CAGED BIRDS IN OPEN SKIES: COMMENTS ON THE EMERGENCE OF A DOMINANT CARRIER

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I. INTRODUCTION

CANADA ENTERED INTO THE Open Skies negotiations in the 1990's with the firm belief that the status quo as set out in the operative bilateral air transit agreement between the United States and Canada was not serving the needs of our airline industry, our consumers, or our economy. In an effort to aid our country in these three areas our nation entered into the Open Skies negotiations. As a result, freer trade in the transborder market has been beneficial to all three areas.

The recent purchase of Canadian Airlines International Limited (CAIL) by Air Canada has radically altered the domestic market with the net effect being a near monopoly within the domestic airline market. The response of our federal government, through the Competition Tribunal, the Canadian Transportation Agency, and promised undertakings by Air Canada, has been to re-institute government regulations in the hope of protecting consumers from the monopolistic tendencies of the new "super" airline, while at the same time ensuring a vibrant domestic commercial airline industry. In choosing this policy path our government has failed both the industry and the consumer. The lessons learned through the process of deregulating transportation industries and our experiment in trade liberalization through "open skies" in this area could provide the first steps in providing a dynamic solution to better serve all stakeholders.

In this essay I will briefly examine the history of deregulation in both the airline and the railway industries. I will point out clear advantages of deregulation as well as some important differences as to the policy choices in each industry. In this context I will outline the airline merger approved by the Competition Bureau, explaining the goals of the actual solution instituted by the government. In the final section I will examine the motivation for the "Open Skies Treaty"[1] in detail. This analysis will comment on the success of this solution, given the trade liberalization tendencies within the North American continent. The morale of these excursions is that

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[1] The full and proper name of the agreement is: "Air Transport Agreement Between The Government of Canada and The Government of The United States of America." *Air Transport Agreement Between the Government of Canada and The Government of The United States of America*, 24 February 1995, KAV 4196.

our airline industry, the travelling public, and other beneficiaries of the airline industry would, in both the long and short run, be better off allowing market forces to ensure consumer protection. The goal of any government legislation with the intention of protecting consumers should be to stop unfair trade practices rather than simply regulate protected industries.

II. A BRIEF HISTORY OF DEREGULATION IN TWO TRANSPORTATION INDUSTRIES

BOTH THE AIRLINE INDUSTRY and the railway industry were deregulated in the mid 1980's for the same reasons. These industries, in their regulated forms, resulted in higher costs to consumers and inefficiency, making it difficult to compete with the recently deregulated American industry. These industries were primarily regulated according to a social contract model. The government recognized the need for various transportation industries in order to transport both people and materials across a vast and under-populated country. While private industry was willing to develop transportation services in select lucrative markets, it was wary of expanding to a nationwide service.[2]

As a result, the government stepped in and regulated the industry. They demanded that both the Crown and private corporations serve both profitable and unprofitable regions so that all areas could gain the economic benefits of reliable transportation services. In return for the ability to regulate the service requirements for regions, the government together with the industries, would formulate pricing requirements for the entire industry so that on an overall basis the respective industries could make "a reasonable profit." The government also restricted the access of new competitors into these sectors of the economy. Any new competitor had to show the economic necessity of additional capacity. In this way, the lucrative routes – either for the railways or the airlines, would subsidize routes and regions which were in isolation and were not, therefore, viable. National transportation services were assured by spreading the cost among all users.

As Canadian manufacturers and producers had to compete with foreign manufacturers and producers in global markets, this arrangement was proving to be costly for the railways. Transportation costs, as a result of this arrangement, were no longer competitive and were seriously affecting our country's ability to compete internationally. Deregulation in the United States provided additional pressure to lower transportation costs for fear of losing transportation opportunities to US companies on southern US routes.[3]

Deregulation of the railways resulted in an ability to set the prices of transporting goods according to market forces and not according to "social

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[2] "Standing Committee on Transport: Evidence" (28 October 1999), online: Parliamentary Internet <http://www.parl.gc.ca/InfoComDoc/36/2/TRAN/Meetings/Evidence/tranev11-e> (pagination unavailable).

