

**RELATIONSHIP BETWEEN TOURISM AND ECONOMIC GROWTH:
EVIDENCE FROM INDIA**

Mohd. Janey Alam Khan & Arpit Mohan Srivastava

Ph.D. Scholar, Faculty of Commerce and Management, Rama University Kanpur Uttar Pradesh
janeyalam1981@gmail.com

ABSTRACT

Tourism is one of the most important sectors in the world economy. It is now considered as an efficient tool for promoting economic growth of the host country. Since last few decades, tourism industry in India has been growing at a rapid pace and it has vast potential for generating employment and earning large amount of foreign exchange besides giving a fillip to the country's overall economic and socio-cultural development. It is thus imperative to examine the dynamics of the relationship between tourism sector expansion and economic growth in India. This paper is an attempt in this direction. The study using popular time series models for the period spanning from 1980 to 2016 provides the evidence of long-run unidirectional causality from tourism activities to economic growth of the country. Therefore, as a part of the policy implications it is necessary that all wings of the central and state governments, private bodies and voluntary organizations should become the active partners in the Endeavour to attain sustainable growth in tourism and overall economy as well.

Keywords: *Tourism, India, Economic Growth, Co integration, Granger Causality, Economy.*

Introduction

In recent years, the role of tourism in the economic development of a country has been the focus of study and research. It is the general consensus that tourism has been pivotal in social progress as well as an important vehicle of widening socio-economic and cultural contacts throughout human history. Over the past years, many developing and developed countries have considered tourism as an option for sustainable development of their nations. The importance of tourism as a contributor to economic growth is so widely accepted that year after year throughout the world a massive investment continues to pour in its development. Tourism has emerged from being a relatively small-scale activity into one of world's largest industries and a fastest growing global economic sector of the world economy from the 1960s onwards. The international tourist arrivals

have shown an uninterrupted growth from 25 million in 1950, to 681million in 1980, to 438 million in 1990 and to 681million in 2000. The international tourist arrivals were 880 million and the corresponding international tourism receipts was US\$ 852 million in 2009.

The tourist arrivals in Asia and the Pacific were 181 million and corresponding tourism receipt was US\$ 204 million. As per UNWTO estimates, the worldwide international tourist arrivals increased by 7 per cent between January and June 2010. For the full year 2010, UNWTO projects a growth in international tourist arrivals of between 3 to 4 per cent. In 2010, tourism is expected to generate 21.7 per cent of world gross domestic product; 10 per cent of global capital investments; 9 per cent of worldwide employment; and 22.2 per cent of worldwide exports of goods and services. All these cast for a significant role of tourism sector in the long-run growth of host countries across the globe.

It was in 1945 that the first ever step was taken to popularize the concept of tourism in India, by appointing the Sir John Sargent Committee which in 1946 submitted the report with suggestions of the formation of regional offices at Bombay, Delhi, Calcutta and Madras. And, it came into being in 1949 with the set up of a Tourist Traffic Branch along with two regional offices in Bombay and Delhi. It was however, on 1 March 1958, that a separate Tourist Department in the ministry of Transport and Communication was established in place of Tourist Traffic Branch in the same ministry. In 1967, tourism elevated to the Ministry of Tourism and Civil Aviation. And, since then the concept of tourism developed and gathered momentum in India.

Tourism today has become an important segment of India economy contributing substantially to sustainable development of the country. India has succeeded in becoming the most preferred place amongst domestic and overseas travelers. Tourism exposes international travellers to India's diverse culture. The tourism sector has been instrumental in generating foreign exchange, employment opportunities and household income for Indians, as it has in many other developing economies. Thus, the development of the tourism sector appears to have been as important as the development of other sectors of the Indian economy.

The biggest advantage of the tourism industry is that it can generate maximum employment opportunity. Tourism helps in regional and economic development. Recent study shows that the globalisation and open economy helped tourism to emerge as one of the biggest forex earners for India. It brings the opportunity of infrastructure development. The overall development of any country depends especially on the improvement of road, vehicles, communication, water supply,

airports and railway stations. Economic progress and industry development depend completely on the overall development of country. And tourism plays a major role in this overall infrastructural advancement. Tourism helps agriculture and other industries directly and indirectly. In India, the tourism industry helped generate about five million jobs; the foreign tourists buy handicrafts worth around Rs. 10 billion a year; the total income from this smokeless industry is around Rs. 200 billion; and the regions like Aurangabad in Maharashtra, Khajuraho in MP, Jammu & Kashmir, and Raghurajpur in Orissa have emerged with the help of tourism only. Tourism is therefore, a major engine of growth for Indian economy. Today tourism is the largest service industry in India, with a contribution of 6.23 per cent to the national Gross Domestic Product (GDP) and providing 8.78 per cent of the total employment. India witnesses more than 5 million annual foreign tourist arrivals and 562 million domestic tourism visits. The tourism industry in India generated about US\$100 billion in 2008 and that is expected to increase to US\$275.5 billion by 2018 at a 9.4 per cent annual growth rate. According to World Travel and Tourism Council, India will be a tourism hotspot from 2009-2018, having the highest 10-year growth potential.

