STATE GOVERNMENT FINANCING OF TOURISM PROMOTION IN THE U.S.

by

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1. Introduction

National governments everywhere actively promote tourist travel to their destinations. These promotional activities include the maintenance of travel information offices abroad, publication of travel brochures and literature, advertising, travel fairs and exhibits, etc. The management of tourism promotion is usually assigned to separate government agencies called national tourism administrations (NTAs) which may contract with other entitites to provide promotional services. The World Tourism Organization reports[1] that surveys from 45 NTA's revealed that their primary sources of revenues were derived either from government general fund revenues or from taxes. Even among the few NTAs that are private entities, such as in Germany and in the Netherlands, their principal sources of revenue came from their governments and not from private industry.

There is also a long history of subnational government participation in destinational tourism promotion. During the late 19th century, the corporation of Blackpool, England levied a two pence property tax to devote "to the cost of maintaining at railway stations and in other public places advertisements stating the attractions and amusements of the town."[2]

In the U.S., all 50 states have state travel offices charged with promoting tourism.[3] Hawaii is the only state that contracts with a private entity--the Hawaii Visitors Bureau (HVB)--to promote travel. The U.S. Travel Data Center reports that during FY1987-88, the sum of the budgets for the 50 state travel offices was $284 million.[4]

Among the 50 state travel offices, 46 relied exclusively on state general fund revenues or from taxes to finance their promotional activities. For Vermont, 1% of its operating budget came from an advertising enterprise. Only 4 states--Alaska (16%), Hawaii (10%),

North Dakota (10%), and Montana (6%)--had significant private contributions to their operating budgets.

The foregoing evidence indicates that destination promotion by governments is a common practice. A review of the tourism literature, however, failed to find any discussion as to why this practice should be so prevalent as many of the same governments do not promote their other exports.[5] Thus, one purpose of this paper is to provide such an explanation. Our explanation is derived from Mancur Olson's (1971 and 1982) theory of collective action.

The paper is organized as follows. The next section presents the reasons for collective promotion of goods. Section 3 examines the conditions under which collective action can succeed. Section 4 examines the characteristics of the tourism industry and implications of these charcteristics on collective destinational travel promotion. Section 5 uses the case of Hawaii Visitors Bureau to illustrate the difficulties in soliciting private support to engage in collective travel promotion expenditures. Implications of public financing of travel proportion are discussed in section 6. Section 7 assesses the incidence of tax financed travel promotion under several methods of tax finance. Our conclusion is presented in section 8.

2. Reasons for Collective Promotion

For our purpose we accept Waugh's contention that the ultimate economic objective of advertising and promotion is to alter the market demand faced by suppliers.[6] Thus, if successful, a promotional campaign for any commodity or by any set of producers would either increase demand or cause demand to become more inelastic.

Schultz and Wittink (1976) distinguish between primary and selective advertising.

Primary advertising is defined as "...the effort expended by the collective firms in an industry either as an ad hoc attempt or systematically through a trade association for the express purpose of increasing primary demand by means of mass communication." Selective advertising is defined as "...the effort expended by individual companies to influence sales for a brand or for the firm by means of mass communication." By their definition, state government travel promotion is primary advertising.

Selective advertising may also affect an industry's demand. For example, when United Airlines advertises travel to Hawaii, the purpose is to increase its own demand. However, its advertising campaign may increase the demand of all airlines serving Hawaii thereby creating a collective good for all airlines.

The implications of advertising spillovers is "free riding" which, in turn, leads to suboptimal promotional budgets when viewed from the industry's point of view. Free riding, however, provides the incentive to advertise collectively, but it does not explain why governments promote tourism.

3. When Can Collective Action Succeed?

The principal problem with collective promotion is that, if membership in an association is voluntary, the incentive is for the individual producer not to belong and, instead, to free ride on other producers' promotional expenditures. That is, he or she may be willing to pay, but does not. Mancur Olson (1971 and 1982) has noted that services of trade associations, such as travel destination promotion, are in the nature of collective goods in that, if they are provided at all, they benefit everyone regardless of whether the beneficiaries are members of the association. He argued that such associations, when they represent large groups, are successful not because of the collective

goods they provide but because of their ability to find "selective incentives". A selective incentive is one that applies selectively to the individuals depending on whether they do or do not contribute to the provision of the collective good. A selective incentive can either be negative (i.e. a punishment) or positive (i.e. a reward or benefit). Olson's thesis is that those groups that can find selective incentives will be more likely to act collectively to obtain collective goods than those that cannot. He observed that it is easier to find selective incentives in small groups than in large groups and in homogeneous groups rather than in heterogenous groups. Large and heterogenous groups have difficulty agreeing on the exact nature of the collective good or how much of it should be bought. In the absence of selective incentives, collective action is likely be absent.

