CHAPTER 1.2

Taking Travel & Tourism to the Next Level: Shaping the Government Agenda to Improve the Industry's Competitiveness

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Governments all over the world are striving to support and increase the well-being of their citizens through sustainable economic growth and the resulting improvements in commercial and social welfare. As globalization brings every country closer together, Travel & Tourism (T&T) has become an increasingly important means of stimulating development, accelerating local investment, and boosting employment. But as the world grows smaller, the competition for business travelers and tourists is heating up. And everyone around the world has watched as disruptive forces such as pandemics and terrorism have adversely affected a country's T&T industry and even set back its entire economy. Given these conditions, what can countries do to sustain and improve their T&T industry, whatever their stage of economic development?

Factors that impact the competitiveness of the T&T industry

The Travel & Tourism Competitiveness Index (TTCI) is a primary indicator of a country's T&T sector competitiveness. As such, it provides a useful measure to identify the critical success factors governments and business leaders need to foster a flourishing T&T industry. By using the TTCI to evaluate and compare an economy's T&T performance with the country's peers within their particular development stage, we have identified a number of "best practice" examples. These can help governments looking to improve the competitiveness of their own T&T sectors, and thus positively influence their country's economic growth.

The overall TTCI is built on three primary subindexes: the T&T regulatory framework subindex (1), the T&T business environment and infrastructure subindex (2), and the T&T human, cultural, and natural resources subindex (3). Together these are composed of a total of 13 pillars that, in turn, are made up of a total of 58 variables. Looking across the different components of the TTCI, it is evident that it pays off for governments to adopt a balanced regulatory framework that attracts private investors, facilitates access for domestic and international travelers, and encourages competition in the market. These factors improve the sector's operational efficiency, services, and price levels. State subsidies and government investments should be limited to areas that are not yet attractive enough for private investment, but always with the intention of moving toward a self-sustaining competitive environment—a necessary precondition for long-term growth. Keeping a good balance between maintaining regulatory control and providing business incentives that attract private investors provides the foundation for an efficient T&T sector.

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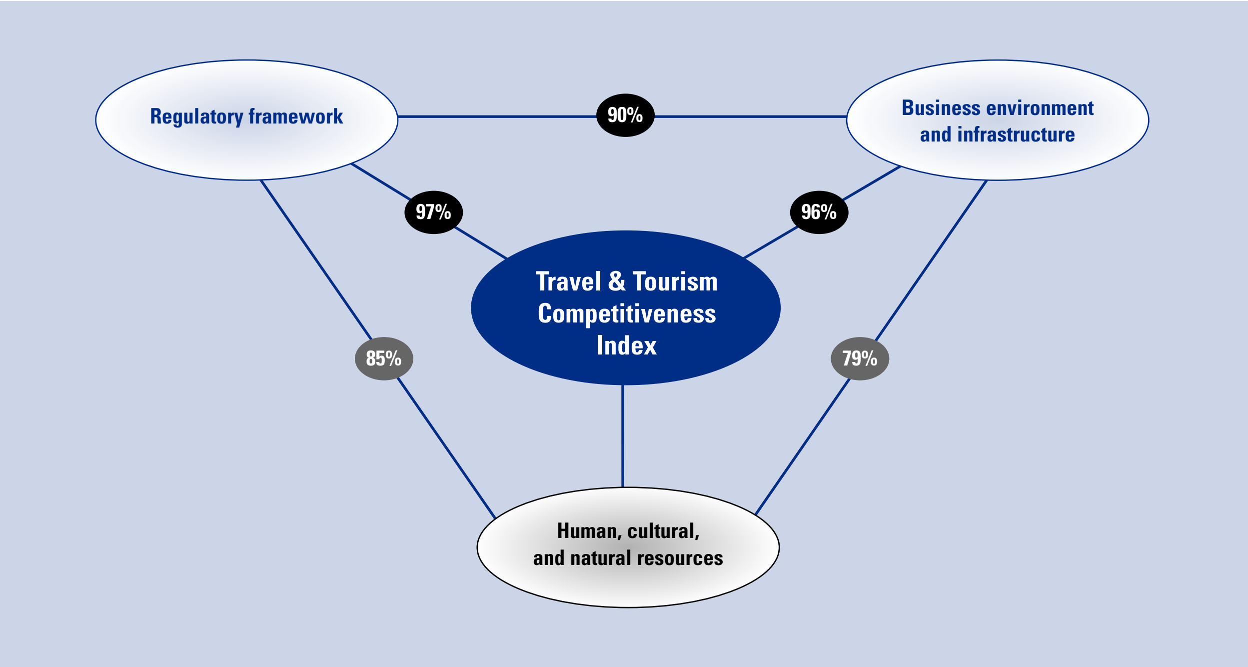
Figure 1: Overview of correlations between the TTCI and its subindexes



Source: World Economic Forum; Booz Allen Hamilton analysis.

It is therefore not surprising that the regulatory framework and the business environment and infrastructure subindexes show the highest positive correlation in the TTCI: these two factors are correlated with the overall Index by 97 percent and 96 percent, respectively (see Figure 1). The high correlation of 90 percent between those two subindexes demonstrates that government policies are strongly related to the quality of the sector's business environment for Travel & Tourism. By providing a powerful regulatory framework that fosters the build-up of an efficient T&T environment, encourages private investments, and guarantees respect for the local culture and social welfare, government action obviously contributes directly to the sector's competitiveness.

T&T regulatory framework. Addressing the various factors that make up a country's regulatory environment is a prerequisite for sustainable growth in a country's T&T sector. The top factors that we found to be the most highly correlated with a country's T&T sector competitiveness are:

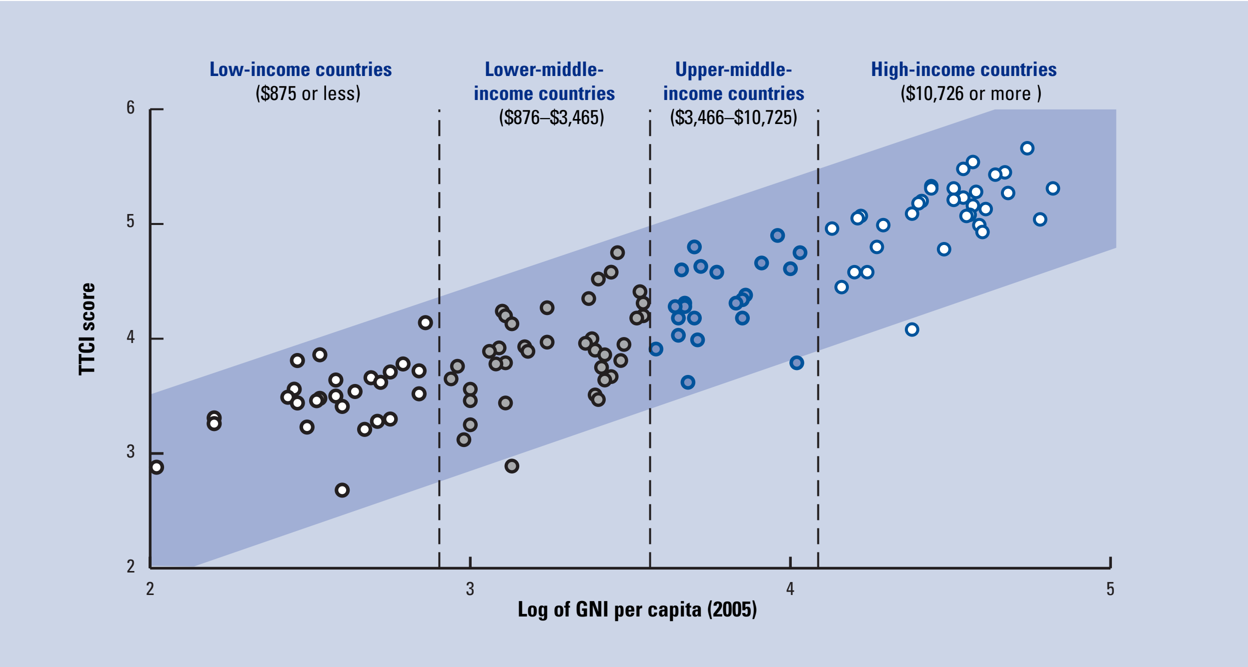
- ensuring political stability and a high standard of safety and security (80 percent),
- securing investments in the sector by adopting and maintaining favorable rules and regulations (80 percent),
- maintaining high standards of health and hygiene for both citizens and travelers (86 percent), and
- implementing and monitoring environmental regulations (87 percent).

Political and economic stability is a critical prerequisite for attracting private capital, foreign investors, and international business travelers and tourists. Because the global business community is averse to very risky economic environments, countries with insecure legal policies are at a significant disadvantage when trying to leverage their business potential. Government regulations that encourage foreign ownership and direct investments, clearly define and protect property rights, and promote business foundations and technical innovation provide an effective framework for a competitive T&T industry.

If a country's regulatory environment allows its public and private sectors to work together effectively, sustainable growth can be strategically planned—further stimulating the sector's potential and defending it against severe disruptions from external events beyond its direct control.

T&T business environment and infrastructure. In addition to a well-designed regulatory framework, an efficient business environment and transport infrastructure is a key driver that directly influences the competitiveness of a country's T&T industry. Ground, air, tourism, and information and communications technology

Figure 2: TTCI score vs. gross national income per capita



Source: World Bank, 2005; Booz Allen Hamilton analysis.

infrastructure are key factors that correlate highly with a country's overall TTCI. Those factors include:

- an accessible, high-quality air traffic network—for example, in terms of routes, frequencies, and number of destinations offered (84 percent);
- established tourism infrastructure, such as a high density of hotels, rental car companies, and banks (86 percent);
- a well-developed ground transportation network, including roads, railroads, mass transit, port facilities, and waterways (89 percent); and
- broad coverage of Information and Communication Technologies (ICT) services, such as television, telephones, and high-speed Internet access (90 percent).

