



Case Study Report

Employment



MANUFACTURING PROGRESS? Employment creation in Sri Lanka

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Cover image: A Sri Lankan worker weaves
handloom sarees. Photo: © ILO / Yamuni
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Two young workers prepare advertising boards. Photo: © ILO / Yamuni Rashmika Perera.

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Abbreviations and acronyms

ADB	Asian Development Bank	LFS	Labour Force Survey
BOI	Board of Investment of Sri Lanka	MFA	Multi-Fibre Arrangement
EPZ	Export Processing Zone	NVQ	National Vocational Qualification
EU	European Union	PPP	Purchasing Power Parity
FDI	Foreign Direct Investment	SLBFE	Sri Lanka Bureau of Foreign Employment
GCC	Gulf Cooperation Council	SME	Small and Medium Enterprise
GDP	Gross Domestic Product	SOE	State-owned Enterprise
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (German Technical Cooperation)	TEWA	Termination of Employment of Workers Act
GSP	Generalised System of Preferences	TVEC	Tertiary and Vocational Education Commission
ILO	International Labour Organization	TVET	Technical and Vocational Education and Training
IMF	International Monetary Fund	UNCTAD	United Nations Conference on Trade and Development
KILM	Key Indicators of the Labour Market	UNDP	United Nations Development Programme
		UNP	United National Party

Abstract

This study aims to explain the employment progress achieved in Sri Lanka from 1990 to 2010. This period has seen a drastic reduction in unemployment, and improved working conditions, particularly for women, accompanied by structural transformation away from agriculture towards manufacturing and services. The drivers of employment progress in quality, quantity and access are examined in terms of policies affecting demand for and supply of labour. While this employment progress has been achieved under unique and challenging conditions, not least a civil war from 1983 to 2009, the study attempts to draw conclusions for policy-makers in other contexts. In particular it points to the long-term adherence to a hybrid

industrial policy agenda comprising outward market orientation and policies to promote investment into export processing zones, attention to education and vocational training, and continuing strong government economic activity in the form of state-owned enterprises and public employment. As for any progress story, employment progress is not necessarily 'success' – outward migration and war-related employment have also been key factors. Nonetheless, Sri Lanka is on a trajectory of economic transformation that, with the end of the civil war, offers a strong basis for further employment progress and improved livelihoods.



A young woman weaves bags from processed sedges plants. Photo: © ILO / Yamuni Rashmika Perera.

1. Introduction

The creation of more and better jobs is essential if economic growth is to reduce poverty and inequality sustainably, and it offers the potential to promote social cohesion, citizen empowerment and personal dignity (Osmani, 2003; Khan, 2007). Globally, 600 million new jobs will have to be created over the next 15 years just to keep employment rates constant – 175 million are needed in South Asia alone, and a large share of the remaining are needed in other developing regions (World Bank, 2013). A growing focus on economic transformation in developing countries also points to the need for policies that promote more, and higher-productivity, employment.

Policy-makers therefore need to understand how to generate more and better jobs, and ensure that disadvantaged groups are able to access employment opportunities. This implies:

- increasing the *quantity* of employment opportunities created
- increasing the *quality* of the jobs being generated in the economy in terms of productivity, remuneration levels, job security, regularity and social security
- improving equitable *access* to employment opportunities for women, youth and other potentially excluded groups.

The International Labour Organization (ILO), International Monetary Fund (IMF) and World Bank provide three different conceptual frameworks for understanding the relationship between employment, growth and poverty reduction.¹ While different, all three highlight factors that affect demand for labour, including macroeconomic policies, investment climate, institutions and infrastructure. They also highlight that while it is vital to promote demand for workers by firms, this must be matched by a supply of workers in the labour market, underlining the importance of education and skills to support human capital accumulation, as well as labour market policies and social protection for vulnerable workers. Institutions, policies and programmes also need to work to make the link between the supply and demand of labour.

This case study aims to explain the employment progress achieved in Sri Lanka from 1990 to 2010. This progress includes a drastic reduction in unemployment and an improvement in working conditions, particularly for women, accompanied by structural transformation away from agriculture. The report examines the key

factors that help explain this progress. The drivers of employment progress in quality, quantity and access are examined in terms of labour supply and demand.

This case study touches on some of the following trade-offs and tensions faced in achieving employment progress:

- What is a suitable balance of government intervention in the economy?
- How can an economy sustainably attract investment and promote employment through incentives?
- What is needed to develop effective systems for upgrading human capital and matching skills to jobs?
- How can an economy capitalise on labour migration while promoting inclusive labour markets?

While progress has been achieved under unique and challenging conditions, including a civil war from 1983 to 2009, the study attempts to draw conclusions for policy-makers in other contexts. In particular, it points to the long-term adherence to a hybrid industrial policy agenda of outward market orientation but with continuing strong state-led market interventions. This is reflected in the combination of support to policies that supported state-owned enterprises (SOEs), public employment, public investment policies, and policies to promote domestic and foreign investment into export processing zones. This has been combined with long-term attention to education and vocational training, thereby providing some policy consistency and predictability despite the civil war. The hybrid policy approach of promoting a market economy alongside large, state-led interventions has proven beneficial for employment growth.

As with any story of progress, employment progress has not been an unmitigated success. War-related, especially military, and civil service employment helped to reduce unemployment. It is argued that the civil war from 1983 to 2009 was both a cause and a consequence of economic policies and outcomes that fuelled ethnic divisions (Winslow and Woost, 2004). Outward labour migration has also played a role in the falling unemployment rate and increasing labour participation, particularly for women and in the absence of stronger social insurance and income risk protection systems. Nonetheless, Sri Lanka is on a trajectory of economic transformation that, with the end of the civil war, offers a relatively strong basis for further employment progress and improved livelihoods.

¹ These frameworks are: the ILO's growth-employment-poverty nexus (Islam, 2004; Osmani, 2003; Khan, 2007, among others), the World Bank MILES framework (World Bank, 2013) and the IMF's advice on labour market issues (IMF, 2013a).

The complex economic, political and social processes that have underpinned employment progress in Sri Lanka reflect the multiple challenges facing conflict-affected and post-conflict countries. While broad lessons cannot easily be drawn from any specific country case, the employment progress made, and remaining challenges, highlights the potential of hybrid policy approaches, as well as the importance of long-term policy consistency spanning multiple opposing governments.

1.1 Foundational factors

Employment patterns in Sri Lanka since the 1990s need to be understood in relation to the preceding decades' economic and social developments. At independence from Great Britain in 1948, per capita income, social indicators, literacy and life expectancy rates were all comparable to those in more developed economies, while Sri Lanka was the most affluent country in southern Asia in 1950, representing 'an oasis of stability, peace and order' with a vibrant democratic system and strong commodity exports (Athukorala and Jayasuriya, 2012).² As will be discussed, these long-term structural factors have influenced the underlying basis for employment progress, not least the high levels of education for which Sri Lanka has long been known.

Following independence, Sri Lanka became a 'state-regulated economic system' (Gunasinghe, 2004), increasingly inward-oriented and subject to government regulations and trade, exchange and price controls. By 1976 the public sector, including state-owned enterprises (SOEs), accounted for nearly 90% of imports and 30% of exports, while large social expenditures led to fiscal deficits and unemployment rose to above 20%, much of this among the educated young (World Bank, 2004). In response, the 1978 elections brought a dramatic outward reorientation towards export promotion.

Market reforms and greater outward orientation were nonetheless accompanied by considerable aid-financed government spending on public investment projects in irrigation, land development and hydropower.³ This trend has continued, as discussed below, but also included 'loss-making favoured state enterprises' (Athukorala and Jayasuriya, 2012). Even by 1990, after 12 years of gradual market reforms and privatisation, a significant part of national production still came from the over 200 public enterprises in agriculture, industry, utilities, banking, transport and commerce that continued to

receive budget subsidies, with as much as 70% of the national economy still in the public domain (World Bank, 2004). Furthermore, perceptions increased that state-owned enterprises were being used as a tool to entrench and centralise political power by providing attractive jobs for useful allies through political patronage (Dunham and Jayasuriya, 2001; Athukorala, 2000).

These economic policies were accompanied by a rise of Sinhalese nationalism, during which a stratum of Sinhala entrepreneurs rose to become industrialists through protected light industrial production (Gunasinghe, 2004). Increasing Sinhalese nationalism, growing Tamil separatism, the negative impact on the wider population of many of the market reforms, as well as ethnic-based patronage, were all key elements in the civil war that erupted in 1983. At the same time, Marxist-oriented political groupings (Janatha Vimukthi Peramunu - JVP) brought further violence in 1987-89 (following a similar revolt in 1971), in response to perceptions among the rural poor and urban working classes that the liberalisation reforms had not benefitted them (Dunham and Kelegama, 1997). This had destabilising effects throughout the economy, dampening the previous increases in foreign investment. At the end of the 1980s, private industries were closing, with economic activity grinding to a halt at times; public services were stalled, and law and order was precariously positioned (Gunasinghe, 2004).

