

Case Study Summary

Employment

MANUFACTURING PROGRESS?

Employment creation in Sri Lanka

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A Sri Lankan worker weaves handloom sarees. Photo: © ILO / Yamuni Rashmika Perera.

- Recorded unemployment in Sri Lanka fell from 15% in 1992 to 4% in 2012, the largest drop among South Asian countries over the period.
- Unemployment among women declined faster than among men, from 22% in 1992 to 10% in 2006 and to 6% in 2012, compared with a reduction from 11% to 5%, to 3% for men for the same years.
- Employment progress has been accompanied by structural transformation: the share of agricultural employment declined from 41% in 1992 to 31% in 2012; industrial employment rose from 20% to 26%, and service sector employment from 38% to 43%.
- Consequently, output per worker has grown more rapidly than in the rest of the region, doubling from just over \$6,000 per worker in 1992 to more than \$12,000 in 2012 (in constant 2005 PPP dollars).

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Why explore employment in Sri Lanka?

The case for studying employment progress in Sri Lanka rests largely on the country's impressive reduction in unemployment and improvement in working conditions, particularly for women. This progress was accompanied by structural transformation from agriculture to services and industry, and occurred despite a damaging internal conflict that ended only in 2009. The period also saw the 2004 tsunami and economic shocks of rising food and oil prices in 2007 and 2008.

Employment progress has been underpinned over the long term by gradual market liberalisation and export-oriented industrial policy, combined with continued government intervention through public employment, state-owned enterprises (SOEs) and targeted public investments.

Progress has not been without challenges: as in other middle-income countries, matching labour supply and labour demand is difficult, particularly with regard to better-educated young people, while regulating outward migration of low-skilled female workers is important for individual wellbeing.

Understanding Sri Lanka's employment progress may therefore help underline the need to put employment more explicitly at the centre of policy debates in developing countries.

What progress has been achieved?

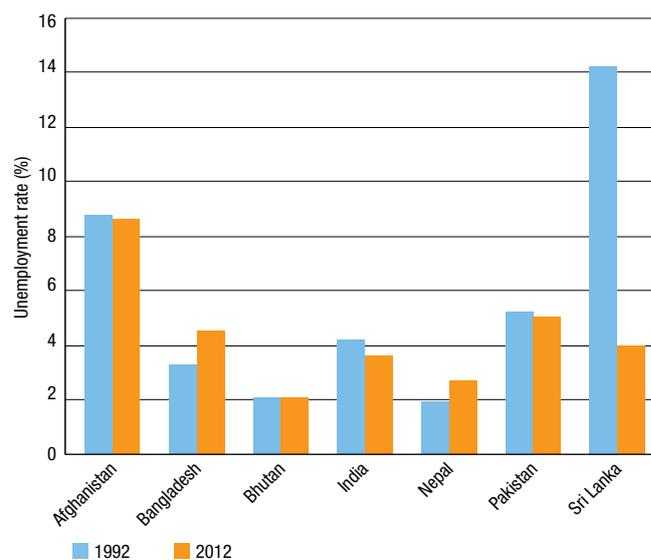
The main elements of employment progress achieved in Sri Lanka over the past two decades are:

- Increased employment creation and access to jobs, with a lower unemployment rate and a higher employment-to-population ratio, as well as increased levels of wage employment.
- Structural transformation of the economy away from agricultural employment and an exceptional increase in the share of employment in industry, with rising labour productivity.
- Related improvements in the quality of employment, with higher wage rates and worker productivity, as well as greater access to employment opportunities for women.

'Employment needs to be looked at not in a sectoral way but in a comprehensive way' – International policy officer

Recorded unemployment in Sri Lanka fell from 14% in 1992 to 4% in 2012 (ILO, 2013), the largest drop in the period among South Asian countries, as Figure 1 illustrates. While other South Asian countries have suffered conflict (including India, Pakistan and Nepal), Sri

Figure 1: Unemployment rate, South Asian countries



Source: based on ILO (2013).

Lanka is the only country to have experienced civil war *throughout* the period while making consistent progress in lowering unemployment. Outward migration has operated as a labour market safety valve, reducing the pool of economically active people in the country, but the fall in unemployment has nonetheless surpassed migratory flows.

