues to foster competition,
- increased direct and indirect benefits - both in passenger and cargo revenues,
- ensuring an adequate return to its investors and shareholders, and
- ensuring that small regional markets are not ignored.

These ultimate goals may require that increased liberalization of air transport services be addressed in Canada-EU negotiations; such liberalization refers to the removal of statutory and regulatory constraints that unnecessarily limit the operations of Canada’s stakeholders. In sum, any negotiations must ensure the development of new air transport services, lower prices for the consumer and greater competition-- wherever net benefits for Canada may be achieved. Increased liberalization of air services can have a significant impact on the viability of other sectors such as tourism and even the business convention market. ICAO estimates that for every dollar spent on air services, \$3.25 is generated in other related economic activities.¹⁴ Also, employment multipliers are significant and cannot be ignored with one job in aviation creating six jobs in other related sectors.

¹² Transport Canada. *Transportation in Canada. Employment in the Air Industry, 1997-2002.*

<<http://www.tc.gc.ca/pol/en/report/anre2003/add/ta237.htm>> (visited 25/02/06)

¹³ Canadian Airports Council. *Liberalization of Air Transport Policy: The Views of the Canadian Airports Council.* Background Paper. Ottawa, December 2004.

¹⁴ *Id.*



Canada’s Carriers

Air Canada is Canada’s largest domestic and international full-service airline, providing scheduled and charter air transportation for passengers and cargo. Ranked 13th among the top airlines worldwide, the Air Canada group includes: ZIP, Air Canada’s low-fare airline that commenced operations in September 2002; and the regional airline, Air Canada Jazz.¹⁵ By December 31, 2003, Air Canada’s route network served 148 destinations including 58 destinations in Canada, 44 destinations in the United States, and 46 other international destinations. Through commercial agreements with third party airlines operating under capacity purchase agreements, an additional 17 North American communities are served bringing the total network to 165 destinations on five continents.¹⁶ Furthermore, Air Canada operates an extensive global network in conjunction with its international airline partners in the Star Alliance. With Air Canada’s strategic alliance and commercial partnerships, scheduled and charter air transportation is offered to over 700 destinations in 128 countries.

From Air Canada’s Annual Report (2003) it is apparent that although Canada’s transatlantic revenue fell five percent from \$1,556 thousand in 2002 to \$1,472 thousand in 2003, Air Canada’s transatlantic revenue increased as a proportion of the company’s total revenues from 2002 to 2003 from 17.7 percent to 21.4 percent respectively which signifies the importance of the carrier’s market with the EU.¹⁷

Air Canada-Passengers	2003 Revenues (1000’s)	% Total	2002 Revenues	% Total
Domestic	2,919	42.6%	3,535	47.0%
US Transborder	1,578	23.1%	1,945	22.2%
Transatlantic	1,472	21.4%	1,556	17.7%
Other	889	12.9%	1,154	13.1%
TOTAL	6,858	100.0%	8,775	100%

Furthermore, the importance of the transatlantic market with the EU cannot be underestimated as an analysis of 2002 versus 2001 revenues demonstrates. For example, for the year 2002, although overall passenger revenues increased \$67 million over those of 2001, the transatlantic market outperformed other markets with an increase of 11% in revenues when considering the declining revenues in the domestic and U.S. transborder markets:¹⁸

¹⁵ Air Canada has three wholly owned subsidiaries: Jazz operates less busy domestic and transborder routes, particularly to small communities; Zip provides frequent low-fare service on domestic routes; and Air Canada Vacations offers tour packages to popular destinations. Jetz, an internal division of Air Canada, offers premium charter service to sport teams and businesses. In addition, four independent local service operators (Air Creebec, Air Georgian, Air Labrador and Central Mountain Air) offer regional services on behalf of Air Canada.

¹⁶ Air Canada. *Financial Statements and Notes, 2003*. “Management’s Discussion and Analysis” at 5.

¹⁷ *Id* at 148.

¹⁸ *Id* at 28.



Market	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Yield per RPM % Change	RASM % Change
Domestic	(1)	(2)	(3)	1	0
Transborder	(8)	(3)	(2)	(6)	(6)
Transatlantic	11	(1)	4	7	12
Pacific	11	(3)	10	1	15
Other	17	21	20	(3)	(3)

Keeping in mind the growing EU market and its contribution to overall revenues, issues for consideration when negotiating international scheduled air services with the EU that would benefit Canada’s major carriers include:

- the extent to which Canada should seek to relax or remove routing, frequency, pricing and code-sharing restrictions on services with EU Member States,
- relaxing or removing routing, frequency, pricing, code-sharing and traffic right restrictions on services with the EU that also involve traffic to third countries,
- increased traffic in EU’s domestic market, i.e. cabotage,
- addressing ownership and control issues in the negotiations with the EU, and
- the possibility of integrating Canada’s air transport services with the EU under a single set of rules for an open aviation area (Annex I).

Low Cost Carriers

Low cost carriers have made tremendous inroads in the domestic market, and the increased competition has eroded Air Canada’s market share. In fact, Air Canada’s capacity has dropped from 79.5% in 2000 to 54.9% in 2004:¹⁹

AIRLINE	CAPACITY (2000)	CAPACITY (2004)
Air Canada Group	79.5%	54.9%
WestJet	6.5%	28.0%
Jetsgo	--	8.4%
CanJet	2.1%	2.2%
Canada 3000	3.9%	--
Others	8.0%	6.5%
TOTAL	100.0%	100.0%

Domestically, and on some transborder routes, Canada has seen the entry and growth of a number of low-cost, no-frills carriers in recent years. In fact, these carriers have been the source of most traffic growth, a trend that can be seen in Canada and around the world. Calgary-based WestJet is now Canada's second-largest airline, having earned \$860

¹⁹ Transport Canada. *Air Liberalization: A Review of Canada’s Economic Regulatory Regime as it Affects the Canadian Air Industry*, 2004, at 5. <<http://www.tc.gc.ca/pol/en/Airpolicy/doc/AirLiberalization.htm>> (visited 17/03/05).



million in revenues in 2003. It serves 24 cities with 44 aircraft. Montreal-based Jetsgo expanded its fleet from three to twelve aircraft during 2003 and served eleven Canadian cities; however, the carrier has recently filed a petition for reorganization and restructuring and is no longer in service.²⁰ CanJet, based in Halifax, operates six aircraft to seven Canadian cities.²¹

In addition to their domestic services, all three low-cost airlines offer seasonal services to international tourist destinations. However, Canada's low cost carriers are not currently included in any air service agreements with the Member States of the EU. Therefore, the impact of Canada-EU negotiations will have no immediate impact on this sector.

Non-Scheduled, Charter Services

International air charter services are operated pursuant to the rules of each country, whether it be the country of origin or destination of the traffic. Canada, as a matter of policy, applies its rules only to charter traffic originating in Canada, while accepting foreign rules for charter traffic destined to Canada from the EU. Charter air services between Canada and the EU require approval on a case-by-case basis.²² For example, Canada has a number of charter airlines that provide international service. They focus on point-to-point transportation, and the markets are typically served with low frequencies and highly seasonal destinations.

The major carriers in this sector are Air Transat, Skyservice Airlines, Zoom Airlines and Harmony Airways. Air Transat, the largest charter carrier in Canada, specializes in charter flights from several Canadian and European cities to vacation destinations, mainly to the south during the winter months and in Europe during the summer. Its fleet of 14 aircraft serves 90 destinations in 25 countries.²³

However, the Canadian air transportation industry has been plagued by over capacity, increased fuel and aircraft maintenance costs, diminishing profit margins, fierce competition and an overall threat of economic failure.²⁴ Against this background, a shift in the travel needs of Air Transat's customers towards new destinations and leisure activities has created intense competition and reduced margins. Issues for consideration when negotiations on international charter services with the EU take place are:

- How should Canada further liberalize its charter policies to lessen or remove remaining restrictions on granting authority for charter services between Canada and the EU?
- Should different approaches be taken for passenger and charter services? Since the distinctions between scheduled and charter services have lessened, does

²⁰ James Ott. "Turning a New Leaf." *162 Aviation Week and Space Technology*. 21 Mar. 2005.

²¹ http://www.tc.gc.ca/pol/en/report/anre2003/9C_e.htm

²² Air Transat. <<http://www.airtransat.com>> (visited 03/03/05)

²³ Cap Gemini Consulting. "Success Stories." Headquartered in Montreal, Air Transat has annual revenues in excess of CDN\$1 billion and provides service to approximately 3.3 million passengers a year, an average of 400 flights per week. <<http://www.capgemini.com/clients/refs/airtransat.shtml>> (visited 03/03/05).

²⁴ *Id.*



maintaining restrictions on charter operators serve any purpose in an increasingly liberalized scheduled services environment?

Air Cargo Services

Air cargo services are important streams of revenue for Canada’s all-cargo and combination carriers. Air cargo can be divided into three principal segments—airmail, air express, and air freight. Whereas air express consists of small, high-value, and time sensitive shipments, air freight usually consists of relative larger shipments which are somewhat less time-sensitive.²⁵ Not surprisingly, high-value items such as machinery and electrical equipment, aircraft and transport equipment, and other manufactured goods make up the majority of the goods shipped by air to the EU.

Air cargo differs drastically from passenger service; air freight movement is uni-directional and it is less concerned with the number of stops or routing. It has therefore been argued that air cargo rights should be negotiated separately from passenger rights, and “preferably on a multilateral basis” to create a multidirectional distribution network allowing freight to move efficiently and take advantage of economies of scale and scope.²⁶

Air cargo is carried in the belly-hold of passenger aircraft in a passenger/cargo combination or in all-cargo aircraft. Canada's domestic air cargo market is deregulated; as such, there are no restrictions on routing, capacity or price. International air cargo services, however, are covered by bilateral air agreements, other international agreements and national policies. Some all-cargo airlines do provide charter services outside of Canada on behalf of foreign-based airlines but have little presence on their own in international markets.²⁷ However, a significant amount of cargo is carried in the belly-hold of passenger aircraft.

