

CHAPTER 2

Literature Review and Theoretical Backgrounds

2.1 Tourism Sector and Economic Growth Review

Several research studies investigated the relationship between tourism development and economic growth in theoretical and empirical point of view. However, the outcomes of the studies showed mixed and conflicting results due to the lack of homogeneity and comparability of data and time-periods. Most of the research papers set up three views on the link between tourism sector and economic growth. The first and most dominant one in studies related with tourism and economic growth is TLG (tourism-led growth hypothesis) which means the development of tourism sector drives to obtain economic growth. The second view points out that the growth of the real sector contributes to the tourism expansion through infrastructure development. This one is growth-led tourism hypothesis. The last view assumed that tourism development and economic growth rely on each other, can say bidirectional causality between them.

From a theoretical perceptive, **Paola Figini and Laura Vici (2007)**; **Ugo Gasparino, Elena Bellini, Barbara Del Corpo and William Malizia (2008)** explained that the relationship between tourism and economic growth has been dealt with a theoretical problem by two strands of the literature. According to the Keynesian theory of the multiplier, the tourism sector affects positively on income and employment of the country through multiplier effect. **Alessandro Lanza and Francesco Pigliaru (1995)** described the application of the Lucas's two-sector model to the tourism sector. The output growth of the two sectors depends on the factors such as technological progress, price changes and natural resources. The investor country will choose to specialize on one out of two sectors depending on the comparative advantage.

At the empirical level, **Brida, J. G., Pereyra, J. S., Risso, W. A., Devesa, M. J. S., & Aguirre, S. Z. (2008)** tested the tourism-led growth hypothesis by studying empirical research in Colombia through the use of quarterly data from 1994 to 2007. After testing with ADF, PP and KPSS tests, the OLS method cannot be applied to this research due to spurious regression problems. Applying the co-integration technique, Johansen co-integration test showed the existence of co-integration relationship between economic growth, real exchange rates and tourism expenditures. The latter two variables are weakly exogenous to the VEC model. And then, the Granger causality test revealed that tourism sector positively affects the Colombian economic growth.

Using the ARDL modeling, **Katircioglu, S. (2009)** investigated the tourism-led growth hypothesis in the case of Malta for the period 1960-2006. ADF and PP unit root tests suggested that real GDP and the real effective exchange rate index are integrated of order one, $I(1)$ whereas the international tourist arrivals are of order zero, $I(0)$. The reason why this study omitted the tourism receipts variables is because of the multi-collinearity problem. Empirical results of the bound test for co-integration showed that there is the long run relationship between tourism and economic growth in Malta. The results of the Granger causality test through the use of VECM model revealed that both the tourism-led growth and growth-led tourism hypotheses are to be valid for Malta.

The research of **Risso, W. A., & Brida, J. G. (2009)** explored the contribution of tourism to economic growth for the case of Chile. The main purpose of this paper is to analyze the probable relationships within tourism expenditure, real exchange rate, and economic growth from 1986 to 2007 by quarterly. Unit root tests indicated that the variables in the study were integrated. There was the co-integration relationship between tourism and economic growth according to the results of Johansen co-integration test. The Granger causality test revealed that tourist's expenditure and real exchange rate positively contribute to the Chilean economic growth.

Figini, P., & Vici, L. (2010) analyzed the tourism and growth in a cross-section of countries. This research had been done on more than 150 countries between 1980 and 2005 by using cross-section analysis through the use of BLP (2004, 2007) as a benchmark and in-depth sensitivity analysis. Unlike BLP and Sequeira and Macus

Nunes (2008), the main conclusion for the period 1990 to 2005 showed that there was no significant relationship between tourism specialization and economic growth. By using sensitivity analysis, the empirical results revealed that endogeneity problems like merging data and omitted variables would not be the main effects on getting different results. So the research would be resulted that tourism specialization would not be the solution to solve the problems of growth and development.

