Workers' Remittances and Economic Growth: A Study in Sri Lanka

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Introduction

The recent period witnesses a steady inflow of remittances to developing countries. Their flows to developing countries contribute the second largest source of external finance after foreign direct investment (FDI) (Ahamada and Coulibaly, 2013) and are about three times larger than official development assistance (Wolrd Bank, 2015). Officially recorded remittances to developing countries were $435 billion in 2014, an increase of 5 percent over 2013. Total remittance flows to developing countries have increased more than six–fold during the period 1995 to 2015 amounting to $454 billion in 2015 (World Bank, 2015).

Remittances have a potential positive impact as a development tool for the recipient countries. The development effects of remittances can be decomposed into its impact on savings, investments, growth, consumption, and poverty and income distribution. The impact on growth of remittances in the receiving economies is likely to act through savings and investment as well as short-run effects on aggregate demand and output through consumption. Workers' remittances are a component of foreign savings and they complement national savings by increasing the total pool of resources available for investments (Solimano, 2003).

According to the literature, some researchers have found that when people migrate - especially females – that has a negative impact on society (Lipton, 2002). On the other hand, others perceive workers' remittances as having a significant positive impact on the economic situation (Ratha, 2003).

Although the evidence on the effect of remittances on long-term growth remains inconclusive, in economies where the financial system is underdeveloped, remittances appear to alleviate credit constraints and may stimulate economic growth, via financing education and health and increasing investments. Some analysts and scholars argue that remittance benefits are only felt at the individual receiver level, but some case studies suggest that the benefits of remittances to individuals have spill-over effects that can translate into a positive impact on the local economy (Carrasco and Ro, 2007). However there is no clear direction between remittances and GDP per capita in Sri Lanka.

Objectives

To investigate impacts of workers' remittances on GDP per capita in the long run and short run in Sri Lanka.

Methodology

The relationship between workers' remittances and GDP per capita in Sri Lanka is examined using annual time series data covering the period of 1990-2016. The data was extracted from the annual reports of the Central Bank.

$$GDPPC_t = \beta_0 + \beta_1 REM_t + \beta_2 EXPO_t + \beta_3 INV_t + \beta_4 FDI_t + \varepsilon_t$$

where *GDPPCt* is per capita GDP, *REMt* is ratio of workers' remittances to GDP, *EXPOt* is ratio of exports to GDP, *INVt* is ratio of gross domestic investments (including both private and public sector fixed capital investments) to GDP, and *RFDIt* is the ratio of foreign direct investment inflow to GDP and ε_t is the usual white noise error term which includes the effects of omitted factors.

ADF test and PP test was used to test the stationary property of time series data and Lag Length criteria test was adopted to identify lag length in the model. Engle-Granger co-integration is used to investigate the long run relationship between variables. Then the VECM is used to identify the short run relationship.

Results and Discussion

The results of the unit root test confirmed that all variables are stationary at their first difference, suggesting that they are integrated in order one. The lag selection criteria suggested one lag as an optimal. Johansen Co-integration rank test identified one co-integrating relationship among selected variables with confirming long run relationship. Results of the long run model are as follows:

$$GDPPC_t = \underset{}{13.08} + \underset{[2.19]}{4.51REM_t} + \underset{[2.17]}{2.42EXPO_t} + \underset{[2.13]}{9.72INV_t} + \underset{[3.40]}{8.37FDI_t}$$

Note: t values are given in the parenthesis.

Accordingly, export ratio, domestic investment, remittances and FDI have positive relationship with the GDPPC in the long run, whereas remittances has negative significant impact on the short run. A negative and significant error correction coefficient of (0.039%) reveals that 3.9% disequilibrium is corrected each year.

Conclusion

This study suggests that increasing of remittances have a significant negative effect on GDPC but a positive significant impact in the long run. Thus the research confirms remittances have mixed results in the economy. So policy makers should try to reduce negative impacts of it by taking appropriate measure to utilize remittances at the grassroot level in the country. Most of the previous studies show that, compared to the households not receiving remittances, households which receive international remittances spend more on non-food items such as durable goods, healthcare, education and investments and spend less on food, liquor, drugs and tobacco. Therefore, it is of paramount important to provide incentives for investing remittances for their own benefits rather than spending for consumption purposes.

References

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