

PUBLIC DEBT & ECONOMIC GROWTH: EVIDENCE FROM SRI LANKA

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Abstract

One of the primary macroeconomic indicators that determines a country's standing globally is public debt. The relationship between public debt and economic growth has been extensively studied in several countries, and the effects of public debt on economic growth vary from country to country. Therefore, it is critical to conduct individual studies for each country. As a result, this analysis uses the most recent data available for the past 45 years to determine the relationship between public debt and economic growth in Sri Lanka. This was investigated utilizing econometric approaches and annual time series data from 1977 to 2021 in order to achieve the goal of determining how Sri Lanka's public debt affects economic growth. The normality and unit-roots values of the macroeconomic time series are examined using the Jacque Bera (JB) and Augmented Dickey-Fuller (ADF) tests, respectively. The short-run relationship of variables studied using the Error Correlation Model and the long-run relationship of variables analyzed using the Engel-Ganger residual-based model (ECM). The analysis demonstrates that Sri Lanka's governmental debt has increased during the study period on both public domestic debt and public external debt. Additionally, throughout that time the public external debt grew closer to the public domestic debt. Economic growth is negatively and significantly correlated with public debt, including public domestic debt, public external debt. In comparison to external debt, domestic debt has a strong negative impact on economic growth over the long term. Furthermore, domestic debt has a short-term negative impact on economic growth than external debt. Due to the negative consequences on economic growth and the need of using public debt effectively for Sri Lanka, this report advises the government to set some borrowing limits.

Keywords: *Economic growth, Public domestic debt, External debt*