Economic Impact of Tourism Finance in Nepal

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This paper investigates the effects of tourism industry on gross domestic product (GDP) and finds a significant positive relationship between tourism financing and GDP. Moreover, the role of various sources of tourism financing, including government financing and the loan financing of banks and financial institutions, on economic growth has also been examined and the result supports the conventional wisdom that there is significant positive relationship between the variables. This paper uses primary data collected from the field survey during February - April 2006 and the secondary data utilizing 30 annual observations from FY 1974/75 to 2004/05. Both the level and logarithmic form data are examined using the OLS estimation method and the Cochrane-Orcutt (C-O) iterative procedure is applied considering the robustness of the model.

I. INTRODUCTION

Tourism comprises the activities of persons traveling to and staying in places outside their usual environment. World tourism is growing fast and even exceeding the expectations. The tourists' arrivals grew by 6 percent to 989 million in 2007 compared to 5.4 percent growth in the previous year (UNWTO, 2008). Similarly, tourism receipt increased by 8.3 percent to US$ 733 billion in 2006 (UNWTO, 2007)[1]. In the world, emerging markets and developing economies drive economic and tourism growth. The arrivals in Nepal (by air only) grew by 27.1 percent to 360,350 in 2007. It is estimated to cross 500,000 in the review year including the arrivals by land. Tourism industry is gradually picking up in Nepal. It is said that more than 1.50 million people are employed directly or indirectly in this industry. This sector directly contributes about 3 percent in GDP (though unofficial figures put it at around 11.0 percent). It earns more than 15 percent of total foreign currency and 30 percent of total revenue.

Financing means the act of providing money for a project or activity whereas investment means placing money so that it earns interest and increases the value. As tourism financing is expected to cover both the investment and financing function, it is imperative to find its role in economic growth and development.

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[1]   If international passenger transport is included in 2006, the figure comes to US $ 880 billion.

Several financing sources can be mobilized for tourism financing. Among these, private investment, government investment and foreign investment are the vital ones (UN ESCAP, 2001). In addition to these sources, loans from international and multilateral institutions/agencies as well as from domestic banks and financial institutions can be mobilized. Oliver Bennett (1991) has enlisted government budget, multilateral and bilateral grant and loans and investment from banks and financial institutions, state enterprises, private sector and overseas investors (including foreign direct investment) as the funding sources for tourism development. In fact, the funding sources comprise a mix of the above sources and appear to be very much similar with the financing of other sectors.

The growth of the tourism industry increases the demand for the product and services of tourism. The availability of such products and services highly depends on the production capacity, natural resources, product attractiveness, and supply conditions of an economy (Goeldner, Ritchie, and McIntosh, 2000). Moreover, it is also related to business entrepreneurship, investment climate, government policy and financing mechanism. Therefore, financing acts as a lubricant in the process of economic growth and its adequate supply increases the overall growth and development (Chand, 2000). Similarly, the investment made by various institutions on tourism accommodation, products and services triggers the earnings and employment along with economic and social transformation (Sharma, 2000).

II. Review of Literature

Tourism is one of the productive business activities directed for the production of the goods and services. It provides the goods and services for the customers (generally foreigners) while providing employment and income for the locals. With this not only the tourism business enterprises generate the earning from the operation of the business activities, but also the people related directly or indirectly with such business generate their earning. Further, tourism as an economic activity produces various direct, indirect and induced impacts in the economy. It increases the foreign exchange earning, generates the employment opportunity and increases the income. Again, the resultant income flows and circulates in the economy and boosts other economic activities ultimately inducing many rounds of income. Therefore, the role of tourism becomes distinct and significant in the economic growth and development of the country.

"In a world of balanced budgets, each spending unit's current and capital expenditures would be financed entirely from its current income" (Gurley and Shaw, 1956: 259). Though, self-financing continued to be important for several reasons, it could not cater to the growing demand for deficit financing. As such, the trend has changed significantly over the decades and made the government, business enterprises and even consumers to lean more heavily on external finance (Gurley and Shaw, 1955). Therefore, they can either mobilize internal finance through saving, for example, reserves and profits or external resources (for instance, loan, trade credit and foreign capital). In fact, they use both the sources for establishing a proper composition, taking into consideration the business opportunities and growth potential.

