Institutional Quality and Tourism Growth Nexus in MENA Countries

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Abstract
The study critically examines the impact of institutional quality within foreign direct investment-financial development-international tourist arrival nexus for selected MENA countries. The dynamic pool mean group Autoregressive Distributed Lag (ARDL) model is employed for the empirical data analysis from 2012 to 2018. The findings reveal that institutional quality has a positive impact in FDI and real GDP model. Contrarily, it has adverse effect in the model of financial development and international tourist arrival overtime. Hence in the short-run, financial development and real GDP vary inversely moreover international tourist arrival and financial development varies directly. The multivariate panel causality test reveals 4 significant uni-directional causalities. The robust finding suggests institutional policy measures to enhance FDI and international tourist arrival, and the deepening of financial development to stimulate and enhance economic growth.

Keywords: *Autoregressive Distributed Lag (ARDL), economic growth. international tourist arrival, institutional quality, MENA countries*

JEL classification: *C5, Q4, Z3, Z0*

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1. Introduction

The quality of institutions regarding democratic accountability, political stabilization, governmental effectiveness, regulatory framework, anti-corruption, and rule base system are credible factors for the economy. Moreover, evidence suggests that credible institutional quality is vital in promoting foreign direct investment (FDI) welfare gain (Acemoglu and Johnson, 2005; Benassy Quere et al., 2007; Buchanan et al, 2012) and enhancing tourism development. Thus, FDI inflow to the country with excellent institutional governance quality can more broadly and easily enhanced tourist arrival. Additionally, poor institutional governance structure significantly diminishes FDI inflow (Wei, 2000; Li and Resnikk, 2003; Belgibayeva and Plekhanov, 2015; Dauda and Stein, 2007) and

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impedes tourism growth, more generally. Therefore the overall institutional quality in terms of good governance, democratic accountability, political stability, and awareness help significantly promotes rapid tourism attraction. Thus, in burgeoning studies, FDI is arguably potent in accelerating tourism potential for recipient countries. The potential linkages of FDI, financial development, and tourism growth within the causal nexus of institutional quality are yet unexplored—adequately, in the extant literature. Accordingly, the question whether FDI, financial development and robust institutional quality in recipient country give impetus for tourism potential, boosting real growth is explored. The reference countries of interest for the investigation are selected economies from the Middle East and North African region (MENA)—notably, Algeria; Egypt; Iran; Jordan; Kuwait; Lebanon; Sudan and Tunisia. Known for its high diversity, the MENA region has undergone various transformation with potential capacity for sustainable growth. Comparatively, the region possess huge advantage in various sector namely, renewables, tourism, manufacturing and financial services. Hence, there has been appreciable efforts at enhancing FDI inflows into the region. In recent times, strengthening institutional reforms and diminishing stifling regulatory framework have been the main focus.

In theory, the spill over impact of FDI is enhanced by technical penetration of innovation, financial development, the soundness of institutional quality and overall economic environment (Chamarbagwala et al, 2000; Alfaro et al. 2004). The current study seeks to close this gap in literature while investigating the following questions. Is there dynamic nexus between FDI, financial development, Institutional quality, and tourism potentials? And does institutional quality matter in the dynamic relationship of FDI, financial development, and tourism potential. And what is there dynamic causal nexus? The study bridge the gap in the literature by exploring the dynamic causal nexus of FDI, financial development, institutional quality, tourism potential, and economic growth. It adopts the empirically robust Pesaran, Shin, and Smith (PSS, 1999) pooled mean group (PMG) econometric technique yielding superior estimates. Hence, estimating the dynamic linkages of the model variables, the study has the added advantage of estimating the causality of the variables in a multivariate sense.

2. Research Method

The PSS (1999) panel ARDL modifies the standard ARDL to a panel estimation framework incorporating respective cross-sectional intercepts, short-run dynamic coefficients, and cointegration terms. This method is applicable even with mixed integration order circumventing the estimation drawbacks associated with standard ARDL – due to the inherent correlation of the mean-differenced regressors and the stochastic specification.

The PMG ARDL model is specified as follows;

$$\Delta q_{it} = \delta_i Ec_{it} + \sum_{k-0}^{s-1} \Delta X_{i,t-k}\, \alpha_{i,k} + \sum_{k-1}^{v-1} \beta_{i,k}\, \Delta q_{i,t-k} + \varepsilon_{i,t}$$

Where $Ec_{i,t} = q_{i,t-1} \quad X_{i,t}\vartheta$ is the equilibrium correction error term, associated with ϑ, the long-run coefficients and δ_i is the dynamic adjusting coefficients.

