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## Exploring The Impact of Tourism Development and Governance on Economic Growth of Developing Economies: Evidence from Driscoll-Kraay Approach

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ARTICLE DETAILS	ABSTRACT
<b>History:</b> Received: December 21,2023 Accepted: December 31,2023	This study undertakes a comprehensive panel data evaluation of 28 developing countries to explore the interconnected dynamics of tourism development, governance, and economic growth in developing economies. GDP growth is used as a proxy for economic growth and taken as dependent variable while International tourism receipts are used as tourism development and governance stability (GS) is used for governance. FDI and labor force are taken as control variables. In this study, analysis is based on Cross-sectional dependency test, Second Generation unit root tests, Driscoll and Kraay (DK) standard error (based on fixed effects estimation) because of Heteroskedasticity, Autocorrelation, and Cross-sectional dependency. The findings indicate a robust positive influence of tourism development, FDI, labor force and governance on the economic growth of developing economies. Nevertheless, effective policy interventions are imperative to address governance challenges prevalent in these economies.  © 2021 The Authors, Published by WUM. This is an Open Access Article under the Creative Common Attribution Non Commercial 4.0
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### 1. Introduction

In developing economies tourism has become a vital tool for economic growth, with its potential impact extending beyond the realm of revenue generation to encompass broader facets of governance. International agencies, donor organizations and policy makers have concluded that tourism promotes employment, industrial sector, agricultural sector and hence promotes overall economic growth [Roudi et al. (2018), Mishra et al. (2011), Gautum (2011), Samimi et al. (2011)]. This study embarks on a comprehensive investigation into the intricate interplay among tourism development, governance, and economic growth in developing nations. With globalization and the tourism industry becoming more and more prominent, it is critical to comprehend the complex relationships between these variables to create successful policy interventions.

According to estimates, the tourist industry would contribute US\$1.9 trillion to the economy in 2021 (measured in tourism-related GDP), up from US\$1.6 trillion in 2020. In the most recent UNWTO Panel of Experts survey, most tourism industry professionals (61%) anticipate better results in 2022. Although 58% predict a bounce back in 2022, primarily in the third quarter, 42% suggest a possible

bounce back only in 2023. After surveying experts in September, just 64% currently predicted that foreign arrivals would reach 2019 levels until 2024 or later (UNWTO, 2023).

The global landscape witnessed a surge in tourism activities, particularly in developing economies, as governments recognize the sector's potential to stimulate economic growth. The interconnection between tourism development and governance becomes paramount as nations seek sustainable strategies to harness the benefits of this industry. The historical context of tourism development in developing economies provides the foundation for understanding its evolving role in shaping economic trajectories.

As tourism increasingly becomes a cornerstone of economic strategies in developing nations, it is necessary to systematically examine the dual influence of tourism development and governance on economic growth. The rationale behind the current research lies in the need to uncover the specific mechanisms through which tourism and governance dynamics contribute to or hinder economic advancement, providing valuable insights for policymakers and stakeholders.

Despite the potential benefits, challenges in governance may pose impediments to the optimal realization of economic gains from tourism development in developing economies. Identifying and addressing these challenges is crucial for sustaining and maximizing the progressive effect of tourism industry on economic growth of developing economies. This research seeks to address the following pivotal questions:

- What is the individual and collective influence of tourism development and governance on the economic growth of developing economies?
- How do specific components of governance contribute to or hinder the economic benefits derived from tourism development?

The primary goals of the current study are to assess the influence of tourism development on the economic growth of selected developing economies, to analyze the function of governance in shaping the relationship between tourism development and economic growth and to identify policy implications to strengthen the beneficial effects of tourism on economic growth of developing economies. This research holds significance in providing evidence-based insights into the interconnected dynamics of tourism, governance, and economic growth. The findings aim to guide policymakers, international organizations, and stakeholders in formulating strategies that optimize the benefits of tourism while addressing governance challenges prevalent in developing economies.

## **2. Literature Review**

A thorough review of existing literature has been conducted to contextualize the study within the broader academic discourse. The current study has explored prior research which focused on the impact of tourism and the role of governance on economic growth of developing economies. Vuković et al. (2023) explained that increase in tourism employment increases gross national income in low regime and in high regime. Policymakers will need to consider the findings of study to develop a tourism employment plan that effectively capitalizes on this expanding trend.

Further Pérez-Rodríguez et al. (2022) examined broad dynamic panel data model for the 14 European countries and supported the tourism-led growth hypothesis (TLGH) for the entire sample, primarily for countries in North Europe, when panel fractional cointegration techniques were applied. In addition to this, Su et al. (2021) examined that tourism of the economy significantly affected the economic growth of China. Consequently, the study added credence to the literature that tourist-related activities have strong impact on economic growth and development.