Despite its increasing importance, tourism has attracted relatively little attention in the literature in tourism financing and investment. However, few studies have dealt with

tourism investment covering either country specific or sector specific cases (Gautam, 2007).[1] Nevertheless, various scholars, such as Pearce (1981, 1989) provided the theoretical framework to measure the economic impact of the tourism activity. Similarly, Ghali (1976), Diamond (1977) and Jamieson and Jamal (1997), among others, attempted to measure the economic impact of tourism as well as the generation of employment opportunity through tourism considering various direct and indirect effects.

The studies of Ghali (1976) and Jimenez and Ortuno (2005), though based on country specific analysis, definitely provided frameworks and ingredients for the economic impact analysis for similar cases ranging from developed to developing countries. The tourism impact analysis presented in Zhang's (2001) paper has shown how regional analysis can be carried out by using an economic model. The purpose of any well-specified model is to offer decision-makers and regional analyst a useful tool for a wide variety of policy-oriented issues. The model presented in the study can be applied in several other policy-oriented projects, such as agriculture, transport and taxation policy and all kinds of regional analysis.

The impact of loan and investment on the economic activity, i.e. the national income, is measured by the money supply they create in the economy. With the increase in money supply, the economic activities increase. This leads to higher savings by the public resulting in an increase in investment and national income. Silber (1969) has attempted to find the answer to certain questions. For instance, does it matter in evaluating the impact of monetary policy whether an expansion (contraction) in money supply occurs through the banking system's purchase (sale) of securities from (to) the public or whether it increases (decreases) loans? If so, what will be the impact of purchase of securities by the banks on money supply, for that matter on national income? Further, is it important to distinguish between different types of loans?

Researchers such as Andersen (1969), Silber (1969), and Campbell (1978) have compared the impact of loans and advances with that of investment in securities to find out their respective contribution to the national income. They assumed that the increase in loans and advances increases the money supply more than that of the investment. Further, the increase in money supply enhances the economic activities, thus leading to higher economic growth. Shrestha's (1995) study had compared all the lending programs of the commercial banks along with their contributions to the respective GDP values. It had analyzed the role of bank lending on the respective share of GDP and concluded that without the bank lending, the sectoral GDP as well as the national income is largely affected. The study, thus, argued for the credit (support) on the various sectors of the economy and concluded that the bank lending in such sectors have been the key determining variable ultimately leading to higher economic growth.

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[1] Studies pertaining to tourism investment include Bodlender (1984), Bull (1990), Franck (1990), Wen (1991), Forsyth (1994) and Schmidgall (1999). However, the coverage of such studies was either country specific or relatively narrow. Burkart and Medlik (1981), Chand (2000), Seth (2001), Raina and Lodha (2004) present brief and quite critical discussions on the subject matter whereas Whitehouse and Tille (1995), Massenger and Shaw (1993), Nagi (1997) and Releigh and Roginsky (1999) focus on the hotel and lodging sector, rather than the single aspect of tourism industry.

The transmission mechanism of bank lending in the economy does not appear much complex because in case of increase in loan, the borrower may quickly spend the money on real goods and services that increase the economic activities and ultimately affect the national income. In case of increase in bank investment on securities, the seller may not invest it immediately on real goods; rather he will invest in purchasing another financial asset (Shrestha, 1995). Hence, the role of tourism financing in the sectoral GDP as well as overall economic growth and development of the country becomes clear.

