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DESTINATION UNKNOWN. IS THERE ANY ECONOMICS BEYOND TOURISM AREAS?

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Destination unknown. Is there any economics beyond tourism areas?

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Abstract

In recent years, several papers have been focussing on various aspects of the tourism destination. The destination is a central issue within tourism studies, embodying in one single concept all the specific and problematic features of tourism, such as its systemic nature, in which "space" plays a fundamental role.

In this paper we argue that is in the analysis of destinations that tourism economics shapes itself as an independent discipline within applied economics. Firstly, destinations are neither microeconomic agents nor macroeconomic aggregates, but territorial systems supplying at least one tourism product (a bundle of goods and services) able to satisfy the complex needs of the tourism demand.

Secondly, the economic analysis of destinations identifies two specific theorems, the *love of variety* theorem and the *coordination* theorem which allow to interpret the tourism destination as a particular type of district, sharing at the same time some of the features of the industrial and of the cultural district.

Keywords

Tourism economics, tourism areas, destination management

JEL Classification

L1, L83, R3, R5

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Destination unknown. Is there any economics beyond tourism areas?

1. Introduction

The related literature has established that the destination is a central concept within tourism economics and, in recent years, several papers have been focussing on various aspects of the destination. Nowadays, research on destinations is one of the "hot issues" in tourism studies. A rough indicator, the number of entries in google scholar, allows to provide some anecdotal evidence: "tourism destination(s)" have 18,730 entries (on 31st of July, 2009); at the same date, "tourism firm(s)" have 1,538 entries, "tourism demand" 6,480, and "tourism market(s)", have 14,750 entries. Clearly, more precise searches in specific databases might lead to slightly different results, but the suggested bottom line is the same: research in tourism studies pivots around the organisation, the management, the development, the sustainability and, we argue, the *economics* of destinations.

Although everyone knows what a tourism destination is, more difficult is the attempt to define it, and early definitions are rather unsatisfactory:

"a tourism destination might be a single district, a big city or a small town, a rural, mountain or a coastal area, clearly shaped" (Davidson and Maitland, 1997).

Such definition does not allow to focus on the intrinsic characteristics of tourism areas, since there is a huge variety of destinations around the world. However, Cooper *et al.*, (2008) identify the following common features of the destination:

- The destination is a "product" in itself, with an economic value;
- The destination is perishable: seasonality, the overload of tourists over its carrying capacity, the heavy use of natural resources which can drive to unsustainability can all lead the destination out of the market.
- In the destination, tourists and residents compete for a limited amount of available resources;
- In the destination, the variety of goods and services which compose the tourism product must be of the same quality to guarantee the success (i.e., a luxury hotel can not be located in a rough and dangerous area).

By merging and reshuffling these features, the following definition has been proposed:

"a destination is a territorial system supplying at least one tourism product able to satisfy the complex needs of the tourism demand" (Candela and Figini, 2009a).

Indeed, the destination embodies in one single concept all the specific and problematic features of tourism, such as its systemic nature, in which "space" plays a fundamental role (Leiper, 1990). It is in the destination that supply meets demand; it is in the destination that natural and cultural resources,

attractions, the hospitality sector etc. are located; it is in the destination that tourism demand reveals. Therefore, the destination is the *trait d'union* between the complexity of the sector, the complementarity of the many goods and services which constitute the tourism product, and the intangibility stemming from the supply of the territory.

Hence, one might conclude that the economics of destinations can be identified with the economics of tourism. Although we will argue in the remainder of the paper that is in the analysis of destinations that tourism economics shapes itself as an independent discipline within applied economics, such equivalence, however, would be misleading.

