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DOMESTIC SAVINGS AND FINANCIAL SECTOR DEVELOPMENT IN SRI LANKA

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ABSTRACT

Economic growth is an important macroeconomic objective in every economy. It is a general condition even in Sri Lanka. In order to maintain a high economic growth, it is important to keep up the level of investments. If Sri Lanka could able to fulfill the needs of total investment resources domestically, it will result in sustainable economic growth. Therefore, it is necessary to develop the financial resources domestically. In order to do that, it is important the development of domestic savings. There are three sectors that contribute to the Sri Lankan domestic savings which is, Government, Firms and Household sector. Among these three sectors household sector has emphasized because of the highest contribution. Therefore, whenever put an effort to develop the domestic savings of Sri Lanka, it is important to pay special attention to the household sector. Before 1987 the government sector has contributed to the domestic savings in a low degree. Furthermore, it has shown a minus value after 1987. Therefore, in present domestic savings are totally depend on the private savings. There are several factors that effect on private savings has identified in savings theory and empirical studies regarding savings. Among those the development in finance sector has been identified as the most crucial factor. In Sri Lanka the development in finance sector after the 1977 caused to the development in financial intermediating activities too. The competition and the development in banking and non- banking sector caused to generate the competitive interest rates. Therefore, it has helped to promote the savings and these situations had an effect on domestic savings.

In this case, this study is an effort to identify the relationship between domestic savings and financial sector development in Sri Lanka. In fact, when analyzing the data of the period 1977- 2015 has confirmed that there's a positive relationship between domestic savings and the financial sector development in Sri Lanka.

INTRODUCTION

Economic growth is an important element in the process of development in every country. As such, most of the theories of growth have contended the growth in investments have identified as the major aspect among the factors that should fulfilled for the economic growth. (Slow, 1956; Romer, 1986; Lucus, 1988). There are two approaches to develop the investments such as, domestic and international. Growth in domestic investments have identified as an important aspect towards sustainable economic growth since depending on the international sources have a negative impact on long term investments. In order to develop domestic investments, it is an important condition to develop the savings of the country. Therefore, the development in domestic savings can caused to faithful and sustainable growth in domestic investments (Fernando, 1991).

Table No. 01 – Domestic savings rate in Sri Lanka

Year	Savings rate
1980	11.2
1985	11.9
1990	14.3
1995	15.3
2000	17.3
2005	17.2
2010	17.9
2015	22.6

Sources: Annual reports - Central Bank of Sri Lanka

According to table no. 1 savings rate in Sri Lanka has increased during past three and half decades. The main reason behind the growth in domestic saving is the growth in "private "savings. The factors that caused for private savings development are, the level of income, interest rate, financial intermediation, price level, household expectations, education, dependent rate and living expectations (Collins, 1991; Modigliani, 1990; Sahoo and Dash, 2013).

After being independent, Sri Lanka has started many projects to develop the economy since last six and half decades. In every attempt the only objective was to gain a rapid economic growth. Thus, the last six and half decades has shown only an average rate of five percent as the growth rate. This has been a below level as was expected. The main reason behind this was the low level of investments. Savings are important in order to increase the investments. In fact, there is a positive relationship between investments and savings (Modigliani, 1990; Japplei and Pagano, 1994; Edwards, 1995; Collins, 1991; Fry, 1978). Growth in savings can caused to several sectors such as, increment in investments, domestic production and the standards of living. In a situation like this, it is important to identify and analyze the factors that effect on the savings of the economy and how it can use or improvements of savings. Therefore, main aim of this study is to identify the effect of the development in financial sector on domestic savings. Mekinnon and Show have provided the theoretical basis for the above analysis (Mekinnon, 1973; Show, 1973).

