the economics of tourism destinations

destination management... ...destination marketing...

...tourism geography...

but, where is the ECONOMICS of DESTINATIONS?

the destination is an original and interesting object of study from the economist's perspective

i. the **tourism product is a bundle of goods** (a set of elementary items demanded, in a relationship of complementarity, by the tourist);

ii. not the firm, not the consumer, but the **destination is the main economic agent**: the territory enters both the production and the utility function.
what is the tourism destination?

• the core of tourism system, where tourism structures, events and services are located and where tourists’ needs are satisfied
• usually, the destination is geographically well defined, but its boundaries may often blur and evolve.

“a destination is a single district, town or city, or a clearly defined and contained rural, coastal or mountain area”.
(Davidson and Maitland 1997, p.4)

• non-operational definition (too vague)
a more precise definition defines a tourism destination as…

“A geographical area of variable territorial scale, where tourism is a predominant activity both from a demand-side (i.e. tourists) and a supply-side (i.e. infrastructure and employment) perspective” (Papatheodorou 2006, p. xv).

• limitations of this definition:
  1. it lacks any reference with the systemic nature of tourism;
  2. tourism is not necessarily a predominant economic activity in the destination.
what is the tourism destination? (3)

“the destination is a territorial system supplying at least one tourism product able to satisfy the complex needs of tourism demand” (Candela & Figini, 2012, chp. 3)

"it is indeed in the destination that tourism supply meets tourism demand; it is in the destination that environmental and cultural resources, attractions, the hospitality industry etc. are located; it is in the destination that tourism demand reveals itself. 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". (Candela & Figini, 2010, p. 257).

the definition is different w.r.t management studies (a product) and geography (the set of resources).
the economics of destinations (3)

the economics of destinations studies the relationship between **DEMAND** (by the different types of tourism hosted in the destination) and **SUPPLY** (by the mix of firms located in the territory) for the whole tourism product.

the destination is seen as an economic agent, with a **function to maximise** and subject to **given constraints**.
the fundamental economic problems for the destination are:

- the **COORDINATION** of the whole tourism product;
- the supply of **VARIETY** within the tourism product;
- to **COMPLETE** the tourism product through the supply of **PUBLIC GOODS**;
- to **TACKLE EXTERNALITIES**.

"**STANDARD**" MARKET FAILURES

PUBLIC INTERVENTION IN THE DESTINATION
the economics of destinations (3)

the development strategy of the destination can be analysed as a two-stage problem:

- first stage: the optimal amount of local resources (a COMMON GOOD), hospitality and variety of the local goods is found;
- second stage, the equilibrium price for the goods and services included in the tourism product (ANTICOMMON GOOD) is set.
\( \Omega = \Omega_1 \)  
no coordination

\( \Omega = \Omega_2 - C_1 \)

\( \Omega = \Omega_2 - C_2 \)

\( \Omega = \Omega_2 - C_2 - \Pi \)

\( \Omega - K \geq \Omega^* \)

coordination

tour operator

\( \Omega - \Omega^* \)

coordination

tour management

tour operator

tour operators

\( \Omega = \Omega_1 \)

\( \Omega = \Omega_2 - C_1 \)

\( \Omega = \Omega_2 - C_2 \)

\( \Omega = \Omega_2 - C_2 - \Pi \)

\( \Omega - K < \Omega^* \)

\( \Omega^* \)  
minimum threshold of receipt for the tourism destination

\( \Omega \)  
overall receipt for the destination

\( C_1 \)  
cost structure for the destination management

\( C_2 \)  
cost structure for the tour operator

\( \Pi \)  
profit for the foreign tour operator

\( K \)  
cost of investment in the resource endowment or in the sophistication of the tourism product

other economic activity
stage 1 – sophistication in the destination: the intuition

how many types of beach there are in the world?
set up of the model

DEMAND SIDE:
- the consumer has to decide how to allocate a given income between a set of consumption goods ($y$) and a tourism product ($T$) in which there is a local resource ($R$) of quality ($z$), hospitality ($h$) and a variety of complementary goods and services ($x_i$).

