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The Effects of LCCs Subsidies on the Tourism Industry*

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Abstract

This paper studies the relationship between air transportation, tourist flows, and subsidies to Low Cost Carriers (LCCs), a policy used by many national and local governments to stimulate tourist arrivals. To test the policy empirically, we use a two-stage empirical model. In the first stage, we estimate a structural model applied to air transport, and in the second stage, we link passenger arrivals to regional tourism flows. In this way, we use exogenous shocks (subsidies to LCCs) in airline supply to analyze the causal link with tourist arrivals. This model is applied to tourist flows from European regions to Italian regions from 2016 to 2018. Our counterfactual analyses consider two regimes for implementing subsidies to LCCs, following the literature coming from [Oates \(1993, 1999\)](#) contributions: a centralized, uniform policy for all regions and a decentralized policy in which subsidies are adopted by a single region. Our simulations reveal that subsidies to LCCs are effective in stimulating tourism, and that a centralized regime is more effective than a decentralized one. In fact, the latter generates externalities in regions that do not implement the subsidy, making the decentralized policy economically sub-optimal and unsustainable.

JEL classification: R41, R48, O18

Keywords: Air transportation and tourism, structural model

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