In summing up, Gurley and Shaw (1956) argued that self-financing cannot cater to the growing demand for deficit financing. Therefore, economic agents lean more heavily on external as well as internal finance. Ghali (1976), Jimenez and Ortuno (2005) and Zhang (2001) provided the frameworks for tourism impact analysis. The impact of different types of loans, including loans to the tourism industries, and resultant contraction and expansion of monetary aggregates and hence the growth of national income are analyzed by Silber (1969). Andersen (1969), Silber (1969), and Campbell (1978) have compared the impact of loans and advances with that of investment in securities to find their respective contribution on the national income. Shrestha (1995) found the prompt transmission mechanism of bank lending to the ultimate goals of the economy and concluded that the sectoral GDP as well as the national income is largely affected unless there is sufficient bank lending.

Despite the increasing importance of tourism for achieving the national economic goal, tourism financing and investment has attracted relatively little attention in the previous studies. The basic approach of this paper is to assess the relationship between the variables, applying both the primary as well as secondary data sources with clear demarcation of the impact of tourism financing and its various sources on economic growth. Taking these aspects into consideration, the basic objective of this paper is to investigate the relationship between tourism financing and economic growth.

III. METHODOLOGY

This paper utilizes secondary data of the required variables collected from Ministry of Finance, Nepal Rastra Bank, Ministry of Tourism and Civil Aviation, Nepal Tourism Board, banks and financial institutions as well as tourism business enterprises. The primary data are based on the surveys undertaken by the author for his Ph.D. research work during February – April 2006.

The coefficients of regression equation of economic growth models are estimated by using Ordinary Least Square (OLS) method. Both in the level as well as logarithmic form of data are utilized: $Y_t = \alpha + \beta_0 X_t + \beta_1 X_{t-1} + \beta_2 X_{t-2} + ... + \beta_k X_{t-k} + u_t$. This model can be written in compact form as: $Y_t = \alpha + \sum_{t=0}^{n} \beta_i X_{t-i} + u_t$ where, Y_t is dependent variable, α_o is intercept term, $\beta_i X_{i-1}$ are the various X_i independent variables corresponding with β_i coefficients. Variables are transformed to logarithm form before the regression is run considering high variability of the variables, so that those coefficients estimated are interpreted as elasticity coefficient, i.e. $\ln Y_t = \ln \alpha_o + \beta_1 \ln X_1 + \beta_2 \ln X_2 + ... + \beta_n \ln X_n$.

The empirical analysis in this paper is broadly divided into two parts: the first is the relationship between tourism financing and economic growth; the second is the relationship between various factors contributing to tourism financing and economic growth. The expected signs of all the independent variables on the dependent variables are hypothesized to be positive. The null hypothesis of first-order partial derivatives is expected to be zero as against non-zero for alternative hypothesis. The variables in the regression model are used in various combinations: bi-variate and multivariate. The statistical significance of coefficient of partial derivative is tested at 1 percent, 5 percent or at 10 percent significant level.

Often the residual term in an equation is correlated with its lagged values in different orders particularly in the time series data analysis. This is called the problem of autocorrelation in an equation. In order to test whether the residual term in the regression equation follows the first order autocorrelation, the DW test statistic is applied. Moreover, time series data are characterized by too high R^2 and too low DW statistic due to data being time trended. Achieving very high R^2 along with very low DW statistic in time series data is thought to be due to spurious relationships between the variables (Gujarati, 2004). This paper utilizes the Cochrane-Orcutt (C-O) iterative procedure (Cochrane and Orcutt, 1949) that transforms the regression model and hence satisfies all the properties needed for applying the least squares procedure. The estimable equation to overcome the autocorrelation problem is as follows:

$$Y_t^* = \beta_1^* + \beta_2 X_{t2}^* + \beta_3 X_{t3}^* + ... + \beta_k X_{tk}^* + \varepsilon_t;$$

where, $Y_t^* = Y_t + \rho Y_{t-1}$, $\beta_1^* = \beta_1(1-\rho)$, and $X_{ti}^* = X_{ti} - \rho X_{t-1)i}$ .... $for t=2,3,...,n, and i-2,...,k$. The iterative procedure is stopped when the estimates of the row from two successive iterations are constant.