1.2 Methodology, sources and structure

This report was produced by a team of researchers from the Overseas Development Institute (ODI), London, the European Centre for Development Policy Management (ECDPM), Maastricht, and the Institute for Policy Studies (IPS), Colombo. It is the result of extensive desk research combined with interviews.

The research team analysed available primary and secondary data and literature, including Labour Force Surveys (LFSs) and publicly available survey reports, government policy documents, academic studies and project reports. Semi-structured interviews with academic experts and practitioners working on employment-related issues in Sri Lanka or South Asia served to clarify and link certain trends and developments emerging from the data and literature review.⁴

Progress in employment is defined in this report as the process of increasingly generating quality employment in

2 Until independence, politics was dominated by class rather than ethnic- or religion-based political differences (Athukorala and Jayasuriya, 2012).

3 Therefore, public expenditure rose to 42.7% of GDP as part of the liberalisation, with a concurrent rapid rise of the fiscal deficit up to 16%-18% of GDP in the early 1980s. While these expenditures were unsustainable, the 1977 reforms also dismantled some tools for political patronage. Import restrictions, which were then possible, distinctly favoured state-owned enterprises involved in the production of intermediate goods for private-sector end-user industries in the allocation of foreign exchange (Athukorala, 2000).

4 Given the broad focus and data requirements, the research is of a descriptive nature and does not attempt estimation using econometric models.

productive sectors.⁵ The majority of the data and statistics originate from the Sri Lanka Department of Census and Statistics' annual LFSs. These offer comprehensive historic data series for the main employment indicators from 1990 up to 2012. Most employment-related data series became available for the two principal conflict-affected provinces, in the north and the east of the country, only in 2008.⁶ Throughout, this report makes use of a number of labour market and employment terms and indicators, summarised in Box 1 (overleaf).

The report is organised as follows: Section 1 presents a general overview of the study and outlines the case for analysing employment in Sri Lanka. Section 2 introduces the main changes in employment outcomes since 1990, focusing on trends in employment creation and the progress of the industrial sector. Section 3 analyses, in turn, the main factors in Sri Lanka's progress on employment. Section 4 looks at the remaining challenges, while Section 5 draws some conclusions and sets out policy lessons that might be drawn from Sri Lanka's experience over the past two decades.

-
- 5 The selection of countries for in-depth analysis was primarily based on the quantitative analysis of two main indicators: (i) change in share of wage employment, and (ii) change in share of the industrial sector in total employment. Countries were ranked according to how well they performed with respect to their initial levels (the 'deviation from fit'), while absolute changes in the 1990-2010 period in the indicators were also examined for the top-performing countries. Efforts were made to maintain a geographic diversity and to include countries where compelling and perhaps unfamiliar stories of progress could be told. Sri Lanka was selected as a story on the basis of shifts to more productive sectors and significant educational achievements. Alongside increases in GDP, the country's increase in the share of industrial employment placed it among the 10 top-performing countries. Wage employment also increased: Sri Lanka ranked 15th in the 'deviation from fit' ranking of increased share of wage employment, although informality remains high.
- 6 For a large number of data series, a full range of year-on-year measurements is not available, with significant gaps for some data ranges, as well as for some breakdowns of the data. Where data on particular indicators are not available in official sources, these were sought in the ILO's Key Indicators of the Labour Market (ILO KILM) database. In addition, specific ranges of data were sought in reports and publications of relevant organisations and institutions, including academic institutions, the Sri Lankan Central Bank and the World Bank's World Development Indicators (WDIs), with the help of IPS researchers. Gaps in some of the data remain, however, and will be highlighted as relevant throughout the report. Where relevant, data are compared with those of other South and East Asian countries.

Box 1: Key labour market data definitions

Throughout this report, extensive reference is made to employment trends, data and statistics. This box provides an overview of the key definitions used in this study. These mainly concern definitions used by the Sri Lankan Department of Census and Statistics in conducting its national Labour Force Surveys.

Work: Activity involving mental or physical effort done in order to achieve a result.

Job: A paid position of regular employment.

Labour force: The labour force is composed of the economically active population of working age. Different countries use different thresholds as the lowest working age – for example, the official threshold in Sri Lanka's labour force figures is 10 years. For this study, we have adopted the ILO's working-age population threshold of 15 years.

Labour force participation (rate): The ratio of the labour force to the working-age population, expressed as a percentage.

Economically active population: all persons of either sex who furnish the supply of labour for the production of goods and services during a specified time-reference period. It includes those who were employed or unemployed during the reference period of the survey.

Employed/employment: Persons who work as paid employees, employers, own-account workers (self-employed) or contributing family workers are said to be employed or in employment. This includes persons with a full- or part-time job but not at work.

Unemployed: Persons available and/or looking for work, and who have not worked and taken steps to find a job for at least four weeks and who are ready to accept a job given a work opportunity within the next two weeks.

Employment in the formal sector: Employment which is with an organisation that is either: (1) legally registered with the government; or (2) has accounting standards and practices in place; or (3) employs 10 or more permanent staff members. The Sri Lankan Department of Census and Statistics uses this firm-based definition to categorise formal/informal employment in the LFSs (thus excluding smaller-scale employment).

Employment in the informal sector: Employment which is with an organisation that is: (1) not legally registered; (2) does not have accounting standards and practices in place; and (3) employs fewer than 10 permanent staff members.

Vulnerable employment: Employment which provides the person employed with an insufficient income, which is insecure due to lack of social protection coverage and more at risk of economic shocks. Following ILO definitions, this has been estimated in this study by adding own-account (self-employed) and contributing family workers.

Working poor: The proportion of working persons living in households below the poverty line.

Employment in the semi-government sector: Employment in government-owned corporations, boards, authorities and public-private partnership companies.

2. What progress has been achieved?

Sri Lanka, classified as a lower-middle-income country since 2010, has managed to reduce unemployment drastically over the broad period encompassing 1990-2010. This was a time of continuing internal conflict, which ended only in 2009. This period also included a natural disaster of great proportions – the 2004 tsunami – and economic shocks of rising food and oil prices in 2007 and 2008.⁷ This section examines the main elements of employment progress achieved in Sri Lanka over the past two decades. These can be summarised as follows:

- Increased employment creation and access, in terms of a lower unemployment rate and a higher employment-to-population ratio, as well as increased levels of wage employment.
- Transformation of the structure of the economy away from agricultural employment, plus 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 for women.

2.1 Employment creation and equitable access

Recorded unemployment in Sri Lanka fell from 14.5% in 1992 to 4.0% in 2012. This is the main element of employment progress that this case study aims to explain. The progress is all the more impressive given that the Sri Lankan working-age population has grown at an average rate of 3% annually over the same period. The labour force, defined as employed and unemployed people of working age, has also grown, even if at a lower rate of 2.5% per annum.

This relates at least partly to the *quantity* of jobs created, accompanied, and to some extent driven, by increasing *access* to employment creation for women: female unemployment declined from 20% in 1992 to only 6.2% in 2012, falling most in the age groups 15-24 and 25-29, and for those with primary school but non-university education. Youth unemployment has also declined, from 36.5% and 18.9% for 15-24 and 25-29-year-olds, respectively, in 1992 to 17.3% and 6.6%

in 2012. Although subject to variation across provinces, unemployment fell in both urban and rural areas.

