THE IMPLEMENTATION OF THE GATS AND ITS IMPACT UPON TOURISM DEVELOPMENT: A CASE STUDY OF KOREA

MISOON LEE

December 2002

Volume 1

A dissertation submitted in part-fulfilment of the requirements of Bournemouth University for the award of the Degree of Doctor of Philosophy

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ABSTRACT

The research is aimed to examine the implementation of the GATS and its impact upon tourism development, particularly in Korea. The GATS (General Agreement on Trade in Services) agreement has been implemented in order to liberalise World Trade in services. In this respect, the research examines the performance of GATT to see how successful GATT has been in securing and fostering world trade in manufacturing industry and then moves on to examine the implementation of GATS and, by drawing upon findings from other trading agreements (such as the NAFTA and EU) estimate the likely impacts that such agreements will have on tourism services and the manner in which they are delivered.

The GATS agreement is a long-term undertaking in which major trading countries are likely to become members. GATS sets up a legal and operational framework for the liberalisation of international trade in tourism as well as other services. The principle of GATS is the liberalisation of exchange of services and it is adapted from the GATT (General Agreement on Tariff and Trade). The GATS has been established as part of the multilateral trade negotiations and introduced new rules for services to complete overhaul of the GATT trade system. The rapid growth of tourism is the product of liberalisation which has been the hallmark of economic policy throughout the world, during the past decade. The UNCTAD report (1999) states that both globalisation and liberalisation have increased the potential for international trade in goods and services to become an unprecedented engine of growth and an important mechanism for integrating countries into the global economy. However, the GATS has many implications for tourism, particularly for tourism policymakers since it covers many different areas and sectors in tourism. Unlike other services, tourism is not a specific type of service, but a mixture of different services consumed by tourists. Therefore, it is essential to understand the rules and the principles of GATS as applied to tourism sectors in international trade.

The overall aims of the study are:

1. To examine the factors that influence world trade in goods and services.
2. To examine the influences that GATS is likely to have on the scope and magnitude of world trade in services.

3. To determine how GATS impacts on tourism development in developing countries and act as a catalyst to enhance the development of developing countries.
4. To examine what are the likely effects of GATS upon tourism development and delivery in Korea.

Since one of the research objectives is to examine what is the likely effect of GATS upon tourism development and delivery in Korea, the case study was a useful technique. In particular, the case study seemed an appropriate strategy to answer the research question because the research area is relatively new. Therefore, descriptive research design was adopted for this particular study. Moreover, the research adopted an explanatory research design, in order to investigate relationships by giving answers to problems and hypotheses. Through explanatory research, this study seeks to explore aspects of tourism development as a result of liberalisation and globalisation in Korea. In particular, this study investigates specified areas such as: how will GATS help future tourism development in Korea? Why are there different perceptions of GATS between the private and public sector? How do government policies and regulations affect future tourism development? by using interviews and questionnaires. For this study, the semi-structured interviews were used and questionnaires were designed to gather information about the impacts of GATS on tourism development in Korea before conducting the survey, but it failed to obtain the necessary information.

It is hoped that these findings enhance an understanding of the role of international trade in services particularly tourism industry, which may assist national and international tourism policy makers to consider the complexities and difficulties of understanding the rules of multilateral trade agreements (such as GATS) not only to develop tourism but also to develop other service sectors, especially in developing countries.

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LIST OF ABBREVIATIONS

AAPA: Association of Asia-Pacific Airlines.

AFAS: ASEAN Framework Agreement.

AFTA: ASEAN Free Trade Area.

ANOVA: One Way Analysis of Variance.

APEC: Asia-Pacific Economic Cooperation.

ASEAN: Association of Southeast Asian Nations.

ATC: Agreement on Textiles and Clothing.

CAP: Common Agriculture Policy.

CBD: Convention on Biological Diversity.

CDMA: Code Division Multiple Access.

CER: Austria-New Zealand Closer Economic Relations Trade Agreement.

CET: Common External Tariff.

CRS: Computer Reservation System.

CSD: Commission on Sustainable Development.

CUSTA: Canada-US Free Trade Agreement.

DMZ: De-Militarised Zone.

DSM: Dispute Settlement Mechanism.

EAP: East Asia and Pacific

EC: European Community.

ECOSOC: Economic and Social Committee.

ECSC: European Coal and Steel Community.

EEA: European Economic Area.

EEC: European Economic Community.

EFTA: European Free Trade Association.

EU: European Union.

FA: Factor Analysis.

FDI: Foreign Direct Investment.

FTA: Free Trade Area.

GATS: General Agreement on Trade in Services.

GATT: General Agreement on Tariffs and Trade.

GDP: Gross Domestic Product.

GDS: Global Distribution Systems.

GNP: Gross National Product.

IATA: International Air Transport Association.

ICAO: International Civil Aviation Organisation.

IIE: Institute for International Economics.

ILO: International Labour Organisation.

IMF: International Monetary Fund.

IT: International Technology.

ITO: International Trade Organisation.

IUOTO: International Union for Official Tourism Organisations.

KATA: Korea Association of Travel Agents.

KISC: Korea Investment Service Centre.

KITA: Korea International Trade Association.

KNTC: Korea National Tourism Corporation.

KNTO: Korean National Tourism Organisation.

KOTI: Korea Transport Institute.

KOTRA: Korea Trade Investment Promotion Agency.

KRW: Korean Won.

KTRI: Korean Tourism Research Institute.

LDCs: Least-Developed Countries.

M&A: Mergers and Acquisitions.

MFA: Multifibre Agreement.

MFN: Most Favoured Nation.

MNE: Multinational Enterprise.

MOT: Ministry of Tourism.

NAFTA: North American Free Trade Agreement.

NBFIs: Nonbank Financial Intermediaries.

NICs: Newly Industrialising Countries.

NTBs: Non-Tariff Barriers.

NTOs: National Tourist Offices.

OECD: Organisation for Economic Cooperation and Development.

OEEC: Organisation for European Economic Cooperation.

OPEC: Organisation of the Petroleum Exporting Countries.

PATA: Pacific-Asia Travel Association.

PCA: Principal Components Analysis.

R&D: Research and Development.

RBD: Recreational Business District.

RIAs: Regional Integration Arrangements.

SITA: Service Information and Technology Architecture.

SME: Small and Medium Enterprise.

SPSS: Statistical Package for the Social Sciences.

STI: Science, Technology and Industry.

TBA: Travel Business Analyst.

TCR: Trans-China Railway.

TNCs: Transnational Corporations.

TRIMs: Agreement on Trade-Related Investment Measures.

TRIPs: Intellectual Property Rights.

TSA: Tourism Satellite Account.

TSR: Trans-Siberia Railway.

TTRs: Travel and Tourism Related Services.

TWA: Trans World Airlines.

UN: United Nations.

UNCTAD: United Nations Conference on Trade and Development.

UNIDO: United Nations Industrial Development Organisation.

UR: Uruguay Round.

VAY: Visit ASEAN Millennium Year.

VERs: Voluntary Export Restraints.

WDS: World Distribution Systems.

WTO/OMT: World Tourism Organisation.

WTO: World Trade Organisation.

WTTC: World Travel and Tourism Council.

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엄마의 사랑과 충고 진심으로 감사드립니다.

CHAPTER ONE:
INTRODUCTION

1.1 BACKGROUND TO THE STUDY

In view of the increasing significance of trade liberalisation in services, international trade in services was given a higher priority on the trade-policy agenda towards the end of the Tokyo Round (1973-1979) of the GATT. The United States in particular was calling for multilateral negotiations to liberalise services markets, in the interest of its expanding services industry. This was rejected by most developing countries, because of fears relating to the negative repercussions they perceived with respect to their development. It was not until the Uruguay Round of multilateral trade negotiations, which began in 1986, that trade in services became an integral element of the talks. In the course of the negotiations, however, the industrial countries came to realise that they themselves would have difficulties with a broad liberalisation of their services markets. Therefore, they revised their ambitious ideas. Subsequently, the developing countries fought successfully for a flexible liberalisation concept that would enable them to adapt their commitments to suit their respective economic possibilities and development interests. As a result, the Uruguay Round produced the General Agreement on Trade in Services (GATS). GATS, rather like the GATT that was created in 1948 for world trade in goods, sets out the first multilateral framework rules for trade in services and for international investment in the sector (Barth, 1999).

With respect to international trade in services, tourism is one of the biggest and fastest-growing sectors in the global economy and has significant economic, developmental and environmental effects, both positive and negative. If undertaken responsibly, tourism can be a positive force for sustainable development; if unplanned, it can be socially, culturally and economically disruptive. Tourism as a sector is far more liberalised than any other GATS sector. In order to generate much needed foreign exchange revenues, 120 member countries have made commitments to facilitate market access and foreign direct investment in tourism. While GATS provides a framework for tourism services that have already been liberalised in most countries, governments are nonetheless engaged in a process leading to further binding and irreversible commitments with potentially significant implications for tourism development. In this respect, multilateral trade agreements such as GATS are important in the tourism industry. The WTO (World Trade Organisation) General Agreement on Trade in Services (GATS) sets a framework for future liberalisation of services trade. It develops rules and disciplines that apply both to specific sectors (e.g. tourism, transport, energy) and the modes of supply of the services rendered (e.g. cross-border, commercial presence in another country). The objective is to open up the services market and prevent WTO member governments from changing their domestic regulations to introduce new barriers to entry into these specific sectors and modes (WTO, 1999[d]). In February 2000, WTO members entered into a new round of multilateral negotiations on services, mandated by GATS. While countries have sovereign authority to regulate their domestic markets, the purpose of trade negotiations in services is to remove so-called 'unnecessary' regulations, to facilitate domestic and foreign business and thereby increase trade and investment in services (Perrin and Tuerk, 2001), which was expected to be more beneficial to developing countries. An important question is whether multilateralism is beneficial to world trade, especially developing countries or whether regionalism would be a better framework for broader international development.

Because of its links with other parts of the economy, the tourist industry is affected by many government regulations, few of which are aimed directly at the tourism sector. They include rules on the entry, departure and stay of foreign tourists, currency and tax rules, environmental and consumer protection rules. Also, because it is labour-intensive, the tourist industry is both the subject of labour and welfare legislation, e.g. restrictions on the employment of foreigners, and a focus for initiatives to boost employment. In contrast to most of the other, more regulated services, however, tourism is not affected by any significant specific trade barriers. Many countries have reduced restrictions on the entry of foreign tourists or the spending of its residents abroad. All countries are interested in the income from international tourism. Bureaucratic entry formalities or excessive costs or charges, e.g. visa or airport charges or government-imposed surcharges on hotel bills for foreign tourists, primarily damage the country's own tourism industry, and scarcely ever represent serious trade barriers for other countries. Almost all WTO countries, industrial and developing countries alike, have made liberalisation commitments for tourism in the Uruguay Round. Some developing countries, including Korea, have restricted the possibility for foreign companies to set up subsidiaries or acquire shareholdings to local companies, and have limited access to computerised reservation systems. In general, however, the conditions for market access in international tourism are very liberal compared with many other sectors. Therefore, it is essential to measure the level of trade liberalisation and analyse the benefits and problems of GATS in member countries in order to understand how trade in tourism changes under multilateral trade agreements.

However, there still exist fundamental problems in the agreement associated with the tourism sector, which are as follows:

- It can be seen as being a threat to sovereignty. GATS may restrict what governments can and cannot do to regulate and control the way services are provided in their countries. It severely limits the kinds of rules governments can impose on companies that provide important services, for example, rules that protect the interests of society and the environment.
- It may be a threat to public services. GATS is likely to be used to achieve the whole or partial privatisation of vital public services. The agreement includes predominantly public services, such as healthcare, education, water, energy and postal services, in its scope. The agreement views all services as commercial opportunities to be exploited by business. Private companies are already making inroads into many public services around the world, and the GATS will provide a boost to that process. With more and more vital services provided on a commercial basis, it may be the poor and vulnerable in society who will lose out. The reason why some services are publicly provided is to guarantee that everyone's basic needs are met. Public schools make sure everyone is educated, national health services make sure everyone gets basic healthcare and so on, regardless of whether or not they can afford it.
- It is being driven by big business. Multinational corporations have been instrumental in lobbying for GATS, and have played a central role in writing the

original agreement. They continue to have enormous influence over the direction of the current negotiations, ensuring that the final agreement will operate in their interests.

- It is irreversible. The fact that GATS could have such sweeping social and environmental impacts is particularly worrying given that the agreement is effectively irreversible.
- It is currently being expanded. The original GATS, agreed in 1994, is full of mistakes made by governments who did not fully understand this extraordinarily complex and technical agreement properly. There is currently insufficient data on the impact and implications of trade in services. Major aspects of the agreement are ambiguous and untested. Yet new negotiations were launched in February 2000 to expand the agreement enormously.

1.2 RESEARCH QUESTIONS

The research question is to examine the implementation of the GATS and its impact upon tourism development, especially in Korea. Furthermore, influences that the GATS is likely to have on the scope and magnitude of world trade in services and tourism development in developing countries under the multilateral trade agreements, are examined. The research framework used will enable an examination of the different effects of GATS upon tourism development and delivery in Korea. For this study, interviewing and questionnaire techniques were used in order to answer the research questions. The questions were divided into five different "dimensions" for both the private and public sector in Korea as follows:

- To recognise problems relating to liberalisation and globalisation of the tourism industry in Korea.
- To identify the level of awareness of the GATS within the industry.
- To discover the degree of general knowledge and information that people who work in the public sector have about the GATS.
- To understand the Korean government's rules and policies toward the GATS.
- To derive expected and possible outcomes of the GATS.

1.3 PURPOSE OF THE STUDY

The purpose of this study is to enhance the understanding of the role of multilateral trade agreements and their impacts in the context of the tourism industry. It is important to reveal the complexities that underlie the fundamental structures and concepts of trade agreements in order to identify to what extent multilateral trade agreements facilitate tourism development in developing countries.

The objectives of the research may be set out as follows:

1. To examine the factors that influence world trade in goods and services. This is carried out within the framework of similarities and differences of international trade in goods and services. In this respect, issues relating to trade regulations, restrictions, protectionism under the concept of trade liberalisation and globalisation are examined.

2. To examine the influences that GATS is likely to have on the scope and magnitude of world trade in services. The GATS agreement has been implemented in order to liberalise world trade in services. This research examines the performance of GATT to see how successful it has been in securing and fostering world trade in goods. The research then moves on to examine the implementation of GATS and, by drawing upon findings from other multilateral trading agreements (such as the GATT and EU), to estimate the likely impacts that such agreements will have on tourism services and the manner in which they are delivered in services.

3. To determine how GATS impacts on tourism development in developing countries. The preamble to the GATS states that the general goal is to establish a multilateral framework of principles and rules for trade in services with a view to expanding such trade under conditions of transparency and progressive liberalisation. This may promote the economic growth of all trading partners and act as a catalyst to enhance the development of developing countries. The agreement expresses the desire to facilitate the increasing participation of

developing countries in trade in services and the expansion of their service exports including, *inter alia*, through the strengthening of their domestic services capacity and its efficiency and competitiveness. The preamble clearly recognises the rights of all parties to regulate the supply of services within their territories. It takes particular account of the serious difficulty of the least-developed countries in view of their special economic situation and their development, trade and financial needs.

The effect of GATS and its significance depends upon a variety of factors, including the extent to which the GATS is adhered to and the economic structure of a country together with its pattern of international trade in goods and services. Each layer of influence will be explored and indicators will be developed to identify the key factors of influence.

4. To examine what are the likely effects of GATS upon tourism development and delivery in Korea. The research analyses the growing importance of the tourism sector in Korea and identifies the country specific features implicit in the GATS. The case study in Korea attempts to provide some insight to a GATS "ON" GATS "OFF" situation in Korea. In this way it will be possible to not only examine the way in which the GATS has altered the development of industries in Korea but also point to future changes that may be expected. A detailed analysis will focus upon the tourist services provided and the way in which these services are delivered and developed.

1.4 HYPOTHESIS

An important consideration in the formulation of a research problem is the construction of hypotheses. The importance of hypotheses lies in their ability to bring direction, specificity and focus to a research study (Kumar, 1999).

There are four hypotheses in this research:

- The government has opened its market to all foreign companies and suppliers in the Korean tourism industry (no restrictions on international trade in the tourism industry).
- GATS (General Agreement on Trade in Services) will not affect Korean economic growth and it will not bring about any changes in the tourism industry in Korea after 2000.
- GATS will have positive impacts on the Korean tourism industry.
- There are different perceptions and awareness of GATS between the public and private sector with respect to Korean tourism.

Formulating research objectives and hypotheses is an important step in the research process, in order to provide a study with specific aspects of a research problem to investigate. Questionnaires and interviews were designed on the basis of those research objectives and hypotheses.

1.5 METHODOLOGY AND RATIONALE

The research was carried out using both secondary and primary data in order to answer the research question. This is because some times information required is already available (secondary sources) and there are also times when the information must be collected from the survey (primary sources).

For this study, the secondary research involved, first, visiting the selected destination to collect the published statistics and any unpublished reports that may be accessible. These data provide a databank from which further analysis can be made, and are combined with the primary data. Secondly, the published and unpublished research that has been undertaken relating to international trade and GATS are collected and assimilated in order to establish where these studies may provide information to assist in the construction of a general framework for trade liberalisation. Finally additional information was extracted from reports published in newspapers and magazines and the Internet.

In addition, several methods can be used to collect primary data. The choice of a method depends on the purpose of the study, the resources available and the skills of the researcher. There are three common types of data collection using primary sources: observation, interview and questionnaire. This research involved all three data collection types. The interview questionnaires were developed as one of the researchers' main techniques in accordance with the characteristics of the research since the use of interviews was the most appropriate method to collect required data for this study because the valid information depends upon the value of contact with key players in the field who can give privileged information.

The interviews took place from December 1999 to June 2000 in the cities of Seoul, Busan, Kyongju and Jeju, Korea. As the topic of the research revolves around the tourism industry, a wide array of managers and owners from government organisations and practitioners (in hotels, restaurants and travel agents) involved directly or indirectly with such an issue were selected:

- **Government organisations and local governments:** 15 interviews from KNTO, KTRI and Ministry of Culture and Tourism in Seoul, Local governments in Busan, Daegu, Kyongju and Jeju.
- **Hotels:** 50 interviews with managers and directors from 3, 4 and 5 star hotels in Seoul, Busan, Kyongju and Jeju.
- **Restaurants:** 40 interviews with managers and owners from foreign and Korean-branded restaurants from Seoul, Busan, Kyongju and Jeju.
- **Travel agents:** 50 interviews with managers and owners from inbound, outbound and inbound and outbound specialists from Seoul, Busan, Kyongju and Jeju.

In respect of sample size, the nature of the research topic suggested that a large sample could be substitutes by a smaller one that was stratified and designed to provide accurate and reliable information from each respondent. It was important to separate sample groups from the public sector and those from the private sector, since one of the research hypotheses was focused on identifying different perceptions and awareness of GATS between the public and private sector in Korean tourism. In addition, identifying different perceptions and attitudes towards the movement of liberalisation under the GATS in Korean tourism between sub-groups such as hotels, restaurants and travel agencies in the private sector was also important. Due to differences between the two main groups of the public and private sector, different sampling methods were used to obtain a representative sample from each group. Non-probability sampling was used for the selection of government organisation officials. The sampling procedure used was a mix of purposive and snowball sampling. Although the researcher selected 22 government officials from 19 different government organisations in the Korean tourism industry including 16 local government and 3 central government organisations, only 15 interviews were possible (including 6 from local governments; 2 from KNTO; 5 from KTRI; 2 from Ministry of Culture and Tourism), which represents an overall response rate of 68%. Interviewees were either managers or directors of different departments who had enough knowledge about government policies and regulations in tourism.

However, for the private sector, three tourism sectors were targeted (hotels, restaurants and travel agents) to participate in the research, because this most effectively represents the Korean tourism industry according to the main criteria of location, size and characteristics of businesses. In terms of location, although cities and regions with a lower concentration of tourism enterprises would be useful, this was not possible because it would increase the costs as well as the duration of the survey since the researcher had to travel a long distance from one location to another. Therefore, four cities (Seoul, Busan, Kyongju and Jeju) were selected. First the two largest cities (Seoul and Busan) in Korea were selected because the concentration of tourism-related businesses is high compared with other areas. The other two destinations were chosen because they are subject to extensive tourism development.

Overall, the response rates are extremely high. This is mainly because the researcher conducted interviews rather than mail questionnaires and telephone interviews. From the pilot study, the researcher discovered that people tend to ignore postal questionnaires and refuse interview requests on the phone but the majority of people find it particularly difficult to say 'No' if they are asked to participate in a study in person. Hence, the researcher decided to conduct interviews rather than mail questionnaires in order to increase the response rate.

After the completion of data collection, the next step was to analyse them with different statistical techniques (such as cross-tabulation, t-test, ANOVA, multiple regression and factor analysis) after the data was carefully inputted into the Statistical Package for the Social Sciences (SPSS) programme.

1.6 CONTRIBUTION OF THE RESEARCH

The impact of trade agreements on the tourism industry is a very recent field of study. Interest in this area has increased since the WTO introduced the General Agreement on Trade in Services in 1994 because the agreement is the first and only set of multilateral rules covering international trade in services. Governments have negotiated the agreement, and it sets the framework within which firms and individuals can operate. An in-depth review of the research literature highlights the complexity of the rules and regulations of GATS as a phenomenon and suggests the need for a clarification of the issues related to multilateral trade agreements in services that addresses this complexity. In this respect, this study will provide a framework to develop the understanding of international trade with respect to various types of trade agreements in services, particularly the tourism sector.

The results of this research will be useful in additional number of ways:

- The findings may assist national and international tourism policy makers, to consider the complexities and difficulties of understanding the rules of multilateral trade agreements not only to develop tourism but also to develop other service sectors in developing countries.
- It will assist WTO member governments, especially developing countries, to further develop the tourism sector by identifying the benefits and problems of the implementation of GATS compared to regional trade agreements. Governments need to take the possible effects of the agreement into account in order to reform domestic regulations. In other words, the results may also help in the formulation of domestic tourism policies and regulations by considering the potential effects of multilateral trade agreements on the tourism industry. The research findings on

the perceptions of the private sector towards GATS can be a framework for the public sector to pursue more effective and efficient tourism development in Korea.

- Korea, and other developing countries which face similar economic and social conditions, can benefit by understanding better some of the key concepts of international trade in tourism and national development planning. Lessons might be learnt which could be incorporated into future planning for the tourism sector, incorporating its interdependent role with other sectors under the GATS.
- Finally, the study will provide valuable information on the general perceptions of tourism experts and professionals towards the GATS in developing countries to the WTO and other tourism-related international organisations in order to deliver an appropriate assistance to the member countries. The cross-regional and cross-sectoral framework of international tourism that is involved in multilateral trade agreements requires an interdisciplinary approach. This study will hopefully provide a richer and deeper contribution to the body of knowledge of tourism and encourage more research and discovery within the area.

1.7 LIMITATIONS OF THE STUDY

According to Goldman, *et al.* (1994), finding adequate data can be a major obstacle to research in the social sciences. A vast amount of data has been collected and published by governments and private organisations, but all too often these data do not provide the exact information needed. All data must be evaluated on the basis of how they were collected, what assumptions were made, what items were excluded, why they were collected, and by whom. The decision to collect new data often depends on the cost and time involved, compared to the quality and adaptability of existing data. The data available and the need to prepare new data can shape the type of analysis that is undertaken. Many researches face the problems relating to a lack of good quality data but where time and resources do not permit the collection of new or additional information. Such data deficiencies are often the most common cause of identified research limitations.

Since this research area is new, data availability and collection are the most obvious limitations. Secondary data on multilateral trade agreements related to tourism issues were extremely difficult to find, thus the research was mainly developed around the framework afforded by the more general economic theories of international trade. However, updated information about the GATS negotiations and other trade agreements in tourism were obtained in the form of articles and reports. The first and second year of the study were devoted to data collection, structuring and interpretation. Korean-related data were obtained from the tourism-related authorities and institutions in Korea (local, regional and national), which had to be cross-checked with the data published by the Korean government and other international organisations, in some cases, in order to determine its consistency and reliability.

One of the limitations of this research was related to the case study in Korea. The analysis mainly concentrated on the Korean tourism industry, which may not be generalised. However, the results could be applied to some other countries in possession of similar economic and political situations to Korea, especially after the financial crisis of 1997. The main issue for Korea is whether GATS can redress or exacerbate imbalances in services. Because the Korean market has been closed to foreign firms for a long period, the application of GATS may result in an influx of foreign companies that may be in excess of that experienced elsewhere. If countries are not prepared for these changes, they will suffer from an inflow of foreign goods and services. Therefore, it is important to know in advance what GATS will cover, how it will work between countries and what kinds of advantages and disadvantages it will bring.

Moreover, additional limitations were imposed on the primary data availability largely as a result of:

- The complex structure of governmental organisations involved in Korean tourism made it difficult to find the right personnel and departments responsible for data relating to this research, policy-making decisions and implementation of regulations in trade. In addition, many tourism experts in the public sector were reluctant to display any negative perceptions of policy and regulations-related issues in which the government has a role.

- One of the research limitations was a time constraint, as the research needs to be completed within a limited time period. The sheer logistics of interviewing senior government and private sector managers was a daunting process. It took more than six months to conduct interviews both with the public and private sector officials in Korea.
- The budget and time constraints limited the duration of the study and consequently the sample size.
- During the survey process, the most important limitation was perhaps, the degree of objectivity from respondents. Many researchers acknowledge the fact that some respondents do not give objective answers because the interviewees often attempt to impress the interviewer by providing socially and politically desirable answers, especially within the public sector respondents.
- The respondents asked the researcher to conduct the survey anonymously because they did not feel comfortable to express their true opinions about the topic with their personal details (such as names and contact numbers) exposed to readers.
- Finally, most of the information obtained for the study was presented in Korean, requiring translations to be made from Korean to English. In this case, it was necessary for the researcher to devote considerable effort to ensure that none of the underlying meaning of the original text was lost or misrepresented during the translation process.

1.8 OUTLINE OF THE THESIS

Having introduced the research objectives and their rationale, the structure of the thesis is divided into ten chapters.

Chapter one presents a general introduction to the thesis. This chapter provides the background to the study; research problems and objectives of the study; the contribution of research findings; the limitations of the study; and the structure of the thesis.

Chapter two provides a review of the relevant literature relating to international trade. This chapter illustrates the main issues (such as the benefits of economic integration and the effects of different market structures in trade between countries, especially between developing and developed countries) and discusses the basic theories of international trade including comparative and competitive advantages. The theories of comparative and competitive advantage are the most important basis of understanding international trade and framework for the developing further studies in the area. Many trade agreements are based on comparative advantages in each member country, particularly for the GATS. In particular, different theories of life cycle play an important role in international tourism, especially in tourism planning and development. The benefits and problems of international trade in connection with tourism are discussed since travel and tourism-related activities operate on the basis of the rules of international trade.

Chapter three discusses the importance of international trade in services under different types of trade agreements (regional and multilateral trade agreements). The main issues in world trade are the movement of liberalisation and globalisation in recent years. In this respect, trade liberalisation is reviewed by analysing the different types of trade obstacles and protectionism that affect services, especially within the tourism sector. Given that tourism services are mainly provided from one territory to another, it is necessary to illustrate the theoretical background regarding structural and operational differences of trade between countries in services. Finally, the impact of trade liberalisation in services is examined, which mainly focuses on developing countries since, in recent years, an interest has arisen in service liberalisation on the part of many developing countries.

Chapter four provides the WTO's legal ground rules and objectives for international trade and its implications on trade in services, including GATT and GATS and its importance to international trade, both in goods and services. The World Trade Organisation (WTO) is the only international body dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by 140 countries as estimated in 2000. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible and grows as a consequence. The WTO's main purpose is to promote trade liberalisation by removing obstacles and ensuring individuals, companies and governments know what the trade rules are around the world. The WTO attempts to achieve the latter through the transparency of its agreements. However, one of the major results of the Uruguay Round was the creation of General Agreement on Trade in Services (GATS). The membership of GATS is very broad. The current members of the GATS around 130 countries and well over 90 per cent of world trade in services is taking place between member countries. This demonstrates how important the GATS is in the promotion of globalisation and liberalisation in terms of trade in services, including travel and tourism-related services.

Chapter five examines the implications of GATS for tourism and its future development in both developed and developing countries. Tourism has become a major economic factor with strong world-wide growth, even in spite of events like September 11th 2001. In fact, if the barriers to world-wide travel were eliminated or reduced substantially, international trade in tourism services is likely to increase dramatically. Therefore, it may be considered important to introduce a multilateral trade agreement, such as GATS in order to reduce trade barriers in international trade in tourism. It is hoped that the GATS will lead to the gradual elimination of some barriers to tourism growth, such as restrictions of foreign personnel employment and the establishment of foreign companies. Hence, suppliers of travel and tourism-related services in the hotel, restaurant, transport, car rental, cultural and other travel related businesses could be expected to benefit directly from such an agreement. Now the General Agreement on Trade in Services (GATS) pays lip service to tourism in international trade. For the purpose of identifying commitments, GATS predictably singles out tourism and travel related services (TTRS), along with other service sectors equivalent to business, communication, construction, distribution, education, environment, finance, health, recreation, culture and sport, and transport. Within this classification, TTRS sub-sectors are not further developed unlike in the majority of other sectors.

Chapter six investigates the current market conditions for tourism in Korea and its future movement towards globalisation and liberalisation. It also examines these trends in relation to the implementation of GATS. Korea has, in the past, concentrated more on the development of the manufacturing industries rather than services, but the government has now realised the importance of services to the economy, especially tourism. The tourism industry in South Korea was a relatively late starter, but the government has attempted to develop tourism in relation with economic growth for the country through hosting mega-events. Mega-events such as the Seoul Olympic Games in 1988 and the World Cup in 2002 have helped not only to build up the infrastructure but also to enhance the country's image abroad and paved the way developing relationships with other countries. A number of factors are responsible for the rapid growth and development of the tourism industry in Korea, which include strong economic growth, increases in disposable income, breaking down political barriers, the reduction of travel restrictions, the liberalisation of air transport, etc. These factors are expected to accelerate the growth of tourism in Korea over the next decade. However, the Korean tourism industry needs to overcome several obstacles relating to trade restrictions, tourism policies and foreign investment if it is to be successful. Therefore, the enforcement of GATS is an important component in the development of the Korean tourism industry in the long run.

Chapter seven focuses on the methodology used throughout this research. It begins with an outline of the procedural flow of the research. The chapter then presents and discusses the research design. A review and discussion of previous methods and models used for different research in social sciences are followed by the rationale for the design of the questionnaires and interviews, and a description of the data analysis.

Chapter seven, first, examines the purpose of research (to discover answers to questions through the application of scientific procedures), which starts by gathering relevant and reliable information from secondary data sources. The research process starts with the question relating to the implications of GATS upon tourism development in Korea. The second part demonstrates that once the research problem has been formulated clearly enough to specify the types of information needed, the research design is arranged for the collection and analysis of data in a manner that aims to combine relevance to the research purpose. The third section focuses on the data collection methods employed. Both quantitative and qualitative methods are assessed, along with matters such as the design of the research instrument (questionnaire), sampling methods, focus groups and locations. The fourth section is focused on the analytical methods adopted for both quantitative and qualitative sets of data. The final section of the chapter presents the limitations and constraints of the research.

Chapter eight presents the general perceptions and characteristics of the public and private sectors in Korea according to its relevance and implications of the GATS, since the survey was conducted mainly in the public and private tourism sectors. As the literature suggests, both the private and public sector play an important role in different areas of the tourism industry. In addition, the government requires the private sector's expertise in order to effect future development in Korean tourism industry. Simultaneously, cooperation between the private and public sector is significant in achieving the liberalisation of tourism-related industries in Korea under the GATS.

The findings of the survey suggest that the general perceptions of the public sector towards GATS are moderately positive. Despite the possible problems from the enforcement of GATS, an important proportion of respondents in the public sector expected that becoming a member of the GATS would be beneficial to many developing countries in the long run with respect to both the economy and tourism development. In contrast to the public sector perceptions, the findings suggest that general perceptions of private enterprises in Korea towards GATS are negative in the short-run. The independence of thousands of small and medium size enterprises, including hotels and tour operators, is at risk because most local enterprises will be hardly able to compete with foreign companies. Moreover, respondents in the private sector suggest that as an outcome of globalisation and liberalisation, Korea may face the prospects of a significant growth in the level of leakages in foreign exchange earnings and a radical restructuring of travel and tourism could strike at the heart of the national economy.

Chapter nine discusses the results obtained from the in-depth analysis including ANOVA, regression and factor analysis to satisfy the research questions. Many studies have stated that groups are not necessarily homogeneous, and respondents' perceptions and attitudes towards GATS in the Korean tourism industry may differ mainly between private and public sector. In addition, the perceptions of the private sector towards the GATS are different from the public sector, to some extent, in the Korean tourism industry. Therefore, one-way ANOVA and t-tests were used to identify significant differences between the main sectors (private and public sector) and sub-sectors (hotels, restaurants, travel agents, and public sector). Moreover, factor analysis was used to identify the main factors to have an effect on the Korean tourism industry related to the GATS. From the result of t-test and ANOVA analysis, the perceptions of GATS between the public and private sector are different in the Korean tourism industry.

Although both the public and private sectors were optimistic about the forthcoming impacts of GATS on the tourism industry, the vast majority of participants in the public sector appeared to be more positive than the private sector. Furthermore, eight important factors were identified in relation to the implementation of GATS in Korean tourism. The results from the factor analysis show that the GATS is regarded as the main instrument to facilitate trade liberalisation in services by the tourism experts in Korea.

In chapter ten, the conclusions of this research are drawn out and discussed. The chapter discusses first the main factors of the study in relation to the findings. In this chapter, issues and problems of tourism in connection to the implementation of GATS in Korea are identified and recommendations proposed. The chapter then discusses the direction of future research. In relation to this last point, the chapter emphasises the need to explore the topics discussed in the research from a theoretical and operational development perspective of multilateral trade agreements in the tourism industry. The research revealed that the GATS has both positive and negative impacts and that the agreement is expected to provide more opportunities than threats to member countries. The effects of trade liberalisation will differ between countries depending on geographical factors, tourism facilities and resources and institutional policies relating to tourism. The type, characteristics and scope of trade agreements also serve to shape results.

CHAPTER TWO:

INTERNATIONAL TRADE

2.1 INTRODUCTION

The definition of 'international trade' in its simplest form is the exchange of goods and services between one country and another. This exchange takes place because of differences in costs of production between countries, and as a result, it increases the economic welfare of each country by widening the range of goods and services available for consumption. Ricardo (1817) introduced the law of comparative advantage for consumption. Differences in costs of production exist because countries are endowed with different resource bases. Countries differ as to the type and quantity of raw materials within their borders, their climate, the skill and the size of their labour force and their stock of physical capital.

This chapter examines the main issues (such as the benefits of economic integration and the effects of different market structures in trade between countries, especially between developing and developed countries) and then moves on to explore the theories of international trade including comparative and competitive advantages. The theories of comparative and competitive advantage are the most important basis for understanding international trade and provide the framework for taking the research in this area further. Many of the current trade agreements are based on comparative advantages in each member country, and this is particularly true for the GATS. Different theories of development life cycles play an important role in explaining the nature of international tourism, especially in tourism planning and development. Therefore, it is only prudent to examine the various benefits and problems of international trade in connection with tourism. Given the nature of international tourism, travel and tourism-related activities are subject to the more general rules of international trade.

2.2 TRADE AND INTERNATIONAL ECONOMIES

The classical economists condemned mercantilism for its advocacy of government control over trade in order to achieve export surpluses, and from the nineteenth to the early twentieth century, there was free trade. This philosophy gave way to the pressures of the impending global depression of the 1920s and in its place came the economic protectionism of the 1930s. However, the move towards freer international economic exchange was revived again with the General Agreement on Tariffs and Trade (GATT) in 1948. GATT has had some success in encouraging the flow of international trade by reducing tariffs on imports, culminating in the Tokyo Round of Trade Negotiations in 1974 and the initiation of the Uruguay Round of Trade Negotiations in 1986.

However, many trade restrictions still remain. In tandem with the onslaught of the WTO and GATT there has been an increase in the number of customs unions and free trade association to eliminate these trade restrictions. While these unions establish freer trade between member countries, they also tend to discriminate against those countries not included within the union.

Developing countries, in their attempt to achieve faster economic growth, are changing from being predominantly raw-material exporters to being exporters of finished, and semi-finished goods. Developed countries are taking advantage of technological specialisation, so that trade in high-value finished manufacture is increasing. However, in recent years, many developing countries are becoming more concerned with exporting services than they are with manufactured goods. In this respect, using the concepts of comparative and competitive advantage, tourism can be a significant sector to economic development in many countries, especially developing countries. The notion of comparative advantage is a static notion, based as it is on the relative supplies of the factors of production. Competition between different sources supplying the same service or product is then restricted to the productivity-related cheapness of the factors of production. Lower wages is one of the principal ways to compete in a comparative advantage framework in tourism. Advantage based on low cost labour, however, can always be undermined by cheaper labour elsewhere. This holds true even for tourism for which there are often more than one suppliers, and closely competing each other.

One way of responding to price competition is to reduce wages and environmental standards. In tourism, it is common to increase a company's competitiveness by adopting advanced managerial skills and technology to improve quality and increase productivity, product differentiation and thus advancing from comparative advantage, based on resource endowments, to what Michael Porter calls "competitive advantage", which can be achieved through innovation (1990, p.164). Of course, innovations can always be copied, so the only way to retain competitive advantage is to upgrade it. On the other hand, in tourism, competitive advantage can be derived from a number of factors. The key distinction between comparative advantage and competitive advantage is that the former is based upon resource endowments and explains why intra-industry trade takes place as well as why some countries specialise in particular forms of production. The latter tends to manifest itself in the market place as firms and countries compete with each other in the sales of specific goods and services. Other factors such as the stages of development of a country can also lead to competitive advantages such as those found in industrialised countries that have a competitive advantage as a result of a highly developed infrastructure used by residents as well as tourists.

Government policies need to be geared to developing the specific kinds of specialised assets and skills required. Universities and training institutions need to be geared to develop the specialised skills needed by the industry concerned. And, particularly in a situation where small and medium-sized firms dominate the market, this also requires that associations of firms take up some common, scale-sensitive activities, say, in areas of marketing and research. Successful competition at the global level thus requires some forms of cooperation at the domestic, cluster level.

In addition, international trade is said to have both a trade effect and re-distribution effect on the balance of payments of any country. In tourism, when taxes are present, it is likely that the cost to tourists of the goods and services they buy will differ from the cost to the economy of supplying them. If the taxes purely reflect the cost to the community of providing services to the tourist, there is no net benefit. To the extent they also involve revenue raising, however, they reflect net benefits. It could be expected that any net benefit to the economy from such taxes would be related to overall tourist expenditure.

There is scope for governments to increase national gains (and perhaps world gains) from foreign tourists by adopting appropriate taxation policies. It has been demonstrated that the scope for this is limited by relevant elasticities of demand and supply. As Tisdell (1983) has emphasised, the public good and common property characteristics of environmental resources (including cultural resources) make it difficult for nations to extract their full potential gains from foreign tourists. In the actual world, moreover, allowances must be made for differences in the nature of competition, the consequences of transnational companies involved in the tourist industry and international regulations affecting tourism. It is also possible that certain types of taxes which one country may levy on foreign tourists, such as an entry or departure tax, may lead to retaliation by another country. This in turn will impact on the net gains to the first country from foreign tourism, possibly resulting in net losses.

Profits are a more complicated matter. Profits in the tourism industry are very volatile and at any time can be positive or negative. As argued earlier, however, most sectors that comprise the tourism industry are fairly competitive and profits will tend to normal levels in the medium to long term. That is, profits in the long term tend to be sufficient to reward investors for the cost of capital and the degree of risk, but no more. It would be a mistake to suggest that any specific segment of the industry is, or is likely to be, inherently more profitable than other segments, or indeed other sectors of the economy operating in a competitive environment. Accordingly, profits earned in any industry operating in a competitive market should not be defined as net benefits to the economy, as they basically represent an adequate return on the cost of its capital. They are not above normal profits and, indeed, there is an opportunity cost in the provision of capital in instances in which it could be utilised to generate comparable or greater profits in other sectors of the economy.

When profits from foreign investments are repatriated, there is not a loss of benefits to the country, as the country is simply paying for the services of capital that it has borrowed. While it is true that such payments represent a leakage, in the sense that they are a payment for an imported service, they are not a loss of a benefit which could have been gained. If profits paid overseas are thought of as a leakage from the economy, then the initial payment for the facility should be thought of as an injection which would not have occurred except for the foreign investment. Over the longer term there is no overall leakage (Dwyer and Forsyth, 1994).

Tisdell has developed several models to analyse the possibilities for the extraction of rent from foreign tourists by a host country (Tisdell, 1983). He has also used these models to illustrate possible conflicts between alternative goals of governments, such as maximising government revenue, maximising net national gains and maximising (gross or net) foreign exchange earnings. He has expressed regret that such trade-off possibilities do not seem to have been considered seriously in tourism policy formulation by governments (Tisdell, 1993, p. 187).

The foreign exchange effect depends on the extent to which domestic resources are demanded by the foreign buyers. It is therefore directly related to total tourist expenditure less the associated direct and indirect leakages. For many developing countries some import leakage will be necessary if the tourism industry is to attract foreign business and attract foreign exchange. From the point of view of maximising net foreign exchange earnings, he suggests there is an optimal import leakage (falling between zero and unity) and that measures which restrict imports may actually reduce the net foreign exchange earnings of the industry (Tisdell, 1993, p. 178).

The terms of trade effect is also likely to be closely related to net domestic expenditure. When the demand increases for tourism resources in less than perfectly elastic supply (such as land near beaches), the price for those resources is bid up and tourists pay more to take advantage of them. On balance, the host country will gain from selling them at a higher price. The size of this benefit will depend on the elasticity of supply of various goods and services and the price sensitivity of demand. There may be some variations in the impact between different types of tourists and the facilities that they use (Tisdell, 1987, p. 23), but in the absence of specific information on such variations, it would be appropriate to assume a close correlation between net domestic expenditure and the terms of trade effect.

A large influx of foreign tourists can have significant consequences for the distribution of income. Gains from tourism may be unevenly distributed in the economy and domestic consumers and domestic tourists may suffer an economic loss in competition with foreign tourists (Tisdell, 1993, p. 180).

An increase in demand which drives this phenomenon may be due to one of or a combination of a range of non-price factors such as an increase in the disposable incomes of people in the destination country's overseas markets, changes in preferences between domestic and international holidays, or substitution away from other items of discretionary expenditure by households.

Nonetheless, in theoretical terms, tourism creates re-distribution effect on a regional and international basis. For example, for domestic tourism, tourists from cities tend to go to the countryside or visit different regions for their holidays, which may help to develop those regions. There spending whilst there transfers some wealth from the relatively wealthy cities to the more sparsely populated areas. In addition, for international tourism, the re-distribution effect also applies to a case when tourists from industrialised countries travel to tourism destinations in developing countries. However, the evidence does not support this view in practice. The vast majority of tourists travel between industrialised countries because advanced infrastructure, including transport, communication, etc., has already been established in those countries.

2.2.1 INTERNATIONAL ECONOMIC INTEGRATION

International economics encompasses the study of economic interdependence between nations. It analyses the flow of goods, services and payments between a nation and the rest of the world, the policies directed at regulating this flow and their effects on the nation's welfare. This economic interdependence between nations is affected by, and in turn influences, their political, social, cultural and military relations. In other words, the complex economic and political ties that bind nations into the world economy are being examined more closely than ever before since the world is full of discussions of international interdependence, and the fact that no country is an economic island has never been more obvious. Many nations feel that they are being increasingly affected by external events over which they exert little or no control and vice versa.

Economies can be examined by different layers or levels of operation and size. One such breakdown might include:

- The independent domestic unit where the family or extended family limits the circulation process.
- The town economy where there is some functional division of labour on an inter-industry basis, but where it remains largely absent at the intra-industry level.
- The national economy where following the advent of what is generally referred to as the Industrial Revolution, industrial specialisation takes place between regions and division of labour occurs within industries. Areas necessarily produce more of their specialised product than they can consume locally (Svennilson, 1960).
- The world economy where there is such a degree of 'industrial interdependence of nations' that few nations could no longer subsist, at least without radical and even violent rearrangement of their entire economic structures, and general economic decline, were their foreign trade totally stopped (Donaldson, 1928).

A similar approach can be applied to the study of the tourism industry since economic size and power are important parts of understanding tourism as illustrated in figure 2.1.

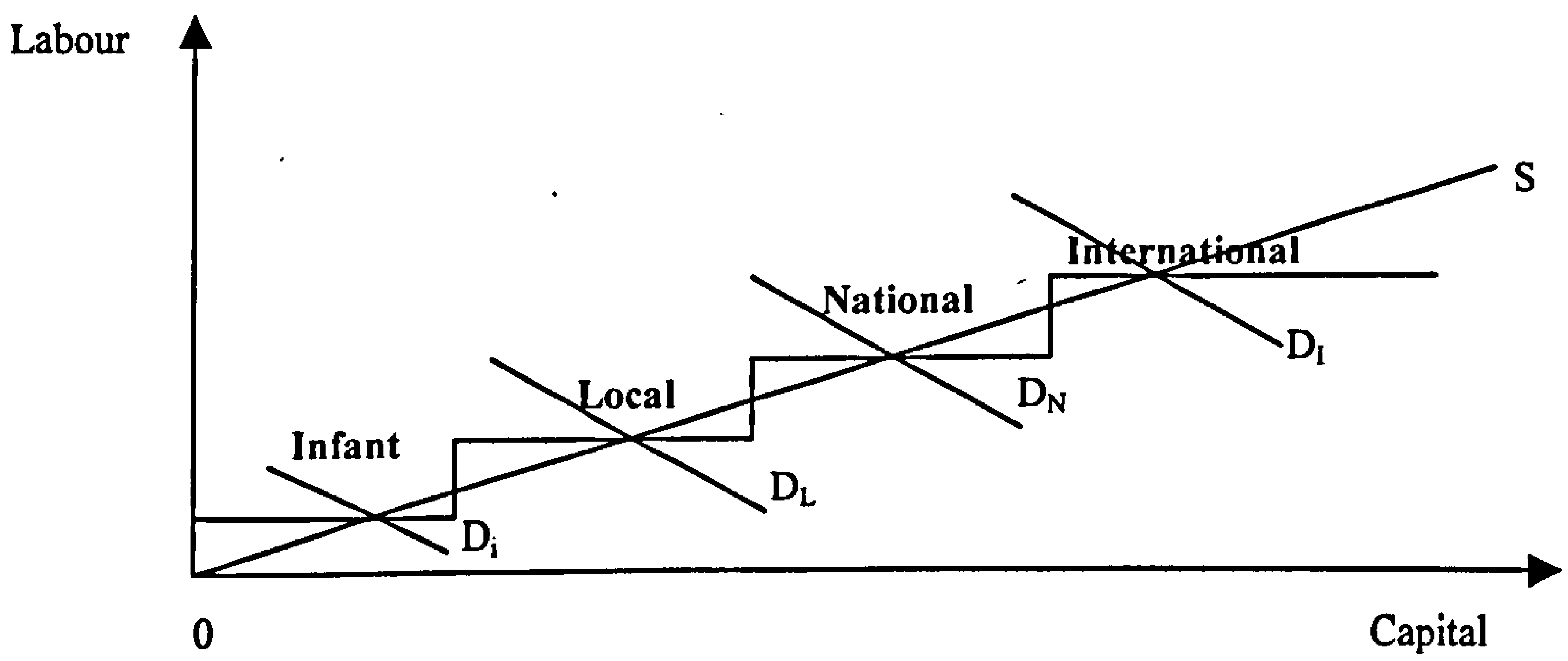


Figure 2.1 The different types of tourism

This may be interpreted as follows:

- The small, independent businesses where the family or extended family operates the business, such as a guesthouse, family hotel, or local restaurants.

- The small businesses and local parks that are based on a town or local area, which extends one step further from the family operating business. In such a market place the guesthouse might set up another branch, creating a 'local brand' which might be recognised among the local residents but not necessarily in national level.
- National tourism that includes museums, festivals and businesses which are well recognised in the country (national level). The business will operate between regions and division of labour occurs within industries. For example, a traditional local restaurant may become successful and expand nationally. Under such circumstances they might need to re-structure the management and it may be necessary for the business to specialise its output in order to achieve the success. It also involves national tourist attractions that attract the residents.
- World tourism that involves trading between countries. In this case, both suppliers and consumers need to move from country to country. It includes all international tourist destinations and multinational companies such as Hilton, Holiday-Inn, Thomson and MacDonalds. International trade is regarded as an important framework for understanding world tourism. In other words, international trade is a tool for providing and operating the necessary services under the terms of world tourism. The quality of the tourism product is a significant factor in order to achieve success in international tourism, thus major changes with respect to the distribution of labour, capital and the level of investment may be needed to improve the level of services. Under such circumstances, where the domestic product is not able to compete within an international arena, trade agreements between countries can become a major concern.

For different types of tourism development as shown in figure 2.1, capital and labour are important factors for tourism development. In fact, the quality/standards to be achieved at the different levels requires different types of resources – these may include skilled workers that are not available and need to be trained. A tourism product does not suddenly attract international tourists but it needs to be developed. Development takes place first as infant tourism and moves along to the local, national and international tourism, with increasing inputs of different resources including capital and labour. In fact, tourism development is depending on the level of consumers' demand. Increased demand may enforce further tourism development.

However, as shown in figure 2.1, there are different demand curves representing different types of tourism. For example, within infant tourism, some tourists may demand unspoiled beauty and adventures on their holiday (D_i) but other tourists might prefer to experience mass tourism (D_N or D_I) which is likely to appear in either national or international tourism. Thus, one may be subject to different demand curves (position and shape) at each level. In other words, there are different types and levels of demand exist in each stage. It is also important to derive the fact that tourist' demand in one stage affects the demand in others. For example, tourists' demand in local tourism influence the demand in national tourism since national tourism includes the concept of local tourism.

However, when it comes to 'the world economy' or 'world tourism', the boundaries between countries can be an obstacle to economic and tourism development. Because of these boundaries, the parameters of international trade are likely to differ from one country to another. The question is how can these boundaries be influenced so that they are not obstacles to world trade, and one possibility may be through international economic integration.

Boundaries can be varied as follows:

- Economic boundaries: Between the middle of the nineteenth century and the beginning of World War I improvements in transportation and communication encouraged increasing interregional and international economic. As regional trading agreements continue to grow, it becomes necessary for the economist to consider the influences of sources outside their political boundaries and move into the economic boundaries or zones. Using the same currency (for example, EU countries introduced Euro) can be regarded as one of economic boundaries. Many European countries joined EU to create a large economic bloc to compete with other countries or regions. In other words, economic boundaries can be explained as the perspective of spatial interaction and economic dependence and interdependence (exchange, trade, transportation, migration, information and capital flows, communication networks and the economic geography of the

Internet).

- Political boundaries: Trade liberalisation and political separatism go hand in hand. In a world of trade restrictions, large countries enjoy economic benefits because political boundaries determine the size of the market. In a world of free trade and global markets even relatively small cultural, linguistic or ethnic groups can benefit from forming small and homogeneous political jurisdictions that trade peacefully and are economically integrated with others. States and nations are defined by political boundaries. Although it is not easy to define political boundaries or border, national state has to have clearly defined political borders and therefore, a "definition" would state: "nation state is a state that has clearly defined political boundaries which coincide with national boundaries (or borders, meaning primarily culture). When a nation state is defined on terms of same culture, religion, language, ethnicity that can be very vague and problematic. Thus, when dealing with definition of a nation state one has to be careful, not only because definition can be extended to certain ways, as the political connotation can be added but because nation state is usually perceived differently by different people.

- Geographical and territorial boundaries: Territorial boundaries defined by natural resources such as landscapes and waters. Boundaries For many social scientists and policy-makers, clear and consistent boundaries are necessary (though rarely sufficient) conditions for social and intellectual progress. The World Bank and others have argued that clearly defined property rights and territorial boundaries are needed not only to bring about more productive patterns of resource use, but also to protect the environment and sustain production over time. Fixed territorial boundaries often operate to constrain people's movements, and restrict people's access to opportunities and resources. District and national boundaries all represent (and help to enforce) the right of some individuals or groups to exclude others, not only from economic resources and opportunities, but often from legal protection, civil rights and political expression as well.

Many governments face a dilemma with protectionism. Although many countries are trying to remove boundaries in world trade, governments still apply rules and regulations to protect domestic companies. Therefore, boundaries can be a tool to differentiate in supplying the services and products between boundaries. Although tourism is one of sectors that help the world to remove boundaries between countries, some of tourism-related services (such as travel insurance, acceptance of credit cards, etc) are only available in some places, not in others). In tourism, tourists exchange different currencies when they travel to different countries which can be called economic boundaries, except between EU countries. However, defining regions is important in tourism as regions can suggest interrelationships among variables, regions are more sophisticated in their definition, regions can be more clearly defined, a greater variety of problems may be addressed, regions can be understood or recognised better. "Understanding the nature of regions requires a flexible approach to the world. The criteria used to define and delimit regions can be as spatially precise as coastlines and political boundaries, or as spatially amorphous as suggesting the general location of people with allegiances to a particular professional athletic team or identifying a market area for distributing the recordings of a specific genre of music. Regions can be as small as a neighbourhood or as vast as a territorial expanse covering thousands of square miles [sic] in which the inhabitants speak the same language. They can be areas joining people in common cause or they can become areas for conflict, both internal and external" (Geography For Life, 1994). Regions defined by natural characteristics such as census tracts, ethnic neighbourhoods, telephone exchanges, transit routes, school districts or boards, trading blocs such as NAFTA members, National Parks, agricultural regions (Cotton belt), countries, cities. Since we tend to see tourist destinations in terms of regions, such as the Caribbean, or Mediterranean Europe, they are useful when analysing tourism patterns and issues. Tourists use regions to help them identify and understand destinations, to learn more about the culture and heritage, conflicts, hazards and issues in a place and to plan suitable equipment, clothing and behaviours for travel.

International economic integration is an area of international economics that has been growing in importance in the past several decades. The term itself has a rather short history; indeed, Machlup (1977) was unable to find a single instance of its use prior to 1942. Since then the term has been used at various times to refer to practically any area of international economics. By 1950, however, the term had been given a specific definition by economists specialising in international trade to denote a state of affairs or a process, which involves the amalgamation of separate economies into larger regions, and it is in this more limited sense that the term is used today. More specifically, international economic integration is concerned with the discriminatory removal of all trade impediments between the participating nations and with the establishment of certain elements of cooperation and coordination. The latter depends entirely on the form that integration takes.

Different forms of international integration can be envisaged and some have been implemented (El-Agraa, 1983):

- Free trade areas where the member nations remove all trade impediments among themselves but retain their freedom with regard to the determination of their policies from the outside world.
- Custom unions which are very similar to free trade areas except that member nations must conduct and pursue common external commercial relations, for instance, they must adopt common external tariffs on imports from non-participants as is the case in the European Community (EC).
- Common markets which are custom unions that also allow for free factor mobility across national member frontiers, for instance, capital, labour, enterprises should move unhindered between the participating countries.
- Complete economic unions, which are common markets that ask for complete unification of monetary and fiscal policies. An economic union is very difficult to achieve and maintain because it requires member countries to agree on an extremely wide range of issues, including micro and macroeconomic policies.
- Complete political integration where the participants become literally one nation, i.e. the central authority needed in not only controls monetary and fiscal policies but is also responsible to a central parliament with the sovereignty of a nation's government.

Each of these forms can be seen as being either stages along a single process towards complete unification or individual end states. It should also be noted that within each scheme there might be sectoral integration, in particular areas of the economy, such as agricultural integration between member nations.

Furthermore, international economic integration can be either positive or negative. The term 'negative integration' refers to the removal of impediments on trade between participating nations or to the elimination of any restrictions on the process of trade liberalisation. The term positive integration relates to the modification of existing instruments and institutions and, more importantly, to the creation of new ones so as to enable the market of the integrated area to function properly and efficiently and also to promote other broader policy aims of the union (Tinbergen, 1954).

According to El-Agraa (1983), the sectoral and free trade areas as discussed earlier are forms of international economic integration that require only 'negative integration', while other types are considered positive integration. However, in reality, all types of international economic integration have found it necessary to introduce some elements of positive integration. The most important vehicle of increased international economic integration after the Second World War was the General Agreement on Tariffs and Trade (GATT) set up in 1947. An important role was also played by certain regional trading organisations such as the European Community (EC) set up in 1958 and The European Free Trade Area (EFTA) set up in 1960.

Any forms of international economic integration are generally driven by political reasons even though the arguments popularly put forward in their favour are expressed in terms of economic gains. However, the gains from economic integration can be analysed on the basis of several economic theories as follows:

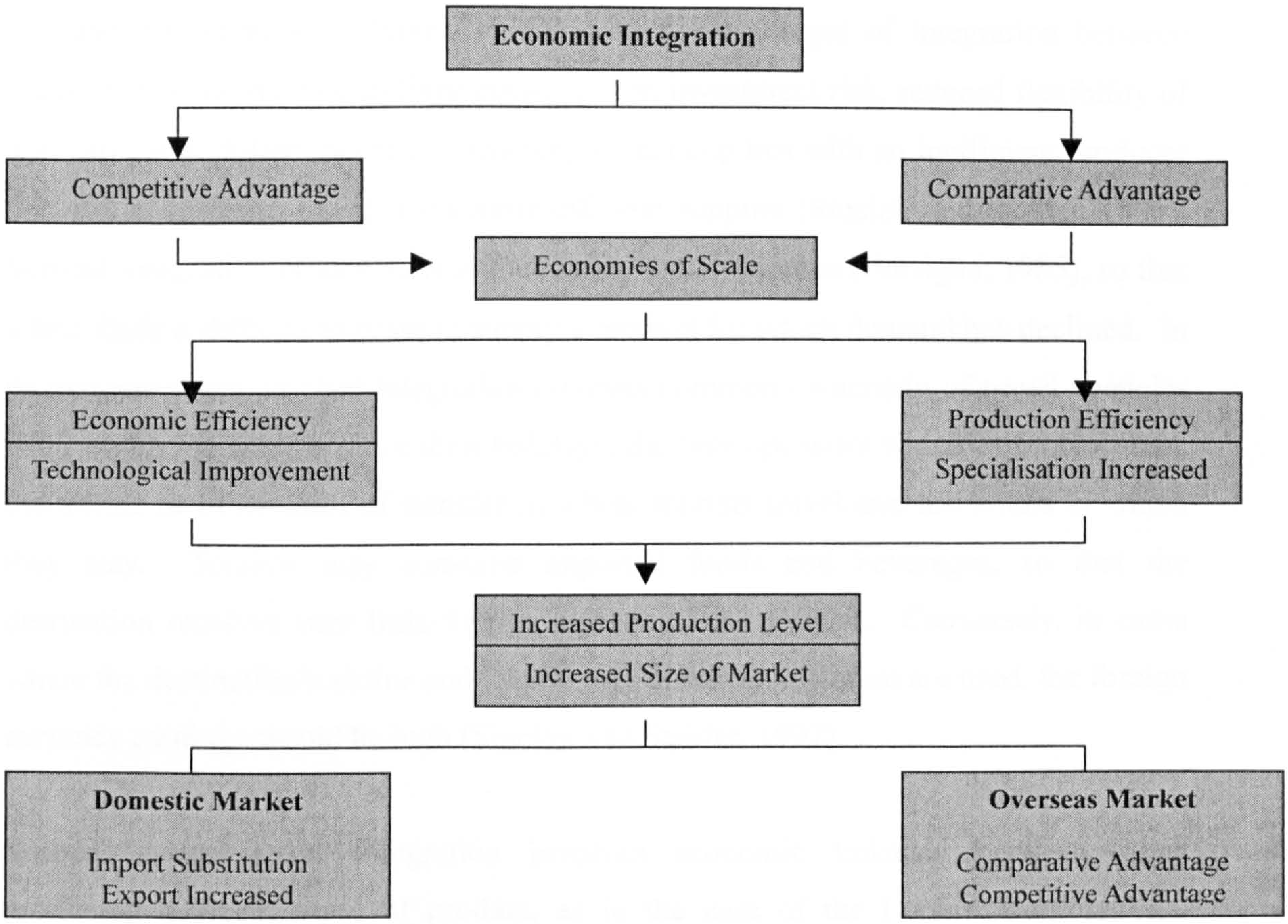


Figure 2.2 The gains from integration

Nevertheless, with respect to the economic integration between firms in the tourism industry, firms may respond to competition from domestic or foreign rivals by means of integration. There may be common ownership between firms or firms may have contractual links with each other with various intermediate arrangements between these positions such as management contracts or franchising. Three main types of integration occur between firms. First, vertical integration involves the co-ordination of production sequence, for example, Airtours' tour operations, Going places chain of travel agents and Airtours International Airline.

The advantages of this type of integration include the reduction of transaction costs (Coase, 1973; Buckley, 1987; Casson, 1987) and improved synchronisation of tourists' inter-country transportation, accommodation provision and entertainment (Bote Gómez *et al.*, 1989). It also facilitates information acquisition (Arrow, 1975), the provision of inputs at known prices (Oi and Hurter, 1965) and can reduce uncertainty about future demand (Carlton, 1979) as well as being used as a strategy to increase market power (Hymer, 1976). The disadvantages of integration between firms include an increase in fixed costs, foreign investment risk, reduced flexibility of operation and 'dulled incentive', whereby ownership ties with an inefficient producer dull the incentive to search for a more efficient supplier (Sinclair and Stabler, 1997). Vertical integration often results in the raising of exit barriers (Harrigan, 1985), so that a firm finds it difficult to cease to supply a product for which demand has declined. In its extreme cases, vertical integration involves common ownership of travel agencies from which tourists purchase their holidays, the tour operators which assemble them, the airline or other form of transfer in which tourists travel and the hotels in which they stay. Tourists may consume imported foods and beverages, so that the destination receives very little foreign currency from tourists. Conversely, in cases where the destination's airline and locally owned accommodation are used, the foreign currency earnings would be high (Sinclair and Stabler, 1997).

Second, conglomerate integration involves economic linkages between firms producing different types of product, as in the case of the Lonhro Corporation's ownership of international hotels or Thomson's tourism as well as printing and publishing activities.

Thirdly, horizontal integration consists of economic linkages between firms, which supply the same type of output, as in the case of international hotels chains such as America's Sheraton or Hong Kong and Shanghai hotels in which groups based on Hong Kong. This type of integration has been widespread in the tourism industry between firms within a country as well as across countries. Acquisitions and mergers have increased the degree of industrial concentration so that a smaller number of firms control a larger percentage of total supply.

The advantages of horizontal integration include increasing efficiency by means of economies of scale and increasing market power, enabling firms, possibly, to raise prices and profitability. Integration may be a means of increasing the firm's growth and market share, increasing barriers to entry, increasing the market valuation of the firm, obtaining easier access to finance (Prais, 1976), decreasing uncertainty and providing the firm with greater control over its environment (Newbould, 1970; Aaronovitch and Sawyer, 1975). It also operates as common ownership including joint reservations arrangements between airlines or management contracts with hotels (Sinclair and Vokes, 1992).

Multinational corporations within the international hotel sector have engaged in both horizontal integration in the form of foreign direct investment, leasing, management contracts, franchising and marketing agreements and vertical integration between hotels, tour operators, travel agents and airlines. Contractual arrangements between tourism firms play a significant role for the management. Firms in many developing countries have little knowledge of the contractual terms which prevail elsewhere. In contrast, firms from developed countries have notable informational and first-mover negotiating advantages, as in the case of tour operators' contracts with hoteliers in developing countries which demonstrates the importance of cross-country integration (Sinclair and Stabler, 1997).

2.2.2 THE CHANGING STRUCTURE OF WORLD TRADE

The period since the end of the Second World War has seen a rapid expansion of world trade. One of the main stimulants of this has been the willingness of countries to lower barriers on their trade with one another and to carry out trade according to an agreed set of rules. This liberalisation of trade brought an increase in the degree of economic integration between countries, which contributed to the fast growth in output. World output has grown at a faster rate than in any other period in history.

The factors that boost international trade and economic growth in the world are important in explaining the recent trade movements between countries:

1. **Technological Factors:** it affects world trade significantly, changing the way goods and services are traded between countries and the speed of transactions. Amongst all the technological developments, information technology and telecommunications have opened opportunities for trading goods and services between countries. In the tourism industry, the revolution in technology has changed the way of operating the whole process between countries or destinations. Developments in information technology are changing the way the tourism industry does business and will continue to do so. Technological changes in

electronic channels, such as real time on-line access and kiosks, will have a far-reaching impact on tourism, including marketing, consumer protection and information, education and employment. Demand for travel information is increasingly sophisticated and tourism industry employees need to learn how to use the technology in order to respond appropriately to a wide range of needs. Governments should pay particular attention to regulatory policy issues, especially with respect to consumer protection, for electronic transactions via the Internet. In the borderless world of cyberspace, information, security issues such as insecure payment methods, loss of personal data, and unreliable products are serious consumer concerns since these services are used increasingly in tourism. Information technology creates a demand for more skilled, but fewer, employees in the tourism industry. The issue of changes in the structure of employment induced by information technology is also a concern in the tourism industry. In addition, small and medium-sized enterprises (SMEs) can cope with emerging information technology and might no longer be disadvantaged compared to big companies. Moreover, the Computer Reservation System (CRS) in the airline industry is a good example of technological effects on international tourism. Global CRS and accounting systems provide advantages of low transaction costs. Computer reservation system (CRS) services contain information about air carriers' schedules, availability, fares and fare rules, through which reservations can be made or tickets may be issued which allow travel agencies, tour operators and hotels to provide more efficient services to their customers in any locations.

2. **Political Factors:** the political tension between Eastern and Western countries has been dramatically eased in recent years. The unification between West and East Germany inspired other countries to improve their political situation, particularly America and Russia. The 'cold war' was one of the factors to increase trade barriers between countries in international trade. China has opened their market to foreign countries, which obviously influences their recent rapid economic growth. These political movements encourage countries to join the WTO (World Trade Organisation), particularly for those countries, which were communist, including China, Slovakia and Russia.

3. **Socio-economic Factors:** Factors such as changes in customers' taste (from

domestic to international), demography, disposable income, transport infrastructure, currency exchange rate fluctuations and shifts in trading partners are influencing the patterns of trade and economic growth.

4. **Changes in Customers' Tastes:** The pattern or direction of trade can be changed as customers' taste or demand pattern changes. In Korea, consumers' tastes for purchasing goods and services have changed over time. They prefer to purchase foreign goods and foreign holidays as their disposable income increases. People want foreign goods and services because of quality but most of all, they want to experience new things that they could not afford before. Thus, changes in consumers' tastes lead to changes in international trade. Korea began to import more luxurious goods than export and also people desired to go abroad for their holiday rather than travelling within the country which led to increase in outbound tourism.

5. **Demographic Factors:** In 2000, there were more than 144 million Europeans aged between 35 and 45 years, a 16 % more than in 1985. The over 65 year old age group increased by more than 14 million people in the same period. The movement of growing senior population (over 60 years old) has occurred not only in Europe but most developed countries and some developing countries as medical technology improved throughout the 20th century. People of 35 to 54 years old generally enjoy the highest disposable income and this group is increasing at a faster rate than any other age group, thus providing a favourable situation for the future expansion of the industry. Nowadays, over 65s also have higher incomes and more free time. Furthermore, older travellers are more flexible with their time and can travel during off-peak periods, thus contributing to a longer tourism season.

6. **Market Segmentation Factors:** Total annual holiday periods are longer, the traditional week or two-week holiday is disappearing. Tourists are abandoning the concept of one long vacation and replacing it with several shorter breaks of one to three weeks spread over the year. This fragmentation and increase in the number of holidays have transformed the international market. New products are being created for each market segment to satisfy the demand for shorter breaks. As a

result, industrial and commercial strategies, adapted to the new conditions of the market, need to be developed and implemented.

7. **Changes in Disposable Income:** The level of disposable income has a strong relationship with international trade in goods and services. The changes in disposable income have an affect on all of the factors discussed above. Changes in holiday patterns, tastes and demands mainly depend upon individual income levels. A change in income can have any conceivable effect on demand, a rise in income may cause the demand for a product to rise, to fall or to remain unchanged. It is clear that as customers find their incomes increasing, they increase their demands for many goods and services. In developed countries, the demand for food and basic clothing dose not increase with income as much as the demand for other commodities. In most developed countries, demand is increasing most dramatically as incomes rise for durable goods and in some of these countries, demand for services, particularly for international tourism is rising more rapidly than the demand for durable goods as income rises. The responsiveness of demand for a commodity to changes in income is termed **income elasticity of demand**, and is defined as

$$Y^{e}_{D} = \frac{\text{percentage change in quantity demanded}}{\text{percentage change in income}}$$

For most goods and services, increases in income lead to increases in quantity demanded, and income elasticity is therefore positive. Normal goods and services have positive income elasticities and inferior goods and services have negative elasticities, which is explained in figure 2.3. For inferior goods and services, a rise in income is accompanied by a fall in quantity demanded. Thus, normal goods and services are much more common than inferior goods and services (Lipsey, 1989).

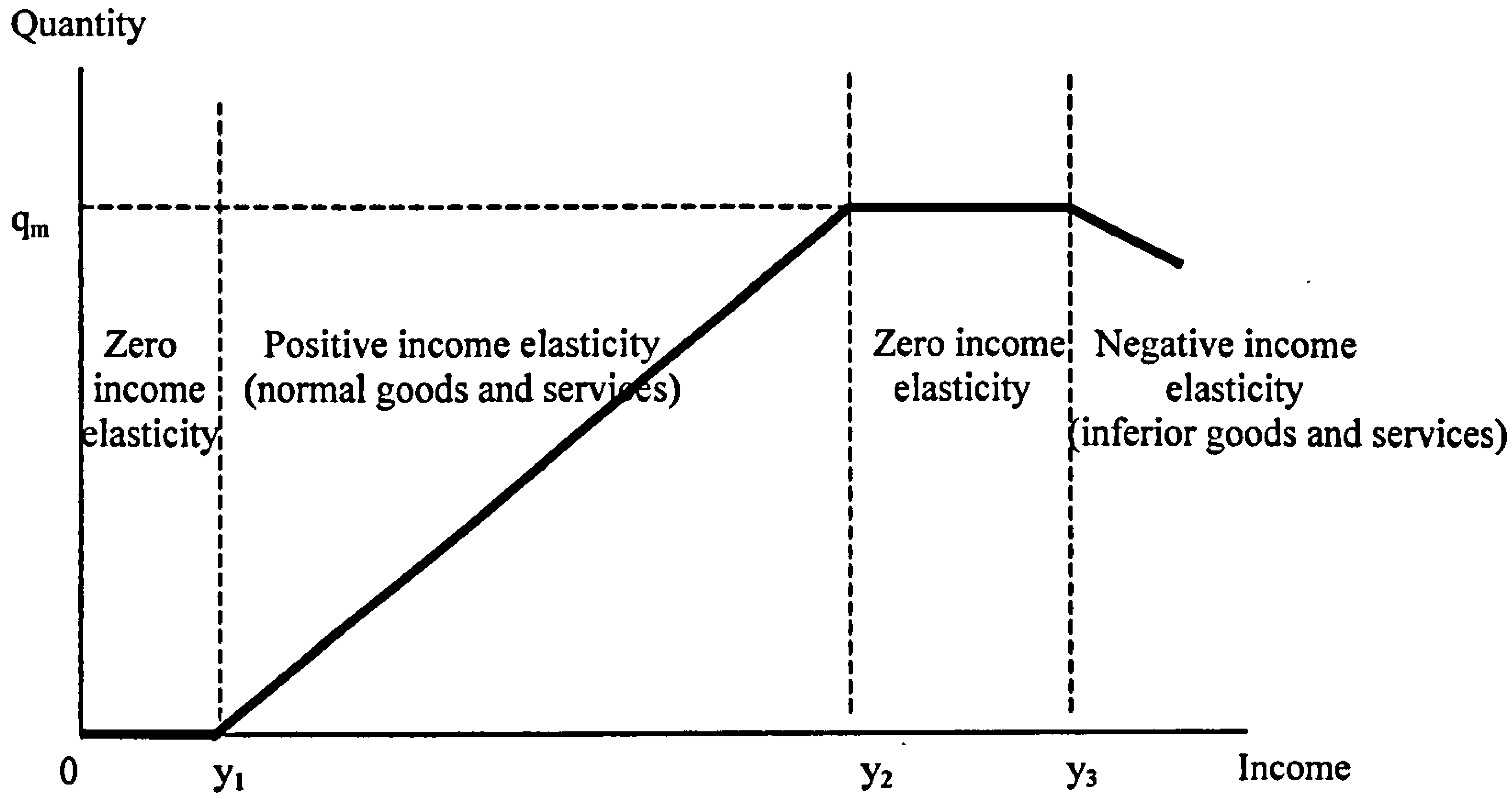


Figure 2.3 The relation between quantity demanded and income

Source: Lipsey, 1989.

No goods and services are demanded at incomes less than y_1, so incomes between 0 and y_1 income elasticity is zero. In this case, consumers cannot afford to purchase any holidays for neither domestic nor international holidays. Between incomes of y_1 and y_2, quantity demanded rises as income rises, making income elasticity positive. Most of commodities and services are regarded as 'normal goods'. As income increases, customers' afford to purchase both domestic and international tourism. Between incomes of y_2 and y_3, quantity demanded stays constant again zero. When the level of income reaches a certain amount, customers would keep their holiday routines, for example, most middle class income customers tend to have one holiday abroad and two at home. This pattern will not be changed although their income increases because they might spend extra income on purchasing something other than more holidays. However, the important point is that the demand for both international and domestic holidays will not increase but at the same time, it will not decrease. At incomes above y_3, increases in income cause reductions in quantity demanded, making income elasticity negative. In this case, customers enjoy international holidays or luxurious holidays because at this level of income, they are not interested in either local or national holidays, which are regarded as 'inferior goods'.

During the past two decades there has been a slow down in world economic growth and this has been paralleled by a return to protectionism by many leading trading countries. Countries have increasingly resorted to a variety of new devices to restrict imports and protect domestic producers. Tariffs remain low but non-tariff barriers have become increasingly important. As a result, the volume of trade has grown more slowly. This has contributed to slower output growth. Suffice it to say at this stage that countries have neglected the fact that there is a link between liberal trade and output growth.

However, growth rates are still quite high in comparison with other periods in history. Over the past fifty years, world trade has grown at an even faster rate than world output. This has been one of the main causes of the growth in output, the result of an increase in the degree of international specialisation, especially in the manufacturing industry and between industrialised economies. One of the reasons for the slowing down of economic growth in recent decades has been slower growth of the manufacturing sectors in the industrialised economies but the faster growth in services.

The rapid growth of world trade relative to world output has meant an increase in the degree of international economic integration. The world has become much more of an interdependent whole. In all the developed countries, the size of the trading sector as a proportion of national output has increased. Important changes have also taken place in the nature and pattern of world trade.

2.2.2.1 Changes of Trade Patterns in Different Regions

The rate of economic growth varies from region to region. The developed market economies enjoyed fast growth in the 1960s with GDP rising by 4.8 % a year and GDP per capita by 3.8 % a year. Of the major developed market economies, Japan had a very high rate of growth; GDP rose by 12.4 % a year and GDP per capita by 11.3 % a year. France also had a high rate of growth along with West Germany and the United States. The United Kingdom had the lowest rate of growth amongst developed countries.

In the 1970s the rate of growth fell in all the developed countries. GDP grew at a rate of 3.3 % a year and GDP per capita at a rata of 2.4 % a year. Japan was still the fastest-growing developed country and the United Kingdom the slowest growing.

Although there were signs that growth in the developed market economies was weakening as early as the late 1960s, the immediate cause of the slowdown was the oil crisis of 1973 to 1974. In the 1990s, the Asian Financial Crisis came at a time when certain weaknesses and imbalances in the global economy were prevalent. Before, the crisis, global growth depended on expansion in the United States and East Asia. In East Asia, the attempt to adjust exchange rates and reduce external deficits to sustain rapid growth had undesirable effects: it reduced the deficits but only by disrupting growth. The direct impact of the Asian crisis on global economic development was not significant in 1997, although growth in the East Asian countries dropped sharply in the last quarter of that year. Growth in world output increased slightly in 1997, to reach 3.2 %, while inflation remained low in most countries at levels not experienced since the 1950s.

Table 2.1 Exports and gross domestic product, 1980-2000

		Average Growth Rate		1980	1990	1995	1996	1997	1998	1999	2000
		1980-1990	1990-2000		(in billions of US dollars, unless otherwise specified)						
World											
	Volume of exports of goods (index, 1995=100)	4.5	6.8	47	73	100	106	117	122	127	140
	Real GDP Growth	3.4	3.2	2.3	2.5	3.6	4.1	4.1	2.6	3.4	4.7
	Exports/GDP			16.7	15.0	17.4	17.8	18.5	18.2	18.1	19.1
Advanced Economies											
	Volume of exports of goods (index, 1995=100)	5.3	6.6	44	74	100	105	117	121	127	140
	Real GDP Growth	3.2	2.7	1.2	2.9	2.7	3.2	3.4	2.4	3.2	4.2
	Exports/GDP			16.5	15.8	16.9	17.2	18.0	17.8	17.3	18.0
Developing Countries											
	Volume of exports of goods (index, 1995=100)	3.2	8.3	48	65	100	109	121	125	131	145
	Real GDP Growth	4.1	5.5	4.4	3.7	6.1	6.5	5.7	3.5	3.8	5.6
	Exports/GDP			20.7	15.8	18.5	18.8	19.2	18.2	19.9	21.8
Source: World Economic Outlook (WEO), 2001.											

For the past 50 years, trade has been a major driving force in economic growth, with global trade expansion far outstripping global GDP growth. In the 1990s alone, world trade grew at an annual average rate of 6.8 %, more than double world output growth of 3.2 % per year. For developing countries, this meant trade growth of 8.3 % per annum, contributing to real GDP growth of 5.5 % yearly, and boosting the export/GDP ratio from 16 % to nearly 22 % today. For Latin America, this meant trade growth of 10 % per annum, contributing to real GDP growth of 3.4 yearly, and boosting the export/GDP ratio from 10 % to nearly 15 %.

Table 2.2 Sectoral composition of GDP, selected years (%)

	Agriculture			Mining			Manufacturing			Services[b]			Others[c]		
Grouping[a]	1960	1970	1978	1960	1970	1978	1960	1970	1978	1960	1970	1978	1960	1970	1978
Developing countries by income group:															
Low (28)	51.5	43.3	39.6	2.6	3.0	3.4	5.7	8.6	9.9	35.5	39.2	40.9	4.7	5.9	6.2
Low middle (23)	39.2	32.9	31.5	5.0	6.7	5.4	9.9	11.9	12.9	39.9	42.8	43.7	6.0	5.8	6.5
Intermediate (20)	30.2	25.0	22.0	3.5	4.4	6.6	13.4	16.0	16.6	46.7	48.1	47.4	6.2	6.5	7.4
Upper middle (10)	17.3	12.5	10.0	7.8	7.5	10.5	15.6	17.9	18.5	51.5	54.1	52.6	7.8	7.9	8.4
High (8)	13.4	7.5	5.5	7.6	15.5	16.4	14.2	15.5	16.4	56.7	52.5	49.7	8.0	9.0	9.8
All countries by size and resource endowment															
Large countries (27)	28.2	22.8	20.0	3.5	3.7	4.7	19.4	20.8	20.6	43.0	45.5	47.0	5.8	7.2	7.8
Small countries with modest resources (52)	41.4	34.2	31.3	2.1	2.8	3.6	8.9	11.4	12.4	41.8	45.0	45.8	5.7	6.6	6.9
Small countries with ample resources (32)	18.6	13.6	12.6	7.6	10.0	10.7	17.4	19.0	18.0	47.7	48.5	49.2	8.7	8.9	9.5
OPECcountries (9)	29.7	22.1	12.7	12.2	21.4	30.4	8.8	10.2	9.6	42.5	39.8	36.6	6.8	6.5	10.6
Developing countries, total (89)	36.3	29.8	27.2	4.4	5.9	6.8	10.3	12.8	13.7	42.9	45.0	45.2	6.0	6.5	7.1
Developed market economies, total (22)	12.3	7.7	6.5	2.3	1.7	2.3	28.6	28.8	25.8	47.8	51.5	55.3	9.1	10.2	10.2

[a] The figure in Parentheses is the number of countries in the grouping.
[b] Including wholesale and retail trade, transport and communication, financing, insurance and real estate, community, social and personal services.
[c] Including construction, electricity, gas and water.
Source: UNIDO, 1982.

However, despite all these changes in world commodity output, the most important change has been the growth experienced by the services sector. The share of services in GDP rose from 47.8 % in 1960 to more than 60 % in 1990. The growth of services took place at the expense of agriculture and manufacturing. The agriculture sector shrank and the share of manufacturing sector has been roughly constant since 1960. In the 1970s, the share of manufacturing sector declined in developed countries, which led to talk about 'de-industrialisation' and the growth of the 'service economy'.

Table 2.3 shows that world exports of commercial services reached 1310 billion US dollars in 1997 and the tourism sector (430 billion US dollars) was one of the important sectors to increase world exports of commercial services. In 1995, the annual percentage change was the highest compared with other years in 1990s. The

Asian Financial Crisis might be the reason for reducing world exports from 1997.

Table 2.3 World exports of commercial services by category, 1990-97.

(Billion dollars and %)	(US$)	(%)					
	Value	Share		Annual percentage change			
	1997	1990	1997	1990-97	1995	1996	1997
All commercial services	1310	100.0	100.0	8	15	7	3
Transportation	320	28.4	24.4	5	13	2	2
Travel	430	33.1	32.8	7	15	7	1
Other commercial services	560	38.5	42.9	9	16	9	6

Note: Exports of transportation services are significantly under-reported.
Source: WTO (World Trade Organisation), 1998.

Among the service industries, tourism is one of the main sectors that influences world economic growth. In economic terms, international tourism receipts are classified as exports and international tourism expenditure as imports. For many countries, international tourism is an indispensable source of foreign currency earnings. According to the World Tourism Organisation (2000), tourism is one of the five top export categories for 83 % of countries and the main source of foreign currency for at least 38 % of them. In 1998, international tourism receipts accounted for around 8 % of total export earnings on goods and services in the world. International tourism was estimated as one of the largest international trading categories as total international tourism receipts were US$532 billion as shown in table 2.4.

Table 2.4 World export earnings, 1998

Sectors	US $ billion	%
Total export of services and goods	6,738	100.0
Tourism	532	7.9
International Tourism Receipts	441	6.5
International Fare Receipts	91	1.3
Automotive products	525	7.8
Chemicals	503	7.5
Food	443	6.6
Fuels	344	5.1
Computer and office equipment	399	5.9
Textiles and clothing	331	4.9
Telecommunications equipment	283	4.2
Mining products other than fuels	158	2.3
Iron and steel	141	2.1

Source: WTO, 1999.

In developing countries also, the services sector has increased in importance, but not as dramatically as in developed countries, which is consistent with the view that the demand for services is income-elastic and so increases with per capita income. However, there is not a perfect relationship between the share of services in GDP and the level of a country's per capita income. Thus the share of services in GDP is lower in high-income developing countries than in upper-middle-income developing countries. The growth in the services sector in developing countries has been largely at the expense of agriculture. This fell from 36.3 % of GDP in 1960 to 20 % in 1990. At the same time, the manufacturing sector increased in importance from 10.3 % in 1960 to 13.7 % in 1980. The growth in manufacturing was a trend, which was common to all developing countries. In the OPEC countries, however, manufacturing declined in importance after 1970 because of the increased mining, including oil production. It appears that the size of a country affects the size of the manufacturing sector.

The growth in world commodity output was exceptionally rapid between 1958 and 1974. Downturns in manufacturing occurred in 1954, 1958, 1975, 1982 and 1997. Over the course of the 1950s and 1960s, mining output grew faster than agriculture output but was slower than manufacturing. However, since 1970, mining output has grown more slowly than agriculture. Output fell sharply in 1975 and again in 1980. Indeed, since 1980, mining output has been in a depressed state, falling back to the level of 1976. Since 1970s, the rate of growth in services sector has rapidly increased, particularly for developing countries.

The growth of the manufacturing sector in developing countries has enabled them to increase their share of world manufacturing production. The developed countries have been experiencing a shift of resources towards services while developing countries have succeeded in increasing their share of world manufacturing output. In the early days, developed countries dominated the services sectors in world trade while developing countries concentrated on heavy industries, including iron and steel, glass and coal but more developing countries become interested in services sector, including financial, telecommunication and tourism sectors.

Moreover, the geographical composition of trade refers to the proportion of world trade, which is accounted for by different regions, or countries of the world. The main changes, which have taken place in the geographical composition of trade over the period since 1963. Until the 1970s over two-thirds of world trade is accounted for by developed countries. However, in the 1980s, the share of developed countries fell to 64 %. The main reason for this decline was the rise in the share of world trade accounted for by developing countries. It is notable that in the early 1940s, developed countries concentrated on seeking their trading partners in their regions or only with other developed countries but the movement of world trade changes from these regional basis to global basis for developed countries. Moreover, from 1980s, developing countries also began to concern about exporting to global basis, such as Hong Kong, South Korea and Taiwan but in recent years, these countries allow themselves to organise regional agreements or bilateral agreements in order to compete with developed countries and increase their share of world trade.

2.3 THEORETICAL APPROACHES TO INTERNATIONAL TRADE

"The theory of international trade shows that how, on the basis of differing analyses and explanations, various conclusions can be drawn relating to a particular problem. This awareness that there is no unique method of analysing a problem, that there is no one answer which is the answer should, it is hoped, contribute to a better understanding of the role of economic theory in policy formation and further studies" (Young, 1972, pp.1).

Young's statement encapsulates the aims and purposes of studying international trade theories. Understanding the theory of international trade provides the framework for developing further theories as the trends or structure of international trade change over time. International trade theory sees trade as deriving from international differences in unit production costs. Differences in costs of production exist because countries are differently endowed with the resources required. Countries differ as to the type and quantity of raw materials within their borders, their climate, the skill and size of their labour force and their stock of physical capital. Countries will tend to export those commodities whose production requires relatively more than other commodities of those resources of which it has most and the theories are recognised as "factors of production" and "Heckscher-Ohlin theory". By increasing the scope for the specialisation of labour and for achieving "economies of scale" by the enlargement of markets, there is a presumption that international trade should be free from restrictions. The classical economists condemned mercantilism for its advocacy of government control over trade in order to achieve export surpluses, and from the 19th to the early 20th century there was free trade. This philosophy gave place to the economic protectionism of the 1930s but it was revived again in the General Agreement on Tariffs and Trade in 1948 which has had some success in reducing tariffs on imports. However, many trade restrictions still remain.

2.3.1 HECKSHER- OHLIN THEORY OF TRADE

Although the principle of comparative advantage plays an important role in understanding the concept of international trade, it has weaknesses, for instance, it fails to explain why factor productivities differ between commodities and countries. The next major contribution was a model advanced, independently, by Heckscher (1919) and Ohlin (1933).

The background of the Heckscher-Ohlin theory comes from neo-classical economists to explain differences in comparative costs in terms of factor proportions. Different goods require different proportions of the various factors of production (land, labour, and capital) in their production. Some goods and services are land intensive, others labour intensive and others capital intensive. At the same time, different countries are endowed with different amounts of these factors. In countries well endowed with land, land is relatively cheap so that such countries will enjoy a comparative advantage in the production of land-intensive goods and services. When countries have a comparative advantage in labour-intensive goods and services, then the countries are well endowed with labour. Finally, in some countries, capital is relatively abundant and hence cheap and these countries will specialise in capital-intensive goods and services (Grimwade, 1989).

The model rests on the following assumptions:

1. There are two factors of production, two commodities and two countries.
2. There are no transportation costs or trade impediments.
3. Both product markets and factor markets are assumed to be perfectly competitive.

4. All products are homogenous, no product differentiations.
5. Each country faces identical production functions, that is the proportions of the various factors required to produce a certain good are the same in all countries.
6. Consumer preferences are assumed to be identical in all countries.
7. All factors of production are perfectly mobile within countries but immobile between countries.
8. There are no tariffs or other trade barriers.
9. All countries enjoy equal access to the same body of knowledge; any new knowledge about how to produce a certain product is instantly diffused internationally (El-Agraa, 1983; Grimwade, 1989).

Many of these assumptions are heroic and bare little relevance to the realities of international trade. However, the theory offers an important framework for further development in international trade. It is important to stress that differences in factor endowments refer to differences in relative, not absolute, endowments. A large country may well have the same factor proportions as a small country despite the fact that the absolute amount of her factors is much larger. These different factor endowments between countries on production possibility curves, which are the net result of the influence of these, two factors. Figure 2.4 shows a case between country A and country B. The pre-trade domestic production and consumption pattern is indicated by points D^A and D^B. Country A is the relatively capital abundant country while country B is relatively labour abundant.

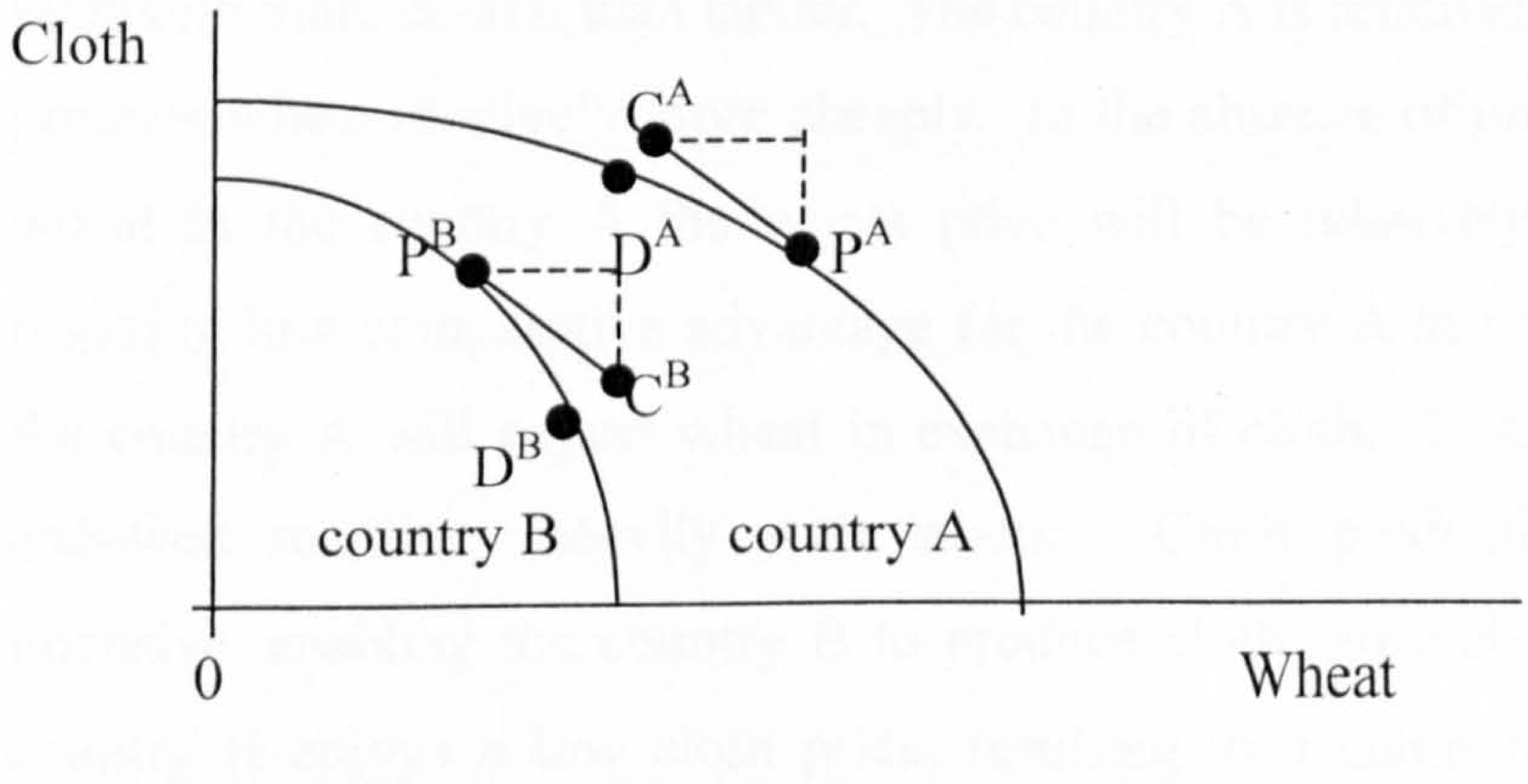


Figure 2.4 A case of two different productions between two countries

Source: Heller, 1973.

Figure 2.4 shows a possible set of international terms of trade. The points of tangency of the production possibility curves with the international terms of trade denote the optimal production pattern P^A and P^B. Two possible trade triangles are also shown in the figure, leading to the consumption points C^A and C^B. Given identical production functions but different factor endowments between countries, a country will tend to export the commodity that is relatively intensive in her relatively abundant factor (Heller, 1973).