The test statistics, such as, t, F, DW test, R^2 etc, are performed for the statistical validity of different aspects of the models. The response to unsatisfactory test leads to improvement and modification of the equation in some way, which helps to make the coefficients unbiased and consistent. The statistical significance of regression coefficients is tested using t-test.

IV. RESULTS AND INTERPRETATION OF THE ANALYSIS

The results of the analysis are divided into two parts. In the first part, an assessment will be made to examine the effect of tourism financing on economic growth followed by the effects of different sources of tourism financing on economic growth. The economic growth variable is taken as dependent variables whereas the variables proxied for tourism financing and various sources of tourism financing are taken as independent variables.

Economic Impact of Tourism Financing

Gross domestic product in nominal value (GDPN) is one important economic indicator of development composed of all the final goods and services produced in the economy over a one-year period (Sharma, 2001). The contribution of hotel, trade and

restaurant (GDPT) to the overall nominal GDP can also be proxied as an important economic growth variable. An increase in this variable has positive impact on overall GDP performance. In addition, the ratio of GDPT to GDPN (RGDPT) is also taken as a proxy for growth variable.

Likewise, it is imperative to see the impact of tourism financing (TFSD), which is proxied by supply of tourism financing which is derived by summing up of credit exposures of banks and financial institutions, development expenditure of the government as well as foreign aid and loan assistance in tourism. Different variables are used for different equations and in different combinations (including jointly) in order to find out the determinants and to reach the representative model. In addition, the study investigates into the presence or absence of autocorrelation and undertakes the remedial measures.

The effects of tourism financing on GDPT, GDPN and RGDPT are examined through log model and the results are presented in Table 1. The calculations are carried out in log linear form based on the respective analysis of R^2 as mentioned earlier and upon selection of the model that provides a better explanation. The theoretical expected sign of the coefficient (β_1) is positive i.e. $\beta_1 > 0$. It implies that tourism financing as an independent variable has a positive impact on economic growth (dependent variable).

The elasticity coefficient of the tourism financing is significant at 1 percent level for all the indices of economic growth. In addition to that, the coefficients are possessing the expected sign. The coefficient of determination (R^2) value, which shows the goodness of fit, is 0.81 for Ln.(GDPT), 0.87 for Ln.(GDPN) and 0.52 for Ln.(RGDPT), which is considered relatively high in the context of time series data. It also signifies that the variation in the dependent variable is explained by the independent variable. The F statistic is also statistically significant.

TABLE: 1: The Effects of Tourism Financing on Economic Growth

Equation	Dependent Variable	Constant	Independent Variable Ln.(TFSD)	R^2	F stat	DW
(I)	Ln.(GDPT)	1.861*	0.970*	0.81	124.4	0.75
		(2.891)	(11.155)			
(II)	Ln.(GDPN)	6.28*	0.72*	0.87	200.8	1.32
		(16.82)	(14.17)			
(III)	Ln.(RGDPT)	-4.421*	0.255*	0.52	31.24	0.31

Note: There are 30 observation covering the period 1975-2005. Ln stands for natural logarithm, TFSD = tourism financing, GDPT = contribution of hotel trade and restaurant to GDP, GDPN = gross domestic product at nominal price and RGDPT = ratio of GDPT to GDPN. Figures given below the coefficient of variable in parentheses indicate t values. Asterisks (*) signifies that the coefficient is significant at 1 per cent level.

All the equations seem statistically significant and possess the expected signs. The DW statistic shows the problem of autocorrelation. Therefore, all the equations are corrected for the problem of autocorrelation through Chochrane-Orcutt (C-O) procedure as discussed earlier. Table 2 presents the result of the corrected estimation.

