

Can Migrant Workers' Remittances Cushion the Macroeconomic Crisis in Sri Lanka?

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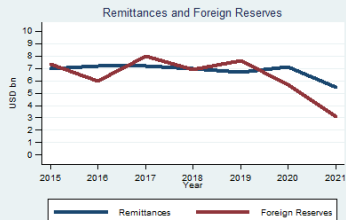
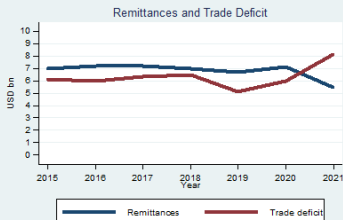
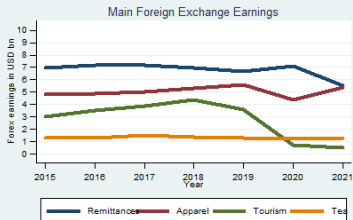
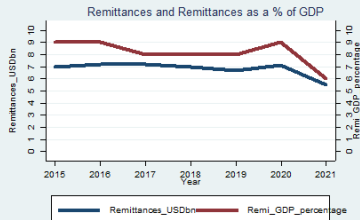


Economic & Socio-Political Situation

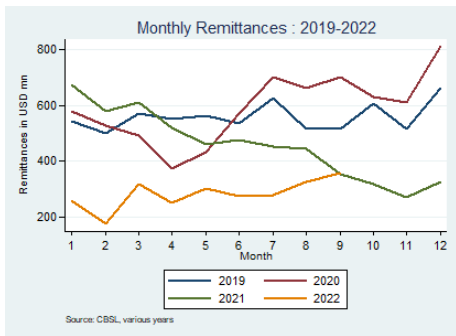
- Economic Crisis
 - Foreign Exchange Crisis
 - Low forex earning from Exports, Tourism and Remittances
 - High foreign currency debt burden
 - Low foreign reserves
 - Fiscal mismanagement, money printing, high inflation
- Social Crisis : rising poverty, food security, transportation issues
- Political Crisis: Instability, lack of support within parliament and from constituents
- SL is banking a lot on remittances for the recovery from the crisis

In this paper I examine how far remittances can contribute to address the macroeconomic crisis

Importance of Remittances



Remittances during the Crisis



- Consistent decline in monthly remittances in 2021
 - y-o-y decline in 2021 : 23 %
 - Annual remittances : USD 5.49 bn; lowest in recent times

Efforts to Attract Remittances

- Adopted / adopting various policy measures to attract greater remittances
- Most based on the assumption that remittances are altruistic
 - highlight the economic issues and aims to attract remittances through formal channels
- However, using older data (1996 to 2004) Lueth and Ruiz-Arranz (2007) showed that remittances to Sri Lanka are pro-cyclical.
- If this still holds the challenges in attracting remittances can be better understood

Objective, Methodology and Data

- This study aims to understand the performance of remittances relative to the macroeconomic fluctuations in recent years
- Methodology : Vector Error Correction (VEC)
- Data: quarterly data for from 2010 Q3 - 2019 Q4.

Data

Variable	Description	Source
REM	Quarterly remittance receipt data in USD Mn (sum of 3 months' data)	CBSL
GDP	Quarterly Gross Domestic Product in LKR Mn at Constant (2010) Prices	CBSL
EXR	Quarterly average ex. rate between USD / LKR (average of the three months in a given quarter).	CBSL
CPI	Quarterly headline Consumer Price Index	One-Stop Source A Global Database of Inflation
IDIF	Difference in quarterly interbank call rate in Saudi & SL	CBSL and Saudi Arabia Central Bank
OIL	Average quarterly global oil price (3 month. av. of monthly prices in USD per barrel)	Federal Reserve Bank of St. Louis

Augmented Dicky Fuller Test for Nonstationarity

Var. Acronym	Var. Name	Level		First Difference	
		t-ADF	Lags	t-ADF	Lags
REM	Ln Remittances	-2.427	4	-2.213 **	4
GDP	Ln Real GDP	-2.2	4	-2.271 **	4
CPI	Ln CPI	-2.677	1	-6.340 ***	0
EXR	Ln Exchange Rate	-2.499	3	-3.980 ***	2
IDIF	Ln Interest Rate Differential	-2.35	2	-3.351 ***	1
OIL	Ln Global Oil Prices	-1.847	1	-5.311 ***	0

Notes:

All models at levels include a constant and a trend.

All models at first difference include a constant and a drift

Lag length selected based on AIC.

** denotes rejection at 5% level; *** denotes rejection at 1% level.

Source: author's estimates

All series become stationary when differenced.

