A Survey of Aviation Trends in the Prairie and Northern Region

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The Prairie & Northern Region (PNR) encompasses the three Prairie Provinces and the three northern Territories. This survey analyses the regional performance of aviation, the air carrier industry and passenger flows. Subsequently, the economic trends and conditions affecting the PNR air market are examined. Much of the downturn in the aviation industry during 2001 has been attributed to the terrorists’ attacks in September and subsequent consumer reaction. While data are still fragmentary, the impact of this attack is placed in context in the final section.

**Regional Aviation Profile**

Aircraft activity is the sum of itinerant and local movements. Loosely defined, local movements have the same origin and destination, while itinerant movements have different origins and destinations.

![Aircraft Movements - PNR](chart)

Since 1981, total aircraft movements have trended down due largely to lower activity in the local movements sector. This reflects a fall off in recreational flying and in flight school training.

Competition by the air carriers drove the activity of the itinerant sector up to 139,000 movements during the 1995-1999 period. This is the third highest level of activity since 1977. In 2000, despite a robust Prairie economy, the five-year rally ended. Central to this retrenchment was the take-over of Canadian Airlines by Air Canada producing a coordinated flight schedule that eliminated many duplicate city-pair flights.

**PNR Air Carrier Frequency**

The PNR monthly departing air carrier fleet since January 1994 was compiled from data listed in the Official Airline Guide. This exercise generates a theoretical level of service provided by air carriers to the traveling public. Cancellations due to inclement weather and mechanical problems cannot be incorporated into the results. Some prominent regional items are:

- The consolidation of Air Canada and Canadian Airlines in the summer of 2000 produced 25.5 percent less air carrier departures from September 2000 to October 2000; and
- The departure schedule is marginally lower during first nine months of the 2002 compared to 2001, reflecting Canada 3000’s withdrawal from operations.
With respect to the latter item, other air carriers may increase their schedule to accommodate unfilled demand. As a result, the 2002 flight schedule may be understated.

**Major Airline Departure Frequency**

Throughout the region air carrier services provided by the major airlines are illustrated in the monthly Departing Air Carrier Chart. By the summer of 1999, the total departing air carrier flights peaked at 25,000. Historically, Canadian Airlines had been the dominant carrier in PNR. By July 2000, Canadian Airlines increased its frequency to record levels. At the same time, Air Canada had reduced its frequency to 3,500 departures. In the latter half of 2000, total air carrier services operating in western Canada had fallen below 17,000. Air Canada's service levels in 2001 were slightly above Canadian Airlines’ historical frequency. Expectations for the summer of 2002 call for 21,500 total departures with Air Canada’s schedule posting almost 10,000 departures.
The total monthly departing air carrier seats are illustrated in the Departing Air Carrier Seats Chart. The October 2000 departing seats are the lowest since 1994; a result of the Air Canada-Canadian Airlines schedule integration. The schedule for the first nine months of 2002 (September) is 13 percent less than the same period in 2001.

**PNR Departing Seats By Air Carrier**

A profile of the monthly Seats by Carrier is illustrated from January 1994 to September 2002.

To September 2001, Canadian Airlines provided more seats than Air Canada. At the height of the competition between them, 1.2 to 1.4 million seats were offered during peak periods. In 2001 and into 2002, peak departing seats are rarely above 950,000. Comparing the first nine months of 2002 to 2001, Air Canada’s schedule indicates a 7.8 percent reduction in departing seats while WestJet increases by 2.2 percent.

In 1994, aircraft operating in PNR had an average of 60 seats. In the first half of 2001, the monthly average air carrier seats ranged from 67 to 69 seats. This increase reflects Calgary International Airport’s ability to attract transborder and international flights. The first nine months of 2002 generates a 70-seat average.

