

HAWAII'S



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A Report from the Department of Business, Economic Development & Tourism

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Tourism Looks to the Future

The decade of the 1990s has been a difficult one for Hawaii tourism. The visitor count peaked just below 7 million near the beginning of the decade and, for a variety of reasons, has been unable to move beyond that level (Figure 1). In the first part of the decade, poor tourism performance on the Neighbor Islands was the major area of concern. However, over the past three years, the Neighbor Islands have done better, while Oahu has lagged, largely as a result of the Asian economic crisis.

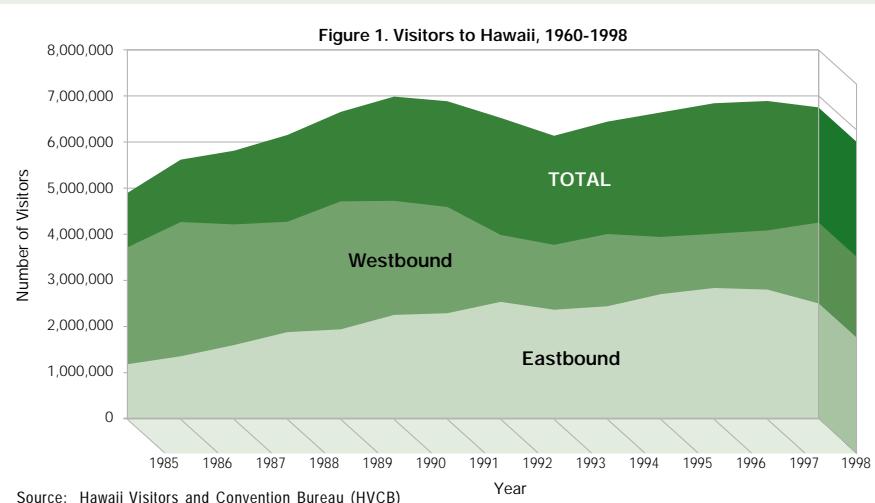
DBEDT's last in-depth report on the visitor industry (*Hawaii's Economy*, Spring 1996) concluded that generating renewed growth in tourism would require Hawaii to expand beyond the sun-and-surf market into emerging travel markets with new activities and attractions.¹

Since that report, significant efforts have been made to revitalize the industry, most notably the establishment of the Hawaii Tourism Authority (HTA) designed to guide the State's most important industry into the new century. The Authority will have a new funding base of roughly \$50 to \$60 million per year coming from the Transient Accommodations Tax to more effectively market Hawaii.

The HTA has prepared a draft Strategic Tourism Plan, which addresses weaknesses in the development and marketing of tourism. The plan targets a host of emerging opportunities for intensive development efforts in order to diversify the tourism product and

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¹ That report is available on the DBEDT web site:
<http://www.hawaii.gov/dbedt/hecon.html>



Tourism – “A New Beginning”

This update report on Hawaii's visitor industry comes at a time of significant change in tourism and the economy. About eight years ago Hawaii's post-statehood boom period, fueled by tourism, came to an abrupt end. Since then, both business and government have been struggling to adjust to a new economic era. Companies in all industries are learning to compete in a global marketplace by becoming more efficient and more relevant to their markets. In the meantime, State government has halted its decades of continuous growth and has sought to become a facilitator of business and economic activity rather than primarily a regulator.



Seiji Naya

Tourism has been undergoing its own adjustment and transition. Hawaii is no longer the fast-growing resort destination it was in the 1960s, 70s and 80s. We have reached a level of maturity as a destination and have found ourselves relying much more on repeat business than in the past. Moreover, we find that we must compete vigorously for visitors with the many established and new destinations that have entered the world

tourism market in recent years. We know that to keep and expand our visitor markets in the face of this competition, Hawaii must maintain its reputation for high quality and become more efficient. We must revitalize our visitor infrastructure and provide an ever-changing menu of attractions and events for new and repeat visitors.

One of the most important milestones so far in this period of transition has been the creation of the Hawaii Tourism Authority (HTA). This agency is a product of the public-private sector effort over the past several years to rethink our approach to the economy. With a dedicated funding source and a mostly private sector membership, the HTA has assumed responsibility for leading the future development and marketing of tourism. The Authority has risen boldly to this challenge and produced a strategic plan designed to launch a “New Beginning” for Hawaii tourism. Moreover, the Authority intends to refine and carry out this plan in cooperation with the community.

While the leadership for tourism policy and marketing has shifted to the Authority, DBEDT still has important responsibilities in tourism. First, we will be working closely with the Authority to make sure marketing and promotion of Hawaii's *developing* industries such as technology, film, health, education and other emerging export activity are coordinated well with tourism marketing. In this way marketing efforts can be leveraged to provide a boost to economic diversification as well.

In addition, DBEDT will be maintaining the critical base of statistical information on visitor activity that serves to measure the industry's performance and provide information for marketing and development purposes. Since assuming this responsibility earlier this year, DBEDT's new Tourism Research Branch has made improvements in the data collection process and, with the help of the Department's Business Resource Center, has established an internet web site for disseminating the information.

The revitalization of Hawaii tourism for the 21st century is essential for our economic wellbeing. But it must be compatible with the imperative need to develop new industries and with our environmental and social values, and must be a positive benefit to all residents of Hawaii. The Hawaii Tourism Authority is committed to these challenging goals and I urge the cooperation and goodwill of all residents, businesses and government agencies to help the Hawaii Tourism Authority succeed in these goals.

A handwritten signature in black ink, appearing to read "Naya".

Dr. Seiji Naya
Director
Dept. of Business, Economic Development & Tourism

Tourism Looks to the Future

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strengthen Hawaii as a top competitor in tourism worldwide.

This report updates the situation in tourism, including the strategies proposed by the Tourism Strategic Plan to address the situation and move forward. The report also presents new estimates of tourism's economic impact on the state based on DBEDT's newly revised Hawaii Input-Output Model. Other sections discuss a number of tourism topics of particular interest, many of which parallel topics addressed in the Tourism Strategic Plan. These include the emerging cruise ship segment, niche markets and air service to Hawaii.

Long-term Structural Change Continues

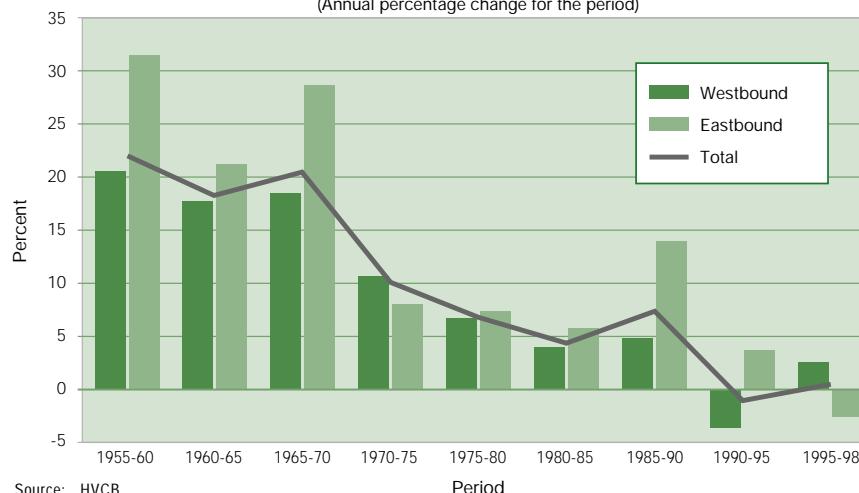
The formation of the HTA and creation of the new funding source are efforts to address structural changes that are impacting the industry and ultimately the entire state economy. At the root of that structural change, and the difficulties tourism has experienced in the 1990s, has been the long-term maturing of the industry in Hawaii and the gradual slowing of its growth rate. As Figure 2 illustrates, tourism growth slowed consistently from the mid-1950s through the mid-1980s.

The slowing trend was interrupted by a temporary period of renewed growth in the second half of the 1980s as the Japan market took off. This surge in tourism from Japan was the result of a sharp increase in the value of the yen, coupled with a policy by the Japanese government to lower its foreign trade surplus by encouraging foreign travel. This was also a period of very high investment in both Hawaii and U.S. real estate by the Japanese.

The long-term slowdown in visitor industry growth resumed in the 1990s as first the U.S. economy and later the Asian economies experienced a series of economic and financial crises. The long-term slowing of tourism appears to have leveled out at one to two percent per year, although arrivals actually declined in 1998, due to the Asian crisis.

Reaching the bottom of the declining growth curve signals the end of the

Figure 2. Growth in Visitor Arrivals, 1955-1998
(Annual percentage change for the period)



Source: HVCB

industry's development period and the beginning of its mature phase. This suggests that future growth in the industry will depend upon Hawaii's competitive skills rather than simply riding the growth in the travel market as a whole. From a marketing standpoint, the industry may have reached the point in its product life cycle in which innovation, revitalization and cooperative effort will be more important in determining its future.

With this overall maturing and slowing of tourism as a backdrop, there have been several notable trends and events

since DBEDT's last tourism report that are worthy of mention.

Resurgence of Westbound Tourism

The U.S. recession of the early 1990s and, the slow growth for several years thereafter, resulted in a general decline in visitors from the Mainland in the first half of the 1990s. Fortunately, this period was one of continued growth in Hawaii's Asian tourism markets, which countered much of the impact of the westbound decline.

But as Table 1 shows, this strength

has seen a dramatic reversal over the last several years. From 1995 to 1998, the westbound visitor count increased by 8 percent. This growth parallels the unprecedented period of strong growth in the U.S. economy, which continues to this day. By contrast, the economic crisis in Asia caused the eastbound visitor count to decline by 12 percent from 1996 to 1998.

The resurgence of the westbound market has been a welcome situation and, as discussed below, has provided a critical boost to the Neighbor Island economies. But the parallel decline in the Asian market has had very negative impacts. Most severely affected has been the tourism-related retail sector. A substantial number of stores had based their growth on serving the Asian and particularly the Japan visitor market, which spends heavily on clothes, accessories and gifts. Asian visitors are also a major market for first-class and deluxe hotel rooms, particularly in Waikiki. The absence of these visitors has hurt occupancy in such establishments.

While the decline in the eastbound market has continued into mid-1999, there are signs that Asia's crisis has stabilized. However it is difficult to tell how soon any improvement would translate into increased visitors from Asia to Hawaii.

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Table 1. Visitor Arrivals 1985 to 1998

Year	Arrivals			Percent Change from Previous Year			Market Share by Direction of Travel	
	Total	Westbound	Eastbound	Total	Westbound	Eastbound	Westbound	Eastbound
1985	4,884,110	3,708,610	1,175,500	0.6	-0.3	3.6	75.9	24.1
1986	5,606,980	4,256,390	1,350,590	14.8	14.8	14.9	75.9	24.1
1987	5,799,830	4,204,010	1,595,820	3.4	-1.2	18.2	72.5	27.5
1988	6,142,420	4,264,730	1,877,690	5.9	1.4	17.7	69.4	30.6
1989	6,641,820	4,705,320	1,936,500	8.1	10.3	3.1	70.8	29.2
1990	6,971,180	4,719,730	2,251,450	5.0	0.3	16.3	67.7	32.3
1991	6,873,890	4,584,460	2,289,430	-1.4	-2.9	1.7	66.7	33.3
1992	6,513,880	3,980,120	2,533,760	-5.2	-13.2	10.7	61.1	38.9
1993	6,124,230	3,764,520	2,359,710	-6.0	-5.4	-6.9	61.5	38.5
1994	6,430,300	3,997,820	2,432,480	5.0	6.2	3.1	62.2	37.8
1995	6,629,180	3,933,110	2,696,070	3.1	-1.6	10.8	59.3	40.7
1996	6,829,800	4,004,450	2,825,350	3.0	1.8	4.8	58.6	41.4
1997	6,876,140	4,077,950	2,798,190	0.7	1.8	-1.0	59.3	40.7
1998	6,738,220	4,245,270	2,492,950	-2.0	4.1	-10.9	63.0	37.0

Tourism in 1999: Performance and Outlook

As in 1998, visitor industry performance in 1999 has hinged on the balance between an Asian market in recession and generally thriving markets in the U.S. and Canada. Table A summarizes tourism performance for the first six months of 1999. The results are mixed, with visitor arrivals flat or down, but with the daily visitor census generally up

around the state.

The strength in the U.S and Canadian markets has helped westbound visitor arrivals increase by 5.4 percent for the period. With a slight decrease in the westbound length of stay, the daily westbound visitor census was up by 4.5 percent. Eastbound visitor arrivals, which are dominated by Asian and

particularly Japanese visitors, were running about 7.7 percent behind the same 1998 period. However a modest increase in length of stay by those eastbound visitors who did arrive helped keep the decline in the average daily census for this group to just 3.3 percent. The overall result has been a 0.6 percent increase in the statewide visitor count in 1999, with an increase in the daily visitor census of 2.7 percent.

The decline in eastbound visitors has been most serious for Oahu, since roughly half of the City and County's visitors come from Asia and the Pacific. Consequently, while Oahu showed gains in westbound tourism for the first six months, the double-digit decline in the eastbound direction pulled the overall arrival total down 3.1 percent for the first six months of the year. Yet, like the state, Oahu experienced a gain in the overall visitor census (a 3.4 percent increase for the period) thanks to the increased length of stay.

Among the Neighbor Island counties, the strong westbound market was able to counter eastbound declines on Maui and Kauai but not in Hawaii County. Hawaii was also the only county to register a decline in the overall visitor census during the first six months of 1999.