[3] "Deregulation" *Canadian Press* (22 May 1984), online: QL (CPN).

contract" regulations. The railways were concerned that this process of deregulation would only be partial, thereby requiring them to maintain unprofitable routes when they had to face competition on profitable routes.[4] The government eventually allowed the railway companies to divest themselves of unprofitable short track rail lines.[5]

Although this rationalization resulted in the loss of jobs and a disruption of service, municipal and provincial governments, as well as local industries, sought and found companies that could specialize in short track railway service. Whereas large national railways could not engage in a profitable service, smaller specialized companies were able to find profitable ways to provide services.[6] An excellent example of this was the sale of CN's short track services to the port of Churchill, Manitoba.

Both Canadian and American companies submitted bids for this route in the belief that they could make the route profitable. Eventually Omnitrax, an American company, was the successful bidder. Both the rail line and the port have become profitable and Omnitrax has purchased additional short line routes in Saskatchewan in order to offer grain farmers of that province an alternative to the ports in Thunder Bay and Vancouver.

Representatives of nationalist organizations decried the sale of a Canadian port to an American company, claiming that this was something that should be disallowed.[7] Churchill however, was (and is) very pleased with the revitalization that occurred as a result of the sale, and grain farmers and speciality crop farmers were pleased with the addition of another transportation option. Despite the protests, Canadians have benefited in a wide variety of industries.

Deregulation in the airline industry, though motivated by similar considerations, had unique aspects. Like the railways, the airline industries wished to abandon less profitable routes, with the goal of competing in the international marketplace. Given our small population, the growth potential within the Canadian market was limited. The explosion in international trade (where in many ways Canada was, and is in the forefront) made it clear that this was where real expansion was possible.

The commercial airline industry, for historical reasons, was regulated by the International Civil Aviation Organization [ICAO] and the many international bilateral agreements which regulated commercial air travel between the contracting states. Like the railways, airlines were permitted to set their schedules and prices according to market forces. The airlines were allowed to divest themselves of less profitable routes or to set up feeder airlines. These feeder airlines could provide profitable regional service by concentrating on their regions and by operating smaller and more efficient aircraft. In areas where

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[4] "Deregulation, Bgt" *Canadian Press* (22 October 1986), online: QL (CPN).

[5] Short track rail lines are regional lines that served remote areas off the main lines. "Capital-Branchline, Bgt, Request" *Canadian Press* (21 November 1991), online: QL (CPN).

[6] *Ibid.*

[7]"New-Rail-Owner" *Canadian Press* (13 November 1996), online: QL (CPN).

services were abandoned, smaller and even more specialized airlines were established to fill niche markets.[8]

There were two key differences with respect to deregulation of the airline industry as compared to the railway industry. First, the government chose to maintain ownership restrictions on airlines. (Canadian regulated and registered airlines are restricted to 25% foreign ownership.[9]) And second, as already mentioned, the airline industry was much more international in its hope for expansion.

III. COMPETITION BETWEEN THE TWO MAJOR CARRIERS

AFTER THE GOVERNMENT DEREGULATED the airline industry, Air Canada and Canadian Airlines engaged in fierce competition. The recently formed CAIL attempted to compete head to head against Air Canada. CAIL was hampered with a huge debt after the merger of Canadian Pacific and Wardair. Air Canada received a huge influx of capital through the selling of shares in the process of privatization. As noted by Rod E. White of the Ivey School of Business at Western University, the emergence of one dominant carrier was not the inevitable result of existing government policies, but rather the result of strategic choices by the competing companies themselves. Animosity, and not necessity, brought us to the present situation of one dominant carrier.[10]

Many analysts had speculated that CAIL would not continue to exist as a major competitor to Air Canada for several years. They also predicted the subsequent emergence of a single dominant national airline. Although there remains some limited competition in the West through Westjet and between the lucrative Toronto-Ottawa-Montreal routes, this competition does not form any type of market-driven protection for the airline passenger. Air Canada has a monopoly and is apt to introduce monopolistic tendencies.[11]

Prior to the final outcome of Air Canada purchasing CAIL, there was much speculation and excitement in the industry as to what would be the final outcome. CAIL requested that s.47 of the Canadian Transportation Act be relaxed so that the two airlines could share otherwise confidential information for a 90 day period in order to arrange a private sector solution to the restructuring of the airline industry.

On 21 December 1999 the Competition Bureau announced that it would not oppose the airline merger. The bureau recognized that although the emergence of a single dominant carrier that promised certain undertakings would significantly lessen domestic competition, they found this solution more "pro-

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[8] This was most clearly seen in northern Canada, a region in which some analysts expected all air service would be lost. These markets have actually become one of the most competitive markets. *Supra* note 2.