To attract private investors to a country's T&T economy, governments need to create a business environment that provides the required air, ground, and tourism networks, either through direct government investment or state subsidies, or by entering into public-private partnerships for those projects too difficult for a state authority or a single company on its own. Involving private investors in infrastructure projects deepens everyone's long-term commitment to the sector. Such commitment that benefits not only those who work in the T&T industry or use its services, but also the surrounding community, thanks to the tax revenues the sector generates. Finally, information technology—whether it be e-booking services, travel and vehicle management systems, or Radio Frequency Identification (RFID) technologies for baggage and passenger tracking—plays a critical role throughout the T&T value chain, boosting efficiency and service quality.

Stages of Development. The importance of the various factors that make up the TTCI is likely to vary depending on each country's stage of development. Although some of the factors are a "must have" for high-income economies, they might not yet be absolutely necessary for developing countries. Political stability, for instance, is a prerequisite for any country looking to attract foreign business and international travelers; government investments in environmental protection and new technologies, on the other hand, might become relevant only once basic infrastructure is in place. A less-developed country that is in the process of building up its air and ground transport network may consider environmental regulations a secondary priority.

Comparing economies within each stage of development makes it possible to identify specific key success factors and lessons learned that are specifically applicable within each peer group (see Figure 2).

Travel & Tourism naturally increases as a country's economic and social welfare improves, and as it does so, it becomes more important to its government and business leaders. That is why the TTCI naturally ranks advanced economies higher than countries at lower stages of development. Taking the gross national income (GNI) per capita as an indicator, it shows that the first 27 rankings in the TTCI are all countries that belong to

Table 1: Top 10 TTCI rankings based on stage of development

HIGH-INCOME PEER GROUP		
Index rank	Economy	Score
1	Switzerland	5.66
2	Austria	5.54
3	Germany	5.48
4	Iceland	5.45
5	United States	5.43
6	Hong Kong SAR	5.33
7	Canada	5.31
8	Singapore	5.31
9	Luxembourg	5.31
10	United Kingdom	5.28

UPPER-MIDDLE-INCOME PEER GROUP		
Index rank	Economy	Score
28	Estonia	4.90
29	Barbados	4.86
31	Malaysia	4.80
35	Czech Republic	4.75
37	Slovac Republic	4.68
39	Mauritius	4.63
40	Hungary	4.61
41	Costa Rica	4.60
45	Chile	4.58

LOWER-MIDDLE INCOME PEER GROUP		
Index rank	Economy	Score
34	Tunisia	4.76
43	Thailand	4.58
46	Jordan	4.52
48	Jamaica	4.41
50	Dominican Republic	4.35
54	Bulgaria	4.31
57	Morocco	4.27
58	Egypt	4.24
59	Brazil	4.20
60	Indonesia	4.20
(71)	*(China)*	*(3.97)*

LOW-INCOME PEER GROUP		
Index rank	Economy	Score
65	India	4.14
80	Tanzania	3.86
84	Gambia	3.81
88	Vietnam	3.78
91	Mongolia	3.72
92	Mauritania	3.71
94	Zambia	3.66
96	Cambodia	3.64
98	Kenya	3.62
101	Uganda	3.56

Source: World Economic Forum; Booz Allen Hamilton analysis.

the high-income category. Only seven high-income economies have been surpassed by countries in either the upper-middle-income or the lower-middle-income categories. Looking at the TTCI score bandwidth within the four different country groupings shows that some economies emerge as high performers relative to their peers—serving as a first starting point for a more detailed investigation of key success factors that drive an economy's T&T competitiveness. Table 1 highlights the top 10 "fly-wheel" countries for each of the four segments shown in Figure 2, illustrating their overall TTCI rank and their respective scores.

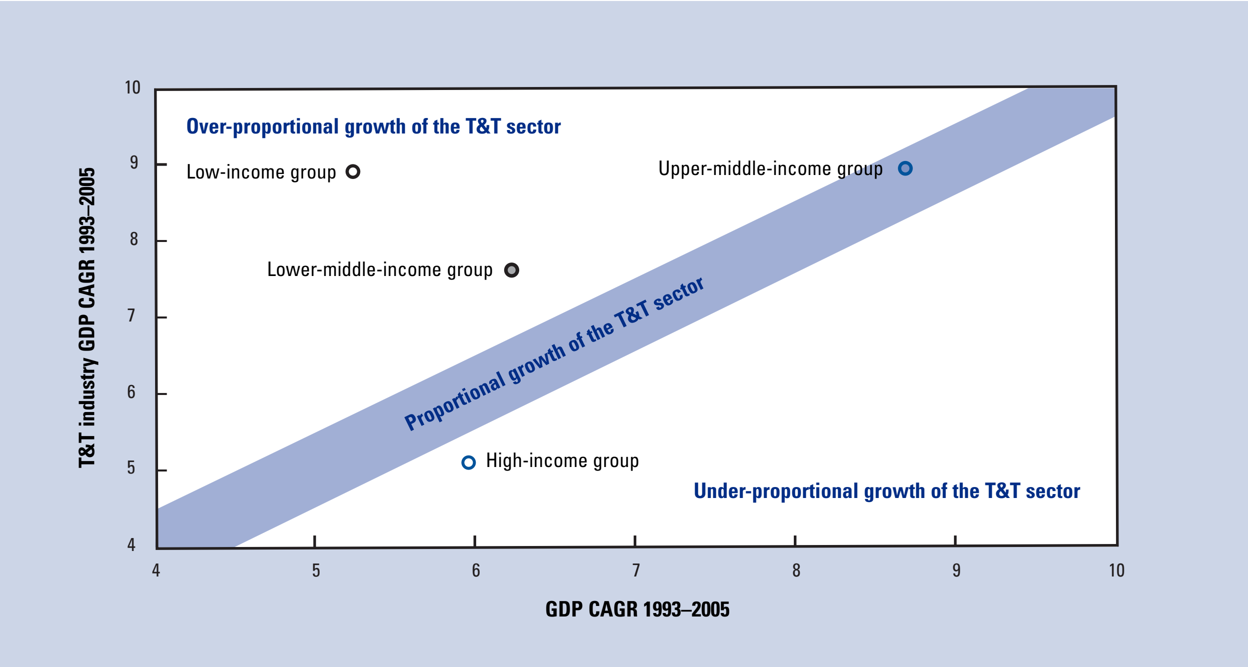
According to the World Tourism & Travel Council (WTTC), China's T&T demand is expected to grow 8.9 percent by 2013—adding an astonishing 11.5 million new jobs in this sector. Since in both absolute and relative terms China's T&T economy grows at an impressive speed and thus serves as a good case example, we show it in the table of lower-middle-income countries even though it does not rank in the top 10 scores but comes "only" in 14th place among the other 39 economies in its peer group.

Travel & Tourism as a driver of economic growth: The application of best practice examples across defined peer groups

As the pace of globalization has increased, many countries have experienced rapid GDP growth rates over the past few years. In such countries, Travel & Tourism is taking off at the same speed, granting people first-time access to foreign travel destinations and directly adding to domestic economic development. With its direct and indirect impacts on overall welfare, Travel & Tourism may be a key enabler helping low-income, lower-middle-income, and upper-middle-income countries to move upward into the ranks of the more advanced nations. Virtually every country in the three less-developed categories are achieving relatively high T&T growth rates, suggesting that they are investing heavily in this sector in hopes of moving toward the next development stage. Going beyond the individual TTCI scores and comparing average GDP growth with increase in GDP specific to the T&T sector reconfirms this trend: low-income and lower-middle-income countries show proportionally higher than average sector growth rates compared to the other country segments (see Figure 3).

If supported by open domestic market conditions—fostered by a focused and well-balanced political and regulatory approach—Travel & Tourism can provide promising economic opportunities in many countries, especially among low-income and lower-middle-income

Figure 3: Travel & Tourism industry vs. overall economic growth



Source: WTTC, 2006a; EIU, 2006; Booz Allen Hamilton analysis.
Note: CAGR is the compound annual growth rate.

nations. In that way boosting the T&T sector can help equalize economic differences among countries and become a major contributor to a nation's overall welfare. Countries that understand the positive impact of Travel & Tourism on their overall economies—and thus out-perform their peer group's average—make excellent "best practice" case studies for understanding how and why a focus on Travel & Tourism pays off.

Case Study 1: High-income economy group: Hong Kong SAR and Iceland

The T&T markets in the high-income economies of the western hemisphere are highly sophisticated from both a demand and a supply perspective. As these economies' T&T sectors reach a high level of saturation, the sector's average top-line growth typically becomes relatively moderate.

