

# Chapter 14

## Tourism–Led Growth Hypothesis and Foreign Direct Investment in ASEAN

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### **ABSTRACT**

*This study tests the relationships of visitor spending, foreign direct investment in the tourism sector, and the gross domestic product (GDP) per capita among members of the Association of Southeast Asian Nations (ASEAN) during the period of 1988 to 2011 to prove the tourism-led growth hypothesis. The results of panel regression show that tourism-led growth hypothesis is valid for the ASEAN countries. Factors determining the GDP per capita in these countries are visitor spending, foreign investment and government consumption in tourism sector, human capital and trade openness. The results from this study suggest that the governments of the ASEAN countries are able to have effective growth policies by encouraging foreign direct investment in the tourism sector and improving their human capital. Therefore, ASEAN Economic Community (AEC) which will strengthen and facilitate investment cooperation and human capital developments in the tourism sector among ASEAN countries will have a significant benefit to economic growth in the region.*

### **INTRODUCTION**

Tourism is one of the world's fastest growing industries. It is an agglomeration of many activities: transportation, accommodation, the restaurant industry, the entertainment industry, sports and recreation, and other activities that support the demand derived from tourists. Tourism requires strong support from financial facilities, telecommunication services, and other environmental factors to determine visitor demand. Players in the industry range from small-scale businesses to transnational corporations (TNCs).

In developing countries, the tourism industry has become a major source of foreign exchange revenues. It generates jobs and promotes economic diversification. It can generate spillover effects: further investments, jobs, and growth in other sectors of the economy. However, since the tourism sector

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depends largely on the demand of foreign visitors, it is sensitive to external shocks, whether economic, environmental, or political. Wages in the tourism sector are considered relatively low, and jobs in this sector are considered labor intensive. The tourism sector is sometimes called a pro-poor industry. It can be associated with criminal activities such as sex tourism. With all the positive and negative effects, a country has to carefully consider the net benefits before making a decision to support the expansion of tourism. A fine balance needs to be maintained in order for developing countries to capture the benefits of this growing economic activity at minimum or sustainable costs (UNCTAD, 2007).

By 2015, Association of Southeast Asian Nations (ASEAN) aim to establish the ASEAN Economic Community (AEC), a security, economic and socio-cultural community of over 600 million people which will account for nearly 5% of world GDP (World Economic Forum, 2012). The Southeast Asian region endowment for tourism includes a wealth of cultural heritage and nature. It possesses a long tradition of tourism and locates in the heart of Asia. They have been joining forces to address travel and tourism-related issues, which greatly benefit from regional cooperation, such as promotion and marketing, connectivity, environment protection, visa policies and mobility, and sector liberalization. The ASEAN member have reached agreements on several aspects. If the AEC makes ASEAN members a stronger connection through market liberalization and factor of production flows, there are a significant opportunity for travel and tourism sector to grow from both inside and outside the region.

Because most countries in Southeast Asia are in the developing country group, there are some gap of investment and saving represented by problems of infrastructure and financial resources. Domestic capital is not sufficient to facilitate a growing sector such as tourism. Also there is little recent literature on FDI and tourism in developing countries, particularly from the empirical perspective (UNCTAD, 2007) and little evidence of either mapping of FDI in the tourism industry or the economic impact of FDI in the tourism industry. The impact of FDI varies according to the specific country and the historical context. UNCTAD (2007) finds that the impact depends upon the host country's level of economic and human development, including the extent to which it can leverage the presence of TNCs to foster domestic enterprise. This ability is related to host countries' absorptive and productive capacities. Another factor influencing the impact of FDI is the motivation and corporate strategy. The main questions in this study are whether FDI in the tourism sector strongly contributes to economic growth in the country, what are directions of causality among FDI in tourism sector, tourist spending, human capital index, exchange rate, trade openness, government consumption in tourism sector and economic growth in the country and is the tourism-led growth hypothesis valid in Southeast Asia.

This paper evaluates the causality and long-run relationship of international tourist spending, FDI in tourism industry, and economic growth in ASEAN countries using the panel co-integration approach and causality test then proves the tourism-led growth hypothesis using FDI as one of the main variables. The study estimates the relationship among expansion in the tourism sector (visitor spending), FDI in tourism industry, and the GDP per capita in the case of members of the Association of Southeast Asian Nations (ASEAN) during 1988-2011. The method used in the study is ordinary least square analysis. The results show that the FDI in the tourism industry has a significant role in the GDP per capita in the Southeast Asian region. Other factors determining the GDP per capita in these countries are human capital, trade openness, and government consumption per output. The results from this study confirm the tourism-led growth hypothesis and indicate that the governments of ASEAN countries are able to have an effective growth policy through the tourism sector using the promotion of tourism FDI.

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