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Developing a Community civil aviation policy towards Canada

1. INTRODUCTION

- 1.1 Traditionally, international air transport is governed by bilateral agreements between individual states. However, the so-called “open skies” judgements of 5 November 2002 of the European Court of Justice marked the start of an external aviation policy at Community level.

As outlined in the Communication of the European Commission “*Developing the agenda for the Community’s external aviation policy*”¹, targeted agreements between the European Community and certain third countries will have the substantial added value of creating new economic opportunities by opening up markets and promoting investment opportunities. Furthermore, such agreements will be the best way to ensure fair competition and high standards of safety, security and environmental protection by promoting regulatory co-operation and convergence.

Therefore, the European Commission has proposed to launch targeted negotiations seeking to achieve comprehensive aviation agreements in the major regions of the world, with the aim of strengthening the prospects for promoting European industry and ensuring fair competition, while at the same time seeking to reform international civil aviation.

- 1.2 With its market-oriented economic and transport policy and high regulatory standards, Canada is a strong candidate for a new-generation of air transport agreement with the European Community. Air traffic between the EU and Canada has doubled between 2000 and 2005 and Canada is a leading aviation partner of the EU. In 2005, 8.5 million passengers travelled between the EU and Canada.²

- 1.3 The new Canadian government has declared its readiness to enter into negotiations with the European Union with a view to liberalising aviation relations that are currently based on bilateral air services agreements between Member States and Canada.

An agreement on the liberalisation of air transport with Canada would bring economic benefits to air carriers, airports, passengers, shippers, the tourism industry and the wider economy both within the European Union and in Canada. According to an economic study launched by the Commission, over nine million additional passengers may be expected to travel following an opening of the markets. Furthermore, an open aviation area is likely to generate at least 72 Million Euro benefits for consumers. The agreement would further strengthen transatlantic economic links and complement the aviation agreement between the US and the European Union. In addition and equally importantly, it will be a milestone on the path towards an international reform of the regulatory framework governing the air transport sector.

- 1.4 With this Communication, the Commission therefore recommends that the Council authorise the Commission to negotiate, on behalf of the European Community, a

¹ COM (2005) 79 final, dated 11.3.2005

² Eurostat figures

comprehensive agreement on an Open Aviation Area with Canada. This would combine market opening with a parallel process of regulatory co-operation and convergence notably in priority areas such as aviation safety, security, environmental protection, protection of passengers and application of competition rules ensuring a level playing field and fair and equal conditions for competition.

2. THE EXISTING REGULATORY FRAMEWORK FOR AIR SERVICES BETWEEN THE EUROPEAN COMMUNITY AND CANADA

Bilateral air services agreements between EU Member States and Canada

- 2.1 Currently, air transport between Canada and the EU is governed by 17 bilateral air services agreements. There are at present no air services agreements between Canada and the other 8 EU Member States.³

The existing air services agreements between the EU Member States and Canada do not allow airlines, passengers and shippers to take full advantage of the benefits of open markets. Moreover, there is considerable variation across these agreements, which establish an unbalanced framework for air services between the EU and Canada as not all agreements are equally liberal with regard to freedoms and capacities available. Some agreements still provide for capacity determination for direct connections between Canada and the EU. A number of bilateral agreements still restrict the number of airlines that may be designated and include restrictive tariff provisions. These differences in the Member States' bilateral air services agreements with Canada lead to inequalities in the opportunities available to Community air carriers. The tariff articles in agreements with Canada are among the most detailed and complex in the world. Canada is one of the relatively few countries that still maintains a tight control on air fares, resulting in higher costs for airlines and consumers.

- 2.2 Like most bilateral air services agreements, the existing bilateral air services agreements between EU Member States and Canada contain nationality restrictions that have been found illegal by the European Court of Justice. Any agreement between the EU and Canada must allow any EU airline to operate flights to Canada from any EU Member State in which it is established. The first step in the negotiations should aim at restoring legal certainty for air services between Canada and the EU.

