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THE IMPACT OF TOURISM ON SMALL ISLAND ECONOMIES

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Introduction

It is generally assumed that tourism has a positive impact on national economies. Foreign exchange earnings, creation of jobs and revenue to governments are often cited as being the main advantages. Such an attitude is reinforced by public and private sector organisations who have an interest in tourism.

Economic disbenefits are derived from tourism are frequently overlooked. Moreover, the complexity of tourism as an economic activity is often underestimated. For example, figures of tourist arrivals are often considered to be directly related to figures of tourism's contribution to the balance of payments. Politicians encourage such a narrow view by quoting tourist arrivals when it suits their purpose. This was certainly the case prior to the 1981 general elections in Malta when new records in tourist arrivals were being set.

The characteristics of small island economies may necessitate a different approach to tourism development. The purpose of this paper is to highlight the range of factors that need to be considered in assessing the economic impact of tourism with particular reference to small island economies.

Arguments for promoting tourism are set out briefly in Part I. In part II, I discuss a range of issues concerning tourism within the national economy including multiplier effects, leakages, inflation, diversification and inter-sectoral linkages. In Part II, tourism's potential for generating employment is discussed. In the final part, I discuss the reasons for and the effect of limited control by national governments on their tourist industry. I also look at revenue and expenditure incurred by national governments.

PART I - ARGUMENTS FOR TOURISM DEVELOPMENT

There are several arguments for development of tourism industry. Firstly, being a source of foreign exchange, promotion of tourism is a useful means of balancing trade deficits. Most small island states are particularly vulnerable to substantial trade deficits because of lack of natural resources. This makes tourism development an attractive policy option.

Tourism has been and still is a growth industry. As personal incomes rise, a higher percentage of that income is spent on holidays and travel (Young: 134). Assisting tourism growth rather than exports of goods appears to be a more feasible option given that expenditure on tourism is likely to rise faster than expenditure on other commodities.

Tourism is a source of employment. It is labour-intensive and can provide employment to semi-skilled and unskilled workers. It can ease unemployment in countries where unemployment rates are high. Even in countries with low unemployment, it can raise activity rates by generating employment for those who would otherwise not work at all, such as retired persons or married women.

There is little or no protection of the tourism market from tourism generating countries unlike trade of goods where import duties are imposed.
Stimulation of industrial production to increase exports may be a difficult process especially where skills, know-how and capital are lacking. Moreover the time lag between establishing a policy of increased investment in industrial production to reaping benefits in foreign exchange inflow may be too long to correct existing deficits.

Tourism is relatively easy to exploit quickly unless no great infrastructure costs are required. Brief and intensive overseas promotional campaigns together with other incentives (ex. granting new air transport rights, reduction of prices) can have almost an immediate increase in foreign exchange earnings.

PART II - TOURISM AND THE NATIONAL ECONOMY

2.1 Multiplier effects of tourism

Expenditure filters throughout the economy stimulating other sectors as it does so. Money spent by tourists goes to hotels and other tourist establishments. These re-spend the money to purchase goods from domestic suppliers, pay the labour force and public sector bills (taxes, duties and licences). All three flows stay within the economy. A fourth flow, namely the purchase of imported goods and services, represents a loss of foreign currency. This creates no further business activity and represents a 'leakage' from the system over the shot-run.

The three primary flows of money that remain within the domestic economy create additional economic activities. Public money is re-spent in domestic business orders for goods and services and to pay public servant wages. Domestic business re-spend money earned from tourism activity for paying taxes, to buy domestic goods from the domestic sector and for workforce salaries. Income earned by households from tourism is re-spent for payment of taxes and bills, buying goods and services. All the above secondary flows remain in the economy. In each of the primary flows, however, there are is another flow which is out of the domestic economy in the form of imports and savings.