Olson, however, identified two situations where voluntary contributions to the provision of collective goods can succeed without selective incentives . First, when the costs of the individual contributions are small, voluntary contributions may or may not occur; but when the costs become large, the contributions will not occur. Second, when there are only a few firms that stand to benefit from collective action, one firm may assume the entire cost of collective action even when the benefits are shared by the other firms. He notes that, in the case of few firms, there is always the possibility that the firms will bargain among themselves and agree on a collective action.

4. Heterogeneity of the Travel Industry

Tourism is a heterogeneous industry. In the broadest sense, the tourist industry is comprised of all suppliers of goods and services to travelers. It includes suppliers of transportation, lodging, meals, entertainment, travel agency services, sightseeing tours, and various other personal services. Hence, tourism encompasses the outputs of many

industries. According to the U.S. Travel Data Center (1988b), in 1986, U.S. travelers spent nearly $253 billion on domestic travel of which 23.9% of the total expenditures were on public transportation, 14.4% on auto transportation, 16.9% on lodging, 26.2% on food and drink, 10.1% on entertainment and recreation, and 8.4% on incidental expenses.

In addition, tourists purchase goods and services from industries and firms which also sell to residents. For example, in 1985 visitors to Hawaii accounted for nearly one-third of total personal consumption expenditures in Hawaii.[7] They accounted for nearly three-quarters of all expenditures on commercial amusements, and over one-half of all expenditures on restaurant meals and beverages and clothing, accessories and jewelry, and over 50% of total expenditures on transportation (excluding the purchase of automobiles) and admissions to spectator amusements. Thus, the benefits of visitor expenditures vary substantially across industries.

Moreover, a survey conducted in 1983 of 1,768 restaurants in Hawaii found that 27.5% of the restaurants had more than 50% of their sales to tourists; 24.5% had 10 to 49% of their total sales to tourists; and 48.1% had less than 10% of their sales to tourists.[8] Because of the large variations in the distribution of the benefits of tourist spending among industries and firms, there will be different demands among them for collective tourism promotion. The heterogeneity of firms make it difficult to organize collective action. HVB's experience in attempting to solicit private contributions to promote Hawaii travel provides an excellent example of the obstacles to organizing collective action in the absence of selective incentives.

5. Failed Collective Promotion: The Case of the Hawaii Visitors Bureau

Hawaii is the only state that relies on a private entity, the Hawaii Visitors Bureau

(HVB), to promote tourism, and only one of four states that rely significantly on private financial contributions to their travel office budgets. The Hawaii Visitors Bureau is a private non-profit organization whose principal function is to promote Hawaii travel. The HVB has a full-time staff of nearly 80. Its volunteer Board of Directors is comprised mostly of executives from tourism-related businesses. In fiscal year 1987-88, the HVB had an operating budget of $13.665 million of which $12.270 milliion (90%) was appropriated by the State of Hawaii, $1.3 million (9.5%) from membership dues, and the balance of $95,000 came from literature sales and interest.[9]

HVB has a membership department with two full-time employees assigned to solicit memberships among local businesses. In April, 1988, total membership in the HVB was 2,648, about one-third of which were from the U.S. mainland. The mainland memberships were mainly travel agents. Thus, less than 1,800 members were from Hawaii. In 1986, there were over 26,000 business establishments in Hawaii[10] so that the total membership of HVB is comprised of less than 7% of all business establishments in Hawaii. Mok (1986) estimated that in 1985, 78% of the airlines, 66% of the hotels, 32 of the lending institutions, and 24% of the restaurants in Hawaii belonged to the HVB. There were only 262 retail firms which were members, representing only about 4% of all retail establishments in Hawaii.

Presently, U.S. mainland travel agents can opt for two types of membership. The $125 annual membership entitles the subscriber to receive the monthly newsletter, HVB posters and brochures while the $300 membership entitles the subscriber to receive the Annual Research Report as well.[11]

In addition to the above benefits, Hawaii businesses which join can participate in HVB-sponsored trade shows and co-operative advertising campaigns, reduced admission

fees to HVB luncheons and meetings, and be listed in the various HVB information guides such as the HVB Hotel Guide and the HVB Restaurant Guide. Since there are few direct benefits to members, the HVB's appeal to Hawaii businesses to join is based on the theme of community responsibility or "Fair Share" approach rather than on specific products or services that members can obtain from the HVB. Suggested annual membership fees (i.e. contributions) are based on internal formulas devised by the HVB, but actual contributions are determined by what each business is willing to pay. For instance, the suggested annual membership fee for hotels is $15 per room. The general guideline for "tourist-oriented" businesses is .1% of gross receipts with a minimum of $500; for "non-tourist" businesses, the suggested contribution is .01% of annual gross receipts with a minimum of $300. If each of the 26,000 business establishments in Hawaii contributed only the minimum of $300 per year, the total private contributions would be $7.8 million or 6 times current contributions. The average level of contribution for the 2,648 members in 1988 was less than $500.