**PNR Passengers**

The majority of the region’s passenger traffic (69 percent) takes place in Alberta. With the fastest growing population and the most dynamic economy Alberta’s share is likely to grow larger. In 2000, Alberta accounted for 57.2 percent of the PNR population and 66 percent of the nominal GDP in the PNR. Calgary International Airport is the dominant hub of the region with 45 percent of PNR passenger traffic.

The large run-up starting in 1995 is attributed to the launch of low cost carriers such as Greyhound and then WestJet in 1996. Even with this activity, the share of the national market has not appreciated and has been stable in the 21 percent range over the past five years as illustrated in the right side scale.
Passenger flows experienced sharp reductions during the recessions of 1980-81 and 1990-92. A minor passenger reduction is noted in 2000, but passenger flows in PNR could fall from 1.5 to 2 million by 2002, considering the effects of the previous recessions. A recovery in the US economy could offset some of the losses in this forecast, but the prospect of renewed growth remains uncertain.

**Economic Trends and Conditions**

Consumer demand for air transport is sensitive to changes in prices, incomes and quality. This varies amongst individuals and by the reasons for travel. Generally, leisure travelers are more affected by price changes than business travelers. Overall, the level of demand rises and falls with the underlying tempo of the economy.
Aggregate Demand

Throughout 2001, solid economic growth on the Prairies moderated largely as a result of slowing US consumption. Despite the retrenching regional economy, PNR outperformed the nation that has been hard pressed to skirt the recession. Canada posted its ninth consecutive year of growth at 1.5 percent while the PNR economy fared better at 1.8 percent.

The fundamentals of maintaining the Canadian economy were instituted as the year progressed. The Bank of Canada discounted the prime rate 275 basis points to allay business and consumer confidence issues. The US Federal Reserve cut its lending rate eleven times in 2001 to 1.75 percent. This action reflects the US central bank’s continuing concern over the overly sluggish state of their domestic economy. Such rates, coupled with the low Canadian dollar, bode well for the Prairie economy with its export based manufacturing industrial base. Barring any implosion of the financial markets or other catastrophic event, the economy should rebound by mid 2002 to traditional levels.

Manitoba and Saskatchewan were less influenced by the continental slowdown because of the dominant position of agriculture and food processing in their economies. Nevertheless, a sharp economic deceleration has materialized, particularly in Saskatchewan where crop production was truncated by drought. Manitoba’s export oriented manufacturing sector was curtailed while agriculture maintained its pace. Alberta was able to sustain several price shocks on the energy front. With the US favouring North American oil stocks, investments in the Athabasca Oilsands have been maintained in the face of lower world prices for oil. Despite Alberta’s enviable fiscal status, some selected spending cuts have been targeted to maintain their aggressive debt reduction program.

The North presents a mixed economic picture with Yukon experiencing royalty revenue shortfalls, as metal prices remain soft. A critical factor in 2002 will be the final decision of the route of the pipeline currently favouring the Alaska Highway route. The Northwest Territories with the diamond industry in full flight, sports an exploding manufacturing sector with annualized increases over 150 percent. Nunavut still seeks some resolution to its fiscal constraints but has the prospect of several diamond mines coming on line this decade. The discovery of at least six new diamond deposits in the Kitikmeot region of Nunavut is creating a heightened interest in the exploration industry. The deposits have been found in a cluster of volcanic kimberlite formations, called pipes, southeast of the Arctic coast community of Kugluktuk.

Airline Costs

Fuel prices are expected to remain well below the 2000 level throughout 2002. The global economic slowdown is creating a surplus supply that will inhibit any price increases, save a concerted effort of the oil producers to cut back exports. Despite attempts to gain a coordinated reduction, the oil exporters have yet to tighten supplies in a significant manner.

Globally, aviation fuel represents 8 percent of total demand. With a reduced air carrier profile, a North American surplus in the range of 11-12 percent (nearly 1 percent of global supply) is available. Consequently, fuel prices are unlikely to be the source of fare increases in the near future.