However, although the air cargo of high-value goods accounts for only ½ to one percent of the total cargo carried in the Canadian transport system, 24 percent of the value of these goods is imported or exported by air to countries other than the U.S.²⁸ As the following table shows, Canadian air cargo by export to the EU was 8.5% of total cargo in 2003.²⁹

Total Exports (2003)	Value (Millions of Dollars)	Percentage of Total by Air
Transborder (U.S.)	81,921	85.1%
Asia	3,496	3.6%
Western Europe	8,118	8.5%

²⁵ Paul Stephen Dempsey and Lawrence E. Gesell. *Airline Management: Strategies for the 21st Century*. Mesa, Arizona: Coast Aire Publications, 1997, at 480.

²⁶ *Id.*, at 480.

²⁷ Doris Kay, The International Air Cargo Association (TIACA). *It’s Time to Set Air Cargo Free*. Winter 2003. <<http://www.tiaca.org/articles/2004/03/19/DB1DC4B404684041B6BC6E9CBA1B86E6.asp>> (visited 02/02/05).

²⁸ Transport Canada. *Freight Transportation*. <http://www.tc.gc.ca/pol/en/Report/anre2003/9D_e.htm> (visited 03/03/05).

²⁹ *Id.* at Table A2-6.



Latin America	1,174	1.2%
Middle East	560	0.5%
Oceania	471	0.4%
Africa	318	0.3%
Other	378	0.4%
TOTAL	96,430	100.0%

Transportation of goods by air for commercial purposes plays an increasingly important role in the Canadian economy; however, air cargo transportation is affected by regulations in a multitude of ways. A range of regulations divides the industry in terms of different kinds of carriers and operators, and govern infrastructure (airports) in ways that create monopolies. The result is a severe cap on competition and a reduced ability in the industry to respond to market demand. More specifically, bilateral regulations delineate *inter alia* market entry, access and trading conditions, thereby affecting the formation of international air freight route networks, the efficiency of operations, the quality of competition, productivity gains, innovations and business strategies. The regulatory framework exerts a direct impact on the efficiency of air cargo services while, indirectly, strongly influencing trade, production patterns and the development of individual countries and regions as well as the entire global economy.³⁰

Canada's air cargo sector conceals immense potential for further product innovation, service development and trade facilitation. Considering the fact that air cargo transportation is thus an area where policy reforms promise great direct and indirect economic benefits, the OECD has formulated "first best" principles of a regulatory framework for the air cargo industry.³¹

- The regulatory framework should allow for free route design and network operation by all categories of carriers; commercial considerations should provide the main criteria determining the establishment and operation of route networks.
- Carriers should be authorised to set their prices (rates) freely, according to economic considerations (this principle is already prevailing in air cargo transportation in a number of countries). Rates should vary according to service characteristics and market structure.
- Carriers should determine their ownership and control structures freely, according to their economic (notably, capital) needs, and their business and marketing policies.
- Carriers should be authorised abroad to employ, under their own name, services of domestic cargo carriers and/or operate multimodal transportation services (notably trucking services) on the surface legs of their operations, in order to be able to offer seamless and efficient services to their customers.

³⁰ Organization for Economic Co-operation and Development (OECD). *Workshop on Regulatory Reform in International Air Cargo Transportation*. Background Document. Paris, 5-6 July 1999

³¹ *Id.*



- Customs procedures and ground handling operations in airports should be made available to all carriers on an efficient, transparent, non-discriminatory basis.

With these “first best” principles in mind, the issues facing Canada in bilateral negotiations with the EU include the option of liberalising the full range of traffic rights in cargo services (1-8th freedoms) providing full market access. The anticipated impacts would be route optimization and free competition between all categories of carriers. Such a package of provisions could be negotiated either multilaterally through the WTO commitment process or bilaterally in the form of a new cargo annex to current bilateral ASAs with the EU.³² Another issue of concern is whether to liberalise the ownership and control of carriers by freeing them from bilateral ownership and control constraints in international markets. Such liberalisation would authorise carriers to proceed with international mergers and acquisitions according to their business strategies, under guidance of clear competition policy rules.

Airports and Auxiliary Services

Another pressing issue now at hand is how bilateral ASA negotiators should balance the conflicting interests of airports and auxiliary services on the one hand, and Canada’s major carriers on the other hand. Canada has approximately 1,700 aerodromes which are facilities registered with Transport Canada as aircraft take-off and landing sites.³³ The aerodromes are divided into three categories: water bases for floatplanes, heliports for helicopters, and land airports for fixed-wing aircraft. Most of Canada's commercial air activity takes place at certified land airports, and because of their level of activity or location, these sites are required to meet Transport Canada's airport certification standards. At the close of 2003, the *Canada Flight Supplement* and the *Canada Water Aerodrome Supplement* listed 1,746 certified or regulated sites.

The importance of Canada’s aviation infrastructure cannot be overlooked when discussing bilateral ASA negotiations. The total capital expenditure at the nine largest airports was \$1.6 billion in 2002, and capital expenditures are rising. At the Toronto airport, a \$4.4 billion capital expansion project (Airport Development Program) is currently under way. The new terminal building, which is to replace the existing Terminals 1 and 2, is scheduled to open in 2004. At Ottawa, a \$310 million capital project, which included construction of a new passenger terminal building, was completed in October 2003.³⁴

Moreover, most of the medium-sized airports (more than 500,000 passengers annually) have experienced declines in both revenues and net income in 2002. The total capital expenditures at the medium NAS airports were \$21 million, as Saskatoon and St. John's airports continued their capital projects. Of all Canadian airports, smaller airports (fewer

³² Within the WTO context, this option could be adopted by each country on a reciprocal MFN basis; this implies that every WTO member should be required to offer all members the elements of its most favourable bilateral agreement on the basis of mirror reciprocity.

could be somewhat cumbersome.

³³ Transport Canada. *Canada Flight Supplement*, December 25, 2003; *Water Aerodrome Supplement*, March 20, 2003. <http://www.tc.gc.ca/pol/en/report/anre2003/9B_e.htm> (visited 02/03/05).

³⁴ *Id.*



than 500,000 passengers annually) experienced the most severe traffic decline in 2002, with similar declines in revenues and net income. Charlottetown and Gander airports were particularly hard hit and experienced double-digit declines in passenger traffic. However, many of the small airports such as Fredericton, Moncton, London and Saint John continued their major capital expenditures. The total capital expenditures at the small airports in 2002 were \$47 million.³⁵

Any negotiations with the EU should ensure that all of Canada's airports receive more traffic. The Canadian Airport Council's position on air policy matters is driven by one overall policy objective:

To promote the broad economic and social interests of Canadians by eliminating policy-based intervention; thereby facilitating and promoting the operation of market forces to provide Canadian communities with a world-class air transportation system that offers the broadest range of competitive passenger and cargo services.³⁶

It should also be noted that, because Toronto, Montreal and Vancouver gateways are located closer to the European continent in terms of great-circle distances, these Canadian gateways are thus able to enjoy a substantial geographic advantage over most of the major U.S. airports. This fact should be considered in any negotiations with the EU.

Canada's Regional Communities

Canada's geography has always presented the airline industry with a huge challenge. How can it ensure that citizens living in smaller centres and rural and remote areas have access to essential air services? The basic approach of market-defined services does not always lead to the most effective solution when the market may be too small to generate sufficient revenues to cover the cost of air transport service.

In a recent report to the Standing Committee on Transportation, the Province of Nova Scotia emphasized its concerns that regional perspectives must be taken into account when developing and implementing any national air policy objectives and initiatives.³⁷ In essence, Canada's focus on major Canadian markets such as Toronto, Montreal and Vancouver should not preclude innovative solutions that address the needs of less populous regions of Canada.

In addition, the issue is made more complex because air transport services are linked to a range of other requirements such as public safety and local economic development. Given these issues, a clear framework to guide policy makers and Canada-EU bilateral negotiations in this area is essential.

³⁵ *Id.*

³⁶ Canadian Airports Council. *Liberalization of Air Transport Policy: The Views of the Canadian Airports Council*. Background Paper. Ottawa, December 2004.

³⁷ Department of Transportation, Province of Nova Scotia. 10 Mar. 2005. *Air Liberalization and the Canadian Airports System*. <http://www.gov.ns.ca/tran/SCOTMarch2005.pdf> (visited 17/03/05).



CANADIAN-EU BILATERAL AIR SERVICE AGREEMENTS

Whereas Canada has a limited “open skies” policy with the United States, Canada’s bilateral air service agreements (ASAs) with EU Member States are somewhat more or less liberal depending on the country involved. For example, the more protectionist Member States of France, Italy and the Czech Republic require pre-determination of capacity rights; on the other hand, the Netherlands permits open capacity.³⁸ Therefore, this section contains a brief summary and comparison of the main features of the EU Member States’ bilateral air agreements and addresses traffic rights, designation, tariffs and capacity. It should be noted that the bilaterals are not structured in the same manner; in some air transport agreements all traffic rights are granted initially, using an annex then to restrict the available traffic rights. In other air transport agreements, only the traffic rights specified in the annex are granted.

The fundamental principle of the bilateral system is that of bilateral reciprocity whereby countries exchange rights on the basis of ‘equality of opportunity’. This essentially means that Canada agrees to exchange rights which will enable its carriers to obtain access to EU markets to the same extent as EU carriers are able to gain access to Canada’s markets. Before analyzing Canada’s bilateral agreements with EU Member States, a brief description of Canada’s negotiation process and the role of its stakeholders deserve attention.