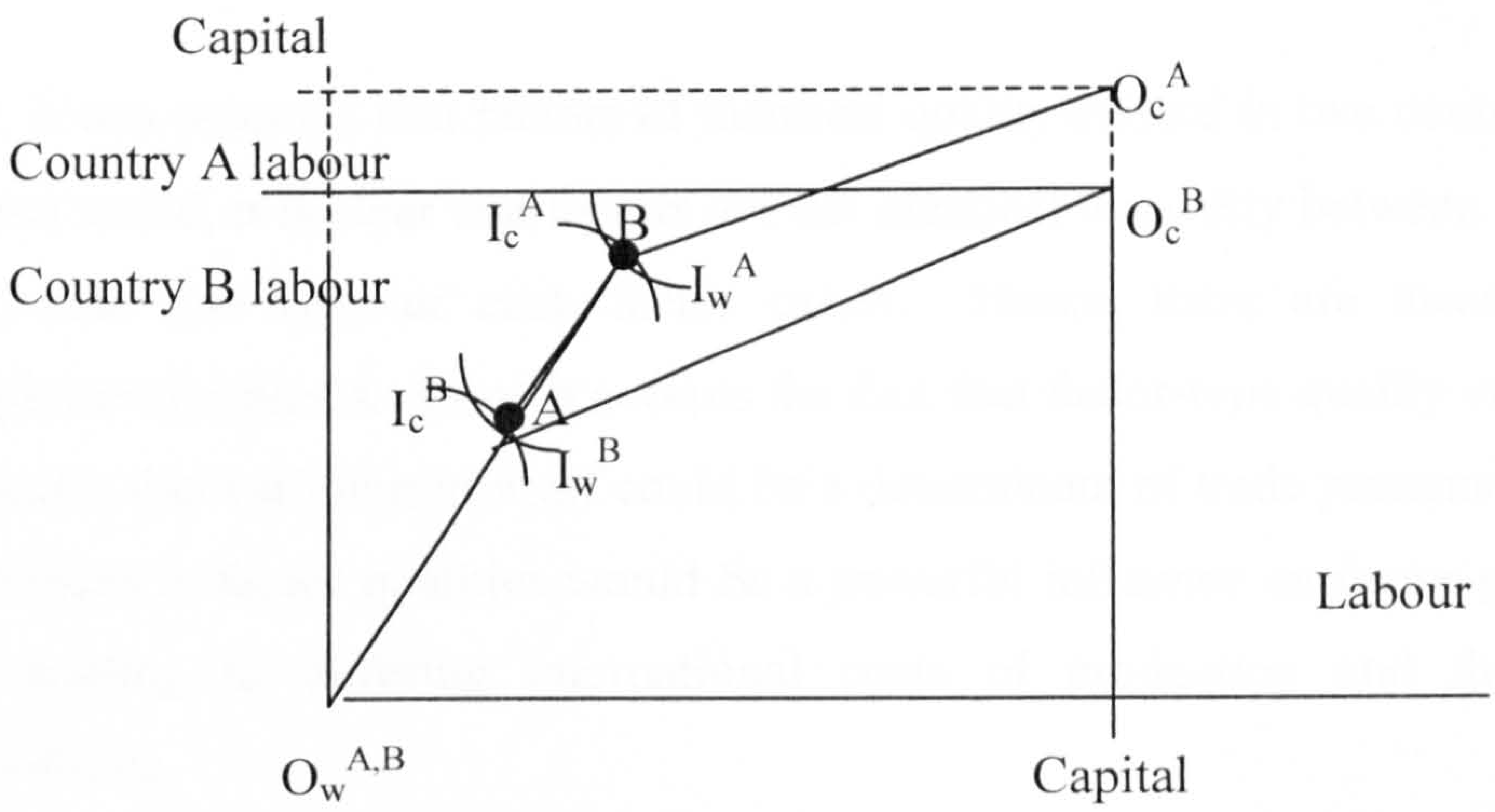


Figure 2.5 Different endowments in two different countries

Source: Begg, *et al.*, 1994.

Figure 2.5 shows differences between two productions of wheat and cloth. Although wheat production is relatively capital intensive, cloth production is relatively labour intensive. At each factor price ratio it can be seen that wheat production utilises relatively more capital than labour. The country A is relatively abundant in capital can produce wheat relatively more cheaply. In the absence of unusually high demand for wheat in the country A the wheat price will be relatively low in the country A, resulting in a comparative advantage for the country A in wheat production. Hence, the country A will export wheat in exchange of cloth. In contrast, the country B is endowed relatively heavily with labour. Cloth production is relatively labour intensive, enabling the country B to produce cloth more cheaply. Consequently the country B enjoys a low cloth price, resulting in a comparative advantage in cloth production (Begg, *et al.*, 1994).

2.3.1.1 Criticism of Heckscher-Ohlin Model

The model relies for its construction on a number of highly simplified and unrealistic assumptions, and it is precisely these assumptions that have been attacked by the critics of Heckscher and Ohlin. The main criticisms that have been made for the model are as follows (Young, 1972):

First, it was assumed that factors of identical quality existed in two countries. But, in the real world, it is clear that factors are not identical in quality between countries and more than one type of each factor exists. Hence, there are measurement and comparison problems. Once it accepts the fact that factor-type quality varies between countries, this variation in itself could be a determinant of trade patterns. In addition, differences in factor qualities would be a powerful influence on factor productivities, thus leading to differing international costs of production and therefore trade possibilities.

Second, Heckscher and Ohlin argued that relative factor prices would reflect exactly relative factor endowments. In other words, supply outweighs demand in the determination of factor prices in international trade. However, if demand factors are important in the determination of factor prices, then it is quite possible for a labour abundant country to export capital intensive commodities and services. This is so, because if the labour abundant country is such that the demand for labour is high enough, then the price of labour relative to capital will also be high and the factor price ratio will exceed the price ratio in the capital abundant country.

If demand is an important variable in the determination of relative factor prices, as it is in the real world, then other explanations of why trade takes place are possible – differing factor endowments become but one explanation among many.

Third, the model was based on the assumption of constant returns to scale. However, if a country starts trading, then its industry will have to produce for a bigger market consisting of domestic and foreign purchasers, which gives rise to the possibility of exploiting economies of large-scale production. Consequently, the prices of the goods purchased by these industries will be higher than actual cost, thus production costs are no longer a direct reflection of price. Also, if factor endowments are differed before trade but no comparative cost differences occurred, it is possible that if one of the countries were to specialise in the production of goods and services requiring its abundant factor, it could reap economies of scale and create comparative cost differences.

In summary, the assumptions for the Heckscher-Ohlin model are unrealistic. In the real world, trade does not just take place in perfectly competitive product and factor markets. There are differences in relative factor endowments, factor qualities and production techniques between countries. International trade also includes the situations with increasing returns to scale and more importantly with consumer demand preferences.

2.3.2 ECONOMIES OF SCALE

The major alternative theories of international trade use the existence of economies of large-scale production as a major departure. Economies of scale or increasing returns to scale exist if increasing expenditure on all inputs while input prices constant increase the output quantity by a larger percentage so that the average cost of producing each unit of output declines. For example, economies of scale exist if doubling all input amounts (labour and capital) more than doubles output. Economies of scale are often not easy to measure precisely, but they appear to be of some importance in many industries (Pugel and Lindert, 2000).

There are two different types of economies of scale, they can be internal to each firm, or they can be external to the individual firm. Scale economies are internal if the expansion of the size of the firm itself is the basis for the decline in its average cost. Larger firms may be able to reduce average cost through greater use of specialisation by their employees, use of more specialised facilities including machines, or the spreading or fixed costs over more units of output.

External economies of scale to the individual firm relate to the size of the entire industry within a specific geographic area. The average cost of the typical firm declines in the long run as the output of the industry within this area is larger. External scale economies can arise if concentrating the industry geographically gives rise to better-input markets, including specialised services for the industry or specialised labour required by the industry. External economies can also result as new knowledge about product and production technology diffuses among firms in the area, through direct contacts among the firms or as skilled labour transfers between firms. External economies appear to explain the clustering of some industries such as computer, high technology semiconductor in Silicon Valley and banking and finance in Wall Street.

Figure 2.6 explains how external economies of scale work in a perfectly competitive industry. If an expansion of an industry lowers costs for each firm, then new export opportunities or any other source of demand growth can have a dramatic effect. Lets assume that a national computer industry is competitive, but characterised by external economies of scale.

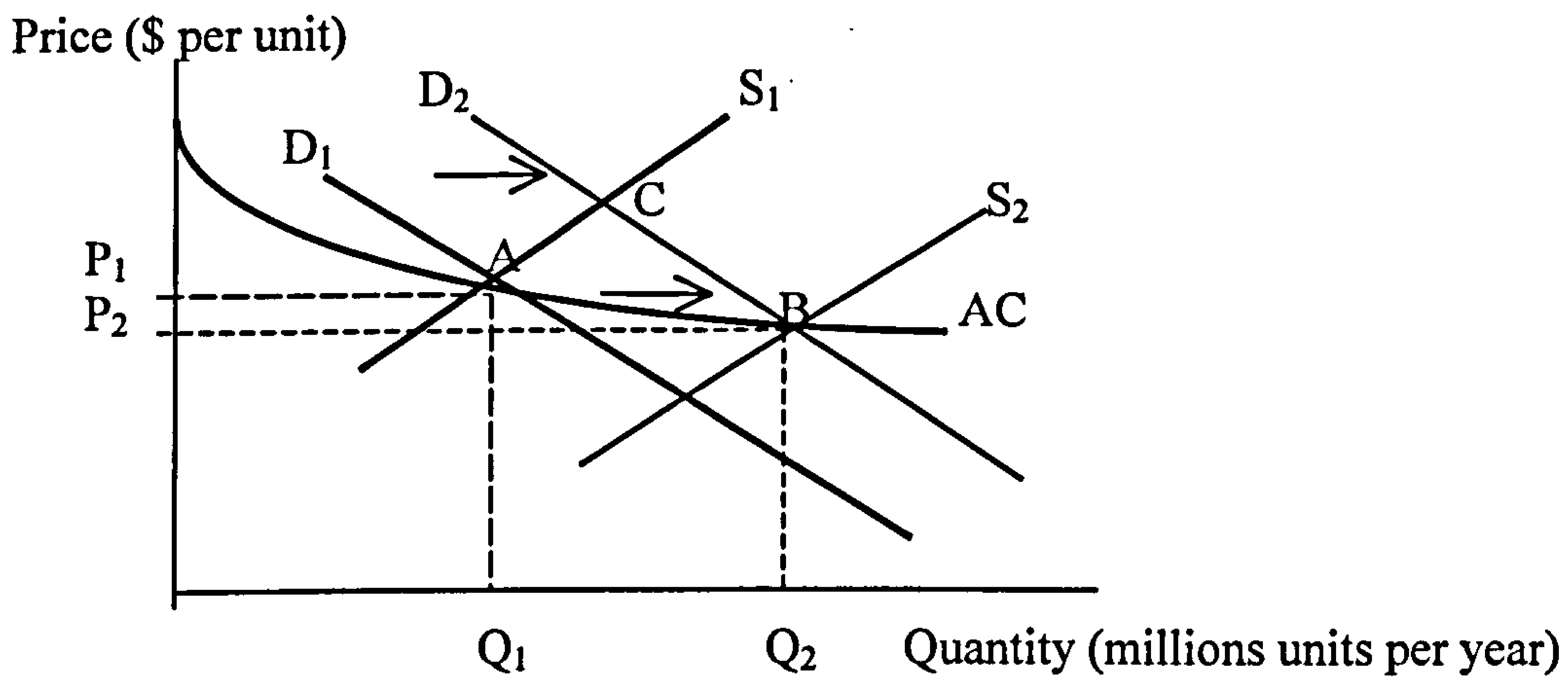


Figure 2.6 External economies and an expansion in a competitive industry

Source: Owen, 1983.

There is an initial equilibrium at point A, with many firms competing to sell Q_1 units at the price of P_1 a unit. Here the usual short run supply and demand curves of S_1 and D_1 intersect in the usual way. The important point of this diagram is the coexistence of the upward sloping supply curve S_1 with downward sloping long run average cost curve AC. The supply curve S_1 is the sum of small individual firms' views of the market. Each firm operates at given level of industry production, which it cannot affect very much. It reacts to a change in price according to its own upward sloping supply curve, and the sum of these supply curves is shown as S_1. However, the industry's downward sloping average curve AC comes into play when demand shifts. Lets assume that opening up a new export market shifts demand from D_1 to D_2 in international trade. Each firm would respond to the stronger demand by raising output. If each firm were acting alone and affected only itself, the extra demand would push the supply curve S_1 up to a point like C. Yet the new export market raises the whole industry's output and employment, bringing additional external economies, which affect the movement of supply curve from S_1 to S_2. As demand and supply expansion catch up with each other at point B, a new equilibrium appears (Owen, 1983).

According to Greenaway (1985), in conjunction with the number of firms, their size and the level of barriers to entry, evidence of the extent of economies or diseconomies of scale can indicate market structure. In order to identify whether economies and diseconomies exist in tourism, it is necessary to look at the cost structures of companies of differing size. In some markets such as transport, particularly air and sea travel, there are technical reasons, which explain why larger aircraft and ships are more efficient, in terms of both operation, and maintenance, therefore reducing per unit passenger costs. In addition, there are economies of scale in production through specialisation. Increasing size in the accommodation sector also yields some economies of scale with respect to the management, staffing and servicing of a greater number of rooms and in the travel agency sector, overhead costs can be spread over additional outlet.

It is possible to increase firm size and greater market power through technical change, so rendering the market less competitive which can be evidence of unexploited economies of scale. The discussion of tourism supply sectors indicated that although large firms can incur economies of scale and dominate some markets, this does not preclude many small firms from being successful in the same market. The small firms can often serve specialised segments which are not subject to large-scale operations and some activities remain small scale because the markets are local or national rather than international; enlargement of their activities would generate diseconomies of scale (Sinclair and Stable, 1997).

Nevertheless, one of the weaknesses of the Hecksher-Ohlin theory of trade is that it ignores the fact that there are demand-side factors in international trade. Tastes are assumed to be identical in different countries. Hence demand-side factors have no influence on relative product prices in different countries. Basically, prices of goods and services are determined by the factor costs, thus demand-side factors have to be taken into consideration as well as supply-side factors in international trade. It is also possible that relative prices could differ between any two countries even when factor endowments are identical. In this case, there is a possibility of different consumer preferences in two countries. When there is a high demand for a particular product the price for the product would be relatively more expensive.

One of the first economists to incorporate the role of demand into a formal model of trade was the Swedish economist, Staffan Linder, writing in 1961 (Linder, 1961). Linder argued that international trade takes place between countries with similar factor endowments. The level of per capita income of a country mainly influenced the structure of demand, particularly for manufacturing goods. Consumers in countries with high per capita incomes tend to have increasing demand for high-quality goods and services. Conversely, consumers in countries with low per capita incomes have demand patterns in favour of law-quality goods. He also argued that once the domestic market demand was satisfied, production for export commences and look for a new market. A country will export local varieties of a particular product to countries with a similar demand structure and a similar per capita income. Therefore, countries with similar per capita incomes will do the most trade with one another, which is the opposite of the Hecksher-Ohlin theory. In short, the Hecksher- Ohlin model assumes that producers produce under conditions of decreasing returns to scale (increasing average costs) but many production activities take place under conditions of increasing returns to scale (decreasing average costs) with the situation that differentiated goods are available in the market.

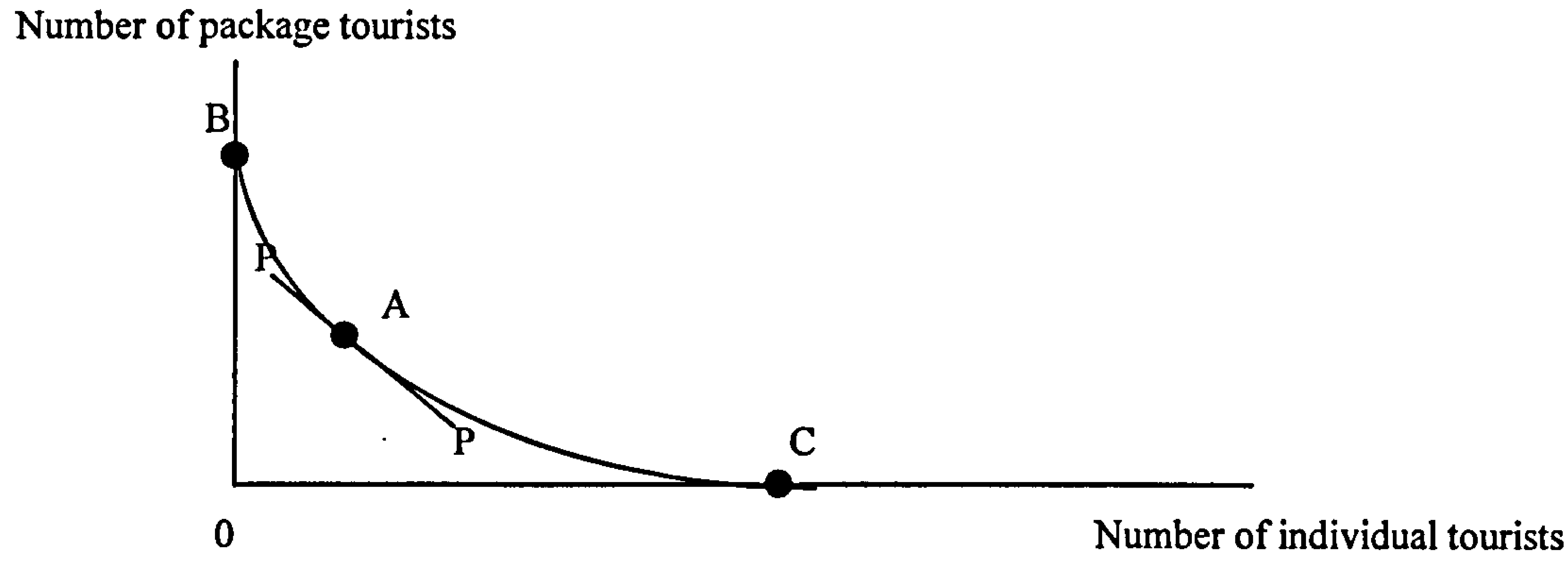


Figure 2.7 Trade under conditions of increasing return

Source: Grimwade, 1989.

Figure 2.7 shows trade under conditions of increasing returns to scale. A country is assumed to attract just two varieties of tourists groups, package tourists and individual tourists. The country's transformation curve is drawn as convex to the origin because of increasing returns to scale (decreasing average costs). The price ray PP represents domestic prices before foreign tourists enter a country and the country attracts both groups at point A. However, trade (entering foreign tourists) will cause the country to move all the way to either point B or point C. If other countries can offer package holidays relatively more cheaply, the international trade will be represented by a price ray steeper than PP. The country's tourist operators will obtain a better price for their individual holidaymakers and will be encouraged to increase its demand. However, because of the existence of increasing returns to scale, they will specialise completely in attracting more individual than package tourists. Tour operators will stop providing package holidays, and resources will be redeployed in promoting individual tourists (Grimwade, 1989).

In tourism, airlines and large hotel chains are clear examples of increasing returns to scale. It is true that the capital investment for introducing new businesses in either airlines or large hotel chains are higher than others but they tend to achieve large returns by selling additional units even after covering their fixed costs. In other words, fixed costs for airlines and large hotels are high but the average cost of these firms decline in the long run as the selling units of the industry within these sectors are larger. Conversely, small firms such as small local hotels or restaurants can often serve only local residents which tend to force firms to remain small scale. Firms may target local or national rather than international customers, thus extension of either size or volume of services would generate decreasing returns to scale.

2.3.3 THEORY OF TARIFFS AND QUOTAS

Despite the gains from trade and specialisation discussed earlier, there are a variety of ways in which trade between countries may be restricted. Such restrictions may take the form of various kinds of natural barriers as well as artificial barriers to trade. Amongst all these trade barriers, tariffs are one such kind of restriction, which governments erect to exclude or restrict the entry of foreign products to the home country. Other forms of restriction include import quotas, together with various other types of administrative and technical barriers to trade.

The tariff is an indirect tax on tradable gods. Indirect tax in trade terms is a tax that is levied on a commodity in contrast to a direct tax which is levied on a factor of production. Tariffs tend to be attached to either imports or exports or both. Import tariffs tend to be far more common than export tariffs in international trade due to protectionism. Tariffs are generally imposed either as revenue raising devices or as a means of protecting domestic producers from foreign competition. Many governments, particularly in developing countries, attempt to reduce the quantity imported from other foreign countries by imposing tariffs which reduces the level of economic welfare of the importing country. Figure 2.8 illustrates the effect of imposing an import tariff.

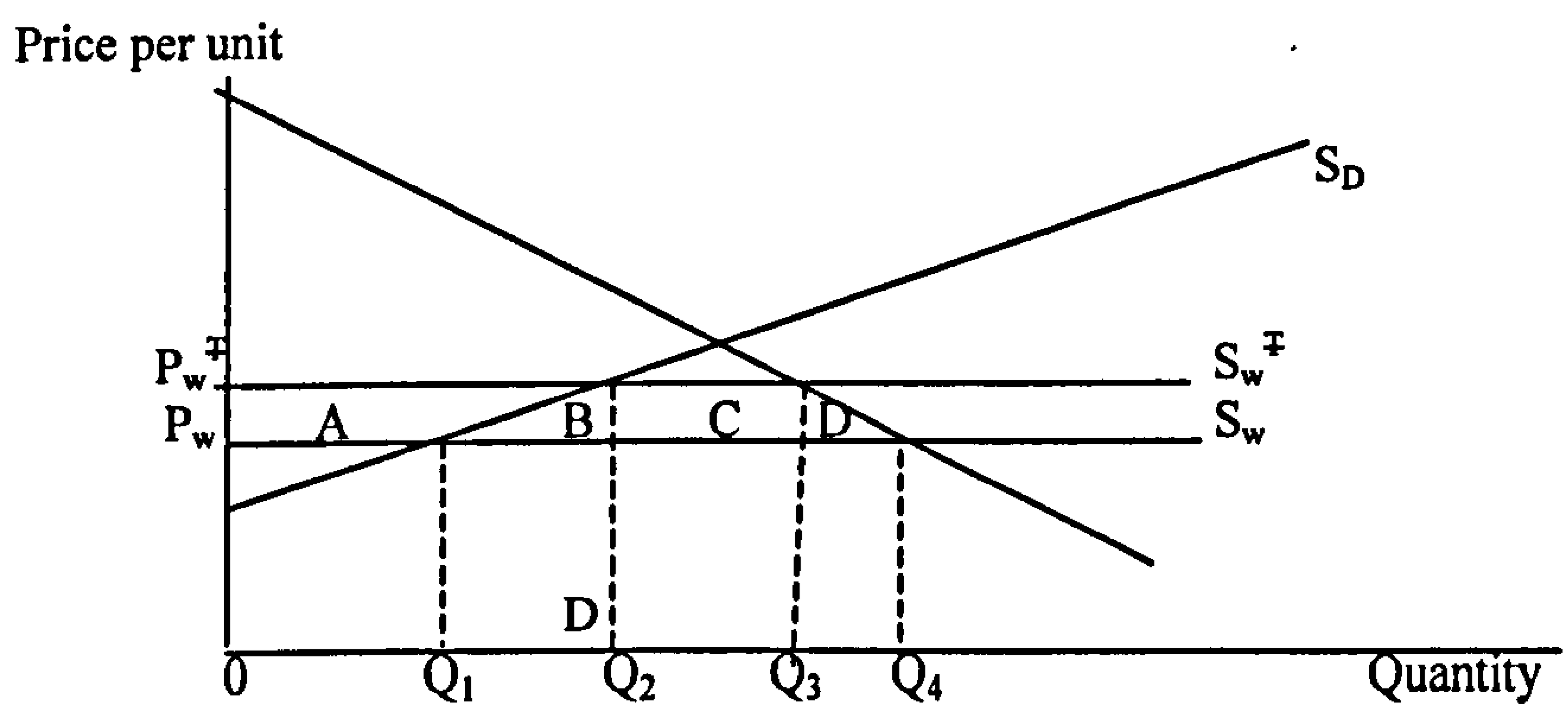


Figure 2.8 The effect of a tariff

Source: Begg, *et al.*, 1994.

Because the country is a small trading nation, it faces a perfectly elastic world supply curve, $P_w S_w$. At the world price of P_w consumption is $0Q_4$, domestic production is $0Q_1$ and imports are $Q_1 Q_4$. The government now wishes to reduce imports to the quality indicated by C. A tariff of $P_w^{\mp} P_w$ per unit is levies, raising the domestic price to $P_w^{\mp}$. Domestic production rises from $0Q_1$ to $0Q_2$, domestic consumption falls to $0Q_3$ while imports fall to Q_2Q_3. The surplus area A is transferred from consumers to producers. The surplus area C is transferred from consumers to the government as tariff revenue. The area B, which is transferred from consumers' surplus to factor costs, is the extra cost of producing Q_1Q_2 at home rather than importing it. Area D is consumers' surplus lost when consumption falls from Q_4 to Q_3. Therefore, the deadweight loss is areas B and D. In this case, the tariff lowers the economic welfare of the importing country as mentioned earlier. This is given by the areas ABCD which lie under the demand curve. Consumer welfare has been reduced by this amount due to the imposition of the tariff although area A and C represent increased revenue to the government (Begg, *et al.*, 1994).

Governments impose tariffs in order to respond to pressures from a particular sectoral interest that stands to lose from free trade. Political and security factors influence governments to move towards protectionism. In other cases, governments might simply be unaware of the damage that tariffs cause. For example, governments may think that a tariff boosts domestic employment in a particular industry by reducing imports and increasing domestic production. This might be true in the short term but it cannot be a long-term solution. The effect of reducing imports can bring the danger of reducing exports because other countries are willing to impose higher tariffs to the country for the revenge and those countries might start to import from their other trading partners instead.

However, there are several arguments that support the existence of tariffs. The most common of the arguments is the infant industry argument (discussed later). Basically, new industries in developing countries may need temporary protection before they have grown to a size large enough to be able to compete with foreign companies. Even in this case, the common policy is to provide government subsidies rather than imposing tariffs on imported goods.

In international tourism, levying a tax is the foremost economic instrument for achieving environmental improvements. Imposing a tax can certainly maximise social benefits and reduce environmental degradation by applying taxes on capital to deter the use of inefficient and polluting technologies or products that pollute. Turner argued that producers have no incentive to reduce pollution below the standard with regulations. However, imposing taxes has advantages such as lower costs of implementation, the possibilities of inducing investment in new, cleaner technologies or substitution to less polluting products or processes. The main difficulty of imposing taxes on polluting environment is the accuracy of measuring environmental costs on the one hand and the social benefits generated by production of the good or service on the other.

Moreover, the terms of trade will also be altered by the imposition of import quotas, which will tend to cause a rise in the price of the imported commodity and thereby limit the extent of importation. Although quotas may be considered similar to tariffs with respect to the effects, tariffs may not prove to be as protective in that the imports concerned can still come into the country at a higher price, however, quotas limit imports to a fixed amount, with the result that the increase in price following quota imposition is more indeterminate than the price increase following tariff impositions. Figure 2.9 illustrates the effects of an import quota under competitive conditions.

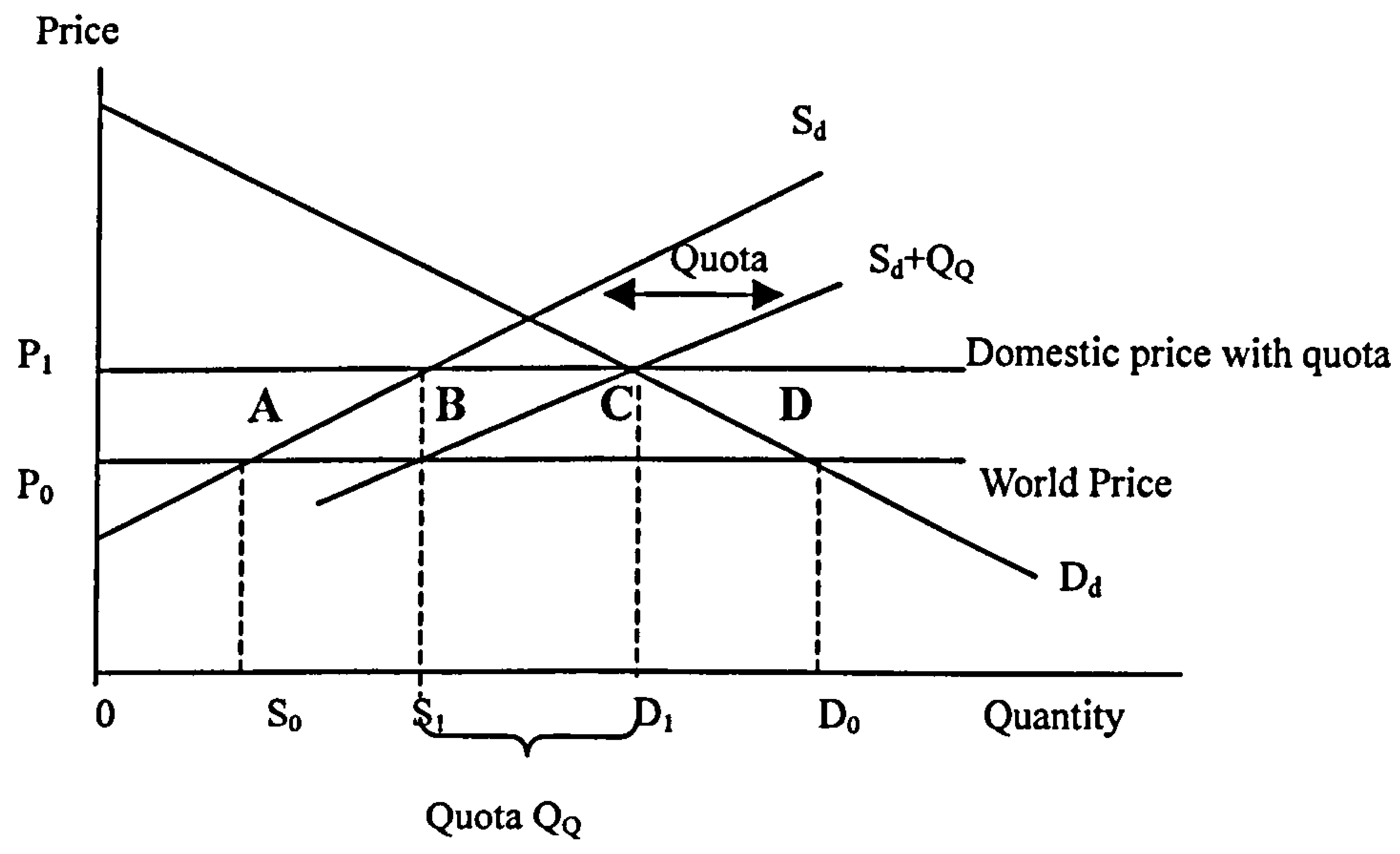


Figure 2.9 The effect of an import quota

Source: Pugel and Lindert, 2000.

Quotas are restrictions on the maximum quantity of imports. Although quotas restrict the quantity of imports, this does not mean they have no effect on domestic prices of the restricted products. With a lower supply, the equilibrium price will be higher than under free trade. In other words, the domestic price to the consumer is increased, in this case to P_1, and it is this higher price that allows inefficient domestic producers to produce a higher output than under free trade (S_d+Q_Q). At the price of P_1, the domestic market clears- the quantity supplied by domestic producers (S_1), plus the quota quantity imported (Q_Q), equals the quantity demanded (D_1).

The welfare effects of the quota are equivalent to those of a tariff under competitive conditions. The quota in figure 2.9 has induced domestic producers to raise their production from S_0 to S_1, costing the nation area B by producing goods at home at a marginal cost that increases to P_1 when they could have been bought abroad for the price of P_0 each without the quota. At the same time, consumers lose area D without its being a gain to anyone else. Because quotas raise the domestic price of the restricted product, the lucky foreign suppliers who succeed in getting some of their products sold will make large profits on these sales. In terms of figure 2.8, the area C, which would have accrued to the government as revenue from a tariff, now accrues to foreign suppliers or domestic importers. It represents the difference between domestic and world prices on the product that are imported, multiplied by the quantity of imports allowed. If these profits accrue to foreigners they represent a net social cost of quotas over and above the costs of imposing an equivalent tariff. However, the government could always auction off licenses to import and so recoup this revenue. Private importers or foreign suppliers would be prepared to bid up to this amount to get their hands on an important license. In this case, the price mark up on the allowed imports, area C in figure 2.9, is an internal redistribution from consumers to whoever commands the licenses since the license holders can import products by paying foreign exporters the price of P_0 and then sell them at the higher home price of P_1, so that the net loss is again areas B and D (Pugel and Lindert, 2000).

Since both quotas and tariffs are similar in their effects, one can say that a quota can do everything that a tariff can such as reduce the volume of imports, raise prices, and even collect revenue if a tariff-quota is used. In fact, a tariff-quota is a flexible system designed to gain the advantages of quotas and tariffs.

Within international trade related to tourism, non-tariff barriers between countries are more common than imposing tariffs because of the characteristics of trade in services. However, many governments levy specific taxes on the tourism sector, including a tourist tax in order to recover the costs associated with the externalities imposed on the host community through the provision of public facilities for tourists. Another reason for taxing tourism activity is simply one of raising general revenue for the government. The main methods of increasing public income from tourism are airport or ticket taxes and taxes on hotel occupancy as value added taxes.

2.3.4 PRODUCT LIFE CYCLE

The Hecksher-Ohlin theory was established on the basis of differences in factor endowments, which resulted in comparative advantage between different countries. Since the Hecksher-Ohlin theory assumes that all countries share the same body of technological knowledge it is possible to take technology into account as a factor of production along with land, capital and labour. This suggests that countries that are well endowed with technological capital will specialise in technology-intensive industries and should have comparative advantage to produce more of technology-intensive products. But comparative advantage in a particular product or industry changes over time as a specific technology is diffused internationally. Multinational firms play a significant role to support this argument. In setting up new production facilities in other countries, multinational corporations transfer technology to other parts of the world. According to the Hecksher-Ohlin theory, the factors of production are internationally immobile but this is not the case in the real world.

Michael Posner (1978) developed a theory related to technology. He argued that an innovation is made in one country but the new technology is diffused internationally with a time lag. The innovation may take the form of a new cost-saving method of production or a new product. For example, if an industry suffers from high labour costs then it may attempt to develop new technology to mitigate these costs. However, Posner classified two types of time-lag involved in the international diffusion of new technology. First, there is a 'reaction lag'. This is the interval of time between the moment when the innovation is introduced and the moment when producers in other countries recognise the need to respond to the change. Only when they begin to export the product, firms in other countries feel the challenge of new competition and recognise the need for appropriate adjustment. Second, there is an 'imitation-lag'. When competitors recognise a need for the new technology or a new product invented in another country, they will eventually succeed in copying or imitating the idea developed by the original innovator. At this point, exports from the original innovating country will begin to fall because domestic production will replace the import. The important point is that such trade flows are finite in time. They eventually come to an end as producers in other countries respond to the challenge posed by the new production method.

New technology is difficult to keep secret, and other countries have an incentive to obtain the technological innovation. The creator of the new technology has the incentive to apply it to production in the national location in which the new technology is most suitable and profitable. These technological activities can be found in the product life cycle.

The product life cycle concept was developed by Raymond Vernon (1966) who identified three distinct stages. First, there is **'the new-product stage'**. When a product is first invented, it must be perfected and all production will be located within the host country because most production will be for the domestic market to minimise costs since it is early in the life of new production in the market; there is a need for a trial period to make constant adaptation and alternations to the new product as well as monitoring consumers' response to it; it is a time for the innovator to enjoy some immunity from competition as the demand for the product will be relatively price inelastic so that he can pass on high costs in a higher price. Second, there is **'the maturing-product stage'** where the overseas demand for the product will increase dramatically and suppliers will attempt to meet such demand through exports. Given the increase in foreign demand for the product, the inventor will try to set up his production facilities in his major foreign markets which will give foreign competitors to copy or imitate the new product. Therefore, the demand for the new product will become much more price elastic so that he cannot pass on high costs in high prices. When competition between the host and other markets for the new product becomes stronger then there is plenty of evidence that it will be difficult for the host country to compete with the overseas market. If labour costs are lower in the overseas market, this will make overseas production even more attractive than the host in price terms and the inventor may face steep tariff walls or high non-tariff barriers which will give domestic firms a competitive advantage. The final stage is known as **'the standardised-product stage'**. At this stage, the price for the product is the most important factor for competition. When the new product is standardised, all producers will seek out the lowest-cost locations for producing the product. Therefore, developing countries have an advantage since their labour costs are much more lower than their competitors' (Grimwade, 1989).

Vernon's theory missed out the significance of quality differences. He argued that when the product reaches the standardised-product stage the price for the product is the most important factor for the competition, therefore the host country of the innovation becomes less competitive after other competitors imitate or copy the product at lower prices. However, in practice, competition in prices is only one aspect and competition through quality is also an important factor. For example, in tourism, competition between countries is strong. The strategy to become more competitive within the market place can be based on either lowering prices for each tourism product or improving the quality without lowering prices, or some combination of both.

In Korea, a travel agency launched a package product called 'travelling with a rucksack'. This package was relatively cheap for travelling to Europe, compared with other products provided by other travel agents because it included travelling mainly by train and mostly sleeping on the train or bus. The product became very popular with young tourists, between 18 and 25, who tolerate physical discomfort and do not have a lot of money. At the same time, tourists look forward to adventure in a different part of the world. After the huge success of the product, other competitors started to copy and promote the product by providing extra services or improving quality, including hotel accommodation or a Korean tour guide, etc. without increasing prices. Therefore, it seems fair to say that competition between travel agents encouraged the improvement of the product's quality, and price was not necessarily the only area of competition.

The product life cycle can be classified into not three but four different stages, the final stage being the stage of improvement or development in addition to the three stages discussed earlier. Beyond the stage of standardisation of the product, there is an intention to consider either improving the quality or developing the new technology in a highly competitive market such as tourism, computer technology and the car industry. Above all, industries including tourism, cannot afford to ignore the existence of 'quality differences'. Destinations such as the Mauritius promote themselves by providing higher quality, thereby targeting middle and high-income tourists. Although prices are not cheap, certain tourists repeatedly return to the destination because the quality of a holiday is different from that offered by other destinations.

According to the product life cycle theory, the development and supply of new products tends to occur in capital-abundant, high-wage countries, underpinned by domestic demand for technology-intensive products and a supply of relatively high-skilled and high-wage labour, which is able to develop and produce them. Increasing maturity and standardisation of the product, imitation by foreign producers and increasing foreign demand result in a transfer of production from the initial innovating countries to medium-wage economies and subsequently to low-wage and therefore low-cost countries.

Figure 2.10 illustrates the product life-cycle. Let's assume America is an innovating country, as Vernon stated that high-wage countries would create more innovations than low-wage countries. Other advanced countries become producers of new products in the later stage of the new product and exporters in the very early stage of standardisation. However, less-developed countries become producers of the product in the later stage of the maturing product and become net exporters towards the end of the standardised product stage.

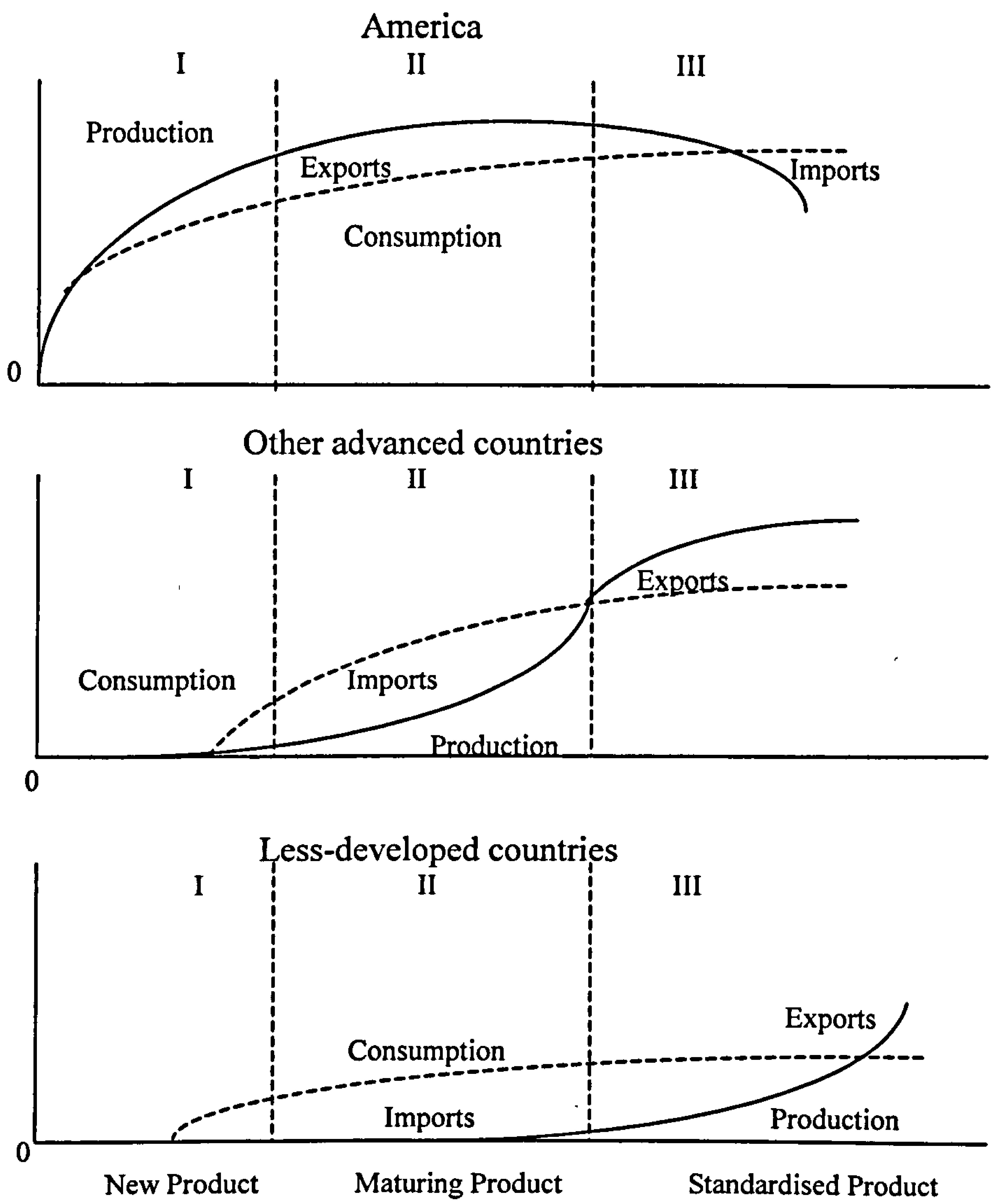


Figure 2.10 The product life-cycle model of trade.

Source: Vernon, 1981.

Vernon's theory can help to explain the initial concentration of international tourism demand and supply in relatively high-income countries and the subsequent growth of foreign holiday tourism in lower-income countries, although other contributory factors such as rising incomes are also relevant. For example, it is clear that each country has a specific set of cultural and environmental endowments, which preclude complete product standardisation. The fact that such endowments together with accommodation and entertainment are consumed on-site, in conjunction with demand for differentiated products, ensures that tourism production and consumption occurs in both low and high-income countries (Sinclair *et al.*, 1997).

2.4 COMPETITIVE AND COMPARATIVE ADVANTAGES

The theories of comparative and competitive advantage are important components when attempting to understand international trade and creating a framework for the study of tourism in this context. Many of the trade agreements are based on the comparative advantages of each member country, particularly for the GATS that is discussed in chapters 4 and 5. As international trade plays an important role in the every day life of most countries, there are possible gains from, and problems associated with international trade. The most well-known theory to help explain the gains of international trade is that of 'comparative advantage' and the most common obstacle to international trade is clearly 'protectionism'.

2.4.1 THE GAINS AND PROBLEMS OF INTERNATIONAL TRADE

The gains from international specialisation and trade are obvious when one country is better at producing one item while its trading partner is better at producing another. However, there are some recognised problems as well as gains from international trade. The problems of international trade are based on the fact that countries are not equally balanced in economic and political terms, especially when developed and developing countries are compared.

2.4.1.1 The Gains of International Trade

What advantages does international trade offer over the closed systems that evolve from protectionism? The answer is that people are better off as a result of trade with other countries. This applies not just to trade and economic relations between individuals but to trade and economic relations between countries as well. When individuals own different goods, have different desires, or both, there is an opportunity for mutually beneficial trades: trade that benefits all parties. Voluntary trade between two countries may involve not a winner and a loser, but two winners.

As mentioned earlier, unrestricted international trade tends to increase the welfare of the world as a whole. Aggregate world welfare can be increased, disregarding for the moment how the possible gains or losses from international trade are distributed between different countries. For the world as a whole, a free trade situation leads to a higher level of economic welfare than a situation in which there is no international trade. In other words, when countries own different resources, have different demand patterns, or both, there is an opportunity for mutually beneficial trade: trade that benefits all parties to the trade. For instance, Nigeria has more oil than it can possibly use, but it does not produce enough food to feed its populace. The United Kingdom has more wheat than the British can possibly consume, but needs oil. Trade can benefit both countries in this case (Lipsey, 1989).

Moreover, capital and manpower are, of course, on the move in all economies in response to stimuli, which are unconnected with international trade. Changes to technology, in levels of productivity, alterations in consumer tastes, all of these directly affect what is produced and in what quantity, and that in turn influences the amount of employment and where jobs are to be had. Adjustments imposed upon capital and labour by internally generated changes are precisely of the same nature and raise difficulties identical to those caused by higher levels of imports generated by removal of barriers to international trade. Thus, the more flexible the realignment of capital and manpower resources to changes in technology and patterns of demand and the more rapid that realignment, the greater the gain in welfare to the entire community within which this recasting of patterns is taking place (Mukherjee, 1974).

In spite of the seemingly persuasive argument that countries engage in trade if they think they will be better off as a result, people often walk away from a deal believing they have been hurt. It is important to understand that when trade makes the two traders better off, they do not mean that it makes both parties happy. Therefore, the problem with international trade is the idea of one party "taking advantage" of the other. The implication, of course, is that if a buyer or a seller can take advantage, then the other party may be a loser rather than a winner. This seems to carry an important message: exchanges that happen in the real world tend to be considerably more complicated than just swapping goods and services. They involve problems of information, problems of estimating risks, and problems of forming expectations about what will happen in the future.

2.4.1.2 Problems of International Trade

Trade can make a particular group within a country worse off, which would also make the country as a whole worse off. The majority of consumers benefit from being able to buy imported products at a good price, which widen consumer choice through imports is an addition to utility, and many workers benefit because their companies export products abroad, but certain industries within the country that are facing stiffer competition may be hurt. Because the world moves towards liberalisation of international trade and free trade, people can lose jobs. For example, if a country imports a product instead of producing the product locally, people who work within that industry will lose their jobs, therefore the government has to either relocate them in other industries or train them to get another job. While the benefits are general and widespread, the costs are specific and bear directly and heavily on particular sections of the community. Workers who lose their jobs because of increased imports are not compensated for this loss by the advantages gained by the rest of the community being able to buy consumer goods and machine tools more cheaply than they were able to do before trade restrictions were moderated or removed.

Another problem with international trade is inequality. International trade involves unequal treatment between countries. Countries tend to have favourable trading nations and give them exemptions to trade, such as low tariffs and subsidies. In addition, some countries treat domestic companies differently from foreign ones in order to protect the domestic industry. That is why the World Trade Organisation (WTO) introduced trading agreements, such as General Agreements on Tariffs and Trade (GATT) and General Agreements on Trade in Services (GATS), to prevent unequal treatments, but it does not really work even though the agreements have helped to make world trade more efficient and effective. In other words, protectionism still exists in many countries.

On the other hand, gains and problems can be seen differently from consumer to producer because their main concerns are different. The producers' concern is to produce goods and services at the lowest price possible and to sell at the highest price possible but the consumers' concern is to be able to purchase higher quality goods and services at the lowest price possible. In addition, the actual terms of trade are of crucial importance to countries in determining the distribution of the gains from trade. Therefore, it is significant to evaluate what factors give rise to differences between countries in comparative costs and what is the basis for comparative advantage as well as to discuss how comparative and competitive advantages can be measured.

2.4.2 COMPETITIVE ADVANTAGE

Competitiveness in markets for tradable goods and services takes place by and large between individual agents and corporate bodies. The terms on which they compete are fashioned by the drivers of comparative advantage (factor endowments, factor productivity, technology) and industrial competitiveness. These terms can also, of course, be influenced by government policy (tariffs, subsides, quotas and so on can impact on the competitiveness of individual firms and sectors). All of this is well known and what is more controversial is a recent preoccupation on the part of policy-makers with 'national competitiveness', a preoccupation which seems to be fed by country league tables of GDP per capita and a feeling that some countries, most notably Japan, may have accelerated their rise up such tables by the systematic use of competitiveness policies.

According to the OECD (1999), the definition of a nation's competitiveness is the degree to which it can, under free and fair market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long term. The definition of competitiveness may only fully consistent, or reinforcing, if improved competitiveness at the firm or industry level can be achieved while maintaining employment levels because the actual meaning of competitiveness exists when a company or industry attempt to increase the level of output and hence profits without cutting the numbers of employment. This may be the objective of a nations' policy where competitiveness is not an end in itself but a means to raising employment levels, productivity growth and living standards.

Hotels in Korea, particularly four and five star hotels, were regarded as a luxury product after the 1988 Seoul Olympics by the government. According to KITA (2000), the government imposed a 13% value added tax on the services industry plus an additional 10% on these hotels because the state believed that imposing higher rates of taxes discouraged Korean people from spending on luxury goods and services and the demand for these hotels was price inelastic. Therefore, customers end up paying high room rates which made hotels in Korea less competitive compared with other Asian countries. However, the present government decided to subsidise and support new entrants in the hotel industry because Korea will be the joint host with Japan of the World Cup 2002. A major concern for the government is providing accommodation as spacious and luxurious as Japan. The government subsidy and support will encourage the Korean hotel industry to be confident enough in quality and quantity to compete with Japan since the competition between these two countries will be strong not just for the event but also to attract future potential tourists. Tourists who attend the World Cup may re-visit either Japan and Korea in the near future if they are satisfied in the country.

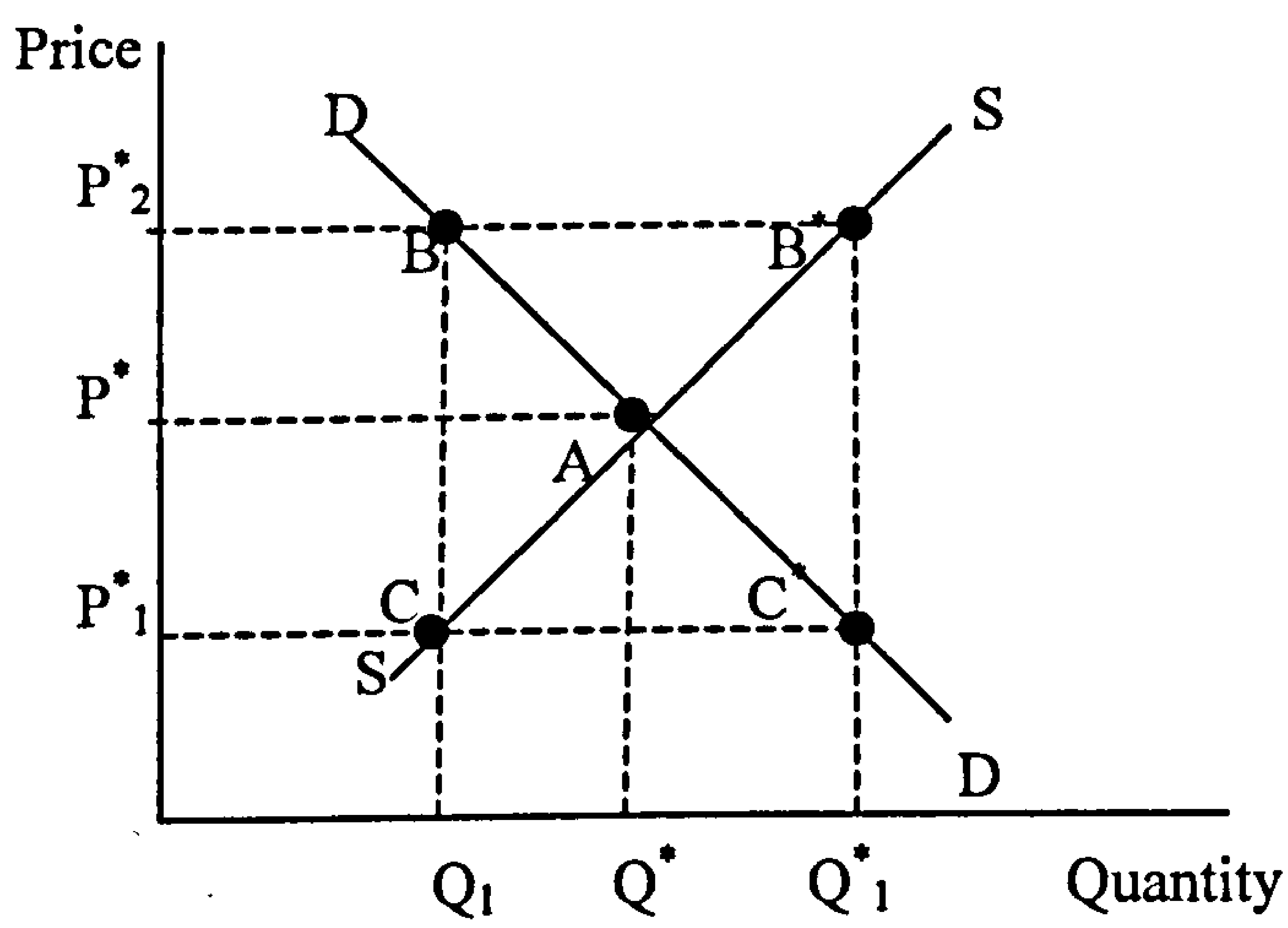


Figure 2.11 Domestic equilibrium and world prices

Source: Begg, *et al.*, 1994.

Figure 2.11 shows the domestic demand curve DD and supply curve SS for a product competitively traded in world markets. In the absence of trade, domestic equilibrium occurs at A. When trade is possible at the world price P^*, equilibrium occurs at A. When trade is possible at the given world price P^*_1, domestic produces supply Q_1 and domestic consumers demand Q^*_1. The excess demand of CC^* is met from imports. Conversely, when world prices are P^*_2, domestic producers supply Q^*_1, domestic consumers' demand Q_1, and the excess supply of BB^* is exported. The world price of a product rises while the original world price was P^*_1 in figure 2.12. The domestic supplier for the product was producing Q_1 but the manufacturers in the country were additionally importing $(Q^*_1\text{-}Q_1)$ since their total quantity demanded was Q^*_1. Another country raises the world price above P^*_1 and this had two effects. First, it reduces the quantity of the product demanded by domestic manufactures. Second, it allows domestic suppliers to charge higher prices and move up their supply curve, expanding output and attracting new resources into the industry (Begg, *et al.*, 1994).

In general, the price of the commodity relates to the quantity producers wish to sell, but only after sufficient time has elapsed to give effect to decisions to change supply will there be a change in the actual quantity supplied. The delay between the decision to do something and actually being done is called a time lag. There is a theory that illustrates the adjustment of the level of prices in terms of time lag, and the level of output will fluctuate accordingly. The 'cobweb theory' applies the concept of time lag to the theory of price. A clear argument is this year's price has no effect whatsoever on this year's supply, the full adjustment to this year's price being made all at once next year. Markets subject to simple one-year time lags are illustrated in figure 2.12.

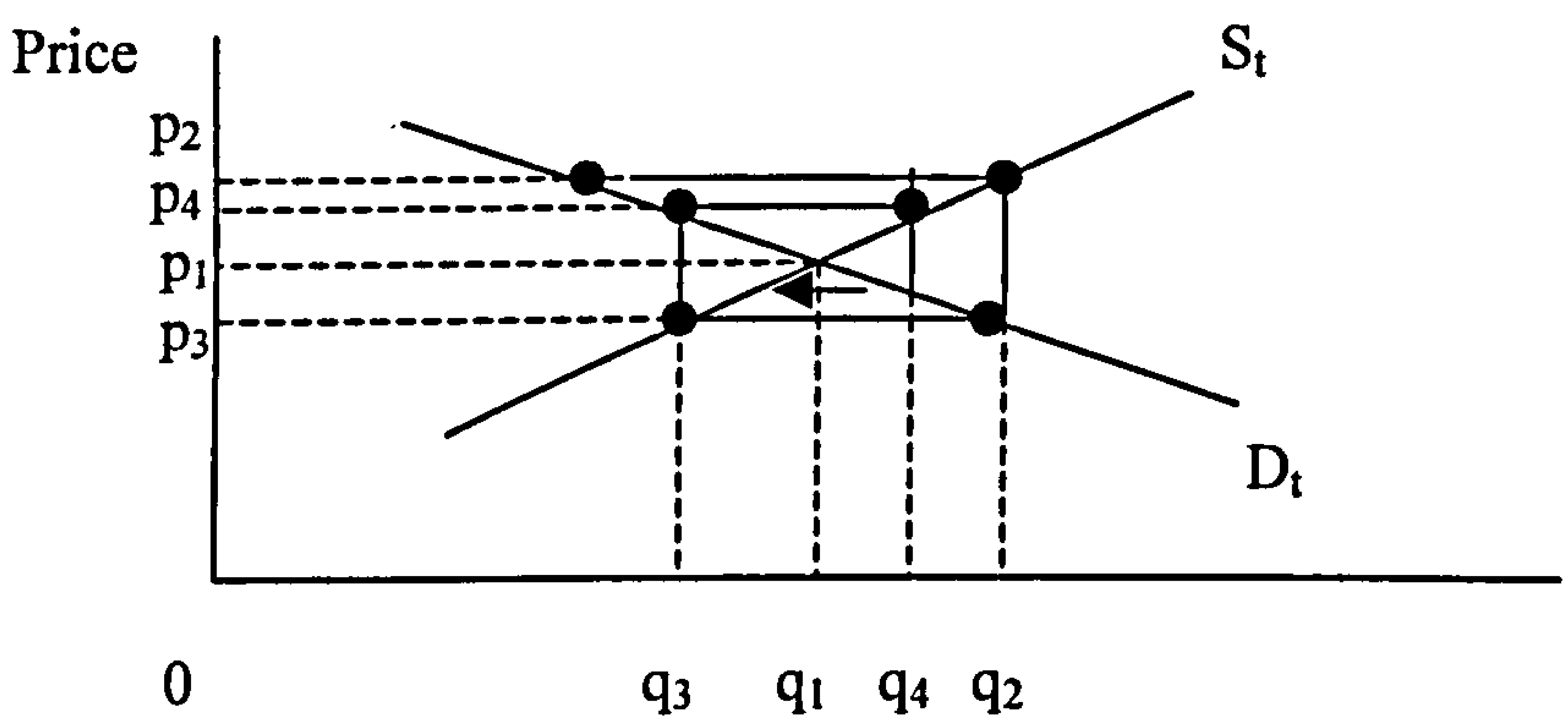


Figure 2.12 A stable Cobweb theory

Source: Lipsey, 1989.

The demand curve, D shows the relationship between the price ruling in any year and the quantity that will be demanded in the same year. At the same time, the supply curve, S shows the relationship between the price ruling in any year and the quantity that will be supplied to the market in the following year. The price that equates demand and supply is p_1. At the price q_1 units will be produced and sold. The theory simply explains that if in one year, year t, the price is p_2, suppliers will plan to produce q_2, in the following year. In that year, 'year t+1', q_2 will come on the market, and, in order that q_2 may be sold, the price will have to fall to p_3. The price of p_3 will induce suppliers to produce the quantity q_3. When this quantity is available on the market in the following year, 'year t+2', the price will rise to p_4. This price will call forth a supply of q_4 the next year 'year t+3', and this will depress the price below p_4. Therefore, the price and quantity will fluctuate around their equilibrium values in a series of diminishing fluctuations, so that, if nothing further disturbs the market, price and quantity will eventually approach their equilibrium point, p_1 and q_1 (Lipsey, 1989).

However, if the economy or the industry is unstable then the level of supply depends more on prices than the quantity demanded. When there is excess supply, a large price fall is necessary to call forth the required demand. This causes a large reduction in next year's supply. When the market will suffer a shortage of the product, which will lead to a large increase in prices in order to reduce the quantity demanded, and it will continue to repeat the process, thus there will be no equilibrium point. In this case, it is difficult to predict the levels of price and output of competitors' for the next year.

The theory could apply to the tourism industry to some extent. The theory of one-year time lag can be a problem in the tourism industry. The levels of demand and supply cannot fluctuate over night, but it might be possible to apply in 10 years or even 5 years time lag in tourism. Skiing holidays in Korea are very popular to other Asian countries such as Thailand, Hong Kong and Singapore. In addition, Korea provides high standard facilities and services and it is cheaper than Japan, thus the number of tourists has increased rapidly since 1998 from Asian countries. The price for a skiing holiday has increased because of high demand but resorts were suffering from excess demand for accommodation throughout winter. The government decided to support any new development in ski resorts in 1999, including providing low interest loans and subsidies, and companies have decided to develop several ski resorts to meet demand but action took place in the beginning of year 2000. Meanwhile, the exchange rates appeared to be stable from the middle of 1999 so that prices for holidays became even more expensive for Asian tourists. Consequently, the level of demand decreased compared with the previous year, which had an effect on the volume of tourism development in the resorts.

Competitive strategy must draw from a sophisticated understanding of the structure of either a country or an industry and how it is changing. In any industry, the nature of competition is emerged from five competitive forces (Porter, 1990):

- The threat of new entrants.
- The threat of substitute products or services.
- The bargaining power of suppliers.
- The bargaining power of buyers.
- The rivalry among the existing competitors.

These five competitive forces determine an industry's long-term profitability because they shape the prices, costs and investment which required to compete in the industry. Competition between multinational companies and SMEs is a good example of recognising the strength of the bargaining powers of suppliers and buyers. Many multinational companies are able to provide lower prices to customers compare with SMEs. In general, large multinational companies are determined to attract more customers at the small loss of profits for the temporary basis.

The current approach to a competitiveness policy in the world highlights areas such as training and education, and investment. The instrumental role of investment in broad terms of capital is also a major issue for competitiveness in international trade. The most pressing problem facing some countries is how to raise capital investment to increase growth, employment and competitiveness. In the tourism industry, competitiveness is an important factor for developing countries. Competition not only between developed and developing countries but also between multinational and small and medium enterprises (SME) is a concern for international tourism, which will be discussed in detail later in chapter 5. Since the world is moving towards liberalisation of international trade, competition in developing countries with well-known foreign companies, particularly hotels and travel agents, affects the country in both good and bad ways.

Simple adjustment of competitiveness between countries or firms in the tourism industry can be explained as follows:

- The advantage of strong competition is adopting advanced skills and technologies which can help SME to improve both their performance and the quality of their services in the long run, but that is if only the companies can survive.

- The disadvantage of strong competition for developing countries is that SME may not survive competition with large companies because they suffer from a lack of capital and skills. However, consumers will benefit from strong competition in the end because prices will be reduced and at the same time, the quality of services will improve. This can be called 'competitive advantage' in tourism (Vellas *et al.*, 1995).

Another important issue is measuring international competitiveness, particularly in services. Measuring countries' competitiveness in internationally tradable services is fraught with many conceptual and practical difficulties. It has suggested by few economists that the best way of measuring competitiveness is an index which takes account of the relative importance of service exports in a country's total exports of all goods and services. There is no single measure of competitiveness. At best it is a composition concept, because different measures (price, export share, profitability, unit costs etc.) give different results (Commission of the European Communities, 1982).

2.4.3 MARKET STRUCTURES AND COMPETITION

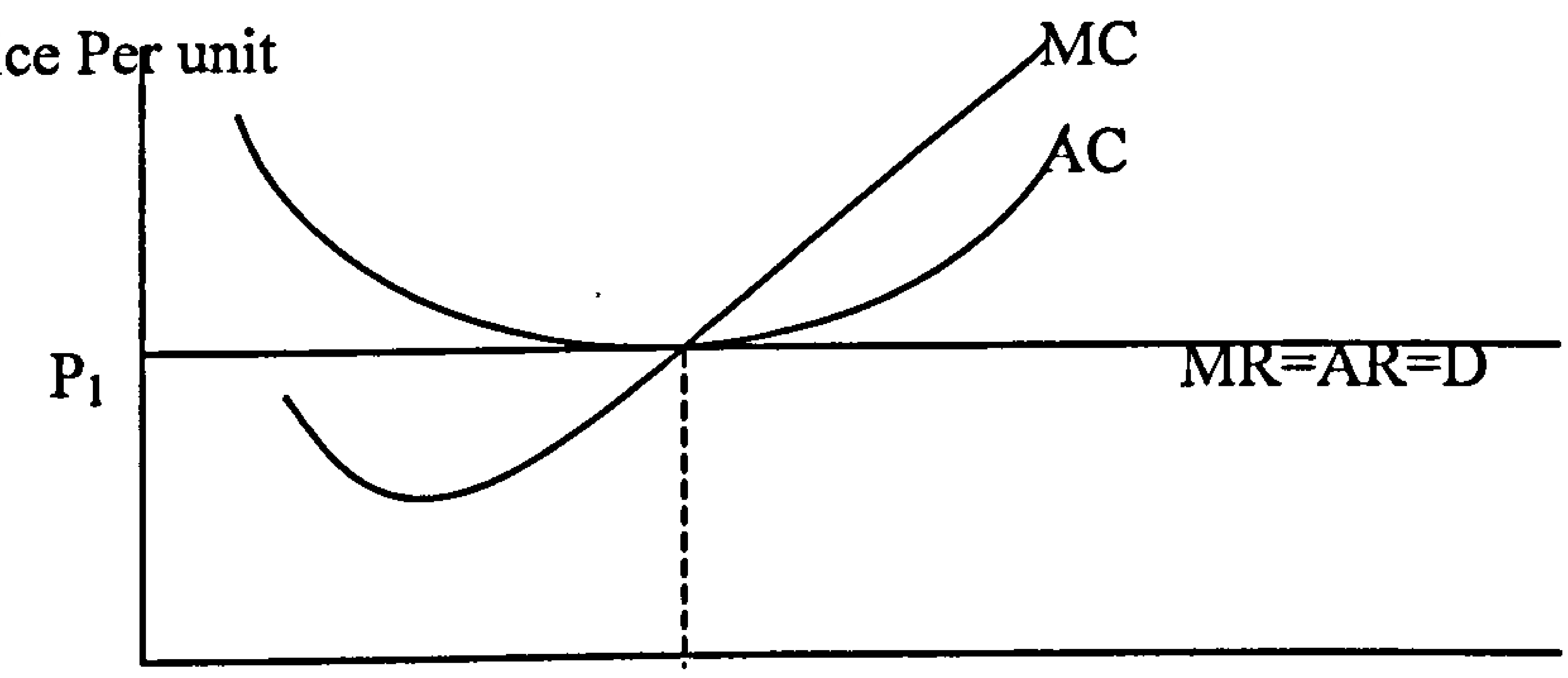
The market structures within which tourism enterprises operate vary between countries and between sectors, from perfect competition to monopoly. The structure of a market is a description of the behaviour of buyers and sellers in that market. Therefore, a general theory of market structure shows how demand and supply conditions together can determine the number of firms and their behaviour. It is useful to establish two benchmark cases, the opposite extremes between which all types of market structure must lie.

2.4.3.1 Perfect Competition

The market structure for small motels, guest houses or hotels in very large holiday destinations in travel and tourism is close to what it is called as 'perfect competition' whereas the condition of perfect competition is rarely related to industries. At the same time, those cases are not perfectly competitive, for example, motels may be able to vary their prices a little, and keep their customers by trading on minor differences in location, service quality or decoration (Bull, 1994). They are thus making use of comparative advantage and product differentiation, which is not possible in perfect competition (Chamberlin, 1956).

The model of perfect competition provides a benchmark, illustrating the limiting case of a market involving a very high level of competition. It is assumed that there are a large number of firms and consumers so that neither producers nor consumers can affect the price of goods and services. It is also assumed that there is free entry into and exit from the market, implying no entry or exit barriers. Perfect competition from the seller's point of view is the situation where that seller is faced with a market-set price level but can sell all their output at that price, hence the seller faces a horizontal individual demand schedule as figure 2.13 (Begg, *et al.*, 1994).

Price Per unit



Q Quantity of enterprise's output

Figure 2.13 Production by individual enterprise in a perfect competition

Source: Stiglize, 1993.

According to figure 2.13, the enterprise faces the demand of D and can sell any amount of output at market price of P_1, but cannot attempt to sell at a higher price since buyers would move to other substitutes at the going price P_1 since there are many alternative products available in the market. Moreover, the cost and revenue conditions for an individual supplier in a perfect competition market in the long run are illustrated in figure 2.13. As discussed earlier, the seller can sell a product as much as they want at price P_1. Each additional unit of output is sold for the same price. Therefore, the extra revenue which the supplier obtains from selling every additional unit of output, the marginal revenue, is equal to the price and is also equal to the average revenue from selling additional unit of output. In addition, the perfectly competitive firm produces at the level of output at which price is equal to marginal cost, provided it makes more profit by producing some output than none at all. It therefore chooses points on the MC curve. At any price above P_1 the firm makes profits because price is above average cost. At any price below P_1 the firm makes losses because price is below average cost. Thus, the firm will not produce any output at prices below P_1. The section of the marginal cost curve to the right of Q is the producer's supply curve, since it shows the quantity of output that the producer would like to supply at each price in the short run. The optimal point of production occurs where the marginal cost is equal to the marginal revenue for the supplier which corresponding to an output Q. This is the point at which profits are maximised (Stiglize, 1993).

The structure of imperfect competition is common among travel and tourism markets, especially where there are many small enterprises. A key factor of differentiation between enterprises is the style and level of service. Service as an attribute, and product input, can be cheaply and easily varied so that the marginal revenue obtained from extra service will exceed the marginal cost of providing it. However, one important point for this theory is that there may be limited needs for expansion of businesses, since expansion in service is less likely to provide economies of scale than expansion in technical production of goods. Therefore, many travel and tourism businesses in monopolistic competition remain small.

2.4.3.2 Monopoly

The pure monopoly is the opposite of perfect competition on the supply side. In the tourism industry, various businesses on the supply-side in different countries are deliberately organised as monopolies, particularly in many developing countries. For example, domestic air flights may be monopolised by the state and railway networks sometimes operate as a single industry.

A monopolist is the sole supplier and potential supplier of the industry's product. The firm and industry coincide. The sole national supplier need not be a monopolist if the good or service is internationally traded. Unlike producers in a perfectly competitive market, the monopolist has considerable control over the product price and level of output. Given normal demand conditions, in order to sell additional output, the product price must be lowered so that average revenue falls and consequently the marginal revenue per additional unit of output sold decreases as the amount sold rises. The relationship between the two forms of revenue is such that marginal revenue decreases by twice as much as the average revenue and hence the marginal revenue curve lies below the average revenue curve, as shown in figure 2.14. Following economic suppositions regarding cost structures, returns increase and then decrease; therefore the marginal and average cost curves initially decline and subsequently rise (Sinclair and Stabler, 1997).

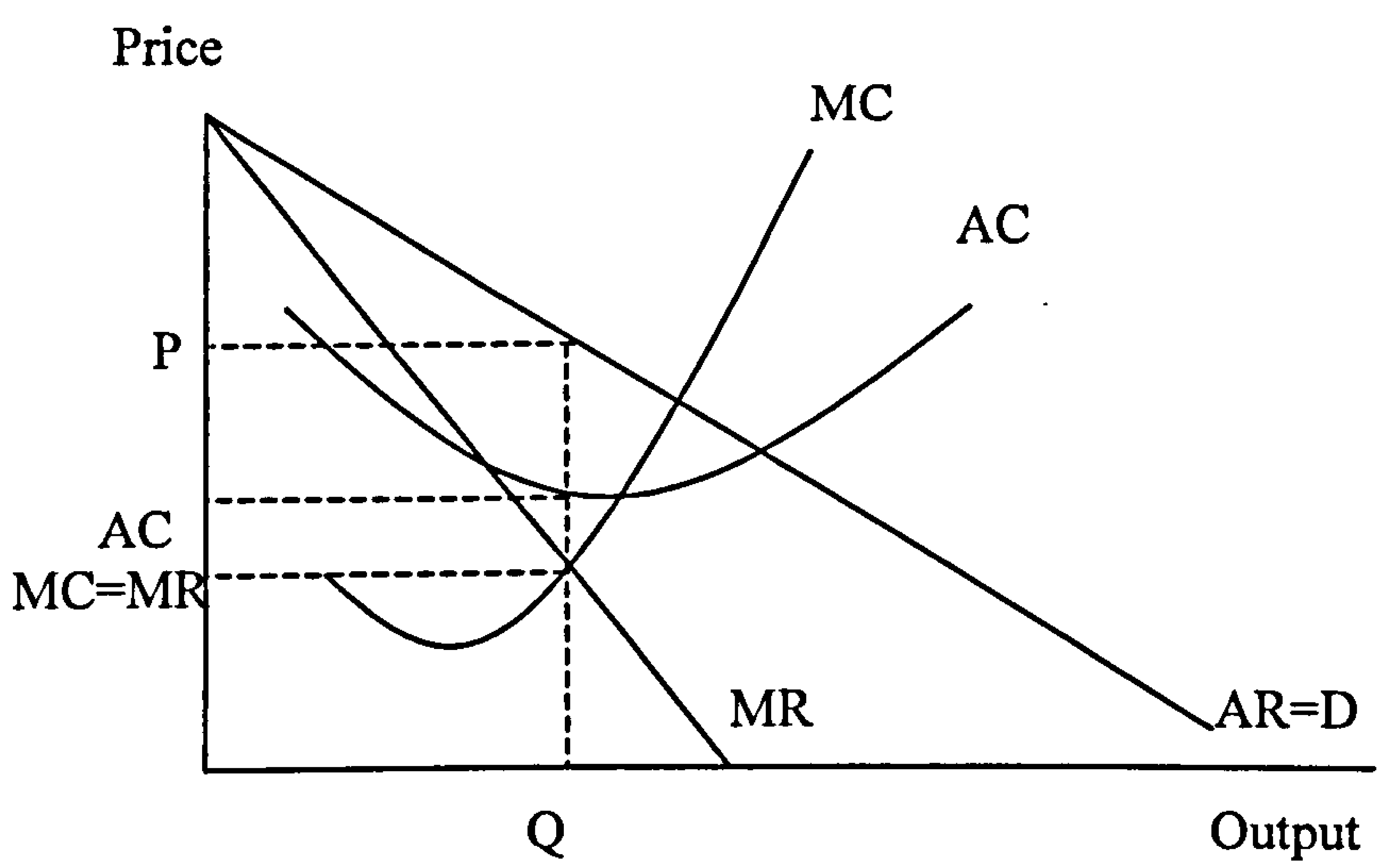
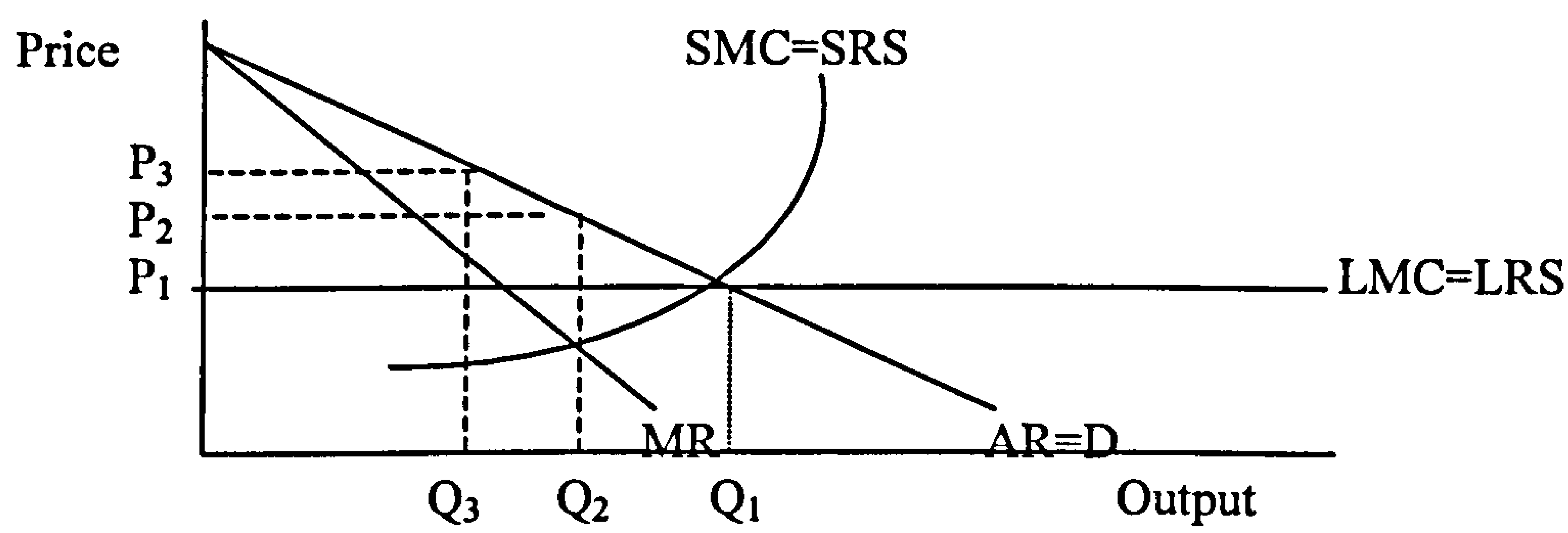


Figure 2.14 Production by a monopoly

Source: Sinclair and Stabler, 1997.

Profits are maximised at a level of output where the marginal cost of production equals the marginal revenue and marginal cost is rising or in cases where increasing returns prevail, marginal cost is falling less rapidly than marginal revenue. As shown in figure 2.14, the average cost of production is lower than the price charged giving rise to supernormal profits, above the minimum required to keep the firm in the industry. Thus, consumers are paying a price in excess of that which might emerge in a more competitive market. This point out the issue of whether the monopoly should be allowed to trade unrestricted or be regulated or reorganised as a competitive industry. Two interesting results however can be expected under monopoly. First, it involves a comparison of the equilibrium price and output combinations under competition and monopoly. It needs to be assumed that a competitive industry is monopolised without any change in production conditions.

Figure 2.15 shows the combination of prices and output under competition and monopoly. Let's assume that each competitive firm has the same costs and therefore, the average cost curve can be excluded. It is clear that the price of P_1 is lower and the quantity produced of Q_1, higher under competition than under monopoly. If the industry was in a monopoly market situation, profit maximisation would occur where the short-run marginal cost of SMC is equal to the marginal revenue of MR which may result in a higher price level of P_2, and lower output level of Q_2. In the long run, the monopoly could affect some production units to close, decreasing output level of Q_3 and increasing the price level of P_3 (Stiglize, 1993). From the result of the situation, consumers would be worse off under a monopoly than under competitive conditions since consumers tend to pay higher prices for a product, which can happen in tourism.



Note: MR = Marginal Revenue, AR = Average Revenue, LRS = Long-run SUpply, LMC = Long-run Marginal Cost, SMC =Short-run Marginal Cost, SRS =Short-run Supply

Figure 2.15 Short-run and long-run production by a perfectly competitive industry
Source: Stiglize, 1993.

In the transport industry, where small independent airlines, bus, coach or ferry operators are amalgamated as, to an extent, has occurred with deregulation. In many cases, large and multinational companies enter the market and take over small and medium companies, which may refer to the monopoly powers.

In this case, production conditions differ according to whether the industry is operated as a monopoly or under competition as large economies of scale can apply when production is undertaken by a single firm, where so-called 'natural monopoly' is occurred. There are cost advantages in having only a few large firms in the industry rather than many small, high-cost firms. In the extreme cases of natural monopoly, costs can only be minimised when the number of firms has been reduced to one. Although prices may be kept near to costs due to competition among oligopolists, no such force exists under a monopoly. Under a natural monopoly, the marginal and average costs are lower over the range of output which could be purchased in comparison with competition. In these situations, consumers could benefit from a lower price and higher quantity of production even if the monopolist made large profits. A good example of the natural monopoly is the airline industry.

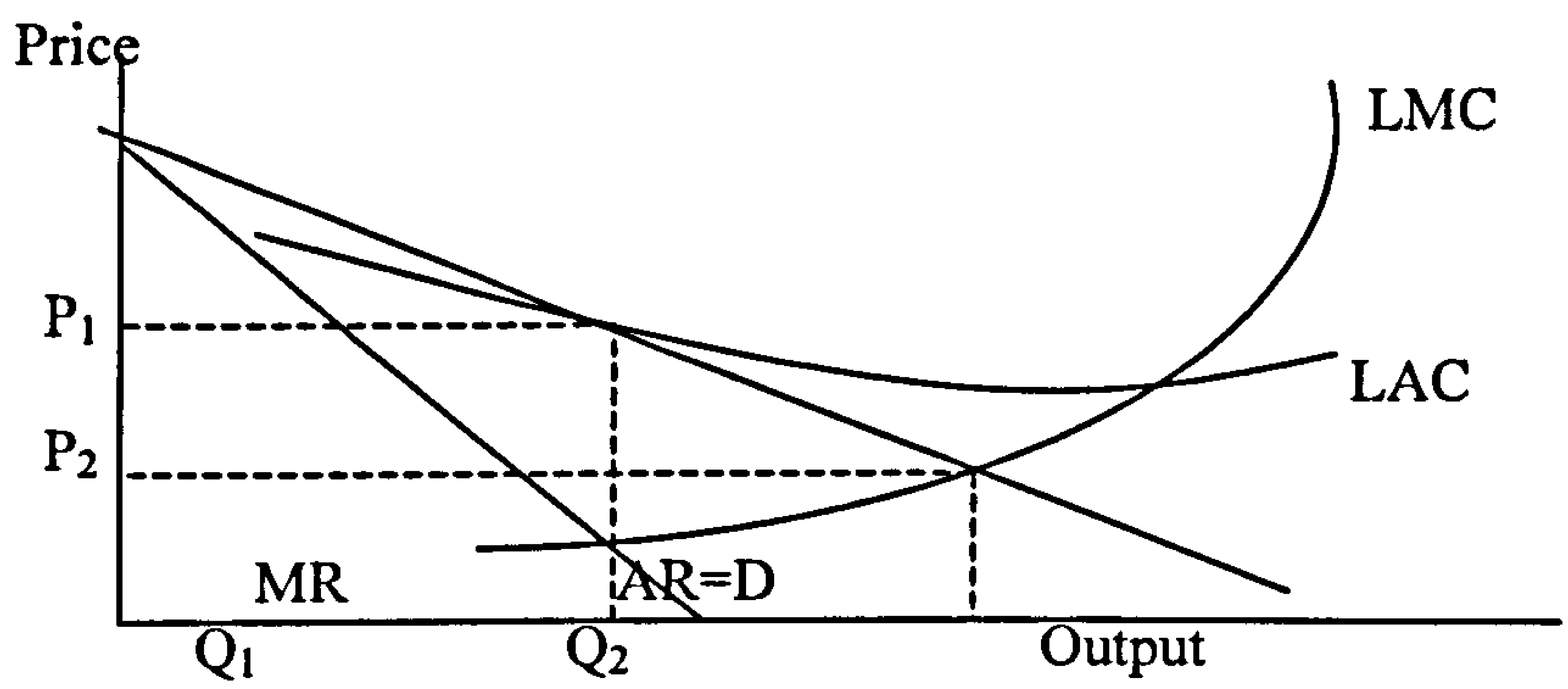


Figure 2.16 Long-run production by an unregulated and regulated natural monopoly

Source: Domainick, 1983.

Figure 2.16 shows the price and quantity combinations under an unregulated monopoly, P_1 and Q_1. If the monopoly were regulated so that the price charged was equal to the marginal cost of production at P_2, it will be benefit to consumers from the lower price and higher output of Q_2. However, a government would need to subsidise production since the price would be lower than the average cost of production, so that the supplier makes a loss (Domainick, 1983).

In the transport industry, most rail systems operate at a loss in terms of not covering average total costs because they are viewed as providing a public transport service and may be required to charge prices at which they attempt to cover operating costs and contribute to meeting fixed costs. Even if the monopoly were not regulated, consumers might benefit in the long run. The monopolist would reinvest the profits gained from selling the products in order to improve the product or innovate the process, including further research and development. In a competitive market, it seems difficult to fund the necessary research and development because it would be difficult for a firm even to compete with other firms to gain some profits which might be only enough to cover fixed and marginal costs (Bull, 1995).

An important argument about a comparison between monopoly and competition market was made by Joseph Schumpeter (1883-1950) who argued that the possibility of technology reduces costs and may allow price reductions and output expansion. A large monopolist with steady profits may find it much easier to fund research and development necessary to make cost-saving breakthroughs. Another issue is that in a competitive industry, a firm with a technical advantage has only a temporary opportunity to earn high profits to recoup its research expenses. Imitation by existing firms and new entrants gradually compete away any extra profits. In contrast, by shifting down all its cost curves, a monopoly may be able to enjoy higher supernormal profits forever.

2.4.3.3 Monopolistic Competition

In tourism, many sellers producing products that are close substitutes for one another and each firm has only a limited ability to affect its price, which is called as monopolistic competition market structure. The hotel accommodation sector can be regarded as a monopolistic competition as it is characterised by many suppliers who provide products which are close but not exact substitutes, so that there is some degree of product differentiation, as in retailing, by the spatial separation and location of businesses.

An industry with monopolistic competition has many sellers producing producers that are close substitutes for one another. Each firm has only a limited ability to affect its output price. Monopolistic competition describes an industry in which each firm can influence its market share to some extent by changing its price relative to its competitors. Its demand curve is not horizontal because different firms' products are only limited substitutes.

Monopolistically competitive industries exhibit 'product differentiation'. This may include either location differentiations or based on brand loyalty. Although brand royalty and product differentiation may also be important in many industries, these need not be monopolistically competitive. Brand royalty limits the substitution between Hyatt and Hilton in hotel accommodation sector but, with so few suppliers, the key feature of the industry remains the oligopolistic interdependence of the decisions of different firms. Monopolistic competition requires not only product differentiation, but also limited opportunities for economies of scale so that there are many producers who can largely neglect their interdependence with any particular rival. Many examples of monopolistic competition are service industries where economies of scale are small.

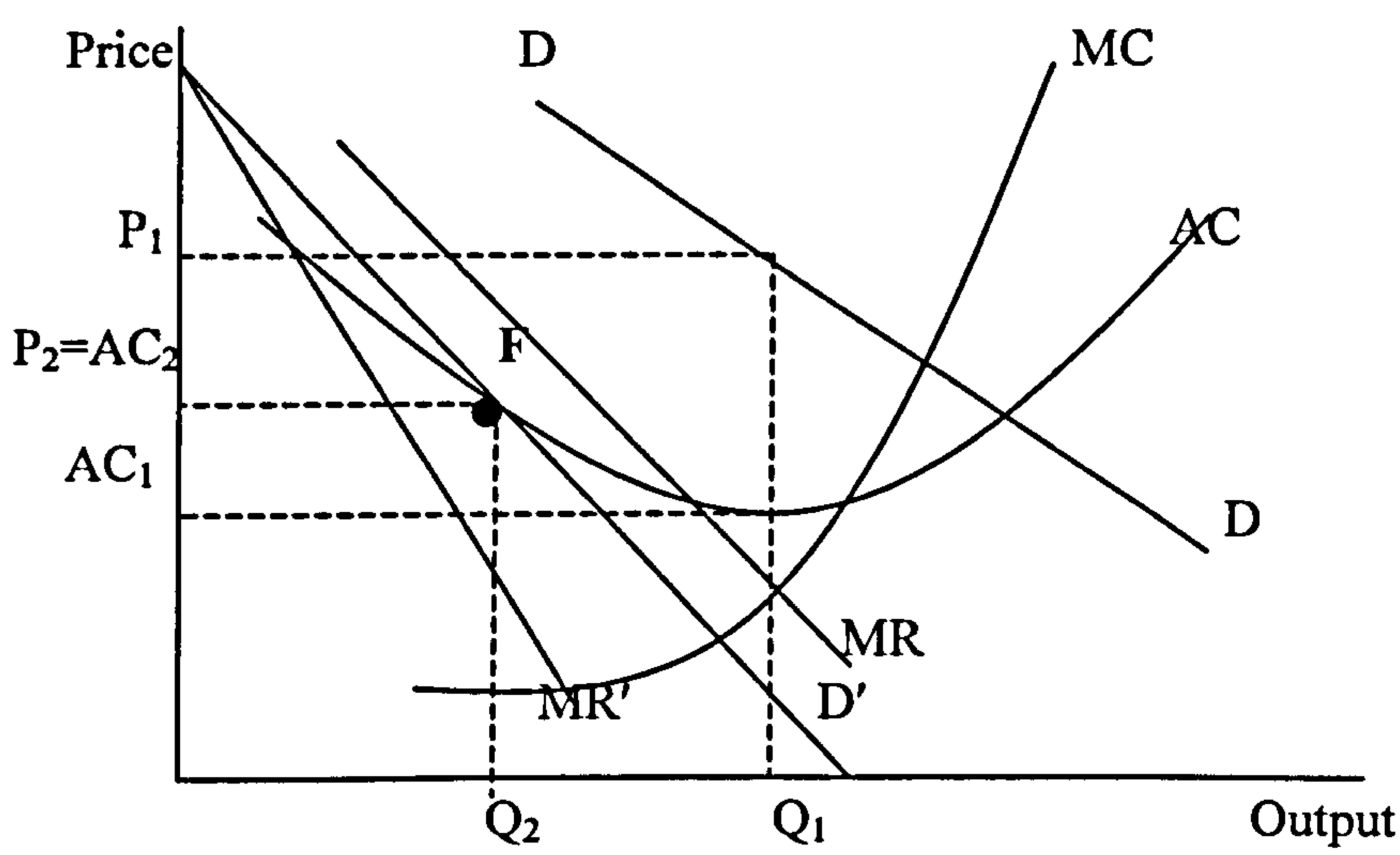


Figure 2.17 Production by a firm in a monopolistically competitive market
Source: Begg, *et al.*, 1994.

Figure 2.17 shows production by a firm in a monopolistically competitive market. In the short run the monopolistic competitor faces the demand curve D and sets MC equal to MR to produce Q_1 at a price P_1. Profits attract new entrants and shift each firm's demand curve to left in the long run. When the demand curve reaches D′ the equilibrium point of F will occur where the level of output and the level of price decrease at O_2 and P_2. The firm sets MC equal to MR′ to produce Q_2 at which P_2 equals AC_2. Firms are breaking even and there is no further entry (Begg, *et al.*, 1994).

There are a number of examples of tourism businesses in this position such as the smaller firms in the contestable segments of the accommodation and transport sectors, where the extent of their market limits the possibilities of operating at a level which reduces their costs as shown in figure 2.17. This might explain why smaller airlines, bus and ferry operators eventually get taken over as they cannot compete at prevailing prices, especially during a price war.

2.4.3.4 Oligopoly

In many countries, the hotel industry is an industry with only a few producers (luxury hotels), each recognising that its own price depends not merely on its own output but also on the actions of its important competitors in the industry which can be a good example of an oligopoly. The room rate of the Hyatt depends not only on its own occupancy rate but also on the decisions taken by major competitors such as the Hilton and Marriott. What makes oligopoly so interesting is that the supply decision of each firm depends on its guess about how its rivals will react. Exciting recent developments in economics offer important insight into what constitutes a smart guess. However, basic tensions between competition and collusion beneath all oligopolistic situations. Collusion is an explicit or implicit agreement between firms to avoid competition with one another (Stiglize, 1993). Therefore, the possibilities of entry can be neglected and focus only on the behaviour of existing firms.

Although the airline industry was used as a hypothetical example of a monopoly earlier, in practice, of course airlines are oligopolists. Even on the popular transatlantic routes, British Airways, Air France, and TWA have significant market shares, and the position of each of their demand curves depends crucially on how their rivals behave and can be induced to behave. In contemplating a cut-price deal, each airline needs to consider whether or not other airlines will follow suit. When new airlines try to break into the market by offering cheap fares, these entrants' prospects depend on how existing airlines respond. Figure 2.18 shows such interdependence by the oligopolist's perceived kinked demand curve, which shows the likely outcome for a firm, should it contemplate a change in its price in the absence of changes in cost or demand conditions that affect the whole of the industry. If it decreases its price, its competitors will follow suit, demand for their own product becoming more inelastic, so that it will not increase its market share by doing so. Conversely, if it increases its price competitors will maintain their prices so its demand is more elastic and it will lose market share. Thus the prevailing market price is the profit maximising price for the firm.

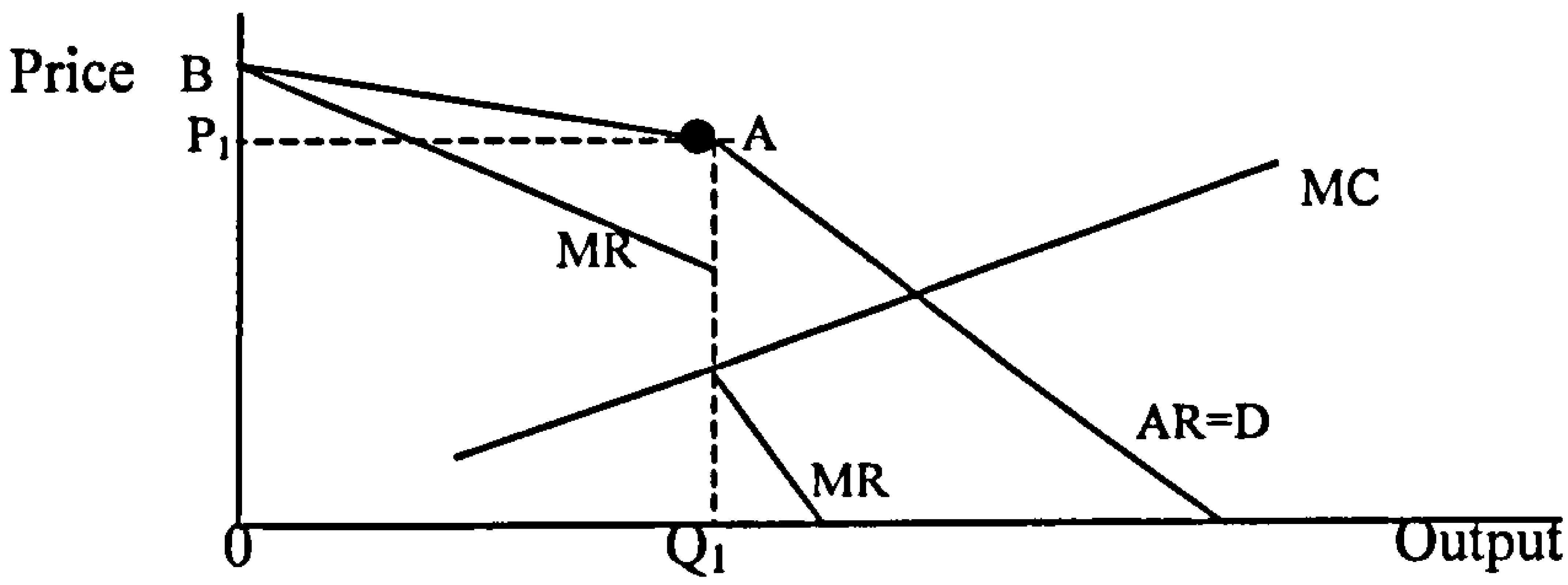


Figure 2.18 Production by an oligopolist

Source: Stiglize, 1993.