LITERATURE REVIEW

When preparing the economic policies, every country in the world present the idea of maintaining a high domestic savings rate would cause to economic growth. As an example, the countries like South Korea, Taiwan, Malaysia, Indonesia, Philippines, China and Hong Kong have gained high economic growth because of the high savings rate that those countries have maintained. Empirical studies regarding developing countries have confirmed this factor (Gupta, 1987). Especially, in 1980 after the globalization many countries including above mentioned have achieved rapid growth in financial sector. Therefore, many researchers have come up with the idea of studies about the impact of macroeconomic factors on growth of financial sector and the studies have resulted that there is a positive relationship between growth of the financial sector and domestic savings (Edwards, 1996; Dayal, Gulati and Thimaan, 1977; Kelly and Movrotas, 2001; Kelly and Movrotas, 2003; Kelly and Movrotas, 2008; Yong et al., 2008; Touny, 2008; Wong et al., 2012; Sharma and Kumar, 2013; Shahbaz et al., 2013; Sahoo and Dash, 2013). According to Edwards, (1996) mentioned that study of data at the time period of 1970- 1992 mainly on Latin America and other 36 countries have identified that there is a positive relationship between growth rate of financial sector and private savings. Similarly, Dayal, Gulati and Thimaan, (1997) identified that the positive link between growth in financial sector and private savings in the study of factors affecting private savings regard with Southeast Asian countries and 14 other Latin American countries with the collected data at the time period of 1975- 1995. Likewise, Kelly and Movrotas, (2001) contended that according to the data of the period 1972- 1997 has identified there is a half a positive linkage between private savings and growth in financial sector in the study of relationship between private savings and growth in financial market. In 2003, The study has conducted in Sri Lanka with the data of the period 1970- 1997 has proven that there's a positive link between private savings and growth of financial sector development (Kelly and Movrotas, 2003). Moreover, Kelly and Movrotas, (2008) stated that the study conducted in 17 South African countries with the data of the year 1972- 1994 has shown that there is a positive link between private savings and development of financial sector. Furthermore, Touny, (2008) mentioned that a research from data between the year 1975- 2006 in Egypt result that development of financial sector and real Interest rate has a positive impact on domestic savings. According to Park and Shin (2009) reported that a study conducted with 137 countries during the period 1965- 2004 has shown the result of positive link between development of financial sector and economic growth on savings rate. Wong et al., (2012) has conducted a research in 31 OECD countries and 12 East Asian countries with the data at the time period of 1960- 2008 has resulted development in financial sector has a positive impact on domestic savings. Sahoo and Dash 2013 shown that there is a positive relationship between development in financial sector, real interest rate and economic growth on domestic savings in their study of the countries regarding India Pakistan Sri Lanka Bangladesh and Nepal with the data between 1975 – 2010. Moreover, Sharma and Kumar 2013 mentioned that in order to identify the impact of development in financial sector on savings and capital formation and they have been conducted research in India by the period 1950 – 2011 and identified that development in financial sector has a positive impact on domestic savings. Finally, Shahbaz et al ., 2013 has conducted a research in Pakistan in order to identify the relationship between development in financial sector, domestic savings and poverty and it resulted that there is an impact of development in financial sector on domestic savings.

METHODOLOGY

This study has conducted using secondary data and data resources such as magazines past studies books, organizational reports etc. In order to analyze and synthesize the data, the descriptive and statistical methods have been used.

Under this simple and multiple regression analysis have used with the data of the period 1977- 2015. The equation of regression models as follows,

$$Y = \beta_0 + \beta_1 X + u$$
$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + u$$

The following relationship has estimated to measure the simple regression analysis,

$$Y = f(FIR)$$

The following relationship has estimated to measure the multiple regression analysis,

$$Y = f(FIR, r)$$

FIR= Financial Intermediation Rate
r = Interest rate

The growth of deposit to relatively growth of financial sector in formal financial sector present by the FIR. This rate calculates as follows.

$$FIR = \frac{\Delta TDB}{\Delta TBB} \times 100$$

Where, TDB is total deposits of licensed and special licensed banks and TBB is total branches of licensed and special licensed banks.

DATA ANALYSIS

A multiple regression analysis has estimated in order to identify the impact of financial sector development and interest rate on domestic savings with the data of the period 1977-2015. The regression analysis has built based on the following equation.

$$Y = \beta_0 + \beta_1 FIR + \beta_2 r + u$$

The regression co-efficiencies of the above multiple regressions has shown in the table no.2 as follows,

Table no.2

Relationship between domestic savings, financial intermediation rate and interest rate (1977- 2015)

Variables	Coefficients	P values
Constant	184785.3	0.007
FIR	848.28	0.000
r	-13059.3	0.007
R^2	0.829	

The different researches conducted in economic theories have shown the positive impact of financial sector development on domestic savings. According to table no.2 estimated regression analysis has shown the positive relationship between financial intermediation and domestic savings. Therefore, it's visible that there is a positive impact of development in financial sector on domestic savings.

To prove this fact further, a simple regression analysis has built based on the following equation,

$$Y = \beta_0 + \beta_1 FIR + u$$

The regression co-efficiencies of the above single regression has shown in the table no.3 as follows,

Table no.3

Relationship between domestic savings and financial intermediation rate (1977-2015)

Variables	Coefficients	P values
Constant	2027.1	0.089
FIR	1106.4	0.000
R^2	0.761	

According to table no.3 estimated regression analysis has shown the positive impact of financial intermediating on domestic savings. Therefore, it's visible that there is a favorable relationship between development in financial sector on domestic savings.

CONCLUSION

The study has conducted by the author with the data of the period 1977- 2015 have found the development in financial sector of Sri Lanka has a positive relationship with domestic savings. Furthermore, several studies have conducted in deferent countries also identify the impact of development in financial sector on domestic savings. Thus, the fact has proven even in Sri Lanka.

RECOMMENDATIONS

Financial activities in the rural sector would not developed enough and the lack in financial instruments have become obstacle to the savings development in rural sector. Therefore, it is useful to extent the financial intermediating activities in rural and state sector because financial organizations more concern with urban and suburb areas when they are commencing new branches. And it would help to increase the financial sector development in rural and state sector.

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