Negotiation Process for Bilateral Air Service Agreements

The negotiation process for bilateral ASAs is normally initiated when Canada or another country requests negotiations. If Canada requests negotiations, it is usually in response to an interest of one of its airlines or related stakeholders convincing officials of the need and appropriateness of increased or modified air services. Other countries’ requests are considered in light of current Canadian policy, but stakeholders’ views are also taken into consideration.³⁹ The following procedures are normally followed to conduct ASA negotiations:

Preparation for Negotiations

- Once negotiations are agreed to, interested and known stakeholders are consulted and informed of what is expected to be addressed in the negotiations.
- Stakeholders are permitted the opportunity to give their input on the issues and any other concerns of interest. The stakeholders include Canada’s provinces, air carriers (scheduled, charter and cargo), airport authorities and airport communities. Any other parties who show an interest in the negotiations are included in the ASA negotiation process.

³⁸ Pre-determination of capacity requires prior governmental approval of capacity before air services on specified routes may commence.

³⁹ Duane Van Beselaere, former Canadian Air Services Negotiator. Open Skies Forum, Canadian Airport Council, 23-24 Feb. 2005, Ottawa.



- Based on research and assessment in house, views received in consultations are measured against Canada’s policy framework, and a mandate memorandum is sent to Ministers requesting authority to negotiate on specified matters.
- The mandate must be approved on behalf of the Cabinet by the Minister of Transport and the Minister of Foreign Affairs and International Trade.
- Moreover, the mandate is “secret” and kept confidential; stakeholders are not informed about its contents.

A Typical Mandate

- The preliminary memorandum seeking a mandate must contain:
 - (1) a summary of current aviation arrangements with the other country,
 - (2) a report on results of the consultations with Canada’s stakeholders,
 - (3) an analysis of the probable impact of any changes being considered, and
 - (4) concluding recommendations for the Ministers.
- The memorandum is always drafted in a high-level safety and security context. Also, the negotiator’s mandate is to obtain the best possible results for Canada in a number of areas with limits on what he can give the other country; for example, 1st and 2nd freedoms (overflight/landing) are readily granted. The negotiators will normally insist on “free choice” of the points of origin in the ASA. They will also attempt to acquire “open points” of destination but will retrench if the other partner appears unwilling to cede on the issue.
- The next step would be an attempt to secure a specified number of points of destination which could be chosen by the parties involved. If this fails, the negotiator may eventually agree to “named” points with a maximum number possible, yet on a reciprocal basis. This is a sensitive issue for airports, but usually all partners want Toronto and perhaps Vancouver included in their ASAs.
- The mandate may allow for a balanced exchange of 5th freedom rights, and Canada has normally been generous in this respect since the open skies agreement with the U.S. has very limited 5th freedom rights. However, according to Van Beselaere, Canadian carriers are “not usually interested in 5ths.”⁴⁰
- Canadian negotiators have been very conservative with 6th freedom rights, yet these are significant for consumers. The other freedoms are generally not negotiated because of Canadian air policy regarding cabotage, ownership and control, and the right of establishment. Other issues which may arise are also included in the mandate (ground handling, CRSs, etc.), and a catch-all authority may be given for any unexpected matters.

Canada’s negotiating delegation normally consists of the Chief Air Negotiator who is appointed by the Ministers of Transport and the Ministers of Foreign Affairs and International Trade. A sector specialist from Transport Canada and a representative from Foreign Affairs and International Trade are also present to assist with regulatory issues. Scheduled airlines are historically invited; however, they are never privy to the mandate.

⁴⁰ *Id.*



Charter airline representatives are invited when charter issues are likely to be significant, and other stakeholders are invited on a case-by-case basis; for example, in the final phase of the U.S. open skies negotiations, airports and pilots were invited to provide representatives for their input.

There are many issues with respect to the negotiation process for ASAs with respect to Canada's stakeholders.⁴¹ The task of the negotiation delegation is to collect the best possible input in the policy making process, but the question remains if the weight given to views of various stakeholders is correctly assessed. As reported in the 2003-04 Report on Plans and Priorities (RPP), Transport Canada will continue to liberalize Canada's bilateral air agreements, which will "give Canadian carriers scheduled international air service access to foreign air markets and allow foreign carriers to operate such services to Canada."⁴² To date, Canada has over 70 bilateral air agreements, and Transport Canada participates in 10 to 12 rounds of air negotiations each year to conclude new agreements or liberalize existing ones. As part of the Government's plan to enhance and strengthen bilateral relations, Transport Canada will continue to consult with stakeholders to assess the merits of further liberalization of its bilateral air service agreements.

Current Air Service Agreements with EU Member States

Currently, there are 17 Canadian bilateral ASAs with Member States that are filed with ICAO; the remaining eight States including Cyprus, Estonia, Latvia, Lithuania, Luxembourg, Malta, Slovakia, and Slovenia have yet to negotiate air traffic rights with Canada.⁴³ Three applicant countries to the EU also have ASAs: Bulgaria, Romania and

⁴¹ *Id.*

⁴² Transport Canada. Report on Plans and Priorities (RPP 2003-2004). <http://www.tbs-sct.gc.ca/est-pre/20032004/tc-tc/tc-tcr34_e.asp?printable=True#2_3> (visited 03/03/05).

⁴³ Canada Treaty Series: Agreement between the Government of Canada and the Government of the Czech Republic on Air Transport, CTS1996/12, (1996/03/13); Exchange of Notes constituting an Agreement between the Government of Canada and the Government of the Hellenic Republic, CTS1995/34, (1995/07/19); Agreement between the Government of Canada and the Austrian Federal Republic on Air Transport, CTS1993/19, (1993/09/01); Agreement between the Government of Canada and the Government of Finland for Air Services between and beyond their Respective Territories, CTS1992/4, (1990/06/27); Air Transport Agreement between the Government of Canada and the Government of the Czechoslovak Socialist, CTS1989/33, (1989/12/27); Agreement between Canada and the Kingdom of the Netherlands relating to Air Transport between Canada and the Netherlands, CTS1990/12, (1990/02/01); Agreement between the Government of Canada and the Government of Spain on Air Transport, CTS1991/59, (1988/09/15); Agreement between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland concerning Air Services, CTS1988/28, (1988/06/22); Agreement between the Government of Canada and the Government of the French Republic, CTS1987/37, (1987/09/28); Agreement between the Government of Canada and the Government of Portugal on Air Transport (Provisionally in force 1987/04/10); Agreement between the Government of Canada and the Government of Belgium on Air Transport, CTS1986/5, (1986/05/13); Agreement between the Government of Canada and the Government of the Hellenic Republic on Air Transport, CTS1987/11, (1984/08/20); Air Transport Agreement between the Government of Canada and the Government of the Polish People's Republic, CTS1977/31, (1976/05/14); Exchange of Notes (September 16 and November 28, 1963) between the Government of Canada and the Government of Denmark concerning Air Traffic Control over Southern Greenland, CTS1963/9, (1963/11/28); Exchange of Notes between Canada and Ireland modifying the Air Agreement of August 8, 1947 between the two countries, CTS1957/31, (1957/12/23); Exchange of Notes between Canada and Sweden modifying the Agreement of 1947 concerning Air Services, CTS1958/14, (1958/05/16).



Turkey (Annex 2).⁴⁴ ASAs generally contain provisions that restrict the services allowed by international carriers between sets of countries. These provisions relate to market access (including freedoms granted and route specification), capacity and frequency, and a method for determining or approving tariffs. There has been an increasing trend to remove some of these restrictions.

ASAs also normally require airlines designated by each party to be ‘substantially owned and effectively controlled’ by the country or the nationals of that country. There is no internationally accepted definition of what constitutes ‘substantial ownership and effective control’ but most countries have legislation that defines their own criteria. The criteria must be acceptable to both parties to the bilateral agreement. The following section compares Canada’s ownership and controls rules with those of the EU.

Ownership and Control Rules

With respect to ownership, only “Canadians” may provide domestic air services, scheduled international air services, and non-scheduled international air services; “Canadian” is defined in the Canada Transportation Act to mean a Canadian citizen or permanent resident, a government in Canada or agent thereof or any other person or entity that is controlled in fact by, and of which at least 75 per cent of the voting interests are owned and controlled by, persons otherwise meeting these requirements.⁴⁵ With respect to control, commercial air transportation services may be provided by companies of which at least 75 percent of the voting interest is owned and controlled by Canadians.

Other provisions, however, apply to ownership and control. For example, regulations made under the Aeronautics Act require that a Canadian air carrier operate Canadian-registered aircraft.⁴⁶ To be qualified to register aircraft in Canada, a carrier must be a Canadian citizen or a permanent resident or a corporation incorporated and having its principal place of business in Canada. Its CEO and not fewer than two-thirds of its directors must be Canadian citizens or permanent residents, and not less than 75 per cent of its voting interest must be owned by them. In addition, all commercial air services in Canada require a Canadian operating certificate issued by the Department of Transportation to ensure safety and security. Canada reserves the right to adopt similar investment control measures in specialty air services such as ground-handling, repair and maintenance, and selling and marketing of air transport.

In the EU, free market access within the European Community is available only to “Community air-carriers” which are licensed by EU Member States in accordance with

⁴⁴ Canadian Transportation Agency. *Report of Bilateral Air Relations Between Canada and Other Countries*. <http://www.cta-otc.gc.ca/air-aerien/agreements/main_e.html> (visited 26/02/05).

⁴⁵ Canada Transportation Act, Section 55 (1996) defines “Canadian entity” as “a corporation or other entity that is incorporated or formed under the laws of Canada or a province, that is controlled in fact by Canadians and of which at least seventy-five per cent, or such lesser percentage as the Governor in Council may be regulation specify, of the voting interests are owned and controlled by Canadians...” <<http://laws.justice.gc.ca/en/C-10.4/>> (visited 26/02/05).

