Tourist Arrivals and Inclusive Growth

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KEY MESSAGES

- The APEC region received 426 million tourists in 2013, an increase of 168% from the 159 million tourist arrivals in 1995.

- Between 1995 and 2013, tourist arrivals in the region grew at an average rate of 5.6% per year. However, in more recent years tourist arrivals growth has slowed down, growing an average of 4.3% per year in 2011-2013.

- The region is on track to reach its goal of 800 million tourist arrivals by 2025, but this is not guaranteed. If long-term growth rates are assumed, then the region will reach 819 million tourists by 2025. However, if more recent growth rates are applied, the region will fall 100 million tourists short of its target.

- Achievement of the 800 million arrivals target by 2025 can lead to significant gains for the region. If this target is achieved, the APEC region could produce an additional USD 3.8 trillion dollars in output, generate an additional 21.1 million jobs, and lift an additional 15.2 million people out of extreme poverty. Data also show that tourism development has positive synergies with bilateral trade and investment, so attaining the goal can contribute to trade and investment growth in the region.

- Attaining the 800 million target requires the calibration of policies that affect tourist flows. Based on the empirical analysis, two policy areas that have the strongest impact on tourist arrivals are visa requirements and air connectivity.

- Imposing visa requirements, by itself, reduces bilateral tourist arrival growth by half a percentage point. Visa requirements serve important security and information gathering purposes, but are costly for the economy imposing them in terms of lost tourism flows. However, the data also show that economies can significantly reduce the impacts of visa requirements by implementing visas-on-arrival or e-visas, or reducing the cost of visa applications.

- Having a direct flight, by itself, increases bilateral tourist arrival growth by a third of a percentage point; only land transport through a shared border has a stronger influence on tourist arrivals. Improving air connectivity through open skies, airline competition, improved airport services, and regional cooperation on connectivity can help raise tourist arrivals growth in the APEC region.

- Other policy areas that can contribute to tourism performance are improving tourist safety, tourism promotion and image management, and cultural exchange programmes. Moreover, trade and investment promotion have positive synergies with tourism development by attracting more people to visit a destination, while tourism promotion can help trade and investment growth by opening visitors' eyes to possible business opportunities.

- Empirical evidence show that tourism development has a positive impact on poverty reduction and inclusive growth (i.e., growth in household incomes coupled with improvements in distribution). Tourism contributes to poverty reduction as every 1% increase in tourist arrivals is associated with a 0.12% reduction in the number of poor people in the region. Data also show indicatively that tourism contributes to inclusive growth by providing the poor with more opportunities for employment and entrepreneurial activity.

- The role played by micro, small, and medium enterprises (MSMEs) is crucial for the inclusiveness of the tourism sector. Employment opportunities for the poor in the tourism sector are usually coursed through MSMEs. This is because MSMEs are more likely to hire locally, generate jobs that are less skill-intensive, and provide more flexible work arrangements that are suitable for poor households.

- Studies have shown the contributions of MSMEs in fostering inclusive growth in the tourism sector, as well as the challenges they face. MSMEs are often less able to respond to macroeconomic instability, corruption, and poor infrastructure, while having insufficient access to credit and skills. MSMEs are also vulnerable to being crowded out by larger firms and multinational chains while competing with poorly regulated informal sector firms.

- Enhancing the inclusiveness of tourism requires active policymaking at three levels: destination, economy, and international. Destination-level interventions involve partnerships between residents, operators, NGOs and local authorities at the tourist site itself. At the economy-level, policies on business licensing and permits, skills training, land-use planning, competition policy, and financial sector reform can benefit MSMEs in tourism. Finally, interventions at the international level include regional cooperation on responsible codes of conduct for travel providers, as well as tourism policy coordination, best practice dissemination, and capacity building.

- The APEC Tourism Working Group (TWG) is well placed to be a forum for information exchange and data sharing for further tourism policy analysis in the region. An APEC-wide dataset for tourism policy inputs (e.g., site promotion efforts, tourist service development) can be collected by TWG, which can then be associated with external data and tourism outcomes to provide a more comprehensive analysis of the sector. Likewise, micro-level case studies on tourism, inclusive growth, and MSMEs can be considered to provide deeper analysis of how tourism development affects firms, households, and individuals; determine gaps and challenges; and glean evidence-based policies that can strengthen the inclusiveness impacts of tourism development in the region.

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1. INTRODUCTION

Tourism has been consistently recognised as an important source of inclusive economic growth in the APEC region. In the 1994 Bogor Goals Declaration, tourism was identified as an area of cooperation that will help "attain sustainable growth and equitable development of APEC economies, while reducing economic disparities among them, and improving the economic and social well-being of our people".[1] This was reiterated by Leaders in 2010, where they emphasised tourism promotion as a means to contribute to inclusive growth through its linkages with business, employment, entrepreneurship, and MSME development, as well as sustainable growth through ecotourism.[2]

In line with Leaders' vision of tourism as a vehicle for inclusive growth, the APEC Tourism Working Group (TWG) was established in 1991 to bring together tourism officials in the APEC region to share knowledge, exchange views, and develop areas of cooperation. In 2000, during the 1st APEC Tourism Ministerial Meeting (TMM1) in Seoul, Korea, tourism ministers agreed to step up actions to "improve the economic, cultural, social and environmental well-being of APEC member economies through tourism". Additionally during TMM8 in 2014 in Macao, China, ministers announced efforts "to achieve the target of 800 million international tourists among APEC economies by 2025" and called on governments to place more emphasis on the development of tourism in the region.[3]

This study aims to contribute to tourism policy discussions in the APEC region in two ways. First, it will examine the likely impacts of policies that can contribute to achieving the target of 800 million international tourist arrivals by 2025. This will be done through an analysis of quantitative tourism data as well as the factors that affect tourism arrival in APEC economies. Second, it will look at the linkages between tourism development and the overall economy, focusing on the linkages between tourism and macroeconomic indicators, inclusive growth, and MSME development.

In the first section, we discuss tourism performance in the APEC region and examine the likelihood of achieving the 800 million target by 2025 based on recent growth trajectories. Following that, we analyse the push and pull factors affecting tourism in APEC with a focus on policy development.

We then examine the linkages between the tourism sector and broader inclusive growth goals. In particular, we will explore how tourism can contribute to poverty alleviation through MSME development. We also estimate the quantitative impacts of tourism growth on economic growth and trade, inclusive growth, employment, poverty, and other indicators.

Figure 1 shows a simplified analytical framework that we will apply for this study, and which will guide the flow of this report. An economy's tourism performance is determined by push and pull factors: push factors are those that lead a person to leave home and become a tourist,
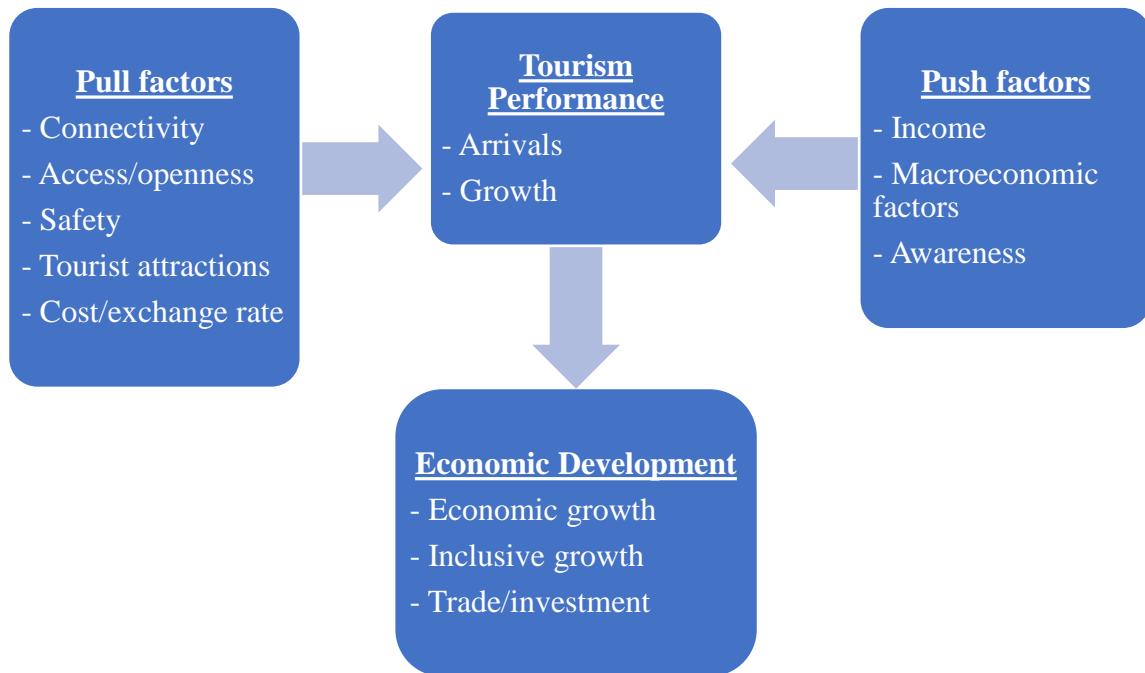
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[1] 1994 Bogor Goals Declaration, para 8: http://www.apec.org/Meeting-Papers/Leaders-Declarations/1994/1994_aelm.aspx.

[2] 2010 APEC Leaders' Growth Strategy: http://www.apec.org/Meeting-Papers/Leaders-Declarations/2010/2010_aelm/growth-strategy.aspx.

[3] 2014 Macao Declaration, para 3: http://www.apec.org/Meeting-Papers/Sectoral-Ministerial-Meetings/Tourism/2014_tourism.aspx.

while pull factors are those that lead that tourist to visit a particular destination. For example, income and awareness of interesting destinations are push factors because they provide an opportunity and desire for a person to become a tourist. On the other hand, that person's choice of where to go is affected by various pull factors such as expected costs, connectivity, safety, and destination attractions—these are pull factors. Both factors come into play to determine an economy's tourism performance. In turn, an economy's tourism performance has direct and indirect impacts on economic development indicators such as GDP growth, poverty alleviation and distribution, or trade and investments.

Figure 1. Analytical Framework

Pull factors
- Connectivity
- Access/openness
- Safety
- Tourist attractions
- Cost/exchange rate

Tourism Performance
- Arrivals
- Growth

Push factors
- Income
- Macroeconomic factors
- Awareness

Economic Development
- Economic growth
- Inclusive growth
- Trade/investment

Source: Authors.

2. TOURISM PERFORMANCE IN THE APEC REGION

TOURISM TRENDS

According to data from the United Nations World Tourism Organization (UNWTO), global tourist arrivals have experienced an average annual growth of 6.3% between 1995 and 2015, growing from 347 million arrivals in 1995 to 1.2 billion in 2015 (Figure 2). As of 2014, total global receipts from tourism amounted to USD 1.2 trillion, a 600-fold increase from the USD 2 billion recorded in 1950 (UNWTO 2015). Between 2010 and 2030, tourist arrivals to emerging economies are expected to grow at 4.4% annually, while the rate of tourism growth in advanced economies is expected to be 2.2% annually. Subsequently, the market share of emerging economies is projected to reach 57% by 2030, almost double their share of 30% in 1980. In terms of international tourism arrivals in 2014, UNCTAD (2013) reports that four of the top 10 spots are held by APEC economies (United States; China; Russia and Mexico). Similarly, four of the top 10 spots in terms of international tourism receipts are held by APEC member economies (United States; China; Thailand; and Hong Kong, China).

