Another look at tourism- economic development nexus

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ABSTRACT

This paper investigates the causal relationships between tourism and economic development in emerging market economies. By using annual data for the period of 1995–2014, this study applies Granger causality analysis across countries to find the causal relationships between international tourism receipts (% GDP) and economic growth (annual %). Impulse responses function is also employed to track the responsiveness of one variable to shocks to another variable. Our estimation results generate evidence for uni-directional causality from tourism to economic growth in Brazil, Mexico and Philippines while reverse relationship is detected for China, India, Indonesia, Malaysia and Peru. No causality is obtained for seven out of sixteen emerging market countries, and finally, bidirectional causality is detected for Chile. The impulse responses analysis confirms causality test results by detecting the linkage between economic growth and tourism receipts. Discussion, policy implications, and further research suggestions are provided in the article.

1. Introduction

The relationship between economic growth and tourism receipts has been extensively studied in the past decades for both developed and developing countries. As tourism industry is growing in many countries, the causal relationship between economic growth and tourism receipts is becoming important for policy makers. According to The World Travel and Tourism Council (WTTC) (2017), this industry has had an impressive impact on the world economy. It created 292 million jobs and increased the global GDP by 10.2% in 2016. It is forecasted that the contribution of tourism industry on global GDP will increase and it will create 380 million jobs by 2027. It means 11% of the jobs in the world.

Governments in current economic environment try to overcome macroeconomic problems such as macroeconomic instability, low growth and unemployment by subsidizing productive sectors. They consider international tourism as one of the significant potential growth sectors (Brohman, 1996). The growth of tourism may lead to an increase in government revenues and household income through different channels like improvements in the balance of payments and additional employment. Tourism can support policy makers to foster economic growth through creating regional employment opportunities, supplying foreign exchange, and promoting transportation, construction, food/beverage and accommodation sectors. In addition, policy makers can use tourism as an instrument to decrease inequalities in regional welfare, because tourism leads to income transfer from developed countries to developing countries (Tugcu, 2014). Hence, the development of

tourism may have a positive contribution to economic growth (e.g. Khan, Phang, & Toh, 1995; Lee & Kwon, 1995; Lim, 1997; Oh, 2005).

Chao, Hazari, Laffargue, Sgro, and Yu (2006) proves that tourism expansion yields a gain in revenue by increasing the relative price of non-traded goods. On the other hand, this increase, may cause a de-industrialization in the traded goods sector and decrease resident welfare through decreasing demand for the capital used in the traded sector. Chao, Hazari, Laffargue, and Yu (2009) indicate that under domination of output effect, tourism expansion increases employment and welfare. However, if the expansion of tourism sector leads to an increase in the cost of labor, this can lead to lower employment and welfare under certain conditions.

Researchers employ different econometric models to verify the relationship between macroeconomic variables. In order to get more reliable results, instead of assessment of individual coefficient estimates, it is necessary to evaluate the significance of variables in an equation, based on joint tests on all of the lags of a particular variable in a model (Brooks, 2014). In fact, the tests described above are referred to as causality tests and described by Granger (1969). Therefore, this study examines the causal relationship between tourism and economic development in emerging market countries using Granger causality test. Of course, this test cannot explain how long these effects require to take place or the qualitative nature of the relationship. Hence, impulse responses function is employed to solve this problem and trace out the nature of responsiveness of each variable to shocks to another variable.

When the main motivation is to investigate the role of tourism

industry in the economy of a country, the important indicator is the contribution of tourism in gross domestic product of that country. Sometimes, a country's tourism receipts (current US$) increases, but at the same time, its share in the economy decreases, because other economic sectors grow faster and play a more important role in economic growth. Therefore, tourism receipts (current US$) cannot be a suitable proxy for studying tourism sector variations and its effect on economic development. Previous studies usually used "dollar-value of tourism receipts" or "tourism receipts as percentage of imports" to evaluate tourism development, which are not appropriate proxies for tourism development. They found many spurious causalities between tourism development and economic growth.

Motivated by aforementioned shortcomings, the aim of this study is to analyze the likely effect of international tourism on economic growth of countries which are in the process of economic development. To this end, the sample of the present study has been deliberately chosen as emerging economies that are in the process of relatively high rates of industrialization and economic growth. These countries play a growing role both in terms of global economy and politics. Furthermore, this paper uses tourism receipts as percentage of GDP to measure tourism development and study its causal relationship with economic growth proxied by annual growth rate of real GDP in emerging market economies.

This study contributes to the literature in two ways: First, investigating tourism-economic growth relationship in emerging economies based upon two complementary methods. Second, comparing misleading results based on selecting inappropriate proxies with reliable results obtained from selecting appropriate proxies to measure tourism and economic growth.

