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## The Main Determinants Affecting Economic Growth in Sri Lanka

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### **Abstract:**

Every country in the world is trying to create a self-sufficient economy through economic growth and economic development. The concept of economic growth is very important there. There are many determinants that a country must achieve in order to achieve economic growth. Accordingly, this study studied the determinants that determine economic growth in Sri Lanka. It considered how the determinants of Exports, Foreign Direct Investment Inflow, Savings and Population Growth affect economic growth. For that, the research was conducted using secondary data related to the period 1991-2020. The Ordinary Least Square (OLS) method was used to identify the relationship between the determinants used and economic growth. Accordingly, it was identified that the factors of foreign direct investment and savings have a positive effect on economic growth, and the factors of Exports and Population Growth have a negative relationship with economic growth. Accordingly, it is important to pay close attention to foreign direct investment and savings in Sri Lanka moving towards economic growth.

**Keywords:** Economic growth, exports, foreign direct investment inflow, population growth, savings

### **1. Introduction**

Every country in the world is trying to become economically stable at every moment. Accordingly, every country pays close attention to economic growth. It is clear that some countries in the world have achieved very high economic growth by the end of the twentieth century, while some other countries have very slow economic growth. This situation is due to the obstacles to economic growth and the influence of factors that determine economic growth (Das & Das, 2020).

Focusing on Sri Lanka According to the World Economic Status and Prospects 2022 report, Sri Lanka is a lower-middle-income developing country. For Sri Lanka to move towards development, economic growth must be accelerated. In discussing economic growth, economic growth refers to an increase in the production of economic goods and services in one period compared to the previous period (Potters, 2021). Considering the economic growth of Sri Lanka, although it has shown rapid growth in some cases, economic growth has decreased due to various reasons in some cases. Economic growth started to increase with the open economic policy adopted by Sri Lanka in 1977. However, especially in the year 2001, Sri Lanka faced the first negative economic growth (-1.55%) since independence in 1948. Also, once again, with the COVID-19 pandemic, Sri Lanka faced negative economic growth in 2019 (-3.47%) (Central Bank Report 2001, 2019).

Thus, it is clear that there are fluctuations in the discussion about the economic growth of Sri Lanka. Sri Lanka is currently under severe pressure due to the economic crisis. In order to alleviate this situation and achieve the expected economic growth in Sri Lanka, it is important to study it. Accordingly, the primary objective of this research is to study the determinants that determine the economic growth of Sri Lanka.

### **2. Determinants of Economic Growth in Sri Lanka**

Several research studies have been conducted on the determinants of economic growth in Sri Lanka. Accordingly, the results of that research can be discussed as follows.

Research conducted by Washima (2019) has found that Research and Development expenditure, Gross Domestic Product per Capita, pattern applications for residents, and capital formation have a positive effect on the economic growth of Sri Lanka, while Gross Domestic Product and export Foreign Direct Investment and expenditure on education have a negative effect. Velnampy and Achchuthan (2013) studied how exports affected economic growth from 1970 to 2010. It has been recognized that exports have a significant effect on economic growth.

Balamurali and Bogahawatte (2004) have studied the relationship between economic growth and FDI in Sri Lanka for the period 1977-2003. It has been recognized that FDI has a positive effect. Also, through research conducted for the period 1978-2015, it has been identified that there is a positive relationship between Sri Lanka's economic growth and FDI in the long term and in the short term. Also, according to a study conducted by Menike (2014), the variables population growth rate, infant mortality rate and labor force growth rate do not show a significant relationship with

economic growth. As indicated by Hevia and Loayza (2013), there is an inverse relationship between economic growth and savings in Sri Lanka.

### 3. Methodology

Through this study, the relationship between economic growth and 4 determinants affecting it has been studied. Accordingly, the determinants of Exports, Foreign Direct Investment Inflow, Savings and Population Growth were used for this purpose. These determinants were selected based on the determinants used in previous studies. Accordingly, this analysis was done based on the data included in the reports of the Central Bank of Sri Lanka from 1991 to 2010. Accordingly, Ordinary Least Square (OLS) method was used in the analysis, and Eviews software was used.



