Sri Lanka
State of the Economy Report 2012

Chapter 11
Looking Beneath Global Ranking and Sri Lanka

by
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11. Looking Beneath Global Rankings and Sri Lanka

11.1 Introduction

An online search of global rankings of countries brings up a dizzying array of indices. From government and gender to competitiveness and corruption, there is an index for nearly everything. Some are relatively obscure and infrequent, while others receive global attention, are published annually, and feature prominently in the policy discourse. Some, like the 'Doing Business Index', are especially relevant to Sri Lanka and their findings particularly important to take note of, and address the challenges that they bring to light. Others, like the 'Most Expensive Cities in the World Survey,' may not be especially relevant for a country like Sri Lanka. Many indices provide room for governments and policymakers to take action to improve a country's rankings, while others use fairly abstract information and measure characteristics of a national economy which are harder to address. There are also differences in the information sources used to compile the rankings. Some indices use annual perceptions surveys which are standardized across countries, while other indices are composites of further indices. The 'Global Competitiveness Index,' for example, uses executive opinion surveys with structured questionnaires standardized across all countries the survey is carried out in. Meanwhile, indices like the 'Index of Economic Freedom' and 'Economic Freedom of the World' are compiled mostly by using existing secondary data sources from organizations like the World Bank, IMF, and Economist Intelligence Unit (EIU).

> ***"Exploring the mainsprings of global ranking indices would expose important policy handicaps, while giving policymakers a clearer insight to help boost Sri Lanka's performance in global rankings"***

11.2 Global Indices - Take With a Pinch of Salt?

Compiling global indices that are free of controversy or contention is not easy. Using, for example, measures of economic freedom in comparisons across countries is questionable given various concerns regarding their reliability. On the theoretical side, in the final analysis, many indices are not very sensitive to substantial variations in the weights of different components. Comparisons are also marred by differ-

ences in collecting statistical data across countries, on which these indices are based. The data collection processes themselves have come under severe criticism.[1]

However, it must be stated that while the appropriateness of a particular index or the credibility and accuracy of its findings deserve questioning, and politicians and bureaucrats often do have serious contentions with these indices (particularly when the country performs poorly on certain indicators), it cannot be denied that many of these global indices are widely published and gain global attention. This makes it crucial that they are duly recognized by national governments and are taken seriously. Particularly for a country like Sri Lanka, with a small open economy competing for trade and investment with other dynamic players in the region, these indices ought to matter. Often, when investors arrive in a country to arrange investment deals, they cite the country's performance on these indices, and negotiate based on them. This is a particular challenge for investment promotion agencies, like the BOI, where investors would negotiate tax breaks and generous fiscal and other concessions, based on the country's good or weak performance on global indices. This was a particular challenge during the conflict era in Sri Lanka.

Yet, despite domestic media featuring quite heavily several of the indices relevant to contemporary Sri Lanka when they are released globally, and with government officials and politicians frequently citing Sri Lanka's improvements on them, there is very little debate and discussion on these indices; their appropriateness, their accuracy, their relevance, their measurement, or indeed how best to address the policy challenges that they pose. This discussion is a preliminary attempt at drawing out these issues using a selected set of global indices, in the hope that it stirs a deeper debate.

11.3 Doing Business Index

The 'Doing Business Index' (DBI) prepared by the World Bank, is an index that ranks countries according the 'ease of doing business,' within their borders. A fundamental premise of the DBI is that economic activity requires good rules, including well defined property rights, rules that increase the predictability of economic interactions and rules that provide contractual partners with core protections against abuse.[2] The DBI looks at domestic, primarily small and medium-sized companies, and measures the regulations applying to them.

Data for the DBI is collected in a standardized way, and the countries are evaluated according to various aspects related to the ease of doing business -- starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. One of the key features of the DBI is that it not only highlights the extent of specific regulatory obstacles to business, but also identifies their source and points to what might be reformed.

In 2012, Sri Lanka was ranked at 89 out of 133 countries, just above China (91) and Vietnam (98), and well above Bangladesh (122), Indonesia (129) and India (132). Singapore, Hong Kong and New Zealand were ranked as the top three countries in the DBI for that year.