Risso, W. A., Barquet, A. and Brida, J. G. (2010) examined the causality between economic growth and tourism expansion in Trentino-Alto Adige from 1980 to 2006. The author tested the stationarity of the variables such as real GDP, tourism expenses per capita and relative prices by using ADF and KPSS unit root tests. The results showed that the data of the variables are integrated of order one, $I(1)$. For co-integration analysis, the VEC revealed that the existence of co-integration between variables by using Johansen maximum likelihood method. The tourism and relative prices are weakly exogenous to real GDP. After that, the Granger causality test described that the tourism expansion can cause economic development in Trentino-Alto Adige.

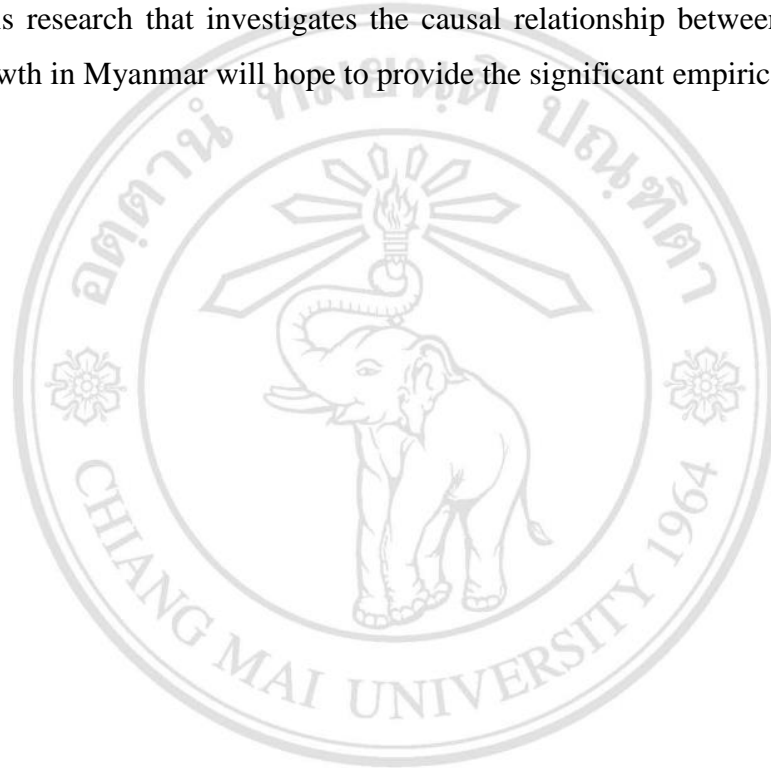
Odhiambo, N. M. (2011) applied the ARDL-bound testing approach to analyze the linkage between tourism and economic growth in Tanzania for the period 1980-2008. The empirical results showed that there is the existence of bilateral relationship between tourism and economic growth in the short run whereas the growth-led hypothesis was found in the long run. Moreover, the results revealed that in the short run the feedback relationship not only between exchange rate and economic growth but also between exchange rate and tourism. But there is the long one unidirectional causality from exchange rate to economic growth. By testing with ADF and Dickey-Fuller GLS tests, the three variables are integrated of order one, $I(1)$. The results of the bound test are reported that there is the long run co-integration between variables while taking real GDP and tourism variables as independent variables. So the empirical results concluded that the dominant hypothesis from the analysis of Tanzanian tourism and its economy in the long run is growth-led tourism hypothesis.

To investigate the relationship between tourism and economic growth in developing countries, the P-VAR approach was applied to this study by **Samimi, A. J., Sadeghi, S., & Sadeghi, S. (2011)**. After testing by IPS unit root test, the findings revealed that the variables such as real GDP and tourism arrivals are integrated of order one, I(1). To investigate the relationship between both variables, the author used Johansen test based on trace and Eigen value statistics. The results showed that there is the long run relationship between tourism expansion and economic growth. The findings of the Granger causality test showed the existence of the bilateral relationship between tourism and economic growth in developing countries.

