

EU Accession and Civil Aviation Regimes: Malta and Cyprus as a case study

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Abstract

Aviation deregulation is usually a challenging and demanding task and accession to the European Union requires that all candidate states should harmonise their legislation in the context of the European Common Aviation Area. Malta and Cyprus, the small Mediterranean island-states to join the EU in 2004, will have to abandon any protectionist policies in favour of their flag-carriers and let them survive in a liberal framework. The paper discusses the implications of this regime change for civil aviation in Malta and Cyprus and in addition to the airline industry, it examines the impacts on the complementary tourism sector. Unless carrying capacity limits are understood, the islands may become victims of successful airline liberalisation. The paper concludes by stressing the need for sustainable development and active policymaking.

Keywords: carrying capacity, Cyprus, air transport deregulation, Malta, tourism

1. Introduction

In May 2004 the European Union will admit ten new countries. These entrants vary greatly in population and country size but also in terms of economic, socio-political and cultural background. The impact of their contribution to the European jigsaw is still unknown and in this context their economic liberalisation and integration into the Single Market constitutes one of the major challenges for the future of the Union. The two smallest countries to join the

European Union are Malta and Cyprus. Both Mediterranean island-states have commonalities in terms of their British colonial past (Malta became independent in 1964 and Cyprus in 1960) and their heavy dependence on tourism that accounts for a fifth of their GDP. By joining the EU the two countries will also become members of the European Common Aviation Area (ECAA) that will comprise the twenty-five EU countries plus Norway, Iceland and possibly Switzerland. Carriers belonging to ECAA countries are granted full traffic freedom rights within the Area (including cabotage) and are banned from receiving any form of state subsidy or other preferential treatment by their governments. This may have major implications for civil aviation in Malta and Cyprus as the lack of an internal aviation market and the seasonal character of mass leisure tourism charter flights raised the need for a protectionist regime in favour of the state owned flag carriers in the past (Papatheodorou, 2001). In the post-colonial milieu, Air Malta and Cyprus Airways acted as institutions of social integration and modernisation (Raguraman, 1997) and guaranteed stability of aviation services throughout the year in addition to state participation in the lucrative leisure market largely controlled by the tourism conglomerates of Northern Europe (Papatheodorou, 2002). As elsewhere in the Continent, however, emerging inefficiencies resulted in the gradual relaxation of heavy regulation and the adoption of market strategies by both carriers: participation in the ECAA necessitates further radical changes.

This paper aims at analysing the strengths, weaknesses, opportunities and threats in the new aviation corporate environment of the two island-states with emphasis on their flag carriers. In particular, threats to the two flag carriers by network, charter and low cost carriers are examined and possible reactions are discussed: in addition to the inevitable cost rationalisation, participation in strategic alliances and acquisition by future Pan-European airline groups are examined from a defensive perspective, while from an offensive one emphasis is given on the exercise of fifth freedom rights, development of regional hubs and majority shareholding in other EU carriers. The paper advises policymakers on the above by also taking into account two major issues, i.e. the ongoing political developments particularly in Cyprus and the need to develop tourism on a sustainable basis that will respect the carrying capacity of both island-states.

2. The Case of Cyprus

a. Regulatory Environment and intra – EU Aviation Markets

Scheduled services between Cyprus and the European Union member states are still highly regulated at least de jure: most bilateral agreements allow single carrier designation, double approval of fares and rates and mutual consent on capacity. In the case of Germany, the United Kingdom and Greece the regulatory framework is looser as it allows dual designation on a country pair basis but single designation in terms of airport pairings. London is served by one carrier operating into Heathrow and the other into Gatwick Airport. Nonetheless, Athens and Thessaloniki (the two largest cities in Greece) are excluded from dual designation as only the two flag carriers are allowed to operate (Vassiliades, 2003).

EU accession and entry into the European Common Aviation Area will signify the end of such regulatory constraints. Interestingly, however, the forthcoming liberalisation will not have a major impact for most of the routes. First, the markets have been long liberalised de facto and state interventions are infrequent. Second, as shown in Table 1, most markets are rather small in terms of passengers and a price war among incumbents and new entrants would have a limited effect on the majority of price-inelastic business travellers. Third and perhaps most important, it is apparent from Table 1 that with the exception of Greece all large markets are predominantly related to charter flights. This is not surprising, as Cyprus is largely a leisure destination for the British, the Germans and the Swedish who visit the island on a seasonal basis mostly to enjoy the sea and the sun. Despite any impediments in the past, charter carriers are now largely unconstrained: the main exception is that such flights cannot originate from Cyprus. Having the above in mind, the main effects of liberalisation should be concentrated on the following:

- traffic creation in the Cyprus – Greece and Cyprus - UK markets, i.e. probably the only ones to sustain additional potential players in direct scheduled services
- traffic creation in the above and other markets by charter carriers originating from Cyprus
- traffic creation and diversion by developing an airport hub in Cyprus
- implications for the political re-unification of the island

As expected, all the above will affect significantly the future of Cyprus Airways, the incumbent flag carrier. For this reason the discussion will now focus on the main market players in the country.