The process repeats itself in futher rounds of expenditure. The amount of money changing hands become less and less as leakages reduce the magnitude of the transactions. For every $100 spent by tourists in the Bahamas economy, $18 were lost from the economy in the first round of transactions; $13 in the second round and $24 in the third; a total of $55 (Archer 1986).

The re-spending of incomes, thereby creating additional incomes, is known as the multiplier effect. Mathieson defines the tourist multiplier as; *"the number by which initial tourist expenditure must be multiplied in order to obtain the total cumulative income effect for a specified period."* It is a measure of the impact of the extra expenditure introduced into the economy.

The size of the tourist multipliers varies from country to country and depends on a range of factors. The higher the leakage, the lower will be the multiplier. Also, the greater the internal linkages, the less likelihood will goods be imported and hence the larger the multiplier.

Small countries generally tend to have lower multipliers due to fewer sectoral linkages and higher import leakages (Archer). Multipliers for some large economies and small island economies are given in Appendix A.

2.2 Leakages from the economic system

In an attempt to increase foreign exchange earnings, governments encourage increases in tourist flows. There is, however, no relationship between volume of tourist flows and foreign exchange earnings for the destination country. A proportion of the money spent by the tourist for travel, accommodation and goods and services is lost from the destination country economy.

Leakages from money spent by the tourist on goods depends on the diversification of the destination economy and its ability to supply goods itself to support the tourism industry. In a large economy, labour and commodities can freely be transferred within its territory and hence leakage from tourism expenditure is less. Small economies are less diversified and hence, goods purchased by tourists are more likely to be imported rather than produced locally. In the late sixties, for example, Barbados and Jamaica imported about two-thirds of food eaten by tourists in hotels (Latimer).

The ratio of leakages to the total inflow will decrease as the local industries and employment skills become more competitive. Supplying a new product for tourist consumption within the destination country provides for the consumption of home-produced goods to replace imports. Hence government policy of diversifiction in the industrial sector results in reduced leakages from tourism apart from being beneficial to the economy as a whole.

In small economies, the initial capital inflow for accommodation is likely to come from countries which are strong external investors. It is motivated by an expected higher rate of return in the destination than elsewhere or by the need for integration. Large hotels in particular are likely to require foreign capital because of the scale of operations. When hotels become operational there are recurrent 'outflows' of capital from the destination country.

Leakages from tourist expenditure on accommodation also depends upon the number of employees per bed; the higher the ratio, the lower the leakage. The ratio varies according to class and type of accommodation with high class hotels at one end and self-catering apartments at the other.

Enclave resorts such as Club Mediterrannee, result in minimal economic benefit for the host country because of their dependence on international charter operations, expatriates in the better paid jobs and imported food and equipment. The resultant leakage rate from such resorts is extremely high.

Tourism destinations will receive nothing from tourism expenditure on travel if airlines based in other countries are made use of. Hence, to maximise foreign exchange earnings destination countries set up national airlines and maximise allocations of freedoms of the air to it.

Referring to Malta, Oglethorpe states that, *"In many instances tour operator, the chartering airline and the hotel (or other accommodation) are all foreign owned, ensuring that apart from taxes, comparatively little revenue finds its way to Maltese individuals and institutions."*

In some countries, employment of expatriate labour in tourism establishments or in the tourism-related construction constitutes another leakage from tourism earnings. In the British Virgin Islands, the Bahamas and the Cayman Islands the proportion of expatriates was high particularly in the managerial and administrative grades (65, 49 and 32 per cent respectively in 1970) (Mathieson:61). Although a proportion of expatriate earnings are spent within the country, much of it is likely to be taken elsewhere.

There are other forms of leakages from tourism earnings. These include marketing, training of personnel overseas and import of materials for construction of tourism infrastructure. Another form of leakage results from what is known as demonstration effect. Particularly in less-developed countries, residents observe and learn lifestyles and consumption patterns of inbound tourists and seek to emulate them. This generates a change in consumption patterns resulting in higher propensity to import consumer items. Such a phenomenon has been observed in Canary Islands and Fiji (Bull:135).