Figure 2. Global tourist arrivals, 1995-2013
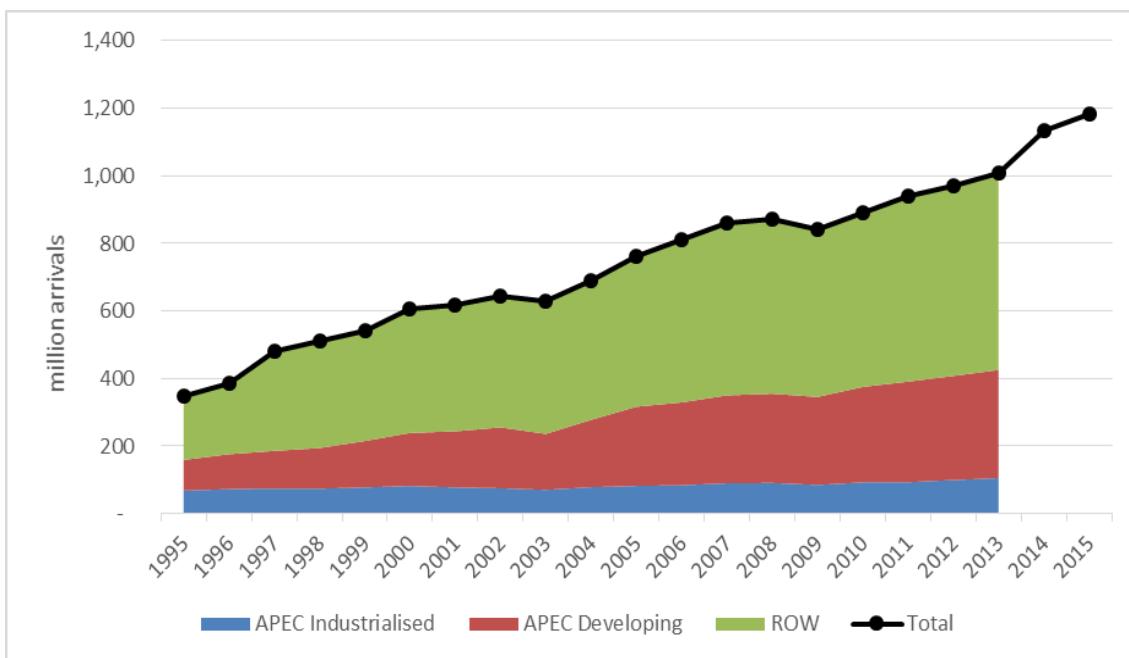
Note: ROW = rest of the world. APEC industrialised economies are Australia; Canada; Japan; New Zealand; and the United States. APEC developing economies are other APEC members not classified as industrialised. Figures include all arrivals of non-residents into an economy regardless of purpose.
Source: UNWTO data and APEC PSU estimates (1995-2013); UNWTO 2015 (2014-2015).

The APEC region experienced positive growth in almost all years between 1995 and 2013, only seeing contractions in tourist arrivals in 2003 and 2009, likely due to the negative impacts of the SARS epidemic and the Global Financial Crisis, respectively. Tourist arrivals into APEC economies grew at an average rate of 5.6% per year between 1995 and 2013, increasing from 159 million arrivals in 1995 to 426 million in 2013 (Figure 2). Of this 426 million, 106 million tourists arrived in APEC industrialised economies while 320 million arrived in developing economies.

Tourist arrivals to APEC developing economies grew annually at 7.2%, outpacing the 2.5% annual average growth rate of industrialised economies (Figure 3). Over time, however, there seems to be a convergence in arrival growth rates between industrialised and developing APEC economies, with both groups hovering around 4.3% per year in the past three years. Moreover, while there is a slight increase in tourist arrival growth rates for industrialised economies in recent years (i.e., average growth rates in 2011-2013 are higher than 1995-2013), growth in developing economies seems to be slowing down.

Figure 3. Tourist arrivals annual average growth rates in APEC
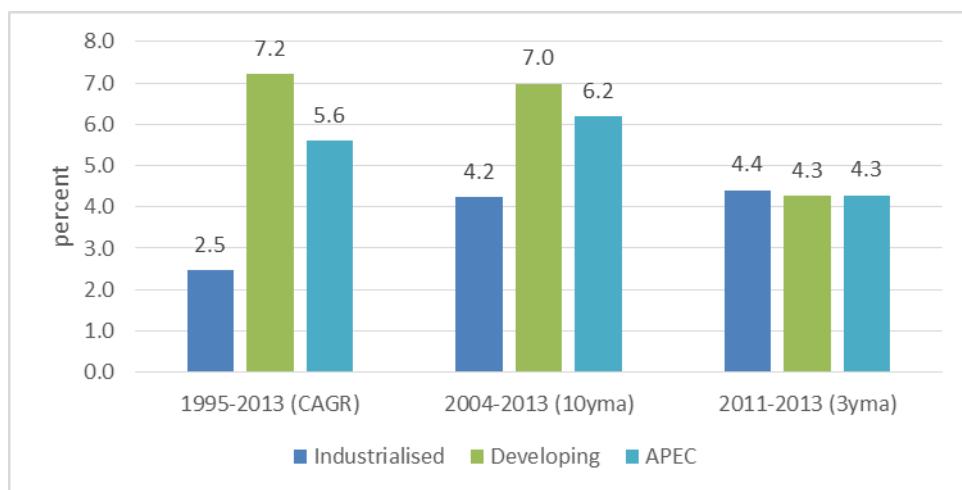
Note: CAGR = compound annual growth rate; 10yma = 10-year moving average; 3yma = 3-year moving average. APEC industrialised economies are Australia; Canada; Japan; New Zealand; and the United States. APEC developing economies are other APEC members not classified as industrialised.
Source: UNWTO data and APEC PSU estimates.

Estimates of APEC tourist arrivals from 2014 to 2025 are projected using the trend growth rates in Figure 3. As seen in Figure 4, if the longer-term average growth rates (i.e., 1995-2013 CAGR and 2004-2013 average) are assumed to continue, the APEC region is on course to reach the target of 800 million tourist arrivals in 2025. However, if more recent average growth rates are assumed (i.e., 2011-2013 average growth rate), the region will fall short of its tourism target by about 100 million tourists.

Figure 4. Estimates of APEC tourist arrivals, 2014-2025
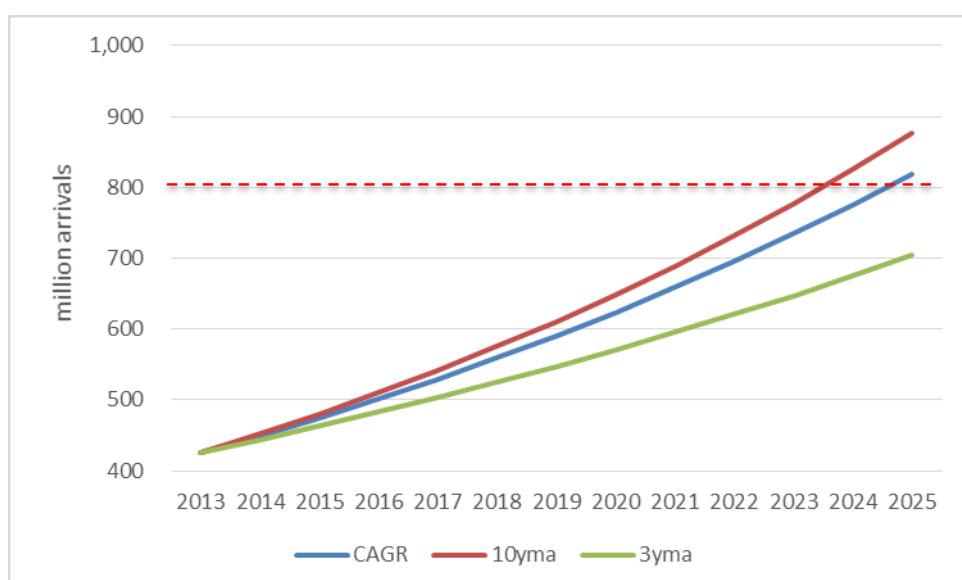
Note: CAGR = compound annual growth rate (1995-2013); 10yma = 10-year moving average (2004-2013; 3yma = 3-year moving average (2011-2013).
Source: UNWTO data and APEC PSU estimates.

There is therefore no certainty that the region is on course to attain its 800 million tourist arrivals goal, depending on the growth rate assumed. In order to have a clearer picture of whether the region is on course to attain the goal, it is important to analyse the factors that affect tourism performance in the region.


Box 1. Intra-APEC Tourism

Intra-regional travel dominates tourism in the APEC region. Of the 426 million tourist arrivals in APEC in 2013, 315 million came from other APEC economies and 111 million came from the rest of the world (Figure B1.1). The relative shares of intra-APEC travel and ROW-APEC travel have not changed much in the past two decades: the share of intra-APEC travel in total APEC tourist arrivals has stayed around 73% since 1995, while ROW arrivals into APEC make up the remaining 27% percent. Looking at Figure B1.1, we can see that most of the growth in intra-APEC tourism came from developing APEC economies, with their share of intra-APEC tourism expanding from 55.0% in 1995 to 75.8% in 2013.

Figure B1.1. Sources of APEC tourist arrivals, 1995-2013
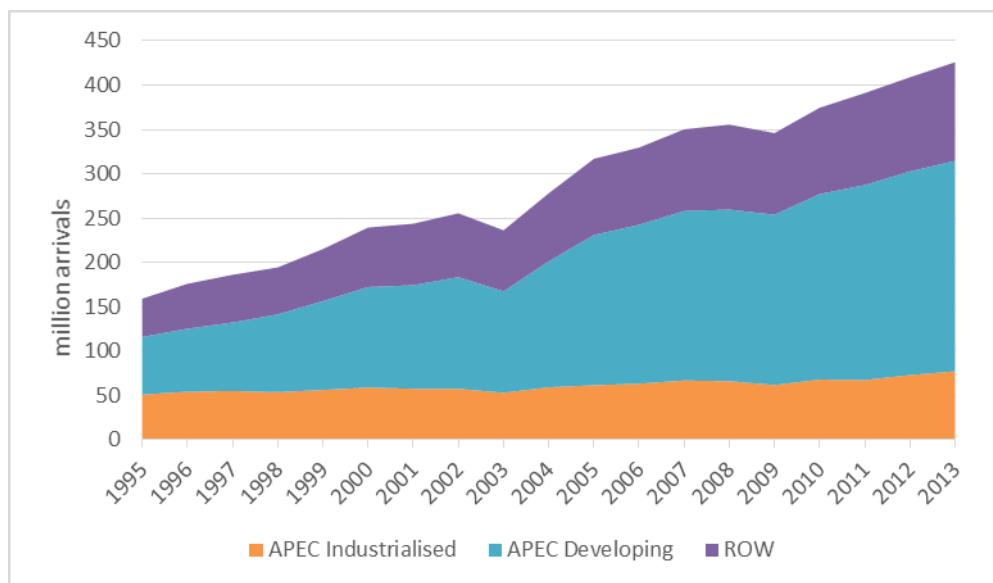
Note: ROW = rest of the world. APEC industrialised economies are Australia; Canada; Japan; New Zealand; and the United States. APEC developing economies are other APEC members not classified as industrialised. Figures include all arrivals of non-residents into an economy regardless of purpose.
Source: UNWTO data and APEC PSU estimates.

Indeed, tourist arrival growth to developing APEC economies has experienced rapid growth during the past two decades. Between 1995 and 2013, travel from industrialised economies to developing economies increased at an average annual rate of 8.1% while travel from developing economies to other developing economies grew at 7.3% annually (Figure B1.2). On the other hand, travel flows to industrialised economies increased by 1.3% annually from other industrialised economies and 4.4% from developing economies. In comparison, travel from the rest of the world into APEC economies increased at an average annual rate of 5.4%.

Figure B1.2. Average annual growth in intra-APEC arrivals, 1995-2013
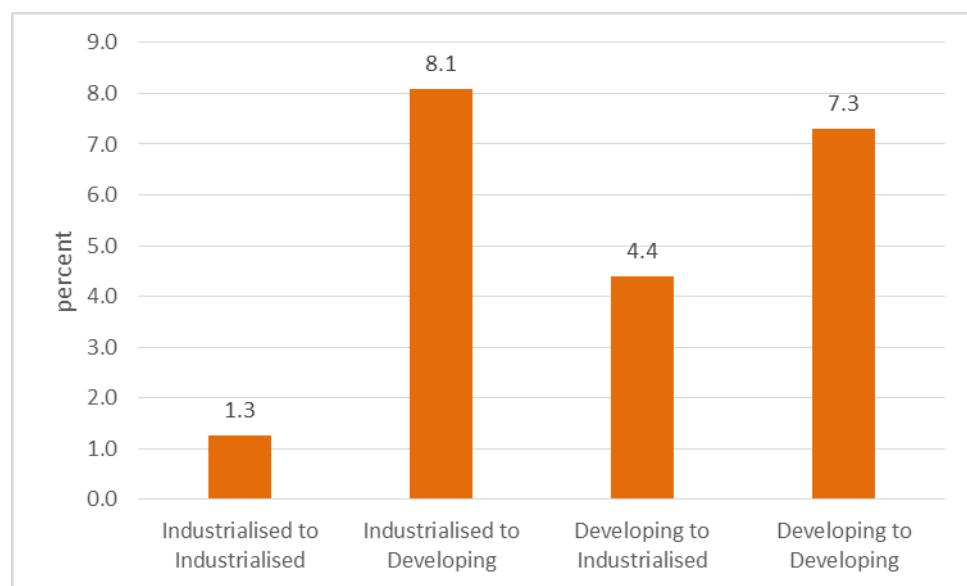
Note: APEC industrialised economies are Australia; Canada; Japan; New Zealand; and the United States. APEC developing economies are other APEC members not classified as industrialised. Figures include all arrivals of non-residents into an economy regardless of purpose.
Source: UNWTO data and APEC PSU estimates.

