Fiscal Vulnerability, Financial Stress, and Macroeconomic Policies in Sri Lanka

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Fiscal policies are crucial when delivering sustainable development goals. Further, fiscal policies support to implement the domestic public resources and enhance the effectiveness of public spending. Moreover, fiscal policies enrich investment and contribute to fiscal reforms. These provide references to SDG target 17.1, which emphasizes the financial options and strengthening domestic resource mobilization. Therefore, it is pivotal to identify fiscal vulnerability to enhance macroeconomic policies. The study aims to examine the imbalance in the public finance structure in Sri Lanka to contribute to fiscal reforms by implementing appropriate macroeconomic policies. The study has selected several variables to develop indexes for fiscal vulnerability, financial stress, and macroeconomic policies. These three indexes were developed based on the historical data in the country under specific indicators. Therefore, the study uses a quantitative research approach where secondary data were collected from 1960-2020 for different indicators available under three indexes i.e., the index of fiscal vulnerability, an index of financial stress, and an index of macroeconomic policies. Further, the study embraces Auto Regressive Distributed Lag (ARDL) model to analyze the casual long run and the short run relationship between variables. The co-integration test captures the causal relationship results of the study, and it illustrates a long-run relationship between variables with directional causality. The study findings describe how important it is to implement a capacity mechanism suitable for Sri Lanka because prior literature emphasized that developing countries should develop their capacity mechanism considering IMF guidelines. Moreover, the study contributes to implementing fiscal monitoring mechanisms and identifying the refinancing risk of public liabilities. The study emphasizes an appropriate fiscal assessment to enhance macroeconomic policies in the Sri Lankan context.

Keywords**:** *Fiscal Vulnerability, Financial Stress, Macroeconomic Policy, SDG, Sri Lanka*

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Introduction

Fiscal policies are crucial when delivering sustainable development goals. Further, fiscal policies support to implement the domestic public resources and enhance the effectiveness of public spending. Moreover, fiscal policies enrich investment and contribute to fiscal reforms. These provide references to the SDG target 17.1 which emphasizes the financial options and strengthening domestic resource mobilization. Therefore, it is pivotal to identify fiscal vulnerability to enhance macroeconomic policies.

17 PARTNERSHIPS FOR THE GOALS

Objective

The study aims to examine the imbalance in the public finance structure in Sri Lanka to contribute to fiscal reforms by implementing appropriate macroeconomic policies.

TARGET 17.1

MOBILIZE RESOURCES TO IMPROVE DOMESTIC REVENUE COLLECTION

Methodology

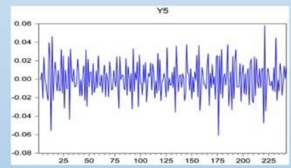
The study has selected several variables to develop indexes for fiscal vulnerability, financial stress, and macroeconomic policies. These three indexes were developed based on the historical data in the country under specific indicators. Therefore, the study uses a quantitative research approach where secondary data were collected over the period from 1960-2020 for different indicators available under three indexes i.e., the index of fiscal vulnerability, an index of financial stress, and an index of macroeconomic policies. Further, the study embraces Auto Regressive Distributed Lag (ARDL) model to analyze the casual long run and the short run relationship between variables.

Results

The co-integration test captures the causal relationship results of the study, and it illustrates a long-run relationship between variables with directional causality.

Conclusion

The study findings describe how important it is to implement a capacity mechanism suitable for Sri Lanka because prior literature emphasized that developing countries should develop their capacity mechanism considering IMF guidelines. Moreover, the study contributes to implementing fiscal monitoring mechanisms and identifying the refinancing risk of public liabilities. The study emphasizes an appropriate fiscal assessment to enhance macroeconomic policies in the Sri Lankan context.



17 PARTNERSHIPS FOR THE GOALS

Strengthen the means of implementation and revitalize the global partnership for sustainable development