

CHAPTER 1

INTRODUCTION

1.1 Overview

According to the World Travel and Tourism Council (WTTC), tourism is one of the largest and fastest growing global industries. Table 1.1 shows trends of global international tourism in terms of arrivals and receipts in the world. For many countries, particularly small developing economies, tourism is the main income earner and major employer that contribute significantly to the growth of the economy. Nevertheless, mainstream economists have paid little attention on it (Papatheodorou, 1999).

Table 1.1: Profile of World International Tourism

Year	Tourist Arrivals (million)	Tourist Receipts (USD billion)
1950	25.3	2.1
1960	69.3	6.9
1970	159.7	17.9
1980	284.8	102.4
1990	455.9	264.1
2000	687.3	473.4
2001	684.1	459.5
2002	702.6	474.2

Note: Receipts exclude international fares
Source: World Tourism Organization

In Malaysia, the tourism industry has become one of the fastest growing industries within the services sector. The growth of the tourism industry has

contributed to the development of the Malaysian economy through its backward and forward linkages with a wide spectrum of industries in the economy. The level of contribution of tourism industry to the country's growth has been increasing over the years. In 2000, the industry contributed about 4.5% of real GDP and this contribution increased further to 6.7% in 2001 and 2002. In addition, the economy has also benefited from the positive net contribution to the services account of the balance of payments by the tourism industry. Currently, tourism sector is the second largest foreign exchange earner after manufactured exports. Both tourist arrivals and receipts from international tourism in Malaysia have increased tremendously as shown in Table 1.2.

Table 1.2: Tourist Arrivals and Receipts in Malaysia, 1998-2002

Year	Arrivals		Receipts	
	No. of person	Growth (%)	RM million	Growth (%)
1998	6,550,748	5.5	8,580.4	-11.5
1999	7,931,149	21.1	12,321.3	43.6
2000	10,221,582	28.9	17,335.4	40.7
2001	12,775,073	25.0	24,221.5	39.5
2002	13,292,010	4.1	25,781.1	6.4

Source: Ministry of Tourism, Malaysia

Like many developing countries, Malaysia's high growth rates in tourist arrivals and receipts account for a minor share of global arrivals and receipts. While small relative to world aggregate, Malaysia's foreign exchange receipts from tourism make an important contribution to the economy, in terms of income generation and employment creation. Recognizing its potential as a catalyst for

future economic growth, the Malaysian government has earmarked tourism as one of the major growth drivers in its medium- and long-term plans. It is, therefore, useful to analyze the relationship between tourism and economic growth that have interesting implications for policy-making.

1.2 **Concepts and Definitions of Tourist and Tourism**

Given the sustained growth of international tourism in both economic and social importance, the United Nations (UN) and the World Tourism Organization (WTO) have put in considerable efforts over the years in developing the definitions and standardizing measurements of tourism so that better international comparability could be made for policy purposes.

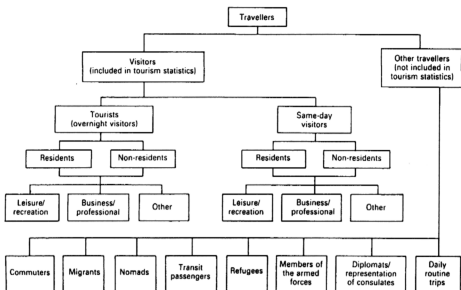
a) Tourist

Travellers are individuals making a trip between two or more geographic locations, either in their country of residence or between countries (Theobald, 1994). There are two types of travellers, namely, visitors and other travellers. Visitor is defined by the WTO as any person visiting a country other than that in which he has his usual place of residence, for any reason other than following an occupation remunerated from within the country visited. Other travellers are some specific categories of travellers to be excluded from visitors as they do not meet the criterion of visitors. They are migrants (both legal and illegal), border workers,

persons traveling as nomads and refugees, members of the armed forces and diplomats/representation of consulates.

There are two distinct categories of visitors, namely, tourists and excursionists. Tourist (overnight visitor) is defined by the WTO as visitor who spend more than 24 hours in destinations other than his normal place of residence, whose journey is for the purpose of holiday-making, recreation, health, study, religion, sport, visiting family or friends, business or meetings. Meanwhile, visitor who spends less than 24 hours in his destination is defined as excursionist or same-day visitor. Given the different impacts they bring onto the economy of a destination country, visitors (both tourists and excursionists) are further divided into two broad categories as resident visitors and non-resident visitors. The classification of travellers is summarized in Figure 1.1.