As per the Travel and Tourism Competitiveness Report 2009 by the World Economic Forum, India is ranked 11th in the Asia Pacific region and 62nd overall, moving up three places on the list of the world's attractive destinations. It is ranked the 14th best tourist destination for its natural resources and 24th for its cultural resources, with many World Heritage Sites, both natural and cultural, rich fauna, and strong creative industries in the country. India also bagged 37th rank for its air transport network. The India travel and tourism industry ranked 5th in the long-term (10-year) growth and is expected to be the second largest employer in the world by 2019. Tourism sector in India is, therefore, growing and it has vast potential for generating employment and earning large amount of foreign exchange besides giving a fillip to the country's overall economic and social development.

It is with this backdrop, this paper is an attempt to investigate the dynamics of the relationship between tourism sector development and economic growth of India for the sample period of 1980 to 2016. The study purports to answer the questions: Is there holds a long-run equilibrium relationship between tourism sector development and economic growth in India? And, if a long-run relationship exists, what is the direction of the causal relationship between them? Above stated the research problem, the rest of the paper is organised as follows: Section II reviews the

related studies, Section III discusses the data and methodology, Section IV makes the analysis, and Section V summarizes and concludes.

Literature Review

There exists plenty of literature about the impact of tourism sector expansion on the host country, but the literature on whether it actually produces any significant economic growth is limited and that too for emerging countries like India, the empirical researches and evidences are almost non-existent. The researchers and analysts hold the view that the rapid growth of tourism sector causes an increase of household incomes and government revenues through its multiplier effects, improvements in the balance of payments, and growth of the tourism industry by itself. As such, the development of tourism has usually been considered a positive contribution to economic growth (Khan *et al*, 1995; Lee and Kwon, 1995; Lim, 1997 and Oh, 2005). Keeping in view such positive impact of tourism on economic growth many researchers have investigated the relationship between tourism sector development and economic growth in a country.

Using Spain's economic data, Balaguer and Cantavella-Jorda (2002) examine the role of tourism sector in the long-run economic development of the country. The hypothesis of tourism-led economic growth was confirmed by applying cointegration and causality tests. In Turkey, Tosun (1999), Guduz and Hatemi (2005) and Zortuk (2009) have also found empirical support for the tourism-led growth hypothesis. Durbarry (2002) also provides the evidence of the tourism-led economic growth by using the cointegration and causality tests for Mauritius.

Dritsakis (2004) shows that tourism has a long-run economic growth effect for Greece. Oh (2005) on Korean tourism concluded that the increase in tourism income influences the economic growth. Kim *et al* (2006) examine the causal relationship between tourism development and economic growth in Taiwan and find a reciprocal relationship between tourism development and economic growth.

Khalil *et al* (2007) examines the role of tourism in the short-run economic development in case of Pakistan through error correction model, and the Causal relationship between tourism receipts and economic expansion. The results points out that there is strong relationship among tourism, receipts and economic expansion which means that economic expansion is necessary for tourism development in Pakistan. Wickremasinghe and Ihalanayake (2006) investigate the issue that tourism industry leads to economic development for a developing country - Sri Lanka, using

annual data from 1960 to 2000. The results of the study suggest that there is a significant causal relationship from tourism receipts to the GDP of Sri Lanka.

Razaq and Masarwah (2006) discussed the effects of tourism sector on the Jordanian economy. The dimensions of the study clarified causal relationship between the tourism revenues and the economic growth, and employment in the tourism sector, and domestic private consumption. Johansen Co-Integration Approach clarified, that there is balanced relation in long-run among the variables of the study, while the findings of the short-run analysis pointed out that tourism revenues played basic role in the most important economic variables. Eugenio-Martin *et al* (2004) investigate the relationship between tourism and economic growth for Latin American countries from 1985 through 1998. The empirical results show that tourism development can contribute to the economic growth of medium or low-income countries, while such a role is unclear for developed countries. Lee and Chang (2008) reached the conclusion that there is a unidirectional relationship running from tourism towards growth for OECD countries whereas a bidirectional causal relationship exists for non-OECD countries. Skerritt and Huybers (2005) investigate the effect of international tourism on GDP per capita of 37 developing countries, the results indicate that tourism positively affect economic development in these countries.