The framework for air transport in Canada

- 2.3 Canada has, for some time, been considering the liberalisation of its aviation policy. In recent months, Canada has shifted towards a more open aviation policy in order to promote travel, trade and tourism. Liberal air services agreements have been concluded with the two most important international markets, the US and the United Kingdom. The new agreement negotiated with the United Kingdom in April 2006 removed existing tariff restrictions to better respond to market demand and opened up fifth freedom operations to third countries. Recent statements by the airline

³ Cyprus, Estonia, Latvia, Lithuania, Luxembourg, Malta, the Slovak Republic and Slovenia have not concluded bilateral air services agreements with Canada.

industry show that it views liberalisation much more favourably than a few years ago. There is a widespread feeling that a Transatlantic Open Aviation Area without the participation of Canada would not serve the interests of Canadian carriers.⁴

- 2.4. Canada's most important international aviation partner is not surprisingly the United States of America. According to Canadian figures, 18.6 million people travelled last year between the two countries. In 2005, Canada and the US broadened their existing air services agreement and further opened up the market. The agreement however did not grant rights for cabotage (carriage of traffic between two points within the other country) nor for 7th freedom operations (stand-alone services between two countries outside the home country).
- 2.5 The airline market in Canada is dominated by Air Canada as the former national flag carrier. Following the merger with Canadian Airlines in 1999, Air Canada in 2004 was the 17th largest airline in the world by passengers carried. Air Canada is member of the Star Alliance, and is owned by the Air Canada Group, a holding company which also owns other Air Canada subsidiaries such as Air Canada Jazz and Air Canada Ground Handling. Air Canada envisages a substantial fleet modernisation. The second largest carrier in Canada is the low cost company WestJet which holds 33% of Canada's domestic market and is also active on the transborder market. On the international market, the charter carrier Air Transat has started scheduled flights to the EU and is offering 48 weekly flights to Europe from different Canadian airports.
- 2.6. According to the Canada Transportation Act, at least 75% of the voting rights of a aviation company have to be owned and controlled by Canadians. A lesser percentage can be specified by a governmental regulation. Moreover a company has to be "in fact" controlled by Canadians. However, discussions in Canada are ongoing on easing restrictions on foreign ownership and control.
- 2.7. The hub of Air Canada, Toronto airport, handles more than 28.6 million passengers per year. Airport charges in Toronto are very high and make it one of the most expensive airports in the world. Other important airports are Ottawa, Montreal, Calgary and Vancouver. Canada's airports are managed under long term lease agreements by airport authorities and have to pay rents to the Federal Government in exchange for the right to collect revenues.
- 2.8 Canada's aerospace industry has a long tradition and in 2002 employed 79,000 people. Canada's best known aircraft producer is Bombardier, including the former LearJet Corporation, which has become one of the two principal manufacturers of regional jet aircraft worldwide.
- 2.9 Canada's aviation regulator is the Transport Ministry (Transport Canada), supported by Canada's national transportation agency (CTA) which is responsible for issuing licences. Transport Canada is responsible for international relations, safety, security and transport-related environmental regulation. Air Traffic Services are provided by Nav Canada, a privately owned service provider. In the field of competition, the Canadian Competition Bureau acts under the supervision of the Industry Ministry.

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The McGill/Concordia Report on International Aviation Policy for Canada. Montreal 2005, p.298

3. FURTHER STRENGTHENING RELATIONS BETWEEN THE EUROPEAN UNION AND CANADA

- 3.1 Canada has a close and longstanding political partnership with the European Union. The relationship between the European Union and Canada is characterised by common values and convergent global objectives.
- 3.2 In 1976 the European Economic Community and Canada signed a Framework Agreement on Economic Cooperation, the first formal agreement of its kind between the EC and an industrialised partner country. The EU and Canada are both committed to reinvigorating global economic growth and embarked on a new type of trade agreement, a Trade and Investment Enhancement Agreement, to eliminate regulatory obstacles and to improve investments in each other's markets. In a Joint Political Declaration and Action Plan adopted in 1996, both sides agreed to increase co-operation in the fields of air safety and air traffic management.
- 3.3 In 2005, the European Community and Canada initialled an Agreement on Civil Aviation Safety providing for reciprocal acceptance of approvals and testing with regard to airworthiness, environmental protection, aircraft maintenance facilities and continuing airworthiness.

