

# Tourism expansion and economic development: The case of Taiwan

Hyun Jeong Kim<sup>a</sup>, Ming-Hsiang Chen<sup>b,\*</sup>, SooCheong “Shawn” Jang<sup>c</sup>

<sup>a</sup>*School of Hospitality Business Management, Washington State University, Pullman, WA 99164, USA*

<sup>b</sup>*Department of Finance, National Chung Cheng University, Chia-Yi, Taiwan, ROC*

<sup>c</sup>*Department of Hospitality and Tourism Management, Purdue University, Stone Hall, Room B-9 West Lafayette, IN 47907-2059, USA*

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## Abstract

This study examines the causal relationship between tourism expansion and economic development in Taiwan. A Granger causality test is performed following the cointegration approach to reveal the direction of causality between economic growth and tourism expansion. Test results indicate a long-run equilibrium relationship and further a bi-directional causality between the two factors. In other words, in Taiwan, tourism and economic development reinforce each other. A discussion follows and managerial implications are identified based on the empirical findings.

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## 1. Introduction

Despite the poor global economic performance and the terrorist attacks on September 11, 2001 in the US, the number of international tourists traveling worldwide reached 715 million in 2002, an increase of 21 million from 2001 for an annual growth of 3.1 percent (World Tourism Organization, 2002). Global tourism receipts were 475.8 billion in US dollars (US\$) for 2000 and 462 billion US\$ for 2001. Tourist spending, as an alternative form of exports, can contribute to the balance of payments through foreign exchange earnings and proceeds generated from tourism expansion and can represent a significant income source for a national economy (Balaguer & Cantavella-Jorda, 2002). Foreign exchange earnings from tourism can also be used to import capital goods to produce goods and services, which in turn leads to economic growth (McKinnon, 1964). Other economic benefits derived from tourism activity include tax revenues, employments and addi-

tional sources of income (Archer, 1995; Belisle & Hoy, 1980; Davis, Allen, & Consenza, 1988; Durberry, 2002; Khan, Seng, & Cheong, 1990; Uysal & Gitelson, 1994; West, 1993). It is generally assumed that tourism expansion should have a positive contribution to economic growth.

Taiwan has been recognized as an export-oriented economy (Ghartey, 1993; Jin, 1995). However, the tourism industry may be another major contributing factor toward Taiwan's economic growth. The 2002 annual statistics of Tourism (Tourism Bureau, 2003, p. 24) reported that Taiwan's tourism receipts accounted for 4.2 percent of the gross domestic product (GDP) in 1996. This figure exceeded the contribution of the agricultural sector to GDP, thereby making tourism one of the major industries in Taiwan.

The Taiwanese government has lately noticed a crucial role of tourism expansion in economic development and is eager to promote tourism internationally. In 2002, the Doubling Tourist Arrivals Plan (DTAP) was introduced as part of the National Development Plan named “Challenge 2008”, which was designed to reinforce Taiwan's overall economy. The goal of the DTAP is to double the number of foreign tourists

\*Corresponding author. Tel.: +886 5 2720411; fax: +886 5 2720818.

E-mail addresses: [jennykim@cbe.wsu.edu](mailto:jennykim@cbe.wsu.edu) (H.J. Kim), [finmhc@ccu.edu.tw](mailto:finmhc@ccu.edu.tw) (M.-H. Chen), [jang12@purdue.edu](mailto:jang12@purdue.edu) (S.S. Jang).

arriving in Taiwan in order to stimulate the overall production value of the domestic economy and enliven the job market.<sup>1</sup> To ensure the successful implementation of the DTAP, the Tourism Development and Promotion Committee (TDPC) was upgraded and the Premier of Taiwan designated as its convener.

Although the tourism industry has grown significantly in Taiwan, tourism researchers have not paid much attention to the empirical assessment of contributions of the tourism sector to Taiwan's economy. This study aims to answer the following two questions. First, is there a long-run equilibrium relationship between tourism expansion and economic growth in Taiwan? Second, if a stable long-run relationship exists, what is the direction of a causal relationship between these two variables? In other words, is tourism expansion an "engine" of Taiwan's economic development or the other way around?