Indeed, one wonders why any firm chooses to contribute to the HVB. Another puzzle, as observed by Mok (1986), is why airlines are more likely than hotels to join the HVB ; and, in turn, why hotels are more likely to join than retail establishments. Olson provides answers to both questions.

In the case of airlines vs. hotels and retail establishments, the airline industry is more concentrated than the hotel industry, and the hotel industry is more concentrated than the retail industry; so are the benefits from collective promotion. Olson (1982, p. 29) has argued that with few firms benefiting from collective action, the cost-benefit ratio of acting in the common interest could be so large that a single firm could bear the entire cost of public promotion and still profit.

Why would any retail establishment in Hawaii choose to join (i.e. contribute to) the HVB since its specific gains are likely to be miniscule? The explanation is that the annual cost of HVB membership at a minimum of $300 and an average in 1988 of less than $500 is extremely small. Olson (1982, p. 28) has hypothesized that even without selective incentives, when the cost of individual contributions are small, voluntary contributions to the provision of collective goods will often occur. It will not occur when the cost is high.

The example of the Hawaii Visitors Bureau illustrates why it is so difficult to form a private trade association to engage in collective travel promotion. Even though the tourism businesses in Hawaii may desire a larger aggregate destination promotion budget, in the absence of selective incentives (i.e. specific benefits or penalties) to induce contributions by those who benefit from HVB's promotional activities, the outcome is that few business will contribute their "Fair Shares", and instead, free ride on the contributions of others. Over the years, the HVB has come to rely more and more on state government contributions, as it has become increasingly difficult for the Bureau to generate private contributions to maintain even a constant real budget.[12] Accepting government contributions has not been costless, as the HVB has had to live with unwanted government intrusion and restrictions. For example, the state legislature even determines how many employees it can have.

6. Implications for Public Financing of Travel Promotion

Hawaii Visitors Bureau's experience with soliciting support from industry to engage in collective travel promotion confirms Olson's hypothesis that groups that do not have access to selective incentives face significant difficulties in organizing collective action. While the HVB example provides an efficiency rationale for state government participation

in destination travel promotion, it does not provide support for the notion that the entire budgets of state travel offices should be funded by the public treasury as is done in most states today. Since some tourism businesses are willing to make contributions to the collective promotion effort even in the absence of selective incentives, one implication of the HVB example is that more states should encourage private subscriptions to the budgets of their state travel offices. Public provision should be rationalized by problems associated with voluntary contributions to public industry advertising, such as free riding. To the extent that extensive free riding remains, some sort of compulsory industry levy to fund travel promotion budgets should be designed with credits granted to firms which make expenditures for generic destination advertising. However, such a scheme might be difficult to implement for a variety of reasons. An alternative is to raise promotional funds through various tourist taxes. Only if it can be shown that there is a general public demand or willingness-to-pay for public promotion can the use of some broader tax or revenue source be rationalized.

The U.S. Travel Data's (1988a) annual survey of state travel offices revealed that in fiscal year 1987-88, 44 states funded their state travel offices at least partially from general funds. Among them, 33 states relied exclusively on general funds. Eleven states combined general funds with earmarked taxes. The most popular of the earmarked taxes is the hotel room tax, used by 8 states (including two states which use it exclusively). Other taxes used to fund state tourism promotion include the tourist promotion tax (2 states), admissions tax (1 state) and highway/gasoline tax (2 states). Thus, most states use broad- based taxes to finance destination tourism promotion rather than targeted industry taxes.

7. Who Actually Pays When Government Finances Tourism Promotion?

Data supplied by Miklius, Moncur and Leung (1989) from their recent study of tax incidence in Hawaii allow us to determine who would pay for state funded tourism promotion under alternative methods of financing in Hawaii. According to our computations, 23.96% of the total State General Fund tax collections in 1988 were exported from Hawaii,with tourists accounting for 17.43% of the total. The federal tax offset accounted for an additional 6.33%. The remaining 76.04% of State General Fund taxes were borne by Hawaii residents.[13] Thus, state financed tourism promotion paid out of general funds is mostly borne by residents rather than tourists.