Unemployment declined faster and to a greater extent for women than for men, with women taking many of the new jobs created and driving much of the outward migration. Unemployment among women declined from 22% in 1992 to 10% in 2006 and 6% in 2012, compared with 11% to 5%, to 3% respectively among men (ILO, 2013). Female unemployment fell most in the age groups 15-24 and 25-29 and for those with education beyond primary school but not university educated.

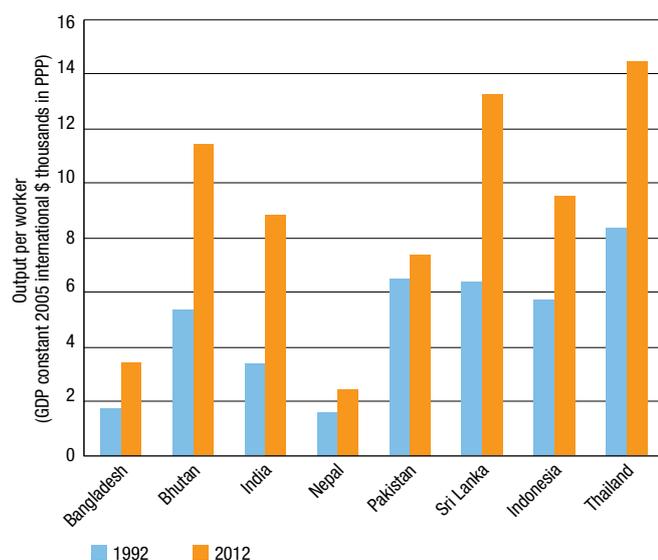
More generally, unemployment among O-level and A-level secondary school graduates declined rapidly from 22% and 26% respectively to 6% and 8% (Government of Sri Lanka, 1992, 2006, 2012).

Employment progress in Sri Lanka also relates to structural transformation. Until the early 1990s, the agricultural sector accounted for more than 40% of Sri Lankan employment (Government of Sri Lanka, 1992, 2012), and depended on the production of just a few crops, such as tea, rubber, coconut and paddy rice. This concentration made Sri Lanka vulnerable to output shocks as well as to external demand and price volatility, with limited earnings and job growth.

The share of agricultural employment declined from 41% in 1992 to 31% in 2012. Consequently, industrial employment rose from 20% to 26%, while service sector employment also increased, from 38% to 43%, shown in Table 1.

Manufacturing employs the most out of any industrial sub-sector and contributed around 17% to GDP

Figure 2: Output per worker (GDP constant 2005 international \$ in PPP), selected Asian countries



Source: ILO (2013).

throughout the 2000s, comparable with Viet Nam and Bangladesh and more than India and Pakistan.

Rising services and manufacturing employment are important for their potential impact on labour productivity and employment quality. Output per worker has grown above that of other countries in the region, doubling from just over \$6,000 per worker in 1992 to more than \$12,000 in 2012 (in constant 2005 PPP dollars) (ILO, 2013), illustrated in Figure 2.

The *quality* of jobs in Sri Lanka, measured as the share of vulnerable employment, is also better than elsewhere in the South Asia region as illustrated in Figure 3. The percentage of working poor almost halved during the 2000s, reaching 6% in 2007 (ILO, 2013) while the poverty headcount ratio declined from 29% of the population in 1996 to 7% in 2013 (World Bank World Development Indicators).

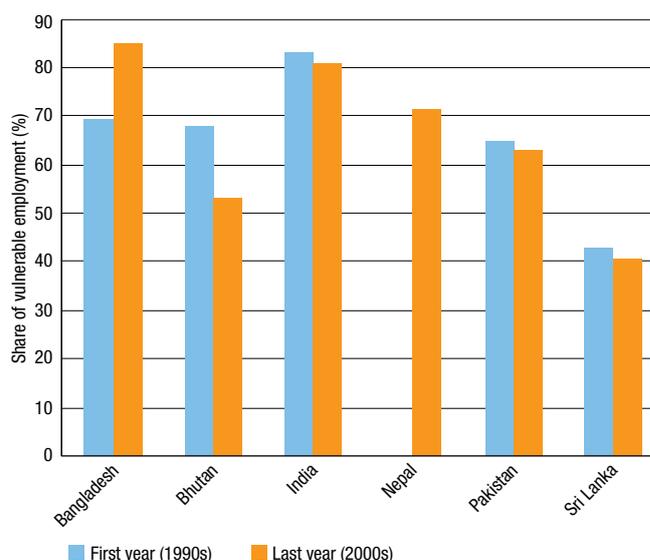
This suggests that rising productivity has translated into increased earnings for formal and informal workers, with average wages increasing by 20% from 2006 to 2012.