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[1] Anecdotal evidence in the past suggests instances where surveys are conducted by foreign consultants at the departure lounge of the Sri Lankan airport, with interviews being carried out fleetingly with one locally-based consultancy firm.

[2] World Bank and IFC (2012), *Doing Business 2012*, World Bank and International Finance Corporation, Washington D.C.

Box 11.1
Issues with the DBI Methodology

The methodology of the DBI is claimed to be transparent; using factual information about what laws and regulations say, and allowing multiple interactions with local respondents to clarify any possible misinterpretations of questions. However, a World Bank (2008) report titled "Doing Business: An Independent Evaluation," found issues in its transparency as the DBI makes ongoing changes to previously presented data that would affect already ranked countries. The report recommended that the DBI web site "disclose all data corrections and changes as they are made, explaining their effect on the rankings to rectify this error" (p. xvii).

Another problem in the DBI methodology is that it assumes that a business has full information on what procedures are required and does not waste time when completing procedures. However, in reality, completing a procedure may take longer if the business lacks information or is unable to follow up promptly. Likewise, the business may choose to disregard some burdensome procedures or may find informal ways of side-stepping them. For both reasons the time delays reported in the DBI would differ from surveys based on perception.

Despite the fairly good data collection methodology discussed above, the DBI does have a few limitations that Sri Lankan stakeholders must be cognizant of when interpreting the data. These have, in fact, been acknowledged in the report itself. One of its major drawbacks is that the collected data refers to the businesses in the 'economy's largest business city' and may not be representative of regulations in other parts of the country.[3] This is particularly relevant to a country like Sri Lanka as the differences between the business environment in Colombo and the rest of the country can be quite significant. Local government regulations pertaining to business registration, trade licenses, etc., can be tedious, and can also vary widely according to the capabilities and business-friendly nature of each local authority. This was clearly revealed in an assessment conducted by The Asia Foundation (TAF) – the Economic Governance Index[4] which evaluated the business environment for private enterprises in the regions through perceptions surveys of stakeholders at the local level.

A particular indicator on which Sri Lanka might be unfairly penalized for is in the 'taxes, incentives and paying taxes' pillar. In Sri Lanka, the statutory contributions to the Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF) pension funds have been counted as separate payments – a total of 24 payments. It is reported that the CBSL is negotiating the status of these payments with the International Finance Corporation (IFC) to consider these payments as one per year, per fund.[5] The same is true of VAT payments, for which the Inland Revenue Department allows payments every quarter (considering cash flow issues of smaller firms), but the DBI has assumed these are excessive multiple tax payments and it results in lower scores on the 'paying taxes' pillar.

Time lags are also an issue, as reforms made in the current year may not be captured in

[3] *Ibid*.

[4] The EGI, thus ranks 48 Municipal and Urban Council localities across 7 of the 9 provinces in Sri Lanka. The survey spans 4,969 firms within 48 Local Authority boundaries, consisting of 15 Municipal Councils and 33 Urban Councils. See TAF (2007), *Economic Governance Index: A Measure of the Local Enabling Environment for Private Enterprise in Sri Lanka*.

[5] 'Improving the Business Climate in Sri Lanka', *The Island*, available at http://www.island.lk/index.php? pagecat = article-details&page = article-details&code_title = 41627

that year's report. For instance in Sri Lanka, in 2011, the Ministry of Finance reduced rates of a number of direct and indirect taxes as well as eliminated some. However, these did not get reflected in the 2011 DBI report.

Through a high-level government task-force, efforts are underway to address weaknesses highlighted in the DBI with the goal of improving Sri Lanka's ranking, in turn with the intention to improve Sri Lanka's attractiveness to foreign investors. Yet, there is a critical flaw in this approach because the DBI is based on the ease of doing business for domestic, particularly small and medium-sized businesses, as clearly articulated in methodology sections of DBI reports. In other words, the benchmark firm of the DBI is not a foreign firm, but a domestic one. Therefore, business regulation issues that particularly impact foreign investors may not get captured. Also, the issues faced by larger firms may also be missed.

Therefore, focusing exclusively on rising up the DBI rankings and assuming that it is the complete remedy to the country's business regulation bottlenecks may not be prudent.

11.4 Network Readiness Index

The 'Network Readiness Index' (NRI) measures the degree to which developed and developing countries across the world leverage ICT to enhance competitiveness. It is a part of the Global Information Technology Report (GITR) produced by the World Economic Forum (WEF) in collaboration with the INSEAD Business School.

