COMPOSITION OF EXTERNAL FINANCE OF SRI LANKA: EVIDENCE FROM FOREIGN DIRECT INVESTMENT

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Abstract

Purpose: Inflow of external finance into Sri Lanka in terms of Foreign Direct Investment is instrumental to overcome socio-economic issues detrimental to achieve economic growth. Objective of this study is to find nexus between Economic Growth and FDI in Sri Lanka by employing time series data from 1978 to 2020.

Methodology: The econometric techniques used in this study are listed as Kernel Fit, Confidence, Ellipse, Co integration, and Error Correction Mechanism – ECM. The dependent variable in the econometric model defined is Gross Domestic Production - GDP which is the proxy for Economic Growth in Sri Lanka. The independent variables are defined as Foreign Direct Investment – FDI and Economic Freedom Index – EFI.

Findings: There is a direct relationship or upward trend between Gross Domestic Production and Foreign Direct Investment. One percent increase in FDI – Foreign Direct Investment leads to increase GDP – Gross Domestic Production by 1.39 percent. An increase of one percent in EFI – Economic Freedom Index lowers down GDP – Gross Domestic Production by 7.99 percent in long run.

Implications: Foreign Direct Investment and integration with the world market are the endogenous determinates which stimulate the economic growth of the county. As per the findings of this study, a positive relationship between Economic Growth and Foreign Direct Investment as propounded by Endogenous Growth Model exists.

Keywords: Co integration, economic growth, error correction, mechanism, external finance, foreign direct investment