An oligopolist believes rivals will match price cuts but not price rises. The oligopolist's demand curve is kinked at A. A price rise leads to a large loss of market share, but price cuts increase output only by increasing industry sales. If the firm increases its price above P_1, it experiences a large decrease in demand as its competitors fail to decrease their prices in line, so that the average revenue curve for the oligopolist is relatively elastic between B and A. Marginal revenue is discontinuous at Q_1. The oligopolist produces Q_1, the output at which MC crosses the MR schedule and Q_1 is the profit maximising output for the firm at the price P_1, given its belief about how competitors will respond (Stiglize, 1993).

Ideally, individual oligopolists prefer prices to be set at a level which maximises the joint profits of all producers in the industry. In effect, if all the firms in the industry act together, the result would be similar to a monopolist, leading to an increase in price and a decrease in the quantity sold, in contrast with the outcome that would occur under competitive conditions. For example, inter-airline pricing and route-sharing agreements are one example of a strategy which has been used to increase joint profits, but with the possibility for the firm to cheat their competitors. However, the kinked demand curve model may explain the empirical finding that firms do not always adjust prices when costs change.

Understanding the differences between each of the different market environments is important to measure the competitiveness of an industry in international trade. More importantly, the impacts of GATS will be different between countries or industries depending upon their economic structure and market environment. For example, many airlines (such as Egypt Air, Korean Air, Thai Airline, etc) are operating under a monopoly or monopolistic competition in developing countries, especially for their domestic routes, hence the GATS will have a larger effect on the airline industry than other tourism-related industries which are in perfect competition. In other words, removal of trade restrictions and barriers can have a different effect on different economic environments.

2.4.4 COMPARATIVE ADVANTAGE

Torrens (1815) and Ricardo (1817) are credited with carrying Smith's doctrine by analysing the case where one country has an absolute advantage in all lines of production. Perhaps the greatest of Ricardo's many contributions to economics was the demonstration that mutually beneficial trade is still possible even if one of the potential trading partners has an absolute advantage in the production of both goods. Ricardo's theory is based on the concept of 'comparative advantage' (Yarbrough and Yarbrough, 1988).

In other words, Ricardo showed by the law of comparative advantage that it was not necessary for one country to have an absolute cost advantage in the production of a commodity for it to find a partner willing to trade. Even if a country produced all commodities more expensively than any other, trade to the benefit of all could take place provided only that the relative costs of production of the different commodities were favourable. Differences in costs of production exist because countries are differently endowed with the resources required. Countries differ as to the type and quantity of raw materials within their borders, their climate, the skill and size of their labour force and their stock of physical capital. Countries will tend to export those commodities whose production requires relatively more than other commodities of those resources of which it has most (Baxter and Davis, 1992).

To see what comparative advantage means with an example, let's say that both the United States and Korea produce two goods, computers and rice. The amount of labour needed to produce these goods is shown in Table 2.5. In the United States, say that it takes 100 worker hours to make a computer (that is, if all the time spent by all the people working to make a computer is added up, the sum is 100 hours); in Korea, it takes 120 worker hours. In the United States, it takes 5 man-hours to make a ton of rice; in Korea, it takes 8 man-hours. The United States is more efficient at making both products. America can rightfully claim to have the most efficient computer industry in the world, and yet it imports computers from Korea because of comparative advantage. The relative cost of making a computer in terms of labour used in Korea, relative to the cost of producing a ton of rice, is low, compared with the United States. That is, in Korea, it takes 15 times as many hours (120/80) to produce a computer as it does to produce a ton of rice; in the United States, it takes 20 times as many hours (100/5) to produce a computer as it does to produce a ton of rice. While Korea has an absolute disadvantage in producing computers, it has a comparative advantage.

Table 2.5 Labour cost of producing computer and wheat (worker hours)

	United States	Korea
Labour required to make a computer	100	120
Labour required to make a ton of wheat	5	8

In other words, in the short run, the production of one commodity, say rice, can only be increased by reducing the production of the other commodity, computer. This means the costs of producing one extra unit of rice in terms of the number of units of computer that must be therefore foregone and vice versa. We can illustrate the nature of choices with the help of the production possibility or transformation curve which is shown in figure 2.19.

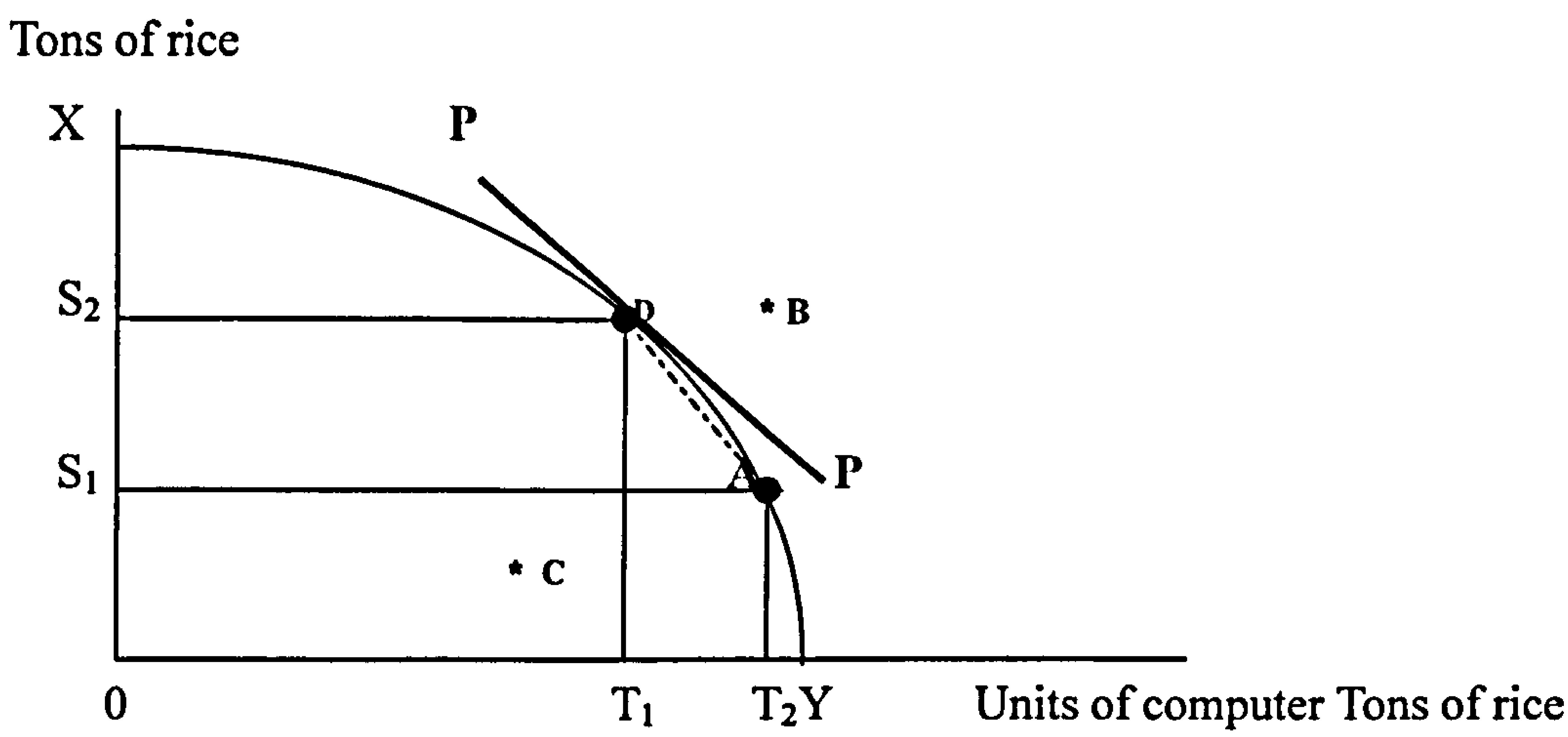


Figure 2.19 Korea's transformation curve

If Korea employs full resources, she will produce somewhere on the transformation curve, such as points D or A. A point such as C would be inefficient since the country would not be fully utilising all their resources. Moreover, a point such as B that lies beyond or outside the transformation curve is unobtainable with their existing resources. The exact point along the transformation curve where they will locate production will depend on the cost of production as well as the preferences of consumers. If consumers demand more tons of rice to be produced and fewer units of computers, relative prices will change. It will be more profitable to produce rice and less profitable to produce computers.

The transformation curve has been drawn as concave to the origin shows that the costs are increasing. The marginal costs of producing rice or computers rise with output. When it reaches at a point such as X or Y, the resources must be switched out of one activity and into the other. The resources that are most specific to just one activity and therefore at least suitable for being re-employed in another activity. For example, some resources will be highly specific to computer production and wholly unsuitable for being re-employed in rice production. Some highly skilled computer-workers may possess skills quite inappropriate for rice production. It will be extremely costly to re-train such workers. It is, therefore, to be expected that the costs of producing computers will rise as output increases and as point Y on the transformation curve is approached.

The costs of increasing computer output by T_1T_2 is S_1S_2 tons of rice. That is shown by the gradient of the line DA. This measures the slope of the curve between the points D and A. The slope of a curve at a particular point such as D is given by the gradient of a line drawn tangent to the curve at point D. This is the tangent of a line PP which shows the marginal costs of producing computers or rice at that point. The steeper the curve, the steeper the tangent and therefore the higher the marginal costs of producing computer (the lower the marginal costs of producing rice). The flatter the curve, the flatter the tangent and therefore the lower the marginal costs of producing computers (the higher the marginal costs of producing rice).

However, let's assume America also employs all its resources fully in either the production of computers or rice. In fact, America can produce both products more efficiently than Korea, but America possesses a comparative advantage in computer production. America's transformation curve is shown in figure 2.20. America's curve is much steeper indicating that marginal costs of producing computer expressed in terms of rice output are lower in America. Similarly, the marginal costs of producing rice expressed in terms of computers are lower in Korea.

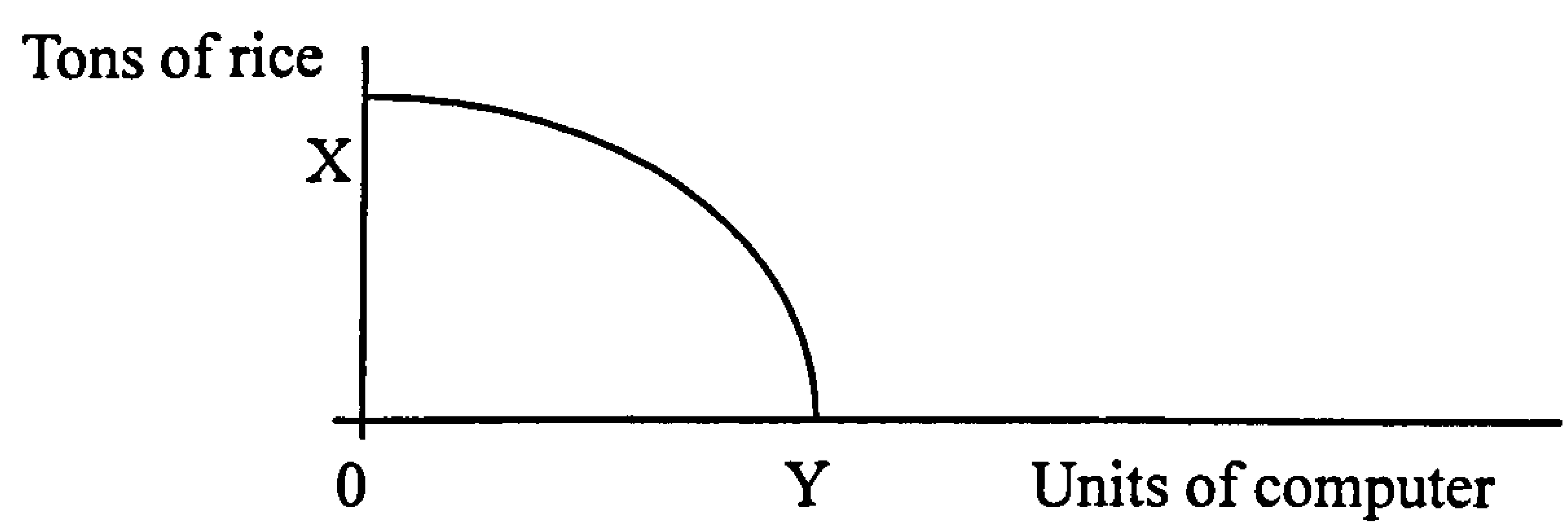


Figure 2.20 America's transformation curve

Note that it is not absolute costs which count but differences in comparative costs. The concept of opportunity costs enables us to express such differences while ignoring differences in absolute costs. So long as there exists a difference in comparative costs between any two countries, a basis exists for specialisation and trade (Grimwade, 1989).

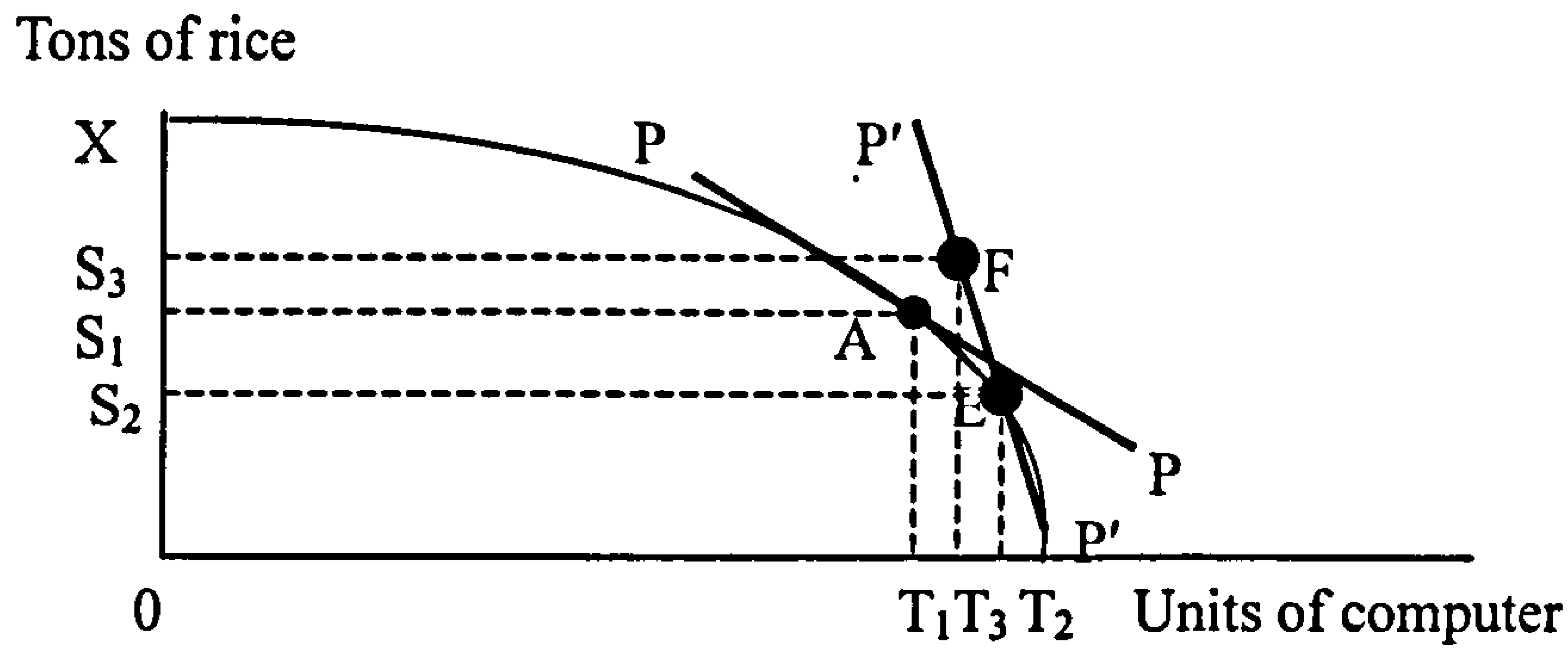


Figure 2.21 Gains from trade for Korea

Source: Grimwade, 1989.

Figure 2.21 illustrates how Korea gains from specialisation. Before specialisation, Korea is assumed to have produced at point A. Output consisted of OS_1 rice and OT_1 computer. After specialisation, she increases production of computer and reduces production of rice since the production shifts to point E. Korea now exports some of her computers in exchange for extra tons of rice. The important point is how much Korea obtains in exchange for computers which depends on the ratio of the price of her exports to the price of her imports. It is clear that America will pay a better price for the computers than it sells in Korea because costs are higher in America. Therefore, the international price of computers will lie somewhere between Korea's low price and America's high price. In this case, lets assume the international price of computers is given by the line P'P' which is steeper than PP. It indicates a higher price of computer expressed in terms of rice. Therefore, Korea can exports T_3T_2 units of computers and imports S_2S_3 tons of rice. This enables Korea to consume at point F which means Korea can obtain OT_3 units of computers and OS_3 tons of rice (OS_2 produced domestically and S_2S_3 imported from America). It is clear that point F is better than before specialisation of point A and point F cannot be reached without specialisation and trade. Therefore, Korea's gain from trade is S_1S_3 more of rice and T_1T_3 more of computers (Grimwade, 1989).

The idea of comparative advantage is a simple extension of the concept of opportunity cost. Country A has a comparative advantage in the production of good X if, in order to produce an additional unit of good X in A, it is necessary to forgo fewer units of good Y than would be necessary in order to produce the additional unit of good X in country B. This is equivalent to saying that the opportunity cost of good X in country

A (measured in units of goody) is lower than in country B. The opportunity cost of each good in each country is reported in table 2.6 both in general form and in terms of a numerical example. In country A, aLX =2 units of labour are required to produce a unit of good X and aLY = 5 units of labour to produce a unit of good Y. Therefore, production of an additional unit of X means forgoing 2/5 units of Y; in other words, the opportunity cost of good X in county A is 2/5 units of Y. Similarly, production of an additional unit of Y in country A is possible only if X production is reduced by 5/2. In country B, bLX = 8 units of labour are required to produce one unit of good X and bLY = 10 to produce one Y. This implies that the opportunity cost of producing good X in country B is 8/10 units of Y and the opportunity cost of Y in B is 10/8 units of X. In the numerical example, country A has an absolute advantage in both goods. Nonetheless, trade according to the principle of comparative advantage can be mutually beneficial. Note that one country cannot have comparative advantage in the production of both goods.

Table 2.6 Opportunity costs of producing goods X and Y in countries A and B

	General Case		Numerical Example	
	Country A	Country B	Country A	Country B
Good X	a_{LX}/a_{LY}	b_{LX}/b_{LY}	2/5	8/10
Good Y	a_{LY}/a_{LX}	b_{LY}/b_{LX}	5/2	10/8

The important question to ask at this stage is what really determines comparative advantage. There isn't a simple answer: in the modern world, it is a fairly complex matter.

- David Ricardo used the example of Portugal's trade with Britain: Portugal had an absolute advantage in producing both wool and wine. But it had a comparative advantage in producing wine, because it could produce wine better than it could produce wool, compared with Britain. Thus, Britain had a comparative advantage in producing wool. From this example, economists tended to assume that a nation's comparative advantage was determined largely by its 'natural endowments' (land). Countries with soil and climate that are relatively better for grapes than for pasture will produce wine, but countries with soil and climate that are relatively better for pasture than for grapes will produce sheep and hence wool. In the modern economy, America's abundance of arable farmland gives the country a comparative advantage in agriculture. Countries that have an abundance of low-skilled labour relative to other resources, such as China and Indonesia, have a comparative advantage in producing goods like textiles, which requires a lot of handwork. The important point is that while this theory, called geographical determinism', can still applied in some places, it has clearly been outdated by developments in the modern economy. Rather than searching for whatever comparative advantage nature has bestowed, nations in today's technological age can act to acquire a comparative advantage.

- A nation's endowments need not be limited by accidents of geography. The Japanese have little in the way of natural resources, yet they are a major player in international trade, in part because they have 'acquired endowments' (capital). Their case underscores the principle that by saving and accumulating capital and building large factories, a nation can acquire a comparative advantage in goods, like steel, that require large amount of capital in their production. And by devoting resources to education, a nation can develop a comparative advantage in those goods that require a skilled labour force. Thus, the resources (human and physical) that a country has managed to acquire for itself can also give rise to comparative advantage. In the modern economy, what is important is not only possessing resources, but also having the knowledge to use those resources productively. Switzerland's comparative advantage in watches is not based on a larger store of capital goods or better-educated labour, nor does it have a better natural endowment of the materials that go into making watches. It is simply that over the years, the country has accumulated superior knowledge (labour) and expertise in watch-making. One of the principal ways that countries acquire a comparative advantage is by establishing or increasing their technological knowledge in a particular area.
- Specialisation may also lead to comparative advantage. The Swiss make fine watches, and have a comparative advantage in that market based on years of unique experience. Such superior knowledge, however, does not explain why Britain, Germany, and the United States, which are at roughly the same level of technological expertise in building cars, all trade cars with one another. How can each country have a comparative advantage in making cars? The answer lies in specialisation. Both Britain and Germany may be better off if Britain specialises in producing sports cars and Germany in producing luxury cars, or conversely, because specialisation increases productivity. Countries enhance, or simply

develop, a comparative advantage by specialising just as individuals do. As a result, similar countries enjoy the advantages of specialisation even when they specialise in different but similar products (Stiglitz, 1993).

It is possible to evaluate comparative advantage in the services industry, particularly tourism:

- In the services industry, it is very clear to see the cases with 'natural endowment'. Countries with natural beauty and warm climate are relatively better off from developing tourism rather than developing agriculture. In this case, the county has comparative advantage in developing tourism products. However, in tourism, other factors need to be considered. For example, tourist arrivals should increase as time passes because Africa has mostly untouched nature to explore but it is not enough to attract a large number of foreign tourists. It has gifted nature but its accommodation and facilities need to be developed since tourists tend to demand comfort and convenience as well as beautiful scenery and adventure.
- Although some countries do not have nature to explore, they develop tourism with a large amount of investment to create artificial tourists destination by building a theme park, a museum, and historical sites, to attract international tourists. For example, Florida attracts tourists through Disneyland, along with hotels and beaches. Although, Florida was already an attractive tourist destinations before introducing Disneyland, the destination can offer different and various activities to tourists such as beaches, shopping and the climate.

Tourism is labour-intensive, so that countries which are well endowed with labour have a comparative advantage. However, Diamond (1974) argued that tourism can involve large inputs of capital as well as skilled labour, as in the case of Turkey, which is supposedly a labour-abundant country but the country requires high capital to produce one more unit of output or income compared with other countries in tourism sectors. The capital intensity of tourism varies between countries and can also vary over time, at different stages of tourism growth. Since it is not homogeneous, it is likely that tourism is relatively labour-intensive in countries with a large supply of labour and capital-intensive in countries which are capital-abundant.

The relationship between tourism production and factor endowments is further complicated by the problem of measuring factor abundance and quality. Abundance can be measured by either the quantity of supply-side or the value of the demand-side, when demand for the product become higher the price for the product will increase and so will the value of the product. Its quality is more difficult to ascertain as, for instance, labour can be classified as skilled or unskilled and capital can be of differing vintages and efficiency. When land is considered the situation can be even more complicated. Land in either the form of natural resources or the artificial environment is usually a key component of the tourism product but it is not clear whether land is complementary to capital or labour or both (Sinclair and Stabler, 1997).

The importance of comparative advantage suggests that, even if someone is very bad at some activity, perhaps even worse than anyone else at it, it could still be efficient for him to pursue it if even more untrained at other activities. The idea is particularly important in international trade, where it is suggested that countries should specialise in area in which they have a comparative advantage.

2.5 INTERNATIONAL TRADE IN TOURISM

In recent developments of international trade, the movement of globalisation has become the focus of world trade, especially in the services industry. Amongst various services sectors, international tourism plays an important role in generating globalisation in the economic, socio-cultural and socio-political processes.

At the end of the 1960s, numerous regions in the world, deprived and far removed from the great centres of industrial development, were simultaneously transformed into resorts for thousands of holiday-makers from the great metropolises of the industrial world. In fact, international tourism is realised as a catalyst for economic development in many countries, especially in underdeveloped countries. International tourism provides economic benefits to those countries where no other economic option seems possible. Thus, through international tourism, poor regions that have been removed from any focus of economic activity find themselves rediscovered and thrust into the path of development and also linked to the international market. Therefore, international tourism is continuously expected to be a tool to promote globalisation in international trade.

2.5.1 THE IMPORTANCE OF INTERNATIONAL TRADE

It is evident that improvements in transport and communication technology are critical for trade development. Every improvement in transport and communication technology promotes an effective geographical extension of the market area that can be supplied with goods and services and the area from which raw material and other production inputs can be sourced (Johns, 1985).

International trade is vital to the health of any nation, and therefore is central to the study of economics. The world's major economies have always been linked in various ways. But dramatic improvements in transportation, telecommunications, and international relations in recent decades have pulled the industrial nations ever closer together. We now truly live in "one world", at least in an economic sense. Economic events in other countries affect our economy for both macroeconomic and microeconomic reasons. For example, the level of net exports is an important determinant of a nation's gross output and employment. However, it is important to examine some of the reasons why international trade is important to a nation's microeconomic well being. The central principle here is the law of comparative advantage, which plays a major role in determining the patterns of world trade.

International trade plays an increasingly important role in our economic life. The volume of world trade has increased during the last decades not only in absolute volume and value but also in importance relative to GNP or other indicators of economic performance. World trade has doubled approximately every decade since 1938. In that year, total world exports amounted to $24.1 billion. In spite of the disruptive influence of World War II, total exports grew to $53.7 billion in 1948. In 1958, trade amounted to $95.4 billion, and a decade later world exports had again more than doubled to $212.8 billion. Since then the volume of world trade has been gradually growing every year.

The volume of world exports rebounded to an impressive increase of 9.5 % in 1997, after slowing down from 9.0 % in 1995 to 5.0 % in 1996; in value terms the expansion was only one third as high. As a consequence, the divergence which has been evident between the growth trend of world trade and that of world output in recent years widened further. The stronger than expected volume growth of world exports in 1997 is the second highest in more than two decades and comes close to the record rate of 10 % in 1994 (UNCTAD, 1998).

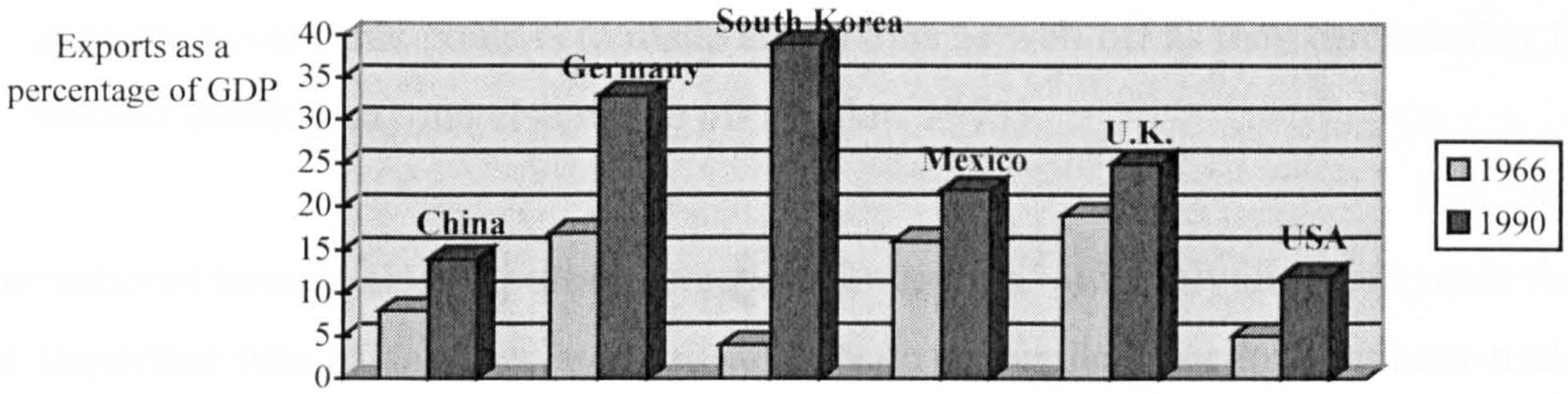


Figure 2.22 The world-wide importance of international trade

Source: United Nation, 1998.

In relative terms the role of international trade differs greatly from country to country. In some relatively small countries, like Belgium, Iceland, and Ireland, imports account for more than one-third of all expenditures. On the other hand, in the United States the foreign trade sector amounted to only small proportion of total GNP but this may be seriously misleading in an overall assessment of the importance of international trade as they do not reveal that even in an economy as large as America, several commodities are not produced domestically at all and the entire country has to rely on imports to obtain these goods, which may be considered vitally important. Also, the distribution of trading partners varies widely from country to country.

However, it is important to ask four main questions associated with international trade:

- What determines the direction of trade? Here we are interested in why a country tends to export one commodity rather than another.
- Intimately connected with the direction of trade is the question of the physical volume of international trade and the prices at which the commodities are traded. Clearly, countries will not only be interested in knowing whether they should be exporting bananas or radios, but they will also want to know in what quantity these commodities can be exported and what prices their products will command

in world markets.

- What are the effects of trade restrictions? The imposition of tariffs and other restrictive devices will change many of the crucial variables, as will the formation of customs unions and common markets.
- Finally, what is the effect of free trade and restricted trade on the economic welfare of the countries? This is doubtlessly significant, since one of the most important economic goals is to make all persons as well off as they can possibly be without making anyone else worse off (Heller, 1973).

International trade is also important to service industries. It is only in recent years that the important role of services industries has been recognised for international trade. The services sector had become more important than manufacturing in total employment. The higher share of services in total employment may occur from the fact that service activities tend to be quite labour intensive. However, the importance of the services sectors in international trade is not only recognised in the higher share in employment but also in other factors, such as large proportions of service activities are directly related to the production of goods such as transport, wholesaling, retaining, and financial services. Therefore, the growth of trade in services sector, particularly in tourism will affect the growth of trade in goods and the economy as a whole.

Tourism is the world's largest growth industry with no sign of slowing down in the 21 century. International tourism have increased by an average of 9 % annually and reaching US$476 billion in 2000. During the same period, international arrivals rose by a yearly average of 4.6 % to reach 698 million tourists. In addition, according to the World Tourism Organisation (2001), international arrivals will top one billion by 2010 and earnings will grow to US $ 1,550 billion by 2010 (World Tourism Organisation, 2001) as shown in table 2.7.

Table 2.7 International tourist arrivals and tourism receipts

	1980	1985	1990	1995	2000	2010
Tourist Arrivals (in millions)	287	327	458	564	702	1,018 (forecast)
Tourism Receipts (in US $ billions)	106	117	266	399	621	1,550 (forecast)

Source: World Tourism Organisation, 2001.

The importance of tourism is well recognised because it is one of the major industries that brings economic benefits to a country. The key benefits of tourism in economic aspects are:

- Export earnings: international tourism is the world's largest export earner and an important factor in the balance of payments of many countries. Foreign currency receipts from international tourism reached US $ 476 billion in 2000 outstripping exports of any other products and services.
- Employment: travel and tourism is an important job creator, employing an estimated 100 million people around the world. The majority of tourism and tourism-related jobs are in small or medium sized family owned businesses. Many researches show that job creation in tourism can grow even faster than any other industries in the future.
- Rural opportunities: tourism jobs and businesses are usually created in the most underdeveloped regions of a country, helping to equalise economic opportunities throughout a nation and providing an incentive for residents to remain in rural areas rather than move to large cities.
- Infrastructure investment: travel and tourism stimulates foreign investments in new infrastructure, most of which helps improve the living standards of local residents as well as tourists since tourism development includes the improvement of roads, airports, sewage systems and other facilities in tourist destinations.
- Tax revenues: the tourism industry provides governments large amount of tax revenues from accommodation, restaurant, airport, sales and many other taxes which can invest and distribute back to the community.
- Gross Domestic Product (GDP): international and domestic tourism generate up to 10 % of the world's GDP and a considerably higher share in many developing countries.

2.5.2 GAINS AND PROBLEMS OF INTERNATIONAL TOURISM

In historical terms, a large amount of tourism activity is relatively new, and only recently has it been considered worthy of serious business endeavour or academic study. However, the tourism industry is of sufficient economic importance and its impacts upon economies, environments and societies are significant enough for the subject of tourism to deserve serious consideration. International organisations support tourism for its contribution to world peace, the benefits of mixing people and cultures, its economic advantages and the fact that tourism is a relatively 'clean industry' (Cooper, *et al.*, 1993). However, seen from a host country's point of view, tourism is more complicated. International tourism has a great effect on economic growth in host countries as well as in the world as discussed earlier. Economic growth is only one piece of a puzzle to explain international tourism. There are positive and negative effects of international tourism to be concerned to host countries. The gains of international tourism can be divided into two different factors:

- Economic gains: The main economic significance of tourism is common to all tourism, whether international or domestic. Each year vast sums are transferred from economies in receiving areas where they provide a source of income and amenities for the resident population. The economic significance of tourism is determined not only by the level of tourism activity that is taking place, but also determines the economic significance of tourism. For instance, the economic significance of tourism activity to a developing country and to a developed or industrialised country is different as regards its ability to generate flexibility or imbalance in the economy. Economic growth leads to increases in disposable income and creating employment. Increases in international tourism activities provide an opportunity to create more jobs in the host countries since they need to provide the demands of tourists in terms of the production of tourist goods and services. International tourism also plays an important role for the movement of liberalisation and globalisation in the world. Increases in international trade in tourism industry have been a major part of reducing barriers slowly between countries. For example, in order to attract more tourists or to increase economic growth, restrictions on passport and visa controls as well as other administrative restrictions need to be reduced.
- Sociocultural gains: Tourism is an important means of promoting cultural and social relations and international cooperation. International tourism acts as breaking down the boundaries of culture, customs and religion that each country has had for thousands of years by the contact between tourists and residents. It seems fair to say that cultural exchange between Eastern and Western countries was the first step towards the globalisation. Also, the development of cultural factors can be viewed as means of enhancing resources for tourism and as an element of attraction for tourists, which can be used in many countries as one of

the means of promoting not only knowledge and understanding but also a favourable image of the nation among foreigners in the tourism industry (Gee and Fayos-Solá, 1997).

However, the main concern of international tourism in recent years has been the associated environmental problems experienced by the host countries. Increases in numbers of tourists' arrivals have an effect on the environment in tourist destinations. Any countries interested in generating local economic activity and employment expect to receive some degree of damage from tourism development. Through changes in technology to improve the use of resources, control waste and manage visitors flows to prevent damage to non-renewable tourism resources, it is possible to reach a point where maximise in developing local economy as well as protecting environment, but it is difficult to achieve in practice. Therefore, many countries are introducing regulations or educating the public to prevent excessive environmental damage.

2.5.3 THE THEORY OF LIFE CYCLE AND TOURISM

It seems fair to say that each stage of tourism development leads to a different level of international trade. As a tourism destination develops further, the market will form stronger international competition. For example, when tourism development reaches the development and consolidation stages, it tends to involve more resources, an increased number of international tourists and service providers whereas the early stages of tourism development may involve domestic tourists with a small number of service providers under less competitive market conditions. In fact, tourists very often make their travel arrangements from abroad and suppliers begin to provide their services through international trade when a destination is at the development stage and onwards. In this respect, the theory of life cycle is important for understanding the relationship between the stages of tourism development and international trade.

Tourism specialists have "borrowed" from the product life cycle theory to derive what Butler and others refer to as the "tourism area life cycle". Tourism area life cycle models to some extent show the role played by the development of the tourist product but within the scope of changing tourist demand. Plog (1991) was one of the first to show how. Plog's theory gave inspiration to the Butler's resort life cycle later.

It may be difficult to predict the true psychological makeup or travellers, but destinations are another matter. Each one has a quality that reflects the character of travellers who select it as a place to visit. Plog attempted to explain why resorts appear to follow a pattern which cause them to rise through development and then to decline. According to Plog, the character of a destination depends less upon its geographic location or physical setting than on the manner in which it has been allowed to develop over the years. Destinations change their personality and ambience over time, and seldom for the better. These evolving transformations typically spell trouble – decay and death as a desirable place to visit (Plog, 1991).

Plog's theory was the first to bring tourist destinations and the life cycle of these destinations together and many researchers developed this further. He acknowledged the possibilities of changing its status of a tourist destination as time passes by. The theory starts by attracting no tourists to reaching a peak where large numbers of tourists visit the destination then the number of visitors to the destination will start to decrease. However, Plog did not consider the possibilities of environmental issues in tourist destinations in his development of the life cycle but Butler adapted the actual physical sequence of the resorts including environmental issues.

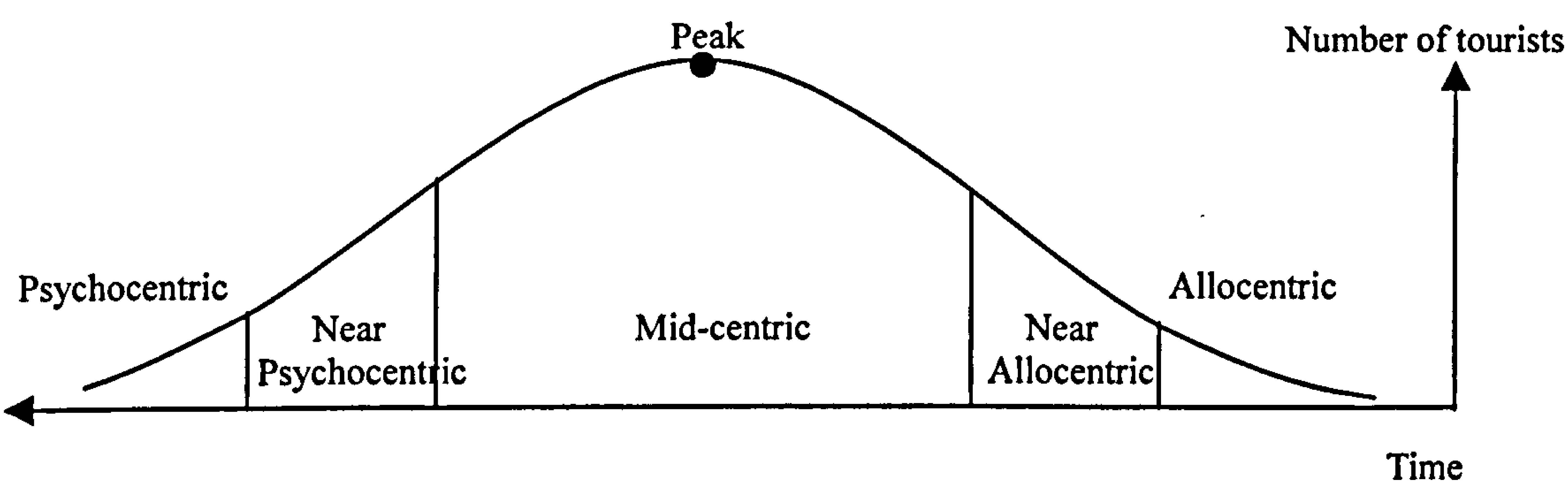


Figure 2.23 Psychographic positions of destinations

Source: Plog, 1991.

Plog's theory suggests that tourism destinations can be classified into five different stages as shown in figure 2.23.

- **Allocentrics**, with their exploring and inquisitive mind-set, are the first to seek out and visit new travel destinations. This involves a sense of discovery for unique and different experiences in relatively unknown travel spots. Tourists do not demand fine hotels and great restaurants to support their travel experiences, but their fulfilment comes from unspoiled beauty of the local scenery, or from enjoying local people and culture which have not been invaded from modern civilisation. These travel resorts are visited by only a few tourists since the resort is yet to be discovered. Visitors' sense of excitement about their discoveries leads to them talking to others about what they have discovered, and, in doing so, they influence the near-allocentrics.

- **Near-allocentrics** may not be as daring as those who first travelled to the new spot, but they are looking for some excitement in their lives and are willing to experience adventure. Now, a destination has slowly begun to move from obscurity to maturity which can be good or bad, depending on the degree to which growth has been planned and controlled. When a destination begins to attract the near-allocentrics, it has become an 'in spot', talked about to outsiders, which will bring more tourists in the destination. Commercial development escalates rapidly as major investors seek to capitalise on what is hot and trendy. Thus, hotels, restaurants, tourist facilities, and various forms of infrastructure begin to clutter the landscape. These developments will change character forever. Now, the destination moves to mid-centric characteristics.
- Many of the most popular travel spots in the world, falling into the middle range on the scale and comprising the bulk of travellers which are called **mid-centric.** Developers and others who control the future of a destination understand that bigger profits can be generated by appealing to mass markets, rather than to select groups. The destination has been attracting increasingly large tourists. Its star is on the rise, and, by most of today's standards, it is becoming extremely successful. The destination has now reached its maximum potential because it appeals to most tourists with a variety of local events and activities and well-developed infrastructure. But the seeds of destruction for the destination have already been planted, and warnings of future decay are overlooked by almost everyone. Destinations do not stand still unless they have been protected through careful planning. They continue to march across the allocentrism / psychocentrism scale. Until this point, the introduction of each new tourist has resulted in a larger and larger base of potential travellers. However, allocentrics abandon the area when it loses its originality and the near-allocentrics drop out when it no longer conveys a feeling of exclusivity.
- As the movement continues toward the **near-psychocentric** and **psychocentric**

characteristics, a destination begins to draw a smaller number of travellers. These travellers have characteristics that make them difficult to attract because they now know that a particular resort is a popular place to visit since so many people have travelled there and, they assume, still do. Psychocentrics do not travel often, they prefer destinations that can be reached by the family car, spend less on a daily basis while there, and stay for shorter periods of time. Local hotels, restaurants, and tourist attractions now face declining tourist populations without knowing why. At first, it seems to be a temporary falloff, then they try to convince themselves that people throughout the country, or the world, are experiencing similar problems. The next step is that usually they blame local crime rates or terrorism. Meanwhile, more hotel rooms continue to be built, and public facilities are enlarged based on the assumption of endless growth (Plog, 1991).

Plog's theory is a useful way of thinking about tourists, but it is very difficult to apply in practice. Smith (1990) tested Plog's model by selecting seven different countries and he questioned the applicability of the model to countries other than the United States. Smith did not support Plog's model of an association between personality and destination types. Smith's typology of tourists was based on sociological development. Using such typologies of tourist activity as these proffered by Plog and Smith, authors such as Butler created the tourist area life cycle.

The product life cycle was the principle theory underlying Butler's resort life cycle in tourism, but it differs in that it is more closely related to the product cycle theory formulated in industrial economics than to the open economy version and also concerned with such issues as the role of the local environment and externalities which are associated with the growth of tourism. Butler's life cycle was based on the fact that tourist destinations change and evolve as new markets and new providers enter and leave. The idea of a tourist area life cycle can be applied to destinations as a framework for considering the interaction between demand and supply and also as a way of thinking about the longer-term implications of tourism development (Cooper, *et al.*, 1998).

One particular benefit of the tourist area life cycle is as a framework for understanding how destinations and their markets evolve. The shape of the curve may vary depending on supply-side factors such as investment, capacity constraints, tourist impacts and planning responses. Although many researchers have suggested that it can be used to guide strategic planning at destinations, or as a forecasting tool, some problems need to be considered, including identifying stages and turning points, the difficulty of obtaining data to assemble the curve and the danger of forecasting for each stage.

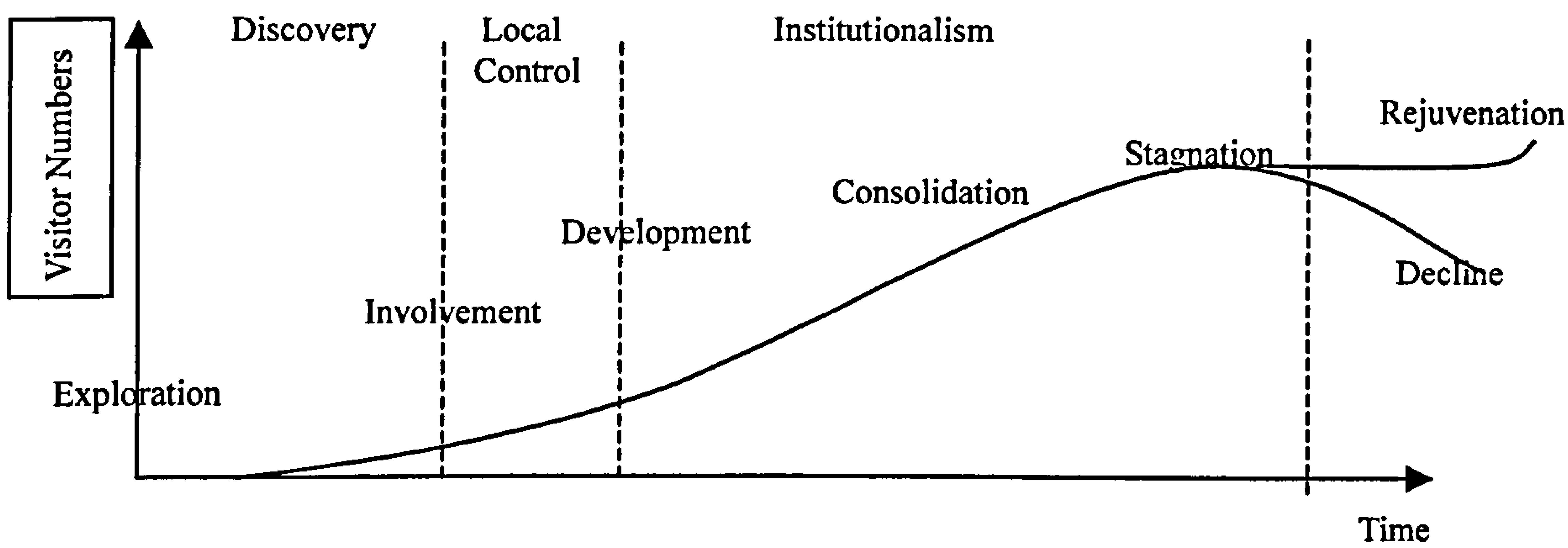


Figure 2.24 Resort life cycle

Source: Butler, 1980 (In: Cooper, *et al.*, 1993, pp 90).

Butler's life cycle involves seven different stages for each tourist destination as shown in figure 2.24:

- Exploration: small numbers of tourists are attracted by the unspoilt natural beauty or culture at the destination. The number of visitors remain small due to poor facilities and access and the destination is not changed either physically or culturally.
- Involvement: by this stage, the promotion of the destination has begun which will lead to increased regular numbers of visitors. A tourist season and market area emerge and pressure may be placed on the public sector to provide infrastructure.
- Development: the number of visitors is increasing and external companies emerge to provide up-to-date facilities which may affect the overall shape of the destination. However, with increasing numbers and popularity the destination may suffer from overuse and deterioration of facilities. The stage includes national and regional planning and travel arrangements need to be made through the trade for the tourists.
- Consolidation: the rate of increase of visitors has now declined, although total

numbers of visitors are still increasing. The major franchises and chains of hotels, restaurants and tour operators are appearing in the destination. This involves an identifiable recreational business district (RBD).

- Stagnation: the number of visitors has reached a peak and the destination is not attractive any more. Major efforts are needed to maintain the number of tourists since the destination relies on repeat visitors and business use of its facilities. At this stage, environmental and social problems can be crucial.
- Decline: the destination suffers from introducing new resorts in the area. The number of visitors is falling as tourists move to new destinations. The destination depends on day-trip and weekend visitors and its facilities tend to be converted into other uses. However, there is an alternative: moving to the stage of rejuvenation instead of decline.
- Rejuvenation: this stage involves deciding on new uses, new markets and new distribution channels, thus repositioning the destination, for instance, changing target segments or providing extra services and activities, changing the attraction by introducing a casino, promoting winter sports and etc., which will affect the destination to reach a cycle/recycle pattern (Cooper, *et al.*, 1998).

Vernon's product life cycle can be applied to the resort life cycle, although each theory has its own characteristics. The stages of exploration and involvement can be explained by the stage of new product from the product life cycle. The tourist destination may refer to the product just introduced in the market and the host country will enjoy large profits that are made by inventing a new product. The stages of development and consolidation of the destination can be treated as the maturing stage of the product. At this stage, other competitors might start to copy and imitate the successful tourist attraction. Finally, the standardisation stage of the product involves the stages of stagnation, decline and rejuvenation of the destination. At this stage, many other competitors have copied or imitated the product and the host country has become less competitive since other competitors provide the same product at lower prices. For example, a success of 'Disneyland' inspired other destinations to introduce a theme park as their main attraction. Let's assume that there are two different resorts, resort A and resort B, in the same area. The main attraction for the resort A is 'a theme park' and it is largely successful in attracting family holidaymakers. At the same time, resort B was losing a number of visitors to resort A, thus they decided to build their own theme park. Once resort B launched the new attraction, the number of visitors would spread between these two resorts which will effect decrease in the number of visitors to resort A.

However, resort A might decide to provide extra services or extra facilities as a response to resort B which will influence these two resorts to fight continuously and both might end up closing business due to financial problems. This movement solely depends on 'capital' and 'investment'.

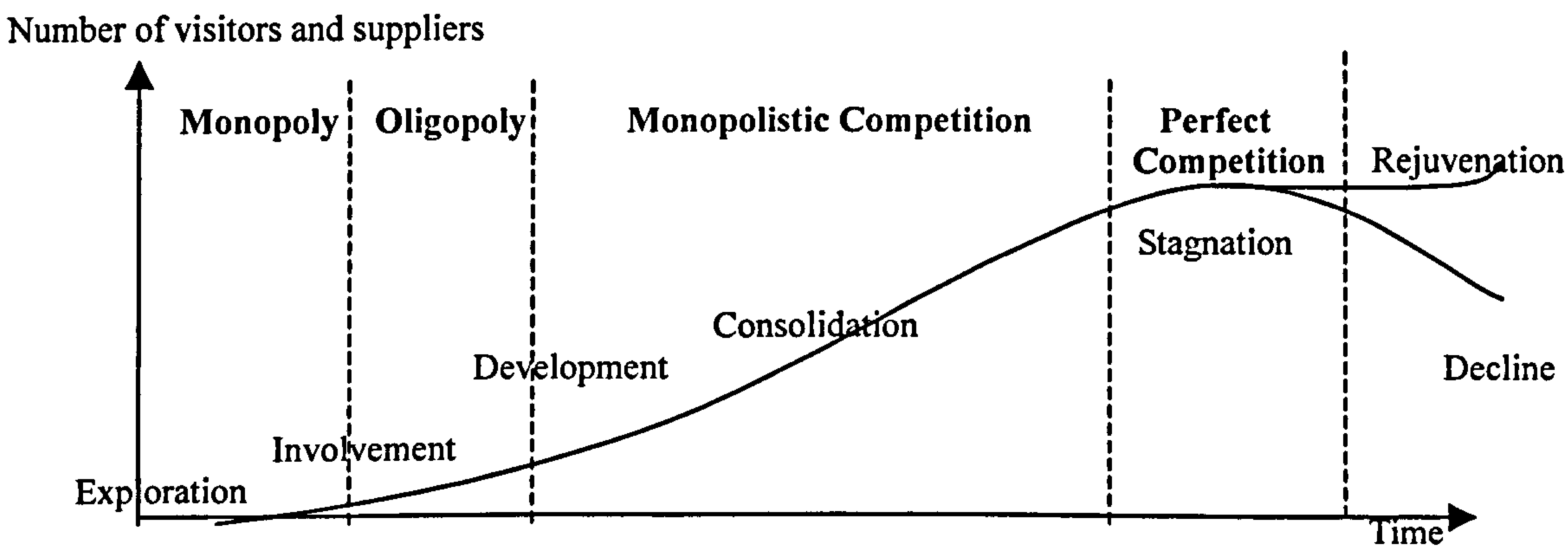


Figure 2.25 Resort life cycle and market structure

Each stage of the resort life cycle can be explained in terms of different market structures. Figure 2.25 shows how different market structures blend into the Butler's resort life cycle:

- Monopoly: in the stage of exploration, a tourist destination attracts small numbers of tourists and yet the destination has been explored to outsiders, thus tourism-related businesses such as hotels, restaurants, and other shops are not even established at this stage. The market structure would be monopoly because small numbers of tourists visit the destination so one or two businesses in different tourism sector may enter the market at this stage, for example, only one hotel, one souvenir shop and one restaurant are available in the resort. The supplier has considerable control and power over the product price and the level of output. Although tourists may end up paying higher prices for accommodation or food, they have no alternative but stay and pay the asked prices.

- Oligopoly in the stages of involvement and development: there will be more than one or two businesses and sectors in the market as the destination starts to attract more visitors and businesses. When the number of visitors increases, the number of businesses or suppliers also increases to meet demand. Therefore, the market structure will be an oligopoly. There are only a few producers, and their prices depend not only on output and demand but also on the actions of important competitors in the market.

- Monopolistic competition in the stages of development and consolidation: As the number of visitors increases all the time, the number of businesses will increase. There are many sellers and producers to provide goods and services that are close substitutes and there are many customers to increase demand. Since different customers demand different types or standards of services, product differentiation is necessary. Some people prefer to stay in a hotel with many indoor facilities and activities but some people prefer a hotel with a larger room and a quieter location at the same price.

- Perfect competition in the stages of stagnation and rejuvenation: When the number of visitors reaches a peak, competition between firms in the resort will be very strong. There is a large number of firms and consumers so neither producers nor consumers can affect the price of goods and services. There is also free entry and exit from the resort. Because competition is high, they have to provide goods and services at a market-set price since there are many alternative products available on the market. However, in the stage of decline of the resort, competition would fall between firms as the number of visitors falls, thus the market structure may return to the either oligopoly or monopolistic competition.

2.6 SUMMARY

International trade is 'a vehicle to increase economic welfare'. Differences in demand patterns, technology, or factor endowments between countries were cited as some of the factors leading to the emergence of international trade. But clearly, countries and people would have no incentive to engage in international trade if it were not going to make them better off. Also trade restrictions are often imposed in an attempt to increase economic welfare. Increases in economic welfare make international trade attractive. In other words, while within individual countries, the changing domestic pattern of demand and resource allocation for production enable greater welfare satisfaction and rising rates of economic growth, freer trade flows between countries enable higher levels of growth to be sustained among the trading partners through a changed and more efficient distribution of scarce resources within all the countries associated with the trade flows. However, both gains and problems of international trade exist as discussed earlier in this chapter. Although freer trade benefit the majority of consumers and suppliers, it can make a particular group within a country worse off. First, strong competition that has been resulted from trade liberalisation might have negative impact on certain industries within the country. In other words, liberalisation of international trade, whether in a free trade area or on a general multilateral world-wide basis, brings benefits that are diffused widely among all sections of those communities which have dismantled trade barriers. The change in production patterns in the countries concerned, made necessary by freer imports, has its impact on particular enterprises and the people employed in them. Second, the world is concerned about the level of protectionism, especially in developing countries. Many countries still apply different regulations and rules to foreign suppliers and investors in order to prevent a sudden invasion by foreign multinational companies as a result of trade liberalisation. Those identified problems need an immediate attention to achieve even further economic growth in the world. In this respect, international trade organisations, such as the WTO, introduced different trade agreements such as GATT, GATS and TRIPS to promote liberalisation and increase participation of developing countries in international trade by providing equal and balanced trading conditions, at least, between member countries.

Furthermore, thus various theories of international trade (in particular, comparative and competitive advantages and life cycle theory) affect studies on international tourism but it is difficult to adopt the theories into the reality because tourism is one of the complicated industries that are depend on other industries and other economic factors. The recent studies on liberalisation and globalisation in international trade have a large impact not only on trade in goods but also on trade in services, especially in tourism. Therefore, the next chapter examines the main issues and effects of globalisation and liberalisation of trade in services, especially in developing countries.

CHAPTER THREE:

LIBERALISATION AND GLOBALISATION ON TRADE IN SERVICES

3.1 INTRODUCTION

Many governments around the world are engaged in a systematic effort to eliminate trade barriers, and this is exemplified by the member countries (there are total of 140 member countries in 2001) of the World Trade Organisation (WTO). The belief that drives this effort is that protectionism and trade barriers jeopardise future growth of the world economy. The movement of liberalisation is necessary and even unavoidable under the concept of living in 'one world,' and this liberalisation encompasses trade in services as well as that in goods. Thus, it is important to examine how services are being liberalised as well as what factors affect the liberalisation in services.

However, trade in services has not been directly affected by the process of liberalisation that has been taking place in merchandise trade. Until recently, no attempt was made to tackle the issue of barriers to trade in services and no internationally agreed rules govern trade in services. This recognition is important because, if world trade is to continue to expand as it did after the Second World War, then the liberalisation of services is needed to fuel that growth. Tourism, which encompasses a number of the services sectors, is the world's largest and fastest growing industry and is an obvious target for the liberalisation camp. However, this was not evident in the first attempt to move towards the liberalisation of services.

In 1994, the World Trade Organisation (WTO) established official agreement of General Agreement on Trade in Services (GATS) between member countries to encourage international trade efficiently and effectively. GATS represents a significant achievement in terms of creating a basic framework, but it has yet to produce significant levels of liberalisation. A new round of services negotiations has begun and represents a valuable opportunity to take matters further, both in terms of liberalising commitments and improved multilateral rules.

This chapter examines the importance of international trade in services under different types of trade agreements (regional and multilateral trade agreements). The main issues in world trade are the recent movements of liberalisation and globalisation. In this respect, trade liberalisation has been reviewed by analysing the different types of trade obstacles and protectionism in services, especially with respect to the tourism sector. The WTO has been main body of achieving trade liberalisation since it is the organisation with the largest number of anticipating countries. The WTO approach to trade liberalisation is ambitious and relatively comprehensive. The WTO also provides a good example of how to deal with different trade issues in a variety of service sectors. Finally, the impact of trade liberalisation in services is examined, which mainly focuses on developing countries since, in recent years, interest has been evident in the liberalisation of services within many developing countries. In fact, one of the most important aims of the GATS is to increase the participation of developing countries in the progress of trade liberalisation.

3.2 BACKGROUND TO LIBERALISING SERVICES IN TRADE

International trade in services is a significant and increasing activity. The increased importance of the services sector in the gross domestic product of many developed countries is more than evident. The post-war period witnessed a major growth in the importance of services. By 1978, 55 percent of the GDP of developed market economies was accounted for by services while manufacturing had fallen to just 26 percent. This represents major transformation in the structure of economic activity in the developed countries. The relative decline of manufacturing and rise of services has been referred to as 'de-industrialisation'. Although a large proportion of services is non-tradable, trade in services accounts for a large and growing proportion of world trade.

Furthermore, many of the fastest growing sectors are services, including telecommunications, health, finance and tourism. The share of services in world trade has been increasing and they have been among the fastest growing components of world trade over the last 15 years.

There are three main reasons for rapid growth of trade in services:

- Technological progress, particularly in telecommunications and information technology.
- Broad trend towards liberalisation/regulation reform in key service industries, which encourages privatisation and competition around the world in major services sectors (Mattoo, 2000).
- Growth in real income that stimulates demand for those services that have high income elasticities.

3.2.1 THE NATURE OF SERVICES

3.2.1.1 Definition of Services

Definitions of both 'services' and 'trade in services' are different in some aspects because the majority of services cannot be traded between countries. Therefore, it is important to understand what are the differences between 'services' and 'trade in services'. Services are often seen as intangible, invisible and perishable, requiring simultaneous production and consumption (Grimwade, 1989). In contrast, goods are visible and storable and hence it does not need a direct interaction between producers and consumers. Stern and Hoekman (1988) suggested that there are three criteria for distinguishing between goods and services:

1. The production and consumption of services have to take place simultaneously whereas they need not for goods.
2. Services cannot be stored whereas goods can.
3. Services are intangible whereas goods are tangible.

However, services are difficult to define unambiguously because these characteristics do not necessarily apply to all services, there are exceptions. For example, a software programme on a diskette or an architect's design on paper are both tangible and storable, many artistic performances are visible, and automated cash-dispensing machine make face-to-face contact between producers and consumers unnecessary. Another reason to distinguish between goods and services is they are frequently supplied together.

The intangible and non-transferable nature of services provides extreme difficulties in accurately measuring the true extent of service activity for the world economy. Also the services sector of the economy in generally considered to be more labour-intensive than the manufacturing sector. However, this can be misleading because with computerisation and the development of telecommunications, buildings and equipment and other plants, much of the services industry now employs more capital per worker than manufacturing industry. Services include some highly skilled activities such as financial services, business services, and so on, and it also involves less skilled services such as cleaning and retailing.

3.2.1.2 The Classification of Services

There are different views with respect to the classifications of services. The Bank of England (1985) classified 'services' into four different types as follow:

1. Consumer services – restaurants, hotels, household services and private transport services.
2. Social services – education, health and welfare services that are mostly provided by the State.
3. Producer or intermediate services – banking, accounting, insurance, consultancy and contracting services, which are used in the production of final goods and services.
4. Distributive services – freight transport, communication, wholesaling and retailing.

In recent years, different types of services have been developed to meet the fast growth in world trade over the years driven ever faster forward by such innovations as 'Internet' services. The GATS attempted to classify 'services' into simple and clear ways but it appears to have some problems with the classification. The differences may arise with the degree of products rather than the quality (e.g. catering, cleaning, communications). Although certain levels of qualitative differences can be drawn from the appropriate authorities, the distinction between them is often not clear. On the other hand, the classification of services is even more difficult because some services, such as management and marketing, are an integral part of other productive or commercial activities. The size of such services could be measured only in an ideal economy in which extensive specialisation prevails and everything has its own market. It is obvious that defining the boundaries of various services is even more difficult since different activities in services blend into each other. However, it dose not mean that the classifications of services on the GATS are inappropriate but it may need to be improved further without any complications between countries in international trade (Nicolaides, 1989).

The GATS uses 12 different classifications of services and they are:

- Business services
- Communication services
- Construction services
- Distribution services
- Education services
- Environmental services
- Financial services
- Health-related and social services
- Tourism and travel-related services
- Recreational, cultural and sporting services
- Transport services, and
- Other services not elsewhere included.

Tourism sits across a number of these sectors and that has implications for effectiveness when a country agrees to liberate some but not all of its services sectors. For instance, it will be difficult to measure the effectiveness of trade liberalisation in tourism sector as a result of the complexity that derives from the classification of services under the GATS if a country only signed tourism and travel-related services and not signed business, financial and transport services, since tourism activities not only relate to tourism and travel-related services but also business; financial; recreation, cultural and sporting; and transport services.

3.2.1.3 Definition of Trade in Services

Only a small proportion of service activity enters into international trade. By their nature services tend to be less tradable than manufactured goods. One of the characteristics of services is that the production and consumption of services have to take place simultaneously. This means, that either the supplier of a service must move to where the consumer is located such as construction services, or the consumer has to move to the location of the supplier such as the case with tourism services. However, it is also possible for services where both the supplier and the consumer could move such as hair cuts or surgical operations.

According to Stern and Hoekman (1988), there are four categories of service activities that can be identified based on how they are traded.

First, 'separated services' requiring no movement of the supplier or consumer of the service between countries, which include transport services, particularly airline aviation or shipping. A civil airline can provide the citizens of another country with a service without the need for the civil airline to be located in the overseas country or for the consumer to go to the country where the particular airline is located.

Second, 'demander-located services' which require the movement of the supplier of the service. In this case, if the supplier wants to be involved in a particular market they need to establish a presence in the market. An example of this would include banking and insurance services.

Third, 'provider-located services' that require the movement of the consumer of the service. In this case, consumers must move to the location where the service is supplied such as tourism, education and medical services.

Finally, there are 'non-separated services' which require the movement of both consumers and suppliers. For example, a Korean bank with a subsidiary in Japan may, through its Japanese subsidiary, make a bank loan to a firm based in America (Grimwade, 1989).

Hoekman (1995) also argues that international trade in services takes place when domestic factors receive income from non-residents in exchange for their services. The proximity aspect of many service transactions has an important implication for the nature of services trade. Furthermore, international transactions in services have been defined according to four modalities of supply, first outlined by Sampson and Snape (1985). This typology was agreed on by participants during the Uruguay Round, and is set out in the GATS. There is some evidence to suggest that the dominant mode of international service supply is through foreign direct investment, which is estimated to constitute well over half of the total output of trade in services.

The Sampson and Snape typology and the modes of supply under GATS are:

Sampson and Snape	GATS
Through **cross-border** flows in which neither the supplier nor the producer move physically but instead rely upon an intermediate service such as a telecommunications network including electronic transfers between member countries.	**Cross-border** trade allows service suppliers of one member country to deliver services from abroad into another member country. Typically, travel agents or tour operators will provide a range of travel related services such as booking arrangements or travel advise, cross-border by means of telecommunications.
Through the **movement of a consumer** to a supplier's country, such as people going to another country to consume tourism or education.	**Consumption abroad** trade allows consumers move abroad to purchase services, which in effect, consumer's country, which in effect, is tourism itself.
Through the **movement of a commercial organisation** to the consumer's country, which associate with foreign direct investment and establishing a branch in another country.	**Commercial presence** enables member countries to establish and expand a commercial presence in another country in order to produce and sell services. All of the legal ways in which a service supplier can be present in the market, for example, an agency, branch, subsidiary, or a joint venture are covered by the agreement.
Through the **movement of an individual service supplier to the consumer's country,** including employees or representatives of services supplier of one member country work in another member country.	**Presence of natural person** allows for the presence and temporary stay in foreign markets of personnel involved in service supply. As nearly every country has strict visa, work permit and residence laws, this can be a hindrance to the movement of professional, managerial and technical staff between member countries.

It is clear from the categories of international service trade in the agreed typology above, that trade in services cannot be promoted without a willingness on the part of governments to consider multiple modes of supply. These must include the movement across national borders of services, or of producers of services, or of consumers of services. If trade must take place through the movement of factors (are the basic propositions of trade theory), particularly based on the notion of cross border trade, there is a question to be asked. It turns out that the economics is not much different but the politics can be.

The economic theory supporting this has no serious problems and it demonstrates that a country can gain from the importation of services regardless of the choice of mode, if the terms at which international transactions take place are more favourable than those available on the domestic market.

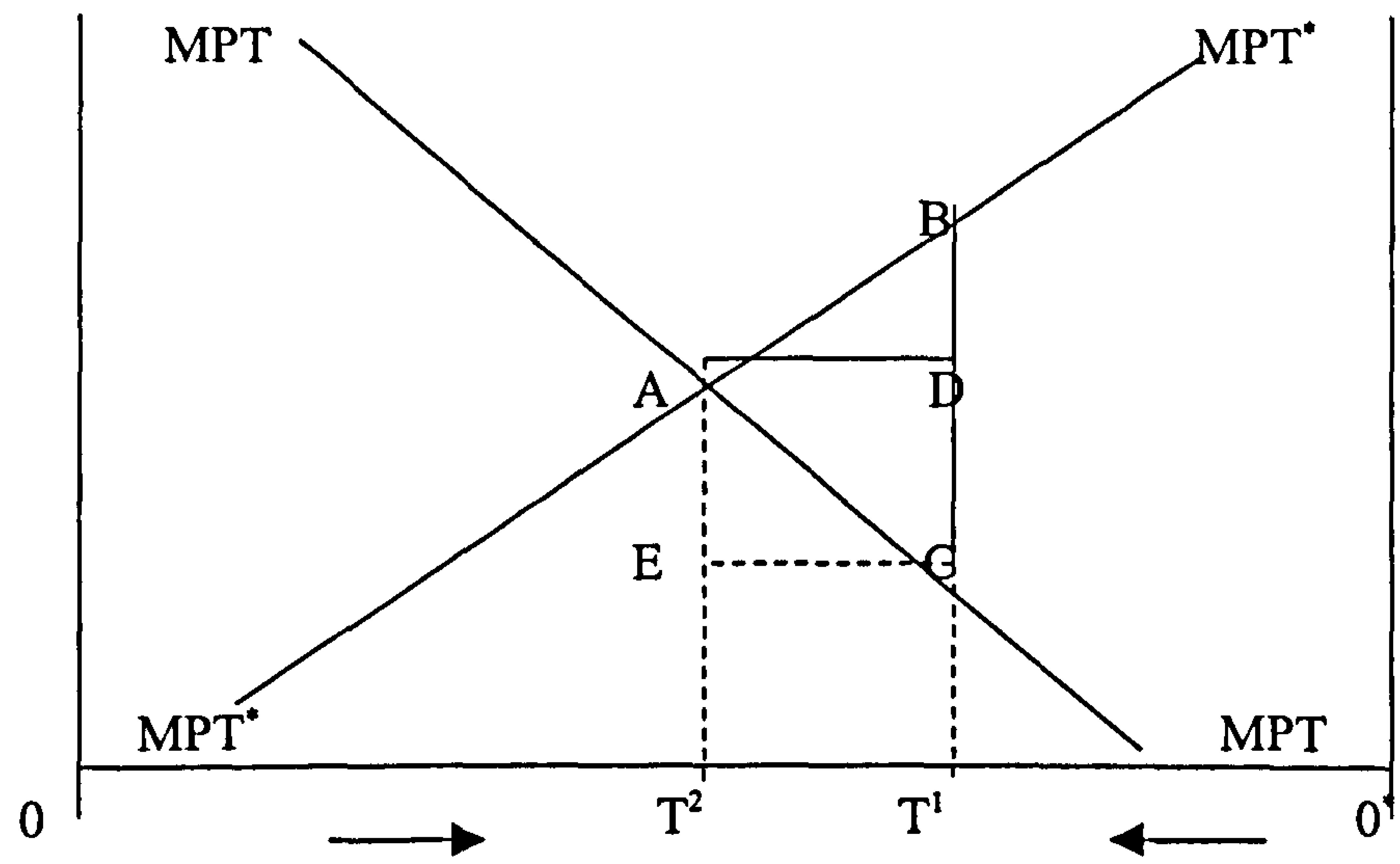


Figure 3.1 Factor mobility between two countries

Source: Mattoo, 2000, p.5.

Assume a world where there are only two countries of 'home' and 'abroad' and two factors of production of capital and tour operators together produce tourism related services which can only be traded by the movement of tour operators to the location of the consumers. In the figure 3.1, the width of the box is equal to the total tour operator endowment of the two countries. Every point along the horizontal axis represents an allocation of tour operators between home and abroad. The number of tour operators at home are measured from the origin 0, and the number of tour operators abroad is measured from origin 0^*. Suppose initially there are $0T^1$ tour operators are at home, and the remaining 0^*T^1 tour operators are abroad. The two lines, MPT and MPT*, represent the marginal products of tour operators in each country, holding the amount of other factors and know-how constant. MPT and MPT* are assumed to be declining in the number of tour operators.

If factors are paid their marginal product, tour operators will be paid T^1C at home and T^1B abroad. Total product (that is output or GDP) of that country can be found by adding up the marginal product of each tour operators in a particular country. Therefore, total product equals the area under MP curve for that country, up to the number of tour operators it has.

The return to tour operators is lower at home than abroad. If tour operators can set up their business somewhere else, some will establish branches abroad to take advantage of these higher returns. Hence, the movement of establishing more branches abroad will eventually stop when the return to tour operators is equal in both countries. The equilibrium point will be A and the equalised return will be T^2A. At this point, home will have OT^2 tour operators whereas abroad have 0^*T^2 units. The area of ADCE represents gain of tour operators who established their business abroad and the area ACE is equal to loss of capital at home when BAD is gain of capital abroad. Therefore, world gain should be equal to the area of ABC.

3.2.2 THE IMPORTANCE OF INTERNATIONAL TRADE IN SERVICES

The share of total world trade attributable to commercial services grew from 17 percent in 1980 to 21.4 percent in 1993 and 22 percent in 1995, before dropping to 19.2 percent in 1996. Thus commercial services accounted for nearly one-fifth of world trade or $1.26 billion (U.S.) in 1996, and an estimated three-fifths of FDI flows. The WTO reports that service exports increased by 8.4 percent on average between 1980 and 1995, while merchandise exports increased by 5.2 percent, as shown in table 3.1 which sets out the value, share and growth of world exports of merchandise goods and commercial services between 1980 and 1996.

Table 3.1 World Exports of Goods and Services (Billion dollars and percentage)

	Value [1980	1990	1996]	Share [1980	1990	1996]	Growth [1980-1996]
Merchandise Goods	1.97	3.51	5.15	83.0	80.2	80.8	5.2
Commercial Services	358	933	1.26	17.0	19.8	19.2	8.4

Source: WTO *Annual Reports*, various years.

While in the past the slow growth of productivity in the service sector was thought to be a drag on long-term economic growth, today this perception of the service sector has changed dramatically. Services have taken centre stage of economic development.

This is due to the so-called "services revolution" characterised by the rapid expansion of knowledge-based services and the growing tradability of services. Information technology has transformed service industries to the point where the development of services is regarded not as a consequence but as a precondition of economic growth. Knowledge-based industries, including professional and technical services, information technology services, banking and insurance, and education, are the driving forces behind the transformation of the service sector (Stephenson, 1998).

These technological changes affect trade in services significantly. The technological developments reformed the way services are traded between countries and also the speed of the transactions. Many services that were considered as non-tradable are only recently being actively traded through the application of information technology and advances in telecommunications. The expansion of electronic networks, particularly with 'Internet services' as discussed earlier in this chapter, has opened up the possibilities of trading services not only within a country but also between countries. It has also allowed for the unbundling of production and consumption of information-intensive services activities such as research and development, computing, inventory management, quality control, accounting, secretarial, marketing, advertising, distribution, and legal services.

It is apparent that part of the growth in services trade is attributable to an increase in the relative importance of service inputs in manufacturing industry. Many manufacturing goods cannot be produced without large amounts of service inputs, which may be seen as a reflection of greater investments of human capital in the production process. The level of service input increases, as production becomes more capital and knowledge intensive. Therefore, several economists argue that it is meaningless to distinguish between trade in services and trade in goods (Grubel, 1987).

The rapid growth of services has been also associated with the diversification of products and the greater specialisation of output derived from an increasingly globalised market to provide comparative and competitive advantages to countries especially to developing countries in international trade. Other factors which have been put forward as possible determinants of the growth of services are the revolution in information technology as discussed above, and the organisational transformation in the production of goods, as well as the movement of globalisation.

International trade in services becomes more important to developing countries than developed countries in recent years because in the area of international trade, services are contributing on a larger scale than ever before. This enhances foreign exchange earnings for developing countries which, in turn, affects overall economic performances for the country. The introduction of new technologies in the telecommunications and computer-related areas has also created major new opportunities for developing countries to provide commercial service exports at long distance. This factor alone could possibly double the present value of such exports (now around $180 billion) within a few years, especially since the developing countries supply these services with lower costs. Some developing countries have shown a revealed comparative advantage in service exports (including Egypt, India, Malaysia, Mexico, Thailand, Republic of Korea and Panama, among others). Areas of comparative advantage vary as between construction services (Republic of Korea), personal services (Southeast Asian economies), transport (Singapore), finance (Hong Kong and Panama), and tourism (many smaller developing economies). Among those services, there remains much scope for expansion in other areas of service exports by developing countries, particularly in tourism, which remains the largest single source of foreign exchange earnings from services for these countries (Stephenson, 1998).

3.2.3 TRADE BARRIERS

One of the main issues relating to international trade between countries is protectionism. In 1973 the volume of world trade fell for the first time since the Second World War. Although growth was resumed in the following year, the rate of growth was slower than in preceding decades. Thus, over the period from 1970 to 1979, world exports grew at a rate of 5.5 percent per annum between 1960 and 1969. From 1980 to 1983 the rate of growth fell to 0.5 percent per annum. One of reasons for this slowdown was the growth of protectionism. The 1970s and 1980s have witnessed a significant increase in the level and extent of protectionism in the world trading system. This has mainly taken the form of non-tariff interventions by governments. Moreover, the case for protection for developing countries is more serious than that for developed countries. The developing countries have experienced a long-run decline in their terms of trade. Their demand for imported manufactures grows much more rapidly as their real incomes rise than does the advanced countries' demand for their exports, with a consequent pressure on their balance of payments.

It is, however, important to know that the elimination of trade barriers is necessary, to some degree, for improving the world trade situation. Liberalisation without some harmonisation would have resulted in "competition among rules". Each country would have an incentive to adjust its own rules to attract footloose goods and service industries by undercutting the rules of other countries. Nevertheless, it was common for countries to concentrate on traded manufactured goods before 1990s but traded services have become a major part of world trade (WTO, 1998[a]).

Tariff barriers among industrial countries have been greatly reduced throughout eight rounds of multilateral negotiations. The negotiations have had less success, however, in attacking non-tariff barriers (NTBs). The NTBs take many forms, such as quotas, product standards, domestic content requirements, state monopolies on foreign trade, buy-at-home rules for government purchases, administrative red tape to excess foreign sellers, complicated exchange controls, and so forth. The protective effects of non-tariff barriers are harder to measure than those of a tariff. As a result, it is difficult to get international agreement on what constitutes an exchange of 'comparable' NTB reductions. In fact, many governments were willing to cut their tariffs because they knew they could just replace the tariff barriers with their non-tariff equivalents under the GATT. There are several different forms of non-tariff barriers in international trade:

- The best-known non-tariff trade barrier is the **import quota**, a limit on the total quantity of imports allowed into a country each year. The government gives out a limited number of licenses to import items legally and prohibits importing without a license. There are a number of reasons for the government to use quotas rather than tariffs to limit imports. The first use is as insurance against further increases in import competition (protectionist insurance) and import spending (balance of payment insurance). Another reason is the quotas give government officials greater administrative flexibility and power in dealing with domestic firms
- A quantitative limit can harm the nation more than a tariff by giving monopoly power to foreign exporters. This odd result has occurred in the case of the

voluntary export restraints (VERs), which are arranged by the government of an importing country coerce foreign exporters to agree voluntarily to restrict their exports into that country. VERs are used by large, powerful countries as a rear-guard action to protect their industries that are having trouble competing against a rising tide of imports.

- There are many other kinds of non-tariff import barriers today. NTBs reduce imports by operating through direct limits on the quantity of imports, increasing the cost of getting imports into the market, and creating uncertainty about the conditions under which imports will be permitted (Pugel and Lindert, 2000).

However, trade in services is more occupied with non-tariff barriers in various forms. The main aim of introducing GATS was to reduce the non-tariff barriers between member countries by providing equal trade opportunities and environments to all member countries. The deregulation of domestic services and the reduction of trade barriers should be seen within the broader context of the shift to more market oriented policies. Some trade barriers have been eliminated unilaterally by countries attempting to increase market competition, efficiency and service quality. This is the case with multilateral agreements such as GATS if member countries maintain their belief in the efficiency of the open market system and the benefits of reducing trade barriers.

In 1990, the OECD published an Inventory of Obstacles to International Tourism in the OECD area. The study concluded that, by comparison with other service sectors, the tourism sector in OECD countries was "remarkably free from protectionist and discriminatory practices". In fact, this is not entirely true in international tourism although tourism tends to face fewer trade barriers and be more liberalised than other industries in international trade. However, it is hard to assert that the tourism sector is free from protectionism and discrimination in trade. Until the early 1990s, there were heavy restrictions applied to the airline industry. These included, limitations on the use of different airports, restrictions on capacity and frequency on the routes, restrictions on operation in international market, restrictions on charters and discriminatory access and use of Computer Reservation System (CRS).

According to the World Tourism Organisation (1990), many of the regulations affecting tourism, such as equity limitations on FDI, tended to be by-products of general economic, political and social concerns applying to a number of sectors. The tourism industry has actually been an important part of the rapid worldwide growth in foreign direct investment (FDI). According to UNCTAD (1998[a]), developing countries can encourage FDI in the tourism sector by undertaking commitments under the GATS. In regard to commercial presence for hotel services, however, it should be noted that such practices as imposing high tariff duties on hotel equipment could be a major barrier to inward FDI. In some cases, both the services importer and the exporter might impose restrictions. Such restrictions may include **immigration and security controls,** together with **documentation requirements,** as well as any **restrictions on currency movements,** which might be applied to individual tourists, tourism businesses, or tourism labour. Specific regulations applying to the tourism sector might have such objectives as consumer protection, ensuring financial responsibility, or the development of the local economy and the domestic tourist industry. A lack of regulatory transparency, or the denial of national treatment, might also act as general barriers to international trade in tourism services (WTO, 1998[a]).

3.2.4 THE GROWTH OF PROTECTIONISM

The period since the ending of the Second World War has been a period of rapid expansion of world trade. One of the main causes of this rapid expansion of trade has been the willingness of countries to lower barriers to their trade with one another and to carry out trade according to an agreed set of rules. This liberalisation of trade brought an increase in the degree of economic integration between countries. This contributed to the fast growth in output. In the last two decades there has been a reversion back towards protectionism. Countries have increasingly resorted to a variety of new devices to restrict imports and protect domestic producers. Tariffs remain low but non-tariff barriers have become increasingly prevalent. As a result, the volume of trade has grown more slowly. This has contributed to slower output growth. Suffice it is to say at this stage that countries have begun to forget the significance of the link between liberal trade and output growth.

Protectionism in international trade from the liberalised post war world economy, until the late 1980s was developed largely from the point of view of protecting developing and less-developed countries from developed countries. In other words, world merchandise trade was dominated by the developed countries. The developed countries are still responsible for the majority of world trade but an increasing proportion of world trade has been attributable to the fast growing developing countries. The emergence of a number of developing countries as major exporters of manufactured goods has represented important geographical shift in world trade. These countries are the so-called 'newly industrialising countries' (NICs). They include the fast-growing Asian group of countries such as South Korea, Hong Kong, Singapore, and Taiwan and South American countries such as Brazil and Mexico as shown in figure 3.2.

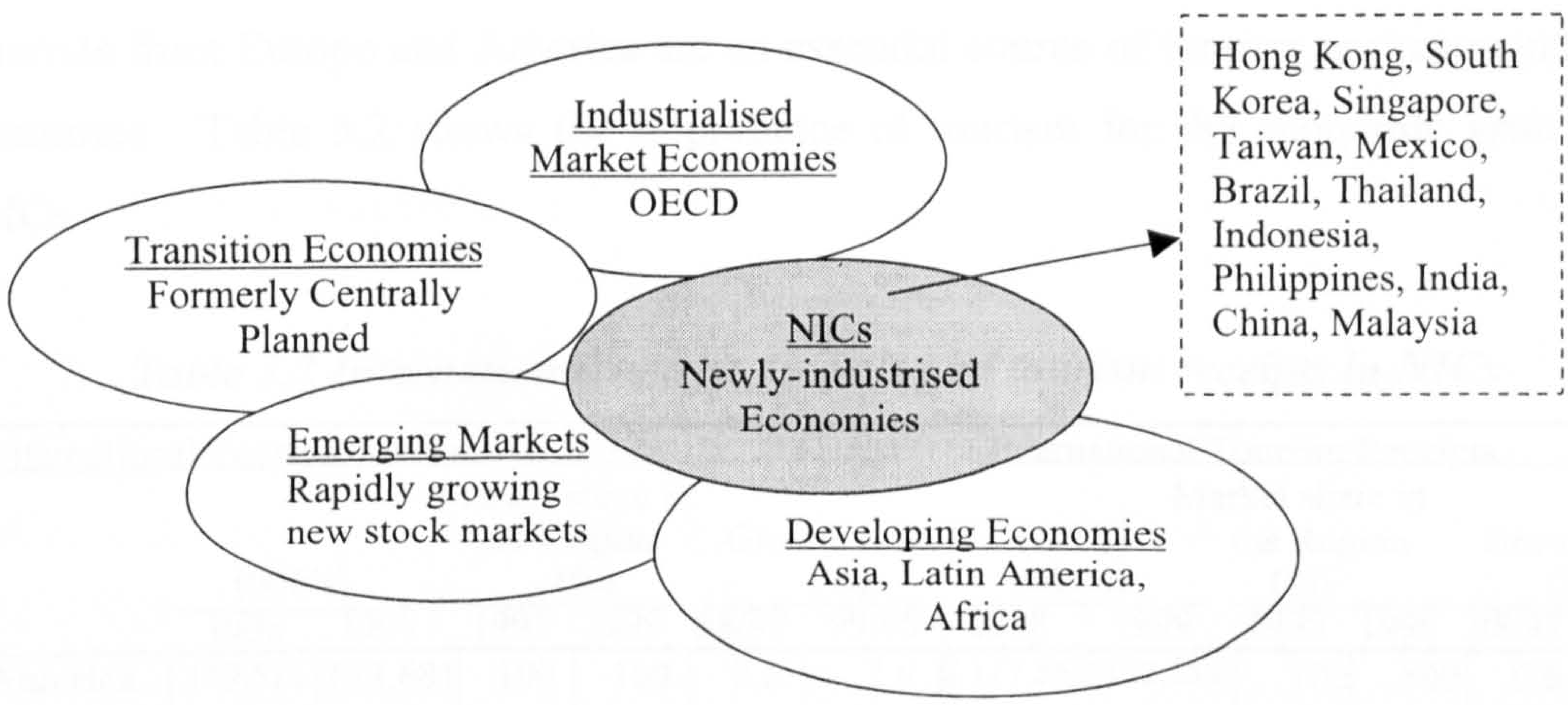


Figure 3.2 Different markets in the world in 2001.

Source: Jorgensen , 2001, p. 8.

Although they are frequently grouped together, the world's newly industrialising countries are a highly heterogeneous collection of countries. They vary enormously in important factors such as the geographical and population size, natural resource endowments, and cultural, social and political complexions. None of NICs is a free market economy in which market forces have been allowed to operate their unfettered course. They are development states where market economies only operate subject to intervention by the State. As a result, a number of countries, especially Latin American and Asian countries such as Brazil, Mexico, South Korea, Taiwan, Singapore and Hong Kong pursued an explicit policy of import substitution. The aim of import substitution was to protect a nation's infant industries so that overall industrial structure could be developed and diversified (Dicken, 1992).

The increased import competition in goods as well as in services posed by NICs has been a major source of protectionist pressure. Overall levels of market penetration for NICs remains quite low, but in the markets for sensitive products, such as clothing, textiles, footwear and toys, the NICs have achieved much higher levels of market penetration. Thus, governments in western industrialised countries have come under increasing pressure from affected constituencies to introduce restrictions on worrying imports. The result has been a proliferation of new import barriers, most of which have been designed to restrict imports coming from either Japan or the NICs. Most of these new restrictions have taken the form of non-tariff limitations on trade. This is why the protectionism of recent decades has been called the 'new protectionism' (Grimwade, 1989). Having said that, NICs have begun to accumulate sizeable trade surpluses with the western industrialised countries especially from tourism since tourists from Europe and America are an essential source of foreign exchange into the countries. Table 3.2 shows the importance of tourism for the economic growth in NICs.

Table 3.2 International tourist arrivals and tourism receipts in NICs

	International Tourists Arrivals						International Tourism Receipts					
	(000's)		Market share in the Region (%)		Growth rate (%)		(US $) million		Market share in the Region (%)		Growth rate (%)	
	1998	1999	1995	1999	98/97	99/98	1998	1999	1995	1999	98/97	99/98
America	119,521	122,681	100	100	2.5	2.6	117,565	122,184	100	100	0.6	3.9
Mexico	19,392	19,043	18.6	15.5	0.2	-1.8	7,493	7,223	6.2	6.4	-1.3	-3.6
Brazil	4,818	5,107	1.8	4.2	69.1	6.0	3,678	3,994	2.1	3.1	41.7	8
Asia	87,428	97,466	100	100	-0.9	11.5	69,020	73,414	100	100	-8.8	6.4
S. Korea	4,250	4,660	4.6	4.8	8.8	9.6	-	-	-	-	-	-
Hong Kong	9,575	11,328	12.5	11.6	-8.0	8.3	7,083	7,210	12.9	10.3	-23.4	1.8
Singapore	5,631	6,258	7.9	6.4	-13.8	11.1	5,402	5,974	11.3	7.8	-11.0	10.6
Taiwan	2,299	2,411	2.9	2.5	-3.1	4.9	3,372	3,571	4.4	4.9	-0.9	5.9

Source: World Tourism Organisation (WTO), 2000[a].

The 1977 Pacific Asia Travel Association (PATA) slogan for the Asia-Pacific travel and tourism industry, 'the consumer - the only person who matters" seems to have become a reality in the Asian newly industrialised countries (NICs) which have embraced Western consumer culture and lifestyles. In fact, the remarkable shift from export-led to consumer-driven economy in the region highlighted the emergence of the middle classes as prime movers. The average Asian person is moving into consumption and incomes are increasing dramatically. If Asian consumers continue their 6 to 10% annual expansion of the last decade, their middle classes will double and triple in the next decade. The Asian middle class, not counting Japanese, could number between 800 million and 1 billion people by 2010, resulting in a stunning $8 to $10 trillion in spending power. That's in the neighbourhood of 50% more than today's US economy. Asia's young population is in its consumer spending prime. Each of the little dragon nations of Hong Kong, Singapore, Taiwan and South Korea has more than 65% of their population between 15 and 65 years of age. The corresponding percentages are also high for developing countries in Asia, with Thailand, Indonesia, Malaysia, China, India, and the Philippines ranging between 59 to 66%. Asia's middle classes are changing the economic, social and political landscape of the region and they tend to be looking for quality rather than quantity. However, it needs to taken into consideration that there are vast historical, socio-economic and cultural differences existing within the region and within individual countries, they partly explain why the last decade of high economic growth has driven conspicuous consumption to new levels and tourism has become a middle-class “rite” throughout the region (Pleumarom, 1999).

Nonetheless, economists have even predicted an end of the 'Asian economic miracle' in view of looming crises in the financial sector, the slowdown of investments, and feared massive unemployment problem. Undoubtedly, a further free fall of Asian economies would have large implications for the regional leisure and tourism industry. Due to the increasing current account deficit in these countries, the governments applied protectionism for both protecting domestic firms in the recession and discouraging overseas travel. In Thailand, apart from a public campaign to promote domestic tourism, announced a limit on the value of products imported by Thai tourists of US$400, in order to reduce shopping expenditures abroad. As a result, the growth rate of travel abroad slowed down to 7% in 1996 compared to previous years. The further deterioration of the Thai economy led to a 30% decline of outbound tourism during the first six months of 1997. But the depreciation of the local currency beginning in July 1997, has delivered the most serious blow: not only is outbound travel expected to fall by more than 50% since the Thai baht lost over 20% of its value, but domestic tourism is also facing a decline due to increased costs of travel, accommodation, food and beverages within the country. Meanwhile, however, tourism officials have predicted higher inflows of foreign tourists because Thailand has become a much cheaper holiday destination in the wake of the baht devaluation. In contrast, in South Korea, concerns have been expressed that people spend far more on vacation overseas than the country receives from foreign visitors, which resulted in a US$2 billion loss in its tourism balance and contributed to its worsening current account deficit in 1996. This prompted the government in May 1997 to impose a tax of US$11 on Koreans each time they book an overseas vacation (Bangkok Post, 1997).

On the other hand, the old version of protectionism mainly took the form of tariffs. A tariff is a tax on imported goods and/or services. It is sometimes called an import duty or a customs duty. In this respect, General Agreement on Trade and Tariffs (GATT) was a tool to reduce and regulate rules about imposing taxes between member countries in international trade. GATT is a charter for freer trade, not free trade. Tariffs are allowed, although GATT seeks both to lower the level of tariffs and prescribe rules relating to the use of tariffs to protect domestic producers in an emergency. However, GATT rules outlaw quantitative restrictions on trade such as import quotas. Import quotas were common in the inter-war period and during the Second World War. Countries, which signed the GATT, were expected gradually to dismantle all such restrictions. Quotas seek to restrict imports by requiring imports to obtain licences from the authorities before goods may be allowed into the country. Such quotas are generally considered to be more harmful than tariffs since they have a more detrimental effect on economic efficiency. An important exception to this rule concerns agricultural imports.

Nevertheless, new protectionism in the form of non-tariff limitations on trade is a more significant issue in services industries. In recent years, trade in services is growing fast between countries and the issue of protectionism has become a major concern for many countries. As technological developments (e.g. financial transactions through computers and internets) play an important role in services trade, non-tariff limitations on trade have been taking places in a variety of forms. Many attempts have been made to classify and measure the extent of the various kinds of non-tariff intervention that affect world trade. Page (2000[a]) defines 'controlled' or 'managed' trade broadly to refer to any trade which is subject to some form of non-tariff control whether by exporter, importer, or both. She has classified mainly into three different non-tariff controls:

- International agreements, such as international cartels (e.g. OPEC, international commodity agreements, GATS, etc.) and market-sharing agreements.
- National controls on trade, such as import quotas, anti-dumping duties, certificates of origin, and other administrative controls, price controls, voluntary export restraints, and government-imposed restrictions on the purchase of imports.

- Other national controls whose major effects is on trade, such as safety, health, or technical product standards, domestic subsidies, customs clearance procedures, patent laws, or licenses and price controls, but main motive may be domestic rather than any desire to restrict imports. The level of such controlled or managed trade is much higher within services industry (Page and Davenport, 1994).

In general, trade protection has been an obstacle to the growth of international trade. In order to achieve free trade and trade liberalisation, protectionism can be a reason to slow down the overall economic growth.

An important issue relating to protectionism is whether it is beneficial or an obstacle to consumers. In other areas consumer organisations tend to find themselves seeking government intervention to regulate or remove an existing market distortion - a monopoly, for example. In the case of trade, however, the distortion is usually introduced by governments. It is national governments that often decide the terms on which imported goods and services are made available to consumers. Where trade is concerned, consumers have more often to be protected from the regulated market than from the unregulated one. They need to be protected from protectionism - that is, from restrictions on trade introduced by governments to serve the interests of their domestic producers. Although not all government interventions in trade may be against the interests of consumers, many are.