‘Traditionally the country has had high youth unemployment, which has often been signalled as a cause/contributor to the war. But since the 1990s, youth unemployment fell for the first time. It is interesting to explore why’ – Academic

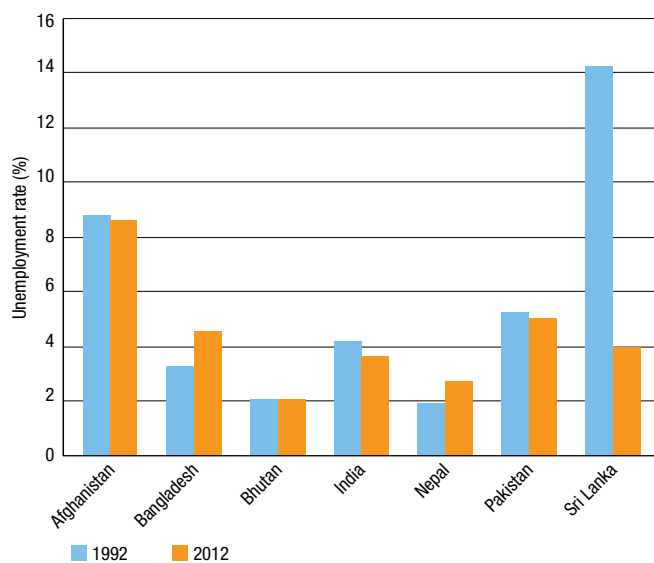
Sri Lanka had consistently high unemployment in the two decades before 1990. This was partly attributable to a voluntary ‘waiting’ phenomena due to the gap between ‘good’ and ‘bad’ jobs in the public and private sectors, which encouraged young people to remain unemployed until they were able to find a job in one of the sectors considered ‘good’ (Rama, 2003). This is reflected in the 1992 unemployment rate for Sri Lanka. The decline in unemployment is the largest in the period among South Asian countries, some of which even showed increases in unemployment rates, as illustrated in Figure 1 (overleaf).

Although Sri Lanka’s unemployment rate remains higher than those of India, Bangladesh, Bhutan and Nepal, the large drop is remarkable and worthy of further exploration, particularly given Sri Lanka’s circumstances over this period. While other South Asian countries suffered from war and conflict during this period (including India, Pakistan and Nepal), Sri Lanka is the only country to have experienced civil war *throughout* the period observed, while making consistent progress in reducing unemployment. Moreover, while labour outflows have potentially reduced the pool of economically active population in the country, the decline in unemployment has surpassed migratory flows (Figure 2, overleaf), an important aspect of Sri Lanka’s employment progress, as discussed below.

Examining Sri Lankan unemployment rates by age group, gender and education level (Table 1, overleaf), there are two clear trends. First, unemployment declined more and faster

⁷ While Sri Lanka and the Aceh province of Indonesia were among the places worst affected by the 2004 tsunami, with 31,000 Sri Lankan lives lost and 6,000 reported missing, the economic impact was relatively limited. The tsunami missed the industrial and commercial centres of all affected countries (other than Maldives), although the Asian Development Bank predicted that the immediate and lingering effects would throw some 250,000 people into poverty (Athukorala and Resosudarmo, 2005). In Sri Lanka, the main economic and employment impacts were felt in the fisheries sector (which contributes around 2% of the country’s GDP) and in key agricultural and commercial hubs for provincial economies.

Figure 1: Unemployment rate, South Asian countries, 1992 and 2012



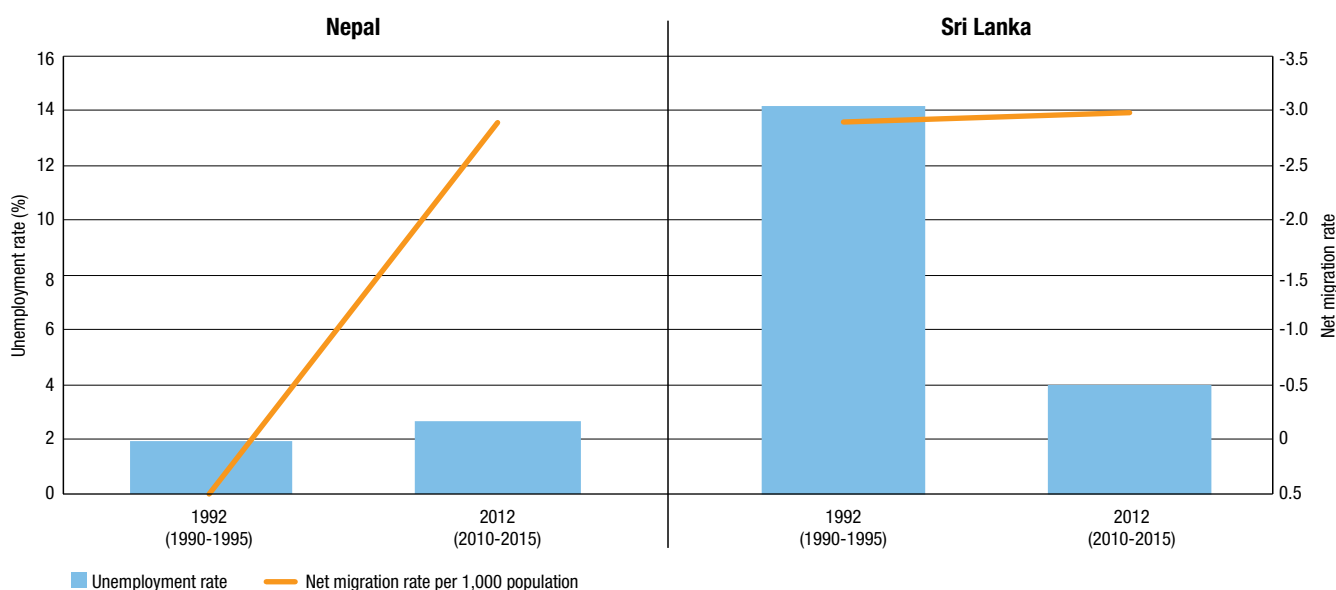
Source: ILO, KILM.

for women in Sri Lanka, though starting from and ending at a higher level than for men: from 22.4% in 1992 to 9.7% in 2006 and 6.2% in 2012, compared with 10.7% to 4.7%, to 2.8% for males. Female unemployment fell most in the age groups 15-24 and 25-29, and for those with education beyond primary school but who were not university educated.

The better-educated of the labour force have also found more jobs: unemployment among O-level and A-level secondary school graduates has declined rapidly, from 22% and 26%, respectively, to 6% and 8%. However, unemployment among youth and those with a university degree or higher qualification persists: unemployment among degree graduates fluctuated around 5% during 1990-2010, reflecting an enduring difficulty in school-to-work transition and youth unemployment.

The long-term decline in unemployment reflects 3.3% employment growth per annum over the 1992-2012 period: 3.5% per annum during the first decade from 1992 to 2000 and 2.4% over the 2000-2012 period. As of 2012, 8.1 million working-age people were employed in Sri Lanka, an increase of 3.2 million on 1992.⁸ This has grown roughly in step with GDP, as seen in Figure 3, at the same

Figure 2: Migration and unemployment, Nepal and Sri Lanka, 1992 and 2012

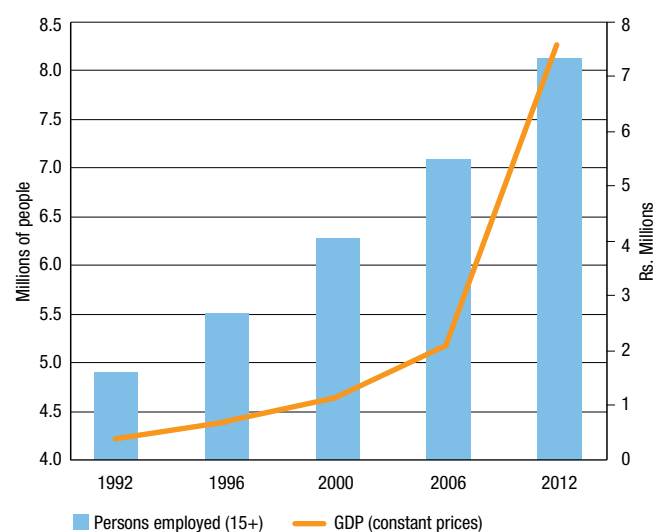


Source: ILO, KILM and UNDESA (2012).

Note: Net migration rate is a modelled estimate of the number of immigrants minus the number of emigrants over a five-year period. It is expressed as net number of migrants per 1,000 people (population of the country); a negative net migration indicates a greater number of outflows than inflows.

⁸ The main source of information for this section is the national Labour Force Survey (LFS) conducted by the Sri Lanka Department of Census and Statistics every four years since the late 1980s (now with quarterly and annual updates) to assess the state of the labour market as well as the nature of the labour supply. The analysis uses LFS data from 1992, 1996, 2000, 2006 and 2012; 2006 was chosen due to a change in the survey schedule that year to provide additional information for planning purposes. For comparative purposes, data are also drawn from the ILO's Key Indicators of the Labour Market (KILM) eighth edition (ILO, 2013a). For an overview of recent LFSs, see <http://www.statistics.gov.lk/page.asp?page=Labour%20Force>.