To empirically answer the research question posed, the following models are estimated ;

$$lnFDI_t = \beta_0 + \beta_1 lnFDI_{it-1} + \beta_2 lnFD_{it} + \beta_3 lnITA_{it} + \beta_4 ISQ_{it} + \beta_5 lnGDP_{it} + \varepsilon_{it1} \quad (1)$$

$$lnFD_t = \gamma_0 + \gamma_1 lnFD_{it-1} + \gamma_2 lnITA_{it} + \gamma_3 lnGDP_{it} + \gamma_4 ISQ_{it} + \gamma_5 lnFDI_{it} + \varepsilon_{it2} \quad (2)$$

$$lnITA_t = \pi_0 + \pi_1 lnITA_{it-1} + \pi_2 lnGDP_{it} + \pi_3 lnFDI_{it} + \pi_4 ISQ_{it} + \pi_5 lnFD_{it} + \varepsilon_{it3} \quad (3)$$

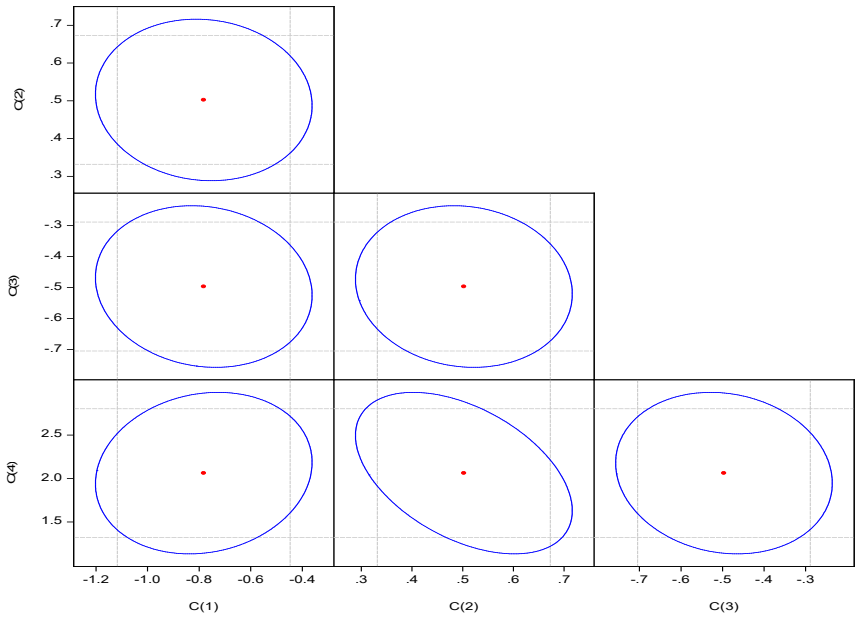
$$lnGDP_t = \varphi_0 + \varphi_1 lnGDP_{it-1} + \varphi_2 lnFDI_{it} + \varphi_3 lnFD_{it} + \varphi_4 ISQ_{it} + \varphi_5 lnITA_{it} + \varepsilon_{it4} \quad (4)$$

Except for the institutional quality variable—a categorical data, the remaining variables are in their natural logarithm. The constant terms are the following; β_0, γ_0, π_0, and φ_0. The stochastic white noise terms are ε_{it1}, ε_{it2}, ε_{it3}, and ε_{it4}. In the specified equations, the 'i' subscript gives the series ith term, where i=1.....8) and the time dimension is represented by 't', where t = 2002 – 2018. The study adopts six components in modeling institution quality, namely; 'accountability, political stability, government effectiveness, regulatory quality, control of corruption, rule of law' (see Kaufman et al. 2010). These indicators are aggregated based on a huge data source from global survey and assessment on governance perception. The indicator on governance approximately range from -2.5 for weak performance to +2.5 for strong performance. The estimates are derived from the World Wide Governance Indicator (WGI) database. To obtain the institutional quality variable, the principal component analysis (PCA) is applied in aggregating the aforementioned indicators.