There are many arguments about whether protectionism is necessary in certain aspects of world trade. The main arguments are made in relation to infant industry and job protection. First, the infant industry argument is one of the oldest arguments in favour of protection. Industries just starting off may well face much higher costs than foreign competitors. Partly this is because there may be large economies of scale in the industry. A new low volume producer will find it impossible to compete on price against an established foreign high volume producer. Once it is sufficiently large, tariff barriers can be removed and the industry exposed to the full level of foreign competition. There may also be a learning curve. It takes some time for managers and workers in a new industry to establish efficient operational and working practices. Only by protecting the new industry can it compete until the learning benefits come through (Anderson, 1995).

South Korea has been very successful in achieving large economic growth for a short time. The country has a tendency to expand some of its industries (car, electric goods and computer industries) on the back of three main factors. First, the South Korean domestic market is heavily protected such that no more than 10 percent of each industry's sales are accounted for by imports. Second, the government has given large amounts of soft loans with little or no interest to domestic producers to finance their expansion as part of a state plan to become an industrialised nation. Third, the South Koreans have well-adopted and well-learnt advanced technologies from other advanced countries throughout 1970s and 1980s.

More importantly, in the tourism industry, many developing and less-developed countries regard tourism as an infant industry, such as the Republic of Korea. The Korean government is very strong about protecting infant industries from foreign companies. Since many of SMEs are competing with some of the foreign multinational companies in their industry, protectionism become unavoidable to prevent foreign companies taking over the domestic market. In Korea, many travel agencies are small scale businesses and it is impossible for them to compete with foreign multinational companies because of the lack of marketing and management skills, lack of finances, and lack of skilled labour. Therefore, the government introduced tight restrictions, including entry, administrative and ownership restrictions, to foreign companies, which make it hard for foreign companies to set up their businesses in Korea, and hence they chose to go somewhere else to establish their business. However, the Korean government does not support tourism development as much as it does other manufacturing industries. In this case, the government perceptions towards the tourism industry can be an important factor. Many governments are not paying enough attention to tourism because they have not recognised tourism as a significant sector that affects a country's economic growth.

The infant industries, in general, have not grown successfully behind their trade barriers. This is because:

- The government needs to be able to identify those infant industries which will grow successfully. Governments have a poor record of picking such 'winners'.
- Industries protected by trade barriers lack the competitive pressure to become efficient. Infant industries all too often grow up to be lame duck industries. They

only carry on operating because they have become skilled at lobbying government to maintain high trade protections.

- It is usually more efficient to use other policy weapons if a government genuinely wishes to encourage the development of a new industry. Specific subsidies, training grants, tax concessions, or even the creation of state enterprises, are likely to be better ways of creating new industries.

The protection of jobs is another argument in favour of protectionism that has a very long pedigree. The idea is that protectionism can create or at least preserve jobs. The rate of unemployment is an important tool of measuring economic growth for a country. If the country removes trade protection to allow foreigners to enter the country to work, the employment opportunities may fall for the residents, particularly when foreign workers are willing to work at lower wages. However, at the same time, it can be argued that the government erects trade barriers and stops foreign companies establishing their businesses in a country and providing more jobs to the residents. Therefore, it is difficult for governments to decide an efficient policy at the appropriate time to remove trade barriers.

In the tourism industry, the issue of protectionism is more complicated than other industries because it is difficult to regulate and monitor the degree of protectionism that can be considered to be an obstacle for developing world tourism. Thus, GATS was introduced to remove these trade barriers and to assure a fair trade between member countries in services, including the tourism industry. GATT was introduced to tackle these trade barriers for manufacturing goods in 1947. Under GATT rules, member countries are not allowed to increase the degree of protection given to their domestic producers. Also, under the 'most-favoured nation' clause of the agreement, a country which offered a cut in tariffs to one country had to offer the same terms to all member countries. GATT rules prevented protection increasing, but did nothing to reduce protectionism. For this reason, GATT has, over the years, organised a series of negotiations aimed at reducing tariffs and quotas and it has been successful to reduce tariffs and quotas but failed to tackle other forms of protectionism. Therefore, GATS has to be monitored carefully in order to succeed with its aims of reducing trade barriers and achieving trade liberalisation in services industry.

3.2.5 THE MOVEMENT OF BORDERLESS TRANSACTIONS IN SERVICES

One of the most effective factors to shape today's trade in services is the electronic revolution, particularly in the tourism industry. Marshall McLuhan (1960) predicted that electronic interdependence would turn the world into a global village. The prediction came true and carries global networking of various knowledge and information, such as the world's business contracts, flight information and currency transactions, without any restrictions of time zones, borders and cultures on trade in services in recent years. Having said that, to some extent, knowledge becomes more important as a factor of production than labour, raw materials, or capital in the services industries.

Before the world focused on the notion or principle of trade liberalisation, the word of 'borderless services' was already on the horizon and playing an important role in the performance of the world economy, e.g. information transfer, travel insurance, foreign currency exchange and Internet. Therefore, it seems fair to say that borderless services were the framework of promoting trade liberalisation in the beginning. Many services sectors would not work with any trade restrictions between countries, particularly for electronic transactions in international trade. There are four broad characteristics of borderless services economy:

- First, it is important to increase indifferences to geography, distance and time. In this case, transaction costs for consumers and businesses will fall rapidly as the many steps that create resistance to trade between buyers and sellers are compressed. The most important results of the development of electronic commerce might be the reducing of barriers and costs to market entry. For instance, starting a new business will be easier since it allows a far greater number of suppliers to enter a market and SMEs will now be full participants in the global marketplace as well as large multinational companies since it dose not need to hold large investments and capital for doing so. In addition, companies in developing countries can now overcome many of the obstacles of infrastructure, capital, and transportation which may have limited their economic potential in the past. At the same time, consumers all over the world could benefit from this growing global competition.

- Second, services industries, especially financial, telecommunications and transport services, are creating the reality of a global infrastructure which is greatly facilitating the adjustment of old industries and the development of new industries. These technological advances along with market liberalisation will allow many developing countries to continue their economic growth and to narrow the gap with the developed world.
- Third, the global services economy is close to being a knowledge based economy. Information and knowledge are not bound to any regions and countries but are almost infinitely mobile and capable of expansion when the classical factors of production, namely land, labour and capital, create trade boundaries in goods and services. This knowledge driven economy is not replacing other economic activities, factories and farming are not going to disappear, software is not going to substitute for the food we eat, but technology is changing the way of supplying as well as purchasing goods and services. In the tourism industry, advanced technology is not going to signal the end for travel agents but the suppliers will advert and promote their holiday products online and consumers will purchase their holidays through the Internet instead of brochures by their credit cards. In this case, customers from all over the world are allowed to access all different travel information without time, distance or location restrictions.
- Fourth, the borderless technology has the potential to equalise relations between countries and regions, because of its capacity to open the way to free and equal access to information and knowledge for every country, every region in the world (Ruggiero, 1997).

In the tourism industry, the technology revolution is already an important issue. For the customers, being able to access appropriate information about their flight and holiday destinations at home changed the way of their whole process of purchasing. For the producers, being able to provide their services to different customers from all over the world without inputting large capital and investment has given them the opportunity to concentrate more on developing their products and improving their services rather than moving around different locations try to promote their products.

3.3 PROGRESS OF LIBERALISATION

Liberalisation is a means of increasing economic efficiency in a wide range of situations. Liberalisation means removing barriers to entry for new, qualified providers. The resulting increase in competition limits the ability of any one firm to offer a relatively low-quality and high-cost service. In other words, competition and freedom of entry have an important role to play in ensuring that users of a service are offered the best available price and quality combinations. A regulatory system that ignores such potential by blocking entry and competition is unlikely to be optimal for the economy as a whole.

As shown in the figure 3.3, the regulations and trade policies are the main factors of trade liberalisation. Once a country joins a trade agreement, the regulations that are set up for member countries will affect the national regulations and trade policies in the country. It is important to recognise whether a country's trade policy is regarded as discriminatory or non-discriminatory in order to take the necessary steps to achieve trade liberalisation for further economic growth.

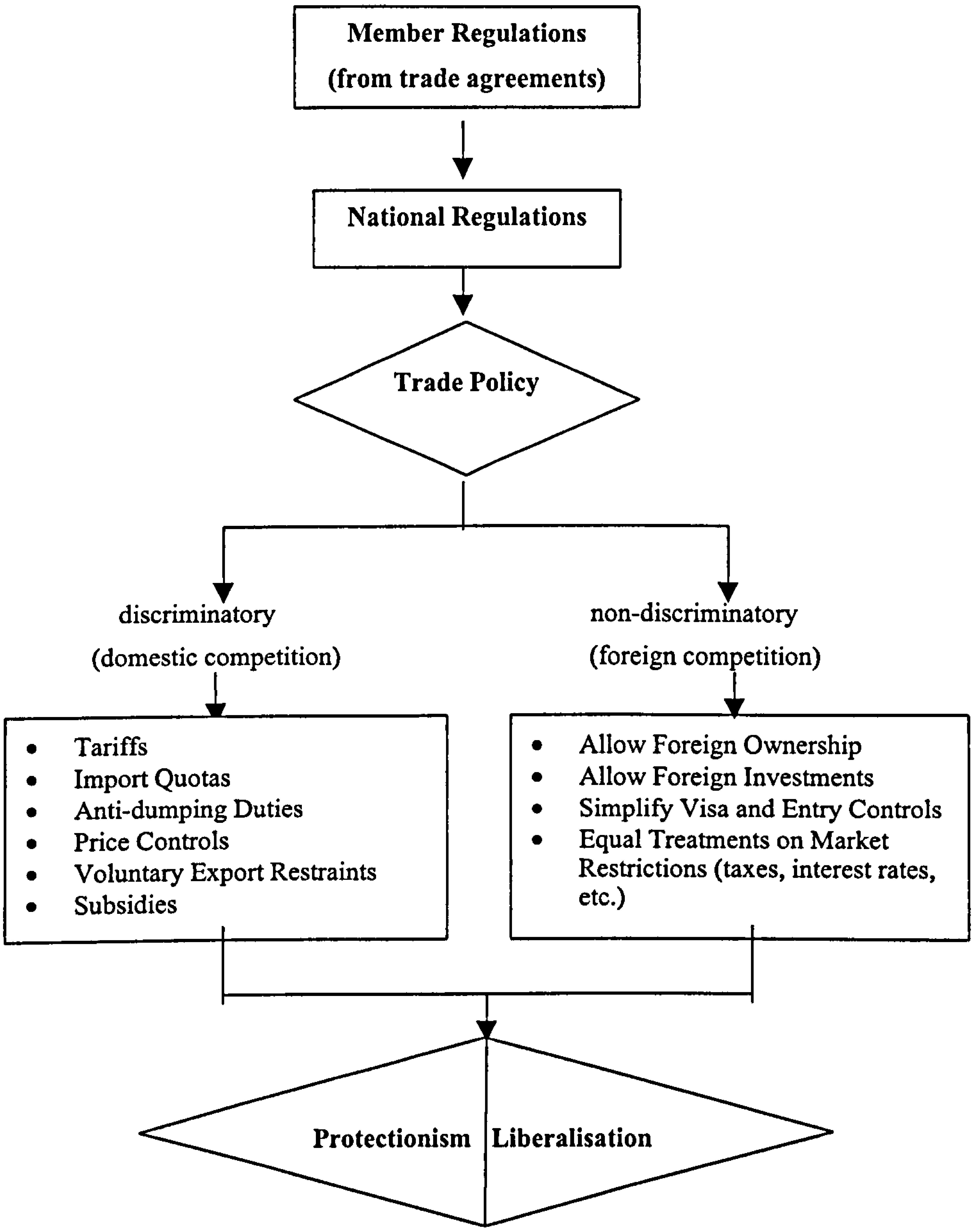


Figure 3.3 The Process of Trade Liberalisation

One of the most striking features in the world economy over the past two decades has been the extent of trade liberalisation in developing countries. More than 100 countries in all parts of the world have undertaken unilateral trade reforms of one form or another. Many of these countries have been attracted into the schemes by two key multilateral lending agencies, the World Bank and International Monetary Fund (IMF), and World Trade Organisation.

3.3.1 CHANGES OF TRADE POLICY IN SERVICES

Trade policy used to be about of whether to raise or to lower tariffs. As mentioned in the previous chapter, the purpose of tariff was either to raise revenue or to achieve further strategic objectives. In this sense, the optimum policy was free trade by reducing tariffs it allows goods and services to be traded more freely. However, trade policy today has little to do with tariffs. In fact, most tariffs have been either reduced or bound as a result of successive rounds multilateral of trade negotiations under the GATT. Many governments formed new trade policy for discriminating in favour of their own domestic firms. Governments' intervention in the economy has been increased and it affects the free trade policy. There are now many theoretically sound reasons why governments may have to intervene to restrict trade.

Countries liberalise through either unilateral actions or though international bargaining, or through both. Since, World War II, the developed and developing countries have moved toward different ways of handling trade policy. For example, developed countries have been multilateral agreed-on liberalisation, whereas trade policy for the developing countries has consisted of some degree of protectionism and unilateral agreed-on liberalisation. In developing countries, multilateral bargaining has had as one of its consequences a high level of protectionism. Almost all countries ended World War II with extensive barriers to imports. But for the independent developing countries, these barriers had been associated with successful import substitution during the 1930s and 1940s. Therefore, those countries felt that there is no reason to change them. Moreover, leaders of newly independent developing countries often condemned liberalism relating it to colonialism. However, the balance of payments is an important factor for trade policy and for economic development. Economic development was often dealt with by a combination of import and exchange controls, which have a strong relationship with protectionism in developing countries. The idea of protectionism in developing countries weakened in 1960s and 1970s, as the movement of trade liberalisation became more obvious. But, despite the attempts at trade liberalisation, few have been successful (The World Bank, 1996).

Furthermore, foreign and domestic public policies have a significant effect on trade, not only because of interaction intensifying, but it is also diversifying. Movement of capital and people has always been an important part of international trade, especially for trade in services, but the physical movement of capital and people is rapidly displaced when dealing with trade in services through the introduction of technological advancement. Technological progress is making possible the trade of services for suppliers and consumers without ever having to leave their countries and also the provision of new and more sophisticated services which were not available before. Therefore, many governments have to reconsider their policy on services to respond to the increasing volume of those borderless transactions on trade as well as physical movement between countries, which greatly affect the movement towards the liberalisation of trade in services (Nicolaides, 1989).

However, some services can be supplied only through personal contact despite technological advancement. In this case, movement of either the provider or the customer becomes necessary. Many governments apply trade policies in order to prevent the domestic market from an influx of foreign goods and services and also in the name of consumer protection. This objective can be distorted in the market by reducing competition and excluding foreign firms from the domestic market. Restrictions on foreign investment assume particular significance in the case of services where cross-border delivery is not possible, so that consumer prices depend on the domestic market structure. In addition, restrictions on new entry and on the participation of foreign capital are the most common, particularly in communications and financial services. Therefore, many governments need to introduce efficient and appropriate regulations and policies from discriminatory regulations to fulfil 'fair trade' between countries. In other words, the first step for trade liberalisation is to examine how discriminatory policies against foreign firms can be identified and eliminated.

With respect to the tourism industry, since tourism is a wide-ranging industry in the sense that it demands products from other sectors of economy, it is necessary to develop policies to provide rational order to such a complex industry. It is difficult to recognise what kinds of early policy existed to influence and determine trade liberalisation in international tourism and it is uncertain whether there were policy guidelines or planned development in early years of tourism. However, it is true that in modern days, tourism policy has taken place at different stages in different parts of the world. Many countries regard tourism as a prime tool for economic development and a potential source for earning much needed foreign exchange, therefore, it is clear that tourism policy cannot be separated from economic policy. The main reasons for introducing tourism policy are (Edgell, 1999):

- To identify tourism and travel related issues, problems, and needs of state and local, public and private sectors of the industry.
- To provide appropriate and efficient regulations and rules to reduce identified problems in tourism industry.
- To promote friendly understanding and appreciation of international tourism movement.

The way in which the industry responds to these policy questions and the need for further trade liberalisation will determine the direction and maturity of tourism policy in the future.

In the discussion of trade liberalisation, developing countries tend to have restrictive trade regimes and thus an important question is whether developing countries will be better off if they move away from those trade regimes. According to Krueger (1998), trade liberalisation offers the only known way to escape from the slow growth rates of developing countries which can be achieved by applying an efficient and non-discriminatory trade policy with development strategy. Trade policy is integrally tied up with the overall development strategy. Although productivity and output growth in agriculture, services, and manufacturing are all essential for growth, an overemphasis on any subset of economic activities is almost certain to result in retarding the development process, the linkage between trade policy and development strategy are crucial which is even more sensitive in developing countries.

The reasons that may explain why developing countries may be more sensitive to reforming trade policies with respect to economic development are as follow (Dixon, 1998):

- First, the economic structure of developing countries tends to change more rapidly than it does in developed countries. In addition, developing countries typically depend on imports for many goods and services used domestically or, they are, at least, in the stages of development of producing themselves which tends to be highly specialised. Hence, there is greater sensitivity to trade policy than in developed countries.

- Second, in developing countries, production patterns are skewed toward labour-intensive goods and services. In accordance with comparative advantage, they import most capital-intensive goods and services. Since services include many investment and intermediate goods, developing countries' growth is contingent upon their ability to import those necessary capital-intensive goods and services. However, when developing countries are faced with relatively slow growth rates of foreign exchange earnings, they tend substitute domestically provided products at higher cost for those capital-intensive products. This substitution process not only pulls resources out of labour-intensive areas, but also it implies slower growth because of inefficient resource distribution.
- Third, the protection of economic activities, particularly in the services industry, results in dilemma for the competition because the size of many service-related firms is relatively small. If large foreign firms enter the market, small domestic firms will suffer from the competition because they are often not competitive enough. On the other hand, if a government protects domestic firms from multinational foreign firms, the possibility of further product development in quality or price will be deceased due to the lack of competition. Therefore, protectionism is an obstacle to trade liberalisation, but in some extent, it is necessary for small domestic firms in many developing countries in order to build up confidence to be able to compete with large foreign firms.
- Fourth, decisions on trade policy tend to force to change a number of other policies. A trade regime normally give bureaucrats considerable discretion either in determining which industries should be encouraged or in allocating scarce foreign exchange in a regime of quantitative restrictions. Changes of trade policy have a greater 'domino' impact on unstable economies, mainly in developing countries than on stable economies.

In recent years, many governments in developing countries have focused their attention on reforming their trade policies in services. New factors, including technological advancement, may force them to change their present trade policies. It is true that traditional trade policies in many countries were designed to control mainly trade in goods rather than trade in services. In other words, the traditional liberalising approach of reciprocally reducing trade restrictions cannot be applied as effectively in services as was applied in goods. The most important points are, however, to recognise the government role to commit themselves to the rule of equal treatment of all firms under their jurisdiction and to recognise importance of 'fair play' in trade liberalisation. Trade policy can be a significant part of the process of liberalisation for not only opening up their markets to foreign competition but also in providing an equal trading environment to both foreign and domestic firms, especially in the tourism industry.

Moreover, countries that have achieved a relatively high level of liberalisation in services have implemented several major trade and macro regulatory reforms, including:

- A reform of quotas and tariffs in the direction of elimination of quotas in favour of tariffs and subsequent reduction of the latter.
- An investment code including well-defined protection of private investors, minimal discrimination between domestic and foreign investors, and, minimal distortion among sectors, including services.
- A reform of foreign exchange regulations towards the country's current and capital accounts.
- A reform of the tax regime consistent with the aims of the investment code, including non-discrimination among firms on the basis of sectors or nationality and an emphasis on stable and predictable tax rates.
- A loosening of the regulatory framework concerning employment, including easier entry for greater numbers of foreign employees, substitution of transparent criteria for the discretionary power of immigration authorities, and the general lowering of entry costs (UNCTAD, 1994).

From the early 1990s, however, the movement of trade liberalisation in services became very important as the volume of trade in services increased in the world, but many countries, especially in developing countries, are maintaining their traditional trade policy in the form of protectionism.

3.3.2 DISCRIMINATION AND REGULATION

Trade regulations were designed to correct for market failure or distortions and it is important to examine how important trade regulations are under a 'free trade' system. Governments regulate trade in services for many reasons, some of which are referred to as being protectionism. In this sense, the important questions are whether there can be a distinction between legitimate, appropriate and discriminatory regulations and whether there is a danger that liberalisation among countries with distinct regulatory systems will give rise to unfair competition. A government may be justified in intervening in services markets, but there are limits to intervention. Moreover, the presence of various member regulations in services industry may have different effect in different national markets. In other words, these regulations may have a useful function in one country, yet be protectionist in another. In this sense, the General Agreement on Trade in Services (GATS) will have to find an appropriate approach to trade liberalisation in services by focusing more on the harmonisation of regulatory systems and national treatment between member countries.

While regulations may be justified by market failure, such regulations are not always implemented for that reason. Services and goods are often regulated for political reasons, which may include the protection of those industries that are perceived to be essential to a national economy. With respect to free trade, services cannot be determined by reducing tariffs because the efficiency or appropriateness of one country's regulatory policies depends on other countries' policies. Therefore, two or more countries may be able to improve their economic efficiency further by adopting common regulations or by co-ordinating their policies. Another reason for regulation is the prevention of 'adverse selection' problems. If consumers cannot distinguish between providers of different quality and competence, goods and services of higher quality may suffer as a result. The providers know how good they are, but their customers may not. There is asymmetry of information between providers and consumers in services. Therefore, the purpose of applying regulations is to improve the information available to consumers and minimise the adverse selection problem (Nicolaides, 1989).

In addition, there are five main reasons why regulations may be necessary. An efficient policy or regulation eliminates distortions without causing any unwanted side effects (UNCTAD and The World Bank, 1994).

- First, the aim of regulation is to provide better-quality information to consumers so that they are able to choose the preferred mixture of quality and price.
- Second, if additional information cannot help consumers, the government may need to specify the minimum acceptable level of quality or other required features and standards.

- Third, in services industry, it is difficult to identify the quality of services provided. The only indication of the quality of the expected service is the credibility and reputation of the provider. Hence, the government tries to impose restrictions on who enters a market by requiring specific qualifications since the competence of the service providers is important.
- Fourth, 'infant industry' is one of the sound reason why many governments impose restrictions.
- Fifth, 'natural monopoly' is a problem for a policy directed at economic efficiency, but a first task for a regulation in such a situation is to ensure that the natural monopoly is not extended to create unnatural and unnecessary monopoly positions.

The government surely believes those regulations will bring benefits to national economy. In this case, applying such regulations to all existing firms in the market is one thing, unequal treatment or discrimination between firms is another. In fact, regulations are discriminatory when they distinguish providers according to their origin or nationality rather than their competence. One simple definition of discrimination is that equals, or those who provide equal goods and services, should be treated equally. A broader definition is that no policy should shift incentives in favour of a particular group. Discriminatory regulation is major concern for many multilateral trade agreements and it has been considered as one of the important issues of GATS.

Since effective regulation of an industry is likely to require a detailed knowledge of that industry, such knowledge will often be found among practitioners or potential practitioners. Therefore, the possible solution for discriminatory regulations is harmonisation. One is political harmonisation between countries, which is related to the 'national treatment'. Another is to harmonise requirements under different regulatory systems to both foreign and domestic firms through the movement of liberalisation. In this sense, joining a multilateral agreement may be an important step to establish international surveillance for reviewing national regulations and resolving trade disputes, since the liberalisation of trade in services requires an ongoing commitment including a process of international consultation among trading countries. However, harmonisation is an attractive solution in principle, but difficult to implement in practice.

3.3.3 IMPACTS OF LIBERALISATION IN SERVICES

In 1999, the value of cross-border trade in services amounted to US$ 1350 billion, or about 20% of total cross-border trade (WTO, 2000[a]). This understates the true size of international trade in services, much of which takes place through establishing offices in the export market, and is not recorded in balance-of-payments statistics. In recent years, developing countries show interests in many services areas including tourism, health and construction. According to the World Travel and Tourism Council (1999), tourism is the world's largest employer accounting for one in ten workers worldwide and tourism exports, estimated at US$ 443 billion, were 33% of global services exports and 6.5% of total exports.

The liberalisation of trade in goods has been promoted through negotiations in the GATT over the past 50 years, which has been one of the significant contributors to economic growth in the world. From the late 20th century, many governments deliberately turned away from the policies of economic nationalism and protectionism that had delivered many problems on trade, and towards economic co-operation between countries. Economic growth in this period was not shared evenly in the world, but there is no doubt that those countries that chose deeper involvement in the multilateral trading system through liberalisation benefited greatly from doing so (Baldwin, 1996).

Trade liberalisation allows countries to pursue specialisation in harmony with their comparative advantages. In a liberalised industry, firms will tend to employ productive resources in those activities where they can be more efficiently utilised and consumers will benefit from access to cheaper products. By contrast, in a protected industry, firms will have to adjust in response to the increase in international competition. However, the net welfare impact of trade liberalisation tends to be positive under competitive market conditions. In addition, the important point is that imperfect competition tends to be the norm in many industries and it does not weaken the case for liberalisation. It is true that imperfect competition can create situations in which free trade is not optimal from a national perspective (UNCTAD, 1994).

There was no obvious movement of multilateral liberalisation of services trade until the negotiation of the GATS and its entry into force in 1995. Since the services sector is the largest and fastest-growing sector of the world economy and providing more than 60 % of global output and in many countries an even larger share of employment, providing a legal framework for international services trade was crucial in two different aspects. First, the lack of a legal framework was anomalous because the potential benefits of services liberalisation are at least as great as in the goods sector, and second, it was dangerous because there was no legal basis on which to resolve political complications and trade disputes between countries.

There are mainly six benefits of services liberalisation as follows (WTO, 2001):

- More competition: Opening domestic markets to foreign services suppliers increases competition, which brings many benefits. It tends to improve efficiency in the short and long term, lowering prices, improving service quality, increasing consumer choice and encouraging productivity gains. It is also often a more effective means of reducing the monopoly power of dominant suppliers than regulation or break-up.
- Lower prices: The evidence that services liberalisation leads to lower prices is compelling. In Korea, prices of domestic flight ticket have fallen slowly after Korean Airline's monopoly was abolished. In financial services, the entry of foreign banks into a domestic market led to lower interest rates and banking charges.
- Faster innovation: Countries with liberalised services markets have seen greater product and process innovation. The explosive growth of the Internet in the liberalised developed market is in marked contrast to its slower take-off in many developing markets where monopoly firms still dominate. Similar contrasts can be drawn in financial services and information technology which are one of the important sectors in the economy, this innovation spills over rapidly into efficiency gains for the economy as a whole.
- Higher employment: In the services sector, there is strong evidence that trade liberalisation creates jobs. According to WTTC (1999), average 14% of total employment in travel and tourism industry in developed markets where competition was relatively strong, but only average 7% in developing markets where competition exists together with some level of protectionism as shown in table 3.3 below.
- Greater transparency and predictability: A country's commitments in its WTO services schedule amount to a legally binding guarantee that foreign firms will be allowed to supply their services under stable conditions. This gives everyone, including producers, investors, workers and users, a clear idea of the rules of the

game. That allows everyone to plan for the future with greater certainty, which encourages long-term investment.

- Technology transfer: Services commitments at the WTO help to encourage foreign direct investment (FDI). Such FDI typically brings with it new skills and technologies that spill over into the wider economy in various ways. Domestic employees learn the new skills and domestic firms adopt the new techniques. In addition, firms in other sectors that use services-sector inputs such as telecommunication and finance benefit too.

Table 3.3 Travel and tourism employment and GDP real growth

	Employment			GDP
1999 Estimates	**Jobs (Mn)**	**% of total**	**Growth***	**Real Growth (%)**
World	192.3	8.2	2.6	3.0
Africa	11.8	7.4	3.3	
North Africa	2.2	7.4	2.8	6.0
Sub-Saharan Africa	9.6	7.4	3.4	5.2
Americas	33.8	9.6	2.0	
North America	21.2	11.9	1.4	2.5
Latin America	8.9	6.0	3.4	6.1
Caribbean	3.6	15.8	1.9	5.5
Asia/Pacific	96.9	6.7	3.3	
Oceania	2.1	16.0	1.9	3.8
Northeast Asia	57.2	7.1	3.0	2.8
Southeast Asia	15.3	7.3	4.7	5.5
South Asia	22.3	5.4	3.3	9.1
Europe	47.8	13.2	1.0	
European Union	22.1	14.5	0.5	2.3
Other Western Euro.	4.4	15.6	1.9	3.8
Central and Eastern Euro.	21.3	11.7	1.3	4.8
Middle East	2.0	6.1	3.2	5.2
* 1999-2010 Annualised real growth adjusted for inflation (%)				

Source: World Tourism Organisation, 2000.

In the tourism industry, trade liberalisation has been a serious issue for a long time and the movement of liberalisation has a large effect on international tourism. For hotels and travel agents, establishing branches and setting up new businesses in different countries is common since the restrictions on entry, foreign investment and foreign ownership were reduced. In addition, an increase in the international activities in airline industry proves that liberalisation and globalisation, such as mergers and air traffic agreements between different airlines, are necessary to increase the volume of trade activities.

Nevertheless, there are benefits and costs of trade liberalisation in service industries. Those benefits and costs may be different between developed and developing countries.

3.3.3.1 Trade Liberalisation in Developed Countries

It is true that developed countries are relatively liberalised on trade in services compared with developing countries, but they still have plenty of protection. In fact, some developed countries are reluctant to liberalise certain "sensitive" industries. For example, agriculture and services have remained relatively untouched by multilateral bargaining. In this case, the problem arises with ineffectiveness of many smaller GATT members as bargainers, which influence an ineffectiveness that for many developing countries reflects a principled unwillingness to bargain. Consequently, protection in the form of both tariff and non-tariff barriers are quite high (UNCTAD, 1994).

According to Baldwin (1996), trade policies of the developed countries need to focus on further liberalisation because not only there are complexions in the instruments and structure of protection in the developed countries, but also there is a problem of trade policy getting worse. For instance, high employment, rapid changes in comparative advantage, and large swings in exchange rates and current account balances have combined to make protectionism increasingly respectable since the 1970s (Nogues, *et al.*, 1986).

Despite the problems of protectionism in trade that mentioned above, many sectors in services industry are more liberalised than manufacturing industry. In this respect, the development of technology had a great influence in achieving trade liberalisation in services, since the sectors such as financial and tourism sectors provide their services through electric transactions between countries. In addition, the development of technology provides various types of services as well as encouraging competition between countries. Having said that, relaxation of restrictions on service transactions can provide substantial gains to consumers and producers. The technical development on service transaction provides savings in time and costs to both consumers and suppliers. Liberalisation of international service transactions poses considerable challenges which are quite different from those in goods. The fact that barriers to trade in services are present in national economies in the form of legislation and administrative practices and not found at the border, make them less transparent than tariffs and quotas, and more importantly, it is difficult to assess their restrictive impact. However, there is still a need for developed countries to promote further trade liberalisation to combine with deregulation in services industry.

In general, protectionism seems to be a more sensitive issue in developing countries than in developed countries, especially the issues on borderless service transactions.

3.3.3.2 Trade Liberalisation in Developing Countries

The services sector constitutes a growing share in both the output and trade of many developing countries. The size of the service sector in Latin America has grown on average from 48 % of total GDP in 1980 to 56 % in 1995. In East Asia, a similar situation has occurred: the size of the service sector for South East Asian economies has increased from 43 % of total GDP to 48 % over the same period. This can be compared with most industrialised economies that now have service sectors accounting for more than two-thirds of their GDP. Developing economies are rapidly moving towards a similar, heavily service-intensive structure of output, though this varies according to the country concerned, with smaller and more open economies (such as Singapore, Hong Kong, and the Caribbean island states) tending to display a greater degree of service intensity.

While the value of trade in goods nearly tripled between 1985 and 1995 for the Western Hemisphere and the Asia Pacific regions, the value of trade in services only doubled. However, for all developing regions except Latin America, the share of services trade in GDP rose over the decade, indicating that the weight of services output has been increasing in national economies. Thus it is possible to qualify the services sector as relatively dynamic with respect to its importance in output, but less dynamic with respect to trade for few developing regions. The likely explanation for this situation is tied to the very considerable unilateral liberalisation in the form of lowered tariff and non-tariff barriers by countries in these regions since 1985 (with duty rates falling from around 40 % on average in 1985 to around 12 % in 1995 in Latin America) which has engendered a rapid expansion of merchandise trade, combined with the still relatively high degree of restrictiveness found in the access to service markets. It is also a result of the poor quality of service statistics. Many traded services are simply not captured at all, while others are embodied in goods, with the impossibility at present of separating out the services component (The World Bank, 1995).

In recent years, however, an interest has arisen in service liberalisation in many developing countries. Delegates from 69 countries including 40 developing countries, signed a 'liberalisation' pact in February 1997 at the World Trade Organisation (WTO) in Geneva, which will allow foreign operators to break domestic monopolies to supply new connections (IIE, 1996). This liberalisation has not manifested itself so much at the multilateral level, as at the national and sub-regional levels. Several countries, particularly in Latin America, have moved to privatise their telecommunications sector and to open their utilities sectors to foreign competition. But the most ambitious market-opening undertakings have been carried out on the sub-regional level, among a restricted number of partners of geographical proximity. The liberalisation of services has become a part of the considerable revival and renewal of interest in regional integration in the world.

Individually, developing countries are important in international trade because they account for half the world's imports. Hence, it would be highly desirable even from a global perspective, for these developing countries to liberalise their market, but they have to be convinced of the direct benefits for the liberalisation to happen.

In the area of international trade, services are contributing on a larger scale than ever before to enhance foreign exchange earnings by developing countries. According to WTO (1999[b]), the application of new technologies in the telecommunications and computer-related areas has created major new opportunities for developing countries to provide commercial service exports at long distance, possibly doubling the present value of such exports (now around $180 billion) within a few years. Some developing countries have traditionally shown a revealed comparative advantage in service exports (including Egypt, India, Malaysia, Mexico, Thailand, and Panama, among others). Areas of comparative advantage vary as between construction services (Republic of Korea), personal services (southeast Asian economies), transport (Singapore), finance (Hong Kong and Panama), and tourism (many smaller developing economies). Exports of computer-related and various forms of data processing activities provided on a long-distance basis by developing countries are growing at remarkable rates (India, various Caribbean countries). Besides long-distance services, there remains much scope for expansion in other areas of traditional service exports by developing countries, particularly tourism, which remains the largest single source of foreign exchange earnings in services for these countries. In addition, these developing countries experienced rapid growth and diversification of exports following the movement of liberalisation in the 1970s and 1980s, but economies pursuing across-the-board protection such as India and Argentina have suffered from low rates of economic growth, balance of payment crisis, high capital intensity and low employment growth in manufacturing (Finger and Olechowski, 1996).

As mentioned earlier, reforming trade policy is necessary for further economic growth in many countries. Across-the-board liberalisation would promote efficiency but selective or partial liberalisation might not. Several developing countries intend to be liberalised by easing quantitative restrictions on imports of what it is called as "essential" commodities and services where tariffs are relatively low. Such liberalisation can increase the variance in incentives and thereby amplify distortions in resource allocation. In Korea, partial trade liberalisation and partial protectionism have applied to international trade. In 1960s, trade liberalisation on manufacturing goods achieved by easing entry and foreign investment restrictions but the country was still one of the protectionist countries in the world. To some extent, the country failed to continue the rapid economic growth in 1990s because of remaining protectionism (Frank, Kim and Westphal, 1975). Complete trade liberalisation may bring easy access to efficient services by combination of competition and economic growth since many service sectors considered to provide the critical infrastructure for economic growth (Stephenson, 1998).

Consequently, for individual countries and for the world, trade liberalisation seems a good idea. For the major developed countries, liberalisation is the only way of securing a satisfactory global environment, because the possible alternative to liberalisation is not the status quo but increased protection. For small countries, both developed and developing, liberalisation can be justified more or less irrespectively of what happens elsewhere, but the attraction would be still greater in an open world economy. It is obviously better to have partners in many cases and world trade is not an exception. Therefore, joining trade agreements either regional or multilateral might be one of the solutions to achieve efficient trade liberalisation for both developed and developing countries (UNCTAD, 1999).

3.4 GLOBALISATION

During the 1980s, the internationalisation of the economy entered a phase of globalisation as a result of two major changes, the deregulation policies and the new role in economic activity played by information and communication technologies (Hatzichronoglou, 1996). It is important to be aware of the growing interdependence of the various levels of globalisation as shown in figure 3.4.

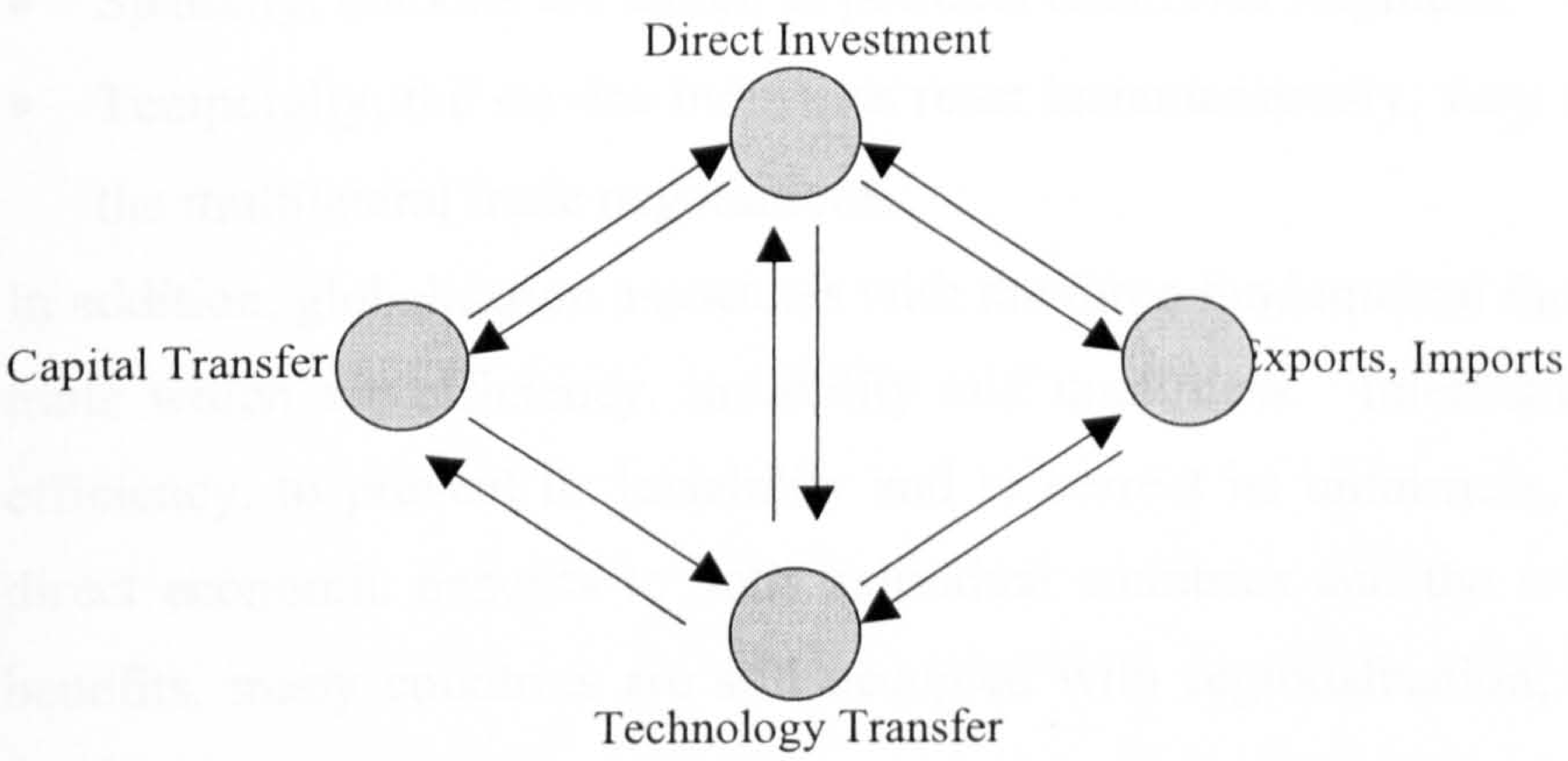


Figure 3.4 Interdependence of the various levels of globalisation

Source: Hatzichronoglou (1996), p.8.

Recently a qualitatively new world economy has been emerging, and it is the economy that refers to globalisation. The most obvious way in which today's economy differs from what preceded it is in the volume and pace of international trade in services. Trade liberalisation in services has been achieved by the development of new services instruments, and new technologies, which currently have created a fully integrated global service market. Therefore, trade liberalisation has, in fact, played itself out in the dynamic interaction between regional and global initiatives to reduce trade barriers (Bergsten, 1996).

More importantly, international tourism has a major effect on the dynamics of globalisation in international trade. Tourism as a source of income and employment, and as a major factor in the balance of payment for many countries, has been attracting increasing attention on the part of governments, private sector entities, regional and local authorities, and others with an interest in international trade and economic development. If the barriers to worldwide travel were eliminated or reduced, the volume of international trade in tourism would increase. Thus, introducing international trade agreement, namely General Agreement on Trade in Services (GATS) was important for further development and liberalisation in the tourism industry, since the GATS has tourism as one of its main focuses (WTO/OMT, 1994). Moreover, the rapid growth of tourism is a product of liberalisation of economic policy throughout the world during the past decade.

According to European Commission (2000), globalisation fundamentally changes two dimensions of the world economy:

- Spatially, markets are united as political territories fragment.
- Temporally, the service industries react instantaneously, very quickly followed by the multilateral trade negotiations.

In addition, globalisation associates with the three fundamental factors of international trade which are efficiency, instability and unfairness. International trade needs its efficiency, to prevent its instability and to correct its unfairness, which will provide direct economic benefits to both individual countries and the world. Despite these benefits, many countries are still occupied with regionalisation, especially for trade arrangements.

3.4.1 THE DIFFERENCES BETWEEN GLOBALISATION AND REGIONALISM

Regionalism verses globalism is a topic often discussed among economists, but it is not easy to either define or measure them. Economists define regionalism as any policy designed to reduce trade barriers between a subset of countries regardless of whether those countries are actually contiguous or even close to each other. However, the definition of globalism in economic terms is not easy and none of the economists have succeeded in defining it adequately. It is probably easy to say that globalism is miltilateralism that includes any policy designed to reach the degree to which discrimination is absent and the extent to which the world's trading regime approximates free trade (Winters, 1996).

Differences between globalisation and regionalism need to be addressed in order to understand the existence of different trade agreements. Many countries have been involved with one or more free trade agreements in world trade regardless of whether they are regional or global trade agreements. However, the important question is whether regional integration arrangements (RIAs) are good or bad for the multilateral system as a whole. It is true that promoting regionalism in world trade can create direct impact on globalism in the field of trade and investment. The relationship between regionalism and globalism is very strong for either negative or positive reasons. As regional trading arrangements stimulate growth and investment, facilitate technology transfer, shift comparative advantage towards high value added activities, provide credibility to reform programs, especially developing countries or small developed countries. On the other hand, regional trading arrangements divert trade in inefficient directions and undermine the multilateral trading system. Therefore, it is difficult to justify whether regionalism is a threat or an opportunity to strengthen the world economy (Bergsten, 1997).

It is true that the regional integration arrangements such as EU and NAFTA have helped to increase the degree of trade liberalisation globally but other regions had to consider to join or arrange their own regional trade agreements to compete with them because Europe and North America dominate the world's trade which create the danger of building up trade protectionism in other regions. Hence, it is often discussed that economic blocs represent a real danger to global welfare because regionalism can easily apply itself with the forces of economic nationalism rather than globalism.

However, there are three different dimensions that characterise the growth of regional trade agreements (RTAs) (Fernandez, 1997):

- the "deepening" of existing regional trade arrangements, as typical regional trade arrangements focused on "hard" trade restrictions like tariffs and quotas on manufactures are extended to "soft" trade restrictions such as health and environments, to other product areas like services and intellectual property where trade policy is typically far more complex to describe or implement. For example, European Union (EU) has made an impressive change from a customs union to a single market to pursue free movement of labour, capital and services, and substantial regulatory harmonisation and they even introduced a single currency to achieve freer trade within the member countries.

- the "widening" of existing RTAs, as countries not previously joined any RTA sought to be a member of one or more. For example, NAFTA essentially involved Mexico's accession to Canada-US Free Trade Agreement (CUSTA), and some of the former EFTA member countries joined European Union.
- the creation of new RTAs, or the relaunching of RTAs that had effectively been operated. For example, the South Asian Preferential Trading Agreement established in 1993 with the aim of forming a common market between Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka to increase the competitiveness in world market.

However, the international trading system has also deepened and widened through multilateral trade agreements. General Agreement on Tariffs and Trade (GATT) has extended for the first time into General Agreement on Trade in Services (GATS) and intellectual property rights (TRIPs). The multilateral trade agreements like the GATT had to extend their form and coverage as the world's economic and political situation changes. The collapse of centrally planned economies and the rapid growth of service sectors in international trade led to the introduction of new international trade agreements like the GATS and the TRIPs. More than 100 countries signed for these agreements because it is necessary to become involved in such arrangements to survive in a highly competitive world market (World Trade Organisation, 1999).

The multilateral trade agreements such as GATT and GATS have been introduced to achieve global trade integration, but their success to date is questionable. The GATT provides fair and equal opportunities to every member country and even provides special treatments to developing and least developed countries but it does not seem enough to pursue global trade harmonisation which clearly needs to have some degree of compromise between member countries. The political and economic situation between developed and developing countries are so much different. The gap between developing and developed countries cannot be bridged overnight. The GATT certainly has helped to reduce tariffs and trade barriers but the question we should ask is "has the GATT given equal benefits to developing countries and developed countries?" However, the experience with the GATT will certainly give an idea to perform better with the GATS and the TRIPs in international trade. Nonetheless, the question of "which trade agreements (between regional trade agreements and multilateral trade agreements) should be invoked to world trade" is almost impossible to answer at this stage (Fernandez, 1997).

The world seems to be step forward to accept RTAs as a necessary accompaniment to world trade but it does not necessarily bring all the benefits to world trade. But over 60 percent of world trade takes place within regional arrangements that either have achieved free trade or have pledged to do so (see table 3.4). Traditional arguments tend to focus on traditional gains and losses of RTAs but it seems there is more to an RTA than simply bringing economic welfare to a country. For example, NAFTA involved relatively small changes to Mexican and US trade policy but they still preferred to be involved in an action, which means there is something more than simple the desirability or attraction of physical economic welfare achieved from joining or creating an RTA. A regional trade agreement probably changes a country's future incentives and behaviour towards world trade (Foroutan, 1998).

Table 3.4 Regional Free Trade Arrangements (Share of world trade %, 1994)

European Union (EU)	22.8
EUROMED	2.3
NAFTA	7.9
Mercosur	0.3
Free Trade Area of the Americas (in addition to its subregionals)	2.6
AFTA	1.3
Australia-New Zealand	0.1
APEC (in addition to its subregional)	23.7
Total	61.0

Source: Bergsten (1997), p.15

3.4.1.1 Gains and losses from Globalisation

It is true that the overall economic impact of globalisation has undoubtedly been extremely positive. In terms of liberalisation, countries could turn to either a regional or global trading system, but the global approach is fundamentally superior because it maximises the number of foreign markets involved and avoids the economic distortions and political risks of discrimination among trading partners, which has been proved by the success of GATT. In addition, increased trade, particularly borderless transactions have generated gains in productivity and efficiency that are stimulating growth and creating many jobs in advanced countries. For many developing countries, globalisation has opened the door to export-led industrialisation. For example, in the tourism industry, foreign investment is building roads, airports, and hotels, and it is providing resources unavailable domestically which increase overall quality of tourism products. Therefore, in many of the world's low-income countries, globalisation is a tool for lifting living standards and bringing economic welfare to those countries (Sutherland, 1998). Consequently, as mentioned earlier, globalisation brings economies of scale and faster technological progress by promoting more efficient resource allocations.

Nevertheless, the problem for many developing countries is not what globalisation has or has not done to the country, but that it threatens to miss out that country altogether. These less developed countries are suffering from the lack of human capital, the institutions, the physical infrastructure, and the policies necessary to get hold of the trade and investment opportunities of globalisation. The most important problem from the point of view of globalisation is inequality between countries. Although globalisation is a powerful factor for political development and economic development by stimulating exports, direct investment and transfers of know-how and technologies, it is also a potential threat to less-developed and developing countries. In these low-income countries, globalisation may bring not only economic losses but also social and environmental losses. The main threat comes from inequality of competitiveness, human capital, infrastructure, and political status between countries. In other words, globalisation is concerned about possible instability, aggression, and loss of identity, but these concerns can be removed by efficient internal policies and the progress towards multilateral rules (EC, 2000).

3.4.1.2 Gains and Losses from Regional Trade Agreements

According to Jacob Viner (1950), a movement towards free trade between two countries whilst maintaining their respective external tariffs toward the rest of the world could leave them worse off. The argument shows that as a result of liberalising trade with only a subset of its trading partners, the country could switch from a relatively lower cost producer to a higher cost producer, potentially decreasing welfare for a country after all which called as "trade diverting". Krugman (1989) argued that this trade diverting could be seen on agricultural trade in European Community. For example, Southern European countries now import grain and other agricultural resources at relatively high-cost from other side of Europe rather than from the lower-cost providers on the other side of the world. This clearly effect on customers even more because those imported products at high-cost would lead to increase its price for consumers.

Krugman (1989) argued another point where most RTAs are likely to entail relatively low welfare losses resulting from trade diversion, since the countries involved are often geographical neighbours and hence already engage in a respectable amount of trade. However, RTAs may result in substantial redistributional losses in the form of tariff revenue for the country that is lowering its tariff barriers. Since in reality it is often developing or least developed countries to make the largest reductions in their protectionist structures, this redistributional cost is most likely to be dealt by them. This is the reason for many developing or economically weaker countries to join or create RTAs with a larger and more powerful partners.

Moreover, there are mainly three important benefits from regional trade arrangements:

- A positive effect from RTAs in terms of economies of scale. Joining or creating a RTA is preferred by small countries than large countries because small countries will have benefits of increased market size resulting from a RTA. If the country's firms were producing solely for the domestic market, the firms now benefit from greater productive efficiency with large international market. In this case, they would also benefit from increased competition.
- RTAs tend to stimulate foreign investment as well as domestic investment. The issue of attracting foreign investment is more important to developing countries, especially as the government and public funds has decreased dramatically since 1997 because of Asian financial crisis. A regional trade arrangement can attract more foreign investment in various ways, such as by reducing distortions in production within the two countries, by increasing the size of the potential market and by creating a single market within a common external tariff wall.
- Joining or creating a RTA with another country where has politically and economically stable structure could stimulate foreign investment as well as domestic investment if one member country is suffering from unstable political and economic situations. Because the future is uncertain the investors are ready to accept some degree of risks on their investment decision, thus the rational behaviour for them is to take even a little chance to be successful within less

developed economies. For example, China was less developed economies for a long time and foreign investors were not attracted to invest a penny on the country because of their unstable political and economical reasons but after the China made regional agreements with other neighbour Asian countries such as Japan and Korea they start to open their market gradually to the world. However, the country now has a great potential to be one of the most important trading country in the world. The country's market is too big to ignore and foreign investment start to flow into the country rapidly (Gyohten, 1992).

Before all these discussions and arguments for globalism and regionalism pursue, an important factor has to be examined. Regionalism need not be opposed to globalism. It is true that all countries have different political, economic and social conditions which affect their nature and speed of trading policies. This individualism cannot be ignored and treated equally for all countries, this is the reason of developing regionalism and globalism at the same time to support each other. Regional trade agreements could be the first step to move forward to international trade agreements after all. Therefore, the world should not have to choose between one and the other. It needs to live with both.

3.4.2 DIFFERENT TYPES OF TRADE AGREEMENTS

International trade negotiations have been one of the major focal points in world trade. In the modern economy, the degree of liberalisation and promotion of free trade are primary issues in international trade and they are the main objectives for World Trade Organisation (WTO). Many countries have already recognised the importance of globalisation and the significant role played by international trade. All branches of economic activity today are fundamentally dependent on international trade. Trade in manufactured goods has been the dominant element in the past but there has also been a significant growth in the services during the latter half of the last century.

International trade agreements are usually based on the reciprocal extension of trade privileges between the nationals of sovereign parties to the specific agreement. However, about 60 % of the world's trade now takes place within some form of free trade agreements and a large part of the world has eliminated all barriers to trade or is in the process of doing it. The European Union (EU) has completed its "single internal market" and agreed with 12 Mediterranean countries to free trade with them by 2010. The 18 countries of the Asia Pacific economic Cooperation (APEC) forum, including the US, Japan and China, have committed themselves to "free trade and investment in the region". Canada, America and Mexico agreed to sign for North American Free Trade Agreement (NAFTA). A number of smaller arrangements, including the ASEAN Free Trade Area (AFTA) in Southeast Asia and Argentina, Brazil, Paraguay, Uruguay in Latin America reinforce the global trend towards market liberalisation. In Southeast Asia, ASEAN has moved during the 1990s from what it had previously been a predominantly political organisation into the active construction of a free trade area. Since 1995, the ASEAN Free Trade Area (AFTA) has been extended to cover liberalisation of trade in services as well.

Major trade agreements in international trade are General Agreement on Tariffs and Trade (GATT), General Agreement on Trade in Services (GATS), The North American Free Trade Agreement (NAFTA), The European Union (EU) and Association of Southeast Asian Nations (ASEAN). They generally serve to lower tariffs, eliminate quota restrictions, or otherwise remove protection barriers to cross-border trade. Most international trade agreements are either between several different countries, a few countries or only two.

There are mainly three different types of trade agreements, namely international, multilateral and bilateral trade agreements (Schott, 1996):

- First, the Organisation for Economic Co-operation and Development (OECD), the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS)/World Trade Organisation (WTO) are all examples of international trade agreements to which most trading nations of the world belong. In general, the terms of these large agreements are designed to provide guidelines for members, not intervene trade policies and procedures.
- Second, world trade has recently seen a trend toward groupings of three or more countries into trading blocs which together have more economic and political power than any one of the individual members such as NAFTA, EU and ASEAN. Multilateral trade agreements usually provide for a free trade or a customs union

between member countries through which people and products may pass freely or with largely reduced restrictions.

- Thirdly, bilateral trade agreements provide for preferential terms of trade and commerce between two sovereign nations. They can range from narrowly defined or informal arrangements to comprehensive agreements, which provide for an essentially free trade zone between the two countries, such as the Common Economic Region of Australia and New Zealand.

Exports of services, particularly of tourist services, are of special importance to many developing economies that may be regarded as emerging destinations. While industrial countries have taken advantage of the GATS to offer market access commitments of some kind on more than half of their service activities, developing countries did so on only 15 percent of their services trade categories. International co-operation in trading services is not new, but the GATS represents the first multilateral trade agreement effort to establish rules governing services trade, including travel and tourism, and to provide a framework for multilateral negotiations on improved market access for foreign services and service suppliers. This represents a significant step forward in international economic co-operation. It reflects a growing realisation of the economic importance of trade in services, as well as the need for closer co-operation among nations in a world with growing interdependence, particularly in international tourism.

3.4.3 A COMPARISON STUDY BETWEEN TRADE AGREEMENTS

Although the total value of international trade has increased in the past five decades, governments continue to adopt trade policies today that really act as barriers to international trade. It is quite clear that national economic interests still take priority over international concerns but this reality is now tempered a recognition that mutually beneficial agreements can be reached between trading nations (WTO, 1996[a]).

There are various approaches to the liberalisation of trade in services that have been adopted by developed and developing countries at the sub-regional level and regional levels, and to determine in what ways these may go beyond the multilateral disciplines and liberalisation under the General Agreement on Trade in Services (GATS). The similarities and differences exist in the approaches to services liberalisation not only within the regions and sub-regions, but also as between the treatment of services within the two broader integration movements in the world as shown in table 3.5.

Table 3.5 Comparing GATS with services provisions of regional trade agreements

Characteristics	GATS	EU	NAFTA	APEC
Sectoral coverage	Most air services excluded. Negative list for MFN exceptions. Positive list of sectors covered by national treatment and market access by supply mode.	All services covered. Sector-specific directives and regulations.	Universal coverage, except for air services, subject to bilateral air agreements. Negative list of exemptions	General commitment to free trade in services by 2020 at the latest. Implementation rules yet to be resolved.
Most favoured nation	Exists for WTO members, but with sectoral exemptions (to be reviewed after 5 years and eliminated within 10 years).	Extends to all members with no exemptions	Exists for members.	Will extend to members and probably non-members.
Market access	Covers all modes of supply for bound commitments. Prohibits six types of quantitative restrictions within scheduled sectors.	Not specifically addressed. Competition policy relevant.	Not specifically addressed; covered under national treatment and competition policy.	Action agenda aims to apply to services progressively.
National treatment	Covers only scheduled sectors subject to bound commitments.	Not specifically addressed. General non-discriminatory requirements.	General obligation, subject to listed exemptions.	Action agenda aims to apply to services and investment progressively.
Government procurement of services	Not included, to be addressed in future negotiations.	Disciplines adopted to ensure open public procurement.	Disciplines for a range of entities covered by a positive list.	Action agenda aims to liberalise government procurement markets, including developing non-binding principles by 2000.
Competition policy	Limited provisions in the articles on monopolies and exclusive services and business practices. Market access provisions relevant.	Disciplines adopted on competition.	Disciplines adopted regarding competition policy, monopolies and state enterprises.	Not included in general commitment. Action agenda aims to promote more effective and transparent competition policies.
Sectors subject to special provisions	Financial services, basic telecommunications, maritime transport, movement of natural persons, and audiovisual.	Transportation services (air, road, and rail)	Maritime transport, financial services, basic telecommunications, and movement of natural persons.	General commitment applies to all sectors. Separate negotiations to continue on trade facilitation and harmonisation, for energy, transportation, telecommunications, and tourism.
Treatment of investment	Commercial presence covered by specific sectoral commitments, as a mode of supply.	Free capital movement.	Separate investment disciplines, covering goods and services.	Covered by general commitment. Action agenda aims to provide MFN and national treatment progressively and to adopt APEC nonbinding investment principles.

Table 3.5 Comparing GATS with services provisions of regional trade agreements

(Continued)

Characteristics	GATS	EU	NAFTA	APEC
Movement of natural persons	Included in schedule of specific commitments as a mode of supply; limited commitments. Provisions for mutual recognition of qualifications, etc.	Common labour market. Directives on mutual recognition for certain professional qualifications.	Disciplines on temporary entry of business people and provision of professional services.	Not covered by general commitment. Action agenda aims to facilitate improved mobility of business people engaging in trade and investment.
Regulatory standards	Regulatory measures must be non-discriminatory.	Disciplines adopted on mutual recognition of standards and common minimum quality standards.	Detailed information on regulatory impediments required in negative list of exemptions.	Efforts at trade facilitation, including standards, covered in general commitment. Action agenda to achieve mutual recognition of conformity assessment.

Source: Snape and Bosworth, 1996, pp.196-197.

3.4.3.1 North American Free Trade Agreement (NAFTA)

In January 1994, the United States, Mexico and Canada entered into the North American Free Trade Agreement (NAFTA), creating the largest and richest free trade area in the world, that combines GDP greater than US$7 trillion. The agreement calls for the elimination of barriers to trade in goods and services, promotion of "conditions of fair competition" within the free trade area, increasing investment opportunities within the free trade area (FTA) and effective protection and enforcement of intellectual property rights. NAFTA was established to generate important income and employment gains between the three economies and enhance the international competitiveness of firms and throughout the region. Most of all, the world's concern for the agreement was the implications for each of the three countries involved and for the world trading system as a whole, including how NAFTA could affect the balance between globalism and regionalism in trade policy in the 1990s and beyond that (Paul, Hastings, Janofsky and Walker, 1993).

The key goals of the NAFTA are:

- To reduce barriers to trade.
- To increase cooperation for improving working conditions in North America.
- To create an expanded and safe market for goods and services produced in North America.

- To establish clear and mutually advantageous trade rules.
- To help develop and expand world trade and provide a catalyst to broader international cooperation (U.S. Department of State 1998).

Nonetheless, number of important factors is needed to look at for NAFTA. First, the degree of liberalisation involved with NAFTA was relatively low because trade flows between the US, Mexico and Canada were already relatively free. Second, the direct macroeconomic effects of NAFTA on the US were very small, especially for GDP and employment figures. This is why it is difficult to see how it could have operated as a commitment device. Finally, an issue of strong political opposition in the US while it was very popular in Mexico. Overall US opponents of NAFTA saw primarily "losses" from free trade because of downward pressure on the wages of relatively low-skilled workers in the US and reduce investment in labour-intensive industries. In addition, Mexico also regarded NAFTA as "losses" from free trade because Mexico barely had any financial support from the US.

The primary effects of NAFTA are:

- The elimination of Mexican duties on U.S. and Canadian products will have a major impact on the competitiveness of those products within Mexico which is considerably more significant than the impact of the elimination of U.S. duties on Mexican products. Mexico's average tariff on imported goods is in the 10 percent and tariffs in the auto sector of 20 percent. Hence, the reduction of these tariffs creates highly attractive potential profit margin for U.S. firms that can establish efficient distribution system in Mexico.
- Mexican manufacturing businesses have not been enthusiastic about NAFTA from the start. While overall employment is expected to grow in Mexico as a result of new plant investment designed to take advantage of NAFTA, much dislocation occur in established industries that previously have enjoyed only limited competition for secure domestic Mexican market.
- U.S. tariff on Mexican goods, by contrast, average 3.9 percent. As a practical matter, eliminating these tariffs would not affect the incentives for Mexican companies to produce for the U.S. market in most product areas.
- Increase the ability of North American service providers to conduct cross-border activities without discriminatory restrictions. This may help to provide a

competitive edge for such service firms in the global market, since they may gain experience in cross-border operations under NAFTA prior to the GATS (U.S. Department of State, 1998).

In the services industries, NAFTA improves access to Canada's huge market, opens Mexico's largely closed services market, and further opens the US services market to providers from the other member countries. In addition to requiring national and most favoured nation treatment, NAFTA also eliminates the requirement that a service provider establish a local presence and resident status.

Trade in non-factor services is an important component of the economic relationship among the North American countries (Factor services refer to income received from the cross-border movement of factors such as investment income for the movement of capital and wages paid to non-resident workers for the movement of labour. Non-factor services refer to other services such as transport, communication, tourism, entertainment, law enforcement and defence, as well as personal services such as health and hairdressing shipment, transportation and travel). As table 3.6 shows, US and Canada trade in non-factor services totalled about $20 billion in 1990 and US and Mexico non-factor services trade reached $15 billion. Bilateral trade between Canada and US has grown rapidly since Free Trade Agreement (FTA) went into effect, mainly because of increased Canadian travel and tourism in the United States. In fact, travel and tourism accounts for the predominant share of both US - Canada and US - Mexico bilateral trade in non-factor services.

Table 3.6 United States: trade in non-factor services with Canada and Mexico, 1988-1990 (millions of dollars)

	Canada			Mexico		
	1988	1989	1990	1988	1989	1990
Exports						
Travel	3,986	4,852	5,690	2,652	3,398	4,004
Passenger fares	648	719	782	191	260	307
Other transportation	927	989	1,078	369	409	469
Royalties and license fees	795	938	1,102	134	150	217
Other private services	3,160	3,711	4,403	829	1,126	1,152
Total services	9,516	11,209	13,055	4,175	5,343	6,149
Imports						
Travel	-3,228	-3,390	-3,490	-4,828	-5,657	-5,999
Passenger fares	-254	-224	-260	-463	-518	-649
Other transportation	-676	-655	-877	372	-392	-362
Royalties and license fees	-222	4	-37	Negl.	1	-13
Other private services	-1,985	-1,877	-1,840	-1,213	-1,420	-1,557
Total services imports	-6,365	-6,142	-6,504	-6,132	-7,986	-8,580
Trade balance	3,151	5,067	6,551	-1,957	-2,643	-2,431

Note: negl. = negligible (less than $500,000).
Source: US Department of Commerce, 1991.

Tourism is a good example of a sector whose treatment was both significantly broadened and deepened by the NAFTA. Sectoral annexes to FTA chapter 14 on architecture, tourism, and computer and telecommunications network-based enhanced services address specific restrictions and regulatory issues in those areas.

In addition, NAFTA are following new rights and obligations developed in the General Agreement on Trade in Services (GATS) in the GATT. The main factors under the agreement regarding to tourism are:

- Considering that member countries share an extended border and have developed close neighbourly and commercial relations.
- Recognising that international cooperation and economic exchange should serve to foster man's development, to enhance mutual respect for human dignity, and to promote common welfare.
- Acknowledging that the promotion of tourism is considered a legitimate diplomatic and consular function.
- Convinced that tourism, because of its socio-cultural and economic dynamics, is an excellent instrument for promoting economic development, understanding, goodwill, and close relations between peoples
- Noting that a valuable structure for tourism, already existing between countries, stands ready for further development (Edgell, 1999).

NAFTA sets out the governing principles and rules under which citizens of each country may have access to the other countries on a temporary basis to pursue business opportunities without meeting a labour-market test. The NAFTA does not create a common market for the movement of labour. However, each country still preserves to protect the permanent base of its domestic workers. NAFTA identifies four categories of travellers eligible for temporary entry (Organisation of American States, 1995):

- Truck and bus drivers engaged in the international traffic and international service providers such as customs brokers.
- Traders and investors who carry on substantial trade and investment between their own country and the country they wish to enter.
- Inter-company transferees who are employed by a company in a capacity that is managerial, executive or involves specialised knowledge and who are transferred within that company or its subsidiaries or affiliates between countries.
- Professionals who are listed in the schedule and are seeking to enter another NAFTA country on a temporary basis to provide their professional skills.

America is concerned about permitting Mexican labour to enter the country because of the increasing number of illegal immigrants. According to the U.S. government (1998), the number of illegal immigrants dwelling in the United States rose from an estimated 3.5 million in 1980 to 6.0 million in 1996. Mexico is the largest source of immigration into the United States. They gain their visa as tourists in the beginning and tend to stay in the country on a permanent base. Although Mexicans accounted for only 12 percent of the total pool of legal immigrants, they accounted for 50 percent to 60 percent of the annual flow of illegal immigrants entering the United States (US Department of Justice, 1990). Having said that, the U.S. needs these illegal workers not only in the farm areas but also in many service sectors such as food outlets, hotels, etc.

Furthermore, in addition to the right of establishment for foreign companies and the movement of tourists between member countries, NAFTA aimed to fully liberalise the cross- border provision of air services within the three countries over a six-year period. It requires that each government accord non-discriminatory treatment to cross-border service providers within NAFTA. This without doubt would benefit the travel and tourism industry in the region. They also remove barriers to various land transport services and it establishes a framework for compatible land transport technical and safety standards. Member nation charter and tour bus operators needed to acquire full access to regular bus routes in the signatory countries by the end of 1996. NAFTA also allowed foreign member bus and trucking firms to carry international passengers and cargo throughout the bloc on a phased in schedule (Hufbauer and Schott, 1992).

The negotiation of NAFTA should be complementary to the GATT and GATS negotiations. The United States, Canada, and Mexico are all strong supporters of the GATT and GATS trading system and seek to build their North American alliance on the foundation of multilateral rights and obligations. They all run a large current account deficit and cannot solve their problems by exporting more to their neighbours. They obviously need to expand total regional exports to third markets. All three countries benefit from GATT and GATS rules and procedures that safeguard their access to overseas markets which prove how much multilateral trade liberalisation to increase each member country's export opportunities.

3.4.3.2 European Free Trade Association (EFTA)

The European Free Trade Association was formed in 1960 with seven countries, including the UK. Since then, the UK, Denmark and Portugal have transferred to the EC, and Finland and Iceland have joined the remaining member states-Sweden, Norway, Austria and Switzerland by the Stockholm Convention to eliminate tariffs and other restrictions on trade between EFTA members. Free trade exists between these EFTA countries but there is no harmonisation of tariffs on trade with non-members (Bayoumi and Eichengreen, 1995). EFTA has a population of some 40 million, and accounts for 6% of world exports.

In the early 1990s, the political and economic problems of the EC itself prevented formal enlargement but this did not stand in the way of intermediate arrangements for closer cooperation with certain states. In 1992 the EC signed an agreement with the seven members of the EFTA which led, on 1 January 1993, to the formation of the 'European Economic Area' (EEA). The EEA consists of 19 states which together form a powerful and wealthy trading bloc. The EEA accounted for over 375m people, \$7bn in combined GDP, over 40 % of world trade and 30 % of total world production (as measured in 1992). Under the agreement the EC extended to EFTA all of the EC's own freedoms in the movement of goods, services, people and capital while the EFTA states agreed to abide by the EC's competition rules. Under agreements existing prior to the EEA agreement industrial tariffs between the 19 countries were already at zero. The 1992 agreement further reduced, however, agricultural tariffs and established a new EFTA fund designed to help the poorer EC regions including Northern Ireland (Siebelink, 1994).

However, EFTA's goals are:

- To remove import duties, quotas and other obstacles to trade in Western Europe.
- To uphold liberal, non-discriminatory practices in world trade.

EFTA seeks to stimulate practical cooperation between its members, to develop common policies and joint support to producers, and in Europe to strive for the adoption of fair trade principles in commercial trading. There are clear achievements among EFTA members:

- The completion of a two-year investigation into the effects of changing international conditions of trade on producers in Africa, Asia and Latin America.
- The start of an elaborate programme aimed at improving and controlling the quality of the imported products.
- The development of partner attendance: the intensive cooperation between a producer and an EFTA member in view of improving communications, transport logistics, product development, and ultimately, of increasing trade.
- The specialisation of EFTA members in expertise, trade and the development of specific food products.
- The strengthening of advocacy work to increase public and political acceptance of fair trade in Europe.
- The launching of a European trademark for fair products (EFTA, 1994).

EFTA does not specify tourism although it is one of the most important service sectors in the area. EFTA seems to concentrate on developing a trading environment for agricultural products such as coffee, tea, cocoa, sugar, and bananas. Member countries did not have common custom tariffs but just abolished customs between them. In terms of cross-border services and the movement of labour, the agreement liberalises trade between member countries without any restrictions, which simply allow tourists to travel without getting visas. Most importantly, EFTA closely follows the elaboration of uniform EU norms and standards.

3.4.3.3 European Union (EU)

What is now the European Union (EU) began in 1951 as the European Coal and Steel Community (ECSC) and it changed to European Economic Community (EEC) in 1957 and the Treaty on European Union, effective November 1, 1993, formally established a European Union, which introduced citizenship thereof and aimed to increase inter-governmental co-operation in economic and monetary affairs, to establish a common foreign and security policy, and to introduce co-operation in justice and home affairs. The EU consists of 15 members (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom). The EU's stated objectives are to create an area without internal frontiers by strengthening economic and social ties between member countries. The EU seeks to establish a full economic and monetary union, including a single currency. As we know, the task for introducing a single currency has been successful but the United Kingdom yet to be agreed with it. The EU has joined or created trade agreements with all over the world such as Eastern Europe, Middle East, Latin America, Asia and Australia, and North America (European Union, 1999).

The advent of the single market in 1993 represented the fulfilment of completing the process of integration between European countries as figure 3.5 shows. Under these conditions, all barriers to trade between the member states were abolished. The EU has a population of over 340 million, and accounts for 31% of world exports. This sought to establish a 'single market', by eliminating all restrictions on the free movement of goods, capital and persons between member countries. EU needed to remove three main trade barriers as a Single European Market:

- Physical barrier controls
    - customs and excise requirement

- movement of people

- Technical barriers
  - differences in national product standards and specifications
  - differences in national business laws
  - differences in degree of protection of public procurement markets
  - differential controls on movement of capital
- Fiscal barriers
  - differences in indirect taxation (e.g. value added tax)
  - differences in excise duties

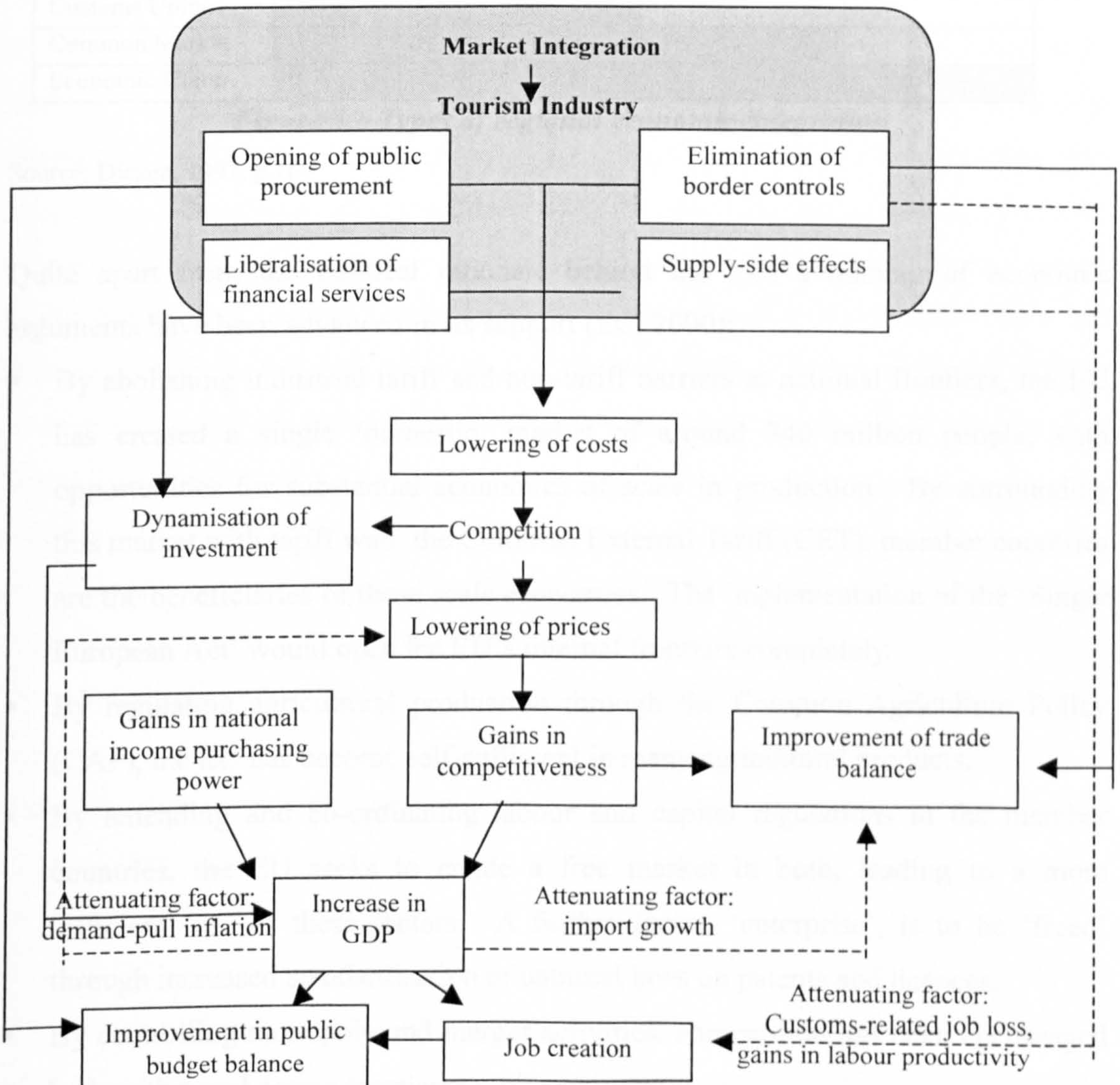


Figure 3.5 Economic changes associated with the completion of the Single European Market.

Source: Cecchini, 1988.

Furthermore, by dismantling tariff barriers on industrial trade between members and by imposing a common tariff against non-members, the EU was to become a protected free trade or 'custom union'. The formation of a customs union was to be the first step in the creation of an 'economic union' with national economic policies harmonised across the member countries. However, the differences between customs union and economic union show in figure 3.6.

	Removal of trade restrictions between member states	Common external trade policy towards non-members	Free movement of factors of production between member states	Harmonisation of economic policies under supra-national control
Free Trade Area				
Customs Union				
Common Market				
Economic Union				

Figure 3.6 Types of regional economic integration

Source: Dicken, 1992, p.169

Quite apart from the political rationale behind the EU, a number of economic arguments have been advanced in its support (EC, 2000):

- By abolishing industrial tariff and non-tariff barriers at national frontiers, the EU has created a single 'domestic' market of around 340 million people, with opportunities for substantial economies of scale in production. By surrounding this market with tariff wall, the Common External Tariff (CET), member countries are the beneficiaries of these scale economies. The implementation of the 'Single European Act' would open the EU's internal frontiers completely.
- By regulating agricultural production through the Common Agriculture Policy (CAP), the EU has become self-sufficient in many agricultural products.
- By amending and co-ordinating labour and capital regulations in the member countries, the EU seeks to create a free market in both, leading to a more 'efficient' use of these factors. A further factor, 'enterprise', is to be 'freed' through increased standardisation of national laws on patents and licences.
- By controlling monopoly and merger activities, competition has been encouraged both within and across frontiers.
- By creating a substantial 'domestic' market and by co-ordinating trade policies, the EU hopes to exert a greater collective influence on world economic affairs than could possibly be achieved by any single nation.

Alongside these factors one must recognise the interdependence of the member states in almost every commercial and economic area. A member country has to act as one European Union, not as an independent country in economic policy aspects which make each member state to have limited freedom of movement. On the other hand, there is a problem of protectionism between EU members and the rest of the world. The EU asks non-signatories to reduce their own tariff barriers while they maintain strong tariff barriers to the rest of the world.

Europe's trading partners are concerned that European companies, many of which are already large and strong, will become even stronger international competitors in the future. They also worry that the single European market may become a mechanism for promoting trade within Europe while reducing international trade between Europe and the rest of the world. These trading ties will be especially important for the economies of Eastern Europe as well as Russia, Ukraine, and the other countries created by the collapse of the Soviet Union. It would be ironic, and economically counterproductive, if the single European market promoted comparative advantage within Europe but hindered the development of trade based on comparative advantage between Europe and the rest of the world (Dicken, 1992). There is evidence that this is happening and the trading relationship between the EU and the USA has been littered with disputes.

The EU represents the most far-reaching agreement with respect to the tourism sector; it goes much beyond GATS in that its goal is an economic union. Thus, not only are there in principle no restrictions on intra-European Community movements of tourists, but tourism suppliers of member states (tour operators, hotels, etc) have the right to establish themselves in any community country. It is worth noting here that the EU (15 countries) signed the GATS agreement as one signatory.

In fact, there is growing awareness of the economic importance of tourism for future growth and employment in the European Union. Europe is one of the most popular tourist destinations in the world. According to the European Commission, 40 % of all worldwide, cross-border tourism takes place in Europe. Tourism is a service industry that has a substantial impact on Europe's economic life, affecting a wide range of sectors – employment, finance and taxation, to name only a few. Despite the EU's declining world market share, which between 1990 and 1996 reduced by 7 % in terms of receipts and 4 % in terms of arrivals, Europe continues to be bolt the main source of origin as well as the principal destination of international tourist flows, in terms of arrivals and departures, of receipts and of international commercial exchanges. EU Member States accounted for 12 out of the 40 leading tourist destinations in the world, and in 1996 they accounted for 40 % of arrivals, 38 % of receipts and 42 % of expenditure in international world tourism. In addition, it is estimated that tourism directly employs 9 million people in the European Union, representing 6 % of total employment and accounting for at least 5.5 % of GDP and 30 % of total external trade in services (EC, 2001).

Article 3t of the Treaty of Maastricht included, for the first time, 'measures in the sphere of tourism' in the list of Community activities foreseen in support of the Community's overall objectives. However, the Treaty gives no particular guidance for a community tourism policy and there is no specific legal base for Community measures on tourism. The European Commission is aiming to ensure that the interests of tourism are fully taken into account in the preparation of legislation and in the operation of programmes and policies. In practice, many programmes and policies now either include a tourism dimension or have a significant impact on tourism-related activities. These Community schemes have an important influence on the development of the tourism industry, on the interests of tourists, and the development of tourism products (EC, 2001).

Another important issue for tourism is the introduction of the euro. Since the tourism sector is relatively globalised and is obliged to work in various currencies, it will benefit greatly from the introduction of the euro. Over 22 % of Europeans travel within the EU each year and expenditure by tourists amounts to 169 billion ECU, excluding transport services. A large number of Europeans are therefore will experience first contact with the euro during their holidays. The new single currency will reduce costs arising from exchange commission in inter-European tourism as well as travelling from non-EU countries by the reduced number of currencies needed to visit these European countries. In addition, the early changeover to the euro by tourist companies is expected to be fairly smooth as the tourism sector is one in which payments using various types of money, such as credit cards, travellers cheques, and Eurocheques, are common (EC, 1998).

It is important to note that European Union is not only promoting tourism sectors but also finding the funds to support tourism-related projects in member states which have not been recognised as an important issue to many other trade agreements and associations. The support is provided for activities that contribute to furthering the co-operation between organisations in different member states as well as dealing with particular issues. This means that a tourism project could be eligible for support under a particular programme if it involves partners from other member states. In practice, this usually means working in international partnerships involving participants from two or more member states.

Consequently, European Union has gone further to liberalise tourism industry than other trade agreements regardless of whether it is regional or multilateral agreements.

3.4.3.4 Association of Southeast Asia Nations (ASEAN)

ASEAN was founded in 1967 with the signing of the Bangkok Declaration by the foreign ministers of Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Additionally, Cambodia, Brunei Darussalam had been admitted in 1984, Vietnam in 1995, and Laos and Myanmar in 1997. The association seeks to strengthen regional cohesion and self-reliance through economic, social and cultural co-operation. The main objectives of ASEAN are:

- To accelerate economic growth, social progress, and cultural development in the region through joint endeavours in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian nations.
- To promote regional peace and stability.
- To promote active collaboration and mutual assistance in matters of common interest.
- To collaborate more effectively for the greater utilisation of agricultural and industrial resources, the expansion of trade, and improvement of transportation and communications throughout the region (ASEAN, 2000).

The ASEAN nations are mainly committed to market and export oriented economic growth strategies. Although some achievements have occurred in all areas under ASEAN, the agreement has been unable to stimulate economic growth to the extent envisioned by the organisers. ASEAN is trying to increase its intra-organisation activity relying on private sectors. In fact, the private sectors of all the member countries are playing an important role in ASEAN co-operation. In addition, ASEAN Free Trade Area (AFTA) was created in 1992 in the region in order to achieve the harmonisation of standards, the removal of barriers to foreign investments, and the promotion of venture capital formation.

ASEAN has evolved into one of the most influential regional associations in the world. Southeast Asia is recognised of global strategic importance because it is the bridge between the Indian and Pacific Oceans. It straddles some of the busiest sea routes in the world. The oil tankers and freighters that pass daily through these routes buttress Japan's status as an industrial power. Although the main trading partners for member countries include the EU, US, Japan, Australia, Canada, Korea and New Zealand in which have achieved rapid economic growth for many years, there are problems that need to be addressed. As we know, substantial trade and investment barriers remain in many of the East Asian economies, including Japan and Korea, making non-contestability of many East Asian national markets as a serious problem for their trade partners. The most important fact is the East Asian economies are unlikely to surrender those trade and investment barriers in order to contribute to globalisation and liberalisation (Young, 1996).

Another problem in the region is the financial crisis. The crisis, which began in July 1997, threatened to reverse the region's economic and social gains of two decade that the ASEAN economies have bounced back after two years of crisis vividly shows their fundamental strength and resilience. In this sense, regional trade agreement might help each member countries to increase trading power as well as political strength in world trade. In fact, many East Asian countries belong economically to the developing world, but some of its member countries have joined the world's top 20 most competitive economies.

With respect to the service industries, wishing to set up a liberal trading framework for trade in services to complement the liberalisation of trade, ASEAN has adopted a Framework Agreement on Services. The agreement seeks to integrate the ASEAN market for services by eliminating restrictions on trade in services among member countries. This involves liberalising trade in services beyond the commitments undertaken by member countries under the GATS. The final goal of the Framework Agreement is to realise a free trade area in services, especially in tourism.

As a result of the economic downturn, some ASEAN Member Countries experienced a decline in tourist arrivals, hotel occupancy and tourism receipts as shown in figure 3.8. Overall, the ASEAN region posted a 9.5 % decline in 1998 tourist arrivals from the previous year. However, ASEAN remains in a good position to attract long-haul inbound tourism from Europe, America, Japan and Australia, as ASEAN remains a "good value for money" tourist destination. The ASEAN National Tourism Organisation continue to implement the Plan of Action on ASEAN Co-operation in Tourism, which was developed at the 1st Meeting of ASEAN Tourism Ministers in 1998. The Plan has five strategies:

- marketing the ASEAN region as a single tourism destination
- encouraging tourism investments
- tourism manpower development
- environmentally sustainable tourism
- facilitation of intra-ASEAN travel (ASEAN National Tourism organisation, 1999).

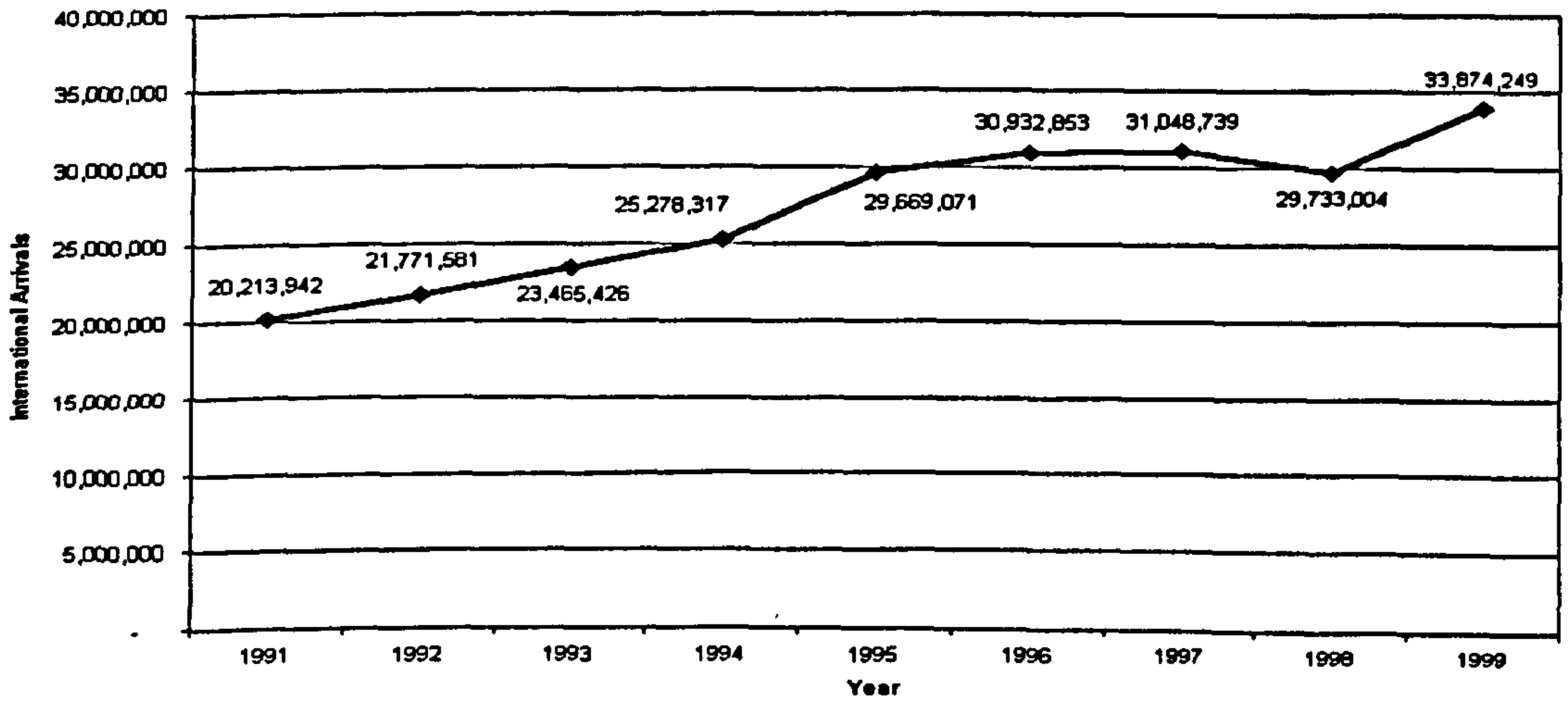


Figure 3.7 Visitor arrivals to ASEAN destinations, 1991-1999.

Source: ASEAN, 1999.

At the same time, the ASEAN National Tourism Organisation formulated the Tourism Action Agenda for the Hanoi Plan of Action. In this action, the ASEAN Tourism Ministers suggested to implement the Visit ASEAN Millennium Year (VAY) Program in the year 2000 which needed a great involvement of the private sectors. In this programme, all member countries shared equal financial contributions to develop and promote the branding and image positioning of VAY 2002. Member countries also pursued marketing activities in targeted areas with the participation of one or more of member countries that were funded by various private sectors (ASEAN, 2000).

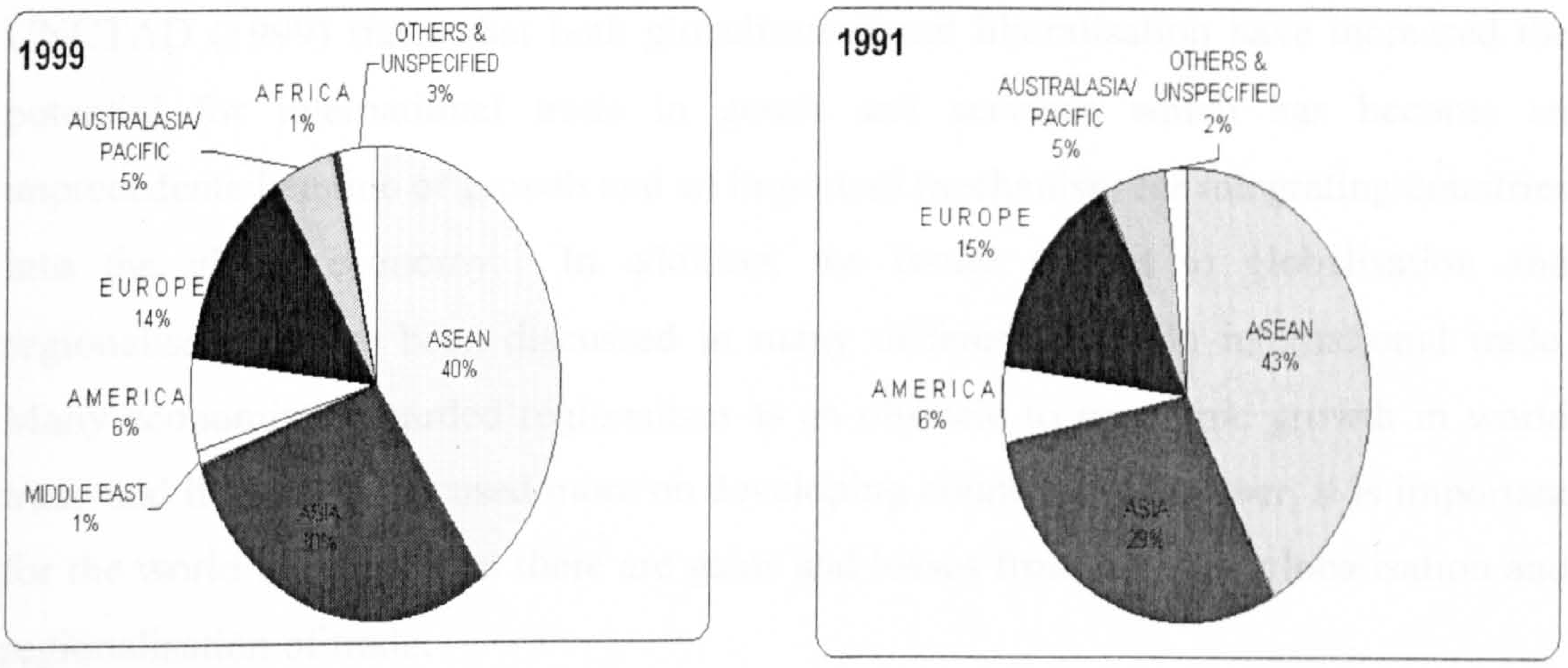


Figure 3.8 Origins of visitor arrivals to ASEAN destinations, 1991 and 1999.

Source: ASEAN, 1999

The tourism ministers have also tried to increase tourism investments into the region by accelerating trade liberalisation and removing all obstacles to the free flow of tourism services, in line with the new rounds of negotiations under the ASEAN Framework Agreement on Services (AFAS). They provide information about the investment climate, infrastructure development, economic indicators and policies, financial framework, statutory requirements for setting up businesses, and contact agencies of ASEAN member countries. In order to increase tourism investments in the ASEAN region, they hold joint investment seminars and joint investment overseas missions. The national tourism organisation has explored different tourism research areas such as airlines and aviation reforms, actions required of the national tourism organisation facilitation measures, actions required of the private sector-led travel trade associations, cruise tourism, e-commerce applications, education, culture and cuisine, conventions and exhibitions, and currency issues. Consequently, ASEAN will obviously make considerable progress in marketing as a single destination by way of advertising materials, continuous researches for developing tourism products and services, human resources development programs, among other means. Therefore, Asia will be one of the important tourists' destinations from different regions of the world in the future.

3.5 SUMMARY

UNCTAD (1999) states that both globalisation and liberalisation have increased the potential for international trade in goods and services which has become an unprecedented engine of growth and an important mechanism for integrating countries into the global economy. In addition, the issues related to globalisation and regionalisation have been discussed in many different ways in international trade. Many economists regarded regionalism as an obstacle to economic growth in world trade and it has been focused more on developing countries. However, it is important for the world to realise that there are gains and losses from both the globalisation and regionalisation of trade.

