

CARIBBEAN COMMUNITY

**CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM
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El Perial Management Services

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CONCEPT PAPER STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM

This Concept Paper has been commissioned by the CARICOM Secretariat to be presented at a Regional symposium to develop the “Elements of the Strategic Vision for Services Sector Development in the Caribbean Community (CARICOM)”. As a start the paper has to understand the level of need for efficient air transport services in the CARICOM Region (Region).

THE AIR TRANSPORT IMPERATIVE

The paper recognises that CARICOM is:

- a grouping of small sovereign countries, mainly islands with small populations and open economies, that rarely enjoy economies of scale
- characterised by separation by water which seems to negatively impact cooperative attitudes and behaviour
- a large geographic area; the distance between Suriname in South America and Belize in Central America is c.a. 2081 nautical miles or a flying time of c.a. 4hrs 20mins by jet aircraft.
- regularly afflicted by hurricanes that adversely impact infrastructure, primary industries (tourism and agriculture) and already limited government resources
- is heavily dependent upon air transport as the Year 2007 visitor arrival statistics in **Appendix A** show
- in the early stages of implementing the CARICOM Single Market (CSM) aspect of the CARICOM Single Market and Economy (CSME) which forms the central theme of the 2001 CARICOM Revised Treaty of Chaguaramas. At present, the full members of CARICOM other than Bahamas and, Montserrat are members of the CSME.

Revised Treaty of Chaguaramas

The paper has therefore been developed cognisant of the absolute imperative for effective air transport services to/from and within CARICOM and the related emphasis placed on air transport in the Revised Treaty.

I. The Preamble of the Revised Treaty notes:

- the vital importance of....air.... transportation for maintaining economic, social and cultural linkages.... among the Member States of the Community
- the importance of promoting adequate air.... transport services for the continued viability of the tourism industry and of reducing the vulnerability of the CARICOM Region resulting from its reliance on extra-regional carriers

- that a viable transport policy for the Community will make a significant contribution in satisfying the demands for the intra-regional movement of people and products in the CSME

II. The CARICOM Transport Policy seeks to provide adequate, safe and internationally competitive transport services for the development and consolidation of the CSME. Its objectives are:

- the organisation of efficient, reliable, affordable, transport services throughout the Community
- the development and expansion of air...transport capabilities in the Community
- the promotion of cooperative arrangements for the provision of transport services
- the development of efficient internationally competitive ancillary transport services
- the development of human resources for employment in all areas and at all levels of the transport sector
- the implementation of standards for the development of safe....air transport services

III. Member States are mandated to cooperate in:

- the development of air transport services in the Community and towards this end may conclude among themselves air transport agreements designed to facilitate the provision of such services
- establishing measures to ensure that the provision of international air transport services in the Community is undertaken by financially viable and technically qualified carriers and operators and that the Community interest in safety, security and economy of air travel is not prejudiced
- ensuring uniformity in licensing and certification procedures and equivalencies within the Community for aviation personnel in conformity with international standards.

Key CARICOM Strategies

CARICOM countries, as a group but normally as sovereign states, have applied various strategies, with varying degrees of success, in their pursuit of effective air transport services to/from and within the Region. The primary strategies include:

- diversification of airlift sources i.e. **liberalised air service agreements/practices** and aggressive wooing of external airlines (but with the primary focus on international air service)
- ownership of airlift capability i.e. **domiciled airlines**, preferably through private sector funding (but usually through public sector funding)

In a number of countries there is sometimes a sense of conflict between these two (2) strategies.

In summary, to date:

- all members of CARICOM are committed to liberalisation of international air service agreements with one (1) extending this to a formal ‘open skies’ Air Services Agreement (ASA) (with the United States) and another to a formal ‘open skies type’ ASA (with Canada)
- four (4) are committed to ownership of airlines providing international service even though such service may be very limited
- three (3) are committed to ownership of airlines providing regional service even though such service has been limited to the Eastern Caribbean
- ten (10) are committed to a somewhat liberal intra-regional air service agreement that is de facto confined to the Eastern Caribbean.

In addition to the primary strategies, the major support strategy is joint action to improve the safety and security aspects of air transport through maintenance of the Cricket World Cup security mechanisms and the establishment of the Association of Civil Aviation Authorities of the Caribbean (ACAAC) and its implementation arm Caribbean Aviation Safety and Security Oversight System (CASSOS) which is now an institution of CARICOM.

Given the socio-economic imperatives of the CSME and the current related realities, the fundamental issues that should be examined in the strategic plan are how to:

- optimise the value of the diversification of air services (liberalisation including ‘open skies’)
- strengthen the CARICOM domiciled airlines so that they can provide the sustained quality of service that the CSME needs and optimize their partnership with the tourism sector
- Ensure that the safety and security systems are enhanced while improving customer friendliness and that the potential of CASSOS is achieved

AIR TRANSPORT DEMAND

People rarely fly as an activity in itself. Usually people use air transport services to visit a place because of some combination of need, willingness and desire aided by the affordability, access and convenience of the air travel experience. In effect people use air transport services when there is a demand for such usage to meet another objective.

The provision of air transport services, while viewed as part of a community’s transport infrastructure, is usually conducted as a profit-making enterprise. Air transport service companies meet (and stimulate in areas within their control) demand for travel, using highly mobile assets, in an attempt to earn an acceptable return on investment.

In CARICOM the main drivers of that demand are the attractiveness and effective marketing of the Region's tourism product and the intra-regional imperatives of the CSM(E). The extent to which that demand is perceived by airline managements' to permit the achievement of an acceptable return on employed assets, determines their willingness to provide such air transport services. The air transport sector, inclusive of airport infrastructure and facilitation, is an important but subsidiary component of the tourism product even as it is dependent on that product for its success.