NRI comprises of three sub-indices that measure the environment for ICT in a country. These three sub-indices are; the environment sub-index, the readiness sub-index and the usage sub-index. Under these sub-indices, NRI covers a total of nine pillars and 71 variables. The final NRI score is a simple average of the three composing sub-index scores, while each sub- index's score is a simple average of those of the composing pillars. In doing this, the index assumes that all components contribute equally to national 'network readiness.'

In the latest rankings, out of the 133 countries listed in 2012, Sri Lanka is ranked 71st with a score of 3.88. However, its position among the South and South East Asian countries appears to have improved considerably. It is now ahead of Thailand (77) and Indonesia (80), and just behind India (69). But it is important to point out that these latest rankings of the index cannot be compared with previous years as the index has now been "radically reworked" for the 2012 report.[6] Therefore, it can only be used as a figure to identify Sri Lanka's position against the rest of the world for 2012 and not for measuring improvement in, or deterioration of, the ICT environment in the country.

Among ICT-related global indices, the NRI has the most number of indicators and uses a combination of survey, quantitative and qualitative data. Since the indicators cover a wide array of ICT-related dimensions, as well as other dimensions that are not directly related to ICTs but may impact ICT environment, usage and readiness, the NRI is considered to be fairly comprehensive in its coverage.

11.5 Indices of Economic Freedom

There are a number of indices that measure economic freedom, but the 'Economic Freedom of the World Index' (EFW) is the most widely recognized due to its coverage of a

[6] http://lirneasia.net/2012/04/revamped-network-readiness-index-for-2012-out/.

Box 11.2
Key Concerns with the NRI

The NRI also has a few weaknesses. Even though the NRI is credited for having a fairly comprehensive coverage, as it includes indicators directly and indirectly related to ICT, it does not have a weighted system in which the indicators are weighed according to their relevance. For example, state of cluster development, number of utility patents, subsidies for R&D, administrative burden, efficiency of tax system, overall infrastructure quality, extent of staff training are factors common to a number of industries and may have little direct connection with the ICT environment, readiness, or usage per se. However, these indicators are also given the same weight, resulting in a country that would score higher on the aforementioned indicators, even though other direct indicators that are directly related to ICT are weaker.[7] The reverse is also true. This poses a challenge for national apex ICT bodies, like Sri Lanka's ICTA, who are constantly under pressure to improve country performance on global ICT-related rankings. However, due to the aforementioned nuances, which officials may not always be aware of, such ICT agencies may receive undue criticism of failing to deliver improved performances on these indicators.

Another problem that arises is that although the NRI is said to use 53 indicators in total to calculate the figures, the report only provides the scores for the main nine sub-indices. Under each of these sub-indices, there are other indicators that are indirectly or directly related to the ICT environment. However, as the report only gives the scores of the overall sub-indices (political and regulatory framework, business and innovation, infrastructure and digital content, affordability, skills, etc.) it is difficult to determine whether the direct indicators had more of an impact on the overall NRI score or whether it is a result of the indirect indicators. For example, variables like effectiveness of law-making bodies, efficiency of the legal system in settling disputes, laws relating to ICT, intellectual property protection fall under political and regulatory framework and are all given the same weightage, but in reality they have varying degrees of relevance to the ICT environment of the country. Since the report does not go beyond the 9 sub-indices, it is difficult to fully dissect which of the 53 indicators had more of an impact on determining the country's NRI score.

While the NRI includes several indirectly related indicators, it is also criticized for missing out some key indicators that are more directly related to the ICT environment. For example, it does not have an indicator that looks at market concentration (with measures like the Herfindahl-Hirschman Index, for instance) or degree of competition in ICT markets. A potential investor would be interested to know if the barriers to entry into a market, for example the telecoms market, are high or low. There are no indicators to measure mobile, fixed line, and internet growth. These areas undergo continuous, rapid change and this makes accurate and up-to-date measurement difficult, if not impossible. Nevertheless, these are critical forces shaping the ICT sector and should be considered as important components. Likewise, measuring the total investment in ICTs by businesses in a country may provide a better picture of usage than the current indicators, but the NRI does not include such components.

longer time period.[8] The EFW is an attempt by the Fraser Institute, based in Canada, to measure the degree of economic freedom in countries around the world. Another popular index that measures the same concept is the 'Economic Freedom Index' (EFI) by the

[7] Goswami, D., (2006), "A Review of the Network Readiness Index", < http://www.regulateonline.org/content/view/823/74/1/.