Comparing the relative growth performance of 14 “tourism countries” within a sample of 143 countries, Brau, Lanza, and Pigliaru (2003) and Lee and Chang (2008) document that, on the average, tourism enhances the economic growth process; i.e. tourism countries tend to grow faster than all the other sub-groups (OECD, Oil Exporting, LDC, Small). Many developing countries have, thus started to regard tourism as an integral part of their economic growth and development strategies since it serves as a source of scarce financial resources, job creation, foreign exchange earnings, and technical assistance (Sinclair, 1998; Dieke, 2004). Fayissa *et al* (2007) using a panel data of 42 African countries, showed that receipts from tourism industry significantly contribute to economic growth of Sub-Saharan African countries. In another study, Fayissa *et al* (2009) using a panel data of 17 Latin American countries for the years that span from 1995 to 2004, investigated the impact of the tourism industry on the economic growth and development Latin American countries within the framework of the conventional neoclassical growth model. The empirical results show that revenues from the tourism industry positively contribute to both the current level of gross domestic product and the economic growth of Latin American Countries as do investments in physical and human capital. Kreishan (2010) examines

the causality relations between tourism earnings and economic growth for Jordan, using annual data covering the period 1970-2009. The findings of the study showed that there is a positive relationship between tourism development and economic development in the long-run. Moreover, the Granger causality test results revealed the presence of unidirectional causality from tourism earnings to economic growth. Aliqah and Al-rfou' (2010) attempted to determine the impact of the tourism sector on economic growth in Jordan during the period 1990 to 2008 by using descriptive statistical approach.

The study concluded that the tourism sector witnessed significant growth in tourism services, tourism infrastructure, tourism legalisations, institutional framework, and the number of tourist arrivals. The study also revealed that the contributions of the tourism sector in GDP for the years 1990-2008 have seen variation ranged between 12.3 to 14.6 per cent and increase in the contributions of tourism sector, in the field of employment to become 2.5% of the total manpower recruitment.

It is at least inferred from the literature review that developing countries have started Considering tourism as an important and integral part of their economic growth and development strategies. It is in this context worthwhile to mention that the literature is almost silent about a causality study between tourism sector development and economic growth in case of India. The current study is an attempt to bridge this research gap.

Methodology

The objective of this paper is to investigate the dynamics of the causal relationship between tourism sector development and economic growth in India for the period spanning from 1980 to 2016. This study uses annual data on variables – Real Gross Domestic Product (RGDP) which measures the overall economic growth of the country, and Tourism Foreign Exchange Earnings (TFEE) and Foreign Tourist Arrivals (FTA) as measures of tourism sector expansion (Wang and Godbey, 1994; Gunduz and Hatemi-J, 2005; Kim *et al*, 2006). The time-series data of RGDP, TFEE and FTA variables on annual basis have been collected from the RBI database on Indian economy, Bureau of Immigration, and from tourism statistics published by Ministry of Tourism, Government of India. All the variables of the study have been transformed to their natural logarithms to avoid the obvious problems of heteroscedasticity. Then, the stationarity of the variables have been tested by Augmented Dickey-Fuller unit Roots Test. In the second step, the Johansen's co integration test has been performed to assess whether a long-run equilibrium

relationship holds between the research variables. Finally, the Granger causality test has been applied in the vector error correction framework to find out the direction of causal relationship between the co integrated variables.

Results and Discussion

At the outset, the Pearson's correlation coefficient between real GDP and Foreign Arrivals (FTAs) in India, and between real GDP and Foreign Exchange Earnings (FEEs) from tourism have been calculated over the sample period and their significance have been tested by the t-test. The value of Pearson's correlation coefficient (r) between real GDP and FTAs is 0.985. Similarly, the correlation coefficient between real GDP and FEEs is 0.988. It shows that these three variables are positively related over the sample period in India and that to a very high degree of correlation is evident between them. To test whether these values of ' r ' shows significant relationships between three time series, student's t-test has been used. The null hypothesis of the test is $r = 0$ against the alternative of $r \neq 0$ for both the correlations. Since the t-statistic at 30 degrees of freedom exceeds the critical value of ' t ' at 5% level of significance, the null hypotheses are rejected. So, it can be said that the correlation between the variables of the study are statistically significant. Correlation, however, does not say anything about long-run relationship and thus, leaves unsettled the debate concerning the long-run relationship between tourism sector expansion and economic growth in India