Higher leakages have contributed to tourism's failure in eliminating large balance of payment deficits. According to Matheison (pp62); *"the existence of high leakages may mean that tourism, in its present form, is doing less well than it might to reduce balance of payments problems in the developing world."*

2.3 Inflation

The inflationary consequences of tourism can arise in several ways. A sharp increase in demand for goods and services will occur where there is rapid growth in the number of tourists. The economy may be unable to respond quickly enough to meet the increased demand thus causing price inflation of goods.

Where there is a disparity between income levels of tourists and host populaion, retailers can increase the profit margins by catering for tourists and by increasing prices on goods and services. Local residents will thus ahve to pay more for their goods.

Property prices in particular may rise very quickly because of developers seeking land for tourism development, tourists wanting to buy holiday homes and expatriate tourism employees looking for rented or permanent accommodation.

Property price inflation has been observed in places such as Spain, Wales, Denmark, the Caribbean and Hawaii (Bull:136). In Graubunden, Switzerland, areas with a high proportion of holiday homes had property price increases of 43 per cent between 1967-1973 compared to 8 per cent increase in areas which had no holiday homes (Pearce:213).

A vigorous hotel building programme can cause rises in construction costs and therefore effect the price of homes for residents. In the late sixties, rpaid tourist development in Malta disrupted the domestic property market and inflated house prices beyond the reach of first-time buyers (Oglethorpe). In general however it is difficult to seperate out tourism-induced effects from general inflation.

Price inflation can be damaging to the tourism industry itself. In Seychelles, for example, with the rise in prices that began in 1971, land speculators bought sites suitable for tourism development. When new hotels were badly needed in 1976, the landowners were asking uneconomic prices thus damaging the tourist industry. Inflation also had a damaging effect on tourism in Puerto Rico and Hawaii. (Latimer)

2.4 Economic diversification

Economic development often proves to be more difficult for small island economies. Because of their size, they have fewer physical and human resources available. Such economies tend to become dependent on a narrow range of economic activity sometimes displaying excessive dependence on one or two sectors. Over specialisation and size renders small economies vulnerable to minor fluctuations in world market conditions. The principle applies to tourism as well as to export-based manufacturing.

<u>Excessive dependence on tourism</u>

Smaller economies tend to become dependent on tourism. In Antigua and the Bahamas, tourism accounts for over 50 per cent of GNP (Bull:122) Such dependence on tourism is unhealthy as it leaves the economy vulnerable to unforeseen climatic or political changes.

In Jamaica, for example, overseas publicity about the growth of violence prior to the 1976 election had an adverse effect on the external perception of Jamaica. In 1976, a state of emergency lasting for one year was declared. (Bastin) Hotel occupancy rates fell and the number of hotel beds decreased by over 6 per cent per year in 1977 and 1978. Cyprus is another example of how political changes can effect tourism. According to Oglethorpe; *"Experience has shown that successful long-term development is dependent upon the evolution of a well diversified economic base - diversified small economies are by far the most stable."*

<u>Tourism as a means of diversification</u>

Where an economy is dependent on one economic activity, tourism development is a means of diversifying the economy. Mauritius, for example, had become over-dependent on sugar cane. Recommendations were made for tourism development to reduce the economy's dependence on one produce (Wilkinson).

2.5 Impacts on other sectors of the economy

In developing countries, the transformation from a traditional agricultural economy to a modern industrial economy requires enormous amounts of capital. Governments in developing countries are encouraged to turn to tourism as a means of acquiring the financial resources requred for industrialisation (Mathieson:41).

Another benefit derived from tourism to other sectors of the economy is the establishment of direct transport links with other countries. Some goods and services may be uneconomic to supply to a small domestic market. Increase in demand by tourism renders supply of the good or services financially feasible. For example, direct shipping links are established on lines which would otherwise have been uneconomic to cater for. Similarly, flights to and from a greater number of destinations can be provided.

