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SHORT ARTICLE

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Public Expenditure and Tax Policies for Tourism

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Abstract: In the post-war years, in many countries, tourism as an economic activity has become a vital sector of national economies contributing a substantial share to the gross national product. Tourism has thus become the focus of governmental attention to macro-manage the sector as well. This paper considers some theoretical aspects of public expenditure and tax policies specific to tourism.

Keywords: ad valorem, incidence of taxation, levy, public expenditure, economic welfare

JEL Classification: E62, H25

Introduction

Tourism is an organized national economic activity of most modern societies. Today, it is an important role player in economic life of any country. As any other economic activity it is susceptible to economic analysis. By using known economic concepts in reviewing the economic activities in tourism we can draw analytical conclusions and apply general or specific policy measures (Sinclair and Stabler, 1997). Also, the experts have now come to realize that the governments have an important role to play in providing a congenial economic environment for the healthy growth and development of this vital economic sector. By now we have learnt that in any market economy there are three possible fields of economic activity for the government's role i.e. promoting general economic welfare; providing non-commercial social services; and owning and managing specific goods and services (Škare and Skoko, 2007).

These roles require governments to devise fiscal, monetary and wage policies, various regulations, planning, and direct involvement in commercial ventures at local, regional, national and international levels. However, economists differ deeply over the degree of government involvement and regulation in these spheres. The

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swing of the pendulum is from absolute freedom of economic subjects to major economic interventions in the economy. The experiences of the 20th century with both the models have proved disastrous. Thus, in the 21st century economists suggest middle way of private-public sector cooperation (Sharma, 1995).

All measures of government's economic policy have direct or indirect impact on every economic activity. From economic point of view, as different from other national economic sectors, tourism is a highly sensitive sector as it reacts more quickly to various policy measures of the government and daily happenings the world around.

Management of national economy or the so called macroeconomic management is a complex sophisticated job for the politicians and planners alike. Various are the instruments of macro-managing the economy but government's budgetary measures i.e. public spending and tax policies are widespread. Although most of these measures are of general nature but they affects each sector differently. Some measure have direct and others indirect effects (Sharma, 1995).

The general economic policies or the ones that are directed towards specific sectors may have indirect effects on tourism (e.g. a tax on business expenses may reduce the demand for business travel and hospitality services). However, the directness and degree of such impacts are not necessarily co-related, as economy wide policies may have more pervasive influences throughout every channel of economic activity.

A government's general policies for tourism are likely to reflect a range of objectives: economic, environmental, social, educational, diplomatic and political (Ferguson and Ferguson, 1994). Almost always, non-economic policies have considerable economic implications for tourism, particularly if social justice and normative judgments are involved.

Our intention in this paper is to examine some of the direct and indirect effects of the government activity on tourism.

Public Expenditure Policies

Since J. M. Keynes publish his magnum opus, The General Theory of Employment, Interest and Money in 1936, it has become customary to use his well known equation (i.e. $Y = C + I + G$, where Y is national income, I investment and G government spending) to explain and justify national economic policies. His fundamental thesis was (later contested by the monetarist school but not rejected out-rightly) that economic welfare of the society depends upon the achievement of the full employment level, which in turn depends upon the level of national income. The growth of national income in a country will depend upon the level of consumption and investment expenditure by the household and private sector. Any deficiency in the consumption and investment activity and the national income, according to Keynes, must be covered by the government expenditure. Based on this very thesis, the governments in most advanced as well as developing countries in the post-war world adopted intensive measures of public spending policies. These so called 'budgetary' or 'fiscal' policies during 1960-1980s ensured an early recovery of the war ravaged economies, improvements in standards of living, increase in national incomes, employment and welfare all around. During the 1980s-2000 worldwide the government fiscal policies were marred by the neo-liberal approach of monetarist school, and it is only in the new millennium that a balanced approach is being appreciated.

The basic principle of government budgetary behaviour suggests that the governments first decide to spend the money and then plan to raise the needed revenues. While the spending takes the form of direct investments, aids and subsidies, and use of other preferential financial instruments etc. The revenues are mostly raised by taxes, levies, and government borrowings at home and abroad. Generally, the spending and revenue policies of the government have no direct link between the two.