[9] *Canada Transportation Act*, 29 May 1996, R.S.C. 1996, c. C-10.4, s. 55.

[10] *Supra* note 2.

[11] *Ibid.*

competitive" than liquidation through bankruptcy proceedings.[12]

The government has set out a three-pronged policy to address the public's concerns with respect to the lack of competition. First, they are attempting to restrain the dominant carrier from predatory pricing through legislation. Second, they are in the process of creating an environment where someone will attempt to create a new domestic competitor. Third, they have demanded specific undertakings by Air Canada in order to both protect consumers and to foster competition. Such attempts can only be partially successful for the consumer in the long and short run.[13]

The Competition Bureau made several recommendations as to what government and the dominant carrier would have to do in order to protect consumers and allow for a vibrant "home grown" airline industry. In order for Air Canada to receive approval for the takeover they signed a series of undertakings. These undertakings included, for instance, forcing Air Canada to sell its feeder airlines at a fair market value, and requiring the airline to surrender a large number of slots at Pearson airport that could then be assigned to a new carrier. In addition, if a new carrier began operating in Eastern Canada, Air Canada would not be allowed to establish its own discount carrier until 30 September 2001. They would also be forced to sell key facilities to the airport authority or Transport Canada at airports across the country where they controlled more than 60% of the gates and bridges of the airport. Finally, the undertakings required Air Canada to give domestic carriers the right of first refusal on the sale of surplus aircraft for a period not exceeding three years.[14]

Soon after, these undertakings were followed by the government-tabled legislation (Bill C-26) to re-regulate the domestic airline industry in certain ways.[15] The legislation gives the Canadian Transportation Agency (CTA, the regulator of domestic airline service) increased powers to prevent price gouging. The Competition Bureau was granted new powers so as to prevent certain anti-competitive behaviour and to foster competition in the airline industry. The bureau and the minister were empowered to issue temporary orders to cease predatory behaviour. The Canadian Transportation Act only specifically sets out predatory pricing, leaving the exercise of this power discretionary. The legislation also includes extensive enforcement measures such as maximum

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[12] "Competition Bureau Announces It Will Not Oppose Acquisition of Canadian Airlines" (21 December 1999), online: Strategis<http://www.strategis.ic.gc.ca/SSG/ct01670e.html>.

[13] "Minister of Transport Prepared to Approve the Air Canada Transaction to Purchase Canadian Airlines – Secures Commitments to Protect Public Interest" (21 December 1999), online: Transport Canada News Release <http://www.tc.gc.ca/releases/nat/99%5Fh113e.htm>.

[14] "Backgrounder: Undertakings to Enhance Competition in a Restricted Airline Industry: Issue Highlights" (21 December 1999), online: Strategis <http://www.strategis.ic.gc.ca/SSG/ct01671e.html>.

[15] *Supra* note 9; s.56.1(1).

imprisonment of five years or a $10,000,000 fine, or both for the failure of Air Canada to comply with the undertakings.[16]

By creating a "false" market in which the airline will be forced to allocate its resources, these measures will be harmful in the long run for the airline industry itself. Air Canada will be in the uncomfortable position of being in a domestic market which is more highly regulated than its international market. The discretionary powers as outlined in Bill C-26 are not curtailed by any specific nor recognized anti-competition purposes. This suggests that the minister is empowered to act in a potentially capricious manner, or at least on the basis of political motives. One way this could be exercised (and historically was exercised) is through utilizing the government's power to delegate particular carriers according to international bilateral agreements. Under the regulated system, which lasted up to the early 1980's, the government exercised its powers of designation in order to extract certain undertakings in the domestic market.

It is not clear that the legislative changes offer sufficient or appropriate protection to foster the development of a new competitor. As already mentioned, the only particular predatory practice identified is that of predatory pricing. The statutory provisions do not address other forms of predatory practices, such as over-capacity in terms of both frequency of flights and size of aircraft. IMP, a company planning to start up a discount carrier to compete against Air Canada, has stopped any further development. It seems more than coincidental that this occurred at the same time that Air Canada announced more routes and frequencies into Eastern Canada.[17]

It is not clear how much protection a new competitor can expect from the federal government. The federal government could have expanded the existing legislation to either treat over-capacity as a predatory practice, or to introduce certain capacity restrictions so that CAIL would not have been placed in such a precarious position. If the federal government was unwilling to enact such regulatory protection when an effective competitor did exist, it seems unlikely that they would do so for a new competitor.[18]

With no potential competitor on the horizon, consumers will have to look to government legislation instead of market forces to protect their interests; yet this could be more effectively accomplished by market forces rather than through government legislation. In an environment which, over the last five years has seen significant advances in trade liberalization, the domestic market has become more restrictive. The snowbirds are caged in an open skies environment. The developments of trade liberalization in our bilateral

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[16] *Ibid.*; s.56.2(1).