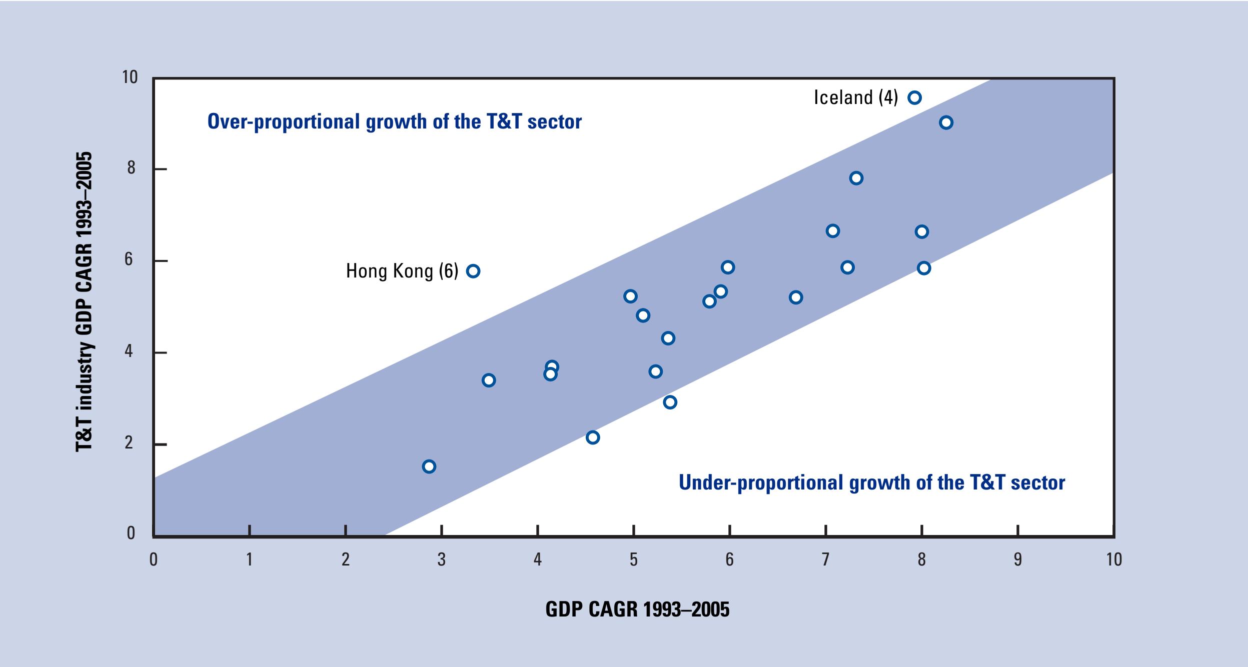
Some regions, however, are breaking the rule. Iceland and Hong Kong could hardly be more different, but both have managed to grow their T&T industries more quickly than the average of their peers (see Figure 4). A detailed look at Hong Kong and Iceland (ranked 6th and 4th, respectively, in the TTCI) makes clear the initiatives and policies each country has taken to drive their industries to perform so well.

The United Kingdom handed Hong Kong back to China in 1997. The immediate effect in Hong Kong was a sudden and severe economic collapse, as private investors feared that public policies and regulations would be tightened, thus increasing overall business risks; that fear also affected the tourism industry. But the worst-case scenario did not take place: TTCI results show that Hong Kong ranked second in the policy rules and regulations pillar, particularly in the categories of favorable foreign direct investments and lack of foreign ownership restrictions.

Since the handover, Hong Kong has succeeded in restoring both its markets and its tourism industry. The Hong Kong Tourism Board (HKTB) was established in early 2001 as an independent cross-sector network for promoting the travel industry from both the demand and the supply sides. The board's activities range from global and regional marketing campaigns, monitoring the industry's quality standards and improvement efforts, and providing guidance to the domestic industry to supporting the further development of Hong Kong as a world-class tourism destination. Today, Hong Kong is a very successful Asian destination for shoppers from all across the world. And it has become the gateway to the People's Republic of China, a trend that has also steadily increased visitors flows. Meanwhile, city officials are considering the privatization of the Hong Kong Airport—the plan is to float 25 percent of the airport's shares—the main goal being to subject the airport to even stronger market and commercial discipline.

An island on the outskirts of the inhabited world, Iceland isn't as easy for visitors to reach as Hong Kong is. In the past, Iceland has been a major destination for "eco-tourists," but the country is making a major effort to place its tourism industry on more than one leg. By combining effective marketing efforts with a clear economic liberalization policy, Iceland has successfully

Figure 4: High-income economy group: Travel & Tourism industry vs. overall economic growth



Source: WTTC, 2006a; EIU, 2006; Booz Allen Hamilton analysis.
Note: Numbers in parentheses show the economy's TTCI rank and its position within its peer group. CAGR is the compound annual growth rate.

managed to redirect a significant share of international convention travelers to Reykjavik, a success that shows up in the country's number 5 ranking in the T&T regulatory framework subindex.

Iceland's banking sector clearly demonstrates how privatization has aided the island's overall economy. Privatization has allowed banks to compete far beyond the island's borders, attracting an increasing number of business travelers to the country. Within Iceland's T&T sector, privately held conglomerate Icelandair has succeeded along the same lines by avoiding governmental influence or international alliances. Since its establishment as Icelandair resulting from a merger of two domestic airlines in 1973 it has expanded rapidly, and in 2004 it bought a 10 percent stake in EasyJet. Although based in a domestic market of only 300.000 people, Icelandair transported roughly 1,5 million passengers in 2005 and Reykjavik has established itself as a hub for international traffic, carrying more than a third of its passengers on transatlantic flights.

Case Study 2: Upper-middle-income economy group: Estonia and the Slovak Republic

As the European Union has expanded its borders into Eastern Europe, with the result that its markets there are continuously opening up to private investors, a fresh group of small countries have become tourist destinations and dynamic business climates. So it is not surprising that some Eastern European countries rank relatively high in the overall index, with T&T sectors growing faster than their overall economies (see Figure 5).

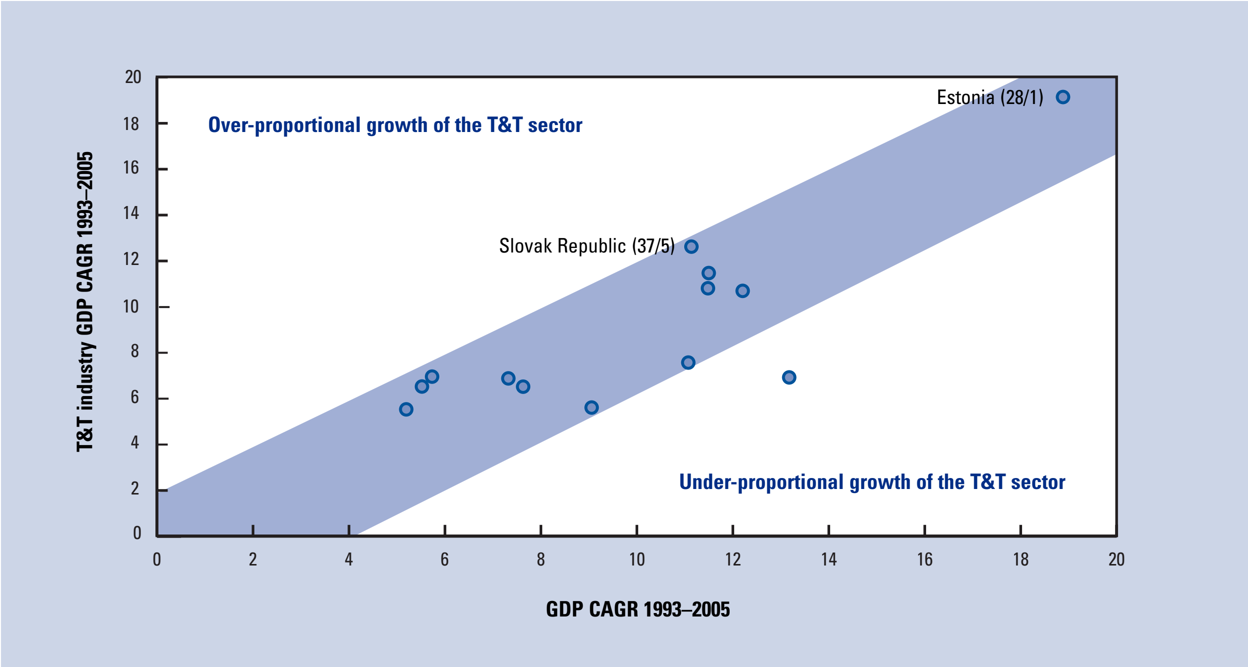
Estonia emerges as a high flyer at rank 28, leaving other more advanced countries—such as Italy, at rank 33—behind.

Since several low-cost carriers expanded their networks to Tallinn, tourists have been pouring into the country in growing numbers. In order not to get branded as a destination for "booze trips" from its western neighbors, Estonia's Tourism Board is following a multiple strategy:

- First, to keep the travel industry growing steadily, low-budget tourists have remained a top priority.
- Second, the country has worked to brand itself as a tourist destination with a strong cultural heritage and traditional countryside getaways.
- Third, Estonia is keeping an eye on newly emerging sources of tourism, especially Russian tourists, and has decided to significantly ease visa requirements for short-term travelers.

Since Estonia joined the European Union in 2004, it has followed the path of privatization of former state-owned businesses. In late 2004, the privately held Go Group was set up to consolidate a number of transportation and hospitality companies in order to raise efficiency and provide better service to Estonians and visitors alike. The group is made up of four businesses—international train services, bus services, tourism, and a hotel business—operating under one integrated brand.

Figure 5: Upper-middle-income economy group: Travel & Tourism industry vs. overall economic growth



Source: WTTC, 2006a; EIU, 2006; Booz Allen Hamilton analysis.
Note: Number in brackets shows the country's TTCI rank and its position within its peer group. CAGR is the compound annual growth rate.

With its strong focus on improving infrastructure access and efficiency, it is not surprising that Estonia scores relatively high in the T&T business environment and infrastructure subindex, ranking 25 and outperforming such high-income countries as Belgium, Greece, and Ireland.

