FINANCIAL LIBERALIZATION AND OPERATIONAL EFFICIENCY IN THE FINANCIAL SYSTEM OF SRI LANKA

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Abstract

This study attempts to evaluate the operational efficiency of Sri Lankan financial system during post liberalization period. Indicators such as assets, deposits and loan concentration in the banking industry, trends of interest rates, employee costs, reserve requirements, return on assets (ROA) are used to capture the effects of financial reforms on the operational efficiency of the financial system.

These indicators revealed high concentration in the banking system, less competition and high cost of banking. It is also evident that banking system as a whole is not very stable. All these lead to the conclusion of partial success of the financial reforms implemented during the post liberalization period.

Introduction

The financial sector liberalization programme of Sri Lanka was introduced in late 1977as a part of wider set of reforms. These reforms were triggered by numerous macro economic difficulties that the country faced in late 1970s. It was further influenced by world wide trend towards financial liberalization and deregulation. A greater reliance was placed on market mechanism and on the perspectives of McKinnon and Shaw.

Since McKinnon and Shaw (1973) presented their argument about financial repression, in which administrative resource allocation is considered as the source of economy – wide inefficiency. It is also believed it would create macro economic instability and leading to low rates of financial savings and