

# Chapter 1

## Introduction

### 1.1 Overview

During the full course of economic development, the absolute and relative size of the service sector seems destined to grow faster than agriculture and industry, and eventually to dominate the entire economy. The predictions of the inevitable structural transformation from an agricultural potential has played a fundamental role in economic development to an industrial and finally to a service economy (Johnston & Mellor, 1961; S. S. Kuznets, 1965; S. S. Kuznets, 1966; S. S. Kuznets, 1971; Mellor, 1976) have been validated by econometric and non-parametric techniques by Chenery, Syrquin, and others (Chenery, 1960; Chenery & Syrquin, 1989; Chenery & Syrquin., 1975; Chenery & Taylor, 1968; Maizels, 1963; Prakash & Robinson, 1979). These studies have shown that, depending upon their initial level of GDP/capita and the rate or reduction of the percentage of the labour force engaged in agriculture, countries move either slowly or rapidly through two consecutive structural shifts called “industrialization” and “post industrialization.” It is during the latter that the absolute and relative size of the service sector comes to dominate valued added and employment generation.

What is true for nations may not always be true for specific regions within nations, however. The state of Hawaii has never been heavily industrialized, yet the economy is largely specialized in the service sector. The northern city of Chiang Mai

and the southern islands of Thailand also seem to have significantly reduced the length and intensity of the industrialization stage, virtually leap-frogging from the pre-industrial to the post-industrial service stages of economic development. The reason is obvious: the natural and cultural beauty that has destined certain places on the planet to serve, at least potentially, as prime tourist destinations. There has thus been what could be termed a “specialization” into tourism within the entire movement into the tertiary stage of the economy. The advantages, risks, contributing factors, and growth impacts of such specialization are the subject of this dissertation.

It should be noted at the outset that tourism is typically regarded as one of the most dynamic economic sectors and a key driver in creating much needed growth and employment. Although tourism has been seriously affected by the global crisis, it is rebounding more quickly and strongly than other export sectors (UNWTO, 2010). This means that specialization in tourism must be simultaneously analyzed through the optics of ecology, medical science, the remainder of businesses in the service sector, government policy, sociology, art, and of course economics. The tourist sector can therefore never stand alone as an object of scientific study or of government policy. For example, its employment potential and source of human capital formation stem from the labour-intensive nature of meeting the physical and transportation needs of the client; and the frequent, wide-scale interaction between host country agents and foreign country nationals.

On the demand side, foreign country nationals accept to invest their time, energy, and money in foreign travel in order to experience not only a new culture, climate or natural setting; but also to enjoy recreation, leisure, shopping, or business at lower prices than in their home country. Their motivations are thus both tangible

and intangible. The complexity of tourism is attributed to the high degree of vertical and horizontal coordination and interaction among the host- and home-country agents involved on the supply side; as well as the major personal, cultural, medical, and or religious transformations that the tourist will undergo on the demand side.

The international conference on Travel and Tourism Statistics in Ottawa, Canada in 1991, organized by the World Tourism Organization (UNWTO) and the Government of Canada, proposed a set of resolutions and recommendations relating to tourism concepts, definitions, and classifications. Based on the UNWTO definitions and classifications, tourism is defined as “the activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business, and other purposes” (UNWTO, 1995). While the standardized definition of tourism was defined, further technical terminology were defined in an attempt to make a clear distinction between different types of visitors. In the tourism context, visitor is defined as “any person travelling to a place other than that of his/her usual environment for less than 12 months and whose main purpose of visit is other than the exercise of an activity remunerated from within the place visited” (UNWTO, 2005). Based on the length of stay at the destination, a tourist is defined as a “visitor staying at least one night in a collective or private accommodation in the place being visited” (UNWTO, 1995).

The study of tourism economics involves detailed analysis at the micro level. The study includes the behaviour of tourists and their associated decision-making process study. In addition it also looks at the cost and benefits for the tourism supplier. Furthermore, in the macro level, the study contains the evaluation on the impact of tourism, as well as forecasting the demand and spending. The findings from

study often results in business planning and public policies that are favourable to the development of tourism.

