Modeling the Long Run Determinants of Private Investment in Sri Lanka

Jeromias Chendooran, Sooriyakumar, K.,Sireeranhan, A.

Department of Agricultural Economics, Faculty of Agriculture, University of Jaffna

This paper investigates the determinants of private investment in Sri Lanka. In recent years, emphasis has been put on the development of the private sector in developing countries to boost economic growth and reduce poverty. Over the last decade there has been a widespread change of opinion about the role of state and private enterprises in promoting economic growth. A strong consensus has emerged that the achievement of more dynamic economic growth requires a greater role for the private sector. Although the bulk of private investment continues to be financed by domestic savings the increased access to foreign savings has played an important role in mobilizing resources for the private sector in developing countries. Foreign investment is an important element in Sri Lanka's economic growth and is therefore actively encouraged. For this study, annual data were collected from 1959 to 2002 from central bank annual report regarding private investment, government investment, gross domestic product, grant, terms of trade and trade liberalization. Augmented Dickey-Fuller(ADF) test was used to test whether the time series data is stationary or non stationary. Results of this test show that these variables are first order integrated. The long run private investment equation is derived using the Johansen Maximum Likelihood procedure. The residuals from this equation are used to form the error correction term in the short run error correction model (ECM). The results of this study indicate that when government investment increases by 1%, holding other factors fixed the private investment decrease by 0.8%. It suggests that there is some what crowding out. When the real GDP increases by 1%, holding other factors fixed, the private investment decreases by 1.9%. When foreign grant increases by 1% the private investment increases by 0.08% while holding other factors fixed. When terms of trade increase by 1% the private investment increases by 0.42% while controlling other factors. The estimated coefficient of trade liberalization shows negative sign in long run but not significant at 5% level. It shows positive sign in short run.