Table 1: Employment shares by sector, 1992-2012

	Employment shares %				Share of GDP %
	1992	2000	2006	2012	
Agriculture	41.3	35.9	32.1	31.0	11.1
Industry	20.4	23.7	26.7	26.1	30.4
Services	38.2	40.5	41.2	43.0	58.5

Source: Labour Force Surveys, Government of Sri Lanka 1992, 2000, 2006, 2012.

Figure 3: Share of vulnerable employment, South Asian countries



Source: ILO (2013).

Note: For each country, data from the earliest and latest available year in each decade is used. Data for Bhutan correspond to the 2000s only. Data for Nepal is only available for 2001.

Female average earnings rose by 25%, compared with 17% for males, although they remain below male earnings (Government of Sri Lanka, 2006, 2012).

What are the factors driving change?

While many factors can account for this progress, we choose five to highlight here.

1. Market liberalisation with state engagement

In response to economic crisis and unemployment levels reaching 20% at the end of the 1980s, the Sri Lankan government implemented reforms as part of an IMF package to address large fiscal deficits. This included privatisation, labelled 'peopalisation' by the Premadasa government (1989-1993), tariff cuts, tax reforms, the removal of exchange rate controls and the reduction of foreign investment restrictions.

While the Kumaratunga government (1994-2005) was ostensibly more leftist, memories of the preceding crisis led it to 'encourage a more market-oriented pattern of economic growth even while it attempted to protect the economic system from the adverse effects of the international market' (Shastri, 2004).

After 2005, the Rajapaksa government set out a new development vision that halted or reversed liberalisation policies and the privatisation of SOEs. Although employment was not an explicit objective, the government promoted domestic industries, infrastructure and poverty alleviation while rationalising and improving the efficiency of SOEs.

The common thread through all of the above policies was the gradual continuation of pro-market reforms and

export-oriented industrialisation while at the same time maintaining an important public-sector role in providing jobs.

In spite of more than 20 years of ostensible market reform, the public sector saw the highest employment growth rate in the period 2006 to 2012 (5%), followed by para-statal employment (3%) and the informal private sector (2%), particularly in the agricultural sector (Government of Sri Lanka, 2006, 2012). Public employment accounted for 26% of total employment in 2012, while formal private employment stood at around 35%.

2. FDI and Export Processing Zones

In conjunction with the above reforms, Sri Lanka used public resources to target inward export-oriented investment. A key part of this was the public investment in creating and servicing Export Processing Zones (EPZs) – industrial parks with specific regulatory conditions that aim to attract both local investment and, especially, foreign direct investment (FDI). Originally adopted in 1978, these took on greater prominence during the second phase of reform in the 1990s, when the Board of Investment (BOI) was also set up to further promote inward investment.

The BOI operates as a ‘one stop shop’ to address impediments to foreign investment and is empowered to negotiate and close bilateral investment agreements with both domestic and foreign firms, to provide customs-free

and tax-exempt investment incentives, and to vary the application of a list of investment-related laws, including those related to inland revenue, sales and business turnover.

As well as offering specific incentives to investors, the BOI was behind programmes such as the 200 Garment Factories Programme, which offered a package of incentives for investors willing to invest in garments exports. While also open to domestic investors, much of this was focused on FDI to EPZs, helping contribute to rising FDI flows and industrial employment, particularly for rural youth. A similar programme was launched in 2005 to set up 300 factories in less developed areas under the Nipayum Sri Lanka 300 Enterprises Programme. Again, much of the focus was on encouraging FDI for export manufacturers.