Short-Term Outlook for Tourism

DBEDT's economic forecast for 1999 expects some improvement in the visitor count in the second half of the year, leading to a slight increase for statewide tourism in 1999. However it is not clear whether the improvement will be consistent among the counties. It is hoped that the Asian market will stabilize this year and begin a gradual recovery thereafter, although the schedule for that recovery depends on how quickly the Asian economies, particularly Japan, can solve their economic problems.

Table A. Visitor Industry Performance Indicators
January to June 1999
(all data are preliminary)

Indicator	Arrivals	
	Number	% Change
Statewide visitor arrivals (by air) ¹		
Westbound	3,368,040	0.6%
U.S.	2,228,970	5.4%
Canada	1,849,810	5.5%
Europe	163,180	15.6%
Eastbound	88,730	0.1%
Oahu	1,139,070	-7.7%
Intended visitors by county		
Oahu	2,288,400	-3.1%
Westbound	1,207,210	5.8%
Eastbound	1,081,190	-11.4%
Maui (Maui, Molokai & Lanai Islands)	1,178,130	0.5%
Westbound	1,008,460	4.1%
Eastbound	169,670	-16.4%
Hawaii	626,980	-3.0%
Westbound	500,490	1.2%
Eastbound	126,490	-16.7%
Kauai	536,340	6.5%
Westbound	477,700	9.0%
Eastbound	58,640	-10.2%
Statewide daily visitor census	162,630	2.7%
Westbound	126,630	4.5%
Eastbound	36,000	-3.3%
Oahu	75,655	3.4%
Maui County	45,547	1.3%
Hawaii County	23,277	-1.9%
Kauai County	18,151	9.5%

¹ About 26,000 visitors arrived on cruise ships in the first six months of 1999. This was 58.0 percent more than in the same 1998 period.

Tourism spending in Hawaii accounted directly and indirectly for about 22 percent of both Gross State Product (GSP) and labor income in 1998. This updated estimate is based on DBEDT's State of Hawaii Input-Output (I-O) Model which was recently revised to reflect valuable new information.¹

The "Visitor Industry"

Tourism is not an industry in the strict sense of the term. A search of the Standard Industrial Classification manual or the U.S. Bureau of Economic Analysis's industrial structure will not turn up an industry called "tourism" or "visitors". What Hawaii defines as the visitor industry is made up of parts of many different

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industries ranging from agriculture to manufacturing to government. The visitor component of each industry is calcu-

lated as a proportion of the industry's sales to visitors. Thus, estimating the size of the "visitor industry" and its relationship to other industries is particularly challenging, since it requires estimating the visitor-related portion of each of the 118 industries that are part of the I-O model.

Visitor Spending

Measuring the economic impact of the visitor industry starts with visitor expenditures—that is, the amount of

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¹ A report on the 1992 I-O model can be found at <http://www.hawaii.gov/dbedt> under Statistics & Publications. The new information are based on the 1992 Economic Census and other sources. Before the revisions, the model was based on 1987 relationships.

Tourism Looks to the Future

Tourism Growth Now Favors the Neighbor Islands

Oahu was the primary beneficiary of the surge in eastbound visitors during the first half of the 1990s. From 1990 to 1997, the proportion of Oahu arrivals accounted for by eastbound visitors increased from 41 percent to nearly 55 percent. But as a result of the shift in the growth from eastbound to westbound visitors since 1997, the visitor count on Oahu has fallen, while Neighbor Islands have experienced stronger growth on average. This trend has restored confidence in the tourism sectors of the Neighbor Islands and provided a needed economic boost. However, the impact on Oahu, which accounts for more than three-quarters of the state's economy, has been the opposite.

Policy Trends

Formation of the Hawaii Tourism Authority (HTA) may be the most significant change in tourism marketing since the formation of the Hawaii Visitors Bureau in 1903. This thirteen-member authority was created through Act 156 HSL 1998, as an outgrowth of recommendations by the Economic Revitalization Task Force of the previous year. The formation of the HTA reflects the notion that tourism is entering a new stage and

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that pro-active, cooperative effort by the private and public sectors will determine the long-run future of Hawaii's major industry.

The HTA has been given the authority to develop and administer marketing and promotional efforts on behalf of Hawaii's visitor industry. The HTA may also develop plans for the future development of tourism in terms of both industry products and infrastructure support. The Authority was finalizing its first strategic plan for tourism as of June 1999.

The HTA assumes responsibilities that were previously shared among several public and private agencies, most notably DBEDT, through its State Tourism Office, and the Hawaii Visitors and Convention Bureau. The legislation establishing the HTA also designated DBEDT to maintain and report visitor statistics as well as conduct tourism-related research.

Tourism Financing Reform

One of the issues raised in DBEDT's 1996 report on tourism was the need to provide more stability in the funding process for tourism marketing. In addition to establishing the HTA, Act 156 also shifted the burden of funding tourism promotion and marketing activities from the State General Fund, where it competed with all other state spending

priorities, to the Transient Accommodations Tax (TAT). A new Tourism Special Fund was created to absorb about 38 percent of the TAT, which was adjusted upwards to 7.25%. It is expected that the fund will provide between \$50 and \$60 million per year for tourism marketing and development.

Previously, tourism marketing funds were appropriated by the Legislature from the General Fund each year, and this meant that tourism marketing needs competed with all other state priorities. The special fund establishes a dedicated financing source that can assure a consistent long-run marketing and promotion effort even as year-to-year state priorities change. The section of this report on tourism issues explores the significance of the policy changes in more detail.

Conclusion

Since 1996 tourism has shown only modest improvement. However with a new Tourism Authority, more funding for marketing, and a Tourism Strategic Plan to set the direction, there is reason for optimism about reinvigorating this essential industry. The next several articles look at particular areas of interest in the emerging tourism market of the 21st century.

The Economic Impact of Tourism

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Table 1. Hawaii Visitor-Related Expenditures ¹			
Year	Visitors by Air	Overseas Airline Expenditures (\$mil.)	Gross Visitor Expenditures (\$mil.)
1992	9,558.9	461.2	10,020.1
1993	8,677.6	447.5	9,125.1
1994	10,603.2	432.5	11,035.7
1995	11,587.7	439.3	12,027.0
1996	10,684.8	441.8	11,126.6
1997	10,770.1	461.6	11,231.7
1998 ²	11,133.3	461.4	11,594.7

¹ Visitors came to Hawaii by Air only.

² Preliminary estimate.

Source: DBEDT

money that out-of-state visitors spend in Hawaii.² Table 1 shows expenditures made by visitors arriving by air. In addition to visitor spending in Hawaii, the visitor-related portion of overseas airline expenditures in Hawaii is also included as a component of visitor expenditures.

The sum of the components in Table 1 equals *Gross Visitor Expenditures*, which include the portion of spending on products or services that were imported and resold to the visitor. As the table indicates, gross expenditures increased in all but two of the last six years and in 1998 were about 4 percent below their peak in 1995.

While gross visitor expenditures correctly represent the total sales made to visitors by Hawaii businesses, it does not necessarily represent the *economic contribution* of tourism to Hawaii. If we are interested in the contribution of the visitor industry to goods and services produced by Hawaii, we must exclude the value of goods that were imported from elsewhere and sold to visitors.

Table 2 shows estimates of the portion of gross visitor expenditures accounted for by imports. When this is subtracted from gross expenditures, the result is a measure of *net* visitor expenditures. Net visitor expenditures represent the value added to the economy by the visitor industry as measured by GSP. Net visitor expenditures declined in two of the past six years and in 1998, it was 4 percent below its peak in 1995.

Table 2. Direct Contribution of Tourism to Hawaii's Economy

Year	Gross Visitor Expenditures (\$mil.)	Visitor-Related Imports (\$mil.)	Net Visitor Expenditures (\$mil.)
1992	10,020.1	3,757.5	6,262.6
1993	9,125.1	3,421.9	5,703.2
1994	11,035.7	4,138.4	6,897.3
1995	12,027.0	4,510.1	7,516.9
1996	11,126.6	4,172.5	6,954.1
1997	11,231.7	4,211.9	7,019.8
1998	11,594.7	4,348.0	7,246.7

Source: DBEDT

GSP, Jobs, Income and Taxes

Visitor expenditures stimulate the economy in three major ways. First, a portion of visitor spending *directly* supports the jobs and income of visitor industry employees, managers and small business owners.³ These are the people and firms that deal directly with the visitor. The operation might be a hotel in Waikiki, deriving most its income from visitors, or a convenience store in Aiea, with only occasional visitor sales.

Second, visitor spending stimulates the economy *indirectly* when firms in the visitor industry and their business suppliers replenish inventories and maintain their facilities. The indirect impact stimulates the inter-business income and production chain by re-circulating visitor dollars to industries and workers who supply goods and services to the visitor sector. For example, cases of macadamia nut candies purchased in a store by members of a tour group are replaced by

ordering more of the product. This impacts local companies all the way down the business-distribution chain, and eventually to the macadamia orchards on the Big Island and Kauai.

The third effect of visitor spending, called the *induced effect*, is felt when *employees* of firms in both tourism and its business-distribution chain spend their household income for goods and services in the community. The induced effect spreads throughout the economy, far beyond the tourism industry and its supply chain. In times of rapid increase in visitor activity, the indirect and induced effect can stimulate incomes and spending throughout the state in all industries with most people and businesses unaware that their prosperity is linked to visitor spending.

Of course the process also works in reverse. That is, a decline in visitor spending will not only reduce the direct effect on the industry; it will also reduce the indirect and induced effects, and the community will eventually see declines in sales and probably job losses in areas that are not directly related to visitor activity. While this lack of visible linkage may help explain why many residents do not think they are or will be affected by declines in the visitor industry, in fact, most residents are vitally affected by the health of this industry.

² While residents can certainly be viewed as tourists when they use hotels and visit tourist attractions, this analysis focuses on sales to out-of-state visitors, which brings new money into the state.

³ Of course, visitor spending also supports stockholder dividends and retained corporate earnings of businesses directly involved in providing goods and services to visitors. However, these are relatively small compared to payroll and inter-business purchases.

Table 3. Economic Impact of Tourism in Hawaii

Year	GSP (\$mil.)		Jobs (1,000) ¹		Labor Income (\$mil.)		S&L Taxes (\$mil.)	
	Direct & Indirect	Direct, Indirect, & Induced	Direct & Indirect	Direct, Indirect, & Induced	Direct & Indirect	Direct, Indirect, & Induced	Direct & Indirect	Direct, Indirect, & Induced
1992	6,262.6	9,872.7	181.6	323.2	3,952.0	6,069.1	752.7	1,112.6
1993	5,703.2	8,990.9	176.3	312.3	3,599.0	5,527.0	687.2	1,015.0
1994	6,897.3	10,873.4	176.4	311.7	4,352.6	6,684.3	826.4	1,222.8
1995	7,516.9	11,850.1	177.7	314.0	4,743.5	7,284.7	912.0	1,344.0
1996	6,954.1	10,962.9	179.6	317.2	4,388.4	6,739.3	870.0	1,269.7
1997	7,019.8	11,066.5	180.7	319.2	4,429.9	6,803.0	880.0	1,283.4
1998 ²	7,246.7	11,424.2	180.1	318.2	4,573.0	7,022.9	903.3	1,319.8

¹ Includes self-employed jobs.

² Preliminary estimates.

Source: DBEDT

Table 4. Hawaii's Dependence on Tourism
(percent of total GSP, jobs, income and taxes supported by tourism directly/indirectly and in total)

Year	GSP		Jobs ¹		Labor Income		S&L Taxes	
	Direct & Indirect	Direct, Indirect, & Induced	Direct & Indirect	Direct, Indirect, & Induced	Direct & Indirect	Direct, Indirect, & Induced	Direct & Indirect	Direct, Indirect, & Induced
1992	20.7	32.6	26.4	47.0	19.4	29.9	21.9	32.4
1993	18.3	28.8	25.7	45.5	17.3	26.5	19.4	28.6
1994	21.6	34.0	25.8	45.6	20.7	31.7	22.1	32.8
1995	23.0	36.2	26.1	46.2	22.4	34.4	24.3	35.8
1996	20.8	32.7	26.2	46.3	20.7	31.8	21.8	31.8
1997	20.5	32.3	26.3	46.4	20.4	31.3	22.0	32.1
1998 ²	20.8	32.7	26.3	46.4	20.7	31.8	22.1	32.2
Avg.	20.8	32.8	26.1	46.2	20.2	31.1	21.9	32.3

¹ Includes self-employed jobs.

² Preliminary estimates.

Source: DBEDT

How big are the indirect and induced impacts of tourism? Table 3 presents the estimates of tourism's impact on several key measures of Hawaii's economy, based on DBEDT's updated I-O model. The measures are GSP, number of jobs, labor income, and tax revenues to state and local government.

For each measure, the table shows two impacts. The first column of each measure combines the direct and indirect effects, or the impact of net visitor spending on the visitor industry and its supply chain.⁴ The second column under each measure shows the broader impact of visitor spending on the economy when the induced effect is taken into account—that is, the economy-wide impact of tourism.

Table 4 shows what percentage of total GSP, jobs, income and taxes are supported by tourism. For instance, the direct and indirect impact of tourism supports about 21 percent of the state's Gross State Product. However, when the induced effect is accounted for, the total rises to almost 33 percent.

