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IMPACT OF GOVERNMENT FOREIGN DEBT ON GROSS DOMESTIC PRODUCT OF SRI LANKA

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Sri Lanka is often portrayed as a country that fell into debt traps as a result of public investment projects financed by foreign governments and agencies. The Government Foreign Debt (GFD) of any country will be increased when new external debt is borrowed. Particularly for Sri Lanka, foreign debt is also severely affected by the depreciation of the exchange rate of the Sri Lankan rupees against other foreign currencies. In this study, the relationship between the Gross Domestic Product (GDP) and the Government Foreign Debt of Sri Lanka has been investigated. Data from annual reports of the Central bank of Sri Lanka for the period from 1950 to 2017 have been used in the study. The results show that there are positive trends in both GFD and GDP variables even after converting them into logarithmic values. According to Augmented Dicky Fuller (ADF) test both variables have been stationary at first difference and variables are cointegrated based on the results of Johansen co-integrated test. Vector Error Correction Mechanism (VECM) was used since Johansen co-integration test has shown co-integration relationships. The co-integrated term became negative and significant as expected. The residuals of the resulted error correction model satisfy the tests for homoscedasticity and stationary. The residuals are also normally distributed. Around 52% of the variation of Gross domestic product (GDP) is explained by the model.

Keywords: Co-integrated relationships, Government Foreign Debt, Gross Domestic Product, Vector Error Correction Mechanism