

Impact of Macro-Economic Factors on the International Tourist Arrivals: An Analysis of Sri Lanka and its Regional Competitors

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ABSTRACT

Globally, tourism has become one of the most rapidly expanding industries because of its economic and cultural importance. Understanding how dynamic economic conditions affect tourism development in Sri Lanka is crucial in achieving the future development goals of the country. This paper investigates the impact of the Gross Domestic Product (GDP), Foreign Direct Investment (FDI), and Inflation Rate (IR) on International Tourist Arrivals (ITA) of Sri Lanka and its two regional competitors, i.e., Malaysia and Singapore. Annual data of variables were extracted from the World Banks Database for the period of 1995 to 2019. The Descriptive analysis was carried out to compare the behavior of the different variables among the selected countries. The effect of macroeconomic variables on tourist arrivals in each country was examined by employing multiple linear regression analysis. It was identified that GDP contributes positively to tourism visits in each country. Further, in Singapore, FDI positively impacts tourist arrivals, whereas Sri Lanka and Malaysia haven't experienced any significant changes due to FDI. However, fluctuations in tourist arrivals in any country did not correlate with changes in national

inflation. Importantly, the growing FDI sector in Singapore has been found to contribute to the increase in the demand for tourism. In conclusion, the economic growth of a country could be identified as an important factor that should be a primary concern for tourism development. The findings of the study assists in developing policies and regulations to achieve sustainable tourism development in Sri Lanka.

Keywords: *Foreign Direct Investment, Gross Domestic Product, Inflation Rate, Macro-economic Factors, Tourist Arrivals, Regional Tourism Competitors*

1. INTRODUCTION

The travel and tourism industry has been accepted as one of the largest service industries in the world and tourism receipts caused by tourism arrivals provide an important source of foreign exchange for countries around the world (The World Bank Group, 2017). With the understanding of the enormous economic benefits gained through tourism, many countries focus on tourism development and attracting tourists.

It is important to explore the impact of the economic sector on the tourism industry, which can cause a huge contribution to the development of the industry. Worth USD 7.6 trillion, the travel and tourism sector accounts for more than 10% of global GDP, represents 7% of all international

trade, and 30% of the world's export in services. Also, tourism has been identified as the third largest global export, after chemicals and fuels, and ranked ahead of automotive products and food. From 2010 to 2015, export earnings from international tourism grew by nearly 25% providing an important source of foreign exchange for countries around the world and supporting economic growth (The World Bank Group, 2017). Tourism has been identified as the second fastest-growing industry in terms of foreign direct investment (FDI) attraction. Also, FDI is considered as a better source of financing for the tourism sector (Rajapakse, 2016; The World Bank Group, 2017).

Similarly, Foreign Direct Investment (FDI), Inflation Rate (IR), and Gross Domestic Product (GDP) have been used by many researches to understand the nature of the economy of a country (Cho, 2001; Croes & Vanegas, 2005; Rajapakse, 2016; Witt & Turner, 2002). Along with that, many studies have focused on various factors that affect the tourism arrivals towards a particular destination emphasizing the importance of different Macroeconomic variables (Croes & Vanegas, 2005; Witt & Turner, 2002).

The tourism industry of Sri Lanka became the third export income earner of the country respectively in 2018 and 2019 (Sri Lanka Tourism Development Authority, 2019) and Sri Lanka has been identified as the world's best destination to travel to in 2019 by Lonely Planet, i.e., a popular travel guidebook publisher (Daily News, 2018) supporting the promotion of Sri Lanka tourism in the global market. However, according to the Travel and Tourism Competitiveness Index, Sri Lanka has secured the rank 77 and regional competitors like Singapore (rank 17th), Malaysia (29th), Thailand (31st), India (34th), Indonesia (40th) and Vietnam (63rd) have ranked well ahead of Sri Lanka in 2019 (Daily FT, 2020; World Economic Forum, 2019).