As far as Tourism is concerned, there too this principle applies. It is only rarely, that there is a link between taxation of tourism and government spending on the sector. Despite, the presence of occasional purpose named taxes (e.g. tourism development tax in some countries) the principle of direct levy to fund the same sector applies to certain aspects of tourism operation such as training. The bulk of government spending on tourism occurs in: (a) infrastructure; (b) promotion and marketing of tourism by respective national tourist boards, and (c) promoting the growth and development of tourism.

(a) In most countries, the governments are responsible for providing economic infrastructure. Related to travel and tourism, the infrastructural activity basically involves fixed passenger transportation investment; destination services such as water, sewage and waste management; sanitation and health facilities, fixed communication facilities etc. In a completely free market one would hope such goods to be provided by the private sector, but in practice in most countries most of such services are provided by the public sector and thus the governments have a considerable interest in the infrastructure.

In fact, when we look at the infrastructure very little of it is for the exclusive use of the tourism sector unless it is a part of the enclave or resort development. Roads, ports, terminals are likely to have multiple users and services may be used by residents and visitors. However, it may be possible to identify tourism as a major cause of any infrastructural project and a minor cause of increased maintenance costs.

If tourism is sufficiently identifiable and separable as an infrastructural user it may be possible to avoid 'subsidizing' tourists by levying the user-pay charges (e.g. where tolls are charged on highways, bridges, and parking, a free pass may granted to residents).

In cases where large investments in tourism related infrastructure has taken place, the investment and maintenance costs are some times recovered through rates and taxes charged to commercial enterprises whose development is then possible (e.g. France did it in Languedoc-Roussillon during 1965-1980 and Cambodia in Angkor-Watt during 1995-2005). International institutions such as The World Bank, Regional banks and others have long been funding such projects and sponsoring the governments to undertake such infrastructural investments.

Where regional and national authorities implement a policy of supporting the development of tourism as an income contributing sector of the economy, it normally entails some form of government spending to help with the commercial provision of services. This is especially important in tourism destinations that are in a developing stage. Not only governments may provide the required money to ensure the viability of marginal projects, but overt political support can be a psychological booster for further investment decisions (Theobold 1998).

(b) A major area in which governments prefer to spend on tourism is the marketing activities of national tourist offices. Tourist offices may be created at national, regional and local. Very few of these are non-governmental and cooperatively funded. In some cases these are government departments (e.g. Spain and New Zealand). In many cases these are semi-autonomous bodies (e.g. India, UK), and in others a completely independent body (e.g. Croatia). The governments have variety of reasons to get involved in promotional activities of these bodies. First, individual domestic businesses are unlikely to get interested in collective marketing. Second, governments might see a potential economic benefit from image building for the country as a whole. Third, the economies of scale may be achieved.

Although specific activities of such bodies vary from country to country (WTO, 1992) the major area of national government spending is marketing (market research, public relation, advertising, product-knowledge communication and distribution, and product development). Except in case of any direct service provided to the tourists, such are the basic cost-centred activities.

Tourist offices may work with commercial enterprises through subsidy or themselves taking over the promotional activities (Middleton, 1988). If they chose the former then the supply costs are effectively reduced making the enterprises more competitive. Centralized marketing (e.g. spots on media like CNN or BBC World) helps to shift upward the international demand for a destination. However, any price effect is likely to be less important to a government than an increased quantity or flow of tourists to a particular destination, and increased total tourism flows of people and income. Sometimes, such activities also have the enhancement of national pride/prestige as a goal to be achieved through building country's image abroad through promotion of tourism. This may have positive domestic impulses.

(c) Governments usually use different methods of public expenditure to promote tourism e.g. direct expenditure (viz. grants and subsidies, long-term low interest rates, state participation in equities, interest rebates, providing research grants, financing specific personnel training); commercial risk reduction measures (viz. tax exemption, duty free imports pf certain materials, preferential treatment in granting concessions); and state guarantees (e.g. surety bonds on internal or foreign borrowings).

Public spending in tourism development affects commercial enterprises in two main ways. First, it may reduce the capital requirement or cost of capital, such that the marginal productivity of an investment proposal is improved to a visible level. Secondly, it may reduce the operating costs of tourism suppliers, and hence improve the profitability and long-term stability of their business. Governments therefore attempt to direct spending into those areas where the direct multiplier effects on employment and business activity are at their maximum. The majority of promotion expenditure goes to hospitality, tourism attractions and capital intensive transportation, with very little injection of expenditure into travel agency, tour operation and other less capital intensive sectors.