The fact that CARICOM's long standing tourism product, which is the main driver of the Region's economic development, has:

- generated a much lower increase in demand than the world-wide tourism product
- required growing levels of guarantees to maintain air service levels

points to the need for an objective review of the tourism product. In the conduct of that review, the following definitions may be useful. In these definitions 'community' is generic and can be as small as a village and as large as CARICOM.

Tourism

"Tourism is a potentially effective way of expanding and deepening economic activity through the expansion of the population of a **community** by **short stay** persons with a disposition to spend on *services* that provide *value*.

To be *effective* over the long term that population expansion must be of *value* to the tourist (as the person exercising choice) **and** to the host community. The community must therefore **conserve**, develop and protect the things and culture that are of *value* to its residents and to its selected tourism target markets.

To provide meaningful and sustainable service there must be the development of a **relationship** of mutual respect and thus inter-dependence between provider and recipient and their co-management of the service".

The related role of tourism planning in guiding the *sustained development of tourism and the related tourism product* in a community must therefore be:

"The development of policy and implementation strategies that permit its residents to deliver innovative services of **superior value** at lower relative cost, consistently and over the long term, to a **well defined** set of visitors in the global competitive marketplace while optimising the benefits to the community by capitalising on its **distinctive** competencies, cultural mores and natural resources without compromising the value systems of its residents".

The key terms in these definitions are 'community', 'short stay' (with the implications for air transport), 'innovative services', 'value' to the 'tourist' and 'host community'. Since

air transport is a key component of the tourism industry, an airline, be it charter or scheduled, also has to deliver “services of superior value.....to a well defined set of visitors”.

Tourist

“Any person visiting a community in which she/he does not normally reside:

- whether or not she/he is a national of the country being visited
- for a period of not less than twenty-four hours and not more than one year
- whose purpose of visit can be classified as leisure and/or business (but not requiring a work permit or similar permission)”.

It is important to note that this definition of ‘tourist’ is not constrained by the type of accommodation used in the destination community.

Tourism Industry

Tourism industry defined as the aggregate of those sectors of a community’s economy, whether public or private, that are stimulated by the expansion of its population due to the presence of “short stay persons with a disposition to spend on services”.

Two other points are worth considering in the review of the Regional tourism product:

Paradise

When a community attempts to position itself as “paradise” it significantly raises the expectation levels of potential visitors and it is difficult to meet such heightened expectations on a sustained basis. Moreover since “paradise” is largely a personal value it really has little meaning in tourism terms. Further residents know that they are not living in paradise and hence tend to believe that they are not being respected by the tourism authorities resulting in an increased tendency to exploit the tourist.

Multi-Destination Tourism

While the countries of CARICOM (and indeed the Caribbean) have many similarities, each also has its unique foot print which when taken together has the potential to produce an attractive, differentiated tourism product. Such a product should have marketing resonance and with the effective implementation of regional airport ‘hub and spoke’ systems stimulate intra-regional traffic and lessen the need for guarantees to attract air transport services.

If this approach is accepted, a critical role of the Air Transport Sector Strategic Plan would be to provide effect support for the Regional Tourism Product Review. An effective strategic plan for the CARICOM air transport sector must therefore interact with

an effective plan for the ensuring the sustained relevance and marketing of the Region's tourism product.

OVERVIEW OF THE AIR TRANSPORT SECTOR

From an air transport perspective, CARICOM may be divided into three (3) sub regions.

- **North West** comprising Belize, Bahamas (not a member of the CSM), Jamaica and Haiti
- **East** comprising Antigua/Barbuda, Montserrat (not a member of the CSM), Dominica, St. Kitts/Nevis, St. Lucia, Barbados, St Vincent/Grenadines, Grenada, Trinidad/Tobago
- **South** comprising Guyana, Suriname, the only two (2) CARICOM countries that share a common border

All countries but Barbuda, Montserrat, Dominica, Nevis and St Vincent/Grenadines can facilitate international air service, reflecting the importance of international tourism to the economy of the Region. St. Vincent/Grenadines has however recently started construction of an airport to facilitate international air service.

Major airport hubs are Miami and Puerto Rico, outside of CARICOM and Barbados and Antigua within East CARICOM. Air Jamaica, early in its restructuring programme, significantly downsized its Montego Bay, Jamaica hub while Caribbean Airlines is building a hub in Trinidad that currently serves the South CARICOM. American Airlines too has recently downsized its Puerto Rico hub focusing more on Miami for CARICOM Service. Opportunities for hubbing exist in St. Maarten, Guadeloupe and Martinique within the Eastern Caribbean, Panama and Venezuela.

As **Appendix B** shows, there is no direct service between Belize, Haiti and the remainder of CARICOM. Indeed within the North West, the only direct service is provided by Air Jamaica between Bahamas and Jamaica. While there is relatively good service within the East and South CARICOM sub-regions, the only effective direct service between the North West and the East and South is Caribbean Airlines' daily Trinidad-Jamaica flight through Barbados and Antigua (St. Maarten). Only the long standing hubs, Antigua (67%) and Barbados (56%) together with Trinidad (50%) had 50% or more of possible intra-CARICOM direct (same plane) service connections.

Appendix C broadly outlines direct international scheduled service to CARICOM countries with international airport facilities. All countries had service from the USA but only two (2) had service from South America.

There has been a drive to upgrade the airport infrastructure in CARICOM especially in Barbados, Jamaica (Montego Bay and Kingston), Bahamas and Trinidad with a start in St Vincent. Antigua and Tobago expect to start major upgrades soon.