Similarly, Naseem (2021) also highlighted that growth has long term positive association with tourism receipt, tourism expenditures and tourist arrival. The empirical findings support the theory that tourism industry fosters economic expansion in Saudi Arab. Moreover, Odhiambo (2021) analyzed how tourism reduces poverty in 32 Sub Saharan African countries using generalized methods of moments technique. The study found that the increase in tourist arrival increases welfare of people, reduces poverty and leads the nations towards the economic growth.

Mahwish et al. (2021) explained the role of tourism in the development of developing economies. The study used ARDL approach for analysis. Further study concluded that policy makers should design and implement such policies of tourism which maximize benefits from tourism and promote growth. Kozhokulov (2019) assessed the social and economic impact of tourism, using weight coefficients to gauge economic and social efficiency in Kyrgyzstan's Issyk-Kul region. The findings revealed a positive influence of tourism on both the economic and social growth of the region.

Similarly, Luqman (2019) investigated the socio-economic aspects of tourism in Sheikh Badin National Park, D.I. Khan, Khyber Pakhtunkhwa. Data collected through questionnaires and surveys highlighted various economic effects of travel. Positive impacts included increased income for residents and the creation of new employment opportunities, while the negative aspects involved a heightened cost of living.

Tabash (2017) explored tourism receipts (ITRs) in Palestine for the period of 1995- 2014 and revealed a distinctive connection between growth and tourism. The empirical evidence presented underscores the pivotal role of the tourism sector in the economic performance of a nation reliant on foreign aid and donations. Consequently, the Palestinian government is urged to formulate dynamic policies to foster the tourism sector, thereby creating employment opportunities, alleviating poverty, and fostering economic growth.

Simimi et al. (2011) explained the impacts of tourism in trade and industry of developing countries using panel vector auto regressive approach. Study comprised on 20 developing countries. Variables used for analysis were economic growth and tourist arrivals. The data had been taken from WDI. Results of study showed association between tourism and GDP. Causality test showed the bilateral causation between tourist arrivals and GDP.

Du and Ng (2011) raised an important question that whether tourism promotes economic growth or not? They had taken dataset of 200 countries for analysis. 1995 was used as a testing year due to the availability of data. They tested the tourism led growth hypothesis in two ways. First, they checked the effect of tourist visits on GDP per capita. Regression results showed that one million arrivals increased the GDP per capita by 0.83%, which was statistically significant. In the second model all those standard factors were added. The findings of the study suggested that economies should also focus on human capital, technology, and institutions to enhance financial development.

Gautam (2011) elaborated the effects caused by tourism in development of Nepal. Data was collected for the period 1974/75 and 2009/2010. The long-term link between the variables was ascertained using the Johansen co-integration test. Short run dynamics were handled using the error correction method. The factors had a long-term association during the review period, according to the results. Hence it was verified that tourism growth increased the economic growth of Nepal. It was also suggested that the government should focus on enhancing the tourism sector to attain high economic growth.

In addition to this Kasimiti (2011) examined the impact of tourism on Greece's economy. The actual effective exchange rate, tourist travel, and GDP were the main variables of the study. Information was gathered from the European Economic Commission's macroeconomic data for the years 1960 to

2010. The findings showed that economic expansion and tourism were positively correlated.

Mishra et al. (2011) expounded on the causality association between tourism and economic growth in India in a different study. The information was gathered for the years of 1978 to 2009. Foreign visitor arrivals, Real gross domestic product, tourism foreign exchange revenues were the study's factors. The fallout of the research work displayed that there was extensive constructive connection among tourist arrivals and GDP of India. In addition to these results indicated that there was an extensive one direction causality ranging from foreign exchange earnings to real gross domestic product. But there was no causality between these variables in the short run. The study confirmed the tourism led growth hypothesis. The study also gave suggestions to achieve a stable increase in the tourism region. India is rich in its cultural heritage and has enormous attractions for tourists. Government and non-government states and intended organizations ought to become dynamic members to achieve the objective.

For the Tunisian economy, Belloumi (2010) examined the causal relationship between tourism receipts, GDP, and real effective exchange rate. Information had been gathered during the years 1970 through 2007. The methodology's results showed that, in the near term, there was no correlation between tourism receipts, GDP, and the actual effective exchange rate. However, there was a unidirectional causal link over the long term. Furthermore, the study verified the idea that tourism drives growth. Risso et al. (2010) collected data from Northeastern Italy's Trentino Alto Adige area between 1980 and 2006. The matching elasticity of demand for tourism contributed positively to economic expansion. The Trentino Alto Adige economy's tourism-led growth concept was found to be experimentally confirmed by the findings. The unidirectional causal relationship between tourism expenditures and real GDP was demonstrated by the Granger Causality Test.

