

Does Oil Price Effect the Gross Domestic Product of Sri Lanka?

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Energy is one of the critical determinants of economic growth, development, and welfare status of any country in the world. The impact of oil price changes on macroeconomic variables is mostly documented in academia and the degree of impacts are varied from energy-exporting vs. importing countries, dependency on non-renewable energy vs. renewable energy, and small country vs. large country. In this context, this study aimed to explore the impact of oil price changes on economic growth in Sri Lanka by employing time-series econometric techniques. The period covered by the study was 1987 to 2017, which coincides with the open economic policy phase. The unit root test revealed that all the variables become stationary at their first difference form. The Johansen Co-integration test confirmed the existence of a long-run association between variables. The Vector Error Correction Model indicated the negative impact of local oil prices on the Gross Domestic Product in Sri Lanka. The negative impact of oil price changes on economic growth in Sri Lanka was mainly due to the higher dependency on imported energy (fossil fuel), inadequate adoption of energy-efficient technologies in the production system, inadequate focus on alternative or renewable energy sources by the economy, higher dependency on traditional export items, and less responsiveness of supply-side adjustment to price changes or exchange rate depreciation to enhance export. The study emphasized the need to move the economy towards renewable energy sources and the adoption of energy-efficient technologies in the production system to minimize the adverse fallouts of the oil crisis in the world market on the economic development of the country.

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