Globalisation, in general, is an unprecedented opportunity to strengthen and spread democracy in the world. For centuries trade has been the important tool of economic interdependence. By promoting more efficient resource allocation it brings economies of scale and faster technological process. In a world united by the market economy, the revolution in telecommunications, information technology and transport, globalisation stands for integrated markets undergoing rapid expansion and dominated by multinational companies engaged in strategic mergers and takeovers aimed at acquiring an edge and sometimes a dominant position on world markets. Moreover, advanced technology also opens up international trade to smaller operations by using international networks (European Commission, 2000). However, a world economy in which global economic arrangements are overshadowed by regional economic blocs. As mentioned earlier, globalisation has been a big issue for the world trade last few decades but now is the time that the world has to consider globalism together with regionalism.

Addition to the various trade agreements that discussed in this chapter, GATT and GATS are major multilateral trade agreements both in goods and services. Therefore, these two agreements will be discussed in great details in the next chapter.

CHAPTER FOUR:

WTO, GATT AND GATS

4.1 INTRODUCTION

The World Trade Organisation (WTO) is the only global body dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by 140 countries (as at 2000). Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. This chapter examines the WTO's legal ground rules and objectives for international trade and its implications on trade in services, including GATT and GATS.

The WTO's main purpose is to promote trade liberalisation by removing obstacles and ensuring individuals, companies and governments to know what the trade rules are around the world which is pursued by transparency of the agreements. Another important side of the WTO's work is dispute settlement. Trade relations often involve conflicting interests and a need of interpretation for these complicating rules. Therefore, the peaceful and harmonious way to settle these differences is through neutral procedure based on an agreed legal foundation which is the purpose behind the dispute settlement process introduced by the WTO agreements.

However, the existence of WTO ensures consumers and producers can enjoy secure supplies and greater choice of the finished products, components, raw materials and services that they use. Producers and exporters also know that foreign markets will remain open to them. Therefore, the WTO plays an important role in international trade both in manufacture and service industry. In this respect, the importance of liberalisation to boost trade activities between countries under multilateral trade agreements such as GATT and GATS is examined in this chapter.

4.2 WORLD TRADE ORGANISATION (WTO)

The WTO began life on 1 January 1995, but its trading system is half a century older. After more than four decades, the GATT was finally transformed into the WTO. An early result of the negotiations in this respect was the decision to establish a trade policy review mechanism. Participants agreed to set up the reviews at the December 1988 ministerial meeting that was intended to be the mid-assessment of the Uruguay Round. Initially these reviews took place under the GATT, and they focused on goods trade. The WTO embodies 50 years of multilateral trade negotiations in the GATT, which liberalised trade and established a substantial body of trading rules. In many respects, the new trading institution is very much like the old General Agreement on Tariffs and Trade (GATT) regime, which had provided the rules for the system since 1948. But with the creation of the WTO, their scope was extended to include services and intellectual property.

The world emerged from the depredation of the Second World War 50 years ago. The challenge at that time was to rebuild economic stability in a world of disorder and dislocation, to restore a sense of world community and to establish the basis for future growth and prosperity. In the late 1940s, it was not just about the end of the most destructive war but also about the curbing of destructive economic nationalism and the search for a new global order.

Nowadays, the world once again faces a new kind of challenges. The end of the Cold War and the collapse of command and control economies, the dramatic rise of many developing countries, and the massive increase in trade and investment flows around the world have greatly expanded the frontiers of the multilateral trading system, and tested its ability to manage an economy of global dimensions. Trade, technology, and communications link a world of different levels of development in different systems into a single market. Therefore, the creation of the WTO was a symbol of the emergence of a global economic system. If the challenge of the last 50 years was to manage a world divided, the challenge of the next 50 will be to manage a world of deepening integration (WTO, 1998[a]).

The past 50 years have seen an exceptional growth in world trade. Merchandise exports grew on average by 6% annually and total trade in 1997 was 14 times the level of 1950. GATT and the WTO have helped to create a strong and effective trading system. The system was developed through a series of trade negotiations held under GATT. The first rounds dealt mainly with tariff reductions but later other areas were included such as anti-dumping and non-tariff barriers.

4.2.1 PRINCIPLES OF THE WTO

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities. The WTO deals with all different trading issues, including agriculture, trade in services, intellectual property and much more. Despite the complexity, a number of simple, fundamental principles run throughout all of these documents. However, The principles of trading system are mainly classified into five different categories.

4.2.1.1 MFN and National Treatment

The trading system should be without discrimination. A country should not discriminate between its trading partners called "Most-Favoured-Nation (MFN)", and the country should not discriminate between its own and foreign products, services or nationals called "national treatment". Under the WTO agreements, each member treats all the other members equally as "most-favoured" trading partners. If a country improves the benefits that it gives to one trading partner such as a lower customs duty rate, it has to give the same "best" treatment to all the other WTO members so that they all remain most-favoured, but there are some exceptions. For example, countries within a region can set up a free trade agreement that does not apply to goods from outside the group, or a country can raise barriers against products from specific countries that are considered to be traded unfairly. Under the GATS, countries are allowed to discriminate in limited circumstances (WTO, 1998[a]).

The MFN principle is enormously important because it is the first article of the GATT which governs trade in goods and also a priority in the GATS and the TRIPs, but each agreement handles the principle slightly different. Under GATS, if a country allows foreign competition in a sector, equal opportunities in that sector should be given to service providers from all other WTO members. This applies even if the country has made no specific commitment to provide foreign companies access to its markets under the WTO.

The principle of national treatment can be found in all three main WTO agreements (GATT, GATS and TRIPs). Foreign and domestic goods, services and intellectual properties should be treated equally. However, it is important to note that national treatment only applies once a product, service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locally produced products are not charged an equivalent tax which become a type of trade protectionism that uses by many developing countries.

4.2.1.2 Free Trade and Negotiations

Reducing trade barriers is one of the most important objectives in trading system. Trade barriers concerned include customs duties or tariffs and measures such as import bans or quotas that restrict quantities selectively as well as exchange rate policies. Since GATT's creation in 1948, there have been eight rounds of trade negotiations and it achieved historic results of reducing tariffs between member countries. However, since the creation of the WTO, the organisation has attempted to cut not only tariff but also non-tariff barriers, especially those applying to services.

While average non-agricultural tariffs in industrial countries will be reduced to low levels once the Uruguay Round (UR) cuts are fully implemented, many of these countries will still maintain high tariffs in selected industrial and agricultural products. Moreover, developing countries also have much to contribute to this "freer trade" movement. To a large extent, trade concessions by developing countries in the UR involved the acceptance of new trade rules and the binding of tariffs well above applied rates. These ceiling bindings allow these developing countries to increase their tariffs. Therefore, both developing and developed countries need to further reduce tariffs and the gap between the bound rates and the currently applied rates (Schott, 1996).

Opening markets to foreign suppliers and producers can be beneficial, but it also requires adjustment. The WTO agreements allow countries to introduce changes gradually, through "progressive liberalisation". In reality, developed countries already have experiences of dealing with foreign produces and suppliers but many developing countries are still classified as closed market in some extent. They certainly need to be accustomed with the idea of becoming open market and also need some time to prepare the strong competition. Therefore, WTO agreements allow developing countries to take a longer period of time to fulfil their obligations than developed countries.

4.2.1.3 Predictability of Trade

It is important to stabilise markets by not only reducing trade barriers but also not raising trade barriers because this will give firms a clearer view of their future opportunity. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition. In general, investors avoid the high-risk areas, especially when their potential investment markets are unpredictable. Consequently, the multilateral trading system is an attempt by government to make the business environment stable and predictable.

In the WTO, when member countries are agreed to open their markets for goods and services, they bind their commitments. For goods, these bindings amount to ceilings on customs tariff rates. In developing countries, often tax import as rates that are lower than the bound rates while developed countries are charging the same amount for both the actual rates and the bound rates. However, a country can change its bindings but only after negotiating with its trading partners, which could mean compensating them for loss of trade. One of the recognised achievements of the UR was to increase the amount of trade under binding commitments as discussed earlier in this chapter. In agriculture, 100% of products now have bound tariffs. This binding system attempts to improve predictability and stability in discouraging the use of quotas and other measures used to set limits on quantities of imports, and also in making countries' trade rules as clear as possible to both public and the WTO (WTO, 1998[a]). Table 4.1 shows the different tariff rates from pre to post UR in developing countries.

Table 4.1 Average tariff rates on imports from developing and transition economies by markets of origin and destination, pre and post UR (%)

Origin	Destination														
	US			EU			Japan			Other industrial			Total industrial		
	Pre	Post	Changes	Pre	Post	changes	Pre	Post	changes	Pre	Post	changes	Pre	Post	changes
Developing economies	6.5	4.5	**-2.0**	7.5	5.9	**-1.6**	4.8	2.4	**-2.4**	12.2	7.7	**-4.5**	6.9	4.7	**-2.2**
Latin America	4.7	3.2	**-1.5**	3.7	4.0	**0.3**	2.6	0.8	**-1.8**	6.0	4.2	**-1.8**	4.4	3.2	**-1.2**
Asia	7.3	5.2	**-2.1**	8.6	6.4	**-2.2**	5.4	2.7	**-2.7**	14.0	8.7	**-5.3**	7.8	5.2	**-2.6**
Africa	3.3	1.9	**-1.4**	9.2	7.5	**-1.7**	4.7	2.8	**-1.9**	6.2	4.3	**-1.9**	8.4	6.7	**-1.7**
Europe	10.2	8.5	**-1.7**	9.4	7.3	**-2.1**	4.9	1.2	**-3.7**	11.7	7.8	**-3.9**	9.5	7.3	**-2.2**
Transition economies	8.0	6.5	**-1.5**	5.7	3.4	**-2.3**	4.8	1.8	**-2.0**	5.9	3.5	**-2.4**	5.9	3.6	**-2.3**

Source: GATT/World Bank data basis, 1995.

4.2.1.4 Promoting Fair Competition

The WTO is a system of rules dedicated to open, fair and undistorted competition, not free trade institution. The rules on MFN and national treatment are designed to secure fair conditions of trade as well as dumping and subsidies. Antidumping is trying to stop countries from exporting at below cost to gain market share. In other words, WTO rules are designed to combat predatory practices by exporters (e.g. dumping) through the imposition of offsetting antidumping duties. While the incidence of antidumping cases has increased over the past decade there has been little evidence that exporters actually pursue predatory pricing or strategic dumping practices. All these issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by changing additional import duties calculated to compensate for damage caused by unfair trade (WTO, 1999[c]).

Furthermore, competition policy has always been on the agenda of the trading system, since the purpose of WTO rules is to promote more open competition in world markets. Many of the other WTO agreements aim to support fair competition and the agreement on government procurement extends competition rules in many countries. Although only few WTO member countries signed for government procurement, opening government procurement to foreign competition could benefit WTO members in some ways:

- Exporters could potentially collect major trade gains if they were able to bid on foreign government contracts.
- Fulfilment with WTO standards would expose and perhaps even constrain

corruption in the letting of those contracts (Schott, 1996).

4.2.1.5 Development and Economic Reforms

It is widely recognised that the WTO system contributes to development especially for developing countries. The WTO agreements include numerous provisions dealing with developing and least-developed countries. However, the WTO came into being following the conclusion of the UR of the multilateral trade negotiations (MTN), is to soon celebrate its fifth anniversary. The major promise of the UR was generation of significant welfare benefit for all countries through strengthening of the multilateral trading system and put to test during the elapsed period. In this process, there are two distinctive trends among developing and developed countries. The developing countries are trying to pursue a proactive approach in their effort to more effectively integrate their economies in the MTN. On the other, the developed countries hesitant on their commitments towards their weaker trading partners which gave a signal to an early launching of a new round of MTN and broadening its scope through inclusion of new issues (Bhattacharya & Rahman, 1999).

Creation of the WTO posed both a challenge and an opportunity in encouraging further participation on the part of the developing countries in the system. Experience of the recent past indicates that the overall level of participation of the developing countries in WTO system continues to remain limited. It is expected to be difficult to balance between developed and developing countries in economic growth and development because of limited financial and human resources as well as institutional weaknesses in developing countries. Thus, strengthening of the capacities of the developing countries not only to participate in the institutional structure of the WTO but also in the global market place has now been widely accepted as one of the fundamental prerequisites for the success of the WTO system (WTO, 1999[c]).

Most importantly, a big challenge facing the developing and least-developed countries is their ability to exercise their rights and meet their obligations to the WTO as their capacity to respond to procedural requirements is limited. Countries participating in regional grouping could draw on joint expert groups and design their respective response strategy through a cooperative effort. In the next round of WTO, a number of new issues including those pertaining to competition policies, investment measures and environmental protection are expected to be raised which will have serious implications for the developing and least-developed countries.

Nonetheless, GATT has a special section on trade and development which includes provisions on the concept of non-reciprocity in trade negotiations between developed and developing countries. For example, when developed countries grant trade concessions to developing countries they should not expect the developing countries to make same offers in return known as "special and different treatment". The GATS also allows developing countries some preferential treatment under the heading "economic integration" (part 5 of GATS). Other measures concerning developing countries in the WTO agreements include:

- Extra time for developing countries to fulfil their commitments.
- Provisions designed to increase developing countries' trading opportunities through greater market access (e.g. services and technical barriers to trade).
- Provisions requiring WTO members to safeguard the interests of developing countries when adopting some domestic or international measures.
- Provisions for various means of supporting developing countries (e.g. to assist them in strengthen their domestic sectors and in technical standards) (UNCTAD, 1997).

All these rules are designed to improve economic performance and stability to developing and least-developed member countries. Developing countries and transition economies were much more active and influential in the UR negotiations than in any previous round. The UR round was particularly focused on increasing participation of developing countries while other rounds were often dealt with issues related to developed countries which derive the notion that the trading system existed only for developed countries.

4.2.2 TRADE AGREEMENTS

The WTO agreements cover goods, services and intellectual property as shown in table 4.2. They include individual countries' commitments to lower customs tariffs and other trade barriers, and to open and keep open markets. The agreements for the two largest areas of trade (goods and services) share some common parts even though the detail is sometimes different:

- They start with broad principles: the old GATT did not include trade in services and intellectual property rights as discussed earlier.
- There are extra agreements and annexes dealing with the special requirements of specific sectors or issues. For goods under GATT, it includes agriculture, health regulations for farm products, textiles and clothing, product standards, investment measures, antidumping measures, customs valuation methods, preshipment inspection, rules of origin, import licensing, subsidies and counter measures, and safeguards. In contrast, for services under the GATS, it includes movement of natural persons, air transport, financial services, shipping, and telecommunications.
- There are the detailed and lengthy schedules of commitments made by individual countries allowing foreign products or service-providers access to their markets. For GATT, these take the form of binding commitments on tariffs for goods and combinations of tariffs and quotas for some agricultural goods. For GATS, the commitments state how much access foreign service providers are allowed for specific sectors, and they include lists of twelve different services where individual countries say they are not applying the MFN principle of non-discrimination (WTO, 1999[b]).

Table 4.2 The basic structure of the WTO agreements

	Goods	Services	Intellectual Property	Dispute
Basic principles	GATT	GATS	TRIPS	Dispute settlemen
Additional details	Other goods agreements and annexes	Services annexes	–	–
Market access commitments	Countries schedules of commitments	Countries schedules of commitments (and MFN exemptions)	–	–

Source: World Trade Organisation, 1999[a].

Two other groups of agreements also important such as the agreement on trade policy reviews, and the two-plurilateral agreements of civil aircraft and government procurement not signed by all members. The agreement on trade in civil aircraft entered into force on 1 January 1980 and it has 24 signatories. The agreement eliminates import duties on all aircraft, other than military aircraft, as well as on all other products covered by the agreement. They are civil aircraft engines and their parts and components and sub-assemblies of civil aircraft, and flight simulators and their parts and components. It contains disciplines on government procurement of civil aircraft, inducement to purchase, and government financial support for the related sector. An agreement on government procurement was first negotiated during the Tokyo Round and entered into force in 1981. The agreement has 25 members. Its purpose is to open up as much of the businesses as possible to international competition. Mainly, it is designed to ensure they do not protect domestic products or suppliers, or discriminate against foreign products or suppliers.

As the WTO attempts to monitor and ensure transparency, it conducts regular reviews of individual countries' trade policies known as the trade policy reviews. These reviews are part of the Uruguay Round agreement, it was a process that was in action even before the round ended. In 1988, member countries agreed to set up the reviews at the ministerial meeting and the first review took place in 1989. At that time, the reviews operated under GATT and focused on goods trade, but the WTO established the Trade Policy Review Body to increase the transparency and understanding of member countries' trade policies and practices. The reviews not only focus on member countries' own trade policies and practices, but also take into account the countries wider economic and development needs. However, the reviews are able to provide two positive results: they enable outsiders to understand a country's policies and circumstances, and they provide feedback to the reviewed country on its performance in the system (WTO, 1998[a]).

Moreover, the UR brought intellectual property rights, including copyrights, trademarks, patents, etc., for the first time. This is an increasingly important part of trade since the world trade is based more and more on electronic transfers. The agreement covers five different issues: how the trading system's principles should be applied to intellectual property rights, how to enforce protection, dispute settlement, and necessary actions while the system is gradually being introduced. Consequently, there are many reasons why the WTO is beneficial to all member countries such as the system helps peace, disputes are handled constructively, rules are making life easier for all, freer trade reduces the costs of living, it provides more choice of products and qualities, trade raises incomes, trade stimulates economic growth, the basic principles make life more efficient, governments are shielded from lobbying, the system encourages good government.

The UR negotiations were concerned with two aspects of trade in goods (GATT) and services (GATS). First, there was the goal of increasing market access by reducing or eliminating trade barriers. Second, there was the goal of increasing the legal security of the new levels of market access by strengthened and expanded rules, procedures and institutions.

4.2.3 THE HISTORY OF GATT AND WTO

Over the years GATT evolved through several rounds of negotiations. The latest and largest round was the Uruguay Round which lasted from 1986 to 1994 and led to the WTO's creation. The creation of the WTO marked the biggest reform of international trade since after the Second World War. It also brought recognition of the failed attempt to create an International Trade Organisation (ITO) in 1948. An official recommendation to the American Administration for the immediate convening of an international conference and for the creation of an international trade organisation was made in 1945 by the House Special Committee on Post-war Economic Policy and Planning but it was eventually failed in 1948. At that time, some extremists believed that the United States should take responsibility for the whole world and see to it that all other countries adopt all American standards. Certain American economists put forward the view that it would be enough if the United States and Great Britain as the two most important countries in international trade and finance could stabilise the dollar-sterling rate and come to an agreement on their economic and foreign trade policy. Other countries would then follow suit. These proposals met with the objection that such a procedure would be interpreted by other countries as a dictate of great power.

Moreover, the Havana Conference in 1948 was a milestone in the drawing up of international trade. At the Havana Conference where the less-developed countries were in the majority the fight for full freedom in their commercial policy become very intense. In their opinion, full freedom meant that less-developed countries should be able to raise tariffs, to use import quotas whenever they considered this necessary, to promote industrialisation during a transition period until half of the population was engaged in industry, to create preferential systems, etc. But developing countries such as America and Western European were very strong about the creation of ITO because Western European countries were desperate to regain economic stability by trading freely with reduced trade barriers to other countries. In fact, they were suffering from economic difficulties (e.g. Great Britain was having economic difficulties because of the financial crisis of 1947). However, although the ITO Charter was finally agreed at a UN conference on Trade and Employment in Havana in March 1948, ratification in some national legislatures proved to be impossible. The most serious opposition was in the US Congress, even though the US government had been one of the driving forces. In 1950, the U.S. government announced that it would not seek Congressional ratification of the Havana Charter, and the ITO was effectively dead.

Therefore, the GATT remained the only multilateral instrument governing international trade from 1948 until 1994 (Kock, 1969). GATT helped establish a strong and prosperous multilateral trading system that became more and more liberal through rounds trade negotiations, but by the 1980s the system needed a thorough overhaul. This led to the Uruguay Round, and ultimate to the WTO.

Table 4.3 World trade and output, 1948-97

	1948	1950	1973	1990	1997	Average Annual change	
						1948-73	1973-97
World merchandise exports							
Billions of current $	58	61	579	3438	5300	9.7	9.7
Billions of constant 1990 $	304	376	1797	3438	5233	7.4	4.6
Exports per capita, constant 1990 $	123	149	466	651	886	5.5	2.7
World exports of manufactures							
Billions of current $	22	23	348	2390	3920	11.7	10.6
Billions of constant 1990 $	93	112	955	2390	3840	9.8	6.0
Exports per capita, constant 1990 $	38	44	247	452	650	7.8	4.1
World output (Indices, 1990=100)							
Commodity output	16.9	18.5	64.6	100.0	111.1	5.5	2.4
Manufacturing output	10.9	12.8	60.3	100.0	111.6	7.1	2.6
GDP (Billions, constant 1990 $)	-	5372	16064	27359	30800	4.9	2.7
GDP per capita (constant 1990$)	-	2134	4162	5177	5215	2.9	0.9
GDP (Billions, at current $ and market exchange rates)	-	-	4908	22460	30000	-	7.8
World Population (Millions)	2473	2517	3860	5285	5906	1.8	1.8

Source: World Trade Organisation, 1998.

From 1948 to 1994, the GATT provided the rules for much of world trade and conducted trade policy over periods that saw some of the highest growth rates in international trade as shown in table 4.3. It seemed well established, but throughout those 47 years, it was a provisional agreement and organisation. The original intention was to create a third institution handling international economic co-operation, to join the Bretton Woods institutions now known as the World Bank and the International Monetary Fund (IMF). The complete plan after 50 years was to create an International Trade Organisation (ITO) as a specialised agency of the United Nations. In 1946, even before any agreement was made, 23 of the 50 participants of the draft ITO charter decided to negotiate to reduce and bind customs tariffs because they wanted to boost trade liberalisation and to reduce protectionism which remained in place from the early 1930s (WTO, 1998[a]).

As mentioned earlier, the early years of the GATT trade rounds concentrated on further reducing tariffs. Then, the Kennedy Round in the mid 60s brought about a GATT anti-dumping agreement. The Tokyo Round during the 70s was the first major attempt to tackle non-tariff trade barriers and to improve the system. The 8th, the Uruguay Round was the most important round due to introducing a new set of agreements.

Table 4.4 The GATT trade rounds

Year	Place/name	Subject covered	Countries
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960-1961	Geneva (Dillon Round)	Tariffs	26
1964-1967	Geneva (Kennedy Round)	Tariffs and anti-dumping measures	62
1973-1979	Geneva (Tokyo Round)	Tariffs, non-tariff measures, "framework" agreements	102
1986-1994	Geneva (Uruguay Round)	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc.	123

Source: World Trade Organisation, 1999.

4.2.3.1 The Early Years of GATT Rounds

During the depression of the 1930s international trade become much restricted as countries imposed tariffs and other barriers to trade in an effort to mitigate the effects of unemployment by protecting their domestic markets for domestic producers. The outcome of these protectionist measures was a sharp decline in the level of world trade, due to increasing incidence of retaliatory protective policy.

These economic policies of the 1920s and 1930s had been major contributors to instability. The political intention on both sides of the Atlantic was to create a structured international economic in order to prevent a repetition of the mistakes made at the end of the First World War. To this end, the United States invested vast sums in the Marshall plan to help the defeated nations achieve economic growth and stability. The Organisation for European Economic Co-operation (OEEC) was formed primarily to distribute the Marshall plan funds, and then to liberalise trade among its member states, in particular through the removal of quantitative restrictions. In 1994, the Bretton Woods conference set up the International Monetary Fund (IMF) and the World Bank. The IMF was to provide a stable system for international payments and exchange. The World Bank was to provide development of loans and assistance (WTO, 1998[a]).

In 1945, the United Nations was set up and in 1946, its subordinate body, the Economic and Social Committee (ECOSOC), adopted a resolution to draft a charter for an "International Trade Organisation". The United States published a draft charter. The first draft was produced in Geneva in 1947 and had three main parts (Kock, 1969):

- A charter for an international trade organisation.
- The negotiation of a multilateral agreement to reduce tariffs.
- A draft of the general clauses relating to tariff obligations.

The second two parts became the general agreement on tariffs and trade (GATT). The first part went to Havana conference in 1948 and was signed by more than fifty nations, but the United States congress refused to approve it and it did not materialise.

In Geneva (1947), GATT was formulated with the objective of avoiding further tariff wars and the consequent domination in trade relations, and the move towards completely free trade on a global scale. The first round among the 23 countries, agreed around 45,000 tariff concessions covering approximately US$10 billion in trade. The biggest tariff cuts were made in the first and sixth rounds. The first round involved cuts of roughly one-third on imports accounting for roughly one-half of world trade. On the other hand, at one time the negotiations were threatened by a breakdown due to different interpretations in the United States and the United Kingdom of the rule concerning the elimination of preferences, which was solved by accepting modest British concessions on the preferences from America.

Each round of GATT since the war has tended to follow the U.S. congress granting the U.S. president a new tariff cutting authority. Without such an authority, the president cannot negotiate. The authority granted will also stipulate the maximum tariff cut which he is able to make. Given the importance of the United States in world trade, meaningful negotiations would be impossible without the involvement of that country. Immediately after the war, the United States was keen to offer large tariff concessions to gain the adherence of the rest of the world to the GATT agreement. The early GATT round was largely concerned with this process. In the middle of 50s, congressional enthusiasm for further tariff reductions waned. There was a feeling that the U.S. had made enough concessions for the time being. However, they could not do so without the involvement of the U.S. The solution was to set up the European Community in 1958 and EFTA in 1960. These agreements involved the European economies eventually eliminating all tariffs on trade between themselves. One of the effects of this was to put pressure on the U.S. to enter into a fresh round of tariff negotiations. The result was the passage of the 1962 Trade Expansion Act and the subsequent Kennedy Round of tariff negotiations (Bagwell and Robert, 1999).

4.2.3.2 Kennedy Round (Geneva), 1964-1967

The Trade Expansion Act was a signal to GATT members to enter into a new and different round of tariff negotiations. The Kennedy Round in the mid-sixties departed from the product-by-product approach to tariff reductions used in previous rounds, and adopted an across-the-board approach to cuts in tariffs for industrial goods. Tariff concessions covered an estimated total value of US $40 billion in trade. Separate agreements were reached on grains and chemical products plus a code on anti-dumping.

Furthermore, the negotiations needed to cover all products whether industrial or agricultural and they should deal not only with tariffs but also non-tariff barriers. Non-tariff barriers had its greatest importance for agricultural products, for which methods were to be discussed for creating acceptable conditions of access to world markets. Another important fact during the negotiations was taken when a state trading country, Poland, was admitted to negotiate for accession. Success at the forthcoming Tariff Conference would create new hopes for the future of the GATT in its work for the liberalisation of trade between the industrialised countries and for the development of the poor countries. But there were many expected obstacles to overcome and the conference was threatened to break down in many occasions during the negotiations (WTO, 1999[a]).

4.2.3.3 Tokyo Round (Geneva), 1973-1979

The Tokyo Round lasted from 1973 to 1979, with 102 countries participating. It continued the GATT's efforts to progressively reduce tariffs. The results included on average a one-third cut in customs duties in the world's nine major industrial markets, bringing the tariff reductions, phased in over a period of eight years, involved an element of "harmonisation". In other issues, the Tokyo Round failed to come to grips with the fundamental problems affecting farm trade and also stopped short of providing a new agreement on "safeguards".

The GATT Council discussed on 16 and 22 November 1979 the two issues, safeguards and the multilateral agricultural framework, on which agreement had not been reached in the Tokyo Round. It was important, as the post-Tokyo Round period opened up, that the complex package emerging from the negotiations be brought into the GATT framework in such a way as not to detract from the authority of the GATT rules; from countries' GATT rights, including those of signatories and non-signatories of the various agreements and arrangements; and from the unity and consistency of the GATT trading system (Long, 1980).

The Tokyo Round produced significant tariff reductions but more importantly it negotiated a series of new agreements or codes to deal with non-tariff measures and more favourable treatment to developing countries. The Tokyo Round codes are: subsidies and countervailing measures-interpreting Articles 6, 16 and 23 of GATT

- Technical barriers to trade
- Import licensing procedures
- Government procurement
- Customs valuation
- Anti-dumping
- Bovine meat arrangement
- International dairy arrangement
- Trade in civil aircraft (WTO, 1999[a]).

They were a beginning of multilateral codes. Several codes were eventually amended in the Uruguay Round and turned into multilateral commitments accepted by all WTO members. In 1997, WTO members agreed to eliminate the bovine meat and dairy agreements.

Overall, there are important factors to note relating to the Tokyo Round:

- Tariffs: The total value of trade affected by the Tokyo Round negotiations on tariff reduction and tariff bindings came to more than US $300 billion.
- Non-tariff measures: The Tokyo Round distinguished itself from previous rounds by grappling with the problem of non-tariff barriers. The core of the Tokyo Round's achievement was to arrive at agreements or codes designed to reduce non-tariff measures and bring them under more effective international discipline.
- A better deal for developing countries: A new clause established the legal basis on which developed countries could extend the generalised system of preferences to developing countries.
- Monitoring and enforcement: The Tokyo Round agreed improvements in the existing mechanisms concerning the notification of trade measures, consultation, disputes settlement and surveillance.
- New agreements in agriculture: The Tokyo round made some progress on agriculture drawing up specific multilateral agreements on bovine meat and dairy products (Croome, 1995).

Consequently, the Tokyo Round represents the GATT agreement as it is now, if the Uruguay Round failed, the Tokyo Round agreement would remain the basis for multilateral trade.

In spite of the benefits brought by multilateral trade liberalisation, trade policy in developing countries in the 1980s and beyond has been characterised by increased protectionism. The turbulent events of the 1970s and early 1980s challenged the industrialised economies to undergo dramatic economic readjustment. Much industrial capacity in the developed countries was becoming obsolete, and the shift to technological and industrial innovation was accompanied by high levels of unemployment. In 1980, trade growth slowed to barely 1% in volume. Non-tariff barriers affect a larger proportion of imports into developed countries than they did at the beginning of the 1980s. Restrictions are most widespread in industries such as textiles, where comparative advantage has generally shifted to the developing countries. By the end of the 1980s, a large number of developing countries had adopted or were heading towards more liberal trade policies. Most of the 63 GATT members, which have joined since the beginning of the Uruguay Round in 1986, are developing countries (National Consumer Council, 1993).

4.2.3.4 The Uruguay Round, 1986-1994

It took seven and a half years, almost twice the original schedule as shown in table 4.5. The Uruguay Round launched at administerial meeting in Punta del Este in 1986. The Punta del Este declaration was agreed by ministers as the basis for the negotiations which were to last four years. By the end, 123 governments participated, of which 96 were GATT contracting parties and the rest were in the process of negotiating membership. The declaration established a very ambitious programme for the negotiations. The old problem sectors of agriculture and textiles were on the agenda, along with the new area of services which had never been covered by the GATT. Revised rules on safeguards, antidumping and subsidies were to be negotiated as well as new rules on investment measures and the protection of intellectual property. Other subjects discussed were improvements to the surveillance and dispute settlement, procedures and the functioning of the GATT system. In fact, it covered almost all trade, from toothbrushes to pleasure boats, from banking to telecommunications, from the genes of wild rice to AIDS treatments. It was quite simply the largest trade negotiation ever in history (WTO, 1999[d]).

Table 4.5 The Uruguay Round – Key dates

Dates	Place	Action
Sep. 1986	Punta del Este	Launch
Dec. 1988	Montreal	Ministerial mid-term review
Apr. 1989	Geneva	Mid-term review completed
Dec. 1990	Brussels	"Closing" ministerial meeting ends in deadlock
Dec. 1991	Geneva	First draft of Final Act completed
Nov. 1992	Washington	US and EC achieve "Blair House" breakthrough on agriculture
Jul. 1993	Tokyo	Quad achieve market access breakthrough at G7 summit
Dec. 1993	Geneva	Most negotiations end (some market access talks remain)
Apr. 1994	Marrakesh	Agreements signed
Jan. 1995	Geneva	WTO created, agreements take effect

Source: World Trade Organisation, 1999[c].

The root of the Uruguay Round was seen in November 1982 at a ministerial meeting of GATT members in Geneva. Although the ministers intended to launch a new negotiation, the conference stalled on the issue of agriculture and was widely regarded as a failure. In fact, the work programme that the ministers agreed to form the basis of for what was to become the Uruguay Round negotiating agenda.

Nevertheless, it took four more years of exploring, clarifying issues before ministers agreed to launch the new round in Uruguay, 1986. All the original GATT articles were up for review. Two years later, in December 1988, ministers met again in Montreal for what was supposed to be an assessment of progress at the round's half-way point. The purpose was to clarify the agenda for the remaining two years, but the talks ended in a deadlock that was not resolved until officials met in Geneva, 1989. Despite the difficulty, during the Montreal meeting, ministers did agree a package of early results. These included some concessions on market access for tropical products aimed at developing countries as well as dispute settlement system. In addition, the meeting included the Trade Policy Review Mechanism which provided for the first comprehensive, systematic and regular reviews of national trade policies and practices of GATT members. The round was supposed to end in Brussels, in December 1990 but they disagreed on how to reform agricultural trade and decided to extend the talks which made the Uruguay Round to enter its bleakest period. Despite all these difficulties, GATT director general managed to compile the draft "Final Act" in Geneva, in December 1991. Although the draft fulfilled every part of the Punta del Este mandate, it did not contain the participating countries' lists of commitments for cutting import duties and opening their service markets. The draft became the basis for the final agreement (WTO, 1999[a]).

For the following two years, the negotiations wavered between impending failure, to predictions of forthcoming success. New points of major conflict emerged to join agriculture, services, market access, anti-dumping rules, and the proposed creation of a new institution. Differences between the United States and European Communities (EU) became central to the hopes for a final conclusion. In November 1992, they settled most of their differences on agriculture known as the "Blair House accord". By July 1993, the "Quad" (US, EU, Japan and Canada) announced significant progress in negotiations on tariffs and market access. Every issue was finalised and resolved, and also negotiations on market access for goods and services were concluded in December 1993 (WTO, 1998[d]).

Consequently, implementation of the results of the Uruguay Round and the inauguration of the WTO mark an important milestone for the world trading system. The many official statements at Punta del Este and the final mandate or "declaration" reflected agreement that the overriding goal of the negotiations is to strengthen and broaden the GATT system. More specially, the overriding goal is to bring about further liberalisation and expansion of world trade by strengthening and improving the existing rules governing international commercial transactions and increasing the responsiveness of the system to changes in the international environment. According to Finger and Olechowski (1996), the main objectives of the Uruguay Round are:

- Circumscribing non-tariff protectionist measures: the issue of protection on trade in goods are important as well as trade in services. The figure 4.1 shows the level of protection in OECD countries. The most corrosive policies of the GATT system have been those involving recourse to negotiate bilaterally for quantitative restrictions that protect domestic producers threatened by imports. The measures have taken the form of orderly marketing arrangements, voluntary export restrictions, unilaterally imposed import quotas, and the like. The first two are called grey-area measures because some people see them as neither legal nor illegal under GATT. These grey-area measures have greatly damaged the most-favoured-nation (MFN) or non-discrimination principle. They have also made a ridicule of the GATT escape clause (Article XIX) and other core GATT articles (XI and XIII) that restrict the use of quantitative restrictions for protection. Further, they promote cartel-like agreements, greatly interfere with market forces, and discourage adjustment to changed competition conditions. In overall, they are in fundamental conflict with the basic tenets of GATT. Finding means of unwinding the most objectionable ones and obtaining a firm commitment to limit their use must be seen as an essential task of the negotiations if the overall goal is to be achieved.
- Increasing the role of developing countries in the GATT: a crucial objective is that the developing countries should participate effectively in the negotiations. Although the principle of different and more favourable treatment embodied in GATT should be honoured, as should the decisions of the contracting parties, the

time has come for some developing countries to contribute more and to assume more GATT obligations. A reason for the limited participation of developing countries in the past negotiations has been the difficulty of reaching agreements as the number sitting around the table increases. However, if developing countries are to participate fully in the round, must have their major objectives met. Similarly, if the agreements are to be a success and engage all then there has to be full stakeholder participation. Key among these are reductions in the tariffs on many of their exports, particularly processed goods which will not be easy because the tariffs that remain in the developing countries really do give much-needed protection. Furthermore, the new round seriously tried to involve Newly Industrialised Countries (NICs) because they are now major worldwide competitors in a wide range of manufactured and sophisticated products. These NICs will be strongly press by those feeling their competition to ease the access to their markets and to reduce tariffs. However, the NICs were earlier excused from making such reductions because they were less developed, even though the MFN rule enabled them to benefit from all tariff cuts negotiated among the industrial countries. Therefore, to obtain greater participations by the NICs in any new code or agreement, the industrial countries will resort to some form of conditional MFN treatment.

- Broadening and extending the coverage: services and agriculture are two main sectors where conflicts among participants are most serious, neither has been adequately dealt with in GATT so far. In the past, GATT dealt exclusively with trade in goods, and primarily non-farm goods. Production and trade in services, both within and across frontiers, have grown rapidly in recent years and promise to continue to grow which increase new restraints on foreign trade in services. This situation caused several industrialised countries to insist that the new negotiations seek to establish rules, rights, and obligations to liberalise trade in services.
- Restoring respect for the GATT: agreements on specific trade issues are not likely to be translated into action unless there is the perception that the system is relevant and in keeping with current realities. This perception will depend to a large extent on how the broad objectives and specific agenda are satisfactorily met. One of the keys to this is the provision of an improved mechanism for settling disputes.

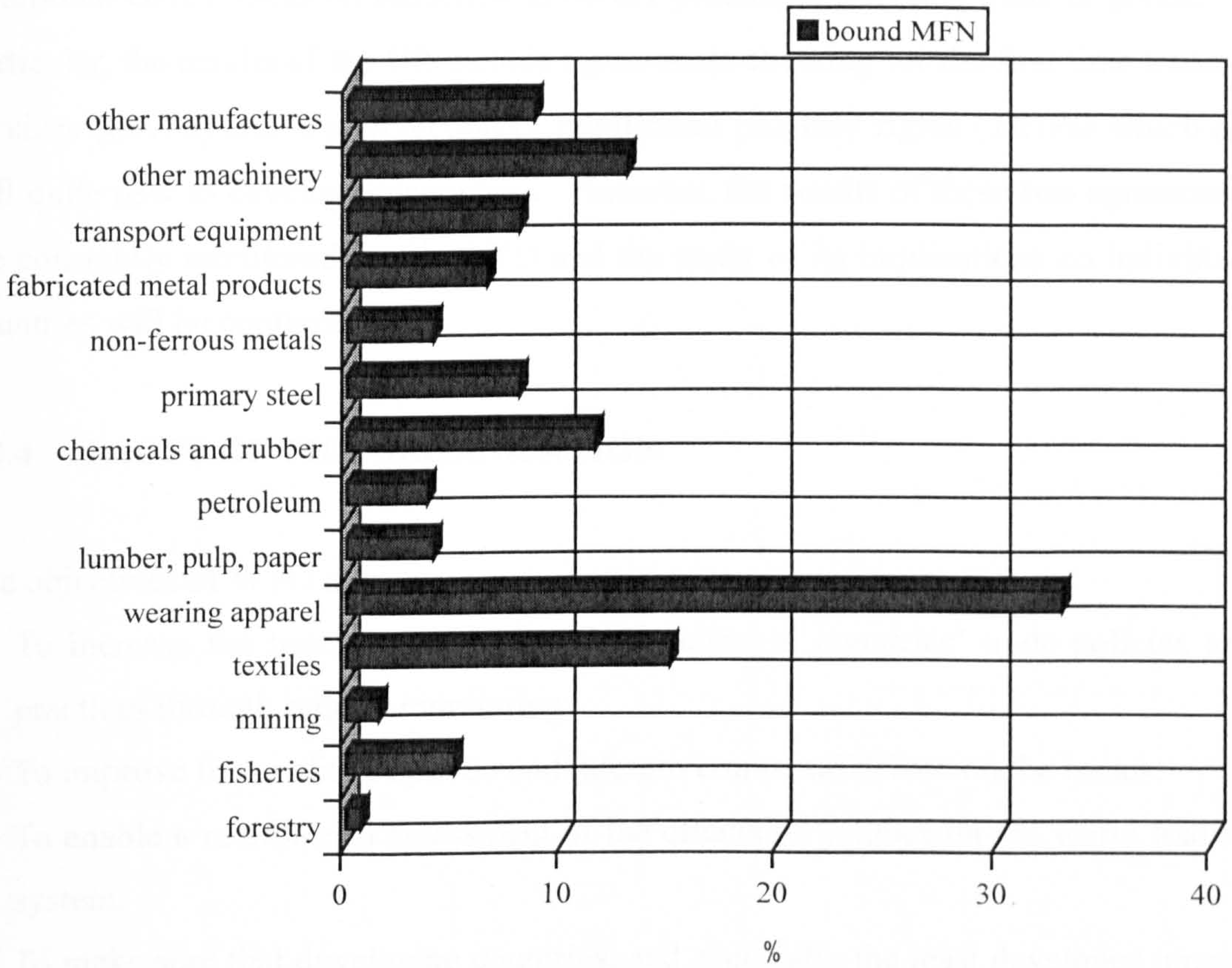


Figure 4.1 OECD protection by sector, tariff equivalent (excludes primary agriculture and services)

Source: Francois, McDonald & Nordström, 1995.

With respect to tariffs, The Uruguay Round (UR) saw average cuts of 40 per cent on industrial products. Prior to the Round, developing countries had on average only bound 21 per cent of their tariff lines. This figure rose to 73 per cent after the UR. Developed countries and transition economies increased their shares of bindings in total tariff lines from 78 per cent and 73 per cent to 99 per cent and 98 per cent respectively (WTO, 1998[a]).

Since the conclusion of the UR, there has been widespread interest among development practitioners as well as governments in assessing the implications of the results of the Round for individual countries, particularly for developing countries. This interest is perhaps due both to the unprecedented commitments undertaken by developing countries in the Round such as market access and other policy disciplines, and to the fact that the UR Agreements include new elements which go beyond the traditional GATT focus on reduction in border protection affecting trade in goods. In particular, the results of the UR include agreements covering for the first time trade in services (GATS) and the protection of intellectual property rights (TRIPs) which are still quite new to developing countries. However, the results of these two agreements are constantly monitored by the WTO and the study of its implications on individual countries will be continued.

4.2.4 FACTS OF THE ORGANISATION

The objectives of WTO are:

- To increase the transparency and understanding of countries' trade policies and practices through regular monitoring.
- To improve the quality of public and intergovernmental debate on the issues.
- To enable a multilateral assessment of the effects of policies on the world trading system.
- To make sure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development.
- To derive the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade in order to develop an integrated and multilateral trading system (WTO, 1998[d]).

As mentioned earlier, however, the overall objective of WTO is to help trade flow freely and fairly and it may achieve by:

- Administering trade agreements.
- Acting as a forum for trade negotiations.
- Settling trade disputes.
- Reviewing national trade policies.
- Assisting developing countries in trade policy issues, through technical assistance and training programmes.
- Cooperating with other international organisation (WTO, 1999[a]).

By April 2001, the WTO had 140 members, who are responsible for over 90% of world trade and over 30 additional applicants negotiating membership (WTO observers). Major decisions are made by the entire membership. A majority vote is also possible but it has never been used in the WTO, and was extremely rare under the WTO's predecessor, GATT. The WTO's agreements have ratified in all members' parliaments. The structure of organisation can be seen in figure 4.2 below.

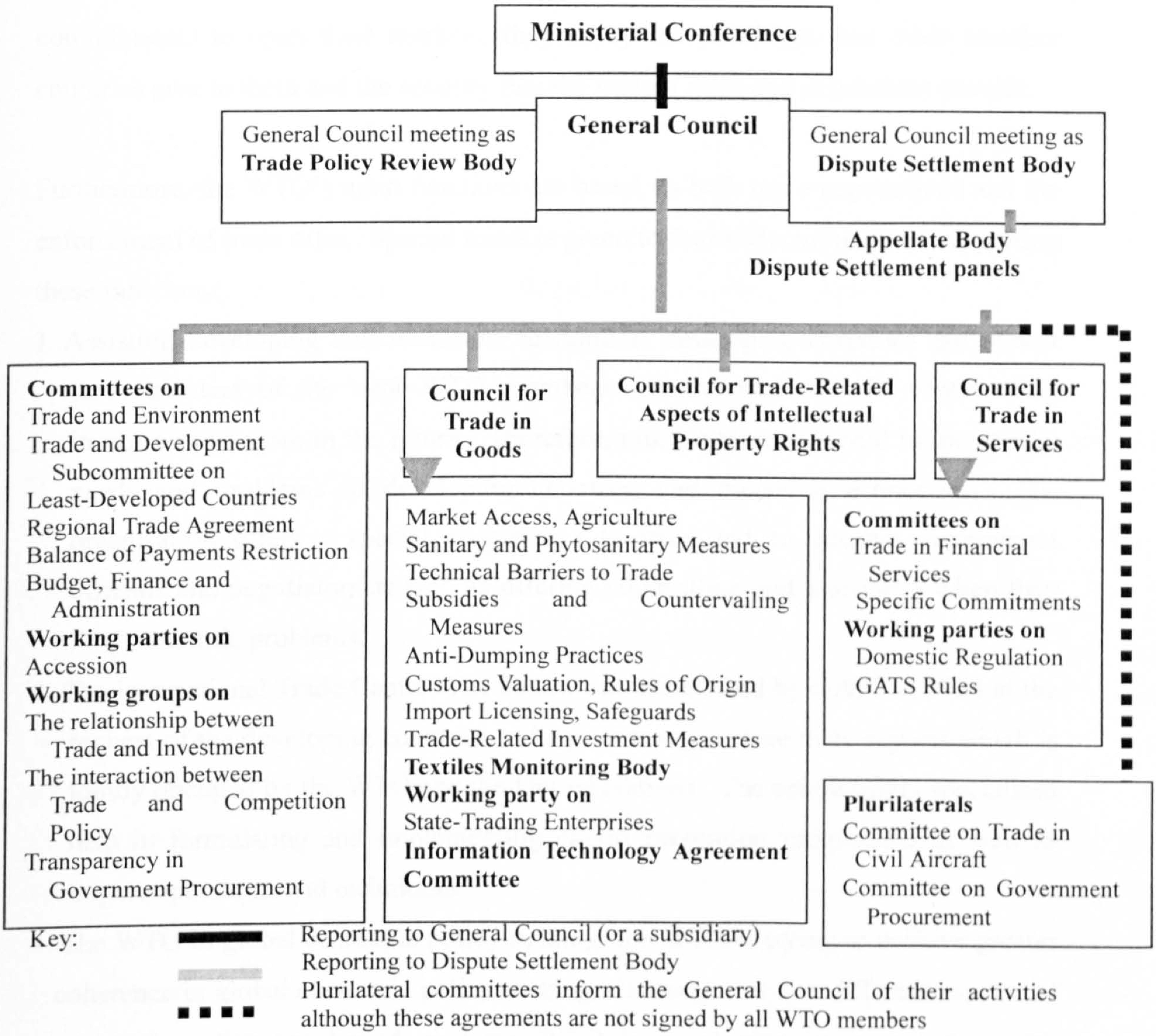


Figure 4.2 The structure of WTO

Source: World Trade Organisation, 1999[a].

All members have joined the system as a result of negotiation and therefore membership means a balance or rights and obligations. For most WTO members, the negotiations took place under the old GATT system. Members of old GATT automatically became members of the WTO when it was established in 1995. In the beginning, 76 governments were eligible to become members and another 50 governments were at various stages of completing their domestic ratification procedures. By the end of 1995, another 28 countries had requested to enter into negotiations to join the new world trade body. However, in order to allow sufficient time for all governments to join the WTO, it was decided in December 1994 that the GATT and the WTO would co-exist through 1995. Although they had to make commitments to open their markets, they enjoy the privileges that other member countries give to them and the security that the trading rules and regulations provide.

Furthermore, the WTO's main functions are based on both trade negotiations and the enforcement of trade rules. Special focus is given to four different policies supporting these functions:

1. Assisting developing and transition economies: developing countries are almost three quarters of the total WTO members and the number will continuously increase even more in the future. Therefore, much attention is paid to the special needs and problems of developing countries and transition economies. The organisation offers a special programme to train and to educate government officials and negotiators as well as offering counselling and assistance when they face economic problems.
2. The International Trade Centre: The centre was established by GATT in 1964 at the request of the developing countries to help them to promote their exports which is jointly operated by the WTO and the United Nations. The centre offers specialised help in formulating and implementing export promotion programme as well as import operations and techniques.
3. The WTO in global economic policy making: the WTO is trying to achieve greater coherence in global economic policy making. It recognises that different aspects of economic policy are linked, and the WTO is developing its cooperation with international organisations responsible for monetary and financial matters since WTO is cooperating with the International Monetary Fund and the World Bank as well as other multilateral institutions.
4. Transparency: There are two different types of transparency.
   - Keeping the WTO informed: the only way to monitor whether commitments are being implemented fully is by requiring countries to notify the WTO promptly when they take relevant actions. Many WTO agreements clearly state "transparency" as one of the important rules, especially for the trade

measures. For example, details of any new anti-dumping or countervailing legislation, new technical standards affecting trade, changes to regulations affecting trade in services, and laws or regulations concerning the intellectual property agreement. Under the GATS, governments must publish all relevant laws and regulations. Within 2 years they have to set up inquiry points within their bureaucracies. Foreign companies and governments can then use these inquiry points to obtain information about regulations in any service sector. And they have to notify the WTO of any changes in regulations that apply to the services that come under specific commitments.

- Keeping public informed: In 1996, the WTO agreed to make more information, including WTO activities available to the public. The information even includes some important documents, including trade policy review, dispute settlement and legal texts of GATT and GATS (WTO, 1999[b]).

4.2.5 DIFFERENCES BETWEEN WTO AND GATT

As a result of the agreements negotiated in the Uruguay Round, which addressed issues previously not covered by world trading rules such as trade in services, WTO obligations apply to a larger share of global trade than the GATT did, which is why WTO is different from the GATT. The first difference is the 'single undertaking' of the WTO agreement. WTO members must accept all of the obligations of the GATT and its agreements negotiated in the Tokyo and the Uruguay Rounds. For many developing countries, the single undertaking commits them to substantially more trade obligations than previously required under the GATT regime. The WTO allows rules known as special provisions for developing countries, the single undertaking helps to achieve to integrate developing countries more fully into trading system under the UR and the WTO regime. The results of the UR negotiations show that the developing countries committed to substantially more trade liberalisation than the developed countries which balance the level of trade liberalisation between two different economies. The WTO rules that commit developed countries to maintain their open markets while their developing-country partners are driving themselves to liberalisation.

The second difference between GATT and WTO regimes is the dispute settlement mechanism (DSM). Although the old GATT was covering only parts of the trading issues, a relatively sophisticated set of procedures for dispute settlement was introduced. This practice was largely embodied in a result from the Tokyo Round, 1979. It included a shift in the late 1950s from the use of a "working party" to consider disputes to the use of a "panel of experts". This is designed to be a more juridical, rather than negotiating, procedure. The experts on a dispute settlement panel were acting in their own right and not representatives of other governments even though they had an obligation to be impartial and to apply careful reasoning to the cases brought before them (Jackson, 1996).

As result of the reforms agreed in the UR, the new WTO dispute settlement mechanism also remedies other basic flaws of the old GATT rules: the long delays from the establishment to conclusion of pane proceedings, the ability of disputants to block the consensus needed to approve panel findings and authorise retaliation, and the difficulty in securing compliance with pane rulings. The UR agreement introduced a more structured process with more clearly defined stages in the procedure. WTO procedures now operate under strict time limits, if a case runs its full course to a first ruling, it should not take more than about one year: countries cannot reject judgements against them; panel findings are subject to review by a new appellate body; and procedures are in place to promote timely compliance, to monitor compliance actions, and to allow retaliation in the event of non-compliance (Schott, 1994). Consequently, the new Appellate Body is exceptionally important because it is now difficult to block the adoption of panel rulings. The Body basically checks that panels do not overstep their authority or make mistakes for each case. In short, the WTO dispute settlement system is faster, more automatic than the old GATT system.

The third difference is membership of the organisations. In the WTO, many countries have joined membership in the organisation than signed under the GATT in the past, and more countries actively participate than did so under the GATT. In addition, the WTO covers almost all the issues relating to trading system, including services and intellectual property while GATT focused only on trade in goods. Therefore, overall, the WTO improves on the GATT in terms of the content of the rights and obligations committed by member countries, the number of countries participating, and its ability to promote trade negotiations and to process trade disputes among their members.

4.3 GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)

There are two different GATTs in the history of the world trading system. One is an international agreement that is based on the rules for conducting international trade. Another is an international organisation created later to support that agreement. However, GATT, the international agency, no longer exists and is known as "old GATT". It has now been replaced by the WTO. GATT, the agreement, still exists but it is no longer the main set of rules for international trade and it has been updated but this is known as "new GATT".

4.3.1 GATT FROM 1947 TO 1994

A major objective of GATT when negotiated in 1947 was to bring order to trading relationships as well as the liberalisation of trade in goods. The global economic and political conditions immediately after the war were conducive to international cooperation and that cooperation was one reason for GATT's early success. The spirit of cooperation after the war helped to meet the challenges of trade and economic reconstruction, but in recent years, the trade problems have increased and become more complex. Three principles of GATT for reducing trade barriers and promoting free market were reciprocity, non-discrimination, and transparency. GATT began with 23 countries as members and the total of 128 countries had signed GATT at the end of the UR. The membership of GATT today is vastly different from that of 1948, and this has affected the way it worked. As its origin, GATT was largely a product of developed countries. Although several developing countries were among the original 23 members, they played a minor role in its operation, even in the Kennedy and Tokyo Rounds, developing countries kept a rather low profile. However, today, GATT has many developing country members with very different economic and political systems (Kelly, 1996).

GATT was provisional with limited fields of action, but its success over 40 years in promoting and securing the liberalisation of much of world trade is incontestable. The average tariff on manufactured goods was 40 percent in 1947 and it is less than 5 percent today. Continual reductions in tariffs alone helped to encourage very high rates of world trade growth during the 1950s and 1960s. The volume of world trade had grown twice as quickly as the world economy. Although GATT has been very successful at reducing tariffs, it is ill-equipped to address many of the other barriers to free trade. During the 1980s, exchange rates were instable in the world. Many countries feared that their economies could be exposed to violent fluctuations from foreign trade because of events in financial markets. This fear led those countries to impose import quotas and other ways of restricting the quantity of imports, which was against the GATT principle of transparency. In addition, many countries were negotiating to form regional trade agreements. These agreements would allow member countries were treated differently from non-member countries, which threatened the GATT principles of reciprocity and non-discrimination, but the old GATT still remains as a useful tool for preventing trade restrictions and increasing the wealth of all member nations (Stiglize, 1993).

There are mainly three successful areas need to be examined under the old GATT (Baldwin, 1996):

- Tariff reductions: tariff reductions were a distinctive result of a forty year programme of negotiations, at least, developed countries have reduced the duties to very low levels. In average, many developed countries reduced their duties on industrial products more than 30 percent under the GATT. This destructing import barriers that industrial countries removed during the economic depression of the 1930s is widely regarded as a key to the nine times increase in world trade and the more than four times increase on world real income between 1950 and 1985. These duty reductions also have helped the developing countries to almost double their share of world exports of manufactured products since the mid 1970s. The tariffs of developing countries, however, remain still high.
- Quantitative restrictions: GATT was able to eliminate not only tariff barriers to trade but also non-tariff barriers such as quantitative restrictions. Quantitative restrictions applied in order to reduce the quantity of imported goods, which was popular in Europe in the pre-war and post-war periods, but developing countries continue to maintain such restrictions.
- Tokyo Round codes: the Tokyo Round non-tariff codes relating to customs valuation, technical standards, antidumping measures, and import licensing were precedential and worked well. Although the government procurement code, the civil aircraft agreement, and the dairy and meat arrangements have had difficulties,

they have generally been successful within the parameters of their objectives and provisions.

Nonetheless, GATT's success in reducing tariffs to such a low level, combined with a series of economic recessions in the 1970s and early 1980s, forced governments to apply other forms of protection for sectors facing increased foreign competition. High rates of unemployment and constant factory closures led governments in Western Europe and North America to seek bilateral trade arrangements with competitors and to embark on a subsidies race to maintain their holds on agricultural trade. The Tokyo Round was an attempt to tackle some of the complicated problems but its achievements were limited. There are also six main problems under the old GATT (Kelly, 1996):

- Limited coverage: by the early 1980s, the General Agreement was no longer as relevant to the realities of world trade as it had been in the 1940s. For example, world trade became far more complex and important than 40 years ago. Since globalisation of the world economy was undergoing, trade in services was of major interest to vast majority of countries which was not covered by GATT rules. At the same time, international investment had expanded to services, especially in tourism sectors but GATT was only tied up with world merchandise trade.
- GATT provisions are limited: each GATT provisions for import restrictions appears to apply only in a specific circumstances, such as a restriction necessary for national security, to safeguard the balance of payments, to promote an infant industry, to offset dumping. In practice, these provisions have proven to be problems towards globalisation and liberalisation in international trade. The industrial countries' practice shows that action against troublesome imports can be legally packaged as an antidumping action or as an emergency action. Similarly, developing countries seeking legality for restrictions that were found it administratively more convenient. For example, if developing countries want to restrict the quantity of imports, they can declare their action as infant industry protection or restrictions to protect the balance of payments.
- GATT provisions do not provide a basis for sorting between restrictions that would serve the national economic interest and those that would not. When import competing producers would benefit from protection, the rules allow protection. The rules do not require that a government, in deciding on a petition for

protection, take into consideration the costs that would accrue to domestic users of imports.

- Tokyo Round codes: although Tokyo Round codes were generally successful to operate world trade more efficiently, the subsidies code has not worked well. The intent of the subsidies code is to ensure that government subsidies do not adversely affect the interests of exporting countries and that countervailing measures by importers do not unjustifiably impede trade. The code dose not try to eliminate all subsidies. Its goal is to create international discipline for government subsidy practices that distort trade. This agreement has been tested by disputes between U.S. and the EEC concerning agricultural products. The subsidies code has been characterised by numerous disputes and lack of agreement between signatories on various issues, in fact, agricultural sector largely excluded from GATT discipline. In addition, U.S. and the EEC have different views on GATT itself. Some countries, especially U.S. tend to look on GATT as a legal system for settling disputes by obtaining legal rulings. Other countries, such as those of the EEC, have a more practical approach that gives much greater emphasis to negotiations for settling disputes. Another issue has been the procedure for notifying GATT about subsidies. Countries have disagreed over which domestic programmes should be classified as subsidies, and there has been resistance to providing information on subsidies when other signatories request it.
- Dispute settlement: an improvement in the GATT mechanism for settling disputes is needed if GATT is to function more effectively. The fundamental problem is based on the interpretation by the contracting parties of the provisions of the General Agreement and the codes. The text of these provisions is sometimes unclear and imprecise. For example, on agriculture, there has been a wide range of views on what constitutes an "equitable share" of world trade, a "previous representative period", and "special factors". It is very difficult to precede dispute settlement since all of these are key concepts in disputes involving agricultural subsidies. Therefore, it needs a clear understanding and agreement on the rules to be respected for dispute settlement mechanism. Another problem is the procedure of the settlement. Procedures are not the central problem in dispute settlement but it is important. The practice is to establish a panel to consider the matter and to make findings and suggestions. Members of the panel are act in their personal capacities and not reflect the views of their governments. It also takes long time to

establish the panel at the beginning and the delays often exceed the time requirements laid down in GATT procedures and the codes.

The GATT and multilateral trade negotiations are meant to contribute to economic growth and development. Three questions, therefore, remain to be answered:

1. why did economic recovery fail to materialise in countries where it was predicted,
2. why did others experience an unexpected slowdown in economic activity, and
3. why are forecasters increasingly cautious in predicting a return to normal rates of economic growth.

The answers to these questions are related to each other. In contrast to the recessions of 1975 and 1982 when the causes of the poor economic performance were clearly identified and strict monetary policies had been introduced to fight high inflation rates in the industrial countries, there is little or no agreement this time on the fundamental causes holding back the world economy. The result is a more than usual amount of uncertainty surrounding the timing and the strength of the upturn in economic growth. This lead to the question of the role which international trade and an open and liberal multilateral trading system play in increasing and sustaining economic growth in an interdependent world. Developments in the trade area alone are not, of course, a solution for all the problems confronting the world economy. But it is equally true that the increasing contribution of foreign trade to the GDP of countries and regions all over the world makes predictability and security in the international trading environment a critical factor in generating jobs, investment flows, technology transfers, and, thus, increasing economic production and growth.

4.3.2 GATT AFTER 1994

Since the successful conclusion of the UR of multilateral trade negotiations in December 1993 and the entry into force of the WTO in 1995, a majority of GATT's members became members of the new WTO. While the GATT of 1947 expired on 31 December 1995, all of its key disciplines affecting international trade goods continue to exist in the form of GATT 1994, and forms an integral part of the WTO agreement. The Tokyo Round codes on antidumping practices and on subsidies and countervailing measures terminated on 31 December 1995 but they continue to apply to disputes which are not subject to the WTO agreement. The GATT's objective was to liberalise international trade and place it on a secure basis, thereby, contributing to the economic growth, development and welfare of the world's peoples. The GATT acted as both as a code of rules and as a forum in which countries could discuss solutions to their trade problems. They could also negotiate the reduction of various trade restrictive and distortive measures. A significant part of the GATT was committed to the economic growth of the developing and, particularly, least-developed countries (WTO, 1996[b]).

During the UR, world trade expanded average of 5%, which proves world trade was moving towards the peak. The 19% increase in the value of world merchandise trade in 1995 represented a sharp acceleration from the 13% gain in 1994 as shown in table 4.6. Trade in manufactured goods was the most dynamic component of world merchandise trade in 1995. On the other hand, trade in clothing expanded significantly less than the average for all manufactured goods, especially for China and Hong Kong. In contrast to 1994, trade in agricultural products expanded at a pace well below that of all merchandise, partly due to previous year's small price increases. However, commercial services exports are estimated to have exceeded $1,200 billion in 1995, up 14% from the previous year. As in 1994, the growth of trade in commercial services lagged behind the growth of merchandise trade. While Asia's exports and imports of commercial services again recorded the highest growth among the regions, the acceleration in the growth of commercial services exports particularly pronounced in Western Europe. In details by major sectors, travel and transportation services increased less, while other private services, such as insurance, banking and telecommunications, expanded faster, than total services. In this case, an important question is whether introducing new GATT and GATS will help to boost world trade both in services and goods even more in the future (WTO, 1996[b]).

Table 4.6 World exports of merchandise and commercial services, 1993-1995.

(Billions dollars and percentage)

	Value			Annual percent change		
	1993	1994	1995	1993	1994	1995
Merchandise	3630	4090	4875	-1	13	19
Commercial services	1000	1080	1230	1	8	14

Source: World Trade Organisation, 1996[a].

New GATT continues to reduce tariff and non-tariff trade barriers and extends its coverage on agriculture and textile industries. Developed countries' tariff cuts were for the most part being phased in over the five-year period from 1 January 1995. The result was a 40% cut in their tariffs on industrial products, from an average of 6.3% to 3.8%. The value of imported products that receive duty free treatment in developed countries jumped from 20% to 44%. There were also fewer products charged high duty rates. The proportion of imports into developed countries from all sources facing tariffs rates of more than 15% declined from 7% to 5%. The proportion of developing countries exports facing tariffs above 15% in industrial countries fell from 9% to 5%. The UR package has been improved. In 1997, 40 countries accounting for more than 92% of world trade in information technology products, agreed to eliminate import duties and other charges on these products on MFN basis by 2000 (WTO, 1999[b]).

Moreover, new GATT introduced an extended coverage on trade in agriculture and textiles.

First, the original GATT applied to agricultural trade, but it could not help much to improve trading environment. For example, it allowed countries to use some non-tariff measures such as import quotas and subsidies. Agricultural trade is very sensitive and has the potential to be highly distorted with the use of export subsidies that would not normally have been allowed for industrial products. The UR agreement attempted to be more practical and efficient and to promote fair competition between member countries in agriculture. It is being implemented over a 6 year and 10 year period for developed and developing countries, respectively, starting in 1995. New rules and commitments apply to market access, domestic support, and export subsidies and other methods used to make exports artificially competitive in agriculture.

Second, textiles, like agriculture, is one of the important issues in the WTO, as it was in the former GATT system. Under a 10-year schedule agreed in the UR, it is now going through fundamental change. The system of import quotas that has dominated the trade since the early 1960s is being phased out. From 1974 until the end of the UR, the trade was governed by the Multifibre Agreement ((MFA) a framework for bilateral or unilateral agreements that established quotas restricting imports into countries whose domestic industries were facing serious damage from rapidly increasing imports. However, since 1995, the WTO's agreement on textiles and clothing (ATC) took over from the MFA. By 2005, the sector is to be fully integrated into normal GATT rules. Under the new GATT rules, the quotas will come to an end and importing countries will no longer be able to discriminate between exporters (WTO, 1999[c]).

Consequently, the GATT has been an important tool for promoting globalisation and liberalisation in the world for 50 years and there is no doubt that world economy would have been a lot worse without the GATT. But, the most important question is how the new GATT will help the world economy develop even further and will it be successful as an agreement. The obvious fact is that new GATT extended its coverage and filled some of the gaps that old GATT had. The future for the world trade with WTO and GATT seems bright even though some of issues are still complicated and hard to tackle.

4.4 GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

The membership of GATS is very broad. The current members of the GATS around 130 countries and well over 90 per cent of world trade in services are taking place between member countries which show how important the GATS is to the promotion of globalisation and the liberalisation of trade in services.

The UR was intended to improve the economic conditions of members by covering new issues and changes in international trade, particularly in services. As economic activities become more globalised through increased trade and investment flows, the need for internationalised intermediation and effective regulation has also grown within the service sectors. Significant potential exists for further expansion of trade in services, as economies continue to be opened and technological developments present new trading opportunities. The continuing globalisation of economic activity and challenge of attracting productive investment in a competitive international environment, accentuate the need to maintain efficient and effective services.

In 1970s, after the Tokyo Round, the USA's trading patterns dramatically moved from manufacturing sectors to service sectors. Despite rapid growth of service trade, there was no single regulation or agreement between countries in international trade in services which led a possibility of international dispute. In this stage, the USA suggested to establish 'working party' for liberalisation of service trade in the GATT discussion table in 1982 but it was failed because developing countries, particularly India against the idea. Developing countries concerned that their domestic firms were not strong enough to compete with highly industrialised countries. However, trade commissioners managed to provide 'working programme' for achieving liberalisation in service trade.

The 'working programme' was actually activated in 1984. Afterwards, 17 countries' and 13 international organisations produced reports for service trade to the GATT in 1986. The 'national study' produced by 13 developed countries included the importance of service trade and its development to the world trade as well as each member countries. These reports showed the complexity, diversity and incomplete understanding of services, and also proposed some form of multilateral agreement which advocated a framework of principles, such as non-discrimination, national treatment and the right of establishment. The commission also included the importance of the special and differential treatment to developing countries in order to encourage fair competitions with developed countries. This study was based on the fact that developing and liberalising trade in services is the first step for improving economic performances, particularly for developing countries.

However, Brazil and India refused to accept the international regulation in trading services. They could not even accept the need for multilateral negotiations on services and they were also arguing about the incompetence of GATT that the GATT has limited ability to control all these trading policies and to govern these special treatments towards developing countries in service trade. Eventually, GATS was introduced in Uruguay Round in 1994 after careful consideration of specific treatments and exemptions towards developing countries in the agreement (Nicolaides, 1989).

The first negotiation concentrated on the stage of what was called 'stock taking' rather than the actual state for liberalisation in service trade. The first issue of the negotiation was that the GATS had to be separated from the GATT or included the GATS in the GATT. At the launching of the UR, the developing countries insisted on a twin-track process that separated services from goods. They did so in order that their manufacturing products should gain greater access to the markets of developed countries. In addition, the fact that there is no standstill or rollback provision in services is a strong indication that industrial countries may attempt to link concessions in goods to concessions in services. However, the commission concluded at the end of the UR as the GATS has to be introduced separately from the GATT and the GATS has to be proceed under the auspices of the GATT (Croome, 1995).

International co-operation in trading services is hardly new, but the GATS represents the first multilateral effort to establish rules governing services trade, including travel and tourism, and to provide a framework for multilateral negotiations on improved market access for foreign services and service suppliers. This effort was a significant step forward in international economic co-operation. It reflected a growing realisation of the economic importance of trade in services, as well as the need for closer cooperation among nations in a world growing interdependence. However, the GATS suffers from major structural weaknesses including a lack of transparency and the sector-specificity of liberalisation commitments that reduce its ability to facilitate effective trade liberalisation (Snape and Bosworth, 1996). In particular, classification problem of GATS for tourism has been a major concern for many tourism-related organisations and experts, which will be discussed in details in chapter 5.

The majority of regional agreements are focused on trade in goods but, the GATS is the only agreement to concentrate on trade in services based on globalisation while regional agreements are based on internationalisation. Member countries for each regional agreement aimed to eliminate all the barriers between them but strongly protect their markets from non-member countries which became one of obstacles of liberalisation in international trade. For instance, the European Union (EU) has a reputation for protecting member countries from non-member countries. The main goal of the GATS is to increase the degree of liberalisation so that countries would reduce protectionism for their own market, which would be beneficial to all member countries' well being in the long-run.

Under the GATS, national treatment, market access or the right of non-establishment, for example, the right to provide cross-border services without an established presence, are not general obligations, whereas they are under the NAFTA and Australia-New Zealand Closer Economic Relations trade agreement (CER). GATS member countries will allow foreign service suppliers to gain access to domestic markets and be treated the same as domestic companies and suppliers. Tour operators, hotel enterprises and other tourism-related companies from one country will be able to set up operations in other countries. In other words, there will be stronger competitiveness in tourism than before. Both the EC and the NAFTA experiences suggest that the application of principles such as national treatment and non-discrimination may not suffice to open service markets to foreign providers.

The GATS allows member countries to have the freedom of not listing particular service sectors. This virtually excludes 'sensitive' industries from its coverage but those regional trade agreements tend to be broadly similar as regards the sectoral coverage of liberalisation of investment and cross-border trade in services. This show a tendency to exclude the same broad range of sectors such as basic telecommunications, broadcasting, air and maritime transport, and government services.

The main goal of UR was to extend the trade agreement to make industrialised countries reduce protectionism in their own industries, thus offering new opportunities for imports from the developing and least-developed countries. Additionally, new trade rules also allow industrialised countries to export their service industries, such as financial services, to the poorer countries, and to protect their inventors from patent violations in the third world by extending coverage in services (GATS) and intellectual property (TRIPs). GATS, like the agreements on goods, operates on three levels:

- The main text containing general principles and obligations.
- Annexes dealing with rules for specific sectors.
- Individual countries' specific commitments to provide access to their markets.

In addition, GATS has a fourth special element: lists showing where countries are temporarily not applying the "most-favoured-nation" principle of non-discrimination, which is different from the GATT.

4.4.1 THE FRAMEWORK OF THE GATS

The GATS is a landmark achievement in terms of creating trade disciplines in virgin territory, but it has achieved little in terms of immediate liberalisation. The GATS applies to measures affecting trade in services supplied by the following modes:

- Cross border - the supply of a service from one country to another (e.g. tour operation, travel assistance).
- Consumption abroad - the supply of a service in the territory of one country to a consumer from another (e.g. tourism).
- Commercial presence - the commercial presence of a foreign company in a host country (e.g. by international visitors).
- Movement of natural person - the supply of labour by a service supplier for work in a foreign country (e.g. hotel manager, consultant, and tour guide).

GATS's 29 articles cover all services sectors and the agreement mainly classified 12 different services sectors which are business services, communication services, construction and related engineering services, distribution services, educational services, environmental services, financial services, health related and social services, tourism and travel related services, recreational, cultural and sporting services, transport services, and other services not included elsewhere. They also contain the general obligations that all members have to apply. The basic principles are (Evans and Walsh, 1994):

- All services are covered by GATS: the agreement covers all internationally traded services, including all the different ways of providing an international service (Modes of Supply).
- Most-favoured-nation treatment applies to all services, except the one-off temporary exemptions: MFN applies to all services in the same way as under the GATT, but some special temporary exemptions have been allowed.
- National treatment applies in the areas where commitments are made: national treatment provides equal treatment for foreigners and one's own nationals like GATT, but it is treated differently for services. For GATT, it is a general principle but it only applies where a country has made a specific commitment, and exemptions are allowed in GATS.
- Transparency in regulations, inquiry points: the agreement follows the general

format of the GATT. Exemptions from MFN status must be included in a country's national schedule. Such measures should normally apply for only 10 years, although they may be held on to for longer if the member wishes it. In an effort to promote transparency, a member government must carry out two steps. First, it must inform the Committee on trade in services of changes in its laws related to services. Second, it must within 2 years, longer for developing countries, establish "inquiry points" for foreign members to obtain information regarding the legal framework for services.

- Regulations have to be objective and reasonable: since domestic regulations are the most significant means of exercising influence or control over services trade, the agreement says governments should regulate services reasonably, objectively and impartially. When a government makes administrative decisions that affect a service, it should also provide an impartial means for reviewing the decision.
- International payments are normally unrestricted: Once a government has opened a service sector to foreign competition, it must not normally restrict money being transferred out of the country as payment for services supplied in that sector. The only exception is when there are balance of payments difficulties, and even then the restrictions must be temporary and subject to other limits and conditions.
- Specific commitments: There are 96 schedules of specific commitments. Most of the offers are accompanied by an MFN exemption list and vary widely in their coverage of sectors and modes of supply. Individual countries' commitments to open markets in specific sectors and how open those markets will be are the outcome of negotiations. The commitments appear in "schedules" that list the sectors being opened, the extension of market access being given in those sectors, and any limitations on national treatment. These commitments are "bound" like bound tariffs, they can only be modified or withdrawn after negotiations with affected countries, which would probably lead to compensation. Because "unbinding" is difficult, the commitments are virtually guaranteed conditions for foreign exporters and importers of services and investors in the sector to do business. The degree of development of the services sector is reflected in the coverage of the sectors offered.
- Progressive liberalisation through further negotiations: the Uruguay Round was only the beginning. GATS requires more negotiations, the first to begin within five years. The goal is to take the liberalization process further by increasing the

level of commitments in schedules.

The core of the GATS is the specific commitments. The impact of the GATS depends on the commitments that are made by members. In addition to the specific commitments, countries also make horizontal commitments. These usually consist of a compilation of laws and policies that restrict the use of a mode of supply by foreign suppliers, independent of the sector involved.

4.4.2 DIFFERENCES BETWEEN GATT AND GATS

GATS was built on the conceptual foundations of the GATT, the GATS is both a set of rules and a mechanism for progressively pursuing trade liberalisation. An important difference between the GATT and the GATS arises from the nature of many services transactions. This means that for a comprehensive approach to services, market access commitments need to be expressed both in terms of cross-border transactions and commercial presence. The GATS does this, thereby taking the multilateral trading system into the field of investment for the first time. Several provisions have not been finalised in the GATS framework of rules, and negotiations are continuing in these area (WTO, 1998[d]). The GATS holds the key principles embodied in the GATT, including MFN status, transparency, reciprocity, national treatment, and negotiated concessions, but there are differences in the manner in which most of these principles are implemented as shown in table 4.7.

Table 4.7 Key features of the GATT and GATS

Key features	GATT	GATS
Market access	Term not used in GATT	Covers only services sectors scheduled by members. Six specified categories of quantitative restrictions are prohibited as restricting market access for scheduled sectors.
Coverage	Addresses only trade in goods and says little on foreign investment.	Addresses trade, investment, and movement of people for services through modes of delivery.
Most-favoured-nation (MFN)	Exists unconditionally for WTO members, without exceptions.	Exists for WTO members, subject to "one-off" sectoral exemptions.
National treatment	For internal measures: general obligation for all goods. Tariffs are a "legitimised" frontier measure. Tariff bindings negotiated for goods using a "positive list". Non-tariff frontier barriers generally proscribed.	For internal and frontier measures covers only sectors scheduled by members, and subject to "bound" commitments not to violate national treatment.
Provisions relating to developing countries	Concept of "special and differential treatment". Relief from meeting certain obligations.	No "special and differential treatment". But market access by developing countries is to be extended progressively in line with "development needs", allowing fewer sectors and transactions to be scheduled. Special treatment may be accorded least-developed countries in negotiating future specific commitments. Developing members may also implement certain requirements more flexibly (e.g. transparency).
Regional integration	Allowable exception to MFN arrangements. Must cover "substantially all trade", be phased in within a "reasonable time (10 years)", and involve no increase in external barriers to non-participants.	Allowable exception to MFN treatment. Must have "substantial sectoral coverage", be non-discriminatory and not raise the overall level of third-country barriers within the respective sectors.
Emergency safeguard measures	Possible when increased imports have caused, or threatened to cause, serious domestic injury.	No measures currently exist. To be implemented within three years.
Commitments to liberalisation	Major commitments in GATT 1994 to liberalise goods trade, eliminate "grey area" measures (e.g. VERs), and control distortive agricultural policies. Standstill commitments. High level of tariff bindings. Preamble endorses progressive liberalisation.	No commitments to liberalise services trade. A limited standstill commitment to not introduce new measures violating national treatment or market access in "bound" schedules sectors. Successive negotiations to be held within five years. Preamble endorses progressive liberalisation.
Dumping and countervailing action	Antidumping action permissible against "dumped" imports if causing, or threatening to cause, material domestic injury. Countervailing duties can offset for certain bounties or subsidies.	No antidumping provisions. Negotiations to be held on the appropriateness of countervailing procedures.

Source: Snape and Bosworth, 1996.

Under the GATT, national treatment is a general obligation, essentially requiring that governments treat imported and domestic both products and suppliers equally once frontier barriers are cleared. As a general rule, an import tariff is the only form of permitted barrier in GATT, through quantitative restrictions are permitted in certain limited and specified circumstances. Under the GATS, however, any form of barrier to services trade can be maintained or increased in any sector until it is scheduled, only then has national treatment any relevance to the services traded in that sector. Although national treatment is not a general obligation, as in the GATT, it is defined more broadly in the GATS to embrace all measures that discriminate between domestic and foreign services. Moreover, in GATS, national treatment is interwoven with "market access", a term that does not appear in the GATT. Market access under the GATS requires foreign services and service suppliers to be treated in a manner no less favourably than that specified in a member's schedule for all modes of supply. In other words, all government-imposed barriers to market access should be scheduled for any scheduled service sector even where these barriers apply equally to domestic and foreign suppliers where as it is not necessary to commit these requirement under the GATT. More importantly, the GATT covers only cross-border trade as a means of supply where as the GATS includes all modes of supply known as cross-border, consumption abroad, commercial presence, and movements of suppliers and consumers (Snape and Bosworth, 1996).

In general, while GATS is very broad in principle, the liberalisation that has been achieved is heavily restricted by the sectoral coverage of core commitments on national treatment and market access in practice. In fact, the number of measures specified in the GATS, especially with MFN treatment, is violating the regulations on national treatment and market access. Most countries currently maintain extensive trade restrictions on services and it is not sure that whether GATS can help to reduce these restrictions, especially in developing countries.

4.4.3 MAIN ISSUES OF GATS

The GATS rules are not quite complete, and are largely untested. The process of filling the gaps will require several more years of negotiations, and experience will no doubt show a need to improve some of the existing rules. Each government's schedule of liberalised commitments for trade in services is also only a first step, comparable not with its GATT schedule of 1994, but rather with initial limited tariff-cutting undertaken when the GATT was launched. Among the most important elements in the GATS package in the promise that successive further rounds of negotiations will be undertaken to continue opening up world trade in services. The new services negotiations started in February 2000 to review MFN exemptions, safeguards and government procurement which will improve the trading conditions under GATS (WTO, 1999[e]).

The GATS extends the rules to which all types of trade become subject, and provides the framework for interdependent markets in an information-based era. Many developed countries have achieved trade liberalisation in services, for example, the EU have progressively achieved the highest degree of liberalisation ever know. Market services form about a half of EU output, and EU exports of commercial services about 43 % of the 1992 global total, compared with 16% for the USA and 5% for Japan. The EU's experience of liberalisation of trade in services made a seminal contribution to the concepts and structure of the GATS. However, the main issues of GATS relate to trade liberalisation in service and increasing participation of developing countries.

4.4.3.1 Trade Liberalisation in Services

The need for the multilateral trading system to catch up with the times appears all the more justified when viewed against the growing importance of services in world trade. In today's global market place, international trade and investment in the services sector are increasingly prominent features of commerce. Although trade in services has consistently grown faster than trade in goods throughout the last decade, the services sector remains heavily protected in many countries, especially developing countries. The main goal of the GATS is to create free trade and increase the degree of liberalisation so that countries would reduce protectionism for their own market, which would be beneficial to all member countries' well being in the long-run. Therefore, GATS represented an attempt to realise that the liberalisation of international trade and investment in services holds the potential for major gains in economic growth and efficiency by negotiating mutually acceptable rules for governmental actions on trade in services and providing a needed institutional setting to pursue the progressive liberalisation (Sauve, 1995).

The meaning of liberalisation under GATS is different from deregulation. Many service industries should and will remain carefully regulated in the public interest. The GATS, therefore, makes a distinction between trade barriers that distort competition and restrict access to markets on the one hand, and regulations which are necessary to pursue legitimate policy objectives and ensure the orderly functioning of markets on the other hand. For example, restrictions on the number of suppliers of a certain service or discrimination against foreign suppliers are considered barriers to trade in services and are in principle subject to liberalisation in negotiations. On the other hand, requiring compliance with technical standards or qualification requirements which aim at enduring the quality of the service and the protection of public interest are considered necessary forms of regulation. Therefore, under GATS, liberalisation means to reduce and eliminate trade barriers while restricting the ability of governments to maintain and develop necessary regulation to meet national policy objectives (WTO, 1998[e]).

Furthermore, the economic rationale calling for services liberalisation under GATS is not different in principle from the rationale that has driven the liberalisation under GATT since 1948. The Uruguay Round results marked a first step in a longer-term process of services liberalisation. Many observers argued that this step was more important in terms of making rules than actual market opening. On the other hands, there is some evidence of liberalisation moves during the extended negotiations on basic telecommunications and financial services. Open markets are expected to encourage quality improvement and product and process innovation. In fact, services have been ignored for a long time in international trade negotiations which is due to the traditional perception of services being non-tradable, for legal and institutional reasons as well as economic and technical restrictions. However, countries throughout the world have recognised the economic benefits to be derived from reforms in sectors such as financial, telecommunication and transport services which are the main factors of infrastructure in any economy. These sectors have a significant impact on growth and efficiency across a wide range of industries and also overall economic performances. In addition, technical innovations in information, communication and transport technologies have added to the importance of these sectors. Therefore, many developing countries seek to trace the effects of such reforms on various price, quality or efficiency indicators. This is no reason to assume that liberalisation measures negotiated under GATS would have produced different impacts on the countries concerned (WTO, 1999[d]).

Nonetheless, the measurement of liberalisation under the GATS is not easy. Implications of trade liberalisation and welfare effects may pursue in developing countries from developed countries by liberalising market access in sectors and modes of supply of export. According to WTO (1999[d]), there are some limitations to carry out an efficient measurement and assessment:

- First, service trade is still relatively modest if compared with domestic production and consumption. The specification of trade models might thus prove more challenging than in mature manufacturing industries such as textiles and clothing. In addition, it is difficult to see how such models could adequately capture not only cross-border flows, but trade through all four modes covered by GATS. In many services sectors, for example, commercial presence is more economically important than cross-border trade; its role is further strengthened by a significant number of commitments under mode 1 (cross-border) and, in particular, mode 4 (movement of personnel) which make access contingent on the existence of a commercial presence.
- Second, there are serious data problems. The only comprehensive source of information on services trade on a global basis are the IMF balance of payments statistics. These statistics only register transactions between residents and non-residents, thus excluding "foreign affiliates trade" (mode 3 of movement of consumer supplies) and the activities performed by foreign natural persons in export markets.
- Third, any UR related liberalisation study would need to start from the assumption that significant policy changes have occurred under GATS. However, there is a significant degree of uncertainty. Available policy information on most sectors and countries is confined to scheduled commitments, leaving it open (i) whether these commitments have actually improved on the status quo, (ii) whether additional changes have been implemented since their entry into force, and (iii) what the access conditions are in non-scheduled sectors. Therefore, any empirical study would need to start with an information gathering exercise such as a questionnaire to member countries.

As discussed earlier in this chapter, participation in the GATS may help governments pursue liberalisation efforts because such liberalisation occurs in a multilateral context, for example, as domestic markets are liberalised, the markets of potential trading partners will liberalised as well. This may help offset opposition by politically powerful forces against domestic liberalisation. The meaning of pursuing multilateral liberalisation is equal to pursuing the increased access to foreign markets which is likely to be of interest to domestic export-oriented industries, and these can be expected to oppose lobbying by import-competing industries to prevent the opening of domestic markets. The result of less liberalisation at home will affect trading partners to face the fewer access opportunities. However, it is optimistic to assume that the GATS will help member countries to implement domestic liberalisation and to improve overall trading conditions (UNCTAD, 1994).

4.4.3.2 Structure Problems of GATS

Because GATS is practically a new and first agreement in services trade there are some rules and obligations far from the perfect completion. The GATS has a number of weaknesses, including a lack of transparency, the sector-specificity of liberalisation commitments, and the limited number of generic rules. The GATS does not do anything near enough to ensure transparency. No information is generated on sectors, sub-sectors and activities in which no commitments are scheduled and most often the sensitive sectors where restrictions and discriminatory practices abound. However, in broad concept, inability to secure more substantial results may be attributable to structural weaknesses of GATS as well as to negotiating attitudes (Hoekman, 1995).

Table 4.8 The structure of the GATS

Part 1	**Scope and Definition**
Article I	Scope and definition
Part 2	**General Obligations and Disciplines**
Article II	Most-favoured-nation treatment
Article III	Transparency
Article III bis	Disclosure of confidential information
Article IV	Increasing participation of developing countries
Article V	Economic integration
Article V bis	Labour markets integration agreements
Article VI	Domestic regulation
Article VII	Recognition
Article VIII	Monopolies and exclusive service suppliers
Article IX	Business practices
Article X	Emergency safeguard measures
Article XI	Payments and transfers
Article XII	Restrictions to safeguard the balance of payments
Article XIII	Government procurement
Article XIV	General exceptions
Article XIV bis	Security exceptions
Article XV	Subsidies
Part III	**Specific Commitments**
Article XVI	Market access
Article XVII	National treatment
Article XVIII	Additional commitments
Part IV	**Progressive Liberalisation**
Article XIX	Negotiation of specific commitments
Article XX	Schedules of specific commitments
Article XXI	Modification of schedules
Part V	**Institutional Provisions**
Article XXI	Consultation
Article XXII	Dispute settlement and enforcement
Article XXIV	Council for trade in services
Article XXV	Technical cooperation
Article XXVI	Relationship with other international organisations
Part VI	**Final Provisions**
Article XXVII	Denial of benefits
Article XXVIII	Definitions
Article XXIX	Annexes

Source: UNCTAD and The World Bank, 1994.

The GATS has two parts as the framework agreement containing rules, and the national schedules of commitments in which each member specifies the degree of access it is prepared to guarantee for foreign service suppliers as shown in table 4.8. The structure of GATS is clearly separates the general obligations and disciplines that would be accepted by all parties upon their signature of the Agreement, and it reflects what was achieved at the time. Unlike the GATT, the GATS is a largely framework agreement, with sectoral commitments left for negotiation. There was always a question of how much in the form of general obligations should be in the framework and how much left to negotiations. Compare with GATT, the GATS is strongly away from the general framework and focused on sectoral commitments which is a fundamental problem.

In GATT, national treatment is a general obligation, with tariffs as a general form of discrimination against foreign supplies. Nevertheless, within GATS, national treatment and market access are specific obligations to be negotiated with respect to all scheduled services and all forms of barriers. In addition, MFN exemptions were also taken across major sectors so members could negotiate sector-specific and country-specific reciprocity later. The fact that the sectoral trade-offs could help to remove major stumbling blocks but it is difficult to secure when negotiations are sector-specific. The chances of success of sectoral-specific negotiations are reducing further by the nature of the barriers to services trade. First, tariffs on goods are flexible to negotiate, for example, a 60 % tariff is negotiable to all levels between 60 and 0 but barriers to trade in services are less quantifiable. Because they are not as divisible, it is often subject to substantial bureaucratic interpretation and is less transparent. Second, some members are addressing negotiated reciprocity not in terms of the extent of market opening commitments as has been under the GATT, but in terms of the degree to which markets are open. This places a political-economy burden on countries where their economy was closed or applying heavy protection to trade in services (Snape and Bosworth, 1996).

Consequently, the way scheduling commitments operate under the GATS limit the usefulness of GATS in promoting future liberalisation. In other words, the structure of GATS encourages sector-specific negotiations and arrangements as liberalising commitments only apply to scheduled sectors or sub-sectors. Experience in multilateral negotiations shows that more market opening has been achieved when negotiations were extended beyond individual sectors. In addition, members have severely compromised the transparency of barriers by refraining from scheduling sensitive sectors in which trade-restricting measures abound. GATS is being implemented not so much as a general agreement while the GATT is one with respect to products and countries, but as a basis for negotiating product-specific agreements which needs to be shifted in the future.

4.4.3.3 The Coverage of GATS

The GATS cover all commercially traded services. This includes all the different ways of providing an international service which known as "modes of supply". But a few services are the subject of specific annexes which limit the coverage in some extent. Under the system of specific commitments, members have to identify exactly in which services they guarantee an open market to foreign service suppliers and which restrictions they wish to maintain in relation to those sectors. Having stressed upon that, most developed countries have identified very long lists of sectors that they wish to liberalise while developing countries have tended to make more modest commitments because their services sectors are often at an earlier stage of development and are not ready to be liberalised.

Although the scope of the GATS is very wide and deals with all measures affecting trade in services, some important matters and sectors lie outside the GATS rules and disciplines (Slotboom, 1998):

- Immigration rules.
- Services supplied under government authority.
- Fiscal policy and taxation measures: there are disciplines to ensure that taxation is applied on a MFN basis and is not distortive.
- Customs system: the import of equipment necessary for the supply of a service.
- Certain aspects of investor protection, concerning the movement of capital.
- Exchange rate management: the WTO will work with the IMF and the World Bank to create conditions of greater economic stability, including exchange rate management by setting certain level of interest rates.
- Privatisation: forms of ownership are not addressed but there are disciplines for state owned trading entities and monopolies.
- Airline services: traffic rights and services directly related to the exercise of air traffic rights are excluded.

4.4.3.4 Developing Countries and GATS

As mentioned earlier in this chapter, nearly four-fifths of WTO members are developing countries. Through their shares of international trade, and in particular of trade in services, is still relatively small they have a major interest in services trade. Table 4.9 and 4.10 show distribution of world exports and the growth of world trade for both developing and developed countries. The GATS recognises their special needs in two ways:

- The pace of liberalisation by any country may reflect its level of development and national policy objectives. Therefore, developing countries are not expected to liberalise as quickly or extensively as developed countries.
- Article IV is designed particularly to promote the increasing participation of developing countries in services trade under the GATS. Specific commitments should be carry out in such a way as to help developing countries to strengthen their domestic services capacity, and to provide access in sectors and modes of supply which are of export interest to them.

Table 4.9 Distribution of world exports: 1990 and 1996 (shares in %)

Sector	Developing economies[a]		Developed economies		Other economies[b]	
	1990	1996	1990	1996	1990	1996
Goods	23.7	28.7	71.8	67.2	4.5	4.1
Services:	18.4	24.9	77.0	71.2	4.6	3.9
Travel	22.6	27.2	74.3	68.1	3.1	4.7
Transport	16.7	22.8	76.5	72.2	6.8	5.0
Other Services	16.4	24.3	79.2	72.9	4.4	2.8

Source: Calculated from IMF balance of payments data, 1997.
[a] Excludes countries in Central Asia
[b] Includes countries in Eastern Europe and Central Asia

Table 4.10 Average annual growth in world trade: 1990 and 1996 (%)

Sector	Developing economies[a]		Developed economies		Other economies[b]	
	Exports	Imports	Exports	Imports	Exports	Imports
Goods	10.9	12.5	6.2	5.5	5.8	4.4
Services:	13.0	9.3	6.0	5.6	4.5	7.0
Travel	11.8	12.9	6.8	5.7	16.4	12.9
Transport	11.1	9.5	4.5	4.6	0.3	7.0
Other Services	15.1	7.5	6.3	6.2	-0.1	8.0

Source: Calculated from IMF balance of payments data, 1997.
[a] Excludes countries in Central Asia
[b] Includes countries in Eastern Europe and Central Asia

Members of the WTO believe that liberalisation of trade in services has great potential for improving infrastructure and general economic efficiency of developing countries. It is also a powerful means to encourage foreign direct investment for many developing countries. By guaranteeing that investment and trading conditions will not be changed against their interests, a commitment in the GATS provides the security which investors need. In this case, their investment in services can upgrade the technical and economic environment in such a way as to improve the competitive strength of the economy. Moreover, GATS allow an additional transition period at the end of UR to finalise their schedules of specific commitments to developing and least-developed countries because they seems to have difficulties in making specific commitments.

In general, developing countries can improve their economic performance by choosing the certain pattern of liberalisation in the GATS (Mattoo, 2000):

- Entry and ownership: restrictions on foreign commercial presence assume particularly significance in the case of services where cross-border delivery is not possible, so that consumer prices depend on the domestic market structure. Restrictions on new entry and on the participation of foreign capital are the most common, especially in communications and financial services as shown in table 4.11. It is true that larger welfare gains arise from an increase in competition than from a change in ownership from public to private hands. In the GATS, countries have often conceded increased market access under pressure from trading partners in the form of increased foreign ownership of existing domestic firms rather than by allowing new entry.
- Pre-commitment to future liberalisation: one reason governments may be reluctant to liberalise immediately is a perceived need to protect the domestic suppliers from competition because of infant industry argument. One reason for the failure of infant industry policies in the past was the inability of a government to commit itself credibly to liberalise at some future date. The GATS offers a valuable mechanism to overcome the credibility difficulty. Governments can make binding commitments to provide market access and national treatment at a future date. Failure to honour these commitments would create an obligation to compensate those who are deprived of benefits, making the commitment more credible than a mere announcement of liberalising intent in the national context. A pre-commitment to liberalise can also inspire a sense of urgency in domestic reform, and in efforts to develop the necessary regulatory and supervision mechanism.