The remainder of this paper is organized as follows: Section 2 reviews the relationship between economic development and tourism expansion; Section 3 describes data and analyses used; Section 4 focuses on specification of econometric models; Section 5 discusses the results of hypotheses and presents managerial implications; finally, the article concludes with a summary of the main points and suggestions for future research.

## 2. Economic development and tourism expansion

Theoretical models that consider a causal relationship between non-traded goods, such as Tourism, and economic growth are recent phenomenon.<sup>2</sup> Some researchers have proposed a Tourism-led growth hypothesis that assumes tourism to be a major factor of overall long-run economic growth (Balaguer & Cantavella-Jorda, 2002; Dritsakis, 2004). Tourism-led growth may take place when tourism demonstrates a stimulating influence across the overall economy in the form of spillovers and other externalities (Marin, 1992).

To date, articles that have analyzed the causal relationship between economic growth and tourism activity are limited and results have been mixed.

For example, using Spanish data from 1975 to 1997, Balaguer and Cantavella-Jorda (2002) discovered a

stable long-run relationship between tourism and economic growth. After conducting a standard Granger (1969) causality test, the authors further found that tourism affected Spain's economic growth in one direction, thereby supporting the tourism-led growth hypothesis. Although the authors mentioned that the tourism-led growth hypothesis is not specific to developing countries, it was not clearly stated that the theory could be applicable to all countries.

Dritsakis (2004) examined the impact of tourism on the long-run economic growth of Greece using a similar method. One cointegrated vector was found among GDP, real effective exchange rate and international tourism earnings from 1960 to 2000. Granger causality tests based on Error Correction Models indicated that there is a strong Granger causal relationship between international tourism earnings and economic growth, a strong causal relationship between real exchange rate and economic growth and simply causal relationships between economic growth and international tourism earnings and between real exchange rate and international tourism earnings. In sum, his study supports both tourism-led economic development and economic-driven tourism growth.

However, Oh (2005) disagreed with the tourism-led growth theory. After Balaguer and Cantavella-Jorda's (2002) work, Oh (2005) counter-argued that the existence of the tourism-led growth hypothesis in Spain may be attributed to the fact that Spain is one of the world's top recipients of international tourist revenues. Tourism earnings in Spain comprise approximately 5.9 percent of its GDP (World Tourism Organization, 2000). The author used South Korea as a destination country for comparison. Although South Korea and Spain are both developing countries, the tourism industry in South Korea is not as strong as Spain. For example, value-added revenue derived from tourism-related activities accounts for 3.5 percent of South Korea's GDP (Bank of Korea, 2002). In his study, the cointegration analysis indicated no long-run link between tourism receipts and economic growth in South Korea over the period from 1975 to 2001. He further found an economic-driven tourism growth instead of a tourism-led economic growth, thereby implying that in South Korea, economic growth led tourism expansion rather than tourism expansion causing economic growth.

Our a priori expectation was that because Taiwan and South Korea have a similar economic structure such as being export-oriented economies (Sengupta & Espana, 1994) and that traditionally neither country has considered tourism as a leading industry, empirical results of this study would be similar to Oh's (2005) results. The following hypotheses are considered in order to verify the existence of the previously mentioned relationship in the case of Taiwan.

<sup>1</sup>For the detailed contents of the Double Tourist Arrivals Plan, see the website: <http://www.cepd.gov.tw/2008/challenge2008.pdf>.

<sup>2</sup>Traditionally, economic scholars have focused on a relationship between traded goods and economic development (Ahmed & Kwan, 1991; Jin, 1995; Kwan & Cotsomotis, 1991; Thornton, 1997; Xu, 1996). Empirical studies have reported the mixed results regarding a causal relationship between exports growth and economic expansion. For example, Shan and Sun (1998) showed a reciprocal relationship between international trade (exports growth) and economic development in China, whereas Marin (1992) demonstrated a unidirectional influence of exports growth on economic expansion in industrialized and developed countries such as Japan, UK, US, and Germany.

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