Hence, the present study focused on how macro-economic factors, i.e., Foreign Direct Investment (FDI), Inflation Rate (IR), and Gross Domestic Product (GDP) impact on the Number of International Tourist Arrivals (ITA) of Sri

Lanka, and its top two regional competitors, i.e.; Singapore and Malaysia. To achieve the aim of the study, the following research objectives have been formulated:

- i. To understand the changing patterns of the selected Macroeconomic factors and the Number of International Tourist Arrivals of the three selected countries.
- ii. To understand the impact of Macroeconomic factors on the Number of International Tourist Arrivals of three selected countries.
- iii. To comparatively understand the impact of Macroeconomic factors on the Number of International Tourist Arrivals of Sri Lanka and its regional competitors, i.e., Singapore and Malaysia.

Thus, the present study serves as the basis for supporting tourism strategies, investment, management, and enabling sustainable tourism development in Sri Lanka to gain competitive advantage among its regional competitors.

2. LITERATURE REVIEW

Many studies have been undertaken to understand the causal relationship between GDP and International Tourist Arrivals. Rajapakse (2016) identified that GDP has a unidirectional effect on International Tourist Arrivals for Sri Lanka. Dhungel (2015) revealed that there is a unidirectional causality relationship from GDP to tourism of Nepal in the long run using econometrics methods. According to Altaf (2021), GDP per capita is a significant positive determinant of tourists' arrival to India. In the reverse, Sulasmiyati (2019) proved that tourist arrivals significantly contribute to the growth of economic activities and also TERZİ (2015) showed that the effect of tourism revenue promotes the economic growth in Turkey. Further, Lee et al. (2008) implemented the new heterogeneous panel cointegration method and found the unidirectional causality running from tourism to growth of economy in Organization for Economic Co-operation and Development (OECD) countries, and bidirectional causality in non OECD countries for the period of 1990-2002. However, a negative bidirectional causality between real GDP and international

tourist arrival in the short-run as well as in the long run was identified by Ben Jebli et al. (2018) for the top ten international tourism destinations using panel cointegration and Granger causality test.

The previous studies also have argued that FDI to be one of the most impactful way for developing countries to boost their tourism sectors. Peri et al. (2011) investigated that FDI has a significant positive influence on the tourist arrivals. It concluded that FDI plays a crucial role in the development of the tourism industry in developing countries. Similarly, Garcia-flores et al. (2008) and Samimi et al. (2013) emphasized the need for FDI in expanding the tourism sector in the countries. Perić et al. (2015) also found that FDI has a significant impact on the tourism productivity of Croatia through regression analysis. The result showed that the stock FDI in tourism affected tourism productivity growth by agreeing with the study of Tondl et al. (2008). Therefore, the positive relationship from FDI to tourism indicates the requirement of FDI for the tourism development of a country. However, the previous studies have suggested a reverse causal relationship between FDI and tourism. Fauzel (2020) revealed a bidirectional causality between FDI and tourism development for the long run. Also Fereidouni & Al-mulali (2014) found that FDI in real estate in OECD countries has a bidirectional causal relationship with international tourism in the long run. Samimi et al. (2013) identified a bidirectional long-run causality between tourism related FDI and tourism growth in developing countries by applying panel-cointegration tests. Using the homogenous and instantaneous causality tests, Craigwell et al. (2008) determined a bi-directional causal relationship between FDI and tourism in Small Island Developing States (SIDS). Accordingly, it could be identified that FDI plays a significant role in tourism growth, while tourism development significantly attracts FDI.

Meanwhile, literature reveals that national inflation is also a critical economic factor that affect the tourism sector. According to Sulasmiyati (2019), inflation factors negatively affected foreign tourist arrivals in Indonesia,

which emphasized the need for controlling inflation. Furthermore, a study by Khan et al. (2022) examined the impact of inflation on tourist inflows and concluded that a high inflation rate exacerbates the problem of declining tourism by making everything more costly and deterring investors and tourists. This aligns with the findings of Huseynli (2022) and Achyar et al. (2021). According to the study by Meo et al. (2018), a decrease in inflation as well as an increase in inflation negatively affects tourism in the long run. Additionally, it demonstrated that an decline in inflation is more likely to affect tourism demand than an increase in it. Therefore, inflation also could be identified as an influencing factor towards the tourism sector of a country.