TABLE 2 : The Effect of Tourism Financing on Economic Growth after Transforming the
Data Using C-O Two Step Method

Equation	Dependent variable	Independent variable		R^2	F stat	DW
		Constant	Ln. (TFSD)			
(IV)	Ln. (GDPT)	1.974*	0.518*	0.41	19.12	0.96
		(5.624)	(4.373)			
(V)	Ln. (GDPN)	4.539*	0.632*	0.74	79.35	1.67
		(12.752)	(8.908)			
(VI)	Ln. (RGDPT)	-0.201*	0.771	0.07	2.14	1.61
		(-6.121)	(1.462)			

The theoretical expected sign of the coefficient is positive. It implies that tourism financing has a positive impact on various indices of economic growth (dependent variable). The calculated DW value of the equations is compared again with the table value and found that there is no autocorrelation except in equation (IV). The equations possess theoretical expected signs. Since GDPN is a major growth variable, it possesses significant coefficients and has a good fit; it is also in conformity with the view that there is a significant impact of tourism financing on economic growth. However, TFSD is not affecting RGDPT in a significant way.

To sum up, it is clear that the indices of development are sensitive enough to the tourism financing. With this analysis and results, it can be concluded that tourism financing has a significant impact on the overall economic growth in the economy.

Effect of Sources of Tourism Financing on Economic Growth

It is also desirable to find out the contribution of various sources of tourism financing separately on economic growth. It is clear that there are different sources for tourism financing such as lending of banks and financial institutions, government budget allocation as well as foreign loan and assistance to the tourism sector. Hence, in order to assess the impact of such sources in the development indices, further regression analysis is carried out in the simple linear model. The model takes the growth variable, GDPT, as dependent variable and the different sources of investment financing as independent variables in the respective equations, both separately and in combination. Table 3, however, presents the major results only.

The theoretically expected signs of the coefficient are positive. It implies that tourism financing from each of sources has a positive impact on GDPT (dependent variable). As mentioned earlier, the contribution of hotel, trade and restaurant to the nominal GDP (GDPT) can also be proxied as an important economic growth variable because it is one of the economic sectors and an increase in this particular variable has positive impact on GDPN.

This section attempts to examine the effects of tourism financing from various sources on the growth variable, GDPT. Here, tourism loan disbursement of Nepal Industrial Development Corporation (LTDNIDC), loan disbursement of commercial banks (LSDCB), tourism expenditure of government (TEXP), government investment in civil aviation (GICA) and foreign loan disbursement in other sector including tourism (FADOT) are the explanatory variables on the model. The analysis, therefore, includes

the above variables in different combinations to determine the explanatory power of different independent variables.

Hence, the estimation is undertaken employing the variables such as LTDNIDC, LSDCB, TEXP, GICA and FADOT with respect to sectoral gross domestic product (GDPT) in the first equation (Table 3). The coefficients of LDSCB and TEXP are statistically significant at 1 percent level with theoretically expected signs. Similarly, LTDNIDC and GICA are significant at 5 percent level with expected signs. The FADOT is not found to be statistically significant because of the inclusion of more variables.

The partial coefficients of LTDNIDC, LSDCB, TEXP and GICA with respect to GDPT are found to be 47.13, 1.81, 64.04 and 2.29 respectively. It implies that one rupee increase in these variables have the impact on GDPT by the respective rupees' increase. For example, one rupee increase in LTDNIDC has an increase of Rs. 47.13 on GDPT.

Moreover, the effect of FADOT on GDPT is expected to be positive, i.e. with the increase in the amount of foreign aid and loan disbursement, there would be an increase in GDPT. In this equation, the coefficient is negative but not statistically significant. When GDPT is regressed only on FADOT, the coefficient turns out to be positive and statistically significant (refer to the fifth equation in Table 3).

However, the model, in terms of F statistic, is found to be a good fit. Further the adjusted R^2 is also found to be 0.92, which is quite high. Further, in the second equation (Table 3), the combination of independent variables comprising TEXP and GICA are included. The variables possess the theoretical expected signs. It is significant at 1 percent level. The value of coefficient of determination (Adj.R^2), which shows the goodness of fit, is 0.87, which is considered quite satisfactory. Further, the DW value shows the absence of an autocorrelation. This equation shows the significant impact of government budget allocation in the tourism sector that induces the economic growth.