b. The Main Market Players

The Cyprus Airways Group is the indisputable dominant player in the market, largely because of the protectionist regime on international flights – there are no domestic services. Cyprus Airways, the main company of the group and the flag carrier of the Republic was established in 1947 with British Airways (44.90%), the Cyprus Government (22.45%) and local investors (32.55%) as main shareholders. Following Independence, Cyprus Airways grew dynamically using the Nicosia International Airport as its base for services to Europe and the Middle East: however, its plans collapsed in 1974 after the Turkish invasion as the carrier was left without aircraft and had to relocate its operations to Larnaca Airport. In 1981, British Airways sold most of its shares to the Cypriot Government, which currently controls about 70% of the company – private investors hold now approximately 25% (Cyprus Airways 2003a). Over the last twenty years, Cyprus Airways developed a second hub in Paphos (on the west part of the island), expanded its network (in 2002 the carrier served 35 airports in 20 countries), enhanced its tactical partnerships and codesharing agreements (at present with KLM, Gulf Air, Alitalia, Syrianair, El-Al, Aeroflot and LOT) and renewed its fleet (with two A319s and two A330s as the most recent acquisitions). In 2002, Cyprus Airways carried 1,654,719 passengers (a 9.9% growth over 2001), had a 73.1% load factor and recorded a loss before tax of C£ 1.2 million (Cyprus Airways, 2003b).

To take advantage of the buoyant leisure market, Cyprus Airways established appropriate companies. Eurocypria Airlines is a charter carrier founded in 1991 that focuses on the main European origin travel markets (with new orders of Boeing 737-800). In 2002, the company carried 497,729 passengers (a 4.3% growth over 2001) and recorded a loss before tax of C£ 1.2 million (Cyprus Airways, 2003b). Cyprair Tours is a specialist tour operator established in 1970 that organises inclusive holidays to Cyprus from the main British cities. Cyprus Airways also owns the Duty Free Shops at Larnaca and Paphos Airports and Zenon NDC, a company that manages electronic information through SABRE. In the financial year 2002, Cyprus Airways Group made a consolidated pre-tax profit of C£ 4.7 million (Cyprus Airways, 2003b).

The other main player in the market is the independent carrier Helios Airways. In May 2000 it started charter services from a number of European origins while in April 2001 Helios acquired license to fly also on a scheduled basis. In March 2002 the carrier commenced regular services from Larnaca to Dublin. At present, however, the charter market is still the

main business of Helios: in 2001 the company carried 221,947 passengers on charter flights as compared to 20,122 in scheduled services (Cyprus Department of Civil Aviation, 2002). The carrier is currently renewing its fleet focusing on Boeing 737-800 (Helios Airways, 2003). During its short presence in the market it has lobbied for full liberalisation and has criticised the government for being overprotective towards the Cyprus Airways Group: for example, in February 2002 the carrier was refused a license for charter flights between Tel Aviv in Israel and Paphos (Koumelis, 2002a). If Helios proves successful in its operations, other new carriers might follow suit. Various plans for charter and scheduled services exist, including those prepared by Capital L Airlines, the subsidiary of the Cypriot tourism conglomerate Louis (Koumelis, 2000a).

c. The effects of Liberalisation on the Cyprus – Greece Market

Greece is the only large aviation market for Cyprus where passengers carried on scheduled flights clearly outweigh those who travel on charter services. Cyprus and Greece have close ethnic (historical and cultural) and business links. For the Greek-Cypriots, Athens and Thessaloniki are the major metropolitan centres of the Hellenic world: they are places suitable to work (Greece is the only EU country where Cypriots can work without immigration control impediments), become educated (the University of Cyprus has only recently started admitting students), be entertained and do shopping. In other words, there is a strong Visiting Friends and Relatives (VFR) and some business-related traffic from Cyprus to Athens and Thessaloniki. The routes between Cyprus - Athens and Thessaloniki are operated on a duopolistic basis by Olympic and Cyprus Airways. Greece accounts for about a third of Cyprus Airways traffic with Athens attracting three quarters of these flows (Cyprus Airways, 2002).

Interestingly, the above-described situation has great similarities with the Ireland -Britain aviation market and in particular the Dublin – London route. British Airways and Aer Lingus were the only carriers serving the route until 1986 when deregulation was introduced. The subsequent entry of Ryanair led to a dramatic reduction in fares, a major increase in the number of passengers and to the eventual exit of British Airways from the market (Barrett, 1997). This scenario could be replicated, therefore, in the context of the Larnaca – Athens (and to a lesser extent the Larnaca – Thessaloniki) route. It should be noted, however, that the level of fares in the Larnaca – Athens route has been significantly reduced over the last few years by Cyprus Airways (Koumelis, 1999), possibly to pre-empt any potential new entry. In

fact, a price war is unlikely to start from the other incumbent, Olympic Airways, as the Greek flag carrier is in a very difficult financial position and faces severe penalisation by the European Court of Justice for receiving illegal state subsidisation in the 1990s. Similarly, although Cyprus Airways is in a much healthier position, it faces substantial cost rigidities related to strong unionisation and staff expenses: the latter accounted for 32.6% of total operating costs (C£ 52.6 million) in 2002 (Cyprus Airways, 2003b). The carrier has also recently faced adverse publicity for lack of meritocracy (Koumelis, 2003). Therefore, a low cost carrier with a more flexible cost base could initiate flights between Larnaca and Athens pressing fares further downwards. This could be an existing EU airline (such as Ryanair or easyJet) using seventh freedom rights or a start-up company based either in Cyprus or Greece. A traditional EU scheduled carrier (e.g. British Airways) could also consider entering the route but the practice in the Single Aviation Market has shown that such moves have been rather unusual so far (British Civil Aviation Authority, 1998). In any case, the new deregulated environment poses threats for the two incumbent flag carriers, which might experience substantial new rivalry in one of their most lucrative routes.