The Slovak Republic has chosen a similar path. It has successfully built its capital, Bratislava, into a dynamic business hub that attracts multinational manufacturing and corporate affiliations, thanks to its flat-tax scheme and low prices. The Slovak Republic's aviation sector has taken off in recent years, with Bratislava airport emerging as a regional hub that has experienced double-digit growth in passenger traffic. Although the Slovakian government recently postponed the privatization of this airport, the country's largest air hub, the sale of a majority stake in the country's second-largest hub—Koŝice airport—has been finalized. It is not surprising that the Slovak Republic shows up among the top 20 percent within the TTCI's policy rules and regulations pillar, at rank 24.

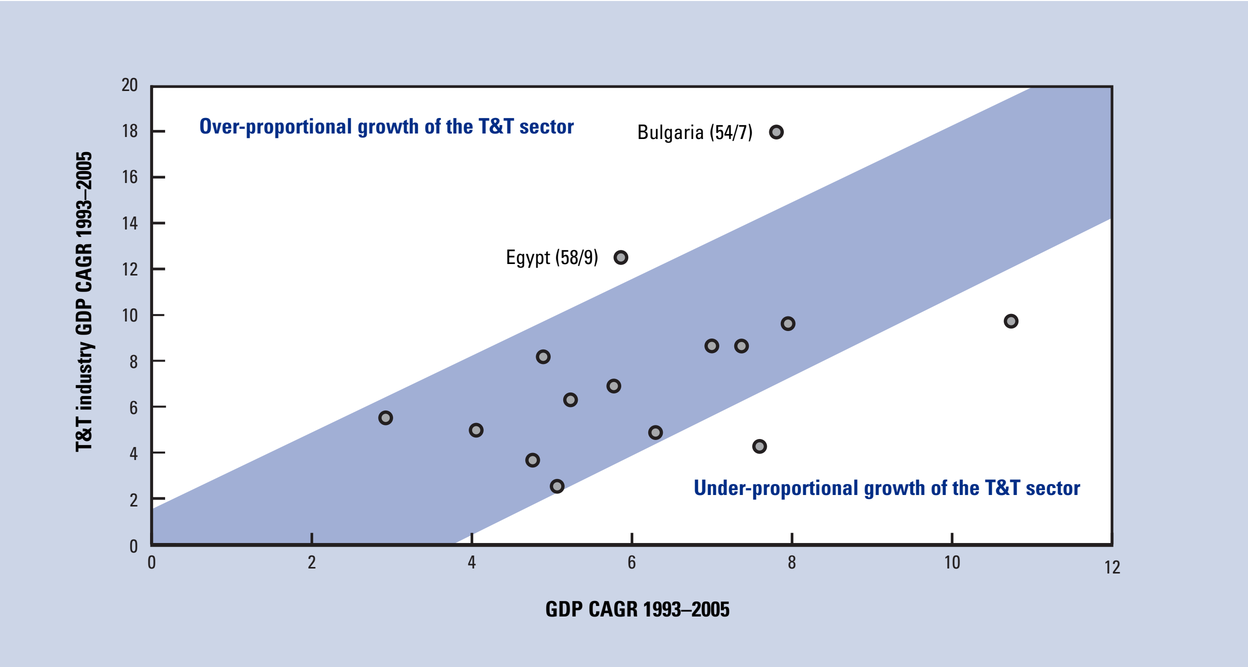
Other outperforming countries in this peer group, such as Turkey and South Africa, already have a well-established reputation in the T&T industry, yet just in the past decade, Estonia and the Slovak Republic have managed to build up this sector virtually from scratch. They are now well positioned to continue their success stories, assuming they carry on their policies of economic and regulatory liberalization.

Case Study 3: Lower-middle-income economy group: Bulgaria and Egypt

Several lower-middle-income economies have been using their long-standing, if underdeveloped, T&T industries as a stepping-stone to long-term economic stability to catch up to their economic peer group. Bulgaria and Egypt both rank in the top 10 in the TTCI group of lower-middle-income economies, significantly outperforming the group as a whole (see Figure 6).

Without its booming tourism industry, which has successfully redirected large numbers of travelers from Mediterranean beaches to the coast of the Black Sea, Bulgaria would continue to suffer from a sky-high trade deficit. Yet today the country celebrates its entrance into the European Union. Bulgaria intends to invest heavily in its sometimes archaic infrastructure in order to put its skyrocketing tourism industry on a more stable basis for further growth. As a sign of its strong economy and ambitious future plans, Bulgaria's government has drafted an ambitious plan to spend 3.3 billion euros on improving roads, railways, ports, and waste treatment facilities in the country by 2015. The plan will be funded in part by the European Investment Bank and in part through a variety of public-private partnerships (PPPs). Bulgaria is now looking to take its mass-tourism markets to the next level, with plans to develop more high-end offerings for visitors. Its success has allowed Bulgaria to score relatively well in the TTCI tourism infrastructure pillar, ranking 25 and outpacing several other well-established

Figure 6: Lower-middle-income economy group: Travel & Tourism industry vs. overall economic growth



Source: WTTC, 2006a; EIU, 2006; Booz Allen Hamilton analysis.
Note: Numbers in parentheses show the country's TTCI rank and its position within its peer group. CAGR is the compound annual growth rate.

tourism destinations, such as the Dominican Republic (39), Tunisia (45), and Thailand (53).

Thanks to its incomparable cultural heritage and a coastline perfect for seaside vacationers and scuba divers, T&T is one of Egypt's key engines of economic growth, contributing close to 8 percent of the country's GDP and 28 percent of total investments. While other sectors of the economy remain state-run and highly regulated, there are no such limits in the tourism industry. For example, Egypt's government has long allowed unlimited foreign direct investments, granted the right to liquidate and transfer capital and profits abroad, and adopted open skies policies for all major tourism airports. This has helped the Egyptian travel industry to overcome several disasters, such as the Luxor attacks of 1997. Today, Egypt has undertaken an extensive tourism development program aimed at expanding its already-rich offerings, with, for example, a special focus on short getaways for Middle East visitors. Egypt's focus on its T&T sector is strongly confirmed in the country's exceptionally high score in the TTCI prioritization of Travel & Tourism pillar, where Egypt ranks 12 out of all 124 countries.

Although Egypt's tourist arrivals are growing at a greater rate than the world average, the country has not yet extracted the full value of its T&T industry. For example, Egypt's 24 natural protectorates and its Mediterranean coast still represent a large number of tourism "white spots"—areas that have yet to reach their full potential. These areas represent another way to increase average visitors' stays and to attract new forms of tourism that have a higher value, such as eco-tourism. In addition, investments in shopping, entertainment, and conference facilities have lagged the region. This represents another opportunity to attract higher-value tourist segments such as Meetings, International Conferences, and Exhibitions (MICE) visitors and luxury shoppers.

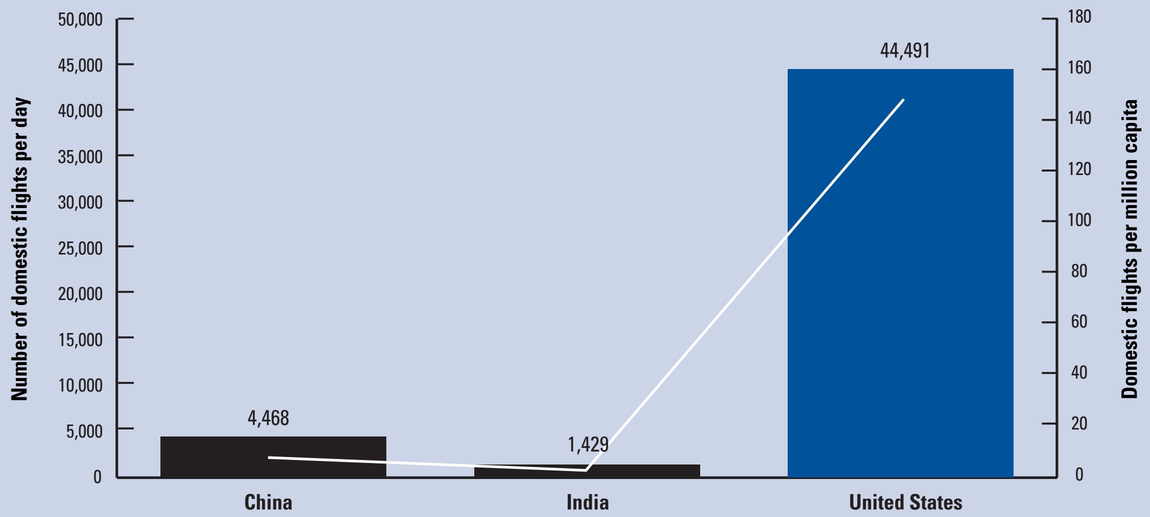
Currently, Egypt is highly dependent on tour operators, which creates a mismatch between the supply and demand for hotel rooms. Although the average length of stay for a tourist in Egypt is high and increasing, the revenue per hotel room is low. This is due in part to aggressive resort package promotions offered by tour operators and the high rate of hotel room overcapacity; but it is also due to an underdeveloped domestic air and land transport network. Because tourists cannot easily travel around the country, they tend to stay in one city for the entire duration of their visit—thus visitors are spending more time in Egypt with very little incremental increase in spending.

To further improve T&T competitiveness Egypt needs to address these challenges, include balancing hotel capacity investments with demand characteristics, transferring knowledge from global hotel and airport operators to the local market, and capturing more value from long average stays per tourist.

Case Study 4: Growing giants: China and India

Because of their large populations, China and India are categorized as "lower-middle-income" and "low-income" countries, respectively, because their per capita gross national incomes are relatively low on average across

Figure 7: Number of domestic flights per capita on a typical weekday



Source: *OAG MAX Online* (accessed September 2006); T&T human, cultural, and natural resources subindex (3), Booz Allen Hamilton analysis.
Note: Domestic flights as scheduled on Wednesday, September 6, 2006

their overall population. Although they show strong economic growth in their industrial regions, there are still many rural areas with limited accessibility and transportation infrastructures.