Conclusion

In this paper, the relationship between real GDP, foreign tourist arrivals and foreign exchange earnings from tourism in a developing country like India has been investigated using popular time series methodologies. The data properties are analyzed to determine the stationarity of time series using the Augmented Dickey-Fuller unit root test which indicates that all the three series are $I(1)$. The results of the Co-integration test based on Johansen's procedure indicate the existence of the co-integration between variables. Therefore, the variables have a long-run equilibrium relationship between them, although they may be in disequilibrium in the short-run. The estimation of vector error correction model based on VAR indicates the existence of long-run unidirectional causality running from foreign exchange earnings from tourism to real GDP in the long-run. However, no short-run causality between variables is indicated. The findings of this study confirms the tourism-led growth hypothesis maintained earlier for other countries that tourism has a positive impact on the economic activity and hence, the GDP growth of India. The

study also validates the stable long-run relationship between tourist activities and GDP growth rate. It means that if tourists activities increase, the GDP growth rate improves via increase in oreign exchange earnings. It provides the rationale of government role for providing and generating the tourism facilities in India. Fortunately, India has several unique opportunities for different types of tourism including traditional tourism, rural tourism, medical tourism, cruise tourism, adventure tourism, and wellness tourism. Its geographical location has made it a historical and cultural hub for the tourism. The country has great potential in coastal tourism, mountain climbing and layout tourism adventures trip and tremendous opportunities in the areas of echo and safari tourism. Some of the recent initiatives taken by the Government of India to boost tourism include grant of export house status to the tourism sector and incentives for promoting private investment in the form of income tax exemptions, interest subsidy and reduced import duty. The hotel and tourism-related industry has been declared a high priority industry for foreign investment which entails automatic approval of direct investment up to 51 per cent of foreign equity and allowing cent per cent nonresident Indian investment and simplifying rules regarding the grant of approval to travel agents, tour operators and tourist transport operators. The government joined hands with leading airlines, hoteliers, holiday resorts and tour operators, and offered them a wide range of incentives and bonuses during the period between April and December.

In spite of the aforesaid initiatives, the major constraints in the development of tourism in India is the non-availability of adequate infrastructure including adequate air seat capacity, accessibility to tourist estinations, accommodation, and trained manpower in sufficient number. Besides, the poor visitor experience is another obstacle in the growth of tourism sector which is due to inadequate infrastructural facilities, poor hygienic conditions and incidents of touting and harassment of tourists in some places.

So the following suggestions may be put forward for the growth of tourism sector in India: First, the Government of India should concentrate on the means of transportation, communication and power for the promotion of tourism industry in the country; Second, to attract the foreign tourist, the security issues should be handled in the best possible manner; Third, as the tax structure plays a vital role in industrialization process, the government should give tax incentives to the air fares, hotels and other tourism related industries; Fourth, the cultural and traditional festivals should be organized to create attractions for foreign tourists; Fifth, the journals, brushers with

maps and proper guidance should be placed in all important hotels and tourists gateways so that the tourist from any corner of the world can benefit from it without any communication barrier; Sixth, both the electronic and print media should be encouraged to play an important role in enhancing the demand for tourism in India through aggressive advertisement; Seventh, the eco-tourism needs to be promoted so that tourism in India helps in preserving and sustaining the diversity of the country's natural and cultural environments; Last but not the least, tourism in India should be developed in such a way that it accommodates and entertains visitors in a way that is minimally intrusive to the environment and sustains and supports the native cultures in the locations it is operating in.