Malik et al. (2010) explained the economic growth in Pakistan for the period of 1972 to 2007 using variables like account deficit, GDP and number of tourist arrivals in Pakistan. The results of the study show that there exists an extended connection among no. of visitors & gross domestic product increase. There was also uni-directional causality from current account deficit to gross domestic product, tourists to gross domestic product and tourists to current account deficit. In addition to this, study had also given some suggestions for the improvement of tourism sector focusing on tourism led growth in Pakistan. So, the government should concentrate on the improvement of this sector.

Prior research has demonstrated the beneficial effects of the tourism industry on economic growth, which serves as a backdrop for this study in the academic community. However, the unique contribution of this study lies in its integration of governance into the analysis. As governance becomes increasingly recognized as a critical determinant of development outcomes, this research aims to fill the existing gap in understanding how governance structures influence the efficacy of tourism as an economic driver in developing economies.

### 3. Data and Methodology

The study collects the panel data of 28 developing countries which has been taken from World Development Indicators (WDI), World Governance Indicators and International Country Risk Guide (ICRG) for the years of 2004-2020. The economies which are taken under consideration due to the data availability are: Algeria, Pakistan, Argentina, Bangladesh, Bolivia, Mali, Brazil, Cameroon, Chile, Costa Rica, Ghana, Cote d'Ivoire, Ecuador, Gabon, Egypt, El Salvador, Ethiopia, Gambia, Guatemala, Guinea, Honduras, Israel, Kenya, Kuwait, Malaysia, Mexico, Mongolia and Morocco. To estimate the objectives of the study, the following model is specified;

$$\text{GDPGR} = \beta_0 + \beta_1 \text{ITR} + \beta_2 \text{GS} + \beta_3 \text{FDI} + \beta_4 \text{LABFORCE} + \mu$$

Where GDPGR is GDP growth rate (proxy for economic growth), ITR is International Tourism receipts (proxy of tourism), FDI is foreign direct investment, GS is government stability (proxy for governance) and  $\mu$  is error term. Description of variables are presented in table 1.

**Table 1: Description of Variables**

Variables	Description of Variables	Expected Relationships	Data Source
<b>GDPGR</b>	GDP Growth (annual %)	Dependent variable	WDI
<b>ITR</b>	International tourism, receipts (% of total exports)	Positive	WDI
<b>GS</b>	Governance stability (Annual averages)	Positive	ICRG
<b>FDI</b>	Foreign direct investment, net inflows (% of GDP)	Positive	WDI
<b>LABFORCE</b>	Labor force	Positive	WDI

The analysis of the paper is based on the followings;

- Pesaran's Test of Cross-Sectional Dependence
- Second Generation unit root tests
  - Cross-sectional Im, Pesaran & Shin testing
  - Cross-sectional Augmented Dickey Fuller testing
- Test for Serial Correlation
- Test for Heteroskedasticity
- Hausman (1978) Specification Test
- Regression with Driscoll Kraay Standard Error with Fixed Effect Model

#### 4. Results and Discussion

##### 4.1 Pesaran's Test of Cross-Sectional Dependence

In table 2, Pesaran test assesses cross-sectional dependence in panel data. The extremely low p-value of 0.000 suggests rejection of the null hypothesis, indicating the presence of cross-sectional dependence. This implies that observations in different countries are not independent, emphasizing the importance of accounting for such dependence in the analysis.

**Table 2: Pesaran Test of Cross-Sectional dependence**

Pesaran's test	Probability value
26.550	0.0000
<b>Average absolute value of the off-diagonal elements</b>	0.390

##### 4.2 Panel Unit Root Test

The second-generation unit root test is used since the data contains cross-sectional dependency. Cross-sectional IPS testing and cross-sectional augmented Dickey Fuller testing have been utilized in the study. In table 3, results indicate that panel are not level stationary and there is an absence of unit root among the variables.

**Table 3: Panel Unit Root test**

Variables	CIPS		CADF	
	I (0)	I (1)	I (0)	I (1)
<b>GDPGR</b>	-1.280	-2.328***	-1.432	-2.741*
<b>ITR</b>	-1.746	-3.28***	-1.56	-2.047*
<b>FDI</b>	-2.883***	----	-2.216***	----
<b>GS</b>	-2.645***	----	-2.618***	-2.71**
<b>LABFORCE</b>	-1.76	-3.072***	-1.340	----

\*\*\*, \*\*, \* represents significance at 10%, 5% & 1% level of significance.

#### 4.3 Test for Serial Correlation

Serial correlation or auto correlation means when error term transform from one time to next time. In table 4, result shows that  $H_0$  is rejected as p-value is less than 0.01 and 0.05. It is concluded that there is a problem of serial correlation.

**Table 4: Test for Serial Correlation**

F Statistic	Probability value
130.765	0.000

#### 4.4 Test for Heteroskedasticity

When the error term of variance is not constant, a problem of heteroskedasticity occurs. to find out the problem of heteroskedasticity, Wald test is used. The results of Heteroskedasticity are reported in table 5. In this, p-value is less than 0.01 and 0.05 showing that null hypothesis is rejected and there is a problem of Heteroskedasticity in the model.