Tourism may also be detrimental to other sectors particularly where there is a shortage of labour or capital. Resources devoted to tourism cannot be used in other sectors.

According to one infuential economist (Winpenny); *"The experience of many small countries is that tourism displaces existing sectors of the economy and makes it more difficult for new ones to develop.... The effect of* *tourism works through via its demand for labour, its pressure on wage levels, its boost to local inflation and its effect in keeping exchange rate for the economy higher than otherwise."*

In the British Virgin Islands, for example, there was a significant decline in national agricultural output. This was attributed to a redeployment of the bulk of farm labour in tourism and to banks giving credit to businessmen rather than farmers (Pearce:211).

Some authors challenge the above line of argument and note that redeployment of farm labour is not due to tourism but to demands for higher standards of living.

In some cases tourism had a beneficial effect on agriculture. In Spain, for example, the greater demand for labour lead to modernisation of agriculture resulting in an increase in production for every agricultural worker (Pearce:212). Also in some countries, tourism has halted and even reversed population decline in marginal agricultural areas. This led to increased demand and hence increased farm profits. (Mathieson:86)

PART III - EMPLOYMENT GENERATION

Tourism-generated employment can be classified into: (de Kadt)

- Direct employment resulting from sale of goods and services to the tourist such as hotels, restaurants and transport operators.
- Indirect employment stimulated by tourists' expenditures in activities that supply goods and services to tourism firms example manufacturing industires and wholesale distribution.
- Employment generated by capital investment in tourism such as construction.

3.1 Direct Employment

Compared to many other industries, tourism requires unskilled labour in the initial stages of development. Hence, it is possible to absorb a proportion of the work-force from traditional sectors of the economy with minimum training. In the Mexican hotel industry, half the jobs were non-specialised (Mathieson). As the industry expands and develops, it becomes increasingly dependent on labour with higher skills. The number of workers employed per hotel bed varies according to size, standard of service and national wage levels.

In Tunisia and Malta, hotels employed around 0.4 persons per bed in 1979. The corresponding figure in East Africa and Seychelles was double. Research in the Caribbean suggests that larger hotels create more jobs possibly because large hotels can attract off-season convention and conference business. Moreover, smaller hotels rely on family labour which are often not counted as employees thus distorting statistics (de Kadt)

Different accommodation types have different employee per bed ratio; for example the employee to bed ratio in self-catering apartments is negligible compared to the ratio in a five star hotel. Hence an increase in tourist beds does not necessarily mean a commensurate increase in employment opportunities. Critics point out that much of tourism employment is seasonal and part-time. In Greece, about half employees work for only part of the year. Tourism employment is characterised by low status and low pay.

3.2 Indirect Employment

Tourism can generate a considerable indirect employment in agriculture, food processing, handicrafts, transport and distribution and light manufacturing industries. In Tunisia for every hotel employee there were three or four persons whose employment was indirectly generated by tourism. (de Kadt) The extent of indirect employment generated in agriculture depends on many factors including local potential for food production, price of imports and efficiency of distribution.

3.3 Investment-related employment

Tourism development creates jobs in the construction and capital industries. In tourism, for each new hotel bed a total of 2.7 man years of employment are needed for construction and fittings (furniture and utilities) (de Kadt)

Rapid tourism development will increase employment in the construction sector substantially. Once the building boom is over, the country will be faced with a serious dilemma; either it accepts the resulting unemployment or seek to maintain high levels of investment in construction to sustain construction jobs.

Small economies are most likely to be hard hit by excessively rapid development. In Seychelles the number of construction workers rose form 1,500 in March 1970 to 4,000 in May 1971. The figure stayed at that level and then dropped to 2,750 in 1975. (de Kadt:41) Evidently such sharp changes in employment in one sector are bound to send ripples throughout the economy; the smaller the country the more damaging the ripples.