Regional Airlines

There are five (5) regionally domiciled airlines, Bahamasair, Air Jamaica, LIAT, Caribbean Airlines (CAL) and Suriname Airways (see **Appendix D**) together with a number of commuter airlines. All five (5) of the domicile countries have now achieved and must now maintain the FAA International Aviation Safety Assessment Programme (IASA) Category 1 status. All of the airlines are public sector controlled and all are unprofitable. CAL is the only airline that is properly capitalised. The current world wide economic environment will have a significant adverse impact on the financial performance of these airlines. The four (4) airlines that provide international service do so primarily from their country of domicile. The commitment of each is primarily national rather than regional. There is at present minimal overlap of the routes served by the five (5) airlines. There is currently no overlap on international services and minimal overlap in the East and South CARICOM sub-regions between LIAT and CAL.

One other airline, American Eagle, domiciled in Puerto Rico, serves the Region and is beginning to exploit 5th Freedom rights within the East CARICOM.

Amerijet, based in Fort Lauderdale, Florida is the primary air cargo carrier serving the Region.

Regionally domiciled airlines have been traditionally unprofitable whether owned by the public sector, private sector or a combination of both. Regional business persons, very successful in other fields, have not been able to operate these airlines profitably. The privatization wave of the mid-late 1990s, the assumed panacea for financial success for the individual national airlines, did not effectively capitalise the airlines, did not attempt to mitigate the lack of economies of scale and was in fact a financial failure although service improvements were generally achieved.

There appear therefore to be fundamental structural problems with Caribbean regional airlines centred on poor capitalisation and the lack of economies of scale. The latter is demonstrated by very small home markets, acute seasonality of traffic, non-competitive aircraft costs and operating costs. The only comparative advantages are lower personnel costs and a higher level of cabin service.

Bahamasair: There was in 2005, an expensive, failed attempt to privatise Bahamasair which has been facing increasing competition from US based Low Cost Carriers (LCCs), Spirit and Jet Blue. Bahamasair has largely outsourced its domestic operations and flies to four (4) points on Florida's Atlantic Coast (Miami, Ft. Lauderdale, West Palm Beach and Orlando), Cuba, Turks & Caicos using two (2) B-737-200 and six (6) Dash-8-300 aircraft. Bahamasair code shares with USAir.

Air Jamaica: This airline has the most extensive international network and the largest fleet of jet aircraft (15) (A-319s, 320s and 321s) among the regionally owned airlines. It flies to nine (9) destinations across the US, (Atlanta, Baltimore, Chicago, Ft. Lauderdale,

Los Angeles, Miami, New York, Orlando, Philadelphia) Toronto and the East CARICOM countries Barbados and Grenada (from New York). The airline also serves Bahamas, Cayman Islands, Curacao and Cuba. Air Jamaica code shares with Virgin Atlantic on the London (Gatwick) route.

In December 2004 Air Jamaica reverted to public sector ownership as the local private sector controlling shareholders were no longer willing to fund the on-going and increasing losses of the airline. Despite a restructuring programme, losses have further increased, far exceeding the US\$30M annual support commitment of the Government of Jamaica and placing a significant burden on public sector finances. Operating losses in the 2006, 2007 financial years are reported to have exceeded US\$100M in each year and US\$90M in the first eight months of 2008. The government, with the support of the IFC is seeking an international private sector partner for the airline by March 2009 but given the current economic climate this is posing a significant challenge. Informed analysis indicates that even if Air Jamaica is sold debt free, the potential partner may need to invest c.a. US\$100M to achieve operational effectiveness.

Jamaica has enjoyed in recent times an increase in service largely from Legacy and Low Cost Carriers (LCC) based in the US in competition with Air Jamaica. Airone, an airline whose shareholders share a common interest with the telecommunications company Digicel, has been seeking permission to start an LCC based in Jamaica.

Caribbean Airlines: Caribbean Airlines (CAL) is the successor airline to BWIA that like Air Jamaica had reverted to public sector ownership as the foreign and local private sector controlling shareholders refused to fund on-going losses. The Government of Trinidad & Tobago (GOTT) decided to close BWIA and replace it with CAL thereby removing its legacy airline characteristics while ensuring that the new airline was properly capitalised. In addition GOTT, until December 2010, covers the increase in fuel price above that charged when WTI crude is at US\$50/bbl. This represents an expansion of GOTT's national fuel price subsidy programme. CAL has utilised this facility from the start of operations until November 2008 when the price of WTI dropped below US\$50/bbl. This facility gives CAL a significant operating advantage over competing airlines. Further GOTT waives the withholding tax on CAL's aircraft lease payments.

With a clear mandate from GOTT to operate commercially, CAL started operations on January 01, 2007 with a much smaller schedule than that operated by BWIA. Despite its name, CAL serves less of the Eastern Caribbean than BWIA did. To date CAL does not provide direct international service to Tobago or any other CARICOM country other than Trinidad. In October 2007, CAL took over the operations of the Trinidad-Tobago domestic route with the traditional pricing support from GOTT. CAL is mandated to fly a minimum of twenty (20) return flights per day on this route.

CAL's operating fleet comprises seven (7) B-737-800s and five (5) Dash-8-300s. It has leased out its eight B-737. The airline flies internationally to Toronto, New York, Miami, Ft. Lauderdale and Caracas and within CARICOM to Barbados, Guyana and Suriname with a daily flight to Kingston, Jamaica via Barbados, Antigua (St. Maarten), the primary

link between the South/East CARICOM sub-regions and the North West sub-region. CAL code shares with British Airways on the London (Gatwick) route. It uses Trinidad as a hub to provide international service to Tobago, Guyana and Suriname. A review of the CAL schedule indicates that it does not at present fully utilize its Dash-8 fleet. There is thus the potential for some Regional Caribbean service expansion that could be in competition with LIAT.

CAL has not yet published its 2007 financial statements but the industry reports a likely loss of US\$27-29M with a possible break-even result in 2008.

Suriname Airways: This small public sector loss-making airline flies to Amsterdam in a joint service with KLM using a B-747-300, Miami, Aruba, Curacao, Belem in Brazil and within CARICOM to Guyana and Trinidad all using an MD-82 aircraft. The airline is currently in talks to upgrade its fleet.