[8] Dawson, John W., (2007), "The Empirical Institution-Growth Literature: Is Something Amiss at the Top?", *Econ Journal Watch*, Vol. 4, No. 2, pp. 184-196.

Heritage Foundation, a US-based conservative think-tank and the Wall Street Journal, a news agency.

The EFW uses 42 data points to formulate a summary index and to measure the degree of economic freedom in terms of size of government (expenditures, taxes, and enterprises), legal structure and security of property rights, access to sound money, freedom to trade internationally, and regulation of credit, labour, and business. The index rarely uses domestic data sources within the country and tends to rely primarily on external sources such as the IMF, World Bank, and WEF.[9]

The EFI is a series of 10 economic measurements created by the Heritage Foundation which touch on various aspects of economic freedom in a country. These areas are business freedom, trade freedom, government spending, fiscal freedom, monetary freedom, investment freedom, financial freedom, freedom from corruption, and labour freedom.[10] Each of the 10 areas is scored out of 100 with 100 being the highest level of economic freedom. The methodology however, has changed over time as various new data sources become available. For example, in 2007, labour freedom was given its own indicator with the increased availability of labour data.

In the latest reports of the EFW (2009), Sri Lanka is ranked 107 with a score of 6.12 (scored from 1 to 10), and for the EFI (2012) ranked 97 with a score of 58.3 (scored from 1 to 100) for the EFI. In the EFW index, Sri Lanka is ranked below most other South Asian and South East Asian countries, but in the EFI Sri Lanka is ranked above India, Pakistan and China.

However, there are a few concerns one should be mindful of. One main issue that arises is related to comparisons between countries. Such country comparisons are flawed to some extent because the differences in collecting data across countries are not accounted for. This can be particularly observed in the Sri Lankan context, in the pillar of labour freedom. Indeed, "the EFW index depicts Sri Lanka as doing well, above both the regional and developing country averages. However, this is hard to explain, given rigid labour market regulations in the country. Sri Lanka's TEWA requires that firms with 15 or more employees must justify layoffs and provide generous benefits to displaced workers. The redundancy cost in terms of number of weeks of salary that is required to be paid in Sri Lanka is a staggering 217, compared to 56 and 87 in India and Vietnam respectively."[11]

11.6 Global Competitiveness Index

The 'Global Competitiveness Index' (GCI) is an annual index, covering 142 economies around the world, constructed by the WEF that aims to rank countries according to the level of competitiveness of their economies.

The GCI identifies 12 pillars that drive productivity and competitiveness in an economy. These pillars include institutions, infrastructure, health and primary education, labour market efficiency, technological readiness, and innovation. These pillars are given a weighted average, depending on their impact on the country's competitiveness. The index consists of over 100 different variables; two-thirds of it comes from the executive opinion survey carried out by various partner institutions in each country, and one-third comes from other publicly available sources.

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[9] Gwartney. J, R. Lawson and J. Hall (2011), *Economic Freedom of the World: 2011 Annual Report,* Fraser Institute, Canada.

[10] The Heritage Foundation website, available at http://www.heritage.org.

[11] Abeysekera, A., and A. Wijesinha (2011), Talking Economics, IPS Blog, available at http://www.ips.lk/talkingeconomics/ 2011/07/economic-freedom-involving-stakeholders-in-improving-the-business-regulatory-environment-in-sri-lanka/.

Box 11.3
Economic Freedom - Imposing Ideology?