The remainder of the data employed are FDI, financial development (FD), international tourist arrival (ITA), and real gross domestic product (GDP) obtained from the World Bank Development Indicator (WDI). FDI is the net inflow of investment capital comprising of equity and earning reinvestments in United States Dollar (USD). FD is proxied with domestic credit to the private sector (percentage of GDP—%GDP). It includes the financial capital of business corporations and to a limited extent financial credit to public sector enterprises. To model tourism development, the international tourist arrival (ITA) data is employed. ITA means inbound international tourist arrival within 12 months to countries outside their domestic residency. GDP is the real gross domestic product in 2010 constant USD.

As part of the estimated coefficient diagnostic examination, the 95% confidence ellipse plot reveals that the regressors are not serially correlated and highly robust. This is revealed by the full circular shape of the plots.

Figure 1 The diagnostic confidence ellipse coefficient test



3. Empirical result discussion

Table 1 presents the estimates of equation (1) to (4). In model 1 financial development and institutional quality have a statistically significant positive

relationship with FDI in the long-run ($\beta_2 = 0.78214, p <$0.01 and $\beta_4 = 0.4967, p <$0.01). Thus, in the long term, a 1% expansion in financial development and institutional quality causes FDI to increase by about 0.78% and 0.50%. The finding confirm Bénassy-Quéré et al., (2007); Daude and Stein, (2007) results where quality institutional governance is critical for FDI inflow. Thus the result shows that the lack of a robust financial system and good institutions diminishes FDI inflow (Choong et al., 2004). Also, the international tourist arrival and output growth have a statistically significant positive relationship with FDI overtime ($\beta_3 = 0.5023, p <$0.01 and $\beta_5 = 2.0622, p <$0.01). Therefore a 1 % increase in international tourist arrival and output growth increases FDI by around 0.50% and 2.06% in the long-run. The result upholds the output growth-FDI inflow bi-directional nexus (Hermes and Lensink, 2003) and confirm the positive relationship between international tourist arrival and FDI (Fauzel, 2020).

Table 1 - The PSS (1999) panel ARDL Estimates

Variable	Model 1 ARDL(1, 1, 1, 1)	Model 2 ARDL(1, 1, 1, 1)	Model 3 ARDL(1, 1, 1, 1)	Model 4 ARDL(1, 1, 1, 1)
Long Run Equation				
LNFDI	-	-0.008692	0.035218***	0.216965***
LNDC	-0.782121***	-	0.254757*	0.746193***
LNITA	0.502269***	0.008320	-	0.293604***
ISQ	-0.496662***	-0.206198***	-0.190937**	0.310216**
LNGDP	2.062233***	0.116136	0.271202**	-
Short Run Equation				
COINTEQ01	-1.036118***	-0.385104***	-0.349786***	-0.040987***
D(LNFDI)	-	-0.026544	-0.073730	-0.002567
D(LNDC)	3.656488	-	-0.091979	-0.039459***
D(LNITA)	5.039808	-0.709050**	-	0.132952
D(ISQ)	-2.216851	0.017036	-0.020715	-0.010385
D(LNGDP)	8.228817	3.205889	1.213628	-
C	-37.35192***	0.363351	2.269758***	0.528445***
Akaike info criterion	2.633750	-0.582930	-1.540434	-4.650049

Variable	Model 1 ARDL(1, 1, 1, 1)	Model 2 ARDL(1, 1, 1, 1)	Model 3 ARDL(1, 1, 1, 1)	Model 4 ARDL(1, 1, 1, 1)
Schwarz criterion	3.918744	0.530732	-0.426772	-3.536387
Hannan-Quinn criteria.	3.155939	-0.130366	-1.087870	-4.197485
Log-likelihood	-119.0950	91.63926	156.7495	368.2033

Note: ***, **, and * indicate significant at 1%, 5% and 10% respectively

The short-run relationship in model 1 yeild estimates that are statistically insignificant. But, the equilibrium adjustment term is as expected, negative and significant ($Ec_t = -1.036118, p < 0.01$). This give dampen and sluggish adjustment of the model to its long-run equilibrium.

In model 2, we found a inverse statistically significant relationship between institutional governance quality and financial development in the long-run ($\gamma_4 = -0206198, p <$0.01). Hence, increasing overall institutional quality governance by 1%, financial development contracts by about 0.21%. Hence, institutional governance measure that creates bottle-neck increases cost of doing business (Wei, 2000) and yield adverse impact (see Belgibayeva and Plekhanov, 2015; Li and Resnick, 2003).