Figure 3: Numbers of persons employed and GDP, 1992-2012



Source: Central Bank of Sri Lanka (2006 and 2013).

time as GDP per capita has also been growing consistently since 1990, despite slower growth in 2001 and 2009, due to the intensifying of the conflict and global economic downturn (Figure 4, overleaf). This progress is reflected in the rapid rise in Sri Lanka's Human Development Index

ranking to 0.75 in 2014, above the Asian average of 0.588 and the world average of 0.702 (UNDP, 2014).

Looking beyond these headline figures, however, there is something of a puzzle in Sri Lankan employment trends. As Table 2 (overleaf) shows, labour force participation rose from 55.6% in 1992 to 57.1% in 2006, but declined to 53.4% in 2012. The overall fall in labour force participation from 2006 to 2012 (stagnation for males), along with falling unemployment, suggests female workers in particular have been *exiting* the labour market. This reflects the recent growing post-war challenges mentioned by several interviewees, but, in particular, it reflects outward migration – an important factor in Sri Lankan employment patterns, as discussed below.

The employment-to-population ratio, the proportion of the working-age population that is employed (ILO, 2013a), followed a similar pattern to labour force participation, increasing from 47.6% in 1992 to 51.4% in 2012, having peaked at 53.4% in 2006.⁹ Despite declining unemployment and an increasing employment-to-population ratio, the proportion of working-age population employed for Sri Lanka remains marginally lower than the South Asian average of 53.9% in 2012, and below the world average of 59.6% (ILO, 2014), reflecting some ongoing challenges, which are discussed below.

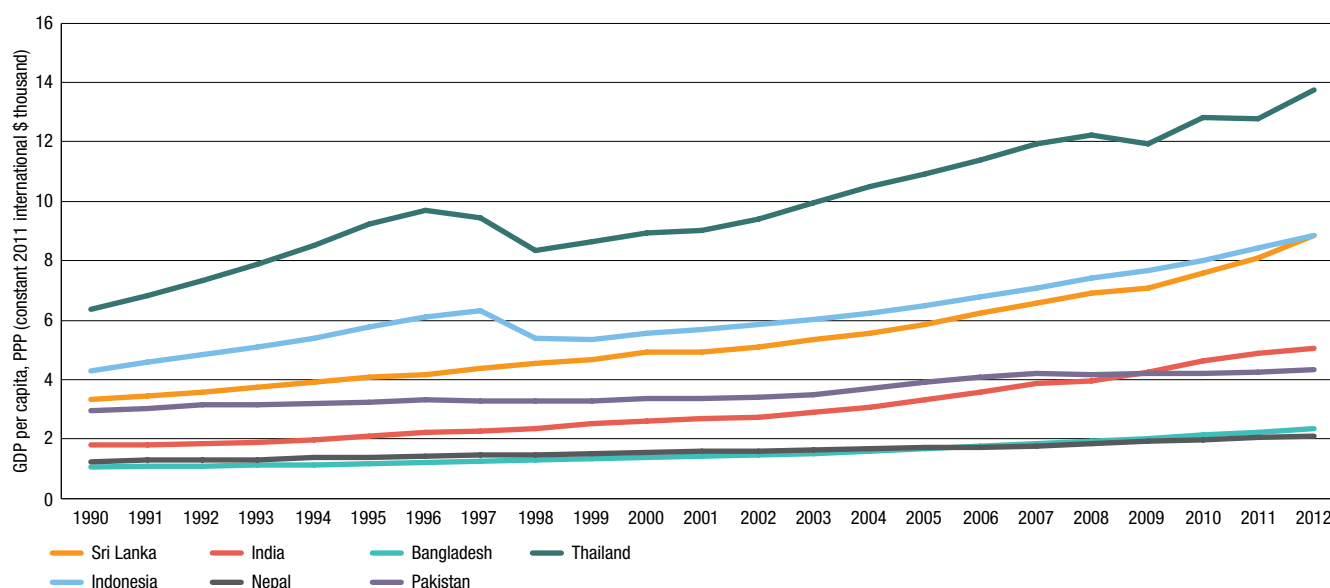
Table 1: Unemployment rates (%), by gender, age group and education, 1992-2012

	1992			2006			2012		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Sri Lanka	10.7	22.4	14.5	4.7	9.7	6.5	2.8	6.2	4.0
Age group									
15-24	30.7	45.9	36.5	17.5	28.2	21.6	14.0	23.5	17.3
25-29	12.5	31.1	18.9	6.8	18.1	11.0	4.3	11.4	6.6
30-39	4.9	12.9	7.7	1.7	6.0	3.3	1.4	4.7	2.5
40-49	2.2	4.2	2.8	1.4	2.3	1.7	0.6	2.0	1.1
50-59	1.8	0.8	1.6	1.0	1.3	1.1	0.5	1.1	0.7
over 60	1.1	1.2	1.1	0.9	0.8	0.9	0.5	0.7	0.5
Education level									
Primary	3.9	4.6	4.2	1.4	1.4	1.4	0.3	1.0	0.6
Below secondary	12.4	25.2	15.9	4.6	8.7	5.8	2.6	4.7	3.2
GCE (O/L)	15.2	35.8	22.2	7.3	14.3	9.9	4.7	8.8	6.0
GCE (A/L)	14.3	37.4	26.0	7.9	19.3	13.3	5.0	12.3	8.4
Degree and above	1.9	12.8	6.1	2.7	6.4	4.5	2.9	6.4	4.8

Source: Authors' calculations based on LFS 1992, 2006 and 2012 data.

⁹ It is 50.4% including the Northern and Eastern provinces, the areas most affected by the conflict.

Figure 4: Real GDP (PPP) per capita, South Asian countries, 1990-2012



Source: World Bank World Development Indicators.

2.2 Structural change

The second aspect of employment progress for Sri Lanka has been the structural transformation away from agricultural employment. Until the early 1990s, the agricultural sector accounted for more than 40% of Sri Lankan employment and was limited to a few crops, such as tea, rubber, coconut and paddy rice. This concentration made Sri Lanka vulnerable to output shocks as well as 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. During the same period, industrial employment rose from 20% to 26%, while service-sector employment also increased, from 38% to 43% (Table 3).

Within industrial employment, the manufacturing sector employs the most of any industrial sub-sector.

Manufacturing is also a significant contributor to GDP, remaining relatively stable throughout the 2000s at around 17% (Table A1 in the annexe to this report), comparable with Vietnam and Bangladesh and above India and Pakistan (Figure 5).

Within the services sector, the biggest employment developments occurred in wholesale and retail trade. This sub-sector's share of total employment rose from 10.7% in 1992 to 14% in 2012, and it accounted for almost a quarter of GDP. Employment in transport, storage and communications rose from 4.2% to 6.5% over the same period, which accounted for over 14% of GDP in 2012.

Although agricultural employment is still clearly important, at 31% of total employment, the increase in services and manufacturing employment are important for their potential impact on labour productivity and

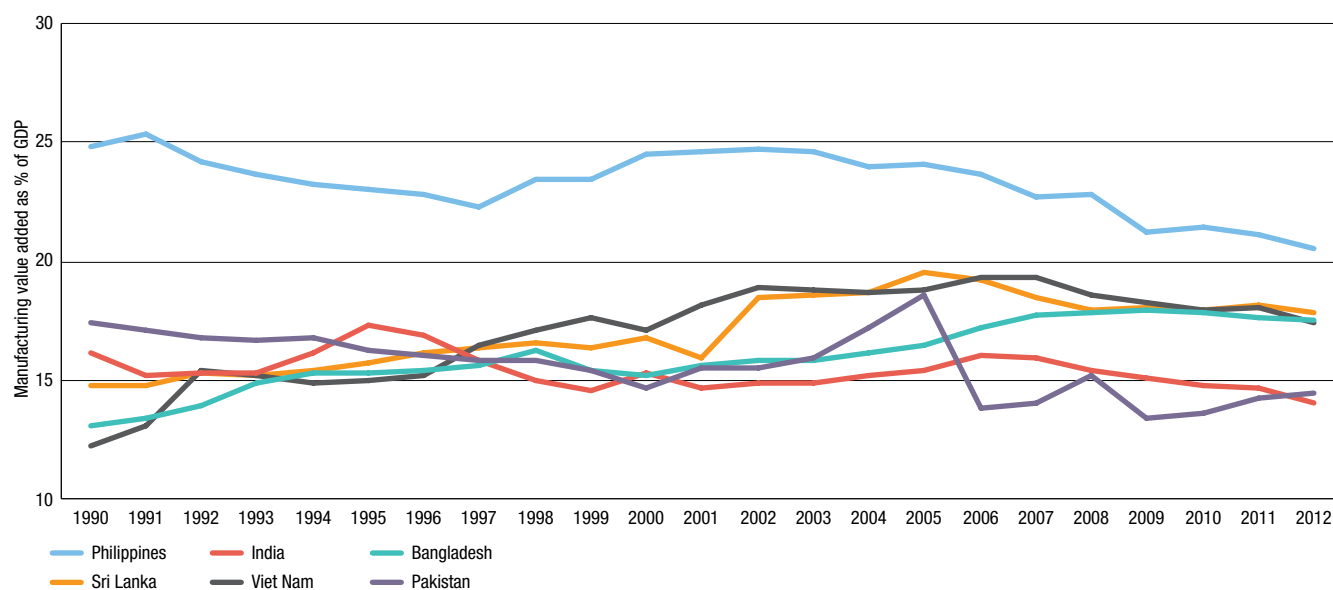
Table 2: Labour force and employment, by gender, ages 15+, 1992-2012