Figure 1.1: Classification of Travellers



Source: Adapted from Theobald (1994)

b) Tourism

Tourism is defined by Jafari (1977) as *'a study of man away from his usual habitat, of the industry which responds to his needs, and of the impacts that both he and the industry have on the host socio-cultural, economic and physical environments'*. Tourism can be studied from a variety of perspectives. In fact, tourism has been variously defined by governments and academics to relate to fields such as economics, sociology, cultural anthropology and geography. For economists, we are concerned with the contributions of tourism to the economy of a destination country. Therefore, the analyses are focused mainly on supply

and demand of tourism, income and employment-generation effects of tourism on an economy and other economic-related factors.

WTO defined tourism as the activities of a person traveling to and staying in places outside his usual environment for not more than one consecutive year for leisure, business and other purposes not related to the exercise of an activity remunerated from within the place visited (WTO 1991). According to the WTO classification, there are three basic forms of tourism that can be observed in a given country as follows:

- (i) *Domestic tourism* refers to travel taken by resident visitors within the national boundaries of the traveller's country of residence;
- (ii) *Inbound tourism* refers to travel taken by non-resident visitors within the national boundaries of a country which is not the traveller's country of residence; and
- (iii) *Outbound tourism* refers to travel taken by resident visitors outside the national boundaries of the traveller's country of residence.

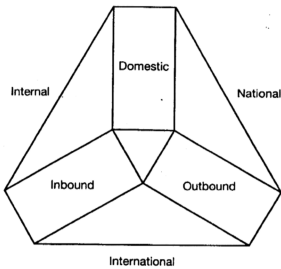
When the above-mentioned basic forms of tourism are combined, they derived the following categories of tourism:

- (a) *Internal tourism* involves both domestic and inbound tourism;
 - (b) *National tourism* comprises both domestic and outbound tourism;
- and

- (c) *International tourism* consists of both inbound and outbound tourism.

A graphic representation of the relationships among the forms of tourism is presented in Figure 1.2.

Figure 1.2 Forms of Tourism



Source: Adapted from Smith (1997)

1.3 Tourism Growth and Economic Effect

Benefits and costs of tourism accrue to both visitors and the host countries. Nevertheless, this analysis focuses on the positive and negative effects of tourism from the perspective of the host country. Tourism provides both significant economic benefits and costs to a destination country. Although non-economic costs and benefits such as the social, cultural and environmental impacts are also

important, the study is focused on the economic aspect, which is easily quantifiable and measurable.

Tourism is often assumed to be advantageous due to its income-generation and employment-creation impacts through its multiplier effects. International tourism is an invisible export that generates foreign currency income to a destination country, thereby alleviating the balance of payments constraints and financing economic growth. Many developing countries that faced with the problems of declining terms of trade for agricultural products and high levels of protection against manufacturers have turned to tourism as a possible alternative source of growth (Sinclair, 1998). This is because the prices charged are more under the control of the host countries than of the tourists (Mill and Morrison, 1985). Unlike other international trade, there are fewer trade restrictions on international travel. As the natural environment and culture heritage are basic components of the tourism industry's assets, each country has the 'raw materials' for tourism within its borders. Meanwhile, domestic tourism redistributes domestic currency income spatially within the economic boundaries of a country. Nevertheless, the tourism income multiplier effect hinges on the industry's linkages to the sectors of the economy. Generally, the closer the link; the greater is the multiplier effects and vice-versa.

As tourism is a human-resource intensive industry, it can create considerable employment opportunities directly through hotels, restaurants, transportation and

souvenir sales, and indirectly through the supply of goods and services needed by tourism-related businesses. In fact, the tourism employment-creation potential has been cited as one of its key advantages for developing countries (de Kadt, 1979). Tourism projects usually create external economies in other sectors of the economy because they increase the quantity and quality of infrastructures. However, external benefits of this sort may not be easily quantifiable. Meanwhile, contributions of tourism to government revenues are categorized as direct and indirect. The direct tax contributions are taxes on incomes from tourism employment and tourism business as well as direct levies on tourists, while the indirect contributions are taxes and duties levied on goods and services supplied to tourists. Again these positive impacts hinge on the linkages of the tourism industry with other sectors in the economy.