In the short-run for model 2, international tourist arrival estimate and financial development move oppositely ($\gamma_2 = -0.709050$). Hence a 1% increase in international tourist arrival results in about 0.72% decrease in financial development. Meaning that uncertainity of international tourist arrival reduces financial flow and possible financial development slowdown (see Seetanah et al. 2019). Although Başarir and Çakir (2015) found a bi-directional relationship for tourism-financial development nexus in the long-run. Song and Lin (2010) study shows that uncertain financial conditions can lead to negative relationship between international tourist arrival and financial development. The adjustment coefficient is found to be negatively significant ($Ec_t = -0.385104, p < 0.01$) in model 2 and the model adjusts by about 39% every period to reach equilibrium.

The estimates of model 3 shows that real output growth, FDI, and financial development have a statistically significant positive relationship with international tourist arrival in long-run

($\pi_2 = 0.271202, p < 0.01$; $\pi_3 = 0.035218, p < 0.01$ and $\pi_5 = 0.271202, p < 0.01$). The results aligned with evidence of postive economic growth-tourism nexus (see Payne and Mervar, 2010) and bi-direction responses amongst tourism output growth, FDI, and financial development nexus (see Shahbaz et al. 2016). Therefore a 1% increase in real output growth, FDI, and financial development means international tourist arrival rises by about 0.27%; 0.035%, and 0.27% correspondingly.

In contrast, institutional quality is found to have an opposite relationship with international tourist arrival ($\pi_4 = -0.190937$ $p < 0.05$) (see also Wei, 2000). Therefore, 1% increase in institutional quality decreases international tourist arrival by 0.19% in the long-run. The finding justifies Wei (2000) that adverse/stringent institutional policy discourages foreign investors and international tourists.

Although the short-run estimates are not individually statistically significant, the equilibrium adjustment term is significantly negative ($Ec_t = -0.349786, p < 0.01$) indicating an adjustment speed of 35% annually to long-run.

Lastly, model 4 evidenced significant direct relationship for the regressors and real output growth in the long-run ($\varphi_2 = 0.216965, p < 0.01; \varphi_3 = 0.746193, p < 0.01; \varphi_4 = 0.310216, p < 0.01$ and $\varphi_5 = 0.293604$, $p < 0.01$). Accordingly, a 1% expansion in FDI, financial development, institutional quality, and international tourist arrival increases real output growth by 0.22%; 0.75%; 0.31%, and 0.29%. This validates De Mello (1999); Lipsey, 2002; Javorcik, 2004 and Alfaro et al. (2004) FDI-GDP growth positive relationship assertion. And the notion that a robust financial system is essential for FDI inflow and economic growth (see Hermes and Lensink (2003) financial, Alfaro et al., 2004; Durham, 2004). In short-run, financial development and real output growth are inveresely related ($\varphi_3 = -0.039459, p < 0.01$). A 1% growth in financial development reduces real output by 0.04%. Demetriades and Hussein, (1996) also found little support for financial development lead growth in their study. Also, the dynamic adjustment coefficient is negative and significant ($Ec_t = -0.040987, p < 0.01$), and the estimated model adjusts to its long-run equilibrium slowly, about 4% annually.

Thus, using the 6 categories of the institutional variable indicators reported by WGI, we found that institutional quality plays a positive role for real outgrowth

overtime and foreign direct investment. Conversely, it has adverse implication for financial development, and international tourist arrival. The result empirically suggests that too much institutional regulation can stifle long-run financial development and international tourist arrival.