4. ECONOMIC BENEFITS OF A COMPREHENSIVE AIR TRANSPORT AGREEMENT BETWEEN THE EUROPEAN COMMUNITY AND CANADA

- 4.1 Around 8.5 million passengers were carried in 2005 between the European Union and Canada, 9 % more than in 2004. This makes Canada one of the largest long-distance air transport markets for the European Union. In terms of offered seat capacity, Canada is the fifth largest aviation market for EC carriers following the US, Switzerland, Turkey and Norway. For Canada, the EU is the second most important international aviation market after the US. While US transborder traffic accounts for nearly half of all air travel to and from Canada, European countries account for some 27% of total Canadian international travel. This includes European traffic via the United States. Other important partners include Australia, Japan, South Korea and China. International (non-US) traffic has been growing since 1991 at a rate of 5% a year, and has higher growth rates than transborder (traffic to US) and domestic traffic. Major market drivers are tourism (inbound and outbound) as well as strong business and trade links between both sides. Around 47% of international travellers to and from Canada are tourists; EU-Canada traffic comprises significant volumes of charter passengers during the summer period.
- 4.2 The United Kingdom (3.6 million passengers in 2005), Germany and France (1.5 million passengers each) and the Netherlands (750,000 passengers) are the most important EU national markets for Canada. These four markets account for around 74% of total EU-Canada traffic. Between 2000 and 2005, frequencies between Canada and the EU almost doubled. New services particularly focused on the new Member States and on Central Europe, and services to the previously strong markets in the UK, Germany and France nearly doubled. The London Heathrow-Toronto route is the ninth busiest in the world. Additional connections have been added between secondary airports in Canada and the EU to the benefit of these airports and consumers.

Benefits and added value of a Community approach

- 4.3 With its modern regulatory framework and its market oriented economic and transport policy, Canada is an obvious candidate for deepening of aviation relations with the Community in an Open Aviation Area – both in terms of market access and in terms of regulatory co-operation and convergence. Enhanced regulatory co-operation between the EU and Canada would facilitate further air services between the EU and Canada. Canada, like the EU, has very high standards for safety and security. There are many similarities in the regulatory approach which – if brought together in a comprehensive agreement - should lead to efficiency gains for the industry. In the field of ATM organisation and regulation, the Canadian system is close to the European one. On aviation safety and security, high standards on both sides should allow for an effective co-operation. The envisaged bilateral safety Agreement between the Community and Canada underlines the readiness of the two sides to mutually recognise their procedures and standards. In the field of aviation security, co-operation with the Canadian Air Transport Security Authority should be stimulated through the agreement.
- 4.4 Liberalisation of air traffic between Canada and the EU would create particular benefits for markets which are still governed by restrictive air services agreements between Member States and Canada. It could remove existing capacity and pricing restrictions and therefore open opportunities for the industry and consumers. Removing existing geographic restrictions (limited number of points) could increase further the number of services between the EU and Canada. In particular, limitations to the Western Coast (Vancouver) and to several EU Member States should be lifted. Finally, new markets in particular in Central East Europe will emerge between Canada and those Member States that do not yet have an air services agreement.
- 4.5 The clear potential benefits of an Open Aviation Area Agreement with Canada have been confirmed in a recent economic study carried out by independent consultants. The results of this study show that over five years after opening the market more than 9 million additional passengers could be expected. In the first year, passenger numbers are likely to increase by 500,000. In addition, an Open Aviation Area may generate consumer benefits of at least 72 Million Euro through lower fares and could create 3,700 jobs already in the first year. The study has confirmed that the regulatory and policy framework for air transport in Canada would allow the Community to achieve a model agreement with Canada which would result in greater levels of regulatory convergence and new opportunities for EU industry and users. An OAA with Canada would increase the competitiveness of EU airlines on the North-Atlantic market. It would lead to an increase in direct flights between the EU and Canada and to a better distribution of air traffic. Furthermore, the study underlined that an OAA would enable airlines to establish closer relationships with carriers of the other side and, through the removal of investment constraints, to make strategic investments. Such investments would provide the opportunity for new economies of scale and scope which would enable EC carriers to address markets which would not otherwise be commercially viable.
- 4.6 Due to the economic benefits of air transport liberalisation in general, various stakeholders have frequently underlined the importance of a reform of the regulatory

framework for international air transport, including the International Air Transport Association (IATA),⁵ representing the interests of international airlines, and the International Chamber of Commerce (ICC),⁶ representing the interests of the business community.