	Labour force participation rate (%)			Employment-to-population ratio			Unemployment rate (%)		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
1992	75.2	36.2	55.6	67.2	28.1	47.6	10.7	22.4	14.5
1996	76.0	36.0	55.7	69.7	29.6	49.4	8.3	17.8	11.4
2000	76.1	37.9	56.7	71.7	33.7	52.4	5.8	11.1	7.6
2006	76.7	39.5	57.1	73.1	35.7	53.4	4.7	9.7	6.5
2012	75.2	34.4	53.4	73.1	32.4	51.4	2.8	5.8	3.9
2012*	75.0	32.9	52.6	72.8	30.9	50.5	2.8	6.2	4.0

Source: Sri Lanka Labour Force Survey 1992-2012.

Notes: 1992, 1996, 2000, 2006, 2012 excluding Northern and Eastern provinces. *All districts included.

Figure 5: Manufacturing value added as percentage of GDP, South Asian countries, 1990-2012



Source: WDI (2014).

employment quality. Figure 6 (overleaf) shows that output per worker has grown quickly, 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).

To examine labour productivity at the sectoral level, Figure 7 (overleaf) looks at real output per employed person, illustrating that the services sector is the highest-productivity sector in the economy, followed by industry, with agricultural productivity considerably lower. Both services and industrial productivity have also increased, particularly since 2008, while productivity in agriculture has remained stagnant, at least from 2005 onwards. The majority of formal private-sector employment in 2012 was in the non-agricultural sector, while formal agricultural employment is mainly in the government-owned estate sector.

2.3 Employment quality

The *quality* of jobs can be measured as an inverse relation to the share of vulnerable employment. This share is much lower in Sri Lanka than elsewhere in the South Asia region, as illustrated in Figure 8 (overleaf). The percentage of working poor almost halved during the 2000s, reaching 5.8% in 2007 (ILO, 2013a), while the poverty headcount ratio declined from 28.8% of the population in 1996 to 6.7% in 2013,¹⁰ pointing again to the current benefits of progress made during the period under analysis.

This suggests that rising productivity has translated into rising wages and earnings, for formal and informal workers, with average wages increasing by 19.8% from 2006 to 2012. Female earnings rose by an even higher 25.4%, compared with 16.9% for males (Table A3 in

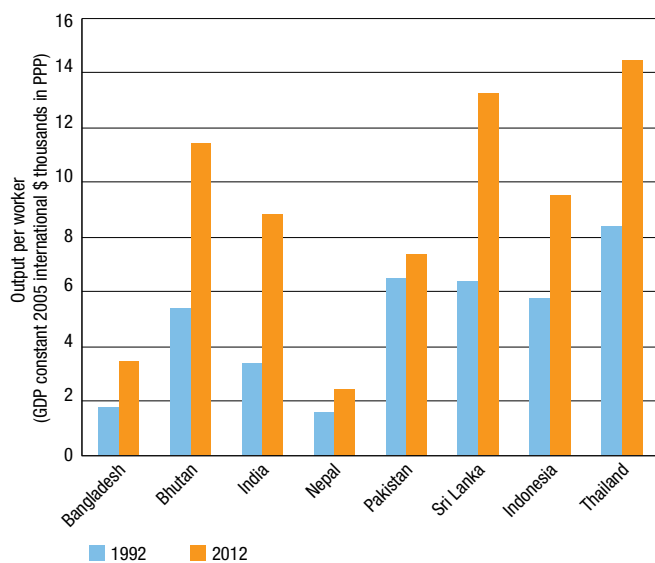
Table 3: Employment shares by sector, 1992-2012

	Employment shares %				Share of GDP %
	1992	2000	2006	2012	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: Sri Lanka Labour Force Survey 1992-2006.

10 National poverty line (World Bank, WDI).

Figure 6: Output per worker, selected Asian countries, 1992-2012



Sources: ILO (2013a), KILM.

the Annexe), although rising from a lower level and remaining below average male earnings in 2012.

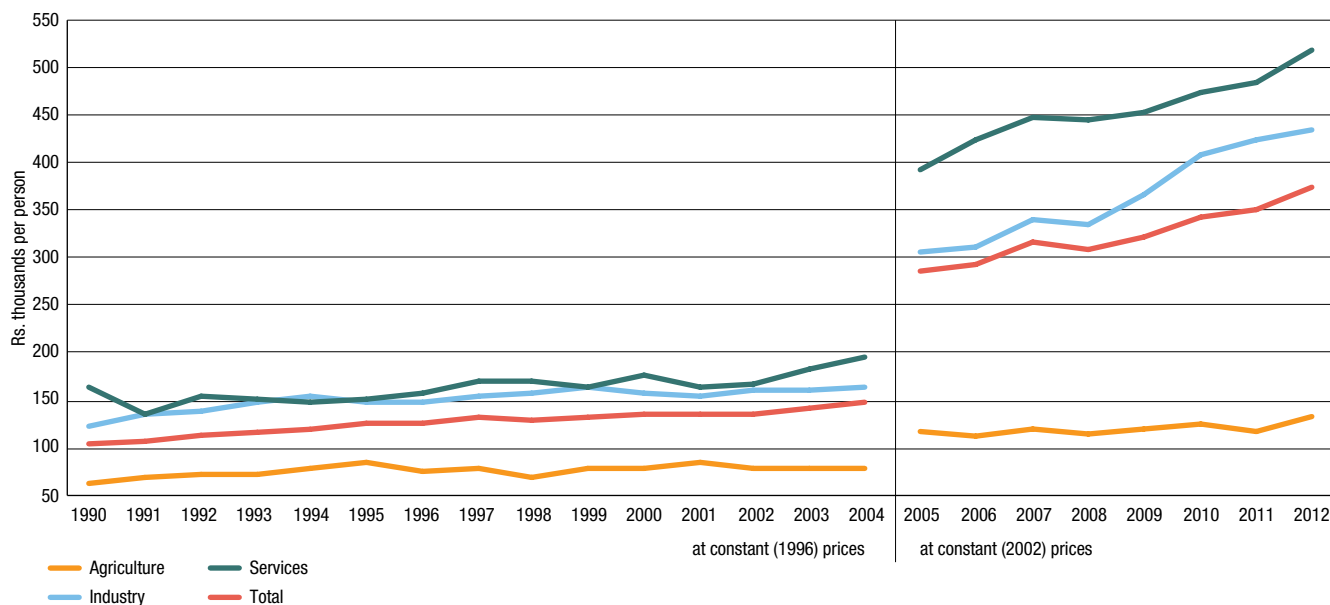
In fact, the largest earnings increases were for all lower-earning occupations, such as services, craft, plant and machine workers, and ‘elementary occupations’,

suggesting at least a degree of catch-up with higher-wage categories. This is confirmed by monthly earnings data for informal employment that suggest these increased by 35.9%, compared with 21.9% in the formal private sector. While the Household Income and Expenditure Survey of 1990/91 to 2009/10 shows a decline in poverty, income inequality has nonetheless remained more or less unchanged, with only a marginal reduction in 2010 (UNDP, 2012). Thus, it appears that the increase in low wages has not been reflected in decreasing inequality, probably because the highest earners are either not captured in these surveys or have non-wage incomes that are rising at a faster rate.

The highest recorded earnings continue to be in the public and semi-government sectors, with average earnings 36% and 10% higher than in the private sector, respectively, even if their growth of 2.4% and 8.7%, respectively, was lower than in other sectors between 2006 and 2012. This points to the potentially strong role of the public sector in promoting overall employment quality. Armed forces and agricultural-sector workers have also seen relatively small increases (5.7% and 7.8%, respectively), the smallest increase in earnings has been for higher-earning professionals, at only 2.7% over the six-year period (Table A3).

As a result of wage and earnings increases, the share of working poor in extreme poverty has decreased

Figure 7: Labour productivity by economic sector, 1990-2012



Sources: Central Bank, annual reports, various issues.