[17] "Canjet principal wants to try startup at Toronto airport" (11 February 2000), online: Canoe <http://www.canoe.ca/AirMergers/feb11_canjettoronto.html>.

[18] As already noted, one of the undertakings agreed to by Air Canada was to wait until 30 September 2001 before starting its own discount carrier if one began in Eastern Canada. This, however, placed no restrictions on the expansion of either Canadian or Air Canada itself into this region. *Supra* note 14.

relationship with the United States provide an excellent example of how trade liberalization strengthens the industry and better serves consumer needs. A brief history of the development of the Open Skies Agreement will make this clear.

IV. THE AIR TRANSPORT AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND CANADA

THE MOST RECENT AIR TRANSPORT AGREEMENT between Canada and the US (prior to the Open Skies Agreement) was last amended in 1974. This agreement was substantially based on the 1966 agreement[19] and simply added more routes. The prime objectives of this agreement were to facilitate direct transportation between the two countries and to ensure an equitable exchange of economic benefits between the two parties.

The agreement allowed for the first four freedoms.[20] The third and fourth freedoms were limited to negotiated city-pairings. While the agreement also allowed for the fifth freedom, this was restricted to flights from North America to Australia with a stopover in Honolulu.[21]

The agreement set out particular city-pairing routes. City-pairings were negotiated on the basis of desired access to the respective cities. Just prior to the signing of the Open Skies Agreement there were 83 city-pairings; 26 were operated exclusively by Canadian carriers, 39 exclusively by US carriers, and 18 were designated for carriers of both countries. The respective government

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[19] *Air Transport Agreement Between The Government of Canada and The Government of The United States of America*, 17 January 1966, 17 UST 201.

[20] ICAO, the International Civil Aviation Organization, was established in 1944 for the purposes of regulating international civil aviation. The contracting parties attempted to establish a broad set of concrete rights for the organization to administer. Although they were not successful in establishing these rights as part of the international agreement, these rights came to be known as the freedoms and now serve as the central rights negotiated in all bilateral agreements. The five freedoms are:

1. The privilege to fly across territory of other states without landing.
2. The privilege to land in other states for non-traffic purposes.
3. The privilege to put down in other states passengers, mail and cargo taken on in the territory of origin of the service.
4. The privilege to take on passengers, mail and cargo destined for the territory of any other contracting state.
5. The privilege to put down passengers, mail and cargo coming from any such territory.

See the Wartime Information Board, *Canada and International Civil Aviation* (Ottawa: Edmond Cloutier, 31 March 1945) 13-29.

[21] *Supra* note 19; Schedule II.

authorities would then designate carriers with these rights.[22] The right to these city-pairings was subject to strict regulation of capacity, frequency, and pricing, with each nation having a virtual veto power if it was not satisfied with the terms proposed by the designated airline. This at once established that a foreign carrier would receive national treatment. The contracting parties were obligated to subject foreign carriers to the same tariffs, customs, and airport fees as domestic carriers.

Proposed rates had to be filed 30 days prior to the date of introduction and were subject to the approval of each country's aeronautical authority.[23] If a state disagreed, its notice of disapproval had to be received within the first 15 days. The parties were then obligated to negotiate. If a dispute could not be resolved, Article XV set out a dispute resolution system. Each country would select an arbitrator from its own country, and would in turn select the third arbitrator who was not a national of either country. If they could not agree, the arbitrator would be selected by the president of the ICAO. These bilateral agreements represented the most comprehensive and complex agreement between any two states. At its height, this bilateral agreement governed the transport of 13 million passengers on transborder flights generating $2.3 billion in revenue. US carriers handled 60% of the traffic and earned $500 million annually more than Canadian carriers did.[24]

Given the relative size of our respective countries and airline carriers, these statistics suggest that Canada did disproportionately well under this agreement. There were several reasons why the status quo was unacceptable to both Canada and the US on the eve of the Open Skies negotiations.