Impact of Tourism by Industry

In addition to estimating the overall effects of tourism on the economy, the I-O model also identifies tourism's effects on each individual industry. By looking at the impact of tourism by industry, we can determine which industries receive the lion's share of visitor dollars and also how much the various industries depend on visitor spending as opposed to resident spending.

Table 5 shows how the industries compare in these two measures. The first column shows, in percent terms, how the gross visitor spending pie is divided among the industries and imports—that is, which industries receive the bulk of visitor dollars. Not surprisingly, hotels top this category, absorbing more than 23 percent of all visitor spending. The second column shows what percent of the industries' sales are derived from visitors, and is used as a measure of the industry's dependency on visitors.

Some of the differences are startling. For example, column 1 shows that about 10 percent of visitor expenditures are spent in the retailing sector, not including eating and drinking. But column 2 shows

Table 5. Industry Composition of Tourism		
Industry	Share of total visitor spending to industry	Share of Industry's total sales made to visitors
Agriculture	0.2	2.4
Manufacturing	1.1	6.2
Air transportation	6.9	82.9
Other transportation	4.1	31.0
Comm. & utilities	0.4	2.1
Wholesale trade	1.5	9.5
Eating and drinking places	7.7	56.4
Other retail trade	10.1	32.2
Lodging: Hotels	16.8	94.4
Other ¹	6.0	7.3
Other services	6.9	10.5
Government	0.7	1.3
Imports	37.5	24.9

¹ Includes mostly accommodations (condominiums for example) managed by real estate firms.

Source: DBEDT, 1992 Hawaii State Input-Output Model.

that this sector is dependent on tourism for about one-third of all its sales.

The last entry (row) in Table 5 shows that about 38 percent of all gross tourism expenditures were for items imported from outside the state. Part of these imports represent entire products sold to the visitor, such as a bottle of California wine. But they also include intermediate imports that become part of the product sold to visitors such as chocolate for macadamia candies and fabric for locally produced aloha wear. The second column of the imports entry shows that about 25 percent of Hawaii's total imports (by value) are used to support the visitor industry in one way or another.

Table 6. Tourism's contribution to GSP
(as a percent of GSP)

	WEFA ¹		DBEDT'S ESTIMATE ²	
	Direct	Direct & Indirect	Direct & Indirect	Direct, Indirect & Induced
1992	NA	25.70	20.7	32.6
1993	NA	23.90	18.3	28.8
1994	NA	25.10	21.6	34.0
1995	NA	29.41	23.0	36.2
1996	18.22	26.71	20.8	32.7
1997	18.40	26.20	20.5	32.3
1998	18.56	26.73	20.8	32.7

¹ WEFA's tourism impact estimates include residents' consumption, private and public investment, and visitor spending.

² DBEDT's tourism impact estimates include only visitor spending.
Sources: WEFA, DBEDT

Other Estimates of Tourism's Impact

With DBEDT's assistance, the World Travel & Tourism Council (WTTC) has also prepared estimates of the contribution of tourism to Hawaii's economy since 1996. WTTC's estimates of the visitor industry's share of GSP are generally higher than DBEDT's because WTTC includes the travel expenditure of Hawaii residents. There are also methodological differences in the approach to calculating tourism's contribution to GSP. Table 6 reports both estimates for comparison purposes.

⁴ Notice that for GSP, the direct and indirect impact is the measure of net visitor spending from Table 2.

Understanding Tourism Niche Markets with Input-Output Analysis

Because tourism is Hawaii's largest economic activity, DBEDT's Research and Economic Analysis Division (READ) conducts economic impact analyses of visitor-related events. To conduct these analyses, READ economists frequently use the State Input-Output (I-O) model. This article looks at the application of these I-O techniques in analyzing two tourism-related activities: cruise ship activity and the Ironman Triathlon.

In most cases, the analysis begins with an estimate of the expected direct dollar impact of the event. In our examples, estimates must be made of cruise ship visitor expenditures or the spending of participants and related visitors for the Ironman. These direct spending estimates are often constructed from information outside the I-O model. The I-O model then converts these direct dollar impacts into additional indirect and induced effects on sales, income, jobs, and so on.

Cruise Ships

Hawaii's cruise industry consists of two components: (1) the domestic operations of American Hawaii Cruises (AHC), and (2) foreign-flagged cruise ships that visit Hawaii from foreign ports. AHC currently operates one, U.S.-flagged cruise ship in its interisland cruise operations, the *S.S. Independence* (see article on page 12 for more information on the cruise and AHC). The *Independence* leaves Honolulu's Aloha Tower Marketplace each Saturday and cruises to Kauai, Maui, Hilo and Kona before returning to Honolulu the following Saturday.

In addition to AHC operations, foreign cruise vessels regularly visit Hawaii and tour among the islands. Indeed, the cruise industry has been growing rapidly for many years. In 1998, 21 foreign cruise ships visited Hawaii, making a total of 220 port calls—up from just 56 port calls in 1994.

Taking into account information on lengths of stay and average spending in port, DBEDT has estimated the total annual expenditures of cruise visitors in Hawaii to be about \$51 million in 1998. Using economic multipliers determined through the I-O model, the impact of this \$51 million expenditures can be estimated on Hawaii's economy.

As shown in Table 1, spending by cruise ship visitors in 1998 was estimated to have increased the output (sales) in the economy by \$86 million. This spending supported \$31 million in household income, more than 1,200 jobs and about \$5 million in state and county government tax revenues.

The relationship between the initial spending by cruise ship visitors and the amount of economic activity generated in the community can be expressed in the form of *multipliers*. The output multiplier of 1.71 in Table 1 means that for every \$1 of spending by cruise ship visitors an additional 71 cents of spending will be generated elsewhere in the economy for a total of \$1.71 generated. The additional 71 cents is composed of increased inter-industry sales and sales induced by the re-spending of income generated by the initial \$1 of cruise visitor spending.¹

The "income" multiplier of 0.62 has a similar interpretation, with \$1 of visitor spending leading to \$0.62 in income. Here, the multiplier is lower, rather than higher, than one because a significant portion of the \$1.71 in sales generated will not become household income. Part of the sales revenues will go to profits, taxes and other business expenses. An even larger amount of revenues will "leak" out of the economy before creating income, in order to pay for business purchases from outside Hawaii and also payment for goods brought in to sell to visitors.

The "employment" multiplier is expressed as jobs per \$1 million of cruise visitor spending. However, an adjustment is made to account for wage and price increases by adjusting the multiplier (downwards) to reflect the higher cost of supporting a job in 1998 compared with 1992. Because of higher wages over the years fewer jobs can be created for each million dollars of visitor spending and this needs to be reflected in the multiplier. Thus, after "deflating" the multiplier, it is estimated that 24.7 jobs were supported in 1998 for every \$1 million of cruise ship visitor spending.

Finally, the ratio of state and county tax receipts to income (which is estimated at about 17%) is used to calculate the impact of visitor spending on government revenue.

The effects of cruise ship operations in Hawaii, paid for through passenger revenues, also add to the economy. The major impact in this area are the operations of AHC, which hires and purchases most of what it uses locally. The effects of AHC operations on the economy are calculated in Table 2.² AHC has passenger revenues of about \$69 million per year. Applying the I-O multipliers for

Table 1. Estimation of Economic Impact of Cruise Visitor Spending

Type of Impact	Value
Output generated in the economy (\$millions)	86
Household income generated in the economy (\$millions)	31
Jobs supported in the economy	1,242
State and county taxes generated (\$millions)	5
Cruise Ship Visitor Multipliers	
Output multiplier	1.71
Income multiplier	0.62
Employment multiplier (adjusted to 1998 value of the dollar)	24.7
Ratio between tax and income (includes all State and county taxes)	0.17

Source: DBEDT

¹ Some sales transactions are not included in the "output" measure of input-output analysis. For instance retail sales are not counted since the value of the goods sold at retail is already counted in other areas of the I-O such as agriculture, manufacturing or imports. Thus I-O "sales" cannot be compared to the Gross Excise Tax Sales Base or other more comprehensive measures of total sales transactions.

² Data are not readily available on the purchases in Hawaii of foreign cruise ships, but they are likely modest in comparison to the other impacts estimated in this analysis.

In the last issue of *Hawaii's Economy* devoted to tourism, four issues were identified as worthy of special attention by policy makers and planners. Those were 1) the need to boost activity on the Neighbor Islands, 2) increasing the proportion of deluxe rooms in the Waikiki area, 3) working for more air seat capacity, and 4) restructuring tourism promotion financing to provide a more stable marketing effort.

Encouraging progress has been made in most of these areas. Neighbor Island tourism now leads growth statewide.

Tourism Initiatives and Issues

Tourism marketing is now funded through a portion of the Transient Accommodations Tax (TAT) which will

provide about twice the level of previous public sector support. Air seat capacity does appear to be improving as the west-bound market recovers (see p. 21). Some modest progress in establishing incentives for renovation and upgrading of room quality in Waikiki has been made. However, the sharp decline in the Asian market, which favors first-class accommodations, has eased the potential shortage for now. Nevertheless, as the Asian market recovers and the convention center bookings increase, the potential for a shortage of high-end rooms will remain.

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Understanding Tourism Niche Markets

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ocean transportation, the model indicates that interisland cruise operations account for \$155 million of sales, \$42 million of household income, and 1,200 jobs in Hawaii's economy.

The economic impacts of cruise ship visitor expenditures and American Hawaii Cruises operations may be added together to estimate the total effect of the cruise industry on Hawaii's economy. Table 3 summarizes these results.

The estimates show that the industry currently generates nearly 2,500 jobs in the state, as well as \$240 million in output, \$73 million in household income and close to \$13 million in state and local government revenues.

Ironman Triathlon

Input-output analysis can also be used to calculate the economic impact on the economy of events held in Hawaii. One example is the Ironman Triathlon which has been held in Hawaii since 1978. Held on the Big Island, the event has grown steadily over the years and now averages about 1,400 participants.

About 95 percent of the participants come from out-of-state. They are accompanied by family, friends, other visitors, and media personnel covering the event. All of these people spend money in Hawaii and thereby contribute to the economy. In order to estimate the impact of the Ironman on the economy, an estimate must first be made of how much those associated with the event spend in Hawaii. This estimate has been calculated at \$14.9 million.

Table 2. Impact of American Hawaii Cruises Operations

Type of Impact	Value
Estimated annual passenger revenue (\$million)	69
Output generated (\$million)	155
Household income generated (\$million)	42
Jobs supported	1,209
State and local taxes generated (\$million)	7.2
Cruise Ship Operations Multipliers (for ocean transportation)	
Output multiplier	2.25
Income multiplier	0.61
Employment multiplier for ocean transportation	17.31
Ratio between tax and income (includes all state & county taxes)	0.17

Source: DBEDT

Table 3. Total Economic Impact of Cruise Industry in Hawaii

Type of Impact	Value
Output generated (\$millions)	241.2
Household income generated (\$millions)	73.3
Jobs supported	2,450
State and local taxes generated (\$millions)	12.5

Source: DBEDT

Applying the estimated tourism multipliers for total sales (1.71) and household income (0.62) to the \$14.9 million spent, it is estimated that the Ironman event results in total output/sales of \$25.4 million and household income of \$9.2 million. Since approximately 17 percent of visitor expenditures become state and local tax revenue, the event generated about \$1.6 million in state and local revenue.

The employment multiplier is generally not applied to annual or one-time events such as the Triathlon. Such events do not generally result in permanent or

ongoing positions. Instead, the economy responds by creating opportunities for overtime and temporary jobs that may last only during the event.

Conclusion

The I-O model provides a powerful tool for estimating the impact of industry activity and events on the economy. It also allows comparison among alternative activities, particularly as to which ones generate the most economic activity for a given amount of export revenue or spending by outsiders in the local economy.

Tourism Initiatives and Issues

New Initiatives

The primary responsibility for anticipating and addressing Hawaii's tourism development needs now rests with the new Hawaii Tourism Authority. The HTA has developed a Tourism Strategic Plan which evaluates the state of the industry and establishes priority needs and issues the Authority will address under its responsibilities and with the resources of the Tourism Special Fund.

Formulated as *Strategic Initiatives*, the priorities and issues on which the HTA intends to focus address issues raised in the earlier DBEDT tourism report and add a comprehensive set of new priorities which were developed through the Authority's extensive situation analysis of tourism. Rather than attempt to add to the HTA list of initiatives and issues, it is more useful for this report to help foster an understanding of the content and rationale of the Authority's intended initiatives.

HTA Strategic Initiatives

A: Communication and Community Relations

The HTA recognizes that public support and participation are essential to the goal of reinvigorating tourism. There are many stakeholders in Hawaii tourism—visitors, residents, private businesses, and government agencies—all of whom have different issues of interest and concern. As the overall government authority responsible for tourism, the HTA will need to link stakeholders and their interests to a common direction. This will mean facilitating relationships among community, industry and government stakeholders to address relevant tourism issues. To accomplish this strategic initiative, the Authority proposes development of a communication plan to increase public awareness and understanding of tourism, and obtain input on issues of concern.

B: Marketing

Marketing and promotion of Hawaii to the world is the HTA's primary responsibility. In the past few years Hawaii's promotional efforts have been overshadowed by those of competing destinations and the state has not been able to keep

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its high-quality product offerings in front of consumers. The Authority believes this situation has been a factor in the decline of visitor expenditures and market share in recent years. With the creation of the dedicated Tourism Special Fund, Hawaii will have the capability to deliver a more globally competitive marketing and promotional effort.

