The Impact of Government Debt on Economic Growth in Sri Lanka

P. T. S. Paranayapa[1] and L. A. S. Perera[2]
Department of Finance, University of Kelaniya, Sri Lanka[1,2]
pujanee.thisharika@gmail.com[1], shanakala@kln.ac.lk[2]

ABSTRACT

Introduction - This study is conducted to analyse the impact of government debt on economic growth and to determine the threshold level of government debt; in other words, a sustainable level of debt for Sri Lanka. Also to study the government debt behaviour over the past decade and to examine foreign financing disbursements and utilization.

Design/Methodology/Approach - Regression models used time series data covering the period from 1970 to 2019. This study applies ordinary least-squares regression to analyse the impact of government debt on economic growth in Sri Lanka. The discrete threshold regression model is used to determine the government debt threshold level for Sri Lanka.

Findings - According to the research findings, government debt has a negative and a significant impact on economic growth in Sri Lanka. The estimated optimal government debt threshold level is 71.82 percent of GDP. During the second term of Rajapaksa government, in nominal terms domestic debt was increased by 82 percent, whereas during Sirisena government the same was increased by 52 percent. Over the period from 2010 to 2017, foreign debt stock/GDP was lower than the domestic debt stock/GDP of the same period. However, in 2018 and 2019 foreign debt stock/GDP and domestic debt stock/GDP was evenly poised. During the period from 2013-2019 major portion of the disbursements was allocated to the transportation sector, water supply and sanitation, power and energy, education and training and health and social welfare.

Conclusion – This study confirms an existence of high government debt burden in Sri Lanka. Therefore, the Central Bank of Sri Lanka, Ministry of Finance, Foreign Ministry and other responsible government authorities should formulate effective debt management strategies that can be implemented to reduce the debt liability.

Keywords: *Government Debt, Economic Growth, Government Debt Threshold, Ordinary Least Squares Regression, Threshold Regression*