3. RESEARCH METHODOLOGY

The present study has used annual time series data on the four variables namely Number of International Tourist Arrivals (ITA), Gross Domestic Product (GDP), Inflation Rate (IR) and Foreign Direct Investment (FDI) for the period of 1995 to 2019. The data for these variables were considered from the three countries selecting Sri Lanka as the country of consideration, and Singapore and Malaysia as its top regional competitors in South Asia and South East Asia. Accordingly, the present study is based on secondary data, and were taken from the World Banks Database from 1995 to 2019 based on the availability of data (The World Bank, 2021). Graphical interpretation and descriptive analysis were carried out to compare the behavior of each variable over the period among the selected countries. Multiple linear regression was employed to examine the macroeconomic variables' impact on ITA in each country. The model used in this study can be specified as,

$$ITA=f(GDP, FDI, IR) \quad (1)$$

where, ITA = Number of International Tourist Arrivals (thousand), GDP = Gross Domestic Product (billion US\$), FDI = Foreign direct investment (million US\$), IR = Inflation (%).

The multiple linear regression model can be written as,

$$ITA_{it} = \beta_0 + \beta_1 GDP_{it} + \beta_2 FDI_{it} + \beta_3 IR_{it} + \varepsilon_i \quad (2)$$

where, ITA_{it} = number of international tourist arrivals of each country, $\beta_0, \beta_1, \beta_2, \beta_3$ = regression coefficients, and ε_i = random error term.

3.1. Conceptual Framework

The conceptual framework of the present study represents the impact of the selected independent variables, i.e., FDI, IR, GDP on the dependent variable, i.e., Number of International Tourism Arrivals.

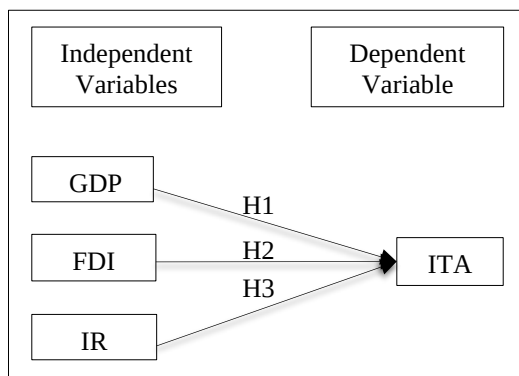


Figure 5: Conceptual Framework

3.2. Hypotheses Formulation

In order to recognize the impact of the independent variables on the dependent variable, testable propositions were developed based on the objectives of the present study. Accordingly, the following hypotheses were drawn.

H1: There is a significant impact of Gross Domestic Product on Number of International Tourist Arrivals.

H2: There is a significant impact of Foreign Direct Investment on Number of International Tourist Arrivals.

H3: There is a significant impact of Inflation Rate on Number of International Tourist Arrivals.

4. FINDINGS OF THE STUDY

4.1. Descriptive Analysis

A comparative analysis of the selected variables over the period between 1995-2019 were analyzed using line charts and the descriptive statistics by comparing each country as follows.

4.1.1. Number of International Tourist Arrivals of the Selected Countries

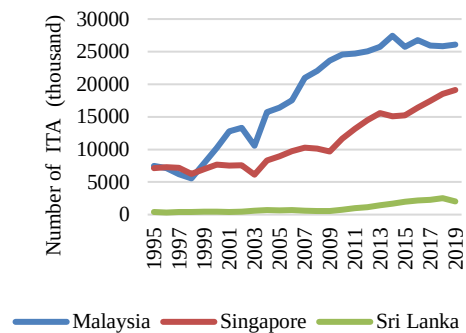


Figure 6: Number of International Tourist Arrivals, from 1995 to 2019

Figure 2 illustrates that the number of tourist arrivals to Malaysia and Singapore has gradually increased during the period of 1995 to 2019, while Sri Lanka showed a slight increase. In the beginning, Malaysia and Singapore have showed a similar pattern from 1995 to 1998, but after 1998 Malaysia remained significantly higher than the other two countries. However, Sri Lanka have showed a very lower number of arrivals compared to the Malaysia and Singapore over the period.

