The Impact Of Financial Liberalization on the Sri Lankan Economy:1977-2012.

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This study examines the impact of financial liberalization on the Sri Lankan economy over the time series annual data from 1978 to 2012. The study examines the impact of financial liberalization on selected economic variables: domestic investment, savings, narrow and broad money and economic growth in the Sri Lanka economy. The Ordinary Least Square (OLS) method based on the Vector Auto Regression (VAR) model and the Granger Causality test were conducted to find out the long-term relationship among the variables concerned in the equations developed to test the hypotheses. An index has been constructed using six major components of financial liberalization namely; interest rate deregulation, reserve requirements and credit ceilings, international capital flows, banking sector entry and competition, securities market reforms and banking sector supervision. Principal Components Analysis (PCA) method is used to construct this index and, it is used as a proxy of financial liberalization to examine the impact of financial liberalization on economic growth, savings, investments and money demand in Sri Lanka.

The findings result include a confirmation of significant and positive long-term relationship between financial liberalization and economic growth in the Sri Lankan economy i.e., positive impact on national savings and on domestic investment. From the findings of the study, financial liberalization was found to have positively impacted on broad money and negatively impacted on narrow money in Sri Lanka. In terms of policy implications,effective role of the government in providing must play a leading role as a facilitator by providing appropriate legislation to strengthen the financial system, developing institutional setup, strengthening bank supervision allowing market forces to operate in the financial market. Are suggested

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