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An initial investigation into the impact of tourism on local budgets: A comparative analysis of Spanish municipalities

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ABSTRACT

The Spanish Federation of Municipalities has, particularly since 2008, been vocal about a "chronic deficit" situation caused by high public expenditures in tourist areas. Within this context, new strategies to increase revenues have been proposed, including the introduction of tourist taxes. This paper contributes to this debate by determining if tourism activity actually has a negative impact on local finances in Spain. To that end, a comparative analysis of budget structures between tourism-intensive and non-tourism-intensive municipalities is undertaken using data from more than 3200 local corporations for the years 2001–2010. The determinants of expenditures, revenues and deficit per capita are identified using a linear regression. The results indicate a direct relationship between tourism intensity and local deficits only in the smallest and largest municipalities, while a beneficial effect is actually seen in the remainder of the sample. In view of this evidence, we recommend revising the existing regulations to allow for municipalities below 20,000 residents to be officially recognized as "tourist municipalities" so that they can benefit from that status. In addition, the option of introducing new tourist taxes should be more restricted in scope and depend upon further evidence of possible cost inefficiency in the affected municipalities.

1. Introduction

The financial crisis has tightened the budgets of local and regional administrations in Spain regardless of their size. Between 2009 and 2012, the aggregate budget of Spanish municipalities decreased by approximately 16%, from 57.6 to 48.3 billion euro (MHyAAPP, 2013). This translated into a severe reduction in public services. These budget cuts are particularly problematic for tourist areas, which must service a transient visitor population that, in many cases, significantly outnumbers the permanent residents in the peak season creating a surge in demand for public services. These additional services include policing, cleaning, tourist offices, cultural and sport facilities, waste processing and environmental protection. In contrast to the increased expenditures, the recession-driven reduction in the number of visitors and their average spending during 2009 and 2010 led to a substantial drop in local revenues that amounted to the problem (IET, 2011).

Spanish law[1] recognises the particularities of the municipalities with substantial tourist activity and establishes a number of specific funding alternatives to help them cover their increased expenditures (Márquez, 2008). Regional governments, such as the Valencian Community, have also introduced complementary regulations along the same lines (Pastor & Soler, 2009). Nevertheless, the Spanish Federation of Municipalities and Provinces reports that local administrations in tourist areas suffer from "chronic deficit" (FEMP, 2008). In relation to that, two main limitations of the existing laws are noted: i) the restrictive definition of "tourist municipality", which requires a population between 20,000 and 75,000 residents and a number of hotel beds plus second residences strictly higher than the number of permanent residences; and ii) the limited funding alternatives associated with that status. A number of strategies to improve local revenues for tourist cities were then proposed by the FEMP, including more government transfers or the introduction of accommodation taxes, some of

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[1] *Ley Reguladora de las Haciendas Locales. Real Decreto 2/2004.*

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which have recently been implemented in major cities, such as Barcelona.

This type of taxes, which generally take the form of a fixed charge per guest per night, have the effect of increasing the final price paid by tourists, as hotels tend to pass the payment of the tax to the consumers (Aguiló, Riera, & Rosselló, 2005). The problem is that international tourism demand for Spanish destinations is generally considered to be price-elastic in the context of significant competition between destinations in the Mediterranean region (see e.g., De Mello, Pack, & Sinclair, 2002; Garin-Muñoz, 2006, 2007, 2009; Garín-Muñoz & Montero-Martin, 2007; Han, Durbarry, & Sinclair, 2006; Papatheorodou, 1999). Thus, the introduction of tourist taxes can actually lead to reductions in both the number of visitors and total tourism revenues, as can be inferred from the results of Aguiló et al. (2005) for the Balearic Islands.

When the potential drawbacks of introducing tourist taxes are considered, the FEMP's demands for more tax differentiation led us to question whether tourism activity actually has the purported negative impact on municipal budget structures to the extent that a new regulatory framework can be justified. We propose a two-stage process to achieve this objective: first, the hypothesis of a "chronic deficit" linked to tourism can be tested by using the observed revenues and expenditures of Spanish municipalities. If such a deficit were to be found, then a second analysis would require removing the effect of cost inefficiency that may be inflating these expenditures. Only at this point should the introduction of new tourist taxes be contemplated.

This paper aims to undertake the first stage of this process and to test the "chronic deficit" hypothesis as a basis for further research on the suitability of revised regulations. This is achieved by identifying any substantial differences in expenditure and revenue structures between tourism-intensive and non-tourism-intensive municipalities in Spain as well as determining the impact of tourism on local finances. Surprisingly, there appears to be a gap in the empirical literature on this particular subject, as previous studies have focused on other political and socioeconomic variables as determinants of municipal budgets.