4.1.2. GDP of the Selected Countries

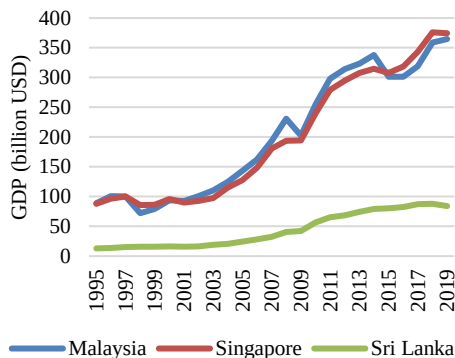


Figure 7: Gross Domestic Product, from 1995 to 2019

According to the figure 3, GDP in Malaysia and Singapore both have gradually increased over the timeframe showing similar patterns. However, during the last 5 years, Singapore has obtained a higher GDP value compared to Malaysia. When focusing to Sri Lanka, the GDP has slightly increased over the years. However, when comparing with the other two countries, a huge gap could be identified where the GDP remained significantly lower than Singapore and Malaysia.

4.1.3. FDI of the Selected Countries

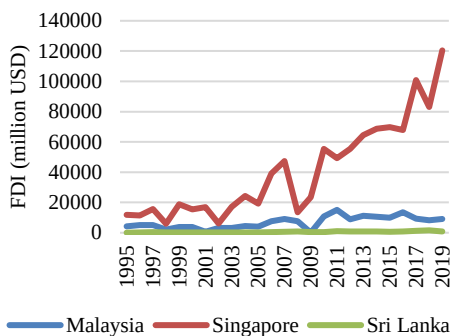


Figure 8: Foreign Direct Investment, from 1995 to 2019

Figure 4 indicates that, FDI in Singapore was significantly higher than compared to other two countries and it has reached its maximum value in 2019. Moreover, Malaysia has shown slight

fluctuations over the years and FDI in Sri Lanka was well below of both Singapore and Malaysia.

4.1.4. Inflation Rate of the Selected Countries

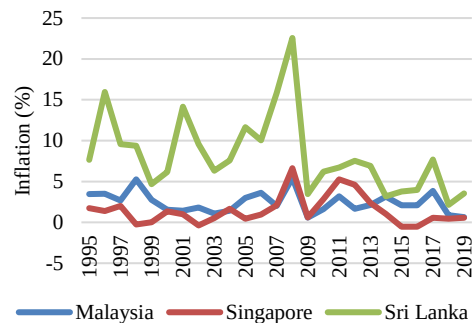


Figure 9: Inflation Rate, from 1995 to 2019

Figure 5 indicates that, IR in Sri Lanka was comparatively higher than the other countries and it has increased to its maximum value in 2008. Moreover, Singapore and Malaysia showed fluctuations in IR over the years and showed a similar behavior in the years of 2007 to 2009 period. However, in most of the years, IR of Malaysia seems to be higher than the IR of Singapore.

4.2. Descriptive Summary Statistics

Table 8: Descriptive Summary Statistics - Malaysia, Singapore, and Sri Lanka

	Mean	Std. Dev.	Minimum	Maximum
<i>Malaysia</i>				
ITA	18214.1	7815.68	5551	27437
GDP	202.8	104.46	72.17	364.68
FDI	6834.93	3952.39	114.66	15119.4
IR	2.43	1.29	0.58	5.44
<i>Singapore</i>				
ITA	11099.9	4193.18	6127	19116
GDP	197.98	105.88	85.73	375.98
FDI	40869.1	31583	5958.65	120439
IR	1.45	1.79	-0.53	6.63
<i>Sri Lanka</i>				
ITA	979.04	702.17	315	2521
GDP	43.84	29	13.03	87.95
FDI	560.49	410.56	56	1614.04
IR	8.25	4.8	2.14	22.56

According to Table 1, the average tourist arrivals to Malaysia during the period from 1995 to 2019, was 18,214.12 thousand tourists which is approximately 2 times higher than the average arrivals in Sri Lanka. A large standard deviation of 7815.68 thousand for Malaysia indicates that the number of tourist arrivals is highly fluctuated in Malaysia. The mean values of GDP in Malaysia and Singapore are close to each other, while the average GDP in Sri Lanka is approximately 5 times lower than them. When focusing to FDI, Singapore averages 40869.1 million US\$ which is far better than other two countries. When focusing to the IR, the average inflation in Sri Lanka is 8.25% which is significantly higher than that in other countries, and Singapore shows a much lower average of inflation compared to others.

