

IMPACT OF CAPITAL FLIGHT ON EXCHANGE RATE AND ECONOMIC GROWTH IN SRI LANKA

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Capital flight is one of the most important problems for developing countries which often lack the necessary financial resources to promote growth and development. Capital-flight is a large-scale exodus of financial assets and capital from a nation due to events such as political or economic instability, currency devaluation or the imposition of capital controls. The UK Overseas Development Institute (ODI) defines capital flight as “The outflow of resident capital which is motivated by economic and political uncertainty. Capital flight has been a source of major concern in developing countries, especially in Africa, where there is shortage of capital essential for development. Capital flight from resource starved countries to economically advanced countries is viewed as a diversion of domestic savings away from financing domestic real investment and in favor of foreign financial investment. Consequently , the pace of growth and development of the economy is retarded. More so, since it involves transferring capital to foreign countries, it encourages increasing demand for foreign currency, especially dollar, which tends to exert pressure on exchange rate. The objective of this paper is to examine the impact of capital flight on exchange rate and economic growth in Sri Lanka for the period 1990 - 2017, using OLS method to analyze the secondary data obtained through the Central Bank of Sri Lanka, World Bank Database and other sources. The findings indicate that capital flight has a negative and statistically significant impact on the exchange rate while positive and statistically significant impact on the Economic Growth in Sri Lanka, and in contrast to previous work, capital flight has a positive effect on economic growth in different countries. Based on the findings, recommendations were made on how to check the menace of capital flight in countries, especially Sri Lanka. Among such recommendations is the need for further training for the Sri Lankan customs so as to improve their effectiveness in tackling cases of misinvoiced imports and exports.

Keywords: *Capital Flight, Exchange rate, Economic Growth, OLS Method*