Can Tourism Encourage Better Export Performance and Diversification in Nepal?

José Guilherme Reis and Gonzalo Varela

Entering and successfully surviving in export markets is a costly process for firms. Key steps for success include learning about the existence of foreign demand, determining the production costs of exportable goods, building a high-quality reputation, succeeding in product branding to reduce competitive pressures, constant upgrading of quality standards to better serve demanding international clients, and remaining competitive with other players in the global marketplace. Drawing on the findings of recent research (Reis and Varela 2013), this note argues that tourism can help alleviate some of these costs by providing a relatively inexpensive platform for cost discovery and acting as a low-cost in-house trade fair, accessible to all domestic producers. Combining product-level data on the world’s and Nepal’s exports (for goods that are both related and unrelated to tourism) with Nepalese data on tourist inflows and expenditures and macro indicators on relative prices results in a positive association between tourist inflows from given destinations and their expenditures with future merchandise exports of tourist-related products to those destinations. For goods previously unrelated to tourism, data reveal no connection between tourism flows and their future exports. The spillovers from tourism into merchandise export performance and diversification imply that there are gains to be had from cooperation between tourism and export promotion activities.

How Does Tourism Help Merchandise Exports Expand?

Two decades ago, European tourists in Nepal discovered the finest cashmere wool, pashmina, a piece of fabric that “makes cashmere feel like cardboard.” Pashmina is the soft fur found close to the skin around the neck and chest of the Chyangra goat, which lives at altitudes of 12,000 to 14,000 feet in the Himalayas. Shawls made out of this wool have been worn for centuries by the royalty and the elites in the region; it is a status symbol in the East. In India and Nepal, pashmina blankets were essential components of a wealthy woman’s dowry. The “discovery” of pashmina by European tourists was a key contribution to the promotion of the fabric in the tourists’ home countries and the rapid increase in Nepal’s pashmina-related exports to the West, where it soon became fashionable.

To what extent is the pashmina case representative of the potential effect that tourist inflows may have on foreign demand of traditional or “niche” goods produced in an economy? Conceptually, the mechanism would work as follows: first, high-income tourists exhibit a preference for traditional, cultural or niche goods, which are not typically demanded by local consumers; second, producers in the host economy diversify their production structure and may be induced to adapt their quality and technical standards to those demanded by the international tourists; third, back in their home
countries, tourists act as promoters of these niche products from abroad, which may generate an increase in foreign demand for these goods.

There are two mechanisms operating within the channel linking tourism to export performance and diversification, both of which are of key importance for a low-income country such as Nepal: (i) tourism facilitates learning, and (ii) it acts as a springboard for product promotion abroad.

First, tourism facilitates learning. As argued by Hausmann and Rodrik (2003), learning what one is good at producing is an important challenge faced by countries on their path to development. Because self-discovery is costly, and the appropriability of the discovery is low once it occurs (other entrepreneurs can imitate the discoveries), there is typically an undersupply of learning on what can be produced and successfully marketed. While the inflow of tourists does not eliminate this market failure, it substantially reduces the costs of self-discovery associated to exportable products, because it brings a sample of the international market to the local economy. Tourism provides virtually free information about international demand, which is one of the greatest uncertainties concerning international trade (Rauch and Watson 2001), particularly regarding tastes; quality and technical standards required; clients’ willingness to pay; and niches, both in terms of goods unavailable in foreign countries and in terms of target export markets for particular products. Tourism also facilitates learning about production costs without having to incur expensive experimentation. As argued by Lejarraga and Walkenhorst (2013), new goods channeled through tourism are ones in which the minimum efficient scale is lower than in most other sectors; tourism-led entrepreneurs can test a foreign market without incurring the transaction costs of exporting abroad (no border or administrative barriers, transport costs, and the like), and the risks associated with the discovery are to some extent offset by the presence of a tourism market, because trial products can be sold to international tourists.

Second, tourism acts as a springboard for promotion of domestic niche goods in foreign markets. It operates as a low-cost, in-house trade fair, accessible to all domestic producers. Exporting firms often participate in trade fairs to increase awareness and interest among foreign traders of their exportable products, traders who will later be more likely to place import orders. In fact, in the United States, trade show expenditures are the second largest item in the business marketing communications budget after advertising (Gopalakrishna et al. 1995). Conversely, for firms in a remote, low-income country such as Nepal, costs associated with participation in trade fairs, or more generally, expenditure in product promotion, can be a binding constraint to export growth. Anecdotal evidence suggests that costs for a Nepalese firm to participate in a trade fair are around US$11,500. For example, for producers of organic essential oils, the German Cooperation Agency (GIZ) encouraged participation in an organic trade fair in Germany by providing a cost-sharing scheme. Six Nepalese firms were invited, of which three agreed to participate. Even if, according to firms’ sources, export revenues more than doubled after participation and they managed to diversify destinations, firms stopped participating when GIZ withdrew financial support. This case suggests that even if standard product promotion strategies are considered promising and profitable, liquidity or other constraints impede domestic firms from taking advantage of them. Tourists inflows help alleviate these constraints by bringing the “fair” to the local marketplace.