To achieve these objectives, a comparative analysis is carried out using a panel database of more than 3200 Spanish municipalities of all sizes between 2001 and 2010. A location quotient between tourism and total tax revenues is used in order to classify the sample municipalities as tourism-intensive or not. Inferential statistics are then employed to establish significant differences between both groups in all components of local budgets and also in the financial ratios calculated from the same data. Finally, the determinants of expenditures, revenues, deficit and debt per capita are identified using linear regression. In addition to tourism intensity, other variables included are population, income, unemployment and, for the first time due to the availability of panel data, election cycles and recession years.

The remainder of this paper will be structured as follows: Section 2 provides a literature review on all subjects relevant to the paper in order to support the originality of our contribution. Section 3 describes the database and methodology. Section 4 carries out the comparative analysis of budget structures and discusses the determinants of municipal revenues, expenditures and deficit per capita. Section 5 discusses the policy implications of our results. Finally, Section 6 summarizes the paper.

2. Literature review

Tourism creates both positive and negative effects for local economies (Kaiser & Helber, 1978), and there is an abundance of research on the economic, environmental and cultural dimensions of the impact of tourism (Brunelli, Macedo-Soares, Zouain, & Borges, 2010). From an economic perspective, tourism has been commonly seen as a relatively risk-free solution to increase local revenues and promote economic activity (Wong, 1996). On the contrary, some authors indicate that the evident impact on municipal expenditures to cater to the floating visitor population must lead to a saturation level when tourism stops producing benefits (Young, 1973). In spite of these opposing views, there is a lack of empirical evidence on the direct impact of tourism activity on municipal finances, especially in recent times. However, a number of relevant perspectives can be identified in the existing literature.

First, the article by Wong (1996) studied the impact of tourism activity on local expenditures for a cross-section of 155 US counties. Exhaustive lists of different components of local expenditures per capita were regressed (using Ordinary Least Squares – OLS) against socioeconomic variables such as population, employment, income and crime rates. In addition, the reliance of the local economy on tourism is measured as a ratio between tourism-related payroll and total payroll expenses. As expected, the results indicate that tourism has a positive impact on many components of municipal expenditures, including fire, police, transportation, parks and recreation and local administration. While the analysis is sound, it is clearly limited by the lack of a revenue perspective to balance the discussion.

Second, Deller, Marcouiller, and Green (1997), who analysed the impact of the provision of recreational housing on local expenditures and revenues (the "holistic approach") using a cross-sectional sample of 69 counties in the state of Wisconsin (US) for 1990. This study employed an OLS regression with similar variables; the tourism activity is now proxied by the number of recreational houses per capita. The resulting elasticities indicate that the provision of seasonal housing pays for itself by increasing local revenues in an amount similar to the associated increase in public expenses.

The related literature on Spanish municipalities is very limited. However, the evidence produced so far is of great interest for our research. The most comprehensive contribution on the topic is from Zafra-Gómez, López-Hernández, and Hernández-Bastida (2009), who focused on identifying the key determinants of local financial performance. Using a large countrywide database, a detailed typology of municipalities was developed based on a number of socioeconomic variables that include local tourism revenues and other indicators of economic activity. The results suggest that tourism development leads to higher expenditures and also to improved liquidity, solvency and overall budgetary sustainability. These results agree with Pastor and Soler (2009), who provided a comparative analysis of budget structures between tourist and non-tourist municipalities (as defined by law) in the Valencian Community in 2005. The analysis is purely descriptive and concludes that the hypothesis of the "chronic deficit" of tourist municipalities is not proven, as local administrations in tourist areas enjoy higher financial autonomy and present a similar tax burden to non-tourist areas. While this result challenges the same claims that motivate this paper, it is worth noting the absence of any statistical inference to support their conclusions.

Additional methodological references can be obtained from a second body of literature, which is linked to the identification of the determinants of local deficit or tax burden (without a specific mention to tourism) focused on Spanish municipalities, including Lago-Peñas (2004) for the Region of Galicia; Sollé-Ollé (2006), Fluvià, Rigall-I-Torrent, and Garriga (2008), Bastida, Benito, and Guillamón (2009) and Benito, Bastida, and Muñoz (2010) with countrywide Spanish samples; and the post-recession studies of López-Hernández, Zafra-Gómez, and Ortíz-Rodriguez (2012) and Zárate and Vallés (2012), the latter for the Region of Aragón.