Remittances and Impacts on Development and Poverty Reduction

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Sri Lanka is a comparatively small open market economy with a large expatriate labour force that sends substantial remittances to the country. In 2007, remittances were around 11% of GDP.

As in many other developing nations, Sri Lanka's official records show that remittances have grown dramatically over the past decade. Nevertheless, the role remittances plays in development as well as the growth effect of this unconditional migrant assistance is under-researched and needs more development policy-oriented attention. In the meantime, the protracted civil war has elevated the importance of this injection of foreign exchange into the national economy.

The overall effect of remittances on recipient countries suffering or emerging from protracted political conflict or violence is relatively unknown. According to the World Bank's Global Economic Prospects 2006, nearly all countries plagued by conflict, other persistent crises, or war- to-peace transitions, are highly dependent on remittances. The availability of remittances undoubtedly has a significant affect on the private disposable income of local inhabitants experiencing the negative fallout from internal conflict or natural disaster.

Sri Lanka's own experience—during the protracted civil war as well as during and after the tsunami—proves the practical validity of the above economic correlation. When recipients in home countries need economic help during hard times, migrants typically tend to remit more funds to their relatives and friends. This personal monetary assistance is tailored by the migrants to suit the family requirements of the recipients.

In the meantime, recipients of remittances in developing countries—who are often victims of the bureaucratic structure and corruption of official aid flows—seem to have long been dependent on foreign finance from their migrant relatives and friends.

Remittances flow directly from one person to other. Also, unlike official aid flows, the process of transferring remittances does not include tax and the only cost incurred is that of the money transfer service. Recent competitive expansion in the remittance industry has reduced the cost of remitting money across countries. Hassle free, faster remittances are also freely available in Sri Lanka.

Sri Lanka has been the most liberalized economy in South Asia, recording greater trade dependency with an export and import share in GDP that is higher than 55 percent (often referred to as the trade dependency ratio). The country persistently depends on worker remittances as an attractive source of financing the widening trade deficit in its balance of payments. Remittances are the second largest source of external financing. They help to offset over 70 percent of the trade deficit and to reduce the current account balance to a manageable level. After garments exports, remittances have become the single largest component of foreign exchange inflows to the economy.

Over the last 30 years, ever since the introduction of outward-oriented liberalized trade policies in 1977, Sri Lanka has continuously recorded more worker remittances than foreign direct investment. This is evidenced by the fact that Sri Lanka's recent remittances have exceeded foreign direct investment inflows by six to seven times.

On a per capita basis, worker remittances to Sri Lanka are the highest in South Asia. In terms of annual volume, remittances were more than double the net receipts of overseas development assistance and reached close to 25 percent of export earnings. This is second only to the garment industry and is ahead of tourism and the tea export industry.

Increased pressure in the foreign exchange market escalates the demand for remittances. Without remittances, there would have been a deeper depreciation of the exchange rate than the current value against the US dollar. It is worth noting that, unlike a declining trend in tourism earnings due to war, remittances have steadfastly been the primary targeted foreign exchange earner of the economy.

The government is faced with a widening trade deficit caused by an unavoidably larger import base that includes the pressure of higher demand for military equipments and mostly astronomical petroleum prices.

Consequently, they seem to be in the process of paving a pathway to facilitate and promote legal migration to draw more remittances into the economy.

For instance—as proposed in the 2006 budget—the government has introduced "Nation Building Bonds" to attract more financial inflows from migrant Sri Lankans. In 2007, the Central Bank of Sri Lanka launched a programme to encourage licensed commercial banks to open branches in host countries with dense populations of Sri Lankan migrants.

Through the Sri Lanka Bureau of Foreign Employment, the government has been promoting migration by seeking more opportunities in the overseas labour market, regulating employment agencies, registering emigrants and providing welfare services to migrants and their families.

It would seem that the adoption of such policies has already augured well—to a considerable degree—for the promotion of labour exports. Job opportunities in foreign markets have become a vital source of employment in the recent past. The export of labour primarily helps declining domestic unemployment.

During the past three decades of trade liberalization, there has been controversy over the pure gains Sri Lanka has made from free trade with the rest of the world and over the country's development trajectory.

