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Tourism: Economic growth, employment and Dutch Disease

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A R T I C L E I N F O

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A B S T R A C T

Since 2008, Spain has sustained a significant economic recession. Tourism is seen as a possible substitute for weakened domestic demand and, thus, an opportunity for to economic revitalisation the economy. Nevertheless, tourism also has profound consequences on the economy at the microeconomic level regarding resource allocation, exchange rate appreciation and demand for non-tradable goods, which can trigger the so-called Dutch Disease. A recursive-dynamic CGE model is developed to assess this possibility. Tourism implies a boost in the economy, although the Dutch Disease acts at the sectoral level causing a shift in resources towards non-tradable sectors which may jeopardize productivity gains, generate a persistent appreciation of the real exchange rate and thus affect the economic growth in the long term.

Introduction

Since 2008, Spain has sustained a significant economic recession (a 0.92% reduction in real GDP from 2008 to 2012 and an unemployment rate of 24.3% in 2012). The main causes and effects of the actual downturn situation are the following: high levels of private debt (driven by years of low interest rates, which also spurred a real estate bubble), a high unemployment rate, lower wages, low levels of private consumption, credit shrinkage (banking crisis) and higher interest rates for public bond emissions.

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Beyond this brief diagnosis, the Spanish crisis has two characteristic factors: Spain's membership in the European currency union (euro) and, as a consequence, a public control deficit to fulfil the EU deficit commitment. The first factor implies that Spain acts as if it had a fixed exchange rate, forcing internal devaluation through lower salaries to earn external competitiveness. The second factor does not permit Spain to fall into persistent public budget deficits and reduces the possibility of carrying out demand policies to foster economic growth. Internal devaluation is already reducing the country's deficit and salaries, but it is also causing domestic demand to falter. Spain, as with most of developed economies, relies strongly on the domestic demand to boost the economy.

Paralleling the economic situation described above, tourism in Spain has been increasing since 2010 as a consequence of the Arab Spring that began on December of 2010 in Tunisia and rapidly spread to other Arab countries in the region. The United Nations World Tourism Organisation (United Nations World Tourism Organisation, 2013) does not share this point of view and asserts that the rise in tourism in Spain beyond the regional average (i.e., the Mediterranean area) is due to internal improvements, such as the modernisation of supply, human resource training, quality improvements and improvements in marketing and promotion. This new situation, together with more optimistic economic forecasts (International Monetary Fund, 2013), has fed the idea that tourism could substitute for weakened domestic demand and revitalise the economy.

The success of some Asian countries in the eighties in promoting economic growth through export-oriented industries (World Bank, 1993) and the export orientation of tourism has guided studies about tourism and economic growth around the export-led hypothesis (Balassa, 1978). Authors such as Dritsakis (2004) and Sequeira and Maças (2008) and agree that tourism, a non-technology-intensive sector, can promote economic growth and enhance capital accumulation. These conclusions contradict Solow (1956) and some other authors' findings, such as those of Aghion and Howitt (1998) and Grossman and Helpman (1991), about the relation between high-technology sectors and long-term growth. Lanza, Temple, and Urga (2003) affirm that the lower growth in productivity in tourism-based economy could be overcome by a progressive specialisation on tourism that could improve the terms of trade and compensate the lost in productivity. Moreover, these authors also highlight the importance of the high price elasticity and income elasticity of demand for tourism that may compensate the loss in productivity in the long term.

Additionally, there are more profound consequences to the relationship between tourism and the economy beyond enhanced growth or the productivity gains that should not be neglected. Differences in the intensive use of capital and labour also have important implications at the sectorial level. Copeland (1991) and Chao, Hazari, Laffargue, Sgro, and Yu (2006) underscore the importance of non-tradable goods in tourism-based economies. According to these authors, tourism enhances the consumption of non-tradable goods and improves the terms of trade, although it could produce capital *decumulation* from the manufacturing sector (capital intensive) to the non-tradable sectors (labour intensives). Moreover, the appreciation of the real exchange rate because of tourism can also undermine the external competitiveness of traditional exports. Both the displacement of capital and labour endowment from traditional sectors to the non-tradable sectors and the appreciation of the real exchange rate can generate an economic "*illness*" known as Dutch Disease, by which the positive effect of tourism on the economy in the short term causes the economy to shrink in the long term (Corden & Neary, 1982).

The Dutch Disease has been traditionally associated with oil-exporting countries such as Saudi Arabia, Qatar, Venezuela or Norway. Many of these countries avoid changing most of the revenues obtained from their oil exports into local currency to prevent the Dutch Disease. However, this *economic illness* can be generalised to any situation in which a country begins to receive an important amount of foreign money that triggers the consequences explained above. For instance, Laplagne, Treadgold, and Baldry (2001), Usui (1996), VanWijnbergen (1986) and White (1992) show how developing countries can suffer from this illness due to the receipt of external aid. VanWijnbergen (1986) argues that the negative connotation of the term Dutch Disease should not hide an important trade theory behind it by which an economy tends to produce those goods that require the intensive use of the most abundant factor of production in the country (Heckscher-Ohlin trade theory). Tourism-led countries are especially sensitive to the Dutch Disease due to the entrance of foreign money. So far, the literature regarding tourism and Dutch Disease has followed a theoretical/descriptive perspective.