Despite this threat on direct services between Larnaca and Athens, Cyprus Airways can take advantage of new emerging opportunities in the Greek market. Over the last few years, Cyprus Airways has repeatedly stated its interest to participate actively in the privatisation of Olympic Airways (Koumelis, 2000b), however, the Greek government has postponed any developments at present. Irrespectively of the outcome, Cyprus Airways decided to establish Hellas Jet in May 2002: this new carrier based in Greece will fly to major European destinations such as London, Paris, Frankfurt and Brussels and is expected to start operations in summer 2003 (Cyprus Airways, 2003b). The existing rules within the European Common Aviation Area preclude Cyprus Airways from having a majority shareholding either in Olympic Airways or Hellas Jet, however, the forthcoming accession of Cyprus both in the ECAA and the EU will obviously relax any such constraints. Moreover, the Cypriot flag carrier will soon be able to use fifth and seventh freedom rights in Greece and endow the Republic with flights to new destinations. In particular, in addition to any stand-alone services between Athens (or Thessaloniki) and cities in other EU states, Cyprus Airways will be able to achieve economies of density by filling its aircraft originating from Cyprus with passengers in Greece en route to another EU country. The financial sustainability of all the above operations, however, is an open question as the aviation market in Greece is in crisis: in

addition to the financial problems of Olympic Airways, Axon Airlines went bankrupt in 2001 while Aegean Airlines and Cronus had to merge in the same year to survive.

A final point to consider is the effect of charter liberalisation on the Cyprus - Greek market. Given the expected rivalry among scheduled carriers, its impact will probably be limited in the main routes of Athens and Thessaloniki. Peripheral tourist destinations in Greece, however, may be affected. For example, the relaxation of the seat-only rules (currently limited to 15% of the total available capacity depending on airport) could exercise downward pressure in existing air fares between e.g. Heraklion in Crete and Larnaca. Moreover, the introduction of charter flights originating from Cyprus will probably strengthen the gradually developing vertical integration practices of major Cypriot tourism conglomerates in Greece, such as the Louis Group. In fact, the latter is currently expanding its portfolio of hotels in major Greek islands, such as Zakynthos: the combination of hotel accommodation with a charter flight and perhaps other ancillary services could offer a cheap Greek holiday package to the Cypriot traveller in the near future. In conclusion, although the major implications of air transport liberalisation will probably be seen in the context of scheduled services, any developments on charter flights and the leisure product should not be underestimated.

d. The effects of Liberalisation on the Cyprus – Britain Market

The largest aviation market for Cyprus is Britain and despite the great majority of passengers flying on charter services, the scheduled market is also of respectable size. Cyprus has old colonial links with Britain and in addition to any business traffic there are strong VFR flows due to the presence first of a large Cypriot community in Britain (mostly in London and Manchester) and second of British military bases and other expatriates (usually retired people) in Cyprus. The British market is very important for Cyprus Airways as it accounts for about 24.6% of its traffic (Cyprus Airways, 2003b).

Having the above in mind, the effects of liberalisation can be substantial. In terms of scheduled services, Helios expects to start operations from Larnaca to London Luton in September 2003 subject to appropriate (and anticipated) changes in the current bilateral agreement between Cyprus and the United Kingdom. Other airlines might follow suit when full liberalisation takes place. Still, the market might not be as promising as it looks from a first glance. The Greek experience can be useful in this perspective as despite initial optimism, the Athens – London market is currently facing crisis: South East European

Airways (a Virgin Atlantic franchise) stopped flying between London and Athens in 2001 and Aegean – Cronus the year after. On the other hand, easyJet expanded its operations in 2002 by adding a daily flight from London Gatwick to Athens on top of the two existing ones from London Luton. Nonetheless, the economics of the London – Athens itinerary do not fit the standard low cost model: it is occasionally argued with a sense of humour that easyJet started flying to Athens because of the Greek origin of Mr Stelios Hadji-ioannou, its founder. Moreover, from a strategic perspective the carrier might have introduced the Gatwick flight to secure valuable slots in this airport (after the relocation of British Airways to Heathrow) that can be later used in other more profitable routes.

Therefore, if the Athens – London route can at most sustain three carriers (Olympic Airways, British Airways and easyJet), it is unlikely that the Cyprus – Britain market will be more successful at least in terms of direct flights. Moreover, the long distance between the two countries precludes the introduction of any low cost carrier de facto. Given the situation in Greece, Cyprus Airways might find it difficult to use fifth freedom rights from Greece en route to a British destination: Hellas Jet, its subsidiary, might also face problems if it decides to feature London as a destination although some feeder services from Athens to Cyprus (and vice versa) could perhaps alleviate the problem. Cyprus Airways could also use fifth freedom rights in another EU city (e.g. Rome, Vienna or Paris) to boost its Cyprus – Britain markets but this is unlikely to materialise in practice.