LIAT: This airline, based in Antigua, with its main hubs in Antigua and Barbados, serves twenty-one (21) destinations primarily the Eastern Caribbean (Santo Domingo to Guyana) using a fleet of Dash-8-300s (14) and 100s (3) that needs a major replacement programme. It too has reverted to public sector ownership as regional private sector controlling shareholders have refused to fund on-going losses. Moreover the public sector shareholding has now been concentrated among three (3) countries, Barbados, Antigua and St Vincent and the Grenadines (a combined 77.7%) as other government shareholders adopted the same attitude as the private sector shareholders.

The airline in late 2005 implemented a LCC type strategy and in June 2007 initiated the purchase of the assets of its major private sector competitor Caribbean Star that also operated throughout its life at a significant loss. Since then, operating as a quasi monopoly with a mandate from its majority shareholders to operate on a commercial basis, LIAT has restructured its finances, rationalised its schedules, reduced its non-fuel unit operating costs and increased airfares. There has been a significant improvement in the capitalization of the airline which has basically removed all long-term debt and provided funding for redundancy payments although more needs to be done so that operational efficiencies can be optimized.

A review of LIAT's schedule indicates it operates commercially albeit with a significant "social conscience" that leads to the operation of marginal and loss-making routes. Indeed a truly commercial schedule would probably require at present no more than 10-12 aircraft, a mere 70% of its current fleet. This additional service responsibility and related cost burden has major implications for quality of service and the ability of the airline to attract financing in the absence of further equity injections.

LIAT also has not published recent financial statements but the industry expects a major improvement was achieved in 2008.

SVG Air: Commuter airline service is the all but forgotten component of the CARICOM air transport sector. Any effective strategic plan for the sector must recognize the role of

the commuter airline services and seek to optimise that role. SVG Air, which started operations in 1990, best represents the CARIOCOM commuter airlines that are privately owned, struggle with debt finance and high fuel costs and generally receive low priority at hub airports and at the regulatory agencies.

SVG Air is based in St. Vincent and operates scheduled (and charter) services within the Grenadines and to Barbados and Grenada. It also operates charter flights primarily to Martinique, St. Lucia, Antigua, Trinidad, Tobago and St. Barthelemy. The airline's current fleet of ten (10) aircraft comprises a Citation 550 jet and the Aero Commander 500S, Cessna 402B&C, BN2 Islander and Twin Otter 300 turbo props.

International Regulatory Structures

CARICOM countries, driven largely by tourism needs, operate de facto liberal international regulatory regimes. However their intra-regional regulatory regimes are more restrictive primarily with respect to market access, tariffs and traffic rights because the economic pressures for liberalization are significantly less. The potential for the development of intra-regional tourism is still not fully recognized.

While formal international air service agreements (ASAs) are not always in place in a number of countries and licensing of airlines may be required, the underlying practical policy is to try to attract as many carriers as possible once international safety requirements are met. The designation and pricing policies are thus liberal and are not a constraint to international air access.

CARICOM Airline Designations have the potential to be operated with a certain degree of flexibility. The adoption of the 'Community of Interest' Designation Principle at ICAO (ICAO Assembly Resolution A24-12) allows CARICOM member states, that do not have domiciled airlines, to designate in their international ASAs airlines of another member state where such carriers are 'substantially owned and effectively controlled by one or more of the member states and/or nationals thereof'. At present only Air Jamaica takes advantage of this non-binding ICAO resolution having been designated by Barbados in its ASA with the USA.

The CARICOM Secretariat has been coordinating a regional approach to an 'Open Sky' ASA with the USA. A regional negotiating brief was adopted but there has been no consensus on a 'model' agreement. The USA has signaled that it wishes to revert to the negotiation of bilateral ASAs with the CARICOM countries and has now implemented, effective October 30, 2008, an 'Open Sky' ASA with Jamaica that however does not appear to include the 'Community of Interest' Designation Principle. This ASA follows the negotiation in February 2008 of an 'Open Sky' "type" ASA between Barbados and Canada that seems to allow for the phased movement to a full 'Open Sky' ASA.

The reality is that the only step to go beyond the status quo in CARICOM is the adoption of 'open skies' but there continues to be a marked reluctance by a number of countries to do so. However it is to be noted that Chile **and** its major airline LAN have been strong

proponents of ‘open skies’ agreements (probably even more so than the USA) and LAN has prospered in this environment. LAN is a properly capitalized non-LCC airline, with a customised business plan and effective market-driven management operating in a strong demand environment. It provides a high level of service and controls its costs. It generates record profits even in the recent high fuel cost environment at a time when the US legacy airlines and some of the key Low cost Carriers (LCCs) have been very unprofitable. LAN’s management is on record that ‘open skies’ is beneficial to it. **‘Open Skies’ gives it the management freedom to operate the optimum mix of destinations to fly.** COPA and TACA in Central America have had similar experiences. Moreover TACA was the result of the application of functional cooperation to a number of loss-making airlines seeking to benefit from economies of scale.

Jamaica too seems to have recognized the benefits of an ‘Open Sky’ ASA to Air Jamaica.

Regional Regulatory Structures

Air services within the Region are governed by bilateral ASAs, licensing regimes and the CARICOM Multi-lateral Air Services Agreement (MASA). These ASAs have restrictive pricing clauses that are not consistent with current airline marketing behaviour. Within the last few years however the countries, inclusive of Barbados, which historically operated the most conservative pricing regime, have given greater pricing flexibility to airlines providing intra-regional service.

There has been an attempt to try to establish CARICOM as a quasi-cabotage region, where service would be restricted to regionally owned and controlled carriers, but grandfather rights to international airlines and individual country international ASAs have diluted this objective. The recently signed ‘open skies’ ASA between Jamaica and the United States may have further weakened this objective.

