

The Study of the Effect of Financial Development on Income Inequality in Sri Lanka

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Abstract

Income inequality is an important economic issue faced by most of the developed and developing countries. Many attempts have been made to identify a link between economic growth and income inequality in Sri Lanka. But there is a lack of literature available to identify a link between financial development and income inequality in Sri Lanka. This paper basically investigates the effect of financial development on income inequality in Sri Lanka with a new framework. This study attempts to analyze the factors responsible for income inequality in Sri Lanka. In this study the Broad money to GDP and Domestic credit to the private sector by banks as a share of GDP are used to measure the direct impact of Financial Development and also used Inflation and Government expenditure as other variables which affect income inequality. This research presents the empirical evidences of Effect of Financial Development on Income Inequality in Sri Lanka for the period of 1980-2012. The test results also confirmed that there is a linear relationship between financial development and Income inequality. And also this paper emphasized that there is a positive relationship between Government expenditure and Income inequality.

Key words: *Financial Development, Income Inequality, Poverty, Sri Lank*