Compared to the Greek market, the impact of charter services liberalisation might be larger. In fact, Britain is the most significant tourism origin for Cyprus and the abolition of the current restrictions on seat-only packages will probably enhance competition and reduce the level of fares: increasingly, more people in Britain prefer to make their own travel arrangements (Thomson, 1999), while the existence of friends, relatives and second homes in Cyprus discourages at present some travellers from booking a package that includes accommodation as a compulsory element. The Cypriot based charter airlines have a good presence in the British market and will probably survive in fiercer competitive conditions if they also take appropriate cost reduction strategies. In 2002, Eurocypria flew about 128,000 passengers from Britain to Cyprus with a market share close to 14% and Helios flew about 66,000 passengers accounting for 7% of the market (Cyprus Tourism Organisation, 2003). Figures very close to Helios were also reported by Excel Aviation, a subsidiary of Libra Aviation, which is a company of essentially Cypriot interests. Moreover, the development of

charter services originating from Cyprus could lead to a decrease of existing fares quoted by schedule carriers.

e. The Impact of Liberalisation on the other Markets

As argued earlier in the paper, the impact of liberalisation on the aviation market for services between Cyprus and the remaining EU countries will be rather limited, as routes are either thin or almost entirely of charter nature. Same conclusions hold for routes between Cyprus and the other states that will join the European Union in 2004 as shown in Table 1. The latter also reveals that Cyprus has significant traffic with other European countries such as Switzerland and Russia as well as with most of the countries in the Middle East. Though this traffic will not be directly affected by the EU accession of Cyprus, there might be some indirect effects in the future if the European Commission is finally granted the power to negotiate traffic rights collectively with third countries. Such a development will undoubtedly strengthen the bargaining power of Cyprus and might also have an impact on sixth freedom rights and the emergence of Cyprus as a regional hub.

In fact, Cyprus Airways seems to have realised the strategic geographical location of the island for transit traffic to Middle East and the Gulf countries. For this reason, the carrier has recently furthered its operations to Paris that accounts now for 50% of its total transit traffic (Koumelis, 2002b). Nonetheless, to develop a regional hub and acquire features of centrality and intermediacy (Fleming and Hayuth, 1994), Cyprus should first renovate its airport infrastructure. Larnaca International Airport accommodated 4,972,758 passengers in 2002 but only 5.5% of these were transit; similarly Paphos International Airport recorded 1,587,057 passengers of which 4.9% were transit (Cyprus Department of Civil Aviation, 2003). At present, the Larnaca Airport seems unable to win the regional 'war of hubs' where it faces serious rivalry by the airports in Athens, Beirut and Istanbul: it has maximum capacity of 7.5 million passengers, a single runway and passengers cannot continue their journey to Turkey due to existing political situation (Butt, 2001). In 2001, the Cypriot government received ten offers by international consortia to renovate the two airports on a Build – Operate – Transfer (BOT) basis (Koumelis, 2001). A decision was expected in early 2003, however, the change of government has postponed any plans for the time being. Still, the aviation legislation has been recently harmonised with the *Acquis Communautaire* on issues of airport ownership and operation, ground handling services, economic regulation and allocation of slots (Official Journal of the Republic of Cyprus, 2002).

In its effort to become a regional network carrier and in addition to any airport infrastructure improvements, Cyprus Airways should seek active collaboration with other carriers. Individual codesharing agreements can be useful, however, the airline should seek entry into one of the main strategic airline alliances, such as OneWorld, Star Alliance or Sky Team. In fact, none of the three has a partner in Eastern Mediterranean or Middle East and EU accession of Cyprus renders the flag carrier a potentially attractive option. Of course, if the long-awaited market structure consolidation in the European aviation industry materialises, then Cyprus Airways could be bought by one of the major surviving carriers that lead the strategic alliances in Europe. Before this happens, however, the company should overcome its state-owned nature and increase its shareholding basis through a privatisation programme. As past European experience has shown, such issues always raise conflicts: the Cypriot case, however, is more complicated due to unresolved political issue on the island.

f. Political Issues

Since the 1974 incidents, the island of Cyprus has been de facto partitioned in two areas, i.e. the Republic of Cyprus controlled by the Greek Cypriots in the South and the northern part governed by the Turkish Cypriots. The latter declared an independent state in 1983, which is only recognised by Turkey and Pakistan. In fact, the northern part is politically isolated; it has no international relations and its airports are regarded as illegal points of entry to Cyprus by the Republic. Consequently, travellers can only fly to the northern part by making a stopover in Turkey, incurring extra time cost. If they wish subsequently to visit the South, they should first go to a third country, e.g. Greece: there are no flights between Turkey and the Republic of Cyprus as the two countries have not even exchanged first freedom rights! In other words, politics have dramatically distorted transport geography and accessibility on the island. Nonetheless, the decision over the EU accession of the Republic of Cyprus in May 2004 may lead to an entirely new political situation, as the Turkish Cypriots are pressed by the international community to follow Greek Cypriots and accept the resolution plan proposed by the United Nations. In essence, the latter suggests the re-unification of the island under a federal status.

The potential success of this plan will have important implications for civil aviation in Cyprus. The emerging détente will enhance political stability leading to new investments and further tourism development of the island: consequently, air traffic flows will grow.

