

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

By

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**Thesis Submitted to the University of Sri Jayawardenepura for
the Award of the Degree of Doctor of Philosophy in Economics**

2007

“The work described in this thesis was carried out by me under the supervisors Prof. P. Wilson and Prof. Jagath Wickramasinghe and a report on this has not been submitted in whole or in part to any University or any other Institute for another Degree/Diploma”.

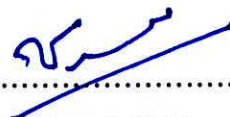
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ACKNOWLEDGEMENTS

It is my pleasure to express my great gratitude and appreciation to my supervisors Professor P. Wilson and Professor Jagath Wikramasinghe, University of Sri Jayawardenepura, Sri Lanka for their continued encouragement, valuable guidance and patience given to me during the preparation of this thesis. I have greatly benefited from the opportunity to learn under their supervision. My special thanks also go to late Professor W. A. Jayatissa, University of Sri Jayawardenepura, Sri Lanka for his valuable comments and suggestions. I also appreciate the kind assistance given to me by Senior Lecturer, Mr Wasantha Athukorala, (PhD student of Queensland University of Technology, Australia), University of Peradeniya, Sri Lanka especially with regard to econometric work.

I wish to express my sincere thanks to Head of the Department, Senior Lecturer Mr Chandra Kumara and other members of the Department of Economics and Faculty of Postgraduate Studies, the University of Sri Jayewardenepura, Sri Lanka for giving me an opportunity and providing facilities to undertake this study.

My thanks are due especially to late Professor Kamal Karunanayake for his valuable comments and supports. I am also grateful to late Professor Sirisena Tilakaratne, Mrs Mangalika Thanthirigama and Professor K. Dharmasena. My appreciation is also should go to my colleagues: Professor Herath Madana Bandara, Senior Lecturer, Dr Mrs K.U.A. Tennakoon, Senior Lecturer, Dr Mrs Ranitha Ratnayake, and Lecturer, Mrs Lakdini Seneviratna, University of Kelaniya, Sri lanka and also Mr Nalaka Gamage, Mrs Manjula Tennakoon, Mr R. B. Tennakoon Mr A. Samitha for their continued encouragement and valuable cooperation during the period of this study.

My thanks are also due to external examiners Professor, D. Atapattu, University of Ruhuna, Sri Lanka and Professor, S. M. P. Senanayake, University of Colombo, Sri Lanka for their valuable comments on the original draft of the thesis.

Finally, I should also pay my affectionate gratitude to my husband Pathi, two sons Chandana, Supun and daughter Dilini for the continuous encouragement and support they extended to me with dedication and helping me to devote time for the research work without interruption.

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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.

According to the causality test, the direction of causation is not towards from FDI to GDP growth but the direction goes from GDP growth to FDI. Among measures proposed in this connection is sound investment and financial polices to promote diversified FDI that needs to be well coordinated within the macro-economic policy framework, and the need for consistency, and firm commitment to such policies.