Milanovic, M., Stamenkovic, M. (2012) discussed about the causality between tourism and economic growth: as a case study of Serbia from 2002:Q1 to 2011:Q3. The empirical results revealed that all the selected variables such as logarithm form of real GDP in millions of RSD and foreign tourist arrivals were stationary at their first difference by using the ADF unit root test. In order to investigate the co-integration relationship between these two variables, Johansen Co-integration test showed that there is the long-run relationship between tourism and economic growth. To know the direction of the causal relationship between the observed series, the Granger causality test explained that the tourism arrivals of the Serbia mainly depends on the economic growth that means this study on Serbia accepts the growth-led tourism hypothesis.

Chou, M. C. (2013) explored the causal relationship between tourism spending and economic growth in 10 transition countries such as Cyprus, Poland, Romania, Slovakia, etc. from 1988 to 2011. The author used the two variables such as domestic tourism spending and real GDP per capita by the way of panel causality analysis. The author used the LM test to analyze cross-sectional dependency. The standard F test was applied in this study to test slope homogeneity. The application of the bootstrap panel causality approach resulted that tourism-led growth hypothesis occurred in Cyprus, Latvia and Slovakia whereas the growth-led hypothesis in Czech Republic and Poland. Moreover, the feedback hypothesis that means these two endogenous factors are mutually influence each other was found in both Estonia and Hungary while the neutral hypothesis that refers to the situation where tourism spending has little or no effect on the country's economy for remaining countries like Bulgaria, Slovenia and Romania.

The findings of the investigation between tourism expansion and economic development are inconclusive. All of the above literature reviews have differences; most of the authors use tourism arrivals, tourism receipts, real exchange rate, and real export volume and tourism contribution to employment as the independent variables and use real GDP and GDP growth rate to determine economic growth. The authors tried to estimate the causal relationship between tourism sector and economic growth by using various models like co-integration analysis, VEC, ARDL and panel analysis approach. This research that investigates the causal relationship between tourism and economic growth in Myanmar will hope to provide the significant empirical results.



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Table 2.1 Summary of Literature Review

Author/s(years of publication)	Observed Country/Countries	Data	Variable as a proxy of Economic Growth	Variable/s as a proxy of Tourism Industry	Model	Results
Brida, J. G., Pereyra, J. S., Risso, W. A., Devesa, M. J. S., & Aguirre, S. Z. (2008).	Colombia	Quarterly 1994-2007	Real GDP per capita	- Tourism Expenditure - Real exchange rate	Co-integration technique	Tourism has significant impact on economic growth.
Katircioglu, S. (2009)	Malta	1960-2006	Real GDP	- Tourist arrivals - Real effective exchange rate index	ARDL	Bidirectional relationship between tourism and economic growth.
Risso, W. A., & Brida, J. G. (2009)	Chile	Quarterly 1986-2007	Real GDP	- Tourism Expenditure - Real exchange rate	- Johansen Co-integration test - Granger Causality test	Tourism has significant impact on economic growth.
Figini, P., & Vici, L. (2010)	More than 150 countries	1980-2005	GDP	- Degree of tourism specialization of the country - ratio of no. of tourist arrivals over local population	- BLP - Sensitivity analysis	No relationship between tourism expansion and economic growth.
Risso, W. A., Barquet, A., and Brida, J. G. (2010)	Trentino-Alto Adige	1980-2006	Real GDP	- Tourism Expense per capita - Relative prices	VEC	Tourism has significant impact on economic growth.

Source: Author, 2016

Table 2.1 Summary of Literature Review (Continued)