However, both countries' strong and growing domestic demand and burgeoning workforce potential have long attracted international business. Both countries have been outpacing the rest of the world in terms of economic growth, and they represent huge markets for inbound tourism. But there are still significant differences in personal income and consumption between China and India and the industrialized world. Therefore, the two countries' T&T sectors are more likely to take off as domestic industries than as international tourism destinations, at least for the foreseeable future.

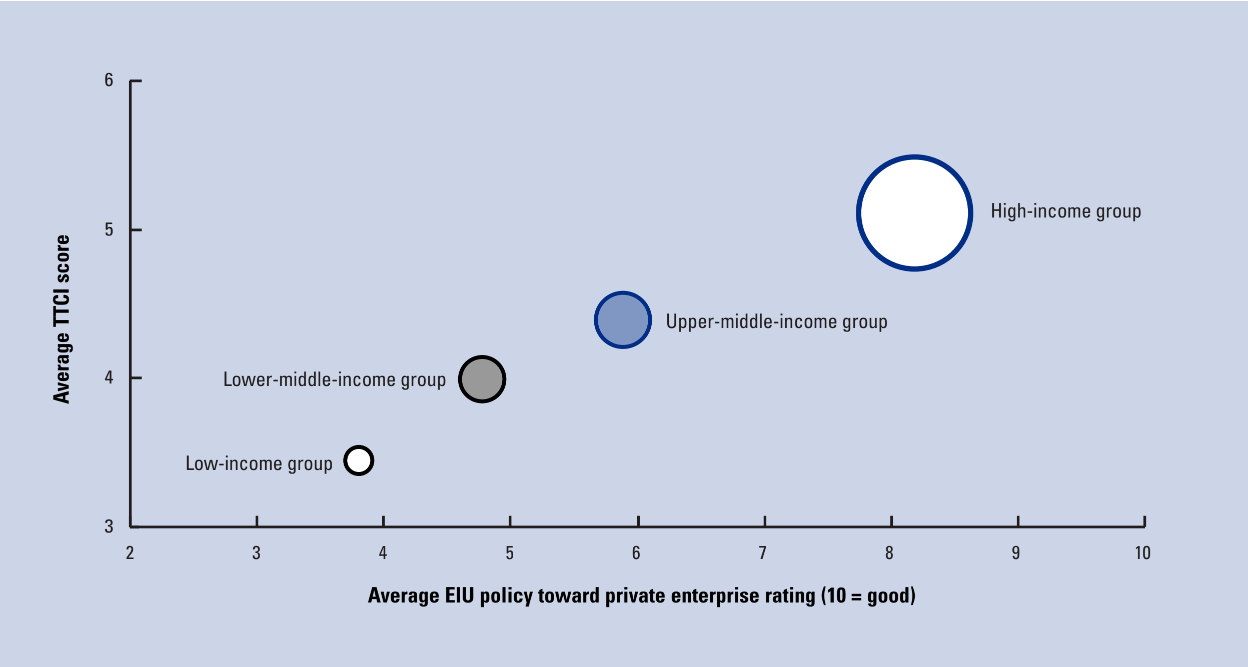
Figure 7 compares the total and relative number of domestic flights in China and India to domestic flights in the United States, an advanced air traffic market. Domestic travel demand in the two Eastern giants has great potential in the years to come.

Although comparable in size and overall growth rates, a closer look at the two countries reveals different starting positions and perspectives for future development. China is looking ahead to the 2008 Olympics, to be held in Beijing, which will certainly boost the domestic as well as the international tourism industry. As a result, the Chinese T&T industry has already seen rapid growth over the past few years. According to the China National Tourism Administration, 31 million Chinese people traveled out of the country in 2005—a large number, but still a tiny figure compared with the country's overall population. Domestic travel—with a total of 1.2 billion trips—has become the backbone of the Chinese tourism industry.

China's T&T sector has been a major beneficiary of the country's "open-door" policy, yet it remains one of the least progressive industries in terms of property-rights reform and financial performance. Most of China's tourism infrastructure is still publicly owned—the government still owns 63 percent of the country's hotels, for instance. That puts China near the bottom end of the tourism infrastructure pillar of the TTCI, at rank 113 out of 124. Just recently, however, the central government has proposed speeding up ownership reforms and encouraging the gradual withdrawal of state capital from commerce and distribution.

China's T&T score of 3.97 puts it below India, at 4.14, which would suggest that the country is not fully leveraging its potential in the sector. Yet China has been improving its ground and air infrastructure assets (through consolidation of its national airline industry, for instance), in order to keep up the pace of economic growth. And in order to boost business Travel & Tourism, the government plans to construct up to 50 new airports by 2010. Thus it ranks relatively high in the air and ground transport infrastructure pillars, at 36 and 45, respectively. In expanding its transport infrastructure, however, China should not forget about the economic split between its much wealthier eastern coast and the rural hinterland: While major economic centers such as Beijing, Shanghai, and the southern province of Guangdong are well served, the government must not

Figure 8: Policy toward private enterprise rating vs. TTCI score (averages per defined peer group)



Source: World Economic Forum; EIU, 2006; Booz Allen Hamilton analysis.
Note: Bubble size indicates overall average 2005 GDP of country cluster. The EIU Index rates countries between 1 and 10 on a variety of measures including protection of property rights and government attitudes to competition, with 1 being low and 10 being high. The average is made up of the 59 countries that are included in the EIU rating.

lose sight of the need to expand the infrastructure connecting the rest of the country.

India, meanwhile, has already gained a reputation as a popular tourist destination, with tourist arrivals expected to grow 10 percent annually for the foreseeable future. Yet India's tourism sector faces a number of constraints, including a severe shortage of budget hotels, regulatory barriers, high visa costs compared with neighboring regions, and significant delays for inbound travelers from South Asia. As a result, ranked 106, India is near the bottom end of the list in the visa requirements variable.

Within the low-income group of countries, however, India is far outperforming its peers, surpassing several countries in the lower-middle-income and even the upper-middle-income segments. In terms of infrastructure, accessibility, and safety, India shows relatively good scores, ranking 33 in air transport infrastructure and 40 in ground transport infrastructure. But, although India is among the fastest-growing aviation markets in the world, it has attained that position despite an infrastructure system that is still inadequate to deal with projected further growth. However, the country has plans for numerous major infrastructure projects, not just in the aviation sector, but in its road and rail systems as well. The Indian government and the US Federal Aviation Administration (FAA) have agreed on a major knowledge transfer effort to help develop and modernize the management, operations, and technology of India's civil aviation infrastructure.

Deregulation and privatization: Increasing demand and improving T&T industry efficiency

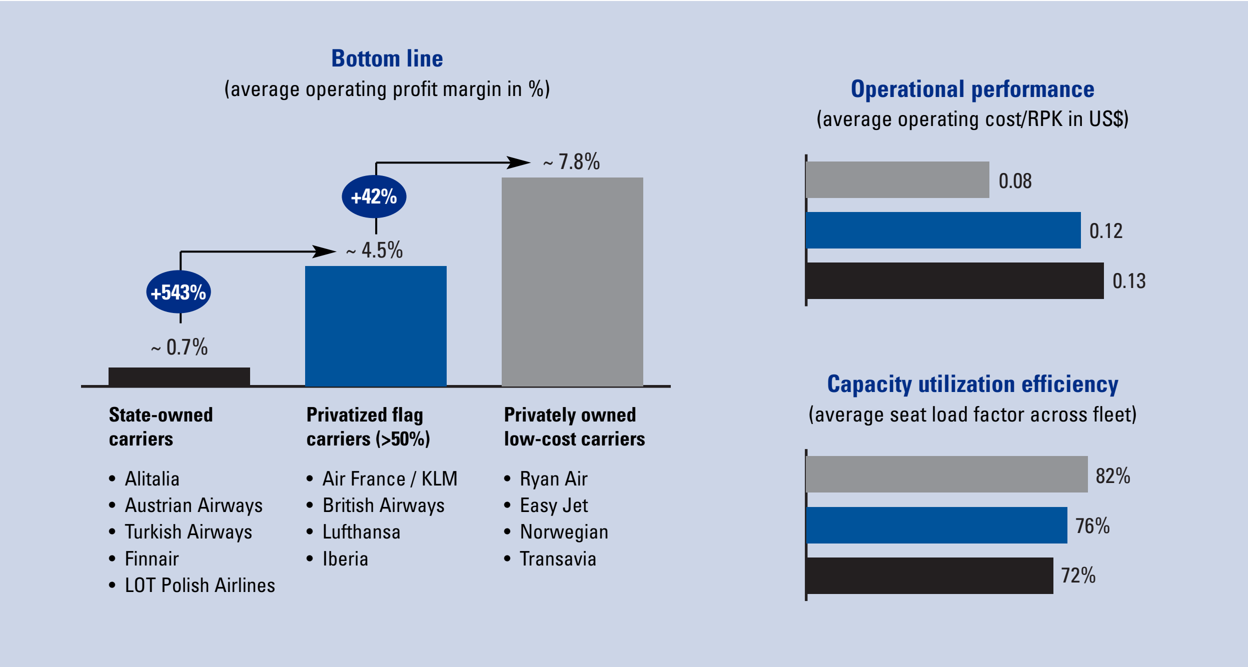
The T&T industry has established itself as an ongoing success story in countries both advanced and still developing. However, rapidly changing economic and social conditions mean that every country must maintain its pace of growth just to keep up with the competition around the world. That can happen only through further liberalization and deregulation of both the domestic and international T&T industry.