The airline industry in Canada remains unsettled in the aftermath of September 11th characterized by the demise of Canada 3000. Even with an 80 percent market share, Air Canada is not invulnerable. After losing over $1 billion during 2001, the shareholder equity is negative. In late December 2001, Air Canada announced a sale-lease-back agreement with GE Capital Aviation Services Inc. for $Can 565 million.iii

The end of the “no involuntary layoff” condition of the merger ended in 2002. Air Canada announced 10,000 job cuts in late 2001, but will likely end up with more.

The ability of Air Canada to raise fares is limited for both leisure and business travelers. Discount operators, like WestJet, are putting a ceiling on leisure traffic ticket prices, as well as eating into business
traffic where their flights are frequent. Air Canada has responded with its Tango brand to halt the growth of discount competitors. Charitably, Tango cannot be expected to add much to Air Canada’s profits, but it does help to keep passenger numbers from falling further.

In business travel, a new competitive threat is forming from time-share private jet. For various reasons, including the requirement for a regulatory framework, the time-share option is undeveloped in PNR. However, two cases of corporate time-share turbo-prop aircraft have operated in Calgary and Edmonton. When the regulatory processes are complete, expectations that this niche market will expand to meet corporate demand. At this time, the scheduled carriers are unlikely to feel much market share loss, but this phenomenon can only grow if business ticket prices increase.

**New Security and Safety Measures**

In the December 10th, 2001 Budget Address, the federal government announced a five year $7.7 billion program to counter terrorism. Among the measures, an agency will be established to assume security operations at airports. The cost of this operation was estimated at $2.2 billion (i.e. the purchase of explosive detection equipment, training, air marshals and staffing of security posts, one time costs for aircraft modifications (e.g. cockpit reinforcement and other associated costs).

A ticket surcharge of $12 per one-way trip for all air travel conducted through airports with security facilities will be implemented by April 2002 to pay for additional security. This could have a significant impact on air traffic in short haul markets. For example, the discount airfare between Calgary and Edmonton is under $50. The new security charge is equal to a 20 percent fare increase. Ultimately, this charge will make the airlines less competitive with luxury high-speed inter-city buses, or private automobiles. The $24 security charge (round-trip) is reported to increase average airfares by 5.9 percent for Air Canada and 15 percent for WestJet. Assuming greater price elasticity amongst WestJet’s leisure travelers, the quantity of travelers could fall by more than 15 percent, while Air Canada would experience at least a six percent loss.

The magnitude of the air security charge is not generally recognized. For the purposes of comparison, the charge to travelers originating at the Winnipeg International Airport will be equal to half the annual operating costs of this airport. On the other side of this equation, the airlines will no longer be responsible for providing passenger screening. The benefits are unlikely to be passed on to consumers, but may hold down general fare increases.

**Insurance Coverage**

Insurance premiums are expected to surge in the aftermath of September 11th. Some evidence of this has been seen with passengers paying a one-way $3 surcharge by some airlines. The airports are also likely to face higher insurance costs that will indirectly be passed on to consumers.

**Trip Substitution (Modal and Telecommunication)**

A decline in the demand for air travel has already occurred. Whether or not it is a temporary change is uncertain. First, the “aircraft fear factor” has been heightened. Under normal conditions, this would abate, however, a prolonged military action could extend this “anxiety” through 2002 and beyond. Second, the longer waiting times due to enhanced security measures can transfer passengers back to the surface modes especially on the short to medium haul trips.

The use of video conferencing to replace air travel is difficult to quantify. Anecdotally, more video conferencing is occurring, but cost and quality is still an issue. A greater threat to the airlines is Internet
based conferencing. As the bandwidth keeps expanding, low cost and convenient video conferencing may soon be a reality.

Nav Canada

Air navigation fees are an additional cost faced by air travelers that is outside the purview of the airlines. Nav Canada provides these services on a not for profit basis, but their charges are very sensitive to air traffic volumes. Most of their costs are fixed.