⁴⁶ Transport Canada. Part II: Aircraft Identification and Registration and Operation of a Leased Aircraft by a Non-registered Owner. <http://www.tc.gc.ca/CivilAviation/Regserv/Affairs/cars/Part2/202.htm#202_15> (visited 26/02/05).



the provisions of Regulation 2407/92.⁴⁷ The air carrier must have its principal place of business and registered office in the Community and be majority-owned and effectively controlled by Member States and/or nationals of Member States. This implies that third country investment in such a carrier must not exceed 49.9 percent; thus, a “community air-carrier” must be effectively controlled by Member States and/or nationals of Member States.

In conjunction with these provisions, ASAs normally permit bilateral partners to refuse, revoke, suspend or impose conditions on the authorisation of air services by carriers owned and controlled by other countries not party to the bilateral agreement. For example, in Canada’s ASA with Hungary:

The aeronautical authorities of each Contracting Party shall have the right to withhold the authorizations referred to in Article V of this Agreement with respect to an airline designated by the other Contracting Party, and to revoke or suspend or impose conditions on such authorizations, temporarily or permanently: (a) in the event of failure by such airline to comply with the laws and regulations normally applied by the aeronautical authorities of the Contracting Party granting the rights; b) in the event of failure by such airline to comply with the laws and regulations of the Contracting Party granting the rights; (c) in the event that they are not satisfied that substantial ownership and effective control of the airline are vested in the Contracting Party designating the airline or its nationals; and (d) in the event that the other Contracting Party is not maintaining and administering the standards as set forth in Article VIII and Article IX of this Agreement.⁴⁸

Such clauses therefore prevent other carriers from using and benefiting from the rights established under the arrangements. They also restrict the ability for carriers from one country to provide services on behalf of another country. The ownership and control provisions of ASAs effectively entrench the bilateral system of negotiation by restricting the ability of airlines to merge across national boundaries. The bilateral system in turn entrenches the ownership and control provisions; a change in the requirements by one party has to be acceptable generally to all bilateral partners.

When assessing Canada’s strategic options *vis à vis* the EU, it must be noted that ownership and control is a significant restriction in any bilateral agreement. Capacity is relevant, but what keeps an ASA bilateral restrictive and bars any potential competitor, who may otherwise enter through acquisition, is ownership and control. The fear that foreign carriers might obtain unreciprocated access to Canada’s markets is the reason why ownership and control is likely to remain an issue in its air services arrangements with the EU until the system of bilateralism itself is replaced. Until such time, the

⁴⁷ Council Regulation 2407/92. *Official Journal*, L.240 (23-Jul-1992). For company to obtain this licence, most of its capital must be held by Member States or nationals of the European Union. The latter must also exercise effective control over the company. The technical capabilities and financial capacity of the companies concerned are sanctioned by means of national certificates. See Dempsey (2004), at 64-67.

⁴⁸ *Agreement between the Government of Canada and the Government of the Republic of Hungary on Air Transport*. Article VI. E103148 - CTS 1999 No. 30. Canada Treaty Series. <<http://www.treaty-accord.gc.ca>> (visited 30/31/05).



classical bilateral agreement of the Bermuda 1 type prevails and is based on detailed negotiation of the grant of traffic rights, capacity, tariffs and other provisions of lesser importance.⁴⁹ Each one of these elements has undergone developments over the past 30 years in Canada-EU bilateral relationships.

Grant of Traffic Rights

Practice over time has led to the identification of eight types of "freedoms" or authorised flights.⁵⁰ In the classical bilateral agreement as in Canada's agreements, routes are negotiated between two countries by reference to city-pairs with intermediate stops and extensions, if any. If the intermediate stops or extensions take place on the territory of a third country, they require the agreement of the third country which must be expressed in another bilateral agreement. The following table from the ICAO Manual on the Regulation of International Air Transport presents a matrix of the routes resulting from these negotiations.⁵¹

Route	Points in State A	Intermediate points	Points in State C	Beyond points
1	City A1		City C1	
2	City A2	City B1	City C1	
3	City A3 City A4		City C2 City C3	Country D
4	City A1	City B2	City C1	City D1
5	Any point or points in A	North Africa	Cities C1, C2, C3	One point
6	Any point or points in A	Middle East and South Asia	Any point or points in C	Australasia
7	City A3	City B2	City C1	City B2

⁴⁹ *Agreement between the government of the United Kingdom and the government of the United States relating to Air Services between their respective Territories*, Bermuda, 11 February. Text provided at <http://www.ibiblio.org/obl/docs/1947_treaty.htm1946<http://www.jeminas.com/aviation/treaties/BII1977.pdf>> (visited 30/03/05).

⁵⁰ 1st freedom: the right of an airline of one country to fly over the territory of another country without landing; 2nd freedom: the right of an airline of one country to land in another country for non-traffic reasons, such as maintenance and refueling, while en route to another country; 3rd freedom: the right of an airline of one country to carry traffic from its country of registration to another country; 4th freedom: the right of an airline of one country to carry traffic from another country to its own country of registration; 5th freedom: the right of an airline of one country to carry traffic between two countries outside its own country of registration as long as the flight originates or terminates in its own country of registration; 6th freedom: the right of an airline of one country to carry traffic between two foreign countries via its own country of registration (this is a combination of third and fourth freedoms); 7th freedom: the right of an airline to operate stand-alone services entirely outside the territory of its home state, to carry traffic between two foreign states; 8th freedom: the right of an airline to carry traffic between two points within the territory of a foreign state (cabotage).

⁵¹ Source: ICAO document 9626, 1996, 4.1-4.



Since ICAO Members are obliged to notify the organization of their bilateral agreements, the totality of the routes negotiated in over 4,000 bilateral agreements now in force is available in two documents produced by ICAO.⁵² As the matrix demonstrates, all the conditions applicable to routes are identified.⁵³ Over the years the increased range of aircraft has tended to reduce the importance any negotiation for intermediate stops. On the other hand, the negotiation of extensions (the fifth, sixth and seventh freedoms) has greatly increased. Obtaining the eighth freedom of cabotage still remains exceptional in most ASAs.

Canada-EU agreements are no exception; however, Canada's agreements with the EU vary to a great degree among Member States; some have also evolved considerably over time. For example, most bilaterals do not permit 5th freedom traffic rights, yet several bilaterals permit limited 5th freedoms. The original 1973 agreement with Germany like most EU bilaterals was fairly restrictive, allowing only the following city-pairs: Calgary, Halifax, Montreal, Toronto and Vancouver in Canada, and Dusseldorf, Frankfurt and Munich in Germany.⁵⁴ Likewise, city-pairs in Canada's original agreement with Italy only include Rome/Milan and Toronto/Montreal.⁵⁵ In subsequent years the agreements with Germany, the UK, Switzerland, Italy and Spain have been amended to include 3rd and 4th freedom open skies provisions.

Over the years, the major change in terms of routes is the appearance of "open skies" agreements a seamless air transport system, under which any town or airport of either of the two participating countries can be an entry point for a carrier of the other country. In this case, the city-pair configuration disappears. The negotiation of specific routes also disappears in favour of the potential of opening up all routes. For example, Canada has a less restrictive bilateral agreement with the Netherlands. The Netherlands has rights to any point of origin in the Netherlands to most points in Canada: Calgary, Halifax, Montreal, Ottawa, Toronto, and Vancouver.⁵⁶ Canada, in return, has rights to any point of origin in Canada en route to Amsterdam and any other two points in the Netherlands. It should be noted, however, that Amsterdam has only one major airport, Schiphol, and a regional airport in Rotterdam. Dutch air carriers also have rights to points beyond

⁵² Source: ICAO document 9511, "Digest of Bilateral Air Transport Agreements", 1988 and 9511 Supplement 1, 1995.

⁵³ These types of conditions are the following: additional traffic point(s) allowed, exemption from any restrictions of certain operations or certain routes, possibility of omission of points along the route with or without permission, time restriction on the exercise of some or all of the rights granted, restriction on the designation of airlines, restrictions on the number of points that may be served on a route, limitations on capacity frequency and scheduling, traffic rights implication of stopover, routes exchanged for all-cargo flights only, routes exchanged for non scheduled flights only, existence of a separate agreement or exchange of diplomatic note concerning the route exchange authorisation of code sharing, geographic restriction within a country or a region, and other or traffic conditions or restrictions.

⁵⁴ *Air Transport Agreement between the Government of Canada and the Government of the Federal Republic of Germany*. 26 Mar. 1973. CTS1975/4. Canada Treaty Series. <<http://www.treaty-accord.gc.ca>> (visited 30/31/05).

⁵⁵ *Exchange of Notes between the Government of Canada and the Government of the Republic of Italy constituting an Agreement to Amend the Agreement for Air Services as specified in the Agreed Minute of April 28, 1972*. Route Schedule, Section II. CTS1972/27. Canada Treaty Series. <<http://www.treaty-accord.gc.ca>> (visited 30/31/05).

⁵⁶ *Agreement between Canada and the Kingdom of the Netherlands relating to Air Transport between Canada and the Netherlands*, CTS1990/12, (1990/02/01);



Canada, although these 5th freedom rights are limited to New York for cargo, and to Mexico City via Montreal/Houston and Montreal/Orlando. In return, Canadian carriers have rights to intermediate stops in London in a code-sharing agreement with British Airways, and beyond rights to points in Europe, Africa, the Middle East and Asia; however, Canada does not use them on an interline basis.

France, on the other hand, has exchanged any points of origin in France for any points of origin in Canada. 5th freedom rights exchanged are those for France beyond to Chicago and for Canada beyond to any three points in Europe. Again, Canada has yet to select any beyond points. City-pairs used by Canada and France currently include Toronto and Montreal to Paris, Pointe-a-Pitre and Fort de France.