Table 2. Pairwise Dumitrescu Hurlin Panel Causality Tests

Null Hypothesis:	W-Stat.	Zbar-Stat.	Prob.
LNDC does not homogeneously cause LNFDI	1.42139	-0.94525	0.3445
LNFDI does not homogeneously cause LNDC	2.90926	0.35866	0.7198
LNITA does not homogeneously cause LNFDI	4.24994	1.53357	0.1251
LNFDI does not homogeneously cause LNITA	2.71776	0.19084	0.8487
ISQ does not homogeneously cause LNFDI	1.66013	-0.73603	0.4617
LNFDI does not homogeneously cause ISQ	1.83255	-0.58492	0.5586
LNGDP does not homogeneously cause LNFDI	2.49840	-0.00140	0.9989
LNFDI does not homogeneously cause LNGDP	5.07661	2.25802	0.0239
LNITA does not homogeneously cause LNDC	5.87692	2.95939	0.0031
LNDC does not homogeneously cause LNITA	3.86640	1.19745	0.2311
ISQ does not homogeneously cause LNDC	3.75195	1.09716	0.2726
LNDC does not homogeneously cause ISQ	3.34533	0.74081	0.4588
LNGDP does not homogeneously cause LNDC	4.26179	1.54395	0.1226
LNDC does not homogeneously cause LNGDP	1.71646	-0.68666	0.4923
ISQ does not homogeneously cause LNITA	9.05230	5.74215	9.E-09
LNITA does not homogeneously cause ISQ	2.75553	0.22393	0.8228
LNGDP does not homogeneously cause LNITA	2.70099	0.17614	0.8602
LNITA does not homogeneously cause LNGDP	2.96910	0.41110	0.6810
LNGDP does not homogeneously cause ISQ	5.19193	2.35909	0.0183

Null Hypothesis:	W-Stat.	Zbar-Stat.	Prob.
ISQ does not homogeneously cause LNGDP	3.51021	0.88531	0.3760

3.1 Panel Granger Causality

In general, the panel Granger causality test is undertaken within bivariate setting of the following form;

$$q_{it} = \beta_{0i} + \beta_{1i} q_{i,t-1} + \cdots + \beta_{ki} q_{i,t-k} + \gamma_{1,i} g_{i,t-1} + \cdots + \gamma_{k,i} g_{i,t-k} + \varepsilon_{it} \quad (1)$$

$$g_{it} = \beta_{0,i} + \beta_{i} g_{i,t-1} + \cdots + \beta_{k,i} g_{i,t-k} + \gamma_{1,i} q_{i,t-1} + \cdots + \gamma_{k,i} g_{i,t-k} + \varepsilon_{it} \quad (2)$$

Where the panel time dimension is given by t and dimension of the cross-sections is dennoted by i. Thus by following the approach of Dumitrescu-Hurlin (2012), the coefficient of the cross-sectional regression is allowed to differ across the sample such that;

$$\beta_{0,i} \neq \beta_{o,j} \beta_{1,i} \neq \beta_{1,j} \ldots . \beta_{1,i} \neq \beta_{1,j} \neq \beta_{1,i}; \forall_{i,j}$$

$$\gamma_{1,i} \neq \gamma_{i,j} \ldots . \gamma_{1,i} \neq \gamma_{1,j} \forall_{i,j}$$

Hence by applying the standard cross-sectional causality regression, the test is performed based on the zbar statistic with a normal distribution.

The result of the causality test is shown in Table 4 and reveal 4 significant uni-directional causalities: From FDI to real output growth ($p < 0.01$); international tourist arrival to financial development ($p < 0.01$); institutional quality governance to international tourist arrival ($p < 0.01$) and real output growth to institutional quality ($p < 0.05$). In each of the aforementioned Granger causality, the historical past behavior of the respective variable can reliably suggest the future trajectory of the other variable in the equation. In the remaining cases examined, the null hypothesis cannot be rejected. Thus it is established that the institutional quality variable matter most in the model of international tourist arrival and real output growth. This is also evidenced in Buchanan et al. (2012). The evidence shows that as economies reach long-run economic growth and attract greater international tourists to the country, institutional quality receives greater attention.

4. Conclusion

The novel panel ARDL estimation approach was adopted to examine the nexus of FDI, financial development, and tourism development for the MENA-8 countries from 2002 to 2018. The estimate of institutional quality in long-run exerts positive impact in the models of FDI; financial development; international tourist arrival; and real GDP. Hence, institutional quality directly impact long-run output growth.

In short-run, financial development and real output have inverse relationship; international tourist arrival and financial development varies indirectly; and institutional quality reduced international tourist arrival. The panel causality test confirmed one-way causality for 4 scenarios. Hence, institutional quality matters significantly in the models of international tourist arrival and real output growth.

Policymakers must vigorously pursue sustainable institutional quality policy to attract international tourist arrival while promoting FDI. And at the same time, deepen financial development to drive economic growth. Finally, the estimates of cross-country regression[2] support country-specific policy initiative for effectiveness

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[2] The result of the short-run country-specific regression is available upon request. For brevity, the result has not been reported here to conserve space.

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