As a result, since 2001 FDI flows into Sri Lanka have been growing fast, rising from \$100 million a year in 1996 to \$900 million in 2012. BOI companies today employ over 450,000 workers, accounting for nearly 65% of exports and 86% of industrial exports (Wijesinha et al., 2013). Two-thirds of new jobs created in Sri Lanka in the 1990s and 2000s were in the export manufacturing sector. The apparel sub-sector accounted for between 60% and 70% of BOI enterprise employment throughout the 2000s. During the 1980s and 1990s, over 90% of the apparel workforce in Sri Lanka were women, who were better educated and better skilled than in other Asian countries (Staritz and Frederick, 2012).



Workers at their stations on the garment production line. Photo: © ILO/M. Crozet.

3. Reforming training and skills education to meet employment needs

Sri Lanka has a long history of investing in human capital. This has translated into impressive gains in education outcomes since independence. Today, Sri Lanka has a 91% literacy rate, near universal enrolment in primary education (99%) and high enrolment rates in secondary education (87%). The average number of years children spend in school rose from 11.3 in 1990 to 13.6 in 2010.¹

While the Sri Lankan government traditionally emphasised free formal education, persistent youth unemployment, social and ethnic tensions and youth unrest in the 1970s provided the impetus for a more 'vocationalised' education system. Increasing export orientation also made improving the skills of workers more pressing (Chandrasiri, 2010; Gajaweera, 2010). Growing numbers of graduates from primary and secondary education have put pressure on government universities, with the technical and vocational education and training (TVET) sector accommodating some of the remaining students.

The number of people receiving qualifications from TVET has more than doubled over the period from 2002 to 2012, boosting the number of people able to access the employment opportunities created through the investments described above.

4. Social protection and access to jobs

Barring a few exceptions, social protection in Sri Lanka consists mainly of social assistance programmes rather than policies to actively integrate the unemployed and underemployed into labour markets. Nonetheless, the following labour market programmes are designed to actively help citizens to access employment and self-employment opportunities:

- The Nanwamu Gammana programme: women heads of rural households are provided with a one-time cash grant for a cottage industrial activity (e.g. clay-based products in Thambuththegama and Galen Bindunuwewa, collective farms in Tangalle).
- Numerous public works programmes set up after the 2004 tsunami by international organisations, NGOs and community-based organisations tried to provide work and reconstruction in affected areas. The total value of these programmes to August 2005 was nearly \$6 million.
- Sri Lanka's Emergency Northern Recovery Project, a cash-for-work programme launched in 2009 and co-funded by the World Bank and AusAid (\$70.5 million), targets 100,000 people in the process of resettlement and has community-generated procurement procedures.
- The Local Empowerment through Economic Development project was launched in 2011 by AusAid and the ILO in collaboration with the Ministry of Labour and Labour Relations. It targets 2,400 conflict-

affected vulnerable households. It also includes a wage subsidy for job placements for people with disabilities.

- The Sri Lankan government also offers financial assistance of up to 10,000 rupees (\$87) for people with disabilities in low-income families to undertake self-employment activities.

5. The labour migration safety valve

Outward migration has played an important role as a 'safety valve' for Sri Lanka's labour markets. In 1999, for example, the number of people moving abroad for foreign employment was more than double the number of new jobs created (85,000) in Sri Lanka that year (Winslow and Woost, 2004). Outward labour migration grew from under 10% of the total labour force in 1990 to roughly a quarter of the labour force, or 1.8 million people, in 2009.

Low-skilled female workers were the principal migrants until the mid-2000s, with many going to the Middle East to work as housemaids (i.e. domestic employment), where little or no experience and skills are required and where pay is generally low. The share of males migrating increased between 2006 and 2012, with 90% going to the Middle East (CBSL, 2013), but with a shift towards more skilled migration.

What are the challenges?

Challenges remain to further advancement of Sri Lanka's progress in employment and to sustain the achieved results so far. These relate to:

- Improving equitable access to employment opportunities for particular segments of the population.
- Continuing to improve competitiveness, raising productivity and attracting further investment and finance.
- Bringing job creation and employment promotion to the centre of policy discussions.

'The practicalities are so complex' – International development organisation researcher

Youth participation (aged 15 to 29) declined from close to 40% of the labour force in 1992 to 24% in 2012, in part due to young people staying longer in the education system or dropping out of the labour force through

¹ See UNDP Human Development Report data: <http://hdr.undp.org/en/content/expected-years-schooling-children-years>

outward migration (World Bank, 2011). This has resulted in an ageing labour force.