The importance of intra-APEC travel to the region's overall tourism performance points to the need for regional cooperation on tourism development. APEC, and TWG in particular, are in a good position to coordinate tourism policies and share experiences and best practices to promote tourism within the region. While tourism to developing APEC economies has experienced rapid growth in the past two decades, more can be done to increase tourism growth in industrialised economies. An examination of the factors that affect tourist flows may contribute to the formulation of policies and programmes that can boost tourist flows within the region.

DETERMINANTS OF TOURISM PERFORMANCE

As mentioned in the introduction, an economy's tourism performance is influenced by both push and pull factors (cf. Figure 1). Push factors are the set of variables that provide a person the opportunity to be a tourist as well as the information to have the desire to be a tourist. For example, higher economic growth, which leads to increased employment and wealth for households, is a push factor because it provides disposable income to more people to become tourists. Likewise, greater awareness about foreign destinations can become a push factor by persuading potential tourists to spend their leisure time and money on international tourism.

On the other hand, pull factors are the variables that lead that tourist towards a particular destination. Choosing one destination over another involves a variety of factors. Economic considerations include cost of travel, affordability, value for money, and even exchange rates. Logistical considerations include travel time and difficulty, ease of entry (e.g., visa requirements), security, and language. On top of these are destination-specific considerations such as tourist attractions, cultural affinity, cuisine, and others that can attract a potential tourist to a particular destination.

Push and pull factors affecting tourism may or may not be influenced by tourism development policy. Factors such as cultural affinity, language, or geography are accidents of history or nature and are beyond any influence from policy. Meanwhile, shocks such as natural disasters, epidemics, or global financial crises are external factors that nevertheless affect tourism arrivals. Although factors such as economic growth, trade, or poverty can be influenced by policy in general, they are quite removed from the area of tourism policy and development and are also considered external to the tourism sector. These factors that are external or indirectly related to tourism development are thus "exogenous factors". On the other hand, "endogenous factors" are those that are more directly related to, or influenced by tourism development policy. Examples of endogenous factors include connectivity, safety, awareness, and ease of entry.

Table 1 provides examples of push and pull factors classified into exogenous and endogenous factors. It should be noted that not all of these endogenous factors are the responsibility of tourism ministries. For example, transportation ministries may have a more direct hand in connectivity, while security services are more involved in ensuring safety. Nevertheless, these factors directly influence tourism performance and a holistic view of tourism policy development will need to consider them.

Table 1. Matrix of factors affecting tourism performance

	Pull factors	**Push factors**
Endogenous factors	Connectivity Ease of entry Safety Attractions	Awareness/interest
Exogenous factors	Economic growth Exchange rate Shocks History Culture Language Geography	Economic growth Exchange rate

Source: Authors.

For this analysis, we focus on the impacts of the endogenous factors on tourism performance while controlling for exogenous factors that are also important for tourism but generally beyond the ambit of tourism promotion policy. To do this, we gather data from various sources that can provide quantitative indicators for the factors outlined in Table 1. Appendix A lists the data and sources gathered for this analysis. While some of the data obtained are direct measurements of the factors we wish to consider—e.g., visa requirements or flights data—we had to find indirect but conceptually correlated indicators for factors that are more difficult to measure. For example, we obtained data for crime and terrorism as indicators of tourist safety in an economy. Likewise, we use relative search popularity and number of UN Heritage Sites as proxies for awareness/interest and number of tourist destinations, respectively.

To analyse the large volume of data, we employ a method of multivariate analysis called gravity modelling. Gravity models are a class of econometric models that are commonly used to explain bilateral trade flows. As the name suggests, these models are analogous to physical

models of gravitational attraction: two bodies are more attracted to each other depending on their mass, distance, and gravitational factors (i.e., the gravitational constant in physics). In trade economics, mass denotes factors such as GDP size and population (indicator of demand and productive capacity), distance is the geographical distance between trading partners (indicator of transportation and transaction costs), while gravitational factors are those that either attract or repel trade between economies such as having a common language or coloniser (i.e., push and pull factors). As tourism is a form of trade in services, analysing determinants of tourism performance lends itself to gravity modelling, and has been done by trade economists looking into the tourism industry.[4]

Results of the analysis are presented in Table 2. First, let us discuss the exogenous factors. As may be expected, tourism arrivals have a positive linkage with macroeconomic indicators such as GDP or bilateral trade: economies with higher incomes and trade linkages are more likely to have larger bilateral tourism flows. Note that origin GDP is a statistically significant determinant of tourism performance (i.e., 1% GDP growth in origin translates to 0.717% arrivals growth to the destination) while destination GDP is not, pointing to the importance of income growth in origin economies as a push factor for tourism. Likewise, an increase in the origin's real effective exchange rate, which implies a relative appreciation of the origin economy's currency, increases tourist flows because it makes prices in the destination relatively cheaper. Also in line with expectations, distance has a negative impact on tourist flows, although the marginal effect is very small as, it seems, distance can be bridged by connectivity. Having a common border is a very strong determinant of arrivals as it makes travel less expensive—this is especially strong in the case where there is a land border crossing, such as China-Hong Kong, China; Malaysia-Singapore; or Mexico-USA.[5] Historical and linguistic ties are also a major determinant of tourism flows as they cultivate cultural familiarity between the origin and the destination economies.

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[4] See, for example, Eilat and Einav (2004); Culiuc (2014); and Morley, Rossello and Santana-Gallego (2014).
[5] This can also point to the weakness of the data as it is sometimes unable to distinguish tourist arrivals from cross-border commuters.

Table 2. **Determinants of tourist arrivals (marginal effects)**

	Coefficient	Significance
Exogenous factors		
Destination GDP[a]	0.218	
Origin GDP[a]	0.717	***
Bilateral exports[a]	0.044	***
Bilateral imports[a]	0.018	*
Destination REER	0.001	
Origin REER	0.004	***
Distance[a]	-0.0001	***
Common border[b]	1.958	***
Common language[b]	0.853	***
Common colony in 1945[b]	3.353	***
Origin population[a]	-0.470	
Endogenous factors		
Visa required[b]	-0.514	***
Origin passport power	0.015	*
Direct flight[b]	0.346	***
Flight time[a]	-0.001	**
Connectedness index	0.014	***
Number of terrorist events	-0.0003	
Homicide per 100,000 people	-0.008	*
Search popularity (economy)	-0.005	***
Number of UN heritage sites	0.006	
Observations	3,401	
Overall R-squared	0.924	
Prob > chi2	0.000	

Notes: The dependent variable is log of tourist arrivals. [a] = marginal effect is an elasticity estimate (regressor is in logs). [b] = marginal effect is for discrete change of dummy variable from 0 to 1. REER = real effective exchange rate. *** = significant at 99% confidence level; ** = significant at 95% confidence level; * = significant at 90% confidence level. Estimation method used random effects panel ordinary least squares (OLS) with controls for destination and origin economy and year idiosyncrasies; dummy variables coefficients are suppressed for brevity.
Source: Various data sources and APEC PSU estimates.

Among the policy-relevant endogenous factors in the analysis, we can see two areas that are the strongest determinants of tourist arrivals: entry requirements and connectivity. The strongest marginal effect, albeit on the negative, is seen with entry requirements: imposing visas alone reduces bilateral tourist arrival growth by 0.514% (all other factors held constant). The type and cost of visas are also important factors affecting tourist flows. Among destination economies that impose visas, easing visa requirements through visa-on-arrival or e-visa systems (rather than applications with consular interviews) has a strong and positive impact on tourist flows (Table 3). However, as may be expected, higher visa costs, even coupled with easier visa requirements, have a negative impact on tourist flows. Conversely, as a push factor, passport power of the origin economy—i.e., the number of economies a passport holder can visit without a visa—is positively linked with tourism flows to any destination economy even after controlling for visa requirements.

Table 3. Marginal effects of visa type and cost

	Coefficient	Significance
Visa-on-arrival/e-visa (vs. consular application and interview)[+]	1.879	*
Visa costs (USD)	-0.020	***
Visa-on-arrival/e-visa x visa costs (USD)	-0.037	***
Observations	17,560	
Overall R-squared	0.744	
Prob > chi2	0.000	

Notes: The dependent variable is log of tourist arrivals. [+] = marginal effect is for discrete change of dummy variable from 0 to 1. *** = significant at 99% confidence level; ** = significant at 95% confidence level; * = significant at 90% confidence level. Estimation method used random effects panel OLS with controls for destination and origin economy and year idiosyncrasies; dummy variables coefficients are suppressed for brevity.
Source: Various data sources and APEC PSU estimates.

On the positive side, connectivity, particularly having direct flights, is a strong determinant of bilateral tourist arrivals: having a direct flight between the origin and destination adds to tourism growth by 0.346% (all other factors held constant). While geographic distance and flight time have negative impacts on tourist flows, it seems that having a direct flight is more than enough to offset these negative impacts of geographical distance. Moreover, if direct flights are impossible, there is evidence to show that reducing the number of flight legs also has a positive impact on tourist flows even after controlling for distance and flight time: reducing flight legs by one (e.g, from 2 stopovers to 1 stopover) increases bilateral tourist arrivals growth by 0.556% even after controlling for distance and flight time. Likewise, having greater connectedness—which is an indicator of both outcomes and policies connecting two economies—has positive impacts on tourism performance in the region.

As may be expected, safety indicators such as terrorist events and crime are negatively correlated with tourist flows. However, while these effects are relatively small in magnitude, it should be noted that terrorism and crime statistics are highly subjective and subject to error and legal definition, so the impacts of these safety factors may be understated in this estimation. Moreover, many of the major terrorist events are one-off shocks that will likely manifest as year-specific idiosyncrasies (i.e., one-year drop in tourist arrivals that will recover in one or two years) rather than affect the longer-run trend of tourist arrivals.

On awareness, it seems that relative search popularity is negatively associated with tourism flows. Note that due to conceptual and manpower constraints, we examined the search popularity of the economy names rather than particular sites (e.g., Indonesia rather than Bali or Borobudur), so a lot of the search popularity may be linked with news events that might not be positive (e.g., natural disaster). Thus, this finding may be more reflective of data constraints rather than image management. That said, this finding indicates that people seem more likely to search for a destination due to negative publicity rather than positive publicity—something that can be due to the reporting bias of news outlets where bad news is more likely to be reported than good news.

Finally, the number of UN heritage sites, as an indicator of tourist attractions, is a positive but statistically insignificant determinant of tourist flows. Many economies have few heritage sites but are nevertheless able to attract tourists: an example is Singapore which until 2015 had no recognised UN heritage site but has been able to attract more than double its population in

tourist arrivals. On the other hand, some economies with many heritage sites are punching below its weight in tourist arrivals. While having more attractions can help boost tourism, it seems other factors have a stronger impact on tourist arrivals.

3. TOURISM AND INCLUSIVE GROWTH

Tourism has long been recognised as a major contributor to economic growth and employment in the region. The WTTC (2002) estimates that 3.7% of GDP and 8.2% of total employment were generated by the tourism industry in APEC economies. The 2012 *Business Growth Opportunities in the New APEC Economy* report by TWG predicts the tourism industry will boost GDP and employment growth significantly within the next decade—by 4.8% and 1.8% per annum, respectively. As a result, an additional 8.9 million jobs are expected to be created within the tourism sector as well as in sectors closely related to it (TWG 2012). Developing economies in particular are expected to benefit from this increase in employment opportunities.

While the overall contribution of tourism to economic growth is well known, for this analysis we attempt to measure the contribution of tourist arrivals to GDP, employment, trade, and investment in the region, while controlling for other factors that can influence these macroeconomic indicators (e.g., natural or economic shocks, good weather, previous economic growth).