Author/s(years of publication)	Observed Country/Countries	Data	Variable as a proxy of Economic Growth	Variable/s as a proxy of Tourism Industry	Model	Results
Odhiambo, N. M. (2011).	Tanzania	1980-2008	Real GDP per capita	- Tourism Variable - Real exchange rate	ARDL	(Short-run) Bidirectional relationship between tourism and growth. Bidirectional relationship between tourism and exchange rate. (Long-run) Economic growth and exchange rate has significant impact on tourism.
Samimi, A. J., Sadeghi, S., & Sadeghi, S. (2011).	Developing countries	1995-2009	GDP	Tourism arrivals	P-VAR approach	Bidirectional relationship between tourism and economic growth.
Milanovic, M., Stamenkovic, M. (2012).	Serbia	2002:Q1-2011:Q3	Real GDP	Foreign tourist arrivals	Co-integration technique	Economic growth has significant impact on tourism.
Chou, M. C. (2013).	Ten transition countries	1988-2011	Real GDP per capita	Domestic tourism spending	Panel data analysis	→For Cyprus, Latvia and Slovakia, Tourism has significant impact on economic growth. →For Czech Republic and Poland, Economic growth has significant impact on tourism. →For Estonia and Hungary, Bidirectional relationship between tourism and economic growth. →For Bulgaria, Slovenia and Romania, No relationship between tourism expansion and economic growth.

Source: Author, 2016

2.2 Concepts and Theories of Tourism as driver for the country's economic growth

Mitra Mahmoudi (2008) explained that tourism sector is hard to measure and evaluate its productivity. The fact is that tourism has no traditional production functions, no common structure within the area of the sector, and lastly no measurable outputs. It is definitely or absolutely sure that tourism sector acts as one of the key foreign exchange earners within the country and it mainly provides job creation and government revenue for economic growth. In comparison with the other sectors of the economy, the benefits of the tourism sector cause the whole society development because the tourism sector involves activities relating with several industries, containing transportation, infrastructure, accommodation, telecommunication, recreation, cultural heritages, and domestic souvenirs and handicrafts. However, it is still confusing among researchers that tourism sector development leads to economic growth (Tourism-led Economic Growth hypothesis) or vice versa (Economic-driven Tourism Development hypothesis) or bidirectional relationship (reciprocal hypothesis) between these two factors.

2.2.1 Theoretical issues between Tourism and Economic Growth Theories

Looking back to the decades of the economy, the emergence of economic theorists talking about economic growth has been found. Starting from the Adam Smith's "Invisible Hands", numerous mechanisms such as Ricardo's Growth Theory, Solow's Growth Model, Neoclassical Approach, Harrod-Domer's saving and investment, New Growth Theory, etc. have been evolved to explain economic growth. **Adam Smith (1776, p. 452-472)** defined the importance of labor productivity. On the Smith's point of view, labor productivity can be measured if it is advantageous to the production of goods. The main purpose of production goods in the economy is consumption. Two factors such as division of labor and the profit shares between factory owners and labor controls the market. That means that the more increases in division of labor, the higher the labor productivity; higher productivity causes to gain higher wages for factory workers and this action shapes the consumer market. However, tourism sector cannot satisfy or qualify this criterion. **Mosese Tavaga Qasenivalu**

(2008, p. 11) pointed out that the labor employed at the service sector was considered as the unproductive labor.

David Ricardo (1973) and John Stuart Mill (1844) explained the importance of return on capital, limited land resource and technology improvement, together with labor productivity; and the ability to be accumulated for wealth. But **(Shelp, 1987, p. 64-65)** said the main thing is services do not qualify to be counted as wealth because they cannot be stored after being produced or carried forward to a future period. **Wolak, Kalafatis and Harris (1988)** analyzed tourism as a service sector has features of intangible, inseparable, heterogeneous and perishable. Therefore, it is distinctly clear that the activity in tourism sector is different with production of goods.

According to the **Solow's Model by Robert Solow** who won Nobel Prize in economics in 1987, the model described about the effect between capital and productive output. In this model, technological progress plays an essential role in output productivity. Higher technology leads to the higher outputs with the same inputs. But all these theories are based on the aggregate production function, which means theorists regard as a function of capital, labor and land, with other input factors. Although most economic theories are talking about the production function that contributes to the economic growth, it is difficult to explain the relationship between tourism and economic growth based on theories. There are limitations in the economic theories relating with tourism sector.