4.3. Multiple Linear Regression (MLR) Analysis

4.3.1. The results of MLR analysis for Sri Lanka

Table 9: MLR Analysis - Sri Lanka

Variables	Coefficient	S.E	t - stats (p-value)
Constant	289.40	186.526	1.552 (0.136)
GDP	15.53	4.746	3.272 (0.004)
FDI	0.385	0.308	1.252 (0.224)
IR	-25.105	13.668	-1.837 (0.080)
R ²	0.875		
Adjusted R ²	0.857		
Std. Error	265.171		
Durbin-Watson	1.763		
F- stats (prob.)	49.095 (0.000)		

Table 2 shows the strength of the relationship between the independent variables and dependent variable related to Sri Lanka. It is identified that the independent variables altogether explain the 87.5% of variance ($R^2=0.875$) in the number of tourist arrivals to Sri Lanka. Further, according to the adjusted R^2 value (0.857), 85.7% of the variation in the tourist arrivals is still explained by the equation

without the influence of the explanatory variables. The F- statistics with a p-value (0.000) less than 0.05 indicates that the model has a good fit at 5% level of significance. The t-test results reveal that GDP has a significant positive effect on the number of tourist arrivals to Sri Lanka, while FDI and IR have no any significant effect.

4.3.2. The results of MLR analysis for Malaysia

According to the Table 3, the value of R^2 (0.888) of this model indicates a strong linear relationship between the number of tourist arrivals and independent variables related to Malaysia. It implies that 88.8% of the variation in the number of tourist arrivals in Malaysia is explained by the model. The significance value of the F-statistic ($F=55.328$) is less than 0.05, which explains that the model has a good fit. According to the t test, GDP has a significant positive effect on the tourist arrivals to Malaysia, where β (69.899) is significant with p-value (0.00) less than 0.05. But the effect of FDI and inflation are not significant at 5% level of significance.

Table 10: MLR Analysis - Malaysia

Variables	Coefficient	S.E	t - stats (p-value)
Constant	5191.280	1830.741	2.836 (0.010)
GDP	69.899	9.713	7.197 (0.000)
FDI	-0.019	0.253	-0.075 (0.941)
IR	-420.505	484.69	-0.868 (0.395)
R ²	0.888		
Adjusted R ²	0.872		
Std. Error	2800.77		
Durbin-Watson	1.704		
F- stats (prob.)	55.328 (0.000)		

4.3.3. The results of MLR analysis for Singapore

Table 4 shows that the GDP and FDI in Singapore have the significant positive effect on the number of tourist arrivals to the country, where the model ($F=427.745$) is significant with the p-value (0.000) less than 0.05. Moreover,

98.4% of variation in the number of arrivals is explained by the variation in the independent variables and this shows a very strong relationship between variables. Further, Durbin-Watson test result (1.844) shows the absence of autocorrelation in the residuals.

Table 11: MLR Analysis - Singapore

Variables	Coefficient	S.E	t - stats (p-value)
Constant	3839.744	281.382	13.646 (0.000)
GDP	31.807	3.336	9.536 (0.000)
FDI	0.027	0.011	2.409 (0.025)
IR	-93.229	73.715	-1.265 (0.220)
R ²	0.984		
Adjusted R ²	0.982		
Std. Error	568.815		
Durbin-Watson	1.844		
F- stats (prob.)	427.745 .000)		

4.4. Hypothesis Testing and Comparative Analysis

Hypotheses of the present study were tested using the P-value (sig level) of each coefficient of the independent variables. The confident interval of accepting hypotheses was taken as 95% and therefore, P value required to be less than 0.05 (Saunders et al., 2008).