Results in Figure 5 show the elasticity of various macroeconomic indicators with respect to tourist arrivals. Elasticity is a measure of responsiveness, indicating how a 1% increase in a variable (e.g., tourist arrivals) affects another variable (e.g., GDP or employment). As may be expected, tourism has a positive and significant impact on all the macroeconomic indicators considered. The positive linkages with GDP and employment are straightforward: tourism boosts demand for goods and services, which results in higher production and employment in the destination economy.

However, it is interesting to see that tourism is also significantly linked with bilateral trade growth: the elasticity estimates for exports and imports are both positive and even higher than for GDP and employment. On one hand, this could be a reflection of the observation that tourist arrivals data can also include a sizeable number of business travellers.[6] Hence, increased tourist arrivals could be a reflection of increased trade and business ties between two economies. On the other hand, tourism has the potential to directly increase trade between two economies. More tourists visiting a destination could spur hotels and restaurants to cater to the tastes of these tourists, resulting in higher imports by the destination economy from origin economies. Likewise, tourists could develop a taste for the cuisine or handicrafts of their destination, leading them to demand more of the destination's products or to set up a business importing its products.

Tourism arrivals also seem to have a positive impact on foreign direct investment inflows, albeit statistically insignificant. Similar to trade, two linkages may be happening: tourist arrivals may include business travellers who are likely to have (or make) investments in the

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[6] Data on business and leisure travel are unreliable as not all economies collect this data at entry. Moreover, some business travellers may be reluctant to provide truthful feedback on the purpose of their travel if this can mean additional questions during entry.

destination economy. Conversely, tourists may see potential business opportunities during their visit and decide to invest in the destination economy upon their return home.

Figure 5. Estimated elasticities to tourism arrivals (in percent)
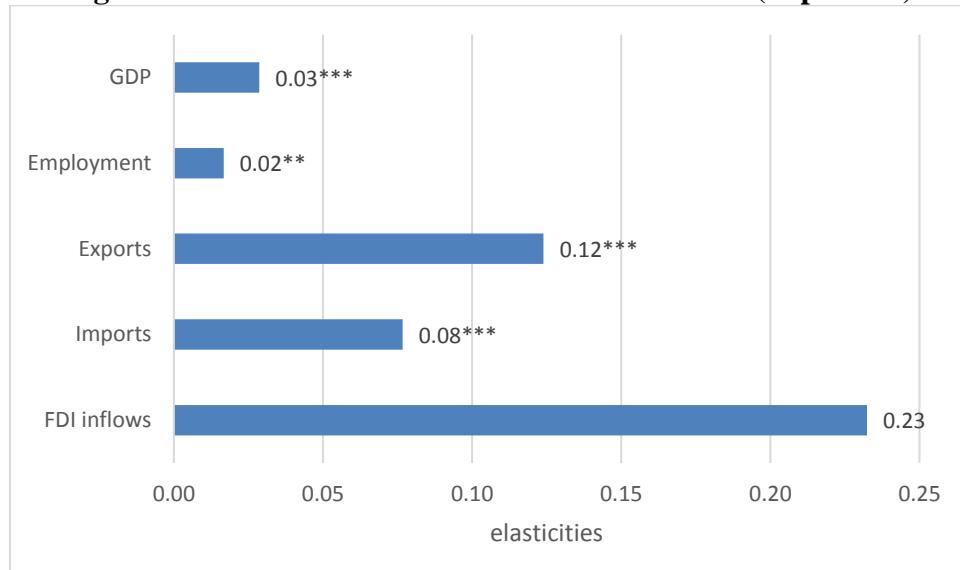
Note: FDI = foreign direct investments. *** = significant at 99% confidence level; ** = significant at 95% confidence level; * = significant at 90% confidence level. Data are for 1995-2013. Figures show the effect of a 1% increase in tourist arrivals on the indicator: a GDP elasticity of 0.03 means that a 1% increase in tourist arrivals translates to 0.03% increase in GDP, all other factors held constant. Regression models used are fixed effects panel OLS (employment, exports, imports, and FDI) and Arellano-Bond estimation (GDP) to control for reverse causality. All regressions control for economy- and year-specific idiosyncrasies.
Source: COMTRADE, DGBAS, UNWTO, WDI data and APEC PSU estimates.

These elasticities help provide insights on the likely impacts of tourism growth on these macroeconomic indicators, particularly on production and employment. If the target of 800 million tourist arrivals is achieved by 2025 and we use 2013 as the base, the APEC region can generate an additional 21.1 million jobs and produce an additional USD 3.8 trillion (in real terms based on 2005 USD) from the increased tourist arrivals. Note that these elasticities were estimated while controlling for other factors that can affect the macroeconomic variable being considered (e.g., economic growth, inflation, population growth, economy-specific idiosyncrasies, and year-specific shocks). Hence, these estimates reflect the more direct linkages between increasing international tourist arrivals and macroeconomic indicators and do not consider second- or third-order indirect linkages.

Although the linkages between tourism and macroeconomic variables are well-established, relatively less is known about the linkages between tourism and inclusive growth. Despite the numerous studies on tourism published in the last two decades, few have been written on how tourism can promote inclusive growth in the APEC region. In the next section, we discuss some of the linkages between tourism and inclusive growth, focusing on the poverty alleviation impacts, as well as the income and distribution effects of tourism. As MSME development is an important component of inclusive growth, we discuss some of the issues linking tourism development, MSMEs, and poverty.

PRO-POOR TOURISM

One concept that aims to enhance the inclusiveness of tourism growth is pro-poor tourism (PPT). Pro-poor tourism is defined as "tourism which brings net benefits to the poor" (Chok et al. 2007; Hall 2007; Harrison 2008; Mitchell and Ashley 2010). The International Trade Centre (ITC 2014), a joint agency of the World Trade Organization and the United Nations, further defines "pro-poor" activities as those "which benefit [people] living under the poverty line and those who may now be above the poverty line… [but] with some degree of insecurity" (p. 5). While the term was only officially coined in the 1990s, the concept of utilizing tourism to alleviate poverty extends back to the 1950s.

From the 1950s to the 1960s, tourism was considered a "catalyst for modernisation [and] economic development" (Scheyvens 2007, p.238) in emerging economies. It purported to alleviate poverty in these developing economies by generating jobs and encouraging foreign exchange (Cattarinich 2001). For economies with few competitive exports, tourism provided an industry in which these economies had an apparent comparative advantage over industrialised economies because of their wildlife, landscape, and cultural experiences that were valued by the industry (Ashley, Boyd and Goodwin 2000; Chok et al. 2007). Additionally, the tourism industry was understood to drive inclusive growth because of its relatively low barriers to entry, high growth rate, labour-intensiveness, and opportunities for small firms to thrive (Ashley and Mitchell 2008; Chok et al. 2007).

In the 1970s and 1980s, criticisms of pro-poor tourism started to arise. Many academics argued that tourism excluded disadvantaged populations, further entrenching the problem of income inequality. Britton (1982) contended that the tourism sector subordinates vulnerable sections of society by making them dependent on meeting the interests of foreign investors and local elites. Dwyer et al. (2000) also highlighted the observation that job opportunities in the tourism sector are secured mainly by skilled workers, and not accessible to the poor (as cited in Mitchell and Ashley 2010).

The emergence of pro-poor tourism (PPT) as a formal term is closely connected to the development industry's focus on poverty alleviation in the 1990s (Scheyvens 2007). The adoption of the Millennium Development Goals in 2000, which pledged to eradicate extreme poverty and hunger, further cemented the promotion of tourism to alleviate poverty. Organisations such as the Asian Development Bank (ADB), the UN World Tourism Organisation (UNWTO), and the World Bank were also heavily influenced by this link between tourism and economic growth in developing economies, and have channelled large amounts of funds towards tourism based on this notion. The ADB, for example, has invested in developing tourism in the Greater Mekong Subregion while the UNWTO launched the ST-EP (Sustainable Tourism for Eliminating Poverty) Foundation in 2004 to alleviate poverty in developing economies.

Empirically evaluating the effects of the tourism industry on the poor is, however, challenging for a number of reasons. The impact of tourism on the economy is conventionally measured by looking at direct, indirect and induced spending using a multiplier approach (Jamieson et al. 2004). However, Jamieson et al. (2004) note that these measures are unhelpful in determining the impacts on the poor. Instead, they advocate specifically identifying the benefits gained by the poor from the tourism industry, rather than relying on vague terms such as "trickle-down effect" or "multipliers". Nonetheless, developing alternative measures to track the benefits accrued to the poor from tourism have also been fraught with a number of empirical difficulties

(Harrison, 2008; Mitchell and Ashley, 2010; Winters, Corral and Mora, 2013). Firstly, not all economies use the standard USD 1 per day (PPP) benchmark to measure poverty levels, especially in the tourism industry (Mitchell and Ashley, 2010). It is therefore challenging to identify exactly who the "poor" are. Secondly, poverty itself can be caused by a variety of intangible factors and not just income (Mitchell and Ashley, 2010). Mitchell and Ashley (2010) elucidate that the ability of the poor to access services, strength of social networks, and vulnerability to shocks are also factors that count towards the level of poverty, but are more challenging to measure compared to income.

Estimates from the World Bank show that, as of 2012, there are 139.2 million people in the APEC region living in extreme poverty; that is, living on an income less than USD 1.90 per person per day (in 2011 PPP dollars). Although the APEC region has made significant achievements in terms of poverty reduction (Figure 6), more can be done towards poverty alleviation, and it is expected that tourism development could contribute to that goal.

Figure 6. APEC poverty indicators, 1990-2012
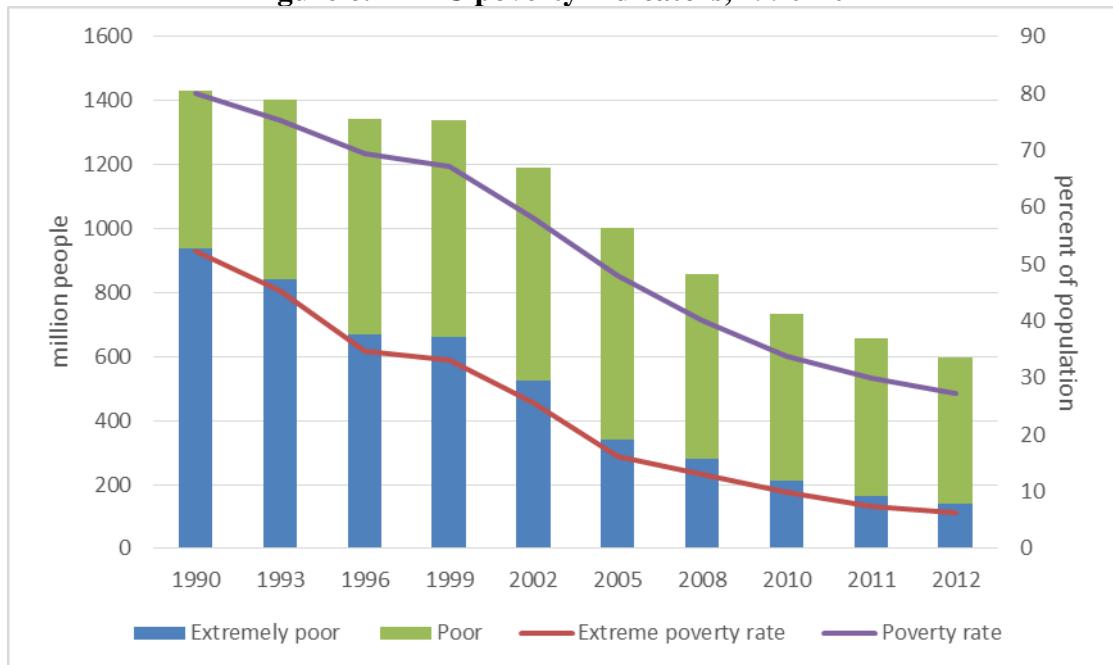
Notes: Data cover Chile; China; Indonesia; Malaysia; Mexico; Papua New Guinea; Peru; the Philippines; Russia; Thailand; and Viet Nam. Extremely poor are those living on USD 1.90 per person per day (in 2011 PPP dollars) or less; poor are those living on USD 3.80 per person per day or less.
Sources: Povcalnet and APEC PSU estimates.