Tariffs

Air transport has historically been a sector in which prices are fixed and managed administratively, and four types of tariff clauses can be distinguished: dual approval – of which Bermuda 1 is the classical type – single disapproval, dual disapproval, and the country of origin method.⁵⁷

1. Dual approval refers to the approval of tariffs by the aviation authorities of the two countries and is still the most common type of tariff clause in bilateral agreements. It can be either explicit or tacit;
2. Single disapproval means that tariffs enter into force unless disapproved by one of the countries. Dual disapproval means that tariffs enter into force unless disapproved by both countries;
3. Under the country of origin method the right of disapproval can only be exercised by one of the parties when the flights in question originate in its territory.

Various refinements are possible, such as the establishment of a "tariff zone" in Canada's bilateral with the United Kingdom in which neither country can disapprove a tariff or the maintenance of pre-existing tariffs in the absence of agreement on a new tariff between the airline companies.⁵⁸

Also, historically there has been a trend, which is still continuing, away from dual approval towards dual disapproval clauses. The development of open skies agreements also tends towards the suppression of tariff clauses. None of Canada's bilaterals with the EU, however, use very restrictive dual approval for tariffs; all allow for either single or double disapproval. For example, Canada's ASA with France entails single disapproval:

5. (a) Each proposed tariff may be approved by the aeronautical authorities of either Contracting Party at any time and, provided it has been filed in accordance with paragraph (4) of this Article, shall be deemed to have been approved by the aeronautical

⁵⁷ Organization for Economic Co-operation and Development (OECD). *Workshop on Regulatory Reform in International Air Cargo Transportation*. Background Document. Paris, 5-6 July 1999.

⁵⁸ *Agreement between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland concerning Air Services*, CTS1988/28, (1988/06/22);



authorities of both Contracting Parties unless, within 15 days (or such shorter period as the aeronautical authorities of both Contracting Party may agreed) after the date of filing, either of the aeronautical authorities have served on the other written notice of dissatisfaction of the proposed tariff.⁵⁹

Capacity

The control of capacity plays an essential part in maintaining the profitability of routes. There are many possible regulation formulae, but to simplify matters ICAO has identified three basic types of capacity clauses:⁶⁰

1. Pre-determination is a prior agreement on capacity which must be reached before operations begin. It can take the form of specified shares or of a procedure for coordination, approval and filing.
2. The Bermuda 1 clause contains principles which airline companies must respect in relation to capacity, "an *ab initio* determination of capacity by each airline acting separately". The parties to the bilateral agreement or their aviation authorities intervene only *a posteriori* through consultation procedures.
3. Free determination consists of agreement by both of the parties not to impose unilateral restrictions on the volume of traffic, the frequency or regularity of service, or on the types of aircraft which may be used by the airline companies designated by the other country.

The development over time in matters of capacity has been away from pre-determination and towards free determination. Open skies agreements in their pure form also assume a system of free determination. Canada's bilateral agreements with the EU Member States, however, are still basically structured on a pre-determined basis. Only the agreement with the Netherlands permits free determination of capacity. All other EU agreements require pre-determination; however, Belgium does permit unlimited capacity entitlements for code-share services.⁶¹

Other Rules

Canadian-EU bilateral agreements include other provisions, concerning for example unscheduled or cargo-only flights, dispute settlement procedures, exemptions from taxes or customs duties (which are often reciprocity-based) and the recognition by one of the parties of licenses, qualifications or certificates of air worthiness issued by the other.

Air cargo service plays an increasingly important role in the Canadian economy, and is an area where policy reforms may provide direct and indirect benefits. Canada's current

⁵⁹ *Agreement between the Government of Canada and the Government of the French Republic*, Article 13: Tariffs, 5(a), CTS1987/37, (1987/09/28).

⁶⁰ Organization for Economic Co-operation and Development (OECD). *Workshop on Regulatory Reform in International Air Cargo Transportation*. Background Document. Paris, 5-6 July 1999.

⁶¹ *Agreement between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland concerning Air Services*, CTS1988/28, (1988/06/22);



bilateral ASAs with EU Member States provide for cargo transport; however, cargo provisions are linked to passenger service provisions in the bilaterals. For example, the following clauses illustrate how cargo and passenger services are coupled in bilaterals:

- France-Canada ASA: “Agreed services” means scheduled air services on the routes specified in the Annex to this Agreement for the transport of passengers, cargo and mail, separately or in combination.⁶²
- Belgium-Canada ASA: “Tariffs” means the prices to be paid for the carriage of passengers, baggage and cargo and the conditions under which those prices apply.⁶³
- Poland-Canada ASA: The laws and regulations of one contracting party relating to the entry into or departure from its territory of passengers, crew, or cargo of aircraft (such as regulations relating to entry, clearance, immigration, passports, customs and quarantine) shall be applicable to the passengers, crew or cargo of the aircraft of the designated airline or airlines of the other contracting party while in the territory of the first contracting party.⁶⁴
- Austria-Canada ASA: Nothing in paragraph 1 of this Article shall be deemed to confer on a designated airline of one Contracting Party the privilege of taking up, in the territory of the other Contracting Party, passengers and cargo, including mail, carried for remuneration or hire and destined for another point in the territory of that other Contracting Party.⁶⁵

When considering the above interlocking provisions for cargo and passenger service, it is evident that passenger service issues impede cargo transport liberalization; cargo service cannot be liberalised until it is “de-linked” from passenger service in bilateral ASAs. In any negotiations with the EU, Canada should press for free route development and network operations for all cargo carriage with freedom to determine prices, ownership and control structures, and multi-modal operations. Any reforms should attempt to separate cargo from passenger services either multilaterally or bilaterally with cargo annexes attached to ASAs.

CANADA’S STRATEGIC OPTIONS *vis à vis* the EU

Canada’s bilateral air service agreements (ASA) currently remain in force as the legal basis for air services between Canada and individual European Member States; however, bilateral ASAs may typically be terminated by either party with one year’s notice. The EC may well urge Member States to give such notice to Canada; the EC has recently required them to give such notice to the U.S.

⁶² *Agreement between the Government of Canada and the Government of the French Republic*, CTS1987/37, (1987/09/28).

⁶³ *Agreement between the Government of Canada and the Government of Belgium on Air Transport*, CTS1986/5, (1986/05/13).

⁶⁴ *Air Transport Agreement between the Government of Canada and the Government of the Polish People's Republic*, CTS1977/31, (1976/05/14).

⁶⁵ *Agreement between the Government of Canada and the Austrian Federal Republic on Air Transport*, CTS1993/19, (1993/09/01).



In the short term, the EC's decisions may not mark an end to bilateralism, but it could be the start of a long and complicated political process resulting in new forms of bilateral agreements. Therefore, the status quo could continue, with or without modifications of Canadian-EU ASAs. The possibility arises that there could be more "open" bilateral agreements with EU Member States, multilateral agreements with the EU partners on a partial Community-wide basis, or a more inclusive inter-continental aviation area between Canada and the EU. At this point, the question remains how long it will take for Canada and the Member States, or the Community, to begin constructive negotiations and what form the resulting agreements will take.

Considering the previous discussion of the current aviation agreements with EU Member States and the concerns of Canada's stakeholders, this section will assess the Canada's strategic options *vis à vis* the EU. In each scenario, the timing and the context of Canada's negotiations with the EU must be evaluated with respect to the ongoing EU-U.S. developments to liberalize air transport services. The following possible strategic options have been assessed: (1) do nothing, (2) conduct early negotiations with individual Member States, (3) conduct negotiations with the Commission on behalf of each Member State with respect to ownership and control, (4) conduct negotiations for a single bilateral ASA on a Community-wide basis, and (5) initiate a unilateral initiative for liberalisation of Canada's air transport services.

Do Nothing, Wait-and-See

This chapter has been designed to investigate how an effective Canadian air transport policy *vis à vis* the EU might evolve over the next few years? The basic question is how to ensure that Canada's policy does not further lag or constrain growth, but rather continues to play a key role in providing its stakeholders and communities with vital access to the global marketplace with increased trade and economic integration.

The question whether Canada-EU or Canada-US negotiations should be initiated first is a complicated one. Canadian Transport Minister Lapierre has indicated that he and U.S. Transportation Secretary Mineta are currently exploring the idea of expanding the 1995 Canada-U.S. air agreement into an Open Skies agreement.⁶⁶ Until such plans become more concrete, is sitting back and waiting a viable option for Canada *vis à vis* the EU?

One could argue that it may not be in Canada's best interest at this time to do nothing; by waiting to see the results of the ongoing EU-U.S. negotiations, Canada may only become an "after thought." Canada could request joining the EU-U.S. negotiations, but considering what the EC has "won" power over with respect to areas of designation of its national carriers, subsidy and establishment issues, there is little reference to traffic rights, other than cabotage, which might be a priority for Canada. It should be noted that the U.S. has refused to address cabotage with the EU. Also, Canada's carriers would not be on a level playing field considering the financial problems facing U.S. carriers. In this sense, there is little incentive for Canada to enter as a major player in the EU-U.S. transatlantic negotiations.

⁶⁶ Jean-C. Lapierre, Transport Minister of Canada. Speaking Notes. "Open Skies Forum." Canadian Airports Council. 23-24 Feb. 2005. Ottawa, Ontario.



In the EU-U.S. negotiations, the EC wants to negotiate open designations for all EU countries on individual countries' route rights, ownership, right of establishment and cabotage--as well as anti-trust in exchange for their Member States subsidies. The only advantage of a wait-and-see stance, *vis à vis* the EU, would be the opportunity for Canada to see what the EU is willing to cede in these areas. Canada could then "cherry pick" those areas in which the EU is potentially more inclined to concede.

It should be noted, however, that the main goal of Canada in any agreement is to increase its traffic to international destinations and thereby increase traffic through its airports with increased benefits, directly or indirectly, for all other stakeholders and the economy in general. One key element of delaying negotiations with the EU until after negotiating with the U.S. would be increased freedoms won in the U.S. market. Due to Canada's limited market, increased traffic with the U.S. would be beneficial to help "feed" any increased routes to the EU. Also, until Canada's carriers achieve increased 5th and modified 6th freedoms, its carriers cannot enjoy the anti-trust immunity that, for example, United Airlines and Lufthansa enjoys in Air Canada's Star Alliance.

