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'Leakage' claims: Muddled thinking and bad for policy?

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'"Leakage" pessimists do us a disservice. The analysis uses muddled thinking and poor arithmetic to generate the wrong answer to an inappropriate policy question. The exaggerated claims divert attention from an important challenge at hand – boosting the linkages between tourism and the rest of the local economy.'

Tourism in poor countries is criticised on many counts – some valid, some debatable, and some rather silly. A valid criticism is that the collision of cultures in long-haul destinations can be deeply offensive and exploitative of people and the environment. This has led some to brand unregulated tourism as 'the unacceptable face of western capitalism'. However, there is an emerging body of international best-practice in how to deal effectively with these issues, and reduce risks to cultures, people and biospheres.

In other instances, anti-tourism protagonists take another, more questionable, line of attack. Using startling statistics, they suggest that tourism leaves minimal economic benefit in host countries, with all the benefits accruing to international tour operators and their corrupt Third World local elites. Some respectable organisations have cited research that 75% of the benefits of tourism 'escape' the host country and ends up in the rich source countries, through what is termed 'leakages'. Unfortunately for the poor in developing countries, these figures are generally based on flawed arithmetic, and can be unhelpful to policy makers trying to improve the impact of tourism on the poor.

Bad arithmetic

A major problem is how 'leakage' is measured. Payments for imported food or expatriate managers are a financial flow out of the destination economy. However, substantial payments in tourism are for services provided outside the destination country. Marketing, insurance, retailing, packaging, and long-haul flights are often 50% to 70% of total package cost and are normally provided by western tour operators and airline companies. Regarding this as a 'leakage' is like suggesting that staff and accommodation costs for serving a cappuccino in a London café are 'leakage' from coffee plantations in Ethiopia!

The use of the term 'leakage' conveys the idea that the host economy is somehow entitled to 100% of the revenue of the global value chain between source and destination markets. In practice, of course, producers never capture the entire value chain, and a more reliable comparison is between tourism and other exports made by African countries. For example, if you compare African tourism with coffee, it performs well. Just over half of total holiday spending (package and out-of-pocket spending combined) from a package purchased at a European travel agent accrues to goods and service providers in The Gambia (from hoteliers to farmers and crafters). Furthermore, about 7% of total spending, and 14% of expenditure in The Gambia, accrues directly to the poor. In the case of coffee, it has been calculated that about 1.5% of the price of a cup of coffee bought in a café in Europe benefits the producer – rising to only about 7% for fair trade coffee. This suggests that package tourism in The Gambia is actually as effective a mechanism for transferring resources from retail expenditure in Europe to poor African producer households as fair trade coffee, and much better than the conventional commodity.

Another major problem with 'leakages' has been the use of wrong denominators and numerators:

- The use of a package price, as opposed to the total holiday cost, for the denominator is inappropriate. Our research estimates that out-of-pocket spending, which is not included in the package price, can be around one-third of the total holiday cost and it is exactly this component that is most likely to stay local. It is pointless to assess what flows out of the economy without taking account of important inflows;
- The numerator should exclude payments

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made for goods and services that are not provided by the destination – and should certainly not claim these as 'leakages'.

Using recent tourism data from The Gambia, we can calculate the impact of muddled 'leakage' arithmetic and definitions. Using the 'wrong' arithmetic would generate a 'leakage' figure of about 90% (i.e. around 30% of the total package cost accrues to The Gambia, mainly to hoteliers. If only one-third of this share is used to pay for wages and locally-produced goods and services, with the rest being held offshore, then this equates to just 10% of total package costs reaching the host country). This would seem to confirm our worst nightmares: tourism in a small, poor, African country, dominated by European tour operators and budget packages, has little benefit for the host country. The only problem is that the answer is wrong.

By changing the definition of 'leakage' to apply to the half of the total global value chain which is accounted for by payment for services provided at the destination (package and out-of-pocket spending combined) we arrive at 'leakage' figure of 50% at most. This 'leakage' overseas takes place in the form of food and other imports, expatriate wages and the repatriation of profits. This estimate is based on the very pessimistic assumption that all financial flows that are not absorbed by expenditure which is demonstrably 'local' – such as non-management wages and locally grown food – is lost to the Gambia. So, our worst case scenario estimate of 'leakage' from The Gambia is 50% at most – not 90%, and not such a nightmare after all.

Bad policy

There are two real dangers with distorted 'leakage' figures. One is that ridiculously high 'leakage' figures may panic decision makers into thinking that tourism is a worse alternative than other, less good, options. Tourism is a major generator of employment, exports and substantial pro-poor flows, and appears to win a larger share of the value chain for the host country than coffee.

The second is that these figures lead tourism policy-makers to focus on plugging 'leakages' to external economies, instead of the more productive avenue of opening up linkages within their economy.

The common assumption that linkages and leakages are mathematical opposites is wrong. Linkages measure how tourism activity affects non-tourism sectors, and so how much the whole economy benefits from tourist growth, while 'leakages' refer to the flow of payments overseas from tourism expenditure. 'Linkages' and 'leakages' are associated ideas but are slightly different. As such, some countries have both high linkages and 'leakages'. Tourism in Malaysia, for instance, stimulates considerable activity in other sectors of the economy – but the non-tourism economy has a high propensity to import. The combined effect of this is a tourist destination with both high linkages and 'leakages' .

This is not to say that 'leakages' are irrelevant. Using correct definitions, it does matter that Rwanda imports tea bags and chicken pieces for hotel guests instead of using abundant local supplies, or that a large share of the hotel salary bill is paid to expatriate staff because local skills are lacking. It matters particularly to the poor, for whom supply chains to the tourism sector can be a significant source of livelihood.

But a simplistic approach to blocking leakages is not the policy solution. For one thing, imports can be essential to developing a thriving tourism economy. Efforts to stem the loss of tourists' foreign exchange may reduce welfare of the host economy: how many small developing countries have sought to operate financially ruinous national airlines or levy extreme tourist taxes in counterproductive efforts to reduce 'leakages'?

Another pragmatic reason for not over-emphasising 'leakages' is that there is not much policy makers can do about them. There is a narrow scope to reduce 'leakages' through policy interventions, because 'leakages' tend to be associated with long-term variables such as endowments of capital, labour and natural resources, institutional capacity, and level of development.

Conversely, there is much that can be done to boost linkages, and this is a more productive focus for policy. Two World Bank researchers recently analysed the policy variables that shape linkages and leakages, and found that – unlike 'leakages' – linkages are sensitive to a broad range of policy measures. A large cross-country regression analysis revealed a close association between strong linkages, a conducive business environment and a healthy educated population with high female economic participation, for all scales of tourism. With high levels of tourism, informal business associations are associated with strong linkages, as scale economies encourage clusters of entrepreneurs to co-operate around tourist destinations. A lack of security (violence or crime) undermines linkages by deterring producers from forming clusters as well as discouraging tourists from venturing beyond their hotel. Strengthening linkages is not necessarily easy, but there is a clear agenda for action for a progressive policy platform that focuses on improving the safety, health, education of the population and the business environment.

In summary then, 'leakage' pessimists do us a disservice. The analysis uses muddled thinking and poor arithmetic to generate the wrong answer to an inappropriate policy question. The exaggerated claims divert attention from an important challenge at hand – boosting the linkages between tourism and the rest of the local economy.

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