“*The worst sin towards our fellow creatures is not to hate them, but to be indifferent to them: that’s the essence of inhumanity*”

George Bernard Shaw

Submission to the Review of the White Paper on Irish Aid: Applying Ireland’s Know-How to Remedy a Uniquely African Problem – Its Inadequate and Debilitating Air Transport System

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25 April 2012

Release of Response: Authorised
Freedom of Information: No objections

This submission to the review of the White Paper on Irish Aid is made in the context of the broadened role of the Department of Foreign Affairs and Trade, the stated aims of Ireland’s *Africa Strategy* and the practical limitations on Ireland’s financial resources in the near to medium term.

As a means of addressing the questions posed in the Consultation Paper, the purpose of this submission is:

1. To identify Africa’s inadequate air transport system as a major inhibitor of economic growth and development;
2. To quantify some of the harm that will be done in terms of permanent capital outflow and the continued unavailability of regional air transport if the *status quo* persists; and
3. To propose an innovative Irish-made solution that will remedy, or significantly mitigate, the worst effects by contributing to the modernization of the African commercial aircraft fleet and thereby to the extension of safe, efficient and affordable air transport to ‘all four corners’ across the continent thus enabling people literally ‘to go about their business’.

A major part of this submission involves the establishment of a PPI commercial aircraft finance entity (“**CAFE**”) for Africa and the Indian Ocean. Leveraging its public-private capital base, CAFE would buy aircraft better, quicker and cheaper than most, if not all, African airlines and lease them to African carriers on a commercial basis, thus accelerating the modernization of the African commercial aircraft fleet and improving airline reliability, efficiency, profitability and safety. Over time, it would also mitigate the significant permanent capital outflow inherent to the *status quo*.

It is neither expected nor necessary for Ireland to make an investment in CAFE. However, leveraging its know-how and international relationships, Ireland could and should play an important mentoring role in advancing the CAFE proposition. In addition to making a major socio-economic contribution to Africa, CAFE would reflect well on Ireland in due course.

For readers who might prefer to read just a synopsis of our ideas, please turn to the **Appendix** for an article on CAFE that the Financial Times asked us to contribute to their *This is Africa* magazine.

1. Introduction

The authors of this report are not especially familiar with the work of Irish Aid on the ground. However, as an aviation consultancy company, we have had close contact, and spent a considerable amount of time, with African airlines and related parties (e.g. airline shareholders, maintenance 'shops') for the past 14 years or so.

Over this time, we have heard a constant refrain from African business leaders that the availability of aid simply leads to demand for more aid and the perpetuation, however unintentional, of an unhealthy state of dependence (as echoed in recent years in a number of books by non-Africans including *War Games* by Ms Linda Polman).

Meanwhile, much has been made of the emergence of significant trade links between China and Africa, particularly in the realms of infrastructure development and supply of commodities, often described as a 'win-win' for their respective economies.

Should we not be asking if there is a separate 'space' within which, leveraging our know-how and international relationships, we could help forge a 'win-win' outcome for Africa and ourselves?

We believe that the answer to this question is, in part, the same as the answer to the questions posed in the Consultation Paper: Ireland should select a limited number of universally recognized problems, such as Africa's inadequate air transport system, and devise strategies to address them.

One such strategy is the establishment of CAFE (www.cafe.aero), a commercial aircraft finance entity that will access previously unavailable sources of infrastructure and related finance on a public-private-initiative basis to participate in the historically profitable business of aircraft leasing and financing, an industry in which Ireland has excelled for over 35 years.

In time, CAFE will buy aircraft better, quicker and cheaper than most, if not all, African airlines and place them with African carriers on a commercial basis, thus accelerating the modernization of the African commercial aircraft fleet and improving reliability, efficiency, safety, profitability and capital retention, as explained below in more detail.

2. What role does air transport play in modern economies?

Based on research of 139 countries over 35 years (1970-2005), the 2009 MIT *Analysis of the Interaction between Air Transportation and Economic Activity: A Worldwide Perspective* verifies the reciprocity between air traffic and economic growth: "high correlation coefficients between air passengers and GDP imply that there is a strong linear relationship between the two variables". The authors observe that "air transportation impacts an economy by providing employment in the aviation sector and creating wider socioeconomic benefits through its potential to enable certain types of activities in a local economy because of its distinctive characteristics: speed, cost, flexibility, reliability, and safety. The region's economic activity, in turn, provides capital and generates the need for passenger travel and freight which drives the demand for air transportation services."