When focusing to the H1, the alternative hypotheses were accepted for all three countries as P-values were less than 0.05. This implies, GDP has a significant impact on the International Tourist Arrivals in all three countries, i.e. Sri Lanka, Malaysia and Singapore. Accordingly, it emphasized that the impact of the GDP is approximately two times higher in Singapore and four times higher in Malaysia, compared to Sri Lanka.

Looking at the results obtained for H2, the alternative hypotheses for Sri Lanka and Malaysia were rejected since P-values were greater than 0.05, which means FDI does not have a significant impact on the International Tourist Arrivals in Sri Lanka and Malaysia. But

a significant impact could be identified for the International Tourist Arrivals of Singapore as its alternative hypothesis was accepted at 5% level of significance. According to the test of H3, the alternative hypotheses belong to all three countries were rejected as P-values were greater than 0.05. Therefore, it could be concluded that Inflation Rate does not have a significant impact on the International Tourist Arrivals in Sri Lanka as well as in Malaysia and Singapore.

5. DISCUSSION

According to the analysis of the present study, it was identified that GDP positively affects the Tourist Arrivals in all the three countries. This finding is in agreement with the previous studies done by Rajapakse (2016) and Akal (2004) emphasizing that, if the country needs to attract more tourists, it must grow GDP that enables better goods and services, facilities and infrastructure for tourists. Therefore, higher the quality of services and hospitality would affect in higher number of tourists and vice-versa.

In terms of FDI, the findings for Singapore are in agreement with the findings of Fauzel (2020), which emphasize a positive and direct relationship between FDI and tourists' arrivals. FDI brings financial capital, technological and managerial expertise beneficial for the tourism development in a country. Further, the implementation of FDI related appropriate policies to explore tourism resources and plan tourism development in terms of accommodation and other facilities to meet the increasing demand of tourism can encourage the international tourist arrivals to a country (Tang, Sumei; Selvanathan, E.A; Selvanathan, 2007). In contrast, any significant effect from FDI on tourist arrivals was not identified in Sri Lanka, and Malaysia which is in agreement with the findings of Rajapakse (2016). Accordingly, unavailability of a favourable climate for investments can discourage the attraction of FDI towards the country. Further, investment projects that are not directly related to the tourism development can have no or less impact on the tourism arrivals.

Inflation has a negative influence on the number of tourists arrivals emphasizing that the price increase of domestic goods, lower the number of

tourists arrivals to Indonesia (Sulasmiyati, 2019). However, findings of the present study revealed that the Inflation Rate has no any significant impact on Tourist Arrivals of Sri Lanka and a similar association in other two countries too. Researcher's view on the possible reasons for this disagreement is that, association of Inflation Rate towards the Number of International Tourist arrivals depends on the economic profile of the top tourist arriving countries, currency of the respective countries and the currency exchange rates. For an example, the top 5 tourist source markets to Sri Lanka in 2019 are India (18.6% of total arrivals), UK (10.4% of total arrivals), China (8.8% of total arrivals), Germany (7% of total arrivals) and France (4.6% of total arrivals) (Sri Lanka Tourism Development Authority, 2019) where the currency and the exchange rates of the respective countries are varying towards one another. This idea is in conformity to Eilat & Einav (2004) which suggests that tourism to developed countries is price elastic, while tourism to less-developed countries is largely unresponsive to price fluctuations.

Additionally, developing countries like Sri Lanka have invested on development projects based on foreign debts rather than FDI. Further, the exchange rates of the host country's currency with other foreign currencies can influence the purchasing power of the tourists that can create impacts on the international tourism arrivals to the considering destinations. Therefore, this study can further be extended by incorporating other macro-economic variables such as exchange rate and foreign debts into the model and accessing how they affect the tourist flow.

6. CONCLUSION

Findings of this study emphasize the effects of the macro-economic factors; GDP, FDI and IR on tourist arrivals vary from country to country. Further, a country's economic growth is one of the top concerns for tourism development. Additionally, the study provides insights towards the directions for the tourism industry and the policy makers for developing strategies, policies, and regulations in line with tourism planning and sustainable tourism development.

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