In order to see the potential of tourism to contribute to poverty reduction, we analyse the synergies between tourism growth and poverty reduction as well as inclusive growth (i.e., pro-poor growth). Poverty reduction is defined as a reduction in the number of people living in extreme poverty. On the other hand, we define inclusive growth as an improvement in income and its distribution, both of which must complement each another. Economic growth that generously benefits the well-off and marginally benefits the poor can hardly be called inclusive. Likewise, a fairer distribution of income (as measured by a reduction in inequality), without an increase in average incomes, can hardly be called growth. Hence, for this analysis, we apply a measure of inclusive growth that considers both an increase in mean incomes and improvements in income distribution that was developed by Son and Kakwani (2008);

Appendix B provides a technical description of the method for calculating inclusive growth in the region.[7] The measure of inclusive growth can be intuitively defined as:

inclusive growth = growth in mean household income – increase in inequality

That is, inclusive growth is income growth adjusted for changes in inequality: an increase in inequality reduces the inclusiveness of income growth. This measure implies that growth is inclusive if the poor's incomes are proportionally rising faster than that of the rich; that is, the benefits of economic growth accrue proportionally more to the poor than to the rich. Note that this does not necessarily mean a narrowing of the income gap: in money terms, the rich may still gain more from economic growth than the poor even if the poor's income grew proportionally faster (e.g., a 1% growth from USD 1 million is still larger in monetary terms than a 10% growth from USD 10,000). However, inclusive growth means that economic growth is being felt among the poorer segments of society who need growth the most.

Using this indicator of inclusive growth, we see that between 1989 and 2012, the APEC region has grown faster than the rest of the world in terms of per capita GDP growth, but has mostly lagged behind in terms of inclusive growth (Figure 7). This indicates that, in general, growth in the region has not been pro-poor; i.e., the gains from APEC's rapid economic growth in the past two decades have not been felt proportionally more by the poor.

Figure 7. Inclusive growth and per capita GDP growth, 1989-2012
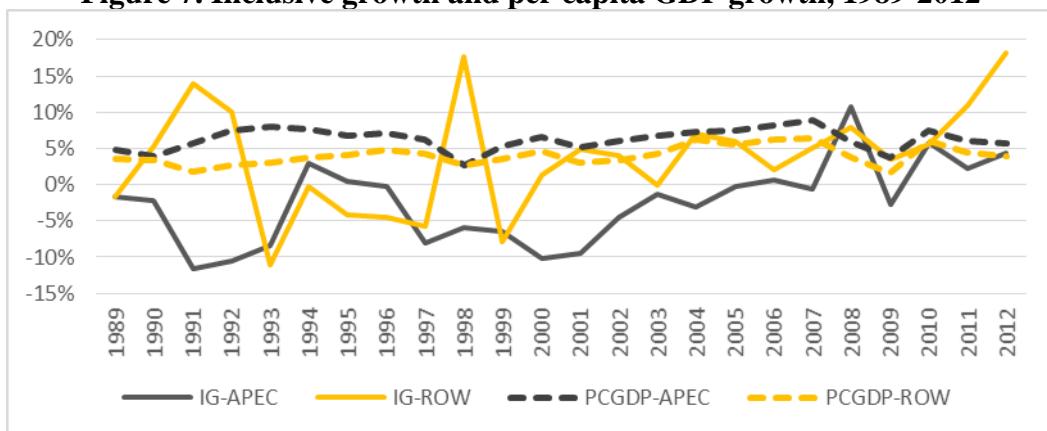
Note: IG = inclusive growth; PCGDP = per capita GDP growth; ROW = rest of the world. Aggregate growth rates are averages of economy-level growth rates weighted by population.
Source: PovcalNet and WDI data and APEC PSU estimates.

Although we have seen in Figure 5 that tourism has a positive impact on economic growth and employment, it does not necessarily follow that it will have a positive impact on poverty reduction or achieving pro-poor growth. Ex ante, it is not clear that tourism development benefits the poor proportionally more than the rich. In order to determine this relationship, we conduct panel data analysis between poverty indicators and tourism arrivals while controlling for other factors that can influence poverty indicators. These factors include GDP growth, population growth, changes in inequality, economy-specific idiosyncrasies (e.g., history, national policy, etc.), and year-specific events (e.g., economic shocks or natural disasters). Results are shown in Table 4.

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[7] The same methodology was used to analyse the linkages between trade and inclusive growth in the report on *Trade, Inclusive Growth, and the Role of Policy* prepared for AMM 2015; the report can be found here: http://publications.apec.org/publication-detail.php?pub_id=1678.

Table 4. Marginal effects on poverty reduction and inclusive growth

	Dependent variable	
Explanatory variables	Number of extremely poor[8]	Inclusive growth rate[9]
Tourist arrivals	-0.124*	0.001
GDP	-0.909***	-0.291
Population	5.845***	-0.060
Inequality	0.096***	-0.036***
N	958	1,051
Prob > chi2; F	0.000	0.012

Notes: *** = significant at 99% confidence level; ** = significant at 95% confidence level; * = significant at 90% confidence level. Coefficients for economy and year dummy variables are suppressed for brevity.
Source: UNWTO, WDI data and APEC PSU estimates.

The results show that tourism generally has a positive effect on poverty reduction and inclusive growth: it can be seen that tourist arrivals (measured in number of arrivals in each economy) has a negative sign for number of extremely poor and positive sign for inclusive growth rate. This means that an increase in tourist arrivals is correlated with a statistically significant reduction in the number of people living in extreme poverty. To be precise, every 1% increase in tourist arrivals is correlated with a 0.124% reduction in the number of poor people. Note that this poverty reduction effect already excludes the impacts of overall GDP growth, population growth, changes in inequality, and economy- and year-specific idiosyncrasies; hence, the tourism-poverty elasticity of -0.124 can be seen as a more direct impact of tourism development on poverty reduction. Using 2013 levels as the baseline, an estimated additional 15.2 million people could be brought out of extreme poverty in the APEC region if the target of 800 million tourist arrivals is achieved by 2025.

There is also indicative evidence to say that tourism development contributes to inclusive growth; i.e., it helps ensure that the poor benefit proportionally more from economic growth. As can be seen in Table 4, there is a positive albeit statistically insignificant coefficient (0.001) for tourism arrivals with respect to the inclusive growth rate. This provides some indication that tourism could be positively linked with improvements in income distribution, which supports views that tourism helps develop service sectors that mainly employ the poor (e.g., food and beverage, personal services). It points to the potential of tourism to provide an avenue for poverty reduction through jobs creation and entrepreneurial activity at the micro-level.

TOURISM AND MSME DEVELOPMENT

The development of small businesses is considered one of the critical means by which tourism promotes inclusive growth (Thomas, Shaw, and Page 2011). These small firms can represent up to half of all employment in the tourism area, even if individually they are not large

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[8] Dependent and independent variables are in logs (except for inequality, which is the Gini index), so coefficients are elasticities; regression model used is the Arellano-Bond method to control for reverse causality of the dependent variable. Due to data coverage period, extreme poverty line used is USD 1.25 per person per day (in 2005 PPP dollars).

[9] Dependent and independent variables are in growth rate percentages (except for inequality, which is the Gini index), so coefficients are marginal effects; regression model used is fixed effects panel OLS.

employers (Hollick and Braun 2005). Additionally, research indicates that MSME development in the tourism industry results in a more equitable distribution of costs and benefits by generating larger local multipliers than large enterprises (Fleischer and Felsenstein 2004; Rogerson 2004). This occurs because MSMEs tend to increase employment opportunities for poorer households as well as utilising mainly locally generated inputs.

Local multipliers refer to the way that tourist spending filters through the economy, and can describe output, income or employment effects (Meyer 2006). Large local multipliers mean that leakages from the tourism industry are minimised, and economic benefits are channelled mainly to the local host economy.

Characteristics of MSMEs

MSMEs in the tourist industry are characterised by the provision of niche products, low barriers to entry, and personal equity forming the initial capital of the business (Fleischer and Felsenstein 2004). Examples of MSMEs in the tourism industry include family-owned accommodation, vendors selling traditional craft or food, tour guides, and service providers.

Certain segments of the tourism market are also more likely to patronise small businesses owned by the poor. Domestic or regional tourists as well as budget or independent tourists tend to stay at cheaper guest houses and interact more with the local economy compared to commercial group tourists (Ashley et al. 2000; Jamieson et al. 2004). This is something that APEC economies can build on, as travel within the region continues to expand even after the 2008 economic crisis (APEC TWG 2012).

Many MSMEs exist within the informal sector because it is more accessible than the formal sector, requiring less start-up costs while being harder to monitor for tax or regulatory compliance. Informal activities can account for roughly 40% of GDP in developing economies (as cited in Webb, Tihanyi, Ireland and Sirmon 2009), which includes a large number of MSMEs owned by the poor (Ashley et al. 2000). Such activities are characterised by low barriers to entry, "reliance on indigenous resources, family ownership, small scale of operation, labour intensiveness, skills acquired outside the formal school system, part-time labour, locally-based ventures, and unregulated and competitive markets" (Timothy and Wall 1997, p. 323). The informal sector operates in an economy without regulation, "in a legal and social environment in which similar activities are regulated" (as cited in Timothy and Wall 1997, p. 322). Consequently, firms in this sector are not licensed, taxed, or eligible for state funding or training, compared to those in the formal sector.

Despite the importance of informal firms as a source of employment and income to the poor, governments often take a negative view towards the informal sector. Officials frequently attempt to eliminate the informal sector because of its perceived lack of contribution to economic growth and its associated safety and political risks (Rogerson 2004; Timothy and Wall 1997). Hence, MSMEs in the informal sector often exist in a state of precarity, with its actors uncertain of their rights and futures. This leads to suboptimal levels of investment in the sector while minimising its possible impacts on poverty reduction.

Tourism, MSMEs, and Poverty

MSMEs in general aid in poverty reduction in three main ways: (1) employment generation, (2) as a "seedbed" for future innovative growth, and (3) by promoting dynamism in the economy (World Bank as cited in Biggs 2002; Beck, Demirguc-Kunt and Levine 2005). Within

the tourism sector, however, employment generation is the major way that MSMEs benefit the poor. Most MSMEs in the tourist sector tend to be quite homogeneous, without much room for innovative growth. They also do not have much impact on the overall structure of the economy. The main theory supporting this is the labour surplus theory, originally coined by Lewis (1955). He argues that the driving force of MSME development is excess labour supply, which cannot be absorbed by large private firms or the public sector. MSMEs therefore develop in response to the needs of workers unable to find jobs in large corporations, of which the poor form a large proportion, especially in the tourism sector.

MSMEs are generally more labour intensive than large firms, with lower capital costs required for job creation (Biggs 2002; Abor and Quartey 2010). This is therefore compatible with the circumstances of the poor who have limited access to capital. For instance, common types of MSMEs in the tourist industry include craft shops, family-owned accommodation, tour guides, or small food stalls. These are enterprises with low barriers to entry and do not require large amounts of capital. MSMEs in the informal sector have even lower barriers to entry, since they bypass the bureaucratic requirements of business registration and regulation. In comparison, employment opportunities in large firms often require some form of formal education, which the poor are more likely to lack. Employment in large firms may also require migration to urban areas, which can cause psychological and financial costs for workers (Scheyvnes and Russell 2012).

Additionally, studies have found that women tend to be more involved in MSMEs, compared to larger firms – although this varies depending on the cultural background of a particular tourist destination (Ashley, Boyd and Goodwin 2000; Abor and Quartey 2010). Food sellers, souvenir shops, or other MSMEs that operate out of homes, for example, tend to be dominated by women. Employment generated by MSMEs can therefore benefit segments of society that do not normally have access to the formal sector.

However, income generated by MSMEs, especially those in the informal sector, tend to be unstable and lower than that from the formal sector. It is usually inadequate for the entire household, and may only act as supplementary income rather than the main source of livelihood (Ashley, Boyd and Goodwin 2000). Nonetheless, locals who might otherwise be disadvantaged by the development of the tourist industry are able to gain access through the informal sector (Rogerson 2004). This can help serve as a "stepping stone" from unemployment, eventually leading to formal employment for the poor (Bennett 2009).

Challenges faced by MSMEs

While MSME development in the tourism industry is an important channel for inclusive growth, small firms face numerous obstacles especially when competing with their larger, more established counterparts.

Firms' perceptions regarding major obstacles to business operations can give indications on what economies need to improve to promote investments. Between 2009 and 2012, the World Bank conducted Enterprise Surveys in eight APEC economies[10], asking firms about major obstacles to their business operations. A total of 11,040 firms in APEC economies were interviewed, of which 2,020 firms can be considered to be operating in the tourist industry[11].

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[10] These economies are Chile; China; Indonesia; Mexico; Peru; the Philippines; Russia; and Viet Nam.