But with the ability to apply additional resources comes the need to be more sophisticated about the approach to marketing and the responsibility to measure the effectiveness of marketing expenditures. The HTA's strategy for marketing is to increase promotional presence and "brand identity" to more competitive levels and to optimize the effectiveness of promotion in each Major Market Area, or "MMA," as the HTA refers to them. The HTA's aim is to allocate marketing resources so as to increase the *total expenditures* made by visitors in Hawaii, thus creating jobs and generating tax revenues.

The HTA has segmented the world into 10 MMAs. Two U.S. regions include the western and eastern halves of the country. Japan and Canada are singled out as MMAs. Europe, Oceania, other Asia and Latin America are each a separate MMA. The Hawaii Convention Center is designated as an MMA, and all remaining markets are contained in an "other" MMA category. Resource allocations to the MMAs will be based on obtaining the highest return on investment in terms of visitor expenditures, not just arrivals.

The challenge for the HTA will be the development of promotional programs to accomplish the goal of increasing expenditures in each of the MMAs.

C: Events

Hawaii has a multitude of events that vary in their degree of impact on the visitor industry. Most industry experts agree that events for visitors, and especially events that attract national media, are an important part of a destination's marketing arsenal. In the past, many events have been funded through the State tourism budget. However, it has not always been clear how the funded events were expected to contribute to the overall

marketing effort or how Hawaii's funding of such events could be optimized to increase the marketing value.

The HTA's Tourism Plan proposes a strategy to develop and support events that generate cost-effective awareness of the Hawaii brand through national and international exposure. The Authority intends to focus first on a year-round series of signature events that will become an integral part of the overall marketing plan for the state. These will include significant and prestigious events in professional and college football, college basketball, professional golf, triathlon and marathon, and ocean sports. The national and international television and other media coverage associated with such events can showcase Hawaii as the premiere location for recreation and sports activity.

The HTA also plans to support visitor attraction and cultural events, which will provide incremental visitor expenditures to the state, particularly during times of the year when visitor counts are seasonally low. These include, among others, the Honolulu Festival and French Festival, and major island events like the Maui Writers Conference, A Taste of Lahaina, Kapalua Wine & Food Symposium, Savor the Flavors of Kauai and the Hawaiian Paniolo Music Festival. They also include cultural events such as the Aloha Festivals, Merrie Monarch and King Kamehameha celebrations, which provide unique insight into Hawaii's host culture. Additionally, there is a widespread desire to increase the number of, and attention to, other special events and festivals.

D: Product Development

The HTA proposes to serve as a catalyst for product and community-based tourism development. The Authority plans to focus on the development of new tourism events and experiences, and also develop community-based tourism programs. The HTA will particularly seek to develop programs in specialty or niche markets related to agriculture, culture, education, health and wellness, nature, sports, and science and technology, to complement Hawaii's traditional leisure product offerings. There are existing

attractions in each niche area which have developed more or less on their own. However, the HTA plans to channel resources into creating a firm base for the growth of these and additional products. (A detailed description of the targeted niche markets can be found on pages 15 to 17.)

The HTA also plans to work with island advisory groups to establish markets for each product area. The strategy includes building on synergies between tourism products well as providing for a coordinated, easily accessible information base.

E: Airlift

As the article on Air Service (p. 21) discusses, in marketing a leisure visitor destination the availability of affordable, convenient and comfortable transportation to and from the destination is an important competitive factor. Not even the most effective marketing program can succeed if the air capacity to the destination is insufficient.

Decisions to fly routes with particular frequency and equipment depend on complex factors, including marketing costs, distribution networks, airport issues, route and hub strategies, international agreements, and yields. Hawaii's dependence on air transportation make it critical that tourism planners and policy makers understand airline economics and the carrier's decision-making process with respect to service levels. The HTA plans to address this issue through direct communication with airline companies and by efforts to increase awareness of air transportation issues among the industry and public.

The HTA will also advocate changes in airport operations and policies to make it more cost-effective for airline companies to operate and expand service in the Hawaii market. The HTA will support efforts to initiate new direct and/or non-stop service from cities not adequately connected to Hawaii. The HTA will balance efforts to improve direct overseas service into Neighbor Island airports with the impact it may have on the viability of Hawaii's critical inter-island air system.

F: Infrastructure and Support Services

The quality of the infrastructure can be a major factor in the success or failure

of tourism product development and marketing. Consequently, the Authority intends to become a strong advocate for investments in infrastructure and support services to strengthen tourism and enhance residents' quality of life. Of particular interest is the revitalization of Waikiki and other key visitor destination areas of the state. HTA's assessment of the infrastructure and support services for tourism has highlighted several areas of concern that the Authority intends to address.

Safety

The HTA is concerned about enhancing Hawaii's reputation as a relatively safe destination. Providing a safe, secure environment for visitors and residents is important in any economy, but it is critical for a resort destination. An actual or even perceived increase in crimes against visitors can cripple a destination long after the problem is mitigated. The Authority intends to proactively work with industry and government to find ways to maintain and improve that level of safety and to ensure that safety in Hawaii remains a positive factor in the vacation decision of visitors.

Waikiki Revitalization

Waikiki is the premier symbol and usually the initial gateway for visitors to the islands. Hawaii's reputation as a resort destination is unavoidably linked to the reputation of Waikiki. The Authority views the revitalization and "re-enchantment" of Waikiki as paramount to the health of Hawaii's visitor industry, now and into the future. The HTA intends to be proactive in advocating tax and zoning initiatives to stimulate capital investment in Waikiki to reconfigure and restore its lost attributes.

Hawaii's Airports

The HTA concludes that the arrival experience of visitors and residents at the Honolulu International Airport and at other state airports is in need of improvement, particularly with the creation of a "Hawaiian sense of place" at these facilities. The Authority intends to actively promote improvements in architecture, landscaping, art and airport signage, to create "a Hawaiian experience" for arriving passengers. The HTA will also advocate infrastructure improvements at Neighbor Island airports. These

measures will help ensure that arriving, departing and traveling inter-island in Hawaii enhances, rather than detracts, from the visitor experience and contributes to the state's competitive edge in the world market.

Maintenance of Public Facilities

Hawaii's parks, beaches, and other facilities are key visitor and resident resources. However, the HTA has concluded that they are inadequately funded, developed, and maintained. The Authority intends to aggressively seek federal funds for preservation of specific natural attraction sites as well as for highway beautification and trail systems and other initiatives. The HTA believes this funding could help resolve some of the debate over funding for tourism development "vs." preservation of natural resources.

Cruise Ship Facilities

The Authority has determined that Hawaii's cruise facilities are unattractive and inadequate for the current and projected needs of the industry. The HTA will advocate multiple island ports and the development of Neighbor Island cruise facilities. The Authority also intends to explore federal funding opportunities for harbors and facilities to enhance and expand Hawaii's market share in this burgeoning market.

G: Regulations and Investment

Incentives

The HTA has found that tourism policy and planning has been marked by tension both within government and among government, private sector and community stakeholders. The HTA will attempt to act as a catalyst for ongoing education and consensus building in relationships for the development of traditional and new tourism products. The Authority has expressed its commitment to the meaningful participation of local communities in planning new types of tourism products.

The Authority also expressed concern that the existing State land use system presents fundamental obstacles to the development of non-traditional, low-impact forms of tourism. Existing land use laws, in the Authority's view, favor agriculture conservation over other uses on lands controlled by the State. Those laws have not been substantially

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The cruise ship industry has become a major force in the North American vacation market. The Cruise Lines International Association estimates that just over 5 million Americans and Canadians took overnight or longer cruises in 1997, up nearly 9 percent from the year before.

Reinvention of the Cruise Industry

In the early 1970s, the cruise business began to reinvent itself in the Caribbean as a vacation format rather than as primarily a form of transportation. As the market grew, cruise ship companies like the Carnival and Holland America lines began upgrading their fleets from the classic 600- to 800-passenger ship designs of the 1950s, to huge 1,500- to 2,000-passenger ships

The Emerging Cruise Ship Market

dedicated to recreation rather than transportation. These new ships were designed to be floating resorts with swimming pools, gyms, restaurants, and in most cases, full-service casinos. A typical cruise lasts a week or more and includes one- or two-day stops at various non-U.S. Caribbean and Gulf ports.

Today the North American cruise market represents 90 percent of the

worldwide market. Caribbean cruises still represent a sizable (46 percent) share of that market, but European cruises now claim a 20 percent share. Alaska has carved out an 8 percent share of the market. Mexico has about 5 percent, while Hawaii attracts about 2 percent of the North American market.

In an effort to improve efficiency in a competitive market, ship owners are commissioning increasingly larger vessels—up to 3,100 passengers. These mega-ships can be built for an average cost of \$160,000 per passenger compared with an average cost of \$245,000 per passenger for ships designed to carry fewer than 1,500 people. Of course improved profitability from the new larger ships depends on running these ships as close as possible to their 3,000-plus passenger capacity.

Tourism Initiatives and Issues

changed since their initial adoption, despite a fundamental shift in Hawaii's economy from agriculture to tourism. Moreover, the HTA found that County land use laws and approval processes are very inflexible and make it difficult to permit, much less encourage, new forms of visitor accommodations and attractions.

The HTA has expressed its intention to exercise a leadership role in securing changes in planning, coordination of laws and permitting procedures, in order to support sustainable land uses related to tourism. The Authority argues that restructuring of these regulations would stimulate substantial capital investment and permit the opening of private land for diverse forms of eco-, edu-, and agri-tourism. The HTA believes this can be accomplished while sustaining Hawaii's natural and cultural resources, and community values.

Finally, the Authority recognizes the strong link between the goals of diversifying both tourism and the economy. The HTA will seek to link tourism with economic diversification by using tourism advertising as a means to promote Hawaii products and to attract investors in technology and other diversified economic activity.

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The Hawaii Tourism Authority

Established: By Act 156 State of Hawaii Legislature, 1998.

Membership: Thirteen members appointed by Governor

Mission Statement: To manage the strategic growth of Hawaii's visitor industry in a manner consistent with the economic goals, cultural values, and community interests of the people of Hawaii.

Goals: Achieve managed growth of Hawaii's tourism industry by focusing on increasing visitor expenditures. Average an annual growth rate of 4.6 percent in visitor expenditures through 2005.

Funding Source: Dedicated Tourism Funding: 2.75 percentage points of the TAT was dedicated to create an annual tourism fund of approximately \$50 to \$60 million.

Conclusions

Since the last report in *Hawaii's Economy* on revitalizing tourism, there has been measurable progress towards the goal of revitalizing this critical industry. Most of the overall issues raised in that report are being addressed.

In particular, the progress in restructuring tourism marketing and promotion support has resulted in a single agency, the Hawaii Tourism Authority, responsible for the development and marketing

of tourism. In addition the agency will have roughly twice the annual funding resources that were available in the past. With input from a broad spectrum of community interests, the HTA has established seven priority initiatives it will pursue, in order to discharge its responsibility to revitalize Hawaii's tourism industry. The Authority intends to pursue these initiatives in cooperation with the community, the industry and government.

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American Hawaii Cruises

Throughout the 1970s and 1980s, Hawaii received periodic cruise ship visits from overseas. While a strong tour boat industry had developed for day or evening excursions, the availability of overnight cruising was virtually nonexistent. However, in 1985 American Hawaii Cruises (AHC) began operating two 800-passenger cruise ships in Hawaiian waters, the *S.S. Constitution* and the *S.S. Independence*. In 1997, AHC took the *Constitution* out of service due to the high cost of refurbishing the ship. In 1988 a competing ship, the *S.S. Monterey*, entered the interisland market. But financial problems forced the withdrawal from service of the *Monterey* only a year later. Since then, AHC has commissioned construction of two new U.S.-built cruise ships of 2,000 passengers each. The first is scheduled to enter service in 2003 with the second ship entering service the next year. In the meantime, special federal legislation will permit AHC to acquire a re-flagged, 2,000-passenger foreign cruise ship for service beginning in January 2000 to supplement the *Independence*. The two older vessels would then be phased out of service. This same legislation will give AHC exclusive rights to the Hawaii inter-island cruise market for at least 25 years.

AHC offers a seven-day cruise with stops at all major islands, starting at about \$1,230 per person. Variations include "theme" cruises, which offer either big band, whale watching, or Hawaiian Heritage as the entertainment and activity focus. These cruises do not permit gaming. AHC registered about 46,000 passengers in 1998 but expects over 140,000 for the year 2000 with the additional ship. The passenger count is expected to level off at about 190,000 per year under the two-ship operation.

Hawaii and Foreign Cruise Ships

Passengers on foreign cruise ships to Hawaii jumped from about 28,000 in 1997 to 42,000 in 1998. Under the U.S. Passenger Services Act (PSA) of 1886 and the Jones Act, only U.S.-built and -operated ships may embark and debark

passengers between U.S. ports. Foreign passenger ships can stop at any number of U.S. ports but passengers must re-board the ship before it leaves port. This has required some rather creative logistics to enable foreign ships to cruise Hawaii economically.

Passengers on foreign cruise ships will either fly to Hawaii first, or fly home from Hawaii after their cruise. A typical cruise scenario is a two-phase operation from the ship's point of view. In the first phase, U.S. and other passengers are embarked from either Ensenada, Mexico or Vancouver, British Columbia. The vessel then spends about four days at sea and stops at Hawaii ports for the remaining four to five days of the ten-day tour, ending the cruise in Honolulu. Passengers then debark to either fly home or spend additional time in Hawaii. In phase II, a new group of passengers who arrived in Hawaii by air are embarked, tour the island ports, and finally spend four days at sea, to be debarked in Vancouver or Ensenada.