PART IV - ROLE OF NATIONAL GOVERNMENTS

The role of government in tourism is two fold. Firstly, governments are responsible for the general health of the economy and hence seek to maximise financial benefits from tourism activity. In many island economies governments find themselves unable to do because of limited control of the tourist industry. Secondly, tourism activities impinge on government revenues and expenditure.

4.1 Control of tourism sector

Reasons for loss of control

Substantial sectors of tourism is controlled from the outside rather than the destination's government. The reason for this are several:

(i) Structure of the tourist industry

Many tourists visiting small islands do so by purchasing an inclusive tour. Inclusive tour charters consist of a package including trasnport, accommodation and often associated activities and utilise chartered flights. Holidays offered on such a basis are usually cheaper than those which are arranged independently, with transport and accommodation being booked separately.

Over the years, as competition increased and profit margins become progressively smaller, survival of operators depended on handling a larger volume of traffic. Several major tour wholesalers began to emerge. By the late 1970s the top six tour operators accounted for over 75 per cent of the UK package tourist market (Pearce 1987). This results in small island tourist destinations relying on a relatively small number of tour operators to maintain good levels of tourist flows. This weakens the bargaining position of the destination country.

Major tour operators have increasingly become involved in all sectors and stages from the market (retail outlets) through the transport sectors (control of an airline) to the destination (ownership and control of hotels). The objective is to keep prices down, ensure access to seats and beds and maintain control over quality. In the UK, Brittania and Monarch airlines are wholly owned by Thomson and Cosmos tour operators (Pearce 1987). This phenomenon, known as vertical integration, has resulted in increasingly larger sectors of the tourism industry being owned or controlled by large multinational companies.

(ii) Limited resources

Less-developed countries often lack the financial resources and the know-how and hence rely on multinational enterprises to set up operation. The more rapid tourism occurs the more likely it is initiated and controlled from outside.

To perform marketing, many small economies have been forced to rely on overseas tour operators because of the expense involved in penetrating international tourism markets (Oglethorpe).

(iii) Competition between accommodation suppliers

Accommodation owners in destination countries are in a weak bargaining position. The service they provide namely accommodation in a sunny resort is also provided by countless other owners within their country and in other tourist resorts. Tour operators can easily transfer a portion of their customers from one destination to another without effecting sales.

In an effort to promote tourism, governments often encourage further hotel building but this may do more harm than good. An increase in room capacity will weaken further the bargaining position of hotel operators and owners of accommodation enabling tour operators to secure very low prices. This effectively shifts control away from local enterprise and national government to the external agency.

Effects of loss of control

If multinationals develop a strong position in relation to a host economy, they can dictate the form of future development and investment. Governments are put in the difficult position of either accepting to invest as required by the multinationals or loose a substantial part of the tourist business. Such expenditure may well result in governments subsidising the inbound tourist out of tax-payers money.

The interests of an island economy do not necessarily coincide with those of the tour companies whose primary motivation is profit. Major policy decisions by tour operators can have negative effects on the island's tourist sector and hence on the economy as a whole.

Regaining control

In recognising the need for greater control of the sector, many countries are faced with a dilemma. National governments have to be careful not to alienate the overseas enterprise upon which the bulk of the tourism sector depends.

To gain increased control of the tourist sector, the Maltese government established a state airline in 1974; Air Malta. The new airline has since taken a share of charter flights and is presently the only airline providing a scheduled service between Malta and Britain. Moreover, Air Malta has taken a majority share holding in several package-tour companies (Oglethorpe).

Bermuda is attempting to restrict large-scale tourism despite pressures from multinational agencies and local interests. It has placed a moratorium on the development of new hotel and restricted the number of cruise ships in port to two at a time. Most small island states do not have sufficient economic and political strength to stand up to multinational in order to protect their interest (Wilkilson).

4.2 Impact of tourism on government finances

Expenditure on Infrastructure

Very little infrastructure is solely for tourism. Roads, utilities and airports generally supply residents as well as visitors. In some cases, extensive use of a facility by tourists necessitates major investment by renewal or expansion of such a facility. Malta, for example, has recently completed a new air terminal because the existing terminal could not cope with the number of visitors.