The MASA entered into force on November 17, 1998 subject to the provision in Article 18 that “it shall not affect any bilateral, multilateral or other contractual agreement or arrangement; or operating licences or other documents evidencing similar authorisation already in force between Member States or between a Member State and a non-Member State”. The understanding is that contractual agreements or arrangements, which were already operational at the time of entry into force of the MASA will continue in operation until such time as they expire or terminate, and thereafter the provisions of the MASA shall apply.

Subject to the constraining proviso defined above, the Agreement allows for ‘CARICOM Air Carriers’ to fly unlimited 3rd & 4th Freedom services (direct flights between the airline’s domicile country and any other signatory CARICOM country) within the Region with full traffic rights (i.e. to embark and disembark passengers, mail and cargo). Multi-carrier designations, where a country wishes to designate more than one airline to fly a specific route, are however constrained by the perceived “characteristics of the market and the likely impact of new operators on the operation of existing carriers” (i.e. the bureaucrat’s perception of the market place can prevent such a designation). The governing tariff regime is ‘single disapproval’ whereby an airfare does not come into

force if **either** party (any one of the two countries that comprise the route) disapproves. Current non-signatories include Bahamas, Jamaica (and Montserrat) who have retained the more restrictive ‘double approval’ tariff regime in their intra-regional regulatory regimes.

It should be noted however that the provisions of the MASA are inconsistent with the Revised Treaty of Chaguaramas. Indeed the aviation corollary to the CSM would be ‘Open Skies’ a concept that goes hand in hand with the single markets of the USA, Canada and Europe.

The CARICOM Secretariat is currently reviewing the MASA to ensure compatibility with the Treaty. In this review MASA should be amended to an ‘Open Skies’ agreement based on the Multilateral Agreement on the Liberalisation of International Air Transportation (MALIAT) model but retaining designation of CARICOM airlines together with those of St. Maarten, Aruba, Curacao, French Territories. The Agreement should allow for the CARICOM Competition Commission to have jurisdiction over unfair competition disputes. This will ensure full compliance with the Revised Treaty of Chaguaramas. It will also signal to the international community that CARICOM wishes to apply to itself that which it may be prepared to negotiate with the international community.

Diversity of Airlift

The liberal international regulatory posture and the aggressive stance of Ministers of Tourism to increase international airlift ensure a reasonable level of competition on international routes. Such service is driven by demand (especially demand for a country’s tourism product), comparative profitability of routes to CARICOM countries within the airline’s overall route network and increasingly, the willingness of CARICOM countries to share (guarantee) route risk with airlines. Initial attraction of air service is dependent on the anticipated profitability of potential demand and the quality and quantity of route risk sharing by the host country. Maintenance of this service is dependent on the competitive profitable performance of the route within the overall corporate strategies of the airline at any given time.

Generally there is competitive scheduled service from the US and UK. Scheduled service competition is limited from Canada and Europe while there is minimal service from Central and South America.

Access to international markets by countries (mainly in the OECS) that are dependent on hubs is limited not only by the factors identified above but also generally by relatively poor facilitation at hub airports, aggravated by an unwillingness of regional client countries to provide tangible support to those hub airports that are in fact their international gateways even though not located in their territories

Intra-regionally, low demand (or at least perceived low demand), the historical lack of profitability of intra-regional services and a more restrictive regulatory regime have

reduced competition. As the MASA reflects, there are potential regulatory barriers to entry, airline managements are not to be fully trusted to make correct pricing decisions and 5th Freedom rights need to be grandfathered. It is possible that Barbados' new role as the single largest shareholder in LIAT may further hinder any new entrants (though none are expected in the near future) into the East CARICOM market.

Competitiveness of Regional Airlines

There has been perennial concern that the socio-economic development of the CARICOM countries are not to be trusted solely to non-domiciled airlines; this despite the ability of a number of countries with tourism based economies to thrive without domiciled airlines. (Aruba and Dominican Republic are Caribbean examples.) This concern has been heightened by the scheduling adjustments of primarily US based airlines especially American Airlines (AA) as they strove for survival in 2008. However at a time when the fundamental *raison d' être* of public sector owned Regional airlines came to the fore, they were not able (willing, perceived not to be capable) to meet the perceived service shortfall.

CARICOM countries, heavily dependent on tourism, decided to enter risk sharing contracts with AA (and other airlines) to ensure continuity of service.

The Regional airlines were confirmed as being essentially weak niche carriers with relatively low market generating capability in the international market place outside of the CARICOM Diaspora.

Perennially unprofitable airlines cannot effectively perform the role the Region assigns to them. They do not have the capitalization and low cost structures to withstand aggressive competition and expand their networks and therefore they make a sub-optimal contribution to competitiveness and to socio-economic development.

Current Regional Responses to Air Transport Challenges

Regional initiatives have had minimal impact to date. Regional institutions are not the final decision makers, shareholders or managers and so they do not have implementation authority. Further where there is agreement, the regional initiative is generally the lowest common denominator. This is reflected in both the current MASA and even more so in the one developed by the ACS but not yet ratified. Neither advanced the process of liberalization of regional air services. A more relevant MASA although recognized does not seem to have had high priority although this is likely to change in 2009. The CARICOM 'Open Sky' initiative has floundered.

The Regional Aviation Safety Oversight System (RASOS) now upgraded to the Caribbean Aviation Safety and Security Oversight System (CASSOS), a CARICOM Institution, is possibly the most successful regional initiative to date and this is driven by the international requirement to perform or be penalized. CASSOS is funded directly by its member states with support from agencies such as FAA and Transport Canada.