ASSUMPTIONS:
- the higher $z$, the higher the utility;
- the higher $x_i$ the higher the utility;
- the higher $H$ (overnight stays), the lower $z$, the lower the utility.
SUPPLY SIDE
- the destination's goal is to maximize overall tourism expenditure, that is: \[ \Omega - K \geq \Omega^*; \]
- \(\Omega^*\) is the minimum threshold of economic sustainability;
- \(K\) represents the costs borne for enhancing the endowment of resources and for attaining environmental sustainability;

ASSUMPTIONS
- tourism resources \((R > 0)\) represent the main reason for the trip.
- the overall level of \(R\) depends on EXOGENOUS (the endowment provided by nature, history and culture) and ENDOGENOUS factors (depending on the investment undertaken by the local community, both public and private sector).
stage 1 – the optimal level of tourism sophistication (2)

ASSUMPTIONS (continued)

- the quality \((z)\) of the resource inversely depends on the number of overnight stays (because of \textbf{CONGESTION} and crowding effects);
- there is only one hospitality firm (\textit{monopolistic sector}) \(h\);
- the variety of the tourism product is measured through \(n \geq 1\), the number of local firms offering goods or services that compose the tourism bundle; \textbf{the higher the number} \(n\), \textbf{the greater the level of sophistication (the variety) of the tourism product.}
- \(\Omega^*\) is assumed to be exogenously given;
- prices are also assumed to be given (in the first stage only).
“the reorganization of the tourism destination toward increasing the variety of available goods and services raises the tourists' welfare and their availability to spend on tourism, so to shift income from non-tourism to tourism consumption. Regardless any possible congestion effect and externalities on the environment, the increased variety will likely stimulate the economic development of the destination”. (Candela & Figini, 2012, chp. 3)
the love for variety theorem (2)

the destination management can trigger tourism development by:

- **investing** in the existing resources;
- **increasing** the "degree of sophistication" of the tourism product;
- **trying to find a balance** between investment in resources and enhancement of variety

the strategy depends on the functional form of $\Omega$, which depends on $H(R, n)$ and on $X(R, n)$, and $z(R)$:

- $\uparrow N \implies \uparrow H \implies \uparrow \Omega$;
- but: $\uparrow H \implies \downarrow z \implies \downarrow \Omega$. 
Stage 2 – coordination in the destination: the intuition

tourism in the destination is interpreted as a 'permission to stay' granted by the several firms supplying complementary services for tourists:

TOURISM IS AN ANTICOMMON
stage 2 – coordination in the destination: the intuition (2)

= lack of coordination
In quality

+ 

= lack of coordination
In quantity
stage 2 – price coordination in the destination

local firms and the hospitality service need to be coordinated in their quantities, quality and prices, in order to build a suitable product for meeting the tourism demand;

- coordination in **quantity** and **quality** is assumed to be already solved, so the relevant issue is **COORDINATION IN PRICES**;
- we release from stage 1 the assumption of given prices: all local firms are now (partially) **price makers**, as they enjoy a certain degree of monopoly power;
- the market regime is of **monopolistic competition**.

three possible organizational structures can be identified:
A) no coordination;
B) coordination through the destination management;
C) coordination through a tour operator.
stage 2 – price coordination in the destination (2)

A. no coordination: firms individually decide the best pricing strategy in order to maximize own profits:
- \( \max_{p_h} \pi_h = p_h H; \quad \max_p \pi = pX \)

B. coordination through the destination management: the DM maximizes overall tourism expenditure:
- \( \max_{p_h,p} \Omega = p_h H + npX \)

since goods are complementary and assuming that the perception of quality (\( z \)) is elastic to the crowding (\( H \)) prices are lower and \( \Omega \) is higher in case B:
- coordination internalizes the effects resulting from the existing complementarity.
stage 2 – price coordination in the destination (3)

C. coordination through the market: the tour operator solves the anticommon problem by stipulating contracts with hotels and local firms with a discount.
- the tour operator then promotes and sells individual services within an all-inclusive holiday package;
- in doing so, it partially bears the risk of no sale.

\[
\max_{p_h, p} \Pi = vH - (p_h - d_h)H - n(p - d)X - C_2 \\
\text{s.t.} \quad (p_h - d_h)H \geq \pi_h^1 ; \\
(p - d)X \geq \pi^1
\]

it can easily be demonstrated that solution \((C)\) equals solution \((B)\)
## stage 2 – price coordination in the destination (4)