Building Cruise Ship Infrastructure

Consultants for the State Harbors Division (the firm of Leo A. Daly) anticipate that passengers on foreign cruise ships visiting Hawaii could reach 100,000 by 2004, 200,000 by 2013, and as many as 340,000 by 2020. Coupled with American Hawaii Cruises expectations, Hawaii could be hosting nearly 400,000 cruise passengers in 2005, before AHC's *Independence* and temporary foreign ship are decommissioned. The level might drop to about 300,000 in 2006 but build slowly back up to over 500,000 by 2020.

To accommodate this potential growth, the consultant report recommends about \$54 million in a phase I improvement program for seven major ports in Hawaii from now through 2004, and an additional \$43 in improvements during a phase II program from 2004 to 2020. Phase I improvements would include new terminal facilities at Honolulu Harbor's Pier 2 and renovations and retrofits to Neighbor Island ports. Phase II would make major improvements to the

ports of Hilo, Hawaii, Kahului, Maui, Port Allen, Kauai, and Piers 19/20 in Honolulu.

The report stressed that the improvements do not reflect an "if we build it, they will come" strategy, but are rather a very selective set of investment options designed to make the most productive and resource-conserving improvements to stay competitive in this market. Nevertheless, the report expects that either additional sources of revenues will be needed to fund the improvements, or arrangements made for development of facilities by a third party.

Potential Impacts of the Cruise Market

Should Hawaii aggressively court this market? One concern commonly raised about the increase in cruise activity is its potential competition with land-based resorts and hotels. The fear is that cruises may be diverting vacationers away from hotels and local restaurants. On the other hand, the cruise may be attracting visitors who were specifically looking for a cruise opportunity and would have otherwise chosen a cruise to somewhere else rather than a land-based Hawaii vacation. It is also argued that cruises could provide new visitors with a taste of what Hawaii has to offer and encourage repeat visits to Hawaii's land-based resorts later on.

Even though they do not stay in hotels, cruise passengers do add to the economy through their direct purchases in the ports they visit and indirectly through the business spending by cruise ship operators. As the analysis on page ___ shows, cruise ship activity in 1998 supported an estimated 2,500 jobs in the state and generated \$73 million in household income and more than \$12 million in revenues to the public sector. At a level of 400,000 cruise visitors in the year 2005, as suggested by the Harbor's consultant study, the number of jobs generated could exceed 10,000, accompanied by over \$300 million in household income and \$60 million in public revenues.

Another benefit of cruise ships is their continued on page 14

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positive economic impact on the ports that they visit. More cruise ship visits could be a revitalizing agent for the communities of Hilo, Hawaii, Kahului, Maui and Port Allen-Hanapepe on Kauai, which are outside of land-based resort areas. For the merchants of downtown Honolulu, a larger volume of frequent cruise ship passengers could create a new market for business during the evenings and weekends. It could also provide a base for new visitor attractions. Finally, a large number of visiting and home-ported cruise ships in Hawaii suggests an opportunity to regenerate Hawaii's ship repair

and maintenance industry, which has been contracting for several decades.

Thus, it would appear that the cruise market could represent a very valuable new visitor segment for the economy as a whole, although there is the possibility of some diversion of visitors from land-based resorts. Cruises could introduce new visitors to Hawaii's beauty and attractions. They may also offer the added benefit of directing economic stimulus to geographical areas, businesses, and industry that have been bypassed by the development of tourism over the past several decades.

Taking advantage of the cruise ship opportunity will mean making a commitment to improving the quality of port facilities. It will also mean working closely with the cruise ship industry to develop marketing strategy, new attractions and special events. Such coordination and planning could help ensure that cruises are a profitable investment for Hawaii and the industry, and a memorable experience for cruise passengers that will motivate them to return to the islands and recommend Hawaii to friends.

The U.S. Passenger Services Act

Introduction

The United States is one of many nations that protects its domestic transportation industries through cabotage laws. These laws reserve to U.S.-flagged vessels the right to transport cargo and passengers between U.S. ports. (Cabotage laws also apply to forms of transportation other than water carriers such as airlines, but this article focuses exclusively on water carriers.) Cabotage has a long history in the United States. The current cabotage statute for transportation of cargo is the Merchant Marine Act of 1920 and its amendments popularly known as the Jones Act. The statute covering cabotage as it applies to passengers is known as the Passenger Services Act and became law in 1886.¹

Proponents of cabotage laws make two main arguments. First, cabotage laws protect national defense interests by preserving both an active merchant marine and a domestic shipbuilding industry. In the past, both industries proved vital to the efficient prosecution of national defense interests during times of war. Second, cabotage laws protect national economic interests in the form of American jobs and businesses from low-wage, subsidized, unsafe and/or environmentally reckless foreign competitors.

Those advocating reform of the cabotage laws take issue with these points. Some argue that much of the defense justification no longer applies because technological

change has made ocean shipping a non-viable method for achieving many national defense goals. Further, defense needs require specially-built craft rather than modified commercial vessels. No U.S.-flagged, ocean-going passenger vessels have been built in the United States since 1951, and there exists only one U.S.-flagged passenger vessel currently in operation (the *S.S. Independence* operating in Hawaii). Others argue that maritime wages are increasingly set in an international marketplace and that foreign government subsidies of foreign vessels accrue to the benefit of consumers. Finally, opponents argue that there are other, more efficient and direct methods than cabotage of enforcing safety and environmental laws in the United States.

The Passenger Services Act

The PSA became law in 1886 and has been a part of U.S. cabotage law since. The full text of the statute as it now applies in the U.S. reads as follows:

No foreign vessel shall transport passengers between ports or places in the United States, either directly or by way of a foreign port, under a penalty of \$200 for each passenger so transported and landed.

Over time, a number of exceptions have been made to this requirement. Canadian vessels may transport passengers between

Rochester and Alexandria Bay, New York and between southern Alaska and U.S. ports until an American carrier enters the markets. Similarly, foreign vessels may transport passengers between Puerto Rico and the U.S. mainland as long as a U.S. carrier does not provide such service.² Foreign-flagged cruise ships may carry passengers from a U.S. port as long as they return them to the same port (a "cruise to nowhere"). Foreign vessels may also call at intermediate U.S. ports as long as no passenger permanently leaves the vessel at those ports and the vessel makes at least one call at a foreign port.

The PSA operates in conjunction with the Jones Act and other shipping laws to define vessels authorized to carry passengers in the coastwise trades. Under the Jones Act, U.S.-flag vessels must be built in the United States, owned by U.S. citizens, and documented under the laws of the United States. Documentation means "registered, enrolled, or licensed under the laws of the United States." In addition, all officers and 75% of the crew must be U.S. citizens. Vessels that satisfy these requirements comprise the "Jones Act fleet."

¹ The Passenger Services Act has also been referred to as the Passenger Vessel Act and the Passenger Ship Act.

² These exceptions are discussed in C. Todd Jones (1995), "The Practical Effects on Labor of Repealing American Cabotage Laws," 22 *Transportation Law Journal* 403, 412-413.

Warm sunny weather and picture-postcard white sand beaches are not unique to Hawaii. Competition has increased significantly from new resorts in Mexico, Guam, Okinawa, the Caribbean, and Australia that possess and market similar assets. An important strategy for reinvigorating Hawaii tourism is to carve out new markets based on *unique* assets of the islands, which would permit the state to develop and maintain a stronger competitive advantage.

Increasing Sophistication of Travelers

Fortunately for Hawaii, Americans and foreign travelers are becoming very sophisticated. They are not only looking for different experiences, but are also looking for more meaningful experiences. A recent survey for the U.S. Travel Data Center shows that very large numbers of Americans are seeking out more active and interesting vacation experiences. For instance, in the past five years, 98 million Americans have taken an adventure vacation ranging from camping to white-water rafting. Nearly 66 million Americans have taken either a historical or

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cultural trip or both. Finally, almost 62 million Americans reported taking an average of 2.5 "romantic" trips in the most recent year. Foreign travelers are also gravitating towards more specialized and involved vacation experiences.¹

Niche Markets

The emerging demand for such specialty vacations is referred to as the tourism "niche" markets in the HTA's Tourism Strategic Plan. The Authority has identified seven niche markets upon which it will focus its product development efforts. The plan offers a number of "strategic directions" for each niche market.

Agri-Tourism

The HTA plan notes that Hawaii has a rich tradition of agricultural activities, many of which are unusual in the U.S. and which many visitors may find very interesting. Hawaii has its share of traditional ranching and crop raising. But our varied climate and resources enable the state to also produce a host of unusual products such as pineapple, coffee, macadamia nuts, taro, and varieties of fish in fishpond environments.

Of course, pineapple has been an attraction for visitors for many years, particularly the Dole Visitor Center in Central Oahu. Visitor sites also exist for ranching and coffee growing on the Big Island. The vast inventory of agricultural activity around the islands could attract a wider niche market,

continued on next page

¹ This article draws heavily on material from both the HTA Tourism Strategic Plan and a report prepared in November 1998 for DBEDT by the UH School of Travel Industry Management (TIMS) entitled, *Repositioning Hawaii's Visitor Industry Products*. Data in this article attributed to the U.S. Travel Data Center, the Travel Industry Association and the World Tourism Organization are reported in the TIMS report. Both the HTA and TIMS reports are available from the HTA Internet web site at <http://www.hawaii.gov/tourism/index.html>.

The U.S. Passenger Services Act

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Economic Implications

There are two important economic implications of the PSA as it applies to Hawaii. First the PSA prevents foreign cruise ships from transporting passengers between Alaska or the U.S. West Coast and Hawaii. Second, the law prevents foreign cruise vessels from picking up and transporting passengers for cruises among the Hawaiian Islands. As a consequence, there currently is no cruise ship offering service from Alaska or the West Coast to Hawaii, and there is only one cruise ship line that operates among the Hawaiian Islands.

Currently the Jones Act fleet contains only one ocean-going passenger vessel, and it operates exclusively in Hawaii. Until recently Great Hawaiian Cruise Line Inc., doing business as American Hawaii Cruises, operated the *S.S. Constitution* and the *S.S. Independence* offering cruises among the Hawaiian Islands. Both ships were built in 1951 and are relatively small by today's standards for cruise vessels (the *Independ-*

dence has 747 berths and the *Constitution* had 779 berths, compared with more recently-built ships with 1,800 to 2,000 berths each). In 1996, American Hawaii Cruises announced that the *Constitution* would not return to service because of excessive cost of repairs.

While the PSA prevents foreign cruise ships from carrying passengers directly from Alaska and the West Coast to Hawaii and from competing with American Hawaii Cruises for interisland cruise traffic, foreign vessels do visit Hawaii. Between 20 and 25 foreign cruise ships visit Hawaii in a given year. American passengers on foreign cruise ships to Hawaii must board in another country—typically, Vancouver, Canada or Ensenada, Mexico. These ships cannot pick up a passenger in one U.S. port and drop off the passenger in another U.S. port. However, after arriving from Canada or Mexico, they may tour the islands and drop off passengers in Hawaii. They may then pick up new passengers, tour the islands, and return to

Canada or Mexico. As a consequence, these foreign cruise ships made approximately 230 calls in Hawaii ports during 1998.

Recent Legislation

In October 1997, federal legislation was passed that permits a person to operate a foreign-built cruise ship in the U.S. coastwise trade provided that the person has entered a binding contract for the delivery of two U.S.-built cruise ships. The first ship must be delivered no later than January 1, 2005, and the second ship must be delivered no later than January 1, 2008. Moreover, in Hawaii, only the existing cruise ship operator may operate a foreign-built ship among the islands unless a new U.S.-built cruise ship is placed into regular service outside of Hawaii. This legislation makes it possible to temporarily employ a foreign-built vessel among the Hawaiian Islands despite the Passenger Services Act while new U.S.-built cruise ships are constructed.

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particularly if agricultural assets are "bundled" with elements of other niche activities such as health, adventure, cuisine, cultural, eco- and edu-tourism.

Cultural Tourism

Cultural tourism, including historical sites, is another growing market. According to the TIA survey, 37 percent of U.S. travelers cite cultural activity as the primary reason for a trip, while 19 percent based their trip on a desire to see historical activity. In this survey, Hawaii ranked second in the nation, next to Washington D.C., for visitors partaking in cultural and historical activity. Nationally, cultural and historical travelers spend 45 percent more on their trips than the average U.S. traveler.

Cultural tourism has the potential to broaden the visitor's perception of Hawaii beyond its physical beauty and commercial image. As in the case of the cruise market (see page 12), cultural and historical tourism could help the economies of smaller, non-resort communities around the state, if they can develop such attractions and activity. The high-profile resources in this niche include such institutions as the Bishop Museum, the Polynesian Cultural Center, and the Aloha and Merrie Monarch Festivals, all of which focus on host culture education. But there is a broad array of physical and event resources beyond the host culture focus which could form the basis of a broader effort to increase Hawaii's appeal in the general market and attract particular visitor niche markets. These include many additional museums, performing arts programs, cultural programs and special events like the Cherry Blossom Festival and the Hawaii International Film Festival. Coordinating activities and common marketing approaches appears to be the key to realizing the potential of this area.