Moreover, the initiation of direct flights between the new Republic of Cyprus and Turkey could facilitate the development of an international hub on the island. Despite this rosy image, however, there are some controversial issues to resolve. The first is related to the flag carrier and the associated traffic rights. At present there is Cyprus Airways in the Republic and Cypriot Turkish Airways in the north: which company will be regarded as the flag carrier of new Cyprus and under what terms and conditions? The second concerns airport development. As argued earlier in the paper, the Republic is in train to renovate Paphos and primarily Larnaca Airport: such a decision, however, would further intensify the existing provocative asymmetry between the South and the North in terms of economic and air transport development. As a reaction, the Turkish Cypriots plan to renovate Ercan Airport: however, the size of the market renders absurd the creation of more than one international hub, while the renovation of the abandoned Nicosia Airport (as a middle solution) might prove a very expensive project. These issues are important and will undoubtedly play a crucial role in future negotiations: the re-unification process of Western and Eastern Germany can perhaps provide a useful benchmark in this perspective.

3. The Case of Malta

As a British Empire military base, Malta's economy prior to achieving independence from Britain in 1964 was dominated by its need to supply dry-docks maintenance facilities for the British Navy. The Maltese economy was still highly dependent on Britain in the early 1960's, and economic development was far behind that of its northern European neighbours. Recognition of the need to diversify Malta's "fortress economy" led to a rapid development of new industries in the light manufacturing and service sectors from the 1960's onwards. By 2003, following years of national division and local debate over the merits of EU membership, the centre-left Nationalist government succeeded in winning a "pro EU entry" referendum and cemented this win with a general election victory shortly after for a further five-year term in office. Accession into the EU is planned for May 2004, and expectations followed that entry into the "Eurozone" (replacing Malta's own Lira currency with the Euro) might materialise three years after accession – within the same term of office of the new Nationalist government.

a. Tourism and the Evolution of the Civil Aviation Regime in Malta

As part of Malta's economic diversification programme, tourism grew rapidly from the 1960's, and the Maltese landscape was transformed over the course of a few decades through intensive hotel development. Mass tourism charter flights to cater for a growing demand for tourism into Malta began during the late 1960s. When Air Malta started operating in 1973, one of its early objectives was to increase tourism inflow from richer European countries, with UK, France, Germany, Netherlands and Italy emerging as the top five supplier markets to Maltese tourism. Air Malta was a government owned carrier, with a mission to increase tourist arrival numbers so as to support the growing tourism economy.

Strong traffic growth in recent decades has resulted in a situation where tourism is now a major contributor to the Maltese economy (24% of GNP according to a study by Mangion and Vella, 2000), and an important element of the new service sector. Tourist arrival numbers soon reached very high levels very quickly for a small and densely populated country. A Maltese population of 0.4 million residents now receives 1.2 million tourist arrivals per year. A carrying capacity assessment by Mangion (2001) suggests that Malta cannot take any more tourist arrivals and that a level of saturation has now been reached.

By 2003 the Republic of Malta had already liberalised air service agreements with four EU countries (UK, Germany, Netherlands and Eire), no air service agreements at all with four accession countries (Estonia, Latvia, Lithuania, and Slovenia), and restricted air service agreements with all the other current and accession EU countries. Its accession into the EU during 2004 and the associated liberalisation of Maltese civil aviation within ECAA will result in the removal of many restrictions in its civil aviation markets (e.g. single carrier designations, flight frequency limits and tariff approval processes which currently exist regarding air transport operations with many European countries). If the market cannot get bigger, and if a consequence of EU membership is that the Maltese government is unable to maintain protectionist policies to cushion its (still predominantly government owned) national carrier from competition, then competition in air transport to and from the Maltese islands may intensify, as carriers seek to erode Air Malta's dominant position in the market place (more than half of all civil air traffic into and out of Malta is currently carried by Air Malta).

b. Competition between Air Malta and carriers originating from other EU countries

Air Malta - given its low cost base compared with European airlines it competes with on the Malta route - has historically done well to fight off competition from its northern neighbours. Though it has been characterised as over-manned, over-unionised, and over-protected as a largely government owned carrier, comparative labour rates are such that it remains nevertheless, low-cost compared with many of its European flag-carrier counterparts (which can also be characterised as over-manned and over-unionised but at much higher pay levels). Air Malta is also relatively well managed by European standards, and it is financially self-sustaining - it is not a drain on the Maltese taxpayer in the way that many European flag carriers are on their taxpayers.

As far as competition from European low-cost carriers is concerned (e.g. Ryanair and easyJet from the UK), Malta's three-hour flight-time from the UK puts it out of single-sector range of the UK's low-cost-carriers, which prefer to operate within a 2-hour sector-range so as to maximise aircraft turnaround opportunities within a 24-hour time period and thereby maximise asset utilisation. Though Ryanair and easyJet are considering establishing central European hubs, and though conceivably the establishment of a north Italian hub near Milan could bring Malta within connecting traffic range of high-frequency, short-sector, northern-European cities; it is thought that the great majority of tourists to Malta will be prepared to pay a premium to fly direct point-to-point services (e.g. London-Malta direct at a higher fare, rather than London-Milan-Malta at a lower fare). Despite the common misconception that low cost carriers only serve point-to-point and do not cater for connecting traffic (according to Jeans (2002), 17% of Ryanair's 2001 traffic at Stansted comprised connecting passengers - i.e. passengers who bought two individual fares to make up their own connecting journey, e.g. Dublin-Stansted-Paris), the majority of mass-market, holidaymakers to Malta are seeking the convenience of a one-stop-shop package which includes a point-to-point air travel component. Comparatively small numbers of connecting passengers will find a cheaper way of getting to Malta on combined low-cost-carrier services, but these are not expected in sufficient numbers to cause Air Malta major problems.

