

Institutional Quality and Tourism Demand : A Review

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Abstract

Tourism sector has been considered as the key sector of economic growth. Policy makers and practitioners need key insights for growth and promotion of this sector. Identifying the determinants of tourism demand may help to recognize and reformulate tourism and growth policies. In the present study an attempt has been made to analyse the various determinants of tourism demand particularly the institutional factors, by reviewing the existing literature on the determinants of tourism demand. The study found that among the core determinates, Income, price level, exchange rate, previous visits, transportation cost are the prominent ones. Besides, recent literature also highlighted the overwhelming role played by institutional quality factors like rule of law, government efficiency, bureaucratic set up, level of corruption, political stability etc. in attracting the international tourist inflows of countries. The study concludes that tourism being backbone of country's development, so policies should be designed to improve the factors determining the tourism demand. Moreover efforts should be made by the policy makers of the country to strengthen the institutional environment of the country.

Key Words:

*Tourism Demand;
institutional Quality;
Determinants*

1: Introduction

Tourism is one of the fastest growing service industries and therefore has attained much scholarly attention at international, national and regional levels. Tourism industry has the potential to open numerous economic opportunities for a country ranging from generating jobs (tourism and its allied industries like hotels, transportation, food industries, handicrafts) to earning foreign exchange earnings (Manuela and Vera, 2015; Roxas and Chadee, 2013). The industry is a significant source for economic growth, generates tax revenue and alleviates poverty particularly in the case of developing countries (Saha and Yap, 2015; Biagi *et al.*, 2017). International tourism plays an important role in cultural preservation, promotion of peace and security, employment generation, economic growth and development throughout the world. People throughout the globe nowadays travel cross borders to understand and experience the cultures, customs and traditions of different countries and therefore helps in removing the prejudice and narrow mindedness among different nations of the world. An ever-increasing

number of tourist destinations throughout the world have amplified the level of investment in the tourism industry and therefore turning it into a key driver of the socio economic development and resulting in an increase in the creation of jobs, export earnings, GDP growth and the development of infrastructure (Tapper, 2011; Mbaiwa, 2003).

Being the key aspect of all the decisions and planning activities related to tourism industry, economists have studied the term tourism demand comprehensively since the beginning of tourism studies as an academic field. Song *et al.*, (2008) defined the term tourism demand as, “The term tourism demand may be defined for a particular destination as the quantity of tourism product (i.e combination of tourism goods and services) that consumers are willing to purchase during a special period under a given set of conditions. The period may be a month, quarter or a year”. Tourism demand of the destination country constitutes any visitor arrivals in a country or a local area that start bestowing the benefits to the destination country as soon as the tourists arrive there (Brown, 1993). The tourism demand of the destination country is very important in the sense that all the tourism related business activities are decided ultimately on the basis of the tourism demand (Song *et al.*, 2008). Therefore to reap the potential benefits from tourism sector the tourism demand of the countries needs to be forecasted accurately.

Economists throughout the world have focused on analyzing the institutional factors (political stability, corruption level, rule of law) as determinants of tourism demand since last few decades. However, little consideration has been given on the exhaustive review of institutional quality factors as determinants of tourism demand. Therefore the present study attempts to fill this literature gap by analysing the already existing literature on institutional factors as determinants of tourism demand. The remaining part of the study is organized as follows: Section 2 discusses the review of literature regarding the determinants of tourism demand. Information source and research methodology adopted are discussed in Sections 3. Finally section 4 concludes the study findings and policy implications.