A. Geography

The US carriers had direct access to more than 90% of our population, since the vast majority of our population is located along a 200 mile strip paralleling the Canada-US border. Conversely, the Canadian carriers had access to 30% of the US market since the population centres are more numerous and are spread throughout the country.[25]

B. Structure of the Airline Industries

Canada's access to the US market was further restricted by the highly

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22 The whole process of designation was a point of contention in other bilateral agreements. The federal government, for political reasons, would withhold an allowable designation in order to protect a carrier from competition on a particular route. It was an ad hoc method of maintaining stability among the two dominant carriers. *Ibid.*; Article III.

23 *General Agreement on Tariffs and Trade*, 30 October 1947, Article XIII.

24 House of Commons, "Minutes of Proceedings and Evidence of the Special Committee on Canada-United States Air Transport Services" Issue No. 15, 1990 at 7.

25 *Ibid.*

developed "hub and spoke" of airports and connections. This restriction manifested itself in two ways. First, at larger, high traffic airports, usually one American carrier dominated the airport, thereby leaving very little airport capacity for remaining carriers. Second, the major hubs to which the Canadian carriers did have access served as entry points to the US. Any passenger who did not have the "hub" as her final destination would have to connect to another flight along a "spoke" to her final destination. The US government instituted pre-clearance facilities at all gateway Canadian cities for their passengers on both Canadian and US airlines. Upon arrival both US carrier and Canadian carrier flights were treated as domestic flights. US carriers, however, had a clear advantage because they could treat both their transborder aircraft and passengers as segments of a domestic flight. The inbound flight and the passenger could continue from the hub to another domestic destination. The US carrier could also co-ordinate schedules, making it preferable for US destined passengers to choose a US carrier that could provide a complete itinerary through its coordinated flight schedule or reservation system.

C. Inherent Limitations in the City-Pairing System of Allocation

By the 90's, the city-pairing method of allocation was close to its market limit. Although there were cities to which Canadian carriers desired access, the number of cities US carriers desired access to was minimal.[26] The Canadian government had very little leverage to negotiate greater access for its airlines. They were unable to offer more cities and were restricted to offering greater access to the existing city-pairings either by expanding the frequency of US carriers or by offering greater capacity. This tactic would only serve to accentuate other structural problems. The status quo was the best that could be achieved under the existing bilateral agreement.

As a result of the FTA, and later the NAFTA, there was a huge increase in the need for transborder routes. The existing system created a bottleneck for this traffic by its failure to address the market opportunities and by creating an inefficient bureaucracy to serve a dynamic market. The status quo was unacceptable.

V. THE OPEN SKIES AGREEMENT

OPEN SKIES DID NOT RESULT in an unfettered exchange of rights that included cabotage. In fact cabotage rights, the right to pick up and transport US domestic passengers by a foreign carrier, were discussed but were eventually excluded. Open Skies resulted in freer trade in the transport market but not in free trade itself.

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[26] Prior to the signing of the Open Skies Agreement, there was no direct connection between Ottawa and Washington, D.C. *Supra* note 19; Schedule II.

The most significant change under the Open Skies Agreement was the elimination of the bureaucratic city-pairs system of flight allocation and permitted scheduled air service between any two points of the two countries.[27] This section also eliminated the controls on both frequency and capacity. Another important aspect of the agreement was a change in slot allocations at airport facilities. The agreement provided for a base number of airport slots at two of the most important airports at New York – La Guardia and Chicago O'Hare. Under the agreement, an airline's proprietary interest in slot times was severely restricted to a "use it or lose it" policy. This allowed fairer access into a congested market because airlines could no longer use their control of slot times to exclude other carriers from "their" airports.[28]

Gate access was not dealt with in the agreement except so far as to facilitate airport access. The increased air traffic, or the expected increased traffic, has resulted in significant airport expansion. The airports that, for reasons of profit, wished to increase airport use, have taken steps to develop more efficient uses of their facilities in addition to expanding airport size. Generally, airport expansion has kept pace with the desire for increased access, something that market forces would indicate.[29]

The agreement also permits market forces to determine the fair price for air transportation:

