The impact of Foreign Direct Investment on Economic Growth in Sri Lanka

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Abstract

Foreign Direct Investment (FDI) is an investment in the form of controlling ownership in a business in a country by an entity based in another country. It contributes to transfer tangible and intangible assets such as technology, capital, knowledge and managerial skills, etc. FDI is the main driver of economic growth and sustainable development especially regarding Least Developed Countries (LDC). Sustainable Development Goals (SDG) for 2030 include Decent Work and Economic Growth as the 8th goal which can be accelerated by attracting FDI. In 1977 the open economic reforms invited Foreign Direct Investors to Sri Lanka. Thus the Board of Investment and island-wide free trade zones started regulating and monitoring FDI activities in Sri Lanka. Later, welfare economic reforms resulted in a dual gap issue of the savings-investment gap and export-import gap which in return caused the continuous budget deficit. Consequently, FDI is used to fill the dual gap problem and also for investment purposes. But the impact of FDI on economic growth in developing countries changes due to country specific factors. Therefore, this study attempts to identify the impact of FDI on economic growth measured by Gross Domestic Production (GDP) and identifying the impact of domestic investment, trade liberalization, inflation, human capital and population on GDP for the period of 1978-2018 in Sri Lanka. The analysis is based on the time series data collected from secondary resources like reports of central bank and the Census and Statistics Department. The multiple regression analysis indicates that FDI has a positive and statistical impact on economic growth in Sri Lanka. But the previous studies revealed that the causation is from the GDP to FDI.

Keywords: Foreign Direct Investment, Economic Growth, GDP, Sustainable Development

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