[11] Although the surveys did not ask about involvement in the tourism industry, firms' industrial sectors were classified based on the 2-digit International Standard Industrial Classification (ISIC) nomenclature. Firms

As can be seen in Table 5, small and medium firms are significantly[12] more likely to be involved in the tourism industry than larger firms: up to 27.4% of interviewed small firms can be considered in the tourist industry, compared to 12.1% of large firms.

Table 5. Industry by firm size

Firm size by number of employees	Tourism	Non-tourism
Small (less than 20)	27.4	72.6
Medium (20-99)	16.1	83.9
Large (100 and over)	12.1	87.9
Number of firms interviewed	2,020	9,020

Notes: Figures are unweighted and should only be interpreted as indicative and not representative across APEC. N = 11,040; the error margin for column percentages is ± 1.0% at the 95% confidence level.
Source: World Bank Enterprise Survey data and APEC PSU estimates.

Among the MSMEs in the tourism industry that were interviewed for the Enterprise Surveys, 33.3% cited corruption as a major or severe obstacle to operations. This is followed by political instability (33.0%), high tax rates (30.7%), unreliable or expensive electricity (30.5%), unfair practices of their informal sector competitors (25.8%), and lack of access to finance. Figure 8 provides a summary of the key obstacles to the operations of tourism MSMEs based on Enterprise Survey data.

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classified under the following ISIC codes were considered part of the tourist industry: 47 (retail, except motor vehicles and motorcycles), 49 (land transport), 50 (water transportation), 51 (air transportation), 52 (warehousing and support activities for transportation, including airports and seaports), 55 (accommodation), 56 (food and beverage services), 61 (telecommunication), and 93 (sports and amusement).

[12] Correlation is statistically significant at the 95% confidence level (Pearson chi2(2) = 292.0258; Pr = 0.000).

Figure 8. Major obstacles to operations cited by tourism MSMEs
(in percent of firms interviewed)

Obstacle	Percent
Corruption	33.3
Political instability	33.0
High tax rates	30.7
Unreliable/expensive electricity	30.5
Practices of informal sector competitors	25.8
Lack of access to finance	25.3
Crime, theft, and disorder	21.0
Inefficient tax administration	20.9
Lack of access to land	20.0
Insufficient workforce skills	19.5
Zoning restrictions	18.9
Logistical difficulties	18.0
Customs and trade regulations	15.5
Poor telecommunications service	15.5
Pricing restrictions	14.1
Unfair or inefficient courts	13.6
Problems obtaining business permits	12.9
Inflexible labour regulations	10.1
Restrictions on operating hours	7.5

Notes: Figures are unweighted and should only be interpreted as indicative and not representative across APEC. N = 1,587; the error margin for column percentages is ± 2.5% at the 95% confidence level.
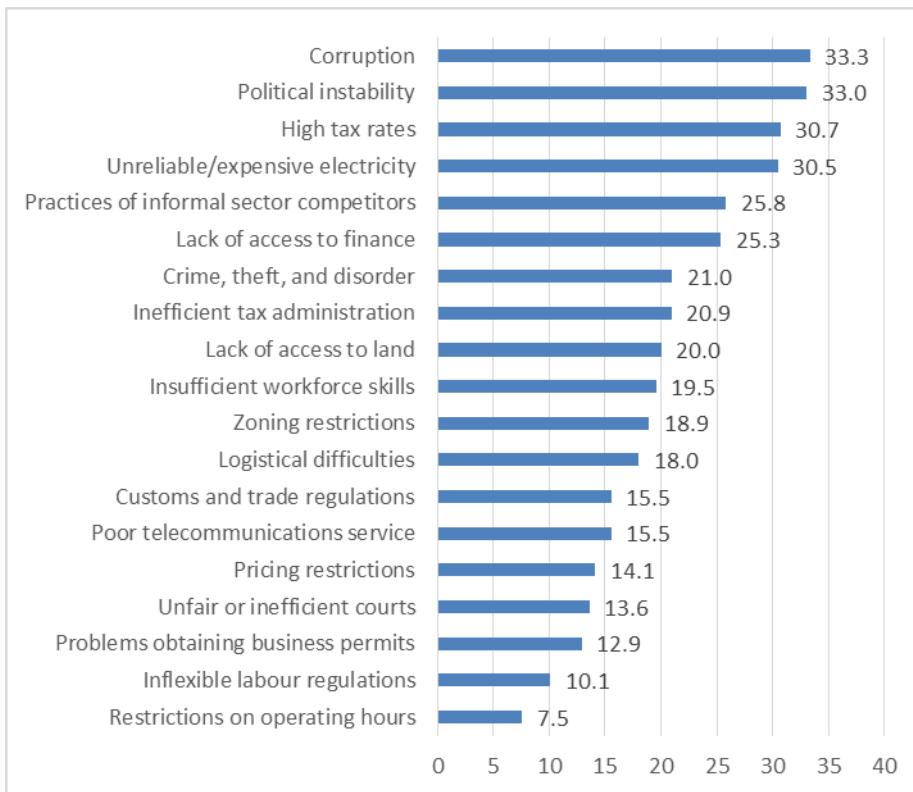Source: World Bank Enterprise Survey data and APEC PSU estimates.

In general, the problems cited by tourism MSMEs in the Enterprise Surveys reflect the general issues cited by other MSMEs included in the surveys. Hence, actions that make it easier to do business, reduce institutional inefficiencies and corruption, and enhance the investment climate can contribute to the development of tourism MSMEs as well. That said, there are some challenges peculiar to tourism MSMEs that may not necessarily be crucial factors for MSMEs in other sectors. These peculiar challenges arise due to the sector's unique situation of providing hospitality services to international clients: multinational firms will have an advantage over local MSMEs in catering to the needs and tastes of international clients, not to mention the goodwill international brands have cultivated with overseas clients. Thus, while a local MSME manufacturing automobile parts can compete on price and quality alone, a tourism MSME needs to compete on price and quality as well as brand recall, advertising reach, and hospitality skills.

Crowding Out Effects

There are two main sources that crowd out the benefits of tourism to the poor: local elites and foreign firms (Britton 1982). Within the community, local elites often dominate community-based development efforts and monopolise the benefits of tourism (Mowforth and Munt 2003). This may result in the poor being excluded from community structures. The poor themselves are also not monolithic: the "poorest" who lack skills and resources are most vulnerable to the negative impacts of tourism and less likely to reap any of the benefits, compared to the "fairly poor" or "near poor" who may have some skills to take advantage of opportunities provided by

tourism (Chok et al. 2007; Harrison 2008). An example of this disparity is the English language skills required to access the tourism industry. The poorest members of the society are less likely to have formal education and will therefore have more difficulty penetrating the tourism industry (Ashley et al. 2000).

Foreign firms may also crowd out local MSMEs, especially when given tax breaks and other investment incentives by governments. This is done on the assumption that knowledge exchange or development of local infrastructure by foreign firms will eventually benefit local MSMEs. However, governments usually do not account for leakages out of their economy, especially when foreign firms repatriate their profits. Indeed, the United Nations Conference on Trade and Development (UNCTAD) estimates that an average of 40% to 50% of foreign exchange earnings from tourists return to the home economies of the tourists (Scheyvens 2007). In an example in the hotel industry, Thomas et al. (2011) noted that the entrance of international budget hotel chains can push smaller domestic firms out of the market. Instead of benefiting from the influx of more tourists, these small domestic firms ended up being closed or converted back to domestic use.

Lack of Skills and Resources

Another reason that MSMEs fail is the lack of business skills by owners (Hollick and Braun 2005; Scheyvens 2007; Wanhill 2004). According to Keen (2004), the ability of entrepreneurs to identify opportunities is integral to the success of small businesses, particularly those in rural area. This lack of skills and quality service is even starker when compared to larger firms that provide four- or five-star services which seasoned tourist may come to expect (Hollick and Braun 2005). While training programmes exist for small firms to develop their business skills, they have "notoriously low levels of participation" (Thomas et al. 2011, p.4) due perhaps to the resistance of family enterprises to accept advice or change, or lack of engagement on the part of organisers (Thomas et al. 2011; Wanhill 2004). Other obstacles that MSMEs face are the inaccessibility of credit at affordable interest rates and the lack of technical expertise (Jamieson et al., 2004). This can hamper the success of MSMEs, especially when combined with poor business skills.

Vulnerability to External Forces

Small enterprises are relatively more vulnerable to sudden changes in the business environment such as rising inflation, interest rates or other macroeconomic policy (Hollick and Braun 2005). A reason for this could be the lack of collective bargaining power to protest against unfavourable policies because of the fragmented structure of MSMEs, as was the case of small-scale accommodation owners in Yogyakarta (Dahles 1998). Additionally, the heavy reliance on personal savings and intangible assets that cannot be used as collateral make it difficult for small firms to obtain loans to weather out economic downturns.

4. POLICY IMPLICATIONS

The analysis in the previous chapters has provided three insights: (1) achieving the 800 million APEC tourist arrivals in 2025 is not a certainty given recent growth trajectories, (2) some policy actions can influence the amount of international tourist flows into APEC economies, and (3)

tourism has positive impacts on inclusive growth, but more can be done. This section will present some of the policy implications arising from the analysis

INCREASING TOURIST ARRIVALS

The analysis on the determinants of tourism performance pointed to two main areas of policy development: easing visa requirements and improving connectivity. Among the policy areas considered, it was these two that produced the strongest impacts on tourist inflows and should be the focus of policy prioritisation.

Easing visa requirements

Among the endogenous factors considered, it was visa requirements that had the strongest impact on tourist flows. Visa requirements discourage potential tourists from visiting a destination and lead them to consider alternative and more open destinations. However, for the economies that impose them, visas provide essential controls for security and immigration and are a useful tool for gathering information on visitors. These are important considerations, but given the costly impact of visas on tourist flows, it would be beneficial for economies to consider easing visa requirements while implementing other measures to meet security, immigration, and information requirements. For example, advance passenger information systems, passport background checks, and information sharing between security authorities of economies (as well as Interpol) can be substitutes for outright visa requirements.

But if visa requirements cannot be eliminated, the data show that making it easier and cheaper to obtain a visa can contribute to tourist arrivals. As was seen in Table 3, if visas are imposed, the use of visas-on-arrival and e-visas have a strong and positive impact on arrivals compared to more traditional methods that require consular paper applications and interviews. Visas-on-arrival are practically visa-free entry: all visitors are welcome unless the foreign affairs or immigration officer at the border has a reason to deny entry. On the other hand, e-visas reduce the transaction costs of applying for a visa, eliminating the need to schedule consular interviews and preparing myriads of documents (unless specifically requested by the system), while fulfilling the information gathering and screening capabilities of traditional application methods. Given the clear benefits of visas-on-arrival and e-visas, economies can be encouraged to consider these alternatives to traditional visa application systems.

Moreover, economies need to consider the costs of visa application as well, which in some destination economies can run into the hundreds of dollars for a single-entry visa. The negative impacts of visa application costs are important enough such that the marginal effect of the interaction variable between visa type and cost is negative (cf. Table 3): having a paper/interview visa that is free of charge is better for tourism arrivals than having a costly visa-on-arrival/e-visa system. Hence, efforts at reducing visa application costs in the region could contribute to increasing APEC tourist arrivals.

Improving connectivity

The other tourism policy area that has the strongest impact on tourist arrivals is connectivity. Improving connectivity between economies—in this case, passenger transport links—enable potential tourists to conveniently arrive at a destination. For economies that share a land border, land transportation linkages can strongly impact tourist arrivals as seen in the high marginal effects for common border.

However, for most partner economies, the main transportation linkage is through air travel. Indeed, marginal effects for direct flights and connectedness index are strongly positive and significant. These findings point to the importance of opening up skies to direct flights. In fact, having direct flights seem to offset the negative impacts of geographic distance: tourists don't mind the distance and flight time too much if there are direct flights between origin and destination. Hence, policies that encourage more direct flights, and more competition between air service providers, can contribute to tourism arrivals in the region. Moreover, efforts at reducing the number of stopovers can contribute to tourism arrivals in lieu of direct flights.

The data also indirectly indicate that improving transport infrastructure will contribute to tourism arrivals; essentially, what makes travel more direct and convenient will encourage tourists to take that route. For example, being a regional hub for airline routes will make it more likely that that airport there will have direct flights to more destinations. However, to become a regional hub requires high standards of airport service quality and efficiency. Economies can thus aim to improve airport services (as well as immigration and customs services in the airport) to get more hub traffic and encourage entries from more travellers who may just be passing by.