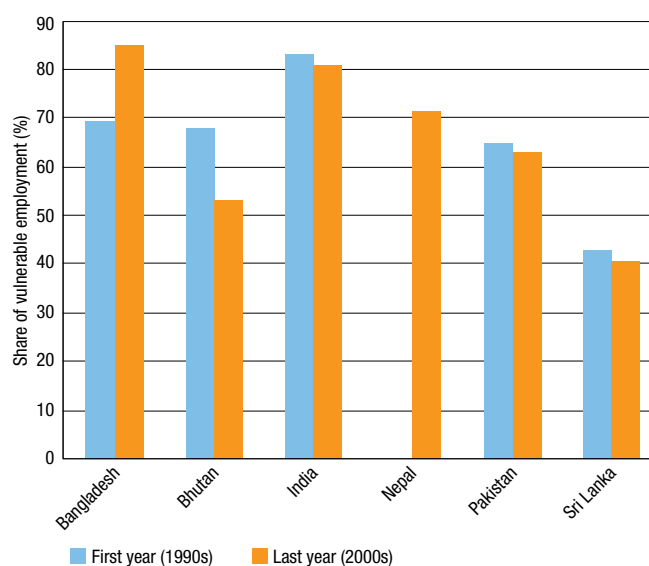
Notes: Productivity shown as real output (Rs 1,000) per employed person. Employment data exclude Northern and Eastern provinces up to 2007 and exclude Northern province between 2008 and 2010. All provinces included in 2011 and 2012.

significantly in Sri Lanka over the past two decades, from 12.4% in 1991 to 5.8% in 2007 (Table 4).¹¹ When looking at those above extreme poverty but below the \$2.00 poverty line, the share of working poor has also decreased, from 31% to 21%. The share of those in the near-poor category has remained relatively stable at 42%, while the share of those working and belonging to the ‘middle class’ has increased from 12% to 28%. Overall poverty has also declined in Sri Lanka, from above a quarter of the population in 1990 to a single-digit figure in 2010 (World Bank, WDI 2014).

In sectoral terms, the largest share of working poor (42.5%) is unsurprisingly in agriculture (Gunatilaka, 2010).¹² Roughly a third of the Sri Lankan workforce has traditionally worked in the agricultural sector, with rice production providing seasonal employment for nearly half the labour force in rural areas outside Greater Colombo. Although real income from paddy production has dropped significantly since the 1970s, rural wages have risen from the 1980s onwards, coinciding with the expansion of rural non-farm employment through small and medium enterprises (SMEs) (Sumanaratne, 2011; Chandrasiri, 2013) and underpinning the increased earnings discussed above.

Another important aspect of employment quality is job security. Whereas the effects of informality on growth and development are debatable, the phenomenon is closely linked to poverty patterns (OECD, 2009) and vulnerable employment.¹³ Approximately 40% of Sri Lanka’s total employed people were considered vulnerable workers from the 1990s through to 2012. The composition of vulnerable employment has not changed much since the 1990s. As Table 5 (overleaf) shows, the share of vulnerable

Figure 8: Share of vulnerable employment, South Asian countries, 1990s and 2000s



Sources: ILO 2013a, KILM.

Note: For each country, data from the earliest and latest available year in each decade are used. Data for Bhutan correspond to the 2000s only. Data for Nepal are available only for 2001. The discrepancy in figures between Figure 8 and Table 5 is due to different data sources. Table 5 relies on national data (from 1992) while Figure 8 highlights ILO data (from 1990).

employment even increased for women, from 34.7% in 1992 to 43.0% in 2012, indicating that the increased access to employment and the increases in participation and employment rates for women have been accompanied

Table 4: Shares of working poor, 1991-2007

Year	Share in total employment (%)				
	Extreme poor (<\$1.25)	Moderate poor (≥\$1.25 & <\$2)	Near poor (≥\$2 & <\$4)	Middle class (≥\$4 & <\$13)	Developed middle class and above (≥\$13, PPP)
1991	12.4	31.3	42.5	11.9	1.8
1996	13.4	27.8	40.7	16.3	1.8
2002	11.7	24.5	40.4	21.2	2.3
2007	5.8	20.6	41.9	28.3	3.5

Sources: ILO (2013a), KILM.

11 It provides an important link between employment (labour market status) and income poverty, and is often used as a proxy for income-related underemployment.

12 Based on the 2006/07 Household Income and Expenditure Survey.

13 Informality is defined on the basis of enterprise informality, which is based on the characteristics of firms (size, legal status) rather than on the characteristics of employment. However, limited data are available on the (in)formality of employment in Sri Lanka, and the definitions adopted in the LFSs are too broad to offer a fair estimation of the degree of precarious (i.e. low-income and shock-prone) employment in Sri Lanka. Hence, the rate of vulnerable employment can be used to approximate informal and precarious employment.

by an increase in vulnerable female employment, a marker of poor-quality employment creation.

Nevertheless, vulnerable employment in Sri Lanka remains the lowest of all South Asian countries, as illustrated in Figure 8, and much lower than the average for lower-middle-income countries, pointing again to the current benefits of progress.¹⁴

To sum up this section, rising incomes in Sri Lanka have been accompanied by a dramatic fall in unemployment from 1992 to 2012, particularly for women, although from a high starting point. A large proportion of employment is still vulnerable, but at a much lower level than elsewhere in the South Asia region.

Output per worker has also grown quickly, above that of other countries in the region, demonstrating productivity growth as the economy has experienced a degree of structural transformation from agriculture towards manufacturing and services, with rising productivity in the latter two sectors and rising incomes for informal and formal private-sector workers.

While this section has focused on employment progress, this is not to ignore the numerous challenges that remain, as discussed below. But the large drop in unemployment, linked with structural transformation and rising productivity and average earnings, points to some degree of policy success, particularly over a period of civil war.

Table 5: Vulnerable employment rate, by gender, 1992-2012

	Male	Female	Total
1992	38.6	34.7	37.4
2006	39.5	44.2	41.2
2012	39.6	43.0	40.7

Sources: LFS 1992, 2006, 2012.

Note: The discrepancy in figures between Figure 8 and Table 5 is due to different data sources. Table 5 relies on national data (from 1992) while Figure 8 highlights ILO data (from 1990).

¹⁴ According to the latest available data (ILO, 2013a), the share of wage employment in Bangladesh is 14% (2005), 28% in Bhutan (2012), 18% in India (2010), 24% in Nepal (2001) and 36% in Pakistan (2008). Aggregate data for 2012 suggest that the share of wage employment in lower-middle-income countries was 27%, while vulnerable employment was 67% (WDI).

**SRI LANKA HAS SEEN
A DRASTIC REDUCTION
IN UNEMPLOYMENT AND
IMPROVED WORKING
CONDITIONS.**



REDUCTION IN UNEMPLOYMENT

Unemployment
in Sri Lanka
fell from

15%

in 1992

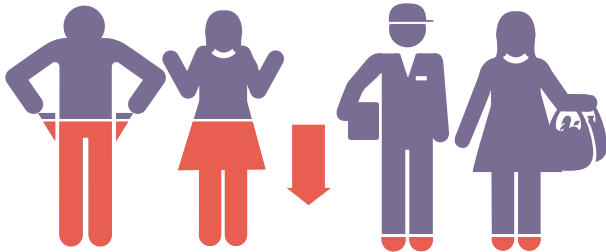
to

4%

in 2012



THE IMPACT PROGRESS HAS MADE



People living in poverty declined from
29% of the population in **1996** to
7% in **2013**

Source: National poverty line, (WB, WDI)

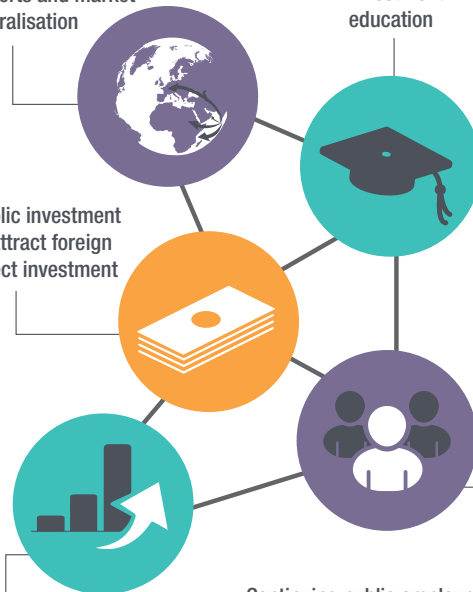
HOW PROGRESS HAS HAPPENED

Five key factors have played a central role
in driving progress in Sri Lanka

A mix of greater
exports and market
liberalisation

Long-standing
investment in
education

Public investment
to attract foreign
direct investment

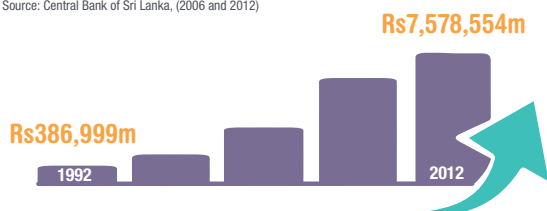


Progress from
a low base

Continuing public employment
in the civil service and
state-owned companies

An increase in GDP has aided employment creation

Source: Central Bank of Sri Lanka, (2006 and 2012)



3. What are the factors driving change?

This section examines some of the key drivers behind Sri Lankan employment progress as described above. We look at these in terms of labour demand and labour supply.

