Tax Revenue and Government Expenditure in Sri Lanka: A Cointegration Analysis

Mohamed Aslam, AL*

Abstract

In the global economic administration, tax revenue has been identified as the engine of the government expenditure, but the relationship of them was not investigated econometrically, this situation formulated a research gap for tasting the relationship of them. The aim of this study was to examine the Cointegration relationship among the tax revenue and the government expenditure in Sri Lanka. This study considered two time series variables such as the tax revenue and the government expenditure. The tax revenue was considered as the independent variable and the government expenditure was considered as the dependent variable. The sample period of this study was from 1950 to 2013.The Cointegration technique was used to check the long run relationship and the Error Correction Mechanism (ECM) was employed to investigate the short run behavior of the tax revenue on the government expenditure. According to the empirical results, the R- squared of the estimated model was 0.99. In the meantime, the Durbin Watson statistics was 0.828. However, this model did not suffer from the spurious problem because the residual of this model was stationary. The tax revenue has sustained positive relationship with government expenditure. And also, the partial coefficients of tax revenue and its probability values in the estimated model were 0.695 (0.000) in short run and 1.031 (0.000) in long run periods. Therefore, the tax revenue and government expenditure had cointegrated at level form I(0) and maintained the long and short run relationship between them.

Key word: Government Expenditure, Tax Revenue, Fiscal policy, Economic development, Surpluses and Deficit

To whom correspondence should be addressed: mohamedaslamalm@gmail.com

* Sri Lanka Planning Service, Ministry of National Policy Planning, Colombo.