These indices are considered as important indicators of growth in a country as the literature posits that economic freedom is positively correlated with economic growth. However, with the developmental-state model followed in the dynamic East Asian economies, and the emergence of heterodox economic ideologies that challenge mainstream, neo-liberal economic thinking that advocates little to no government role in the economy and free markets, the suitability of examining economic freedom as measured by these indices and its relationship to economic growth has come in to question. In fact, many have gone to the extent of referring to the EFI, which is a product of the Heritage Foundation and the Wall Street Journal, as being a measurement that enforces liberal policy thinking as the measures used to determine economic freedom, and are very selective and often considered debatable. The problem here arises when the level of economic freedom of a country is used to make assumptions regarding its growth and development. Although there is a positive relationship between these two factors, it can be argued that the effect of business regulations is more important than reduced government consumption, for instance. In fact, some of the countries ranked highest in the EFW are Nordic states like Finland, Sweden, and Denmark which have extensive, publicly-funded welfare policies. Therefore, it is safe to assume that the various paths taken by countries to achieve growth and development are far more complex and intricate than what is indicated by these indices and that it is a vital aspect that needs to be taken into account.

Sri Lanka is ranked at 52 out of a 142 countries in the latest GCI report with an overall score of 4.33. It is above all the South Asian countries listed in the 2011-2012 rankings, including India (56). Switzerland, Singapore and Sweden are the top three countries ranked in this index.

Box 11.4
GCI - Contentions on 'Competitiveness'

Although the GCI is widely known as a well crafted measure of a country's level of competitiveness, there are some contentions regarding the concept of 'competitiveness' and its usefulness. The concept originates mainly from business school literature in which the competitiveness of companies is measured relative to their market share and profitability.[12] When this concept is transferred to a national economy, questions arise regarding its relevance and necessity. For instance, if country A produces textiles and its textile market share increased in 2012, it is meaningful to say that country A has become more competitive in producing textiles but would it be as meaningful to say that country A is less or more competitive as an economy in 2012? The answer may vary according to individual interpretations of the issue, but it is still an interesting question worth probing further, when using indices such as the GCI, to make judgments about a country's economy. However, assuming that the answer would be 'yes' to the above, the GCI is still problematic as it only looks at competitiveness from the macro-level and fails to provide insights into the competitiveness of separate sectors (i.e., textiles, computers, etc.) that impact the level of competitiveness of the economy as a whole.

[12] Lall, S., (2001), "Competitiveness and Developing Countries: An Economic Evaluation of the Global Competitiveness Report", *World Development*, Vol.29.

The GCI is also often used as a tool to measure the yearly performance of a country but it is important to keep in mind that a country accelerating its rankings may not necessarily be a reflection of the country's improved competitiveness; rankings are relative to other countries. For example, Sri Lanka's improvement in terms of rankings could be due to an increase in competitiveness in Sri Lanka or a decrease in competitiveness of other countries. For the purpose of analysis, however, it would be more useful to look at the score rather than the ranking as this would give a better indication of the level of, and changes in, competitiveness indicators in a particular country.[13] Sri Lanka for instance, leaped to 52nd in 2011-2012 from its previous rank of 62nd in 2010-2011. While much attention is given to this increase in rankings, in terms of scores, Sri Lanka has only increased by 0.08 from 4.25 in 2010-2011 to 4.33 in 2011-2012. This is a significant area that needs to be considered when using the index for analysis and decision-making.

11.7 Corruption Perception Index

The CPI is a measurement of the degree of corruption in countries, covering 182 of them. It looks into corruption which involves the public sector of a country -- public officials, civil servants and politicians. Created by Transparency International (TI), a global good governance watchdog, the index is an aggregate indicator that combines different sources of information about corruption. The countries assessed must have three or more data sources for it to be included in the index. Initially the CPI used a wide range of indicators such as experts' assessments as well as surveys of households and firms, but since 2002, it has dropped the surveys of the general public. In 2011, the index used 17 data sources from 13 institutions.

The data sources used to compile the index include responses to questions involving bribery of public officials, kickbacks in public procurement, embezzlement of public funds, and on questions that explore the strength and effectiveness of anti-corruption efforts by the public sector. Through this method, it strives to cover both the administrative and political aspects of corruption. TI notes that perceptions are used to measure corruption in this index because corruption is largely a hidden activity and therefore is difficult to measure.

Sri Lanka is currently ranked 86 in the latest list of rankings (2011) with a score of 3.3. New Zealand, Denmark and Finland are the top three countries with the lowest levels of corruption with scores of 9.5, 9.4 and 9.4, respectively. Serbia, Bulgaria, Panama and Jamaica are also ranked 86 with the same score as Sri Lanka, while India, Vietnam, Bangladesh, and Indonesia, are ranked lower down.