### **Economics as Applied to Tourism: Microeconomic and Macroeconomic perspective**

Applied economics as a method for studying the tourism market can provide a better understanding of the forces that trigger the ebb and flow in the demand and supply of products/services. Economics can also be utilized to assess the impact for the purpose of establishing a policy to control the negative effects that are deemed as detrimental to the tourism industry as well as on other social factors such as community health, environmental sustainability, and illicit activities (smuggling of forbidden items, narcotics, human trafficking, etc.). If economics is taken from a micro perspective, the study on tourism would be concentrated on trying to understand the behavioural side that portrays the various profiles of tourism demand. Microeconomics allows the research to see how choices and decisions are made on maximizing the value of purchasing such a product from an individual. Individuals who are engaged in the travel and tourism sector can offer an abundance detail of information on how one arrives at planning, managing and marketing of a certain product or service while at the same illustrates why they purchase such a product or service. Microeconomics refers to tourism as the analysis of the markets in which the elementary items composing of the tourism product are supplied, in demand, and exchanged among the tourist and tourism provider. These items include such things as accommodation, package tours, and transportation. On the other side, macroeconomics deals with the performance, structure, behaviour and decision

making from the big picture of the economy as a whole. From a macro perspective tourism is put under the microscope to analyze the aggregate demand and production as well as the impacts on the national income, balance of payments, growth and development.

### **1.2 The Signification of the Problem and Research Motivation**

Based on the information from the World Tourism Organization, an affiliate of the United Nations, tourism since the 1960s has experienced a dramatic global expansion. The World Tourism Organization maintains that tourism has become one of the important sources for generating foreign exchange earnings, creating employment, promoting private sector growth, as well as infrastructure development (UNWTO, 1997). Tourism has evidently experienced continued growth and diversification to become one of the most diverse industries, as well as one of the largest and fastest growing economic sectors that has a strong influence on the social and economic activities of today's world (Edgell, 1990; Laws, 1995; UNWTO, 1997, 2009). Tourism development is consequently encouraged in many countries. It is encouraged particularly among the developing countries around the world as the alternative mean of achieving development when the establishment of manufacturing or exportation of natural resources have become unable to be commercially viable (UNWTO, 1997). Tourism development is a major contributor to trade and economic growth; it accounts for a significant 45 percent share of developing countries' service exports and 65 percent for least developed countries (LDCs) (UNCTAD, 2007).

The increasing importance of tourism in the global economy is firmly confirmed by the worldwide tourism statistics. The number of international arrivals



has evolved over the passing decades from a mere 25 million in 1950, to 277 million in 1980, to 438 million in 1990, to 684 million in 2000, and reaching 922 million in 2008 (UNWTO, 2009). This information could easily be considered as a natural outcome in a world that is increasingly interconnected through new modes of transportation and communication. According to the UNWTO's World Tourism Barometer, the results through August 2010 clearly showed that the number of international tourist arrivals worldwide grew by 7%. The positive current trend during 2010 indicates that international tourist arrivals continue to grow in the range of 5%-6% over the full year. The assessment for 2011 points out an expected growth rate of international tourist arrivals will continue to grow gradually at around the long-term average of 4% (UNWTO, 2010). Moreover, the forecast from UNWTO's "Tourism 2020 Vision" expects the figures for international arrivals to reach near the 1.6 billion mark by the year 2020. It is projected that these 1.2 billion worldwide arrivals will be intraregional while 378 million will be long-haul travellers. Having considered the roles of travel and tourism in the economy in the highest regards due to the value that it contributes towards the overall GDP of a nation or region as well as reducing the number of unemployment, it is estimated that tourism's contribution to the world GDP will be approximately at 5%. The contribution to employment tends to be just slightly higher. It has been estimated to be in the order of 6-7% of the overall number of jobs (direct and indirect) worldwide (UNWTO, 2000).

Given the fact that the role of tourism is of a significant essence, on a global basis, the primary attention is initially paid to the assessment in contribution of tourism to the economic development of destination economies. On a global scale, tourism has been regarded as one of the feasible means to promote economic

development of destination areas through a variety of economic benefits. It generates foreign exchange earnings and employment; in return there is an increase in social well-being and stability. There have been evidences that can be used to illustrate the role of tourism in being a tool for developing destination regions in many developing and developed countries. Government policy at a variety levels has been accordingly used to direct tourism to less economically developed areas (Weaver & Opperman, 2000). These issues are discussed as examples in literature. (Blair, 1995; Bull, 1995; Clewer & Sinclair, 1995; Goeldner, Ritchie, & McIntosh, 2000; Mathieson & Wall, 1982; Pearce, 1989; Tosun & Jenkins, 1996; Tribe, 1996).