Edu-Tourism

Education tourism is a niche in which Hawaii has many advantages. Apart from the thousands of out-of-state students who are in Hawaii for formal education, there is a growing segment of the education sector that focuses on short-term learning and training opportunities. These include cross-cultural training/executive management programs, English as a second language (ESL) programs, contract training, and life-long learning opportunities. Hawaii's mid-

Pacific location again lends itself to short-term educational activities that help East and West learn about one another in a tolerant setting that is conducive to cultural awareness and understanding. More information on the development of educational tourism and the export of educational services is contained in the November 1998 issue of *Hawaii's Economy*.

Health and Wellness Tourism

Health tourism is a relatively new sector that is expected to become an important niche market as the population in developed countries ages. Health tourism is comprised of two sub-markets – medical or health care tourism and fitness and wellness tourism.

Modern medicine and health sciences have combined high technology, education and research (three areas of the economy that Hawaii is seeking to develop) to produce leading-edge treatments and health care regimens. Hawaii possesses some of the most sophisticated medical facilities in the nation and can compete in this area. Our proximity in the mid-Pacific makes Hawaii's facilities a natural resource for Asia and the Pacific Islands.

Although sports tourism is itself a targeted niche market, numerous sports events along with fitness and exercise programs originating in Hawaii also help promote health tourism. Many hotels and resorts feature fitness, gyms and exercise programs for their guests. It has been suggested that hotels and medicine could link up to provide a unique health tourism package that could attract a growing market.

The development of medical/health care tourism has been slowed somewhat by the economic crisis in Asia, which has negatively affected the growth of incomes and, consequently, the demand for such services as foreign medical care. Nevertheless, the long-term outlook for this activity remains positive and the medical infrastructure to serve this market is evolving. State and private sector efforts were successful in facilitating a joint venture between Queen's Medical Center and the Mayo Clinic in 1998 to market diagnostic laboratory services to clients in the Pacific Rim nations as well as in Hawaii. Telemedicine is also progressing as a potential adjunct to the medical-care tourism infrastructure.

The significant potential of the fitness and wellness tourism market is being

addressed by resort hotels. A number of these properties are marketing packages offering five- to seven-night "get-aways" featuring exercise, meditation, yoga, stress reduction, nutrition and holistic healing. Japan is a prime market for such activity, as a considerable boom in self-healing and health-related practices has emerged in that country.

Eco-Tourism

Eco-tourism (also referred to as nature tourism) has become a distinct market segment over the past decade. Worldwide, eco-tourism is estimated by the World Tourism Organization to have been increasing at an annual rate of more than 10 percent in recent years. In Hawaii, it is estimated that nature-based tourism expenditures exceeded \$413 million in 1993, or about 5 percent of all visitors spending.² Activities under this heading can range from botanical garden tours to rigorous camping and hiking trips through Haleakala Crater on Maui.

There are concerns as well as opportunities associated with eco-tourism. In some ecologically sensitive areas, the added presence of tourists may pose a threat to protected resources. On the other hand, nature tourism can provide a valuable revenue stream to help fund more protection and management for the resource.

To protect both the resource and the eco-tourist, it is important that operators be knowledgeable and responsible. The State has a pilot project to license operators utilizing public trails for organized hiking tours. The program ensures that operators have liability insurance and helps raise funds for the State to upkeep and improve trails.

The establishment of the 120-member Hawaii Ecotourism Association in 1995 was a step forward in developing a coordinated, public and private sector effort to develop and market nature tourism. This has given the industry a means to work with government to develop activities, certify operators, and interface activities and marketing with related niches such as cultural, adventure and health tourism.

Sports Tourism

Sports tourism, including related recreational tourism, is increasing in popularity. Sports tourism includes both spectator and

² TIMS report, p. 19.

participant activities and attractions. The Travel Industry Association reports that more than 75 million U.S. adults traveled 50 miles or more to sporting events over the past five years. Hawaii is an established sports destination in a number of areas including the Honolulu Marathon, the Ironman Triathlon, the NFL Pro Bowl, the Aloha and Hula college bowls, and a host of PGA events including the Sony Open. The publicity and media exposure surrounding such major events is of enormous value to general tourism promotion and the increasing prestige of the events.

Recreational tourism overlaps with sports enough that joint marketing is feasible. Golf is the leading recreational activity for visitors, although opportunities exist to attract niche markets for surfing, sports fishing, diving and tennis as well.

The HTA Tourism Strategic Plan stresses development of "life style" sports, which are

participant-oriented and can be pursued over a lifetime. Running, swimming, cycling and golf are prime examples.

Techno Tourism

The Tourism Strategic Plan notes that Hawaii has developed an extensive infrastructure of high technology, which could serve as the basis for a techno tourism niche market. The plan cites such technology resources as the observatories on Mauna Kea, the ocean research facilities on the North Kona coast (Hawaii County), Maui's "supercomputer" and the Pacific Missile Range Facility on Kauai.

These and other technology resources could be coupled with conferences and symposiums to form the nucleus of the techno-tourism niche, according to the strategic plan. Techno-tourism could also help enhance Hawaii's business image, and encourage further development of the

technology sector, as well supplementing the tourism product.

Conclusion

Hawaii cannot continue to rely solely on beaches and beautiful scenery as the basis for its tourism appeal. Vacationers' tastes and needs are changing and maturing. Moreover, the competition for the sun-and-surf market has intensified considerably in recent years. The identification and development of niche tourism markets based on Hawaii's unique set of assets can provide the product diversification Hawaii needs to attract first-time and repeat visitors alike. The HTA Tourism Strategic Plan has identified seven key opportunity areas to build niche markets. These niche areas may also help improve the economic situation of businesses and workers in industries and areas of the state whose benefit from tourism was previously limited.

Strategic Directions for Developing Niche Markets

From the HTA Draft Strategic Tourism Plan, June 1999

Agri-Tourism

- Create menus of experiences to make it easier for visitors to purchase agri-tourism experiences and products.
- Promote the value-added component of agricultural products.
- Promote cuisine related to Hawaiian products.
- Advocate "Bed & Breakfasts" (B & B's) and "Country Inns" on agriculture lands, farms, and ranches.
- "Bundle" agricultural experiences with health, adventure, culture, eco-tourism, and edu-tourism.

Cultural Tourism

- Coordinate organizations presently involved in cultural activities to market Hawaii as a rich, multi-cultural center.
- Create and support "signature" cultural events and supplement with other product offerings.
- Provide resources for community-based cultural initiatives and supplement with other products.
- Change paradigm to "grass roots" perspective.
- Coordinate what Hawaii wants to sell with what visitors want to buy.

Edu-Tourism

- Integrate the tourism marketing objectives with those of the academic and learning communities to achieve the overall goals of the HTA, with a focus on statewide synergy.
- Foster partnerships of the visitor and education communities benefiting both visitors and residents alike.
- Develop programs to attract out-of-state visitors to Hawaii for educational purposes.
- Create packages and partnerships with airlines, travel agents, and wholesalers.
- Develop programs and activities to expand product offerings in this area.

Health and Wellness Tourism

- Integrate aspects of health tourism with other tourism products such as sports, agriculture, ecology, culture and technology.
- Create programs that relate complementary medical practices to traditional western medical care.
- Facilitate and develop partnerships of the visitor and health and wellness communities to provide expanded product offerings and visitor attractions.
- Establish programs based on telemedicine and dissemination of health care.

Eco-Tourism

- Support activities which promote conservation and sustainability of Hawaii's natural resources through educational programs.
- Create programs that will leverage federal or private sector funds through matching challenge grants for the protection of the environment.
- Encourage synergy with the worldwide interest in ecologically responsible and economically sustainable tourism.
- Advocate changes in constraining laws that will encourage capital investments in resources and private lands for eco-tourism product development, reducing pressure on public lands.

Sports Tourism

- Build Hawaii's image as a lifestyle sports center.
- Build complementary events around "signature" events.
- Market on a mass media as well as on a person-to-person basis.
- Advocate investment in venues and training camps and create events to support their use.

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The opening of the Hawaii Convention Center (HCC) in 1998 made Hawaii a new player in an important and fast-growing segment of the travel market. The market for conventions and business travel is quite large and many other destinations besides Hawaii have invested in facilities to capture a piece of this lucrative travel segment. A recent survey of business travel concluded that nearly 43 million Americans took at least one business trip in 1996. On average, business travelers made more than 5 trips during the year. Internationally, a 1997 survey indicated that the average world business traveler makes 21 trips per year, and spends 37 nights away from home. Moreover, business travelers are increasingly including their families on trips. The number of business trips with a child in the traveling party increased from 7.4 million in 1987 to 24 million in 1997.

Conventions and business meetings are also very lucrative markets. For instance, the average spending by all westbound visitors to Hawaii in early 1999 was estimated to be about \$136 per day, including lodging. By comparison westbound *convention* delegates spend an estimated \$360 per day per person, while *corporate meeting* attendees spent nearly \$900 per day on average.

The Hawaii Convention Center

Hawaii's new convention center has been praised for its design, amenities and state of the art technology. Nevertheless, the level of activity at the HCC has been below projections made before its construction. Consultants initially projected 30

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events in 1998 with the total rising gradually to about 60 events per year by 2008. The center actually hosted 15 events in 1998. Consequently, the Hawaii Visitors and Convention Bureau has established targets for the number of events over the next six years averaging roughly two-thirds the levels projected before construction (See table 1).¹ The reduced number of events has meant that operating income of the facility will likely be lower and the operating deficit higher than earlier projected.

The lower number of events has caused some to suggest that the HCC was a bad idea and there has even been talk of privatizing the Center.

Does the inability to cover costs with its rental income mean that the HCC was a mistake? What would it take for the HCC to cover its costs or even make a profit? The answers to these questions depend on how narrow a perspective one wishes to take. If the center is viewed as an independent business activity, the operation will likely never be able to cover all its costs with convention rental income.

However, from the wider perspective of the economy as a whole, the HCC may not only be covering costs, but may already be

making a very positive contribution to the economy. These seemingly contradictory conclusions result from a comparison of the costs and benefits of the HCC from different perspectives. An examination of these alternative perspectives helps show why many public investments that may, at first glance, appear to be losing propositions, are in fact making significant contributions to economic growth.

Convention Center as a Stand-alone Activity

The most straightforward approach in assessing whether the convention center is worth the cost is to compare the direct expenditures on the Center (debt service, operating, and marketing costs) with the direct receipts (payments from users of the facility). This viewpoint treats the center as if it were an independent, stand-alone business. Table 1A shows that the Center clearly loses money from this perspective. In fact, projections of anticipated receipts and costs from this direct comparison suggest that the Center would never break even.

The problem is that a convention center by itself has nothing else to sell but the use of its meeting facilities. It has no hotel rooms to rent and no restaurants or entertainment facilities to generate additional income. The table suggests that in order to break even, the facility would need to roughly quadruple its charges to convention organizations.

¹ This does not necessarily mean that the earlier consultant projections are unattainable. Rather it represents a set of more conservative planning targets, based on the actual number of events to date.

Strategic Directions for Developing the Niche Markets

Techno-Tourism

- Integrate tourism marketing objectives with those of the science and technology communities to achieve the overall goals of the HTA, with a focus on statewide synergy.
- Establish partnerships with non-profit and community organizations designed to leverage state funding with that of the federal and private sectors.

- Foster partnerships to provide for visitor attractions of technology venues.
- Market existing and emerging visitor centers.
- Integrate HTA objectives with those of the science and technology communities to provide for trade shows, seminars, expositions, and visitor centers which will enhance Hawaii's business image.

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- Establish marketing and business attraction programs that will increase tax revenues to Hawaii by attracting incremental and diversified businesses, thus stimulating job creation as well as an increase in visitor expenditures.

Of course raising fees significantly could make the center uncompetitive and actually result in little or no income if convention business decides to go elsewhere.

The results from this stand-alone perspective help explain the general lack of interest by a private firm to build and operate a convention center without alternative revenue sources such as an adjoining hotel complex with restaurant and entertainment facilities. It also highlights the difficulty of privatizing such an operation.

Convention Center as a Public Investment

A second approach assesses the HCC from a broader perspective. This views the convention center as a State enterprise which, like the first example, needs to pay operating and capital costs. But as a State operation, the HCC not only receives fees from convention organizers and exhibitors, but also results in the collection of tax revenues for the State from economic activity generated by the Center.

The costs and benefits of the HCC from this perspective are shown in Table 1B. The costs consist of Center operating, marketing and debt service expenditures plus some additional costs to State government such as road maintenance.¹ The benefits from the Center include the same fee income as before but also include the General Excise and other taxes paid in Hawaii by out-of-state visitors associated with the convention or meeting held at the center.²

When viewed as a "State" facility, the HCC is still operating at a loss but the loss declines as the projected activity of the center picks up in later years. It even appears that the Center could break even if convention center business continues to increase (line 15) or the average convention size rises. Line 16 of Table 1b shows that the center would need about 70 events with an average 3,000 delegates per year to reach the break-even point by 2004 from this perspective. However, if the average convention size were to increase to 4,500 delegates, the break-even point would be reached at about 40 events per year (the trade off between events and size will be discussed in a moment).