References

- Aliqah and Al-rfou' (2010): "The Role of Tourism Sector on Economic Development in Jordan During the Period 1990-2008", *European Journal of Economics, Finance and Administrative Sciences*, Vol.18, pp.173-180
- Balaguer, L. and M. Cantavella-Jorda, (2002): "Tourism as a Long-Run Economic Growth Factor: The Spanish case", *Applied Economics*", Vol.34, pp. 877-884.
- Brau, R., A. Lanza, and F. Pigliaru (2003): "How fasts are the Tourism Countries Growing? The Cross-Country Evidence", *CRENoS Centro Ricerche Economiche Nord Sud, Working Paper No.03-09*,
- Dickey, D.A. and W.A. Fuller (1979): "Distribution for Estimators for Autoregressive Time Series with a Unit Root", *Journal of the American Statistical Society*, Vol.74, pp.427-431.
- Dickey, D.A and W.A. Fuller (1981): "Likelihood Ratio Statistics for Autoregressive Time Series", *Econometrica*, Vol.49, pp.1057-1072.
- Dieke, Peter U.C., (2004): "Tourism in Africa's Economic Development: Policy Implication," *Management Decision*, Vol.41, No.3, pp.287-295.
- Dritsakis, Nikolas, (2004): "Tourism as a Long-Run Economic Growth Factor: An Empirical Investigation for Greece", *Tourism Economics*, 10, pp. 305-316.
- Durbarry, R. (2002): "The Economic Contribution of Tourism in Mauritius". *Annals of Tourism Research*, Vol.29, pp. 862-865.
- Engle, R.F. and Granger, C.W.J. (1987): "Cointegration and Error Correction: Representation, Estimation and Testing", *Econometrica*, Vol.55, pp.251-76.
- Eugenio-Martin, J. L., N. M. Morales, and R. Scarpa (2004): "Tourism and Economic Growth in Latin American Countries: A Panel Data Approach", *Fondazione Eni Enrico Mattei Working Paper Series*.
- Fayissa, B. C. Nsiah, and B. Tadasse, (2007): "The Impact of Tourism on Economic Growth and Development in Africa", Middle Tennessee State University, Department of Economics and Finance, *Working Papers*, No. 16.

- Fayissa, B, Nsiah, S. and Tadesse, B. (2009): “Tourism and Economic Growth in Latin American Countries (LAC): Further Empirical Evidence”, *Working Paper Series*, Department of Economics and Finance,
- Granger C. W. G. (1969): “Investigating Causal Relationships by Economic Models and Cross Spectral Models”, *Econometrica*, Vol.37, pp. 424-38
- Granger, C.W.J. (1986): “Developments of the Study in Cointegrated Variables”, *Oxford Bulletin of Economics and Statistics*, Vol. 48, pp.213-28.
- Granger C. W. J. (1988): “Some Recent Development in a Concept of Causality” *Journal of Econometrics*, Vol. 39 p. 199-211.
- Gunduz, L., and A. Hatemi-J (2005): “Is the Tourism-Led Growth Hypothesis Valid for Turkey?” *Applied Economics Letters*, Vol.12, pp. 499-504
- Johansen, S. (1988): “Statistical Analysis of Cointegration Vectors”, *Journal of Economic Dynamics and Control* 12, 231–54.
- Johansen, S. (1989): “The Power of the Likelihood Ratio Test for Cointegration”, *Institute of Mathematical Statistics, University of Copenhagen*, (Mimeographed).
- Johansen, S. (1991): “Estimation and Hypothesis Testing of Cointegration Vectors in Gaussian Vector Autoregressive Models”, *Econometrics* 59, 1551–80.
- Johansen, S. (1992): “Cointegration in Partial Systems and the Efficiency of Single Equation Analysis”, *Journal of Econometrics* 52, 389–402.
- Johansen, S. (1995): *Likelihood-Based Inference in Cointegrated Vector Autoregressive Models*. Oxford: Oxford University Press.
- Johansen, S., and K. Juselius (1990): “Maximum Likelihood Estimation and Inference on Cointegration - with Applications to the Demand for Money”. *Oxford Bulletin of Economics and Statistics* 52, 169–210.
- Khan, H. S. Phang, R. Toh, (1995): “The Multiplier Effect: Singapore’s Hospitality Industry”,
Cornell Hotel and Restaurant Administration Quarterly, Vol.36, pp. 64-69.
- Khalil Samina, Mehmood Khan Kakar, and Waliullah, (2007): “Role of Tourism in Economic Growth: Empirical Evidence from Pakistan Economy”, *The Pakistan Development Review*, Vol. 46, No. 4, Part II (2007) 985–995.
- Kim, H.J., M.-H. Chen, and S.S. Jang, (2006): “Tourism Expansion and Economic Development: The Case of Taiwan”, *Tourism Management*, Vol.27, pp. 925-933.
- Kreishan, F. M. M (2010): Tourism and Economic Growth: The Case of Jordan”, *European Journal of Social Sciences*, Vol.15, No.2, pp.63-68
- Lee, C. and K. Kwon, (1995): “Importance of Secondary Impact of Foreign Tourism Receipts on the South Korean Economy”, *Journal Travel Research*, Vol.34, pp. 50-54.
- Lee, C-C and C-P Chang, (2008): “Tourism Development and Economic Growth: A Closer Look at Panels”, *Tourism Management*, Vol.29, pp. 180-192.