

Ambo university Waliso campus

School of Business and Economics

Department of Tourism Management

Course Title: Tourism Economics

Course Code: Tmgt3075

Credit hrs.3

ECTS: 5

Complied by: Negash Solomon

CHAPTER ONE

RESOURCES IN TOURISM

Upon the completion of this chapter students will be able to:

- ❖ Describe the major realities shared by tourism industry
- ❖ List and describe some working definition of tourism industry
- ❖ Differentiate classification of resources
- ❖ Identify tourism resources and tourism products by giving examples for each of these tourism variable
- ❖ Describe the combination of resources

Introduction

Tourism need to be supported by many components of which resources plays a very crucial role for the existence of tourism. Resources in tourism energize other components of the industry. This chapter introduces some working definition terminologies, tourism industry's products (every experience in a given tourism destination), resources and its classification and factors make tourism to earn a low reward.

1.1 Tourism Concepts

Tourism is neither a phenomenon nor a simple set of industries. It is a human activity, which encompasses human behavior, use of resources, and interaction with other people, economy and environment. It also involves physical movement of tourist to locales other than their normal living place. Although most tourism around the world is a form of recreation which uses individual discretionary/free time while, some tourism like business and health related movements are inevitably/certainly linked with obligations.

However, travel and tourism includes:

- tourist needs and motivations
- tourism selection behavior and constrains
- travel away from home
- market interactions between tourists and those supplying products to satisfy tourist needs
- impacts on tourists, hosts, economies, and environments

Economics plays a role in many of those areas, particularly where there is a need to analyze market forces relating demand by tourists to supply of ‘products’, and in analyzing economic impacts and measures to control tourism’s effects.

The significance of tourism for economic development has been intensely debated since the 1960s, and there is a growing consensus that tourism has the potential to significantly contribute to development, especially in developing countries (DCs) and least developed countries (LDCs). A downturn of this sector thus causes serious repercussions for the development perspectives of various countries. The tourism sector’s potential is primarily linked to foreign exchange earnings and government revenues, as well as to the linkages with other economic sectors such as construction, handcrafts and agriculture.

Tourism is a labour intensive sector and, due to the nature of its job positions, it tends to generate employment and income opportunities, namely for poor and vulnerable groups (youth, women and low-skilled workers) particularly, but not exclusively, in rural and remote areas. In developing countries, a large part of vulnerable groups of the population, such as women, low-skilled and low-wage workers, migrant workers, and in general informal workers, earn their income from the tourism sector.

The World Economic Forum (WEF) acknowledges tourism’s leading role in poverty reduction by stating that most of the new jobs in developing countries are created by the tourism sector. In this regard, tourism is one of the largest employment generators and a fast entry vehicle into the workforce for young people and women in urban and rural economies. As such, tourism has been recognised as a main lever for poverty alleviation and the achievement of the Millennium Development Goals (MDGs). (UNWTO 2013)

Activity 1.1

Based on the above session answer the following questions

1. List some of the major elements to be fulfilled for tourism to happen
 - A. _____
 - B. _____
 - C. _____
 - D. _____
 - E. _____
2. What is the significance of studying economics in tourism?
3. What does “tourism is labor intensive” mean? How can tourism create job opportunities for poor and vulnerable groups? Who are these groups which are considered as vulnerable and poor in tourism?
4. How is tourism seen as a mechanism for poverty alleviation?

1.2 Working definitions in travel and tourism

For statistical purpose, the most widely accepted baseline definition for international visitors were first agreed by UN Conference on International Travel and Tourism, in Rome 1963. Visitors were divided in to:

- **Tourist** (overnight visitors)¹ – a visitor who stays at least one night (24hrs) in a collective or private accommodation in the country visited for the purpose of leisure or business.
- **Same-day visitors (former Excursionists)** – atemporary visitors staying in country less than 24hrs for the same purpose but excluding transit passenger.
- **Leisure tourism:** - is normally held to include travel for recreation or holiday, sport, health, religion or study. The majority of the world’s tourists are vacationers, but one could still include here visiting sports teams or Muslims on pilgrimage to Mecca.
- **Business tourism:** - can include business people traveling, presumably/most probably onexpenses, convention delegates, and those visiting friend or relatives (VFR). Business travelers are generally less numerous/ abundant than vacationers, but usually spend more per head.
- **Diplomats and expatriate:** - Are foreign workers, who travel to a destination in order primarily to undertake employment paid by organizations based in the destination, are not counted as tourists. Students travelling for a working holiday might be classed as a tourist.

Generally, Tourist brings money earned at home to spend at a destination.

Example: U.S.A —————> Rome —————> Ethiopia
 Generator Transit point Destination

Activity 1.2

1. What is the need of knowing these terminologies? Give examples
2. How are these terminologies used in the definitions given? Which of the international organizations are responsible to give universally accepted definition for these terminologies?

¹World Tourism Organization (2002), ‘TechnicalNotes’, *Yearbook of Tourism Statistics 2002*, WTO, Madrid

In the travel and tourism market place, it follows that the tourism industry, or industries, consists of any organizations supplying goods and services to peoples defined as tourists and same-day visitors, as part of their 'tourist requirement'.

This is bound to encompass a whole mass of organizations, the majority of which are likely to be involved in passenger carriage (or travel), accommodation and amenities or attractions. In addition, there are specific and supporting organizations, such as tourist information centers, souvenir manufactures and retailers, or broacher distributing companies.

Travel and Tourism Industries when classified in sectors, it produces²:

- Carriers- in any form of transport for tourist travel
- Accommodation: Place to stay
- Man-made attractions- which could also include the managed areas of natural attractions.
- Private sector support services: Tourism related business activities owned by private investors.
- Public sector support services: Government expenditure directly or indirectly used for operation of travel and tourism business. Eg. Infrastructural development.
- 'Middlemen'- such as tour wholesalers or travel agent

By their nature, the majority of organizations in travel and tourism are concerned primary with their own individual product, and probably at best with the market place represented within their sector. Thus, whilst /at the same time/ admitting to being within the travel and tourism industry, most will not claim to be supplying a product called tourism. Some business, such as restaurants in tourist area, may be selling principally/mainly to tourists, so are part of the tourism industry, whereas others, such as restaurants in city business districts, supplying similar physical product, but to non-tourists are not really part of the tourism industry.

The products felt to be supplied by members of the industry are not necessarily the same as those products perceived to be in demand by consumers. Tourists have a more global concept of the travel and tourism which they are buying than are individual suppliers. The end benefits which many tourists seek may not be tradable product. Tourists really seek to buy a dream, total experience, activity or business opportunity.

²Holloway, J.C. (1989), *The Business of Tourism*, 3rd edition, Pitman, London, UK

Mismatch of product perceptions between supply side and demand side will lead to dissatisfaction by the consumer.

Activity 1.3

1. What are the classifications of Travel and Tourism when classified by sectors? List and describe each classification
 - A. _____
 - B. _____
 - C. _____
 - D. _____
 - E. _____
2. What factors lead to dissatisfaction of tourists? Try to relate with demand and supply side of tourism and with customers expectation

1.4 Resources

Economists divide resources into;

- **Free resources:** they are in such abundance that there is no need for any mechanism to allocate them to users
- **Scarce resources:** their supply is limited in respect to their actual or potential demand

Scarce resources may be further subdivided into³;

- **Natural resources** – land, minerals, water, biological
- **Labor resources** – human work, and ‘enterprise’
- **Capital resources** – man made enhancement of other resources

Most economic study is concerned with production and allocation decisions about these scarce resources.

Decisions about resource allocation are made at many levels of society.

- A country may adopt a political system which provides the methodology for resource allocation.

³Norton, G.A. (1984), *Resource Economics*, Edward Arnold, London

For example, a government, industries, and pressure groups negotiate over a tract of land which may be available for mining, or agriculture, or tourist use (alternative industries), or to remain as a natural habitat (economically non-productive).

- At an industry level, individual firms compete for resources which have been more or less bound to the industry.

For example, hoteliers and restaurateurs compete using attractive remuneration/salary/compensation package to get good chefs – a ‘skilled food production labor resource’.

- Even within a productive operation, there will be competing demands on scarce resources and a need to determine their allocation/what can I do by what?

For example, National Tourist Office spends its entire available advertising budget on promotional video, or a mixture of brochures and posters, or on something else. The organization should think on by what promotional tools can be effective as per cost as well as reaching its customer.

The ways in which outcomes of these decisions are determined are central concerns of economic study.

So one of tourism economics’ main areas are;

- What resource allocation mechanisms apply in generating areas and at destination?
- How does tourism compare with other activities or industries in competing for scarce resources?
- What competition for resource use, as well as for market, is there between suppliers in travel and tourism?
- Are there significant opportunity costs⁴ involved in using particular to use those resources for tourism use?

Activity 1.4

1. List the five classifications of resources

- A. _____
- B. _____
- C. _____
- D. _____
- E. _____

2. Decision about resources allocation can be done at different levels. List each of these level

1.5 Travel and tourism resources

- As there is frequently a mismatch between producer and consumer perceptions of what constitutes the tourism ‘product’, there may be conflict in ideas of which resources are properly involved.
- Many of the resources likely to be in demand for tourism are public goods like road, power and water supply, communication facilities (telephone and internet), or even free resources(culture, tradition, way of life, etc).

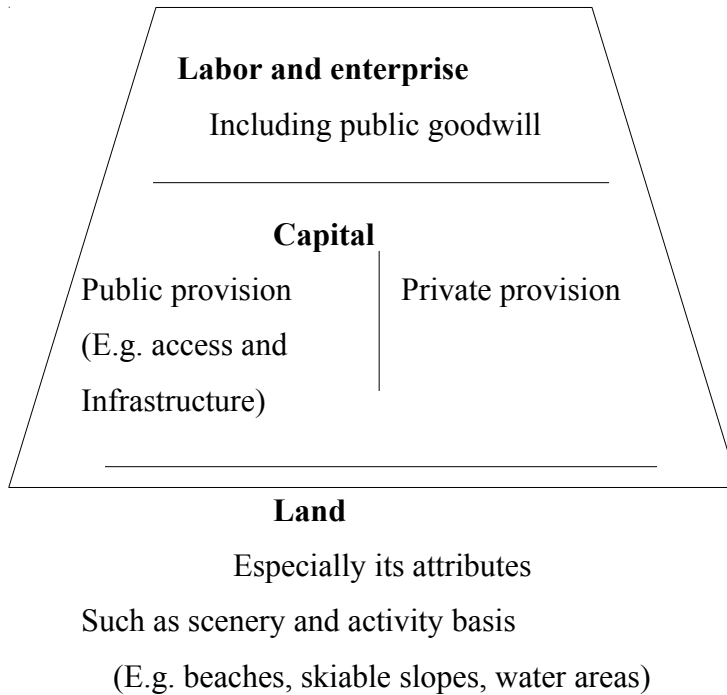
The demand for tourism involves a substantial amount of public goods, defined as existing facilities which are under-utilized. An individual make use of public goods without reducing the amount of the facilities available to others. This is a situation of **zero opportunity cost**.

For example, if a family takes a camping vacation by car at an off-season period, they may use the road network, public or national parks, beaches, and they may ‘consume’ scenery by looking at it or taking photos, without impinge/interrupting/ in any way on other people.

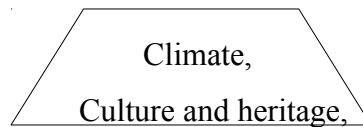
Exercise: Do you think that there is a difference b/n Trip to Semien Mountain National Park in July off season and in September, peak season? Discuss.

Travel and tourism suppliers use combinations of the same scarce resources that other producers use. Tourism is built upon a basis of free resources, with a mixture of public and privately used scarce resources superimpose/overlay/. Thus, there is a combination to form what tourists may perceive as the ‘product’ they are consuming, and what suppliers are producing.

Scarce resources



Free resources



Including 'way of life'

There are a terms used to identify types of tourism products, particularly destinations and their attractions. They are:

- ✓ **Resource Based products-** include unique attractions created by nature and human activities in the past E.g. Landscape (Mountains, valleys), water bodies, exotic natural Habitats, tangible and intangible heritages, etc
- ✓ **User- oriented products-**are more widely spread and likely to have been created specifically for touristic activities/use. E.g. Sport stadia, convention centers designed for recreation purposes.

However, most successful tourism products are neither entirely of one type nor the other. For downhill skiing, a mountain requires specific tourist oriented capital investment in runs, lifts and lodging as well

as the natural slope and a successful convention center benefits from being located in a scenically or culturally interesting place.

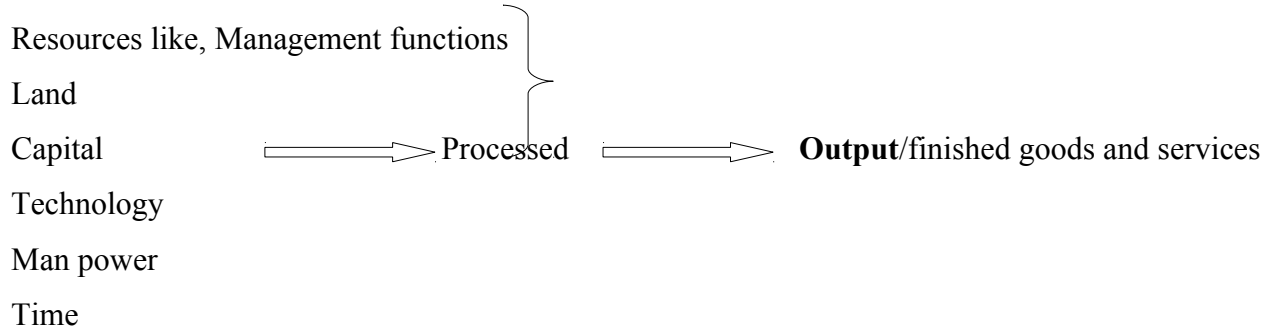
Activity 1.5

1. Differentiate resources based and user oriented products?
2. What do you think is the difference between trip to one of tourist sites in a particular destination in July off season and in September peak season? Discuss.
3. Assume that you are expert of destination development and management in your locality. Do you think that one of the above resources is effective by its self? If no/yes, reason out with example to develop environmentally and socio-economically effective destination?

1.6 Resource combination

Any organization whether it is manufacturing or service organization, the final products i.e. goods and service delivered to the customer/users passes through different processes.

Input



Relationship between resources used (input) and output produced depends on the production function⁵. Examining production functions enables an understanding not only of the total amount of scarce resources required to make a product, but also of the alternative ways in which those resources may be combined or replaced to produce similar product or service.

⁵**Production Function(Resources):** $Y = F(\text{Land, Labor, Capital})$

Classical theory holds that at given state of technology, and other things being equal, resource use depends on the marginal productivity⁶ of each resource, and its price (cost of input) or reward from output

E.g. Assume that XY Bakery produces quality cake mostly consumed by its customer from imported wheat.

- a) The price of the imported 100 kg wheat is 700 birr producing 600 cakes while,
- b) That of local 100 kg wheat is 500 birr with similar quantity but little difference in test with the first one. The Bakery can either use **b.** only to produce similar cake with **a.** even though there is little difference in test/quality or mix **a** with **b** and produce similar cake and be cost effective.