- 4.7 Quite apart from the legal problems that would remain unsolved, maintaining the status quo would deny the EU-Canada market the growth opportunity seen in other examples of opened air transport markets. Continued negative effects of more restrictive bilateral agreements, including on pricing, would constrain the development of a certain number of carriers and therefore create distortions in the internal EU market. The EU-Canada market could even also suffer real losses as other markets press ahead with liberalisation to exploit the network structure of international aviation.
- 4.8 In particular, EU airlines could be disadvantaged relative to US and Canadian carriers if the EU-Canada market is not opened to the same extent as the US-Canada and EU-US markets. Following the recent open skies agreement between Canada and the US, US carriers will enjoy significant access to the EU-Canada market via both fifth and sixth freedom rights. The competitive position of EU carriers would be strengthened considerably if they were able to enjoy not only unlimited access to the EU-Canada market, but also access to the US-Canada market. The envisaged EU-US air transport agreement would grant EU airlines fifth freedom rights between the US and Canada, but these rights need also to be obtained from Canada if EU airlines are to be able to take advantage of these opportunities. Given the developing integration between the EU and US aviation markets on the one hand, and the Canadian and US markets on the other, it would make sense to extend this integration to the EU-Canada market too.

5. CONCLUSIONS: SUBSTANTIAL ADDED VALUE OF A FUTURE EU-CANADA AIR TRANSPORT AGREEMENT

- 5.1 Canada has recently shown interest in starting negotiations on a comprehensive agreement on air transport with the European Community. The EU should respond favourably and seek to capitalise on Canada's interest. In order to remove the legal problems in bilateral air services agreements, a horizontal agreement should be negotiated as a priority.

A modernised framework for air transport between the EU and Canada offers significant new opportunities for strengthening air transport on the basis of a competitive and level playing field. In addition, it would further strengthen the already excellent commercial and political relations between the EU and Canada.

The model of an air transport partnership between the European Union and Canada is inspired by the ambition to take forward an agenda for reform at the international level. The resulting agreement on the liberalisation of air transport between the

⁵ IATA Global Press Briefing 14 December 2004: *"Carriers need the freedom to do business where markets exist."*

⁶ See ICC Recommendations on negotiations between the United States and the European Union to open aviation markets

European Community and Canada would replace the existing bilateral air services agreements between Canada and EU Member States and establish a modern framework for air services between the EU and Canada, with market access as open as possible and regulatory standards as high as possible. It could thereby be the model for an extended air transport partnership with other third countries. In view of the envisaged creation of an Open Aviation Area between the US and the EU, aviation relations between Canada and the EU should also be modernised so as to replace the existing patchwork of partly restrictive bilateral agreements with a fully integrated approach.

- 5.2 The negotiation of an Open Aviation Area agreement with Canada would aim at an opening of both market access and investment opportunities. The reciprocal opening of market access with Canada has already been implemented by some Member States. However, several agreements are still fairly restrictive. This imbalanced framework has led to inequalities in the opportunities of Community air carriers which are not consistent with the equal opportunities for all Community air carriers in the Single Market. The expected economic benefits of such an agreement have been shown in a recent study. A comprehensive air transport agreement on a Community level would make the Community's aviation relations with Canada coherent and would grant equal rights and opportunities for all Community air carriers for air services to Canada.

Furthermore, it would create new market opportunities for air carriers in those Member States that currently do not have any rights concerning air transport from and to Canada.

- 5.3 An agreement between the European Union and Canada would need to maintain and reinforce high standards of safety, security and environmental protection for air services. In the field of aviation safety, a specific agreement has already been negotiated.

With respect to environmental issues, the agreement must be consistent with the EU's commitment to sustainable development. Apart from the economic benefits highlighted above, the expected growth in air traffic also has unwanted side-effects, notably on air quality and noise levels around airports and through its contribution to global climate change. It is important that the agreement does not restrict the EU's ability to apply regulatory or economic instruments to mitigate these adverse effects.

Safeguarding fair competition is another key issue in open aviation markets. By achieving greater levels of regulatory convergence, a comprehensive air transport agreement between the Community and Canada would ensure a competitive level playing field to avoid distortions of competition.

Regulatory convergence can only be achieved at Community level. Canada and the Community have already taken the first steps towards a high level of regulatory convergence and this partnership can be progressively developed towards an Open Aviation Area between the European Community and Canada. The result of the proposed new partnership would send a clear signal to other third countries to join the trend towards a more flexible international framework for air transport.

- 5.4 In light of the above, the European Commission therefore recommends that the Council authorises the Commission to open negotiations with Canada with a view to concluding a comprehensive air transport agreement.
- 5.5 The Commission will work closely together with Member States and all relevant stakeholders in further developing and achieving the objectives set out in the negotiating directives.