Generally, most public spending programmes on promotion become the constituent part of the tourism development plans. These may range from small ongoing commitments (e.g. expenditure on research projects) to many ad hoc agreements (e.g. tax exemptions and providing cheap/free land for resort development).

Economists are sometime critical of the use of public spending in support of commercial tourism. There are two arguments. Firstly, such practices may distort the market. In pursuing tourism developments which provide high employment opportunities, subsidies and guarantees may support low economic efficiency enterprises and thus may not compete in free markets. In defence it can be argued that the net welfare of additional employment may exceed the dis-benefits of economic efficiency. However, unfortunately, it is difficult to prove or disprove the thesis as very little precise data on opportunity costs can be obtained in this respect. Moreover, the markets may also get distorted. Secondly, it is argued that by non-charging of a fee for the infrastructure, a part of benefits generated go to the tourists rather than to the service providers.

Tax Policies

The main aim of any governments economic policy directed towards tourism is to maximize its share of contribution to the gross domestic product of the country. This general aim can be achieved through increased inflows to the balance of payments, providing employment, redistribution of incomes, increasing socio-economic welfare and maximizing fiscal revenues.

In any economy the financial authority withdraws money through taxation, national borrowings and raising the level of bank deposits, it infuses money through public expenditure. Sometimes, it may adopt both types of measures for redistribution. In case of tourism, a government may regulate the providers of travel and hospitality services by imposing controls on output prices, or/and may act as producer and consumer of such services.

Today, most governments use tourism as a source of tax earnings, and many conservative economists consider travel and tourism as a non-essential expenditure on the part of consumers. Most indirect taxes in tourist sector, as elsewhere, are basically those levied on tourism products and are ad valorem or specific (licensing fees, fuel surcharge etc.), i.e. taxes on the commercial products, or on consumption by the tourists, or a service user charge.

Taxes on commercial tourism products are simple examples of consumption taxes generally levied on producers (sales, purchases or value added taxes) with the intent that finally their incidence may be transferred to the tourists. This however depends on the price elasticity of demand facing each producer. While the producers in a highly competitive market may not be able to raise prices and thus are likely to absorb the taxes, the monopoly or price-collusion is likely to transfer successfully the incidence. Most likely targets for this type of taxation are accommodation, meals, rentals, and fuel excise are ad valorem. A thesis has been advanced by Fish (1982) that taxes on fixed costs (e.g. land tax) do not affect the equilibrium in tourist market the same way as does the variable tax (e.g. lodging), but this may be true only in short-run (e.g. one season). Over a longer period the effects of any consumption tax will have to be taken into account by the service providers. This is valid for both ad valorem and specific taxes.

An ideal guideline for tourism taxation is that the burden of taxation in a location should be borne by those using the location (Fuji, Khaled, and Mak 1985). This tax exportation avoids immiserising effects of taxing residents of a particular location. Many governments impose specific taxes directly on tourists (international tourists particularly) regardless of the bundle of goods and services purchased, and collected at gateways.

Countries with unfavourable balance of payments generally impose travel taxes on their residents, at times fairly high, to discourage personal expenditure abroad.

Rarely, as did Japan in 1993, introduce tax deductions for outbound travel. There are some countries (e.g. Venezuela, Paraguay) that impose arrival tax on tourists. A hidden form of tax is high costs of travel visas and other documents. Most popular source of revenue is the departure tax. Some charge effective or nominal fees for airport terminals others include in the air fares other than exit taxes. It has been observed that except the exit taxes there are none that can serve as deterrent to tourist consumption expenditure. Lately, user pay charges are getting increasingly popular. This type of levy is mostly based on the "rent" rather than "cost" principle, but a combination of the two is also possible.

Conclusion

It is evident from the above discussion that so as to promote tourism in general and particularly international tourist inflows, the governments at different levels within their own country resort to various fiscal measures with the objective to help service providers to be increasingly efficient on the one hand and raise the overall share of income generated by tourism as a proportion of gross national product.

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