To begin with, we need to select some criteria to distinguish those aspects that are specific of single firms, those that characterise the whole sector and those that are specific of the destination. To justify the lack of equivalence between the destination and tourism for the economist' point of view, we can therefore distinguish:

- the *microeconomics of tourism*, which refers to the analysis of markets in which the elementary items composing the tourism product are supplied, demanded and exchanged: accommodation, package tours, transport, etc. The typical tools of economics, particularly of industrial organisation, are applied in this field of study. In such microeconomic framework, the destination is nothing more than the location in which markets work and show their effects.
- The *macroeconomics of tourism*, which refers to the aggregate analysis of tourism demand and production and their effects on national income, the balance of payments, growth and development. Again, the typical tools of economics (i.e., the Keynesian multiplier, endogenous growth theory, the models of international economics, etc...) can be applied.
- The *economics of destinations*, which refers to the relationship between demand and supply of the whole tourism product, for the different types of tourism hosted in the destination.

Such distinction allows us to classify the recent literature on destinations, by separating the papers for which, paraphrasing Lundberg *et al.*, (1995)

"[destination] is an umbrella concept" (Lundeberg *et al.*, 1995, p. 4)

nothing more than a geographical location, not necessary for the analysis carried out, from those papers which, on the contrary, study specific features of the destination at this intermediate level of analysis between the micro and the macro.

Among the first group, most of the economic content can be easily explained with the standard models and tools of applied microeconomics and macroeconomics. For example, in papers dealing with problems of quality uncertainty, product differentiation, price discrimination, information asymmetries, externalities, public goods, the destination seldom represents something different from the concept of the market in which firms and tourists face the problem. Although it is not the aim of this paper to provide a literature review of the economics of tourism destinations, recent papers on such issues are, among many, Candela and Cellini (2006), Candela *et al.* (2009), Figini and Vici (2009).

When the theory calls for public intervention, it is by using the standard tools advocated to the "allocation bureau" (Musgrave, 1959) to solve microeconomic inefficiencies: regulation of the market, antitrust and competition authorities, contract theory, taxation, etc. Tourism economics and destinations are, in this sense, a field of application of sound (and well known) economic principles.

Similarly, at the macroeconomic level, the impact of tourism (in particular international tourism) on the whole economy can be explained by using standard concepts as the Keynesian multiplier or international trade theory (Sahli and Nowak, 2007); the effect of specialisation in tourism on economic growth can be analysed using standard endogenous growth theory (Lanza and Pigliaru, 1995); the long run effect of tourism on the environment as a whole can be studied by applying the concepts of sustainability to tourism (Cerina, 2007; Lozano *et al.*, 2007). Again, in this literature, destinations can be seen as examples where to apply sound (and well-known) economic principles. The public intervention, in such framework, completely overlaps with the aims of the "stabilisation bureau" to solve macroeconomic inefficiencies at the country or regional level.

Among the second group of papers, the ones focussing on specific features of the destination, another observation is needed. Most of these papers do not have a proper economic content and belong to other disciplines, such as management, marketing and organisation. Concepts such as life-cycle of tourism areas (Butler, 1980), destination management (Laws, 1995), destination marketing (Heath and Wall, 1992), destination branding (Morgan *et al.*, 2004), web management of the destination (Choi *et al.*, 2007; Wang, 2008) have been developed and the specific features, both theoretically and in terms of practical applications have been identified.

Again, such a gap in the literature let us wonder whether something such as the economics of destinations really exists. We believe it does exist, and our thesis is that:

- a) There are some particular economic features in the tourism sector that call for a novel and independent analysis;
- b) Those economic features involve the destination level;
- c) It is the existence of such "economics of tourism destination" that allows tourism economics to be defined as an independent discipline within applied economics.

While the discussion of point (c) is left to another paper (Candela and Figini, 2009b), we focus, in the remainder of the paper, on the identifications of the issues involving points (a) and (b).

2. The tourism product and the destination

Re-organising the four characteristics of the destination borrowed by Cooper *et al.* (2008), the fundamental economic problems of the destination can be summarised as follows:

1. In the destination, it is necessary to coordinate the different activities provided by independent firms.
2. In the destination, it is necessary to supply a variety of goods and

- services in order to meet tourists' needs and improve their satisfaction.
3. The destination needs to "complete" the tourism product through the supply of those public goods, structures and infrastructures which can not be efficiently offered by the private sector;
 4. The destination faces problems of inter-spatial externality (between tourists and residents) and inter-generational externality (between present and future tourists – sustainability).