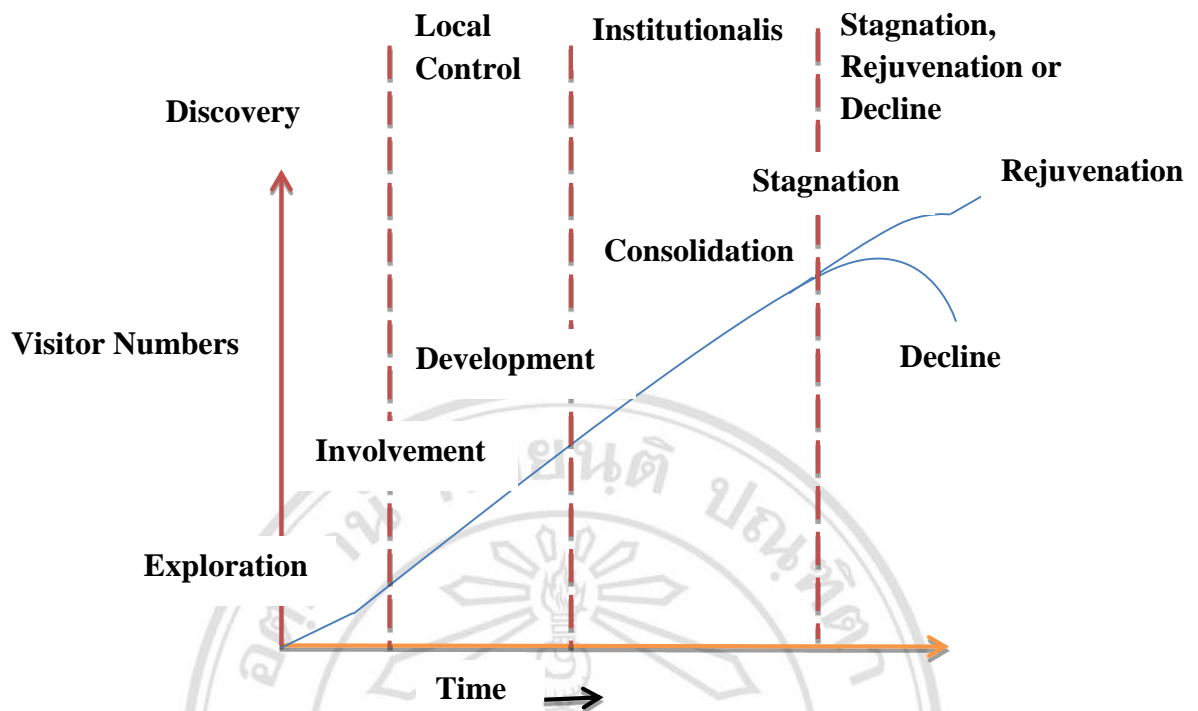
According to **Mosese Tavaga Qasenivalu (2008)**, based on the economic theories of income growth, widely exports were regarded as the exchange of goods such basic needs like agricultural products for food, clothes, and raw materials; and luxury things such as cars, electronic things for entertainment, and other tangible products. Mostly the things that can be stored after being produced had been referred as exports for income growth. Most classical theorists and researchers assumed service as the unproductive sector because the activities undertaken in the service sector cannot be stored after being produced **(Shelp, 1987)**. Latter-day, tourism which is one of the important service sectors in the economy could be accepted as the exchange item which has also the same value as goods. To obtain the evidence that shows the relationship

between tourism development and economic growth, in 1979, the World Bank let the tourism department temporarily closed and stopped financing in the tourism projects that had been implemented for almost ten years. Several countries couldn't take loans from the World Bank for tourism activities. The result showed that tourism which was exactly and completely set as a private sector did gain success for just only short term period and it would not be advantageous to long term growth for the economy. Later, World Trade Organization recognised tourism as exchange item in 1995 because it has the characteristic of trade such as consumption abroad where tourist business services are consumed by one country in the area of another country where services are provided. (WTO, 2005).

