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The Role of Foreign Tourists in Economic Growth: Evidence from Indonesia

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Abstract
Foreign tourism is indicated as one of important instruments to boost economic growth of some countries, including Indonesia. It is reported that more than 15 million tourists have visited Indonesia in 2018 and the number is going to increase for further years ahead. Meanwhile, the Indonesian economic growth also experiences the positive trend over the years which more than 5.17% in the same year. Hence, this paper seeks to find out whether foreign tourists contribute to economic growth in Indonesia. International tourist expenditure, length of stay, exchange rate of origin country, countries with free visa entry are considered as independent variables. This research is conducted for a decade starting from 2006 to 2016. Except for tourist length of stay, all variables were found to be statistically significant with positive signs in this study. Hence, Government needs to focus more on improving tourism industry such as build more attractive tourism objects, educate more human resources to escalate tourism services, expand more job creation to bring more income for local communities. These potentially would lead to boost economic growth.
Keywords: Tourist Arrival; Economic Growth; Visa-free; Exchange rate
JEL Classification: L83; O11; Z32; Z38

1. Introduction

More than decades, tourism has been considered as an important element to boost the economic growth of countries, particularly in the developing countries, including Indonesia (Savas, Beskaya, & Samiloglu, 2010). It is reported that more than 15 million foreign tourists visited Indonesia throughout 2018 and the number is expected to have an increasing trend in the future (BPS, 2018). The data also suggests that economic growth in Indonesia has increased in the same year. It reached more than 1 5.17% in 2018 (World Bank, 2019). The benefit of being host countries would be plenty enough to achieve rapid economic development as well (Lorenzini, Pisati, & Pompili, 2014). However, the development of tourism industry potentially has side effect to the economy. International tourist may lead to increase the competitiveness among local firms and other international tourist destinations. If government cannot execute the best strategy to promote Indonesia, it may cause the adverse effect to tourism and economic development (Mariyono, 2017). Thus, understanding the contribution of international tourism inbound toward economic growth is important.

Tourism is considered as a substantial economic activity for some countries. Many studies reveal that the main factors that play a role in tourism development are transportation capacity, extension of paid vacation duration in developed countries and improvement of communication technology (Aktas, 2005). International tourism contributes to a country's income generation in at least two aspects. For starters, it boosts productivity by encouraging businesses to compete in a similar manner to that of other international tourist destinations (Bhagwati & Srinivesan), Second, it boosts the economy of local businesses (Helpmen & Krugman). Tourism's rapid growth has direct and indirect effects on household and government income, such as creating a balance-of-payments surplus and encouraging tourism that supports government policy. As a result, tourism production is often regarded as having a positive impact on economic growth (Khan & Toh, 1995). Although tourism industry is important as one of the main sources of income; however, world economists are paying little concern to the possible contributions caused by tourism activities. In several countries, according to Papatheodorou (1999), tourist spending has acted as an alternative form of export as a result of improved balance of payments due to increased foreign exchange earnings. Tourism activities also have a major impact on gaining employment (Oh, 2005). The absorption of its workers is the primary advantage of the tourism industry, so growing tourism activities is equal to increasing jobs. This is critical for economies that want to reduce unemployment, even though it can cause labor market shocks that raise service sector salaries and promote cross-sector mobility.

In order to find out the correlation among tourism and economic growth, the benefits and drawbacks of tourism growth must be considered by researchers (Sinclair, 1998). Tourism has the potential to increase the currency supply, which can reduce the foreign exchange gap and increase personal and tax revenue. Furthermore, the expansion of tourism-related activities could impact demand for specific goods and products (Syriopoulos, 1995), which includes transportation, access roads, and a variety of other services (Eugenio-Marty'n & Morales, 2004), which subsequently boost economic growth. On the other hand, tourists can cause environmental damage such as garbage and pollution. As a result, this has a negative impact on local communities and the sustainability of tourism in the future. In addition, tourism activities can damage the culture of local communities along with high tourist activity (UKEssays, 2018).

Since tourism is so important to the economy, many researchers have attempted to analyze its contribution in recent decades. One well-known study by Proença & Soukiazis (2005) mentioned that a 1% increase in infrastructure in the tourism sector led to a 0.01% increase in income per capita of the Portuguese. Lanza & Pigliaru (1999) extend the analysis into country's tourism specialties and their role on economic growth. They come to the conclusion that countries with abundant natural resources gain comparative advantages in tourism and expand faster than countries that specialize in manufacturing.

Further, Brau, Lanza, & Pilgiaru (2007) analyzed the empirical correlation among economic growth, size of country and tourism. They found that countries that rely on tourism are growing more rapidly. They also discovered that small countries with a strong tourism industry would develop quickly. Fayissa et al (2007) investigated the tourism industry's contribution to Africa's economic growth and development. By applying panel data from 42 African countries within 10 years, they found that tourism revenue has significant and positive contribution to the current level of national income. Over a 15-year period, Samimi & Sadeghi (2011) investigated the causal and long-term relationship between tourism and economic growth in developing countries. Their results show that tourism creation and economic growth have a long-term positive relationship. Several literatures have shown the importance of foreign tourism and economic growth in the worldwide. According to (Tian, Mak, & Leung, 2011), foreign tourism has direct contribution to the GDP of Hawaii, with nearly 8.2 Billion US Dollar. The positive relationship between tourism and GDP may benefit the destination countries since tourism could be counted as an important element to increase the level of economic growth and development as well (Bayramoğlu & Ari, 2015).

