

Sri Lanka climbs in income and declines in competitiveness

WEDNESDAY, 24 SEPTEMBER 2014 11:08



<https://www.dailymirror.lk/features/sri-lanka-climbs-in-income-and-declines-in-competitiveness/185-52860>

The Global Competitiveness Report is produced by the World Economic Forum and currently compares and ranks the competitiveness landscape of 144 countries. In 2013, Sri Lanka was ranked at 65. This year, Sri Lanka has dropped eight places to 73. Looking under the hood to understand this drop is quite revealing for understanding not only the Sri Lankan economy and its future challenges, but also the economic assessment of competitiveness.

What is competitiveness and what drives it?

Competitiveness simply means the ability to compete in the global market place in the production of goods and services. Countries that are more productive are able to produce more with less labour and resource costs and can compete better.

But competitiveness can have different drivers. For instance, labour costs can be low for three very different reasons: (i) because workers are paid little, (ii) because the workers are more efficient, (iii) because the production method is better designed so as to require less effort.

The global competitiveness index takes this into account when assessing the competitiveness of countries. In creating an aggregate score, the weights it assigns to the different aspects of the economy vary, according to whether a country is in the basic 'paid little' stage, or the mid-level 'efficiency' stage, or the advanced 'innovation' stage.

The 12 aspects of the economy that are evaluated by the index can be grouped in terms of their relevance to these different drivers (See Exhibit 1).

Climbing in income and declining in competitiveness is not sustainable. If competitiveness does not increase, the growth potential will also be choked out

Where is Sri Lanka and why does it matter?

Cross country analysis shows that the relevant drivers of competitiveness (basic, mid or advanced) are closely correlated with the per-capita gross domestic product (GDP) of a country. The index is therefore designed to assign progressively higher weights to the mid and advanced drivers as the per-capita GDP of a country increases (See Exhibit 2).

In 2009, Sri Lanka passed the US \$ 2,000 per capita mark and currently it has passed the 3,000 per capita mark. Therefore, in calculating the global ranking, the weights assigned to variables in Sri Lanka have been gradually increasing for the mid and advanced categories and declining equivalently in the basic category.

The GCR methodology reflects then an important insight for Sri Lanka: sustaining and moving up in the regions of GDP currently achieved, will critically depend on the drivers of efficiency in the country's economy.

Exhibit 1: Key Determinants of Competitiveness based on Stages of Development of a Country		
Basic: Factor Driven	Mid-level: Efficiency Driven	Advanced: Innovation Driven
1. Institutions	5. Higher education and training	11. Business Sophistication
2. Infrastructure	6. Goods Market Efficiency	12. Innovation
3. Macroeconomic environment	7. Labour market efficiency	
4. Health and primary education	8. Financial market development	
	9. Technological readiness	
	10. Market Size	

Sri Lanka's problems

The problem for Sri Lanka is that while GDP levels are higher than for those countries in the basic 'paid-little' stage, Sri Lanka is not doing too well on the mid-level efficiency-driven variables.

In fact, Sri Lanka's ranking in the sub-index of only the efficiency-driven variables, dropped from 69th place to 75 and Sri Lanka declined in four of the categories under this sub-index and remained the same in the other two (See Exhibit 3).

But added to that, even in the components of the economy comprising the 'basic' sub-index, Sri Lanka is not doing well. Its global ranking has slipped with regard to both institutions and infrastructure and even though it has improved in macroeconomic environment, the ranking is very poor at 114. In this sub-index, it is only with regard to 'health and primary education' that Sri Lanka has improved and has a respectable ranking.

Exhibit 2: Sub index weights and income thresholds for stages of development

	Stage 1 Factor Driven	Transition from Stage 1 to Stage 2	Stage 2: Efficiency Driven	Transition from Stage 2 to Stage 3	Stage 3: Innovation Driven
GDP per capita (US\$)	<2,000	2,000 - 2,999	3,000 - 8,999	9,000 - 17,000	>17,000
Weight for Basic Requirements	60%	40-60%	40%	20-40%	20%
Weights for Efficiency Enhancers	35%	35-50%	50%	50%	50%
Weights for Innovation and Sophistication	5%	5-10%	10%	10-30%	30%

Message to Government and Private Sector

When examining the components of the index that are doing well or improving, vs. doing badly or declining, there are messages to both the private sector and the government.

In the efficiency drivers, Sri Lanka has fallen 10 places in 'higher education and training'. At the same time, loud and repeated appeals to the government to increase budgetary provision for education – especially higher education – have been going unheeded. Sri Lanka is also doing very poorly at rank 135 with regard to 'Labour Market Efficiency', which again is policy driven.

Sri Lanka has a relatively high rank in 'Goods Market Efficiency', which is very much driven by the private sector. However, the rank has dropped two places in the last year.

There are two areas in which both the government and private sector have a combined responsibility. One is 'Financial Market Development' where Sri Lanka was ranked well at 41 but dropped six places to 47. The other is 'Technological Readiness' where Sri Lanka had a poorer rank at 93 and dropped one place to 94.

Looking at the 'advanced' sub-index, it's worth noting that Sri Lanka ranks relatively high in both business sophistication, and in innovation, even though Sri Lanka has dropped a bit in the former. The private sector is the likely driver of both these areas as well and they could be helping to compensate for some of the weaknesses in the components under the 'efficiency' sub-index.

Exhibit 3: Change in Sri Lanka's ranking, by sub-indexes and their components.			
	2013/14 Rank/148	2014/15 Rank/144	Direction of change
Basic Requirements	77	75	▲
Institutions	54	62	▼
Infrastructure	73	75	▼
Macroeconomic Environment	120	114	▲
Health and Primary Education	52	45	▲
Efficiency enhancers	69	75	▼
Higher education and training	62	72	▼
Goods market efficiency	37	39	▼
Labor market efficiency	135	135	-
Financial market development	41	47	▼
Technological readiness	93	94	▼
Market size	61	61	-
Innovation and Sophistication	42	43	▼
Business Sophistication	34	39	▼
Innovation	49	46	▲

Developing Right Comparisons and Focus

Sri Lanka is ranked above almost all SAARC countries in many of the international economic evaluation and this is an important achievement. In the competitiveness ranking only India is ahead of Sri Lanka (at number 71) from SAARC. But as Sri Lanka seeks to grow its GDP well above other SAARC countries, comparisons with SAARC will not provide the right benchmarks, Sri Lanka will have to look further east to Thailand, China, etc.

Sri Lanka has posted high levels of post-war economic growth. There has been many discussions on the sustainability of this growth. Using the global competitiveness index and its sub-components, the insight is that sustaining growth depends increasingly on improving the productivity of the economy through those factors that contribute to increasing efficiency. In that regard, the focus can no longer be on exploiting low wages – Sri Lankan workers are migrating or stepping out of the labour force and refusing that proposition in any case.

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