In many destinations, an increasing significant contribution of tourism to the host economy has led governments to focus more in increasing the number of visitors by promoting mass tourism and large-scale production in the tourism sector itself as well as in other tourism-related sectors. The aim is on receiving a large amount of taxes from the successful private tourism businesses with little participation in collaborative tourism planning. The excessive rapid and unplanned development of tourism unintentionally creates benefitting results that are derived by communities (Ashley, 1998; Poultney & Spenceley, 2001). From this point of view, local residents may directly and indirectly gain benefits from additional development programs, such as the construction of infrastructure, or an introduction to anti-crime measures, This primarily aims at promoting a destination itself to be more attractive to tourists and improving the country's international competitiveness (A. Hashimoto, 2004).

However, despite the benefits to both the destination and tourists offered, the economic consequences and employment can be somewhat distorted if tourism development is limitedly concentrated in some particular areas of a country, while the

corresponding development in other parts has not been significantly promoted (UNWTO, 1994). Criticism focused specifically on the problems associated with the development of tourism is widespread and taken into high consideration (Croall, 1995; Poon, 1993). It is primarily concerned with optimizing the benefits of tourism to the destination areas and to tourists, whilst minimizing the negative consequence of tourism (Smith & Eadington, 1992). Also, there is an attempt to allow host communities to be socially and economically involved in the decision-making process in tourism development; which is often made by multinational tour companies and service providers (D.J. Timothy & Ioannides, 2002; Wilkinson, 1997). The alternative form of tourism development, with an emphasis on the involvement of local communities and local residents as a key resource in tourism planning and management, has become an important issue for debate and discussion in the tourism literature since the 1980s (Blank, 1989; Hardy, Beeton, & Pearson, 2002; Haywood, 1988). Community participation in tourism involves the psychological satisfaction of business ownership, a feeling of taking responsibility in decision-making, implementing and identifying local problems (France, 1998) introducing something that is adapted to the local needs (Lea, 1988), and having practical involvement in various forms of business participation. Opportunities for local residents to own businesses, to work in various industry-related jobs, to receive appropriate training, and to be well educated for tourism expansion are some characteristic form of participation (D. J. Timothy, 1999). As a result, the quality of life for the local people should be improved through the creation of employment, increased level of income, a better level of social welfare, and decreasing dependence on external agents and suppliers.



There are many case studies on the issue of capacity-building and training programs. In South Africa, these programs have provided the Makuleke community members benefits in employment opportunities and accessibility to communal land which was taken away from them during the apartheid years (Ashley & Roe, 2002). Also, in Costa Rica where it is often regarded as one of the most community-friendly destinations, 70% of the hotels are small and locally owned (Griffin, 1998). In addition, community-based ecotourism in the southeast region of Thailand has contributed to the communities in Phuket and its neighboring provinces by making direct payment to individuals and local suppliers (Kontogeorgopoulos, 2005). Furthermore, in Campbelltown, Australia, the existing tourism coupled with potential new products offers the local community benefits while natural resources and historical sites are conserved (Dwyer & Edwards, 2000). Thus these examples provide the fortunate benefits of countries being involved in the tourism development process. However, the level and types of benefits to the host countries/communities will vary from destination to destination. It depends on the kind of participation that takes place.

While tourism significantly contributes apparent benefits to destinations, it is often argued that tourism can also generate negative impacts on the natural, social, and cultural environments of that destination. In many destinations, there are concerns about social changes such as gender empowerment, family structure, and traditional values. (see (Bruner, 1995; A. Hashimoto, 2000; Leontidou, 1994; McCarthy, 1994; Mignolo, 1998; Momsen, 1994; Patterson, 1993; Staudt, 1998), for example) Tourism also creates a specific awareness on the significance of natural and living environments as tourism assets, particularly with environmental pollution and

resource depletion (see (Croall, 1995; Jenner & Smith, 1992; Lovatt-Smith, 1993; Mieczkowski, 1995; Southgate & Hulme, 2001), for example).