Points (3) and (4) above are, however, "typical" market failures which require the intervention of the public authority, defined at the destination level. On such issues (particularly the n. 4) there already exists a vast literature which in part as already been recalled.¹

In what follows, therefore, the focus will be on points (1) and (2) listed above, which constitute, in our opinion, the core on which the economics of the destination shapes itself and leads to two important theorems for tourism economics: the *theorem of coordination* and the *theorem of variety*.

Before getting there, we first have to describe the two specific features that render the tourism product an interesting object of study for an economist: a) the tourism product is a bundle of goods; b) the territory is part of the production function.

A. The tourism product is a bundle of goods

The tourism product is a complex good, in the sense that it is composed of a set of elementary items (goods and services), demanded, in a relationship of complementarity, by the tourist during the experience of the holiday. Hence, in a technical sense, the tourism product is a bundle of several goods (accommodation, transport, shopping, natural attractions, events etc.). The usual object of study of economics, on the contrary, is the single good (for microeconomics) or aggregate production (for macroeconomics).

Due to such characteristics of the tourism product, neither the market criterium nor the technological criterium are able to identify a tourism sector in the system of national accounts. Tourism satellite accounts have to be developed, to measure the impact of tourism on the economy.

The "bundle" is an important economic feature, being very useful in both microeconomic theory (i.e., the theory of consumption), in applied economics (to build price indices), and in macroeconomic theory (to estimate the aggregate value of production and income). However, in all those applications, the consumption bundle is a tool used by economists, rarely an object of study in itself.² In tourism economics, on the contrary, that particular bundle of goods and services called "tourism product" is the object of study, from which peculiar effects and behaviours of demand and supply derive.

B. The territory is part of the production function

1 See Candela and Figini (2009a), Chapters 14 and 15 for a broader analysis and for bibliographic references.

2 An important exception is the theory of Lancaster (1971) which gave rise to the hedonic price approach. Not surprisingly, such approach finds in tourism a natural field of application (see Aguilò *et al.*, 2003).

In economic theory, demand and production meet in markets: abstract institutions which location is irrelevant. Only rarely, and recently, the spatial boundary of economic processes is considered a relevant object of study (for example, in the new economic geography, in transport economics, in the theory of industrial or cultural districts).

In tourism economics, the measurement of tourism flows involves the spatial definition of the destination: arrivals, nights spent, length of stay, and tourist expenditure from the demand side; carrying capacity and accommodation capacity from the supply side. In other words, the "quantity" of the tourism market is measured at the destination level, which is neither a firm nor an industry, but a system. In other words, a mix of heterogeneous firms providing different goods and services which are the elementary items composing the tourism product. Therefore, the main "agent" in tourism economics is the destination, neither the firm nor the consumer.

3. The economics of destinations

Having defined a particular object of study (the tourism product) produced by the destination (a territory defined as a system of firms producing the elementary items of the holiday),³ we are able to shed light on the two results which, in our opinion, constitute the bulk of the economics of destination: the *love of variety* theorem and the *coordination* theorem.

The "love of variety" theorem

Destinations gain by increasing the degree of diversification of the tourism product, defined as the variety of goods and services included in the holiday. The greater the variety, the higher the willingness to pay of the tourists, the higher the profits of the firms operating in the destination (Andergassen and Candela, 2009).

To simplify, the "love of variety" theorem would require the destination to supply at the same time a seafood restaurant and a pizzeria, a golf course and an amusement park, etc. Variety, in this sense, is different from the typical concept of variety stemming from horizontal differentiation models. In those models, differentiation has the scope of increasing the willingness to pay of consumers by supplying the good closer to their preferences, but each consumer chooses one single variety. In the "love of variety" theorem, on the contrary, tourists' willingness to pay increases because, within the same holiday, tourists can enjoy a seafood meal at lunch and a pizza at dinner, a day on the golf course, and another spent on the roller coaster, etc.