➤ **Can it be applicable in Travel and Tourism?**

In travel and tourism, some resources are unique or so individual that they are irreplaceable. To offer a similar or identical tourist experience to visit the Semien Mountains and the Gondar Enclosure would be either impossible or uneconomic. Such resources usually belong to ‘Free resources’ and these are fixed.

Other resources are used and varied in combination to bring about a productively efficient solution. Some firms in travel and tourism constantly seek optimal resource combinations. For example, a standard ‘international-style’ hotel is likely to operate a property in the United States with a staff-to-guest ratio of 1:2 or even 2:5. In a low-wage Asian country, a similar property’s ratio is 1:1. The high-wage American property is likely to have a much more substantial investment in capital equipment.

➤ **There are some common trend in travel and tourism relative to other activity.**

1. Tourism at destinations often makes considerable use of land, or more particularly the facilities or attributes of land.
‘Land’ here includes landform, flora and fauna, water space and landscape scenery, as well as purely spatial needs.
2. Much of the travel and tourism industry, both at generating areas and destinations, is relatively labor intensive. Traditions in hospitality and ancillary/supplementary areas have been based on principals of domestic/family service. Most tourists prefer personal contact and services rather than automated/mechanized or self-service system.

⁶**Marginal product:** the increase in total output resulting from the use of one additional unit of variable factor of production
Marginal productivity: the increase in total output / the amount of additional input

3. Alternative use of time: - Time is one among the scarce resources needs to be invested to obtain the finished good or service. Tourism calls upon a resource possessed by tourists themselves, namely time. Like money, time has an opportunity cost: that is, the other things which have to give up in order to travel.

Proper attention should be given by tourism industries in saving a time of their customer by giving the tourists fast service or alternatives. Unless, it may have negative impact on the tourism products they deliver when tourists may cancel their trip, or take short trip or expend other resources to reduce time taken as an opportunity cost is high.

Activity 1.6

1. What is the importance of using alternatives resources (inputs) instead of scarce of resources to get similar outputs? What consideration needs to be considered in substituting these resources?
2. Are tourism resources are replaceable? Can one resource substitute the other resources in tourism? Think of whether scarce resource can be substituted by idle resources?

1.7 Controlling and rewarding resource use

In market economics, some form of pricing mechanism is normal to help allocate scarce resources. In capitalist economies, resources may be owned by private individuals or corporations, who will provide them for productive use in exchange for the best money price, other things being equal. Such resources are factors of production, and the money price for their use is rewards.

Thus, land provider for productive use earns rent, labor earns wage, capital earns interest, and enterprise earns profit as a reward. In addition, governments may insist on some control over resource use for social welfare.

It has been frequently found that factors of production in travel and tourism **do not** earn the best possible reward. In other word, there are comparable factors in other industries earning higher rewards.

Why Tourism Earns Low Reward?

1. **The nature of the sector:** -Travel and tourism industry is not the same with the other manufacturing industry. Travel and Tourism has the reputation/character of being a relatively 'clean and pleasant' industry in which to work or invest. As a result;
 - a) It attracts more resource suppliers than a less well-perceived/supposed industry, so competition keeps reward price down.
 - b) Travel and tourism is frequently highly seasonal, offering rewards that are comparative with other industries for only some of the time.
 - c) Destination products are often in locations which are of little use to other industries, so competition for resource use is minimal and hence rewards are low.
 - d) Resource suppliers tradeoff⁷/substitute some monetary return for non-pecuniary/non-profitable considerations, such as working place in a pleasant beach resort.
2. **Wrong understanding among investors/staff:** -Setting up in the industry is often seen as simple and requiring few skills. If finances are brought from those retiring from or leaving other jobs and investments, income from travel and tourism is not expected to be optimal.
3. **Government pressure:** - Tourism is a human activity having direct and indirect contact or interaction with environment, people and economy. To avoid the adverse impact of tourism, many governments are extending diffident policies and strategies to controls over tourism. Beside these decisions of sustainable management, there is problem that the industry face in obtaining the expected reward from the resources utilized to deliver tourism products to the customers.

Activity 1.7

1. Why does the tourism earn low reward? List some of the reasons making tourism be low reward industry?
 - a. _____
 - b. _____
 - c. _____
 - d. _____
2. How does wrong perception among investors and staff affect the reward of tourism negatively?

Self-check Questions

Say ‘Yes’ for the activity you can perform well and ‘No’ for the activities you can’t perform well if you encounter activities you cannot perform well, please go back and read the materials and references given

S. No	Expected objectives	Yes	No
1	Describe the major realities shared by tourism industry		
2	List and describe some working definition of tourism industry		
3	Differentiate classification of resources		
4	Identify tourism resources and tourism products by giving examples for each of these tourism variable		
5	Describe the combination of resources		

References

- ❖ Organisation for Economic Co-operation and Development, United Nations, 2008: **Systems of National Accounts**
- ❖ Sara Proença, 2008: **Tourism as an economic growth factor: A case study for Southern European countries**
- ❖ Alain Dupeyras, Neil Maccallum, 2013: **Indicators for Measuring Competitiveness in Tourism**
- ❖ John Tribe: **2004 The Economics of Recreation, Leisure and Tourism**, Third edition
- ❖ Holloway, J.C. (1989), **The Business of Tourism**, 3rd edition, Pitman, London, UK

CHAPTER TWO
TOURISM GROWTH AND NATIONAL ECONOMIES

Up on the completion of this chapter students will be able to:

- ❖ Describe the main elements of GDP
- ❖ List factors affecting tourism's contribution to GDP
- ❖ Identify problems of measurement of contribution of tourism to the national economy (GDP)

- ❖ Differentiate Tourism satellite account and input output analysis
- ❖ Define GDP and differentiate it from GNP

Introduction

In many economies the travel and tourism sector has for sometimes been recognized as a major area of activity which both draws up on the resources of those economies and affects their nature and development. Additionally, the governments have increasingly seen fit to use tourism as a subject or agent of macroeconomic policies. Tourism often has high involvement in policies related to employment levels or the balance of payment, whose significance in modern macroeconomic management is high.

2.1 The national Economy

The System of National Accounts, 2008 (2008 SNA) is a statistical framework that provides a comprehensive, consistent and flexible set of macroeconomic accounts for policymaking, analysis and research purposes.

The size and value of national economy is usually expressed as the total value of all goods and services produced by that economy during a specified time period, such as one year. A country 's Gross Domestic Product, or GDP which contains two main elements of GDP are

1. goods and services produced for consumption(C), or use in their own right,
2. And those produced for fixed capital formations or investment (I) in capacity to produce further goods and services.

The size and value of a national economy is normally expressed as the total value of all goods and services produced by that economy during a specified time period, such as one year. We can call this value a country's Gross Domestic Product (GDP).

The two main elements of GDP are;

- Goods and services produced for consumption (**C**)
 - ~ Used in their own right
- Goods and services produced for fixed capital formation or investment (**I**)
 - ~ Capacity to produce further goods and services.

$$\Rightarrow \text{GDP} = \text{C} + \text{I}$$

This simple definition ' $\text{GDP} = \text{C} + \text{I}$ ' assumes that an economy is closed to foreign trade. As this is an unrealistic assumption for almost all economies, we should;

- include the value of all exports (**X**),
- Exclude that of all imports (**M**), of goods and services during the chosen time period.

⇒ **GDP = C + I + X – M**

GNP excludes from GDP such factor receipts as property income from overseas since this money has really been generated in the overseas, rather than the home economy. National income can be defined as the net amount earned by the economy's factors of production which means deducting the value of assets "used up" or capital consumption from GDP.

Travel and tourism is likely to figure in all aspects of GDP. i.e. C, I, X and M

1. Most expenditure by tourists would be regarded as consumption spending (C), if it is for domestic tourism or for the home-provided elements of an international trip.
2. Expenditure by businesses on buildings, plant, and equipment and so on to provide tourism services is part of investment (I), much of which is likely to be government expenditure, especially on infrastructure.
3. A tourist who is spending money in a foreign country or traveling on transportation services owed by other countries is in a sense ‘importing’ (M) services. This expenditure is a leakage/outflow/ from the national economy.
4. The reverse situation provides an ‘export’, when a country can sell its transportation or tourism services to international tourists/inbound/ from elsewhere.

Activity 2.1

1. What is national economy? What are variables included in the national economic account?

2. Write the two basic elements of Gross Domestic Product or GDP? _____

2.2 Factors affecting tourism’s contribution to GDP.

Tourism is not officially defined as an industry; its output is embedded in various standard industries. For that reason, it had been difficult to measure the size of its separate contribution to a Country’s or region’s economy.

The best methods of measuring the contribution of tourism to the economy is to subtract out domestic business travel from tourism expenditures and treat it as intermediate purchase, then use the resulting expenditures to calculate the direct contribution of tourism to GDP. In a second step apply input-output (I-O) multipliers to tourism expenditures net of domestic business travel to derive the indirect effects. As we explain below, there is no other way to derive the direct and indirect effects by using the TSA alone unless the import content of tourism is zero.

Why Is It Necessary to Use I-O to Estimate the Total Contribution of Tourism to GDP?

In his 2006 article, Smeral (2006) employed I-O multipliers to estimate the indirect contribution of tourism to GDP. tourism's total (direct and indirect) contribution can be derived directly and thus more simply from tourist expenditure data in the TSA without applying a second-step multiplier exercise as employed by Smeral, provided the import content of tourism expenditures is zero. To show this, we first examine the relationship between TSA and I-O.

Building the TSA account employs the same process as constructing the input-output (I-O) table. As in the I-O table, tourism demand in the TSA is presented in the supply and consumption account. The differences between the TSA and the I-O table are: (1) TSA does not show the inter-industry transaction while the I-O table does; and (2) TSA includes business travel spending in the tourism demand column while the I-O table includes business travel spending in the inter-industry transaction section of the table. In other words, business travel is treated in the TSA as final demand but is treated as an intermediate good in the IO table. If we assume that there is no business travel spending, then the TSA account and the I-O table are basically the same. Moreover, if we assume that the import content of tourist expenditures is zero, then tourism demand is equal to tourism value-added.

This derives from the well-known identity that $GDP = C + I + G + (X-M)$,

Where C: is household consumption spending,

I: is investment spending,

G: is government spending on goods and services, and

(X-M): is net exports.

For the sake of simplicity, we can assume all tourism spending (X_t) is in X. If the import content of tourism spending is zero, then $M_t=0$ and $(X_t - M_t)$, is equal to X_t . X_t is tourism's contribution to GDP, or tourism value-added (Eugene et.al 2011).

Variation in tourism's role in and contribution to national economies in different countries are caused by a number of factors. Some these are demand side factors, that is the importance of tourism is partly determined by the strength of domestic and inbound demand for local tourism, but the ability of tourism sector to expand within an economy to satisfy these demands and create more depends more frequently on supply side factors. It is possible to identify five major factors which determine tourism's role in GDP.

1. The stock of resources
2. The state of technical knowledge
3. Social and political stability
4. Attitudes and habits
5. Investment

1. The stock of resources

Economic activity depends on stock /accumulation/of resources available to use as factors of production. These include the resources of land, labor, capital and enterprise.

Travel and tourism needs...

- particular resources concerned with land and its attributes,
- labor with a positive attitude towards tourism and tourists,
- An economy's willingness and ability to supply the capital investment required for tourism industry in the shape of infrastructure, hotels, transportation etc. will influence the size to which that industry can grow as well as its contribution towards country's economy.
-

2. The state of technical knowledge

Many less developed countries have regarded tourism as an easy industry to develop because it demand relatively low technology compared with many other industries, and skills which can be easily mastered. As tourism worldwide has grown and become more sophisticated, high value contributions to GDP by tourism have tended to become associated with higher technologies. For example, ranges from the ability to operate the fleet of large cost efficient air craft with the associated technology in

reservations and passenger handling, through to technical innovation in providing more interesting, all season attractions is required to airline staffs and Travel agencies..

Generally, when technical advances are applied to existing input of other resources, they enhance the productivity of the industry concerned and hence its contribution to GDP.

3. Social and political stability

Non-economic factors, particularly cultural and political ones, are recognized as vital in determining the capability and growth of sectors in an economy. Especially for tourism, ‘consuming tourists’ must go to the ‘factory’ to buy the product. Social and political conditions in that ‘factory’ will directly influence the acceptability of the product and therefore; the success of the industry. Tourists never visit a country in political turmoil/disorder.

In fact, social and political stability has been cited as the characteristics for tourism product, which for many tourism segments directly influences demand. As social and political conditions may be far more variable in destination than, say the stock of productive resources they are more likely to be responsible for short-term fluctuation in the value of tourism sector. E.g. buying the product imported from Afghanistan and visiting the factory in Afghanistan is not the same.

4. Attitudes and habits

Another major non-economic determinant is that of psychosocial values, both of suppliers and consumers.

The attitudes of a host population towards tourists – supply side. A tourist will be directly affected by the attitudes of a host population. Negative attitude in Spain during the 1970’s, for example, began to have such a serious effect on tourism that government ran promotions advising ‘be nice to tourists – they are your bread and butter’.

Tourism consuming habits – demand side. Two generating markets with similar levels of income may, all thing being equal, have different propensities to travel. This may be a function of cultural and traditional values, attitudes, or the quality of climate and physical surrounding at home.

5. Investment: The level of investment or fixed capital formation which an economy undertakes is important. Some areas of the tourism industry are becoming more demanding of fixed capital formation – notably passenger carriage, accommodation and infrastructure.

Activity 2.2

1. List factors affecting tourism's contribution to the GDP? Explain how the factors affect tourism's contribution to GDP? _____

2. Differentiate between GNP and GDP. _____

2.3 Problems in measuring tourism's contribution to GDP

Estimating the value to an economy of a service sector is more difficult than with goods, owing to the non-tangible nature of products. Tourism is particularly difficult because of the fuzzy definitions of services included in it. Despite these difficulties, most countries still attempt to provide an estimate of the value of tourism, for comparative and planning purposes. This value will be a summary of private commercial transactions openly accounted for.

It may be satisfactory comparatively with other industries or countries. However, it will be inadequate to permit an accurate assessment of the 'real value' of the sector, because it will omit some positive and negative items. The most important of which are;

- Unpaid services
- Non accounted services
- National costs
- Public and private revenue distribution
- Balance of payments anomalies
- Social costs and benefits
- Public goods

1. Unpaid service

Unpaid services are those performed for no payment, or a payment in kind or reciprocity. If no payment of any kind is made, one can argue that no economic activity has taken place even though the service exists. However, an economic transaction certainly exists for a reciprocal or barter payment. For example, VFR tourists receive 'free' accommodation from their host; there is a true reciprocate or give their hosts some other services or 'present', there is a true but unrecorded transaction.

2. Non accounted services

Non accounted services are those which take place and for which payment is received, usually in cash, but are not accounted for formally. Non accounted services are very common in travel and tourism, particularly in hospitality, taxi driving, and souvenir selling and so on, where there is often much part-time work, gratuities and second jobs or moonlighting.

3. National costs

National costs are those which relate in principle to activity A, but are accounted for within activity B. For example, if a vacationer buys a second home, which is once-and-for-all property purchase, that home may be used for vacations. Owners then pay no recurrent accommodation costs, but may be considered to be paying a 'national cost' to themselves equal to the commercial rental value of their properties.