CASSOS, which will be formally inaugurated in February 2009, will have a strong mandate to continue to build a strong self sufficient, Regional Safety and Security Oversight System that will assist in reducing the regulatory bottlenecks in the CARICOM air transport sector while ensuring the adoption of international standards of safety and security oversight. These in turn would facilitate internationally accepted air services at reduced costs primarily by Regional airlines and by international airlines serving the Region.

It is imperative that CASSOS continues to be fully supported.

STRENGTHENING THE REGIONAL AIRLINES

An analysis of Caribbean airlines indicates that they are generally under-capitalised and that they lack economies of scale, inclusive of demand. **A review of successful airlines indicates that they are well capitalised, operate in an environment of high demand and enjoy economies of scale. It is also generally recognised that endemic loss-making airlines are unable to provide the sustainable high quality of service that tourism economies need.** Since the owners of these airlines want them to contribute effectively to the socio-economic development of the tourism-driven economies of CARICOM, it is incumbent on them to provide the environment and tools to give the airlines a reasonable chance of success.

Improving Demand

The core demand for airlift capacity is driven by the extent to which the tourism product is of quality and relevant to the defined target markets. Creating this demand is a function of the tourism sector and the governments of the CARICOM, including those that own the airlines. In addition demand is boosted by:

- giving increased focus to intra-regional and multi-destination tourism; CTO studies have indicated that on average the regional visitor spend is at least as comparable to the international visitor spend and the impact on the economy is more direct and goes deeper while countries such as Barbados and St. Vincent recognise the importance of the regional component of their tourism industry
- reviewing the ticket taxes on intra-regional fares. The East CARICOM tourism industry has noted a decline in intra-regional visitors as intra-regional air fares have increased. A preliminary review indicates that the taxes average 40% of the intra-regional fares paid by the passenger. Further an IATA study suggests that the tax component is among the highest world wide. A question that needs examining would be what is the stimulation in demand with a reduction in air fares and whether the tax take on the overall economic impact of the increased number of visitors would be greater than the related reduction in the ticket taxes. The recent promotion between LIAT and the Barbados Tourism Authority to

redress the fall in numbers of regional visitors to Barbados seems to indicate that the answer may be positive.

- maintaining the International Aviation Safety Assessment (IASA) Category 1 status of the domicile airline countries and continuing to give support to CASSOS. These actions will allow for strategic alliances with foreign airlines thus facilitating increased demand
- adopting ‘open skies’ regimes across CARICOM for intra-regional and international service thus allowing airline managements to readily respond to changes in the sources of demand.
- improving hub airport-client country relations, (*see ‘Hub & Spoke’ Systems below*) thus facilitating service and encouraging demand to countries without airports capable of handling passenger jet service.

Generating Economies of Scale

Responding to increased demand requires expansion of the operations of the airlines thus providing the potential for internally generated economies of scale. Further, economies of scale can be generated by pursuing:

- *functional cooperation among the domicile airlines.* However the concept of a regional airline or even aggressive functional cooperation has not been implemented in CARICOM despite supportive Regional studies and successful examples in the industry outside of the region. It appears that in the broadest sense the level of trust between the airlines is too low to allow for such action. Yet in its ideal form functional cooperation seeks to generate economies of scale by integrating those activities of the airlines that do not directly affect the individual airline brand. An easy start would be common purchasing and combined back office functions. The Caribbean Association of Industry & Commerce (CAIC), Caribbean Tourism Organisation (CTO) and Caribbean Hotel Association (CHA) support a single regional carrier as a replacement for the current national loss-making carriers at best or functional cooperation among these airlines at a minimum.
- *strategic alliances with international airlines* – apparently preferred over regional functional cooperation by CARICOM airlines **even though the two (2) mechanisms are not mutually exclusive.** The ideal situation would be to be invited to join one of the international airline networks (One World, Star Alliance, Sky Team) but the regional airlines would likely have to show improved market share and quality of service to be invited. A single regional airline would more likely receive an invitation.

Hub & Spoke Systems

Airlines adopt ‘hub & spoke’ systems as one mechanism for creating economies of scale when it is in their interest to so do. However passengers tend to prefer same plane non-stop service unless the price premium for such service is significant, loyalty programmes

are not available or flight times are grossly inconvenient. When operated efficiently ‘hub and spoke’ systems can be of financial benefit to airlines and of service benefit to passengers. When operated inefficiently, which is all too easy to do, these systems can significantly increase the operating costs of an airline and its hub airport and be powerful disincentives for passengers to use the airline. LCCs tend not to adopt ‘hub and spoke’ systems although this strategy is changing – witness the South West/West Jet strategic alliance.

In the East CARICOM sub-region the effective adoption of ‘hub and spoke’ systems can:

- facilitate service to low demand generating islands
- allow such islands to attract international visitors without the capital and operating expense of providing airports capable of supporting trans-continental service
- generate increased service for the hub airports thus allowing capital and operating costs to be spread across a larger number of flights
- be of particular benefit to the commuter airlines.

The ‘hub and spoke’ strategy demands a more effective level of planning at both the developmental and operational phases of the hub airport(s). It requires a higher level of on-time performance by the participating airlines and for inter-airline connecting systems (e.g. BA-LIAT) a greater degree of trust among them for the effectiveness of their security systems. It needs more efficient support systems at the hub airport(s).

Most of all there must be a sea change in behaviour, overcoming the negative impact of separation by water and sovereignty with both the hub airport countries and the client countries recognizing mutual benefits and working closely even to the extent of sharing capital costs to optimise such benefits. Once again the issue of trust arises. To date neither the country hosting the hub nor the client countries using the hub have fully recognized their obligations to the effective management of the hub. Indeed one hears accusations from time to time by client countries about host countries “stealing” their visitors. In turn one hears about client countries getting a ‘free ride’ by not having to financially support the operations of the hub. Yet airlines, hub airport and client country all benefit from the effective operations of a hub.