Finally, whether the EU is even willing to negotiate with Canada at this time is an important factor. Currently, the EU is aggressively pursuing a new agreement with the U.S. Also, the EU is negotiating to expand its open skies with China and Russia. Such mandates on the EU's part may put comprehensive negotiations with Canada on the "back burner." In fact, some EU carriers are worried that even talks with the U.S. may be delayed by the EU's outreach agenda to include China and Russia.⁶⁷ A China-EU aviation summit is planned for June 2005.

In sum, Canada should negotiate with the EU when an agenda has been established that will benefit Canada -- if a reasonable amount of what Canada wants is available and if Canada can pay for it. Thus, Canada should always be realistic about what it will be able to achieve in any negotiations with the EU and the costs involved. In this sense, Canada may wish to wait-and-see where the EU and U.S. are willing to give and take. Therefore, if the EU and U.S. sort out issues of each other's agenda, Canada may be able to assess if it wants to attain such concessions and whether the related costs would be bearable. However, the downside of passively waiting too long could be the loss of market share in the trans-Atlantic market, or the opportunity cost of losing traffic that could have been directed via Canadian hubs.

Negotiations with Individual Member States

The first step in negotiations with individual Member States would be to address bringing Canada's bilaterals in line with EU law concerning nationality clauses; this would be the minimum that the EU would require. On the one hand, Canada could approach Member States to initiate preliminary discussions; this could be considered a "good will" effort on the part of Canada to begin negotiations for more liberal access. On the other hand, individual Member States may approach Canada requesting renegotiation of the current

⁶⁷ Robert Wall. "Priority Check: European Commission's External Outreach Receives Lukewarm Support from Airlines." *162 Aviation Week and Space Technology*. 21 Mar. 2005.



bilateral ASAs; moreover, Member States could possibly renounce their ASAs with Canada.

Accepting the EU horizontal clauses with respect to nationality of airlines should not pose any problem for Canada as long as capacity is not unlimited. It should be noted that Canada's current ASAs with Member States already address capacity issues; therefore, whether Air France or Lufthansa operates on the bilateral's restricted capacity between Paris and Toronto would not affect capacity. Although France could not discriminate between Air France and Lufthansa, the level of competition for Canada's carriers would not be affected due to the current designation quotas in ASAs. However, a situation could arise in which a Czech carrier could compete on the same route with less expensive labor and infrastructure allowing it to offer less expensive fares in comparison with Canadian carriers.

Whether Canada negotiates with Member States on a case-by-case basis or with the Commission, Canada must approach the negotiations with certain goals in mind. An environment that fosters competition would be a priority. This would include an increased share of the traffic and capacity to the EU as well as an increased number of passengers and cargo through Canada's airports. Also, negotiators must acknowledge the direct and indirect benefits from increased competition and ensure that smaller regional markets are not ignored.

Negotiations with the Commission

Short of negotiating a single Community-wide bilateral ASA with the EU, Canada could accept the horizontal clauses proposed by the Commission in one grand sweep. In other words, Canada would authorize traffic rights to any EU carrier provided that:

1. the EU air carrier is established in the territory of the designating Member State and has a valid operating license in accordance with European Community law;
2. effective regulatory control of the air carrier is exercised and maintained by the Member State responsible for issuing its Air Operators Certificate (AOC) and the relevant aeronautical authority is clearly identified in the designation; and
3. the air carrier is owned and shall continue to be owned directly or through majority ownership by Member States and/or nationals of Member States, and shall at all times be effectively controlled by such states and/or such nationals.

It should again be noted that current bilaterals with the EU designate a limited number of points, routes and air freedoms. Also, certain carriers are designated by EU Member States which involves each EU country nominating one or more carriers to operate on any agreed international route. For example, the Netherlands has designated KLM and Martinair in its bilateral ASA with Canada; Portugal has only designated TAP. Therefore, the question remains whether the Netherlands or Portugal would allow another EU carrier to replace their national carriers in any bilateral agreement.

One might ask, however, what Canada should ask for in return for accepting the horizontal clauses. Canada may wish to renegotiate elements of its bilaterals such as ownership and control, increased frequency and capacity, increased code-sharing



agreements and anti-trust immunity on a case-by-case basis with Member States. Although Canada has no true “open skies” policy with any Member State, the bilateral agreement with the Netherlands demonstrates the evolution towards a “more open” open sky regime, as discussed earlier. It appears that any negotiations would be permitted by the EC as long as the “horizontal clause” is incorporated into any new ASA. As discussed earlier, however, there are traffic and designation issues with the more protectionist EU Member States such as France, Italy, Portugal and Greece; any negotiations for more liberal traffic rights at that level might not be practical on an individual basis with these states.

Also, renegotiating 25 individual agreements would be a time-consuming and costly effort. In the classical bilateral ASAs between Canada and the EU, routes are negotiated between two countries by reference to city-pairs with intermediate stops and extensions, if any. If the intermediate stops or extensions take place in the territory of a third country, they require the agreement of the third country which must be expressed in another bilateral agreement. This fact must be taken into consideration, because all of the Member States’ bilaterals with third countries would also need to be renegotiated which could be a lengthy and complicated process.

Negotiations for a Single, Bilateral Air Service Agreement

Whether Canada could collectively negotiate a single bilateral with the EU on a Community-wide basis is a more complex issue. It would be practically impossible for Canada to negotiate a single agreement on a Community-wide basis unless the new bilateral agreement addressed each of the key elements of air service agreements: access, designation, capacity and tariffs. However, such an agreement could afford Canada the opportunity to press for more liberal options with respect to these key elements.

Access

The geographical limits of a carrier’s market are defined by access. A Community-wide agreement would need to address the number of points and city-pairs, routes, and the air freedoms authorized by individual Member States. These are normally specified in the annexes to bilaterals and may or may not be affected by a Community-wide agreement. A major change which would affect competition would be the inclusion and exchange of cabotage rights which are normally prohibited in bilateral agreements. For example, the Canada-U.K. bilateral restricts cabotage in Article 3, Grant of Rights:

- (2) While operating an agreed service on a specified route the airlines designated by the Contracting Party shall enjoy [...] the right to make stops in the territory of the other Contracting Party at the points specified for that route in the Schedule of Annex I to this Agreement for the purpose of taking on board and discharging international traffic in passengers and cargo, including mail, separately or in combination.
- (3) Nothing in paragraph (2) of this Article shall be deemed to confer on the designated airlines of one Contracting Party the right to take on board, in the territory of the other Contracting Party, passengers and cargo, including mail,



carried for hire or reward and destined for another point in the territory of the other Contracting Party.⁶⁸

EU carriers, however, theoretically enjoy cabotage rights within the territory of EU Member States; any EU carrier may provide domestic service within any EU member state. The EU also has bilateral air services agreement with Iceland and Norway which are fully included in the EU air transport market, including cabotage. Article 7 of the Chicago Convention, however, provides that states have the right to refuse cabotage, but they cannot grant cabotage on an exclusive basis:

Each contracting State undertakes not to enter into any arrangements which specifically grant any such privilege on an exclusive basis to any other State or an airline of any other State, and not to obtain any such exclusive privilege from any other State.⁶⁹

Therefore, from a legal standpoint, the EU is granting cabotage on an exclusive basis; it is also seeking cabotage services in the U.S. since its carriers enjoy 5th freedom rights to operate between Member States. Although an exchange of cabotage rights in a Canada-EU agreement could provoke reaction from other states, it should be noted that the EU grant of intra-EU cabotage rights have not resulted in any formal protest from non-EU states. Also, as discussed earlier, such an exchange would also require amendment of related national legislation. Naturally, Canada could proceed with cabotage on a limited, step-by-step basis. Such a strategy could allow the implementation of cabotage on a reciprocal basis with certain limitations with respect to routes and capacity. Also, cabotage could be limited to the extension of designated international routes. For example, KLM could fly from Amsterdam to Montreal, and then continue to Vancouver. Finally, cabotage could be avoided with increased code-share agreements and participation in alliances.

Nevertheless, there are advantages to granting reciprocal cabotage rights in bilateral agreements. The following table illustrates favorable, as well as unfavorable, consequences of increased competition derived from cabotage.

⁶⁸ *Agreement between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland concerning Air Services*, CTS1988/28, (1988/06/22). Article 3: Grant of Rights.

⁶⁹ Chicago Convention. Article 7: Cabotage. *Annals of Air and Space Law*. Montreal: McGill University, 1993, at 9. “Each contracting State shall have the right to refuse permission to the aircraft of other contracting States to take on in its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory.”



Table 1. Exchange of Cabotage Rights with the EU on a Community-wide Basis.

FAVORABLE	UNFAVORABLE
<p><i>Foreign Carriers in the Canadian Market</i></p> <ol style="list-style-type: none"> 1. Cabotage could ensure that goods and passengers would continue to move when and where Canadian airlines could not provide services. 2. Cabotage would not impede Canada from imposing rules on carriers operating in Canada. 3. Cabotage would allow foreign carriers to establish new routes, either in new city-pairs or extended legs or spokes to hubs. 4. Travel agencies, tourism and regional airports would benefit economically from increased traffic. 5. Cabotage and increased competition would lead to lower shipping and freight costs for goods. 6. Increased competition would be an incentive for domestic carriers to diversify services and offer new products. 7. Cabotage is the “ultimate free market situation that would yield maximum economic efficiency.”⁷⁰ 	<p><i>Foreign Carriers in the Canadian Market</i></p> <ol style="list-style-type: none"> 1. Increased competition for Canadian carriers on domestic routes and the possibility of new low cost carrier entrants. 2. Canadian domestic carriers face the possibility of becoming feeders for EU carriers’ traffic. 3. EU carriers may target profitable trans-continental routes such as Toronto-Calgary and Toronto-Vancouver. 4. Loss of control. Only by strictly limiting the right to engage in domestic transportation can Canada ensure the continued existence of safe, reliable, and efficient transportation. 5. Some argue that prohibition of cabotage is essential to national security. 6. Increased point-to-point, city-pair does not help Canada to create new markets; foreign carriers will only compete with current domestic traffic. 7. Global alliances other than the Star Alliance may enter the Canadian market.
<p><i>Canadian Carriers in the EU market</i></p> <ol style="list-style-type: none"> 1. Canadian carriers would have more choice of itineraries for their Canadian and EU passengers. More markets would be available. 2. Canadian carriers could establish gateway hubs in Europe for extending their routes. 	<p><i>Canadian Carriers in the EU market</i></p> <ol style="list-style-type: none"> 1. Canadian carriers would face a highly competitive market with increasing low cost carrier (LCC) market share. 2. Canadian carriers would face more restrictive slot allocations than those found in the U.S.