<table>
<thead>
<tr>
<th>Case</th>
<th>Case A without coordination</th>
<th>Case B with central authority</th>
<th>Case C private coordination</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>( \frac{a}{3} )</td>
<td>( \frac{a}{2} )</td>
<td>( \frac{a}{2} )</td>
</tr>
<tr>
<td>( p_h )</td>
<td>( \frac{a}{3} )</td>
<td>( \frac{a}{4} )</td>
<td>( \frac{a}{3} )</td>
</tr>
<tr>
<td>( p_r )</td>
<td>( \frac{a}{3} )</td>
<td>( \frac{a}{4} )</td>
<td>( \frac{a}{3} )</td>
</tr>
<tr>
<td>( v )</td>
<td>( \frac{2a}{3} )</td>
<td>( \frac{a}{2} )</td>
<td>( \frac{a}{2} )</td>
</tr>
<tr>
<td>( \pi )</td>
<td>( \frac{a^2}{9} )</td>
<td>( \frac{a^2}{8} )</td>
<td>( \frac{a^2}{9} )</td>
</tr>
<tr>
<td>( d )</td>
<td>-</td>
<td>-</td>
<td>( \frac{a}{9} )</td>
</tr>
</tbody>
</table>
given the anti-common nature of the tourism product, coordination among firms in the destination, which can either be provided by the destination management or by the tour operator, increases tourism expenditure.

A corollary - when coordination is provided by a foreign tour operator, profits of the local firms are lower than in the case of coordination provided by the destination management.

The type of coordination chosen in the destination is therefore not distribution neutral.
a sort of taxonomy of destinations

we provide a theoretical basis for the plurality of real-world destinations.

- as regards sophistication, we can list: resource based destinations, sophistication based destinations, mixed based destinations.
- as regards coordination, we can list: community based destinations, centrally managed destinations, corporate based destinations.

in total, we identify nine types of destinations, plus non tourism destinations, regions in which tourism is not economically viable.

our set-up has more explanatory power than the TALC model (Butler, 1980) and Plog (1974) model, that are merely descriptive:

- it does not reduce the development trajectory at one;
- it explains why destinations can be locked in a given phase or jump it all together.
conclusions

Our approach analyses the diversity of destinations and of their development strategies by focusing on:

- **The sophistication of the tourism product** (this aspect is related to the long-term development strategy);
- **The intra-destination price coordination** (this aspect is related to the short-term pricing strategy).

Open problems to be addressed:

- Overcome some simplifying assumption (i.e., regarding the **Cost Function** of TOs and DM);
- Include the effect of different pricing strategy due to the type of tourism hosted by the destination (**Snob/Bandwagon** effect);
- Overcome the two-stage with a **Simultaneous Model**;
- Introduce competition **within** and **across** destinations.
application of the product life-cycle model to the tourism destination (TALC - Tourist Area Life Cycle)

caveats of the model:
- the shape of the curve can vary a lot;
- the process can stop in a step of the cycle.

purely descriptive model fascinating but not robust

Real and organizational restyling
# The Tourist Area Life Cycle – TALC (2)

## Table 4.1 A synthetic representation of the life cycle of a tourism area

<table>
<thead>
<tr>
<th>Phase</th>
<th>Tourism flows</th>
<th>Features of the supply</th>
<th>Destination planning and control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration</td>
<td>A few tourists</td>
<td>No tourism facilities</td>
<td>No planning and control</td>
</tr>
<tr>
<td>Involvement</td>
<td>Increasing tourists</td>
<td>Early tourism structures are born</td>
<td>Local but uncoordinated control</td>
</tr>
<tr>
<td>Development</td>
<td>Increasing tourists, at a higher rate</td>
<td>Investment in infrastructures and in the completion of the product</td>
<td>Public control through the destination management</td>
</tr>
<tr>
<td>Consolidation</td>
<td>Increasing tourists, at a lower rate</td>
<td>Internationally integrated, with multinational operators</td>
<td>International control</td>
</tr>
<tr>
<td>Stagnation</td>
<td>Peak in the number of tourists</td>
<td>Obsolescence and loss of competitiveness</td>
<td>Conflicts among different stakeholders</td>
</tr>
<tr>
<td>Decline/Rejuvenation</td>
<td>Decreasing tourists</td>
<td>Decay of many facilities, need of restyling</td>
<td>Search for rejuvenation strategies</td>
</tr>
</tbody>
</table>
the phases of development of the destination are linked to the type of hosted tourists: Package holiday / independent tourists.

private sector local control → public sector local control → international control

the phases of the destination and the tourists (Plog, 1974)

- psychocentrics;
- allocentrics.


Candela, G., & Figini, P. (2012). *The Economics of Tourism Destinations*, Berlin: Springer-Verlag, (chp. 4.3.1, 4.3.2, 4.5.1, 4.5.2).