Table 4.11 Types of market access restrictions on commercial presence in services sectors (all countries)

	Sector	Number of members with commitments	Restrictions per commitment on					
			Number of suppliers	Value of transactions or assets	Number of operations	Number of natural persons	Types of legal entity	Participation of foreign capital
1	Business services	89	0.2	3.4	0.0	0.8	4.0	3.6
2	Communication services	85	3.9	2.1	0.2	0.5	4.3	3.8
3	Construction and related engineering services	60	0.1	0.9	0.0	0.2	0.9	0.9
4	Distribution services	38	0.2	0.7	0.0	0.1	0.4	0.4
5	Educational services	32	0.1	0.3	0.0	0.0	0.9	0.5
6	Environmental services	40	0.2	0.7	0.0	0.1	0.7	0.6
7	Financial services	91	4.6	4.3	1.4	0.9	8.6	4.4
8	Health and related social services	34	0.2	0.3	0.1	0.2	0.6	0.4
9	Tourism and travel related services	114	0.2	0.4	0.1	0.1	0.5	0.4
10	Recreational, cultural and sporting services	49	0.1	0.3	0.0	0.1	0.5	0.2
11	Transport services	70	0.3	0.9	0.0	0.1	1.9	1.4

Source: Mattoo, 2000.
Note: Restrictions per commitment are calculated by dividing the total number of restrictions in a sector by the number of members with commitments.

In order to take advantage of trading opportunities, service firms from developing countries would need to continuously keep up to date with technical and professional advances, as well as to meet and exceed international service quality standards and incorporate information technology in the provision of their services. The expansion of service exports from developing countries depended not only on national capabilities, but also on the quality of the telecommunications infrastructure in place and on emerging market opportunities. The effective supply of services requires the use of all modes of supply, and to effectively compete in world markets requires the liberalisation of all factors of production. In this sense, the GATS had created a flexible framework for liberalisation (UNCTAD, 1998[c]).

As discussed in the previous chapter, the significance of information networks and distribution channels for the maintenance of a competitive position in international trade in services is dramatically apparent in many service sectors. Information technology is both a service in itself and an essential element to facilitate the internationalisation of many other service activities. Information technology and transborder data flows have been used to establish networks and distribution channels for services that could act as a barrier to the market entry of developing countries. However, entry barriers can be lowered where the public telecommunication infrastructure is used to market or distribute services, especially when access to, and the cost of, the network is shared by all users. Access to such networks can be a determining factor not only in trade in services but also in trade in goods. The extremely uneven distribution of the systems and infrastructure necessary to increase the productivity of transport services to the world markets is a major impediment to increase exports of services of the developing countries, in particular financial, audiovisual, software, professional and tourism services. Tourism sector is traditionally considered as a sector of interest to developing countries because balance of payments figures show that many developing countries are running large surpluses in tourism. In the tourism services, worldwide tourist revenues are dominated by developed country firms that have been able to establish networks, such as hotel chains, travel agencies and computer reservation systems (CRS). The CRSs are a good example of the importance of information networks. Major airlines have found it necessary to link up to maximise the profitability of information networks (UNCTAD, 1994[b]).

Service suppliers from developing countries were faced with a number of barriers to market access, such as requirements which limited or prohibited the temporary movement of natural persons, a lack of credibility in foreign markets, the lack of appropriate and timely market information, the lack of access to distribution networks, financial constraints and a high degree of market concentration as a result of mergers and acquisitions and strategic alliances. Economic needs were a major barrier to trade in services and left considerable uncertainty as to the level of a country's commitment to market access. The adoption of specific identifiable categories of professions would be central to future efforts to liberalisation in services and also facilitating the movement of service providers would enhance the service exports of developing countries through the GATS. In addition, particular attention needed to be given to the cross-border mode of supply of services, in view of the opportunities offered by electronic commerce for the supply of long distance and labour intensive services.

The Internet was changing market structures and eliminating the need for intermediaries especially in tourism. Efforts needed to be made to ensure that the access of developing countries to cross-border data flows was not constrained. International mechanisms were required to regulate and harmonise cross-border and provide competitive safeguards against the creation of monopolies. Therefore, for developing countries, it is important that the provisions of articles as well as the annexes on related sectors of GATS are faithfully implemented (UNCTAD, 1998[c]).

4.5 SUMMARY

The WTO is an important organisation for the world's trade in order to achieve free and balanced trade, especially between developed and developing countries. The WTO introduced GATT and GATS to promote international trade both in manufacturing and services, but there are several weaknesses that need to pay attention in near future as well as strengthens. As GATS is the first multilateral trade agreement in services, it needs to develop and solve the structural and coverage problems that have been recognised in early stage of the process. The most important aim of introducing GATS is increasing participation of developing countries in the progress of liberalisation, however the question for whether the agreement would bring benefits to developing member countries is uncertain to answer.

Overall, the implications of developing countries of the GATS are limited. The GATS imposes few limitations on national policy, only requiring that no discrimination across alternative sources of supply occurs. Many developing countries have been able to agree to the GATS with only minimal specific commitments. The non-generality of national treatment, and the sector-specificity of market access commitments reduces the value of the GATS to governments seeking to liberalise. One of the important purposes of introducing GATS was an attempt to open the markets in developing countries by reducing protectionism. Releasing the competitiveness and comparative advantages of countries at the heart of the GATS. It is true that the more trading would occur if companies find easier to compete and do business that will lead to the growth of economy to all trading countries. In other words, if trade in services becomes less restrictive after applying the GATS, those who produce services relatively cheaply and efficiently would be more competitive than others. On this basis the developed countries more likely to be the most competitive producers of services compare with the less-developed countries. Therefore, many developing and least-developed countries are reluctant to open their markets to foreign suppliers and producers although they realise the potential benefits from the liberalisation (Hoekman, 1995).

Consequently, the future holds a number of serious challenges to international economic relations. More open markets also mean more fierce competition for the new opportunities created and more liberal economies and more open trading regimes imply social and political pressures resulting from structural changes caused by shifts in the patterns of competitive advantage. In the long term, developing countries can seek greater access to technology and know-how from developed countries, greater access to distribution channels and information networks and to reduce export barriers. It is important to recognise the changing patterns and needs of international trading system. More importantly, GATS should play a crucial role for achieving the efficient and effective trade between member countries to build up world economy, especially in the tourism industry. The importance of GATS and its impacts on the tourism industry will be discussed in the next chapter.

CHAPTER FIVE:
GATS AND INTERNATIONAL TOURISM

5.1 INTRODUCTION

The significance of tourism as a source of income and employment, and as a major factor in the balance of payments for many countries, has been attracting increasing attention on the part of governments, private sector entities, regional and local authorities, and others with an interest in international trade and economic development. If the barriers to worldwide travel were eliminated or reduced substantially, international trade in tourism services is likely to increase significantly. One way of reducing trade barriers in international trade in tourism is the introduction of multilateral trade agreements, such as GATS. GATS could lead to the gradual elimination of some barriers to tourism growth, such as the restrictions of foreign personnel employment and establishment of foreign companies. Hence, suppliers of travel and tourism-related services in hotels, restaurants, transport, car rentals, cultural and other travel-related businesses can expect to benefit directly from the agreement. The General Agreement on Trade in Services (GATS) focuses on tourism as one of its prime components of international trade.

This chapter examines the implications of GATS for tourism and its future development in both developed and developing countries.

5.2 TOURISM DEVELOPMENT AND ITS IMPACTS

Tourism is one of the most remarkable economic and social phenomena of the last century and it will continue to be one of the most important industries for the coming centuries. In economic terms, international tourism receipts are classified as exports and international tourism expenditure as imports. According to the World Tourism Organisation's tourism economic report in 1998[a], tourism is one of the five top export categories for 83 % of countries and the main source of foreign currency for at least

38 % of them.

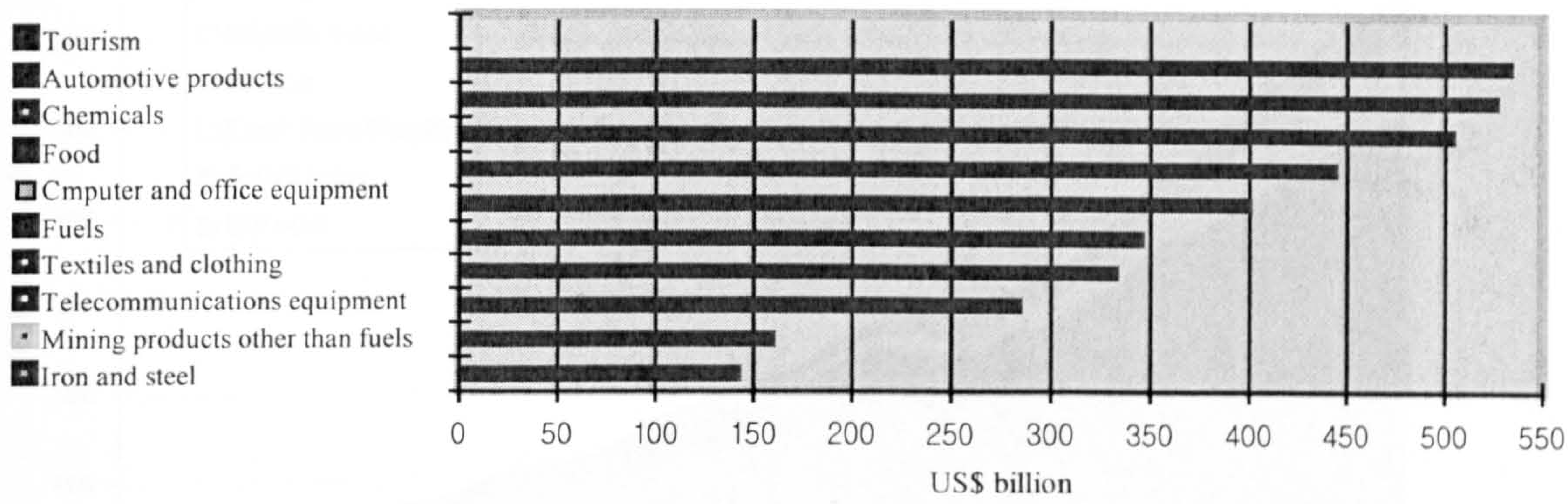


Figure 5.1 Worldwide exports earnings, 1998

Source: World Tourism Organisation, 2000[a]

Despite fluctuations caused by global events such as the Gulf crisis, the Asian financial crisis and the event of September 11[th], 2001, the sector has shown strong growth in terms of both arrivals and receipts. According to the World Tourism Organisation (1999[a]), international tourism and international fare receipts accounted for around 8 % of total export earnings on goods and services worldwide. Additionally, total international tourism receipts were estimated as US$ 532 billion and the number of international tourists travelling in the world reached 664 million in 1999 as shown in figure 5.2. In addition to its strong overall expansion, the development of modern day tourism is also characterised by its geographical spread. Many countries have been successful, not only in attracting significant numbers of tourists, but also in turning tourism into a source of wealth. A notable diversification in tourism destinations has taken place, joining with those of emerging destinations, such as Asia, North Africa and Latin America and the Caribbean. In 1950, only 15 countries received 25 million international tourist arrivals in total. In 1999, more than 70 countries and territories received more than one million international tourist arrivals. By 1999, the top 15 tourist-receiving countries saw their share decrease to less than two-thirds and some traditional top destinations have been replaced by newly recognised destinations from Asia and Central /Eastern Europe (World Tourism Organisation, 2000[a]).

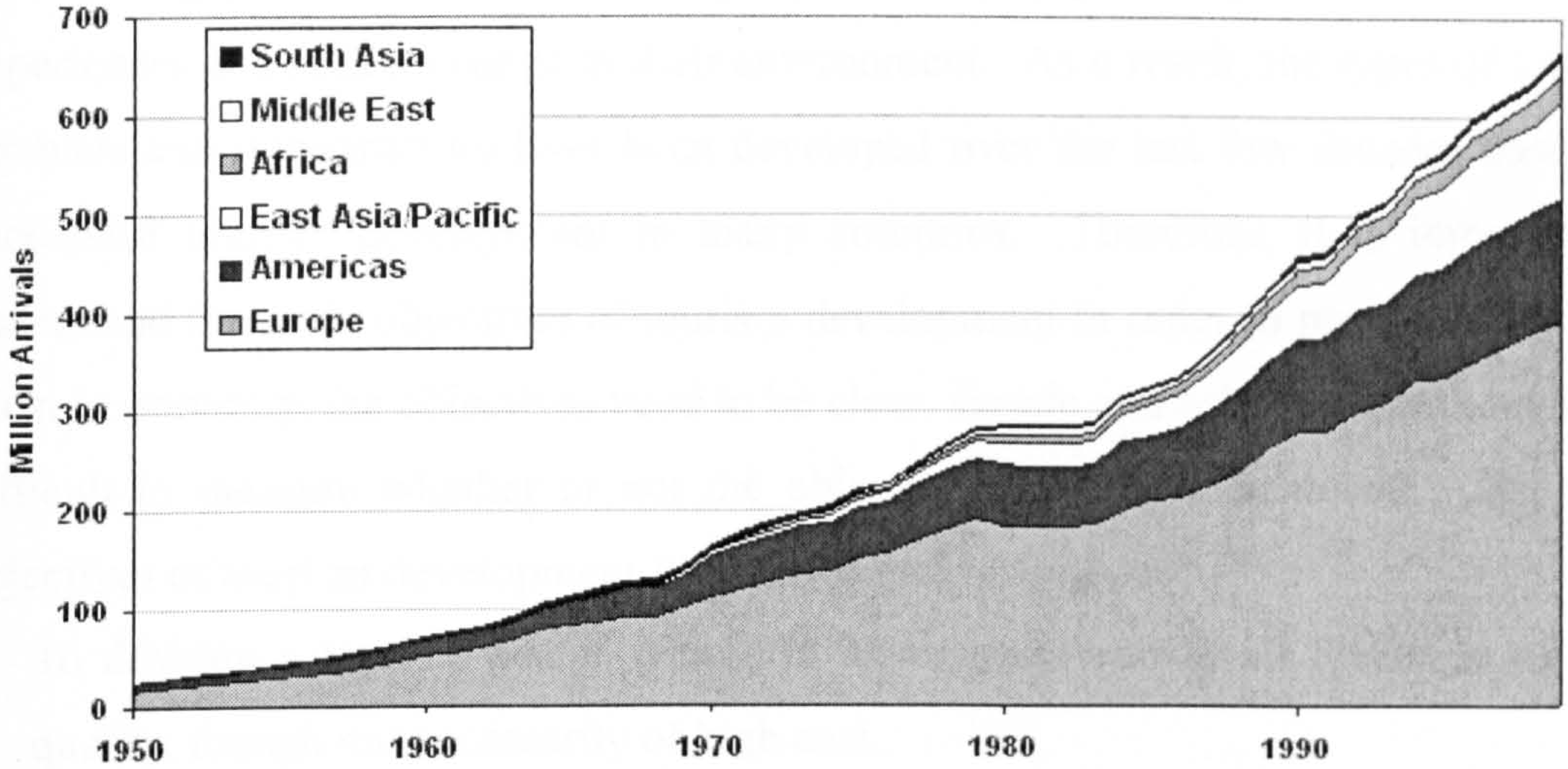


Figure 5.2 International Tourist Arrivals, 1950-1999

Source: World Tourism Organization (WTO), 2000[a]

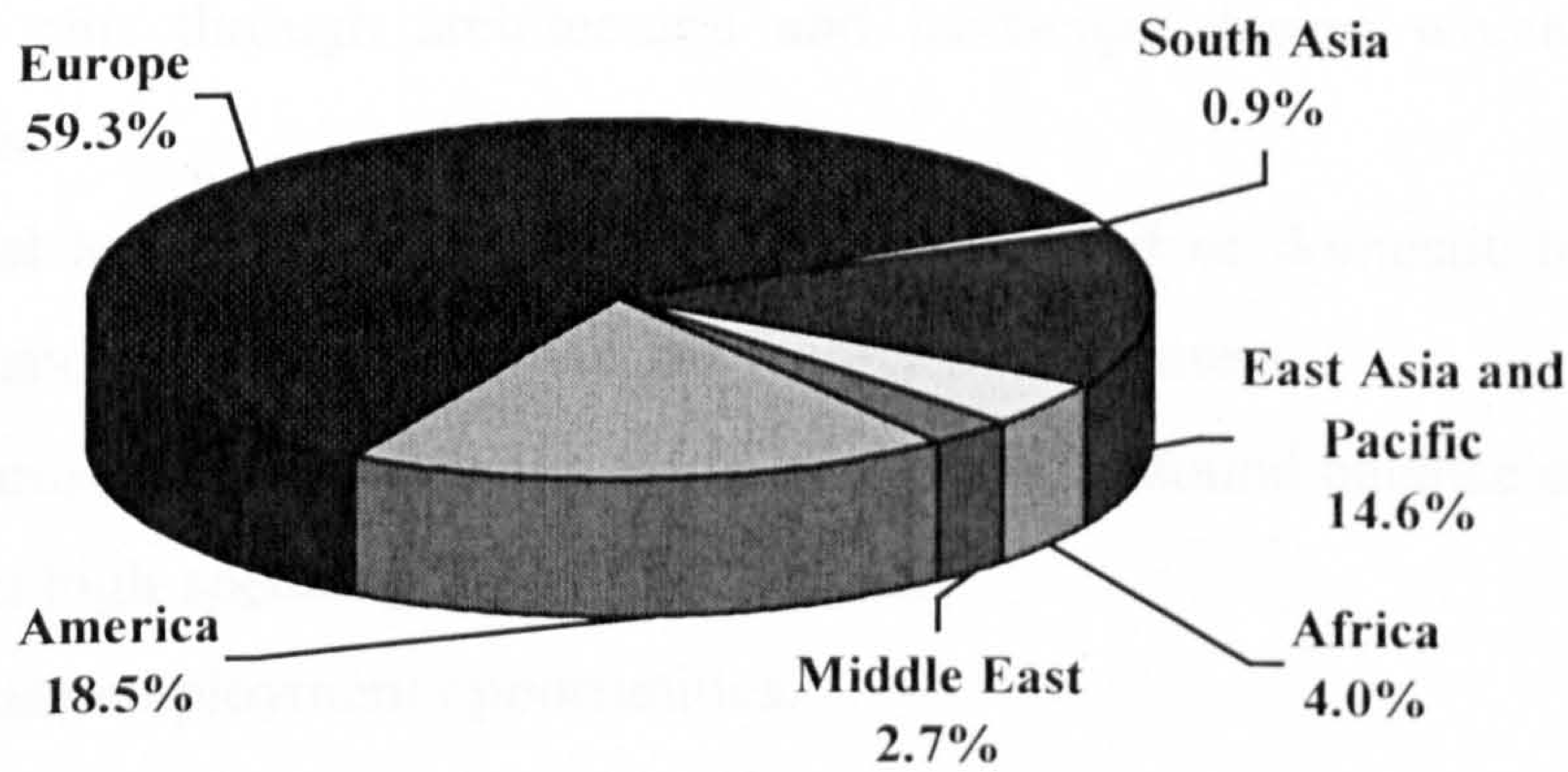


Figure 5.3 International tourist arrivals share of world total (%), 1999

Source: World Tourism Organisation, 2000[a]

As illustrated in figure 5.3, tourism is no longer focused only in developed countries. It is an important industry for economic growth for both developed and developing countries and it is a leading industry to boost the movement of globalisation and internationalisation in trade since the industry mainly provides their services from one country to another.

5.2.1 DEVELOPMENT OF TOURISM

Tourism is no longer an activity reserved only for the privileged few, it is now an activity engaged in by millions of people who enjoy new places, and different experiences and seek a change in their environment. As a result, the types of tourism products and infrastructure have been developed over the last few decades based on successful tourism development in many countries. Therefore, it is important to understand the main objectives of tourism development in order to pursue its success. Most importantly, the objectives need to be clear, simple and achievable although it is difficult to measure whether or not the objectives have been achieved. The main objectives of tourism development for many countries include:

- To develop a tourism sector which, in all respects and at all levels, is of high quality, though not necessarily of high cost.
- To encourage the use of tourism for both cultural and economic exchange.
- To distribute the economic benefits of tourism, both direct and indirect, as widely and to as many of the host community as feasible.
- To preserve cultural and natural resources as part of tourism development, and to facilitate this through architectural and landscape design which reflects local traditions.
- To appeal to a broad cross-section of international or domestic tourists through policies and programmes of site and facility development.
- To maximise foreign exchange earnings to ensure a sound balance of payments.
- To attract high-spending up-market tourists.
- To increase employment opportunities.
- To aid peripheral regions by raising incomes and employment, thus slowing down or halting emigration (Cooper, *et al.*, 1993).

Tourism development is derived from the combination of desire, mobility, accessibility, and affordability. With the invention of new technologies, such as aviation, computers and satellite communications, the way that people live and work has changed affecting the development of mass tourism. It is uncertain that tourism will continue to be one of the most dynamic growth sectors of the global economy due to uncertainties about price, recession and political condition. However, international tourism is the largest single item in the world's foreign trade budget, three times bigger than world expenditures on defence (Gee and Fayos-Solá, 1997).

5.2.2 TOURISM TRENDS IN THE WORLD

In order to identify the issues and the needs of the travel and tourism industry in the world, it is important to understand the current trends and patterns of tourism, including international and regional trends and regional travel patterns along with political, social and demographic changes.

5.2.2.1 Tourism Growth

According to the World Tourism Organisation (1996), the scale of world domestic tourism far exceeds that of world international tourism. In 1995, total domestic tourist arrivals were estimated to be 5.6 billion whereas total international tourist arrivals were 567 million, representing a ratio of 10:1. In some countries, domestic tourism dominates often for geographic reasons, for instance, the U.S. is a large country hence it is reasonable for the people to travel less to foreign countries when they can enjoy all different experiences from domestic travel. However, the global industry is mostly driven by international tourism which generates economic growth and improves foreign trade primarily from earning foreign currency. In this sense, international tourism has been growing steadily from 1950 to the present. As shown in figure 5.1, in 1950, 25 million tourists crossed an international border but in 1999, international tourist arrivals were around 700 million (Frangialli, 1997).

Table 5.1 World Tourism Organisation forecast international tourist arrivals and receipts

Year	Arrivals (million)	Receipts (US$ billion)
1995	563	399
2000	702	621
2010	1,018	1,500

Source: World Tourism Organisation, 1999[a].

Furthermore, it is important to note that a large portion of travel is received, as well as generated, by relatively few countries. In fact, the top ten destinations, mostly in Central and Western Europe, account for 54 % of the world volume of tourism flows. Surprisingly, as shown in table 5.2, China is one of the top ten tourism destinations, as East Asia and the Pacific become one of the popular areas for international tourism in recent years.

Table 5.2 Top ten tourism destinations and tourism earners, 1999

	Top ten tourism destinations		Top ten tourism earners	
Rank	Destination	No. of Arrivals (million)	Destinations	International Receipts (US$ billion)
1	France	73	United States	74.4
2	Spain	51.8	Spain	32.9
3	United States	48.5	France	31.7
4	Italy	36.1	Italy	28.4
5	China	27.0	United Kingdom	21.0
6	United Kingdom	25.7	Germany	16.8
7	Canada	19.6	China	14.1
8	Mexico	19.2	Austria	11.1
9	Russian Fed.	18.5	Canada	10.0
10	Poland	18.0	Greece	8.8

Source: World Tourism Organisation, 2000[a].

Among these top ten destinations, Poland, the Russian Federation and Mexico were the only destinations that did not also appear in the top ten tourism earners table. These three countries were under-developed countries and suffered insecure political conditions in the past, hence their economic situation is too unstable to charge internationally recognised prices for tourism products, together with the devaluation of their currency against US dollar. In other words, their prices are relatively cheap, compared with other destinations, which made them attractive to visitors but their tourism earnings less.

5.2.2.2 Tourism Trends in Different Regions

Regional tourism trends play an important role in understanding the full story about international tourism. More than 70 % of international travel takes the form of short-haul travel, and more often tourists visit their neighbouring countries, such as tourists between the nations of Europe and nationals of Canada, the U.S. and Mexico. The World Tourism Organisation (1999[a]) estimated arrivals by region suggest that Europe and the Americas are still the main tourist-receiving regions. The figures from the World Tourism Organisation shows that Europe accounted for 59 % and the Americas for 19 % of total arrivals. Europe attracted more than 70 % of all tourist arrivals in 1995 and it was estimated that 80 % of all travel in Europe was intra-regional in nature. On the other hand, the Kosovo crisis and instability in the Russian market caused problems for well-known destinations in Central and Eastern Europe, including Hungary and Poland. However, in recent years, tourism trends in Europe show that outbound long-haul travel from the region is beginning to increase faster than intra-European travel as their disposable income and available time increase. Moreover, East Asia and the Pacific experienced the highest growth rate giving them a 15 % share of the world market in 1999, although they suffered a decrease in tourist arrivals and tourism receipts from the financial crisis in 1997 and 1998 (World Tourism Organisation, 2000[a]).

Table 5.3 International arrivals by region forecast (in million)

Region	1995	2000	2010	Average annual growth rate 1990-2010
Europe	337.2	397	525	3.1
East Asia/Pacific	84.0	122	229	7.6
Americas	111.9	138	195	3.7
Africa	18.7	25	37	4.6
Middle East	11.1	14	21	4.9
South Asia	4.4	6	11	6.7
World	567.4	702	1,081	4.1

Source: World Tourism Organisation, 1996.

After two years of decreasing tourist arrivals, the East Asia and the Pacific region bounced back strongly in 1999 and 2000, attracting nearly ten million more tourists than the previous year. The growth rates show how strong the tourism market is in the region. In addition, it is interesting to see that the East Asia and the Pacific region is expected to continue to grow into the future. Since opening its doors to tourism in 1978, China has attracted millions of tourists who are interested in the country's history, heritage, cultural diversity, and natural landscapes. However, one of the obvious factors for China to attract more international visitors can be the extensive efforts of the Chinese government to promote tourism and the removal of restrictions on the movement of tourists. Another factor is the efforts of the private sector in the Chinese tourism industry to increase the quality of tourism services and their perceptions of foreigners.

5.2.3 IMPACTS OF TRAVEL AND TOURISM

The tourism industry is of sufficient economic importance and its impacts upon economies, environments and societies are significant enough for the subject of tourism to deserve serious consideration. Moreover, international organisations support tourism for its contributions to world peace, the benefits of mixing peoples and cultures, the economic advantages which can ensue, and the fact that tourism is a relatively 'clean industry' (Cooper, *et al.,* 1998). But seen from a host country's point of view, tourism is more complicated than that and it seemed to have both good and bad sides. As many studies have been undertaken to assess the impacts of tourism on host destinations, whatever impact does occur appears to operate most significantly on the economic front where increasingly sophisticated forms of analysis have been used to evaluate it.

The impacts of tourism can be categorised into economic, political, social, and environmental impacts. When travelling away from home, tourists come into contact with the places they visit and with their inhabitants, and social exchange takes place. Their presence and their social background affect the social structure and mode of life at the destination. In bringing together people of different backgrounds from different countries, tourism, therefore, has a political and social significance. But the manifold significance of tourism does not arise only when people visit other countries. Internal, domestic tourism promotes similar interaction between people and places and contributes to that knowledge and awareness, which may enhance understanding. Political, social and economic factors thus often provide motivations for tourists to travel away from home as they influence tourism and tourism in turn has an influence on them. In addition, sustainable tourism has become a significant issue in recent years in international tourism. Both visitors and residents are concerned about environmental issues since the concept of tourism was introduced based on natural scenery in the early era of international tourism.

There has been an attempt by a number of researchers to study the different dimensions of tourism impacts on a destination but it does not provide a framework for analysis. Cooper *et al.* (1998) suggest that the impact of tourism on any destination will be determined by a wide variety of factors as follows:

- The speed of changes.
- The volume of tourist arrivals.
- The structure of the host economy.
- The types of tourism activity.
- The difference in sociocultural characteristics between the hosts and the tourists.
- The fragility of the local environment.

5.2.3.1 Socio-Cultural Impacts

Social and cultural aspects of tourism are considered to cover all those aspects of travel whereby people learn about each other's ways of life and thought. Personal contacts between residents and tourists have always been an important way of spreading ideas about other cultures. Moreover, Peters (1969) and Naylon (1967) stressed the need to preserve a local social system as a tourist attraction in itself, particularly important in areas of distinct social customs. Tourism is thus an important means of promoting cultural and social relations and international cooperation. Conversely, the development of cultural factors can be viewed as a means of enhancing resources for tourism. They can be seen as an element of attraction for visitors which can be used in many countries as one of the means of promoting, not only knowledge and understanding, but also a favourable image of the nation among foreigners (World Tourism Organisation, 1997[a]). However, the economic and sociological impact of tourism on the host population will be partly determined by the type of tourism products.

Table 5.4 Classification of the social impacts of tourism and examples of their components

Impacts	Examples
Socioeconomic impacts	Personal income, municipal tax, prices of goods and services
Tourists-hosts relationships	Anthropological perspectives of host/guest cultural exchange
Demographic impacts	Age/sex, size of population
Occupational impacts	Change of occupation, professionalisation
Cultural impacts	Change in tradition, language
The authenticity problem	Problem of authenticity of events, crafts and arts
Transformation of norms	Change in values, morals, sexual role
Modification of consumption patterns	Education, infrastructure, commodities, food
Impact on the environment	Pollution, ecology, congestion

Tourism involves three socially interacting groups, the tourists, the tourist operatives or employees and the local people. When the tourist operatives are wholly drawn from the local population the degree of total social contact depends on the numbers of local people who remain outside the tourist interaction pattern. When the tourist operatives are drawn from non-local people, there is a more complex set of interactions between all three groups. In addition, the tourist operatives are not always completely independent.

However, most theories relating to the social impact of tourism have regarded interaction as only taking place between tourists and local people. According to Archer and Cooper (1998), any form of economic development will carry with its implications for the social structure and cultural aspects of the population. Even domestic tourism, where hosts and tourists are generally from the same socio-cultural background, results in social and cultural change because of host/tourist contact. It is common to discuss the issues relating to the social impact of tourism based on the host and tourist contact, but the relationship between tourists is also significant. The demand patterns can be different between different tourists' groups. In other words, tourists have different financial and social backgrounds even though they spend their holiday in the same tourist destination. For example, the majority of foreign tourists come from either America or England in St. Lucia, but the status of tourists are different between these two groups of tourists. In general, there is a complexion between low-income Americans and high-income European visitors in St. Lucia. Because the destination is situated far away from Europe, it is more expensive for European tourists than Americans to purchase a holiday in St. Lucia. The expectations and requirements of the quality of holiday in St. Lucia are different among those two groups, which creates an apprehensive atmosphere between them.

Discussions of the socio-cultural impacts of tourism can be derived from several social determinants such as age distribution, the pattern of stages in the life cycle of families, terminal level of education, occupation structure and population concentration. Age has become a more important factor in determining consumer behaviour as different age groups develop different interests and patterns. Population growth and development can be closely linked to the stage of economic growth and age, life cycle patterns are also linked with income whilst of undoubted significance in explaining individual behaviour and in marketing. There are practical difficulties in their use as determinants of tourism growth generally, and in comparisons of tourism propensity between countries. On the other hand, in the long run, certain consequences may be expected to follow not only from size of the population, but also from changes in particular age groups and in different life cycle stages. For example, the age group 25-44 tends to be better educated and widely travelled than other groups, but we cannot ignore the growing older segment of the population with retirement savings and relatively higher disposable incomes for leisure travel. Among those determinants of socio-cultural impacts of tourism, family structure seems to play an important role in tourism with different types of tourism product and patterns between Western and Eastern countries. With respect to consumer behaviour in tourism, different family structure leads to different choices of holiday destinations, duration and type of holiday.

5.2.3.2 Economic Impacts

The economic significance of tourism is determined not only by the level of tourism activity taking place, but also by the type and nature of the economy considered. Economic growth leads to increases in disposable income and in factors such as holiday entitlement. Increases in trade and commerce derived from economic growth similarly stimulate demand for business travel. A society's level of economic development is a major determinant of the magnitude of tourist demand because the economy influences so many critical and interrelated factors. In broad terms, the highest participation in tourism is to be found in countries with a relatively high standard of living, in which a large proportion of the population is urbanised such as in North America and in Western Europe. A high standard of living is related to high disposable income, which tends to be accompanied by a reduction in hours of work and by lengthening of holidays with pay. Therefore, we can say that tourism is a result of industrialisation and the more highly developed an economy, the greater the levels of tourist demand

Tourist expenditure has a cascading effect throughout the host economy which starts with tourist establishments, such as hotels, restaurants and taxis, and then goes into the rest of the economy. The direct level of impact is the value of tourist expenditure less the value of imports necessary to supply those 'front-line' goods and services. Therefore, the direct impact is likely to be less than the value of tourist expenditure except in the rare case where a local economy can provide all of the tourists' wants from its own production sectors. The establishments which directly receive the tourist expenditure need to purchase goods and services from other sectors within the local economy. For example, hotels need services from other sectors of builders, accountants, banks, food and beverage suppliers, etc.

A further important factor in tourism is its low propensity to import costly manpower such as is frequently required for the operation of high-tech industries. Tourism is also responsible for the creation of employment outside the tourist industry properly defined and it again scores noticeably over other forms of new industry. If these induced employment effects are included, i.e. increased employment in agriculture and the construction industry, the amount of employment for which tourism is responsible would increase substantially. The range of jobs created by tourism extends from unskilled through to management tasks (IUOTO, 1979).

The balance of international payments in the concept of tourist receipts and expenditure is sometimes referred to as being important. However, there are considerable dangers in the concept of a travel balance because tourist expenditures and tourist receipts are two different commodities and there is no inherent merit in the achievement of a balance between them. But, any country may improve its overall balance of payments by promotional activities aimed at increasing tourist receipts such as to attract visitors to view their ancient monuments or to enjoy other cultural attractions or by applying restrictions on tourist expenditures of their own nationals abroad.

There are positive and negative economic impacts from tourism. One of the main positive impacts of international tourism on the economy of a tourist destination is the creation of employment opportunities. This is difficult to measure when related to tourism and requires a specific study because of the range of sectors involved. Tourism as a source of employment is particularly important for areas with limited alternative sources of employment, as if often the case in non-industrial areas deficient of other industries. Because of visitor traffic, residents may enjoy a higher standard of public transport, shopping and entertainment facilities than they would be able to support otherwise (Cooper, *et al.*, 1998).

Tourism destinations try to fulfil the demands of tourists, and this can create several negative impacts. For example, it can create a migration from rural to urban area because of the need for more labour in the tourism industry. Furthermore, labour can be attracted into tourism from other industries, thereby creating an opportunity cost. Where there is a shortage of skilled labour in tourism an employer may need to import labour from abroad. This may result in additional economic leakages as income earned from this imported labour may be repatriated. Also we have to take the wider opportunity costs and displacement associated with factors such as investment and land use into account with respect to negative impacts on the economy of a tourism destination.

The traditional concept of an industry is often defined by reference to their particular market and, in this case, includes the providers of tourist services. These businesses and those that supply them derive their revenue from the tourist expenditure. In short, the contribution to incomes arises both from incomes generated in the tourism sector itself and from incomes generated in the rest of the economy. In addition, in some locations tourism may provide an infrastructure, which in turn forms the base and the stimulus for the diversification of the economy and for the development of other industries. Tourism itself may be expected to create some demand for goods and services necessary for the creation and expansion of some local industries but over and above this, an established infrastructure often acts as an attraction to new and less directly related economy activity. Tourist expenditure may therefore be said to stimulate an economy beyond the sectors directly concerned with tourism.

Furthermore, there are political determinants such as wars, terrorism and monetary and fiscal policies. Politics affect travel propensity in a variety of ways. For example, the degree of government involvement in promoting and providing facilities for tourism depends upon the political complexion of the government. Socialist administrations encourage involvement of government in tourism. Governments in times of economic problems may control levels of propensity for travel overseas by limiting the amount of foreign currency that can be taken out of a country, or demanding a monetary bond to be left in the country while the resident is overseas. Governments can also restrict travel on visas, passport controls and taxes, however, these controls are not totally effective. In addition, wars and terrorism tend to affect tourism. For example, 1991 and 1992 were the worst years for hotel occupancy in the UK since 1982 because of recession and the Gulf war and the devastating effects of 11th September 2001 are still being felt today.

5.3 THE ROLE OF GOVERNMENT IN THE TOURISM INDUSTRY

" Tourism is comprised of industries and activities that stretch not only across nations and regions, but across traditional lines of business and industry as well. The businesses that provide tourism services, therefore, must contend with actions of different levels within a government, of many different governments, and of a variety of types of laws and regulations aimed at different industries" (World Tourism Organisation, 1997[a], pp. 281)

International tourism relies on a great deal of government involvement since the industry needs a high degree of communication and cooperation among nations through regulations and policies set by individual governments which affect both demand and supply of tourism. First, the demand for tourism destinations by international visitors can be determined by stable international currency markets, customs-related agreements and entry status. On the other hand, it will not be an attractive tourism destination if the government imposes restrictions on foreign businesses and foreign workers entering, which may limit the overall quality of services.

Tourism policies and regulations are developed and implemented by either national tourism organisations or international organisations. The tourism policies of many countries are a component of their overall economic policy. Despite operating in a competitive environment, the different agents of national tourism policies are required to cooperate by international organisations, particularly the World Tourism Organisation and World Trade Organisation to ensure a balanced growth of international tourism by applying effective programmes and rules. Tourism policy must take into account a number of external variables such as demographic and social changes, the economic and financial situation of generating countries, currency exchange rate fluctuations, political and statutory change, technological progress, shifts in trading patterns, transport infrastructure, the security of travellers and the protection of sites and the environment. Tourism organisations aim to promote national and international tourism development and to balance the macroeconomic policies of each region and each sector involved in tourism. Nationally, these are public sector agencies and professional associations, and internationally, governmental and non-governmental organisations (Vellas and Becherel, 1995).

5.3.1 GOVERNMENT INTERVENTION IN TOURISM

Government involvement or intervention in the economy occurs at different levels. There are mainly three different levels of government involvement, such as international, national and local involvement, although the exact structure and relationships of those levels varies between countries. First, international involvement refers to international political organisations known as UN, World Tourism Organisation and EU, multilateral trade agreement known as GATT, GATS, NAFTA and EC, and bilateral air agreements. A key point regarding international governmental involvement is the sovereignty of the national government, which reminds us that international government involvement or intervention depends solely upon unforced cooperation. Therefore, it has been difficult for international agreements and organisations to address controversial issues such as creating multilateral air regulatory system. Many nations prefer to act in their own interests, rather than surrender to a multilateral organisation, particularly on sensitive issues that may give the nation negative impacts.

Secondly, national involvement is often critical to the success of the nation's tourism industry since it handles directly related issues such as entry and exit control, policy and planning control, infrastructure development and marketing.

Thirdly, local involvement includes important activities such as controlling the land development process, enforcement of laws and regulations relating to health, safety, and employment, and issuing licenses to tourism related persons and businesses.

In theoretical terms, government intervention is regarded as a characteristic of command economies which can be an obstacle to tourism development. Even though market economies are supposed to be freer of government involvement, they are still involved in their economies for different reasons. The primary reasons for government intervention can be classified into five different factors:

- Promoting economic development: it is obvious that all governments have an interest in achieving a strong economy which will be the principle aspects of participating in the global economy. The government of an economically weak nation will be more occupied with internal challenges and pressure. In other words, it is difficult to pursue economic development without taking a part of the global economy. Therefore, economic development is highly dependent upon political and governmental actions, especially on currency exchange, foreign ownership and consular relations.

- Facilitating and supporting industries: there is always one or more certain industries that governments support in order to encourage the industry to be active, which will help to develop overall economic situations in a country. However, governments often take various approaches, such as tax credits, subsidies and creating new industrial policies to support the industries. For example, Korean government try to encourage tourism sectors in recent years, especially in hotel industry to meet the demand for mega-events such as 2002 World Cup. The government changed tourism policies to simplify the administration work for foreign companies and brands as well as offering subsidies.
- Raising revenue: It is necessary for all governments to generate the revenue to maintain its agencies and activities in the economy. As governments grow more complex and providing more services, their need for revenues increases simultaneously. For example, governments need to raise revenues to meet their expenditures relate to tourism include the costs to maintain different departments for different tourism areas. The obvious method of raising revenues is taxation on personal consumption, business income, and special permits and licences.
- Pursuing other policy goals: governments can use their power to intervene in business activity to achieve broader policy goals. Some of the policy areas that governments often address when considering tourism development include employment, human resources, education and environmental protection. The important goals of government intervention are justice and fairness. Governments are obliged to take the right action when an inequitable distribution of wealth is being created in the economy (Gee and Fayos-Solá, 1997).

In developing countries, government intervention can be an important issue for both positive and negative effects in tourism development. The main reason for government intervention in developing countries is to protect domestic industries as explained earlier but it is not simple to assess how it affects the economy. Many private industries in tourism in developing countries are less competitive than in developed countries, hence governments try to enforce protectionism in order to prevent multinational foreign companies from entering the market.

On the other hand, in developing countries, infrastructure is not comprehensive compared to developing countries. Since tourism requires infrastructure, governments in developing countries are involved in developing infrastructure to encourage the tourism industry. In contrast, the private sector in industrialised countries tends to rely on the government to provide infrastructure and in return, the level of taxes collected which are higher in developed countries than developing countries. However, there are incidents in developing countries where; although the private sector must take on the responsibility for the provision of services, the public sector is dominant in the sense that govern the availability of suppliers even the movement of people.

5.3.2 THE PUBLIC AND PRIVATE SECTORS

To be successful, tourism development requires a public/private sector partnership and the nature of the tourism industry requires clear public sector involvement. Many activities in the tourism industry such as research, regulation, planning and management can only effectively be achieved by the public sector. As a rule, the greater the importance of tourism to a country's economy, the greater is the involvement of the public sector. Therefore, we need to examine the impact of the public sector, which includes demand and revenue management, and supply and cost management. Of all the various productive sectors involved with the provision of tourism services, four key sectors are worthy of specific consideration such as accommodation, restaurants, transportation and tour operators. Each sector plays an important role in the tourism industry both nationally and internationally. The failure to provide one of these sectors could be vital to the tourism industry, thus the roles and impacts of each sector needs to be examined. While it is important to understand the operation of the industry and trends which shape industry practices, it is equally important to understand the linkages and relationships which exist among the various parts of the tourism industry. In other words, tourism involves many different sectors and industries whether it is large or small, thus it is essential not to miss out any of them. If one of these tourism-related sectors or industries even one small sector is missing from the linkage, it will have a large impact on tourism industry (Vellas and Becherel, 1995).

5.3.2.1 Roles of the Public Sector in Tourism

In general, government involvement in regulating rules and policies in tourism affects the overall performance of the industry and its further development. The roles of government in tourism development are illustrated in figure 5.4. The figure shows that economic policy is the main government role in tourism.

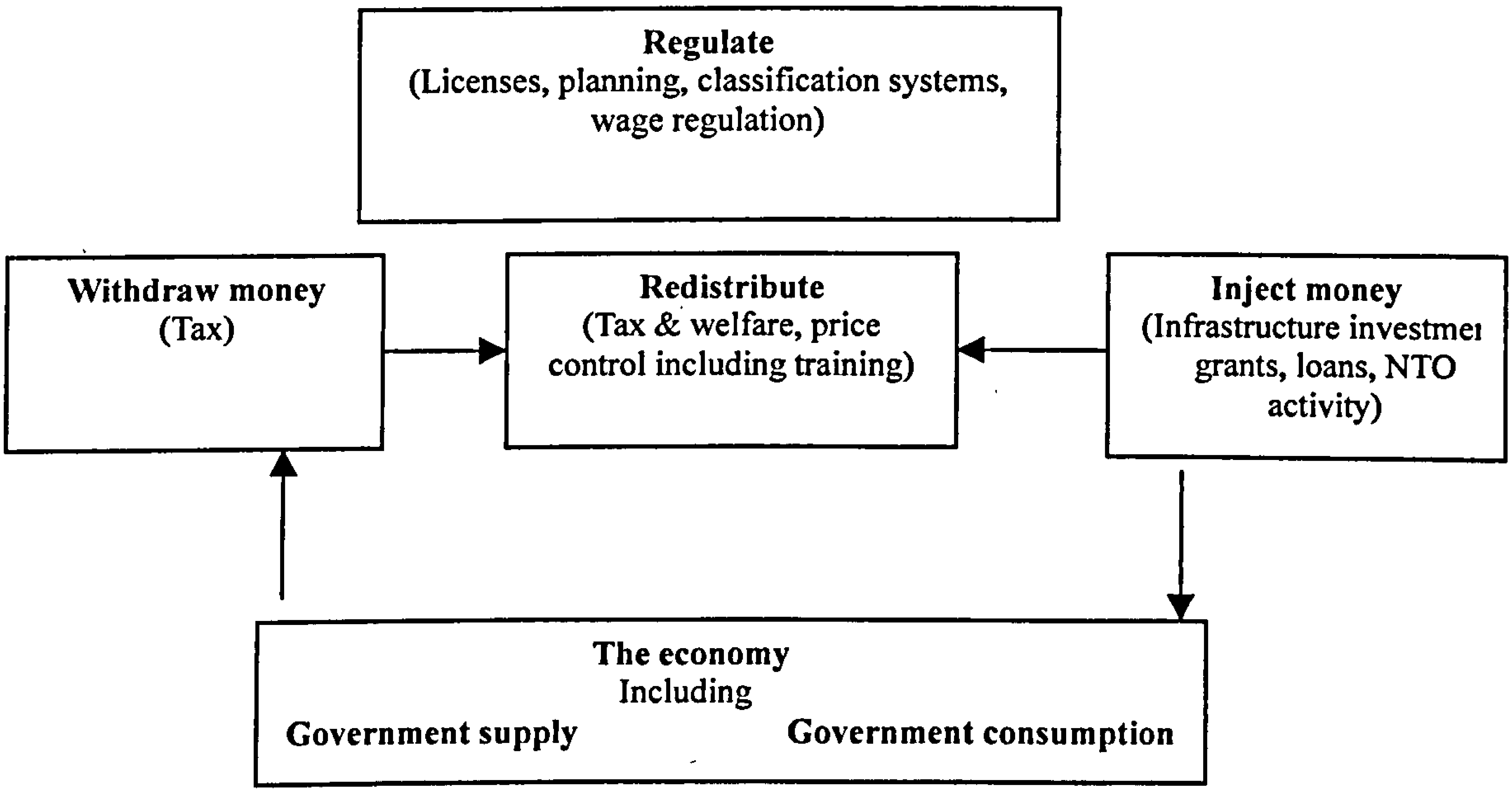


Figure 5.4 The roles of government in tourism

Source: adopted from Bull, 1995.

Public sector actions involve various categories such as policy, planning, development, and regulation control, which play essential role in either encouraging or discouraging tourism.

- Policy: In the tourism industry, policy is meant to provide guidance by addressing the issues that are vital to tourism development. Tourism policy is generally considered to be an area within a nation's overall economic policy. Economic policy is concerned with the structure and growth of a nation's economy and is focused on labour force, investment and finance, and trade. In general, a country's different policy areas are interrelated and impacts in one policy will likely effect changes in other area. Therefore, policy makers in tourism have to consider possible relationships with other areas and its impacts. In other words, tourism policy represents goals and strategies that a government has adopted with respect to economic development, employment, and political relations. Moreover, tourism policy requires policy makers to consider the following issues in order to pursue the kind of development its people want:

- To recognise how important tourism is to the overall economy or to other industries.
- To acknowledge the kind of tourism development that is desirable and appropriate to benefit the country.
- To control the amount of public resources that need to be directed to tourism's support and growth.
- To consider at what level should tourism be represented in the government's organisational structure.
- To address tourism impacts, both positive and negative, on existing society, culture, and environment (Gee and Fayos-Solá, 1997).

▪ Planning: As discussed earlier, economic growth is an important reason why governments are enthusiastic to develop tourism industry. But both general economic and tourism development in today's complex and global business environment is far from being a simple process, especially as tourism is a unique industry with its own requirements, impacts, and rewards. Therefore, the primary goals of tourism planning are to satisfy those requirements, minimising the negative impacts, and obtaining the rewards. In other worlds, without planning, it may create unexpected and unwanted impacts. In addition, tourism should be planned at the national and regional levels. According to the World Tourism Organisation (1997[a]), there are several important benefits of undertaking national and regional tourism planning, which include:

- Establishing the overall tourism development objectives and policies.
- Developing tourism so that its natural and cultural resources are indefinitely maintained and preserved for future, as well as present, use.
- Integrating tourism into the overall development policies and patterns of the country or region, and establishing close linkages between tourism and other economic sectors.
- Providing a rational basis for decision-making by both the public and private

sectors on tourism development.

- Making possible the coordinated development of all many elements of the tourism sector.
- Optimising and balancing the economic, environmental and social benefits of tourism, with equitable distribution of these benefits to the society, while minimising possible problems of tourism.
- Providing the framework for effective coordination of the public and private sector efforts and investment in developing tourism.
- Offering a foundation for the continuous monitoring of the progress of tourism development (World Tourism Organisation, 1997[b])

The planned approach to developing tourism at national and regional levels is now widely accepted as a principle in many countries. Overall, the planning process can be essential in forcing governments to think systematically about the total impacts of tourism, particularly for those destinations that are environmentally sensitive or whose cultures have not been exposed to market-oriented activities.

- Regulation: Regulations may be imposed by government bodies for a variety of reasons such as consumer protection or as part of macroeconomic policy. Firstly, consumer protection policies mainly apply to travel agents and accommodation in tourism industry. Purchasers of travel normally pay in advance of receiving the product, and therefore face the risk of losing a deposit or full payment if suppliers or travel agents fail in the interim. Many governments have introduced licensing and bonding arrangements to protect consumers. These apply to any suppliers who take payments in advance and the government set the regulations to ensure that the money will be used for the purpose of securing their reservations. On the other hand, consumer protection rules apply to official accommodation classification systems. Many countries have introduced official classification systems rather than relying on independent guides and associations to ensure that customers are paying appropriate prices for the different level of standards. Secondly, the most important macroeconomic policy related to tourism is balance of payments. Those countries, which see international tourism as an important contributor to balance of payments flow, may impose foreign exchange restrictions in addition to the use of taxation and complex documentary requirements. In generating countries, demand for foreign tourism can be restricted by exchange control regulations limiting the amount of both domestic currency and foreign exchange which may be personally exported. The restrictions on foreign exchange applied in many developing countries due to unstable economic situations (Bull, 1995).

- Development: In general, development is often thought of as a private sector activity but there are certain circumstances in which the government can act as a developer. In certain types of development, the public sector is obliged to provide specific resources such as capital in order to undertake the development which may be difficult for the private sector to pursue.

5.3.2.2 Roles of the Private Sector in Tourism

According to Youell (1998), there are four core components in the tourism industry which are destinations, visitor attractions, transportation and accommodation/catering, as shown in figure 5.5. Tour operators and travel agents act as intermediaries by packaging tourism products and services. These five elements of international tourism are provided by a range of commercial and non-commercial enterprises, although the industry is dominated by private sector providers. The non-commercial enterprises consist of public sector organisations and institutions that operate in the non-profit sector whereas private sector enterprises operate to maximise profits.

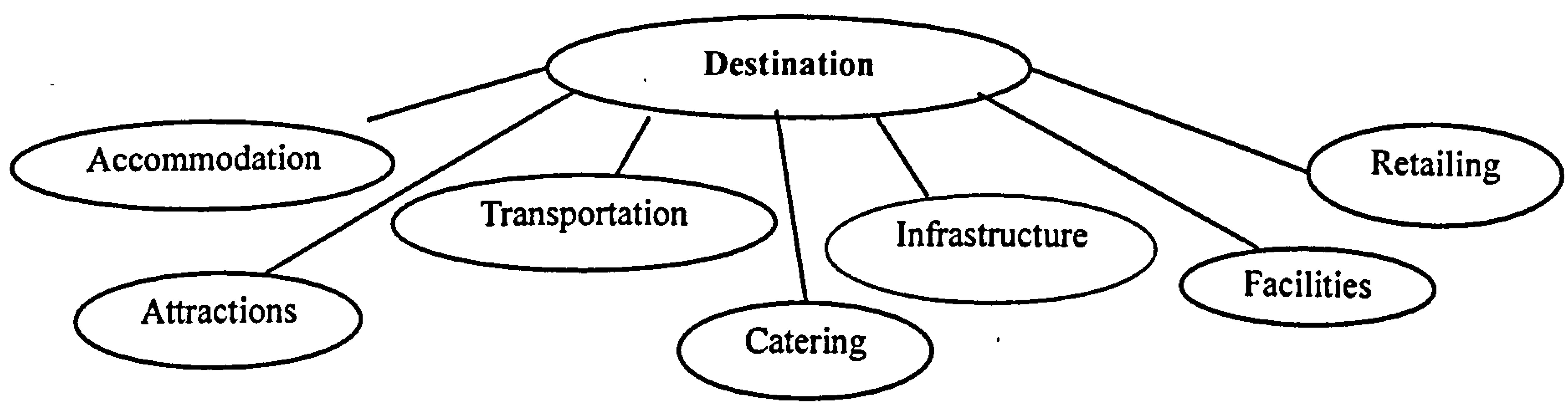


Figure 5.5 The composition of the tourist destination

Source: Youell, 1998.

Although destinations do not represent a sector of the tourism industry, they are the essential part of creating tourism industry itself for both public and private sectors. Figure 5.6 indicates that a destination can be considered as the platform of partnership to provide facilities and services in tourism industry. Therefore, the primary role of the private sector in the tourism industry is providing more comfortable and convenient facilities and services to meet the needs of tourists. Additionally, they are rewarding themselves in the form of profits by providing those facilities and services to customers. In the process of tourism development, private sector enterprises generate multi-ownership patterns and introduce multiple products. However, there are some problems such as competition between SME and multinational companies in order to operate fair trade because of technological and economic factors.

Many researchers generally classify the private sector in tourism into four categories:

- The accommodation and catering sector: the sector provides tourists with somewhere to stay and sustenance while travelling to or staying in their destinations. It covers hotels, self-catering accommodation, restaurants, fast-food outlets and other enterprises. Knowles *et al.* (2001) stated that an important influence on the tourism industry is the type of customer and the type of accommodation that he or she demands. In economic terms, accommodation and catering is the most significant of all sectors of international tourism, since it is the biggest employer and accounts for the largest proportion of tourists' expenditure. However, hotels are the most common type of accommodation used by tourists, particularly for international tourists. Although hotels are the dominant form of accommodation used in international tourism, other types of accommodation, such as motels, B&B, and guest houses, are more popular in a country's domestic travel. Nowadays, hotels, especially luxury hotels, are not just in the form of accommodation but also plays as a leisure and business complex to provide several different services and facilities. For example, the majority of four and five star hotels worldwide provide not just a room to stay but also provide a business centre to do business, a swimming pool and a health club to enjoy spare time, a function room to serve wedding or other celebrations, and different types of restaurants to experience exotic food which show how important the accommodation and catering sector is in tourism industry.
- Tourist attractions: tourist attractions have an important role to play in world tourism since they often provide the motivations to travel, thereby energising the many components of the tourism industry. In general, anything that has the beauty or power to draw visitors to it can be considered an attraction. Attractions can be

either places or objectives, but overall perception of a destination should be recognised as an attractive place to visit which can be identified from either natural resources or images of a destination. China's current popularity as a tourist destination with all different types of visitors around the world is a good example. Tourists are not attracted primarily by the 'traditional' attractions such as the Great Wall and Buddhist Temples, but rather by the image of a mysterious oriental world and a nation of rapid economic growth (Youell, 1998).

- Transportation: the transportation sector of the tourism industry covers a variety of water, air and land based services, including travel by coach, train, private car, taxi, aircraft and ferry. The simple role of transportation in the tourism industry is carrying tourists from one destination to another for both domestic and international tourism. On holiday, the tourist uses public or private transport, stays in hotels or other accommodation, eats in restaurants and engages in a multitude of activities. The providers of these services exercise a significant influence on the level of participation in tourism. In terms of the transportation sector, transport developments in nineteenth century made tourism possible and the revolution of the twentieth century created the term mass tourism. A reduction in fares and an increase in speed of transport added to the volume of tourism. Therefore, the price, frequency, and speed of transport can restrict the volume of tourism as well as stimulate tourism growth. Continuous developments in technology will be the centre of future changes in tourism growth. Governments are still involved with the transportation sector in many countries. With respect to rail and air transport, governments own and manage the operation because of safety and financial reasons (Burkart and Medlik, 1981).
- Travel agents and tour operators: the retail travel agent plays an important role in promoting the efficiency and the quality of the distribution of the various travel products. The public uses the expertise of operators which saves time, effort and money. In other words, the travel agent provides a convenient location where the intending tourist may seek first of all information about his or her travel plans and, secondly, a location where he may purchase the various travel products he wants. In addition, the travel agent often provides additional travel services such as obtaining foreign currency, travellers' cheques, passports and visas, and holiday insurance. In return, principals and suppliers gain access to a widespread network of outlets, the business community gains appropriate advice regarding travel, hotel

reservation and ancillary services. The agent's goal is to understand what satisfies the tourist' needs and try to provide it. The travel agent carries out an equally important function as a salesperson. Therefore, it is not easy to maintain a harmonious relationship between serving a customer and selling the products of preferred suppliers. The situation became even more complicated after the deregulation of the field. Deregulation has allowed agents to obtain different commissions and even override different suppliers. However, it is important to remember that stocking the principals' travel products is not a function of the travel agent. The normal retail shops in the economy buy products from manufacturers for his own retail stock but the travel agent carries no stock of the travel product. They only provide information, access to the principals' stocks via their reservation systems, and facilitate travel arrangements by providing various ancillary services. In general, the travel agent enjoys an oligopolistic situation where new entry can be a threat in the market. His immediate competitors will be other agents within his local area or neighbourhood (Gee and Fayos-Solá, 1997).

5.3.2.3 Multinational Corporations in the Tourism Industry

A multinational enterprise (MNE) is defined as an enterprise that seeks to expand operational commercial activity beyond the frontiers of its home or parent economy. There are three main classes of foreign involvement which MNEs undertake. These are equity ownership, loan capital supply and non-investment management arrangements:

- Equity ownership: the most solid form of MNE is purchasing equity stock in an existing business in foreign countries or setting up a partly or wholly owned subsidiary from nothing. It may include direct branch offices in other countries, where it may be necessary under the laws of those countries to incorporate there. In addition, there is often complication of ownership of shares for MNEs, particularly if a country restricts foreign company ownerships.
- Supply of loan capital: not a true MNE and it involves high risks since it is not on equity basis. A parent company tends to lend money directly to companies in other countries based on the recipient enterprise's assets or some trading agreement which provides the parent company with an operational or production advantage as well as earning interests.

- Non-investment management arrangements: this is the most common form in a large enterprise, whether domestic or multinational, to find a parent that operates a subsidiary under a management contract, or offers a franchise agreement. In this case, the enterprises in each country are separately owned, but usually there is a single multinational trading name used such as McDonald, Body Shop, and Hilton hotel. The majority of enterprises are willing to use these arrangements in order to obtain marketing advantages. When domestic markets are too restricted to provide a background for strategic expansion, and where foreign markets are open to production and sale of similar products, international external economies may be valuable. Moreover, parent enterprises can export to other countries when they have superior production, technical and marketing skills (Bull, 1995).

In the tourism industry, multinational enterprises appear to have a large impact on many different sectors. The forms of equity ownership and non-investment management arrangements are common, especially in the hotel sector. In assessing the role and impact of MNEs in tourism, accommodation is the most important sector of all in the tourism industry due to the high visibility of chains as an element of tourism and large international flow of investment. It is obvious that hotels demand a substantial fixed investment in land, buildings and equipment before earning any profits. Nowadays, many hotels adopt the system of non-investment management rather than equity ownership because of direct investment costs and interest. Regardless of the methods of foreign involvement, MNEs in accommodation have one of the fastest growth rates of any sector in tourism and Japanese, Korean and Hong Kong-based groups have grown even faster (Shaw, 1989).

Many nations are interested in identifying the real impacts of MNEs on host economies. Attention has been drawn to this issue following the introduction of GATS in order to promote liberalisation in international trade. Dunning and McQueen (1982) classified the three most important areas of concern to a host economy:

- A MNE may control the structure and development of the tourism industry. In small countries, MNEs can impose a monopoly by prohibiting both the entry of other MNEs and the development of local enterprises, which may or may not be beneficial to the host economy. It can be even more dangerous to the host economy if they are able to exert pressure on governments to tailor future tourism to their own needs. In this case, a MNE may demand governments to finance the infrastructure of tourism industry through taxation which will be collected from local residents.

- Multinational travel and tourism enterprises controlling specific flows of tourists and markets. The level of commitment which a MNE has to a host economy depends on the relative profitability to be gained from that economy compared with others. A MNE will pull out from the host economy immediately if they find better destinations to gain more profit from. For example, Japanese tour operators pulled out instantly from Canada in the early 1980s and moved to Hawaii and Europe because of better profitability. In the 1970s and 1980s, American cultures and styles of living flowed into Japan and the people were desperate to experience America. Therefore, large numbers of Japanese tourists visited America and Canada because Canada was just next to America. But Japanese tourists started to visit Hawaii for honeymoons after the tour operators moved in. The tour operators promoted tourism products in Hawaii because they were able to maximise profits by spending less in Hawaii than Canada, but also the potential for developing mass-tourism in Hawaii was much bigger than Canada since Japanese tourists prefer an exotic holiday environment. Consequently, market conditions can be changed by foreign MNEs in the host economy as well as tourists flows.
- Many MNEs have more advantages in logistical skills and experience in the industry, access to advanced technology, skilled labours, and superior techniques of producing and delivering services including CRS than local small and medium enterprises. Hence, they are in a more comfortable position to compete with local enterprises. Furthermore, MNEs can also play with the prices of tourism products. In the tour operator and travel agent sector, MNEs are financially secure to reduce prices or to introduce special offers to attract more customers which may lead to local enterprises being bankrupt. As globalisation and liberalisation direct the movement of current and future international trade, the competition between foreign MNEs and local enterprises is an important issue, particularly in developing countries.

5.3.3 TOURISM ORGANISATIONS AND TOURISM POLICIES

As discussed earlier in this chapter, tourism is a unique industry that requires a great deal of communication and cooperation among government, business, and host communities. In order to satisfy the need for communication and cooperation, many kinds of organisations, including ones of voluntary membership, have been established to serve travel and tourism-related interests. Tourism organisations have many different agendas and purposes. The broad objective of establishing different tourism organisations is to promote national and international tourism development and to balance the macroeconomic policies of each region and each sector involved in tourism. The major areas of concern to international tourism organisations as follows:

- Promotion of industry interests is an important part of the tourism industry. As a result, the most common type of organisation is an association of members representing the same professions or industry. These organisations include activities such as monitoring laws and rules, setting standards for financial operations and statistics, and regulating prices of tourism product in each sector.
- Because tourism is based on the movement of consumers to specific locations, a first step for any destination is creating awareness. Regional organisations are important vehicles for creating greater awareness of a destination because they facilitate destinations to participate and collaborate in marketing campaigns.
- Providing necessary data and advice on required areas in tourism to both public and private interests is a primary activity of many organisations.
- Tourism development needs capital investment in many different areas, such as infrastructure improvements, human resources education and training, and housing. Many organisations designed to provide direct assistance on these areas along with local governments, which will beneficial to local population.
- As international tourism grows in importance, the fundamental issues, such as trade, social, and environmental issues, need to be addressed to fulfil effective and appropriate tourism development (Gee and Fayos-Solá, 1997).

5.3.3.1 Types of Tourism Organisations

There are different types of tourism organisations. At a national level, there are public sector agencies and professional associations and at an international level, governmental and non-governmental organisations. Firstly, national public sector tourism organisations are responsible for the organisation, development and operation of a country's tourism industry. They organise tourism promotion at a national level, control the activities of all tourism sectors and provide national coordination for regional tourism development. At the national level, a government is responsible to formulate policy which provides a statement of the means by which the objectives are to be attained, the means cover such matters as the administrative arrangements, the respective roles of the private and public sectors, and the fiscal arrangements. Public sector organisations are usually composed of government representatives such as ministers, department heads, and directors and tourism-related agencies.

The World Tourism Organisation has identified four key government functions (coordination of tourism activities, legislation and regulation, planning, and finance), which control the development of tourism. The key point for national tourism organisations is that they must have the necessary powers and resources to carry out their responsibilities properly. Local administrations are important national tourism organisations because they provide their own tourism services such as tourist information centre and tourist offices, which play an essential role in welcoming tourists and promoting tourism (Vellas and Becherel, 1995).

Secondly, the regional tourism organisation is an intermediate level between the national and local levels and represents the latest development in tourism organisations. Most regional organisations (the European Union, the Association of South East Asian states, and etc.) are concerned with various aspects of the tourism sector, such as developing common projects, recommendations to member countries, and researches. Regional organisations are formed initially for the purpose of marketing and increasing the travel market' awareness of their respective regions. In general, a region becomes a separate main destination within a country for foreign tourists and it also tends to replace the individual resort as a destination for domestic tourists. Therefore, it is important for such regions to provide a basis for the formulation of tourist products which can be promoted in appropriate markets and which call for information services based on a region. In order to achieve this, regional tourism organisations may form a network of component bodies coordinated at national level and each regional organisation may in turn coordinate local tourism organisations in its area. On the other hand, it is difficult to define regions for purposes of tourism organisation. The simple and efficient way of defining tourism regions is to follow government administrative boundaries where administrative arrangements are facilitated (Burkart and Medlik, 1981).

Thirdly, the increasingly international character of mass tourism and the growing influence of international agencies are reflected in the growth of international organisations in tourism. International organisations have had a long history and many of the first organisations came into being in the field of transport and communications such as International Telecommunications Union and Universal Postal Union. Although there are many international tourism organisations in tourism, the World Tourism Organisation and WTTC play an important role. The World Tourism Organisation focuses on public sector and WTTC concentrates on private sector in world tourism. The WTO is the only intergovernmental organisation to hold worldwide responsibilities, encompassing all tourism activities. The organisation plays a major role in the development of international tourism. Its membership is composed of 133 countries and territories, and over 300 affiliate members from the public and private sectors (in 2001). The WTO's aim is to promote and develop tourism as a significant means of fostering international peace and understanding, economic development and international trade (World Tourism Organisation, 2001[a]). The organisation particularly aims to assist tourism development in developing countries by offering various services as follows:

- Formulation of policies, plans, and programmes for development of domestic tourism.
- Institutional framework of national tourism administrative structures; tourism development corporations; legislation and regulations.
- Evaluation of the impact of tourism on the economy and on the environment.
- Statistics, forecasting, statistical analysis, market research, market analysis; promotion, publicity and public relations.
- Training; feasibility studies for tourism-related schools; management development.
- Area development, development of new tourist sites, and development of particular tourism products.
- Planning, location, operation and improvement of accommodations; hotel classification systems.
- Sources and methods of finance for tourism investments.
- Safety of tourists and tourist facilities (Gee and Fayos-Solá, 1997).

5.3.3.2 Future Movement of Tourism Organisations

As the importance of tourism in the world and its continuous growth prospects into the next century increase, tourism organisations face many challenges. One of the important challenges is financial viability since the activities of voluntary tourism organisations require substantial funding.

Another challenge for tourism organisations is to ensure that their mission reflects the needs and desires of its membership. Given the dynamic, interactive and competitive nature of tourism, these needs are likely to change quickly from time to time. Therefore, organisations need to respond and adapt adequately and effectively to these changes in their membership. This challenge can be difficult because the organisation may experience structural destabilisation and loss of focus on long-term strategies in an attempt to respond these changes too quickly.

Consequently, it is important for tourism organisations to work closely with each member in order to discover their members' needs and problems. Additionally, the principles and strategies of tourism organisations in any kind need to be firm and secure in the beginning otherwise the organisations will fail to assist members in different areas of the industry.

5.4 IMPLICATIONS OF GATS FOR THE TOURISM INDUSTRY

The principle of GATS is the liberalisation of exchange of services and it is adapted from the GATT (General Agreement on Tariff and Trade). The GATS has been established as part of the multilateral trade negotiations and introduced new rules for services to complete overhaul of the GATT trade system. The rapid growth of tourism is the product of liberalisation which has been the hallmark of economic policy throughout the world, during the past decade. The UNCTAD report (1999) states that both globalisation and liberalisation have increased the potential for international trade in goods and services to become an unprecedented engine of growth and an important mechanism for integrating countries into the global economy. However, the GATS has many implications for tourism, particularly for tourism policymakers since it covers many different areas and sectors in tourism as shown in figure 5.6. Unlike other services, tourism is not a specific type of service, but a mixture of different services consumed by tourists. Therefore, it is essential to understand the rules and the principles of GATS as applied to tourism sectors in international trade.

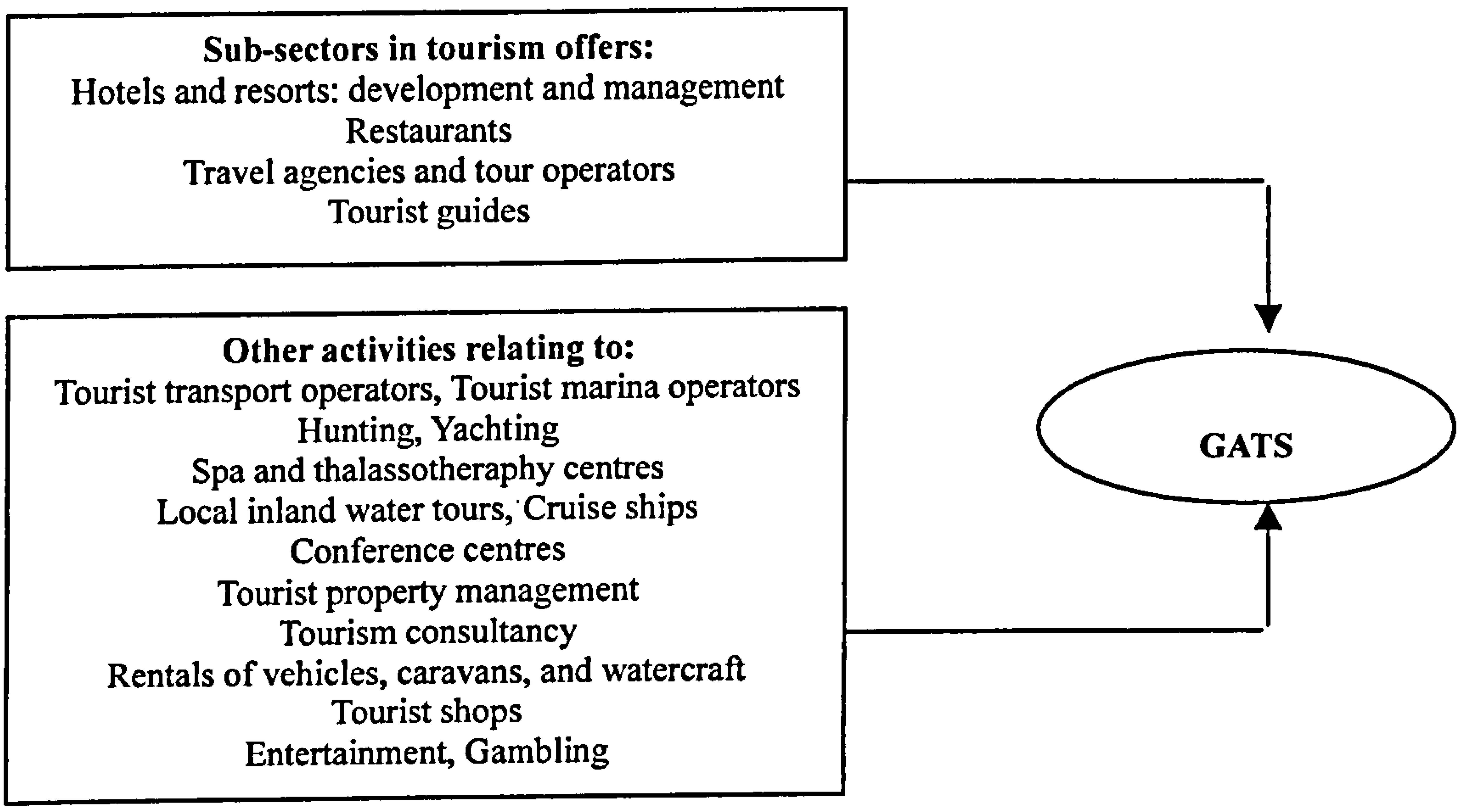


Figure 5.6 GATS and tourism offers

Source: Handchouz, Kanasabe and Diaz, 1994.

The main issues and the barriers confronting international trade with respect to individual aspects of tourism are:

- Customs regulations.
- Documentation formalities.
- Regulation affecting transportation.
- Lodging and travel agencies.
- A number of political, economic and social factors influence government actions and regulations affecting tourism.
- Government concern is immigration control which strictly control the entrance of immigrants and enforce laws against illegal entry.
- Exchange controls and restrictions on remittance of earnings tend to discourage the establishment of businesses by non-nationals.
- Investment laws which require minimum ownership by local national are intended to promote domestic economic development.
- Restrictions on the use of foreign-made promotional and advertising materials also

are intended to stimulate local business enterprises.

- Discriminations against the activities of non-established businesses often are designed to encourage inward investment and employment of local nationals. In some countries, tourism promotion offices are established as government monopolies and private foreign companies are excluded to ensure full control of the business (Morrison, 1995).

GATS attempted to cover all these issues relating to tourism in order to reduce trade barriers to boost globalisation and liberalisation in international trade when it was established in 1994, but it appears to have both negative and positive impacts on tourism industry in different countries. Although the agreement entered into force in 2000, it will take a long time to find out whether the GATS has been successful, especially for developing countries.

5.4.1 THE ROLES OF THE GATS AND TOURISM SERVICES

The GATS agreement is a long-term undertaking that is intended to attract the major trading countries. GATS sets up a legal and operational framework for the liberalisation of international trade in tourism as well as other services. The agreement deals with services supplied, such as the production, distribution, marketing, sales and the delivery of a service, by natural persons of individual services suppliers and juridical persons of established companies, also to travellers and tourism-related enterprises whenever such transactions are carried out between national and foreign persons. For the purpose of identifying commitments, GATS singles out tourism and travel related services (TTRS), along with other service sectors equivalent to business, communication, construction, distribution, education, environment, finance, health, recreation, culture and sport, and transport. For the tourism sector, the GATS classification can be considered 'open-ended' because distinct tourism-oriented services such as computer reservation system (CRS), travel assistance, car rental, tourist health services, convention centres, and many others are covered under various sectors (not included under the travel and tourism sector) or not specified at all (WTO, 1996[a]).

In recent years, international trade has been clouded by discriminatory practices, protectionism and lack of transparency. GATS intends to improve this environment by clearly stating the rules and applying them equally to all enterprises involved in service transactions to member countries. GATS will enable liberalisation through detailed negotiations between member countries. The negotiations are about reducing barriers that restrict the freedom of service suppliers to operate in foreign markets. In tourism, restrictions affect companies in many different ways, including their ability to move staff to a foreign country, the use of trademarks, the creation and operation of branch offices abroad and the repatriation of profits. The barriers to such trade derive from restrictions on market access and national treatment.

GATS will affect tourism services in different tourism sectors as follows:

- Tour operators, hotel enterprises and other tourism and travel related companies from one country will be able to set up operations in other countries.
- In the hotel sector, GATS will facilitate franchising, management contracts, technical services agreements, licensing and patents.
- Foreign companies will be able to sell their services under the same terms and conditions as domestic companies and suppliers from other countries.
- They will be equally eligible to government incentives and benefits.
- They will be able to move their staff to a foreign country and base them there.
- They will be allowed to effect international transfers and payments for current transactions (WTO, 1995^{b}).

However, this does not mean that foreign tourism companies will enjoy the same freedom and rights as domestic companies. Members of GATS will be free to adopt restrictive measures in order to protect public morals, privacy of individuals, and the environment, to maintain public order, prevent descriptive and fraudulent practices, for safety and security in general. Since it is difficult to define 'restrictive measures' under the agreement because each member country has the different economic, social and political situation, there is a potential danger for a member country to find a way to apply some kind of restrictions to foreign companies. For example, the definition of 'public morals' may vary with different concepts and perceptions in each member country.

5.4.1.1 Modes of Supply for TTRS

The liberalisation objective of GATS applies to regulatory measures (including rules, regulations and laws) within member countries that restrict the ability of foreign suppliers to gain access and operate and develop in a market without discrimination. To this effect, GATS is attempting to expand trade between member countries in agreement by supplying services internationally. Therefore, GATS aims to open up and ensure market opportunities for different ways of trading a service, hence GATS classified four different modes of supply as cross border, consumption abroad, commercial presence, and presence of natural persons.

First, cross-border trade allows service suppliers of one member country to deliver services from abroad into another member country. Typically, travel agents or tour operators provide a range of travel related services such as booking arrangements or travel advise, cross-border by means of telecommunications. Specific provisions in the GATS agreement in this context is meant to facilitate the trans-border flow of information by guaranteeing that the foreign supplier will have fair and non-discriminatory access to, say, the telecommunications networks. What this means for tourism is that the service suppliers will be guaranteed telecommunication facilities to arrange, sell, and advise on travel arrangements.

Second, consumption abroad makes allowances for the fact that trade in services takes place when consumers move abroad to purchase services, which in effect, is tourism itself. As the growth of tourism could be seem to be limited by any restrictions on the ability of the individual tourist to leave home and be permitted to return, and be able to pay or make financial arrangements for the services purchased abroad, the GATS agreement attempts to move restrictions on consumption abroad. However, it is recognised that the GATS agreement will have a limited effect on liberalisation in this area as restrictions relating to visa and frontier/customs requirement fall outside the agreement. In addition, the 'restrictions of safeguard balance of payment' (Article XII) means that foreign exchange restrictions are not negotiable as trade barriers. The implication for tourism is that governments will still have the ability to restrict the movement of individuals if they choose, and to limit foreign exchange, thereby indirectly restricting the development of tourism.

Third, commercial presence enables member countries to establish and expand a commercial presence in another country in order to produce and sell services. All of the legal ways in which a service supplier can be present in the market, for example, an agency, branch, subsidiary, or a joint venture are covered by the agreement. The GATS agreement will prevent government restrictions on the transfer of funds into and out of the country concerned, and it will eliminate obstacles, which affect companies that provide services to facilitate travel. It is perhaps in this area where there is likely to be the greatest impact on tourism, as it is often essential for operations like hotels, tour operators, and travel agents to market services in the country where the commercial presence is situated. With the removal of barriers concerning limitations on foreign investment, the number of permitted foreign owned establishments, the difficulty in obtaining a license to operate, and access to computer reservation system, there is likely to be a huge growth in the number of travel and tourism operators with a foreign commercial presence. With respect to the hotel sector, GATS will facilitate franchising, licensing and patents, technical service agreements and management contracts. These kinds of measures will create stronger competition for the tourism services than existed before.

Fourth, presence of natural person allows for the presence and temporary stay in foreign markets of personnel involved in service supply. As nearly every country has strict visa, work permit and residence laws, this can be a hindrance to the movement of professional, managerial and technical staff as well as consumers (e.g. tourists) between member countries as seen in table 5.5. The GATS agreement attempts to address this issue by providing a framework for negotiation of temporary staff leaving one member country to work in another member country. However, the agreement does not prevent individual countries from controlling the admission and stay of foreign workers for security, health or economic reasons. Also, the liberalisation of personnel is not concerned with the free movement of labour across borders, therefore does not require alterations to national immigration laws (UNCTAD and The World Bank, 1994).

Table 5.5 Measures affecting movement of consumers of services

1. Market Access -requirements relating to travel documentation (country of origin) -exit visas (country of origin) -entry visas (country of destination) -residence permits (country of destination) -proof of vaccination (country of destination)
2.National treatment -limits on foreign currency available to the travellers (country of origin) -taxes on travel (country of origin) -regulations relating to trans-border medical insurance (country of origin) -rules relating to the recognition of educational standards and certificates obtained abroad (country of origin and country of destination) -restrictions on land ownership (country of destination) -regulations relating to local currency (country of destination) -restrictions on freedom of movement (country of destination) -price discrimination (country of destination) -measures relating to gainful employment (country of destination)
3. Other measures -general consumer regulations (country of destination)

Sources: UNCTAD and The World Bank, 1994

As regards movement of natural persons, the negotiations are still not clear under GATS. The main issue for tourism is that many activities involve movement of natural persons, for example, the movement of skilled and technically trained manpower like chefs, hotel maintenance personnel, software experts, telecommunications, and travel professionals. In this case, the problems seem to arise with a temporary relocation of skilled persons who will eventually bring benefits to both countries where they are working and their own country when they return. The commitments of members in this area leaves much to be desired and some particular category has not been offered and where it has been, the offers are highly encumbered, i.e. subject to conditions like sectoral limitations, labour market tests and economic needs tests. More importantly, entry regulations and qualification requirements for temporary movement of natural persons, are not covered under GATS. The movement of natural persons under GATS only involves those who are highly qualified and highly skilled. In this case, it is more likely to be active movements of highly skilled manpower from developed to developing countries rather than from developing to developed countries. However, the GATS framework for the movement of natural persons should ease market access not only for intra-corporate transferees but also for business visitors and natural persons without commercial presence (World Tourism Organisation, 1995[a]).

The implications of this for tourism are that the quality of the tourism service often depends on the expertise, skills and knowledge of company owners and employees. As a consequence, it is often central to the growth of a successful tourism business to be able to re-locate and move around key personnel into foreign markets. The free movement of personnel will allow tourism companies to develop and expand without the constraint of having to draw employees from the local labour market. GATS also provides rules regarding the recognition of the education, experience and qualifications obtained by an individual wishing to work in another country.

Table 5.6 Number of countries by mode of supply in TTRS

Mode of Supply	Market Access			National Treatment		
	Full	Part	No	Full	Part	No
Cross-border Supply	33	49	30	37	48	27
	29%	44%	27%	33%	43%	24%
Consumption Abroad	55	47	10	58	42	12
	49%	42%	9%	52%	38%	11%
Commercial Presence	25	86	1	49	61	2
	22%	77%	1%	44%	54%	2%
Presence of Natural Persons	1	105	6	12	90	10
	1%	94%	5%	11%	80%	9%

Source: WTO, 1998[b].

The GATS still needs to do more work to liberalise the international trade of services, particularly of tourism. In fact, it is easier to control and monitor something visible but tourism involves many invisible activities. It is not something you buy and take with you when you go back to your country or you can purchase in your country. Tourism is something you must go to another place to purchase, therefore the "movement of persons" is a very important mode in tourism although these four modes of supply are equally important to operate international trade between countries. As seen in table 5.6, many member countries still impose partial restrictions on market access and national treatment, especially for commercial presence and presence of natural persons modes of supply in TTRS sectors. These two modes of supply play a significant role in hotel and restaurant sectors thus the question of how GATS will help international trade in tourism industry remains unanswered particularly to these two sub-sectors.

5.4.1.2 Commitments in TTRS and Sub-sectors

According to WTO (1995), the GATS classification list mentioned more than 140 services categories and no country submitted commitments on all of them. Tourism and Travel Related Services (TTRS) are defined as one sector of twelve specific commitments and TTRS received more attention than any other services sector, with 97 schedules of commitments from the 115 countries which participated in the Uruguay Round. Tourism featured prominently in the GATS agreement since the percentage figures of presenting TTR commitments were high, over 90%, except for the Middle East as shown in figure 5.7. In addition, 37 countries presented commitments on CRS. They were entered under air transport services and TTRS and only two countries mentioned CRS in their lists of MFN exemptions. However, it is important to know that the several countries, especially developing countries, intend to join GATS because they want to be the part of globalisation for political and economic reasons with the least commitments (World Tourism Organisation, 1995[a]).

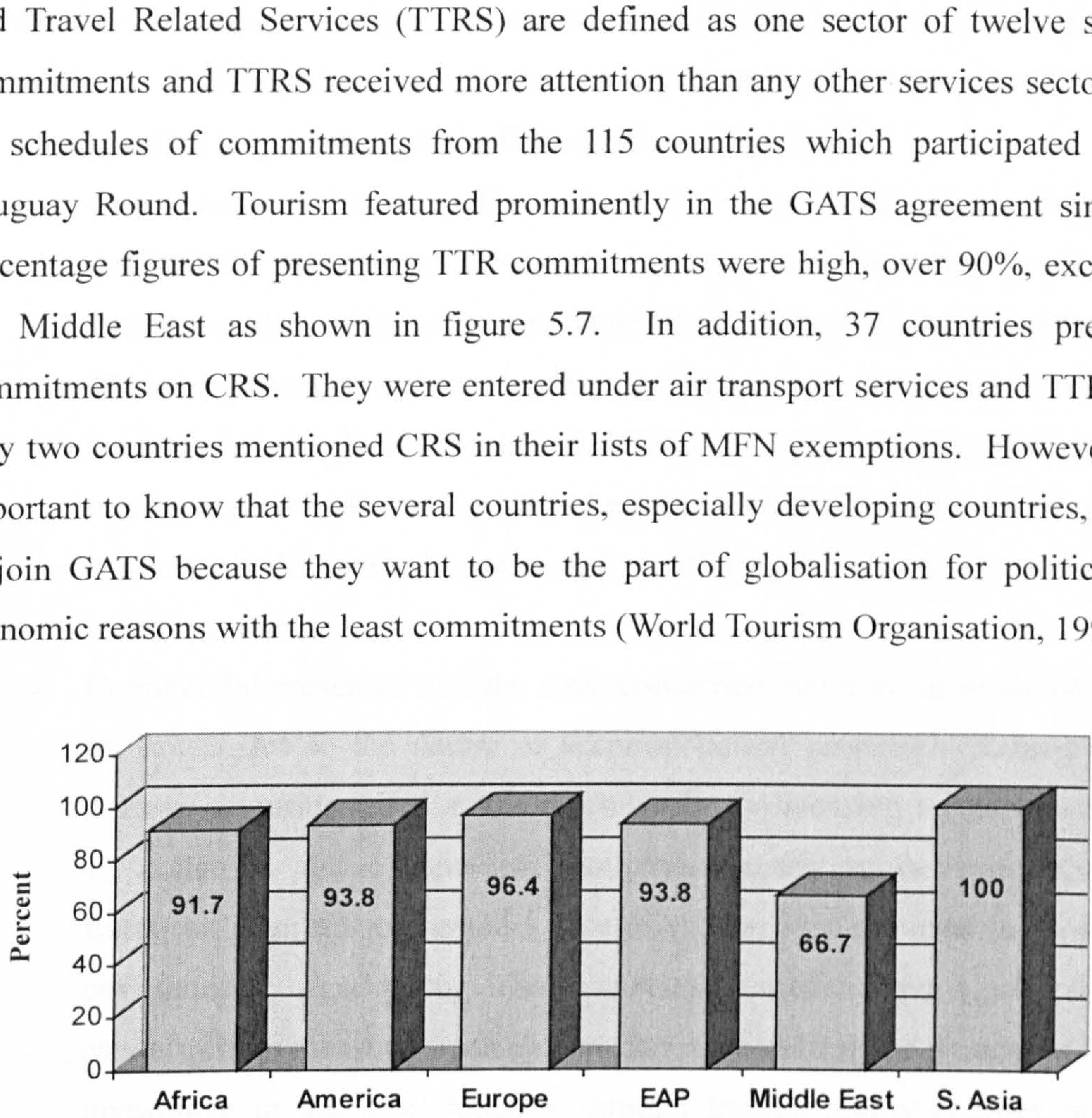


Figure 5.7 Percentage of regions with country commitments in TTRS

Source: WTO, 1996[a].

Table 5.7 Sectoral breakdown of TTRS commitments in the GATS agreement.

Regions	TTRS	Hotels	Restaur/cat.	Trav. agencies	Guides
Africa	22	22	22 / 7	18	10
America	30	30	22 / 9	20	11
Europe	27	27	27 / 20	27	22
EAP	15	15	13 / 4	12	5
M. East	2	1	2 / 2	2	1
S. Asia	4	4	1 / 1	3	0
Total	100	99	87 / 43	82	49

Source: World Tourism Organisation, 1995[a].

Limam (1995) explained country commitments in TTRS sub-sectors as follows:

- Hotel sub-sector: Among 100 countries presenting commitments in TTRS, only Kuwait did not present commitments in hotels. For most countries, 'hotel services' refers to accommodation services, to some it means hotel management which is normally part of business services, and to others hotel development which is usually part of another sector or construction and related engineering services. It is important to note that no MFN exemption was reported by any county, which help to strength the liberalisation commitment.
  - Cross-border and consumption abroad: The cross-border mode of supply is not usually appropriate for hotels because accommodation services are mainly supplied in the recipient country through locally established facilities. Therefore, most member countries presented no restrictions or declared "unbound due to lack of technical feasibility" with respect to both national treatment and market access. For the same reason, a hotel chain investing in a country will clearly be interested in offering its services to a country's incoming tourists.
  - Commercial presence: It is the most concerned and popular mode of supply for hotels due to the nature of accommodation services explained earlier. African countries relied almost exclusively on licensing requirements, with 15 countries and 5 American countries presenting no restrictions. 4 European countries presented a restriction based on the need to protect the environment. In addition, Asian countries seemed to have a preference for capital-related measures with five countries, restricting the amount of foreign investment in the hotel industry through foreign equity ceilings or joint-venture requirements which affect the market access principle.
  - Presence of natural persons: The hotel industry is labour intensive like most other services of the tourism sector, thus it relies on it work force and free movement from one site of operation to another. But, this is the least liberalised mode of supply since most countries restrict the movement of hotel staff. Both developing and developed countries impose restrictions on the entry of foreign workers committing themselves only to letting in intra-corporate transferees especially managers, experts/specialists, and business visitors whose aim is to contribute to the commercial presence of a hotel facility. In fact, most countries let top employees in and not let lower-level employees in certain carefully designed conditions.

- Restaurants/catering sub-sector: 13 per cent of countries having presented commitments in TTRS did not offer any in this sector, most of them being in Caribbean or Asia include Indonesia and India, which is probably somewhat artificial since many countries meant to include catering in their restaurant services but failed to do so explicitly. Also, 44 countries either specifically mentioned catering as part of restaurant services or singled it out for separate commitments.
  - Cross-border and consumption abroad: the cross-border mode of supply is also not applicable to restaurant services as its services can only be provided to consumers on the site. For the same reason, many signatory countries declared themselves "unbound" or committed themselves to "no restrictions".
  - Commercial presence: This is the most direct mode of supply for restaurant services as with hotels. No country declared itself "unbound" with around 60 countries presenting no restrictions to the establishment of restaurants in their reasons. The remaining countries presented restrictions to the commercial presence of restaurants by using various types of measures. African countries also relied on licensing requirements, American countries on residency/citizenship requirements and European countries on the economic needs test and measures aimed at protecting the environment and artistic and historic sites, whereas Asian countries base their regulatory strategy on capital measures, mainly joint-venture requirements, foreign ownership restrictions and foreign equity ceilings. As with accommodation sector, no MFN exemption was filed.
  - Presence of natural persons: Many countries applied restrictive regulatory systems when it comes to the mobility of their staff. Only 4 countries, including Namibia, Niger, Myanmar and Egypt, open up their market completely whereas most countries permit entry to only managers and high-level staff. Africa and Americas applied restrictions by using citizenship/residency requirements and European countries applied restrictions on practice.
- Travel agencies/tour operators: 81 per cent of the countries that presented commitments in TTRS also presented commitments in travel agencies/tour operators.

- Cross-border mode of supply: This mode of supply is relevant to travel agencies/tour operators since the services offered by travel agencies and tour operators are often supplied through cross-border from one country to another. 33 of the 81 countries presenting commitments in this sub-sector, including 7 in Africa, 8 in the Americas, 11 in Europe and 7 in Asia.
- Consumption abroad: Poland is the only country to mention a specific restriction on commercial presence. They require travel agencies/tour operators to open offices in its territory in order to offer their services. But, 70 countries presented no restrictions and the remaining 10 countries in South Asia and Latin America declaring themselves "unbound".
- Commercial presence: 41 countries in Europe and America present no restrictions thus opening their markets fully. However, Tunisia presented no commitment, whereas some developing countries allow free access to their markets but not full national treatment.
- Presence of natural persons: 6 developing and transition-economy countries (Namibia, Nigeria, Trinidad & Tobago, Egypt, Hungary and Turkey) presented no restrictions to travel agencies and tour operators staff mobility. 7 other countries include Hong Kong, Indonesia, Macau, Myanmar, Costa Rica, Senegal and Malta offered no commitments whereas 4 other countries (Dominican Republic, Nicaragua, Morocco an Tunisia) allow personnel movement with no national treatment commitment.

■ Tourist guides: This sub-sector appears as the most protected of TTRS services since many countries fixing commitments in TTRS offered commitments in this sub-sector. The most protective countries being from the Caribbean (over 15), Latin America and Africa (over 14), EAP (over 10), all 4 South Asian countries, and 5 transition-economy countries from Central/Eastern Europe.

- Cross-border and consumption abroad: This service is not relevant to both cross-border and consumption abroad thus almost no country presented a specific restriction with most countries declaring themselves "unbound" or "unbound for lack of technical feasibility".
- Commercial presence and movement of natural persons: Most restricting countries reserve the right to exercise the profession of guide to their citizens in the continuance of which they use various types of measures such as citizenship/residency requirement and licensing, in combination with

personnel movement restrictive measures permitting entry to managers and expert intracorporate transferees only. Korea reserves the right to exercise the tourist guide to their citizens but they restrict the service by using outright prohibition measures on tourist guides.