4. Public and private revenue distribution

Public and private revenue distribution concerns the distinction between sourcing and using revenues earned by the private sector in one area, but spent by the public sector in another. For example, if government levies a tourist tax and uses this revenue in expenditure on agricultural support, it must be decided to avoid double counting, whether tourism includes the gross value of transactions, while agriculture includes nothing, or whether tourism includes the value net of tax, with the tax being included under agriculture.

5. Balance of payments anomalies

Balance of payments anomalies in area such as investment, repatriation of earnings and, foreign exchange values of tourism revenues expressed in floating currencies, cause measurement problems.

6. Social costs and benefits

Social costs and benefits are the difference between the value of private commercial transactions and their value to an economy or society as a whole, including third parties. Travel and tourism brings benefits, but impose costs, on the third parties in many ways, in such a way that the social net product of the sector may be quite different from the private net product.

7. Public goods

Public goods are in a sense part and parcel/package/ of social benefits. For example, governments are increasingly aware of the 'value' to society of national parks, outstanding scenery, or heritage buildings, for which no tourist entrance price has been charged.

2.4 Methods of Measurement

Measurement is a major problem in analyzing tourism's contribution to GDP. Travel and tourism services are sold directly to thousands and millions of individuals who themselves may not be identifiable as tourists. Services and goods may be sold at varying prices, and records may be inaccurate. In addition, different countries use different methods of measuring the value of travel and tourism expenditure / receipts.

Tourism analysts have identified four main basic measurement methods⁸:

- 1. Direct observation of expenditure**
- 2. Direct observation/census of receipts**
- 3. Surveys of tourists**
- 4. Household surveys**

In addition, simulation methods can estimate expenditure and bank returns available to regulated economics.

1. Direct observation of expenditure

To follow tourists everywhere and record their expenditure would provide an accurate record of a consumption approach to GDP contribution. However, this is patently impossible. The only feasible alternative lies in getting a sample of tourists to diarize their own expenditure.

2. Direct observation/census of receipts

A direct income approach to valuation results from aggregation all sales receipts figures from tourism enterprises. This information may come from government trade ministry census returns or tax returns.

3. Surveys of tourists

En route or in-destination sample surveys of tourist are used widely in tourism value analysis and they can be fairly reliable. For those passing through entry or exist points to a destination, gate method are available.

4. Household surveys

It is possible to estimate tourism expenditure at the generating point by household surveys, in which general household expenditure can be disaggregated and tourism spending isolated. Coupled with an

⁸Frechtling, Douglas C. (1987), 'Assessing the Impacts of Travel and Tourism – Measuring Economic Benefits' in Ritchie, J.R. Brent &Goeldner, C.R., *Travel, Tourism & Hospitality Research*, Wiley, New York, pp. 333-352

analysis of business travel expenses from tax returns, those can provide a reasonably reliable picture of tourism-generation expenditure

❖ **Bank Returns**

In economies whose foreign exchange controls are tight, and where incoming international tourists must spend in the local currency (assuming import and export of that currency is not permitted), the total value of personal foreign currency exchanges reported by banks often provides an estimate of foreign tourists' spending.

Activity 2.4

1. List and describe basic measurement methods of tourism spending _____

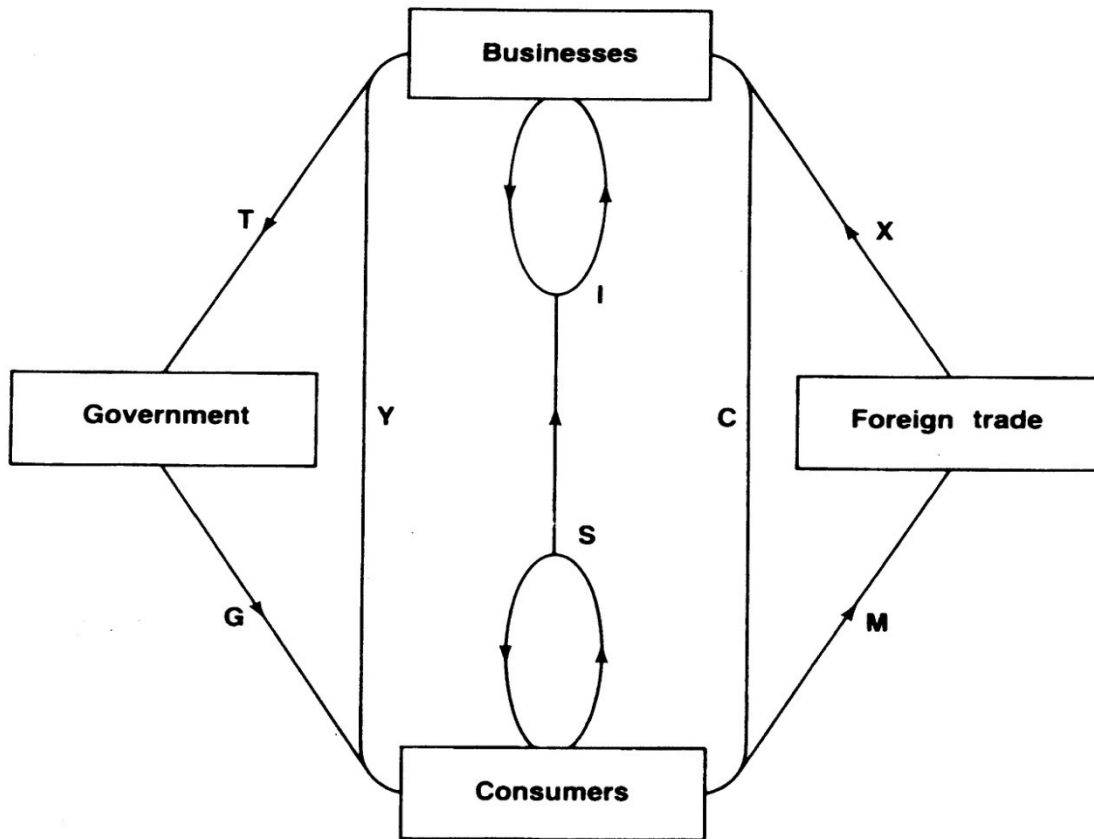
2. How is measurement a major problem in analyzing tourism's contribution to GDP? What mechanism should be used to identify the tourists from other peoples? _____

2.5 Tourism growth and its effects on an economy

A simple representation of an economy shows the major flows of **goods** and **service**, or money in exchange, and the major component 'players'.

Monetary flows are defined as follows:

- C Consumption spending
- I: Investment
- G: Government spending
- Y: Factor payment (incomes/ rewards of scarce resources)
- M: Import
- T: Taxation
- S: Savings
- X: Exports



Consumer Spending (**C**) and Investment (**I**) are the bulk of travel and tourism value in the economy for domestic recreational and business tourism expenditure, Exports (**X**) for inbound international tourism, and Imports (**M**) for outbound international tourism. These tourism **expenditures** circulate throughout an economy, and the sector may also be important in other areas.

Tourism receipts by business are transformed into payments for factors of production – **rent, wages, interest and profit** – which shall income (**Y**) and provide tax and income tax revenue (**T**) to governments.

Other direct injection and leakage also takes place through travel and tourism. Governments may **stimulate** development of a tourism industry through **grants** and **loans**, and by undertaking their own fixed investment (**G**). And if the capital required is obtained from **capital** markets by government, there is direct increase in Investment (**I**).

Outbound tourists take expenditure out of an economy equivalent to an **import (M)**, but the method of funding trips may also affect the economy: tourists intending long expensive trip may put aside money towards the trip for some time either in **advance** or by **credit installment/repayment** afterwards. In the short term this may represent increased **savings (S)**, and less **(C) consumption** of other items.

Airlines and tour operators also affect short term capital markets in the same way. By **obtaining** payments in advance for many types of ticket, but **postponing**/delaying their payments to suppliers as long as possible, they maximize **saving** on short and medium term money market.

E.g. Bright Tour and Travel, book different class of hotel and flight ticket for many tourists two months before Irrecha ceremony to be held in Finfine. Say tourists make their package of payment for their total expenditure in their stay. Assume, one group tour with the member of 20, paid in advance 10,000\$ to the Agency for their stay in Ilili international Hotel, Adis Ababa. The agency may, change the dollars to Birr and save in one of local bank for the coming almost two months still the tourist arrive. During this time it is increasing its saving as well as interest and also benefits obtained from the currency for the government. This will have its own positive impact in money market contributing to the economic growth of the country.

The same is true when at the beginning of summer peak European Holyday period, up to \$4 billion may be supplied in this way. As tourism growth, the effects **vary** in different flows in the economy according to the structure/composition of the economy and **changes** in the **type** of tourism

2.5.1 The Effects of Inflation

Inflation: - Is a situation of continuous rising of average price of goods and service. During inflation some price of goods and services increase, others decrease and also some remain constant.

Cause of inflation:

- Demand pull: - Resulted by an increase in aggregate demand of basic goods and service means when too much money chases too few goods.
- Cost push (Supply- Side):- Arise due to continuous decrease in aggregate supply which is mostly resulted by bad weather or increase in wage or other input.

Tourism role within a growing economy can be altered/ distorted by inflation. Classical economic theory holds that production of most goods will be stimulated by the anticipation of rise in price, partly

to insure that input factors are acquired as soon as possible before their price rise, and partly in anticipation of selling out put later at higher price.

Let's prove the impact of inflation on economy:

Let us see in manufacturing sector of Economy:

Example: Assume, in the coming five years development plan of Ethiopia, the construction of basic infrastructures like rural road is among the top agendas of the government. One can easily notice that the demand of **cement** may be increased leading to **increase** its price by the given **rate**. As a result, many investors may decide to involve in the sector and increase their production before **increase** of inputs or ingredients to produce cement so as to sale later when the price rises. This may have **positive** impact on the economy for **initiating** firms to involve in investment when the country may obtain different economic **benefits** like creation of **job** opportunity for the society, taxation and others.

How about in Tourism Sector?

In another side, because of the instant, production and sale of most tourism services, however, tourism production rarely/infrequently respond in the same way. Firms making investment decision will also discount their potential cash flow by the expected rate of inflation, which may reduce their willingness to invest. In addition if the consumer price increase runs a head of increases in incomes, then higher proportion of consumption(C) will be needed for buying basic goods and service every day, leaving less for tourism expenditure.

Example: Assume that Mr. X has planned to develop standard lodge near Bale National Park by huge capital with in mind of European Tourists to be his/her customers. By this time, the economic crisis say inflation/unexpected price increase/ happened in many of generating countries for Ethiopian tourism. Mr. X, with the understanding of increased price of basic goods and service in Europe may lead to increase of consumption(C) not of saving for recreation. If there is no saving, no enough expenditure allow tourist to take trip to Ethiopia, as well to the Lodge of Mr. X. With this expectation He/she may decide not to involve in investment. This has negative impact on the economy of the country in different dimension.

List and discuss them.

Activity 2.5

1. Differentiate between demand pull and cost pull causes of inflation. _____

2. What are factors of production transformed from tourism receipts? And how do these factors benefit the government? _____

2.6 Forecasting the value of tourism

In order to provide for policy and planning, many governments and other institutions attempt to forecast aspects/features of tourism activity. In the content of GDP, the most important forecasts are those of tourism demand (in numbers of tourists – domestic, inbound and outbound), and tourism expenditure either in absolute/fixed terms, or relative/comparative to the rest of GDP.

The variables are usually:

- Numbers of tourists- Come to the destination
- Total expenditure or per capita expenditure- to consume the service
- Tourism market shares- among other sector of the economy
- The tourism sector share of GDP- from total country's annual economy.

It is important to ensure that variable selected relates directly to the forecast data need. Forecasting expenditure is valuable in finding tourism's relative contribution to income or GDP; Forecasting tourist numbers is more helpful in assessing the call that tourism will make on resources.

Methods used for tourism forecasting are:

1. **Qualitative method**
2. **Quantitative method**

- **Qualitative methods:** Are perhaps the least well known in tourism forecasting. They include brainstorm/suggestion/, executive consensus/managerial agreement/ to do something.

This type of forecasting is not supported by clear formula but it is an ideal, if this happens, this will happen, but not proved and has tended to be used mostly by commercial organizations in predicting/guessing their own demand, such as IATA for Air Traffic demand. They are sometimes considered as less rigorous/exact/accurate than quantitative method but appropriate where data are insufficient or unreliable for quantitative forecast.

- **Quantitative methods:** - Quantitative forecasting divides broadly into techniques founded in economy theory and techniques which are purely statistical or borrow ‘system’ from other disciplines. In forecasting terms, comparison of their usefulness can only be made on their accuracy of prediction rather than explanatory or analytical/investigative/ elegance/style.

The role of most forecasting is to provide reliable ‘future data’ to help tourism and economic policy decision-making. As a result the forecasters are more concerned with predictive accuracy than with explanatory power and statistical elegance.

High technical standard of econometric modeling do not necessary improve the forecasting ability of such models compared with more naïve/clear methods. So that a mixing of methods is sometimes more appropriate. Accuracy is not cheap, however, so that lower cost and more understandable methods sometimes prevail/exist/ such as using simple spread sheet methods.

Activity 2.6

3. Write the two types of methods of tourism forecasting. Which of the methods of forecasting is the least known? What do you think is the reason behind?

4. What are the possible benefits of forecasting tourism?

Self-check Questions

Say ‘Yes’ for the activity you can perform well and ‘No’ for the activities you can’t perform well if you encounter activities you cannot perform well, please go back and read the materials and references given

S. No	Expected objectives	Yes	No
-------	---------------------	-----	----

1	Describe the main elements of GDP		
2	List factors affecting tourism's contribution to GDP		
3	Identify problems of measurement of contribution of tourism to the national economy (GDP)		
4	Differentiate Tourism satellite account and input output analysis		
5	Define GDP and differentiate it from GNP		

References

- ❖ Frechtling Douglas C. (1987), 'Assessing the Impacts of Travel and Tourism – Measuring Economic Benefits' in Ritchie,
- ❖ J.R. Brent & Goeldner, C.R., **Travel, Tourism & Hospitality Research**, Wiley, New York, pp. 333-352

CHAPTER THREE

EMPLOYMENT AND INCOME CREATION

Up on the completion of this chapter students will be able to:

- ❖ Describe the manifestation of closed economy.
- ❖ Explain how tourism can create income for the local community and for the national economy as a whole

- ❖ Understand why peoples employed in tourism will be high at some point in a given year.

Introduction

Tourism is a fast growing economic activity in many countries around the world, and plays an important role in the economic and technological development of nations. As Edgell (2004) points out, **tourism** serves to stimulate the development of basic infrastructure, contributes to the growth of domestic industries, attracts foreign investment, and facilitates the transfer of technology and information. Fair distribution of wealth across the population is a manifestation of the smooth running of a given economy. Tourism can be seen as a mechanism to do so. The direct value of tourism for employment factors for the locals is a tool to have even income distribution across the citizen.

3.1. National Income

In a basic closed economy (or one in which the government plays a neutral role, and there is zero external trade balance) the level of national income is determined by the total value of consumption (C) and Investment(I) in any one time period. Income distributed may be spent on further consumption or saved. The total C+I or C+S may or may not yield full employment.