2.2.2 Butler's "Lifecycle Theory"

In 1980, Butler's "Lifecycle Theory" clearly expressed about the nature of tourism growth. For the first time, this model discussed about impacts of tourism on environmental and social sectors. However, most of the tourism projects undertaken by the World Bank in 1970s met with a huge success in targeting economic growth and tourism growth.

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Source: Salvo Creaco and Giulio Querini (2003), (Butler, 1980)

Figure 2.1: Hypothetical Tourist Area Life Cycle

At the “exploration” stage, a small number of people start coming to visit for adventure and they visit to see pristine and undamaged condition of rich natural, cultural and environmental resources; and endowed national heritages, with uninterrupted or peaceful communities and simple facilities. It is the stage where a new tourist area or product is introduced.

In the “involvement” stage, as large number of tourists being built and local community start to involve in tourism activities. It is the stage where tourism market is defined and tries to get a balance between other economic sectors.

Showing at the “development” stage, the majority of new visitors coming to the country’s tourist attractions and the government set tourism as the national plan for the overall development.

Coming to the “consolidation” stage, tourism sector acts as a main instrument of economic activity for local and regional community. Large number of visitors is still coming at a decreasing rate.

By the “stagflation” stage, the volume of tourist arrivals is at the peak. But most are repeated visitors and their purpose has changed to business use instead of leisure and pleasure. Most tourist attractions are attracted to visitors no more.

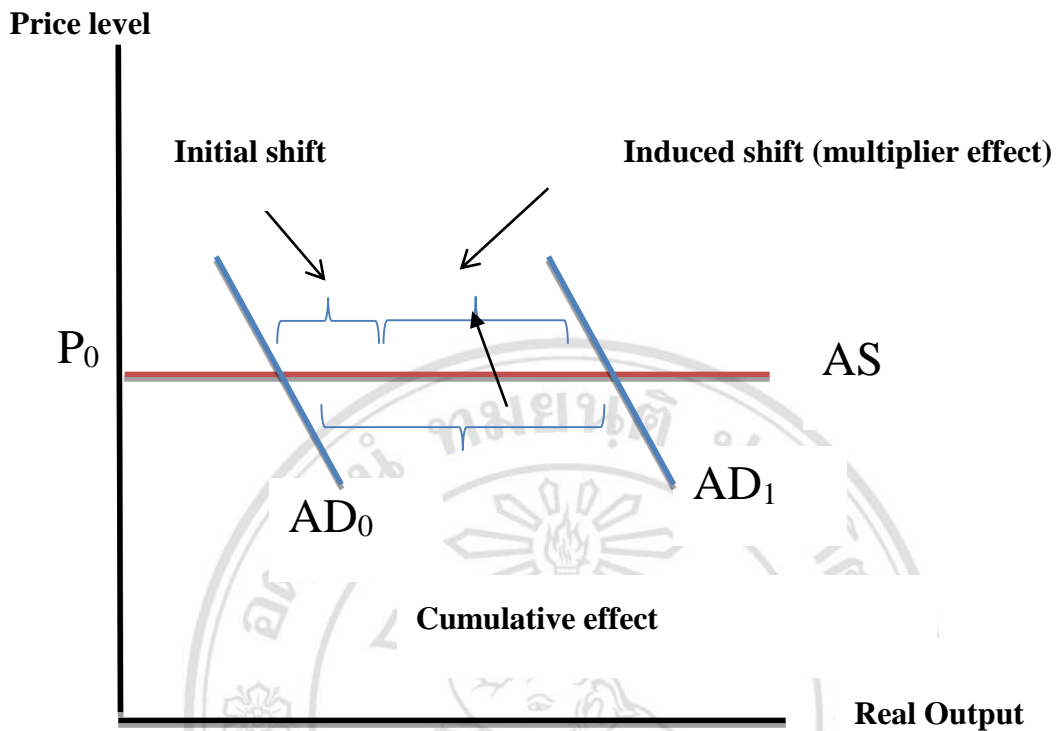
According to the paper by **Salvo Creaco and Giulio Querini (2003)**, tourism sector has been in conflict with other sectors, especially with agriculture, because of limited resources in the developing countries. They pointed out that if the tourism growth cannot be well controlled by the host country, it will damage to the environment. However, tourism sector serves as a facilitator for economic growth in less developed countries with multiplier effect which is an effect that leads to an increasing in national income and consumption in the economy more than the initial investment used in the tourism sector. But one important thing to note is that as tourism sector has to rely on natural resources and cultural heritage sites, preservation and conservation of natural things is extremely essential not to occur deterioration of the environment.