- Airlines have higher load factors, faster turnaround times and maybe increased schedules.
- The hub airport earns higher revenues and may attract more airlines.
- The client countries attract more visitors.

Proper Capitalisation

This is probably the area of greatest challenge to owners of CARICOM airlines whether they are from the public or private sector. Such capitalization needs to remove the debt burden accumulated through years of financial losses, provide funds to update equipment, improve operating systems and facilitate any redundancies as well working capital. For

government owners the competing demands for limited funds have continually restrained their ability to adequately capitalise their airlines. Yet such capitalization is necessary if the airline has to make reduced (preferably none) on-going demands on the public purse and achieve its mandate of providing sustainable high quality service at acceptable prices to customers.

Given their financial restraints government owners of Regional airlines state that they wish to have private sector funding but given the recent history of major loss generation of the individual national airlines under private sector control, private investment (both regional and international) has indicated that there will be little interest unless a single regional airline replaces the current national loss generators. Bahamas in 2005 failed to attract private investment for Bahamasair and Jamaica is fully aware of the major challenge it faces in its current search for private investment in Air Jamaica.

Thus in 2006 Trinidad & Tobago was able to properly capitalise Caribbean Airlines (and since then to provide on-going operating cost support) while in 2007 the major shareholders of LIAT were able to draw on the CARICOM Stabilisation Fund and borrow in their own right from the Caribbean Development Bank (CDB) following management's restructuring of a major equipment loan to remove LIAT's onerous debt burden and provide funds for severance.

Yet there are entrepreneurs who continue to have faith in CARICOM aviation. Privately owned commuter air services continue to exist (although without a safety net the mortality rate is high). Airone, a private company using a variant of the LCC model wishes to start service but has not received permission from the CARICOM country(ies) in which it wishes to be domiciled.

Maintaining a Commercial Culture

Government shareholders of the Regional airlines have been mandating their boards of directors to operate on a commercial basis. In a number of instances, Regional governments, including those that are shareholder, have been requesting variations of that mandate and not always with the related financial support. History documents us the impact of such behaviour. Apart from sending mixed signals to airlines' boards, management and staff the result is a continuation of losses which weakens already precarious capital structures, reduces service quality and does not allow the optimum contribution to CARICOM's socio-economic development.

In order to maintain the commercial drive within the airlines it is recommended that:

- the airline be mandated to develop a financially viable business plan meeting agreed criteria; board and management will be judged against this plan
- to the extent that the shareholder(s) wish additional flights to be performed, the level of funding and the related service expectations will be agreed and once again board and management will also be judged against this agreement

Such a transition in relationships should be made easier by the Region's growing experience in sharing route risk for international service. Further the recent BTA/LIAT promotion is a variant on the theme.

It is expected therefore that the airlines will seek competent market-driven management and that tenure and compensation of all staff would be performance based.

It is important that these strategies for strengthening the Regional airlines be treated as a cohesive whole and not be cherry-picked.

RECOMMENDATIONS

It is apparent that the CARICOM air transport sector is adversely affected by the same centrifugal forces that affect a number of CARICOM initiatives. The issues centre on seemingly low levels of trust and the strong perception that the National good is on too many occasions in conflict with the Regional good. In broad terms, within the air transport sector the policy framework exists, the failures are implementation and cohesive action.

The Strategic Plan has to address these issues squarely otherwise it will remain just that – a plan on paper. The degree of progress on the Revised MASA in 2009 could be a good indicator of the likely success of the Strategic Plan.

Further the Regional and National validating elites have to internalize that profitable, competitive Regionally domiciled airline(s) are in fact in the best interest of CSME and the leading tourism industry. Once this internalization is achieved then the core of the strategic plan is the identification of the policies, plans and programmes to achieve this basic objective.

Central to this achievement is the recognition of the leading role of tourism product development and the air transport services' important though subsidiary role. Thereafter the Plan needs to focus on the development of the detailed strategies identified for the Strengthening of the Regional Airlines, including the commuter airlines. Limitations on access to technology and equipment are essentially financial and the cost of acquisition can be significantly reduced with effective functional cooperation.

With respect to human resource development the technical skills relate primarily to aircraft operation and maintenance as well as Information and Communication Technology (ICT). CARICOM currently has a surplus of pilots (visit the Middle East where they are all flying for rapidly expanding, profitable airlines). There is a much smaller surplus of aircraft engineers but additional ones can get primary training as mechanical, electric, electronic engineers and technicians at the Region's technical tertiary level institutions before receiving specialist training either at the airlines or at schools abroad... The region is currently producing an increasing number of ICT specialists. Management development will have to be a function of the Regional business

schools coupled with normal corporate training programmes within the airlines and personnel migration across the corporate sectors.

CASSOS can be mandated to provide technical training for the key support areas, aviation security, air traffic control and safety oversight. CASSOS can be supported by the Civil Aviation Authority Training Institute in Jamaica and Caribbean Aviation Training Institute in Puerto Rico.

The IDB, World Bank and the EU have recently shown active interest in the air transport sector in CARICOM, recognizing its critical role in ensuring socio-economic development of the Region especially with the start of the CSME. The commitment of the CDB is already established. Once the Region fully supports the Air Transport Sector Strategic Plan and implementation is initiated, these institutions should be key sources of support for the full implementation of the Plan.

Moreover private equity investors and debt financiers may then feel more confident to invest in the sector.