The 2009 Oxford Economics Report *Aviation - The Real World Wide Web* draws similar conclusions: "Air transport lies at the heart of modern, globalised economies".

And IATA's *Vision 2050 Statement* asserts: "More important [than the traditional understanding of the economic value of air transport] is the infrastructure asset created by air transport connections between major cities and markets".

We contend that, in Africa, an aircraft in motion often corresponds more to a bridge than a bus due to the continent's topography (**A**ircraft=**B**ridge). Mr Ed Farquharson, head of the Private Infrastructure Development

Group and author of *How to Engage with the Private Sector in Public-Private-Partnerships in Emerging Markets* agrees: "Any initiative that mobilises private sector capital to expand Africa's infrastructure (and in this respect I fully agree with your portrayal of aircraft as bridges not buses) must be applauded and especially if this also enhances African ownership and helps to build African businesses."

3. Africa's air transport system

(a) Intercontinental traffic

Non-African airlines generate billions of dollars from flights to/from/in Africa: by some estimates, as much as US$10 billion a year. Allowing for half being beyond the reach of African airlines anyway still leaves US$5 billion a year in foregone revenues or, more pertinently from an African economic perspective, permanent capital outflow.

Industry commentators agree that, over the next 20 years, the African market is likely to triple (and nine of the top 20 fastest growing routes worldwide will be to/from/in Africa). So if the *status quo* persists whereby non-African airlines currently account for over 80% of intercontinental traffic, the cumulative permanent capital outflow from the continent will amount to US$200 billion over the next 20 years: that's 200 billion reasons for the public sector to take notice.

24-Feb-12: O.R.Tambo International Airport, Johannesburg: Air France, Emirates and Lufthansa 'double-decker' A380s, and a Singapore Airlines B777 (ca. 1,900 seats daily)

In fact, it will be even more because the lion's share of African airlines' cost inputs is for non-African supplies and services (aircraft, engines, parts, maintenance services and fuel).

(b) Regional and domestic traffic

It has long been a bugbear of Africans and non-Africans alike that, on a continent so well suited to air transport on account of topography, borders and population distribution, it is so difficult, expensive and sometimes unsafe to transport passengers and cargo by air.

Acceptance of the *status quo* referred to above will result in most African airlines ceding all intercontinental traffic to (or being subsumed into) non-African carriers and concentrating, largely by default, on offering local and regional services in which the non-African carriers have little or less interest. Such routes will remain relatively 'thin' and fares relatively expensive to cover high operating costs. So the *status quo* will prevent, to borrow from ICT terminology, the 'last mile' being served by safe, efficient and affordable air transport services.

There will be a partial brain-drain and loss of skill-sets as Africa's cities become mere destinations and the future potential of African skies will be enjoyed in large part outside of Africa (foreign airline owners, aircraft/engine investors, banks and maintenance providers). Perhaps most important of all, any significant prospect of materially curtailing the permanent capital outflow identified above will have been lost.

4. What is CAFE?

CAFE is a commercial aircraft finance entity that accesses previously unavailable sources of infrastructure and related finance on a public-private-partnership basis to participate in the historically profitable business of aircraft leasing and financing. By conservatively leveraging such capital, CAFE will acquire aircraft for placement with African airlines on a commercial basis.

(a) Why would the Public Sector participate?

About US$50 Billion is spent each year on African infrastructure, of which 30% at least is acknowledged to be 'inefficient'. Conceptually, for every US$100 spent, there is a pro-forma 'T' account with the entries: credit cash, 100; debit investment, 70; debit expense, 30.

Through CAFE, we are proposing a public sector involvement that would attract private investment, help create a virtuous economic spiral and be represented financially in more wholesome fashion: credit cash, 100; debit investment, 100. There should even be a modest return on the public sector investment.

Through its participation in the modernisation of African airline fleets, CAFE will stimulate economic activity by:

- Facilitating airline operational efficiency improvements, permitting network development for both passenger and cargo activity
- Making travelling on African airlines a more attractive option, thereby helping to mitigate the competitive external forces identified earlier in this paper
- In due course, creating and developing African demand for African capital as it develops a successful track record and increasingly seeks to source funding from the continent itself

Africa as a whole will thereby experience a series of self-reinforcing benefits:

- Younger commercial aircraft
- Better reliability and efficiency
- Improved maintenance and safety standards
- Less pollution
- Increased skills
- Enhanced direct, indirect and catalytic economic prospects
- Less permanent capital outflow

(b) Why would the Private Sector participate?