> [i]ntervention by the aeronautical authorities shall be limited to:
> a. prevention of unreasonably discriminatory prices and practices;
> b. protection of consumers from prices that are unreasonably high or restrictive because of the abuse of a dominant position;
> c. protection of airlines from prices to the extent that they are artificially low because of direct or indirect government subsidy or support; and
> d. protection of airlines from prices that are artificially low, where evidence exists as to an intent of eliminating competition.[30]

The Open Skies Agreement makes the government's role with respect to prices reactive rather than proactive.[31]

As a result of the Open Skies Agreement there was a significant increase in the transborder market. Air Canada increased its presence from 14 destinations and 32 routes to 46 destinations and 79 routes. Prior to the

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[27] *Supra* note 1; Article 4.
[28] *Supra* note 1; Annex I.
[29] *Supra* note 1; Article 5.
[30] *Supra* note 1; Article 5.
[31] M. W. Lacey, "Freedom in the Air: The 1995 Canada-United States Bilateral Air Transport Agreement" in *Annals of Air and Space Law*, vol. XX, (Montreal: McGill, 1995) 157.

take over of CAIL by Air Canada, they had also attempted to take advantage of the Open Skies Agreement, but their ongoing and predating financial difficulties made their expansion much more limited.

The result of the Open Skies Agreement was to improve passenger service and pricing through trade liberalization in the airline industry. The agreement allowed market forces to control pricing, capacity, and frequency with strong reactionary regulation to prohibit anti-competitive behaviour. This serves as an excellent model for our domestic market.

VI. A MARKET BASED SOLUTION

ALL ANNOUNCEMENTS MADE BY DAVID COLLENETTE, the transport minister, are claimed to be based on the reports submitted by either the Standing Committee on Transport, or on the basis of recommendations from the Competition Bureau. What neither he nor his department mentions, is that they only follow some of the recommendations, and not all of them. All of the government actions and undertakings demanded by Air Canada can be found in the reports submitted by these two offices. The minister fails to mention long term solutions which can also be found in the reports.

The Standing Committee on Transportation, the Senate Transportation Committee, and the Competition Bureau have all recommended various desirable long term market-based solutions. These solutions involve re-examining the question of cabotage.[32]

The Open Skies Agreement strictly forbids it, in Article 1, note 1:

> Nothing in this Article shall be deemed to confer on the airline or airlines of one Party the right to take on board, in the territory of the other Party, passengers, their baggage, cargo or mail carried for compensation and destined for another point in the territory of that other Party.[33]

Although cabotage was a topic discussed during the initial negotiations, it was abandoned for fear that it would be the stumbling block for reaching a comprehensive agreement. Both sides saw advantages in granting it, provided that access to both airport slots and gates could be established. As recommended by the Competition Bureau, (as well as both the Parliamentary and Senate Standing Committees on Transportation), Canada should look into re-negotiating this provision.

In the context of a domestic monopoly, cabotage provides a nearly ready-

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[32] Cabotage involves permitting foreign carriers to operate commercial segments of their flights within another country. This can be part of a routing which takes the foreign carrier back to its own country or the operation of a purely domestic flight within a foreign country.

[33] *Supra* note 1; Article 1.

made solution for the dangers of a monopolistic domestic carrier. Cabotage could be offered on a phased-in basis. Access to low density routes could intially be offered unilaterally, followed by allowing carriers a phased-in access to more lucrative routes. The first carrier in would then have the best access to the more lucrative routes.

Even if cabotage were negotiated on a merely unilateral basis, the Canadian consumer would benefit. Prices would be lowered through competition or the threat thereof. The prices achieved would be better regulated through the open market than by government regulation. Ross and Stanbury make the very cogent argument that even the best government regulations for protecting consumers will ultimately make them prisoners to an inefficient airline. Their view is that, although more painful for the airlines, consumers benefit from competition. While consumers benefit from lower fares, airlines benefit from developing more efficient ways to allocate capital. In a protected market, such as the proposed domestic market, there is little incentive or ability to reallocate resources more effectively. Given the strange hybrid of liberalized transborder trade and protectionist domestic markets, the dominant airline will have great difficulty in coordinating the two aspects of its business.[34]

The general aversion to cabotage has its roots in the beginnings of international civil aviation. Airlines were traditionally viewed not as industries, but as agents of their respective states and economies. Their role was seen as maintaining the wealth generating capacity of passengers within the country of origin. While passenger traffic was seen as a commodity, it was the commodity of an industry that relied on strong government policy and resource input to make it feasible.[35]

This establishes a basic protectionist tendency for bilateral agreements. Whereas states want access to other states, it is for the purpose of reaping the profits from their commodity. Article 7 of the Chicago Convention cannot be seen as restricting cabotage per se, but as restricting it so that a nation that is not a party to the cabotage agreement would not be subject to international discrimination. Just as the General Agreement on Tariffs and Trade (GATT) allows for regional free trade zones, the Chicago Convention must be interpreted in light of the general trend towards trade liberalization. Cabotage therefore, would be permitted, given the unique relationship between Canada and the United States.