Besides the economic benefits suggested above, there are certain economic costs associated with tourism development. Over-dependence on tourism for growth can make countries vulnerable to economic instability (Liu, 1998). In terms of employment creation, tourism is a double-edged sword as tourism can create employment but the seasonality nature of tourism also contributes to unemployment.

Tourism development often creates inflationary effects on local economies, relating to land, property and goods (Page et al. 2001). In addition, if tourism import content of a country is high, foreign exchange generated by tourism

activity may not benefit the economic of the destination due to leakage effects. Generally, the higher is the leakage effect, the less significant the indirect impact on income generation for the country. Furthermore, the balance of payments position of the country would be affected adversely.

Tourism development may give rise to high opportunity costs in that it hinders the development of other economic sectors that rely on the same resources (Liu, 1998). In less developing countries, tourism development may crowd out other essential development projects as the funds directed into tourism development are no longer available for other uses.

In addition to economic benefits and costs of tourism discussed thus far, tourism development also brings about socio-cultural and environmental impacts to the host country. The social and cultural impacts of tourism are largely determined by the socio-cultural differences between the host and the tourist, as these impacts are effects on the people of host country caused by their association with tourists. It has been suggested that developing countries are likely to experience more negative socio-cultural effects as a result of tourism development than developed countries (de Kadt, 1979).

Tourism development would inevitably cause various changes in the environment of the host country. These changes could result in both positive and negative effects on the natural environment of the host country. The extent and magnitude

of these impacts are determined by various factors, such as the intensity of use of tourist site, the resilience of the ecosystems, the degree of tourism development and etc. (Liu, 1998).

1.4 Tourism Development in Malaysia

Compared with other countries in the region, Malaysia is a latecomer to the tourism industry. In the 1960s, tourism was virtually unknown in Malaysia. Although the Department of Tourism was established in January 1959 under the Ministry of Commerce and Trade, the Department played a relatively passive role in promoting the industry due to its limited functions and low priority extended to the industry by the Government.

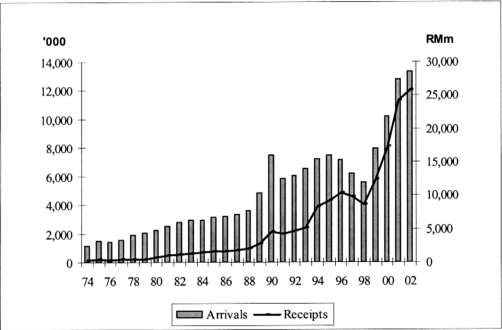
The lack of emphasis on tourism development in Malaysia was mainly attributed to two reasons. Firstly, tourism was not considered as a prime sector in the economy then as the economy was well supported by two primary commodities, namely rubber and tin, which were the important sources of foreign exchange income for the country until the 1970s. Secondly, during the early years of political independence, the Malaysian government focused more attention on its development projects, particularly the New Economic Plan following the domestic political unrest in 1969 (Okposin et al. 1999). An earlier estimate by the authorities suggests that Peninsular Malaysia received some 27,000 tourists in 1963, growing to 47,470 in 1967 before declining to 45,571 tourists in 1969. Based on the information provided by the Malaysian Immigration Department,

employment and business dealings were the main reasons tourists visited Malaysia during this period (Okposin et al. 1999).

In the late 1960s and early 1970s, Government's policy stance changed when Malaysia was inspired by the development of tourism as an economic activity by its neighboring countries (Goh, 1989). The Malaysian government began to put in considerable efforts towards attracting international tourists by participating in international trade fairs and exhibitions as well as advertising in various media. In 1972, three events happened simultaneously in Malaysia to stimulate the growth in the Malaysian tourism industry. (Goh, 1989). In January 1972, Kuala Lumpur hosted the Pacific Area Travel Association (PATA) Conference which set the stage for Malaysia to move into the international tourist markets. On 10 August 1972, the Tourist Development Corporation of Malaysia (TDC) was established under the Ministry of Trade and Industry to replace the Department of Tourism, to coordinate and implement tourism development in Malaysia. In the same year, the formation of our own national air carrier, the Malaysian Airline System (MAS) on 1 October was another stimulus to the tourism development in Malaysia. In 1975, the Malaysia Tourism Development Plan of TDC was formulated to intensify the development of tourism industry. The 1975 tourism masterplan aimed to decentralize tourism from the urban areas of the west by developing tourist regions and corridors on the east coast (Shaw and Williams, 1994: 118). Consequently, from having less than 500,000 tourists in the beginning of 1970s, the number of tourists visiting Malaysia almost doubled to 1

million in 1972. By 1974, tourist arrivals exceeded 1 million with a total tourist receipt of RM353.9 million. With the exception of 1976, the upward trends continued and tourist arrivals hit the 2 million mark in 1979.