Convention Center as an Economic Catalyst

Finally, we can also look at the cost and benefit of the HCC from an economy-wide

Table 1. Cost-Benefit Estimates for Hawaii Convention Center

Line	Items	Fiscal year basis: July 1 to June 30					
		1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
1	Number of Events (target goals) ¹	16	24	31	33	36	40
A: Direct Costs and Benefits (dollars in millions)							
2	Costs	35.9	44.5	43.8	44.4	45.0	45.7
3	Debt Service *	23.5	27.7	26.4	26.4	26.4	26.4
4	Marketing Costs **	4.1	4.3	4.5	4.7	5.0	5.2
5	Operating Costs	8.3	12.4	12.9	13.2	13.6	14.0
6	Benefits	3.6	7.8	8.7	9.2	9.6	10.1
7	Convention Fees	3.6	7.8	8.7	9.2	9.6	10.1
8	Net Benefits (Benefits minus Costs)	-32.3	-36.7	-35.1	-35.2	-35.4	-35.6
B: State Perspective (dollars in millions)							
9	Costs	38.0	47.6	47.9	48.7	49.7	50.9
10	Center Costs (Line 2)	35.9	44.5	43.8	44.4	45.0	45.7
11	Indirect (road repair, police, fire, etc.)	2.1	3.2	4.1	4.3	4.7	5.2
12	Benefits	12.6	21.5	26.7	28.7	31.4	34.8
13	Convention Fees (Line 7)	3.6	7.8	8.7	9.2	9.6	10.1
14	State Tax Revenue from Additional Visitors***	9.0	13.7	18.0	19.6	21.8	24.7
15	Net Benefits (Benefits minus Costs)	-25.4	-26.2	-21.1	-20.0	-18.3	-16.1
16	Number of Events Needed to Break Even***	65	76	74	72	71	71
C: Economy-Wide Perspective (dollars in millions)							
17	Costs	38.0	47.6	47.9	48.7	49.7	50.9
18	State Costs (Line 9)	38.0	47.6	47.9	48.7	49.7	50.9
19	Benefits	77.8	120.7	157.5	170.7	189.4	213.9
20	Convention Fees (Line 13)	3.6	7.8	8.7	9.2	9.6	10.1
21	Household Income from Additional Visitors***	66.5	101.3	133.5	144.9	161.2	182.7
	Additional Indirect Business Taxes	7.7	11.6	15.3	16.7	18.5	21.0
22	Net Benefits (Benefits minus Costs)	39.8	73.1	109.7	122.0	139.7	163.0
23	Number of Events Needed to Break Even***	7	8	8	8	8	8
D: WTTC Convention Center Account² (dollars in millions)							
24	Costs	37.9	44.5	55.5	58.2	62.8	62.4
25	Operating Expenditures	10.3	12.4	12.9	13.2	13.6	14.0
26	Marketing costs	4.1	4.3	4.5	4.7	5.0	5.2
27	Debt Service	23.5	27.7	38.1	40.2	44.2	43.1
28	Benefits	37.3	48.8	52.5	55.9	59.5	63.3
29	Convention Fees	3.8	7.8	8.7	9.2	9.6	10.1
30	TAT Revenues	23.4	27.3	27.9	28.6	29.4	30.2
31	State Taxes (excluding dedicated TAT)	10.1	13.8	15.9	18.1	20.5	23.0
32	Net Benefits (Benefits minus Costs)	-0.6	4.4	-3.0	-2.3	-3.3	1.0

NA: not available

¹ Source: Hawaii Visitors and Convention Bureau

² Source: World travel tourism council, *WTTC Hawaii Tourism Report 1999*. The WTTC assumption on the number of events was not published.

*Based on refinancing schedule effective July 1, 2000, for a 25-year term at 6 percent interest rate.

** Assumes a 5 percent annual increase.

***Assumes an average 3,000 delegates per event.

Source: DBEDT except as noted.

perspective. This view compares all of the quantifiable costs of running the center with all of the quantifiable benefits, regardless of who bears the costs or enjoys the benefits. The costs include those already identified for the center and the State government. On the benefit side, the Center fee revenue and State government tax revenue would also be included. In addition, the benefits from an economy-wide point of view include *all* of the income generated from the additional spending of visitors associated with convention activity, visitors who would not have come in the absence of the facility.

Table 1C shows the results of the economy-wide analysis. From this perspective continued on next page

¹ Whether the capital costs should be included in the calculation is an issue to some. The capital costs were funded from an increase in the Transient Accommodations Tax (TAT) rate in 1994 as well as a dedication of a portion of TAT receipts. Arguably, a portion of these funds would not have been raised but for the need to fund the Hawaii Convention Center. Therefore some argue that from the State's perspective, they do not constitute a cost. The effect of this view is a much smaller annual cost for operating the center. This is how the WTTC has effectively treated capital costs in its analysis. However to avoid complicating this particular presentation, the issue is left aside and the full capital costs are included.

² This assumes that all of the convention visitors and companions would not have otherwise come to Hawaii (on this trip) had their meeting not been held at HCC.

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tive, the Center is already providing a net economic benefit to the state as a whole after costs are covered. Indeed, the striking discovery in the table is that the Center only requires 8 events per year and an average 3,000 delegates per event, to break even as far as the economy is concerned (line 23).

The economy-wide perspective offers the most comprehensive view of whether the convention center was a good idea or a mistake. In fact, most convention centers around the country are developed under the assumption that the facilities themselves will not likely generate enough revenue to cover their costs. However, by attracting a new and very high-spending visitor market to the destination, the economy as a whole is expected to benefit significantly in excess of the operating losses of the center.

This comprehensive view also highlights very clearly a unique role for the public sector (government) in directly facilitating economic activity. Without public participation, some investments that would benefit everyone will not be made because the benefits to any single player in the private economy will not be enough to justify the investment. The public sector, however, can make the investment and recoup the cost through the overall increase in economic activity generated.

Convention Size and Break-Even Points

As one might guess, the break-even point for the Convention Center under the last two perspectives presented above depends on both the number of events and the number of delegates per event. The larger the size of events, the smaller the number of events required to break even and vice versa. Figure 1 illustrates the relationship between the break-even points of various combinations of convention numbers and sizes. The left side of the chart shows the break-even curve for the State facilities perspective while the right side show the same for the economy-wide perspective.

The average size of a convention turns out to be a critical factor from the State-facilities perspective. In order for the costs and benefits to State government to balance, about 65 conventions must be

held annually if the average size is 3,000 delegates. This point is not anticipated before 2004 and could take years after that to reach. However, as the average convention size increases, the break-even point for the State falls swiftly. The State would require 37 events to break even at an average of 5,000 delegates. Of course the opposite is true. If the average size were to fall to 1,500 delegates the number of events needed for the State to break even would be an unlikely, 222 per year.

From the economy-wide standpoint, however, the number of events needed for the benefits to equal costs is relatively easy to attain regardless of the average size. For instance, even if the average size falls to only 1,500 delegates, the HCC needs only about 17 events per year for the benefits to the economy to equal total costs to the economy. At an average delegate level of 5,000, the economy would break even with only four events for the year. This illustrates the tremendous economic leverage the center has in generating overall economic impact as opposed to simply covering its costs as a facility.

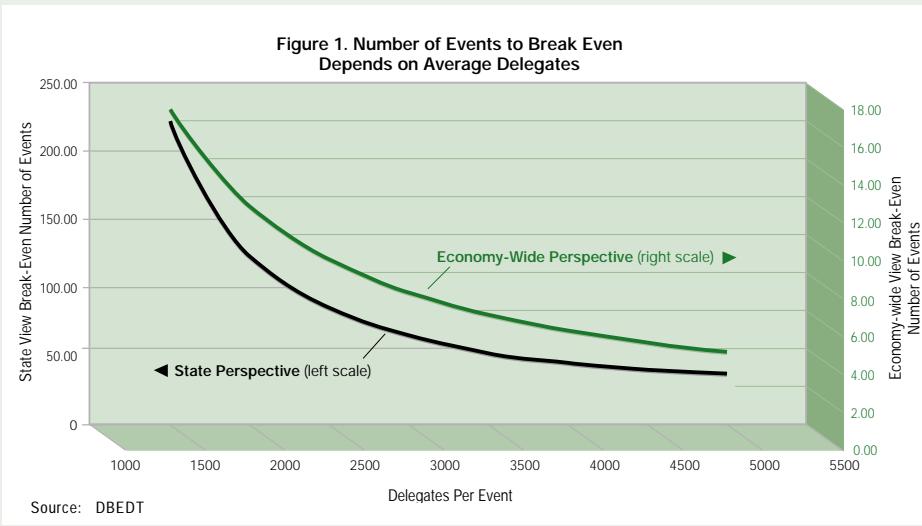
World Travel and Tourism Estimates

As a comparison to the cost-benefit estimates prepared by DBEDT, Table 1D shows a similar cost-benefit analysis of the HCC as a stand-alone facility, as prepared by the World Travel and Tourism Council (WTTC). However, the WTTC analysis takes the position that the proportion of the tax

on visitor rooms that pays the debt service of the HCC would not be flowing into Hawaii if the Center were not here. If it is assumed that the portion of the TAT used for the Center's debt service would not be used for any other purpose but the Center, then that funding is actually a benefit of the center's activity. That is, it reduces the need to use other tax money to support the center. For a number of reasons this argument is problematic. However, the WTTC results are shown here for comparison and information purposes. Because the TAT revenue is a benefit in the WTTC analysis, the benefits outweigh the costs and the Convention Center almost breaks even.

Conclusion

In examining the economic viability of the HCC from several perspectives, this article has found that the "loss leader" principal applies to Hawaii's convention center. At the very narrowest level, the direct revenues charged by HCC will probably never cover its costs. From the State government perspective, including the tax revenue expected from additional economic activity, the HCC could cover its costs if the number of events reaches 65 to 70. But from an economy-wide perspective, the HCC is not only covering its costs, it is making a substantial contribution to the economy, even though the number of events is fewer than anticipated.



Hawaii's economic lifeline is the extensive overseas air transport system connecting the state with its markets on the U.S. mainland, Asia, and elsewhere. The capacity of the system to accommodate the demand for travel has always been a concern. In addition, more cramped conditions in the air and rising fares for business travel may increase disincentives for long-distance air travel, which should be addressed.

What Determines Air Seat Capacity?

The State government and its Congressional delegation have fought to expand international air service to Hawaii, which is governed through bilateral agreements between the U.S. and each individual nation. This effort has resulted in more flights from Japan and direct flights to the Big Island, which has been a boon to Hawaii County's economy. The domestic air transport system has been deregulated since the late 1970s. Air carriers choose in a competitive market where to fly, when to fly, what to charge and how many planes will be allocated to a destination.

Air Service to Hawaii— Seats, Comfort and Cost

The number of seats devoted to Hawaii has been an issue over the years. Some have argued that airlines are constraining the number of seats available to Hawaii in order to increase fares and revenues (the "constraint argument"). If they would instead increase capacity, the argument contends that visitor arrivals would rise and with it the economic activity that sustains Hawaii's standard of living.¹

Another perspective argues that air seat capacity is a function of supply, demand and profitability. If the number of passengers to Hawaii and revenues generated by those

passengers are too low, or the costs of flying to Hawaii are too high, then airlines will reduce the number of seats devoted to the market.

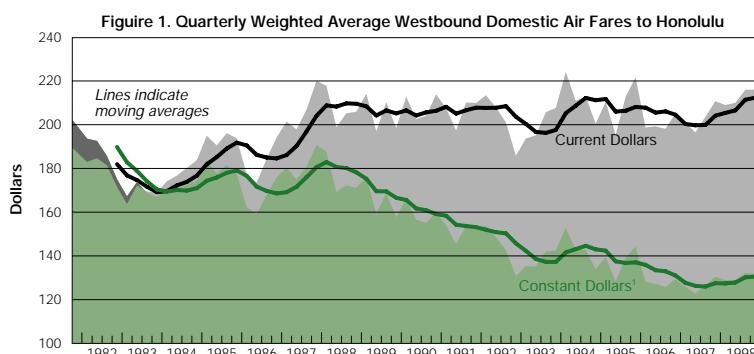
Airfare Comparisons

One piece of evidence against the air seat-constraint argument is that airfares to Hawaii have been falling after adjusting for inflation rather than rising. If airlines were restricting the number of air seats to Hawaii in the face of strong demand, one might expect upward pressure on airfares. But this does not appear to have occurred. As Figure 1 shows, since the early 1980s, not long after the U.S. airline industry was deregulated, inflation-adjusted airfares to Hawaii declined.² Average real airfares to other destinations in the U.S. also fell, reflecting the effect of deregulation and increased competition since the late 1970s.

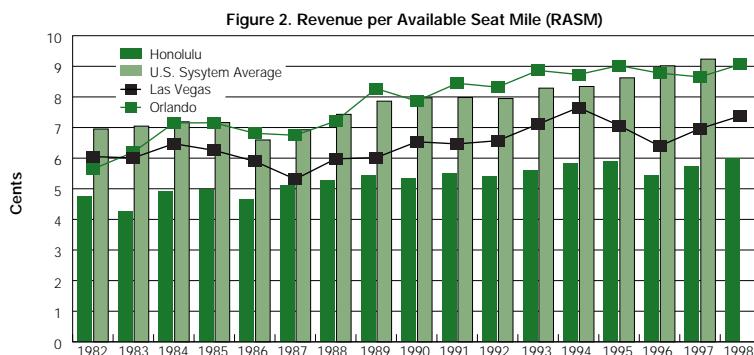
However, there is some evidence that even adjusting for distance and capacity, airfares to Hawaii are significantly lower than the U.S. average. Figure 2 shows that revenue per available seat mile (RASM) to Hawaii is dramatically lower than the U.S. average.³ RASM will generally be lower for "leisure" destinations because passengers can plan in advance and take advantage of discount programs. But the figure also shows that compared to the leisure destinations of Orlando and Las Vegas, Hawaii RASM is low.