Figure 1: Conceptual Framework

Here, GDP Per Capita (US \$) was used to measure economic growth. Goods and Services Exports (Percentage of GDP) were used to determine Exports. Foreign Direct Investment Inflow (Percentage of GDP) was used to determine Investments. Gross Domestic Savings (Percentage of GDP) was used to determine Savings. Population Growth percentage was used to determine Labor (Jayawardana et al.).

### 4. Results and Discussion

Data were analyzed based on the criteria used for 1991 to 2020. The results are as follows.

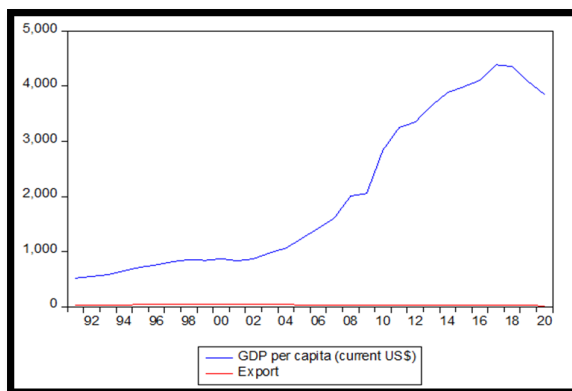


Figure 2: GDP Per Capita (US \$) and Exports

Source: Author’s Computation Based on World Bank Data from 1991 to 2020

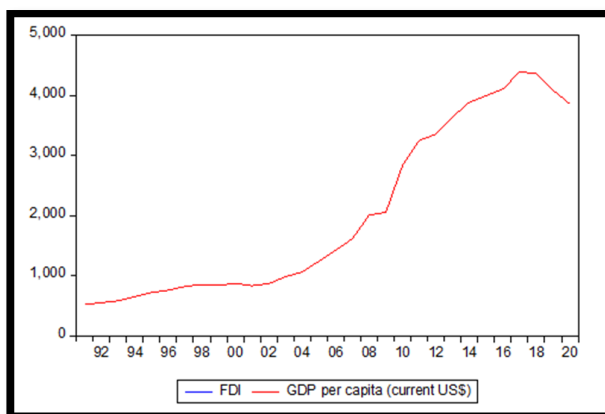


Figure 3: GDP Per Capita (US \$) and Foreign Direct Investment Inflow

Source: Author’s Computation Based on World Bank Data from 1991 to 2020

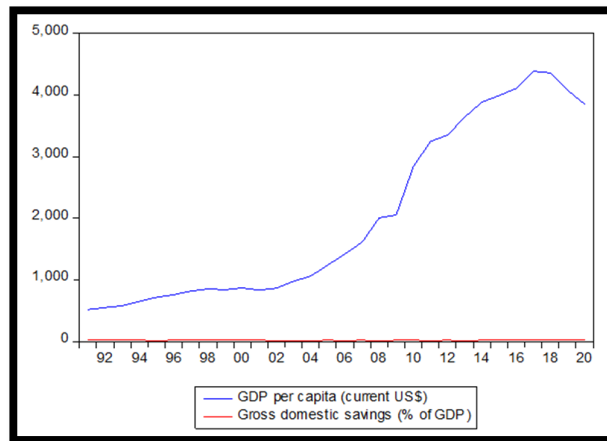


Figure 4: GDP Per Capita (US \$) and Gross Domestic Savings  
 Source: Author's Computation Based on World Bank Data from 1991 to 2020