The Canadian domestic market is somewhat limited and encompasses a small number of city-pairs which might limit the potential for a European carrier’s entry. These city-pairs may also not be able to support more than one or two competitors. Therefore, the EU may not be interested in negotiating cabotage on a reciprocal basis. Therefore, a comprehensive agreement could provide for “consecutive” cabotage or 8th freedom service which is the right or privilege granted by one state to an airline or airlines of another state to put down and to take on traffic in the territory of the first state coming from one city in that state and destined to another city in that state as an extension of its 3rd and 4th freedom rights. Under this right, for example, KLM would be allowed to pick up passengers in Montreal destined for Toronto on its route Paris-Montreal-Toronto. It should be noted that this does not entail direct flights between points in the domestic market; rather, it merely lifts the restriction on marketing of existing opportunities operated via a Canadian or EU hub. For example, Air Canada could establish a European hub and carry additional traffic beyond on a route such as Toronto-Amsterdam-Prague.

Designation

Canada could avoid the complications with respect to the exchange of cabotage rights as described above by allowing EU carriers the right of establishment in Canada, and vice versa. Relaxing foreign ownership limits might do more to ensure the survival of domestic competition than any other policy changes with respect to traffic rights. This could also increase the sources of capital available to Canadian carriers. Such capital is imperative for fleet renewal and the addition of new aircraft for extending the Canadian international market.

Currently, Canadian airline ownership rules are particularly restrictive with a 25 percent limit on foreign equity. For Canadian carriers, the amount of ownership and control is embodied in national law and would require amendment for more relaxed ownership and control rules. The fact that foreign ownership limits could initially be increased to 49 percent could be considered; the limits could then be raised to 100 percent at a late date.

Capacity and Tariffs

The following table examines the favorable and unfavorable consequences of relaxing foreign ownership and control rules:

Table 2. Relaxation of Foreign Ownership and Control in Bilateral ASAs

FAVORABLE	UNFAVORABLE
<p><i>EU Ownership in the Canadian Market</i></p> <ol style="list-style-type: none"> 1. Airline strategies are limited by ownership rules; Canadian carriers could strengthen their positions through mergers with EU carriers. 2. Limits on the amount of capital that Canada carriers could obtain from EU could be removed; increased investment could satisfy the need for fleet renewal and additions. 3. Increased competition would be an incentive 	<p><i>EU Ownership in the Canadian Market</i></p> <ol style="list-style-type: none"> 1. EU carriers may be attracted to trans-continental Toronto-Calgary and Toronto-Vancouver markets which are key profit centers for Canadian carriers. 2. Canada would not stand by and allow its market shares to wither. 3. Relaxed ownership rules translate into loss of national security.



<p>for domestic carriers to diversify services and offer new products.</p> <ol style="list-style-type: none"> 4. Foreign investment would enhance the transfer of technology, knowledge and skills; new managerial strategies could be introduced 5. New entrants may help create new inter-continental hubs or gateways. New carriers will also help feed traffic to domestic hubs. 6. New traffic may be stimulated. Expanded networks and new city-pairs may be created for domestic carriers. 7. Increased employment and tax revenues. 8. Increased movement of passengers in airports; increased slot revenues to meet increasing rents. 9. Increased competition with EU low-cost carriers could lower fares and stimulate travel. <p>Canadian Ownership in the EU Market</p> <ol style="list-style-type: none"> 1. Possible 6th freedoms: EU-CAN-U.S. 2. Addition of new spokes from hubs established in European market. 3. Anti-trust immunity for Air Canada in Star Alliance with UA/Lufthansa. 4. Expanded networks and new city-pairs may be created for Canadian carriers in Europe. 5. Acquisition of merging partner's slots for increased traffic in Europe. 10. International traffic may be stimulated for Canada's low-cost carriers. 	<ol style="list-style-type: none"> 4. Loss of control over particular routes. A foreign-owned Canadian carrier could be structured as a shuttle service in short-haul, high-density markets. 5. Possibility for flags of convenience. 6. Increased EU 5th freedoms for EU carriers: EU-CAN-US. 7. Loss of control; EU carriers could lay off Canadian employees, cut non-commercial routes, or merge local offices. 8. Decreased security; loss of airlift capacity during emergencies. 9. EU carriers may not be able to offer the frequencies required to attract the business traveler in the thin Canadian market. 10. Low-cost EU carriers could offset delays with lower fares to attract Canadian leisure travelers. 11. Canadian carriers may become feeders for EU traffic. 12. Canada's low-cost domestic carriers with thin margins would suffer most from new EU entrants. Air Canada could offset domestic market loss with increased international traffic. <p>Canadian Ownership in the EU Market</p> <ol style="list-style-type: none"> 1. Strong competition from EU carriers and increasing numbers of low cost carriers. 2. Added infrastructure costs. 3. Limited access with respect to slots. 4. Likelihood of delays which would not attract the business traveler. 5. Financial difficulties facing Canadian carriers may discourage investment in the European market. 6. Air Canada already has strong links with its alliance partners in Europe. <p>Canadian tax burden on fares may be disadvantage for traffic in the EU market.</p>
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In contrast to possible negotiations with Member States on an individual basis, the EC may be more inclined to conduct a Community-wide agreement with Canada. The comprehensive agreement could include liberalization of air traffic regulations on licensing, prices, and market access along with regulations on miscellaneous issues such as ground handling, slot allocation, and airport fees. Entering into such an agreement would allow Canada and the EU to create the first inter-continental aviation area, an area where both Canadian and European carriers would be able to fly freely in each other's domestic markets. Such an endeavor would thus include cabotage, removal of foreign investment restrictions, and rights of establishment. Although the establishment of foreign carriers in Canada would benefit the Canadian economy with increased employment and increased revenues from taxes, the question arises if Canada could bear the increased competition with European carriers in its limited domestic market, and if



Canada could offset such competition with increased routes to and within the EU market and beyond.

The distinction between business and leisure traffic should not be neglected when discussing tariffs. The use of gateway hubs would entail more delay for connecting flights for both Canadian and EU carriers; this would need to be offset by reduced tariffs to attract the leisure traveler. International business traffic is very lucrative and creative marketing strategies would need to be formulated to approach this market. Flight frequencies are very important for time-sensitive business travelers who prefer flexibility and shorter waiting times, low prices, reliable service, and additional amenities.

Unilateral Initiative for Liberalization

One option that could also be considered is a unilateral initiative for liberalisation which could be incremental by liberalising cabotage or ownership and control, for example, on a step-by-step basis. An even more ambitious approach would be the “big bang” approach similar to that experienced in Lebanon as discussed in the previous chapter. Such an approach, for example, would permit unrestricted services by the airlines of foreign countries to, from and beyond the others' territories, without prescribing where carriers fly, the number of flights they operate, or the fares they charge.

Any unilateral initiative for liberalisation seems unlikely for many reasons. First, Canada's air transport policy has historically been very protectionist; the Canadian domestic market should only be served by Canadian carriers. Also, any “big bang” approach would require tremendous efforts to amend current legislation restricting cabotage, foreign investment and rights of establishment. Such an endeavor would also require harmonization of competition and certification rules and the establishment of a separate regulatory entity to administer the agreement. On the other hand, such an initiative could possibly offer the most competitive environment for Canada's stakeholders and consumers.

CONCLUSION: INCREMENTAL RECIPROCITY?

This Chapter has examined Canada's priorities *vis à vis* the EU with respect to air transport services. As noted earlier, the EU has recently requested its Member States to renounce its bilaterals with the U.S., and it may only be a matter of time before they will be formally asked to do the same with Canada.

Also, this Chapter has argued that any negotiations with the EU should take the ultimate interests of Canada's stakeholders into consideration which should imperatively include an increased share of traffic and capacity to the EU, an increased number of passengers through Canada's airports, more efficient shipment of goods, and an environment that continues to foster competition. The negotiations must also ensure an adequate return to investors and shareholders with increased direct and indirect benefits - both in passenger and cargo revenues – for the Canadian economy. This includes ensuring that Canada's smaller regional markets are also not ignored.

These ultimate goals may require that increased liberalization of air transport services be addressed any Canada-EU negotiations; such liberalization refers to the removal of



statutory and regulatory constraints that unnecessarily limit the operations of Canada's stakeholders. According to the Council of Canadian Airports, the purpose of international air transportation is to serve the needs of passengers and shippers; however, policies designed to promote carrier financial interests at the expense of user interests are "inherently self-defeating."⁷¹

Many have regarded the liberalisation development of the 1995 Canada-U.S. Open Skies Agreement a measurable success. Nearly 60 new transborder routes opened up shortly after the treaty was signed, air traffic between Canada and the U.S. doubled, and airfares were generally significantly lower than those prior to deregulation in real terms today.⁷² Prior to the 1995 Agreement, for example, Air Canada Jazz served only five regional scheduled destinations in the United States. Today, however, Jazz operates more than 105 non-stop flights per day, on 20 routes to and from 17 U.S. and 4 Canadian cities.⁷³

With respect to Canada's air transport policy with the EU, the costs of continued protectionism in the air industry may be far greater than the benefits. In the long term, restrictive air policies fail to protect even the smaller, regional markets. For example, foreign carriers such as Lot Polish Airlines, Iceland Air and Martinair have in the past been prevented from providing scheduled non-stop service to such markets as Edmonton despite the fact that there is a well-established, proven market need for these scheduled services.⁷⁴ Also, no Canadian carrier has been able or willing to service this need. While such restrictions arguably stifle Canada's regional economies, it should also be noted that only a few select Canadian cities are favoured through the current bilateral agreements with the EU.