Johansen Test for Cointegration

for REM, GDP, CPI, EXR, IDIFF OIL

Maximum Rank	Eigenvalue	Maximum Eigenvalue		
		Max Statistic	Critical Value at 5%	Critical Value at 1%
0		77.6343	39.37	45.1
1	0.88427	64.1864	33.46	38.77
2	0.83186	37.9712	27.07	32.24
3	0.65172	16.9784	20.97	25.52
4	0.37601	12.5764	14.07	18.63
5	0.29485	0.1386	3.76	6.65

VEC Model Estimation

- The VEC model is estimated with
- One co-integration equation
- Two lags
 - To balance degrees of freedom and autocorrelation of residuals
- No autocorrelation
- Disturbances after VEC are normally distributed
- Model is stable

Long Run Equation Cointegration Relationship

Beta	Coef.	Std. Err.	z	P>z	95% Conf.	Interval]
ln REM	1	.	.	.	.	.
ln GDP	-9.0231	0.3932	-22.95	0	-9.7937	-8.2524
ln CPI	5.4651	0.5048	10.83	0	4.4758	6.4544
ln EXR	2.0109	0.2355	8.54	0	1.5492	2.4725
ln IDIFF	-0.0226	0.0875	-0.26	0.796	-0.1941	0.1489
ln Oil	-0.1104	0.0412	-2.68	0.007	-0.1912	-0.0296
Constant	88.0593	.	.	.	.	.

- In the long run when the normalized ln REM is positioned as the dependent variable
 - ln GDP & ln OIL have a statistically significant positive effect on remittances
 - ln CPI and ln EXR have a statistically significant negative effect on remittances

Short Run Equation for REM

- In the short run only lagged value of Ln REM and Ln GDP are statistically significant.
- Ln REM of last period has a negative effect on this period remittances
- Lagged Ln GDP values of two previous periods have a positive effect on this period's remittances.

Summary of Findings

Remittances to SL falls when :

- SL economy contracts - pro-cyclical (+ln GDP)
- Exchange rate depreciates LKR/USD (-ln EXR)
- Inflation in SL rises (- ln CPI)
- COD economy deteriorate (+ ln OIL)

Motives to Remit and Pro-Cyclicality

Pro-cyclicality is likely to be guided by investment, inheritance and exchange motives of remittances.

- Reasons to discourage remittances for investment purposes:
 - The low interest rates in SL before April 2022
 - Economic, social and political uncertainty
 - Issues in accessing foreign currency savings in Sri Lanka
- Reasons to discourage remittances for inheritance motive:
 - Economic decline in Sri Lanka => decreased the value of inheritance

Exchange Motive to Remit and Pro-Cyclicality

- Exchange motive to remit is nuanced due to inflation & exchange rate dynamics in SL
- Decline in the GDP growth rate was midst high inflation
- For exchange motive, remittances should ideally increase with rising prices
- But this is not the case observed in SL
- Flow of remittances due to inflation is likely to be countered by the exchange rate
- Float in Mar22 saw a 78% depreciated by Jun22

Remittances, Inflation & Exchange Rate

- Depreciation of the LKR provides a higher LKR value for a given amount of USD remittances
- Under the exchange motive the net effect of the twin movement of exchange and inflation rates will lead to
 - A lower USD value of remittances if the lower remittance can ensure a constant amount of purchasing power for the left behind family.
- This is likely to have contributed to the decline in formal remittances

Economic Conditions in COD

- Remittances originating from overseas for investment and insurance motives are indeterminate (De, Islamaj, Kose and Reza, 2019)
 - Depending whether or not migrants retained their income sources in the CODs
 - If migrants lost their jobs in CODs remittances will be pro-cyclical to COD economy
- Many Sri Lankans lost their jobs in CODs during the pandemic.
- This COD aspect under the investment and insurance motives would have contributed to the overall decline in remittances to SL.

Way Forward

- Altruistic and counter-cyclical remittance assumptions are challenged
- To improve remittances
 - Improve the domestic economy to attract remittances :
 - Rather than thinking that attracting remittances would improve the domestic economy
 - Economic recovery policies need to factor in co-movements of remittances with macroeconomic variables
- For worker departures :
 - Target markets with economic growth uncorrelated with that of SL
 - Ensure strong conditionalities in foreign employment contracts to avoid disproportionate lay off of migrants during economic downturns in CODs

Background
Motives to remit
Study details
Estimation
Results
Findings

Summary of Findings
Motives and pro-cyclicality
Exchange motives and pro-cyclicality
Remittances, inflation & exchange rate
Economic conditions in COD
Way forward

Thank You