In summary, tourism provides an overall quality of life and well-being in that destination. But at the same time, tourism itself can sometimes become a double-edged sword for governments to handle. On the beneficial side some of the things that tourism does is promoting new tourism-related activities, increasing the production of indirect suppliers to tourism business owners, creating additional employment and extra income for earning, and stimulating consumption for new goods and services. Simultaneously, the impacts of tourism, (particularly on the social, cultural, and environmental issue) make changes that are not always considered as positive (A. Hashimoto, 2004). What makes it compelling to analyze the developmental roles of tourism in the economy is addressed on whether tourism is an applicable development option for all destination areas. The content should be addressed on the influential factors/conditions that potentially determine the extent to which tourism can provide effective consequences on the host economies. There should also be a review on whether the extent of a country's relevance to tourism (or alternatively a country's specialization in tourism) significantly causes a differential impact, which is principally referred to as "economic benefits".

Taking economic growth as the fundamental indicator of economic development, the first two studies in this dissertation is therefore concerned about the success of any economic growth attributed to the tourism sector, which is depended upon the country's different. In other words, the extent of a country's specialization in tourism may have a differential effect on economic growth with respect to the conditional variables that tourism has an influence on. In this respect, the first study in

this tripartite dissertation identifies whether and to what numerical extent that tourism actually leads to economic growth in various economies; it is classified according to the degree of tourism specialization. The second study further examines whether specialization in tourism has the same impact on economic growth in countries that are different in their degrees of trade openness, investment share to GDP, and government consumption as a percentage of GDP. To conduct this study, the analysis is undertaken with different threshold variables. As far as the presence of the potential contribution of tourism to development is a prime concern, there is an important reason to quantify the apparent relationship between tourism specialization, economic growth, and correction for biasness that has arisen from the endogeneity problem in the economic growth model by applying an instrument variable estimation.

The continuing growth of worldwide tourism demand has also stimulated stronger interest in studies using time-series modelling. The focus of the third study is on the time-series tourism modelling, which particular pays attention to exploring the historic trends and patterns. The changes in tourism demand have been recognized as an important potential mean for achieving economic development. Substantial research has been conducted to evaluate the role of international tourism, and its associated volatility, within and across various economies. However, there has been minimal effort in exploring the interdependence between tourism demand in leading tourism countries such as South-East Asia; which is considered as one of the strongest performing sub-regions of Asia and the Pacific. Each country could obtain a benefit as well as a shock that could occur from an affected country. If such condition continues on, this should increase and stabilize the demand from those neighbouring countries. For example, negative shocks, which can be alleged as political instability,

terrorism, violent criminal behaviour, and natural disasters, generally have the potential to reduce the stipulation and increase volatility in tourism demand. The topic of the third study verifies whether the impact of shocks to tourism demand in one destination would likely be volatile to the demand for international tourism in other neighbouring destination.

### 1.3 Objectives of the Study

The influence of tourism specialization on economic growth has received great attention in recent studies (see (Adamou & Clerides, 2010; Algieri, 2006; Arezki, Cherif, & Piotrowski, 2009; Brau, Lanza, & Pigliaru, 2007; Figini & Vici, 2010; Lanza & Pigliaru, 2000; Po & Huang, 2008) Furthermore, the existence of nonlinearity and threshold effects has been increasingly recognized as a critical issue for tourism and economic growth, with a more complex and heterogeneous relationship. The main objective of the first and second study is to identify nonlinearity and threshold effects in the tourism and economic growth relationship conditional on the various macroeconomic variables. In the first study, the travel and tourism (T&T) economy GDP (in which the role of domestic tourism as well as international tourism are included) is used as a threshold variable in tourism and economic growth relationship.

In the second study special attention is given to identify the relationship between tourism specialization and economic growth, with different possible threshold variables which are highly related to tourism development, namely degree of trade openness, investment share to GDP, and government consumption expenditure as a percent of GDP, as well as to correct for potential endogeneity problem that is likely to happen in the relationship between tourism specialization and economic growth. To

the best of my knowledge, there has not been any analysis that identifies the existence of threshold effects of tourism specialization on economic growth with a correction for potential endogeneity.

The purpose of the third study is to estimate the conditional variance, or volatility, of monthly international tourist arrivals to four tourism leading South-East Asia economies, namely Indonesia, Malaysia, Singapore and Thailand. The purpose is to also determine the interdependence of international tourism demand of leading ASEAN destinations for the period of January 1997 to July 2009. The modeling and analysis of volatility in tourism demand can provide a useful tool for tourism organization and government agencies that are concerned with travel and tourism. This is especially for encouraging regional co-operation in tourism development among ASEAN member countries and to mobilize international and regional organizations to provide an appropriate policy for action.