While we refer to Andergassen and Candela (2009) for the complete model and for the formal demonstration of the theorem, for our purposes it is sufficient to describe their assumptions and the intuition of the model. They consider a representative tourist with a Constant Elasticity of Substitution (CES) utility function (Dixit and Stiglitz, 1977). The arguments of the utility

³ In our approach we mainly have in mind the independent tourist who composes his/her own holiday by separately buying the elementary items in the destination. However, the framework proposed in this paper also holds for package tourists: the only difference is that, in this latter case, the holiday is produced *in house* by the tour operator.

function are: i) the length of stay in the destination, proxied by the number of overnight stays consumed in the (only) accommodation firm; ii) the consumption of a local product, which is produced in n varieties by the n firms located in the destination (they constitute the different tourism attractions); iii) the consumption of non-tourism goods. Such set-up allows, in line with subsection 2.A, to represent the tourism product as a bundle of different goods, including accommodation and a variety of local goods.

Under general assumptions (the local goods and accommodation are gross complements, the local goods and non-tourism goods are gross substitutes, the different varieties are gross substitutes, the local goods are produced in competitive markets), Andergassen and Candela show that the satisfaction of tourists increases with the variety of local goods. As a consequence, the demand for accommodation and the share of budget spent in the destination both increase with the richness of its variety.

Indeed, this result is not new: Dixit and Stiglitz (1977) seminal paper is the founding result of monopolistic competition markets. What is new, for economics, is the policy implication stemming from such application to tourism economics. The "central planner" which we call *destination management*, representing the system of firms, has some tools to increase "its" firms' profits. If the tourist loves diversifying experiences in the holiday, the destination has to increase the variety of local goods and services accessible to tourists, (i.e., by favouring the development of local firms, or merging in districts, i.e., the *Sistema Turistico Locale* in the Italian legislation).

A corollary of Andergassen and Candela's model is that the "love of variety" also means the preservation and the availability to tourists of natural resources that enter as public (or common) goods the utility function, and for which tourists do not pay. As a consequence, the destination has to raise funds to finance such preservation, and this should come from taxation of the extra-profits of the firms.

The coordination theorem

Within the destination, the tourism product can develop if the many firms offering single parts of the holiday are coordinated. This theorem stems from the existing complementarity between the single items composing the holiday; i.e., lodging in a hotel is a complement good of the meal offered in the restaurant, and, in general, of all the other goods offered by local firms.

This is tantamount to say that each firm owns the right to accept or refuse the tourist in the destination. If the hotel refuses the accommodation, it produces a negative externality on the restaurant, since tourists will not travel to the destination at all. The assumption of a good on which many agents own the same property right defines the anticommon.⁴ It is interesting to notice that such a case of fragmentation of property rights is exactly the opposite of the common good, in which property rights are not defined (Hardin, 1968).

The question we need to answer is whether there is a tragedy of the anticommons in the destination.

We believe there are three different reasons why the answer is "yes",

⁴ The anticommon has been introduced by Michelman (1982) and developed by Heller (1998 and 1999). See Parisi *et al.* (2000) and Parisi *et al.* (2004).

stemming from three different dimensions of the coordination problem. In fact, firms have to coordinate in quantity, quality, and price. We present very briefly the first two aspects, then focussing on the third aspect, price coordination.

A. Coordination in quantities

Coordination in quantity simply means that the carrying capacity of one firm has to match with the carrying capacity of its complements, otherwise tourists would not gain the physical access to the destination. This involves, for the destination authority, the right to plan the (sustainable) development of the destination in the long run, and the possibility to use pricing and booking strategies in the short run to counteract phenomena of seasonality, overbooking etc.