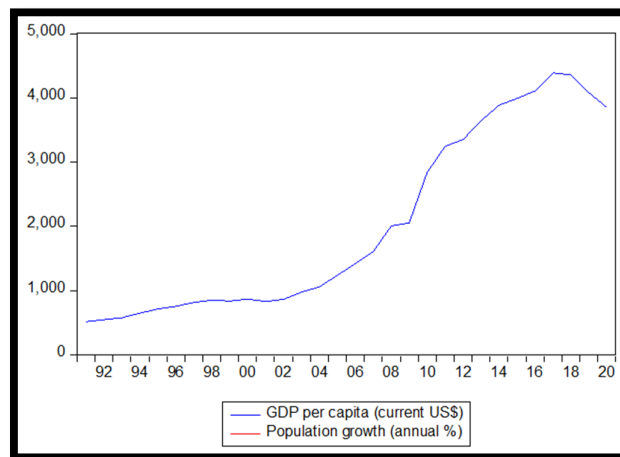


Figure 5: GDP Per Capita (US \$) and Population Growth Percentage  
 Source: Author's Computation Based on World Bank Data from 1991 to 2020.

Before estimating the regression line to identify the relationship between economic growth and its determinants, some tests should be done. It should be checked whether the variables are stationary or non-stationary. The results are as follows.

<b>Null Hypothesis: GDP Per Capita has a unit root</b>			
<b>Exogenous: Constant</b>			
<b>Lag Length: 0 (Automatic - based on SIC, maxlag=7)</b>			
		t-Statistic	Prob.*
		-3.000525	0.0471
Augmented Dickey-Fuller test statistic			
Test critical values:	1% level	-3.689194	
	5% level	-2.971853	
	10% level	-2.625121	

Table 1: Unit Root Test Results for GDP Per Capita  
 Source: Author's Computation Using E-Views Based on World Bank Data from 1991 to 2020

Table 1 represents the unit root test of GDP Per Capita. ADF Test statistics on GDP Per Capita record a value of -3.000525 and a P-value of 0.0471. Therefore, it has been identified that series are stationary.

<b>Null Hypothesis: Exports have a unit root</b>			
<b>Exogenous: Constant</b>			
<b>Lag Length: 0 (Automatic - based on SIC, maxlag=7)</b>			
		t-Statistic	Prob.*
		-5.191860	0.0002
Augmented Dickey-Fuller test statistic			
Test critical values:	1% level	-3.689194	
	5% level	-2.971853	
	10% level	-2.625121	

Table 2: Unit Root Test Results for Exports

Source: Author's Computation Using E-Views Based on World Bank Data from 1991 to 2020

Table 2 represents the unit root test of Exports. ADF Test statistics on Exports record a value of -5.191860 and a P-value of 0.0002. Therefore, it has been identified that series are stationary.

<b>Null Hypothesis: Foreign Direct Investment Inflow has a unit root</b>			
<b>Exogenous: Constant</b>			
<b>Lag Length: 1 (Automatic - based on SIC, maxlag=7)</b>			
		t-Statistic	Prob.*
		-6.062872	0.0000
Augmented Dickey-Fuller test statistic			
Test critical values:	1% level	-3.689194	
	5% level	-2.971853	
	10% level	-2.625121	

Table 3: Unit Root Test Results for Foreign Direct Investment Inflow

Source: Author's Computation Using E-Views Based on World Bank Data from 1991 to 2020

Table 3 represents the unit root test of Foreign Direct Investment Inflow. ADF Test statistics on Foreign Direct Investment Inflow records a value of -6.062872 and a P-value of 0.0000. Therefore, it has been identified that series are stationary.

<b>Null Hypothesis: Gross Domestic Savings have a unit root</b>			
<b>Exogenous: Constant</b>			
<b>Lag Length: 0 (Automatic - based on SIC, maxlag=7)</b>			
		t-Statistic	Prob.*
		-4.315649	0.0022
Augmented Dickey-Fuller test statistic			
Test critical values:	1% level	-3.689194	
	5% level	-2.971853	
	10% level	-2.625121	

Table 4: Unit Root Test Results for Gross Domestic Savings

Source: Author's Computation Using E-Views Based on World Bank Data from 1991 to 2020

Table 4 represents the unit root test Gross Domestic Savings. ADF Test statistics on Gross Domestic Savings record a value of -4.315649 and a P-value of 0.0022. Therefore, it has been identified that series are stationary.