According to Oh (2005) and Tugcu (2014) the causal relationship between tourism and economic growth is defined in terms of four related hypotheses: First one, the so-called "growth hypothesis" suggests that tourism expansion is the dynamic that strengthens the economic growth. In this situation, government can boost economic growth by subsidizing tourism. Second one, the "reverse hypothesis" refers to a situation in which the economic growth plays an important role in tourism development. In this case, government can transfer subsidies to other sectors without any negative impact on economic growth. Third, the neutrality hypothesis denotes that tourism development and economic growth are not affected by each other. This hypothesis is supported if there is no causality between tourism and economic growth. Fourth, the feedback hypothesis indicates a reciprocal relationship between growth and tourism. When this hypothesis is supported, tourism expansion polices may raise economic growth, and also higher economic growth can have a positive effect on tourism development.

The rest of this paper is organized as follows: The next section reviews the Literature. Section 3 describes the data and methodology. Section 4 presents the results of our analysis including Granger causality test. Section 5 concludes the paper. Finally, Section 6 provides policy implications and further comments.

2. Literature review

2.1. Economic growth - tourism development relationship

Over the past several decades, the tourism industry has experienced a rapid growth and has emerged an important sector proving to be beneficial to the economy in terms of employment creation, foreign exchange earnings, government revenue, and reduction in poverty (Clancy, 1999; Yap & Saha, 2013). Besides these direct effects, tourism industry has also made incredible indirect positive impacts on the economy through its contribution to the balance of payments, improvement of human living standards, rising government revenues through profits and taxes and the expansion of production of goods and services (Paramati, Alam, & Chen, 2016). Fayissa, Nsiah, and Tadesse (2011) provided empirical evidence of tourism industry contribution to

the GDP growth and investment in infrastructure and human capital development of Latin American countries. Therefore, tourism development has been the engine of economic growth across the world (Brida & Risso, 2009; Tang & Tan, 2013).

Alongside the rising importance of the tourism industry for a country's economy, the subject of investigating the relationship between tourism and economic growth has gained lots of attention during the last decades (Balaguer & Cantavella-Jorda, 2002; Durbarry, 2004; Holzner, 2011; Lee & Brahmasrene, 2013; Lee & Chang, 2008; Narayan, 2004; Oh, 2005; Tang & Tan, 2015; Tugcu, 2014); however, the results appear to be mixed.

Upon examination of relevant literature, it is noted that the relationship between tourism development and economic growth is categorized in four different strands: 1. Tourism-led economic growth (TLEG), 2. Economic-driven tourism growth (EDTG), 3. Reciprocal relationship between economic growth and tourism development, and 4. No causal relationship (Chen & Chiou-Wei, 2009; Oh, 2005; Paramati et al., 2016).

2.1.1. Tourism led economic growth

Tourism-led economic growth (or growth hypothesis) proposes a positive effect of the growth of tourism activities on economic growth. A growing body of literature has examined the aforementioned hypothesis.

Balaguer and Cantavella-Jorda (2002), Proença and Soukiazis (2008), Ivanov and Webster (2007), Lee and Brahmasrene (2013), Cortés-Jimenez and Pulina (2010) and Nowak, Sahli, and Cortés-Jimenez (2007) studied the validity of TLEG hypothesis in different samples of EU countries, and all of them except Ivanov and Webster (2007) proved this hypothesis in their sample of countries. Among these studies, Balaguer and Cantavella-Jorda (2002), Proença and Soukiazis (2008), Cortés-Jimenez and Pulina (2010) and Nowak et al. (2007) proved the validity of TLEG hypothesis in Spain and Ivanov and Webster (2007) rejected it. Proença and Soukiazis (2008) justified this hypothesis in Greece and Ivanov and Webster (2007) falsified it. Furthermore, the evidences presented by Proença and Soukiazis (2008) and Cortés-Jimenez and Pulina (2010) confirm this hypothesis for Italy.

In the following, above mentioned studies about EU countries are explained in detail.

Spain has been an important tourist destination in the last four decades. Foreign exchange income has a significant weight in this economy, and tourism receipts plays an important role in current account and trade balance. Balaguer and Cantavella-Jorda (2002) investigated the effect of tourism on long-run economic growth in Spain. They applied causality and cointegration approach and confirmed TLEG hypothesis in Spanish economy.

Lee and Brahmasrene (2013) have analyzed the relationship between tourism receipts per capita (in current US$), economic growth, foreign direct investments and CO_2 emissions per capita (in metric tons) in European Union countries during 1988–2009. The results from the panel cointegration and fixed-effects models showed that long-run relationship exists between the variables. Moreover, there is a positive relationship between economic growth and the other three variables (FDI, tourism receipts, and CO_2 emissions).

Proença and Soukiazis (2008) investigated the importance of international tourism revenues (at PPP constant prices) as a conditioning growth factor for improving the host population's standard of living for four southern European countries (Italy, Greece, Portugal and Spain) between 1990 and 2004. By using a conditional convergence approach, the results confirmed tourism revenues as the conditioning factor for economic growth for these countries. Thus, the results provided evidence that support the TLEG hypothesis.

Cortés-Jimenez and Pulina (2010) examined the above-mentioned hypothesis for the case of Spain and Italy by applying cointegration and multivariate Granger causality tests. The sample period covered 1964–2000 for Spain and 1954–2000 for Italy. Using a more advanced