CHAPTER 13

GOVERNMENT SUPPORT

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"Why can't the tourist industry pay for travel promotion and a convention center?"

Many people believe that government should interfere as little as possible with the private sector. They argue that government tends to make markets work less, not more, efficiently. But that argument does not always apply. Sometimes government intervention and direct provision of public services actually increase efficiency in our economy. Tourism provides two such examples: destination travel promotion and convention center financing.

Tourism promotion. National governments around the world actively promote tourist travel to their countries. This is also true of state governments in the United States. All fifty states have government travel offices that promote local tourism. In fiscal year 1991/92, the budgets of these state travel offices totaled nearly $331 million. Most of that money came from taxes. Only Alaska (18 percent industry contribution), Hawai'i (11 percent membership fees and miscellaneous income), and Washington, D.C. (10 percent corporate sponsorship) received significant private contributions toward travel promotion.

Why can't the tourist industry promote itself? After all, industry-financed generic promotion—the promotion of a particular commodity rather than a brand name product—is a common practice in agriculture. For example, the Florida citrus growers got approval to tax themselves to finance their well-known television commercials. Here in Hawai'i, the papaya industry assesses fees on all its growers and uses the revenues to promote the sale of papayas.

These assessments on individual growers are based on either the volume sold or a percentage of the sales revenue, and therefore they are proportional to the potential benefits received from generic promotion. Growers are required by federal or state legislation to pay these assessments, although sometimes there are provisions to allow them to apply for refunds. There is no enforcement or compliance problem.

Free-riding. What would happen if there were no legislation to force papaya growers, for example, to pay for promotional expenditures? Even if each grower could see the need to promote papayas, he would know that he too would benefit from promotions paid for by others. This would be true even if he didn't contribute a dime to the promotion fund. Some growers (maybe all) would yield to the temptation to enjoy a free ride on the promotion spending of others. Of course, if many were to behave in this selfish way, there wouldn't be enough contributions to mount the size of promotion campaign the growers collectively want.

Legislation forcing all growers to contribute money toward product promotion also reduces the effort and cost (compared to private solicitation) of raising the desired level of money to promote their product. For these reasons, government intervention in the generic promotion of agricultural products increases economic efficiency.

The tourist industry also benefits from collective promotion, but free-riding is a chronic problem. When an airline, a hotel, or any other tourist attraction promotes Hawai'i travel on its own, other tourist businesses, which did not contribute to the promotion campaign, also benefit. But unlike the Papaya Administrative Committee, which promotes one specific product and has legal authority to compel compliance, the Hawai'i Visitors Bureau (HVB) is a voluntary trade association. It has no power to compel businesses that benefit from its activities to join or to pay their fair shares of the association's promotional expenditures. One study found that fewer than 7 percent of all businesses in Hawai'i belong to the HVB.

Reliance on government. Not surprisingly, the HVB never seems to have enough of its own funds to promote Hawai'i travel adequately. Consequently, it has had to rely increasingly on the state government to finance its budgets. In 1918, the territorial government's contribution to the HVB's predecessor (the Chamber of Commerce's Hawai'i Promotions Committee) represented 22 percent of the total budget. During the 1950s, the government's share of HVB budgets averaged around 50 percent. Through the 1960s and 1970s, state government contributions climbed to just over 70 percent of the budget. The government's share today exceeds 90 percent!

Since the tourist industry is unable to engage in collective destination promotion, the government has essentially taken over the function in Hawai'i. The HVB is a private entity only in the legal sense; every aspect of its operations is subject to review and approval by the state government.

How should the state government raise money to finance the HVB's tourism promotion? Ideally, we want tourism promotion taxes to fall on the parties who benefit from tourism promotion in proportion to the benefits each receives or is likely to receive. But, unlike the papaya industry, it is not easy to devise a simple and fair formula like so much per pound or per dollar-volume of sales. What makes tourism different from papayas is that it is difficult to pin down who benefits from tourism and its promotion.

Diverse industry. For one thing, tourism is a diverse industry representing businesses that sell a wide variety of goods and services. Moreover, businesses that sell to tourists also sell to local residents. Some rely more on tourists, others on residents. The percentages vary greatly, not only from company to company but from year to year. And that assumes each company has a practical way to determine who's a tourist and who isn't. That's not even close to being realistic in most cases. Plus, the economic benefits of tourism are widely dispersed. Most of us benefit at least indirectly from it, but a few may actually be worse off as a result of increased tourism. Where would we draw the line on who has to contribute to the HVB budget and how much?

Given this difficulty, governments use a variety of ways to finance travel promotion. Most states, including Hawai'i, allocate money from their general funds to finance their travel promotion. When the benefits of tourism are very large and diffused widely through the economy (as they are in Hawai'i), the use of general fund revenues for tourism promotion is appropriate.

Many states also use taxes that specifically target the tourist industry. The most popular industry-specific tax is the hotel room tax, used by nine states in 1991/92 to fund their state travel promotion. Four of those states use the hotel room tax exclusively to fund state travel promotion. Other industry-specific taxes used to fund state travel promotion in the United States include a tourist promotion tax (two states), car rental tax (two states), and gaming tax (one state). All these industry-specific taxes target a selected segment of the industry and bear no resemblance to the industry-wide "benefit" assessments employed in agriculture.

Several states use revenue sources that have no relation to tourism whatsoever. For example, West Virginia uses its lottery revenues to fund its state travel promotion, and in North Carolina 5 percent of the state travel promotion budget is derived from the sale of personalized auto license plates.

Earmarking. What about earmarking a specific tax—say, the hotel room tax—for tourism promotion? Earmarking is the practice of designating or dedicating specific revenues to finance specific public services. Indeed, when the legislature was debating the passage of the 5 percent hotel room (i.e., transient accommodation) tax in 1986, one argument in favor of its passage was that the new tax would enable the state to give more money to the HVB and also to fund the new convention center. However, the legislature chose not to earmark the revenues from the hotel room tax. Instead, it allocated the money into the state general fund. Earmarking would have assured the HVB a more predictable source of revenues. Currently, it has to beg for money from the state legislature every year.

On the other hand, earmarking would result in less fiscal accountability. The current arrangement requires the HVB to account annually for its intelligent use of the prior year's allocation. Plus, with earmarking, it's quite likely that the tax will generate either too much or too little for travel promotion. Hong Kong used to earmark its hotel room tax money for tourism promotion, but it stopped when it was determined that too much money was being spent on tourism promotion relative to funding levels for other worthy public services.

The case *for* earmarking is political rather than economic. The promise of earmarking increases the chances that the industry will support the passage or increase of the tax at the legislature.

Convention center. The same reason the tourist industry cannot successfully engage in collective travel promotion explains why the local tourist industry cannot be expected to raise the money to build and operate a convention center.

Convention center facilities usually operate at a loss, so no individual business wants to build and run them. The tourist industry cannot collectively finance the building and operation of a convention center because each tourist business in Hawai‘i would benefit whether or not it contributed. As in destination promotion, the incentive would be to free-ride on the contributions of other businesses.

Voluntary solicitation would be inefficient and highly unlikely to generate enough money to build any kind of facility, much less the world-class convention center the industry wants (remember, fewer than 7 percent of all businesses in Hawai‘i are dues-paying members of the HVB). As with the promotion of tourism generally, government intervention to provide a convention center increases rather than decreases economic efficiency. That's why large convention centers in the United States get built by state or local governments and not by private businesses.

In conclusion, government takeover of destination travel promotion and convention center development from the private sector does not necessarily imply state subsidy of the travel industry. It merely indicates a more efficient way to fund travel promotion and convention center facilities.

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