If, instead, travel promotion budgets were funded from an earmarked hotel room tax, the implicit allocatiion would have been 97% to tourists and 3% to local residents as consumers. According to Miklius, Moncur and Leung (1989) the highway/fuel tax in Hawaii is largely borne by residents rather than by tourists. Therefore, funding of travel promotion by use of this tax would also largely fall on local residents. By contrast, Fujii, Khaled and Mak (1985) showed that an entertainment/admissions tax, if enacted in Hawaii, would largely be borne by tourists rather than by residents.

Since, in Hawaii, the state contribution to the HVB's annual budget is primarily financed from the State General Fund , one can argue that it is largely borne by Hawaii residents. Table 1 presents the distribution of Hawaii's General Fund tax burden on residents by income classes for calendar year 1988. In using General Fund taxes to finance tourism promotion, the burden of financing (and, as well, the implicit assumption about the distribution of the benefits) is distributed as in Table 1, i.e. on all income classes but largely on middle and upper middle income residents.

We have not performed similar calculations for the other states. However, Phares

(1980) has shown that in most other states, state taxes are even less exportable than in Hawaii; thus their general fund tax revenues are also primarily borne by residents rather than tourists, and our observations about the incidence of tax financed tourism promotional expenditures are applicable to them as well.

8. Conclusion

The purpose of this paper was to offer one possible explanation why promotion of travel by governments is so commonly observed throughout the world. The central argument of the paper is that state governments in the U.S. and elsewhere finance tourism because of the inability of suppliers of tourism services to advertise collectively. While the "capture" explanation has been suggested as an alternative explanation, the practice is so ubiquitous that it is difficult to see how the necessary conditions for capture would be satisfied in so many different situations.

Our argument, however, has some normative implications. It does not lead to the conclusion that budgets of state travel offices should be financed entirely by the public treasury as is done in most states. We make the case that more states should encourage industry contribution to the budgets of the state travel offices. Public provision should be rationalized by problems with voluntary contributions such as free riding, etc. Only if it can be shown that there is a general public demand or willingness-to-pay for public promotion can the use of some broader tax or revenue source be rationalized. Government financing of travel promotion carries with it an implicit allocation of costs among the beneficiaries. In the U.S. most state travel promotion budgets are primarily financed by general fund tax revenues which are borne largely by middle income local residents rather than by tourists.

FOOTNOTES

* We thank Sumner LaCroix and Richard Pollock for their helpful comments.

1. World Tourism Organization (1986).

2. Brown (1988), p. 178.

3. U.S. Travel Data Center (1988a).

4. U.S. Travel Data Center (1988a), pp. 5 and 10.

5. A major exception is agriculture. See Holloran and Martin (1989).

6. Waugh (1959).

7. State of Hawaii, Hawaii Gross State Product Accounts, 1958-1985 (Honolulu: Department of Business and Economic Development, 1988), pp. 42-45 and pp. 162-163.

8. Fox and Breatchel (1984).

9. Hawaii Visitor Bureau (1988).

10. State of Hawaii, Data Book, 1988, p. 414.

11. The Annual Research Report can be purchased by anyone for $100.

12. In 1918, the government contribution to Hawaii Visitor Bureau's predecessor (the Hawaii Promotions Committee) represented 22% of HPC's budget. In the 1950's, the government's share of HVB budged averaged around 50%. Throughout the 1960s and 1970s, state contributions comprised over 70% of the HVB budget. See Crampon (1976) for a detailed history of the HVB.

13. Estimate of the proportion of General Fund taxes borne by residents is biased downward since the transient accomodations tax, which in 1987 accounted for 3% of general fund tax collections and which is almost totally exported, is included. The hypothetical case we are discussing is de novo, i.e., if a state is considering promotion of tourism should it use general fund or other taxes.

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Table 1

Distribution of Hawaii General Fund Tax Burden by Income Class: 1988

Income Class ($000s)	Total Paid ($000s)	% of Total Paid
5 <	$ 74,048	5.3%
5 < 10	97,858	7.0
10 < 15	125,724	9.0
15 < 20	97,792	7.0
20 < 30	212,219	15.1
30 < 50	332,585	23.7
50 < 100	325,620	23.2
100 < 200	75,462	5.4
200 +	60,000	4.3
Total	$1,402,277	100.0

Source: Computed by J. Moncur from data supplied by Miklius, Moncur and Leung (1989).

Note: Income include the following: wages, taxable interest, alimony, business income, gross capital gains, supplementary gains, reported pensions, farm rent, other rent, royalties, partnership income and losses, estate or trust income, sub-s corporate income, farm income, gross unemployment income, gross social security income, imputed tax exempt interest, imputed rent of owner-occupied housing, workmen's compensation, imputed interest income.