CARIBBEAN COMMUNITY

**CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM
Appendix A
Visitor Statistics 2007**

El Perial Management Services

**APPENDIX A
CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM**

VISITOR STATISTICS 2007 (K)

Country	Air Arrivals	Population	Arr/Pop
Belize	251.7	301.0	0.8
Bahamas	1527.6	329.5	4.6
Jamaica	1700.8	2667.3	0.6
Haiti		n/a	
Antigua/Barbuda	261.8	84.3	3.1
Montserrat	7.7	5.0	1.5
Dominica	54.6	71.0	0.8
St. Kitts/Nevis		50.0	
St. Lucia	287.4	166.8	1.7
Barbados	574.6	274.0	2.1
St. Vincent/Grenadines	89.6	105.3	0.9
Grenada	129.1	106.6	1.2
Trinidad	449.5	1297.9	0.3
Guyana	131.5	760.2	0.2
Suriname	162.5	504.3	0.3

Source: CTO
2007 Arrivals
2006 Population

CARIBBEAN COMMUNITY

**CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM
Appendix B
Direct Scheduled Regional Service**

El Perial Management Services

**APPENDIX B
CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM**

DIRECT SCHEDULED REGIONAL SERVICE

Country	Belize	Bahamas	Jamaica	Haiti	Antigua	Barbuda	Montserrat	Dominica	St. Kitts	Nevis	St. Lucia	Barbados	St. Vincent	Grenadines	Grenada	Trinidad	Tobago	Guyana	Suriname
Belize	n/a	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No
Bahamas	No	n/a	Yes	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No
Jamaica	No	Yes	n/a	No	Yes	No	No	No	No	No	Yes	Yes	No	No	Yes	Yes	No	No	No
Haiti	No	No	No	n/a	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No
Antigua	No	No	Yes	No	n/a	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No	Yes	No
Barbuda	No	No	No	No	Yes	n/a	No	No	No	No	No	No	No	No	No	No	No	No	No
Montserrat	No	No	No	No	Yes	No	n/a	No	No	No	No	No	No	No	No	No	No	No	No
Dominica	No	No	No	No	Yes	No	No	n/a	No	No	Yes	Yes	No	No	No	No	No	No	No
St. Kitts	No	No	No	No	Yes	No	No	No	n/a	Yes	No	No	No	No	No	No	No	No	No
Nevis	No	No	No	No	Yes	No	No	No	Yes	n/a	No	No	No	No	No	No	No	No	No
St. Lucia	No	No	No	No	Yes	No	No	Yes	No	No	n/a	Yes	Yes	Yes	No	Yes	No	No	No
Barbados	No	No	Yes	No	Yes	No	No	Yes	Yes	No	Yes	n/a	Yes	Yes	Yes	Yes	No	Yes	No
St. Vincent	No	No	No	No	Yes	No	No	No	No	No	Yes	Yes	n/a	Yes	Yes	Yes	No	No	No
Grenadines	No	No	No	No	No	No	No	No	No	No	No	Yes	Yes	n/a	No	No	No	No	No
Grenada	No	No	Yes	No	Yes	No	No	No	No	No	Yes	Yes	Yes	No	n/a	Yes	Yes	No	No
Trinidad	No	No	Yes	No	Yes	No	No	No	No	No	Yes	Yes	Yes	No	Yes	n/a	Yes	Yes	Yes
Tobago	No	No	No	No	No	No	No	No	No	No	No	Yes	No	No	Yes	Yes	n/a	No	No
Guyana	No	No	No	No	Yes	No	No	No	No	No	No	Yes	No	No	No	Yes	No	n/a	Yes
Suriname	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	Yes	No	Yes	n/a
No of Connections	0	1	5	0	12	1	1	3	3	2	7	10	6	3	6	9	2	4	2
% Connections	0%	6%	28%	0%	67%	6%	6%	17%	17%	11%	39%	56%	33%	17%	33%	50%	11%	22%	11%

CARIBBEAN COMMUNITY

**CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM
Appendix C
Direct Scheduled International Service**

El Perial Management Services

**APPENDIX C
CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM**

DIRECT SCHEDULED INTERNATIONAL SERVICE

Country	USA	Canada	Central America	South America	United Kingdom	Europe
Belize	Yes	No	Yes	No	No	No
Bahamas	Yes	Yes	No	No	Yes	Yes
Jamaica	Yes	Yes	Yes	No	Yes	Yes
Haiti	Yes	No	Yes	No	Yes	No
Antigua	Yes	Yes	No	No	Yes	Yes
St. Kitts	Yes	No	No	No	Yes	No
St. Lucia	Yes	Yes	No	No	Yes	No
Barbados	Yes	Yes	No	No	Yes	Yes
Grenada	Yes	No	No	No	Yes	Yes
Trinidad	Yes	Yes	Yes	Yes	Yes	No
Tobago	Yes	No	No	No	Yes	Yes
Guyana	Yes	Yes	No	No	No	No
Suriname	Yes	No	No	Yes	No	Yes
Number	13	7	4	2	10	7
Percentage	100%	54%	31%	15%	77%	54%

CARIBBEAN COMMUNITY

**CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM
Appendix D
Regionally Domiciled Airlines**

El Perial Management Services

APPENDIX D
CONCEPT PAPER
STRATEGIC PLAN FOR AIR TRANSPORT SERVICES IN CARICOM

REGIONALLY DOMICILED AIRLINES

Airline	Base	Ownership	Operations	Profitability	Base IASA Status	Controlling Shareholder
Bahamasair	Nassau, Bahamas	Public Sector	Limited International (USA), Domestic	Unprofitable	Cat 1	Govt of Bahamas
Air Jamaica	Kingston, Jamaica	Public Sector	International (North America), Limited Regional	Unprofitable	Cat 1	Govt of Jamaica
LIAT	St. John's, Antigua	Public Sector	Regional	Unprofitable	Cat 1	Govts of Barbados, Antigua St. Vincent
Caribbean Airlines	Port of Spain, Trinidad	Public Sector	International (North America), Regional, Domestic	Unprofitable	Cat 1	Govt of Trinidad & Tobago
Suriname Airways	Paramaribo, Suriname	Public Sector	Limited International, Limited Regional	Unprofitable	Cat 1	Govt of Suriname