These two mechanisms will likely affect exports both on the intensive and extensive margins. They will improve export performance of firms already exporting touristic products through the promotion effect, and they will facilitate entry of new firms into export markets of existing and new touristic products by reducing both the fixed and variable costs of exporting, and thus making export activities more accessible to relatively less productive firms.

The literature on the economics of tourism has typically focused on the direct and indirect effects that tourists’ expenditures have on economic growth via increased expenditures in hotels, restaurants, entertainment and so forth, and their associated multiplier effects, which involve a subset of the links between tourist spending and domestic performance, described at the top of figure 1, including the leakages (see, for example, Kweka, Morrissey, and Blake [2003] for Tanzania, or Durbarry [2004] and Cattaneo [2009] for Mauritius).

**Figure 1. How Can Tourism Affect Domestic Economic Performance?**

Source: Authors’ adaptation based on Cattaneo (2009).
However, literature has been relatively silent on the boost that tourist spending can provide—through promotional, network, and learning effects—on export performance and diversification, which is where this note contributes. An exception is the work of Lejarraga and Walkenhorst (2013); in line with Reis and Varela (2013), Lejarraga and Walkenhorst argue that tourism-related activities help diversification by reducing self-discovery costs. They provide positive cross-country correlations between tourist receipts as a portion of gross domestic product (GDP) and export diversification. Further, Lejarraga and Walkenhorst argue that the ability with which countries can leverage tourism to discover new products and exports depends on the strength of the links of tourism with the rest of the economy, and they provide some evidence on factors that may influence the extent of these links, such as the entrepreneurial capital of the host economy and the level of economic and social development, as well as the absence of violent crime and, more generally, safety and stability.

**Trends on Tourism and Trade in Nepal**

The total inflow of tourists, as well as their expenditures, has been trending upward since the early 1990s, with a temporary decrease during the conflict years of the late 1990s and early 2000s. Indeed, tourists’ expenditures per day measured in current U.S. dollars more than doubled in the last 20 years. In real terms, after controlling for the loss of purchasing power of the dollar over that period of about 50 percent, tourists’ expenditures increased roughly by 50 percent over the last two decades (figure 2). The length of stay seems stable over the last 20 years, just above 10 days, on average. On the other hand, the real exchange rate depreciated substantially during the 1990s, while it has displayed the opposite trend during the past decade, which implies that Nepal is becoming more expensive in dollars, with likely negative implications on exports, both of touristic services and of merchandise in general (figure 3).

The composition of tourist inflows by origin changed, reflecting the international changes in the distribution of income per capita. While inflows from high-income countries represented about 55 percent of the total in the early 2000s, they accounted for 35 percent of total inflows in 2011. During the same period, Chinese inflows increased from 2.4 percent to 8.4 percent, Indian inflows increased from 17.8 to 20.3 percent, and inflows from Sri Lanka (mainly related to pilgrimage) increased from 2.7 to 8.1 percent (figure 4).

**Identifying the Spillovers from Tourism into Merchandise Exports**

**Strategy**

The spillover effect that the inflow of tourists may have on merchandise exports can be identified by estimating an augmented export supply function that exploits three sources of variation: (i) variation over time, by looking at the period 1990–2011; (ii) variation over products, by looking at the 19 goods, including tourism-related or niche goods as well as products that should, in principle, be unrelated to tourism, but also important in Nepal’s export basket; and (iii) variation across country of origin of tourists/destination of merchandise exports. The export supply function incorporates as regressors the evolution of the real exchange rate to capture relative price effects, a world demand factor proxied by world exports of the product, and product-fixed (or product-destination) effects to control for time-invariant factors affecting the supply of exports of specific products. In addition, the export supply function incorporates tourist inflows and their per-day expenditures and interactions with a touristic product dummy to capture potential spillover effects.

**Figure 2. Tourist Inflows and Expenditures (Income) per Day**

![Figure 2. Tourist Inflows and Expenditures (Income) per Day](Source: Nepal Tourism Board.)

**Figure 3. Real Exchange Rate**

![Figure 3. Real Exchange Rate](Source: World Development Indicators (WDI).)
The evidence
Table 1 reports the results of different specifications of the augmented supply function for exports. The first column reports the results when year dummies are not included. Results suggest that increases in inflows of tourists from country $j$ in period $t-1$ are associated with increases in exports to that country $j$ in period $t$, all other things equal. The second column reports results when the (log) expenditure per day of tourists and its interaction with the tourist product dummy are incorporated. Results are virtually unchanged and tourist expenditure per capita seems to exert no effect directly or indirectly via its interaction with the tourist product dummy. The third column reports the results of the baseline specification now introducing year dummies, which implies that those regressors with time variation only are dropped (the real exchange rate and the per day expenditure of tourists). The spillover effect from tourism into greater exports of niche or traditional goods withstands the inclusion of the year dummies. The fourth column introduces a set of year dummies interacted with the touristic product dummy to control for possible macro shocks that disproportionately affect exports of touristic goods and the previous year’s inflows of tourists.