Assume that people at some point wish to consume more- that is the propensity to consume increase. These may be because of expectation of later price rise, a change in social attitude or other reasons. The effect may be an increase in general price if producers do not wish to produce more or the economy is already at full employment (demand pull inflation), or producer may expand output to meet the increased demand and so GDP and National income increase.

If business wish to increase their investment, in fixed productive capacity (perhaps because they anticipate good, future demand, or to take the advantage of new technology) the economy will, all else being equal, expand to provide the new investment products, and later expand again through out of all products from the new investment. This once again may expand national income.

In an economy where government plays an active budget role through taxation (T) and government expenditure (G), and where the import (M) and the export(X) level do not balance, net inflow or injection to the economy $G-T$ or $X-M$ is greater than 0 are likely to have the same effect.

Net export surpluses allow foreign investment to build up, or the acquisition of latter import without cost. However, net positive government expenditure, like increased consumption, may be financed

through credit- which may not be only inflationary, but may drive up interest rate and affect business investment.

Net out flow or leakage from an economy ((**G-T**) or (**X-M**) is less than **0**) can reduce the value of national income as money flows **out** to government or to foreign suppliers- the latter becoming creditor to the economy.

Investment decision, which will then induce further expansion in national income, are influenced by the need to replace worn out productive assets, but also by interest rate and expectations. A government's monetary policy can control both of these as it can go some way towards controlling the general level of consumption through consumer credit and supply of money.

Activity 3.1

1. What does closed economy mean? _____

2. How can tourism create income? How can even distribution of income be obtained? And how can tourism be a solution for unfair distribution of income? _____

3.2 Distribution of National Income

Not only has the size of national income, including per capita measured importance to an economy, but so its composition and its allocation or distribution to the citizen. A large diversified economy will have many productive sectors and little sectoral concentration. It will be less vulnerable to cycle and specific slump than a small economy based on few sector. This has a particular importance for the value obtained from developing tourism.

The way in which national income is then split up and also helps determine the size of the economy. For example two economies with similar populations may start with similar GDP in time period one.

Suppose in a country **A**, the distributions of incomes is very even, as is the distribution of shared wealth is productive capital. People are likely to spend and save in similar ways, other things being equal, and economic growth should smoothly reflect the country's marginal propensity to consume and save. Suppose however, that country **B**'s production is the hands of few individuals or businesses, and that it is highly automated, requiring plenty of capital but little labor.

Economic growth probably depends on export market or re-allocative government fiscal policies: propensity to save amongst the majority of the population is probably zero, and imbalance- based political instability make prediction of country B's future national income very risky.

Whilst/at the same time/ classical economic theory assumes that income distributions will through market force, correct itself to reflect the marginal productivities of factors of production, economists have shown that this does not always happen. Because of market imperfections, social systems, regional imbalance or other reasons, a 'steady state' income distribution can exist which does not reflect marginal productivities. Policies for development including tourism development may then promote not just income generation, but normative goals of income distribution.

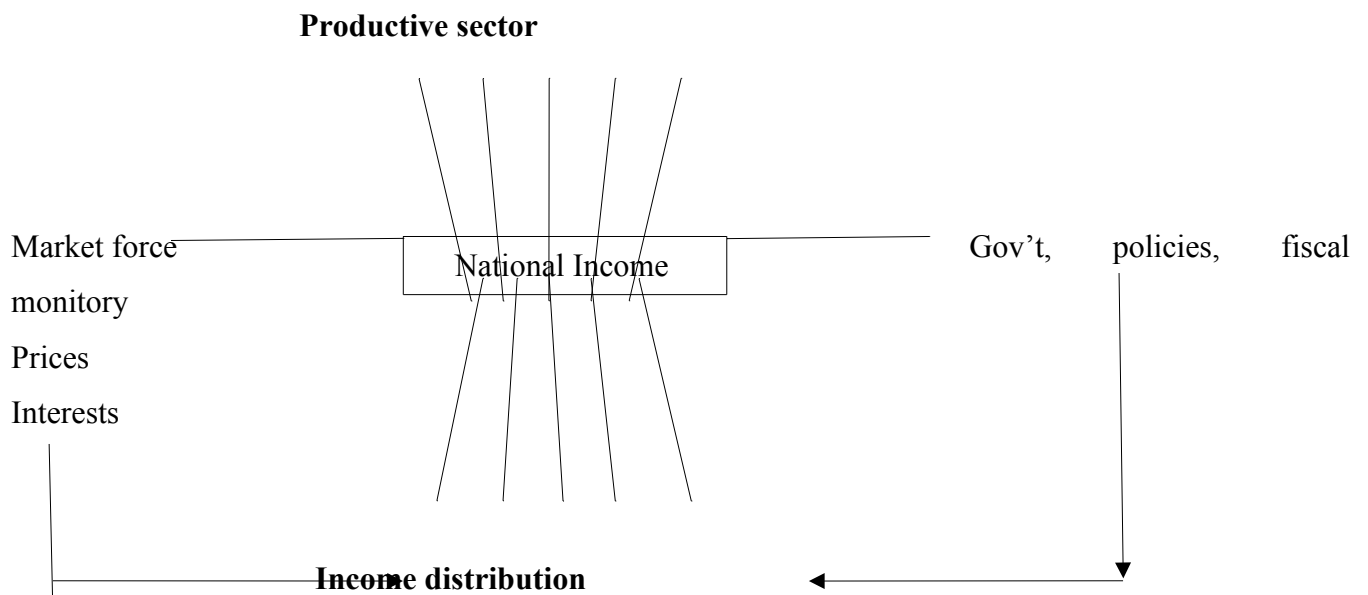


Fig 3.1 Composition and distribution of national income

Activity 3.2
 How can tourism achieve normative income distribution? _____

3.3 Direct Value of tourism to employment of factors

In the above context, travel and tourism has significant impact in many economies. First, it is a sector of relatively **recent** development in many economies, and is still showing **growth** in most. Most countries now identify travel and tourism as a discrete/separate/ productive sector of their economies which was unusual until 1960/70.

Secondly, because travel and tourism can assume many different forms, from backpackers 'meet the local's, experience through business trading and convention centers to segregated, exclusive up market resorts, an economy may need only minor sectoral changes of resource **reallocation** in to tourism. This attracts governments looking for development opportunities.

Thirdly, tourism can often be developed specifically in locations and with resources which have little alternative economic use (that is low opportunity costs), such as picturesque /charming/attractive/ landscape locations with no mineral resource and little agricultural value. This allows the direct employment of land as a factor at little marginal cost.

The direct and indirect impact of tourism on an economy is not of the most intensively researched areas of tourism analysis. The effect of tourism on local economy can be seen from three perspectives. These mentioned as follows.

- A. **Direct effect:** concern expenditure within the tourism sector, based on a list of typical tourism products drawn up. Indirect effects of tourism should be distinguished from direct and induced effects.
- B. **Indirect effects:** concern intermediate consumption for the production of goods and services in the tourism sector. These are goods and services that tourism companies purchase from their suppliers, forming the tourism supply chain.

Indirect effects can be particularly important for the production of local products. So-called frontline companies take the initial purchasing decisions that determine what visitors can consume.

For example, if a frontline accommodation provider decides to buy local products wherever possible, the tourist will be the originator of the purchase and of the production of goods and services in the host country. It is therefore important to be able to encourage the tourism sector to procure locally produced goods and services in order to maximise the economic impact of tourism revenue in a country or region.

- C. **Induced effect:** concern expenditure by employees from wages paid by companies in direct contact with tourists. Induced effects also include the consumption of companies that have benefited directly or indirectly from initial expenditure in the tourism sector.

An example of such induced effects would be purchases of consumer goods such as food, clothing and electronic goods by people employed in the hotel sector. For companies, this would be purchases of capital goods or expenditure related to the reinvestment of profits.

Activity 3.3

1. What is the impact of tourism over the economy? _____

2. Differentiate direct, indirect and induced effects of tourism on economy.

3.4 Labor market and employment

Relative to other sectors, travel and tourism has often been shown to be high employer of labor per dollar of sector income. Thus many authorities have considered tourism development as ideal in soaking up unemployment in regions which have few other employment opportunities even if those regions have a high income. (This may come about where a region possesses a high value-added, but capital-intensive industrial structure with a heavily-skewed distribution of resulting income, and few jobs.

The job value of travel and tourism, depends on how one measures employment and the nature of local labor market. The number of people employed in the sector at some point during the years is likely to be high for four main reasons.

- 1) Relative labor intensity
- 2) Many low-wage occupation occupations
- 3) Much part- time and casual employment
- 4) Seasonal peaking

1. Relative labor intensity

As mentioned earlier, some areas of travel and tourism are labor intensive. This is true of front-office situations in travel, Lodging, restaurants, souvenirs and small scale tourism activities and especially in low waged economy.

The major reason in traditional importance of personal service accompanied by the fact that in many of these areas is that labor-saving equipment and automation have only been late arrivals. Transport, tour operation and back-of-house activities have by contrast a much higher capital-labor ratio in general.

Thus in restaurant businesses, it is common to find more capital intensive methods being introduced in food production, but staff numbers being maintained in food service.

Another feature of labor intensity in travel and tourism is that of small scale entrepreneurial activities in 'niche' areas of activity. As tourism production is so fragmented, in most economies there is room, in many roles, for specialists who are largely labor-only or labor mainly suppliers.

Examples include very large numbers of hawkers/sellers and souvenir seller in cruise port or at tourism attractions in less-developed countries, scalp hunters or tout/advertize at major sport or art events or outside events or outside revue bars in cities from Bangkok to Las Vegas, some cab driver and instant 'guides' and 'fix-it' people

Often technically self-employed, their capital investment is usually negligible. Their income is often dependent on pestering ability: it is earned in cash and not declared. Nonetheless they are working in the tourism sector. When tourism destinations are developed, labor intensity varies according to the type and stage of the development and has been found in some cases to be less than in other industries. The travel and tourism create jobs should not therefore be taken for granted.

2. Low Wage Occupation

Tourism does not necessarily create both employment and income to the same extent. In most economies wages in tourism sector are low relative to other industries for a number of reasons:

- Many jobs are unskilled
- Many jobs are treated by employers as unskilled even if some level of skill, say in customer service, is really called up on but not recognized.
- Many employees are transitory, and labor turnover is high.
- Unionization and collective bargaining are often weak.
- As a result of transitorizes of labor and weak unionization, even where minimum wage regulations do exist employers often flout/ignore them without reprisal/payback.
- In areas where there are few or no alternatives to tourism, there is zero or negligible opportunity cost associated with employment within the industry. With no competitive job available, tourism is monopolists industry in buying the service of labor, and depresses the price accordingly.

Where tourism is being newly expanded in less developed countries (LDCs), wage levels are often very low since there may be a large supply pool of labor, which is anxious /uneasy to secure 'quality employment' in tourism.

Employers may also argue that they must spend on basic training as recruits/workers may not possess even simple reading skill of knowledge of tourists' customs.

On the other hand, tourism sometimes been developed, in the Caribbean/western, for example where labor supply was quite inadequate forcing up wages for both tourism jobs and competing industries. High wage applies where internationally transportable qualifications restrict supply. Qualified passenger air line pilots, chefs with completed apprenticeships or European-trained hotel managers can command high wages internationally.

3. Part-time and Casual Employment

There is distinction between the number of workers employed in the travel and tourism industry and hours of work completed. In virtually, all economies of considerable number of workers are part-time and more are casual, working only for temporary periods when employers consider that final demand warrants taking on extra staffs. The use of part-time and casual employment is dictated by two factors:

- With many fixed capacity enterprises, using part-time and casual labor enables employers to alter some labor cost from fixed to variable.
- The nature of most travel and tourism activities requires 24 hour working or at least work beyond normal business hours: this in turn means split shift and /or part-time extra work.

Many such workers are 'moon lighters' taking second jobs, or people not normally reckoned/considered to be labor force, such as students. Again the contribution that tourism makes to the economic activity through this type of employment is difficult to access, as much goes unrecorded.

4. Seasonality

In most recreational tourist destinations, seasonality means there are effectively at least two labor markets: One for permanent workers through the years and a second market for peak season work. As with casual work, seasonal employment may draw in marginal workers, and demand pressure is high enough, wage may increase.

This may draw labor away from full-time employment in other sectors forcing up seasonal wage in those sectors or reducing their viability. Seasonality occurs not only in direct tourism employment but also in indirect work generated by tourism activity. In free labor markets the result is often substantial temporary migration of workers, with consequent shifts of regional income and induced expenditure.

Activity 3.4

1. List and describe using your own words why tourism employment at some points in a year is high.

- A. _____
- B. _____
- C. _____
- D. _____
- E. _____
- F. _____

Self-check Questions

Say 'Yes' for the activity you can perform well and 'No' for the activities you can't perform well if you encounter activities you cannot perform well, please go back and read the materials and references given

S. No	Expected objectives	Yes	No
1	Describe the manifestation of closed economy.		
2	Explain how tourism can create income for the local community and for the national economy as a whole		
3	Understand why peoples employed in tourism will be high at some point in a given year.		

CHAPTER FOUR

THE BALANCE OF TOURISM PAYMENTS

Up on the completion of this chapter students will be able to:

- ❖ Define what by mean balance of payments
- ❖ Solve problem related to balance of payment using the right formula
- ❖ Identify basic sources of tourism payments statistics with their characteristics
- ❖ Define travel payments

- ❖ List the policies that countries need to design to improve balance of tourism payment

Introduction

Though tourism can be defined from multiple perspectives, the best definition which better fits for this chapter (balance of payment) states that the spending of money in the destination is earned in the generating area. The money injected into the local economy will play a very crucial role in stabilizing the balance of payment. Money earned in country A being used as payment for services rendered in a destination. The multiplier effect of the money earned from tourism is another dimension by which tourism payments can be analyzed. Balance of tourism payment can be represented by “Receipts from overseas tourists visiting a country - Payments abroad by that the country’s own outbound tourists” Individual countries do possess specific comparative advantages, which lead to international tourism flows. Countries should be keen to focus on their comparative advantages. Almost all available and used simple balance of payments data on tourist receipts and payments is unreliable.

4.1 Balance of payments terminology

Tourism has a major influence on many countries’ balance of payment. We have largely defined tourism, in term of money flow, as ‘the spending (in the destination) of money earned in a generating area’. Internationally, this means ‘Money earned in **country A**. being used as payment for services rendered in **country B**’

Many countries maintain **data** to represent foreign accounts for specific classes of goods and services. Hence at the very simplest level there may be a ‘**balance of tourism**’ which would be represented by: ‘Receipts from overseas tourists visiting a country’

Minus

‘Payments abroad by that the country’s own outbound tourists’

(Example) Balance of tourism, year 2000⁹

Ethiopia:

International Tourism, Net Receipts	US\$68 million
International Tourism, Net Expenditures	US\$74 million

\$68 million - \$74 million = - US\$6 million ~ Balance of payment

Kenya:

International Tourism, Net Receipts	US\$276 million
-------------------------------------	-----------------

⁹Source: World Development Indicators 2003, CD-Rom

International Tourism, Net Expenditures US\$132 million
\$276 million - \$132 million = US\$144 million ~ Balance of payment

The net tourist expenditure merely measures final payments by tourists for services and some goods in destination countries. Therefore, only final tourism payments and travel payments are not enough to find out what tourism is really worth to countries, or its real cost. International payments for goods and services for investment in, and operation of tourism industries also needed to be included. The result can be termed the ‘travel and tourism external account’.

i.e. **Travel and tourism External account/worth to the economy**=the final travel and tourism payment + Investment cost on production of good and service and also operation of tourism industries

Activity 4.1

1. What is balance of payment? What is the difference between balance of tourism payment and tourism multiplier effect? _____

2. What is net tourist expenditure? How can it be accounted? _____

4.2 Comparative advantage in tourism

Individual countries do possess specific comparative advantages, which lead to international tourism flows: this are

There may be specific base resources unique attractions created by nature and human activities in the past E.g. Landscape (Mountains, valleys), water bodies, exotic natural Habitats, tangible and intangible heritages, etc

- In certain countries, which are fundamental tourist attractions, as already identified in chapter one. (Example) Tourists from France may exchange ‘consumption’ of the Eiffel Tower for ‘consumption’ of the Grand Canyon with tourists from the United States.