First, we look at *labour demand*. Key policies include a long-running, gradual export orientation, starting in the late 1970s, combined with promotion of inward investment through fiscal incentives and Export Processing Zones (EPZs). The outward orientation was intended to encourage foreign and domestic investment in the garments sector in particular, but also more recently in tourism (Gunasinghe, 2004).

While implementing market-oriented reforms, the state also maintained a strong role through state-owned enterprises and major public investments in housing, hydroelectric dams, the EPZs, and programmes such as the 200 Garment Factories Programme, all used as instruments to promote investment and job creation. Tax incentives, concessional financing, export credit insurance and other instruments were widely used to promote investment, while public-sector employment has also been important.

Despite several changes of government throughout the period under analysis, Sri Lanka is striking for the observed continuity in policies and approaches to promoting economic development. While none has ostensibly targeted employment creation, the mix of outward orientation and public spending programmes, all during a period of prolonged civil war, had clearly met with considerable employment success.

Second, we discuss factors affecting *labour supply* in Sri Lanka. While Sri Lanka had an educated labour force before independence, it has continued to invest in education and was among the first few countries to achieve the second Millennium Development Goal (MDG 2), with 98% literacy. At the same time, investments in technical and vocational education and skills training (TVET) have helped to fill emerging gaps in the formal education system in matching labour supply with demand, also helping in encouraging foreign direct investment (FDI) and the quality of employment.

Labour supply has also benefited from continued support to Sri Lanka's post-independence social protection model throughout successive governments, with free universal healthcare and several social safety nets and pension funds in place. Worker conditions, training and protection improved in the garments sector in collaboration with manufacturing firms. Voluntary outward migration, as well as military expenditure and employment from 1970 to 2010 (Gunasinghe, 2004; Venugopal, 2011) have also influenced Sri Lanka's employment progress.

Government interest in training and capacity came with the emergence of new manufacturing destinations in South East and South Asia in the 1990s, so was also very much related to attracting inward investment to produce for export markets. This was led by the government, together with the private sector, donor assistance and non-governmental actors, with a particular emphasis on providing effective regulation of the TVET sector. Section 3.1 describes these efforts.

Despite some improvements in the supply side, matching supply and demand for labour remains a challenge, and many Sri Lankans have sought employment opportunities abroad. Subsequent parts of this section discuss programmes and approaches to improving labour matching in Sri Lanka, followed by policies adopted around labour migration. We examine these drivers in detail in the following sub-sections.

3.1 Market liberalisation with state engagement

In response to the crisis at the end of the 1980s, with unemployment at over 20%, the Sri Lankan government embarked on a wide-ranging programme of market reform. Although implemented as part of an IMF package to address large fiscal deficits, this had wide consensus so was apparently not seen as externally driven. The UNP-led Premadasa government, in power from 1989 to 1993, pursued privatisation¹⁵ initiatives as part of what it labelled 'peopalisation' in addition to further tariff cuts¹⁶

15 Prior to the change of government in 1994, 47 SOEs were divested through sales of shares and management contracts, in the ceramics, cement, distilleries, textiles, tyres and plantation sectors (MFP, 1998).

16 Intermediate goods saw duties reduced from 19% in 1989 to just under 5% in 1995.

(particularly for consumer goods and intermediates), tax reforms,¹⁷ removal of exchange rate controls and reduced foreign investment restrictions, all intended to promote greater investment in export-oriented production.

Although the following Kumaratunga government, in power from 1994 to 2005, was ostensibly more leftist, given the preceding crisis it continued 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). The system of proportional representation that was introduced for parliamentary elections in 1994 also led to a rise of coalition politics, resulting in more piecemeal reforms and a loss of focus as smaller parties were able to advance the interests of narrower constituencies. This is also said to have led to a deepening of political patronage. While the Premadasa ‘peopalisation’ privatisation approach was not pursued aggressively, the Kumaratunga government did divest major stakes in SOEs from 1994 to 1998 in public

utilities (electricity) and services (telecoms, airlines), by way of cabinet tenders.¹⁸

The following 2005 Rajapaksa government set out a new development vision, the ‘Ten Year Horizon Development Framework (2006-2016)’, halting or reversing liberalisation policies. SOE privatisation was also halted, while domestic industries, infrastructure and poverty alleviation were promoted and effort went into rationalising and rendering efficient SOEs. While having succeeded in ending the war in 2009, and being recognised for investment in infrastructure, Rajapaksa was voted out in the 2015 election amid frustration at what was perceived as cronyism and corruption.

The common thread through all of the above was the continuation of pro-market reforms and outward orientation while maintaining an important public-sector role in the economy, with implications for employment outcomes. While privatising major public utilities, the Kumaratunga government still relied on public investment programmes, mainly focused on capital expenditure



Two young workers build glass fish tanks. Photo: © ILO / Yamuni Rashmika Perera.

17 As part of liberalisation and industrial promotion efforts, successive Sri Lankan governments have tried to simplify the tax structure, both domestically and on trade, with varying degrees of success. Rather than streamlining the tax structure into a single or a few legal Acts, the tax structure burgeoned with 37 separate Acts. Hence, while the tax system in the early 1990s was characterised by very high statutory taxes, by both international and regional standards (with corporation income tax at over 50% on privately owned companies and 33% on small businesses (15 employees or fewer)), this was matched by a wide variety of tax exemptions as investment incentives (Jenkins and Barreix, 1992). For a listing of the successive changes to various tax codes from 1980 to 2000, as well as a summary of the Sri Lankan tax system circa 1990, see IMF Institute (1996).

18 The Public Enterprise Reform Commission, established by Act No. 1 of 1996, was mandated to improve efficiency in the economy, increase government revenue and motivate the private sector, though not explicitly to divest from and privatise SOEs. Nevertheless, divestiture did generate over \$500 million between 1995 and 1998 and attracted a further \$400 million in foreign inflows, and private investments in the gas, steel, telecoms, plantations and civil aviation sectors.

Table 6: Employment by sector, 2006 and 2012

	2006	Percentage of total	2012	Percentage of total	Ave. annual rate of change (%) 2006-2012
Public	656,091	16.6	876,725	19.1	4.8
Semi-government	299,107	7.6	353,673	7.7	2.8
Formal private	1,486,547	37.7	1,617,317	35.3	1.4
Informal private	1,506,025	38.2	1,736,397	37.9	2.4
All employees	3,947,770		4,584,112		2.5

Source: Authors' calculations based on LFS 2006, 2012 data.

in information & communications technology, energy and road infrastructure, as well as a new poverty alleviation programme, which included elements such as the Mahaweli Ganga Development Programme, a large integrated rural development multipurpose programme (MFP, 1998). The 1990s also saw a strong rise in military expenditure, from below 3% in the late 1970s, to over 5%-6% in the late 1990s and up to over 20% of government expenditure in the early 2000s. Military employment also rose, as a result of the conflict.

Continued public investment and involvement in SOEs partly relied on the availability of external finance. Sri Lanka's relationship with donors was critical in financing employment progress. For a long time, Sri Lanka was seen as a 'donor darling', receiving large amounts of money, especially for infrastructure – from massive irrigation and power projects to schools, hospitals and housing. Trade preferences from industrial countries through the Multi-Fibre Arrangement (MFA) and the EU GSP+ export quotas were also channels for support and contributed to the development of the manufacturing industry in Sri Lanka. As the war continued, with military expenditures also rising, traditional donors (mainly the EU and the US) became increasingly reluctant to finance the country, and pressured for a ceasefire and resumption of peace talks. Sri Lanka then drew on support and financial resources from new partner countries, including China¹⁹ and Iran,²⁰ but also Japan and India, tilting its foreign policy away from the West. This was particularly the case after the Rajapaksa coalition government was elected to office in November 2005, leading to full-scale hostilities with the Liberation

Tigers of Tamil Eelam (LTTE), also known as the Tamil Tigers, in July 2006.²¹

Recent figures suggest that, even in the period 2006 to 2012, the highest employment growth rate by far was in public-sector employment (4.8%), followed by semi-government (para-state) employment (2.8%) and the informal private sector (2.4%) (Table 6), where the informal private sector relates particularly to the agricultural sector (smallholder farming of cash crops).²² This illustrates the strong role that public employment has had in Sri Lanka's recent employment progress, accounting for 27% of total employment, compared with formal private employment at around 35% in 2012, despite more than 20 years of ostensible market reform.