Other policies for tourism development

While the data analysis pointed to two policy areas that have the strongest impact on tourist arrivals—i.e., visa requirements and connectivity—other tourism policy areas also have a role to play in improving tourism performance. While crime and terrorism data are notoriously unreliable and incomparable, data do indicate that destination economies need to ensure the safety of their visitors: crime rates and terrorist events do have negative marginal effects on tourist arrivals.

On the other hand, the negative correlation of tourist arrivals with relative search popularity points to the need to counteract publicity from the news events which are likely to be negative. Excluding economies with significant soft power, most economies make it in the international news cycle if there is a natural disaster, terrorist event, or some other bad news. It seems that curiosity about economies peaks in response to this negative publicity, leading to the negative correlation. In this sense, tourism promotion and advertising can contribute to providing an alternative and positive message about an economy. While bad news and natural disasters are beyond the control of tourism policy, these could be mitigated by public relations and image management.

The data also show that historical, cultural, and linguistic ties matter for tourist arrivals. This is expected as cultural affinity and familiarity can encourage tourism. While having the same coloniser or language are accidents of geography and history, economies can do more to strengthen cultural affinity and familiarity through cultural exchange and education programmes. Indeed, the APEC Connectivity Blueprint 2015-2025 endorsed by Leaders in 2014 calls on APEC economies to hold at least one cultural awareness event in every other economy (para 35). Cultural exchange events improve awareness about a destination's natural beauty and cultural heritage, encouraging tourists to come for a visit.

It is also apparent in the data analysis that economic growth, bilateral trade ties, and monetary policy (through exchange rates) can influence tourist arrivals. While economic growth and monetary policy are matters much larger than tourism development, it seems there might be space for tourism and trade policymakers to coordinate their efforts to develop their respective

sectors. As seen in the analysis, there is a strong and robust synergistic relationship between tourism flows and trade flows, and it seems that what promotes trade also promotes tourism (and vice versa). Hence, a holistic tourism development plan may benefit from trade promotion and liberalisation, while trade may be encouraged by policies easing entry restrictions and people-to-people connectivity.

Box 2. APEC Tourism Working Group (TWG) Initiatives

Many of the policies needed to increase tourism arrivals in the APEC region are already the subject of TWG initiatives. To help member economies leverage on the vast economic growth and employment potential from the increasing tourist numbers, TWG has laid out its strategic plan for 2015-2019. This can be broken down into four directions: (1) Promoting tourism as an engine for economic growth and prosperity; (2) Ensuring sustainable and inclusive growth in the travel and tourism sector; (3) Promoting labour, skills development and certification in the tourism workforce; (4) Promoting competitiveness and regional economic integration through policy alignment and structural reform.

Recent projects by TWG include topics on improving connectivity through the Tourism Facilitation Initiative (TFI); taxes and tourism; improving skill standards in the tourism industry; and sustainable tourism, among others.

While TWG has produced a number of reports, best practice manuals and case studies that support their strategic plan, there is currently only one report on MSMEs in the tourism industry. Research suggests that MSMEs can aid inclusive growth in the tourism sector by generating employment for low income groups. This could perhaps be a topic for further cross-cutting collaborations.

Travel Facilitation Initiative
The APEC Travel Facilitation Initiative (TFI) was developed in 2011 to expedite the movement of travellers across the Asia-Pacific region, with the goal of enabling more efficient, more secure, and less stressful travel. This multi-year action plan is set to benefit three main stakeholders: travellers, the private sector (including transportation providers and facility operators), and governments.

The initiative focuses mainly on air travel, with six pillars:

1. Airport Partnership
   – Showcasing best practices and building capacity on efficient and secure processing of travellers for international departures and arrivals
2. APEC Business Travel Card (ABTC)
   – Underscore support for ongoing efforts by the Business Mobility Group to enhance the ABTC program as a means of facilitating business travel in the region
3. Trusted Traveller
   – Develop an APEC-wide consensus on characteristics of trusted traveller programs to facilitate travel for large numbers of people in a secure manner, including business and non-business travellers.
   – This includes automated entry processing and robust background checks for program members.

4. Facilitation of Air Passenger Security Screening
   – Exploring technology and approaches that will increase travel efficiency and security in the APEC region, with consideration for the varying capacities of developed and developing economies.
   – This may also involve cooperation with international organizations such as the International Civil Aviation Organization (ICAO), International Air Transport Association (IATA) and Airports Council International (ACI).
5. Advanced Passenger Information
   – By receiving passenger information in advance of travel, APEC economies could expedite the processing of legitimate travellers through ports of entry and focus on those requiring additional scrutiny.
6. Checked Baggage Facilitation
   – Facilitate delivery of checked baggage to passengers when they arrive at their final destination or for re-checking during transit, especially for passengers who are members of trusted traveller programs.

The TFI is implemented by three SCE sub-fora: the Counter-Terrorism Working Group (CTWG); the Tourism Working Group (TWG); the Transportation Working Group (TPTWG), and two Committee on Trade and Investment (CTI) sub-fora: the Subcommittee on Customs Procedures (SCCP) and the Business Mobility Group (BMG). Many activities are cross-cutting in nature, and implemented jointly by two or more sub-fora. These sub-fora are to produce a consolidated progress report, reporting each year to the Concluding Senior Officials Meeting from 2012 until 2017.

Taxes and Tourism Study
Based on a previous project by TWG, taxation was highlighted as one of the impediments to fulfilling the economic potential of tourism in the region. TWG therefore embarked on a study to ensure that taxation policy introduced in the tourism industry are based on good governance and sound decision making. In particular, the study aimed to: 1) assess the impact of current taxation measures as well as their changes over time in relation to travel and tourism demand, revenues, and job growth in participating APEC economies; 2) evaluate the comparative position of taxation levels in the travel and tourism industry against taxes imposed on other key sectors in participating APEC economies to ensure fair and equitable treatment of taxation across industries in the region; and 3) determine the degree of inhibition to regional economic integration and growth by taxation policies.

In May 2015, TWG together with the World Tourism and Travel Council (WTTC) presented their findings at a conference in Boracay. Notably, they found that a 1% increase in tax leads to, on average, a drop in GDP by USD 56.7 million and 4,030 less jobs in the tourism sector per economy.

Developing Skills in the Tourism Workforce
In 2000, TWG established the APEC Skill Standards System to develop a common approach to competency standards. Since then TWG has developed almost 400 Skill Standard Units covering general and tourism sectors, based mainly on the Indonesian and Australian National Competency Standards. The skill standards have been utilized by individual economies as well as other regional organizations such as ASEAN in developing their own scheme of mutual recognition agreements in this area.

TWG is currently working on a project, "Developing the Tourism Workforce of the Future through Labour and Skills Development, Certification and Mobility in the APEC Region". The project aims to address the shortage of skilled labour across the region by improving skills development, career pathways, retention and opportunities for labour mobility for women and youth particularly. This is done through barriers and benchmark studies, enhancing access to training, and identifying best practices.

Sustainable Tourism

The promotion of sustainability of tourism businesses and destinations was identified by TWG as one of its goals in the Medium-Term Workplan (2011-2015). In order to evaluate, monitor and control tourism sustainability in destinations, the Tourism Indicators User Manual, together with the Tourism Sustainability Assessment Tool was developed as a practical tool to help stakeholders assess their performance in terms of tourism sustainability. Additionally, the User Manual and Assessment Tool provide a framework for understanding sustainable tourism development, identify tourism indicators which support sustainable tourism development, and provide recommendations for certifications for evaluating, measuring and controlling tourism indicators.

In 2013, TWG also worked on "Sustainable Development of Tourism Destinations", a report on sustainable tourism concepts, best practices, indicators and certifications. Reference benchmarks were drawn from a survey including several APEC member economies to serve as common guidelines for stakeholders involved in developing sustainable tourism.

INCLUSIVE GROWTH THROUGH MSME DEVELOPMENT

The previous analysis shows that tourism development has positive impacts on both poverty reduction and inclusive growth (i.e., pro-poor growth patterns). These positive impacts mainly come through the ability of tourism development to generate employment opportunities for poor workers. Many of the jobs in the tourism sector—e.g., transport, food preparation, handicraft production, or personal services—are relatively low-skill jobs that are within the reach of the poor who may not have advanced levels of schooling. Moreover, training for these jobs require little investment in terms of time and money, so it may be feasible for poor households to obtain training to tap into these jobs. However, employment in the tourism sector is usually done through the filter of firms, usually MSMEs. While an individual poor worker can theoretically approach a tourist to sell food items or handicrafts, it is more efficient to work with others to pool financial resources and skills to produce a better product and reach more tourists. Hence, strengthening the inclusiveness of tourism development needs to consider the important role of MSME support and development.

Sound government policies are important for the survival of MSMEs in the tourism industry. Weak regulatory frameworks and poor labour standards for instance, can pave the way for price wars and other anti-competitive practices by larger firms that hurt the poor. There is also a tendency for policy outcomes to focus on firm formation rates, when the survival rates of small tourist firms are arguably as, if not more, important (Thomas et al., 2011). Moreover, crafting policies to address issues faced by small tourist enterprises is further complicated because many of these firms are located in the informal sector and therefore not recognised by the authorities. Without being licensed, these informal enterprises are usually not eligible for state support, even though they may be the ones most in need of aid.

Ashley et al. (2000) advocate a three-level approach to ensure that the tourism industry is pro-poor. Firstly, the destination-level of intervention involves partnerships between residents, operators, NGOs and local authorities at the tourist site itself. The second level is the economy-level, which entails reforms such as licensing, training, and land-use planning in both tourism and non-tourism sectors. Thirdly, intervention on an international level includes tourism policy cooperation and coordination, and promoting responsible consumer and business behaviour as well as commercial codes of conduct.

Most government interventions act on the destination-level, since such policies are relatively easier to implement and produce the most immediate and observable results. Interventions on an economy or international level, on the other hand, are more complicated as they may involve approval from multiple levels of government and require compatibility with existing macroeconomic policies. However, long-term improvements require structural changes on the deeper national and international level (UNCTAD, 2013), even if outcomes are not as immediate.

Active policy making

Researchers (Ashley et al., 2000; Briedenhann and Wickens 2004; Jamieson et al. 2004; Scheyvens 2007) as well as organisations like the United Nations Environment Program (UNEP) and World Trade Organisation (WTO) (2005) emphasise the need for active government intervention to ensure that tourism remains inclusive. This stance is a stark political shift from the *laissez faire* approach that was advocated previously (Thomas et al. 2011). There are a number of reasons for a proactive, interventionist approach. Growth in a *laissez faire* economy tends to skew towards the wealthy and may not significantly benefit the poor because of market failure (Chok et al. 2007; Wanhill 2004). Therefore government intervention is needed to prioritise the well-being of low-income groups, rather than waiting for trickle-down effects. A report commissioned by the UK Department for International Development (DFID) in 1999 uses the analogy of tilting, rather than expanding the cake to discourage a "growth at all cost" model (cited in Chok et al. 2007). Furthermore, governments generally have access to a wider range of resources compared to private organisations. They therefore have the ability to unite the fragmented, individual businesses towards a common, social goal (UNEP and WTO 2005).

Considering private interests of MSME owners

Another significant factor for effective pro-poor policies is the ability of the government to develop policies that achieve public goals and yet align with the private interests of small businesses. Private interests may vary depending on factors such as the culture of the economy, the type of business, and personal characteristics of the owner. For instance, Shaw and Williams (2004) find that non-financial factors such as aspiring to live in a particular area or desiring autonomy are significant factors in establishing a small business. Keen (2004) also suggests that some small tourist businesses in rural areas prioritise contributing to the community over financial gain. Likewise, Morrison and Teixeira (2004) find a reluctance by some small business operators to reduce the quality of other non-economic life indicators for increased income.

Researchers by Morrison (2003) and Ashley et al. (2000) have additionally urged governments to consider the perspectives from small businesses by including them in the planning process, rather than focusing on consultancies and top-down training programmes. The informal sector

is often neglected by policy makers as a result of this top-down approach, even though a significant number of small enterprises owned by the poor are in this sector (Ashley et al. 2000).

This misalignment between the goals of public policy and small business has been a long standing problem noted by numerous researchers as well as international organisations such as the European Commission and OECD (as cited in Thomas et al. 2011). However, it is challenging to rectify because of high financial and political costs associated with changing such a deep-rooted problem (Thomas et al. 2011).

