

THE NEXUS BETWEEN WORKERS' REMITTANCES AND FINANCIAL DEVELOPMENT IN SRI LANKA

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ABSTRACT

Workers' remittances are an important source of external finance in Sri Lanka since the later part of 1975. Most empirical literature confirmed that the remittances increase the money supply through the velocity of money. Therefore, it can be also assumed that the workers' remittances have a positive relationship on the financial development in Sri Lanka. Hence, this study attempts to examine the relationship between workers' remittances and financial development in Sri Lanka over the period of 1975 to 2017 by using autoregressive distributed lag (ARDL) bounds testing approach. To attain the objective of this study, the following variables: gross domestic credit to private sector as the share of GDP (FD) was proxy variables for financial development and dependent variable, workers' remittances (WRE), interest rate (IR), foreign direct investment (FDI), gross domestic product (GDP) were employed as independent variables. In terms of the Augmented Dickey Fuller (ADF) unit root test, all the variables in this study were stationary in mixed order $I(0)$ and $I(1)$. Further, both long – run and short – run relationship between workers' remittances and financial development were investigated. Accordingly, the bound test F - statistic was 7.612 which was significant at 5% level. It means that the workers' remittances maintain the long – run relationship on the financial development in Sri Lanka. Meanwhile, in short – run period the workers' remittances significantly influence on financial development in the second year onwards. The estimated Error Correct Model shows that the coefficient of error correction (ECM) term was negative and significant. It indicates that the workers' remittances were moved to financial development towards long – run equilibrium path. Diagnostics tests showed that the estimated models were robustness. Based on the conclusion of this study, it was confirmed that the workers' remittances in Sri Lanka influenced on the financial development in long – run and short – run period. Therefore, this study suggests that the government of Sri Lanka have to follow a proper plan to regularize the financial system by considering the workers' remittances as a factor for financial development. The findings of this study could be useful to policymakers in formulating an appropriate financial development plan in Sri Lanka.

Keywords: Workers' remittances, financial development, ARDL approach, Sri Lanka