The Benchmark indicators

Methodological considerations

It is not reasonable to assume that two very different countries in terms of e.g. population or GDP per capita should have equal levels of financial development. Therefore, benchmarking has been conducted on some indicators so as to compare country-level indicators relevant to the development of LTF with relevant benchmark values.

The benchmarking tool is based on a three step process:

1. Assign general weights to the importance of each of several structural indicators (GDP per capita, population, old and young dependency ratio, being an off-shore financial center, oil exporting country, a former transition economy or a landlocked economy, and the year in which those indicators are measured) in determining each financial development indicator (using a regression model based on a global sample of countries over the period 1960 to 2017).

2. Use the general weights determined in 1) and the observed levels of the structural indicators for a specific country on a given year to determine the “predicted” value of the financial development indicator for that specific country on that given year. Predicted value reflects the level of financial development that a country with such structural characteristics is expected to have (its “optimal” level of financial development).

3. Calculate the financial development “gap” by subtracting the “observed” value from the “predicted” value. If the “observed” value is lower than the “predicted” value, there will be a positive gap. If, on the other hand, the “observed” value is higher than the “predicted” value, the gap will be negative, indicating that the financial development of this country is higher than what one would expect given its structural characteristics.

The regression analysis described above requires data to be available across a large sample of developed and developing countries. The benchmarking tool is only available for indicators for which international data availability is sufficient.

The benchmarked value is based on panel regressions for a global sample over the period 1960 to 2017 (where available) where the log of each financial development indicator is regressed on (i) log of GDP per capita, (ii) log of total population, (iii) log of old dependency ratio, (iv) log of young dependency ratio, (v) dummy variables for off-shore financial centers, oil exporting countries, former transition economies and landlocked economies, and (vi) year dummies. The regression results then provide us with a predicted value for each country and year of the financial development indicator in question. The gap between the actual and predicted level of financial development indicates whether the level of financial development is below or above the value consistent with the country’s structural characteristics.