Whether an overall agreement should be negotiated all at once or step-by-step is an important consideration. In any event, however, reciprocity appears to be the key to any new bilateral negotiations with the EU. For example, current restrictions prohibit EU carriers from landing to pick up Canadian passengers en route to U.S. or Asia. A more open skies policy introducing 5th freedom rights would make that possible, potentially providing passengers with an array of new direct flights. Canadian carriers would benefit with the opportunity to pick up EU passengers en route to a third country; a Montreal flight to Rome could pick up EU passengers during a stop in Paris, for example. On the basis of reciprocity, EU carriers would be able to fly through Canada, and pick up passengers en route to the U.S.

Keeping the ultimate goals of international air transport service in mind, these 5th freedom rights would allow the consumers greater choice in routes and carriers, and they would provide lower fares and more service to secondary airports by EU carriers. The larger airports, on the other hand, would benefit from new or increased service by larger aircraft needed for longer international flights. Not only would such service result in higher airport revenues, but Canadian carriers would also gain greater access to the lucrative EU market that is currently dominated by the U.S. In any event, Canadian carriers must strive to divert more traffic from EU and U.S. carriers in the transatlantic market. Incremental introduction of 5th freedom rights would be a step in this direction as Canadian carriers could "top off" more distant flights with European passengers.

An incremental, reciprocal approach may appear to be a cautious attempt to open up bilaterals that currently restrict the number of EU carriers to Canada's airports. However,



such liberalisation could be advanced on a case-by-case basis where demand exists or could be forecast. The right of establishment is also an issue which could be addressed on an incremental basis; negotiators could establish a schedule whereby foreign ownership of Canadian carriers would rise initially from 25% to 49% and eventually to 100%.

On a reciprocal basis, Canadian stakeholders could establish domestic air carriers in the EU to feed traffic to mainline operations at Canadian gateways; EU carriers would have the same right in Canada. The pros and cons of liberalising ownership and control have been earlier discussed; however, the fact remains that Canadian carriers are currently constrained in their ability to attract capital because of existing foreign ownership restrictions. The right of establishment could increase equity capital for Canadian carriers and increase the level of domestic competition. Additional capital would be essential for the additional aircraft necessary to penetrate the EU market and beyond.

Cabotage, therefore, does not appear to be an option, at this time, in an incremental, reciprocal approach to liberalising Canada-EU bilaterals. On the one hand, any Canadian capacity should not be forfeited to EU entrants in the domestic market. On the other hand, due to Canada's particular geographical constraints, Canadian airlines could stand to gain more from the EU market than EU carriers from the Canadian market. Therefore, a strategy of targeting the EU market on an incremental, reciprocal basis may give Canadian carriers a stronger foothold in the EU market in the long run rather than facing EU competition "head on" in one comprehensive, fully liberalised agreement. Furthermore, initiating a "more open" skies policy with the EU could also be complemented later with increased traffic to feed transatlantic traffic resulting from a more open skies policy with the U.S.

The reduction of global barriers and the creation of a truly liberalised aviation market is the long term ideal. An immediate policy for Canada should allow its air transport industry to aggressively exploit its strategic location as a future gateway to Europe and beyond.



ANNEX 1: Summary of Canadian-EU Issues for Consideration

Scheduled Carriers

- To what extent should Canada seek to relax or remove routing, frequency, pricing and code-sharing restrictions on services with EU Member States?
- To what extent should Canada relax or remove routing, frequency, pricing, code-sharing and traffic right restrictions on services with the EU that also involve traffic to third countries?
- Should Canada negotiate increased traffic in EU's domestic market, i.e. cabotage?
- Should Canada address ownership and control issues in negotiations with the EU, and should Canada investigate the possibility of integrating Canada's air transport services with the EU under a single set of rules for an open aviation area?

Non-Schedule, Charter Services

- How should Canada further liberalize its charter policies to lessen or remove remaining restrictions on granting authority for charter services between Canada and the EU?
- Should different approaches be taken for passenger and charter services? Since the distinctions between scheduled and charter services have lessened, does maintaining restrictions on charter operators serve any purpose in an increasingly liberalized scheduled services environment?

Air Cargo Services

- How can a regulatory framework allow for free route design and network operation by all categories of carriers? Should commercial considerations provide the main criteria determining the establishment and operation of route networks?
- Should carriers be authorised to set their prices (rates) freely, according to economic considerations (this principle is already prevailing in air cargo transportation in a number of countries). Should tariffs vary according to service characteristics and market structure?
- Should carriers determine their ownership and control structures freely, according to their economic (notably, capital) needs, and their business and marketing policies?
- Should carriers be authorised abroad to employ, under their own name, services of domestic cargo carriers and/or operate multimodal transportation services (notably trucking services) on the surface legs of their operations, in order to be able to offer seamless and efficient services to their customers?
- Should customs procedures and ground handling operations in airports be made available to all carriers on an efficient, transparent, and non-discriminatory basis?

**ANNEX 2: Canada-EU Bilateral Air Agreements and Designated Air Carriers⁷⁵**

	EU Country	Agreement Date	Designated Canadian Airline(s)	Designated Foreign Airline(s)
1	Austria	93/06/22	Air Canada	Austrian Airlines
2	Belgium	86/05/13	Air Canada	
3	Cyprus			
4	Czech Republic	96/03/13	Air Canada	Czech Airlines
5	Denmark	89/02/17	Air Canada	Scandinavian Airlines System
6	Estonia			
7	Finland	90/05/28	Air Canada	Finnair
8	France	76/06/15	Air Canada Air Transat	Air France, Air Liberté, Corsair Aeris, Air St. Pierre
9	Germany	73/03/26	Air Canada Air Transat	Lufthansa, Condor Flugdienst, LTU
10	Greece	84/08/20	Air Canada	Olympic Airways
11	Hungary	98/12/07	Air Canada	MALEV Hungarian Airlines
12	Ireland	47/08/08	Air Canada	Aer Lingus
13	Italy	60/02/02	Air Canada	Alitalia
14	Latvia			
15	Lithuania			
16	Luxembourg			
17	Malta			
18	Netherlands	89/06/02	Air Canada	KLM, Martinair
19	Poland	76/05/14	Air Canada Air Transat	LOT Polish Airlines
20	Portugal	87/04/10	Air Canada Air Transat	TAP Air Portugal
21	Slovakia			
22	Slovenia			
23	Spain	88/09/15	Air Canada	Iberia, Spanair
24	Sweden	89/02/17	Air Canada	Scandinavian Airlines System
25	United Kingdom	88/06/22	Air Canada Air Transat Skyservice Zoom	British Airways, Virgin Atlantic, British Midland, Airfreight Express Ltd, Trade Winds



EU (Candidates) Bilateral Air Agreements and Designated Air Carriers

	Applicant Countries to EU	Agreement Date	Designated Canadian Airline(s)	Designated Foreign Airline(s)
1	Bulgaria	91/04/12	Air Canada	Balkan Bulgarian Airlines
2	Croatia			
3	Romania	83/10/27	Air Canada	TAROM S.A.
4	Turkey	60/05/21	Air Canada	

Canada-EU Bilateral Air Agreements and Designated Air Carriers

	EU Country	Grant of Rights	Designation	Tariffs	Capacity
1	Austria	As specified in Annex	Multiple	Double Disapproval	Pre-determination
2	Belgium	As specified in Annex	Multiple	Double Disapproval	Pre-determination, unlimited capacity entitlements for code-share services. ⁷⁶
3	Cyprus				
4	Czech Republic	As specified in Annex	Multiple	Single Disapproval	Pre-determination
5	Denmark	As specified in Annex	Multiple	Single Disapproval	Pre-determination on own equipment
6	Estonia				
7	Finland	As specified in Annex	Multiple	Double Disapproval	Pre-determination. Code-share limitations. ⁷⁷
8	France	As specified in Annex	Multiple	Single Disapproval	Pre-determination
9	Germany	As specified in Annex	Multiple	Double Disapproval	Free determination
10	Greece	As specified in	Single	Single Disapproval	Pre-determination



		Annex			
11	Hungary	As specified in Annex	Single	Single Disapproval	Pre-determination
12	Ireland	As specified in Annex	Multiple	Single Disapproval	Pre-determination
13	Italy	As specified in Annex	Single by route	Single Disapproval	Pre-determination
14	Latvia				
15	Lithuania				
16	Luxembourg				
17	Malta				
18	Netherlands	As specified in Annex	Multiple with limitations, Air Canada, KLM and Martinair.	Single Disapproval	Open Capacity
19	Poland	As specified in Annex	Multiple	Double Disapproval	Pre-determination
20	Portugal	As specified in Annex	Multiple	Single Disapproval	To be agreed between designated airlines.
21	Slovakia				
22	Slovenia				
23	Spain	As specified in Annex	Multiple	Double Disapproval	No unilateral action.
24	Sweden	As specified in Annex	Multiple	Single Disapproval	Pre-determination for own-equipment. Code-share entitlements in Code-share section.
25	United Kingdom	As specified in Annex	Multiple	Zonal disapproval. Double disapproval on cargo.	Pre-determination