Figure 1.3: Tourist Arrivals and Receipts in Malaysia, 1972-2002



Source: Ministry of Tourism, Malaysia

Although tourism in Malaysia began to receive some serious attentions from policy makers in the early 1970s, it was not until the mid-1980s and the poor performance of traditional exports that tourism was accorded high priority. The fluctuations in commodity prices in the early 1980s have drawn the Malaysian government's attention to other activities, including tourism, as a potential foreign exchange earner (Fifth Malaysia Plan: 395). In January 1985, a Cabinet Committee on Tourism was formed to expedite development of tourism sector in

Malaysia (Fifth Malaysia Plan: 402). TDC began the tourism promotion by embarking on large scale marketing and advertising in domestic and overseas markets as well as participating in international and regional exhibitions related to travel and tourism. Bulk of the promotional efforts was undertaken jointly by TDC and MAS. Equal emphasis had also been given towards the promotion of domestic tourism whereby the state governments were active in promoting their own states. To ensure that tourism services rendered in Malaysia was of good and acceptable standards, TDC implemented the Tour Operating Business and Travel Agency Business Regulations in 1985 to protect the interests of the tourists and prevent malpractices in the industry (Fifth Malaysia Plan: 399). Besides promotional activities, the Malaysian government also provided training programs to improve the skills and professionalism in the industry. The aggressive promotion and the improved tourism services during the ensuing period increased arrivals from a fairly modest 2.3 million with receipt of less than RM1 billion in 1980 to exceeding 3 million tourists in 1986. Despite the high arrivals, Malaysia only recorded a total receipt of RM1.7 billion as the majority of its tourists were from relatively low-yield neighboring countries. Table 1.3 shows tourist arrivals to Malaysia by country of origin.

Table 1.3: Tourist Arrivals by Country (Selected Years)

	1990	1995	2000	2001	2002
Tourist Arrivals ('000)	7,446	7,469	10,221	12,775	13,292
<i>By Country of Origin (%)</i>					
ASEAN	73.8	73.5	70.3	72.1	74.1
Japan	6.8	4.4	4.5	3.1	2.7
China	-	1.4	4.2	3.5	4.2
Taiwan	-	3.9	2.1	2.0	1.6
Hong Kong SAR	-	2.0	0.7	1.1	0.9
India	-	0.4	1.3	1.1	1.4
Australia	2.0	1.8	2.3	1.7	1.5
United Kingdom	2.6	2.2	2.3	2.1	1.8
US	2.0	1.3	1.8	1.1	1.0
Others	12.8*	9.1	10.5	12.1	10.8

* include China, Taiwan, Hong Kong and India.

Sources: MTPB and Malaysia Plans (various issues)

In May 1987, the Ministry of Culture, Arts and Tourism (MOCAT) was established and TDC was transferred from the Ministry of Trade and Industry to this new ministry to spearhead tourism development (Mid-Term Review of Fifth Malaysia Plan: 262). At the same time, the fiscal incentives for tourism sector were reviewed and new incentives were introduced under the Promotion of Investment Act 1986, which widened the scope of incentives available to include tourism-related sector and activities other than hotels (Fifth Malaysia Plan: 404-405). In 1989, the Malaysia Convention Bureau was established to create awareness of Malaysia as a convention centre. These movements reflect the Malaysian government's commitment to further accelerate the tourism

development in Malaysia. The large increase in government spending on overseas promotions with Fascinating Malaysia in 1988 and Visit Malaysia Year in 1990, product and infrastructure development as well as the extension of incentives for tourism-related investment in the national budgets have successfully raise the awareness of Malaysia as a major tourist destination among foreigners. Complemented by hosting prominent international conferences and events such as Commonwealth Heads of Governments Meeting (CHOGM), Malaysia recorded a dramatic increase in tourist arrivals to 7.4 million in 1990 (1989: 4.8 million tourists) and a three-fold increase in receipts from RM1.5 billion in 1985 to RM4.5 billion in 1990. As such, tourism sector became the third largest foreign exchange earner for the country.