**Table 5: Test for Heteroskedasticity**

Chi Square test	Probability value
5678.98	0.000

#### 4.5 Hausman (1978) Specification Test

The result of Hausman test given in table 6 examines that null hypothesis of Random Effect model as suitable may be rejected and it may be concluded that Fixed Effect model may be applicable for the reliable estimates.

**Table 6: Hausman Test**

Chi-square test value	1.817
P-value	0.000

#### 4.6 Regression with Driscoll – Kraay Standard Error with Fixed Effect Model

The results displayed in Tables 4 and 5 above demonstrate the presence of Heteroskedasticity and serial correlation in the model. Given that the model contains serial correlation, Heteroskedasticity, and cross-sectional dependency, the current study uses the Driscoll – Kraay standard error technique. Driscoll-Kraay standard errors are robust to Heteroskedasticity problem and cross section dependence.

**Table 7: Driscoll – Kraay Standard Error with fixed effect model**

Variables	Coefficients	Standard Errors	t-value	p-value	95% Confidence Interval	
<b>LABFORCE</b>	1.29	2.06	0.626	0.000	7.39	1.80
<b>GS</b>	0.479	0.180	2.67	0.018	0.094	0.825
<b>FDI</b>	0.161	0.0402	4.00	0.001	0.075	0.245
<b>ITR</b>	4.97	7.62	6.55	0.000	3.35	6.59
<b>Constant</b>	-0.753	1.051	-0.72	0.474	-2.813	1.307
<b>Mean dependent var.</b>		3.782	<b>SD dependent var.</b>		3.690	
<b>Overall r-squared</b>		0.244	<b>Number of obs.</b>		448	

The findings (table 7) indicate that tourism receipts have a positive and significant impact on GDP growth. On the average, 1% percent increase in international tourism receipt increases the GDP growth by 4.97%. Similarly, governance stability also has a positive and significantly contributing to the GDP growth. FDI and total labor force also has positive effect on GDP growth. The results are in line with Roudi et al. (2018), Mishra et al. (2011), Tabash (2017) and Kozhokluv (2019). The study shows that GDP growth in developing economies will be higher if tourism receipts rise and governance remains stable.

## 5. Conclusion and Policy Recommendations

This research underscores the intricate dynamics between tourism development, governance, and economic growth in developing economies. So, the study collects the panel data of 28 developing countries which has been taken from World Development Indicators (WDI), World Governance Indicators and International Country Risk Guide (ICRG) for the years of 2004-2020. The economies which are taken under consideration due to the data availability are: Algeria, Pakistan, Argentina, Bangladesh, Bolivia, Mali, Brazil, Cameroon, Chile, Costa Rica, Ghana, Cote d'Ivoire, Ecuador, Gabon, Egypt, El Salvador, Ethiopia, Gambia, Guatemala, Guinea, Honduras, Israel, Kenya, Kuwait, Malaysia, Mexico, Mongolia and Morocco.

The positive influence of tourism development, as indicated by the significant coefficients of ITR in the regression models, highlights its role in fostering economic growth. Governance stability proves to be a crucial factor, emphasizing the importance of effective governance in optimizing the benefits of tourism. While the study contributes empirical evidence supporting the beneficial impact of tourism development and governance on economic growth, it also brings attention to the need for continuous monitoring and policy interventions. The significant role of governance challenges in developing economies is emphasized, suggesting that addressing these challenges is imperative to fully realize the potential benefits of tourism on economic growth.

So, it may be suggested that, local governments should provide the infrastructure facilities and public utilities to attract the tourists. Government should enhance those programs to provide employment opportunities to the locals through tourism. Domestic tourism is also important for generating Government revenues, but little attention has been given to this. Economies should also focus on the promotion of domestic tourism. As tourist arrivals are increasing in this region, regional cooperation is necessary than individual efforts of the countries. These efforts can be made on different levels, like between two or more economies, between private organizations of different economies, between private and government organization of two or more economies. Foreign investment must be encouraged in the region on the cost benefit analysis.

The government should also invest its surplus revenues in the promotion of the tourism industry. Environmental degradation and political issues must be resolved to attract foreign tourists in the region. Skilled human resources are the main determinant factor of economic growth of an economy.

Government of these economies should emphasize in the training of human beings and build such institutes which serve the international tourist. Electronic and print media should play their role and attract tourists. To encourage local investors to make larger investments and to draw in more tourists, the government should provide tax subsidies to hotels, airfare, and all other tourism-related businesses. Security threats must be resolved to promote tourism. All the official institutes should try to handle these issues in the best manner. This is beneficial for attracting not only foreign tourists but also for domestic tourists.

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