- Some countries offer all-round advantage in the production of tourism services, such as an attractive climate plus plenty of beach space and low labor costs.

(Example)

Spain has used their climate and comparative low labor costs to attract other Europeans. Mexico also has used them especially for Canadians and Americans.

- A destination country’s geographic location relative to mass tourism generators may be an important ‘pull’ factor.

(Example)

In small and a few industry economies such as some Caribbean countries, transferable resources are concentrated into tourism even from industries in Europe and North America.

Tourists sometimes visit another country because its product is entirely different from anything available domestically, rather than merely because of a price advantage. They, therefore, make use of specific tourism resources of factor endowments possessed by the destination.

Activity 4.2

What is comparative tourism advantage? Could you name some of the comparative tourism advantages of Ethiopia? _____

4.3 Tourism payments’ statistics

Almost all available and used simple balance of payments data on tourist receipts and payments is unreliable.

There are three basic sources of tourism payments statistics:

- Direct spending totals provided by tourists themselves

- Indirect data gained from multiplying tourist number by average length of stay and by average daily spending
- Exchange figures from banks and other financial institutions

The first two rely on surveys (either census or more likely by samples) of tourists in situ or post-visit. Therefore, they are subject to the normal problems facing survey research methods, neglecting ‘investment’ and ‘operation’. Much of this survey work is undertaken at international departure points such as airport gate – Gate Methods.

Bank data is really only useful in countries with non-convertible currencies and a prohibition on import and export of their currencies.

The real value of international tourist payments is also altered in two specific circumstances.

- When VFR tourists travel, they are unlikely to spend much on accommodation, food and other services in their destination, these being items in the host family’s domestic budget. Therefore, tourism services in major VFR destinations are likely to be undervalued.
- Most of statistical systems are not sufficiently accurate to account of the value of expenditure by the tourists on inclusive tours purchased in the generating country. Although payments made by tour operators to destination suppliers will be evaluated, much payment may be channeled through multinational enterprises in third countries, or there may be contra payments. In these cases, tourism is often undervalued.

Activity 4.3

1. Write the three basic sources of tourism payments statistics.

A. _____

B. _____

C. _____

2. What is gate method? _____

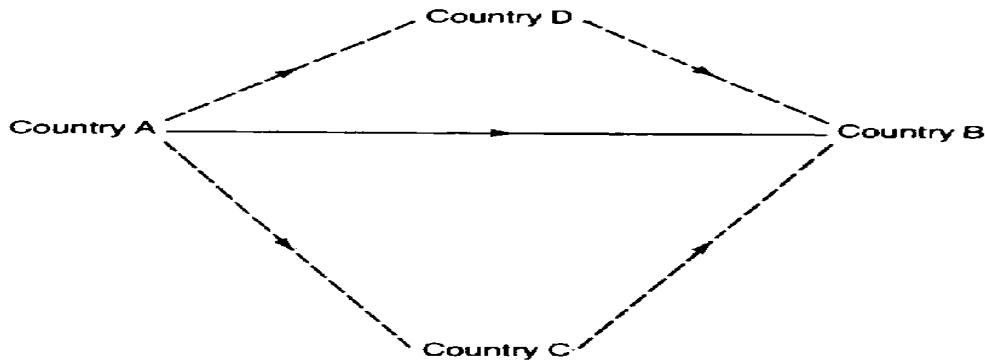
4.4 Travel receipts and payments Statistics

Travel payments are defined as:

‘Money paid for international carriage to and from destination’

– International airfares, etc.

Tourism destinations may receive nothing from travel.



Tourist who is resident in country A and visiting country B may travel on an airline based in country A, one based in country B, or one based in a third country C. On long-haul routes, the tourist may indeed use more than one airline, based in more than one country. The reasons lie in bilateral air agreements, competition, and complexity of tourist itineraries.

- First, A and B will have a bilateral agreement to share direct traffic between their countries amongst their own countries' airlines. This uses third and fourth freedom rights of the air.
- Secondly, a tourist may want to visit both countries B and C, and given the same freedoms there is an option to use country C's airline on two sectors.
- Thirdly, country D's airline may be using fifth and sixth freedom rights to grab a market share of traffic from A to B by offering a cheap virtual through service via its own country.

To take an example¹⁰: Australia, through its main international airline Qantas (QF), does not earn very much at all on the travel account from tourists arriving from the UK.

30% of UK tourists used Qantas (QF)
 27% used British Airways (BA)
 8% used Singapore Airlines (SQ)
 35% used other means (mostly Asian airlines)

Singapore and other Asian airlines are clearly in the position of country D; the destination country B (Australia) receives only about one third of total travel payments in this market.

Travel account policies often seek to maximize foreign exchange earnings from international visitor flows. A destination country will carefully examine 'freedoms of the air' which it grants, and attempt to

¹⁰Source: Australian Tourist Commission

maximize inbound use of its own airlines. Generators will encourage their outbound tourists to ‘fly the flag’; other airline-operating countries in favorable intermediate geographical positions may try to get travel revenues from travelers who are not their tourists.

Activity 4.4

1. Define travel payment. _____

2. What are the main objectives of travel account travel? _____

4.5 Tourism receipts and payments

Tourism payments are defined as

‘Money spent on goods and services in destination countries’

– Ground services (including domestic air transport

On arrival in destinations, tourists purchase goods and services, with money presumably brought with them and exchanged.

The broad categories of product bought are:

- * Accommodation and food
- * Domestic transport
- * Tours/excursions and ‘entrance to attractions’
- * Souvenirs and daily necessities

One of the main concerns of a destination country is whether it owns the means to produce, and actually produces, the above goods and services it provides.

In many cases, this is becoming increasingly difficult as multinational enterprises and organizations based in tourist generators supply or take over supply of those products. We, therefore, see a flow of foreign exchange earnings on tourism products sold in destinations to countries which themselves are not destinations, but which provide resources, particularly capital, to tourism production elsewhere.

In addition, values of tourism payments and receipts are also influenced by exchange rates.

For example, Japanese outbound tour operator contracts Ethiopian inbound tour operator on the US dollar base. And the price of tour is US\$500. Then, the Japanese operator sells the tour on ¥60,000 (\$1 = ¥120) for tourists.

Outbound tour operator usually transfers the tour fee after completion of tours (time-lag). Exchange rates may change to '\$1 = ¥100'. In this case, tourists paid US\$600, but the Ethiopian tour operator receipts only \$500.

Activity 4.5

1. Define tourism payment? _____

2. What are the effects of exchange rates on tourism payments? Try to show with examples:

4.6 Foreign exchange dependence on tourism

It is possible to gain some idea of how dependent a country is on tourism earnings as part of its balance of payments from a published data on tourism payments and earning as a rough guide.

Countries which are much dependent on tourism are sensitive to changes in tourism demand and travel conditions. Such dependence on any single industry is likely to be unhealthy, as a change in market conditions or production difficulties can severely damage a nation's balance of payments.

The level of dependence on a single generator is also crucial. Changes in the economic well-being, or fashions, in the generator, as well as changes in the political and travel links between generator and destination, can have a significant effect at the destination.

Activity 4.6

What are merits and demerits of dependent of balance of payments on a single generator? _____

Tourism developments in destinations have become less sporadic and more organized. So their implications for a national economy and its balance of payments have become clearer and more important.

In addition, the supply of tourism products designed for international consumers has become the province, to large extent, of multinational investors and organizations.

To assess the impact of tourism developments on a country's balance of payments, it is necessary to identify as many items as possible within the tourism external account, rather than just simple foreign exchange receipts.

Stage	Inflow to balance of payments		Outflow from balance of payments	
	Investment	Capital inflow (Capital account)	Dividends/share & interest (Current account)	
Construction	-----		Design & consultancy fees	
Operation	Receipts from foreign tourists		Royalties & technical aid	
	Souvenir sales		Imported materials and spares	
	Taxes on foreign operator's		imported consumer goods	
	Wages received from foreign operators			
	Saving from supplying domestic tourism			
Marketing	Product (import substitution)			
	-----		Overseas promotion	
			Overseas based personal costs	
Total Inflow (I)			Total Outflow (O)	

The initial capital inflow is likely to come from countries which are strong external investors – mostly rich, developed nations. It is triggered either by prospects of higher rates of return in the destination than elsewhere (net of taxation or including investment incentives), or by some need for integration. This inflow is a once-for-all capital account movement, where the interest 'reward' outflows are recurrent/regular.

Other recurrent outflows will depend on the degree of development and diversification in the destination economy, and its ability to supply goods itself to support the tourism industry. Less diversified economics has a higher need or propensity to import, and thus greater outflows. Most destination

governments hope that the operational inflows will easily pay for all the outflows and leave a net positive balance of I-O.

It is important to view the value of inflows in relation to all tourism-related and tourism-induced foreign exchange effects. One notable inclusion is the saving from supplying a new domestic tourism product. Whilst this means no actual receipt from abroad, it implies that tourists domestically now have available a more attractive product than one overseas which otherwise would be in demand. This import substitution is analogous/similar to consumption of home-produced goods to replace imports.

As further development take place, destination governments would hope that the I-O surplus ratio increases, as:

- The destination attracts an increasing range of inbound tourists
- Local support industries and employment skills become more sophisticated and competitive, thereby reducing the need to import
- Unavoidable overseas expenses (such as overseas promotion) cover an enhanced range of tourism products with little cost increase – i.e. there are increasing returns.

Activity 4.6

What variables will increase with increase in input output surplus ratio as a further development takes place? _____

4.8 Policies for the balance of tourism payments

A very large number of countries have to deal with balance deficits. They do not pay their way. They must, therefore, embrace policies to reduce deficits or even obtain surpluses.

In addition, in those cases where their own currency is not an acceptable form of international payment, they need ways to earn ‘hard’ or convertible currencies.

Using tourism to improve a balance of payments position in the above circumstances is popular. There are several reasons for this:

- Negative or prohibitionist policies to reduce imports, by such action as quota enforcement or increased tariffs, not only have possible injurious effects on the domestic economy, but also may incur retaliatory measures from trading partners.

- Stimulation of domestic goods producers to increase exports may be a difficult process, especially where a country has few immediately exploitable comparative cost advantages. Also, the lags between stimulatory policy → sales of goods → shipment of goods → payments received may be so long as to be useless in making an immediate correction to a balance of payments deficit.
- Tourism is relatively easy to exploit quickly, providing no great infrastructure development is needed. Brief but intensive overseas promotional campaigns, the granting of new transport or taxation rights, or measures to reduce prices (by devaluation for example) can have almost instant effects in attracting more inbound tourists and their money. It is also relatively simpler and ‘cleaner’ than much new industrial development.
- Reducing outbound tourism by enforcing special transaction or severe exchange control does not normally attract retaliation, as it is not usually seen as a specific anti free trade weapon.

So, a number of specific policies have been used to take advantage of these factors, which we may group as follows:

- **Promotional policies**

Overseas promotions; Special tourist price reductions (for example, a special tourist exchange rate; cheap ‘tourist rail-pass’ or ‘tourist domestic air-pass’); Market repositioning to attract not more but higher spending, inbound tourists

- **Development policies**

Grants or tax allowances for businesses developing products to attract international tourists; Infrastructure development, including transport links with generators

- **Regulatory policies**

Devaluation: - Exchange control/currency export prohibition; Departure taxation for residents; strict negotiation in bilateral air agreements to preserve the largest share of travel receipts for home carriers; visa relaxation

Almost every country seeking to reduce a balance of payments deficit has used combinations of these policies. They work by a mixture of demand-side and supply-side management, and of course are normally integrated into overall economic policy.

Activity 4.7

What policies destination’s government need to formulate to improve the balance of payment?

List and describe all the policies: _____

Self-check Questions

Say 'Yes' for the activity you can perform well and 'No' for the activities you can't perform well if you encounter activities you cannot perform well, please go back and read the materials and references given

S. No	Expected objectives	Yes	No
1	Define what by mean balance of payments		
2	Solve problem related to balance of payment using the right formula		
3	Identify basic sources of tourism payments statistics with their characteristics		
4	Define travel payments		
5	List the policies that countries need to design to improve balance of tourism payment		

CHAPTER 5

THE ECONOMIC ROLES OF GOVERNMENT

After the completion of this chapter, students will be able to:

- ❖ Identify the roles of government in economic activity
- ❖ Understand the direct and indirect impacts of governments policy on tourism development
- ❖ Describe issues pertaining consumer protection
- ❖ Differentiate the roles of government as supplier and consumer
- ❖ Understand regulation in travel and tourism sector

Introduction

The level of government involvement and role played in the economic activity depends on several factors. In a country where there is stable economic condition and suitable political situation, the government can play active role in economic activity. Some of these roles includes: taking appropriate measures to promote economic wellbeing enforcement of justice and diplomacy and owning the means of production for specific goods and services. Government policies over economy may affect tourism both directly and indirectly. Government tax on tourism may be one of the implications for this.

5.1 Macroeconomic Management

The scope of a government role in economic activity depends on the economic system and associated political doctrine.

The major roles of governments in the economy are:

1. Taking measures to promote socio-economic wellbeing, including improvement in standards of living, maintaining employment, and welfare equity
2. Levying the economy in order to supply noncommercial social provisions (such as justice and diplomacy)
3. Owning the means of production for specific goods and services, and managing them as enterprises

The ... ment.