Aviation is an extraordinarily capital-intensive activity: it is estimated that, for 2012, the aggregate funding required for new deliveries globally amounts to about US$95 Billion. As a consequence, there is a constant need to develop new sources of investment and financing.

The private sector already invests in aircraft for lease to certain African airlines. Additional equity capital from the public sector for African aircraft financing is appealing as it would enhance and accelerate the private sector's penetration of a growing market.

(c) Describe the benefits for the various actors?

For commercially-viable African airlines, CAFE would be a reliable provider of aircraft financing on terms equal to or better than market.

For the public sector, CAFE would be an appreciating, monetizable asset.

For the private investment sector, CAFE would unlock previously unavailable capital thereby accelerating and/or increasing market opportunities.

For manufacturers, export credit agencies and financial institutions, CAFE would be a dedicated partner in African aircraft financing.

For policy makers, voters and their elected representatives, CAFE would be a genuine example of money being used to good effect.

(d) Is there a better way than CAFE to accelerate the modernization of the African commercial aircraft fleet and thereby achieve the benefits enumerated above?

Over the past two years, we have asked public and private leaders to demonstrate their support for CAFE, explain their objections or come up with a better alternative. Not a single alternative has been put forward.

The background to the inadequacy of the African air transport system is as follows: a variety of structural and circumstantial reasons have coalesced to inhibit the modernization of the African airline fleet as a whole, bar a handful of noteworthy exceptions such as Ethiopian Airlines and Kenya Airways. Those reasons include Africa's topography, borders and population distribution; the ill-fitting legacy of the 1940s Chicago Convention (which paved the way for politically-negotiated, largely reciprocal bilateral air services between designated airlines of sovereign countries) on the newly emerging and numerous independent African states of the 1960s; unsustainable business models (in term of potential revenues versus systemically high operational and ownership costs); capability shortfalls at middle and senior management level; poor corporate governance; and government interference.

However, all of those reasons have arguably been trumped by the non-implementation of the Yamoussoukro Decision ("YD"), the African Union policy instrument that was supposed to liberalize African skies. Due to the fitful and still incomplete implementation of YD, the quasi-Darwinian processes observed in the US and Europe since deregulation in those markets have not yet occurred in Africa to any great extent. Understanding that each sovereign nation has its own reasons for its behaviour, our purpose here is not to criticise non-implementation but rather to emphasise one of the major consequences thereof insofar as Africa's fleet composition is concerned: few, if any, African airlines have succeeded in reaching the economies of scale required to achieve the virtuous circle of bargain basement aircraft prices, superior buying conditions (e.g. extended manufacturer warranties) and lower finance costs such as that achieved and enjoyed by the likes of Ryanair. Most African airlines were put at a further disadvantage with the international proliferation of frequent flyer programs in the 1990s and the emergence of major airline alliances in the 2000s.

Although the major African airlines have been gradually catching up, the 'traditional' non-African airlines, mainly European, have become more entrenched in Africa over the past decade and a host of newcomers, particularly from the Levant and the Middle East, have extended their operations to the continent over the same period such that the long-term trend has been a decline in African airlines' share of the intercontinental market.

5. CAFE Summary

African countries still tend to favour having national carriers and African airlines tend not to cooperate very much with each other. In seeking ways to address the twin challenges of mitigating permanent capital outflow and extending safe, efficient and affordable air transport across and throughout Africa, one is therefore left with a choice:

- Be *prescriptive* (and propose an unworkable 'solution' along classic liberalization lines that have not just been unsuccessful for over 20 years but have also allowed non-African airlines to steal a march over their African competition) or
- Be *pragmatic* and address the inadequacies of Africa's air transport system and their effects in an innovative and workable way.

6. Conclusion

Concerning the questions put forward in the Consultation Paper, we believe that:

- The Government has mostly been successful in implementing the White Paper commitments;
- The changes in the international and domestic context oblige Ireland to reconsider its priorities and focus on areas that are within its fields of expertise and scope of capabilities;
- In this connection, Ireland should select a limited number of universally recognized problems, such as Africa's inadequate air transport system, and devise strategies to address them (e.g. CAFE);
- Ireland should reflect its commitment to human rights by continuing, where practicable, to help people to help themselves in a way that actively discourages dependence; and
- In devising aid programmes, Ireland should solicit practical views more widely from representative cross-sections of society (including the business community in particular) in the countries/regions that are to benefit and from Irish missionaries and workers who have lived there.