Integration

Researchers (Ashley et al. 2001; Harrison 2008; Jamieson et al. 2004) and the United Nations Conference on Trade and Development (UNCTAD 2013) emphasise that policies to foster pro-poor tourism must be integrated into wider tourism systems, and should not be stand-alone options. Rates of success are higher if communities engage in businesses that complement their existing livelihood strategies rather than compete or replace them (Harrison 2008; Ashley et al. 2000). This is especially important in the informal sector, where Timothy and Wall (1997) advocate working towards decreasing friction between the tourism industry and the locals, rather than adopting a stringent stance towards informal activities. Locals who might otherwise be disadvantaged by the development of the tourist industry may be able to gain access through the informal sector (Rogerson 2004), which can help serve as a gateway leading to formal employment for the poor (Bennett 2009).

Strengthening linkages between domestic industries and the tourism sector as part of the global supply chain is vital for the development of small firms, including those in the informal sector (Rogerson 2004; UNCTAD 2013). These linkages are important to reduce the dependence on foreign firms and therefore reduce the level of leakage from the tourism sector (Rogerson 2004). One method of doing so is through outsourcing or subcontracting activities from large, foreign enterprises to domestic MSMEs.

5. CONCLUSION AND NEXT STEPS

This study was conducted to explore tourism trends in the region, analyse policies that can help attain the target of 800 million tourist arrivals by 2025, and look into the linkages between tourism development and inclusive growth. While some answers have been found through this study, more questions remain. This study could have ideally explored the impacts of a wider range of tourism policies and programmes, but constraints prevented it from doing so.

The most important constraint in conducting this study was the relative dearth of information on tourism-specific policies. While there are sufficient data on tourism arrivals and spending—i.e., the outcomes of tourism policy—there is no time-series, cross-economy comparable data on tourism policy inputs. For example, a large part of tourism development is in the promotion of tourist sites and destinations, mainly through advertising, media programming, or outreach programmes. However, there is no publicly available data on, say, advertising minutes, advertising or outreach expenditure, or capacity-building programmes held. Even budgets allocated or spent by tourism ministries can be hard to come by. It would be good to include these policy inputs in the analysis so their impacts can be compared relative to other endogenous factors that affect tourism flows such as visa requirements or connectivity.

While the linkages between tourism and inclusive growth was a main topic for this analysis, there were limits on what linkages can be established due to the macro-level focus of the study. At a macro level, what can be analysed are impacts and correlations between tourism arrivals and poverty reduction and inclusive growth, and the analysis shows positive, pro-poor linkages. However, a closer look into these linkages will require a micro-level study. While conjectures on why tourism seems pro-poor were offered in the analysis, establishing what is really happening on the ground will require the identification of who are hired by the tourism sector, how are revenues and profits shared between capital and labour, what level of skills are required, what is the level of informality in the tourism sector, and what constraints are faced by MSMEs in the tourism industry. It is also important to determine what will be the likely impacts of interventions, as well as who the main beneficiaries are of tourism spending (i.e., a sector-specific benefit incidence analysis). This analysis will need micro-level data down to firms, households, and workers. Most economies already collect this data in firm-level surveys, household income and expenditure surveys, and labour force surveys, but utilising and combining them will be a major undertaking.

If further tourism policy analysis is desired for the APEC region, the TWG is well placed to be a forum for information exchange and data sharing. An APEC-wide dataset for tourism policy inputs can be collected by TWG, which can then be associated with external data and tourism outputs to provide a more comprehensive analysis of the sector. This will require cooperation among all TWG members, as the usefulness of this database is dependent on the amount and quality of data gathered. Likewise, micro-level case studies on tourism, inclusive growth, and MSMEs can be considered by TWG to provide evidence-based policies that can strengthen the inclusiveness impacts of tourism development in the region. As micro-level case studies are time- and resource-intensive to accomplish, and extensive amounts of data need to be gathered and processed, some economies with existing micro-level data can volunteer to be covered by the case studies and the methodologies developed can then be replicated by other economies using their own data.

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APPENDIX A: DATA AND SOURCES

DATA	DESCRIPTION	SOURCE
Tourism Performance Indicators		
Bilateral tourism flows	Annual tourism flows from each economy to each economy; 1995-2013.	UNWTO
Tourism sector indicators	Various data on the tourism sector (e.g., purpose of travel, mode of transport, hotel nights, etc.); 1995-2013.	UNWTO
Tourism Sector Variables		
Connectedness	The DHL Global Connectedness Index details an analysis of the state of globalization around the world from the period of 2005 to 2013. A higher Global Connectedness Score implies that the economy is more globalized.	DHL Global Connectedness Index 2014
Bilateral flights	Time and flight legs between economies using the most direct flight connections between busiest airports as of 2015.	Various flight-search websites
Passport power	The passport power states the number of economies a person holding a specific passport can travel to without a visa as of 2015.	Henley & Partners' Visa Restrictions Index
Bilateral visa requirements	Visa requirements imposed by each economy on visitors as of 2015. Visa requirements include e-visas, visas on arrival, and visas requiring prior application at consular offices).	Foreign affairs ministries of each economy
World Heritage Sites	Cumulative number of UNESCO World Heritage Sites in APEC economies; 1995-2014.	UNESCO World Heritage Centre
Crime	Homicide, assault, and rape rates per 100,000 people; 2000-2013.	UNODC
Terrorism	Number of terrorism incidents and casualties; 1995-2013.	START Global Terrorism Database
Awareness/popularity	The relative search popularity of an APEC economy; 2005-2014.	Google Trends
Macroeconomic and Exogenous Variables		
Bilateral trade	Annual bilateral import and re-import; 1995 to 2014. Annual bilateral export and re-export; 1995 to 2014.	UNCTAD; Bureau of Foreign Trade and Ministry of Economic Affairs (Chinese Taipei)
Foreign direct investments (FDI)	Annual FDI inflow and outflow from 1995 to 2014. Data on FDI flows are on a net basis (capital transactions credits less debits between direct investors and their foreign affiliates); 1995-2014.	UNCTAD

Macroeconomic and social indicators	GDP, GDP growth, population, employment, exchange rates, poverty, inequality, etc.; 1995-2014	IMF; World Bank; Directorate General for Budget, Accounting and Statistics (Chinese Taipei)
Bilateral gravity variables	Land area, landlocked, continent, common language, former colony, distance	Centre d'Etudes Prospectives et d'Informations Internationales (CEPII)
Geographic indicators	Mean elevation, mean distance to coastline, land area in tropics	Portland State University

APPENDIX B: MEASURING INCLUSIVE GROWTH[13]

Inclusive growth requires the consideration of changes in mean household income as well as changes in distribution. An increase in mean income means that there is more wealth circulating in a society, which in turn can lead to higher standards of living and welfare. Having a higher mean income also implies a higher capacity for productivity and investment, not only in capital goods but also in education and health services.

However, having more wealth is not enough for inclusive growth; the distribution of wealth is also an important consideration. An increase in society's wealth can hardly be called inclusive if it only accrues to those who are already wealthy. Indeed, for growth to be called inclusive, it should be benefiting the poorer segments of society, albeit not to the detriment of the more well-off. Inclusive growth is not a zero-sum game; rather, it is meant to benefit all members of society, but with a bias for those who need growth the most.

In this section, we first discuss the computational concepts of mean income and distribution. Then we operationally define inclusive growth as applied in this paper.

Mean income

The concept of mean income in a population is straightforward. Suppose there are N individuals in a population with each member having an income of M_i. Then the mean income in the population, M, is defined as

$$M = \frac{\sum_{i=1}^{N} M_i}{N}$$

Hence, an increase in mean income (keeping N constant) implies a net increase in total income in the population regardless of distribution. It is thus possible for mean income to increase even if some individuals experience a decrease in their income, so long as other individuals experience a bigger increase in their income.

Distribution of income

The concept of distribution is a bit more involved as it requires matching incomes with individuals. As previously, suppose there are N individuals in the population with each member having an income of M_i. But this time, we arrange individuals in an ascending order according to income, so individual 1 with income M_1 is the poorest individual and individual N with income M_N is the richest individual. Let us then define a share of the population, $0 \leq p \leq 1$, that indicates the proportion of the population from individual 1 to individual p; i.e., the poorest p percent of the population. The distribution of income in a population can then be described by a Lorenz curve[14], $L(p)$, that indicates the share of total income owned by the poorest p percent of the population (Figure A1). By definition, $L(0) = 0$ (i.e., zero percent of the population owns zero percent of the income) and $L(1) = 1$ (i.e., 100 percent of the population owns 100 percent of the income).

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[13] This section is taken from the PSU study on *Trade, Inclusive Growth, and the Role of Policy* prepared for AMM 2015; the report can be found here: http://publications.apec.org/publication-detail.php?pub_id=1678.
[14] Named after Max Otto Lorenz (1876-1959) who first described the curve in 1905.
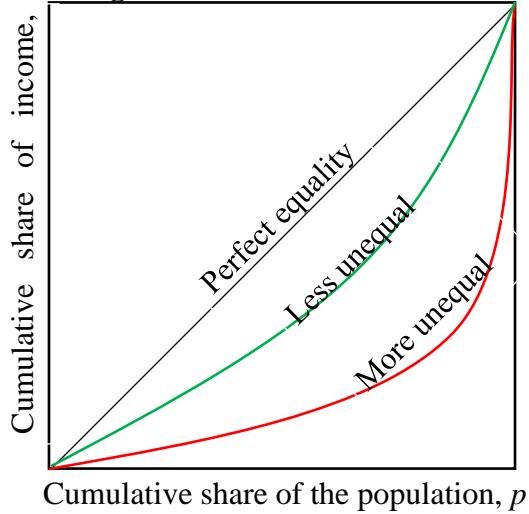
Figure A1. The Lorenz Curve

Figure A1 illustrates three different income distributions. If every individual has exactly the same income, then the poorest 10 percent of the population ($p = 0.1$) has 10 percent of total income, the poorest 50 percent has 50 percent of total income, and so forth. This is the line of perfect equality in Figure A1. With more inequality, the Lorenz curve will be bowed out from the line of perfect equality since the poorest 10 percent of the population will own less than 10 percent of total income, etc. Note that a common measure of inequality, the Gini index, is actually based on the Lorenz curve. The formal definition of the Gini index is

$$G = 1 - 2\int_0^1 L(p)dp$$

which is unity minus twice the area under the Lorenz curve (note that the square in Figure A1 is a unit square, so each side is equal to 1).

The inclusive growth indicator

Following Son and Kakwani (2008), and using the same terms as above, we define the inclusive growth rate, γ, as

$$\gamma = \Delta\ln(M) - \Delta\int_0^1 [\ln(p) - \ln(L(p))]dp$$

The first term of γ, $\Delta\ln(M)$, is the growth rate of mean income, M.[15] The second term, $\Delta\int_0^1[\ln(p) - \ln(L(p))]dp$, indicates the growth rate in inequality. Note that if there is no change in income distribution, so the second term is zero, then $\gamma = \Delta\ln(M)$. If inequality increases, so $\Delta\int_0^1[\ln(p) - \ln(L(p))]dp > 0$, then $\gamma < \Delta\ln(M)$. Conversely, if inequality decreases, so $\Delta\int_0^1[\ln(p) - \ln(L(p))]dp < 0$, then $\gamma > \Delta\ln(M)$.

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[15] Note that for any variable x, $\Delta\ln(x) = \Delta x/x$, or the growth rate of x.

Note that $L(p) = M_p p / M$, where M_p is the mean income of the poorest p percent of the population. Thus, we can rewrite γ as

$$\gamma = \Delta \ln(M) - \Delta \int_0^1 \left[\ln(p) - \ln\left(\frac{M_p p}{M}\right) \right] dp$$

From this equation, we can see that $\partial \gamma / \partial M_p > 0$, so that an increase in the share of total income among the poorer p percent of individuals while keeping average income M constant (i.e., rich-to-poor transfer) increases γ by reducing the second term. Conversely, a decrease in the share of income among poorer individuals (i.e., poor-to-rich transfer) decreases γ by increasing the second term.

The above equation is best suited for household survey data so that we have a near-continuous distribution of observations. However, for this analysis, we use a discrete transformation of γ using decile income data so that the above equation becomes

$$\gamma = \Delta \ln(M) - \Delta \sum_p \left[\ln(p) - \ln\left(\frac{M_p p}{M}\right) \right], p = 0.1, 0.2 \dots 1$$