Nav Canada is facing a $145 million shortfall on revenues of $850 million in 2001/02, largely attributed to September 11th. Nav Canada expects to compensate by:

- Drawing down from the $30 million reserve;
- Implementing higher efficiencies; and
- Posting a 6 percent fee increase as of mid-October.

Recently, Nav Canada announced its interim financial results for the three months ending November 30, 2001. The results reflect reductions in air traffic as a result of the September 11th terrorist attacks and the decline in the economy. Revenues for the first quarter were $246 million with total operating expenses for the period at $185 million, including salaries and benefits of $126 million. Revenue over expenses (profit) was $11 million.

Economic Downturn Versus Terrorism

In the first half of 2001, and with a slowing economy, the aviation industry was struggling. This latter half of 2000 had been reduced by the Air Canada-Canadian Airlines consolidation. In August 2001, PNR total aircraft movements responded with a 6.9 percent jump and 2.9 percent nationally compared to the same period in the previous year. September 11th temporarily halted aviation and subsequently reduced demand. A comparison of September 2000 to September 2001 identifies total movements as declining by 6.4 percent in PNR and 9.8 percent nationally.

Much media attention was given to the terrorist attacks of September reducing air demand. Without diminishing the tragedy, the reduced demands for air services in PNR were well entrenched before September. The comparison of preliminary total aircraft movements at PNR sites with air traffic control illustrates the position prior to September and subsequent activity.

<table>
<thead>
<tr>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
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<td>107,204</td>
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<td>112,175</td>
<td>104,834</td>
<td>98,747</td>
<td>107,689</td>
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<td>2001</td>
<td>102,076</td>
<td>106,886</td>
<td>112,579</td>
<td>112,082</td>
<td>92,458</td>
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<tr>
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<td>-4.8%</td>
<td>-3.5%</td>
<td>0.4%</td>
<td>6.9%</td>
<td>-6.4%</td>
<td>-9.2%</td>
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The traffic declines in September and October are larger than occurred in the spring months and are consistent with the response to September 11th. November 2001 appears to be tracking close to previous months consistent with an economic slowdown. If this trend continues the impact of the terrorist attack could be short lived in the PNR.
Observations

The PNR is a well-established aviation market that is exposed to the vagaries of national and international economic forces. Aviation is very sensitive to macroeconomic growth and this is evident in the tracking of passenger numbers with periods of contraction and expansion. The last five years have been more dynamic for many reasons. New discount airlines emerged, while the large full service airlines merged and streamlined, and several carriers have entered and exited the industry.

The future of the aviation industry remains uncertain. Direct costs, like fuel and financing rates are falling, but higher charges for navigation, insurance rates and new security fees are likely to offset any fare reductions for passengers. On balance, Canada is too reliant on the US economy to track an independent path, but the PNR appears to be somewhat more independent because of its resource base.

This survey raises some interesting topics for further research. The competitive challenges of “fractional” corporate jet ownership and video conferencing are only beginning to appear. Much will depend on their costs, convenience and effectiveness as substitutes for scheduled air passenger services.

The role of Alberta in shaping the aviation industry in PNR is another interesting subject. Alberta has the fastest growing and youngest population amongst the Prairie Provinces, and its economy is twice as large as Saskatchewan and Manitoba combined. Calgary has already emerged as the dominant airport hub in the PNR, and its influence can only grow. Will Calgary draw traffic away from other airports in the PNR, or siphon traffic from larger gateways, like Vancouver and Toronto, or both?

The surge of air travel in the PNR during the last half of the 1990s coincided with the emergence of discount airlines. Whether the change in quantity demanded reflects a movement along the demand curve (a price response), or simply a demand shift caused by the growing economy (an income response) is likely to become evident in this decade.

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1 The views expressed are those of the author and not necessarily those of Transport Canada.
2 The transaction involves 16 A-320’s and one A-319. Additionally, the leasing of six new A-319/A-320 aircraft in 2003 and 2004 will permit the sale of six older aircraft with an average age of 12 years.