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Canadian airport security: The privatization of a public good

Barry E. Prentice*

I.H. Asper School of Business, University of Manitoba, Canada

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ABSTRACT

Economic theory would define airport security as a public good; no different than border control or the military, but this is not how it is treated in many countries. In Mexico, airport security is financed entirely from the public treasury. In the U.S., the cost is split evenly between air passengers and the public treasury. In Canada, air passengers pay the entire cost of airport security. The Canadian case is examined in detail. Forcing air passengers to bear the full cost of airport security creates a number of economic distortions. Air travel in Canada is discouraged by the added cost of security, but worse it encourages travelers to cross the Canada-U.S. border where they can fly from lower cost U.S. airports. The tax losses to the public treasury because of this policy are arguably greater than the total security fees collected.

Airport security evolved organically rather than by design because governments were forced to react quickly to escalating threats. As a result, a “user-pay” financing system was put in place in Canada without careful policy analysis.

1. Introduction

The benefits of air transport security are significant and broadly spread. At the individual level, the avoidance of inconvenience and personal injury is paramount. In the collective interest, the costs of a terrorism incident on national reputation, public expenses and business confidence, could be large or very large. The economic impact of terrorism has been simulated, and the cost estimates for even limited events are stunning (Gordon et al., 2009).

Society as a whole is impacted by breaches in air transport security, but this does not determine who pays or in what proportion. Other security services, like national defense, border guards and intelligence agencies are recognized as public goods and funded from the general treasury. The burden of aviation security, as it is applied in Canada and many European countries, falls squarely on the shoulders of airline passengers.

Economic theory holds that public goods, such as national security, cannot be delivered efficiently by free market forces because of the free-rider problem. Too few people would pay for their share of the benefits voluntarily, and the cost of collecting from everyone is excessive. Consequently, public goods are either financed from the general treasury, or under produced.

Over the course of the past three decades Canada has effectively quasi-privatized aviation security, and imposed the cost on air passengers. A Crown corporation, the Canadian Air Transport Security Authority (CATSA), operates passenger screening and other security functions. CATSA reports to parliament through the Minister of Transport and is paid out of the general treasury. However, the Finance Department levies an Air Travellers Security Charge (ATSC) on air passengers to offset payments from the treasury to CATSA. Effectively, Canadian air passengers are forced to pay privately for security services whose benefits are national in scope.

Poorly designed taxation policies can have unintended consequences that are detrimental to the economy. Raising taxes on air travel reduces general taxes that would otherwise be collected on economic activity associated with aviation. Higher input taxes, which raise the cost business, are passed on in consumer prices that reduce the competitiveness of Canadian products in export and domestic markets. Taxing leisure air travel reduces tourism demand. This diminishes the taxable activity of secondary service businesses, like hotels and restaurants, across the country. Unlike general consumption taxes, input taxes create distortions and diminish activity in specific sectors of the economy. Shippers and travelers using other modes of transport are not forced to pay security fees.

In the worst cases, ill-considered taxation policies can create consumer revolts. In the case of the ATSC, another tax added to an airline ticket is more reason for Canadian travelers to drive across the border where they can fly less expensively from U.S. airports. The “export of air passengers” reduces spending that could be taxed

* 181 Freedman Crescent, Winnipeg, Manitoba, R3T 5V4, Canada.
E-mail address: barry_prentice@umanitoba.ca.

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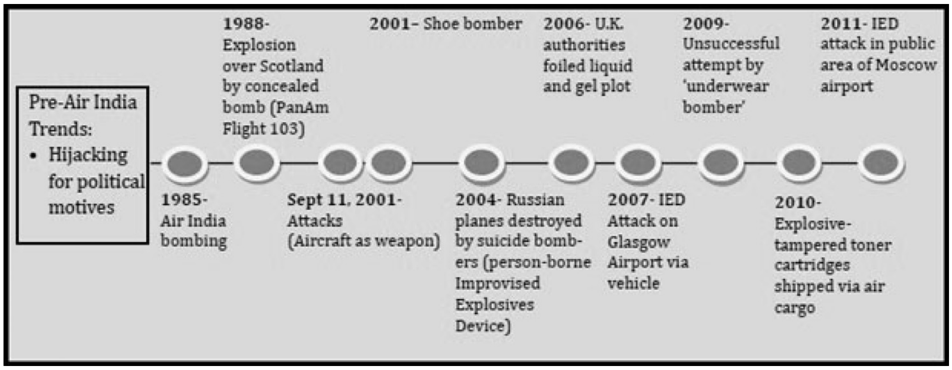

Fig. 1. Time-line of aviation security incidents.
Source: Transport Canada. *Canada's National Civil Aviation Security Program.*

at Canadian airports and the aviation supply chain. It is by no means obvious that the federal treasury is coming out ahead. Tax revenues lost directly from cross-border traffic leakage, and indirectly by the drag placed on the economy, could easily exceed the federal taxes collected by the ATSC.