- Computer Reservation Systems: 37 commitments are presented in CRS and only Turkey did not present any market access/national treatment limitations affecting any of the four modes of supply, or any exemptions.
  - Cross-border supply: None of the European member countries restrict market access but do not guarantee equality in national treatment either. This restrictions deals with CRS's controlled by an air carrier of one or more third countries, in which case no commitment ("unbound") is entered with respect to the obligation of the parent or participating carriers. One third of the countries, mainly in the Americas and EAP, presented no restrictions to cross border supply of CRS services. 5 developing and transition-economy countries declared themselves "unbound".
  - Consumption abroad: This appears as the least restricted mode of supply since only two countries (Chile and Thailand) declared themselves "unbound", with all the other countries presenting no restrictions.
  - Commercial presence: 46.2 per cent of participating countries declared restrictions not to market access but to national treatment using same restrictive measures as cross-border supply. Over one-quarter of signatories, mainly in developing and transition-economy countries, presented no limitations, the harshest restrictions ("unbound") coming ironically from developing or emerging-economy countries.
  - Presence of natural persons: this appears as the mode of supply most restricted by GATS signatories. 36 countries announced limitations except for Turkey. 19 countries restrict CRS staff entry to those involved with managerial/specialist tasks, and 11 more add to this limitation restrictions on practice reserving market access to their nationals. Honduras is only country to present "unbound" commitment.

Table 5.8 CRS commitments under GATS

Regions	CRS Commitments	MFN Exemptions
Africa	2	0
Americas	8	0
Europe	22	6
East Asia/Pacific	5	1
Total	37	7

Source: World Tourism Organisation, 1995[a].

It is important to note that an obvious difference between the TTRS sub-sectors and CRS services is that almost no MFN exemption was filed by the contracting parties for TTRS sub-sectors whereas 7 countries, including EFTA countries (Austria, Iceland, Liechtenstein, Norway, Sweden, Switzerland) and Korea, specified such an exception for CRS services. According to the WTO (1995[a]), Korea restricts access to foreign CRS through SITA network to domestic travel agencies which want to access CRS designated by carriers of the United States. The duration of the exemption is indefinite and justified by the following conditions:

"Access to foreign CRS through the SITA network could be limited or otherwise affected by negotiations on granting or receiving traffic rights" (Limam, 1995, pp.59).

Consequently, tourism is one of the most liberalised service sectors with commitments presented by most member countries, including Korea. Although Korea has restrictions in trade (including restrictions for CRS and personnel movement) as mentioned earlier, tourism and travel-related services are one of the most liberalised service sectors in specific commitments under the GATS (see Appendix E). As discussed earlier, commercial presence and personnel movement are mostly affected by restrictive measures and cross-border appears to be the most important mode of supply to CRS and travel agencies. All of these factors prove that four different modes of supply play different roles in different tourism-related sectors under GATS.

5.4.2 IMPACTS OF GATS ON TOURISM

The important question about GATS is whether or not it can help to re-address imbalances that exist in international trade. The issue includes monopoly and imperfect markets, balance of payments, and imbalances between tourism generating and receiving countries. Travel and tourism as one of the major industries in services, means that it is important to eliminate obstacles, including the issues mentioned above, to encourage balanced tourism development between member countries, which can be achieved by GATS.

By creating new prospects for businesses and jobs, tourism had brought economic revival to many declining areas and had also fostered social and cultural integration by promoting encounters and dialogue between visitors and hosts. However, according to Frangialli (2001), it is society as a whole will be damaged from tourism development if it is not controlled in some way as the physical environment and host communities are already suffering from the anarchic development of certain sites or the unrestrained exploitation of certain destinations. Against a backdrop of international tourists expected to triple in number from 1995 to 2020 to 1.5 billion, according to WTO's own forecasts, the lack of proper management would bring unbearable pressure on the environment. It would also cause serious congestion on cities and sites, put pressure on facilities and services, and threaten local cultures and traditions. Through "encouraged but controlled liberalisation", GATS will enable the industry to plan its development and ruthlessly combat the abuses that it inevitably engenders. On the one hand, it sets out to minimise the negative impact of tourism on the environment, host communities and the cultural heritage. On the other, it sets out to maximise the potential benefits for the residents of the areas visited as well as for the private sector of both tourist-receiving and generating countries.

However, it is important for the Korean tourism industry to increase sector stability through the strengthening of domestic tourism, which will create conditions for balanced development. In Korea, the number of outbound tourists (KNTO accounted 6,084,476 in 2001) is larger than the number of visitor arrivals (KNTO accounted 5,147,204 in 2001), which create a deficit in tourism balance of payments (TBP) with tourism expenditures of US$ 6,887 million and tourism receipts of US$ 6,283 million (KNTO, 2002). Therefore, GATS would help the Korean tourism to improve its infrastructure and facilities by attracting more foreign investments and suppliers, which may encourage domestic tourism and provide a foundation for further tourism development in Korea.

The GATS will have positive and negative impacts simultaneously but the degree of its impacts will be varied from country to country and, more importantly, from developed countries to developing countries. With respect to the newly-industrialised countries, especially those in Asia, a common front was formed by Europe and the US in order to obtain liberalisation commitments that would be compatible with their economic expansion, especially in financial services. The developing countries, were particularly concerned that the negotiations should not turn into a north-south conflict, and requested that, for them to be able to endorse it, the framework agreement should include a set of regulations that would be sufficiently flexible to take into account their different stages of development. Many of the developing countries, especially India, considered that the main objective was to obtain degrees of liberalisation of labour-intensive sectors by the industrialised countries, especially by means of the removal of restrictions to the movement of labour. In theory, liberalisation and an open market certainly benefit a country but it is not always the case, especially for developing countries.

Many developing countries' economic structure is not as stable as those of developed countries and most of them have suffered from complicated political situations. Before applying GATS and focusing on liberalisation, the main issue for them is to make their market stable and firm enough to compete with developed countries. The main problem with developing countries is that they still have a strong protectionism against foreign companies, therefore if they accept completely open market without any intervention or protectionism from the government, small and medium sized domestic companies may find very difficult to compete with foreign companies. Countries have different levels of economic development, different structure of society, different political issues and different priorities. Therefore, the success of applying the GATS will differ from one country to another.

5.4.2.1 Benefits of GATS for Tourism

Travel and tourism in many countries has long supported the idea of a services agreement that is effective in terms of opening up new trade and investment opportunities, eliminating distortive practices that restrict competition and guaranteeing long-term stability in market access. GATS will benefit tourism in several ways. Since the overall objective of GATS is to encourage trade and economic growth, there will be more demand for tourism activities, through exhibitions, incentive and business travel, meetings and conventions. More trade in both goods and services means more movements of people and more business opportunities for the trade in tourism (WTO, 1996[a]). However, the benefit of GATS to tourism is mainly classified into three factors: the production of tourism services, the movement of people linked to these services and the global development of tourism.

Firstly, the key resources of any service business are the financial, human and intellectual capital, which are required to solve business problems, exploit opportunities and compete in the market place. Therefore, GATS can help to deploy those key resources by moving money, information and people across borders more efficiently and fairly.

Secondly, GATS is intended to facilitate the movement of people supplying services. Tourism services are also labour-intensive in the sense that the provision of such services often requires close personal contact between consumers and suppliers and the ability to move key personnel into and out of markets can be an essential element of business strategy for tourism enterprises with international operations. However, in reality, almost every country imposes visa and work permit restrictions, which can be an obstacle to operate effective trade in the tourism industry between member countries. The GATS agreement can be of use to tourism services because it provides a framework for negotiating temporary entry without intent to establish permanent residence of service personnel into the territory of other parties (Vellas and Bécherel, 1995).

Overall, GATS will contribute to the worldwide development of tourism. With a reduction of trade restrictions for tourism companies, tourism will grow and increasingly focus on quality. The tourism sector will benefit not only by allowing the major tour operators and hotel chains to expand their reach worldwide, but also by opening up competition to small-medium scale enterprises. Until now, they have suffered under large-scale companies and monopolies because they are not strong enough to overcome existing trade barriers. But, under GATS, a monopoly situation will be dealt with by the GATS rules and regulations. Furthermore, it will provide increased transparency to provide clear and detailed information on market conditions including access and operation in all services markets of GATS members. It will also eliminate government discrimination towards foreign service companies along with a dispute settlement mechanism to provide rights of compensation or retaliation in cases of violation of the national treatment principle. It is important to know that liberalisation in all other sectors, including business, communication, construction, finance services and etc, as well as TTRS will help tourism enterprises to do business better and quicker at lower cost. Other trade agreements such as GATT and TRIPS will help to reduce trade barriers towards tourism-related activities related merchandise and solve problems with trademarks that tourism services abound (WTO, 1996[a]).

The most recognised benefit of GATS is the increasing participation of developing countries in world services trade through the negotiation of specific market opening commitments, which will be discussed in detail later in this chapter.

5.4.2.2 Problems of GATS for Tourism

Although promoting trade liberalisation in services is the main objective of the GATS, the agreement has not yet changed the hotel industry because the industry was already fairly internationalised and liberalised. However, there are a few problems such as strong protectionism, particularly in developing countries. Many developing countries still maintain heavy restrictions on foreigners owning shares, properties or owning companies despite all these movement towards liberalisation in international trade. For example, India's post-independence economic policy combined a vigorous private sector with state planning and control, treating foreign investment as a necessary evil. Prior to 1991, foreign firms were allowed to enter the Indian market only if they possessed technology unavailable in India. Almost every aspect of production and marketing was tightly controlled, and many of the foreign companies that came to India eventually abandoned their projects. At the same time, foreign equity participation was limited to 40 percent, and foreign investors were saddled by numerous operating constraints. Foreign equity investments in excess of 51 percent, or those which fall outside the specified "high priority" areas, must be approved by the Foreign Investment Promotion Board (FIPB) and approved by a Cabinet Committee (India Finance and Investment Guide, 2002). In Korea, foreigners who come to work temporarily are not allowed to own any properties, they are only able to rent (Department of Finance in Korea, 1989). Another problem is work permits. The GATS has not covered work permits in the agreement. This seems even more important as an issue than visas. Many wealthy countries such as USA, UK and EU operate work permits unevenly. In other words, they operate differently to foreigners who came from wealthy countries or favoured trading partner countries (WTO, 1995[b]). It seems easier for them to get work permits than foreigners who came from poorer countries. A multilateral trade agreement like GATS should able to provide equal opportunities to foreigners to work between member countries. However, it will take a long time to settle because of political reasons. The fundamental questions about GATS are " will the GATS solve restriction and protectionism problems?" and "will trading liberalisation benefit developing countries?"

Apart from the problems relating to developing countries, classification problems are the central issues for TTRS sectors under GATS. Based on the GATS classification, only four sub-sectors have been identified in GATS sector as hotel and restaurant (including catering), tour operators and travel agencies, tour guides, and other. The World Tourism Organisation (WTO) argued that "the classification of tourism services for the purpose of GATS is a compromise result and a convention responding to the practical need of moving forward the presentation of commitments". Given the complexity, overlaps and linkages between services, their ideal classification is perhaps not possible at all, but classification problems for tourism and travel related services, regarding the airline, finance and CRS services cannot be ignored. Although those services are highly related to tourism, they are not included in tourism and travel related services. It is important to note that air transport services, which are of fundamental importance to the tourism sector, to a large extent fall outside the coverage of the GATS. In other words, the GATS classification system does not recognise the complexity and diversity of travel and tourism. However, according to Handchouz, *et al.* (1994), the definition of tourism services simply aim to clarify the situation and invite its comprehensive and imaginative interpretation which is important for tourism policy purposes. Instead of "tourism services" the GATS classification introduces the term "tourism and travel related services", i.e. services related to tourism and travel. By such wording, the term corresponds partly to the United Nations/WTO definition of tourism which is described as comprising "*the* *activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes*" (Handszuh, 1995).

The sub-sectors of tourism services in GATS are not entirely focused and in this form, they are probably insufficient for tourism policy-makers and services suppliers. Tourism sectors interact with other sectors such as business services, distribution services, recreational, cultural and sporting services and particularly, transport services. Only by comprehensive coverage of all commitment areas can policy-makers and operators be sure that tourism is completely included.

Finance services related to tourism

The concept of tourism services will vary according to the perspective and nature of the different agents involved in tourism but finance services cannot be separated from tourism. For consumers it is essential to be able to use whatever financial methods they can in a tourism destination. Most tourists use credit cards when travelling because it is much safer than carrying cash. In this respect, member countries need to agree on financial services and tourism and travel related services under GATS but since they are separate sectors some countries probably signed for tourism and travel related services but not for finance services. It is same with travel insurance which is classified as a sub-sector of financial services. However, classification issues are currently a major focus of work in Geneva (Sinclair, 2000). Decisions about how to classify services could affect the interpretation of existing commitments and definitely will shape how future commitments are made. In other words, it is important to emphasise the need for improvement on scheduling guidelines and classification of sectors in order to enhance the effectiveness of GATS with broad and general guidelines and procedures, towards (a) achieving deeper and broader liberalisation commitments, and (b) elaborating effective rules for trade in services.

Computer Reservation System (CRS)

The selling and marketing of air transport services and computer reservation services (CRS) are attributed to the air transport services sub-sector, not to the tourism sector. For the tourist consumer buying a tour it would be difficult to understand why its transport is non-tourism in the package. The same applies for the tour operator. CRS is applied only to air transport. Travel agencies also operate CRS that are used for booking destination services and their packaging for the consumer. Therefore, CRS should be classified as a tourism sub-sector.

Business services related to tourism

As the world moves toward globalisation, the role of marketing is very important in international trade. In tourism sectors, promotion and marketing is essential to build up a positive image of a country. However, these tourism market research and marketing activities are sub-sectors of business services rather than tourism and travel related services. When a country signs for TTRS but not for business services then the country is not allowed to do any tourism marketing and research activities.

5.4.2.3 Air Transport and GATS

According to UNCTAD, a developing county's tourism exports are hindered by the distance from the main tourist-generating centres, and the high air-fares caused by low air traffic density. Protectionist aviation policies, states the World Travel and Tourism Council (WTTC), severely constrain the development of tourism. According to a WTTC official, aviation protectionism pulls customers away from the whole travel and tourism chain – from hotels, resorts, car rentals, computer reservations systems, entertainment, cultural attractions and all the rest of our industry (Morrison, 1995). A recent WTTC report strongly promotes aviation liberalization, noting that, in most countries, the gross receipts from hotels and other tourist activities are substantially greater than those of the national airline, and the "leakage" of foreign exchange earnings is proportionately much less (WTO, 1998^b).

In spite of the fact that international air transport plays an important role in the movement of people for tourism and is central to many travel destinations and travel distribution networks, the implications of GATS for air transport has been limited. However, these could be broadened and progressively liberalised over time. International air transport is a sector where full inclusion is not possible due to the existence of an extensive and complex framework of multilateral agreements. Although the basic rules and principles of the GATS appear simple, its practical application and implications are unclear. The GATS agreement attempted to cover all the services sectors, but some important factors and sectors were not covered, especially for air transport sectors (Smithies, 1995).

The Annex on air transport services states that the agreement applies to measures affecting three types of services:

- Aircraft repair and maintenance services: undertaken when an aircraft or a part is withdrawn from service, as opposed to line maintenance.
- Selling and marketing of air transport services: freedom to sell and promote air services including all aspects of marketing, such as market research, advertising and distribution, which does not apply to the pricing of air transport services.
- CRS services: Computer Reservation Systems containing information about airline schedules, availability, fares and fare rules, through which reservations can be made or ticket issued.

The EU and 14 other countries have filed Article II exemptions for one or more of the three air transport services covered in the Annex, with most exemptions being filed for CRS and selling and marketing. In addition, 30 states and the EU made specific commitments on market access and national treatment in air transport sectors. Most of the limitations and exemptions filed for CRS and selling and marketing reflect the fact that more detailed trade arrangements or codes of conduct already govern these activities. By contrast, the GATS obligations are stated in general terms applicable to all kinds of services. The United States provided a reason for filing an exemption regarding CRS that the common policy and practice of exchanging rights, settling disputes, and applying laws and other measures pertaining to the operation of civil aircraft and air transportation differentially, with respect to the activities cited above, on the basis of mutual agreement and balanced exchanges of rights (Smithies, 1995). To this effect, GATS has few implications for the development of air transport which is more influenced by a range of multilateral and bilateral agreements, and are not related to the GATS agreement. This is particularly significant for developing countries as air transport plays a crucial role in the development of tourism. A lack of consistency between air transport and tourism policies can seriously reduce the potential development of developing countries' tourism sectors that are often heavily reliant on air transport for the movement of tourists.

5.4.3 THE IMPACTS OF GATS ON TOURISM SERVICES IN DEVELOPING COUNTRIES

In industrialised countries, decentralisation has resulted in development of tourism better adapted to the needs of the population of each region. In developing countries, tourism development programmes set up with the financial and technical help of international organisations have resulted in regional planning. This has reduced the financial burden on developing countries and increased the profitability of tourism infrastructures that have been created. Tourism contributes to the transfer of wealth from North to South and from the industrialised to the developing countries. International tourism for developing countries is undoubtedly paramount as a creator of jobs and the most readily exploitable source of foreign earnings to finance investments or reduce foreign debts. Tourism is already a strong component of the economy in many developing countries. It is significant to evaluate the features of international tourism and impact of international tourism in developing countries as well as tourism development policies. The main issue for developing countries is the liberalisation of international trade in services. The GATS was established to reduce trade barriers between countries and this agreement would bring changes in the tourism industry world-wide.

The tourism sector is already a major employer in developing countries, and the importance of tourism employment is increasing, due to the high growth of the sector relative to the domestic economy as a whole. UNCTAD notes that the tourism trade has traditionally been concentrated in developed countries, but the share of developing countries has been rising gradually, and now accounts for about one-third of the total. On the other hand, 49 countries are currently designated by the United Nations as "least developed countries" (LDCs). These 49 LDCs are enjoying a strong increase in tourist growth, but their share of international arrivals and tourism receipts remains very small, at 0.7 and 0.4 per cent, respectively. It is true that the situation differs between countries, and is heavily affected by political and economic instability as well as the availability of transport facilities. Considering the highly labour-intensive nature of tourism, developing and least developed countries would appear to have strong potential comparative advantage.

The obvious benefits of GATS to developing countries related to tourism development are as follows:

- Strengthening the domestic services capabilities of developing countries through access to technology on a commercial basis. The greater access to technology and know-how is the most beneficial features of joining GATS for many developing countries. In addition, it will help to reduce restrictions on market access to foreign companies because developing countries may realise that foreign companies bring advanced technology and information into the country.
- Improving the access of developing countries to distribution channels and information networks. In the tourism sector, the access to computerised information and reservation networks is essential, thus developing countries can easily access those facilities and services that managed and owned by industrialised countries. As noted by the World Tourism Organisation (1998[a]), adequate infrastructure must be in place and sufficiently maintained to support any intended tourism activities, both for domestic and international tourism. This most obviously includes airport facilities, port facilities road systems and telecommunications, as well as water supplies, electric power and sewage treatment facilities. Regarding actual tourism facilities, adequate consideration must be given to lodging and food, as well as local transportation. Developing countries also face significant cost and technical barriers to Global Distribution Systems (GDS) access: small airlines and tour operators find the booking fees of individual CRS prohibitively high, and the "back office systems" in developing countries are also often insufficiently developed. Grouping into associations could provide the necessary economies of scale for the CRS. Also, GDS could be developed on a national basis. Standardisation of electronic systems and interfaces could also reduce costs.
- Liberalising market access in sectors and modes of supply of export interest to

developing countries. This refers to the freedom to set out abroad no only key personnel but also regular personnel in places where developing countries are supplying tourism-related services (Vellas and Bécherel, 1995).

However, many developing countries reacted negatively to GATS during the early stages of negotiations, fearing a "foreign invasion" but GATS may help to strengthen the ability of developing countries to compete by attaching conditions to their market opening commitments and requesting the transfer of technology and expertise (WTO, 1996[a]).

India is a good example of negative reaction against GATS. In India, within the entire GATT and GATS agreements, the country was extremely cautious about presenting schedules of commitments on agriculture and tourism-related sectors. In addition, there was a communication gap between the WTO and Indian government regarding the exact meanings and terms of the agreements, which could happen to all member countries, particularly under GATS since the agreement is new and it is still in the process of development. India wanted to protect their own market by imposing restrictions on market access. However, although the country was not totally convinced that joining GATS would bring benefits to the nation's economy, the Indian government signed GATS to gain international recognition in political and economic terms (WTO, 1999[d]).

India signed 6 commitments, including tourism and travel-related sector out of 12 specific commitments, but the country has not signed for transport and recreation, culture and sporting sectors, which is similar to many other developing and least-developed member countries (WTO, 1998[f]). In all, India has made commitments in 33 activities, compared with an average of 23 for developing countries (GATT, 1994). These commitments generally bind India's existing policy framework, although in some cases, the applied policy may be more liberal than the binding commitments. India has listed some MFN exemptions under Article II of the GATS and reserves the right to offer more favorable treatment to some WTO members in communication, recreational and transport services. India further liberalised its commitments in basic telecommunication services in early 1998. India's commitment in commercial presence mode of supply for the sub-sectors "hotels and other lodging services" and "travel agency and tour operator services" as regards market access is local incorporation with a foreign equity ceiling of 51 per cent. Non-resident Indian investment is allowed up to 100 per cent and foreign equity holding above 51 per cent is also allowed subject to the clearance of the Foreign Investment Promotion Board (Chadha, 2000). Therefore, the GATS has essentially provided a binding which will attract a large amount of foreign investments. Since the liberalisation of the Indian economy in 1991, 78 proposals of foreign investment and foreign collaboration have been approved in the tourism sector up to July 1994, including proposals from Holiday Inn, Hyatt International, TGI Friday, Marriat, Avis Rent a Car and etc., thus there is a large potential for India to attract even greater foreign investment after joining GATS (Eapen, 1995). In fact, the Indian government is aware of the need to improve the provision of services, and that the investment requirement is beyond the means available to the government. Hence, the government is looking forward to private support (Mohan, 1996).

Furthermore, the least-developed countries were given an additional year to negotiate and present their first package of commitments as well as long-term process of consultations and negotiations to be carried out every five years. They are also the main ones to use the safeguard provisions of GATS, such as protecting the balance of payments, which will give advantages to both developing and least-developed countries in the long run. Countries have different levels of economic development, different structure of society, different political issues and different priorities. Therefore, the success of applying the GATS will be different from one country to another.

5.5 SUMMARY

Although the GATS provides for the total coverage of services, the focus on just "tourism and travel related services" in the GATS classification terminology unexpectedly narrows and even distorts a full view of the tourism sector, particularly in the eyes of tourism policy-makers. Whatever classification is adopted for conventional orderly purposes, it must not determine policy. It is true that making clear classification on TTRS is not easy because of linkages that tourism services have with other services but at least the GATS should not create any complications for member countries. Many economists and trade experts argued that GATS is yet to be completed to work effectively in services trade because of limited sectoral coverage, particularly for air transport and classification problems as explained earlier. Therefore, although the GATS is a very welcome multilateral trade agreement for services, particularly tourism, it needs to be developed further in the future.

Furthermore, the GATS excludes traffic rights and the supply of services directly related to the exercise of traffic rights such as routes, capacity, and pricing, the basic authorisation required to operate services to and from another country. International Civil Aviation Organisation (ICAO) and IATA already provides a balanced and broader multilateral environment between countries on the basis of fair and equal opportunity, thus the question is what GATS can offer to member countries that these organisations and other trade agreements cannot. The answer is simple and clear. The agreement provides the multilateral framework based on common rules embracing all trading activities to encourage liberalisation, but the immediate impact of the GATS for air transport is very limited. As mentioned earlier, one of GATS's objectives is to achieve progressive liberalisation over time, which leaves open the possibility that other issues could be added at a later date. At the same time, the airline industry will continue to restructure and develop commercial regulations and competition laws as regional integration, and the effects of growing competition and financial imperatives will play a determining role in the future.

At present, the multilateral trading system between countries has many problems so that it is important to build up a strong and credible multilateral framework of rules and disciplines in order to achieve integration of the world economy and make trading activities safe nationally and internationally. Therefore, the first step is to extend its members for the agreement. In the short term, the liberalisation of the GATS effect on tourism services directly depends on each country's response. However, it is too early to determine just how far each country is prepared to go and how many barriers will be left to future negotiations. Despite some weaknesses of the GATT and GATS, its strengths may help to recover from the current slowdown in world economic growth.

CHAPTER SIX:
TOURISM IN KOREA

6.1 INTRODUCTION

Over the past several years, the service sector has become a very important part in the economy and travel and tourism is one of the largest segments of the service industry in many countries, particularly in many developing countries. In a world of change, one constant over the last two decades has been the sustained growth of tourism as both an activity and an industry. By 1990, tourism was the world's third most important industry in terms of export earnings. Tourism has been remarkable in its resistance to adverse economic and political conditions (Cooper, *et al.*, 1993). As tourism has continued to grow over the last few decades, international trade in services has become an important issue in many countries, the world recognised the need of a carefully designed and efficient trade agreement in services industry. Therefore, it was inevitable that GATS would be introduced by the WTO. Many developing countries became members of GATS, but it is uncertain whether GATS will help these developing countries including South Korea and improve the trading environment for the tourism industry.

The demand for tourism is determined by exogenous variables which need not necessarily be factors directly related to tourism but may nonetheless influence the extent and form of demand for tourist activity. Tourism demand for the Asian region has increased over the last few years and it has become an important tourist destination in terms of its international tourism share. There is likely to be further increases into in the future. Moreover, most of the Asian countries, especially the Far East developing countries such as Korea, Taiwan, Thailand, etc. are influenced by various factors including socio-cultural, political, and economic factors in relation to the tourism industry.

The tourism industry in South Korea was a relatively late starter, but the government has attempted to develop the tourism sectors in order to harness economic growth for the country. The mega-events such as Seoul Olympic Games in 1988 and the World Cup in 2002 helped not only to build up the infrastructure but also to enhance the country's image abroad, and pave the way for developing relationships with other countries. At the same time, Korean outbound travel increased dramatically because the government liberalised Korean overseas travel in 1989, just one year after the Olympics. The purpose of this section is to investigate the current market situation of tourism in Korea and its future movement towards globalisation and liberalisation, particularly in relation to the implementation of GATS.

6.2 BACKGROUND TO KOREA

Korea concentrated more on developing manufacturing goods than services until recent years but the country realised the importance of services to the economy, especially tourism.

During the 1990s, the number of outbound tourists has greatly increased as have inbound tourists, as the economic conditions of some of the Asian countries flourished in the past decade because of the upturn, downturn and then revival. Tourism has been a significant source of foreign exchange earnings for South Korea. As tourism has become more welcome as a desirable and feasible means for promoting economic development, it has received increased attention from central and regional government. In 2000, foreign tourist receipts of US$ 6.6 billion contributed 2 %of the total GNP and 8.3 % of exports (KNTO, 2001[b]). However, it is important to identify the different factors that affect tourism in Korea, including history, culture and the economy in order to develop tourism even further.

6.2.1 LOCATION AND CLIMATE

Location Poised strategically in the northeastern part of the Asian continent, the Korean Peninsula thrusts in a southerly direction for about 1,000 kilometers. To the north are regions of China and Russia, while the Chinese mainland lies directly to the west. To the east, the peninsula faces the islands of Japan. The closest point from Korea to China is China's Shantung Peninsula which lies 190 kilometers. The closest point in Japan is the island of Honshu which lies in 180 kilometers from Korea's southern port of Busan. With its north-south elongation, Korea separates the Yellow Sea from the East Sea. The land boundary between China and Korea is largely formed by two rivers: the Amnokkang River (Yalu River in Chinese) and the Tumangang River (Tumen River in Chinese). The last 16 kilometers of the Tumangang River also serve as a boundary with Russia. The Amnokkang River flowing southwest empties into the Yellow Sea; the Tumangang River first flows northeast and then southeast, emptying into the East Sea (KNTC, 1994). Korea is one of the Pacific Rim Countries (Australia, British Columbia (Canada), California (USA), Chile, China, East Timor (Timor Timur), Hawaii (USA), Hong Kong, Indonesia, Japan, South Korea, Macau, Malaysia, Mexico, New Zealand, Pacific Northwest (USA), Peru, Phillippines, Singapore, Taiwan, Thailand and Vietnam).

The Peninsula, contiguous to the two continental powers of China and Russia and adjacent to oceanic Japan, long acted as a land bridge over which continental cultures were transmitted to Japan. The peninsular location brought not only the advantage of easy access to adjacent cultures but also the disadvantage of furnishing a target for aggressive neighbors. The area of Korea is 221,607 square kilometers (about 85,563 sq. miles). At present, the land is divided into two parts: the Republic of Korea (South Korea) and the People's Republic of Korea (North Korea). The administrative area of the Republic of Korea is 99,237 square kilometers or about 45 percent of the whole of Korea. South Korea is slightly larger than Hungary or Portugal, and a little smaller than Iceland.

Regional variations of Korea are greater than one might expect, partly because of topographical diversity and partly because of historical developments over a long period. From the early days of the Choson Dynasty (1392 - 1910) up to the year of 1896, Korea was divided into eight administrative provinces: Hamgyong-do, P'yongan-do, Hwanghae-do, Kyonggi-do, Kangwon-do, Ch'ungch'ong-do, Cholla-do, and Kyongsang-do. These eight provinces were subdivided into 13 provinces in 1896, and eight of the 13 provinces currently are in South Korea. After 1945, Chejudo Island became an independent province, and Busan, Daegu, Inch'on, Kwangju, and very recently the Daejon metropolitan areas took on a status equivalent to provinces directly under the central government. Seoul, the capital of South Korea, is the only special city, which is administratively higher than a province. Thus, the Republic of Korea is comprised of one special city, five metropolitan areas, and nine provinces. The nine provinces are subdivided into 55 cities (shi) and 138 counties (gun).

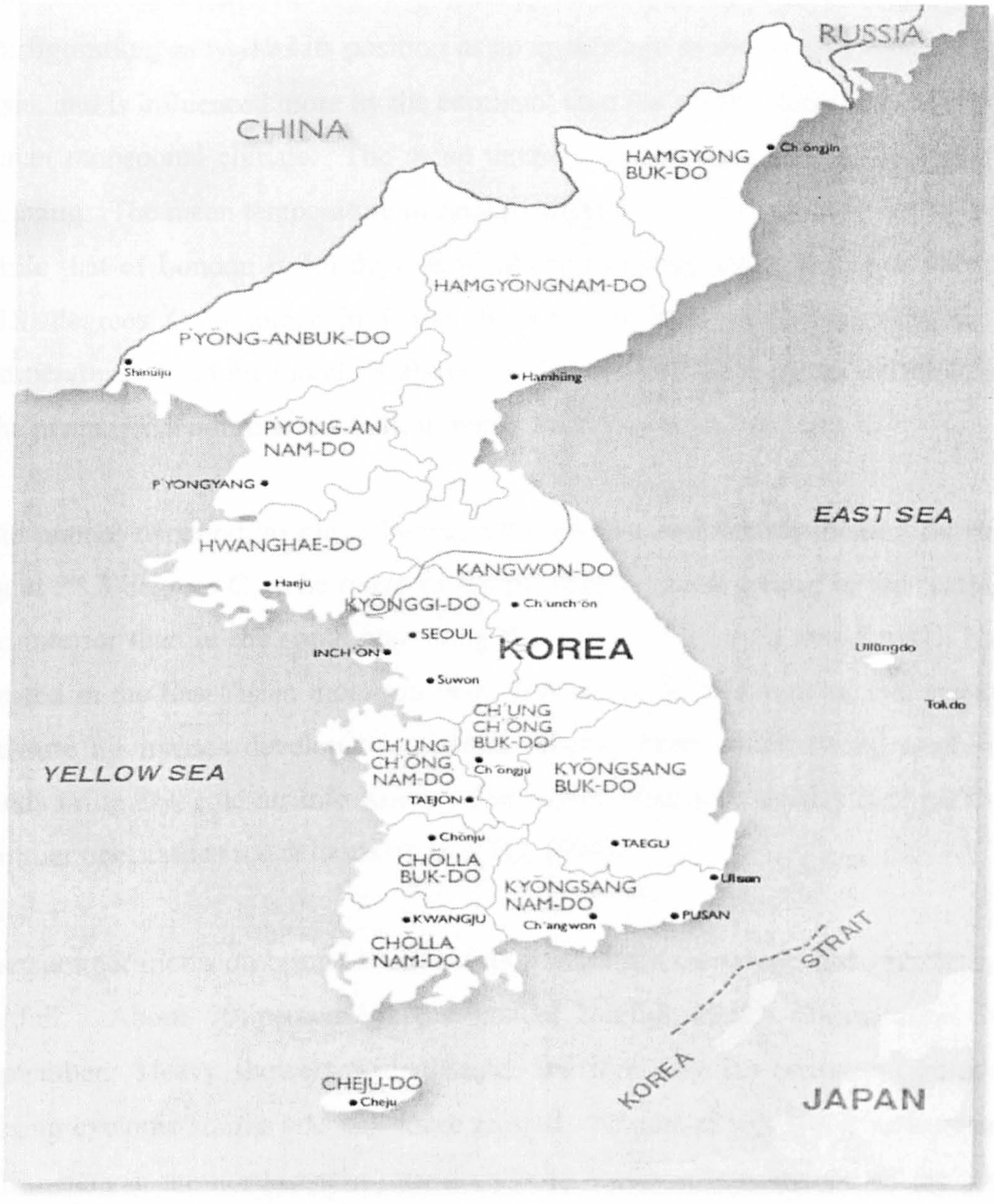


Figure 6.1 Map of Korea

Source: KNTO (2000)

Korea also may be divided into six larger traditional regions: Kwanbuk on the east and Kwanso on the west, now part of North Korea; Kiho, roughly the area of Kyonggi-do province, and a part of the Ch'ungch'ong-do province; Kwandong, a part of Kangwon-do province, east of the T'aebaek mountain range; Honam, the area comprising a part of the Ch'ungch'ong-do and all of the Cholla-do provinces; and Yongnam, the Kyongsang-do provinces. Minor differences are found in dialects and customs among the six traditional regions (KNTO, 2000).

The nature of Korea's climate is defined by its midlatitudinal location and peninsular configuration, as well as its position as an appendage to the world's largest continent, Asia, and is influenced more by the continent than the ocean. Korea has a humid, East Asian monsoonal climate. The mean temperature during winter is generally below freezing. The mean temperature in January in Seoul is 3.5 degrees C. below freezing, while that of London is 4.6 degrees C. above freezing, and that of San Francisco is 10.1 degrees C. Summer in Korea is hot. In most of the country, the mean temperature of hottest month is above 25 degrees C. except in the northern interior. The mean temperature of the hottest month for Seoul is 25.3 degrees C.

The annual temperature range between the coldest and hottest months for Seoul is about 28.3 degrees C. The range of temperature is much greater in the north and in the interior than in the south and along the coasts. Monsoon and Rainfall Korea is located in the East-Asian monsoon belt. During the winter months, continental high pressure air masses develop over inland Siberia, from which strong northwesterly winds bring dry, cold air into Korea. The winter monsoon, usually stronger than the summer one, causes much hardship (KNTC, 1994).

The summer monsoon brings abundant moisture from the ocean, and produces heavy rainfall. About 70 percent of the annual rainfall comes during June through September. Heavy showers with thunder and lightning are common. In addition, passing cyclonic storms add still more rainfall. Annual precipitation varies from 500 millimeters in the northeastern inland areas to 1,400 millimeters along the southern coast. The amount of rainfall decreases from the south to the north. The middle and upper parts of the river basins of the Somjingang River, Hangang River, and Ch'ongch'ongang River are areas of comparatively heavy rainfall, partly because of the convergence of wet airflows along the river valleys and the orographic uplift of the air flows. The southern coastal belt and the islands of Chejudo and Ullungdo also are heavy rainfall areas which receive about 1,400 to 1,500 millimeters annually.

The winter monsoon, which originates in the interior of the Asian continent, is dry and low in temperature. It produces little precipitation except for a few winter snowfalls. The winter months normally receive less than 10 percent of the total annual precipitation. Seoul receives about 126 millimeters of precipitation during the winter months, December to March, which is less than one third of the amount of rainfall for July -- 383 millimeters. There are great variations in precipitation from year to year. According to 178 years of precipitation records, the maximum annual precipitation in Seoul was 2,135, recorded in 1940; the minimum was 633.7 millimeters, in 1949. The statistics show that about once every eight years, annual precipitaion falls below the 1,000 millimeters mark, which is usually considered the minimum for rice cultivation where no irrigation is available. This explains why in the days of an insufficient irrigation system the Seoul area would have a rice crop failure once every eight years. Storms and Typhoons There are two types of storms which affect the climate of Korea. One originates in the Yangtze Valley and usually passes Korea in March and April and in the early part of summer, bringing abundant rainfall which is important for transplanting rice. The other type is the typhoon. Typhoons usually originate in the east Philippines, move toward the north and around Taiwan and shift direction mostly northeastward. The most common period for typhoons in Korea is July through August. The southern coast generally gets one or two mild typhoons a year, and a strong one every two or three years (Sangji University, 2001).

6.2.2 HISTORY AND CULTURE

Korea has been subject to warring tribes, warring neighbours, the brutal colonial rule, fratricidal war, division and division. South Korea lies on the southern half of the Korean peninsula, in East Asia. To the north are North Korea and China, to the northeast lies Russia and to the southeast are the islands of Japan. A distance of only 190 km to China and 180 km to the Japanese Island of Honshu has led to various political, economic and cultural links between South Korea and its neighbours. The area of Korea is 221,607 square kilometers (about 85,563 sq. miles). At present, the land is divided into two parts: the Republic of Korea and the People's Republic of Korea. The administrative area of the Republic of Korea is 99,237 square kilometers. At the end of 1999, the population of South Korea was estimated to be 46.85 million and North Korea 22.08 million with an annual growth rate of 0.92% (1998) and the urbanization ratio of 86.4% (1998). Average family size was about 3.3 persons (1998). Number of foreign residents was 55,016 in 1998 (KNTO, 2000).

The circumstances surrounding the Korean War and the colonial period are important to understand. In those times, Korea raised voluntary innovative movements to change the structures of politics, economics and society. On 15 August 1945, the Japanese surrended to UN and WW II was over. At the same time the Koreans were freed from Japanese occupation after 35 years. After independence, the United States and the Soviet Union partially occupied Korea. Military administrations were established in Korea. Thus, the national land and the nation were divided into two. The Chosun Democratic People's Republic was established in the north in 1948. On 25 June 1950, North Korea invaded the south. The Korean War ended with the establishment of a truce line in 1953. With deep discord in the Korean nation, the War caused huge numbers of casualties and property damage. After the Korean War, there were serious political disruptions during the reconstruction of each government. On 16 May 1961, a military revolution occurred in the south. Since then, South Korea has managed to establish eight different governments. The first six governments were based on military revolution but the last two governments were the civilian governments thus if the reforms continue with their success, the present president Kim's civilian government will set the precedent for what a clean and democratic government can and should accomplish in Korea (Song and Han, 1993).

Korea's rich culture is often described as being unique. An understanding of the culture of Northeast Asia is a prerequisite for any study or serious discussion of the country and its culture. The early influence of other Asian countries on Korea has been crucial. The early growth and development of the Korean people was not uniform, but was generally characterised by active contact, and sometimes struggle, with the Chinese. From the time the Korean people developed an agriculture society, centring around the cultivation of rice, their culture gradually became identified with that of China. Korea produced iron tools and weapons, and developed politically, economically, philosophically and culturally under strong Chinese influence. But an understanding of cultural exchange alone cannot fully explain the Korean culture. A proper understanding of the characteristics of the Korean people is essential, and these characteristics cannot be explained purely in the context of the nation's historical development (KNTO, 1994). The religions of Buddism and Confucianism have had an important cultural effect on society because Korean politics were based on Buddism between B.C.18 and A.D.1910.

6.2.3 ECONOMY

Korea's economy has shown outstanding performance despite unfavourable initial conditions for development, such as limited natural resources, a narrow domestic market, negligible domestic savings and a lack of development experience. Japan, Korea and Taiwan have mostly succeeded in promoting development of their economies in general and several advanced industries in particular and as a result, Korea is one of Pacific Rim economies. Since Korea launched its first five-year development plan in 1962, real GNP has expanded by an average of more than 8 % per year (Korea was a typical agricultural society before launching its first five-year development). As a result, Korea's GNP grew from $2.3 billion in 1962 to $443 billion in 1998, and per capita GNP increased from a meager $87 to $9,544, all at current prices. In addition, Korea's industrial structure has been drastically transformed. The manufacturing sector enlarged its share of the GNP from 14.3 % in 1962 to 32 % in 1997 before the financial crisis. Korea's commodity trade volume increased from $500 million to $166.0 billion at current prices, and the ratio of domestic savings to GNP grew from 3.3 % to 34 % during the same period. Since the mid-1980s, South Korea has been encouraging the transition from heavy to high-tech industries, such as the computer, semiconductor, communication and media industries. The government and private companies have invested much money in these industries. Despite these dynamic manufacturing activities, service industries have gradually increased in the 1990s, while manufacturing has slightly decreased, as shown in table 6.1. The South Korean economy may be dominated by service industries in the future.

Table 6.1 Industrial sector's share of gross domestic product (%)

	1966	1971	1976	1981	1986	1992	1995	1999
Tertiary	44.7	51	48.1	53.1	55.6	64.7	65.9	65.1
Secondary	20.5	23.2	28.4	31.3	32.6	27.7	25	23.8
Primary	34.8	26.8	23.5	15.6	11.5	7.6	9.1	11.1

Source: *The Bank of Korea* (2000)

The development Korea has experienced is even more remarkable in view of its record up until the early 1960s. For most of its long history, Korea had been economically backward. Few significant industries developed in Korea before its independence from Japan. Soon after that, the economy was devastated by the effects of the 1950-53 war, followed by a long period of recovery. Thus, as late as 1961, Korea suffered from many of the difficulties facing less developed countries today. In addition to extreme poverty, the population was growing by 3 % annually, and underemployment was pervasive (Kim, K., 1993).

However, the economic reform started from the late 1970s and increased economic growth. After 1980, the Korean economy recovered its vitality; from 1980 to 1991 GNP increased by 8.4 % annually. The sixth five-year plan (1987-1991) was revised in 1988 because economic performance during 1987, the first year of the five-year plan, far exceeded the original projection, and because political democratisation and the subsequent demand voiced by different segments of society made the adjustment of macroeconomic management and the priorities of economic policy inevitable. The sixth five-year plan was carried out successfully and Korea embarked on a new five-year plan, looking forward to the 21st century. In Korea, economic prosperity is not far off. This country is one of the best examples that economic development can be accomplished without sacrificing national defence or social stability. The country has grown rapidly but the ongoing region-wide Asian financial crisis, which began in 1997, has drastically affected Korea's economy. Prior to this crisis, the Republic of Korea's economic growth over the past 30 years was spectacular and the country was ranked as the 11th-largest economy in the world.

Table 6.2 Growing Asian economies

Country	Population (million)	GNP (billion US $)	Growth rate (%) (1985-1995)
Japan	125	3,924	3.6
China	1,175	581	6.5
Hong Kong	6	105	5.3
South Korea	48	338	8.1
Indonesia	187	137	4
Singapore	3	55	6.1

Source: EC, 1995.

In the last few years, Korean economic growth has decreased as the country has suffered from the financial crisis. In December 1997, Korea entered a severe financial crisis as foreign exchange reserves became inadequate to meet its short-term obligations and numerous private-sector conglomerates faced the possibility of bankruptcy. As of late October 1998, a far-reaching economic reform programme launched by the Korean government, in conjunction with assistance from the IMF, had stabilised the financial situation, and a financial and corporate restructuring program had begun. The fundamental causes of Korea's economic troubles can be traced to structural weaknesses and pervasive moral hazard from a lack of market discipline. The government immediately tried to tackle the situation and overcame the crisis far more quickly than expected. The GDP growth rate leapt a remarkable 10.9 % in 1999 from the -6.7 a year earlier. In 2000, the GDP growth boomed by another 8.8 % despite slowing considerably in the third and fourth quarters. In addition, while the immediate task of controlling the crisis may be over, the administration's economic policy mandate is to transform the fundamentals of Korean economy so that an open, transparent, and fully fledged market mechanism can operate to global standards. Ambitious reform plans have been launched to restructure all segments of the Korean economy. In many areas, the effort has exceeded expectations but the economic situation remained grim, with unemployment of 8 % and negative 7 % GDP growth. Reform of the large industrial/commercial corporations, whose excessive debt levels and non-market-based investments played a part in bringing about the financial crisis, will be central to Korea's full economic recovery (Ministry of Finance and Economy in Korea, 2001[b]).

Table 6.3 Major economic indicators of the financial sector in Korea.

	1997	2000
Foreign Exchange Reserves (US $ billion)	8.9	94.5
Number of Unemployed (thousand)	1,781	797
BIS Ratio in Banking Sector (%)	7.04	10.34
Debt to Equity Ratio in Manufacturing (%)	396.3	193.1
Number of Regulations (thousand)	11	0.5

Source: Ministry of Finance and Economy, Korea (2001[a])

Furthermore, the structure of the Korean economy has changed since the crisis as the global community is going through a paradigm shift from an industry and capital-led system to a knowledge-based economy. At a time when integration into a global economy is more crucial than ever, Korea is paying particular attention to establishing a knowledge-based economy suitable for the new millennium. A knowledge-based economy is focused on knowledge utilisation, namely further strengthening of R&D,

sustaining human resources development, and including advanced management techniques and systems (Bank of Korea, 1995).

The Korean government expects the industries such as logistics, information/telecommunication, and service among other relevant areas to be emerging Korea's leading industries for the future. Also included in Korea's high-growth industries of the future are technology-intensive areas such as material science, chemical, machinery and energy. However, this is not to suggest that Korea is lessening the current focus on manufacturing industries. In other words, the government views that the current leading industries, when mixed with the right cutting-edge industries, can be reborn as high value-added businesses. In a broader context, leading businesses of the future should be decided by the private sector, based on free market principles. The public sector will only be responsible for laying a solid foundation to guarantee fair and free competitions within the market (Ministry of Finance and Economy in Korea, 1998). Consequently, the Korean government has attempted to liberalise both manufacturing and service industries to stabilise the economy over the last few decades.

More importantly, the political conflicts between Korea and Japan influence the Korean economy and trade. The government applied heavy trade restrictions on Japanese goods due for political reasons. Korea and Japan remain geographically very close but distant neighbours in reality. The Korea -Japan relationship offers a classic case for mutual enmity, friction and suspicion between the two countries in spite of their close geographical proximity. Among the WTO member countries, Korea and Japan are practically the only two major trading nations that are not aligned with regional free trade area (FTA) arrangements.

However, Japan and Singapore have been negotiating a FTA arrangement, which has reached the final stage for its conclusion. Clearly, a long-term survival regime for Korea requires joining some FTA arrangements in view of Korea's fragile economic structure and steadily deteriorating international competitiveness. In June 2001, Korea's exports dropped 13.4 % compared with the corresponding figure of June 2000, a drop by the biggest margin in 26 months. Since Korea and Japan are each other's second largest trading partners, only behind the U.S., it is not difficult to see that the mutual benefits attributable to the FTA arrangement will be great. The Korean and Japanese economy are basically complementary, though they are competitive in some areas. The Korean and Japanese economy have reached a development plateau at which they can become best customers for each other. Recognising the potential benefits of a FTA agreement, Japan has taken the initiative of promoting a momentum for the Korea-Japan FTA agreement and both countries signed the agreement in 1998.

In recent years, both countries focused on two aspects: service trade, and the dynamic effects through division of labour and industrial cooperation. The service sector including travel, transport, construction, telecommunications, and finance usually has either no or very low tariffs and non-tariff barriers. In the service sector, enhanced integration of the market is expected to intensify competition between Japan and Korea, taking into account the fact that the similarities in cultural and social structures in both countries would contribute to market integration. The competitive environment would not only stimulate domestic firms but also attract foreign direct investment from third countries. The dynamic effects are expected to be the most important focus here. To truly integrate the markets, both countries need a taxation treaty, agreements on investment, mutual recognition of standards and certification, intellectual property rights, and standardisation of customs and clearance procedures and other trade facilitating measures. Promotion of foreign direct investment and efficiency improvement are positioned as the core effects. Though stereotype arguments have stressed competitive industrial structures such as shipbuilding, steel, petrochemicals, semiconductors, electronic appliances, telecom equipment, automobiles and many others, in reality there has been a certain degree of intra-industrial trade already. The FTA framework is expected to produce a more competitive environment for these industries, paving the way either to strategic alliances for more horizontal division of labour, or restructuring of the over-capacities based on market mechanisms. Industrial cooperation is stressed to enhance efficient technology transfer, joint R&D activities, and improvement of supporting and related service industries.

6.2.3.1 Domestic Economic Liberalisation

Korea has introduced various liberalising measures since the early 1980s together with its stabilisation efforts. Some of the most important sectors affecting the Korean economy need to be discussed in relation to economic liberalisation.

First, the Korean economy has suffered from serious sectoral imbalance and structural problems since the Korean War. In 1980s, the disorganised financial market started to play an important role in channelling private saving into the business sector. Due mainly to negative real interest rates in the organised financial sector and rapid inflation, financial dualism resulted in Korea. As a result, financial sector liberalisation efforts were initiated in recent years:

- Government-held shares of all nationwide commercial banks were privatised between 1981 and 1983. The Korean government can still influence these banks as the economy and politics are strongly related. However, privatisation was the first step to reduce government intervention and give banks more independence. Without ownership, government intervention in bank operations would become more visible to the public, and as a result, would also become more difficult. Most significantly, in 1982, the bank interest structure was made simple by unifying all bank loan rates into one, which included various preferential rates for policy loans. In addition, a prime rate system was introduced in 1984 for the first time in Korea. Banks were allowed within a limited range to charge different rates to their clients depending on their credit standing.
- Major interest rate deregulation was not introduced in the early 1980s, but a major interest rate reform was introduced in December 1988. Many policy makers in Korea were convinced that it was the most appropriate time for interest rate liberalisation, though they faced strong opposing forces, arguing that interest rates would be pushed up too high. There were various persuasive factors for the decision, including:
  - The Korean economy had achieved macroeconomic stability, and inflationary expectations were low.
  - National savings exceeded domestic investment. As a result, interest differentials between regulated rates and free market rates were substantially narrowed.

- There was strong pressure for capital inflow to check rising interest rates with the appreciating Korean currency and growing current account surplus.

- With regard to nonbank financial intermediaries (NBFIs), both entry barriers and operational restrictions were eliminated or reduced further in the 1980s. Some important nonbank financial intermediaries, such as short-term investment and finance companies, and mutual savings and finance companies, were allowed to be established in 1972 to help induce unorganised financial activities in the organised financial sector. These institutions were less restricted by government regulations regarding their internal operations or by regulation of interest rates. In fact, these institutions were allowed to pay higher interest rates to their deposit holders from the beginning. As a result, these institutions and their deposit base have been growing faster than bank deposits. Competition among financial institutions has been continuously promoted by allowing different institutions to engage in similar asset markets and by lowering entry barriers. Therefore, the growing number of foreign financial institutions is becoming a significant factor in Korea's financial market development and a new competitive stimulant (Sakong, 1993).

Second, the Korean government decided to change the nature of Korea's industrial policy in the early 1980s. A new law replaced the selective industrial promotion law in 1986, which made rationalisation of declining industries, such as electronics and petrochemicals, and support for technological upgrades possible. It supported the fact that the government should get involved in industry in cases of obvious market failure as one of the basic principles in economy.

Third, the public enterprise sector in Korea has played an important role in both qualitative and quantitative terms. The sector's importance in terms of its contribution to GDP generation is well recognised. Simultaneously, its strategic importance for the economy as a whole can be seen from its high linkage with the rest of the economy. Public sector's contribution has been substantial throughout the last several decades in the nation's overall fixed capital formation (as seen in table 6.4).

Table 6.4 Public enterprise share of gross domestic fixed capital formation, 1963-86

	1963 (%)	1970 (%)	1975 (%)	1980 (%)	1981 (%)	1986 (%)
Public enterprises	31.7	18.9	33.2	27.6	30.7	15.6
Government	9.5	19.1	11.6	7.0	n.a.	n.a.
Private enterprises	32.0	42.2	31.9	41.5	n.a.	n.a.
Individuals	26.8	19.8	23.2	23.9	n.a.	n.a.

n.a. = not available
Source: Sakong, 1987, p.28.

For these reasons, the economy as a whole can benefit by making the public enterprise sector efficient. According to Sakong (1987), a 5 % increase in the sector's efficiency could have contributed approximately 1.5 to 2 % to GNP in 1980. As the government realised the importance of the sector, they introduced major reforms for public enterprises in 1984. Privatisation has continued to be a government concern as the economic situation has changed. At the same time, remaining public enterprises have to be kept efficient. The key element of the reform was to give more autonomy to public enterprises and to introduce an *ex post* performance evaluation scheme with an accompanying incentive bonus system. More autonomy was provided by eliminating complicated governmental controls regarding budgeting, personnel, material purchase, and inspecting (Sakong, 1987).

Fourth, during the 1960s and 1970s, economic growth was such an overriding objective that the nation's macroeconomic policy was for the most part expansionary; therefore, persistent inflation was always a problem. The inflationary problem was dealt with mainly through various administrative controls. The temporary law for "price regulation" of 1961 served as the basis for administrative controls in the 1960s. According to this law, ceiling prices could be applied on important items, and remaining products became subject to administrative guidance. A more solid basis for controlling prices was provided by ratification of the Price Stabilisation Act of 1973. In addition, the Price Stabilisation and Fair Trade Act was introduced to deal with monopolistic practices as well as to monitor price rises of monopolistic items without prior government permission in 1976. However, this approach created a dualistic price system and largely distorted the distribution system. The economy suffered from administratively suppressed inflation and it became more serious in the late 1970s. The necessity for decontrol was widely recognised by many government organisations and economists. As a result, the Monopoly Regulation and Fair Trade Act was introduced to deal with monopolistic market structure and conduct in a more fundamental way and to promote fair competition in 1981. The most important objective of the law was to move away from direct intervention, instead promoting competition and dealing with monopolistic market practices on a fair trade basis. Import liberalisation and tariff reduction programs were also started in an effort to promote a more competitive environment (Sakong, 1993).

6.2.3.2 International Market Opening

Korea has been taking a gradual approach to opening markets and to external liberalisation. Since 1983, the process of external liberalisation has been more rapid as the government has accelerated the liberalisation of imports, foreign direct investment, current and capital account transactions, and the reduction of tariffs. Korea joined the GATT in 1967 and shifted to a new system of import permits. Under the new system, only import-limited or prohibited items and the restrictions on them were announced in advance; all other goods were allowed to be imported. This system was designed to gradually eliminate restricted import items from the list, but the system did not much improve the import liberalisation ratio (the number of goods that could be freely imported compared to the total number of goods) until 1980.

According to the Ministry of Trade and Industry in Korea (1993), the import liberalisation ratio was 58.5 % in 1967, but it was reduced to 49.1 % in 1975. More active import liberalisation was initiated in late 1977 when the balance of payments improved which helped to increase the import liberalisation ratio to 64.9 % in 1978 compared with the previous year of 52.7 % (as seen in table 6.5).

Table 6.5 Import liberalisation in Korea, 1977-1991.

Year	All items[a]	Items with automatic approval	Automatically approved items as a share of all items
1977	1,312	691	52.7
1978	1,097	712	64.9
1979	1,010	683	67.6
1980	1,020	693	68.6
1981	7,465	5,576	74.7
1982	7,560	5,791	76.6
1983	7,560	6,078	80.4
1984	7,915	6,712	84.8
1985	7,915	6,945	87.7
1986	7,915	7,245	91.5
1987	7,911	7,408	93.6
1988	10,241	9,694	94.7
1989	10,241	9,776	95.5
1990	10,274	9,898	96.3
1991	10,274	9,991	97.2

Note: [a] 1977-80 four-digit classification, 1981-1987 eight digit classification, and since 1988 based on the harmonised system.
Source: Ministry of Trade and Industry, Korea, 1993, p.19.

In 1979, the Korean government suspended their liberalisation plan due to the second oil shock and other unfavourable factors. However, liberalisation was resumed in 1981 as the economy started to recover yet Korea recorded a current account deficit of over $5 billion that year. The primary objective of import liberalisation at the time was to make the domestic economy more efficient and competitive. In order to minimise the impact of sudden import liberalisation, a preannounced schedule and an import surveillance system were implemented. However, the original preannounced schedule duration set at six months to one year, was to be quite short for appropriate adjustments. Therefore, various research institutes and independent researchers conducted a comprehensive competitiveness study regarding import-limited items, and based on the results of the study, the duration of the preannounced schedule was to be one to five years. This gave import-competing firms to adjust, either to improve their competitiveness or move into new businesses (Sakong, 1993).

The 1984-86 import liberalisation schedule was announced in 1984 and the schedule was extended to cover the period of 1986-89 in 1985. It is important to note that this schedule reflected bilateral trade disputes, particularly with the United States. At the same time, monopolistic and oligopolistic products were to be liberalised as soon as possible whereas small and medium sized company products were allowed a slower pace of liberalisation. Most agricultural items were not included in this schedule.

Agriculture is an important industry in Korea since one in three households are related to farming in one way to another. Having said that, Korean farmers are much poorer than many of their counterparts in other OECD member countries. Using historical perspective, over the 30 years from 1910-1945, Korea attempted to build economic stability by increasing productivity in agriculture and the primary sector after the Korean War and Japanese Invasion. However, if the government opens Korean market to foreign agricultural products, the prices for these products will fall dramatically, which will be a serious threat to Korean farmers. For example, China forced the Korean government to import a large amount of their potatoes in the early 1990s and the government began to import a small amount in 1995. At the same year, farmers who produced potatoes were badly affected with lower market prices and many changed their occupation. Therefore, trade liberalisation is complicated and a sensitive issue for the agriculture industry in Korea. On the other hand, the speed of import liberalisation was accelerated when the nation started to generate a balance of payments surplus (Noland, 1990). In fact, the Korean government decided to liberalise all manufactured imports because the country was under strong external pressure from its major trading partners and was having difficulty in managing domestic liquidity.

In conjunction with import liberalisation, a tariff reduction program was introduced in Korea based on the preannounced schedule and five-year tariff reduction programs announced in both 1983 and 1988. Regulations on foreign exchange transactions were also gradually introduced, accelerating from 1986, when the country recorded a balance of payments surplus. Market liberalisation for services was introduced and joining GATS will help the country to boost liberalisation in services. The government made a detailed timetable to help the market to get ready for international exposure considering the market was in infant stage of development. Although Korea has attempted to liberalise the market for both goods and services like many other developing countries, they still apply some kind of protectionism to international trade. In fact, possible negative effects of full liberalisation on the domestic economy may cause the government to hesitate to remove trade barriers completely.

6.2.4 FINANCIAL CRISIS IN KOREA

Prior to the Asian economic crisis that began in 1997, the Korean economy experienced high growth, low unemployment, and relatively moderate inflation. However, in terms of its external balances, there were signs indicating a number of serious problems. The most notable was the rapid rise of the trade deficit in the 1990s. The trade deficit reached more than 10 billion dollars in 1995, and peaked at more than 20 billion dollars in 1996. While Korea had lowered its border trade measures considerably by the 1990s, much of the increase in Korean imports in 1995 and 1996 may be attributed to the rapid increase in foreign capital inflows, which increased the value of the Korean currency won.

At the end of 1997, Korea experienced the worst economic crisis since the Korean War. As foreign debt holders refused to renew the short-term borrowing of Korean firms and banks, and withdrew their funds, Korea's foreign exchange reserves were rapidly decreasing. As a result of the capital flight, the value of the won swiftly depreciated, from 965.10 won per dollar at the end of October 1997 to a low of 1964.80 won in December 1997. At the urgent request of the Korean government, the International Monetary Fund (IMF) agreed to provide a stand-by arrangement, supplying immediately needed liquidity to the foreign exchange market in Korea.

From the beginning of the crisis and throughout much of 1998, the Korean economy experienced a serious downturn in all aspects. Real GDP fell by 6.7% in 1998. The unemployment rate rose, reaching a high of 8.6% in February 1999 and more than one million Koreans were thrown into poverty. The difficult economic and social situation forced the authorities to quickly implement a wide range of macroeconomic and structural reforms, particularly in labour markets. The crisis made the government think and learn carefully about future development and the importance of maintaining economic growth. Future improvements in the Korean economy will have to rest on using resources more efficiently, rather than more intensively as was the case before the 1997 crisis. A more qualitative approach to the development strategy may be needed, particularly in labour market reforms, including encompassing an increased emphasis on enterprise training and a reduced labour market duality (OECD, 2000). Moreover, at the peak of the crisis, Korea's usable foreign exchange reserves were reduced to just 3.9 billion dollars. The crisis affected manufacturing, construction, and service, and caused private consumption to drop to its lowest level. Consequently, external trade volume also dramatically decreased. Table 6.6 shows the different economic situations between 1990 and 1999 in Korea.

Table 6.6 Major Korean Economic Indicators (1990-1999)

	Nominal GDP (US$ billion)	Real GDP Growth Rate	Gross National Income per capita (US dollars)	Unemployment Rate	Inflation Rate (Consumer Prices)	Won/dollar
1990	252.5	9.0	5,886	2.4	8.5	708.0
1995	489.4	8.9	10,823	2.0	4.5	771.0
1996	520.0	6.8	11,380	2.0	4.9	804.8
1997	476.6	5.0	10,307	2.6	4.5	951.1
1998	317.7	-6.7	6,742	6.8	7.5	1,398.9
1999	406.7[a]	10.7	8,581[a]	6.3	0.8	1,189.5

[a] Preliminary figures
Note: Unemployment rate and exchange rate are annual averages.
Source: derived from Bank of Korea, 2000.

The financial crisis placed a heavy burden on Korea's trade. In 1998, the value of Korean exports fell by 2.8%. Despite the massive currency depreciation of the Korean won, Korea's exports did not increase because of widespread recession in other Asian markets including Indonesia, Thailand and Japan, which accounted for a great share of Korea's total exports. Korean imports also fell by a surprising 35.5%, resulting in the highest trade surplus of 39 billion dollars in Korean history. This trade surplus indicated a weak economy rather than a strong one. In general, a nation is recognised as strong economy when they celebrate trade surplus by increasing exports rather than by decreasing sudden imports.

However, in late 1998, the Korean economy began to show signs of recovery as a result of the Korean government's efforts to stabilise the economy. Real GDP rose by 10.7% and the unemployment rate fell to 4.8% in 1999. In addition, both Korean exports and imports recorded a considerable growth of 8.6% and 28.4% respectively, and resulted in a trade surplus of 23.9 billion dollars (as seen in table 6.7).

Table 6.7 Changes in Korean Trade (US$ million)

	Exports	Growth rate (%)	Imports	Growth rate (%)	Trade balance	Current account
1990	65,016	4.2	69,844	13.6	-4,828	-2,003
1995	125,058	30.3	135,119	32.0	-10,061	-8,508
1996	129,715	3.7	150,339	11.3	-20,624	-23,005
1997	136,164	5.0	144,616	-3.8	-8,452	-8,167
1998	132,313	-2.8	93,282	-35.5	39,031	40,558
1999	143,685	8.6	119,752	28.4	23,933	25,000

Source: derived from Korea International Trade Association, 2000.

Korea continued to remove its barriers to both incoming and outgoing foreign investment throughout the 1990s. As a result, foreign investment into Korea increased significantly (by 90.4% in 1998 and 62.5% in 1999). Following the 1997 economic crisis, Korea actively removed nearly all of its barriers to incoming FDI as a part of the liberalisation. Such liberalisation was intended not only to attract foreign capital, but also to introduce greater world market competition and international management standards in the Korean economy (WTO, 2000[b]).

Overall, Korea has made impressive progress since the crisis in establishing a market-oriented framework and in achieving a strong economy recovery. However, this framework needs to be implemented effectively in order to restructure the corporate and financial sectors and ensure that the hard-won gains obtained as a result of the crisis and severe recession are not wasted. Although significant progress has been achieved, many problems need to be tackled in the long run. The economic statistics show that the country recovered from the crisis, but many Korean people are suffering unemployment and large debts. The amount of debts per household increased dramatically among medium and low class citizens. The government increased their budget to train the unemployed, but they need to change the structure of the economy and trade policies instead of looking for temporary solutions. In other words, the government financially and politically supported Korean multinational companies called "chebol" prior to the crisis, but it is time to focus more on medium and small companies. The nation's economy is unstable because only a few large companies seem to control the whole economy and many SMEs depend on these large companies.

According to Booze (1997), corporate restructuring should be stepped up, in part through allowing non-viable firms to exit. It is important to ensure that the exit mechanism functions properly, so as to avoid having non-viable companies continue to absorb resources at the expense of their competitors and thereby reducing potential growth. Moreover, progress in restructuring would not only improve the prospects for an early economic recovery, but would also reduce Korea's vulnerability to crisis and enhance the long-term growth potential.

6.2.5 THE ASIAN FINANCIAL CRISIS AND TOURISM

The Asian financial crisis has affected the tourism industry in many different ways since 1997. The obvious factor is a depreciation of different currencies in the Asia region, including Korea, Indonesia and Thailand, which had a large impact on prices of travel expenses. Travel expenses including airfares have decreased significantly during the crisis.

The reasons for reducing airfares is not only because of the financial crisis but also because of other factors in the region at that time:

- Many tourists tend to have negative perceptions of visiting tourist destinations in Asia due to the instability of economic and political situations in the area.
- The outbound market in Asian region has decreased in size because of the financial crisis. People in many Asian countries are suffering either a reduced income or joblessness, thus it is difficult for them to consider domestic or international holidays.
- The number of tourists visiting Hong Kong has reduced after the handover to China. Hong Kong was one of the Commonwealth countries and it was controlled by the British government for 100 years, but it had to be returned to China on 1 July 1997. Because China is a centrally controlled country, most outside viewers are concerned about the situations in terms of their economy and politics, which could have a negative impact in tourism industry (WTO/OMT, 1998[c]).

According to the World Tourism Organisation, the number of arrivals to the Asia and Pacific regions rapidly reduced in 1997. In fact, the growth of tourist arrivals was estimated as 9.7% from 1995 to 1996, but the growth was less than 1% from 1996 to 1997. However, the competitiveness of hotel prices is the main tool for many Asian countries to attract more tourists into the region. In recent years, several international tour operators have demanded lower prices for package products in Asian destinations. For example, due to the high competition, the Amari group offers tour operators US$40 on the first night and free for the second night and the Hilton Sarawak offers less than US$50 per night in Thailand, which are a lot less than the international price standards. From the end of 1999, tourism industry started to recover in different destinations in Asia. An increased number of European tourists want to spend their holiday in South East Asia and the World Tourism Organisation forecasts that long-distance visitors to East Asia and Pacific region will continuously increase in the next few years as shown in table 6.8. European tourists dominate the tourism market in East Asia and Pacific area that estimate the growth of 15% followed by 12.5% from Americas, and its growth will continue to increase as the value of Asian currencies decreases.

Table 6.8 The annual growth of long-haul to East Asia and Pacific (%)

Long-haul	96/95	97/96	98/97*	99/98*	00/99*	Average growth 1995-2000
Africa	7.6	9.5	11.9	4.7	4.7	7.62
Americas	7.2	3.2	12.5	6.0	6.0	6.94
Europe	9.1	11.7	15.0	7.0	7.0	9.91
Middle East	5.2	5.6	7.4	2.9	2.9	4.82
South Asia	6.2	7.1	9.0	3.6	3.6	5.88

*: Forecasting figures
Source: WTO/OMT, 1998[b], p.103.

6.2.5.1 Domestic Travel and the Outbound Market in the Asia Region

Asian people were shocked by the financial crisis because they did not predict it and they were used to their countries being recognised as able to achieve the fastest economic growth and development. People in Asian countries, particularly Indonesia, Thailand, and Korea, on average lost one third of their property as well as losing jobs and suffering bankruptcy. In other words, people were psychologically affected and encouraged to spend less and to reduce leisure time, especially travel abroad.

Although the outbound market in East Asia and Pacific is not optimistic in the near future, many international tourism institutes predict growth for long-distance travel of at least 2% every year. Those countries which suffered the financial crisis achieved strong recovery in both domestic and international tourism by stabilisation of foreign exchange between 1999 and 2000.

Table 6.9 The growth of outbound market (%)

Outbound	96/95	97/96	98/97*	99/98*	00/99*	Average Growth 1995-2000
EAP-EAP	9.9	-2.2	0	7.0	9.0	4.61
EAP-Long Haul	6.4	-2.2	-2.0	4.0	5.0	2.18

*: Forecasting figures
Source: derived from WTO/OMT, 1998[a].

The Asian financial crisis has been recognised as an obstacle to development in various industries, particularly financial, banking and investment industries, but it can be turned into a positive factor to boost tourism industry in many Asian countries. Although tourism is an industry that suffered seriously from the crisis, particularly for restaurants and travel agents, it is one of the important sectors that needs to be developed as tourism grows rapidly in global terms.

On the other hand, the most significant impact of the crisis was a loss of confidence by the EAP countries. It is clear that many EAP countries, including Thailand, Indonesia, and Korea, lost confidence in themselves regarding international competition and maintaining high economic growth in the world economy, which can be a critical obstacle to fast recovery in the future. In addition, the Asian Financial crisis affects current trends in tourism for business tourists from the rest of the world into the region. As economic performance slowed down both export and import in the region, the number of business tourists have decreased between 1997 and 1999. The volume of foreign investment reduced in the EAP countries and potential foreign investors are reluctant to enter the markets due to economic and political complex. For example, the demonstrations and riots that took place by the majority workers in Indonesia during the crisis, created a bad image for the country among foreign tourists. Nevertheless, the World Tourism Organisation estimated that 24 million tourists were travelling abroad from the East Asia and Pacific region and there were approximately 78 million domestic tourists in the year 2000. In contrast, there will be more than 1 billion foreign tourists entering the region between 2001 and 2002.

However, tourism in Asia was concentrated as intra-regional tourism (neighbouring countries accounting for the largest shares of the markets), for instance, the largest group of tourist arrivals to Korea is Japan, China and other Asian countries, rather than Europe and the Americas, as shown in table 6.10. According to KNTO (2001[b]), it is time for developing countries in Asia to develop the tourism market even further. In order to achieve this, the countries need to focus on developing marketing skills and introducing new tourism products to tackle the European and American markets. In the short-term, the depreciation of their currency can be a major device to attract more foreign tourists by offering high-quality holidays at lower prices. Consequently, tourism is a key industry for many developing countries to improve their economic situation and the East Asia and Pacific (EAP) region certainly has potential for further growth in tourism.

Table 6.10 Number of tourist arrivals to EAP from different regions (000s)

Departure destinations	1995	1996	1997	1998	1999	2000	Average growth 1995-2000
Africa	381	410	449	502	526	550	7.62
Americas	5,628	6,035	7,007	7,427	7,427	7,873	6.94
EAP	60,695	66,704	65,203	65,203	69,767	76,046	4.61
Europe	9,359	10,209	11,404	13,115	14,033	15,015	9.91
Middle East	286	301	318	342	351	362	4.82
South Asia	1,261	1,339	1,434	1,563	1,619	1,678	5.88
Others	2,133	2,468	2,412	2,412	2,581	2,813	5.69
Domestic	62,828	69,172	67,615	67,615	72,348	78,859	4.65
Long-haul	16,915	18,294	19,833	22,529	23,956	25,478	8.54
Total	79,743	87,466	87,448	90,144	96,304	104,337	5.53

Source: WTO/OMT, 1998[a], p.117.

6.2.5.2 Korea's Tourism Strategy during the Financial Crisis

Most parts of Korean industry are striving to survive by making structural adjustments, and the tourism industry is no exception. However, tourism has been newly recognised as one of the best ways to overcome this economic crisis because it can attract foreign exchange, the lack of which was initially a main cause of the crisis. Tourism as an export industry was never really emphasised as much as it has been since the crisis. In the 1960s and 1970s when the Korean government was implementing National Economic Development Plans, the foreign currency earned from tourism was an important source of national development. In other words, the government knew at that time the importance of tourism and supported the tourism industry in many ways. Although the importance of tourism for earning foreign exchange decreased as other industrial sectors such as manufacturing and trade grew rapidly, it continued to grow by hosting mega-events mostly in the 1980s. In the early 1990s, the government made regulative policies for tourism, which were based on concerns that over-investment in hotels would incite Korean people to over-consumption, but this rendered tourism growth almost sluggish. Only a few new hotels opened in Seoul, and the VAT exemption was withdrawn for foreign tourists staying in hotels (KNTO, 1999).

Since the crisis, the value of tourism is under re-evaluation. For the new government, tourism promotion is an important strategy in the recovery plan to overcome Korea's economic difficulties. From 1998, the new government initiated several aggressive measures to promote inbound tourism. Firstly, the office in charge was promoted to ministerial level, from the Tourism Bureau to the Ministry of Culture and Tourism, which indicates a change in governmental attitude. Secondly, the government declared that Korea will no longer require a visa for Chinese travellers visiting Cheju Island, which KNTO is developing as a holiday destination in the Asia-Pacific region. At the same time, the Chinese government designated Korea as free-travel country for Korean tourists. For Japanese travellers, length of stay without visa was extended. Finally, in order to secure a reliable financial source for inbound tourism development, a US$ 20 departure tax is now levied for all Korean outbound travellers.

Furthermore, for the long-term development of Korea as a leading destination in the Northeast Asia region, the government is active in supporting South-North tourism trade through the so-called "sunshine policy", which aims to foster a peaceful atmosphere and cooperation between two parts of the peninsula. In fact, KNTO launched tourism promotion worldwide, as well as nationwide. Together with the promotional campaigns abroad, various campaigns were pushed forward such as Welcome to Korea, to enhance the awareness of tourism and to promote service standards for tourists, Tourism Watch which consists of 300 guards nationwide to report potential problems that might inconvenience tourists, a Tour Guides Contest, and Good Arts and Crafts Awards were all set up to enhance professionalism in tourism service. The development of tour products has also been active. A tourism fair was held to stimulate the development of tour products at the provincial government level. The de-militarised zone (DMZ), traditional markets, folk festivals, snow and skiing, etc., were featured, particularly Snow Fun festival and the Panmunjom tour serve as good examples of KNTO product development. Road signs, the tourist help phone service, and KNTO's existing information-providing services are now all being renovated (KNTO, 1999).

Those promotional campaigns and active endeavours have turned out to be successful. For the first time in Korean tourism history, the annual volume of foreign visitors passed four million in 1999. Although stimulated by the devaluated Korean Won, this four million milestone has special significance in today's shrivelled international tourism atmosphere caused by the depressed Asia economy and resulting flight reductions from Southeast Asia, North America and Europe. KNTO estimated 3.5 billion dollars of tourism surplus and continuous growth in tourist arrivals and tourism receipts are expected.

6.3 CURRENT TOURISM TRENDS IN KOREA

When speaking of the Far East, most people first think of China and Japan, rather than Korea. Korea, which was the last country in the region to open up to the West in the 19th century, is also the last to become a centre of international tourism. South Korea's emergence as an international tourism destination is a result of the 40 years of steady economic progress dating from the end of the Korean War until 1997, before the financial crisis. The country turned its attention to developing tourism industry as one of the economic resources, following decades of developing manufacturing. In 1962, South Korea hosted just over 15,000 international visitors, which was a small number of tourist arrivals even to an infant tourism industry. In the same year, the government formed the tourism organisation called Korea National Tourism Cooperation (KNTC) to boost tourism development in Korea (Ahn and Ahmed, 1994).

Table 6.11 Tourism Market in Korea (1983~1999) *( )=Growth (%)*

Year	Visitor Arrivals (Number)	Korean Departures (Number)	Tourism Receipts (US$ 000s)	Tourism Expenditure (US$ 000s)
1983	1,194,551 (4.3)	493,461 (-1.2)	596,245 (18.7)	554,401 (-12.1)
1984	1,297,318 (8.6)	493,108 (-0.1)	673,355 (12.9)	576,250 (3.8)
1985	1,426,045 (9.9)	484,155 (-1.8)	784, 312 (16.5)	605,973 (5.2)
1986	1,659,972 (16.4)	454,974 (-6.0)	1,547,502 (97.3)	612,969 (1.2)
1987	1,874,501 (12.9)	510,538 (12.2)	2,299,156 (48.6)	704, 201 (14.9)
1988	2,340,462 (24.9)	725,176 (42.0)	3,265,232 (42.0)	1,353,891 (92.3)
1989	2,728,054 (16.6)	1,213,112 (67.3)	3,556,279 (8.9)	2,601,532 (92.2)
1990	2,958,839 (8.5)	1,560,923 (28.7)	3,558,666 (0.1)	3,165,623 (21.7)
1991	3,196,340 (8.0)	1,856,018 (18.9)	3,426,416 (-3.7)	3,784,304 (19.5)
1992	3,231,081 (1.1)	2,043,299 (10.1)	3,271,524 (-4.5)	3,794,409 (0.3)
1993	3,331,226 (3.1)	2,419,930 (18.4)	3,474,640 (6.2)	3,258,907 (-14.1)
1994	3,580,024 (7.5)	3,154,326 (30.3)	3,806,051 (9.5)	4,088,081 (25.4)
1995	3,753,197 (4.8)	3,818,740 (21.1)	5,586,536 (46.8)	5,902,693 (44.4)
1996	3,683,779 (-1.8)	4,649,251 (21.7)	5,430,210 (-2.8)	6,962,847 (18.0)
1997	3,908,140 (6.1)	4,542,159 (-2.3)	5,115,963 (-5.8)	6,261,539 (-10.1)
1998	4,250,216 (8.8)	3,066,926 (-32.5)	6,865,400 (34.2)	2,640,300 (-57.8)
1999	4,659,785 (9.6)	4,341,546 (41.6)	6,801,900 (-0.9)	3,975,400 (50.6)

Source: derived from Korean National Tourism Organisation (KNTO), 2001[a]

Korea's tourism industry has been growing by leaps and bounds over the last two decades. The number of foreign visitors increased from 239,000 in 1970 to 4.6 million in 1999. The development of Korea's tourism industry is a natural consequence of its phenomenal economic growth, but the specific allocation of resources has also been a vital factor. The government enacted a series of tourism promotion laws which resulted in an average growth rate of 6 % annually in tourist arrivals during the last decade. In addition, the nationality of tourists arriving in Korea has been shifting over the last two decades, from Americans to Asians. In 1970, Americans accounted for 32 % of inbound tourists, while Japanese formed the second largest group. By 2000, however, visitors from Japan comprised 46 % of the total, followed by visitors from North and South America, mainly the United States, at 11 %. In addition, following Korea's recent opening to Chinese citizens, visitors from China have been increasing steadily. Other Southeast Asian countries such as Hong Kong have also recorded growing numbers of visitors to Korea. Moreover, international visitor expenditure grew strongly at 19.5% per annum on average from US$ 3.3 billion in 1992 to peak at US$ 5.6 in 1995. Thereafter, the expenditure dropped to US$ 5.1 billion in 1998. During the peak years, an increasingly higher proportion of average international expenditure was spent on accommodation rather than shopping (KNTO, 2000).

The rapid growth in tourism brought increased activity in related sectors such as tour operations, facilities and sites, all boosting the demand for trained, multi-lingual personnel. To help meet such needs, more than 70 universities and colleges offer degrees and other qualifications in hotel administration and related tourist fields. Looking to a continuing expansion of tourism, there have been a number of plans and programmes to explore, develop and enlarge tourist resources and facilities in such areas as hotel accommodations, land, sea and air transportation, tourist services, national parks, museums, golf courses and casinos. Governmental financial help for tourism has been extensive and is expected to grow. Most tourism development and promotion projects are spearheaded by the Korea National Tourism Organisation (KNTO), which has several multi-million dollar projects under way both in the cities and provinces (Korean Overseas Information, 1993).

Furthermore, the WTTC conducted tourism satellite accounting research for Korean tourism in 2001 and the results were very positive, as shown in table 6.12. Travel and tourism was expected to generate US$ 55,346.9 million of economic activity in 2001, growing to US$ 163,402.0 million by 2011. Travel and tourism demand is expected to grow by 6.6% per annum, in real terms, between 2001 and 2011. In addition, the Travel and tourism industry was expected to contribute 2.2% to GDP in 2001 US$ 10,710.7 million, rising to US$ 25,814.0 million (2.1% of total) by 2011. Most importantly, in 2001, travel and tourism economy employment is estimated at 1,506,390 jobs or 7.0% of total employment, which is 1 in every 14.2 jobs. By 2011, this should grow to 1,717,140 jobs, 7.1% of total employment or 1 in every 14.0 jobs. The 420,005 T&T Industry jobs accounted for 2.0% of total employment in 2001 and are forecast to rise to 452,071 jobs or 1.9% of the total by 2011 (WTTC, 2001).

Table 6.12 WTTC TSA estimates and forecasts on Korean tourism

Republic of Korea	US$ Mn	2001 % of total	Growth[a]	US$ Mn	2011 % of total	Growth[b]
Personal travel and tourism	19,024.7	7.4	20.1	63,945.8	9.5	7.7
Business travel	4,049.4	.....	9.8	10,732.5	....	4.9
Government expenditures	11,048.6	2.5	6.8	21,879.6	2.6	2.1
Capital Investment	12,087.2	7.9	18.6	30,960.4	8.1	5.1
Visitor exports	8,422.6	3.8	8.7	17,053.6	2.2	2.6
Other exports	10,048.1	4.5	17.0	38,859.7	5.1	9.5
Travel and tourism demand	55,346.9	......	16.2	163,402.0	...	6.6
T&T industry GDP	10,710.7	2.2	9.9	25,814.0	2.1	4.4
T&T economy GDP	37,096.0	7.5	10.5	94,684.0	7.6	5.0
Republic of Korea	**Thousands**	**2001 % of total**	**Growth[a]**	**Thousands**	**2011 % of total**	**Growth[b]**
T&T industry employment	420.0	2.0	4.5	452.1	1.9	0.7
T&T economy employment	1,506.4	7.0	5.0	1,717.1	7.1	1.3

Notes: [a] 2000 Real Growth Adjusted for Inflation (%);
[b] 2001-2011 Annualized Real Growth Adjusted for Inflation (%)
Source: WTTC (web site), 2001.

Overall, the tourism industry has a bright future in Korea, but the government needs to concentrate more on appropriate and efficient tourism development in order to achieve continuous growth. With its scenic beauty and unique cultural and historical heritage, Korea has much to offer tourists. A peninsular country with four distinct seasons, the nation boasts picturesque valleys, mountains, rivers and beaches. Throughout the country, there are numerous ancient temples and shrines, royal palaces, sculptural images, pagodas, archaeological sites, fortresses, folk villages and museums. Most recently travel between South and North Korea was launched, and other sightseeing programs under co-sponsorship with the North Korean authorities are anticipated.

There have been massive projects to develop tourism resources and facilities such as accommodation, transportation, tourist services, national parks, museums, golf courses and casinos mainly by KNTO and the Ministry of Culture and Tourism. Increasing numbers of tourist guides, proficient in English, Japanese and other languages, are being trained and deployed.

6.3.1 KOREAN TOURISM IN THE WORLD

According to the World Tourism Organisation, world tourism grew by an estimated 7.4 % in the new millennium, which is the highest growth rate in nearly a decade and almost double the increase in 1999. Nearly 50 million more international trips were made in 2000, bringing the total number of international arrivals to a record 698 million. Moreover, receipts from international tourism climbed to US$ 476 billion, an increase of 4.5 % over the previous year. All regions of the world hosted more tourists in 2000, although the fastest developing area continued to be East Asia and Pacific with a growth rate of 14.5 % and some 14 million more tourists than 1999. Europe, which accounts for 58 % of international tourism, grew by an impressive 6.2 % to 403 million arrivals, nearly 25 million more trips than previous year. Despite the strong dollar, the US also welcomed millions more international tourists and achieved a growth rate of 8.7 %. The tourism industry in Middle East, however, suffered from the political complication between Israel and neighbouring countries, which virtually stopped the flow of tourists to the region. But, overall, the region managed to grow by more than 10 % and Egypt was a prime country to contribute to this growth by attracting nearly 15 % more tourists. Africa is the only region to be left out of the tourism boom in 2000. It managed to grow just 1.5 % in international arrivals, which is the poorest rate ever (WTO/OMT, 2001[a]).

In Asia, particular countries contribute to a large increase in international arrivals, as seen from table 6.13. East Asia/Pacific saw growth in tourist arrivals that were driven by big increases in China and its special administrative regions of Hong Kong and Macao. Southeast Asia, especially Thailand, Malaysia, Cambodia and Vietnam, is becoming one of the world's favourite tourism destinations with demand outstripping tourist facilities. In addition, Australia enjoyed its own tourism growth due to the Sydney Olympics and other methods of publicity.

Table 6.13 Top tourism destinations in Asia region

Top destinations	Arrivals in 2000	% Change
1. China	31,236,000	+ 15.5
2. Hong Kong	13,059,000	+ 15.3
3. Malaysia	10,000,000	+ 26.1
4. Thailand	9,574,000	+ 10.7
5. Singapore	7,003,000	+ 11.9
6. Macau	6,682,000	+ 32.3
7. Rep. Of Korea	5,336,000	+ 14.5
8. Indonesia	5,012,000	+ 6.0
9. Australia	4,882,000	+ 9.5
10. Japan	4,758,000	+ 7.2

Source: derived from World Tourism Organisation, 2001.

South Korea welcomed 5,336,000 tourists in 2000 and achieved a growth rate of an impressive 14.5 % compared with the previous year. Although Korea was suffering from the economic crisis, the nation managed a continuous increase in both the number of visitor arrivals and tourism receipts amongst Asian countries. However, Korea is still far from becoming one of the popular tourist destinations. It is obvious that foreign tourists, especially from Europe and Americas, are willing to visit other Asian countries such as Japan, China, rather than Korea. Due to its proximity, China, Japan, and Korea in Far East Asia could compete against or cooperate with each other to attract international tourists. These countries are better off in either case when they position themselves effectively. Positioning is an appropriate tourist products and marketing mix to have a specific position in actual and potential tourists' minds. Because tourists tend to prefer a destination with a unique image and want to explore different tourist products, China, Japan and Korea need to position themselves differently to become more competitive destinations in East Asia (Pyo, 1998).

6.3.2 THE INBOUND MARKET IN KOREA

The significant economic importance of international inbound tourism had not been fully recognised until the government attempted to hold the Seoul Olympics in 1988. Korean tourism surpassed 2.3 million annual foreign tourist arrivals, and foreign tourism receipts exceeded US$ 3.2 billion, which represents a growth of 24.9% and 42.0% over the previous year (Ministry of Transportation and KNTO, 1989). As discussed earlier in this chapter, it is certain that foreign tourism is significant to the Korean economy in providing foreign exchange earnings. International inbound tourism to South Korea continued to increase by an annual average of 16.6% for tourist arrivals and 8.9 % for tourism receipts after the Olympics. The growth of Korea's inbound tourism is expected to continue, since several well-recognised mega-events enhanced the attractiveness of Korean tourism.

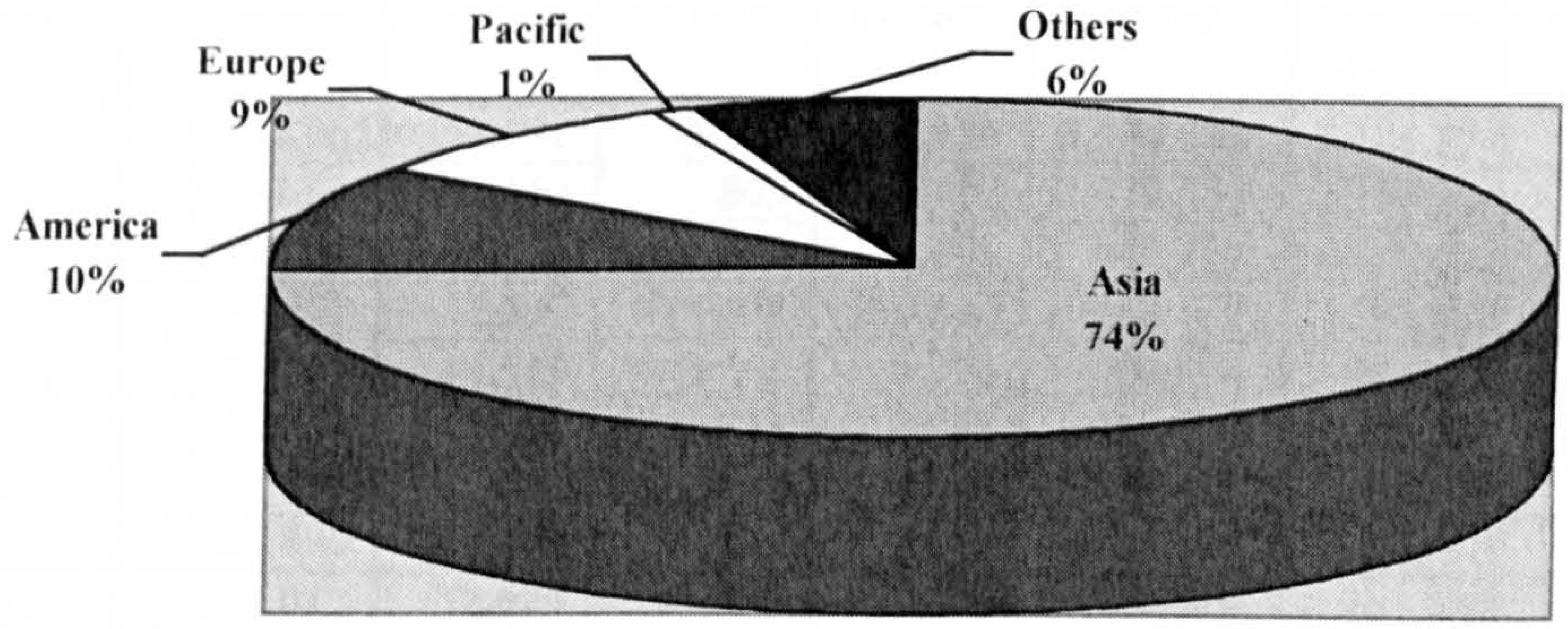


Figure 6.2 Visitor arrivals by different regions

Source: derived from KNTO, 2000.

The dominance of Japanese tourists in the Korean inbound market is largely attributable to Japan's proximity, appreciation of the yen against the US dollar, the excess foreign exchange holding, the Japanese project of generating 10 million outbound tourists annually cultural similarity between two countries and accessibility. Some of the largest tourist-generation countries such as Canada, the United Kingdom and Germany represent only about 3.2% of the Korean inbound tourism market, but they are still important in terms of market diversification. The European market to Korea consists of 8.5% of the Korean inbound market tourism in 2000 in which the United Kingdom accounts for 13% of the European market, followed by Germany with 12% of the market. However, one of the important markets to Korean inbound tourism in Europe appears to be Russia, but the reason for a large number of Russian tourists visiting Korea is not as simple as it seems. In recent years, many Russians entered South Korea with a temporary tourist visa to find a job, which is illegal and cause many social problems in South Korea. The number of Russians who want to work in Korea increases every year and they have been classified as genuine tourists for the national tourism statistics. Therefore, it is difficult to identify Russia as one of the major inbound markets amongst European countries to Korea.

Table 6.14 Visitor arrivals by nationality and purpose of visit, Jan-Dec 2000

Nationality	Pleasure	Business	Official	Others	Total	Jan-Dec 1999	Growth (%)	(%) of Total
Asia	**3,184,062**	**118,036**	**4,631**	**678,159**	**3,984,888**	**3,446,177**	**15.6**	**74.9**
Japan	2,381,619	40,164	809	49,462	2,472,054	2,184,121	13.2	46.5
China	194,266	48,714	1,215	198,599	442,794	316,639	39.8	8.3
Philippine	35,212	2,503	408	210,614	248,737	198,583	25.3	4.7
Hong Kong	194,160	519	2	6,193	200,874	234,087	-14.2	3.8
Taiwan	116,519	451	203	9,947	127,120	110,563	15.0	2.4
Thailand	57,796	227	263	29,599	87,885	63,679	38.0	1.7
Others	204,490	25,458	1,731	173,745	405,424	338,505	19.8	7.6
Americas	**395,012**	**32,279**	**23,656**	**83,572**	**534,519**	**463,937**	**15.2**	**10.0**
U.S.	335,936	30,933	23,443	68,305	458,617	396,286	15.7	8.6
Canada	44,089	783	47	11,385	56,304	50,678	11.1	1.1
Brazil	3,920	203	3	366	4,492	3,748	19.9	0.1
Mexico	3,346	95	15	997	4,453	3,604	23.6	0.1
Others	7721	265	148	2,519	10,653	9,621	10.7	0.2
Europe	**246,261**	**15,074**	**1,118**	**190,025**	**452,478**	**385,511**	**17.4**	**8.5**
Russia	47,576	4,597	293	102,926	155,392	127,892	21.5	2.9
U.K.	49,261	1,957	42	6,635	57,895	53,902	7.4	1.1
Germany	37,556	2,257	142	11,138	51,093	47,318	8.0	1.0
France	24,792	2,847	353	5,999	33,991	29,424	15.5	0.6
Others	87,076	3,416	288	63,327	154,107	126,975	21.4	2.9
Pacific	**41,390**	**2,352**	**225**	**10,100**	**54,067**	**44,464**	**21.6**	**1.0**
Australia	32,034	2,216	183	5,181	39,614	33,378	18.7	0.7
New Zealand	8,582	126	13	1,169	9,890	8,390	17.9	0.2
Others	774	10	29	3,750	4,563	2,696	69.3	0.1
Africa	**7,756**	**5,404**	**155**	**5,002**	**18,317**	**18,669**	**-1.9**	**0.4**
South Africa	1,975	195	6	1,937	4,113	3,987	3.2	0.1
Egypt	1,008	652	9	1,560	3,229	3,081	4.8	0.1
Others	4,773	4,557	140	1,505	10,975	11,601	-5.7	0.2
Korean residents overseas	–	–	–	**277,523**	**277,523**	**301,027**	**-7.8**	**5.2**
Total	**3,874,481**	**173,145**	**29,785**	**1,244,381**	**5,321,792**	**4,659,785**	**14.2**	**100.0**
Growth (%)	**12.2**	**10.4**	**0.3**	**22.1**	**14.2**	–	–	–
(%) of total	**72.8**	**3.3**	**0.6**	**23.4**	**100.0**	–	–	–

Source: derived from KNTO, 2001[a].