Overall, results strongly suggest that the quantity of tourist inflows are associated with exports of touristic-related products to the tourists’ home countries in the year after their visit to Nepal. This confirms spillover effects from tourism into exports of niche or country-specific goods. Consistently with this hypothesis, the quantity of tourists is not associated with exports of non-tourist-related products in the year after their visit. The spillovers are significant statistically and economically; indeed, their magnitude is sizable. The observed average increase in the number of tourists of about 5 percent per year is systematically associated with, all else being equal, higher exports of touristic-related products by about 2.85 percent per year, taking as a reference the results from the most demanding specification (column 4 of table 1).

Why Should Policy Makers Care about Tourism Spillover Effects?
Tourism can act as a platform to improve export performance in existing traditional products and to turn traditional goods...
Policy makers of low-income countries with tourism potential should take stock of this channel for at least two reasons. First, there is space for cooperation between efforts by the export and tourism promotion agencies. If increased tourist inflows have positive effects on exports of traditional products, then efforts to attract tourism are of interest not only to agents directly related to the tourism industry, but also to current or potential exporters. This means that there are gains to be realized from cooperation between tourism and export promotion agencies. These efforts may include, for example, incentivizing the use and promotion of local products in hotels at the high end of the market. For example, in Mauritius, a country that has succeeded in achieving substantial gains from the tourism industry, a yearly food exhibition (Food Exhibition Mauritius) is organized to maximize trade opportunities, bringing together producers of potentially exportable local food products, international traders, and tourists. Similarly, the Creole Festival in the Seychelles attracts tourists from around the world and promotes local food products abroad. Nepalese authorities could encourage and smooth the way for international hotel chains already operating in the country to work with producers and traders of traditional exportable food products such as spices, tea, coffee, honey, and so forth to organize small-scale food exhibitions that could help build a trade-mark for domestic products and promote them internationally through the tourism channel.

Given that tourism acts as an export promotion channel, a top priority is strengthening domestic quality standards and product certification systems. While efforts have been made to improve product certification processes, particularly in export markets, it is important that these processes are also implemented domestically. For example, the “Chyangra Pashmina” logo introduced by the Association of Pashmina Exporters of Nepal is used only by Nepal’s exporters. However, if tourist consumption of products in Nepal also promotes exports, building the brand domestically can also help to build it internationally. This is especially relevant for food products, where sanitary concerns are likely to be a binding constraint for tourist experimentation of domestic products.

Table 1. Results Exploiting Variation over Time, across Products, and across Origin/Destination

<table>
<thead>
<tr>
<th>Dependent variable: exports</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lagged predicted log tourist</td>
<td>0.277</td>
<td>0.187</td>
<td>-0.254</td>
<td>-2.418*</td>
</tr>
<tr>
<td>Lagged predicted log tourist*touristic export products</td>
<td>1.494***</td>
<td>1.380**</td>
<td>0.713**</td>
<td>2.989**</td>
</tr>
<tr>
<td>Log world imports of the same product</td>
<td>0.456***</td>
<td>0.423***</td>
<td>0.246***</td>
<td>0.255***</td>
</tr>
<tr>
<td>Log real exchange rate</td>
<td>-0.32***</td>
<td>-0.32***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lagged log expenditure per day tourists</td>
<td>0.0782</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lagged log expenditure per day tourists*touristic export products</td>
<td>0.214</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-19.1***</td>
<td>-15.8***</td>
<td>-4.341</td>
<td>-3.179</td>
</tr>
<tr>
<td>Year dummies</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Year dummies*touristic product dummy</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Product—tourism origin FE</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>2,465</td>
<td>2,430</td>
<td>2,465</td>
<td>2,465</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.161</td>
<td>0.161</td>
<td>0.212</td>
<td>0.223</td>
</tr>
<tr>
<td>Number of product-origin combinations</td>
<td>204</td>
<td>204</td>
<td>204</td>
<td>204</td>
</tr>
<tr>
<td>F-test (p-value) lagged pr. log tourists + lagged pr. log tourists*T=0</td>
<td>0.024</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Authors’ calculations.
Note: Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1. FE = fixed effects.
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Notes

2. This notion departs from standard neoclassical growth theory, where technology is assumed common knowledge, so no cost uncertainty exists, and hence, no costly self-discovery processes either.
3. All dollars are U.S. dollars, unless otherwise noted.
4. The loss of purchasing power of the dollar is measured as the GDP deflator inflation of the United States over the period, which is slightly above 51 percent (source: World Development Indicators).
5. The choice of products is based on three criteria: the importance of the product in Nepal’s export basket, the identification of the product as "strategic" under Nepal’s Trade Integration Strategy 2010 (NTIS), and whether it is traditionally associated with the “Nepal brand.”
6. These results are likely an underestimate of the spillovers of tourism on exports of these products, given that part of the “exports” take place through the direct purchase of niche goods by tourists in Nepal, and therefore are not actually registered as exports, but as domestic sales.

References


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