

DYNAMICS OF REAL EXPORTS AND REAL ECONOMIC GROWTHS IN SRI LANKA: EVIDENCE FROM CO INTEGRATION GRANGER CAUSALITY TESTS

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INTRODUCTION

The export-led growth hypothesis (ELGH) postulates that export expansion is a main determinant of economic growth. It holds that the overall growth of a country can be generated not only by increasing the amount of labor and capital within the economy, but also by expanding exports. Economists behind export-led growth hypothesis consider exports can perform as an "engine of growth". This type of advocacy has been generated from the following reasons: First, expansion in demand for the country's output through export growth facilitates the exploitation of economies of scale for small open economies. Second, exports expansion may relax foreign exchange constraints thus making it easier to import inputs to meet domestic demand, for output expansion. Third, expansion in exports may promote specialization in the production of export products, which in turn may boost the productivity level and may cause the general level of skills to rise in the export sector. This may then lead to a reallocation of resources from the (relatively) inefficient non-trade sector to the higher productive export sector. The productivity change may lead to output growth. Finally, an outward oriented trade policy may also give access to advanced technologies, learning by doing gains, and better management practices that may result in further efficiency gains. Thus, international trade and development theories suggest that export growth propelled by export-oriented policies contribute positively to economic growth (measured by output growth). It should be noted that the theory also suggests that output can affect export. A one-way causality from output to exports is justified by, for instance, Kaldor (1967), Lancaster (1980), and Krugman (1984). They argue that output growth has a positive impact on productivity growth and improved productivity or reduced unit cost is expected to facilitate exports. It could be interesting, from a policy making point of view, to study the causal nexus of exports and economic growth in Sri Lanka.

Research Problem

Do exports cause economic growth in Sri Lanka? Very few empirical studies have been done in the recent past to investigate the export led growth (ELG) hypothesis in Sri Lanka. Abhayaratne, A.S.P, 1996 Shirazi and Abdul Manap (2005), Dilrukshini (2007) find no support for the ELG hypothesis. However, other cointegration studies in Sri Lanka, Fernando and Colombage (2002), Ekanayake (1999) support the ELG hypothesis. They employed real export and real GDP data. The available evidence in relation to export-led growth in Sri Lanka appears rather mixed and contradictive. This study intends to answer the following questions:

- i. Is there any evidence for the export-led growth hypothesis in Sri Lanka?
- ii. Does any causality exist between exports and economic growth?
- iii. Is there existence of the long run equilibrium relationship between export and economic growth?

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OBJECTIVES

The main objective is to investigate the dynamic relationship between export growth and economic growth in Sri Lanka.

The specific objectives are:

- i. investigate the time series properties of Export and GDP growth in Sri Lanka
- ii. examine the long run equilibrium relationship
- iii. investigate the causality relationship between these variables
- iv. suggest policy implications.

METHODOLOGY

Data

The data used in this analysis are obtained from the various issues of the Annual Report of the Central Bank of Sri Lanka. The Consumer price index (CPI) price index is used to deflate the series. The series is transformed into natural logarithm terms. The variables used in this study are real GDP(LRGDP), real exports(LREX). The Sample period is from 1960 to 2010.

Analytical tools

This study uses various tools to study the objective of this study. Econographicology is used to understand the underlying dynamic behavior pattern of these variables. The unit root test is employed to identify the time series properties of the series. Co-integration and error correction model are used to examine the long run dynamic relationship between export growth and economic growth. Granger causality analysis is employed to investigate the causal relationship between export growth and economic growth.

Justification of Study

The motivation for undertaking this study is to confirm the validity or otherwise of the mixed results obtained in the empirical literature for Sri Lanka as well as other countries. The causality directions between economic growth and export growth have a very crucial role in policy implications. Therefore, this study is conducted to investigate the relationship between economic growth and export growth in Sri Lanka by using the recent time series econometric methodology, Engle –Granger causality test, co -integration and Error correction model.

Empirical Results

The results indicate that export growth, and economic growth, are integrated under one, $I(1)$. Hence, each variable is stationary in its first difference. The empirical results show that bi-direction long-run causality exists between real export growth and real GDP growth, and supports the existence of a "stable" long-runequilibrium relationship between real export growth and real GDP growth. The findings provide empirical support for the Export-Led growth paradigm for Sri Lanka and existence of the long- run relationship. R^2 statistics is very high and the Durbin –Watson (DW) test for autocorrelation in the error term indicates there may not be autocorrelation (value =1.80). Error correction model results show that every year 14% of the disequilibrium error is corrected.

CONCLUSION AND RECOMMENDATION

There are different opinions among economists about the relationship between export

growth and economic growth. In an attempt to resolve these disagreements, we examined the causality between exports and economic growth for Sri Lanka, using time series data from the Central Bank of Sri Lanka for the period of 1961 -2010. An assessment of the empirical evidence has been carried out using the co- integration , error correction model, and the Granger causality tests. The findings of the study validate the export-led growth hypothesis. The results have also confirmed the existence of long-run relationship between economic growth and exports. In addition, a bidirectional relationship between exports and economic growth has been found. These results support the previous finding of Fernando and Colombage (2002), Ekanayake (1999) that export-led to economic growth (ELG) is valid for Sri Lanka .

The policy implication of the positive relationship between exports and economic growth is that an expansion of exports will lead to an increase in economic growth . In addition , the increase in economic growth may also lead to an increase in exports. In this regard, the study recommends the diversification of export commodities, infrastructure development, maintenance of stable exchange rate and operationalization of export processing zones in Sri Lanka. Further, the positive relationship between exports and economic growth in Sri Lanka found by the study may also pave way for other research. Particularly other areas of study may examine the impact of structure change in exports on economic growth , impact of export diversification on economic growth or sector led growth in Sri Lanka . Addressing the endogeneity problem between exports and economic growth that is examining dual causality between the variables may also be another area of study.

The limitations of this study is that it uses only one country. The findings of this study cannot be generalized for the causality link nexus . Future research could focus on all South Asian countries and more variables. Finally , in the era of growing globalization and trade liberalization , the importance of exports cannot be overemphasized . In this regard , Sri Lanka undoubtedly needs to become competitive to be able to challenge the world market and realize its long -term goal of sustainable economic growth and development.

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