Over the years water production in Malta has been put under severe strain because of high levels of tourism flows. During the summer months of the early eighties, the system could not cope with demand and cuts in mains water supply were frequent. This caused dissatisfaction amongst tourists many of whom are unlikely to return. Moreover, overpumping of the water aquifer caused permanent damage to the water table.

Since then, government has invested heavily in reverse osmosis plants to ensure water production could cope with demand throughout the year.

In providing facilities and infrastructure, government may be subsidising the tourist out of tax-payers money. In some countries, the price of consumption of utilities does not reflect production costs. This results in a subsidy to the tourist unless tourist establishments are charged at a higher rate; one that reflects true production costs.

Moreover, tourist-related investment in infrastructure is targeted to meet peak summer demands. Substantial financial resources are tied up in facilities which are underutilised for most of the year. Hence, for peak periods government incurs a marginal cost per tourist which is disproportionately larger then the marginal benefit derived to the economy from the tourist.

Incentives for tourism development

National governments may adopt a policy of support for tourism development as a means of generating income to the economy. This is particularly important where tourism is in the development stage. Government spending in tourism development can take a variety of forms including grants and subsidies, long term low-interest loans, tax exemptions, preferential terms for sale of state land and financing training. Government assistance reduces the cost of development such that productivity of an investment proposal is sufficiently enhanced to make it viable. Governments attempt to direct spending in areas where multiplier effects are perceived to be highest (Bull:204).

There are two problems with public expenditure in commercial tourism support. Firstly, it may be supporting enterprises whose contribution to the overall balance of payment is limited and where resources used may have reaped greater benefit in other sectors of the economy. Secondly, tourist will benefit from lower prices of tourism facilities and hence public funding is used to subsidise the tourist rather than the supplier.

Marketing Expenditure

Another area of government expenditure is for marketing normally through a National Tourist Organisation. Activities of NTOs include market research, public relations and advertising. The aim is to enhance the image of national tourist product and hence increase the number of tourists to a destination.

Financial benefits to governments from tourism

National governments reap various financial benefits from tourism activity. Taxes on goods and services such as accommodation, meals, car rentals and fuel excise is one source of income.

Effective collection of tax on profit from accommodation may be difficult. By receiving payment in foreign bank accounts, owners can declare low profits and hence pay low levels of taxation.

Other financial benefits to governments include tax on income of tourism workers and reduced social service expenditure (such as unemployment benefits). Many governments are shareholders or own outright tourism facilities such as national airlines and hotels.

CONCLUSION

The assumption that tourism's impact on national economies is always positive should be discarded. There are many examples of tourism being beneficial but there may be instances where the disbenefits outweight the benefits.

Evaluation of tourism solely on economic factors is insufficient. Environmental and social issues are just as important and may, in some case, be of greater relevance than economic issues.

Effective tourism policy making can only be made if there is an awareness of the issues involved. The purpose of this paper is to highlight economic issues with particular reference to national economies of small island states.

Appendix A

Comparison between tourism income multipliers for large economies and small island economies.

LARGE ECONOMIES	
Turkey	1.96
United Kingdom	1.73
Republic of Ireland	1.72
Sri Lanka	1.59
Egypt	1.23
SMALL ISLAND ECONOMIES	
Jamaica	1.23
Dominica	1.20
Cyprus	1.14
Bermuda	1.03
Hong Kong	1.02
Indian Ocean Islands	0.95 - 1.03
Hawaii	0.90 - 1.30
Mauritas	0.96
Singapore	0.94
Antigua	0.88
Bahamas	0.78
Fiji	0.69
Cayman Islands	0.65
British Virgin Islands	0.58

Sources: Archer 1982 and Fletcher 1989
Note: Figures should be treated with caution as different methodologies may have been used and the values were calculated as different points in time.

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