Part of this difference may be the need to charge somewhat higher fares on shorter trips, which do tend to cost more per mile than longer flights.⁴ Still, other things equal (such as cost), it would not pay a carrier to add capacity to Hawaii where it earns only 6 cents per passenger mile when it can add capacity to routes like Orlando or Las Vegas where it can earn 9 cents per mile.

continued on next page



¹ Corrected for effects of inflation.
Source: BACK Information Services, U.S. Dept. of Transportation OD1A Database.



RASM = yield x load factor. Yield calculated from OD1A data; load factor calculated from T100 data. Honolulu, Las Vegas, Orlando from U.S. origins only. U.S. System includes domestic and international operations.
Source: BACK Information Services, U.S. Dept. of Transportation T100 and OD1A Databases.

¹ Officials of other "leisure" destinations, such as Las Vegas, Orlando, and New Zealand have also expressed concerns over air seat capacity.

² Figure 1 reports average airfares on domestic westbound flights to Honolulu, weighted by the share of seats from various Mainland cities. In nominal terms, airfares have been relatively constant at about \$210 one-way (based on roundtrip fares) since 1987. Adjusting for inflation, the real price of a one-way ticket has fallen from about \$200 to \$130 in 1982-84 dollars. The airfare data reported here include only paying passengers. Passengers traveling on frequent flier programs and other "free" status are excluded.

³ RASM is yield (revenue per passenger per mile) multiplied by the load factor (passengers divided by seats); it is a standard industry measure of revenue.

⁴ This is because the fixed costs associated with take-offs, landings, maintenance and capital costs, can be spread over more miles, making longer flights less costly per mile.

Air Service to Hawaii—Seats, Comfort and Cost

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Load Factors

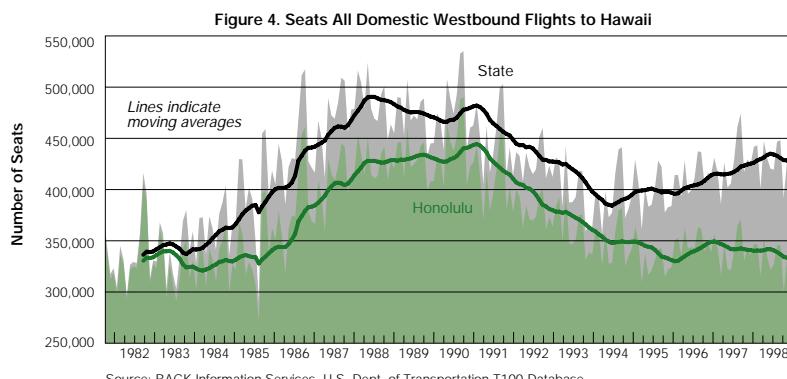
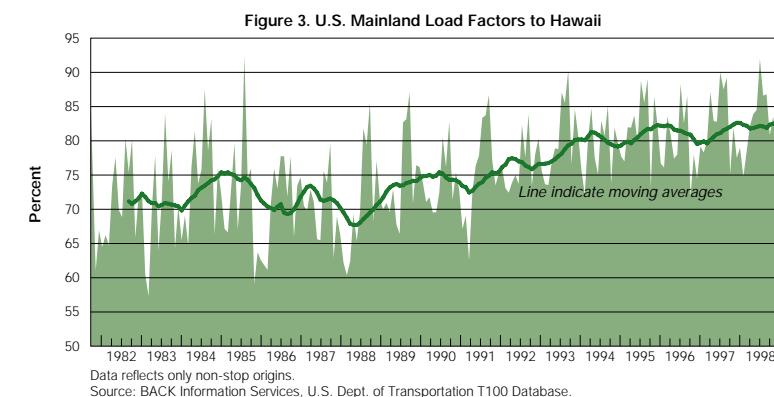
Data on load factors (the ratio of actual passengers to available seats on a flight) provide another piece of evidence on the air seat capacity issue. If air seats were "constrained" in the face of stable or increasing demand, one would expect load factors to rise to high levels. Indeed, the average load factor range for Hawaii has increased from about 70-75 percent during most of the 1980s, to an 80-85 percent range since 1995 (Figure 3).⁵ Average load factors in Hawaii have also been significantly higher than load factors elsewhere—about 14 percentage points higher on domestic flights to Honolulu than on average domestic flights between 1982 and 1997.

Some have interpreted this as evidence in favor of the constraint argument. However, while high or rising load are factors consistent with the *constraint* hypothesis, they may also be consistent with the *economic* argument. With the real airfare level actually falling for Hawaii in recent years as discussed earlier, it may well be that airlines have been flying fewer flights or smaller planes in an attempt to boost efficiency at the lower fare level.

Air Seats

While the number of air seats to Hawaii is lower today than in the late 1980s, the number of seats has been rising since 1994 (Figure 4). However, all of the increase has occurred on flights to the Neighbor Islands, principally Maui. Average load factors to Maui peaked in late 1993 and early 1994 at about 90 percent. Since then, they have drifted downward to about 85 percent. Interestingly, the number of seats flown to Maui increased at about the same time that the average load factor peaked. This suggests that once rising average load factors begin to strain the available seat capacity, an increase in the number of air seats will likely follow.

This trend appears in the statewide figures as well. Load factors reached 85 percent for the state in early 1994, just about the same time that the total number of air seats began to rise. This suggests that, given declining real airfares, load factors apparently must remain high before the number of air seats to Hawaii will begin to rise. Once high load factors are achieved, the number of air seats does, in fact, rise.



Long Flights — Addressing the Negatives

An increase in the number of seats does not mean that Hawaii's concern with overseas air transportation is over. Shorter vacations, families traveling with children and increasingly more senior traveler's pose a disincentive for long-distance travel on increasingly crowded and less roomy aircraft. Within the constraints of reasonable cost, a warmer, more personable welcome and smoother processing through the Honolulu Airport might help to mitigate the effects of long, cramped flights. Ensuring that the first and last experiences of visitors to Hawaii are enjoyable would also help to make visitors feel they are truly guests in Hawaii and not simply tourists. More travelers might be willing to endure a 5-8 hour flight if they were confident that their arrival at the destination will be appreciated and made as comfortable as possible. Some research into how long-haul air travel and airport experience affects people and their receptiveness to a destination may help both the airlines and Hawaii mitigate some inconveniences.

Rising Business Travel Costs

Another potential problem related to air service is the recent increase in fares mostly applicable to business travel. While real airfares have declined on average, a bias appears to have developed in the structure of fares, causing an increasing gap between relatively low-cost leisure travel and business travel. The American Express Company has found that the average business traveler booking through the company's travel service paid 39 percent more than the average air passenger for a ticket during the first quarter of 1999. Business travelers usually pay a premium over leisure travelers because they do not book flights very far in advance. But the latest data indicate a widening gap, up from a 26 percent difference in the first quarter of 1996. In fact the gap is now the widest it has been since American Express began keeping track of the data.

The impact of this increasing difference on Hawaii is problematic. Conventions and

⁵ As the graph shows, on a month-to-month basis the volatility in load factors is very high.

corporate meetings are planned far enough in advance that lower-priced, advanced tickets are readily feasible. However the increasing spread in airfares affects the cost of doing business in Hawaii for firms whose employees and officers must travel frequently. Since the situation is apparently a nationwide phenomenon, the solution might best lie with national business associations. Nevertheless the situation bears monitoring from Hawaii's standpoint.

Conclusion

Concerns about air seat capacity are

often expressed by those interested in "leisure" destinations. In addition to Hawaii, officials in Las Vegas and New Zealand have expressed concern over adequate capacity. At least with respect to Hawaii, the evidence suggests that the provision of air seats is largely an economic decision. Unfortunately, direct data on costs are not available, so that one cannot compare profitability across routes. Nevertheless, relatively low revenue per available seat mile reduces the incentive to increase capacity. Airlines have compensated for this by increasing load factors, thereby spreading costs over a greater

number of travelers. However, it appears that once the load factor reaches a critical level, the number of seats will increase as market demand increases, a trend which has been occurring since 1994.

Apart from seat availability, a decline in the ease and comfort of flying long distance coupled with a changing traveler profile may present disincentives for long distance travel. Hawaii may be able to mitigate these disincentives by working with the airlines and airport. Finally, the rising cost of business travel is worrisome and should be monitored for any measurable negative impacts.

Selected Economic Indicators: State

Series	Period (calendar year basis except for taxes)			Percent change from same period of previous year		
	1998 (12 mo.)	Jan-May 1999p	May 1999p	1998	Jan-May 1999	May 1999
Civilian Labor Force (persons) ¹	597,050	598,250	598,900	0.1	0.9	0.9
Civilian Employment	559,750	564,100	565,950	0.2	1.4	1.9
Civilian Unemployment	37,300	34,150	33,000	-2.4	-6.8	-13.5
Unemployment Rate (percent) ²	6.2	5.7	5.5	-0.2	-0.5	-0.9
Total Wage & Salary Jobs	537,550	536,850	539,700	-0.2	-0.2	-0.2
Total Non-Agr. Wage & Salary Jobs (number)	530,000	529,650	532,200	-0.3	-0.2	-0.1
Contract Construction	21,250	20,450	20,350	-4.7	-3.8	-5.1
Manufacturing	16,300	16,050	16,100	-1.5	-1.5	-1.2
Trans., Comm., Utilities	41,000	40,250	40,150	-0.7	-2.1	-1.5
Trade	131,750	130,200	130,050	-1.9	-1.3	-1.1
Retail	110,750	109,400	109,400	-2.3	-1.4	-0.9
Finance, Insur. & Real Estate	35,500	35,050	34,950	-1.8	-0.7	-1.4
Services & Miscellaneous	171,950	174,150	176,000	1.6	1.9	2.4
Hotels	37,750	37,350	37,450	-1.6	-2.2	-1.2
Government	112,200	113,550	114,850	0.4	-0.5	-0.8
State	64,950	67,100	68,500	1.1	-0.2	-0.6
Federal	30,400	30,050	29,950	-0.8	-1.0	-1.3
Agriculture Wage & Salary Jobs	7,550	7,000	7,100	4.9	-2.1	-3.4
Taxes (\$thousands, state fiscal year 1998-99)						
Total State Tax Collections	3,367,700	1,372,988	267,235	3.6	-1.4	1.0
State General Fund Tax Revenues ³	2,889,291	1,151,704	209,063	4.8	-2.6	-1.3
(Selected taxes)						
Transit Accommodations Tax Revenue	125,882	62,872	12,187	-0.8	15.7	31.2
General Excise & Use Tax	1,436,654	595,657	105,265	0.3	-0.3	-0.1
Personal Income Tax Collections	1,093,241	413,822	74,439	11.0	-3.5	-8.3
Corporate Income Tax Collections	50,113	24,043	3,459	-11.9	-11.9	-26.1
Visitor Arrivals (persons)	6,738,230	2,781,300	524,760	-2.0	0.0	0.0
Westbound Visitors	4,245,280	1,839,530	344,530	4.1	5.1	4.9
Eastbound Visitors	2,492,950	941,770	180,230	-10.9	-8.6	-8.3
Hotel Occupancy Rates (percent) ²	72.0	73.3	66.3	-2.0	-1.0	-0.8

¹ Labor force and jobs averages are based on monthly rounded data. Labor force data were also rebenchmarked in March 1999.

² Change is expressed in percentage points rather than actual percent change of the rates shown.

³ If tax period ends on a weekend some of the collections may be shifted to the next period.

Note: Most data are preliminary and subject to revision.

**Selected Economic Indicators by County, January to May 1999
(value and percent change from same 1998 period)**

Series	C&C of Honolulu		Hawaii		Maui		Kauai	
	Value	Percent Change	Value	Percent Change	Value	Percent Change	Value	Percent Change
Unemployment rate ^{1,2}	5.0	-0.2	8.8	-0.8	6.1	-1.0	7.9	-2.4
Non-Agric. wage & salary Jobs	399,150	-0.6	49,050	-1.0	56,500	1.0	24,650	4.2
Construction	15,100	-8.2	1,600	-22.0	2,550	34.2	1,300	52.9
Manufacturing	12,450	-2.0	1,450	-3.3	1,700	3.0	450	12.5
Retail	77,750	-2.6	11,350	1.3	13,800	0.0	6,500	4.8
Services & miscellaneous	125,600	2.5	16,600	-2.6	22,450	-0.4	9,150	3.4
Hotels	16,350	-3.8	6,500	-4.4	10,850	-0.9	3,600	2.9
Government	91,350	-0.5	10,550	0.0	7,550	-0.7	4,000	-1.2
State	51,800	-0.4	7,450	0.7	5,200	-1.0	2,600	-1.9
Federal	28,350	-0.9	850	0.0	550	10.0	350	0.0
Agriculture wage & salary jobs	2,100	2.4	2,300	-8.0	1,950	5.4	800	0.0
Visitors, total number ³	1,879,400	-3.9	522,750	-3.8	981,960	0.4	443,930	7.2
Westbound	986,730	5.8	418,710	1.0	834,000	3.8	394,690	10.5
Eastbound	892,670	-12.8	104,040	-19.5	147,960	-15.5	49,240	-13.6
Room Occupancy Rate (%) ¹	72.1	-3.4	67.9	-5.6	79.8	4.9	71.9	5.6

¹ Measured in change in percentage points rather than percent change in rates.

² Labor force and jobs averages are based on monthly rounded data. Labor force data were also rebenchmarked as of March 1999.

³ Preliminary data.

Note: Most data are preliminary and subject to revision.

Sources: State DLIR, READ, PKF-Hawaii. Compiled by EPIS/READ, DBEDT.

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