The ... mies'

and

All

Activity 5.2

1. Differentiate Government policies which affect travel and tourism both directly and indirectly: _____

2. What is the general goal for economic policy in tourism? _____

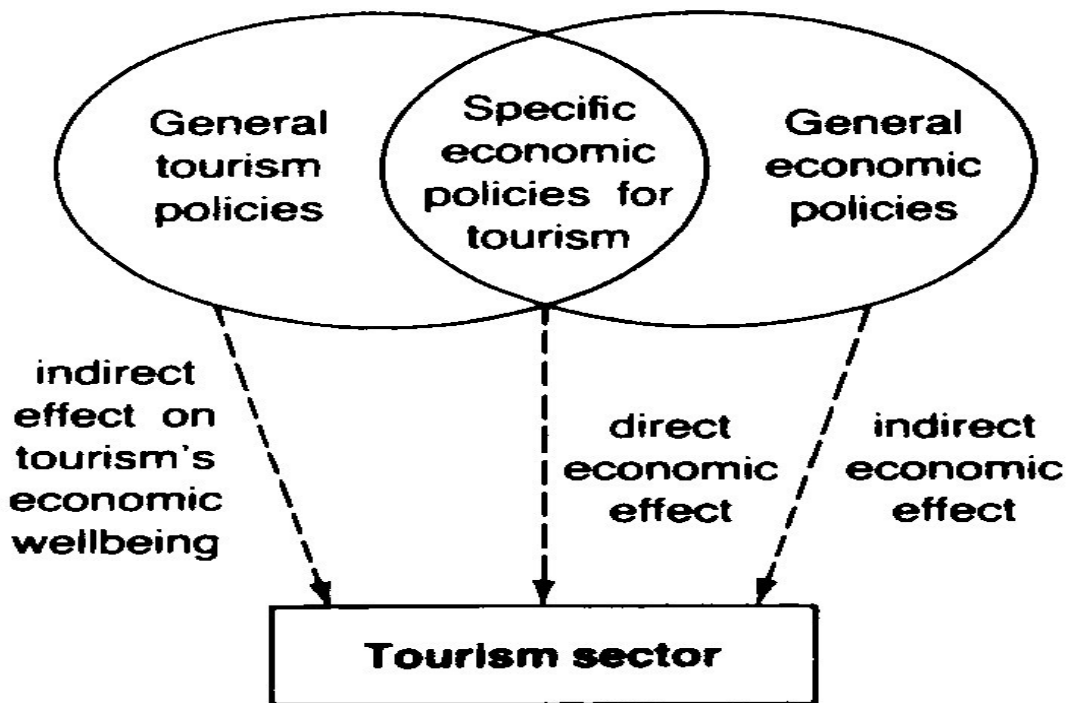
Activity 5.1

1. Mention the major roles of governments in the economy: _____

2. Which one of these factors is related with politico-economic system? _____

5.2 Sectoral economic management in tourism

Government policies may affect travel and tourism both directly and indirectly. General economic policies may have substantial indirect effects on tourism. For example, business expenditure tax may reduce demand for business travel. General tourism policies are likely to reflect a range of objectives: economic, environmental, social, educational, diplomatic, etc. Almost always, the non-economic Policies have considerable economic implications for tourism, particularly if equity or normative judgments are involved.



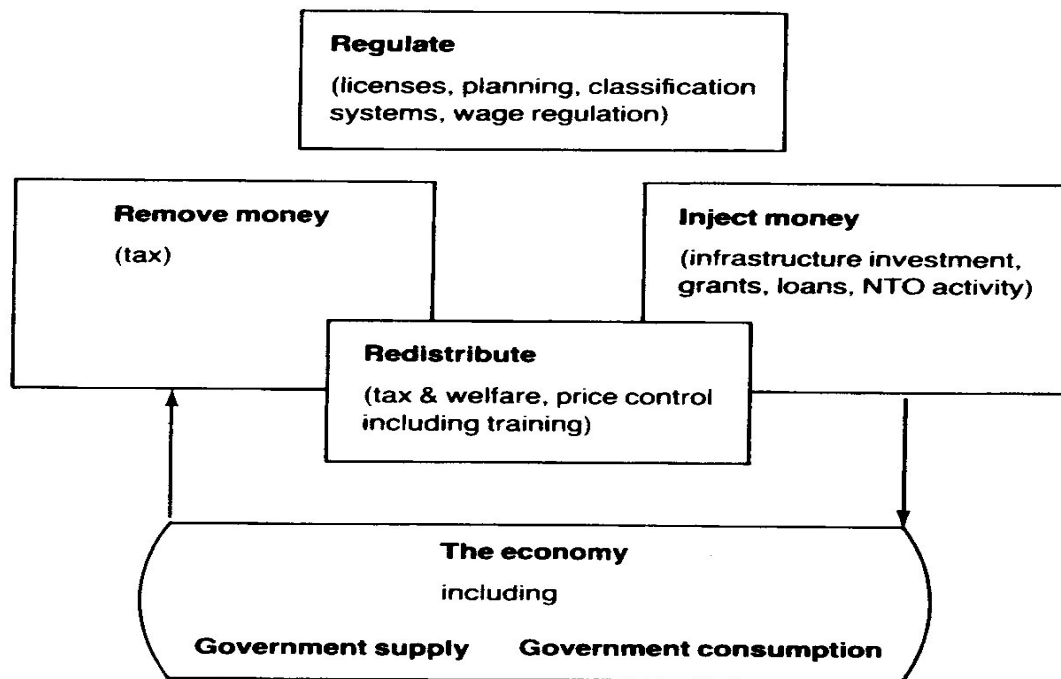
The general goal for economic policy in tourism is likely to be the maximization of tourism's contribution to

Activity 5.3

1. List the three types of taxes: what is the main distinction between these types of taxes?

- Optimizing contributions (usually inflows) to the balance of payments
- Providing a focus for regional development or regional economic balance
- Providing employment
- Redistributing and improving incomes
- Contributing to social (economic) welfare
- Maximizing opportunities for fiscal revenue

These goals translate into the roles outlined in the Figure.



- A government may remove money from an economy by taxation and borrowing.
 - A government may inject money through government expenditure, both for consumption and investment.
- ~ It may combine removal and injection for the purposes of redistribution.
- A government may regulate the suppliers in travel and tourism, imposing controls on such things as output and prices.
 - A government may itself act as producer, and consumer, in many areas of travel and tourism activity.

Activity 5.2

1. Differentiate Government policies which affect travel and tourism both directly and indirectly: _____

2. What is the general goal for economic policy in tourism? _____

5.3 Tourism taxation

Many governments use tourism as a source of tax revenue. Taxes can be divided into three types:

1. Taxes on commercial tourism products

Taxes on commercial tourism products are straightforward example of consumption taxes. They normally levied on producers, who must then decide if it is possible to pass the incidence of taxation on to the consuming tourist.

This depends on the price elasticity of demand facing each producer. Those in a highly competitive market are unable to raise prices and maintain demand, and thus absorb taxes. Where monopolistic or collusive practices, lower price elasticity of demand means the incidence of such taxation falls more directly on tourists.

Favorite targets for this type of taxation are accommodation, meals, car rentals and fuel excise. Taxes on accommodation – room sales taxes – are imposed in many destinations. Like sales tax on eat-in meals and car rentals, or VAT/VTA, they are mostly ‘ad valorem tax’ at rates ranging up to over 20%.

2. Taxes imposed on consumers in the act of being tourists

Many governments impose specific taxes directly on tourists regardless of the bundle of goods and services purchased. These are generally levied on international tourists and collected at gateways.

- Some countries impose exit or travel taxes on their residents seeking to travel internationally. Those taxes are primarily designed to deter foreign travel and consequent foreign exchange outflows.

- Some countries impose an arrival tax on tourists. It often greatly exceeds administrative cost of supply with the hidden taxation in many countries' high prices of visas and other documentation. The resulting monopolistic economic rent is straight revenue-raiser.
- It is the most popular revenue-raiser, in the form of a departure tax, on both residents commencing a trip and returning tourists leaving a destination. Some are user charges for airport terminals such as 'Airport Tax' or 'Civil Aviation Tax' and others are general revenue 'Departure Tax' or 'Embarkation Tax'.

3. User pays charge

User pays charges are becoming increasingly accepted. There is no clear distinction between these charges as the price of a tourism facility purchased and as a tax on the use of that facility. In principal, the 'price' approach covers costs associated with supplying the facility, whilst the remaining economic rent is regarded as tax.

Activity 5.3

1. List the three types of taxes: what is the main distinction between these types of taxes?

Activity 5.4

1. What are government spending on tourism? List and describe each of the government spending on tourism? _____

2. List some of the direct expenditures on tourism by government?

A. _____

B. _____

C. _____

D. _____

E. _____

3. Most of the time infrastructure solely constructed for tourism is very few. Infrastructure developed for other purpose will benefit tourism in multidimensional aspects. Do you think this situation can enable countries to get what is expected from tourism

identifying tourism as a major ear of infrastructure investment, and as a marginal cause of increased maintenance costs.

Where large-scale investment in tourism-related infrastructure takes place, investment and maintenance costs can sometimes be recouped from rates and taxes charged to commercial enterprises whose development is then possible.

International organization such as World Bank have for many years been major suppliers of capital for tourism infrastructure investment.

5.4.2 Facilitation of tourism development

Where national and regional authorities offer a policy of supporting the development of tourism as an income-contributing sector of the economy, this normally entails some form of government expenditure to help with the commercial provision of services. This is especially important in tourism destinations, which are in a developmental stage.

Not only may government provide the funds required ensuring the viability of marginal projects, but also overt political support can be psychological rein-forcer of decisions to invest.

The table lists the main methods by which governments use their spending to facilitate development.

Direct expenditure

- Grants and subsidies
- Long-term low-interest loans
- State participation in equity
- Interest rebates
- Financing research assistance
- Financing vocational training

Reduction of commercial liability

- Tax exemption or reduction
- Duty-free importation of materials
- Preferential terms for sale or concession of state land

Activity 5.5

1. List some of tourism redistribution policies. _____

2. What is social tourism? _____

- It may reduce the capital requirement, or the cost of capital, such that the marginal productivity of an investment proposal is improved to a viable level.
- It may reduce the operating costs of tourism suppliers, and hence improve profitability and long-term stability of their enterprises.

Government, therefore, attempt to direct spending into those areas where the direct multiplier effects on employment and business activity are highest. The majority of facilitation expenditure goes to capital-intensive sectors.

Most public spending programs on facilitation are part of tourism development plan. They may range from small ongoing commitments to large multi-million dollar assistance programs. Additionally, many ad hoc agreements such as tax exemptions and the release of cheap government land for resort development are negotiated as the ‘price’ a government must pay to induce a specific developer.

5.4.3 Undertaking tourism marketing

The third major area in which governments spend on tourism is on the marketing activities of tourist offices. Majority of National Tourist Organizations (NTO) are either government departments or semi-autonomous bodies with significant government funding.

There are three reasons why most governments manage the organization.

- The individual suppliers of inbound and domestic tourism products are unlikely to be able completely to subordinate competition to co-operative marketing programs.
- A government may see a potential economic benefit nationally from tourism, which transcends those of private market suppliers.
- A centralized marketing authority can gain economies of scale in operation.

Specific activities of each NTO vary, but major expenditure areas are nearly always those of marketing:

- Market and marketing research

▪ **Activity 5.4**

1. What are government spending on tourism? List and describe each of the government spending on tourism? _____

2. List some of the direct expenditures on tourism by government?
 - A. _____
 - B. _____
 - C. _____
 - D. _____
 - E. _____
3. Most of the time infrastructure solely constructed for tourism is very few. Infrastructure developed for other purpose will benefit tourism in multidimensional aspects. Do you think this situation can enable countries to get what is expected from tourism

5.5 Redistribution policies

Governments use a combination of taxation and expenditure to redistribute resources, incomes and economic benefits. This normally relates to the whole economy rather than any one sector.

In tourism there are only a few examples of redistribution policies. These concerns follow.

- Regional development
- Social tourism
- Price control in factor markets
- Levies for reasons such as training

1. Regional development

As economic development and levels of income vary regionally in all but the smallest economies, common policy goal is spatial redistribution.

For those parts of travel and tourism in which resources are mobile (other than fixed unique attractions), it is possible to develop fiscal and planning policies to aid economic redistribution. For example, designating and controlling airport development for use regionally can change flows of both generated and destination travel.

Decentralization and relocation of tourism activity is a part of broader regional economic policy. Policies of this type have involved regionally variable taxation and development grants, sometimes with the former funding the latter.

2. Social tourism

Social tourism is a system by which the state intervenes to provide tourism as a social welfare benefit to low-income consumers. In some countries, social tourism is funded through labor unions or insurance schemes, which in turn receive taxation allowances for this activity.

3. Price control in factor markets

Control of elements of factor markets, especially labor, can have important redistributive effects. In any industry with diversity of types of producer and types of activity, governments may intervene to control restrictive trade practices, or to protect individuals and economic wellbeing.

Labor markets in hospitality are frequently the subject of government intervention to fix minimum wages and conditions. As the hospitality industry is fragmented and many positions are unskilled and casual, wages are on average to be 20% lower than for other sectors.

4. Levies for reasons such as training

Vocational training for a tourism labor force is income redistributive if it is financed by an industry levy. It is more equitable for training to be controlled by professional association because there is no guarantee that the efficiency benefits of training will return to a hotel which is too small to have its own training. Workers on completion of training may move elsewhere.

Activity 5.5

1. List some of tourism redistribution policies. _____

2. What is social tourism? _____

Activity 5.6

1. What is the consequence of consumer protection? _____

2. What is orderly markets? And how does government regulate price and quantities produced using this technique? _____

5.
Re
pr

her

They generally cover such questions as.

- * Who may supply a goods or services?
- * What quantity of products or money may be traded?
- * What price may be set?
- * Under what conditions may production and exchange take place?

5.6.1 Economic controls on tourists

Most direct economic controls on tourists themselves are imposed as part of balance of payments policy. Those countries, which see international tourism as an important contributor to balance of

payments flows, may impose foreign exchange restrictions in addition to the use of taxation and complex documentary requirements.

- Effective demand for foreign tourism can be restricted in generating countries by exchange control regulations limiting the amounts of both domestic currency and foreign exchange, which may be personal, exported.
- Countries may effectively restrict foreign business tourism by controlling its tax deductibility. If a trip is tax deductible, the cost to the purchasing enterprise is the price less the marginal corporate tax rate. To reduce non-essential business travel, governments limit deductibility.
- Destinations may impose regulations on tourists in the form of compulsory currency exchange. A visitor to these destinations must exchange a minimum daily amount of convertible currency into local units on arrival. And it is not possible to exchange to convertible currency again on leaving. As local currency export is prohibited, this forces a minimum level of expenditure per tourist per day.

5.6.2 Consumer protection

Consumer protection policies can easily have marketplace consequences, and there are two major examples in travel and tourism.

1. Licensing and bonding arrangement

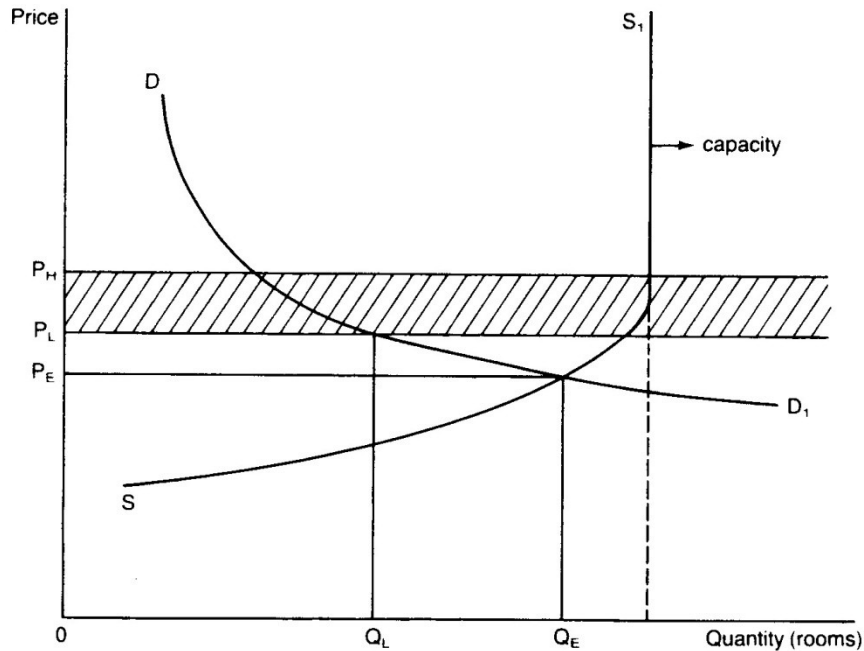
Purchasers of travel must normally pay in advance of receiving the product, and therefore face the risk of losing at least a deposit, or possibly a large full payment, if suppliers or their agents fail in the interim.