TABLE 3 : Effect of Various Sources of Tourism Financing on Economic Growth

Equation	Constant C	Independent variable					Adj. R^2	F - stat	DW Stat
		LDTNIDC	LDSCB	TEXP	GICA	FADOT			
1	351.72	47.125**	1.806*	64.040*	21.45**	-0.288	0.92	57.16	1.51
	(0.154)	(2.127)	(2.863)	(3.847)	(2.291)	(-0.123)			
2	-402.488			115.575*	31.94*		0.87	83.17	1.85
	(-0.145)			(8.415)	(3.120)				
3	1131.69			95.989*	23.49**	3.578**	0.89	66.70	1.80
	(0.425)			(6.193)	(2.303)	(2.197)			
4	2568.81	118.74*	3.73*				0.87	96.81	0.54
	(1.436)	(4.961)	(13.633)						
5	8177.2*					12.99*	0.62	45.49	0.59
	(3.244)					(6.744)	(R^2)		

Note: There are 30 observation covering the period 1975-2005. TFSD = tourism financing, GDPT = contribution of hotel trade and restaurant on GDP, LDTNIDC = tourism sector loan disbursement of NIDC, LDSCB = service sector loan disbursement of Commercial banks, TEXP = development expenditure of government in tourism sector, FADOT = foreign aid disbursement in other sector including tourism and GICA = government investment in civil aviation. Figures given below the coefficient of variable in parentheses indicate t values. Asterisk (*) signifies that the coefficient is significant at 1% level, asterisks (**) at 5% level and asterisks (***) at 10% level.

Similarly, in the third equation, TEXP, GICA and FADOT variables are included as explanatory variables. The variable TEXP is found statistically significant at 1 percent while GICA and FADOT are statistically significant at 5 percent significance level. All the variables possess the theoretically expected signs. Again, the model has a good explanatory power as well as good fit in terms of adjusted R^2 and F statistics, respectively. The DW value also shows the absence of an autocorrelation. Therefore, this result also demonstrates the significant role of these sources of tourism financing on the growth variable.

In addition, in order to map out the impact of lending in tourism industry from the banks and financial institutions, the fourth equation (Table 3) is undertaken. Here, the coefficient of loan disbursement of NIDC (LTDNIDC) is significant at 5 percent level and that of the service sector loan disbursement of commercial banks (LDSCB) at 1 percent level with respect to GDPT. The adj.R^2 signifies that about 87 percent of the variation in the dependent variable is explained by the independent variables.

To sum up the analysis, the first equation presented in Table 3 is considered to be a better model to show the impact of tourism financing from various sources in the development index. This model has a good coverage of the variables, better fit, significance of the coefficients and the theoretically expected signs of the variables. Therefore, the indicators of tourism financing such as LTDNIDC, LSDCB, TEXP, GICA and FODOT explain the economic growth in the sector. It shows that the tourism financing from various sources has a significant impact on the growth.

V. SUMMARY AND CONCLUSION

Tourism financing over the years has increased. To finance the tourism sector, several strategies and sources may be tapped. Among these, domestic private investment, government budget and foreign aid (bilateral and multilateral) have been tapped and other sources such as foreign direct investment and capital market, among others, should be explored.

It can be concluded that the government expenditure for tourism promotion and investment on civil aviation, as well as the loan disbursed by the commercial banks and Nepal Industrial Development Corporation has been significant for the development of tourism industry. Moreover, it has been a benign agent for hotels and other tourism business. It is the investment that has brought the significant changes in the infrastructure and superstructures necessary for tourism in order to reap the benefits from such industry. The empirical analysis relating to the effectiveness of tourism financing showed the significant impact of tourism financing on economic growth. It clearly illustrated that tourism financing has a significant economic impact. Further, the analysis also showed the significant impact of various sources of tourism financing such as the government, commercial banks and Nepal Industrial Development Corporation as well as foreign aid and loan disbursement.

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