2: Review of Literature

Similar to the notion of tourism demand, researchers throughout the globe have analyzed the determinants of tourism demand (Dogru *et al.*, 2017; Luzzi & Fluckiger, 2003; Eilat & Einav, 2004; Balli *et al.*, 2016). Initially the researchers used to focus on the traditional determinants of tourism demand which are as follows:

2.1: Traditional determinants of tourism demand

The traditional determinants of tourism demand used as explanatory variables by the researchers throughout the world include income, tourism prices, exchange rate, previous visits and transportation costs. The income of the tourist originating country has been prevalently employed in the estimation of tourism demand as one of the explanatory variables (Salleh *et al.*, 2007; Luzzi & Fluckiger, 2003; Eilat & Einav, 2004; Balli *et al.*, 2016; Dogru *et al.*, 2017). GDP has been mostly used as a proxy for income and the popularity of this as an independent variable might be mainly due to the easily available data on the variable. The variable income has been mostly used in per capita terms (Song *et al.*, 2008). Tourism being a luxurious good therefore as the income of the nation increases the residents of the country travel to different countries of the world for the sake of pleasure (Luzzi & Fluckiger, 2003; Eilat & Einav, 2004; Balli *et al.*, 2016). While analysing the tourism demand, tourism researchers have usually chosen prices level of the destination country as an important determinant of tourism demand (Eilat and Einav 2004; Dogru *et al.*, 2017; Lim, 1997; Martins *et al.*, 2017; Song and Wong, 2003; Song and Witt, 2006; Martin and Witt, 1988). The demand theory hypothesizes that there exists an inverse relationship between the tourism prices and the tourism demand which implies as the cost of living in the destination country decreases, huge flow of tourists will be attracted towards that very destination (Crouch 1996). Exchange rate has also been widely used in the estimation of tourism demand (Salleh *et al.*, 2007; Balli *et al.*, 2016 and Martins *et al.*, 2017). Culiuc, (2014) and Uysal and Crompton, (1984) found in their studies that tourism demand is highly responsive to the exchange rate between the destination and the origin country. Contradictory to these studies Lee *et al.*, (1996) and Loeb, (1982) found that the impact of exchange rate on tourism demand is statistically insignificant. However, there arise some controversial questions over the appropriateness of including both the prices and exchange rate as the separate variables in the empirical analysis of the tourism demand (Martin and Witt, 1987).

Lagged dependent variable or an autoregressive term has been widely employed in the econometric estimation of the tourism demand models (Lim, 1997 and Song and Li, 2008). The inclusion of the lagged dependent variable as one of the explanatory variable of tourism demand can be justified on the grounds that it captures the “word of mouth” or “habit persistence” effect. This is because people tend to return the destinations they have visited earlier due to the satisfaction achieved by them in their previous visits. They prefer to visit the places they are

familiar with as compared to places they have never visited before (Witt and Witt, 1995). Transportation costs also have played an important role in explaining the tourism demand models. Uysal & Crompton, (1984) and Salleh *et al.*, (2007) found that transportation costs play an important role in the determination of tourism demand. However there may arise some issues while using the proxy for transportation cost. Accordingly, some researchers have employed traveling costs (Martin & Witt, 1988) while as some researchers have used distance as a proxy for transportation costs (Deluna & Jeon, 2011; Kosnain *et al.* 2013; Culiuc, 2014). Alternatively Munoz, (2006) in his study has used crude oil price as a proxy for transportation costs. Kosnain *et al.*, (2013); Culiuc, (2014) and Deluna and Jeon, (2011) found that there exists a negative relationship between the transportation costs and tourist arrivals of a country.

2.2: Institutional Quality as determinant of tourism demand

Like any other business activity, tourism industry is very much responsive to the institutional quality factors. In recent literature researchers throughout the world have focused on institutional quality factors as determinants of tourism demand. Balli *et al.*, (2016) found that institutional quality has significant impact on the demand of tourism throughout the world with Africa and Europe being the exception. Similarly Kim *et al.*, (2018) and Roxas and Chadee, (2013) while analysing the impact of institutional quality on the tourism demand found that the institutional quality factors exert a strong and positive impact on the tourist inflows of the countries.