In contrast to most studies of tourism, Figini & Vici (2010show that tourism specialization isn't a panacea for resolving development and growth issues. Their empirical evidence suggests that, on average, countries that depend on tourism do not develop substantially differently than other countries. In addition, Oh (2005) looked into the long-term relationship among the tourism industry's development and South Korea's national output. They come to the conclusion that tourism and economic growth have no long-term relationship. Furthermore, the relationship between economic growth and tourism creation is one-sided.

There are many variables that can affect the economic growth through foreign tourism. However, this study would concern on using variables namely number of international tourist arrival, length of stay, expenditure of foreign visitors, exchange rate and free visa policy. These variables might help government to re-evaluate the tourism strategies and programs to enhance economic growth (Loganathan, Ibrahim , & Harun, 2008). The main objective of this study is to measure the effect of the number of arrivals, expenditures, and length of stay of foreign tourists on economic growth in Indonesia. Furthermore, this study aims to examine whether visa-free policy is able to increase Indonesia's economic growth.

2. Research Method

This study uses panel data from 34 countries of origin over a 10-year period, from 2006 to 2016, to examine the effect of international tourism on economic growth in Indonesia. Natural logarithm of economic growth, as determined by Gross Domestic Product, is the dependent variable, while the independent variables consist of foreign tourism indicators, including number of tourist arrival, tourist expenditure, visitor's length of stay, exchange rate and free tourist visa. All of the independent variables are denoted in natural logarithm, except a dummy variable of free tourist visa. The data used for this study are compiled from Statistics Indonesia and the World Bank. The estimation method from panel data regression model further can be done through three approaches: Pooled Least Square (PLS) Model, Fixed Effect Model (FEM) and Random Effect Model (REM). In attempt to locate the most suitable model, two tests should be employed, Chow Test and Hausman Test.

The empirical estimation of this study can be expressed as follows:

$$\text{Ln } GDP_{it} = \beta_0 + \text{Ln } \beta_1 ITA_{1it} + \text{Ln } \beta_2 ITE_{2it} - \text{Ln } \beta_3 ITL_{3it} + \text{Ln } \beta_4 EXCH_{4it} - \beta_5 FV_{5it} + \mu_{it}$$

Whereas:

GDP	= Economic Growth (GDP)
ITA_1	= International Tourist Arrival
ITE_2	= International Tourist Expenditure
ITL_3	= International Tourist Length of Stay
$EXCH_4$	= Exchange rate of Indonesia (US$)
FV_5	= Countries with visa-free entry to Indonesia
β	= Constant
μ_{it}	= error term

The independent variables were chosen based on previous research. In addition to the main independent variable, which is international tourist arrival, we consider foreign level expenditure variable due to its importance in the economy (Kareem, 2008). Increases in foreign tourism expenditure tend to escalate the economic activities in the destination country which lead to raise the productivity, absorb more employments and eventually enhance the economic growth. We also consider length of stay as one important determinant of economic growth in the destination countries (Lorenzini, Pisati, & Pompili, 2014). More length of stay of foreign visitors would create a lot of profit to host countries through more spending, and this could generate income to the countries.

We use exchange rate of Indonesia and visa facilitation as control variables in the regression equation. International trade, foreign direct investment, and macroeconomic stability are three ways that exchange rate volatility can drive economic development (Schnabl, 2008). because tourism activities are included in international trade, the weakening of the exchange rate in Indonesia can increase tourist activity in line with the increasing ability of tourists to consume. We consider visa facilitation is a relevant determinant of economic growth based on a study of Mariyono (2017) which claims that many ASEAN members are more willing to visit other ASEAN countries, since it does not require a visa. Free visa would also increase bilateral trade and foreign investment, resulting in higher economic growth (Czaika & Neumayer, 2017).

3. Result and Discussion

Firstly, we conduct a Chow test to select which one is a better model between Common Effect Model or Fixed Effect Model. Since the probability is less than 5% level of significance, we are encouraged to select Fixed Effect Model. Hausman test is then carried out as the second step to select best model for this study. It is found that the Fixed Effect Model is selected again since the probability is less than 5% significant level. In addition, Fixed Effect Model also has satisfied the classical assumption in a sense that there are no heteroscedasticity and multicolinearity problems (see figure 1 and table 1, respectively), making it the best model to proceed the data in this study.