B. Coordination in quality

If in the destination there is a luxury hotel, tourists would probably ask a luxury restaurant. If, instead, there is only a pizzeria, or a take-away, tourists will probably not come to the destination at all. This case can be easily considered as a specific case of point (A), if we reinterpret quantity in terms of "quantity of the complementary good asked by a particular type of tourists". A complication arises when the destination hosts at the same time different types of tourism. In such case, the destination has to offer a range of different qualities (and varieties) in order to match the specific demands.

Coordination of quality allows to consider the destination as a club, with the well-known problems of quality maintenance of clubs that the destination management has to face (Cuccia and Santagata, 2004).

C. Coordination in prices

While the implication of point (A) is obvious, and point (B) has already been tackled by the literature of cultural economics,⁵ point (C) might provide some new insights into the coordination problem. To focus on this issue, Candela *et al.* (2008) consider a very simple set up in which quality is the same throughout the destination and there are no capacity constraints. Moreover, the single firms operating in the complementary markets have some monopoly power: in the simplest case, the authors analyse two monopolist firms.

They easily show that, without coordination among firms, the final price paid by the tourist is too high, overnight stays too low and, what is more important from the destination point of view, profits of the firms are not maximised. This is tantamount to say that, without coordination, there is a market failure stemming from the anticommon property.

This problem calls for the intervention of the destination management, which has to: i) coordinate the firms offering the single parts of the holiday; ii) fix the price of the whole tourism product (the holiday); iii) impute the price of each single component of the tourism product, by redistributing across firms portions of the extra-revenue due to coordination. With such effort of coordination, profits are maximised, and overnight stays increase.

It is important to notice that the coordination supplied by the destination management (which can either be a public authority or a private association of firms) is not the only solution to the anticommon problem. An alternative

⁵ In the literature of tourism economics, see also Calveras and Vera-Hernandez (2005).

solution can be found in the market, the one provided by the tour operator, who sells the package holiday. In such case, the tour operator has to: i) coordinate the firms supplying the single parts of the good in a single "all-inclusive" holiday; ii) fix the price of the holiday; iii) offer a payment to the single firms (these prices will be lower than market prices, but will allow them to reach at least the same level of profits, in order to satisfy the participation constraint); iv) keep the extra-profits, which are not redistributed to the local firms. Therefore, also with market coordination total profits are maximised and overnight stays increase, although profits for local firms are lower than in the case of coordination provided by the destination management.

To summarise, the coordination theorem states that, when the good has the anticommon property, coordination among firms, which can be provided by the destination management or by the tour operator, increases total profits.

The theorem explains two important facts of the tourism sector: the need of a centralised destination management to coordinate single firms and/or the development of a decentralised firm offering the holiday, the tour operator.⁶

The economic goal of the destination

A recent debate has developed around the economic goal of the destination (see, for example Dwyer and Forsyth, 2008; Scott and Breakey, 2007). What is the measure of yield which can be applied to the destination and which can evaluate its competitiveness? Theoretically, following the theorem of coordination, and for imitation of the tour operator, the goal of the destination should be the maximisation of aggregated profits. However, a central planner does not have all the information needed to reach such goal (i.e., it does not know the cost function of firms).

Therefore, an operational proxy should be identified. The proxy generally considered by the literature is revenue maximisation or, which is the same, tourists expenditure.⁷ Revenue maximisation imposes to set the holiday price in the point where the elasticity of demand is equal to one in absolute values (Cournot price).

The toolbox of the destination management

In the previous sections we have stated that there are many economic reasons to justify the existence of a central destination management, particularly when the tour operators are not active in the destination, i.e., when tourism is mainly composed by independent tourists. Moreover, we have identified the economic goal of the destination as revenue maximisation. Now we briefly discuss the tools that can be used by the destination management.