In 1991, the Malaysian government implemented the National Tourism Policy (NTP). The NTP provided specific long-term policies and strategies for a more coordinated and integrated development of tourism industry in Malaysia until year 2000 (Seventh Malaysia Plan: 504). However, in 1991, tourist arrivals declined dramatically as a result of the Gulf War. In 1992, the Tourist Development Corporation of Malaysia Act 1972 was replaced by the Malaysia Tourism Promotion Board (MTPB) Act 1992 whereby the MTPB was officially established. Following this change, the MOCAT is primarily responsible for setting policy guidelines for the tourism industry, regulating the industry by issuing licenses to tour operators and enforcing the Tourism Industry Act 1992. MOCAT's functions are complimented by the MTPB which focus on promoting

tourism in the country. With this change, MTPB has actively undertaken several major tourism promotion activities locally and abroad. With the aggressive worldwide marketing campaigns to promote Malaysia as a tourist haven and the increased allocation of funds for the tourism sector under the various development plans (Table 1.4) to develop new and improved tourism facilities, Malaysia's tourist arrivals reverted to show positive trends and international tourism receipts almost doubled during the period 1992-95.

The intensified and concerted tourism promotional activities undertaken at international and regional levels as well as the hosting of special events such as Flora Fest, Malaysia Fest and Langkawi International Maritime and Aerospace exhibition have further enhanced Malaysia's image as an attractive tourist destination in the region. The industry was boosted with the introduction of new tourism products such as educational tourism, ecotourism, agro tourism and sports tourism during this period. The tourism industry was further enhanced with the improvements in land and sea transports in Malaysia. During the same period, the Malaysian government worked very closely with the private sector to promote Malaysia as a venue for meetings, incentives, conventions and exhibitions (MICE) (Mid-Term Review of Seventh Malaysia Plan: 238-239). In 1996, the industry recorded an impressive receipt of RM10.4 billion despite a decline of 4.4% in the number of tourist arrivals to 7.2 billion. This significant amount of receipt contributed about 8.2% to Malaysia's total GDP, making tourism the second foreign exchange contributor to the country's economic growth.

Table 1.4: Development Allocations and Expenditures for Tourism in Malaysia, 1971-2005

Malaysia Plan	Allocation (RMm)	Expenditure (RMm)
Second Malaysia Plan (1971-1975)	8.59	4.26
Third Malaysian Plan (1976-1980)	27.19	21.28
Fourth Malaysia Plan (1981-1985)	40.16	37.95
Fifth Malaysia Plan (1986-1990)	140.5	132.1
Sixth Malaysia Plan (1991-1995)	746.3	559.0
Seventh Malaysia Plan (1996-2000)	605.5	484.2
Eighth Malaysia Plan (2001-2005)	1118.3	758.7*

* Expenditures for 2001-03 from Mid-Term Review of Eighth Malaysia Plan, 2001-05
Sources: Malaysia Plans (various issues)

The occurrence of haze, the outbreak of Nipah and Cocksackie and the negative coverage by foreign media on Malaysia and ASEAN region in 1997 had affected tourism industry in Malaysia adversely (Mid-Term Review of Seventh Malaysia Plan: 233). The negative impact on tourism industry in Malaysia was exacerbated by the Asian financial crisis which had impacted on most of the countries in the region. As most of the crisis-hit countries are Malaysia's leading tourism sources, Malaysia experienced a fall in both international tourist arrivals and receipts for two consecutive years despite hosting the Commonwealth Game in 1998. Consequently, Malaysia recorded only 5.6 million arrivals (the lowest level since

the beginning of the decade) with international tourism receipt of RM8.6 billion in 1998.