<b>Null Hypothesis: Population Growth Percentage</b>			
<b>Exogenous: Constant</b>			
<b>Lag Length: 0 (Automatic - based on SIC, maxlag=7)</b>			
		t-Statistic	Prob.*
		-4.159057	0.0032
Augmented Dickey-Fuller test statistic			
Test critical values:	1% level	-3.689194	
	5% level	-2.971853	
	10% level	-2.625121	

Table 5: Unit Root Test Results for Population Growth Percentage

Source: Author's Computation Using E-Views Based on World Bank Data from 1991 to 2020

Table 5 represents the unit root test Population Growth percentage. ADF Test statistics on Population Growth percentage records a value of -4.159057 and a P-value of 0.0032. Therefore, it has been identified that, series are stationary.

Also, the Granger causality test is done to consider whether the series can be predicted by another series. The results are as follows.

Pairwise Granger Causality Tests			
Sample: 1991 - 2020			
Lags: 1			
Null Hypothesis:	Obs	F-Statistic	Prob
FDI does not Granger Cause EXPORT	29	0.47963	0.4947
EXPORT does not Granger Cause FDI		0.89508	0.3528
GROSS_DOMESTIC_SAVINGS__OF_GDP_ does not Granger Cause EXPORT	29	0.00171	0.9674
EXPORT does not Granger Cause GROSS_DOMESTIC_SAVINGS__OF_GDP_		8.89658	0.0061
POPULATION_GROWTH__ANNUAL__ does not Granger Cause EXPORT	29	1.08129	0.3080
EXPORT does not Granger Cause POPULATION_GROWTH__ANNUAL__		0.99927	0.3267
GROSS_DOMESTIC_SAVINGS__OF_GDP_ does not Granger Cause FDI	29	0.13850	0.7128
FDI does not Granger Cause GROSS_DOMESTIC_SAVINGS__OF_GDP_		0.50479	0.4837
POPULATION_GROWTH__ANNUAL__ does not Granger Cause FDI	29	0.49846	0.4865
FDI does not Granger Cause POPULATION_GROWTH__ANNUAL__		0.03608	0.8508
POPULATION_GROWTH__ANNUAL__ does not Granger Cause GROSS_DOMESTIC_SAVINGS__OF_GDP	29	6.15513	0.0199
GROSS_DOMESTIC_SAVINGS__OF_GDP_ does not Granger Cause POPULATION_GROWTH__ANNUAL__		0.18773	0.6684

Table 6: Granger Causality Tests

Source: Author's Computation Using E-Views Based on World Bank Data from 1991 to 2020

In this case, except for the population growth rate and national domestic savings, the null hypothesis is accepted. After performing the above tests, the regression equation can be defined using OLS.

$$GDP\_PER\_CAPITA\_CURRENT\_US\$ = 7728.39840848 - 152.163019525*EXPORT + 15904.5910079*FDI + 8.86282022711*GROSS\_DOMESTIC\_SAVINGS\_OF\_GDP\_ - 1971.0663*POPULATION\_GROWTH\_ANNUAL\_$$

Their impact was considered here using the criteria that determine economic growth. Accordingly, it was considered how the determinants of exports, foreign direct investment inflow, savings, and population growth affected the economic growth of Sri Lanka in relation to the period 1991-2020. According to the regression equation, it was clear that Exports and Population Growth have a negative effect and that factors such as Foreign Direct Investment Inflow and Savings have a positive effect.

## 5. Conclusion

This study studied the determinants of economic growth for the period 1991-2020. Accordingly, it could be recognized that foreign direct investment and savings have a positive effect. Accordingly, it is important to focus on these determinants in Sri Lanka's efforts to achieve economic growth. It is important to take necessary measures to increase foreign direct investment flowing into Sri Lanka. It is important to develop and implement necessary action policies. It is also important to promote savings in Sri Lanka. For that, household savings and government savings should be increased locally. Savings should be increased by maintaining appropriate interest rates. Thus, it is clear that FDI and savings are important in achieving economic development in Sri Lanka.

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