Another solution that could introduce competition into the marketplace is to relax ownership restrictions on domestic carriers. As previously mentioned, one of the key differences between deregulation in the railway industry and the airline industry is that there are no Canadian ownership requirements for short

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[34] T. W. Ross & W. T. Stanbury, *Avoiding the Maple Syrup Solution: Comments on the Restructuring of Canada's Airline Industry*, online: The Fraser Institute: Policy Sources <http://www.fraserinstitute.ca/publications/pps/32/index/html>.

[35] Sir G. Cribbett, "Some International Aspects of Air Transport" (1950) J. Royal Aero. Society 669 at 671 in *The Public International Law of Air Transport* (Toronto: McGill University Press, 1974) 53.

track rail lines.[36] This has allowed foreign investment and ownership to reinvigorate the rail industry. The investment by Omnitrax, in both short track lines and the port of Churchill, has not only benefited the railway industry, but also the communities that these rail lines serve. Left-leaning nationalists are set on finding a "maple syrup" solution[37] at the expense of consumers and the economy which requires affordable scheduled airline service domestically and internationally. This government policy is based on the dubious assumption that limits on foreign equity ownership result in effective domestic control over our airline industry. The fact that the last three Air Canada CEO's have been Americans[38] is an irony which highlights this misconception. "Control" is not so easily legislated. Air Canada, through its participation in the Star Alliance,[39] has willingly given up some of its autonomy in order to reap the benefits of being one of the originating partners to this global strategic alliance.

The relaxation of the 25% maximum foreign ownership would have two clear benefits. First, it would allow for the influx of foreign capital into the domestic airline industry. This increases the possibility of establishing effective competition in the domestic market. Second, as shown by the unwillingness of Canadians to invest in the port of Churchill, a foreign corporation may see an investment opportunity that Canadians fail to notice or consider too risky. If we as a nation are unable or unwilling to invest in a particular industry, then we should allow those with a more entrepreneurial spirit to take advantage of the opportunity. Whether the owners of a new domestic carrier are American or Canadian, our economy and society will benefit from increased employment and effective competition.

VII. CONCLUSION

THE DUST HAS YET TO SETTLE after Air Canada's purchase of CAIL. Although Air Canada has agreed to the undertakings in order to satisfy the Competition Bureau, these undertakings have yet to be fulfilled. While Minister David Collenette has tabled legislation to re-regulate the industry and increase the enforcement provisions of the Competition Act and the Canadian Transport Agency, these have yet to take their final form. There is no

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[36] *Supra* note19. Part III dealing with operations of the railway does not have a section restricting the ownership of railways, whereas Part II (definitions section) defines "Canadian air transportation" as being no more than 25% foreign ownership.

[37] Ross & Stanbury, *supra* note 38. The authors made this point in the context of allowing cabotage. Their thesis was that the economy and society are always better served by protecting the consumer through effective competition, whether that competition is by a Canadian or foreign company, rather than relying on intrusive government regulation into the market place.

[38] Both Lamar Durett and Robert Milton, however, became Canadian citizens.

[39] For more information on the Star Alliance airline, see online: Star Alliance <http://www.staralliance.com>.

clear domestic competitor on the horizon and therefore, both consumers and other players in the industry must rely on government legislation, for at least the short term.

The long term however, provides for an innovative and market based solution. The general liberalization of trade throughout the world, and especially in North America as a result of the NAFTA, is a trend that can and should be applied to the airline industry. Allowing some form of domestic competition by a foreign carrier, or allowing foreign ownership of a domestic carrier will serve both the consumer and the industry better than any government regulations will. Governments need to play a role. Their role and regulations must be reactive to stop unfair trade practices as opposed to being proactive, which inevitably serves to stifle market opportunities and efficiencies through well-intentioned though misguided policies.