Many governments have introduced licensing and bonding arrangements to protect consumers. These apply to any suppliers who may take payments in advance and therefore principally apply to travel agents. However, such controls make a considerable barrier to entry.

2. Official accommodation classification system:

Many countries have introduced official classification systems to protect consumers. Typically, systems classify accommodation into six or fewer categories. Control does become effective in situations where some countries accompany their classification system with price controls linked to ratings.

However, this consumer protection policy may work against consumers, forcing prices to be higher than they would be in a free market.



Assume some hotel operates with relatively elastic demand $D-D_1$, and in a free market might achieve equilibrium at price $O-PE$, selling quantity $O-QE$ of accommodation. If the government classifies the hotel and sets a price band between PL and PH , the best, which the supplier can achieve, is price $O-PL$ and sales quantity $O-QL$. It is a considerably lower occupancy rate than equilibrium.

5.6.3 Orderly markets

Governments regulate prices and quantities produced or offered for sale in many markets for 'orderly marketing' or the protection of existing suppliers. Although 'orderly marketing' is exactly the reverse of antitrust legislation, the policy has been accepted as part of regulatory.

One of the major sector targets for regulatory policies is passenger transportation. The principles of bilateral air agreement generally regulate international air carriage, by controlling which airlines shall operate routes, and fixing supply quotas in terms of seats flown per time period.

Regulations lead to stability of fares and services, guaranteed trading for operators, and the possible prevention of monopolization as a result of competition forcing closures. Later monopolization brings higher fares without competition and flows concentrated to particular destinations with service

re

Activity 5.6

1. What is the consequence of consumer protection? _____

2. What is orderly markets? And how does government regulate price and quantities produced using this technique? _____

5.7 Government as supplier and consumer

National and local authorities themselves are significant suppliers and consumers of travel and tourism products.

1. Government as supplier

Major areas of public ownership are in passenger carriage and tourism attractions. In air travel, 80 of 155 (IATA airlines) are government owned or have a majority government stock holding. Most rails, and many bus and ferry, services are publicly owned or controlled. Even where carriers are privately owned, many terminals are publicly operated.

Through public corporations, trusts or direct management, national and local governments own very many tourism attractions, especially where they are based on 'national heritage' resources or involve community recreation.

Roles and activities of government-owned suppliers reflect political as well as economic requirements. Government-owned suppliers may not be able to maximize profits through their economic activities. For example, airlines are often required to service international routes for diplomatic rather than economic reasons, and domestic rail or air networks may be forced to supply services to isolated areas to meet social needs. Governments frequently direct attractions' managers to fulfill a primary educational or conservation role (in, for example, museum collection) to which tourism's need are secondary.

2. Government as consumer

The market share of tourists traveling on government business ranges from an average of 3% of tourists in Europe to 12% in Africa (WTO 1993).

Government demand for tourism has some notable features:

- Daily allowance for each grade of staff will, all else being equal, determine expenditure levels on food and lodging.
- Tourism largely emanates from, and flows to, administrative centers; if these centers have administration as their major function, then much of their tourism plant must be geared to government tourism need.
- Governments may limit their employees' choice of suppliers by, for example, contracting for all air trips to make on a state owned airline.
- In some countries government owned tourism services must be supplied free of charge to government officials, or at preferential rates which do not reflect true costs.

Because of a variety of control and accounting procedures, it is difficult to estimate the true impact of government consumption on travel and tourism markets. It is likely to be greater than many national authorities would admit.

Self-check Questions

Say ‘Yes’ for the activity you can perform well and ‘No’ for the activities you can’t perform well if you encounter activities you cannot perform well, please go back and read the materials and references given

S. No	Expected objectives	Yes	No
1	Identify the roles of government in economic activity		
2	Understand the direct and indirect impacts of governments policy on		

3	<p>Activity 6.1</p> <p>1. Which source of finance is more relevant and recommended for investment? Give you own conclusion. _____</p> <p>_____</p> <p>_____</p> <p>_____</p>		
4			
5			

TOURISM INVESTMENT

Up on the completion of this chapter students will be able to:

- ❖ Describe areas of tourism investment
- ❖ List factors affecting tourism investment and provide possible professional recommendation.
- ❖ List out source of finance for investment
- ❖ Describe some of special consideration in tourism investment

Introduction:

Investment is the allocation of resources to fixed capital formation. Investment enables further production to take place. Investment is that part of an economy's production which is not consumed, and is financed by the share of income which is not spent on consumption. There are some areas that need investment. The principal factor determining the amount of new investment which takes place is the profitability which can be gained. Tourism is a key sector for economic development: it is a fast-growing and labor-intensive industry that involves many economic activities. Investment promotion

Activity 6.2

1. List some of the reasons for tourism investment. _____

2. Some investments are made for 'lifestyle' reasons. What do you think examples of such investment? _____

production to take place.

In macroeconomics terms, investment is that part of an economy's production which is not consumed, and is financed by the share of income which is not spent on consumption.

In microeconomics terms, investment relates to the allocation by an enterprise of whatever resources are needed as productive assets.

There is a need for investment in three areas:

1. New fixed assets, such as buildings, plant, equipment and fixtures
2. Refurbishment or replacement of fixed assets which have reached the end of their useful life in current form
3. Working capital, to provide a fund from which to pay recurrent costs of production

The growth and development of any industry depends on its ability to generate a return on investment, and therefore to be able to fund that investment through capital markets and internal earnings. Returns are measured primarily through the factor rewards (interest and dividends) earned by investment, but also by capital growth and other benefits.

The principal factor determining the amount of new investment which takes place is the profitability which can be gained. This is the difference between the net revenue or yield which can be expected from the investment and cost of capital employed.

Net revenue consists, in commercial enterprises, of expected sales less expected costs, and so is dependent in tourism on expectations of tourist numbers, their patterns of demand and expenditure, and some assumptions of what will happen to costs of goods and services required.

In a non-commercial venture, net revenue may include valuations of expected social benefits and costs of an investment project.

The cost of capital is the average rate of interest needed. Capital may come from several sources.

* Internal finance:

Retained profits or surpluses; Provision for depreciation; Provision for taxation

* External finance:

Equity (and investment grants); Long-term loan capital; Short-term finance (bank credit, hire purchase, trade credit and so on)

Whilst borrowed finance carries a direct rate of interest, equity requires dividends in line with the risk class for the type of investment proposed, and on internal finance there is an opportunity cost of capital, which could otherwise be, employed elsewhere.

Activity 6.1

1. Which source of finance is more relevant and recommended for investment? Give your own conclusion. _____

Mainly Commercial

Shops

Supermarket Offices

6.2 Investment in travel and tourism

In most countries, and most sectors of travel and tourism, investment depends on the same commercial principles as any other industry. Suppliers anticipate profitable returns from selling products either to tourists or in some supporting sector, and set their own decision rules and methods on evaluating projects.

Tourism, however, brings out some other reasons for investment, which are often linked to the general objectives of enterprises in the sector. These are:

1. Noncommercial social end benefit

Governments often undertake investment in tourism projects for non-commercial social end benefit. Investment in transport infrastructure, tourist information centers, national parks' amenities or interpretation centers, training establishments and the like may be justifiable on the basis of cost-benefit analysis rather than pure commercial profitability.

2. Property driven

A great deal of fixed capital formation in tourism destination areas is property driven. Entrepreneurs who are primarily property developers construct new building such as hotels, resorts, trade and convention centers as alternatives to offices, factories or warehousing.

Their investment motivation is a profitable rate of return from rental income, but more importantly a significant growth in capital value of the property. Investing developers may, therefore, be organizations with no active interest in tourism at all, such as banks, financial trusts, insurance, construction and manufacturing corporations.

3. Lifestyle

Some investments are made for 'lifestyle' reasons. For example, individuals seeking a pleasant lifestyle or tax loss may invest in a yacht/cruise/ for wet chartering, or other leisure attraction. Tourism may be needed to subsidize an existing lifestyle: cash-strapped owners of stately /royal/majestic/ homes in Europe may invest in tourism facilities for this reason.

Activity 6.2

1. List some of the reasons for tourism investment. _____

Activity 6.3

1. Explain the following main features which are important in bend /slant the balance in considering a marginal project
 - A. *Public use project:* _____
 - B. *Short- term project:* _____
 - C. *Future substitute use:* _____
 - D. *Recycle-use of Transportation equipment:* _____
 - E. *Mixed use venture:* _____
2. What are the effects of seasonality over tourism investment? _____

products that result. Any investment in new equipment will yield joint cash flow and returns from both sets of consumers.

For example, city buses may be required for excursion tours and general tourist travel, but may also serve local consumer and other resident travel needs. It is inconceivable to an international tourist that London buses should not be double-decked and red, yet such vehicles may not always be suitable for residential services.

2. Short- term project

Tourism provides an opportunity for many short-term projects with quick payback periods. Because tourists travel to the production 'plant', consume mostly service, and frequently demand new, location non-specific attractions, it is possible to develop projects, which offer very quick returns.

3. Future substitute use

Where producers invest in tourism property, they may take it consideration future substitute uses of that property, which increase the end value of the assets.

For example, a new city center hotel tower with an income producing life in tourism use of x years

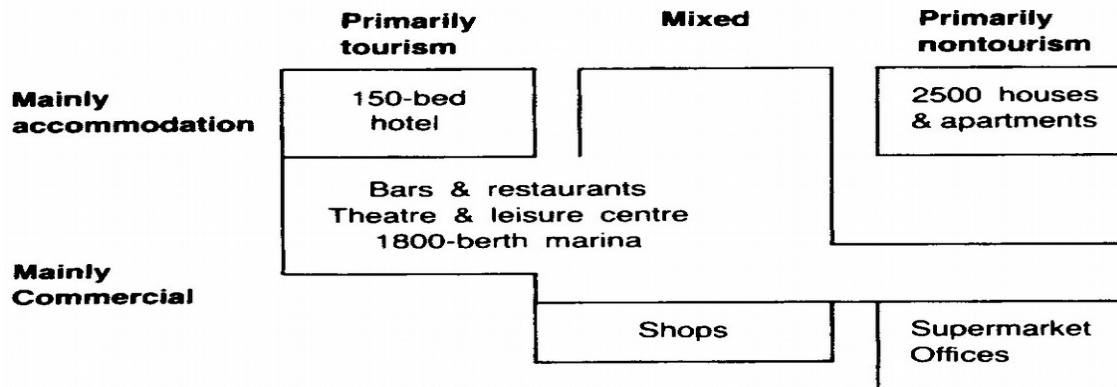
Activity 6.4

1. What is tourism investment? _____

For example, car rental companies sell off cars normally at anything between 9 and 24 months to fleet company, taxi or individual purchasers. Major bus operators purchase new vehicles for tourist excursion use, transfer them after some time to regular bus line operation, and finally commission them for school transport or similar use. Airlines which aircraft to service a particular route may at a later stage switch aircraft to use on a different route, which had not been considered as an investment opportunity.

5. Mixed use venture

Many destination-based ventures are mixed use ventures involving some investment for tourism purposes and some for non-tourism reasons. Unlike joint use projects, those possess separate elements of investment, which are complementary in nature but separate in use.



Activity 6.5

1. What are possible sources of capital for tourism investment? _____

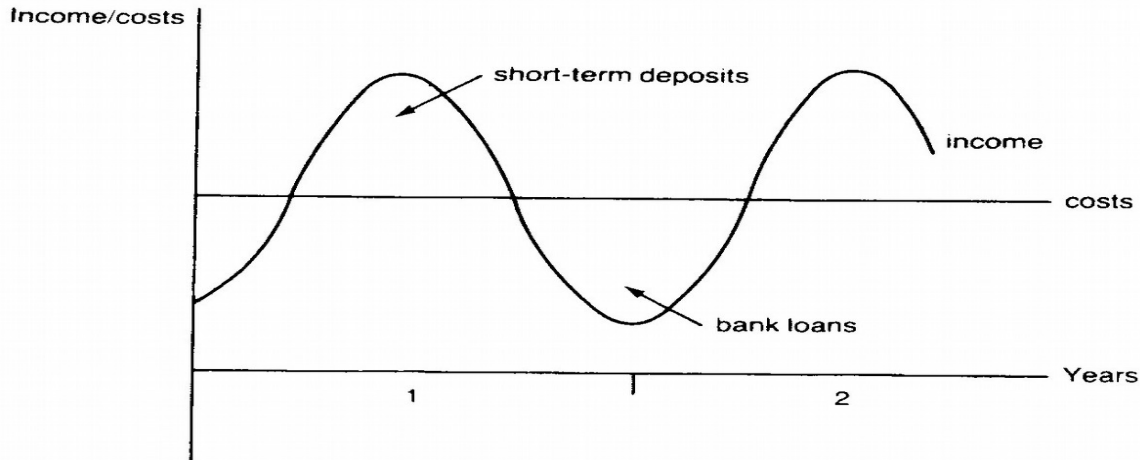
2. Which source of capital do you think is more feasible? And why? _____

6.
M
vi

its
lar

nature of periodic income values. Seasonality implies a need for good cash management, which requires either:

- * Short-term credit to cover low season costs, or to be withdrawn Saving from high season cash flows in short-term deposits or securities to cover low season costs (see Figure)



Both of these incur a cost – the first in interest payable, and the second in the opportunity cost of use of funds.

Astute/wise entrepreneurs can assuage/ease cash flow problems by using assets in contra-cyclical production. For example, some winter resorts are used highly successful as fitness, climbing and grass skiing centers in summer, and cruise lines reposition vessels from summer cruising grounds around Scandinavia to the Caribbean in winter.

Activity 6.3

1. Explain the following main features which are important in bend /slant the balance in considering a marginal project
 - A. *Public use project:* _____
 - B. *Short- term project:* _____
 - C. *Future substitute use:* _____
 - D. *Recycle-use of Transportation equipment:* _____
 - E. *Mixed use venture:* _____
2. What are the effects of seasonality over tourism investment? _____

6.4 Investment in tourism ‘events’

Tourism events are tourist attractions of fixed duration. They may range from small, local festivals to major international activities.

Investment in events of fixed duration is related to different factors from investment in permanent tourism plant. Some events need mostly only working capital, using otherwise fixed facilities, such as sporting events. Others require more significant fixed capital formation, but still have a short payback period – such as biennial expositions. Such tourism investment projects are, therefore, very attractive to entrepreneurs who appraise on the basis of fast payback.