The CPI has been widely praised for bringing the issue of corruption to the global policy agenda and raising international awareness regarding corruption in the public sector. However, there are a few limitations that need to be considered.

11.8 Conclusion

It is clear from the preceding discussion that many of these indices are by no means perfect and sans-contention. While this 'brief' has only considered a select set of global indices to highlight this challenge, it speaks

[13] Wijesinha, A. and D. Hirimuthugodage (2011),"Sri Lanka Continues its Rise Up Global Competitiveness Index," *Talking Economics*, available at http://www.ips.lk/talkingeconomics/2011/09/sri-lanka-continues-its-rise-up-global-competitiveness-index-jumps-10-ranks-in-2011-12-world-economic-forum-report/.

Box 11.5
Corruption - Too Multifaceted to Measure?

Corruption is most often a phenomenon that is difficult to measure due to its concealed nature. This has resulted in the CPI using perceptions as its tool of measurement. However, perceptions are often subjective and are affected by various external factors such as media attention; and while external factors could influence perceptions, the index itself could also affect perceptions. Therefore, the overall level of influence over its main tool of measurement would vary from country to country and person to person. The CPI has taken measures to make this index as objective as possible by removing the use of public opinion and using professional data sources and institutions to obtain data. However, even though this may reduce the degree of subjectivity, it cannot be completely eliminated. In addition to this, the index indicates that it distinguishes between the 'perception' and the 'experience' of corruption, but studies have shown that the 'distance' between perceptions and experiences varies greatly from country to country.[14] Therefore, there is a large gap between objective and subjective data, and this has been one of the major sources of controversy in corruption indices like the CPI.[15]

Moreover, there are many ways in which corruption can occur, and the different types of corruption will cause different problems, depending on the circumstances resulting in the 'degree of corruption' being somewhat ambiguous. For example, the information from the Gallup International survey (used in the 1997-99 CPIs) refers to the 'number of corrupt acts.' The International Crime Victim Survey (2000 CPI), Global Competitiveness Report, and World Bank Private Sector Survey are directed toward the 'amount of bribes paid.' The Asian Intelligence Issue and World Bank Private Sector Survey question the 'damage done by corruption.' The other sources of corruption ratings do not indicate which definition of the 'degree of corruption' that they attempt to measure.[16] As these sources measure various aspects of corruption and CPI uses these sources to form a composite, it becomes difficult to clearly distinguish what the CPI is really measuring.

The CPI is also said to use, for the most part, expert assessments of expatriates of the country in question. However, this can be considered problematic as the longer these expatriates live outside of their country of origin, the less likely they are to have a good understanding of the real situation in the country.

These drawbacks in the CPI could have undesirable effects. Countries that are ranked high in the list would be discouraged from taking measures to minimize corruption in the public sector because the high score (lower level of corruption) would conceal or disregard corruption in that country. While others with significantly low scores (higher level of corruption) would be less attractive to potential foreign investors resulting in harmful effects to that country's economy.

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[14] Byrne, K. (2010), *Building Public Support for Anti-Corruption Efforts*, World Bank, Washington D.C.

[15] Urra, F., (2007), "An Analytical Review of Corruption Measurements and its Problems: Perception, Error and Utility", George Town University.

[16] Thompson, T. and Shah, A. (2005), "Transparency International's Corruption Perception Index: Whose Perceptions are they Anyway?" Discussion Draft (unpublished), available at http://www.acb.gov.jm/pdf/TransparencyInternationalCorruptionIndex.pdf [accessed on 2nd May 2012].

to a broader issue emphasized in the introduction – that closer examination of the construction, relevance, and biases of global indices is essential; particularly when taking policy and/or economic decisions based on them.

Yet, however much these indices are criticized on various grounds in the domestic economic arena, they are a key element in the basket of factors that foreign investors and business partners look at when considering doing business with and in Sri Lanka. Therefore, ignoring them would be to the country's peril. At the same time, taking them at face value is also imprudent. Peeling a few layers and exploring what lies beneath the surface of these indices would not only expose important caveats and reveal the limitations, but also provide a better understanding to governments and policymakers on what they can do to boost Sri Lanka's performance in global rankings, and improve how the country is perceived in the global arena.