

**IMPACT OF FOREIGN DIRECT INVESTMENT (FDI) ON
ECONOMIC GROWTH IN SRI LANKA: 1978-2003**

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ABSTRACT

Foreign Direct Investment (FDI) has been recognized as a major source of promoting economic growth and development with its package of tangible and intangible assets such as capital, technology, knowledge, managerial skills and market access to developing countries. The deficiency of capital due to the saving-investment and import-export gaps has been considered as a major constraint to economic growth in Sri Lanka. FDI has been an important source of foreign financing to fill these two gaps and overcome the problem of capital formation since 1977. The study is based on time series data mainly from Central Bank of Sri Lanka and Board of Investment (BOI) covering the period of 1978-2003. The prime objective of this study is to analyze the impact of FDI on export-led manufacturing development and its contribution to employment generation in the economy. Both qualitative and quantitative approaches have been used to analyze these impacts of FDI. The production function approach has been utilized as the theoretical framework for undertaking empirical work to test the relationship between FDI and economic growth along with other two variables domestic investment and exports. In this empirical investigation unit root test, cointegration analysis, error correction modeling approaches and causality test have been utilized. The overall results indicated that there was no short-run impact of FDI on GDP growth in Sri Lanka, but the long-run relationship could be recognized. The econometric results further show that FDI alone does not exert an independent influence on economic growth but with the combined effects of domestic investment and exports have made a significant contribution to economic growth.