Over the past decades, most high-income countries have opened their domestic and international transport markets to competition. Today, these countries are profiting from a rock-solid tourism industry that lays the groundwork for long-term economic prosperity. The Economist Intelligence Unit (EIU) private enterprise rating, an indicator of a country's degree of economic liberalization, shows that the competitiveness of a country's T&T sector is very highly related to its degree of liberalization. Countries that engage in deregulation and privatization encourage competition, which forces all economic players to improve operational efficiency; that, in turn, drives up the T&T sector's competitiveness. Figure 8 indicates the relationship between the four economic groups' liberalization rating and their TTCI scores.

Case Study: Increasing T&T competitiveness by liberalizing the European aviation sector

For western Europe, the connection between economic liberalization and the competitiveness of its T&T sector

Figure 9: State-owned vs. privatized European airlines



Source: ATW, 2006; Booz Allen Hamilton analysis.
Note: RPK = Revenue Passenger Kilometer.

can be seen in the two-decade-old history of Europe's decision to open up its aviation industry. The market's development since then has clearly shown that a cross-country liberalization plan can have a strong impact on growth, both within Travel & Tourism and beyond. Since the countries that make up Europe are at similar stages of development—they are all politically stable and boast comparable social welfare systems—Europe's experience with market deregulation provides valuable lessons that can be applied both domestically and internationally across borders.

The deregulation of the European aviation industry was driven by the 12 member states of the European Union at the time, under the basic premise of improving access and encouraging overall competition. This shift away from state protection opened the door not to the kind of competition that was first imagined (that of the state's respective flag carriers competing in each other's territories) but to competition in the form of new entrants. Indeed, once state subsidies were eliminated, some established carriers, such as Sabena, were forced into bankruptcy.

Once the airline market itself was deregulated, the European airport landscape entered into a phase of privatization, which started with the initial public offering of the British Airport Authority and was followed by many others. Now that the British air traffic service provider (NATS) has been privatized, and plans are on the table to sell off DFS (the German air traffic control provider), the overall European air traffic control sector is also expected to follow this trend soon.

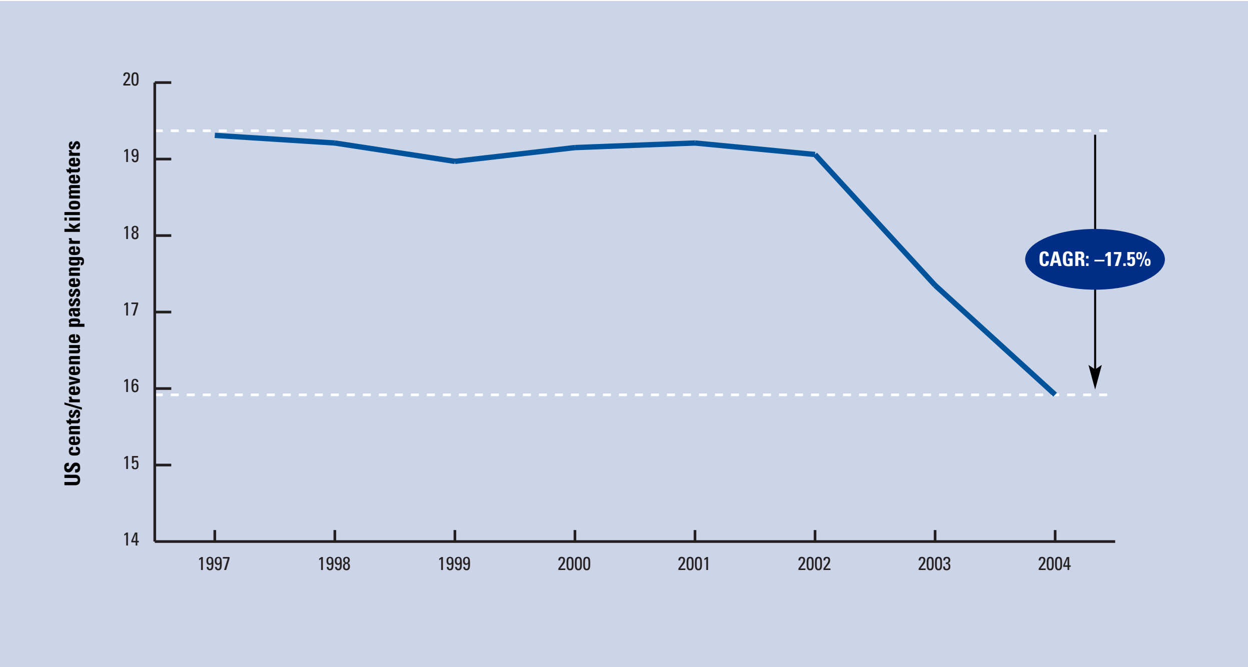
The rise of the European aviation industry clearly demonstrates that privatization efforts pay off, even in the short term:

- Deregulation of the airline market triggered industry consolidation and fostered the development of broad domestic and international aviation networks.
- These global networks have provided better access to more destinations, stimulating air-travel demand and lowering prices.
- Communities throughout the region have seen higher employment and economic growth enabled by the increased access to and from key European business centers.

Meanwhile, most of the surviving flag carriers have transformed themselves from government air transport agencies into smart global players that compete successfully in a highly competitive and global business environment. In this market, ticket prices to the end-consumer are no longer subject to bilateral negotiations between country representatives, but to the principle of supply and demand under strong competition.

A comparison of fully privatized flag carriers with those in which governmental bodies still hold significant shares shows that airlines under private leadership operate much more profitably than state-owned airlines, thanks to their tighter rein on costs, better operational efficiency, and higher seat-load factors (see Figure 9).

Figure 10: Yield development of European carriers (1997–2004)



Source: AEA, 2005.
Note: Passenger revenue per revenue passenger kilometer at constant prices (1991). CAGR is the compound annual growth rate.

The private investors who control the newly emerging European Low Cost Carriers demand even more efficiency, which shows up not only in the bottom line, but also in terms of better operational performance and capacity utilization.

Market deregulation has forced incumbent airlines into competition and introduced a wide range of new competing players into the marketplace, driving down overall market prices by more than 17 percent since 1997 (see Figure 10). Today, European travelers can chose from more direct connections within a vastly expanded route network. Most importantly, the rise of the low-cost carriers has shaken up not just the industry but customer behavior as well. Altogether, these market changes have added both more traffic and more money to the skies of Europe than was ever envisioned in the early days of liberalization.

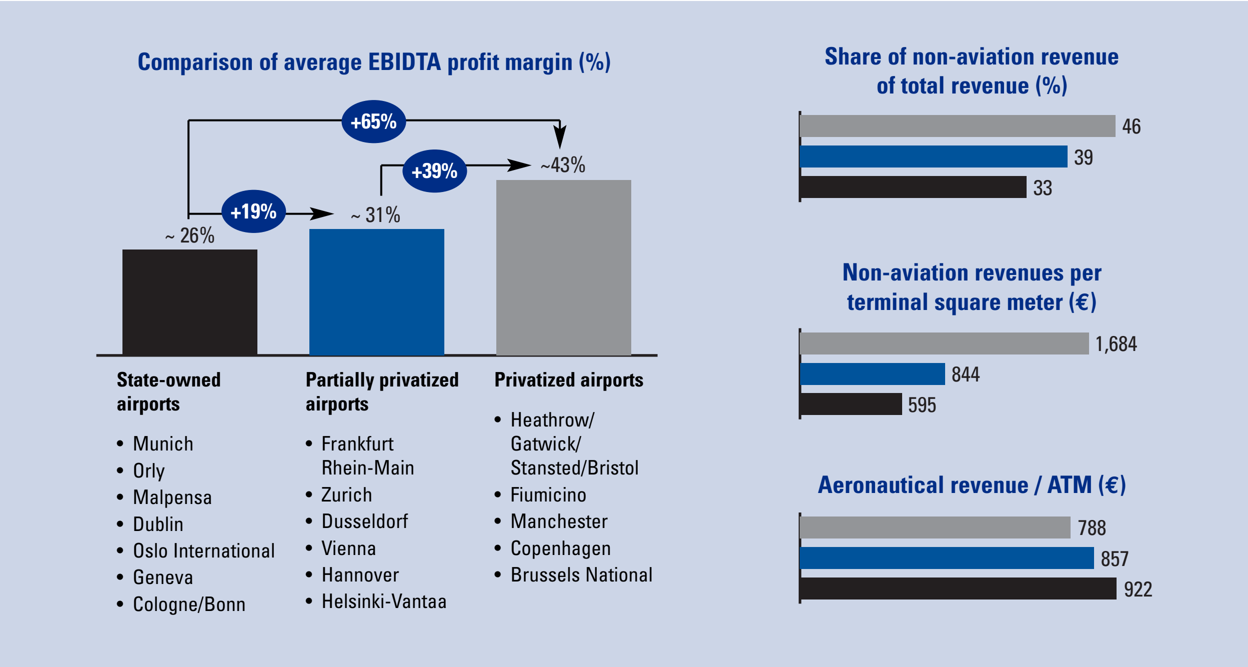
For Travel & Tourism, basic infrastructure such as roads, rails, public transport, and—most importantly—airports are essential to get travelers into, around, and out of the country. In western Europe, former state-owned airports that have been privatized during the last decade work significantly better than those still controlled by governments. Open market conditions in the airport sector have led to a variety of ownership and operating models for airports, ranging from state-owned to partially and fully privatized.

