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The relationship between tourism, financial development and economic growth in India

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Abstract

This study investigates relationship between tourism and economic growth in India by considering the relative importance of financial development over the period of 1960–2014. The results of newly-developed Bayer and Hanck combined test indicate that tourism, economic growth and financial development are cointegrated. It is shown that the inbound tourism spurs economic growth in India both in long-run and short-run. In addition, the analysis indicates the presence of a long-run one-way Granger-causation running from tourism to economic growth. It is suggested that policies for attracting more international tourists should be promoted.

Keywords: Economic growth; India; Bayer and Hanck model; ARDL model; VECM; Variance decomposition

1. Introduction

The tourism has become the world's fourth largest export industry after fuels, chemicals and food (Tugcu, 2014; Balli, Curry & Balli, 2015). Specifically, tourism accounts for 6 per cent of the world's total merchandise and service exports that represent 30 per cent of international trade in services in the year 2014. Besides, 9.8 per cent of the world's total gross domestic product (GDP) originates in the tourism sector during the same period. The influence of inbound tourism on national economies is becoming increasingly important because of the growing size of the tourist market. In this context, the tourism-led growth hypothesis (TLGH), proposed by Balaguer and Cantavella-Jordá (2002), postulates that expansion of international tourism activities generates economic growth. The TLGH is directly derived from widely known export-led growth hypothesis (ELGH) which suggests that economic growth can be promoted not just by expanding human resources and technology inside of the economy, additionally by expanding foreign exchange earnings.

Analogously to the export, inbound tourism can stimulate economic growth in numerous ways. For instance, first, tourism significantly contributes to foreign exchange reserves which help in bringing new technologies for production process (McKinnon, 1964). Secondly, tourism stimulates investments in new infrastructure, human capital and increases competition (Blake, Sinclair, & Campos, 2006; Lemmetyinen and Go, 2009). Thirdly, inbound

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tourism promotes industrial development through spillover effects (Cernat & Gourdon, 2012). Fourthly, tourism creates jobs and hence stimulates earnings (Lee & Chang, 2008). Finally, tourism generates positive economic externalities (Punia, 1994; Andriotis, 2002; Weng & Wang, 2004; Croes, 2006).

Regarding other factors affecting economic growth, it may be noted that financial development is also emerging as an important driver of economic growth (Shahbaz, Kuma, Ivanov & Loganathan, 2016). Besides, Ridderstaat and Croes (2015) established a link between money supply and tourism demand cycles.[1] Indeed, the global tourism has been severely affected by the recent financial crisis (Papatheodorou et al., 2010). From our foregoing discussion, it appears that there is a reasonable relationship between economic growth, tourism and financial development. Against this background, the objective of the current study is to investigate the plausible linkages between economic growth and tourism while considering the relative importance of financial development in the context of India.

1.1. Importance of tourism in India

The enduring ability of the tourism sector to advance economic growth and make employment at a quicker rate than the other sectors of the economy has driven the Government of India (GOI) to reform its tourist visa policy, develop infrastructure, and rationalize the rates of luxury tax in conformity with best international practice. Besides, the GOI has also recently formulated National Tourism Policy 2015 which is aimed at promoting the country as a honeymooners' paradise. Moreover, India's new government has set tourism as a key sector to meet the overall objective of the faster economic growth. Presently, the significance of tourism in Indian economy is relatively low (Aramberri, 2004, Narayan, Rajendran, Sai & Gopalan, 2009). For instance, just 6.7 per cent of GDP originates in this sector in 2014. This implies that there is a large untapped potential in Indian tourism industry. In fact, UNWTO (2015) noted that India recorded the strongest growth in international tourists arrival during the last decade. In view of these reservations, it becomes imperative to know whether the new government efforts to transform India into a travel haven will stimulate the country's economic growth. Therefore, the main objective of this study is to examine whether and if so, to what degree India's economic growth is responsive to the development in inbound tourism.

Our choice of India as an empirical attempt is motivated by the fact that the country is one of the fastest growing Asian economies, which implies that its tourism industry can be expected to grow faster in the years to come (Ohlan, 2016a). The choice of India is further motivated by the fact that it has been the world's third largest economy in terms of purchasing power parity next to the USA and China (Ohlan, 2012). Another distinctive feature of India is that it has recorded double-digit growth in international tourism receipts, a compound annual growth rate of 11.23 per cent during 2005–2014. India is eager to promote tourism internationally, and it offers enormous natural and cultural advantages for those who are looking for a vibrant destination (Jauhari, 2009). It is clear here that exploring the link between tourism and economic growth in India enables the policy makers to design effective tourism policy.

The remainder of the study is organized as follows. Section 2 provides an analytical review of the literature establishing a link between tourism, economic growth and financial development. The data, empirical model and econometric techniques used in the study are deliberated in Section 3. The empirical findings and their discussion are given in Section 4. Finally, the concluding remarks with the policy implications of our findings for promoting sustainability of the tourism industry are outlined in Section 5.

2. Literature review

A brief review of the relevant literature on tourism-growth nexus for the world at large, link between tourism and financial development, and applicability of tourism-led growth hypothesis in India is in order.

2.1. Tourism-growth nexus in the world

To the best of our knowledge, Castro-Nuno, Molina-Toucedo, and Pablo-Romero (2013), Pablo-Romero and Molina (2013), Brida, Cortes-Jimenez, and Pulina (2016), Kumar, Loganathan, Patel, and Kumar (2015) and Tang and Abosedra (2016) have compiled comprehensive survey of literature for the TLGH. To avoid repetition, different strands of the literature on tourism-growth nexus are provided here. First, on the dynamics of tourism and economic

[1]Our attention was drawn to this by an anonymous referee of this journal.