Table 1. Heteroscedasticity Test for Panel Data

Chi2 (1)	**0.04**
Prob>Chi2	0.836

Source: Data Processed

Table 2. Multicollinearity Test for Panel Data

Variabel	**VIF**	**1/VIF**
Ln Length Stay	2.71	0.368850
Ln Expenditure	2.71	0.369202
Ln Exch Indo	1.46	0.686258
Visa	1.40	0.713307
Ln Tourist Arrivals	1.15	0.871438
Mean VIF	1.89	

Source: Data Processed

Table 3. Estimation Result of Regression Analysis

Variables	**Coefficient**	**T Statistic**
C	18.13***	51.47
Ln International Tourists Arrivals	0.222***	10.55
Ln International Tourists Expenditure	0.267***	8.82
LN International Tourists Length of Stay	−0.015***	-4.72
Ln Exchange Rate of Indonesia	0.534***	12.56
Free Visa	0.005	0.29

*** denotes significance at 1% level

R^2=0.7890 F-stat=233.28**;** **(**P-value= 0.0000)

Source: Data Processed

Based on estimation result, it can be seen that all variables, except free visa, are statistically significant to the economic growth variable at the 5% level of significance. International tourist arrival, expenditure and exchange rate of origin country have positive effect to economic growth, while international tourists’ length of stay reveals a negative sign. One percent change in International tourist arrival, expenditure and exchange rate of Indonesia will result in a 0.22 percentage point rise in economic growth, 0.26 percentage points and 0.53 percentage points, respectively. On the other hand, one percent change in foreign tourist length of stay would reduce economic growth by 0.02 percentage points, while free visa policy is found to have no statistical associations with economic growth.

From all variables mentioned above, exchange rate variable has the largest contribution to the economic growth, followed by International tourist expenditure and number of tourist arrivals. An increased of exchange rate in origin country may indirectly affect economic growth of the destination country. A relatively weak currency of Indonesia compared to US Dollar would attract more foreign visitors coming to Indonesia, Exchange rate devaluation in tourist destination countries attracts tourist flows and vice versa (Agiomirgianakis & George, 2012)Tourists are more sensitive to the exchange rates they use for living costs in tourist destination countries (Artus, 1970). An increase of number of foreign tourist arrival would excite investor to put their money for tourism purposes. This would generate job creation, increase society’s purchasing power and stabilize the economy in the destination country. Similarly, expenditure of foreign tourist could stimulate tourism development in the destination country. This result is consistent with the finding from (Lashkarizadeh, 2007) given that foreign tourist arrival and tourist expenditure would increase the productivity of destination country and strengthen the economic growth. Hence, this implies that the government would loss if they do not treat tourism sector as an important element of the Indonesian economy. Therefore, the government needs to pay higher attention to improve tourism industry so that more visitors are interested to visit and spend more money in Indonesia.

In contrast, the increment of length stay of foreign visitors tends to reduce the economic growth of destination country, though it was a small magnitude. There are two justifications on why length of stay diminishes the government income. First, Longer-staying international visitors are more price sensitive (Becken & Schiff, 2011). Foreign tourists who stay longer in destination country are usually those who prefer leisure travel instead of business purposes, hence they would think twice to buy some products since they need to save more money (Lorenzini, Pisati, & Pompili, 2014). Second, tourists need to apply visa if they want to stay longer in the destination country so that they would spend less and save more. As a consequence, raise of length of stay would significantly reduce economic growth in the destination country.

Visa exemption has no effect on economic growth in Indonesia. The arrival of the largest number of international tourists in Bali, 4.58 million, demonstrates this. Meanwhile, referring to the statement to the Bali Trade and Industry Office, more than 75 percent of Bali tourism revenue is controlled by foreign investors. Therefore, it can be concluded that the income from tourism mostly flies abroad. As a result, it has little effect on Indonesia's economic development[1].

4. Conclusion

Using a panel data approach, from 2006 to 2016, the aim of this research is to establish a link between foreign tourism and Indonesian economic development. The results of the fixed effects test declare that there is a strong correlation among tourism and economic growth in Indonesia. In particular, the number of international tourist arrivals, tourist spending, and the exchange rate all have a positive and significant impact on economic growth, while the duration of stay has a negative and significant impact.

[1] Bali Trade and Industry Office, 2012

In contrast to the other variables, visa-free facilitation has no impact on economic growth. These findings suggest that the government should prioritize the tourism industry, which has the potential to be the country's main economic driver. This analysis confirms the need for government involvement in the development of tourism infrastructure and facilities. It is critical to improve tourism-related infrastructure and other facilities in order to boost tourist arrivals. Indonesia needs to invest a lot in infrastructure to promote its country. In addition to tourism infrastructure, more efforts are required to encourage more tourists increase their spending, which will help increase the economic growth through more tourism revenues.

It is critical to maximize the tourism sector's contribution to the country's economic development. Government tourism investment must also be sustained in order to help the national tourism sector's growth and make it more profitable and competitive. In addition, the government also needs to consider granting visa-free to several countries whose economic conditions are no better than Indonesia. Law enforcement on the ownership of foreign investors' assets needs to be controlled so that the income from tourism does not go to foreign countries.

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