ABSTRACT

Tourism cannot make residents worse-off, in potential Pareto terms, due to monopoly power in product markets as claimed by Hazari and Ng (1993). Resident welfare cannot fall with such a monopoly distortion as tourism demands increase. Though prices of goods that were previously non-internationally traded do rise for residents with increased tourism demand, these residents are always at least compensated by the income they earn as sellers of the same goods.

I. INTRODUCTION

Hazari and Ng (1993), hereafter HN, argue that because of “monopoly power in the trade of non-traded goods and services” tourist purchases of non-traded goods may reduce the welfare of local residents. Furthermore, they claim increases in such demands can increase this welfare loss. The loss, it is argued, justifies the “expansion of the non-traded goods and services sector” which “requires action in the form of government policy.” There are no tariffs in the HN model and no externalities affecting production and consumption except possible monopoly power operating in the market for non-traded goods.

The HN result is inconsistent with general trade theory and with other specific literature on tourism issues: see for example, Copeland (1991), Clarke and Ng (1993). The correct
conclusion is that, without introducing distortions not considered by HN, increased trade in any type of good or service (traded or non-traded) cannot inflict potential Pareto losses on residents. If the relative price of non-tradeables rises with such demands there are strict welfare gains.

We establish this proposition in two stages. First, the relevant "gains-from-trade" theorem is cited proving that residents are never made worse-off by increased tourism demand for non-traded goods. Second, the intuition of the result is discussed and the precise reasons why the HN result is questionable in their three-good setting provided. HN assume that a fixed proportion of the non-traded tourism good is consumed by tourists irrespective of resident preferences and equilibrating price adjustments. This ignores the fact that residents have property rights to the tourism good and therefore will be persuaded to sell it only if they derive a benefit.

II. NON-TRADED GOODS AND WELFARE

The standard "gains from trade" theorem used in international economics has been recently restated by Kemp (1993, page 1): "If some country s abandons all artificial obstacles to international trade, either in the whole set of potentially tradeable goods or in some proper subset, and if the preferences, technologies and endowments of the trading partners are suitably restricted, then there is a scheme of lump sum compensation in s and an associated competitive world equilibrium such that no individual in s is worse off than in autarchy."

This conclusion is not conditional on the nonexistence of monopoly power in product (or factor markets). It has been known, since Kemp (1962), that this "gains from trade" conclusion is independent of such power. Nor does it require that non-traded goods be consumed in other countries. The goods could be consumed locally by tourists (perhaps making repeated visits!), guest-workers or even immigrants who remained permanently. In all cases the residents there before newcomers arrive are not worse-off, in potential Pareto terms, with the various forms of market-broadening. This general theorem therefore covers the undistorted economy considered by HN as a special case so their conclusion that tourism can reduce resident welfare is inconsistent with "gains-from-trade" analysis.

Increased tourism provides potential Pareto gains to residents essentially because it corresponds to a reduction in the international barriers to trade. Residents can continue to trade with each other (and preexisting customers in other countries) as before but now have the additional option or opportunity to trade with tourists.

In HN it is said that tourism demands "affect the domestic consumption possibility locus." Also, because tourists may have a "relative preference" for the non-traded good, they are made worse-off when tourists consume the non-traded good. Intuitively these views suggest that tourism makes residents worse-off because the tourists demand goods that are strongly preferred by residents.

The HN suggestion is that tourists demand a good so keenly (or inelastically) sought by residents that consumption-losses more than offset any income gains they may derive from being able to sell to a larger market. This is questionable because if the good is keenly sought by residents, the price at which it is sold to tourists will reflect this strong preference. As shown below the dubious HN conclusion derives from their assumption that
tourists consume a fixed fraction of total output of the host country's nontraded good irrespective of prices.

The HN three-good model (and our criticism of it) is illustrated using Figure 1 (similar to Figure 1 in HN). In HN the country receiving the tourists produce two goods: a nontradeable "tourism" good $X_0$ and an export $X_2$. The country consumes $X_0$, an import $M_1$ but not the export $X_2$. The prices of $X_2$ and $M_1$ are fixed internationally. The production possibility curve $TT'$ in Quadrant 2 implies a consumption possibility curve (CPC) in Quadrant 1. (This derivation is achieved using the fixed terms of trade line in Quadrant 3 which determines the country's imports given its exports and the 45° line in Quadrant 4). The pre-tourism equilibrium is at $B$ where the CPC touches the highest community indifference curve $U_0$.

With tourism and the assumption that a fixed fraction of $X_0$ is consumed by tourists, HN interpret tourism as moving the CPC from $TD'$ to the dashed curve $TD''$. The point $T'$ corresponds to production occurring at $T$ with $X_0$ alone being produced, a fixed fraction of which is consumed by tourists. This leaves the host country with less $X_0$ after tourism but with foreign exchange to purchase $M_1$ thus leaving it at $T''$. 

Figure 1. The HN Model
However if $T'$ or any other point on $TD'$ is below the community indifference curve $U_0$ and distributional issues are ignored (as here and in HN) then people owning $X_0$ will not sell it to tourists making points like $T'$ irrelevant. To consume part of $X_0$ the tourists need to bid up its price shifting equilibrium relative prices from $(P_t/P_0)$ to $(P_1/P_0)$. This enables the host country to reach a higher indifference curve at $B'$ with production taking place at $P$ with imports $RG$ of $M_1$ being financed by the export of amount $PR$ of $X_2$ and $HB'$ amount of $M_1$ being financed by selling $GH$ amount of $X_0$ to tourists.

Thus tourism can only make residents worse-off if tourists can force residents to sell the non-traded good against their wishes. Otherwise the CPC cannot move inward. Rather the equilibrium price line must move along the unchanged CPC resulting in an improvement in host country welfare.

Thus even if residents consume less of a strongly-preferred non-tradeable because of tourism demands for that good they will still always be better-off if the good’s price rises in the face of such demand increases due to the increased income received from tourists for the good.

III. HOW TOURISM CAN MAKE RESIDENTS WORSE-OFF

There are a host of reasons why tourism can make residents worse-off. Some of these relate to income distribution effects while others can be understood as some type of unpriced external costs. With respect to the latter pollution, littering, and tourism-induced xenophobia are all possible ways tourists can disadvantage residents. In this way tourists do not pay adequately for their visitations: See, for example, Clarke and Ng (1993) for ways of dealing with distortions through efficient pricing.

Also, as in standard trade theory, if there is foreign ownership of those fixed factors whose values are enhanced by tourism, increased tourism can reduce resident welfare by increasing the prices residents must pay but not the incomes they receive on fixed factors. This idea is discussed by Copland (1991).

None of these factors are addressed in either our model above or in HN. If these factors were present then it might be reasonable to compensate those groups in the community adversely affected by such costs thereby justifying interventionist policies.

Also, ignoring retaliation, appropriate tariffs might further increase the gains residents derive from tourism in accord with standard “optimal tariff” arguments. These tariffs could be supplemented by charges to industry to market tourism if, due to a diffuse distribution of benefits, there were “free-rider” issues creating market failures in relation to such marketing procedures. These optimal tariff policies increase the gains residents derive from tourism. However, even without such policies, residents will never be disadvantaged in potential Pareto terms by increased tourism.

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REFERENCES