The Canadian approach to air security policy had an organic development that occurred incrementally and in line with U.S. aviation practices. Then, in the shock of the post 9/11 terrorist attack, the ATSC was imposed by a government still struggling to contain large budget deficits. Canada is not the only jurisdiction tempted to use aviation as a "piggy bank"; much of this behavior parallels U.S. policy where excess taxation of aviation is also alleged.[1] Mexico is the only NAFTA member that treats aviation security as a public good and imposes no passenger taxes.

This paper explores the genesis of the airport security system in Canada and the impact that passenger taxes have on the competitiveness of air transport. The discussion begins with a brief account of the development of Canadian air transport security. This is followed by a conceptual framework that places airport security in the theory of public goods and the positive externalities. Next, the aviation security taxes imposed by other NAFTA partners (United States and Mexico) are compared with Canadian practice. The penultimate section considers the economic impacts of airline passenger taxes. The paper concludes with some thoughts on public finance and transportation policy direction.

2. Evolution of aviation security in Canada

Aviation security policy in Canada developed in response to isolated hijacking incidents, international obligations, an airport commercialization strategy and the frenzy created by a dramatic terrorist attack. Fig. 1 provides a timeline of aviation security incidents that shaped the development of Canada's policy.

The need for better aviation security became apparent first in the late 1960s and early 1970s because of a rash of aircraft hijackings. Some mainly unsuccessful criminal hijackings were attempted,[2] but most of the hijacking activity involved forcing airplanes to fly to, or from, Cuba for political purposes. The propaganda war between the United States and Cuba celebrated some of these initial incidents. However, it soon emerged that political hijackings were in no one's interest and they became officially discouraged by both parties in the early 1970s.

In December 1970, the International Civil Aviation Organization (ICAO) held meetings that resulted in the Hague Convention for the Suppression of Unlawful Seizure of Aircraft. Security measures were defined in subsequent international meetings that led to the adoption by Canada of ICAO Annex 17 – Security – Safeguarding International Civil Aviation against Acts of Unlawful Interference.[3] Transport Canada was designated as responsible for the development of a national policy on aviation security in Canada.

Canada had its first and only airline hijacking during this period. On December 26, 1971, a US citizen armed with a handgun and a grenade forced an Air Canada flight from Thunder Bay to Toronto, to land, discharge its passengers, refuel and fly to Cuba.[4] Subsequently, the gunman exited the airplane and it returned to Canada. In 1972, an amendment to the *Criminal Code of Canada* made it an offense to bring weapons and explosives on board an aircraft.

2.1. Privatization of airport security

In 1973, the *Aeronautics Act* was amended to require air carriers to establish and operate security programs at their own expense.[5] As the owner and operator of the national airports, Transport Canada provided space and purchased metal detectors and X-ray machines to screen passengers and carry-on baggage.

The Air India bombing in 1985 intensified demands for better airport security in Canada. The *Aeronautics Act* was amended further to require more rigorous screening, including X-ray inspection of all checked baggage and passenger matching on international flights. In addition, 26 explosive detection systems were installed by Transport Canada to be operated by the air carriers.[6]

Technically, the quasi-privatization of airport security began in 1973 when the government mandated the airlines to pay for passenger screening. The next step in privatizing security ensued as part of the National Airports Policy (1994)[7] when Canadian Airport Authorities (CAAs) were created to manage the 26 airports that comprise the National Airport System. The Government of Canada retained ownership of the airports that the CAAs operate under a Ground Lease with increasing rental payments to the Crown. All responsibility for passenger and baggage screening was shifted to the CAAs, as well as the provision of police security. By the year

[1] See Plungis, 2013.
[2] The most infamous criminal hijacking is the unsolved case of J.B. Cooper (November 24, 1971).

[3] ICAO. http://www.icao.int/secretariat/PostalHistory/annex_17_security_safeguarding_international_civil_aviation_against_acts_of_unlawful_interference.htm.
[4] The hijacker, Patrick Dolan Critton, was finally arrested 30 years later (2001) at Mt. Vernon, NY. http://www.airliners.net/aviation-forums/general_aviation/read.main/568100/.
[5] http://laws-lois.justice.gc.ca/eng/acts/c-11.2/FullText.html.
[6] Ibid.
[7] https://www.tc.gc.ca/eng/programs/airports-policy-menu-71.htm.

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