Firstly, if the destination has a central management, some power over the price and the pricing strategies is needed. As already said, revenue maximisation imposes to find the Cournot price. Three interesting corollaries for the pricing strategy of the destinations exist:

- destinations have to go where the wind blows, by raising prices if the

⁶ It is important to highlight that the anticommon problem has not been developed in tourism economics, but find in this field a perfect application.

⁷ This is like to assume that costs are the same for all firms: in such case profit maximising is equal to revenue maximising.

- demand increases, and decreasing prices if the demand falls;
- the pricing strategy is the effect, not the cause of the type of tourism hosted. If a destination is selected by mass-tourism, it has the advantage, since demand is more elastic, to keep prices low; if a destination is selected by élite-tourism, it has the advantage, since demand is less elastic, to keep prices high.
- If the destination is concerned with the quality of the environment and the preservation of natural resources, *ceteris paribus*, prices have to be higher (Pintassilgo and Silva, 2007).

Secondly, all the pricing and yield management strategies nowadays used by single firms (overbooking, price discrimination, first and last minute offers etc.) might also be applied to the destination, thanks to the development of ICT.⁸

Thirdly, a vast literature analyses the main tool used to finance the management (taxes), and the problems involving its distribution between tourists and residents, and among residents, between the tourism and non-tourism sectors.⁹

4. Discussion

The arguments developed in this paper allows us to support two conclusions.

Firstly, destinations can be seen as a particular type of districts, which share some of the aspects of industrial districts (positive externalities on costs stemming from the agglomeration of firms) and of cultural districts (positive externalities on quality stemming from the common belonging to a club). Tourism destinations share both externalities. They increase the quality of the holiday, as it is perceived by tourists (and measured by their willingness to pay) if they invest in variety ("love of variety" theorem). They join a positive externality, with positive effects on prices and on profits of the local firms if there is coordination provided by the destination management or by the tour operator (coordination theorem). Candela *et al.*, (2008) summarise such conclusion in this way:

Table 1 – A Comparison of industrial districts, cultural districts and tourism destinations

Type of district	Reasons for the birth	Need for public intervention	Rationale of public intervention	Local community welfare
Industrial district	Externalities	No	---	Welfare increases
Cultural district	Product idiosyncrasy	Yes	Remedy to the problem of	Welfare increases in case of success

⁸ The recent literature has also suggested that several other instruments might be used to reach different targets. For example, in order to counteract the historical trend in the fall of the length of stay (which has negative consequences on the average quality of the holiday in the destination, see Candela *et al.*, 2003), the management might use a two-part tariff in order to affect tourists decisions on the number and the length of the holiday (Candela *et al.*, 2009).

⁹ For a recent survey, see Vaccaro (2007).

			<i>commons</i>	
Tourism destination	Tourism product as a bundle of goods	Yes	Remedy to the problem of anticommons	Uncertain result depending on income distribution

Source: Own elaboration on Candela *et al.* (2008), Table 1

Secondly, the issues raised in this paper allow us to enter the debate on whether tourism economics can be considered a discipline. Different positions can be found in the literature, ranging from negative answers:

“Tourism is found not to be a discipline” (Tribe, 2004, p. 48)

“While tourism rightly constitutes a domain of study, at the moment it lacks the level of theoretical underpinning which would allow it to become a discipline” (Cooper *et al.*, 2008, p. 5).

Other positions are more open to identify tourism economics as a field of study:

“Tourism is an established area of study in applied economics” (Papatheodorou, 2003, p. 407).

Our thesis is that tourism economics can be defined as an independent discipline within applied economics because of the following reason: it has a specific object of study, the holiday (a bundle of complementary goods and services) produced and consumed in a territorial system (the destination), which has its own theorems, goals and tools, different from the ones of the single firm or from the aggregate economic system (Candela and Figini, 2009b).

Therefore, tourism economics satisfy the four criteria needed to define a discipline (Hirst, 1974). Hence, re-quoting Papatheodorou (2003), we can conclude by affirming that:

“the economics of tourism is an established economic discipline in applied economics”.

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