c. Competition between Air Malta and other carriers which may originate from Malta

Though Air Malta is well placed to see off competition from its more expensive and arguably less efficient northern European neighbours, it may however, find increasing competition at home. Maltese entrepreneurs such as Robby Borg of Bargain Holidays Ltd may take

advantage of liberalisation opportunities post May 2004 through the establishment of new, home-grown competitors to Air Malta which could be even lower cost than Air Malta is now. Borg suggests that “although Air Malta will continue to enjoy a monopoly in terms of providing Maltese originating air services this cannot continue after May 2004” (Busuttil, 2003). He has already been prevented from establishing a new Maltese based airline called European Air Bargains – a Maltese government decision which was brought to the attention of Neil Kinnock, the EU’s Transport Commissioner. Borg already attempts to undercut Air Malta by offering the Maltese public discounted flight-only fares from block-bookings he has with existing UK charter carriers via a retail outlet in Malta’s capital and via his internet booking site www.bargainholidays.com.mt.

Clearly the numbers of tickets sold is still small scale compared with Air Malta’s current Malta-originating traffic levels but the Maltese flag carrier may need to consider how big a potential threat Borg could be. Though Malta-originating traffic numbers are small, if European Air Bargains is successfully launched after May 2004, Borg may start to build up a customer base from the major tourist supplier markets to Malta large enough to cause Air Malta some problems. A future “European Air Bargains” airline based in Malta might provide significant competition to Air Malta for the provision of block-space bookings of airline seats to northern European tour operators, a market which is crucially important to Air Malta since it represents the majority of seats sold on Air Malta flights.

d. Other competitive pressures on Air Malta

It is not only Air Malta’s privileged position in the air that could be challenged. Air Malta will also lose its monopoly on the supply of ground handling services at Luqa airport, and EU procedures for the non-discriminatory allocation of airport slots may also erode some of Air Malta’s previously held operational advantages. Air Malta is likely to come under pressure to restructure in order to address its problems of over-manning in the face of such competitive threats. EU pressure to discourage the Maltese government from bailing out Air Malta from any financial problems it may face along the way will add to pressures for Air Malta to privatise, restructure and improve efficiency. In Air Malta’s favour however, is that it does benefit from a professional management team, which is well aware of its need to continuously improve performance in the face of increasing competition. Air Malta has a history to date of demonstrating a long-term trend to profitable operations without the need to resort to seeking financial assistance from its government. Air Malta has also proved itself in the past by

competing successfully in a marketplace populated with highly competent carriers such as British Airways and Lufthansa, so it should find itself well prepared to face up to the challenges and difficulties ahead.

4. Carrying Capacity in Malta and Cyprus

The demand for air transport services is essentially derived as most people fly to participate in certain activities in a place away from their origin. Tourism plays a major role for Cyprus and Malta and as the previous analysis indicated, the forthcoming aviation deregulation will enhance tourism flows. But is such development sustainable or is it likely to exceed the carrying capacity limits of the two island-states causing environmental and other destruction that would outweigh the benefits of liberalisation?

Entrepreneurs such as Robby Borg are lobbying the Maltese government with a view to trying to persuade them to allow a dramatic increase in tourist arrival numbers in Malta. Borg does not believe that 1.2 million tourist arrivals per year represent a capacity limit. He wants to see numbers rising to 1.7 million over a five-year period (he believes that his company can grow the market by 100,000 per year). His views are in conflict with a range of stakeholders in Malta who are keen to keep tourist arrival numbers down and yields up. Similar discussions and friction are also apparent in the Cypriot context.

a. Challenging assumptions regarding the tourist arrivals capacity limit

There are essentially two schools of thought regarding tourism planning on Malta that can be characterised as follows. First, there is the *pile-it-high-and-sell-it-cheap* philosophy. Its advocates suggest that 3* hotel capacity should be expanded – that the bottom end of this highly price-elastic market is the place to make money. Large scale, low-cost hotels with cheap bars and swimming pools are what the great majority of holidaymakers to Malta (and certain resorts in Cyprus) are looking for. Interestingly, planned upgrades (overbooking lower class product sales when higher class demand is low with a view to giving someone a 4* room for the price of a 3* holiday) do not tend to work well in the hotel market in the way that they work in airline sales: whereas many people would relish the prospect of a free upgrade to business class on an airline, someone looking forward to the consumption of cheap food and beverages in a 3* hotel might not be grateful for being transferred to a more expensive environment, even if it does come with a nicer bedroom. The supply sector (e.g. brewers,

caterers selling their products to hotels) also subscribes to this view, often preferring to win higher-volume lower-margin supply contracts with 3* hotels which might prove more profitable than lower-volume higher-margin supply contracts with 5* hotels.

The second philosophy stresses product quality improvements and focus on the high yield sector. Malta and Cyprus are essentially price-elastic holiday markets – and that's their problem (say critics of "pile it high and sell it cheap"), they need to change and move more up-market. Overcrowding makes a stay on an island less enjoyable for its visitors and consequently lowers the prices charged for services. It also becomes a less enjoyable experience for the residents who complain that their home is being "invaded", rather than celebrate the fact that foreign visitors are bringing in much needed hard currency. By only allowing the development of 5* hotels on the two island-states, and by converting existing 3* hotels to retirement homes and apartment blocks, Malta and Cyprus could become less congested while tourism revenues will be maintained because yields will improve (a higher price can be charged for a premium product).