Aircraft=Bridge: Accelerating the Modernization of the African Commercial Aircraft Fleet

by Mark Tierney, Co-Founder and Managing Director, Crabtree Capital mark.tierney@cafe.aero

If asked to think of African aviation success stories over the past decade, what comes to mind? Perhaps Comair, Ethiopian Airlines, Kenya Airways, Royal Air Maroc or South African Airways? For various reasons, I would agree with all of these. Take Ethiopian Airlines' remarkable growth for example: their revenues increased from 4.3 billion Ethiopian Birr in 2005 to 16.8 billion ETB [US$1.3 billion] in 2010, a 3.8 fold increase.

But what if I countered with Emirates or Air France/KLM (or IAG or Lufthansa or even Turkish Airlines)? Over broadly the same time scale, Emirates' African revenues have increased 3.3 times from AED1.7 billion to AED5.6 billion [ca. US$1.5 billion]; and for 2011, Air France/KLM reported revenues of about US$4billion for the combined region of Africa and the Middle East.

Non-African airlines generate billions of dollars from flights to/from/in Africa: by some estimates, as much as US$10 billion a year. Let's say that half is beyond the reach of African airlines anyway – that still leaves US$5 billion a year in foregone revenues or, more pertinently from an African perspective, permanent capital outflow.

Industry commentators agree that, over the next 20 years, the African market is likely to triple (and nine of the top 20 fastest growing routes worldwide will be to/from/in Africa). So if the *status quo* persists (non-African airlines currently account for 80% of intercontinental traffic), the cumulative permanent capital outflow will amount to US$200 billion over the next 20 years: 200 billion reasons for the public sector to take notice.

(In fact, it's even more because the lion's share of African airlines' inputs is for non-African supplies and services).

Of course, there are initiatives under way: examples include the 20-year old effort to implement 'Open Skies' through the Yamoussoukro Decision; the laudable 'Single African Sky' initiative to make navigation more efficient and the recent innovative African Airlines Association-led Joint Fuel Purchase Project.

But even when these initiatives are well thought through, they tend to be slow rolling out. And delay is as good as defeat in the aviation business if it means that you cede ground to the competition. The 2011 RBS discussion document *What would you do with 90 A380s?* envisages no fewer than 211 weekly Emirates frequencies to 24 African cities by 2020, of which 56 such frequencies would be operated by A380s.

This is not intended to strike a protectionist nerve. The availability of safe, efficient and affordable air transport is essential for modern economies; if non-African airlines are doing what African airlines cannot, so be it. But we believe there is a way for African airlines at least to stem the tide and for African economies to recapture some of that permanent capital outflow.

Our solution is CAFE (www.cafe.aero), a commercial aircraft finance entity that accesses previously unavailable sources of infrastructure and related finance on a public-private-initiative basis to participate in the historically profitable business of aircraft leasing and financing. Why might the public (infrastructure) sector consider investing in CAFE? Because, in Africa, an aircraft is more a bridge than a bus: Aircraft=Bridge.

In time, CAFE would buy aircraft better, quicker and cheaper than most, if not all, African airlines and place them with African carriers on a commercial basis, thus accelerating the modernization of the African commercial aircraft fleet and improving reliability, efficiency, safety, profitability and capital retention.

For commercially-viable African airlines, CAFE would be a reliable provider of aircraft financing on terms equal to or better than market; for the public sector, CAFE would be an appreciating, monetizable asset; for the private investment sector, CAFE would unlock previously unavailable capital; for manufacturers, export credit agencies and financial institutions, CAFE would be a dedicated partner in African aircraft financing; and for policy makers, voters and their elected representatives, CAFE would be a genuine example of money being used to good effect.

Pie in the sky? After devoting two years to CAFE, I hope not. We have circled private money for a trial and are encouraged by the public sector's openness to the idea. For example, Mr Edward Farquharson, head of the publicly-funded Private Infrastructure Development Group (www.pidg.org) comments: "Any initiative that mobilises private sector capital to expand Africa's infrastructure (and in this respect I fully agree with your portrayal of aircraft as bridges not buses) must be applauded and especially if this also enhances African ownership and helps to build African businesses."

The final words belong to Ato Girma Wake, ex-CEO of Ethiopian Airlines and newly appointed Chairman of Rwandair: "Africa needs CAFE".