In view of the deterioration in the economy and the industry in 1998, the National Economic Recovery Plan, which was drawn up by the National Economic Action Council, had identified tourism as a key sector to revive the economic growth for the country as well as the engine of growth in the future (Mid-Term Review of Seventh Malaysia Plan: 233). As such, the MTPB had implemented a two-pronged strategy of increasing foreign tourist inflows and receipts, that is, to attract tourists from non-crisis affected markets (such as China, India, Middle East, Australia and Europe) and from the top traditional markets (such as Singapore, Thailand, Hong Kong, Indonesia and Japan). At the same time, domestic tourism was aggressively promoted to contain foreign exchange outflows attributable to the overseas leisure travel made by Malaysian. These strategies were successful in raising the arrivals and revenues in the tourist industry in Malaysia. Besides existing incentives, the Government also reinstated the Special Funds for Tourism to provide soft loans to small- and medium-sized tourism-related projects (Mid-Term Review of Seventh Malaysia Plan: 245). Coupled with the strong world economic performance, Malaysia's international tourist arrivals and receipts hit record levels during the period 1999 to 2002. As a result, tourism sector became the second largest foreign exchange earner for Malaysia since 2000, after the manufactured exports. Position of tourism as

foreign exchange contributor to the country for the period 1990-2002 is presented in Table 1.5.

Table 1.5: Major Export Earners for Malaysia, 1990-2002

Year	Position of Export Commodity			
	First	Second	Third	Fourth
1990	Manufactured goods	Crude petroleum	Tourism	Palm oil
1991	Manufactured goods	Crude petroleum	Palm oil	Tourism
1992	Manufactured goods	Crude petroleum	Palm oil	Tourism
1993	Manufactured goods	Crude petroleum	Palm oil	Tourism
1994	Manufactured goods	Palm oil	Tourism	Crude petroleum
1995	Manufactured goods	Palm oil	Tourism	Crude petroleum
1996	Manufactured goods	Tourism	Palm oil	Crude petroleum
1997	Manufactured goods	Palm oil	Tourism	Crude petroleum
1998	Manufactured goods	Palm oil	Tourism	Crude petroleum
1999	Manufactured goods	Palm oil	Tourism	Crude petroleum
2000	Manufactured goods	Tourism	Crude petroleum	Palm oil
2001	Manufactured goods	Tourism	Crude petroleum	Palm oil
2002	Manufactured goods	Tourism	Palm oil	Crude petroleum

Sources: Ministry of Tourism, Economic Reports and Bank Negara Malaysia Annual Reports (various issues).

1.5 Need for Empirical Work on the Tourism Industry in Malaysia

Despite having a far reaching impact on the economy, there is not much work on the contribution of the tourism to the long-term economic growth in Malaysia. So far, there are very few studies have been done on tourism in Malaysia. These studies have focused mainly on tourist demand projection and short-run growth effects of tourism¹. This situation deprives both the government and the industry players of information essential in formulating appropriate policy and developing better business strategies in the long run, which is one of the most important contributions of tourism economics, as Gray (1982) articulates in his paper. Also, the limited empirical studies on tourism in Malaysia reduce social awareness of the importance and potential of tourism industry as a factor promoting growth as delineated in the Eighth Malaysia Plan.

The development of tourism in Malaysia for the past three decades has provided sufficient time to assess the contribution of tourism sector to Malaysia's long-term economic growth process. Accordingly, the main objective of this paper is to examine whether a tourism-led growth strategy is valid for Malaysia by establishing the existence of the long-run as well as the causal relationships between tourism and growth using time series techniques of the Johansen Cointegration and Granger-causality tests. To the best of my knowledge, no study has used these methodologies to study the relationship between tourism and growth in Malaysia. In this regard, it is expected that this paper will make a

¹ Chong Y. H (1982) , Tucker, Seow and Sundberg (1984), Tan K. E. (1986), Goh P. C (1989), Walton, J. (1993) and Shamsuddin, S. (1995)

modest contribution to fill the gap in the current empirical literature on tourism and growth in Malaysia.

1.6 Organization of Study

This chapter provides the definitions of tourism and a brief review of the tourism development in Malaysia. The research objectives are also specified in this chapter. The remaining of the study is organized as follows. We begin with a review of previous empirical works which seek to determine the linkage between trade and growth with special reference to tourism in chapter two. The theoretical relationship between exports (tourism) and domestic growth inherent in two models, namely, the open-economy Harrod-Domar model and the two-gap model by Chenery and associates are discussed in chapter three. In chapter four, we provide a brief account of the research methodologies which are employed in the study, namely, the Johansen cointegration technique and the Granger causality test. Definitions and collection of data are also explained in this chapter. This is followed by chapter five which presents the results from the data analysis and the implication of the results. Finally, chapter six summarizes the important findings and limitations of the study.