Resolving which is the "best" strategy to pursue for Malta and Cyprus (or which mix of the above approaches is optimal), will entail the application of sensitivity analyses and evaluations of the impact of relaxing a range of "hard" and "soft" constraints in a model. This should be designed to identify the optimal mix of capacities/prices in the overall Cypriot and Maltese tourism economy such that revenues are maximised for the economy as a whole rather than just favouring one sector such as air transport or hotel and catering.

b. Hard constraints on the expansion of tourist arrivals

First, there are energy supply considerations. Can the power plants on the two island-states generate enough electricity? This is probably the most binding constraint. Power consumption among tourists requiring air conditioning and other amenities can be very high. Expansion beyond the 1.2 million visitors level in Malta might prove expensive in terms of the need to expand power plant output and might be infeasible if the development of a new power plant is required. Second, there are water supply problems. In this case, we need to consider whether the desalination plants on the islands can generate enough potable water. This might not be as critical as the electrical power constraint but it also needs serious consideration.

Third, there is an issue of land supply. Robby Borg, for example, advocates the replacement of existing small-scale 3* hotels with the development of fewer but larger (more commercially efficient) 3* hotels with swimming pools and capacities in excess of 400 bedrooms. Malta is a very small country and this may prove difficult to achieve on the scale advocated by Borg. The current planning philosophy advocates granting planning permission only to 5* developments and high-yield boutique hotels, with a preference for converting existing 3* hotels to retirement homes and apartment blocks. Cyprus is larger in terms of size and has greater flexibility to diversify its construction activities and tourist products (e.g. development of rural or mountainous tourism). Still, the introduced upmarket tourism policies have occasionally failed or even accentuated the problems caused by conventional mass tourism (Ioannides and Holcomb, 2001).

c. Soft constraints on the expansion of tourist arrivals

The first important factor to consider is the residents' concerns regarding increased congestion from tourism. Malta already becomes very crowded during the peak visitor months of July and August, especially in the conurbation around Valletta towards the east of the island which is very heavily populated by local residents. The quality of the Maltese road network is poor, car ownership is rising quickly and roads are becoming congested. Advocates of expanding the 3* sector on the Qawra/Buggibba peninsula towards the north of the island, however, suggest that most of their 3* customers are more interested in cheap beer and discos and coastal attractions within walking distance of their Qawra/Buggibba hotels than they are in hiring cars and exploring museums and cultural attractions in the conurbation around Valletta. The implication is that though July/August crowding is currently a problem, it might not get significantly worse. The additional 3* tourists – they argue – will probably remain concentrated around the Qawra/Buggibba peninsula. Furthermore, they suggest that as the quality of the road network improves (perhaps with help from EU structural funds post May 2004), and as the quality of the public transport service improves (new, improved buses and bus services are already being introduced to replace Malta's ageing bus fleet), Malta's congestion problems might even ease to some extent. It remains to be seen whether EU structural funds will materialise, whether new buses, bus routes, park-and-ride schemes will help, and whether 3* visitors really do confine themselves to tourist complexes.

There are also substantial residents' concerns regarding the cultural impact of tourism. The argument that most tourists largely keep themselves to themselves is not one which will find

much support among those Cypriots and Maltese concerned with the erosion of traditional values among the youth. Malta (and also Cyprus to a large extent) is a deeply religious country, with strong family values. Some Maltese consider tourists a bad influence on local residents and would be particularly worried about an expansion of the 3* end of the market rather than the 5* end of the market, since they would be quick to characterise 3* customers as being partly responsible for an increase in licentious behaviour and alcohol and drug consumption among Malta's youth. They do not see raucous behaviour and loud partying as being confined to the Qawra/Buggibba peninsula – the St Julians/Paceville district towards the north end of the conurbation around Valletta is itself a centre for discos and bars and nightlife which is popular among both Maltese residents and tourists alike. It should be noted that such traditional attitudes are not only found among a few old-fashioned “fuddy-duddies” who represent a tiny constituency – many Maltese disapprove of soft-drugs, drinking to excess, pre-marital-sex, topless-sun-bathing etc and would see mass-tourism as part of the problem. This is a complex issue however since many Maltese would also consider tourism to be an essential component to the Maltese economy. A study by Mangion (2000) showed that 71% of the Maltese people considered tourism essential, with a further 28% considering it very important to the Maltese economy. This study showed that the main perceived benefits of tourism are improved economy, job opportunities, cultural exchange and attaining recognition from other countries; with the main perceived problems being pressure on the infrastructure, traffic/parking, overcrowding, increase in prices, deterioration of values and beach related problems.

5. Conclusions

EU membership will result in increased competition in a more liberalised civil aviation regime in Malta and Cyprus – but this should not necessarily imply a massive expansion in terms of tourist arrivals numbers. The Cypriot and Maltese governments will still be able to exert a certain amount of control and strategic direction on the development of their tourism industry through the regulation of planning permission for the development of the islands tourism infrastructure, but a lot of attention has to be paid to considering what is the best size and mix of different elements of the tourism product. The most rational way of reaching a conclusion, which maximises utility for the majority of organisations and stakeholders in the two economies, is to apply forecasting and optimisation techniques to the problem - as in the case of the airline industry, revenue management techniques might help.

