

Free Lunches and Tourist Taxes

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In many industries whether it's aeronautics, engineering or finance often the only way to make sense of large complex and interacting sets of data is to build a model. There are many models of the modern economy: classical; Keynesian; monetarist and neoliberal to name a few, but back in 1949 an economist at the London School of Economics built an actual hydraulic model of the British economy.

The Phillips machine, named after Bill Phillips, he of the "Phillips curve" and the designer, was an Heath Robinson affair with multicoloured water flowing down pipes, sluices and tanks representing the flow of income around the economy. Changes to taxation, consumption and investment were modelled by loosening or tightening various valves and the change in water flow was calibrated to estimate the impact of such changes on the real economy. It was used for a time by the Bank of England during the 1950s.

Whether or not the changes to the flows round the machine provided any real quantitative data applicable to the conduct of monetary policy is doubtful but the model did indicate that in a complex equilibrium such as a modern economy it is not possible to operate one lever without affecting the rest; change cascades through the system frequently in unpredictable ways.

The model also gave graphic illustration to the old adage that the "there is no free lunch in economics." Too much in the spending pipe led to overflows in the inflation pipe!

As we head into the holiday season, the tourist industry gives a real-time example of how changes in flows, in this case people not multi-coloured water, affect local economies around the world. Mass tourism has led native populations to protest about the annual influx of visitors, who are themselves left bemused since, in return for sun, sea and sangria, they bring money and resources.

The key is scale.

The native population of Dubrovnik is 42,000 people but the Harmony of the Seas operated by Royal Caribbean carries slightly fewer than 7,000 passengers. To see a small fleet of cruise ships anchored off a small Greek island is some sight but when you consider that the local population can double and halve in an afternoon, you begin to see the germ of a problem.

More broadly, in 2023, Ryanair, everyone's favourite low-cost airline, carried 181 million passengers around Europe. Ryanair is exclusively short-haul, and like him or loathe him, nobody has understood the economics of asset utilisation better than Michael O'Leary. Nonetheless, 181 million passengers, rising toward 200 million in 2024, is a quarter of Europe's total population.

Low-cost travel has opened up Europe and much of the rest of the world in a way that was unthinkable only a generation ago. Yet like Bill Phillips' model, opening the sluices of travel has created a raft of "negative externalities," carbon emissions, water depletion, traffic congestion and inadequate shelter for local people, that have largely gone uncompensated.

One of the reasons the low-cost airlines can offer very low prices, apart from the smoke and mirrors of disaggregating the costs into constituent parts – seat, luggage, sports equipment – is that, as hinted above, travellers are not paying the “full cost” of their trips.

This is changing: in 2024, travellers will have to pay new entry fees to stay in Paris, Amsterdam, Venice, Valencia, Barcelona, Madrid, Olhao, Faro and Figueiro da Foz. In the UK, Manchester has already introduced a tourist tax (raising £2.8M in its first year). Where one goes...others will follow.

Ryanair and others may have blown open the sluice gates of mass travel but as Bill Phillips’ model suggested, valves elsewhere need to be closed if the system is to maintain its integrity. Even as the cost of airline tickets continues to fall, total travel costs will almost certainly rise. In economics, there are no free lunches.

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