The connection between airport profitability and the degree of privatization makes clear the value private operators put on factors that go far beyond simply providing the necessary infrastructure. Such factors include the importance of non-aeronautical revenue and the potential for improved efficiency that comes with new technologies. Putting more emphasis on the travelers themselves means a higher proportion of revenues from non-aviation operations. A benchmark of bottom-line performance among Europe's national and regional hubs reconfirms the efficiency gains privatized airports have made since deregulation (see Figure 11).

As a result of deregulation, all industry players have been forced to improve efficiency and to expand their network at competitive prices to survive competition. As a result, beyond the conventional growth that has occurred prior to deregulation (~6 percent), additional demand of approximately 81 million passengers has been stimulated, triggering an overall air traffic market increase of 20 percent since 2002 alone (see Figure 12). Meanwhile, the number of intra-community routes grew by more than 40 percent, creating an entirely new market of weekend travelers. Today, low-cost carriers carry nearly a fifth of all air passengers in Western Europe. Lower flight fares and new direct connections have attracted many European travelers to visit places they would not have gone to otherwise.

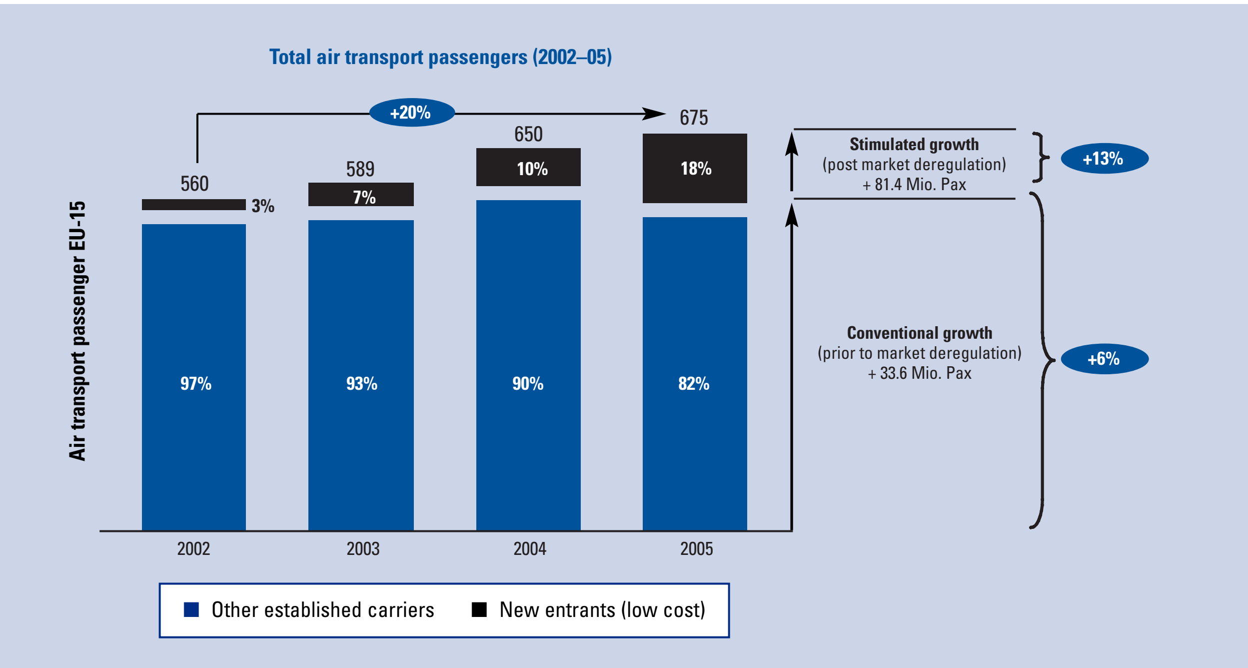
The deregulation of the European aviation sector has also contributed significantly to the growth of economic and social welfare in the European Union. Direct stakeholders in the aviation industry now account for 4 million jobs and €220 billion of added value—making up an additional 1.5 percent of Europe's gross domestic product (GDP).

Figure 11: Bottom-line differences of different airport ownership models



Source: Company Annual Reports, Booz Allen Hamilton analysis.

Figure 12: Growth of European air traffic demand after deregulation



Source: Eurostat, 2006; Eurocontrol, 2006; Booz Allen Hamilton analysis.
Note: Numbers refer to intra-European traffic only.

Lessons learned

The goal of this chapter has been to use the TTCI to lay out both a rationale and a strategy for how countries at various stages of economic development can make their T&T sectors more competitive. So how should countries in each of the four economic development groups help boost their T&T sectors? Here are some lessons learned.

High-income economies. These economies typically score high in the TTCI. However, that is not necessarily because they actively manage their T&T sectors, but because their overall economic environment—in terms of regulation, business environment, and resources—is favorable. In other words, these countries are not successful because their T&T industries are strong; rather, their T&T industry is successful because the countries themselves are strong. Their T&T infrastructure is state-of-the-art, not primarily for the sake of foreign visitors, but for the sake of their own citizens and businesses. Their advanced economies require a high level of regulatory sophistication, so industry policies and regulations are clearly defined and monitored. Even though mere size is not a factor in the TTCI, large countries such as the United States do benefit in their ranking from their economic power. Yet smaller high-income economies and regions, such as Iceland and Hong Kong, can make it to the top of the Index, too.

Nonetheless, even high-income countries have room to improve their T&T sectors. To do so, they should continue to fully leverage their existing potential and concentrate on preserving their T&T-related assets. For the first goal, an explicit T&T strategy and marketing campaign is instrumental; for the latter, consistent environmental regulations as well as rules for conservation of monuments, tourism sites, and areas of natural beauty are key factors.

Upper-middle-income economies. These boast many of the same advantages as high-income economies, and they should set similar goals for maximizing their T&T competitiveness. There is one major difference, however: most upper-middle-income economies are currently working to build up state-of-the-art infrastructure—transportation, information and communications technology, and the like—in the hopes of creating a business environment that the high-income economies already possess. The risk from the perspective of the TTCI is that upper-middle-income economies may focus too much on achieving world-class standards in basic industrial categories, leaving little attention for the T&T sector. If that happens, improved Travel & Tourism may end up the result of economic development, not a driver of it.

The upside of such a strategy is that, by building an advanced economy almost from scratch, countries can avoid a lot of the entrenched structures and legacy issues —the complex taxation models and multiple layers of regulation—that still hinder some of the more advanced countries. Furthermore, because they can be more agile than the established industrialized nations, some upper-middle-income countries, such as the Baltic states, have already built out more advanced ICT technologies than their larger neighbors—and thus can benefit from more efficient T&T sales channels.

Upper-middle-income countries should focus on making sure they have enough leeway in their national strategies, policies, and budgets for T&T development, leveraging this sector as an additional source of income and as an accelerator for the exchange of people, knowledge, and money—within their national boundaries, between their regional neighbors, and around the world.

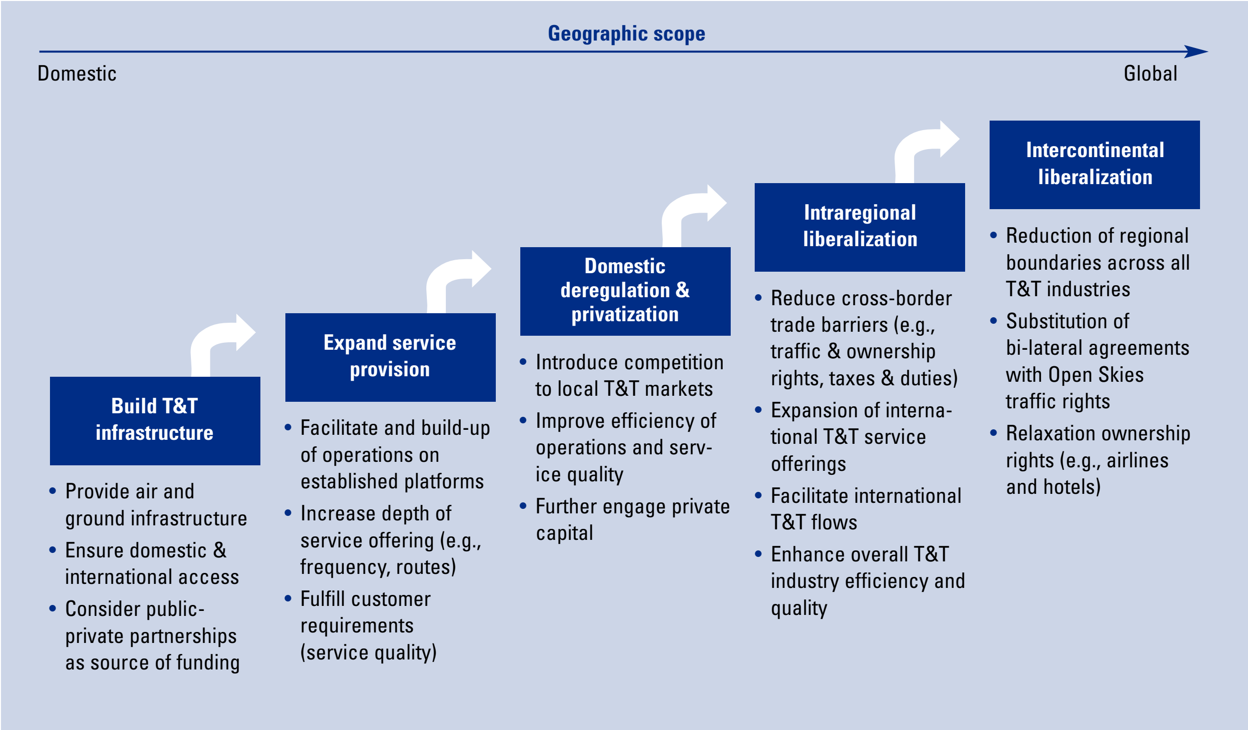
Lower-middle-income and low-income economies. These countries should pay the closest attention to the build-up of their T&T sectors, since they will reap the best return-on-investment from such efforts. Because these countries usually have limited sources of income and access to foreign capital, they may have only partially started to invest in industry and trade. In such cases, investment in Travel & Tourism is an ideal incubator for their national economy, contributing to overall development in four ways:

- Money raised through the T&T sector can be invested in other sectors.
- Necessary upgrades to Travel & Tourism are also beneficial for their own citizens and domestic business environment.
- Domestic workforce working in the T&T sector will further develop their skills and can act as role models for advanced education for all citizens.
- Growth in the T&T industry will have spillover effects in other markets—by attracting foreign investors, for example.