Revenue management is the integrated control of capacity and price through the application of demand forecasting techniques at varying price/quality levels, and the subsequent application of price mix optimisation techniques to those forecasts so as to maximise overall revenues. The application of such techniques might also suggest better pricing strategies to help smooth to some extent some of the peaks and troughs in demand (seasonality has a major impact on employment and asset utilisation in Cyprus and Malta, with many hotels having to close during winter as a consequence of insufficient demand at current winter price levels). Apart from package price, another factor to consider in a model aimed at optimising revenue contributions to the overall Cypriot and Maltese economy will be length of stay. It could be shown that on a per-day basis, short stay visitors spend more than long stay visitors. This suggests that during peak periods (e.g. summer) more one-week holidays rather than two-week holidays should be sold, and during trough periods (e.g. winter), discounts should be available for very long visits (e.g. there is a market for retired northern Europeans to fly south for extended winter breaks of one month or more – such trips can prove very cost effective for them in cost of living terms, considering the costs of staying at home and paying their heating bills).

Apart from considering absolute numbers (i.e. demand in terms of number of tourist arrivals on the islands – capacity constraints discussed suggest that these numbers might not necessarily increase in any case), the quality and value dimensions might be improved benefiting tourists arriving in Cyprus and Malta and making the two island-states a more attractive tourist destination for potential EU visitors. Deregulation of civil aviation as a result of EU accession might also mean that Cypriot and Maltese residents departing the island for holidays in Europe would also benefit from the lower prices offered by new operators. It is suggested that tourism planners in Cyprus and Malta need to adopt strategic revenue management techniques to better optimise tourism resources to maximise revenue opportunities. Whether this should be from a stable tourism arrivals numbers base or a growing tourism arrivals numbers base remains to be seen. Improvements in the tourism attributable contribution to the Cypriot and Maltese economy may not necessarily come from more tourists but from a better mix of tourism arrivals by hotel class, time of year and length of stay.

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Table 1 – Arrivals in Cyprus by Air in 2002

Countries	Charter Tourist Arrivals	Air Traveller Arrivals	Charter Share
<i>UK</i>	931.658	1.354.156	68.80
<i>Greece</i>	5.059	396.820	1.27
<i>Germany</i>	122.147	189.357	64.51
<i>Sweden</i>	95.126	95.897	99.20
<i>Netherlands</i>	17.597	66.377	26.51
<i>Norway</i>	52.581	49.273	106.71
<i>Finland</i>	2.475	45.941	5.39
<i>Austria</i>	8.473	43.315	19.56
<i>Ireland</i>	29.857	41.709	71.58
<i>France</i>	2.841	38.179	7.44
<i>Denmark</i>	30.990	34.301	90.35
<i>Italy</i>	356	27.230	1.31
<i>Belgium – Lux</i>	10.657	23.117	46.10
<i>Spain</i>	71	1.138	6.24
<i>Portugal</i>	n/a	0	
<i>Iceland</i>	n/a	0	
Total ECAA	1.309.888	2.406.810	54.42
<i>Czech Republic</i>	13.866	35.309	39.27
<i>Hungary</i>	2.907	24.590	11.82
<i>Poland</i>	10.473	21.040	49.78
<i>Slovakia</i>	1.916	4.674	40.99
<i>Baltic Countries</i>	2.156	1.188	181.48
<i>Slovenia</i>	48	n/a	
Total New EU	31.366	86.801	36.14
<i>Russia</i>	97.199	161.749	60.09
<i>other CIS</i>	6.732	n/a	
<i>Switzerland</i>	43.538	74.317	58.58
<i>Lebanon</i>	n/a	41.198	
<i>Egypt</i>	n/a	37.007	
<i>Israel</i>	8.913	33.873	26.31
<i>UAE</i>	n/a	23.021	
<i>Syria</i>	n/a	20.765	
<i>Bulgaria</i>	139	20.330	0.68
<i>Romania</i>	426	10.427	4.09
<i>USA</i>	0	0	
Total Market	1,520,930	3,028,939	50.21

Source: Cyprus Tourism Organisation (2003) and personal calculations

Notes: ECAA refers to European Civil Aviation Area (i.e. the fifteen European Union countries plus Norway and Iceland) and Lux to Luxembourg. The Baltic Countries are Estonia, Lithuania and Latvia. Total statistics for the new EU countries do not include Malta. Where data are not available (n/a) a zero value is assumed.

The second column (*Charter Tourist Arrivals*) shows tourist arrivals on charter flights by nationality, whereas the third column (*Air Traveller Arrivals*) shows arrivals by air (excluding excursionists) and country of flight origin. Consequently, the two columns are not directly comparable and it is possible to have a *Charter Share* (the ratio between numbers in columns two and three) that exceeds 100% (as for Norway). Still, the assumption that somebody flies to Cyprus on a charter carrier from their own country is very plausible, i.e. nationality in column two coincides with country of origin of flight: therefore the fourth column is informative.

The Table refers to arrivals, but since the great majority of passengers buy return tickets the total Cypriot air transport traffic is about twice this size. In fact, the year closed at 6.03 million travellers (Cyprus Tourism Organisation, 2003).