2.2.3 Keynesian Multiplier Effect

The multiplier model explained how aggregate supply (AS) may change as the aggregate demand (AD) shifts due to the initial expenditure in the assumption that prices do not respond to shocks and quantities such as production, income and employment just only adjusts.

$$AE = C + I + G + (X - IM) \quad (2.1)$$

According to the equation, aggregate expenditures in the Keynesian multiplier model consist of consumption, spending by consumers in the economy; investment, spending by business; government expenditure; and net foreign spending. The model assumes the production in the economy creates the equal amount of national income or output. Although if income is zero, there is still spending in the economy because autonomous expenditures such as the amount results from borrowing and previous saving are still left. So the expenditure function can be expressed as the relationship between aggregate expenditures and income.



Source: 2003, Mc Grow-Hill Ryerson

Figure 2.2: The Keynesian Multiplier Effect

$$AE = AE_0 + mpcY \quad (2.2)$$

Based on the equation, AE is the aggregate expenditure, AE_0 is the autonomous expenditure, mpc is the marginal propensity to consume and Y is income. The expenditure function will be shifted up and down cause of changes in exogenous factors such as C , I , G , X and IM . The multiplier model cannot be used to investigate the income independent of the historical position.

$$Y = (\text{multiplier})(\text{autonomous expenditure}) \quad (2.3)$$

The multiplier is a number that shows how changes in the autonomous expenditure will impact on the income. Multiplier can be calculated as follows:

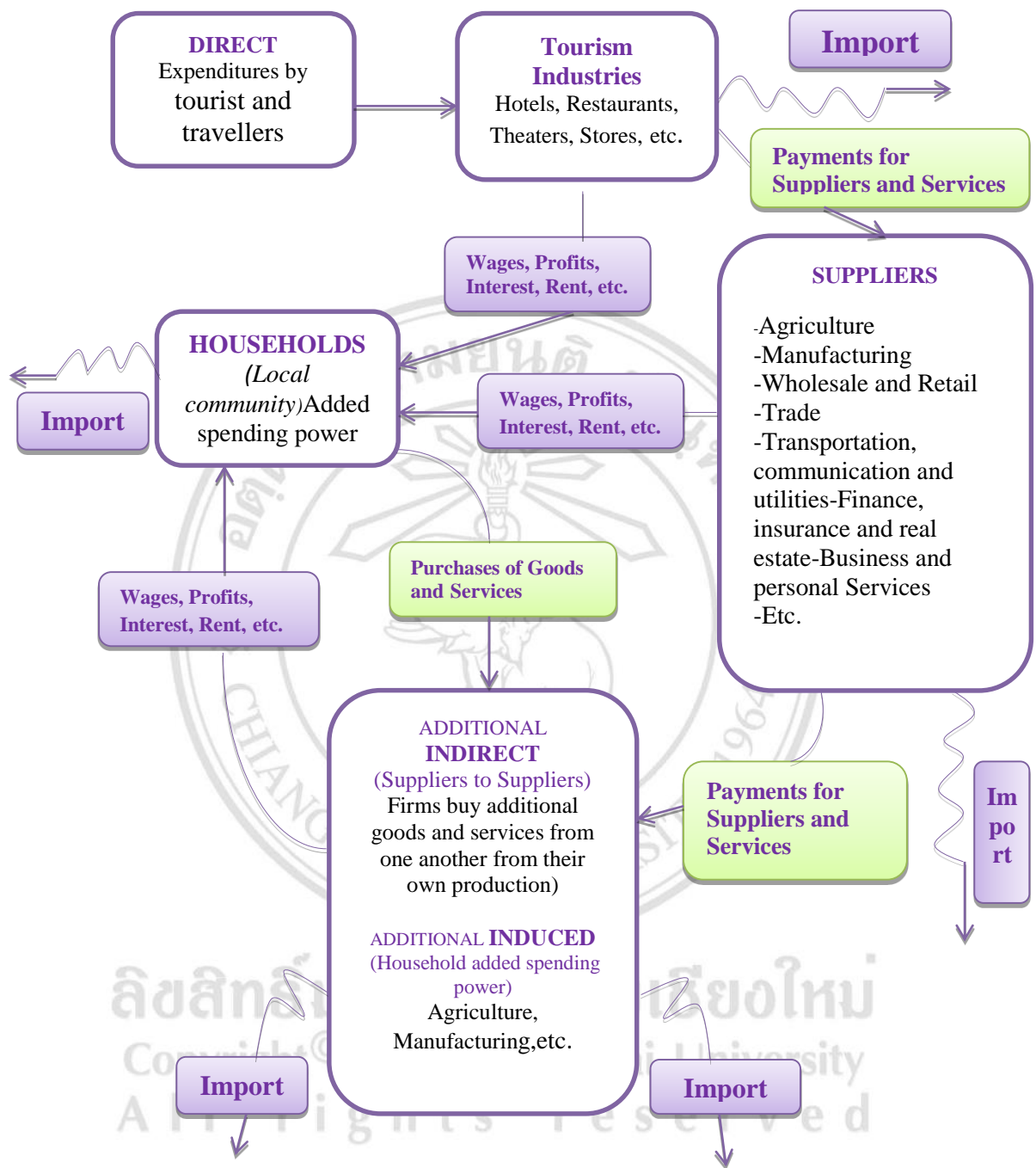
$$\text{Multiplier} = 1/(1 - mpc) \quad (2.4)$$