These effects also underline the priorities for national governments: build attractive resorts and business centers, train people, and bring transportation infrastructure up to international standards. Strong property rights, reliable health care, and adequate security standards will be required to attract investors as well as travelers.

Globalization is forcing every country—large or small, rich or poor—to compete with one another for the benefits of strong business Travel & Tourism. That means governments need to create an environment that best prepares their economies for the opportunities arising of the T&T sector. In an era where business travelers and tourists alike have many choices for travel and investment, every country—but especially lower middle income and upper middle income countries—must strengthen their T&T sectors rapidly and intelligently, addressing the real needs of their domestic economies while taking into account the actions of their regional neighbors.

Figure 13: Steps toward a competitive T&T industry



Source: Booz Allen Hamilton.

How to realize the opportunity: Steps toward improving T&T competitiveness

Successfully building a highly competitive T&T sector requires several evolutionary steps (see Figure 13). Governments must first make sure the appropriate infrastructure capacity is in place to provide access for domestic and international travelers; preferably by leveraging private capital early in the process through such strategies as public-private partnerships. And both public regulators and private investors need to ensure that they jointly manage such partnerships efficiently, by focusing on the demand characteristics of their markets.

Once infrastructure is in place, governments should focus to ensure that market demand is fully met—both in terms of service quality and quantity (for example, routes and level of frequency served). To increase performance efficiency of the T&T sector, governments should engage in deregulation and privatization, providing a platform for further demand stimulation and growth. Following domestic deregulation, a cross-border liberalization of a whole region's policy framework, such as Europe's Open Skies agreement, can effectively attract new market entrants and improve the industry's overall performance. That in turn can drive down both prices and costs while stimulating service quality and demand across all T&T players within the region.

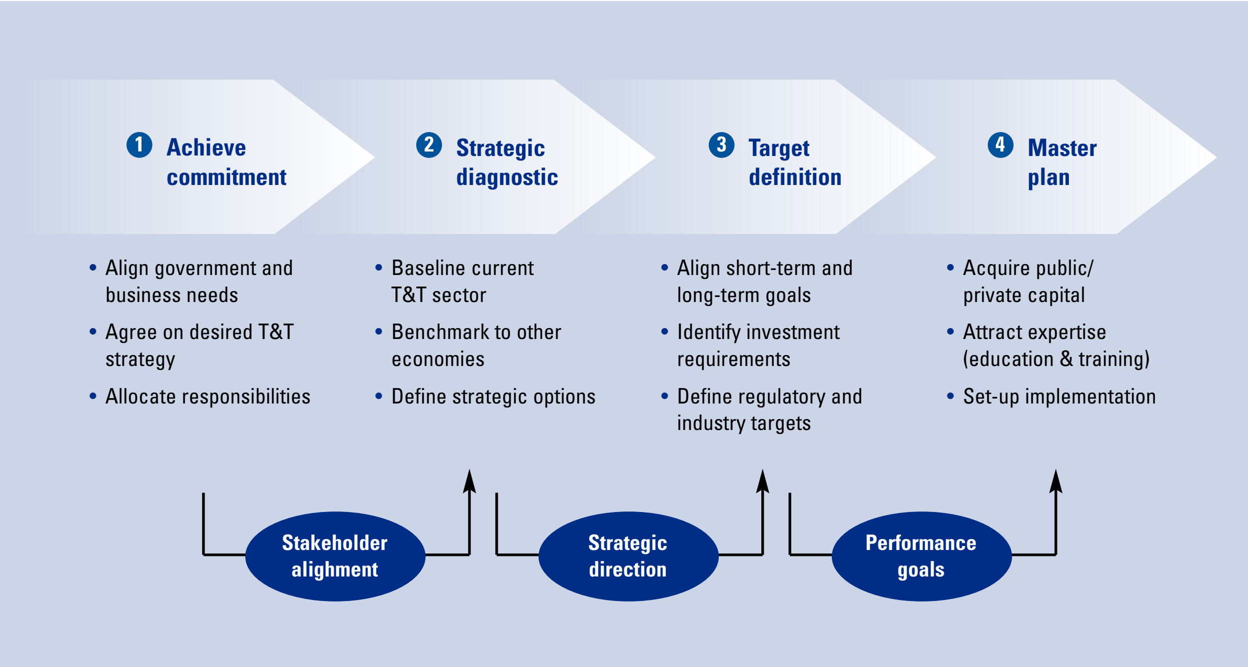
The last step, a full intercontinental—or even global—liberalization of travel regulations has not yet been reached, but given what the global T&T sector has achieved over the past two decades and what is currently underway (for example, the Open Skies agreement between Europe and North America), even this vision may become reality in the years to come.

The positive correlation between a healthy T&T sector and the wealth of individual nations, along with the examples of countries and economies that have successfully leveraged that correlation, provide a clear indication that governments can influence the competitiveness of their T&T sectors and their impact on overall GDP and welfare. Any government that wants to start the evolutionary process to improve its T&T sector competitiveness needs to shape its political agenda accordingly, aligning both public and private interests, evaluating its current situation, initiating relevant measures and targets, and applying lessons learned from the strongest of their peer economies (see Figure 14).

Achieve commitment. Before governmental bodies and business leaders can agree on the steps required to boost their T&T sector, they must agree on just how beneficial the further development of the T&T sector can be for their country's welfare. Once they choose a direction to pursue, it must be followed tenaciously, since only persistent action will bring about real progress.

Commitment on the part of a country's public and private stakeholders is the first step, but aligning closely with neighboring governments and business leaders are just as necessary for all the stakeholders to understand the full picture of a country's strategic options. Economies with close regional ties must set their strategic agendas jointly in order to define an aligned approach to the successful development of an efficient and effective T&T system. That alignment can also help

Figure 14: Action steps toward unleashing the T&T sector's potential



Source: Booz Allen Hamilton.

mitigate cross-border risks, such as the possibility of investing in ground infrastructure with overlapping catchment areas. (This risk was highlighted for the Middle East in a Booz Allen Hamilton study, "Mastering the Challenges of the Middle East Aviation System," that was developed as a result of a 2006 World Economic Forum meeting in Sharm-el-Sheik.)

Strategic diagnostic. Developing a workable plan requires a thorough understanding of the current state of a country's and region's T&T industry. This baseline approach involves not only the evaluation of the sector's current competitiveness but also a gap analysis that compares its own performance, on both the regulatory and the business side, with comparable "best practice" countries. The strategic assessment must include a sound analytical foundation, and the TTCI should serve as a first indicator. The critical factors described in this study must be carefully screened and, if appropriate, adapted to the country's specific social, economic, and regulatory environment. The results of the baselining and benchmarking analysis can then set the overall strategic direction that both private and public stakeholders will pursue, and can serve as a solid basis for defining the required operational targets going forward.

Target definition. Once all the stakeholders agree on an overall strategic plan, the tradeoffs between short-term expenses and long-term benefits must be clearly evaluated, and a target for a satisfactory return on investment determined. These targets need to be translated into sound and realistic planning. Governments must compare the targets with their plans for T&T infrastructure, support services, and sector capabilities, and then identify the gaps. As they do so, they need to review their regulatory policies and evaluate the size of the infrastructure investments required, as well as any additional budget needed for new services and education of travel professionals. The resulting performance goals will set the stage for the subsequent master plan.

Master plan. The most critical prerequisite for an efficient T&T master plan is the liberalization of the transportation sector as well as of financial markets. Domestic as well as international air and ground travel should be opened to competition, including, ideally, competition from other countries. Investors in the sector should be able to own capital equipment, real estate, and the companies that provide travel services (if only in the form of public-private partnerships). In considering how state-owned infrastructure is to be shared, nondiscrimination clauses need to be enforced to ensure fair and efficient competition between former incumbents and new entrants into the market.

The master plan should focus on several major elements to enable the improvement of the T&T sector's competitiveness, including:

- accelerating the national deregulation plans of major transportation markets, while taking into account spillover effects with neighboring regions;
- reducing subsidies and public investments by limiting them to critical areas where private investors are not yet willing to take on the full business risk; and

- improving safety and security, especially along major travel routes and business centers.

The master plan must also align T&T policies with a broader agenda of national economic growth, including a coherent roadmap for air and ground travel that builds on realistic projections of future traffic growth. And the plan needs to include a comprehensive education and training agenda for the national T&T sector, which may involve turning to international service partners to help kick-start the transformation.

Creating a coherent long-term plan for the T&T market and its needed capacities is essential. A plan will strengthen the positive elements of national transformation programs, such as employment benefits and strengthened privatized national companies, and it will prevent potential overinvestment in misplaced infrastructure.

To succeed along those steps, governments must define a clear vision and a commitment to engage all stakeholders in the process, and they must make a determined effort to work together hand-in-hand with the private T&T sector.

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