The separate but complementary objectives of the three empirical studies are briefly concluded as followed:

1. To investigate whether the relationship between tourism and economic growth is different in each sample that is grouped on the basis of certain threshold, which is the travel and tourism (T&T) economy GDP, in the 131 cross-country panel dataset.
2. To identify nonlinearity and threshold effects in the tourism and economic growth relationship, conditional on the degree of trade openness, investment share to GDP, and government consumption expenditure as a percent of GDP, with a correction for potential endogeneity in the 159 cross-country panel dataset and pure cross-section dataset.



3. To estimate the conditional variance, or volatility, of monthly international tourist arrivals to four tourism-leading South-East Asia countries, namely Malaysia, Thailand, Singapore, and Indonesia, and to determine the interdependence of international tourism demand of these countries.

#### **1.4 Contribution of the literature**

There are at least three areas of novelty or connection in the present dissertation:

- No previous studies have been rigorously evaluated in the nonlinear relationship between tourism and economic growth through two powerful methods, namely the panel threshold model (Hansen, 1999) and instrumental variable (IV) estimation of a threshold model (Caner & Hansen, 2004). These two models have advantages over traditional approaches and are used to deal with the potential endogeneity of the level of tourism specialization in empirical growth regressions.

- No previous studies have investigated the existence of the heterogeneity in the tourism and economic growth relationship and the extent of tourism's contribution conditioning on the various key variables, namely the degree of trade openness, investment share to GDP, and government consumption as a percentage of GDP. To achieve this objective, the analysis is undertaken with different threshold variables and regimes through the panel threshold regression model of Hansen (1999) and IV threshold model of Caner and Hansen (2004).

- The analysis of uncertainty in monthly international tourism arrival to major destinations in South-East Asia has not been empirically investigated in the

tourism literature. The results will indicate the existence of tourism interdependence among those countries.

#### 1.5 Policy Relevance

Recognition of the existence of the heterogeneity in the tourism and economic growth relationship yields important implications for the development of tourism, trade and associated macroeconomic policy. Tourism's contribution to economic growth exhibits either an increasing or diminishing rate after reaching a certain threshold. The findings could provide a useful partial guidance in devising a plan for the economy's resource allocation. For example, if it is found that the contribution of tourism to economic growth lessens as the country attains high level of specialization, reallocation of resources in the tourism sector to other high potential economic sectors would lead countries to being better off. Moreover, if countries closely monitor the level of three important key variables (degree of trade openness, investment share to GDP and the government consumption expenditure as a percent of GDP) they can keep them at an appropriate level that would ensure that the extent of tourism's contribution will not be less significant to their economy beyond some certain level of such factors.

The estimates from tourism demand volatility analysis provide an indication of the relationship between shocks to the growth rate of monthly international tourist arrivals in each major destination in South-East Asia through the multivariate GARCH framework. This should provide useful guidance for government as well as for entrepreneurs in the tourism sector of these countries in implementing proper policies and business plans which would lead to great benefits gained from tourism volatility linkages.

## **1.6 Structure of the Dissertation**

Chapter 2 provides a study of tourism specialization and economic growth within the econometric models. The macroeconomic variables are incorporated to verify whether the heterogeneity relationship between these two variables varies across the samples classified by the level of tourism specialization which is defined by the degree of tourism relevance to the economy.

Chapter 3 assesses the determinants of growth, where the focus is on the role of tourism specialization within the neoclassical framework. In this study, panel threshold regression method as well as the instrumental variable threshold model is used to investigate threshold effect in the relationship between tourism specialization and economic growth. Three macroeconomic variables related to tourism variables, namely the degree of trade openness, investment share to GDP and the government consumption expenditure as a percent of GDP, are used as threshold variables in this study.

Chapter 4 identifies the multivariate conditional volatility of international tourism demand, as measured by international tourist arrivals, and its associated volatility in the four leading destinations in ASEAN, namely Indonesia, Malaysia, Singapore and Thailand. The estimates provide an indication of the relationship between shocks to the growth rate of monthly international tourist arrivals in each major destination in South-East Asia through the multivariate GARCH framework.

Chapter 5 provides conclusions from the three studies. Recommendations are also made for future research.