So the multiplier model reveals that how much income will change by multiplier times based on changes in autonomous expenditures. The action of this process will be done in the looping system until it reaches the new equilibrium level.

Archer (1982) pointed out that multipliers adjust the appearance of tourism sector in the economy which contributes to the effects of economic growth. It reveals the generation of income in the whole economy by increasing the spending in tourism sector. For example, if the investment in tourism sector is about 1 million dollars and the amount of income that generates in the economy is round about 6 million dollars, the Keynesian multiplier would be 0.7. Several types of multipliers that can be used in the tourism sector are sales multiplier, output multiplier, government revenue multiplier, income multiplier and employment multiplier. These multipliers are related each other. **Ugo Graspertino, Elena Bellini, Barbara Del Corpo and William Malizia (2008)** explained that not only tourism characteristics and economy of the country but also its size and population affect the multipliers.



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Source: Ugo Gasparino, Elena Bellini, Barbara Del Corpo and William Malizia (2008)

Figure 2.3: Direct, Indirect and Individual Benefits and Effects on the economy triggered by Tourist Spending

According to the facts said **Ugo Gasparino, Elena Bellini, Barbara Del Corpo and William Malizia (2008)**, visitors spend their money to buy goods and services in the host country. This expenditure directly flows to the economic activities

in the tourism industry such as hotels, restaurants, recreation places, and transportation. This can be the direct effect to the tourism industry. Some proportion of these revenues from the tourism sector are used to invest in buying intermediate goods and services from other sectors; to make repayment to households and suppliers for the factors of service production such as land, labour and capital; and to pay taxes to the government. So this proportion of earnings from the tourism sector is leaked out of the industry. This will lead to the occurrence of job opportunities inside and outside the industry. This can be referred to the indirect effects. The more employment will be in the economy, the more national income or output can be obtained in the country. Some proportion of this income will be used for saving and the rest will be for goods and services consumption. It is like another demand generation. This will be induced effects. So the multiplier effect in the tourism sector can define tourism development can be advantageous to economic growth in the near future.



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