Many ‘mega’ events require both public and private investment. In investments in facilities necessary to stage ‘mega’ events such as Olympic Games, only a modest percentage will be recouped during the short event period. Investment in sports venues, hotels, transport and communications infrastructure and so on must inevitably rely on long-term post-event revenue. Over estimation of these revenues may leave hoteliers and taxpayers with long-term losses in destinations.

Activity 6.4

1. What is tourism investment? _____

6.5 Sources of capital

- Investments from fragmentation/division.

Activity 6.6

1. What are factors influencing travel and tourism investment? _____

2. Other than changes in market rates of interest, and anticipated changes in inflation, what are the two major factors influence viability in short term? _____

As many of latter involve property investment, they attract trust-type funds from insurance companies and superannuation funds.

- Investments by large manufacturing corporations

Large manufacturing corporations use retained earnings to diversify directly into tourism ventures. Activity by those enterprises, combined with lending by large bank and organizations such as World Bank, contributes to the increasing internationalism investment.

- Investments by publicly owned enterprises

Investment by publicly owned enterprises in travel and tourism is usually funded either by direct government subvention or by public bond issue. The cost of capital may be cheaper than commercial market rates because of the lower risk level attached to government-backed borrowing.

- Induced investment by governments' policy

Governments direct grants, loans and other subsidies towards specific sectors of tourism to enable investment and growth in those areas. Such aid reduces either the cost of the investment, the cost of capital, or the risk. Risk reduction is the most important aspect of government incentives.

Activity 6.5

1. What are possible sources of capital for tourism investment? _____

2. Which source of capital do you think is more feasible? And why? _____

6.6 Factors influencing travel and tourism Investment

Development of travel and tourism globally depends heavily on the expected future profits (and social benefits) which enterprises and governments forecast from their investments.

A number of specific factors influence individual and regional tourism investment.

1. Short term factors

Activity 6.7

1. What are investment incentives? _____

2. List some examples of investment

A. _____
B. _____
C. _____
D. _____

factors

The first is change in tourist flows, caused by altered circumstances in generators, destinations or links. This is principally locational change in the pattern of tourism demand. International tourism is highly susceptible to exchange rate variations, which alter prices, both generators and destinations. Equally, government fiscal and control policies, transport costs or poor weather for one or two seasons markedly change tourist flows. Specific locations thus gain or lose potential profitability.

The second short term factor is high level of inter-dependence between suppliers of travel and tourism products. The viability of a resort hotel in an isolated island, such as Hawaii or Majorca, depends on air services, ground transfers, and retailing and tour operating in generating markets. With complementary products, any one may be the limiting factor, such as airport capacity, amenities or inter-island ferry travel. Cross effects on viability are therefore substantial.

2. Stochastic shocks

Econometric and other techniques cannot deal adequately with the effects of stochastic or periodic shocks on tourism. Researchers can estimate the effects that such shocks will cause, but cannot predict the occurrence or severity of the events themselves. In tourism, these events tend to relate either to destinations or to travel links.

- Air traffic control strikes, pilots' stoppages, and air terrorism are examples of stochastic events affecting travel.
- Gulf War in 1991 adversely affected international travel worldwide.
- Substantial fuel price changes have an impact on car and air travel.
- Political violence and natural disasters such as tsunami waves and earthquakes may both reduce tourism demand and destroy tourism production plant in destinations.

All of those events demonstrate lagged effects on the industry, with recovery times varying between two months and five years.

3. Long-term factors

Investment in significant destination facilities or attractions, or capital-intensive transport assets, is required to identify potential changes in trends, and significant new opportunities. These influence the long-term future development of travel and tourism.

Tourists' tastes and comfort requirements can change over a number of years. This stimulates the need for shorter cycles of replacement investment, to upgrade facilities to currently accepted standards.

Not only are tourist needs influenced by fashion and search for ‘new experiences’, but also the relative importance of tourist-generating markets changes, through economic and social variables.

Long-term investment must cater for the cultural requirements of future markets, which may currently be insignificant. Environmental changes, including shifts in climatic patterns, have the ability to affect destinations, by directly changing some attributes of the tourism product itself and by altering locational advantages of different types of destinations.

One of most important variables affecting travel and tourism is technological changes. In the 20th century, for example, transport technology for air, road and off road vehicles has allowed the spread of mass tourism to widespread destinations.

Information technology is making travel and tourism markets more efficient and competitive, as more perfect information is available to consumers, and more competitive distribution to producers.

It seems inevitable that advances in technology will continue to have major impacts on the economics of travel and tourism.

Activity 6.6

1. What are factors influencing travel and tourism investment? _____

2. Other than changes in market rates of interest, and anticipated changes in inflation, what are the two major factors influence viability in short term? _____

6.7 Investment incentives

Policies to attract foreign investors often include various incentives. Some IPAs have responsibility for the administration of investment incentives. Most agencies, however, do not, but they can nonetheless play an important role in improving incentive schemes. Through their provision of services to investors,

IPAs may gain insights into how incentives work in practice, and based on the investor feedback, advocate remedies.

Incentives can be used as an instrument to enhance the beneficial impacts of FDI. Host governments may thus offer incentives to TNCs that establish in rural areas, promote environmental conservation, or train local staff. In designing incentives, it is important not to make the loss of government revenue too high or the administration of the system too difficult, or to discriminate unduly against local investors. Incentives may also have adverse effects on the development of the local economy. Providing duty-free access to imports, for example, may discourage supply linkages between tourism TNCs and domestic firms. Such incentives could be phased out over time to minimize negative side-effects. Finally, it should be emphasized that while FDI incentives may be important in attracting investors, they can never be a substitute for a good investment climate.

Examples of incentives include:

- (a) Duty-free imports of capital goods, equipment and inputs;
- (b) Training grants for locally employed staff;
- (c) Accelerated depreciation on environmentally friendly assets;
- (d) Assistance with the long-term lease of business property;
- (e) Loan guarantees for small firms;
- (f) Grants or tax breaks for investors in key opportunity areas.

Activity 6.7

1. What are investment incentives? _____

2. List some examples of investment
- A. _____
 - B. _____
 - C. _____
 - D. _____

Self-check Questions

Say 'Yes' for the activity you can perform well and 'No' for the activities you can't perform well if you encounter activities you cannot perform well, please go back and read the materials and references given

S. No	Expected objectives	Yes	No
-------	---------------------	-----	----

	Describe areas of tourism investment		
	List factors affecting tourism investment and provide possible professional recommendation		
	List out source of finance for investment		
	Describe some of special consideration in tourism investment		

References

- ❖ Endo K (2006). **Foreign direct investment in tourism – flows and volumes**. Tourism Management. 27: 600–614.
- ❖ UNWTO (2007b). **A Practical Guide to Tourism Destination Management**. Madrid.
- ❖ UNCTAD (2008a). **Investment Promotion Agencies as Policy Advocates**. Investment

Activity 7.1

1. What is pareto optimality? _____

2. List some of examples of choice involving tourism or non-tourism use of factors, in the public domain. _____

other

- ❖ Define externalities
- ❖ List and define classification of externalities
- ❖ Understand cost benefit analysis for travel and tourism development
- ❖ Propose mechanism on how to optimize the social value of tourism

Introduction

Many countries regard tourism as the only economic use of local factors of production though there may be moderate consumption of tourism for some factors of production. The issue is whether tourism can be efficiently and effectively use factors of production which are less important for other economic activities. Some examples of areas where tourism use which seems to be less important factors for other economic sectors includes: Zoning water front land either for open space to be enjoyed by resident or to construct a tourism marina, Operating a museum collection or historic site either as fully preserved

entity for scholarly study, or as tourism attraction, where combination is difficult and applying scarce government fund to a National Tour Office, or any alternative spending program.

7.1 Tourism Value and opportunity cost

Although tourism is frequently the only economic use of local factors of production, there may be other semi or non-economic uses for those factors.

Is tourism then the most efficient user of these factors? In commercial operations this problem is solved by using market and profit earned from the use of factors to determine their allocation, through production functions. In non-market or unpriced sectors, test of efficiency are less simple.

Example of the choice involving tourism or non-tourism use of factors, in the public domain, might include:

- Zoning water front land either for open space to be enjoyed by resident or to construct a tourism marina.
- Operating a museum collection or historic site either as fully preserved entity for scholarly study, or as tourism attraction, where combination is difficult.
- Applying scarce government fund to a National Tour Office, or any alternative spending program.

Tests off allocative efficiency in these and similar cases are within the area of welfare economic, whether or not third parties are involved as separate group.

If a factors of production, or resource, is used for tourism, its basic welfare/benefit/ or social cost to an economy is its opportunity cost, or the lost opportunity of using it in the (presumably)/most likely/ next best activity.

Evidently, to maximize general welfare, the opportunity cost of using resource in tourism must never exceed the benefit accruing, and should be minimized where there is a choice. The criterion for efficiency in resource allocation is in generally held by economist to be pareto optimality; use of resource is said to be pareto-optimal if no reallocation can increase one individual's utility without reducing that of others.

If by taking resources from tourism for example and employing them elsewhere, some people's utility could be increased without reducing that of others, the tourism allocations would be pareto-non optimal.

Conditions for pareto-optimality are complex for public goods and very few attempts have been made to establish whether tourism in specific areas is the best user of available resources.

For example, Lake X.Y in Florida has serious conflicting demands made up on it for tourism (sport-fishing), tomato irrigation, public water supply and so on. With or without its additional pollution problems, pareto-optimal allocation of its use is vital.

Different approaches towards solving the above problem have been suggested. Since tourism involves a wide range of activities, value and impacts, a social welfare function approach might be used to aggregate individuals' general utility values of tourism resource use compared with their judgment on other uses. Alternatively, benefit cost-analysis has been suggested as a method of establish the net value of tourism activity or resource use.

These could be accomplished for example by summing all consumer surplus and economic rent accruing/increasing to a tourism activity (the benefit), and treating as a cost those surpluses and rents which might obtain from alternative resource alternative resource use. The difference would be net value.

In using any of the above analyses, a difficulty which is specific to tourism is that of determining whom to include in assessing value. Government and other decision makers normally measure social welfare in relation to local nation/region. This is fine if all tourists are domestic, as all consumers' surplus is part of domestic economy's social welfare- and we may assume that tourism resources are owned by residents.

If however, some or all tourists are international visitors, their consumers' surplus 'flows out' of the economy, and the questions arise as to whether the social value of tourism activity in an economy should exclude this amount.

Nationalists would presumably answer yes, and advocates of single global society no. Since the 1960s

<p>Activity 7.1</p> <p>1. What is pareto optimality? _____ _____ _____</p> <p>2. List some of examples of choice involving tourism or non-tourism use of factors, in the public domain. _____ _____ _____</p>
--

Activity 7.2

1. What is externalities? Could you mention some of externality example from your experience? _____

2. What are the classifications of externalities? _____

3. Mention some of negative externalities caused by travel and tourism. How to boost the positive externalities from tourism? _____

externality that is they are outside a specific market transaction. In legal, social and environmental terms, the effects may normatively be considered as ‘good’ or ‘bad’ on third parties; in economic terms an externality can be examined to see what it causes a net increase or decrease in social welfare.

The concept of external effect or externalities was first comprehensively explored by Pigou(1950), who noted that in the course of economic activity the utility of people other than supplier or consumer of a commodity may be enhanced or reduced. An enhancement given ‘free’ is social benefit, and a reduction not compensated for is a social cost.

Although to establish a valuation of externalities it is necessary to be able to measure them in money terms, they are mostly un priced value effect, not dealt with in commercial markets. Externalities are usually divided in to:

- Social/economic benefits which increase the welfare of the third parties, in contrast to costs, which reduce welfare, and
- Aggregate externalities of all economic activity of that of a particular sector, compared with marginal externalities which are related to a specific investment or economic development.

More researchers have concentrated on cost than on benefits, particularly in relation to travel and tourism, largely because benefits are frequently incorporated in to secondary effect of multiplier studies.

Most analysis also addresses externalities associated with specific development or sectoral growth, in order to examine marginal changes to, or consequent fresh impacts on, welfare.

Classification of Externalities

Many of the effects on third parties which tourism activities cause are by no means specific to tourism.

Activity 7.3

1. What are some of the cost-benefit analysis that should be studied before a certain development is carried out? Mention and discuss in detail. _____

2. What do you suggest to balance the cost and benefit of tourism development in a given tourism destination? What if the cost outweighs the benefit?

Various classifications have been proposed, such as:

- Environmental restructuring
- Waste generation
- Direct biological impact of tourism
- Population dynamics
- Fiscal effect – generally falling on government
- Quality of life effects- generally falling on individual resident

For economic assessment, a more generalized classification of tourism's externality may be useful as the following table. Those affected are either individual not involved in tourism, or government and societies collectively. These together with tourist and tourism supplier (who may also, of course, be government authorities), make up the generally accepted 'four groups' in tourism impact.

Who is affected	Type of effect		
	Benefits	Economic New transport links,	Social Positive

Mainly individuals		new recreational amenities and shops rising property value	demonstration effect e.g. better health care, education	a view
	Costs	Falling property values, inflation	Traffic and people congestion, higher crime, negative demonstration effect	Spoiling views and landscape (Visual, noise, air, litter and water pollution)
Governments and collective welfare	Benefits	Increased direct and indirect tax revenue.	Increased value of culture, reduced loss from migration	Preservation of floras and fauna
	Cost	Maintenance of infrastructure tourism amenities if no user pays system.	Extra policing health services fire protection, sanitation and garbage	Distraction of floras and fauna

The types of effect concerned are either directly economic (in which case their benefits and costs are

Activity 7.4

1. Could you suggest some mechanism that should be used to boost the social value of tourism development? When destinations are trying to achieve the economic gain, the social issue will be at risk. What will you recommend to balance these two issues? _____

2. What are the classifications of externalities? _____

3. Mention some of negative externalities caused by travel and tourism. How to boost the positive externalities from tourism? _____

7.3 Cost benefit analysis for travel and tourism development

Social pressures increasingly force the developers involved with any new investment project to assess externalities, where possible, as an adjunct/additional/attachment/ to normal commercial investment appraisal. Thus, social and environmental impact studies are now a normal part of feasibility studies for such development as new resorts, airports or tourism attractions. The assessment technique most commonly invoked/paid attention/ is cost benefit analysis, depending on researcher's origin. COBA involves:

1. Identifying externalities
2. Valuing them where possible in money terms
3. Incorporating them as positive benefits, and negative costs, into some form of social account.
4. Summing the resulting 'net' costs or benefits into a net present value which can be subtracted from, or added to, the commercial or private value of a development, to form a social value.

As with tourism asset valuation, cost benefit analysis essentially provides shadow prices for non market value, either independently or as an addition to or subtraction from market prices. Again as with asset valuation, the benefit prices are highest where there is zero or low opportunity cost – that is little economic alternative to tourism development. The major difficulty with cost benefit analysis is that it is empirically very complex, and often involves subjective valuation of externalities. Pp 176

Activity 7.3

1. What are some of Cost benefit analysis that should be studied before a certain development is carried out? Mention and discuss in detail. _____

2. What do you suggest to balance the cost and benefit of tourism development in a given tourism destination? What if the cost outweighs the benefit?
