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EXPORT LED GROWTH HYPOTHESIS AND ITS VALIDITY FOR SRI LANKA

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An outward looking regime favours the productivity performance of developed as well as developing market economies. In the literature, causality from exports to economic growth in terms of real output growth is recognized as the Export Led Growth (ELG) hypothesis. Larger exports contribute to the stock of knowledge, human capital and output. Thus ELG hypothesis postulates a positive relationship between exports and economic growth.

This research aims to test the applicability of the ELG hypothesis in the context of Sri Lanka. Moreover it aims at identifying any causality relationship between exports and GDP growth during the period 1960 to 2010. For the purpose of this analysis, data on constant exports and constant GDP (SLR) in Sri Lanka from 1960 to 2010 is obtained from the World Development Indicators website. This analysis employs time series methods such as unit root test and cointegration (Simple Regression Analysis) to examine the dynamic relationship between export growth and economic growth. The model is developed using E-views 3.1.

The estimated equation based on the sample, suggests that when everything else is held constant, a 1% increase in Constant Exports will on average lead to an increase in Constant GDP by 1.003%. Thus there is a positive relationship between the two variables. However we infer that there is no cointegration and cohabitation between constant GDP and constant exports based on cointegration test. This indicates that the two variables do not move in the same direction in the long run. Perhaps this could be due to the omission of other important variables that affect GDP in Sri Lanka.

Appropriate macroeconomic policies such as low fiscal deficit, low inflation and a flexible and realistic exchange rate policy are important for vital export growth. Neglecting these while using micro strategies to encourage exports would fail. However, from a policy point of view, it is recommended that some institutional bottlenecks and or structural problems including tariff reforms might explain the failure of the ELG hypothesis. Therefore, rather than rejecting the ELG hypothesis and export-oriented policies, the country might cautiously need to look at its structural problems.

Keywords: *Exports, GDP, Economic Growth, Developing Countries, Good Governance*