Moreover the political instability, political strife, warfare, political strikes present in the destination country can adversely impact the tourist inflows of the country (Neumayer, 2004; Enders and Sandler, 1991; Hall and Sullivan, 1996; Ankomah and Crompton, 1990). Hall and Sullivan, (1996) in their study mentioned that “issues of political stability and political relations within and between the states are extremely important in determining the image of the destinations in tourist generating regions”. Therefore when a country experiences any kind of political unrest, the potential tourists may be warned not to visit the country and this could significantly affect the tourism industry. Further, the impact of political problems of the destination country affects more severely as compared to a one time attack (Fletcher and Morakabati, 2008), implying that the impact of political instability is highly destructive for the economic development of the economy. Some researchers suggested that the violent events have long term negative impacts on the tourist inflows because the tourists are sensitive to the

negative image of the tourist destination country long after the event has happened (Enders and Sandler, 1991).

Likewise Yap and Saha, (2013) in their study found that all the political risk variables (internal conflict, External conflict, corruption, military in politics, religion in politics, ethnic tensions, and terrorism) have a negative impact on the tourist flows of countries. Additionally, political inconsistency arising from constant changes in governments can increase the cost of doing business in corrupted countries and will hamper the investment in the tourism industry (Tosun and Timothy, 2011). The political crisis present in a country makes it difficult even for the policy makers of the country to control the situation and therefore have speedy detrimental effects on the level of business (Evans *et al.*, 2003). Additionally, the inconsistency in the political institutions of the country arising from frequent changes in government raises the cost of doing business and therefore further hampering the investment in the tourism sector (Tosun and Timothy, 2001). Political violence is usually considered as bad news for the country's tourist arrivals even if no damage is caused or if no killing of the tourist is reported (Neumayer, 2004).

To sum up researchers have tried to analyse the importance of different determinants of tourism demand in diversified countries and different time periods. The existing literature revealed that the income, tourism prices, previous visits, exchange rate, transportation costs have been traditionally considered as main determinants of tourism demand. However, recently the factors like institutional quality, political stability, warfare, political strikes present in the destination country have also gained much scholarly attention as determinants of tourism demand.

3: Information Source and Methodology

To examine the various determinants of tourism demand, the present study is based on the already existing literature related to determinants of tourism demand in general and institutional quality factors in particular. The material used in the present study has been extracted from different database sources ranging from open access to limited access domains. The various database sources include Elsevier science, Emerald, JSTOR, SAGE journals online, Google Scholar, Google, Taylor and Francis etc. In order to get the required database different key words were entered. The main key words used for the present purpose included tourism demand, determinants of tourism demand, traditional determinants of tourism demand, impact of institutional quality and political stability on tourism demand. As a result of these searches

different papers were extracted published in different peer reviewed international and national journals. Moreover online proceedings of different international conferences were also taken into consideration. Good quantities of relevant articles were extracted from these sources and analysed in order get the empirical findings.

4: Conclusion and policy implications

The present study analyses the factors that determine the tourism demand of a country. in this study both theoretical as well as empirical studies have been analysed and there has been a strong evidence that the income of the tourist originating country, tourism prices, previous visits, transportation cost have played an important role in determining the tourism demand . However, recently the factors like institutional quality, political stability, government functioning, corruption level present in the destination country has gained much scholarly attention while estimating the tourism demand models. This is on account of the fact that tourists being rational economic agents are more concerned about their safety and therefore takes into consideration the political conditions, lawfulness, corruption level while deciding about the places to be visited.

Tourism demand being the main aspect of all the decisions and planning activities related to tourism industry, the policy makers of the country should work for improving the factors that boost the tourist inflow towards their countries. The recent literature on tourism demand suggests that the policy makers in addition to the traditional determinants of tourism demand should work for improving the institutional environment of their nations. The countries should establish rule of law, efficient bureaucratic system, proficient regulatory quality and should take steps to reduce the corruption level and political instability in the country. This will prove to be very helpful for countries (particularly developing countries like India) where the nuisance of unemployment and poverty can be reduced by taking these initiatives. The main limitation of the present study is that it is based on the secondary sources of information. Therefore the future research might base their studies related to institutional quality and tourism demand, on both primary as well as secondary data.

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