Strong promotional efforts have been made by the KNTO in order to attract the European market, which is regarded as one of the highest potential markets. The direct air services between South Korea and Europe by Korean Air, Air France, Lufthansa, KLM, Swiss Air, ad British Airways will continue facilitating growth in this potential market. In addition, as the Korean government pursued the export-driven economic policy, business travellers initially paved the way for the development of international inbound tourism (Lee, Var, and Blaine, 1996). Thus, business travellers were dominant in the early 1960s, but pleasure travellers began to surge from the early 1970s. The latter comprised 72.8% of the Korean inbound market in 2000, while business tourists accounted for 3.3%. At the same time, the convention market increases dramatically from later 1980s. In 1989, South Korea hosted 218 conventions and events with 107,168 attendants and it is continuously growing every year except during the financial crisis.

Nevertheless, although the Korean government has focused more on promoting Korean tourism in recent years, the figures for both tourist arrivals and tourism receipts have not increased as much as the government expected as seen from table 6.15. The growth rate for tourism receipts from 1998 to 1999 was unstable all year around due to the financial crisis, but the growth rate started to be steady as the nation's economy recovers from the serious recession in 2000. The figures represent a respectable growth rate from April and August, known as the peak season for Korean tourism.

Table 6.15 Tourism receipts in 2000

(US$ 1,000,000)

Month	2000	Growth (%)	AEPC US$	1999	Growth (%)	1998
January	478.9	-11.9	1,285	543.4	33.2	407.9
February	539.5	-3.4	1,265	558.5	-1.0	563.9
March	582.9	-5.8	1,316	619.1	8.2	572.2
April	559.3	12.5	1,290	497.2	-15.4	587.6
May	583.9	10.4	1,233	528.9	-9.4	583.9
June	629.0	21.6	1,406	517.3	-4.7	543.0
July	529.6	-11.1	1,162	596.0	8.1	551.5
August	605.3	10.3	1,359	548.8	-1.5	557.2
September	519.3	-12.3	1,132	592.1	0.1	591.6
October	532.1	-11.7	1,132	602.9	-5.2	636.3
November	564.2	-4.4	1,241	590.3	1.6	581.0
December	485.1	-20.1	1,126	607.4	-11.9	689.3
Total	**6,609.1**	**-2.8**	**1,244**	**6,801.9**	**-0.9**	**6,865.4**

AEPC: Average Expenditure Per Customer
Source: derived from KNTO, 2001[a].

A problem that has the potential to impede expansion of the Korean inbound market is the intense price competition that currently exists between Korean inbound travel agents as they have attempted to attract foreign tourists as a large group in certain countries, especially from the Chinese and Japanese markets. Travel products are sold on the basis of price not quality and tourists often find that the standard and location of hotels are different from that indicated on brochures. Many inbound operators have attempted to gain market share by competing on price alone, offering Korean wholesalers ground rates that are below cost. In fact, many inbound operators are forced to offer low prices for package products in Korea, especially to Chinese, Thailand, and Indonesia tourists. Even though many tourists from those countries show great interest in having a holiday abroad, they simply cannot afford to spend a large amount of their income on their holidays. Therefore, many Asian tourists are attracted by low prices, rather than the quality of the products. As a result, in an effort to claim back revenue, inbound operators have resorted to arrangements with duty free shops, restaurants and souvenir shops for large commissions, usually in the order of 30%. Inbound operators also charge high prices for optional tours and pressure hotel operators to offer large discounts in exchange for promises of continued business. These problems obviously lead to express a high level of dissatisfaction from foreign tourists about Korean tourism.

The optimum pattern of foreign tourists to Korea is to have a growing number of first time visitors, combined with a high percentage of repeat visitors, who are predominantly independent travellers. In order to achieve this pattern of travel, it is important to put considerable effort in tourism development and change the way of tourism operates:

- Increasing the number of Koreans who speak English, particularly people involved in tourism-related businesses.
- Recognising the particular cultural attributes of foreign tourists.
- Developing appropriate tourist services and products that suit the foreign tourist including itineraries that give tourists the opportunities to visit some of Korea's unique scenic areas.
- Enhancing the range of shopping opportunities available including improvements and developments of the variety and quality of unique Korean made products for souvenirs.
- Policy measures to prevent the excesses of inbound operators who attempted to gain business by undercharging and afterwards recovering losses by taking tourists only to businesses which pay high commissions to tour operators.
- Increasing the number of direct air services.
- Expanding funds and investment on various tourism researches to study the tourism trends in foreign markets and to discover their needs (Prideaux, 1999).

6.3.3 THE OUTBOUND MARKET IN KOREA

South Korea, long known as the outsider in international tourism because of its desire to remain isolated from the non-Korean world, has recently emerged as a significant tourist country in terms of both outbound and inbound travel. The country has grown to become the fourth largest source of travellers in Asia, just behind Hong Kong, as shown in table 6.16.

Table 6.16 Resident departures from major Asia Pacific source markets

Source	1990	1995	1996	1997	1998	1999
Hong Kong[a]	2,043,123	3,022,541	3,445,090	3,757,979	4,196,718	4,117,415
Japan[b]	10,997,431	15,298,461	16,700,272	16,799,613	15,805,809	16,696,050
Korea[b]	1,560,923	3,818,740	4,649,251	4,542,159	3,066,926	4,336,546
Taiwan[b]	2,942,316	5,188,658	5,713,535	6,151,932	5,912,383	6,558,663

[a] Figures exclude travel to China and Macau [b] Citizens
Source: derived from Travel Business Analyst (TBA) from national tourist offices (NTOs).

The outbound market in Korea used to be limited because of government restrictions on the age and spending levels of people travelling outside the country. As a result, until the early 1980s, the outbound travel market from Korea consisted mainly of workers leaving for the Middle East and the USA. In 1983, a process of liberalisation began, with citizens over the age of 50 being permitted to travel overseas for leisure purposes, which had only a minor effect on total outbound travel numbers and the share of leisure travel remained minimal. In addition, restrictions were gradually eased further and the age limit was reduced until in 1989, it was lifted altogether. From the relaxation of foreign travel restrictions on Korean citizens, Korean outbound travel grew rapidly, increasing by 526.6% between 1988 and 1995 (Prideaux, 1999). The government only allowed children less than 18 years old to travel abroad for study when their parents were studying themselves abroad or government workers before removing restrictions. However, applicants still had to wait six months before travelling abroad, although this represented an improvement on the previous period of 12 months, which had effectively made the age limit 46 (Bailey, 2000).

Furthermore, the government imposed heavy restrictions on spending allowances, but the situation started to improve in 1987. Travellers were only permitted to take US$ 3,000 in cash plus credit card expenditure of up to US$ 3,000, but the government now allows people to take out US$ 5,000 in cash and sign US$ 5,000 on credit cards when Korean citizens travel abroad. At the same time, Koreans were allowed to bring back more overseas purchases without paying duty, which led to increased numbers of Korean tourists travel abroad for shopping, especially to America and Japan.

Table 6.17 Departure of Korean citizens, 1980-99

Year	Departures	% annual change
1980	338,840	14.7
1985	484,155	-1.8
1990	1,560,923	28.7
1995	3,818,740	21.1
1996	4,649,251	21.7
1997	4,542,159	-2.3
1998	3,066,926	-32.5
1999	4,336,546	41.4

Source: derived from KNTO, 2000.

Most of the 1990s witnessed double digit increases until the financial crisis between 1997 and 1999. But there was a recovery in 1999, which almost reached the previous peak of 4.7 million in 1996. Until 1985, Africa was a reasonably important destination for Korean tourism, sustained by worker traffic and political initiatives in Korea, but Africa was no longer seen as one of important tourism destinations for Koreans once leisure travel was liberalised, as neighbouring destinations such as Japan and Thailand flourished as seen from table 6.18. At the end of the 1990s, Asia still accounted for 64.7% of all departures from Korea, followed by the Americas at 15.2%. Additionally, there was a rise in traffic to Europe and Oceania as the market became more mature in the 1990s.

Table 6.18 Departures of Korean citizens by geographical regions

Year	Asia	Americas	Europe	Oceania	Africa
1985	312,596	113,061	34,329	3,293	20,876
1986	276,593	120,566	37,229	541	15,169
1987	311,800	128,636	45,585	8,236	16,281
1988	500,363	145,751	54,412	9,172	15,478
1989	907,906	198,566	76,974	15,053	14,613
1990	1,177,191	254,338	94,661	22,820	-
1995	2,433,723	721,413	308,307	172,296	-
1996	2,880,821	928,829	374,875	241,414	-
1997	2,854,137	902,776	374,345	252,010	-
1998	1,915,864	480,743	171,236	80,108	-
1999	2,808,541	660,148	278,966	127,914	-
% change 1999/1998	46.6	36.2	62.9	59.7	-
% share 1999	64.7	15.2	6.4	2.9	-

Source: derived from KNTO, 2000

However, in 1999, there were a number of significant indicators in terms of the outbound market in Korea. China grew rapidly, and gained a large share on the main destination amongst other destinations known as significant tourist destinations for Koreans. The important fact is that China and Japan, two neighbouring countries, now represent 43% of the total. Thailand and Hong Kong also appear to be important destinations as the statistics show a continuous rise in travel to these two countries. Korean tourists visit Thailand for leisure purposes, the destination is known as the land of pleasure in the modern era. Although a rise in Taiwan appeared for the first time since the political rift, it was at a slower pace than other destinations, and it is likely to drop out of the top 10 in the next two or three years.

Table 6.19 Departures of Korean citizens to major destinations, 1998-1999

Destination	1998	% change 1998/1997	% share	1999	% change 1999/1998	% share
Japan	822,358	-27.0	26.8	1,053,862	28.2	24.3
China	484,009	-17.2	15.8	820,120	69.4	18.9
USA	425,330	-47.0	13.9	571,332	34.3	13.2
Thailand	166,867	-44.8	5.4	269,700	61.6	6.2
Hong Kong	122,577	-43.7	4.0	168,456	37.4	3.9
Singapore	57,583	-53.2	1.9	127,630	121.6	2.9
Philippine	62,616	-57.9	2.0	109,563	75.0	2.5
Australia	62,742	-67.3	2.0	97,436	55.3	2.2
Taiwan	61,167	-32.4	2.0	74,992	20.6	1.7
Germany	42,977	-35.1	1.4	73,355	70.7	1.7

Source: derived from KNTO, 2000.

In recent years, the characteristics of the Korean outbound market have gradually changed, as shown in table 6.20. In the mid-1980s, the share of leisure travellers accounted for only 1% of total departures, but with the liberalisation of the tourism industry, it rapidly increased, representing 1 million in 1994 and 2 million only two years later. By 1996, the share of leisure travel exceeded 50% and when the financial crisis came in 1997, leisure travel was hit harder than the other modes, falling by 70% in 1998. Even though the volume of leisure travel started to recover from 1999, it is still far from reaching the same level as the peak of 2.3 million in1996. For the business travel mode, travel on business purposes dramatically increased between 1990 and 1997. At the end of the 1980s, business trips accounted for 26% of the total outbound volume, which was followed by a steady decline, caused mainly by the encroachment of the leisure segment. However, business travel regained some market share in 1998 as a result of a 70% drop in leisure travel.

Table 6.20 Leisure and business travel departures from Korea

	Leisure			Business		
Year	Departures	% of annual change	% share of total departure	Departures	% of annual change	% share of total departure
1985	1,745	-32.3	0.4	134,031	8.1	27.7
1990	590,486	31.6	37.8	400,603	27.4	25.7
1995	1,770,770	37.3	46.4	900,050	14.7	23.6
1996	2,347,166	32.6	50.5	1,002,448	11.4	21.6
1997	2,032,537	-13.4	44.7	1,087,044	8.4	23.9
1998	603,079	-70.3	19.7	973,542	-10.4	31.7
1999	1,387,277	130.0	32.0	1,239,335	27.3	28.5

Source: derived from KNTO, 2000.

Another trend since the removal of age restrictions has been the steady increase in the number of female travellers as the position for women has improved in society and their earning power has grown dramatically over the last two decades. At the end of the 1980s, women accounted for one-third of total departures from Korea for both leisure and business travel. In other words, the male share has been falling and the female share is at around 40%, including crews in 1996, but the share decreased in 1998 because the economic downturn hit leisure travel more than business travel, which pushed the male share back up.

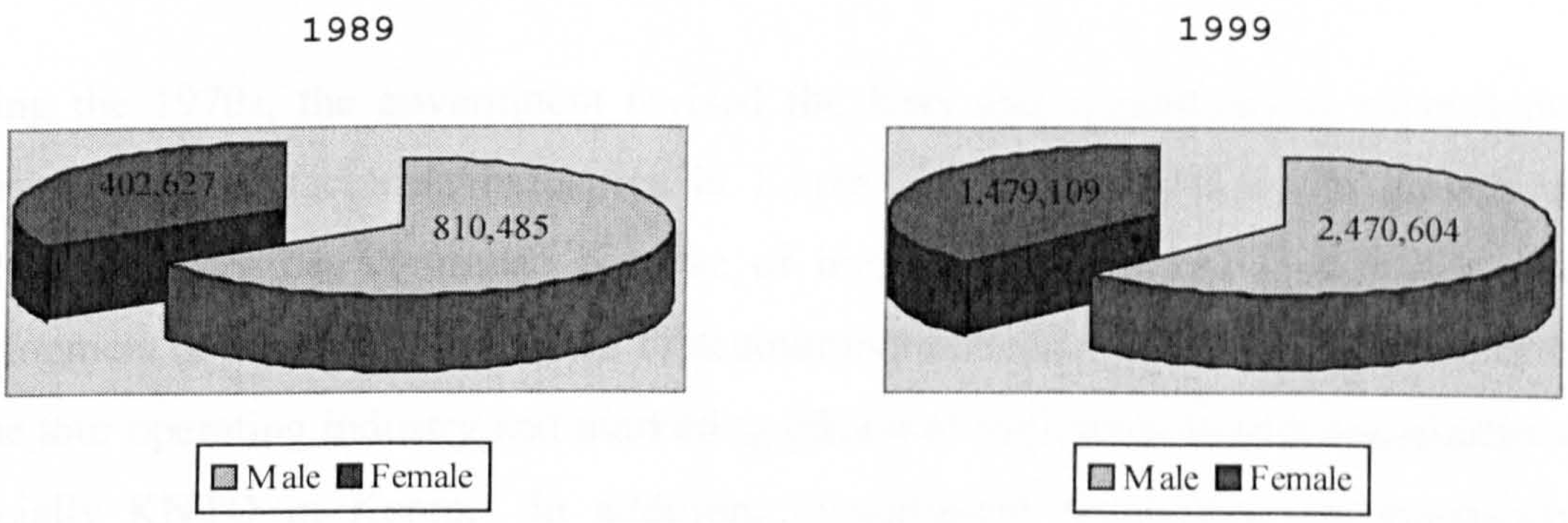


Figure 6.3 Departures of Korean citizen by sex

Source: derived from KNTO, 2000.

In economic terms, the government has been concerned about Korean tourists' expenditure pattern. In 1980, spending on trips by outbound Korean citizens stood at just over US$ 1,000 per person. In 1990, the expenditure total peaked at double the amount. The decline in the value of the Korean won against the US dollars in the early 1990s means that the actual amount in won would be higher. With spending measured in US dollar, there is a likelihood of great misrepresentation; the big drop in 1998 took the total back to the level of 10 years earlier, but spending per person was less than half. This shows that even if the travel numbers have almost recovered, spending figures are still well down, and may take five or ten years to reach the levels in 1996.The travel patterns discussed earlier, such as more travel to nearby destinations, is a further indication that the loss in value of the Korean won has damaged overall outbound travel figures (Bailey, 2000).

There are obvious factors that encouraged the rapid growth in the Korean outbound market. The first is the change in tourism policy on outbound travel, such as easing age restrictions, obtaining passports without hassle and exchanging currencies more freely. The improvement of cross border receiving functions such as visas and air services. Secondly, many Koreans now have the financial capability and the philosophical readiness to travel abroad. However, all these positive factors seemed to disappear after the financial crisis. From 1999, the situation is indeed getting better but full recovery will take a long time.

6.4 TOURISM DEVELOPMENT IN KOREA

During the 1970s, the government revised the laws and regulations to support the tourism and manufacturing industries in Korea. Since the 1980s, the growth of tourism in Korea has continued because of improvements in living standards, the development of air travel, new forms of accommodation such as hotels, the emergence of the tour operating industry and marketing efforts of individual tourist organizations especially KNTO in Korea. In addition, Government regulations are constantly reviewed and revised to accommodate the needs and desires of tourists (KNTO, 1994). Tourism policy in Korea started at the beginning of the 1960s and can be categorised into three stages. In the 1960s, the regulations and laws were fundamental to the development of tourism and the Korea National Tourism Corporation (KNTC) was established in 1962 that later became the Korea National Tourism Organisation (KNTO). The KNTO is largely responsible for the development of tourism infrastructure in Korea (Ahn and Ahmed, 1994).

From the 1960s, the government offered the tourism industry incentives to develop the service industry in order to achieve a balance with the manufacturing sector. Such incentives included tax exemptions for joint ventures, streamlined legal procedures, and financial assistance for tourism facilities. In recent years, the government has provided tax incentives for foreign investors in tourism-related enterprises by exempting some of the profits from taxation. These tax incentives apply to customs taxes, certain excise taxes, value-added taxes, and currency investments (Ministry of transportation in Korea, 1991). Tourists are also granted some relief from taxes on souvenirs and other specified purchases.

On the other hand, the rapid development of Korea's tourist industry is seen as a natural consequence of the country's rapid economic growth. To support the industry, the Korean government enacted a series of tourism promotion laws, which resulted in a growth rate of 11.1 % annually in tourist arrivals in the last decade and a rate of 23.6 % in tourist receipts from 1983 to 1996.

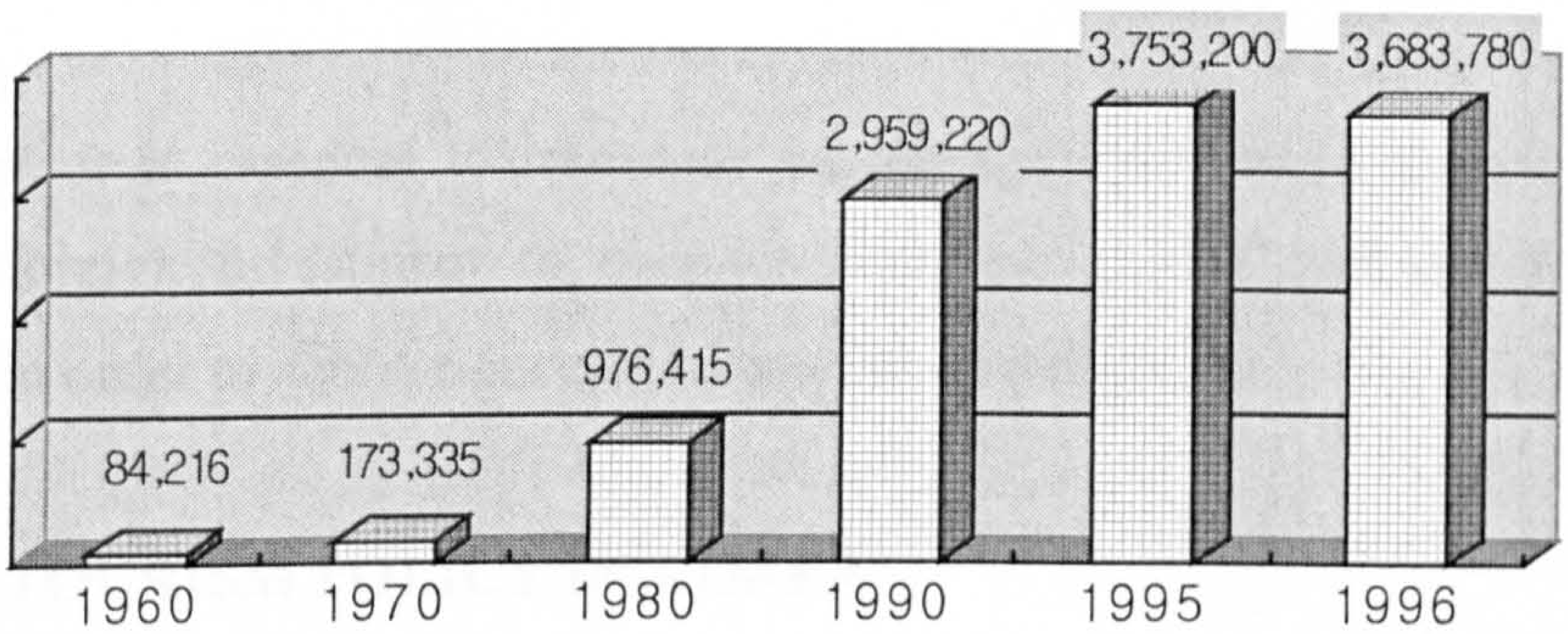


Figure 6.4 The growth rate in tourist arrivals

Source: Korea National Tourism Organisation (KNTO), 1997, p.24.

In 1991, however, the country experienced the first substantial decrease in tourism receipts in several years. Tourism recorded a decline in receipts of 3.7 % from the previous year, after having the benefit of an average 20 % annual growth through the 1980s and even higher growth in the 60s and 70s.

Foreign tourist receipts in 1996 totalled US $5,419 million, a 3.0 % decrease from the previous year, however, the number of foreign visitors increased from 84,216 in 1967 to 3,683,779 in 1996. The number of hotel rooms increased 35 times, from 1,244 in 1963 to 43,401 in 1996. The increased number of tourists has outstripped that of other groups of visitors. In 1969, tourists accounted for 30.2 % of the total, business people

12 %, visiting relatives and friends 21 % and official visitors 21.3 %. But in 1992, 57.6 % of foreign arrivals were tourists, 10.9 % were visiting relatives and friends, 11.2 % were on business and 0.7 % were official visitors (KNTO, 1997).

Tourism development of Korea is mostly based on provincial and heritage places. A different culture and people could be the main attraction for foreign tourists to Korea. In 1990, the government declared the year 1994 as the "Visit Korea Year". The Korean government established tourism promotion plans to place more strategic importance on its tourism industry, targeting 4.5 million visitors and US $ 5 billion tourism revenue for 1994, but the event was not successful due to uneasy situation on the Korean Peninsula, such as the sudden death of the president of North Korea and discovering North Korea's nuclear development programmes. As a result of the failure of the event, the South Korean government suffered a negative balance of one billion dollars in 1994, and the deficit amounted to US$ 504 million (Lee, 1997).

Therefore, it is essential to introduce an appropriate tourism policy and to attract enough foreign investment to enhance both the quality and quantity of tourism services in order to achieve successful tourism development.

6.4.1 TOURISM POLICY IN KOREA

The Korean government, recognising the importance of tourism, set up a long-term vision to promote Korea as the centre for tourism in Asia in the 21st century. Based on this vision, the Korean governmen arranged and implemented several policies to foster the tourism industry in various fields such as strategic marketing, developing tourism resources on a large scale, improving the posture to accommodate tourism and expanding productive welfare through stimulating people's tourism-related activities (KNTO, 2001[a]).

First, by actively implementing overseas marketing that differentiated in various markets, Korea could attract 4.66 million foreign visitors in 1999 and hence could be ranked from 30th to 28th in the world. Achieving US$2.5 billion of surplus in 1999 in the balance of payment from tourism, together with US$3.8 billion of surplus in 1998, Korea recorded US$6.3 billion of surplus for 2 years consecutively. In addition, the government expects to attract more than 5 million tourists in 2002. In order to open the era of 5 million tourists, the government will exert efforts to attract Chinese tourists and to explore in earnest the newly emerging markets of Russia and India.

Korea has laid the foundation to promote tourism in the 21st century. As mentioned earlier, the government finalised the five-year plan to promote tourism, "Tourism Vision 21", setting up various development plans for five years from 1999 to 2003 to foster Korean tourism. The target of this plan is to attract 7 million foreign tourists by 2003. The government selected 30 main projects like the development of the South Coast Tour Belt from 8 fields, and set up detailed action plans by project (KNTO, 2000).

In November 1999, "The Expanded Meeting for Tourism Promotion" was held by the President, ministries, city mayors, provincial governors and representatives of tourism businesses in order to explore tasks to improve various rules and regulations and to find solutions to improve market conditions in tourism. In addition, the government completed the measures to ease over 60 rules and regulations in total including the liberalisation of resort condominium prices, which was decided in 1998, and the permission for wedding ceremonial businesses at super-deluxe hotels. By doing so, the government laid the foundation strengthened competitiveness of Korean tourism (Investment Company Institute, 1999).

Second, the government exerted efforts to explore new tourism resources and to develop tourism products. For the development of large-scale tourism resources equipped with international competitiveness, the government has carried out research projects on the South Coast Tour Belt Development, on the development of Confucian culture zone in Northern Gyounbuk Area and on the development project of linking Mt. Seorak to Mt. Geumgam to cope with the activated South-North tourism exchanges in the future (Korea Herald, 2001).

According to KNTO (2001[a]), the Korean government recently decided to extend financial support to the development on Mt. Geumgang tourism project under the auspices of the KNTO because of its extensive experience and know-how in tourist promotion. The government's financial support for the North Korean tourism project is regarded as seed money for future inter-Korean tourism deals. With assistance, the government believes that the Mt. Geumgang tour program will now be able to make a profit, and other interested firms may join since the future of the endeavour is no longer in doubt.

The government's decision to extend financial support to the project is based on several fundamental reasons. Since the Mt. Geumgang project has emotional as well as economic ramifications, it is important to follow through with new ideas and funding. Also, the Mt. Geumgang project is seen by many as creating a favourable climates for inter-Korean reconciliation and cooperation. However, if the project were suspended for any reason, it is feared that both inter-Korean relations and international cooperation with South Korea's "sunshine policy" toward North Korea would suffer. Another adverse impact of the possible discontinuation of the tour programme is its possible effect on foreign investors, who might slow or withdraw their investment in Korea, thus further slowing the recovery of the economy (Korea Herald, 2001).

On the other hand, by organising "the strategic meeting for tourism publicity", the government strengthened cooperation with related authorities to publicise Korean tourism, and selected symbols of Koran tourism and publicity slogans which can represent the charms of Korean tours in order to produce overseas publicity CF materials and to air them. In order to foster the highly value-added convention industry, the government plans to attract more international conferences from 73 cases in 1999 to 100 cases in 2002. Through holding the 1st APEC Tourism Ministerial Meeting with great success, Korea is trying to position itself as a country attracting world-class international conferences (KNTO, 2001[a]).

Besides, the government will increase tourism revenues by developing steadily various things to see, enjoy, eat and buy for foreign tourist. From 2000, the government will strengthen support at policy level for activating common people's tour activities such as introducing the system of distributing the vacation seasons all year around, developing low-priced tour products and selling people's tour products certificates. By doing so, the government plans to improve people's productive welfare and to activate tourism related-business.

6.4.2 FOREIGN INVESTMENT IN KOREAN TOURISM

Currently, there are 3,170 cases of inward foreign direct investment (FDI) totalling US$ 7.0 billion in South Korea. As of the end of 1989, two-thirds of the cases were from Asian countries, amounting to US$ 3.8 billion, especially 1,922 cases and US$ 3.5 billion were from Japan. The United States was the second-largest investor next to Japan, with 717 cases totalling US$ 1.9 billion followed by West Germany, Hong Kong, and the United Kingdom (Ministry of Finance and Economy, Korea, 1998).

Table 6.21 Foreign agencies in major Korean cities, 1987 and 1990.

	1987			1990		
	Seoul	Pusan	Taegue	Seoul	Pusan	Taegue
Embassy	48	1	0	60	0	0
News agency	25	0	0	27	0	0
Communications	9	0	0	13	0	0
Broadcasting	8	0	0	12	6	0
Bank	66	8	0	77	11	0
Major branch office	374	4	0	595	7	0
Convention and sports event	146	4	2	189	4	5

Source: Park, 1991, p.12.

About three-quarters of the FDI are invested in the manufacturing sector and only one-quarter is invested in services sector. Although only 16.1 % of the FDIs in the manufacturing sector are located in Seoul, the satellite cities and suburbs of Seoul have 35.7 % of the entire inward FDI in the nation. Thus, 56.7 % of FDI projects in manufacturing are located in the capital region. In contrast, more than 82.9 % of the FDIs in the services sector are located in Seoul, the satellite cities and other regions of the country share 17.1% of FDIs between them (Park, 1991). In other words, Seoul has the dominant share in both the number of cases and the amount of investment, with 82.9 % and 90.9 % for the services sectors as seen from table 6.22.

Table 6.22 Direct foreign investment (inbound) by region

Region	Cases				Value			
	Manufacturing		Service		Manufacturing		Service	
	No.	%	No.	%	US$'000	%	US$'000	%
Total	1,301	100.0	321	100.0	3,184,917	100.0	2,215,369	100.0
Seoul	209	16.1	266	82.9	297,590	9.3	2,014,503	90.9
Pusan	70	5.4	18	5.6	55,029	1.7	103,066	4.7
Taegue	26	2.0	2	0.6	14,041	0.4	2,030	0.1
Incheon	120	9.2	7	2.2	176,610	5.5	10,852	0.5
Kwangju	1	0.1	-	-	125	0.0	-	-
Kyunggi	405	31.1	5	1.6	751,197	23.6	7,446	0.3
Kangwon	9	0.7	-	-	20,726	0.7	-	-
Chungbuk	52	4.0	1	0.3	173,827	5.5	3,000	0.1
Chungnam	49	3.8	-	-	90,900	2.9	-	-
Jeonbuk	39	3.0	-	-	77,494	2.4	-	-
Jeonnam	29	2.2	-	-	409,738	12.9	-	-
Kyungbuk	95	7.3	3	0.9	266,429	8.4	2,088	0.1
Kyungnam	195	15.0	8	2.5	849,302	26.7	18,420	0.8
Jeju	2	0.2	11	3.4	1,909	0.1	53,964	2.4

Source: derived from Department of Finance, Korea, 1989.

Furthermore, FDIs increased every year in the 1990s and the government endeavours to improve the investment environment for foreign investors in Korea. In 1993, FDI accounted for US$ 1,044 million, but it increased dramatically to US$ 3,687 million in 1997. The government changed the regulations on foreign direct investment as a part of the liberalisation:

- In 1995, a government institution that was responsible for dealing with foreign investment was moved to the Ministry of Commerce and Trade in order to reform the regulations related to foreign investment. In the same year, the government introduced a scheme to encourage foreign investment on Korean market by reducing various taxes.
- Foreign companies needed to get permission or a licence in order to invest on Korean companies before 1996, but it changed to report instead of applying for the permission for the investment.
- In 1997, the government removed a regulation relating to the ownership of Korean companies' shares and stocks for foreigners. From 1997, foreigners do not need to report the details of their ownership for any Korean companies and the administrative work for foreign investment became simple (Ministry of Finance and Economy in Korea, 1997).

However, foreign direct investment is still limited in the tourism industry of Korea. In many cases, FDIs tend to take in the form of sharing ownership with Korean companies, especially in the hotel sector. In Korean tourism, more than 70% of super-deluxe hotels are foreign branded. These hotels and restaurants are involved mainly in two different forms of foreign investment. First, a foreign company involved with a Korean company in the form of M&A. In this case, the Korean company owns more than 60% of the share and the foreign company owns the rest of the share. Second, a Korean company has sole ownership and a foreign company provides a commercial loan with a high interest rate, which is uncommon in Korean tourism. In many countries in which tourism development was regarded as a successful story, most development projects related to tourism sectors involve foreign direct investment from building a hotel to constructing an entire tourist resort. But tourism development in Korea tends to depend more on the government or domestic multinational companies for financial support. As a result, tourism development has been performed on a small scale and even a small project takes longer than necessary.

6.4.3 TOURISM DEVELOPMENT IN DIFFERENT SECTORS

The Korean government used a mixed private and public sector approach in its development of tourism. However, developing the private sector in the tourism industry is essential to enhance the quality and the price of tourism products in Korea. The Korean government has attempted to develop tourism since the 1960s, but the nation still suffers from many problems such as those that occur in an infant industry. However, the Korean government has shown its interest in attracting mega-events in recent years, including the 2002 World Cup and the visit Korea Year. Since many foreign tourists were expected to visit Korea during those events, the government planed to exert all efforts to improve measures by sector and check the progress on a regular basis ranging from the expansion of tourist accommodation facilities, improving of tourist information services, and improving the quality of tourism services, especially in restaurants and travel agents.

For the expansion of the tourism infrastructure, the government introduced 44,7 billion won over 2 years for projects developing tourism attractions and tourism resources throughout the nation. In order to expand tourist accommodation facilities, the government changed some rules and regulations including the relaxation of standards in parking lot size and pass over the power of deciding the grade of tourist hotels to the private sector. In order to improve the tourist information system, the government established 13 city and provincial tourist information centres in major cities. The government also opened the tourist information telephone line exclusively for foreigners. The government additionally installed 353 tourist attractions signs both in Korean and Chinese, and exerted efforts to enhance the tourist information service for both domestic and foreign tourists by producing and distributing 930,000 copies of city and tourist maps (KNTO, 2001[a]).

Furthermore, from the point of view of the country's well being, the economic impact of tourism is important. As shown in table 6.23, the transport sector generated the largest impact and the hotel sector had the second largest impact on output, personal income, value added, government revenue, and imports. The restaurant sector created the largest number of jobs (123,544), accounting for 35.3% of the employment impact, and had the third greatest impact on output, income, government revenue, and imports. A relatively low impact was found for the shopping and entertainment sectors.

Table 6.23 Tourism sector impact, 1993

(in US$ million)

Sector	Hotel	Restaurant	Transport	Shopping	Entertainment
Output	2,938	1,925	3,436	1,855	1,573
Personal income	595	452	724	321	343
Employment[a]	75,772	123,544	68,007	37,533	45,204
Value added	1,573	993	1,723	1,048	821
Indirect tax	127	113	162	108	108
Import	191	140	437	105	105

Source: derived from Bank of Korea (1993, 1994); MOT and KNTO (1994)
[a] Unit of employment is number of full-time jobs created.

According to Lee and Kwon (1995), the tourism industry generated the same economic value as would 35 million TV sets exported by the electronics industry or 760,000 passenger cars exported by the automobile industry. Assuming that each sector exports products equivalent to US$ 1 billion, the injection of this exogenous money into the economy will generate the primary and secondary impacts of output, income, employment, value added, indirect tax, and import throughout successive rounds of respending. From this, it is obvious to derive the importance of the development in each tourism sector, especially in transport, hotel and restaurant sectors.

6.4.3.1 The Hotel Industry in Korea

There are two types of hotels in Korea, "international" and "national". The national hotels are aimed at Koreans and budget travellers, while international hotels generally target foreign travellers. The ordinary hotel offers fewer amenities than the tourist hotel, but it provides an at-home atmosphere for natives. These hotels offer a small room with modern amenities. As of 1988, there were 33,922 tourist hotel rooms in Korea. Tourist hotels are divided into five classes: super-deluxe, deluxe, first class, second class and third class. Despite the rapid growth in the number of hotel rooms in the 1980s, Korea's hotel industry has enjoyed a healthy occupancy trend. The deluxe-class hotels that cater mostly to international visitors have experienced the highest occupancy (Chon and Shin, 1990).

On the other hand, a major problem facing the Korean accommodation industry stemmed from the appreciation of real-estate values. Rooms were in short supply, even as tourism increased. In 1985, the number of foreign tourists visiting Korea was approximately 1.4 million, and that figure had increased more than 2.5 times, to approximately 3.7 million, in 1995. The room supply of luxury hotels totalled 12,173 rooms in 1985, while that number had increased only 1.5 times, to 19,214 rooms, in 1995. Table 6.24 shows a comparison between Korea and other countries of total tourist hotel rooms available per 10,000 foreign tourists. The United States ranked first with 683 rooms, followed by Australia with 345 rooms per 10,000 foreign tourists. By contrast, the number of hotel rooms available in Korea was 118 per 10,000 international visitors. However, given that few foreign visitors stay in other than first-class tourist hotels, the actual number of hotel rooms available for foreign tourists would be much smaller than 118 per 10,000 tourists (Kim, Shin, and Chon, 1998).

Table 6.24 Comparisons of hotel room supply, 1995

Country	Per 10,000 Tourist arrivals	City	Total hotel rooms
U.S.	683	New York	67,000
Australia	345	Bangkok	49,000
U.K.	322	London	46,000
Italy	322	Hong Kong	34,000
Korea	118	Seoul	17,000

Source: derived from Department of Culture and Sports, Korea (1995)

Although Seoul has been recognised as an internationally well-known city, Seoul had only 17,000 rooms, which was the lowest among the five competitive cities. While Seoul probably has relatively adequate accommodation for tourists and international conventions compared with other cities in Korea, many tourist resorts and areas in the southern portion of the peninsula need more hotel rooms. Taejon, 150 kilometres south of Seoul and the site of the 1993 international exposition, had fewer than 1,300 rooms as of 1992, and none of those hotels was classified as deluxe-first class.

Despite the short supply of hotels in Korea, Seoul still has the greatest number of hotel rooms compared with other major cities in Korea as shown in table 6.25. Seoul has 39 % of the nation's hotel rooms and the change in the number of hotel properties and rooms has been minimal since 1991 due to many different factors, including the lack of government incentives and high building costs related to hotel development.

Table 6.25 Korean tourist-hotel supply (1995)

	Super Deluxe		Deluxe		First Class		Second Class		Third Class		Total*	
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms
Seoul	12	7,296	15	4,099	23	2,656	27	1,942	23	1,368	100	17,361
Cheju	5	1,676	5	840	16	1,527	8	481	3	139	37	4,663
Pusan	4	1,269	2	487	16	1,577	12	633	23	959	57	4,925
Kyungbuk	5	1,690	1	105	11	862	8	472	10	386	35	3,515
Kyungnam			2	465	12	1,266	12	740	4	203	30	2,674
Kungki			1	165	10	670	15	706	6	230	32	1,771
Taegu			4	482	13	770	9	439	2	73	28	1,764
Kangwon			3	453	9	702	5	319	5	245	22	1,719
Taejun			3	426	7	534	12	514	3	152	25	1,626
Chungbuk					9	663	5	247	6	239	20	1,149
Chungnam					7	745	3	159	2	100	12	1,004
Chunnam					4	281	8	355	3	124	15	760
Inchon			2	365	3	228	3	101	2	60	10	754
Kwangju			1	110	7	437	2	85			10	632
Chunbuk			1	111	2	146	2	180	2	107	7	544
Total	26	11,93	40	8,108	149	13,064	131	7,373	94	4,385	440	44,861

* Some existing hotels excluded because they do not fit into one of any classes above.
Source: Kim, Shin, and Chon, 1998, p.63

The occupancy rate in Korean hotel industry is reasonably high as shown in table 6.26. According to KNTO (1999), the national average occupancy rate during 1995 was 69 %. The average hotel occupancy rate has been increased to almost 90 % during the crisis. The number of foreign tourists increased as the value of won decreased, especially to tourists from Asian countries. Package tourists started to flow into the country mainly for the shopping, which affected a huge increase in hotel occupancy in Seoul.

In Korea's case, although the average occupancy rate is not higher than 80% for deluxe hotels as seen from table 6.26, it needs to increase the number of rooms in the next few years. The seasonality of Korean tourism is important to understand Korean inbound tourism patterns. In the summer and winter season, almost two-third of foreign tourists visit Korea, especially package travellers from neighbouring countries. In the peak season, travel agencies are fighting for hotel rooms. In addition, Korea will be the host for 2002 World Cup and other international conventions, thus the shortage of room supply may be a serious problem in the future. Therefore, attracting more foreign investment as well as domestic private sector investment is essential to the Korean hotel industry.

Table 6.26 Occupancy rate by hotel class (1995)

	Rooms available	Rooms sold	Occupancy percentage
Super Deluxe	3.951	3.011	76%
Deluxe	2.826	2.190	78%
First Class	4.549	3.102	68%
Second Class	2.720	1.732	64%
Third Class	1.455	0.727	50%
Total	15.777	10.928	69%

Note: Rooms in millions.
Source: derived from Korean National Tourism Corporation, 1995.

The shortage of hotel rooms will probably take some time to be solved. Even before the problem of financial support occurred due to the crisis, high land and construction costs made it difficult to initiate new hotel projects. On average, it costs approximately US$ 156,000 to build a luxury hotel room excluding land costs. Combined with high fixed investments, the relatively low profitability of the Korean hotel industry has made it more difficult to attract diverse investors.

According to Kim, Shin, and Chon (1998), developers in Korea discovered that even though the revenue-generating ability of the hotel sector is almost nine times larger than other office buildings, the office building produced more than three times the net income of the hotel operation. In addition, the hotel business requires almost 17 times more employees than the office building, as the hotel is a labour-intensive enterprise. However, although it is difficult to attract more foreign and domestic investors to the

Korean hotel industry, the crisis created an opportunity for foreign investors as several well-recognised hotels in Seoul have been offered for sale at prices much lower compared with the prices prior to the crisis because of the devaluation of the won. Properties owned by Korean multinational companies have also been put on the block. For example, Daewoo owned the Hilton hotel, but they sold the company due to bankruptcy. At the same time, the ownership of hotels such as Shilla that is currently owned by Samsung and Inter-Continental owned by LG Group is uncertain.

Table 6.27 Foreign investment in Korean luxury hotels, 1996

Hotels (hotel rooms)	Location	Year of registration (year of approval)	Foreign investment		
			Nationality	Amount invested (US$ '000)	Share ownership (%)
Grand Hyatt	Seoul	1979 (1973)	Japan	50,864	99.00
Shilla Hotel	Seoul	1979 (1973)	Japan	15,331	9.23
Hotel Lotte	Seoul	1979 (1973)	Japan	668,671	100
Bugok	Kyungnam	1981 (1978)	Japan	770	50.00
Sheraton Walkerhill	Seoul	1981 (1977)	Hong Kong	4,881	5.97
Cheju Royal	Cheju	1983 (1980)	Japan	3,711	49.40
Bugok Hawaii	Kyungnam	1983 (1987)	Japan	6,028	49.00
Hilton	Seoul	1984 (1977)	America	45,954	38.28
Ramada Olympia	Seoul	1984 (1975)	Japan	2,850	50.00
Dongdaegu	Daegu	1986 (1985)	Japan	1,200	75.00
Masan Royal	Kyungnam	1987 (1985)	Japan	2,538	98.66
Cheju Oriental	Cheju	1987 (1986)	Japan	3,352	96.70
Cheju Green	Cheju	1987 (1987)	Japan	4,364	99.38
Cheju Palace	Cheju	1988 (1986)	Japan	1,220	68.72
Seoul Renaissance	Seoul	1988 (1986)	Japan	15,500	33.68
Hyatt Regency, Pusan	Pusan	1988 (1983)	Hong Kong	4,480	14.90
Swiss Grand	Seoul	1989 (1986)	Switzerland	10,800	20.00
Prima	Seoul	1989 (1987)	Japan	12,311	58.85
Nobotel Ambassador	Seoul	1993 (1988)	France	8,000	30.19
Emerald	Seoul	1993 (1987)	Japan	12,798	49.00
Lotte Hotel, Pusan	Pusan	1997 (1984)	Japan	292,500	99.99
Haeundae Grand	Pusan	1996	Japan	82,320	93.00
Lotte Zamzil	Seoul	1998 (1988)	Japan	284,699	51.91

Source: derived from Ministry of Finance and Economy, Korea (1997)

Table 6.27 shows the current situation of foreign investment in the Korean hotel industry. As seen from the table, foreign investors involved in Korean hotels are mainly Japanese followed by Hong Kong, which proves the fact that Korea has a strong relationship with Japan and Hong Kong in trade for both services and manufacturing goods. This is because the construction and maintenance costs for luxury hotels are higher in both Japan and Hong Kong than in Korea. These Japanese and Chinese investors often own hotels in their company and they are looking for new markets such as Korea where they can expand their business. In addition, the share ownership for foreign investors is relatively high in the Korean hotel industry since the relaxation of restrictions on foreign investment.

Another obstacle for the Korean hotel industry is the rapidly increasing labour costs compared with other Asian countries. A recent study of Korean luxury hotels suggested that the ratio of labour cost to sales was 28.6 % in 1993 and the figure increased to 33.4 % in 1994. In Japan, the ratio was 30.9 % in 1994 and had increased by only 0.7 % over the previous year (Kang, 1996). In fact, it is difficult to run profitable hotel operations with such high labour costs. At the same time, staff reductions cannot be the solution because reducing the number of employees would result in poor service, which will affect the long-term profitability. Therefore, the Korean government began to remove restrictions on new hotels and maintenance of existing hotels from 1988 as part of liberalisation in the services industry. The government applied heavy restrictions on building new hotels as well as repairing and expanding existing hotels, which may help to solve basic problems such as the shortage of hotel rooms in the tourism industry.

In summary, the government needs to work closely with the private sector in order to find the solution for those problems. According to Ahn and Ahmed (1994), the most efficient solution is that the government should offer incentives to encourage both international and local private sector investments to develop lodging properties and other tourist facilities in up-and-coming destinations. Joint ventures between international investors and Korean hoteliers would go a long way toward remedying the shortage of accommodations outside of Seoul. Such economy level chains as Days Inns, Best Western, and Comfort Inn would be particularly welcome (Ahn and Ahmed, 1994). The detailed and immediate solutions in the Korean hotel industry are as follows:

- Overcome the shortage of room supply: the hotel industry's current financial disadvantage in debt financing should be ended in order to solve the shortage of room supply and to encourage hotel development. The Korean government should require banks to offer advantageous debt financing to the hotel industry as it does to manufacturing industries. More importantly, the government should end proscription on hotel investors' borrowing abroad. The hotel industry should be given the same incentives as manufacturing industries considering that income generated from the hotel industry contributes to the Korean economy as much as manufacturing exports.

- VAT relief: the Korean government should reduce the hotel industry's tax burden. The industry faces a value-added tax, an acquisition tax, a luxury-consumption tax, and other fees such as traffic-congestion fee and an environment fee, which result in an increase in the price of hotel rooms. Investment tax credits are another way to stimulate hotel projects.
- Regulatory relief: removing bureaucratic regulations may ease Korea's room-supply shortage. At present, the hotel development process involves 35 different approvals for design, site selection, and hotel construction. It is common to find a hotel not being able to open as scheduled due to delays in local governments' approval process. The complex and time-consuming approval process should be improved to appeal to more potential investors in the hotel industry.
- Development funds: even though the Korean industrial banks offer tourism development funds to hotel investors, the funding is too small to support capital-intensive hotel construction and renovation projects. The government, however, proposed to increase the fund by collecting a fixed fee from outbound travellers, which should augment the fund for future hotel developers.
- Boosting returns: the low return on hotel investment can be improved by reforming the classification system that encourages developers to build luxury hotels, which require extensive capital investment. Instead, the government could encourage development of mid-price or budget hotels, which should be profitable alternatives for many hotel developers and attract many international travellers and domestic tourists who seek hotels with low prices (Kim, Shin, and Chon, 1998).

On the other hand, some economists argue that "incentives" do not always bring positive impacts into a country (Krueger, 1993; Nicolaides, 1989; OECD, 1999). A reason for governments to introduce incentives is to encourage both foreign and domestic private sectors to invest, but it can create unexpected problems as it happens often in many developing countries. In general, governments, especially for developing countries, are under continual pressure to increase tax revenue and nations' economic growth by attracting more of foreign and domestic investment. Hence, most commonly used types of incentives are tax and regulatory incentives to boost foreign investment:

- In theoretical terms, developing countries tend to tax exports more heavily that they should, even taking into account the administrative constraints inhibiting other forms of taxation. In contrast, many tourist countries seem to undertax their tourist exports (Bird, 1992). In the tourism industry, the most important segment is the hotel sector, which is the most capital intensive and owing in part to the extreme sensitivity of international tourism to political events and image problems. This is one reason why foreign capital has often proved reluctant to invest in this sector in many developing countries without substantial official assistance via grants, tax incentives, and guarantees. However, even with all those incentives, foreign investors are often concerned about economic and political stability of a country that they are going to invest. In other words, it is difficult for governments to attract more foreign investment by offering only tax and regulatory incentives. For example, in Korea, the government introduced new policy towards tourism development to ease tax and regulation burden for both new and existing hotels. As a result, the government suffered from largely reduced tax revenue instead of increasing foreign investment for few years during late 1980s and early 1990s, as the political situation was unstable between North and South Korea.
- Regulatory relief can bring benefits to a country in long run, but it is also difficult to bring instant result by offering few different types of incentives. In Korea, the government relieved regulatory burden to both foreign and domestic investors in early 1990s. Before the regulatory relief, setting up travel agencies and building hotels were extremely restricted because tourism-related businesses were regarded as luxury services, hence the government imposed heavy taxes and introduced complicated regulation work. However, after lifting the regulatory burden in the 1990s, the number of small and medium sized travel agencies has increased dramatically, which resulted in a strong competition between them. The price of a tourist package dropped on average by 30-40% and at the same time, the quality of products was poor. Therefore, it is important to know that any kinds of incentives can be a tool to improve foreign capital investment, but it cannot be a platform to achieve immediate success for attracting hundreds and thousands investors to boost the industry.

Consequently, the Korean hotel industry faced substantial challenges even before the fragile structure of interlocking loans made by the Korean multinational companies fell apart. The Korean hotel industry has improved in number, size, and quality, but it still needs to develop to tackle fundamental problems as discussed earlier. In broad terms, the problem of Korean tourism arises from the fact that the number of outbound travellers is higher than the number of arrivals, as shown earlier in table 6.12. With the fall in the Won's value, fewer Koreans are travelling overseas for the time being and hotels in the Korean provinces enjoyed some of the highest occupancy rates in recent years at the end of 1997. As the Korean economy is recovering fast since 1999, Korea's tourism industry could show a strong export surplus in the next few years, giving Korea much-needed foreign exchange.

6.4.3.2 The Catering Industry in Korea

As opportunities for expanding businesses have increased by the movement of globalisation and liberalisation in the world, hospitality companies have increasingly turned their sights to Asia. This largely unexplored region presents a wide array of opportunities as well as an entirely new sets of circumstances. South Korea is one of the major developing countries in East Asia. The country is developing radical changes in its foreign investment regulations and exchange controls, as mentioned earlier in this chapter. In other words, as Korea has begun to move toward a free market, the opportunities for franchise entry and development are worthy of serious consideration. Franchising is an essential method for restaurant businesses in worldwide. It provides a unique solution to ownership for the expansion of foreign products and technology into Korea. Therefore, the absence of a regulatory regime undoubtedly lowers the barriers of entry into restaurant franchising in Korea (Korea Trade and Investment, 1996).

The catering and restaurant industry in Korea is extremely advanced in both quantity and the quality compared with other developing countries. The people in Korea can experience various kinds of foods and services in different types of restaurants. The catering industry is not only important to attract more foreign tourists but also to satisfy Korean people as eating out has become a significant part of our daily life. In Korea, there is very stiff competition originating all over the world, but most franchising opportunities are accomplished through large conglomerate Korean businesses and joint ventures that have established with local Korean companies.

There are 25 foreign franchisers and ten local fast food franchisers which compete with each other in the Korean catering industry. Many of these franchisers originate from the United States and they play an important role in the Korean market, as shown in table 6.28.

Due to the Seoul Olympics in 1988, many foreign franchising firms have recognised the Korean market as their prime target area in all of Asian countries. Interest in the Korean market increased since the government lifted its restrictions and regulations regarding the foreign capital investment in 1990 and 1992. Therefore, many foreign restaurants have opened their units including TGI Friday's, Ponderosa, Sizzler and Bennigan's in 1990s. Moreover, the variety of types of foods has increased as customer tastes have changed in accordance with changing life style, increased disposable income, and car ownership. Even though there are numerous restaurants in the Korean market, they have managed to maintain healthy growth in units and sales (Huo and Yang, 1997).

Table 6.28 Restaurants franchising in South Korea by brand

Brand	Founded Year	Units '95	Units '96	Growth (%)	Sales '95 (US$ million)	Sales '96 (US$ million)	Growth (%)
Burger King	1982	27	37	37	25.38	38.75	52.7
Hardee's	1990	23	28	21.74	18.74	25	33.3
Lotteria	1979	260	300	15.38	187.5	225	20
McDonald's	1986	48	77	60.42	51.25	63	22.9
Wendy's	1984	29	34	17.24	50	57.5	15
KFC	1984	100	110	10	135.9	168.3	23.8
Popeye's	1994	32	75	134	15.63	52.25	34.4
Kenny Rogers	1994	4	14	250	3.75	3.75	50
Chicago Pizza	1988	140	180	28.57	15	18	20
Domino Pizza	1989	39	60	53.85	10	15	50
Pizza Hut	1985	95	120	26.32	121.1	145	19.7
Romano Pizza	NA	28	NA	NA	11.88	15.6	50
Round Table Pizza	1990	10	16	60	9.75	12.5	28.2
Bennigan's	1995	1	4	300	0.27	1.21	348.2
Coco's	1988	33	48	45.45	41.25	62.5	51.5
Denny's	1987	3	6	100	4.5	12.5	177.7
Ponderosa	1992	2	3	50	3	4.25	41.7
Sizzler	1993	2	5	150	7.5	1.5	100
Sky Rock	1994	5	13	160	6.63	14.25	115.1
T.G.I Friday's	1992	7	9	28.57	31.25	43.75	40

Source: derived from Korean Foodservice Institute (1996)

More importantly, there are several important external factors that affect the Korean catering industry, especially franchising restaurants:

- Political factors: the "foreign investment law", which became effective in May 1990, was intended to grant foreign investors more favourable terms than other countries do competing for such investment. The government actually targeted foreign investment including industries that would use raw materials, produce products to replace imported goods, and boost exports. The government also preferred industries involving high technology. In order to provide reasonable working conditions for foreign businesses, the government attempted to improve transportation, communications, hotels, banking, and other services. As of January 1, 1995, foreign investment was entirely liberalised for 38 different business lines. An additional 14 business lines were partially freed for investment, which brought Korea's liberalisation ratio for foreign investment to 90.6%.
- Government regulation: the government regulates franchising through foreign investments and exchange controls. The government controls the introduction and growth of franchising in the country by central government agencies which review and approve investment opportunities and proposals according to the relative economic growth. Franchising is inaccurately regarded as a hindrance to economic development because the profits from the franchising businesses often return back to their headquarters in their own countries. In other words, franchising businesses provide little economic incentives and net benefits to the local economy. Also, as franchising organisations do not provide high technical products or services, it is not considered a high priority in business approval. However, franchising is the most commonly used way of entering developing countries' markets since the regulations on foreign investment and ownership are more restrictive than developed countries. By setting up franchising businesses in those countries, a country will benefit from creating more jobs and boosting the business environment as high competition arises in a market. As many economists have argued, high competition will bring benefits to unstable economies by reducing the danger of creating a monopoly situation and improving both the price and the quality of goods and services. As a result, franchising can be an ideal way of expanding businesses internationally, particularly in developing countries. Nonetheless, Cheesman (1992) reports that although Korea has removed many market barriers aimed at foreigners, doing business is still tough in Korea. Most fast food restaurants have entered the market through franchises or joint ventures to avoid complicated administration work and overcome the problem of foreign

companies not being able to own property for retail purposes.

- Economic factors: As explained earlier, the Korean government announced the "Five-Year Plan for the New Economy" in June 1993 to promote transparency in trade-related government policies and regulations, to improve the domestic investment environment, to undertake step by step liberalisation, and to upgrade domestic economic practices to meet international standards (Korea Trade and Investment, 1996). The Ministry of Finance and Economy declared that they would create an adjustment on the Foreign Capital Inducement Act centring on promoting foreign investment in 1995. For example, the adjustment includes some alterations such as replacement of the approval system for foreign direct investment with a notification system; allowance of the acquisition of outstanding shares of Korean companies by foreign investors; allowing for the leasing of a factory sites, free of charge, for a certain period of time (up to 20 years), in state-owned industrial parks. The new liberalisation plans and relaxed government restrictions are opening the door to previously closed markets and making foreign investment less bureaucratic. Therefore, many foreign franchisers and their franchisees such as KFC, McDonald's, Burger King, and Wendy's have succeeded in establishing a foothold in the major cities in Korea.
- Socio-cultural factors: As the GNP per individual has been over US$ 10,000 since 1994, a notable social change is the development of an urban middle class. With less working hours, greater income, and car availability, Koreans are more interested in travel abroad than ever and also tend to use highly graded restaurants and hotels. The hospitality industry would be the potential beneficiary of these trends in increasingly diverse lifestyles if it manages to adopt to demographic shifts that are occurring, which will dramatically transform the level and nature of franchising business. In other words, in order to be a successful franchising business in Korea, it is important to understand and adopt Korean cultures and lifestyles as they change over time. Nowadays, Korean people are enjoying extra leisure time and thus they are keen to explore new things such as a new menu in restaurants, and new facilities and services in hotels, which require changes in marketing strategies in franchising businesses. For example, McDonald's changed the interior design in their branches to meet Korean customer taste.
- Technological factors: among the most frequently cited obstacles by franchisers is ensuring and controlling quality and service technology. Governmental

regulations imposing usage of local raw materials such as Korean meat jeopardises the quality standardisation of products and services. For example, the American-based gourmet ice cream chain, Hoson's, after penetrating the numerous red tape and trade barriers typical in Korea, faced real problems. Twelve months after the first store was opened, the government required the company to stop importing ice cream from the United States and to either buy it or make it in Korea. The company eventually decided to make ice cream in Korea rather than compromise on quality (Huo and Yang, 1997).

Consequently, the most important challenge to entering the Korean market is selecting the correct distribution channels or method of controls. It seems the Korean market is not an easy one to which foreign companies can adapt because of the different operation systems and culture. Additionally, the government limits royalties and transfer of funds which also limits franchising opportunities. Among several strategic options for gaining access to the Korean markets, is forging strong relationships with a local investor or prospective franchisee as many franchising restaurants do in Korea. In fact, the opportunity for franchising in Korea has improved. The government is now envisioning opportunities for local residents to act as business owners in franchising organisations. The main obstacle for a franchise to overcome is the justification that the franchise will provide economic development for local residents and the country in general. As long as the franchiser can demonstrate that the franchise will help the economic strength of the Korean economy, then franchise opportunities are accepted and encouraged.

6.4.3.3 Travel Agencies in Korea

Travel agencies in Korea are divided into three categories:

- General travel agency, which is authorised to handle inbound, outbound and domestic travel.
- Outbound agency or overseas travel agency which handles only outbound travel.
- Domestic travel agency, handling only domestic travel.

In 1989, the government further liberalised the requirements for opening new travel agencies and the number increased rapidly. Despite the decline in the number of tourists in 1998, more travel agencies opened (Bailey, 2000).

Table 6.29 Number of general travel agencies in Korea by province, 1990-1998

City/province	1990	1995	1996	1998
Seoul	186	279	270	302
Pusan	10	19	19	20
Cheju	10	11	32	4
Total	**211**	**335**	**328**	**372**

Source: derived from KNTO (2000)

The number of outbound travel agencies grew rapidly from 1988, trebling between 1990 and 2005, and there was still an increase in 1998 despite the decline in business due to the financial crisis.

Table 6.30 Outbound travel agencies in Korea by province, 1990-1998

City/province	1990	1995	1996	1998
Seoul	278	647	801	950
Pusan	56	110	148	177
Cheju	11	14	32	125
Total	**551**	**1,570**	**2,064**	**2,326**

Source: derived from KNTO (2000)

Table 6.31 shows the number of travel agencies in Korea with IATA licenses, which revealed a more rapid and deep reaction to the region's economic crisis. Travel agency sales in IATA travel agencies increased much faster than the rate of agency locations until 1997. The number of locations also fell greatly in 1998, back to the level achieved in 1993.

Table 6.31 IATA travel agency locations and sales in Korea, 1990-1999

Year	Locations	% annual change	Sales (US$ mn[a])	% annual change
1990	195	NA	210	NA
1991	192	NA	670	219.0
1992	380	25.0	889	32.7
1993	389	2.4	1,141	28.3
1994	407	4.6	1,577	38.2
1995	437	7.4	2,034	29.0
1996	464	6.2	2,309	13.5
1997	477	2.8	1,980	-14.2
1998	386	-22.8	1,094	-44.7
1999	397	2.8	1,661	51.8

[a] Under the IATA billing and settlement plan; quoted in US$.
Source: derived from IATA billing & settlement plan, 2000.

The number of travel agencies increased as the government lifted travel restrictions in

1996, but the quality of services has not improved to meet customers' demand. The number of travel agencies increased dramatically in a short time, which created strong competition between them in Korea. Tourism products in Korea are limited and almost all travel agencies offer the same products to customers, which is a serious problem in the Korean tourism industry. Therefore, travel agencies compete on prices rather than quality of product differentiation.

Table 6.32 Sales of general travel agency in Korea, 1996

Classification	Sales (US$)	% of total
Inbound	276.033,026	12.0
Outbound	859,780,511	37.4
Flight tickets	1,164,661,147	50.6
Total	**2,300,474,684**	**100.0**

Source: derived from KATA, 1996.

Another problem in the Korean tourism market is that there are too many small travel agencies that cannot afford to employ more than two or three people. It will be difficult for these small scale-businesses to survive in the industry when multinational foreign companies enter the Korean market. During the crisis, more than 50 % of small scale-agencies reported a bankruptcy every month, but at the same time, many new agencies were entering the industry. More than 90 % of Korean travel agencies focus on Japanese market. Among a total 191 foreign branches for Korean travel agencies, 179 branches are established in Japan, and Japanese tourists create almost 80 % of their total profits, which represents a limitation in Korean travel agencies' marketing skills and methods (Ministry of Finance and Economy, 1997).

Table 6.33 Trends of foreign branch establishment for Korean travel agencies, 1995

Classification	Japan	America	China	Taiwan	Hong Kong	Russia	Others	Total
No. of branches	179	3	2	2	2	1	2	191
% of total	93.8	1.6	1.0	1.0	1.0	0.6	1.0	100.0

Source: derived from KNTO, 1997.

In contrast, there are only eight registered branches of foreign travel agencies, including Club Med, HIS Korea, and Korea-China travel agency in Korea. Several internationally well-known travel agencies include Thomas Cook which attempted to enter Korean market in recent years, but they all cancelled the project because they found that the Korean market is not big enough to invest in compared with other popular Asian markets for both inbound and outbound travel. In order to improve the quality of tourism products and services provided by travel agencies, the government should encourage foreign companies to invest in the Korean market by removing restrictions related to foreign capital investment and by offering exemptions of taxes for certain period of time. Fair competition between Korean and foreign travel agencies will eventually rely on the quality of the products rather than prices. It is true that foreign multinational companies can afford to charge less than local companies if they need to because foreign companies are, in general, financially stable to be able to survive without large profits for several months. Therefore Korean travel agencies cannot beat foreign companies by offering low prices, but the quality.

The Korean travel industry needs to overcome these problems in order to compete with foreign companies. The major problem is lack of new products development and lack of financial support for development. In broad terms, the distribution structure of Korean travel agencies needs to be changed, as shown in figure 6.6. The current distribution structure is too simple and it seems not specialised enough to achieve efficient and effective operation between customers and suppliers in the Korean travel agencies market, which can be found in many developing countries, as shown in figure 6.5.

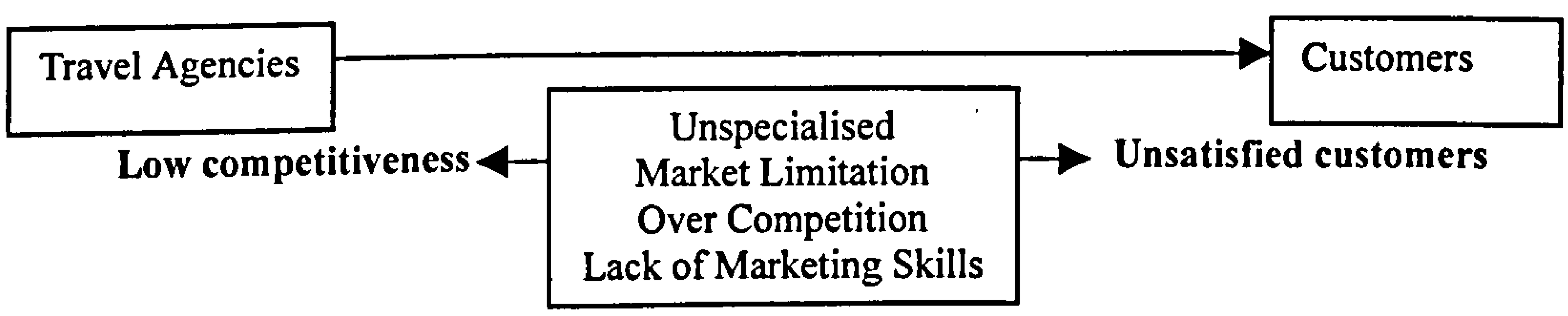


Figure 6.5 Current distribution system for Korean travel agencies

Source: Ministry of Finance and Economy, Korea, 1997, p.7

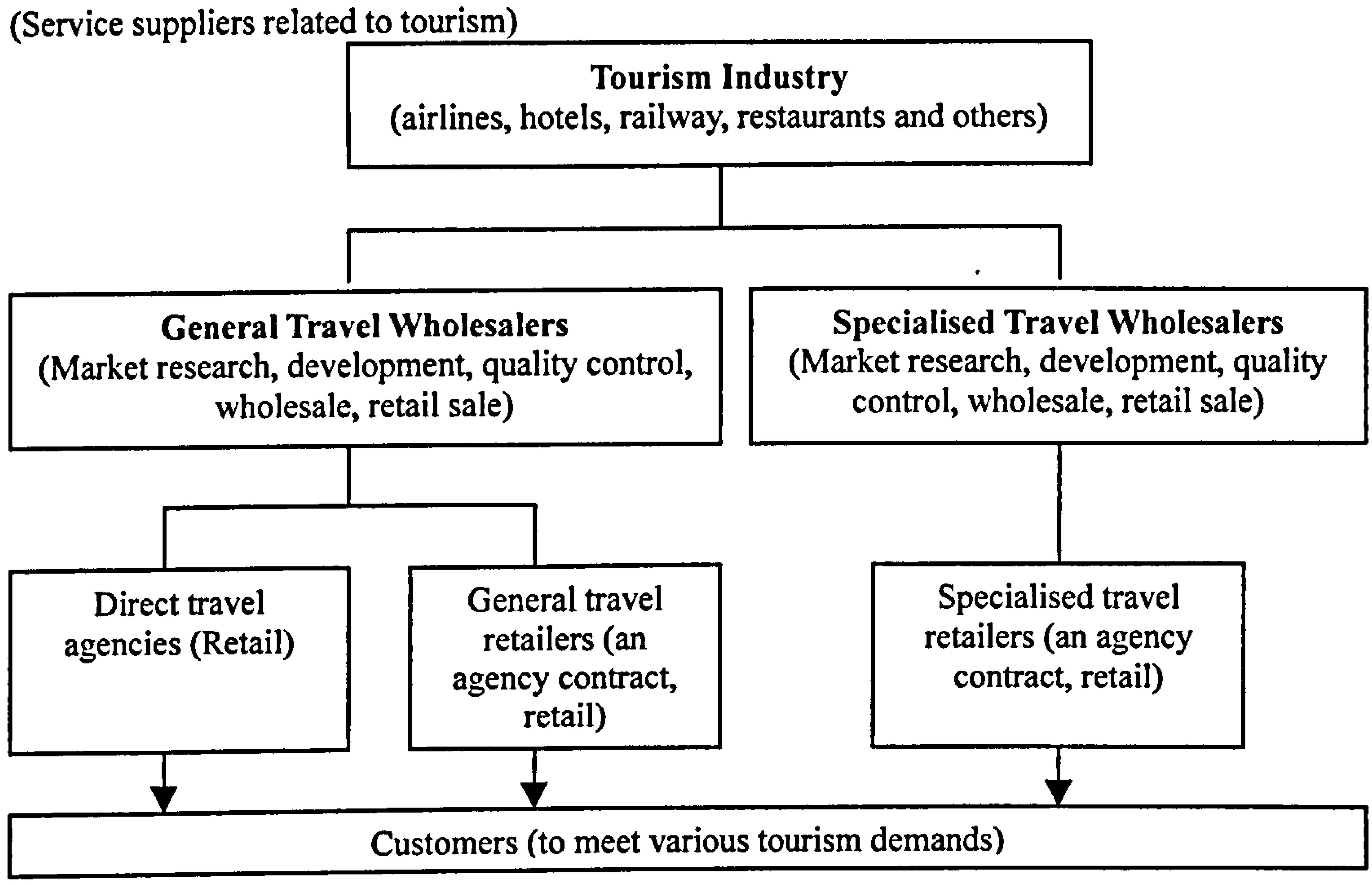


Figure 6.6 Future changes of the distribution structure for Korean travel agencies

Source: Ministry of Finance and Economy, Korea, 1997,p.8.

6.4.3.4 Air Services in the Korean Tourism Industry

Since 95 % of international travellers arrive in Korea by air, the quality and availability of an airline service is critical to the nation's tourism industry. The number of carriers scheduling flights to Seoul increased greatly in anticipation of the 1988 Olympics. Seoul Kimpo airport has grown rapidly, handling 8 million international passengers at the start of the decade, but reaching nearly twice that by the time the crisis hit in 1997. In addition, Seoul's new Inchon airport opened in 2001. The airport has two independent runways, and an opening capacity for 27 million passengers, international traffic at Kimpo in 2000 was 20 million. However, there will be problems initially as rail transport for the airport, which is 60 kilometres from the city, will not be ready for another two years until 2003. In 1993, 25 airlines offered flights to Korea from 18 nations and several more flights were being negotiated. The two flag airlines, Korean Air and Asiana Airlines, maintain a monopoly on domestic flights and also transport more than half of all international passengers. According to International Air Transport Association (1999), Korea is one of the world's fastest growing aviation markets. The IATA anticipated an annual increase in Korea's air travel of 9 to 10 % per year between 1995 and 2000 (Ahn and

Ahmed, 1994).

Nevertheless, it is difficult to monitor progress at Korean Air, as the company is not consistent with its delivery of statistics to the main international air bodies such as Association of Asia Pacific Airlines (AAPA) and International Air Transport Association (IATA). However, the figures, which available to the public show that the airline experienced a decline in seats sold in both 1997 and 1998, but probably not as much as expected considering the sizeable decrease in the outbound travel market. This indicates that the airline increased its loads from visitors attracted by the advantages of a falling currency to Korea.

Table 6.34 Traffic carried on Korean Air on international routes, 1990, 1995-1999

Year	Seats sold ('000)	% annual change	RPK (mn)	% annual change
1990	4,769	6.9	16,777	0.0
1995	6,856	7.8	29,179	14.0
1997	7,086	-3.7	30,622	5.0
1998	6,200	-11.4	N.A.	N.A.
1999	7,626	11.9	N.A.	N.A.

Note: RPK = revenue passenger-kilometres.
Source: TBA for calendar years; AAPA for fiscal years through March.

In 2000, Korean Air formed a partnership with Aeromexico, Air France, and Delta to create an alliance, named Skyteam, now one of the four largest in the world. The airline is known as one of the airlines that frequently involve many serious accidents. Following a series of aircraft incidents and accidents, Korean Air is restructuring its operations division with the addition of a US safety expert as managing vice president, replacing four out of five current vice presidents and adding nine chief pilots (Bailey, 2000).

The figure on Asiana shows a gentler decline in 1998/1999 than for Korean Air and Asiana is of over one-third the size of Korean Air. The airline represented on more Asian and American routes than the rest of the world.

Table 6.35 Traffic on Asiana, 1996-1999

Year	Seats sold ('000)	% annual change	RPK (mn)	% annual change
1996/1997	10,031	N.A.	13,075	N.A.
1997/1998	10,564	5.3	14,007	7.1
1998/1999	8,783	-16.9	11,274	-19.5

Notes: for fiscal years through March RPK = revenue passenger-kilometres
Source: derived from AAPA, 2000.

A rise in activity is expected from overseas airlines. The first route of Air Japan, a planned ANA subsidiary began operations in January 2001 on the Osaka Kansai-Seoul route. One of the two low-fare Japanese airlines, Skymark, started international routes in 2001. The first route was to Korea and Guam, after starting with charter flights in 2000.

6.4.4 INFRASTRUCTURE AND COMMUNICATIONS

South Korea has an adequate road network, modern telecommunication network and several international airports. Moreover, South Korea has one of the best public transport services including buses, trains, boats and planes in the world. The first railway was built at the beginning of the twentieth century, and during Japanese rule, a poor railway network was established to link together major cities.

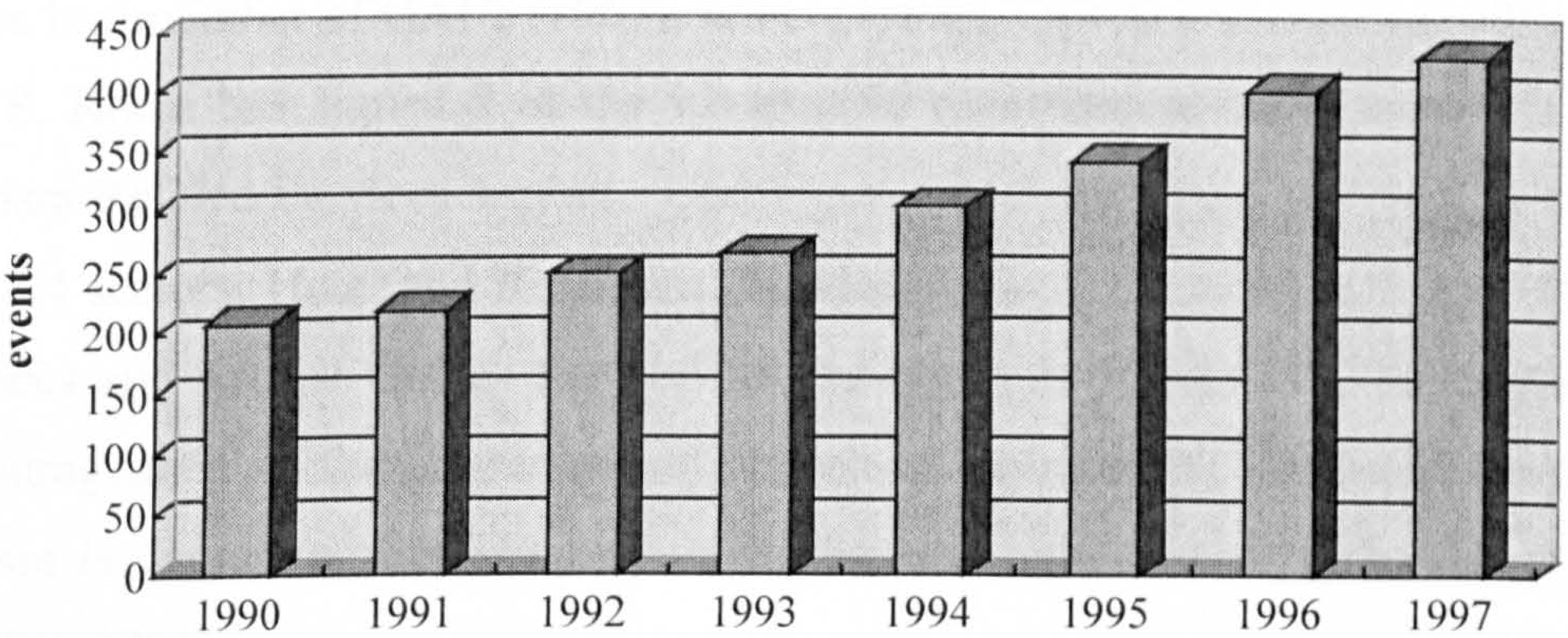


Figure 6.7 International convention demand in South Korea

Source: derived from KNTO (Korea National Tourism Organisation), 1999.

South Korea has an adequate road network, modern telecommunication network and several international airports, including newly established Inchon airport. Inchon airport is located 52 km west of Seoul, it is easily accessible by express railways and underground from the centre of Seoul. Another key development is the Cheju International Convention Centre, which has completed in 2000 with 5,000 seats available. The Korean government has also started to construct world-class convention centres in the seven other Korean convention cities.

6.5 GATS AND THE TOURISM INDUSTRY IN KOREA

The Marrakesh Agreement establishing the World Trade Organisation is the most comprehensive multilateral agreement to date, as mentioned earlier in the previous chapter. The reduction of tariffs is only one part of the agreement, which also imposes disciplines in many other areas of trade, such as agriculture products, textiles and clothing, services and the protection of intellectual property rights. However, it is worthy to note that developing countries, which had little involvement in previous GATT negotiating rounds, were actively participated in the Uruguay Round, making significant concessions and opening their domestic markets. In return, there has been a significant mutual agreement in overall negotiating fields which gives developing countries improved access and new export opportunities to international markets for both manufacturing and services industries (Roh, 1996).

Korea is a member of GATT (1967), WTO (1995[a]), OECD and GATS (1995). Within GATS, Korea has signed 8 of the 12 specific commitments category 9, Travel and Tourism Related Services sectors. Under category 9 Korea has committed itself to 3 of the 4 sectors: Hotel and Restaurant Services; Travel Agencies and Tour Operators Services and Tourist Guides Services as explained in chapter 5. The January 1998 discouragement of the promotion of overseas travel and the campaign for domestic tourism is depressing outbound travel further and airline capacity has been reduced (WTTC, 2001).

6.5.1 URUGUAY ROUND AND INTERNATIONAL TRADE IN KOREA

According to UNCTAD (1996), the Republic of Korea had certainly been one of the active members in the negotiations during the seven years the Round was under way. Being a country generating more than 55 % of its Gross National product (GNP) from international trade and having benefited from the GATT sponsored free-trade regime during its development period, the country also faces serious challenges, as well as opportunities, for continued economic development after the Round's successful conclusion. The important question for the country is whether services industry will benefit from joining GATS as much as manufacturing industry gained from the GATT.

In the Uruguay Round, the main concessions made to industrial products, agricultural products and services by the Korean government. For industrial products, 24 % of MFN imports were subject to tariff bindings in the pre-UR period, and 89 % after the conclusion of the Round. The pre-UR trade weighted tariff average on MFN imports was 18 %, and was reduced to 8.3 % as a result of the concessions granted. On the other hand, 4 % of MFN imports were duty free in the pre UR period and this proportion now stands at 26 %. However, service concessions are extremely difficult to analyse, since services are often characterised more by quality than by quantity, but the provision of a number of services has been opened up to foreigners. Of the total of 155 services dealt with in the negotiations, 78 have been opened up. Construction and related engineering services are completely open, and much progress has been made in opening financial services, covering some 88 % of the total. However, not many concessions have been made in communications and transportation services and non have been made in educational services, health-related and social services, and recreational, cultural and sporting services (Young, 1988).

It is important to know that the progress of globalisation has significant implications for the Korean economy. If the country successfully faces the new challenge, the emergence of a single world market will greatly improve Korean market access to the world, which could provide an opportunity to maximise growth potential, especially for services. According to a recent report by the World Economic Forum and International Institute for Management Development in Switzerland, out of a sample of 15 developing countries, the Republic of Korea fell to sixth place in international competitiveness in 1993, down from third place in 1991. This negative outcome was mainly the result of the country's lower degree of globalisation, one of the criteria by which each country was ranked and on which the nation had fallen from fourth to eleventh place. Since Korea cannot sustain any appreciable economic growth without engaging actively in trade with other countries, it is indisputable that the only choice which can revive its economy is to internationalise its economic institutions and practices, and then make positive efforts to become a fully fledged member of the world economy. Therefore, the Korean government has decided to chart out a set of comprehensive globalisation plans designed to help the country better face the challenges of freer and more open trade in the post-UR era.

6.5.2 TRADE IN SERVICES AND KOREA

International trade in services is largely based on globalisation and liberalisation. The services industry is highly liberalised compared with other industries in Korea. However, investment liberalisation is a significant element that might increase the share of world trade in services, especially for developing countries such as South Korea. In fact, the five-year foreign investment liberalisation plan raised the liberalisation ratio from 85.1 % in 1993 to 93.4 % by 1997, as shown in table 6.36.

Table 6.36 The five-year foreign investment liberalisation plan

(number of businesses)

Sector	Subject to restrictions in 1992	To be liberalised in					
		1993	1994	1995	1996	1997	Total (1993-1997)
Agriculture, fishery, and mining	35	5	5	1	3	9	23
Manufacturing	14	2	-	-	2	5	9
Services	175	9	22	34	13	22	100
Total	224	16	27	35	18	36	132
Liberalisation ratio (%)	83.0	85.1	86.9	89.6	90.9	93.4	

Source: Roh, 1996, p.72.

As one of many steps being taken in accordance with the five-year foreign investment liberalisation plan, some 52 businesses, including foreign language institutes, credit analysis firms and hospitals, previously closed to such investment will be opened up to investment by foreign entities and individuals. Of the 52 business lines scheduled for entire or partial liberalisation in 1996, 17 that were originally set to be liberalised in 1996 or 1997 are included with the 35 already scheduled for 1995. This brought the ratio of foreign investment liberalisation to 90.6 %. Specially, 9 businesses in agriculture, forestry, and mining are being opened up to foreign investments, 1 in manufacturing, 9 in wholesale/retail trade and consumer products repair, 11 in transportation, 4 in real estate, leasing and business services, 14 in education, health and social welfare, and 3 in public, social and private services (Roh, 1996).

Nevertheless, many economists suggested that many developing countries will benefit from joining GATS, but it will be difficult to know whether or not GATS plays positively for economic development in developing countries in the near future.

GATS is one of the most important trade agreements to achieve trade liberalisation in the services industry, especially in developing countries. GATS introduced a central objective of the negotiations on services the achievement of a progressively higher level of liberalisation through the reduction or elimination of trade barriers and the promotion of the interests of all participating countries on a mutually advantageous basis and the securing of an overall balance of rights and obligations, while giving due respect to national policy objectives. However, Korea fully subscribes to these objectives, and believes that further liberalisation and a removal of barriers in the services sector worldwide will contribute more to overall economic growth, significant increase in trade in services and foreign investment and the enhancement of productivity in the manufacturing sector (WTO, 2000[b]).

To participate effectively and maximise the benefits of GATS negotiations, it is essential that governments have a well-defined domestic reform agenda they desire to pursue. They also need to know what the major barriers to their exports are. Ideally, governments should use multilateral trade agreements to pursue domestic reforms that are desired in any event, seeking better access to export markets in the process. In Korea's case, a major problem confronting the government is the determination of priorities both for domestic reform and regarding foreign market access barriers which play an important role for the country to maximise benefits of GATS negotiations. For instance, the financial crisis in Korea was partly the result of highly protected and badly regulated market conditions. Therefore, the Korean government needs to reform domestic regulations to ensure that such situations do not occur.

Of particular importance to trade in services is the impact of restrictions on inward FDI, both ownership limitations and operating requirements. Despite the worldwide liberalisation of FDI that has occurred in the last decade, policies often remain restrictive, especially as regards ownership limits. The government, however, attempt to release the restrictions on foreign ownership under the GATS. Korea signed more sectors compare with other developing countries in order to achieve the liberalisation of trade in services, considering that they have signed the average of 6 sectors under GATS.

The Korean market has developed the impression of being liberalised in many sectors and industries in international trade, but it is too early to decide whether or not this is true in practice. It is possible for the Korean government to join GATS and GATT more for political reasons than for the nation's economic growth. South Korea submitted a schedule of specific commitments on limitations on market access and limitations on national treatment by four different modes of supply for the GATS, which apply to all sectors included in the schedule. According to the WTO (1994), South Korea presented specifications only on "commercial presence" and "presence of natural persons". The details of Korea's schedules of specific commitments are represented later in Appendix. Meanwhile the key schedules are as follow:

- Commercial Presence: individual foreign investors can own up to 3% of each company's total stock, while total foreign investments cannot exceed 10% per each company. In addition, the amount of foreign investment must be at least 50 million won (equivalent to US$ 3.5 million).
- Presence of Natural Persons: entry and stay of natural persons as defined as natural persons who are employees of firms that supply services through 100% foreign ownership, joint venture companies or branches established in Korea and who have been in the employ of their firm for a period of not less than one year, is can stay in the country for a limited period not exceeding three years. Natural persons are responsible for the setting up a commercial presence of a service supplier in Korea, can stay in the country no longer than 90 days.

More importantly, Korea has been recognised as a liberalised market for cross-border trade in services, as shown in table 6.37. Since the provision of tourism services is mainly linked to the cross-border movement of consumers, it is important to maintain certain level of trade freedom, not only for tourism sectors but also other sectors such as financial and transport sectors to increase number of tourist arrivals in Korea.

Table 6.37 Top 15 service trading countries with the highest relative specialisation in cross-border services, 1997.

Importers	Share (%)	Cumulative share (%)	Exporters	Share (%)	Cumulative share (%)	Countries with highest revealed comparative advantage	
USA	11.1	11	USA	16.7	17	Kiribati	71
Japan	9.9	21	UK	7.8	25	Nepal	54
Germany	8.0	29	Japan	7.2	32	Mozambique	53
Italy	5.9	35	Germany	6.6	38	Neth. Antilles	52
France	5.1	40	France	5.9	44	Cape Verde	52
UK	4.8	45	Netherlands	4.8	49	Greece	37
Netherlands	3.7	49	Italy	4.7	54	Egypt	37
Canada	2.7	51	Belgium	3.2	57	Djibouti	36
Belgium	2.6	54	Hong Kong	3.0	60	Ethiopia	34
Korea	2.4	56	Singapore	2.7	63	Philippines	32
China	2.2	58	**Korea**	**2.3**	65	Vanuatu	30
Spain	2.2	61	Canada	2.3	67	Latvia	29
Taiwan	1.8	62	Switzerland	2.0	69	Samoa	28
Malaysia	1.7	64	Spain	1.9	71	Jordan	27
Austria	1.6	66	Austria	1.7	73	Antigua and Barbuda	26

Note: The revealed comparative advantage (RCA) of country i for product j is measured by the item's share in the country's exports relative to its share in world trade. That is, if x_{ij} is the value of country i's exports of j, and x_{it} is the country's total exports, its revealed comparative advantage index is $RCD_{ij} = (x_{ij}/x_{it}) \div (x_{wj}/x_{wt})$. Source: Karsenty, 2000, p.131.

On the other hand, with tourism and travel related services, the Korean government claimed that the tourism sector is more liberalised without any recognisable restrictions to be obstacle to tourism development than any other sectors involved in the schedule. Table 6.38 shows the specific commitments in the tourism sector that South Korea presented.

Table 6.38 Specific commitments on tourism and travel related services

Sector or sub-sector	Limitations on market access	Limitations on national treatment	Additional commitments
A. Hotels and restaurants	1) Unbound* 2) None 3) None 4)Unbound except as indicated in All Sectors	1) Unbound* 2) None 3) None 4)Unbound except as indicated in All Sectors	
B. Travel agency and tour operators	1) None 2) None 3) None 4)Unbound except as indicated in All Sectors	1) None 2) None 3) None 4)Unbound except as indicated in All Sectors	
C. Tourist guide services	1) None 2) None 3) Only travel agencies are allowed to supply tourist guide services 4)Unbound except as indicated in All Sectors	1) None 2) None 3) None 4)Unbound except as indicated in All Sectors	

*Unbound: Unbound due to lack of technical feasibility.
Note: 1)Cross-border supply 2)Consumption abroad 3)Commercial presence 4)Presence of natural persons
Source: derived from WTO, 1994.

6.5.3 IMPACTS OF GATS ON KOREAN TOURISM INDUSTRY

Tourism is still regarded as an infant industry in Korea, but the government is attempting to develop tourism sectors further, especially after the financial crisis. The Korean government announced that the country's trade policy will be changed over next 10 years in the process of globalisation and liberalisation. However, the Korean government has applied protective trade policies toward infant industries such as tourism, but becoming a member of GATT and GATS will help the country to change trade policies and economic management systems to be globalised. The fundamental problem of the Korean tourism industry is that the industry is not large and specialised enough to compete internationally. The tourism industry in Korea, especially airlines and travel agencies, is concentrated more on outbound travel markets, rather than inbound markets. Therefore, the government is encouraging both foreign and domestic private investors to participate in tourism development in Korea, which can be achieved by applying GATS.

However, according to the Ministry of Culture and Tourism in Korea, several important positive implications of GATS are expected for Korean tourism. First, GATS will help to establish and adopt an "open and fair competition system" as it is the basic paradigm for economic development. Although GATS specifies fair treatment between domestic and foreign companies, the principles of creating open and fair competition will eventually apply not only between foreign and domestic companies but also between domestic companies:

- "Competition" in the context of the free market system should be firmly established throughout the entire economy. This implies that the government should pursue a programme of sweeping reform, ceasing its practice of market intervention and removing regulations which had become entrenched in the past when concerns regarding market failure were much greater.
- Since the term "fair" itself implies the establishment of a fair competition system governing all aspects of economic activity, the government should ensure that reward goes where it is due whether it is individuals or firms. It is important to receive rewards that correspond to the level of performance and contribution to the country's economic growth, thereby creating the incentive to work, which would in turn maximise growth potential. Government policy which favours specific

industries through the granting of subsidies and tariff reductions or which specifically penalises conglomerates should therefore be changed, making it more conducive to fair competition.

- An "open" competition system, which implies that foreign firms will be treated in the same manner as domestic firms, should be introduced by the resolute acceptance of international norms. Such a system will be instrumental in encouraging domestic firms to enhance their competitiveness and inducing a greater inflow of foreign direct investment (Ministry of Finance and Economy in Korea, 1997).

Second, GATS will help Korean tourism industry to accommodate the new trends in world tourism and it will help member countries to react fast and efficiently to new tourism trends. For example, if Korean tourists prefer to travel to Australia instead of America, Korean travel agencies may need to set up branches or send tour guides to Australia, and Korean airlines may increase frequency of flights to Australia. Because both Korea and Australia are member countries under GATS, it will be easier for Korean tourism-related firms to expand their business abroad and guarantees fair treatment.

Third, GATS will be beneficial to Korean tourism-related businesses seeking to expand throughout the world. Korean firms would have a much stronger presence on the world market if they assumed a much more active role in the process of globalisation. Toward this end, it is especially important for Korean firms to capitalise on the newly emerging international division of labour, discovering both the country's comparative advantages and those of Korea's trading partners as industrial structures rapidly change. In this sense, the government should lift regulations which bar the free movement of factors of productions and services across borders, which have been substantial obstacles discouraging overseas investment and the formation of strategic alliances with multinational firms.

Fourth, GATS will help to expand and develop human resources. Globalisation will accelerate the adjustment of the industrial structure, resulting in greater demand for new and more highly skilled manpower. Plans should therefore be formulated to ensure that such manpower will be available. In addition, to participate as a fully-fledged member of GATT and GATS, the country must foster the development of professional manpower specialised in overseas matters as well. Human resource development can be achieved by learning and adopting skills from more advanced trading partner countries (Young, 1988).

Overall, GATS is expected to be beneficial to the Korean tourism industry in the long-run, but there are important issues need to be consider:

- In order to accommodate international economic norms, the ultimate goal of which is the integration of all economies into a single world economy, all possible sectors of the Korean economy should be opened to foreign competition, including tourism sectors. National economic institutions should also be improved so that the country can properly present itself as a fully-fledged player in the world economy.
- The facilitation of domestic firms' business operations abroad and liberalisation of foreign exchange transactions and capital movements should be pursued more aggressively, bringing national practices into line with developed countries. The financial sector is strongly related to tourism and it is underdeveloped in Korea compare with developed countries, therefore GATS will help to upgrade financial sector as well as tourism sector by bringing strong competition with foreign firms. Foreign firms from developed countries hold advanced technology and efficient management skills, which can be adopted by Korean firms.
- Changes need to be made to the support system for SMEs, which are inherently anti-competitive. Under the present system, SMEs receive preferential treatment as they are granted special lines of credit, protection of markets, and other means of support that are not available to other firms. Such measures are in violation of international norms. The government should support such firms through other means, such as expanding the supporting infrastructure, thereby encouraging them to exert their own efforts to improve competitiveness. In this connection, GATS may create negative implications on Korean tourism industry in short-term. The majority of travel and tourism related businesses in Korea are small and medium enterprises, therefore the differences in operation system and financial stability will be large between those multinational foreign companies and domestic SMEs. Therefore, after the government opens up the tourism market completely to foreign firms, those domestic SMEs may not survive in the market as they are

competitive enough in both quality and quantity of services (Roh, 1996).

6.6 SUMMARY

It is no surprise that the key to the success of tourism in Korea is a clear recognition by the government of the important role of tourism in the economic development of the country. Tourism serves as an important means to increase economic growth, raise the quality of life, create employment, and improve the overall balance of payments by helping to offset deficits in other sectors. As mentioned earlier, Japan, Taiwan, and South Korea are the major tourist generating countries in the Asia Pacific region and this is reflected by the deficits in their respective travel balance of payments accounts. Mak and White (1992) attributed the travel account deficits for these high income countries to a higher allocation of disposable income to leisure travel. The relaxation of travel restrictions in Korea also had a significant impact on its travel account, due to the large increase in outbound travel despite the financial crisis.

In addition, a number of factors are responsible for the rapid growth and development of the tourism industry in Korea. These include strong economic growth, increase in income, breakdown of political barriers, easing of travel restrictions, liberalisation of air transport, and focused marketing campaigns. These factors are expected to accelerate the growth of tourism over the next decade. However, the Korean tourism industry needs to overcome several serious problems in both public and private sectors in terms of trade restrictions, tourism policies and foreign investment. Therefore, the enforcement of GATS is important to develop the Korean tourism industry in the long run.

The problem with enforcing GATS in Korea is that some of the language in the GATS is unfortunate in implying that trade liberalisation in tourism-related services is a luxury that the developing and less-developed countries may be unable to afford. The truth is that Korea cannot afford expensive and inefficient service providers. In other words, the fastest way to upgrade a services economy may often be to introduce foreign competition, freeing government and taxpayers from that burden but the country may not be ready to open the market to foreigners. In fact, there are plenty of tourism-related services in which inefficiency and high costs are protected by regulations not necessarily designed to discriminate against foreign suppliers, which make entry unnecessarily difficult.