Economic growth and employment have been largely concentrated in the Western and Southern provinces of the country. As such, unemployment has fallen much more slowly in the South, Central and Eastern provinces compared with the Western province around Colombo.

A significant percentage of the labour force remains in vulnerable employment. This stood at close to 40% from 1992 through to 2012. Moreover, 60% of employment in Sri Lanka takes place in small, unregistered firms in the informal sector, reflecting ongoing challenges for the *quality* of employment.

Until 2008, the Northern and Eastern conflict-affected provinces of the country were excluded from the government's labour force surveys, with the Northern Province first surveyed only in 2011. Current employment challenges also relate to skills matching, with unemployment higher among the better educated. While TVET has helped, inadequate linkages still exist between the higher education system and the requirements of the industrial sector, contributing to high unemployment among graduates, which has fluctuated around 5% over the 1990-2010 period.

Rising labour productivity is part of the progress described in this report, but it must rise further for Sri Lanka to remain globally competitive (World Bank, 2013). Balancing the hybrid approach of market liberalisation

with state intervention has been hard to sustain, and some argue is responsible for Sri Lanka's export-led industrial policy having a more limited impact than was the case for the East Asian pioneer countries (Athukorala and Jayasuriya, 2012). Public intervention has not targeted improved productivity, but instead has taken the shape of subsidies and welfare.

While not victim to disasters such as Bangladesh's Rana Plaza building collapse, the apparel industry has suffered from a poor image and has consequently struggled to attract workers. The government launched its 'Garments without Guilt' campaign in 2006 to improve the industry's image, while some large private companies have also launched their own corporate social responsibility programmes (Staritz and Frederick, 2012). However, such strategies need to be coupled with more efforts to enforce the many decent work conventions signed by Sri Lanka² to improve working conditions.

The important role of outward labour migration in the falling unemployment rate may have come with some risks, particularly for women and in the absence of stronger social insurance and income risk protection systems.

Finally, although economic policies have been quite consistently maintained in the face of economic and political crises and numerous changes of government, job creation and employment promotion have only recently started to approach the centre of policy debates in the country.

² It is the only Asian country signatory of all core ILO conventions.

Lessons learned

- **Hybrid policy approaches, combining market liberalism with a strong role for the state, can underpin employment progress.** While not without its problems, the commitment to outward-oriented economic policies spanning several different governments has been a salient characteristic of employment progress in Sri Lanka, helping to transform the economy towards more productive and diverse economic activities. Employment progress has emerged from a complex industrial policy linking economic, political, ethnic and military processes.
- **Countries need to reflect on the sustainability of incentives and revenues foregone from attracting private investment for employment.** Sri Lanka has used tax and other financial incentives to promote foreign investment into EPZs, thus foregoing government revenue and accumulating large public debts. The government has tried to retain public investment in large-scale infrastructure programmes while maintaining social protection and welfare policies. While these had positive effects, unsustainable fiscal incentives have led to restricted fiscal capacity, limiting the scope of social protection investments in particular to reach the most vulnerable.
- **While Sri Lanka has maintained its high achievements in formal education participation, a more responsive skills system is fundamental in matching employment opportunities with the skills of the labour force.** TVET sector reforms have had a positive impact but more could be done to ensure a wider reach and to ensure the formal education system teaches relevant skills in a changing economic environment. This will be imperative to ensure that young people, women and those in less well-integrated areas of the country are employable.
- **Population movements and trends affect employment outcomes.** Outward labour migration has undeniably eased the pressures on the domestic labour market, generating an outlet for surplus labour. More emphasis now needs to be placed on the sustainability of migration flows and policies – ensuring the protection of migrants and the productive use of remittances. While economic reforms have been crucial to employment progress, the large labour migration flows emphasise the need to broaden access to employment opportunities for excluded groups, as well as opportunities for those who are university educated. Some recent policies point in this direction, but efforts need to be sustained by focusing on inclusive employment as the key outcome of future reforms.

This summary is an abridged version of a research report and one of a series of Development Progress case studies being released at developmentprogress.org

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