Sri Lanka must, therefore, be prepared to identify the comparative advantages of its labour export.

It is necessary to explore more opportunities in the integrated global labour market as well as improvements in overall labour productivity and professional skills of the local labour force.

Additionally, the economic potential of labour export in shaping linkages between trade, development and poverty reduction is undeniable in small open economies high in labour resources but deficient in capital.

Remittances, in fact, have great potential to generate a positive impact on development and poverty reduction in Sri Lanka. It is important to note that remittances can reduce the probability of food-based and capability-based poverty among underprivileged entities at the receiving end. This applies to both rural and conflict affected areas of the country.

Where widening inter-regional income disparities are concerned, the migration of rural men and women could contribute to family income and, thereby, to rural economies. In many cases, this happens through the remittances of the primary breadwinners.

It is evident that much of Sri Lanka's labor exports is induced by household economic hardships. The departure of housemaids to the Middle East—from where the highest volume of remittances flows into Sri Lanka—is mainly determined by economic hardships in their families. The volume of remittances may, therefore, have positive correlation with wage levels of migrant workers and the economic needs of their families back home. Significantly, a colossal portion of the total remittances received by Sri Lanka meets day-to-day consumption needs rather than long term productive purposes. In most cases, remittance recipient households set aside little or no savings for their future.

Sri Lanka receives remittances through the migration of skilled, semi-skilled and unskilled labour for employment in prosperous countries. But there is another motivation for migration—unlike most other developing countries, migration in Sri Lanka is also prompted by its protracted conflict.

Internally displaced people in areas affected by conflict are often caught up in the battle between government forces and the Liberation Tigers of Tamil Eelam (LTTE) and have been fleeing the country for safer destinations mostly in the West. In many such cases, they are sponsored in the host destinations by their migrant relatives, friends and civil society organizations on compassionate grounds.

Those who are left behind in the North (and the East) are usually the less economically influential inhabitants or people who may have little or no interest in migration. They are highly vulnerable to economic hardships caused by the loss of livelihoods and the unusually steep prices of daily necessities brought about by an internal economic embargo. For their survival, therefore, they are often economically dependent on the assistance of their migrant relatives.

In that sense, remittances in war-torn areas have been the backbone of many families and have to a certain degree minimized the impact of the economic embargo on household welfare.

Another noteworthy phenomenon is that much of the remittances to war-torn economies come through unregulated channels rather than through a formal banking system.

Although foreign remittances are the main income source in the economies of conflict affected North and East, there are no accurate figures on the extent annually remitted to these areas by migrant Tamils. As a result of such undocumented money transfer vehicles, official remittance figures may be significantly underestimated.

According to the World Bank, model based estimates and household surveys suggest that the unidentified extent of remittances flowing through informal channels across countries may add at least 50 percent to official estimates.

In Sri Lanka, as the Central Bank has disclosed, up to 30 percent of total earnings by migrants never reach official channels. Still, the influence of remittances in mitigating the impact of conflict is a controversial and complicated subject due to skepticism over terrorist financing.

However, disturbing tales of the negative social and political consequences of migration has rendered its total development impact complex in Sri Lanka.

For instance, the conjoint issues of security and social or psychological wellbeing of children and adolescents left behind by one or both parents may pose risks to the overall well-being of the family institution and society. The trade-off between the economic benefits of migration and broken family structures should be considered in a broader review.

Secondly, the most dangerous facet of remittances is their involvement in the civil war as a major source of terrorist financing**.** Therefore, despite the growing importance of remittances as a constant source of financing external deficits, the money transfer system has come under intense scrutiny of monetary authorities.

Finally, there is no dispute that Sri Lanka as a developing country—and seemingly as a floundering economy struggling to withstand the burden of a 25-year-old war–needs to attract more opportunities to integrate with the global labour market.

In pursuit of this financially rewarding objective, the government has a formidable responsibility to mitigate the aforesaid adverse effects of labour migration at the domestic level. Here, in dealing with both prospects and challenges of labour migration and remittances the country mainly needs a rationally designed and improved institutional framework.

The government should also think of channeling remittance flows towards more effective poverty reduction and rural development outcomes.

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