DEVELOPMENT OF FINANCIAL INTERMEDIATION IN SRI LANKA: A GENERAL TO SPECIFIC APPROACH

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This study undertakes theoretical and empirical investigation of financial intermediation development in Sri Lanka during the post liberalization period. The purpose of study is to identify the major determinants of financial intermediation development in Sri Lanka for the period 1978 to 2013. The study incorporates macro approach to capture the available empirical data. The analysis of the study was broadly carried out on the basis of deductive research methodology. That is the investigation will start with formulation of the relevant theoretical framework and match the theory with available information. Accordingly, study develops a general model for financial intermediation development and subsequently this model applies for country specific analysis. The results are obtained using time series econometrics analysis, which involves unit root, co-integration and causality tests. The theoretical literature on financial intermediation classified under traditional and modern theory of financial intermediation. Although, traditional theories do explain an important thing about financial development, it fails to identify other important factors in financial intermediation in the current global setting. Those factors are taken into account under the modern theory of financial intermediation. This study highlights the importance of more integrated approach in order to explain finance growth nexus in developing countries. The development of general model on financial intermediation provides the basis for the integrated approach. The development of financial sector is impressive during the post liberalization period. The study develops financial development index using principle factor component analysis to capture level of financial development in Sri Lanka. The said index shows a moderate growth in Sri Lanka throughout the period. The econometrics analysis confirmed that broad money ratio, national savings, real interest rates, external assets, public borrowings, interest rate spread and inflation rate as the major determinants of financial intermediation development in Sri Lanka. The findings of the study will enrich empirical literature and provide guidelines for rational policy formulation and implementation in order to uplift financial system for achieving sustainable development.

Keywords: Co-integration,Financial intermediation, Financial system, General model