TAXATION AND THE REGIONAL AIRLINE INDUSTRY

The regional airline industry has been characterised by a high degree of commercial difficulties. The last three decades has seen the Caribbean airspace littered with the remains of more than thirty carriers - some of these departures have been through acquisition, some through restructuring and others insolvency. Notwithstanding these changes and periodic injection of investments by regional government and, in some cases, investors, the region's airlines continue to face major financial challenges. It is against this backdrop that there appears to be fundamental structural problems with the regional airlines, centred on poor capitalisation, and lack of economies of scale and non-competitive aircraft and operating costs. These problems are compounded by high airfares further reducing regional demand for travel and starving airlines of revenue needed to become successful.

The Greater Caribbean is the most tourism-dependent region in the world, four times more dependent on tourism revenue than any other area and although it only accounts for less than 5% of international tourism arrivals, it contributes over 15% to Caribbean GDP. Notwithstanding this importance, travel around the region has become disjointed, prohibitively expensive and subject to multiple layers of taxation. Tourism products are generally outward facing, focusing on leisure travellers from the USA, and Europe and Canada, among others while the market for travellers originating within the region is considered small and thin characterised by low disposable personal income and limited options for travel. As a consequence of this, and the cost and hassle of traveling regionally, intra-Caribbean travel has largely become non-discretionary. Despite the region seeing an increase in tourist arrivals, with an expected increase of 5.5% expected in 2016, only a small percentage of intra-regional travellers are on holiday. It is therefore not surprising that intra-Caribbean travel has been declining: For instance, regional carrier LIAT, has seen passenger numbers shrink from 1.1 million in 2008 to 850,000 in 2013. Despite intra-regional travel peaking in 2015, with 1.7 million trips, analysis of the trend over the longer term indicate that intra-regional travel is falling and the markets have experienced a continuous seat capacity reduction averaging 2.9% annually.

Given the seasonal nature of the global tourism market, increasing intra-regional travel could serve to bolster the performance of regional carriers; in essence smoothing out the declines in fortunes seen during the shoulder season for international tourist market, and improving the economic fortunes of member states. Studies by the Caribbean Tourism Organisation (CTO) have shown that on average the per-day spend of the regional visitor is on par with his better-heeled international counterpart, and the impact of his spend on the economy goes deeper. A review of regional fares indicated that on average taxes and fees are approximately 80% of the base airfare charges, thus comprising over 40% of total ticket cost. High airport charges and taxes for outbound traffic represent a large proportion of ticket prices with US$48 being the average charge levied on a departing passenger. Further studies by IATA indicate that the tax component on regional travel is among the highest worldwide, surpassed only by the Pacific region. The correlation between the increase in intra-regional air fares, in part due to high taxes, and the decline in intra-regional travellers is not to be missed. A key opportunity now available for regional governments is to reduce taxes on tickets, thus stimulating regional demand for travel. This naturally raises the question of whether the overall economic impact of the increased number of visitors would be greater than the reduction in ticket taxes.

While there is much debate in the international arena about the impact of taxation on air travel, a growing body of independent economic researchers consider that taxes and charges do have a suppressing effect on air connectivity and reduce the economic benefits of aviation. The Chicago Convention contains a number of provisions regarding aviation taxation. The convention states that tax cannot be levied on fuel used for international air transport and the International Civil Aviation Organisation (ICAO) also recommends that value-added taxes (VAT) and other sales taxes should similarly not apply to international air tickets. These recommendations however are ignored by many governments.

An examination of global ticket prices indicate that while there are many factors which can influence per mile costs including type of aircraft flown, routes flown, local salary and fuel costs, ancillary revenue, and airport landing fees, there is a clear linear relationship between distance travelled and airfares; the longer the flight, the more expensive it should be. Consequently, it is reasonable to expect that, despite the fact that short haul carriers using mainly turboprops exhibit a higher operating cost per mile, fares around the Caribbean should be lower than fares to fly extra-regionally. Counterintuitively however, the cost to travel around the region is most times on par with the cost to travel to global points such as London and New York. This reflects the fact that many of the taxes and charges levied are a flat amount rather than a rate, thus having a disproportionate and distortionary impact on what should be shorter and cheaper flights.

While there is the understanding that the Caribbean region has high airport charges as a consequence of lack of economies of scale, much discussion has taken place on mechanisms to improve intra-regional travel. These have ranged from general initiatives which are expected to make travel more efficient such as promoting regional open skies agreements, harmonisation of standards, implementing regional promotion strategies, to financial initiatives such as reducing the various miscellaneous taxes that are levied and implementing a differential tax structure.

Despite advocacy at different levels, regional discussion and initiatives have had minimal impact to date. Regional institutions are not the final decision takers, or shareholders, nor do they have implementation authority. Governments have signed open skies agreements with external trade blocks such as the European Union and the USA, while regional initiatives such as the CARICOMs Multilateral Air Services Agreement (MASA) and the Association of Caribbean States Air Services Agreement (ASA) have not advanced the process of liberalization leaving this to bilateral negotiation between parties. Accordingly, these agreements have not been effective in making a significant difference to the number of points connected or to the reduction in cost of air travel.

Surprisingly the impediments to facilitating easier intra-regional travel have not been addressed in a systemic way, despite clear evidence that such an approach has worked in other parts of the world. The "public interest" in air travel is, however, evinced in the continued recognition that an efficient and effective air transportation system is essential to the region’s economic wellbeing. In a region driven by mainly by tourist traffic, it is a product for which there is no perfect substitute. There however appears to be a fundamental inconsistency between the policy positions of regional governments, the posture of airlines and the business they are in, and the resultant implications for economic development of our different societies. But given that air connectivity is a proven enabler of economic development, overtaxing flying will have a negative effect on national economies and government revenues.

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