3.2 FDI and Export Processing Zones

In addition to creating public jobs, part of the public expenditures that accompanied market liberalisation described above went into creating and servicing Export Processing Zones (EPZs) – industrial parks with specific regulatory conditions with the aim of attracting FDI specifically but not exclusively. Originally adopted as a policy objective in 1978, EPZs took on greater prominence during the second phase of reform in the 1990s, when the Board of Investment was also set up, and continued to be used as a strategy to encourage FDI for employment creation and foreign exchange earnings. Again, this strategy has been followed through successive changes in government.

19 China's Export-Import Bank funded subsidised investment projects including Sri Lanka's first four-lane expressway, a second international airport and a port in Hambantota city.

20 Iran provided soft loans and investment in major infrastructure projects such as the \$450 million Uma Oya hydroelectric project and the \$750 million upgrade of Sri Lanka's only oil refinery at Sapugaskande.

21 Western pressure also reflected an implicit disapproval of Sri Lanka's growing economic ties with China and Iran, which had been fostered not only as a means of enhancing economic growth, but also to provide a counterweight to such pressure from the West (e.g. Weiss, 2011).

22 LFSs before 2006 do not allow disaggregating employment by sector in a comparable way. However, previous estimates from the 1992 LFS indicate that public-sector employment was close to 20% of total employment.

Box 2: 200 and 300 Enterprise Programmes

The export-oriented production of clothing (ready-made garments) began in the 1970s and expanded rapidly after the liberalisation of the economy in 1977. During the 1980s, garment exports were growing rapidly and by 1986 garment exports accounted for the largest share of all exports (27%). In 1992, the Board of Investment (BOI) of Sri Lanka offered an attractive incentive package to all garment manufacturers to move into rural areas of Sri Lanka under the 200 Garment Factories Programme, considered the turning point for the apparel industry. The BOI was able to set up 163 factories under the said programme by 1995. By 1992, the garment industry had become the largest foreign exchange earner in the country (worth \$400 million), overtaking the tea industry. By 2002, Sri Lanka's textile and garment sector accounted for 6% of GDP, 30% of industrial production, 33% of manufacturing employment, 52% of total exports and 67% of industrial exports.*

Similarly, in 2006, under 'Nipayum Sri Lanka' (the 300 Enterprises Programme), incentives were given for industries to relocate in the regions, which included exemption from income tax for 5-10 years and from duties and value added tax for the import of new plant and technologically advanced machinery. This is a major step towards bridging the gap between the incentives granted for BOI and non-BOI projects. Under the 300 Enterprises Programme, many concessions given to BOI investors were extended to local investors as well. Further, factories that relocated outside the Western province were allowed to deduct the costs of relocation from their taxable income (CBR, 2006).**

* Explanation on the 200 Garment Factories Programme from the BOI website (http://www.investsrilanka.com/key_sector/apparel/apparel_overview).

** <http://www.ilo.org/public/french/dialogue/download/epzsrilanka.pdf>.

3.2.1 The Board of Investment and its incentives

A cornerstone of the strategy to encourage FDI into EPZs was the establishment of the Sri Lanka Board of Investment (BOI).²³ This provided incentives for industry to locate in EPZs as a way of offering employment, providing customs-free and tax-exempt investment incentives, streamlined administration, cheap utilities and better infrastructure. It also formed programmes targeting rural youth through the parallel 200 Garment Factories Programme for Pradeshiya Sabha Divisions, which aimed at both domestic and foreign investors, inside and outside the EPZs (Box 2). The BOI operated as a 'one-stop shop' to address impediments to foreign investors, with the legal right to negotiate and close bilateral investment agreements with both domestic and foreign firms, to grant exemptions or vary the application of a list of investment-related Acts, including those related to inland revenue, sales and business turnover.

Although not tasked with financing the supporting physical investments in EPZs, the BOI did have an impact on public funds through the forgone revenues from tax incentives and duty-free imports of inputs (Athukorala and Rajapatirana, 2000). It also provided major support schemes, including concessionary financing and export credit insurance (Weerakoon and Thennakoon, 2006). Further, the BOI also facilitated 39 Double

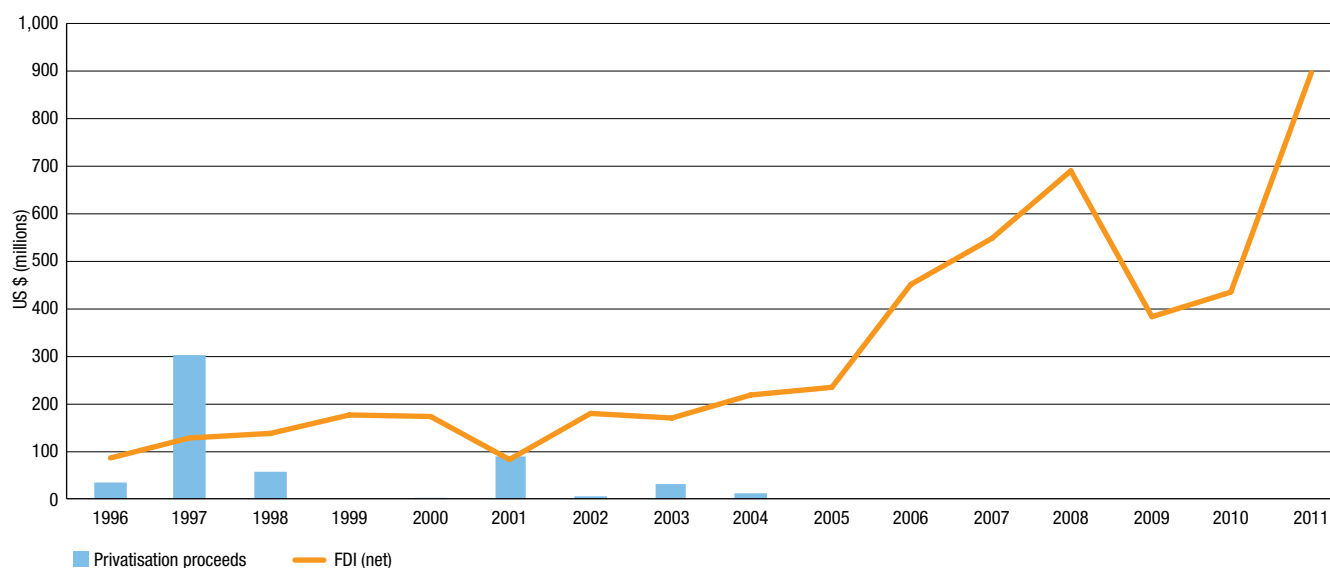
Taxation Avoidance Agreements (DTAs) with major investing countries, as well as 28 Investment Protection Agreements.²⁴ The BOI therefore served as a useful means to shortcut the lengthy legal process of changing laws to improve the business environment.

Since 2001, FDI flows into Sri Lanka have grown fast, except in 2009, which saw the intensification and ending of the civil war (Figure 9, overleaf). Attempts to spread the benefits of investment more widely have also been a large part of Sri Lankan government strategies. Under the Industrial Promotion Act of 1990, six Regional Industrial Services Committees were set up in Sabaragamuwa, Central, North-Western and North-Central provinces to increase the spread of investment beyond the southern regions, where investment and employment opportunities had been concentrated. Meanwhile, the development of seven new industrial estates in Gampaha, Matara, Galle, Monaragala and Chilaw brought the total number of investment projects to 1,482 by the end of 1994. The continued rise in FDI, particularly after 2005, was mainly due to the substantial reinvestment of retained earnings by existing BOI companies and, more importantly, to new initiatives by the BOI to attract investments for the setting up of 300 factories in less developed areas under the Nipayum Sri Lanka 300 Enterprises Programme.

23 The BOI, a merger of the Greater Colombo Economic Commission and the Foreign Investment Advisory Committee (FIAC) in 1992, was set up as one of the main tools for attracting foreign investment to foster economic growth. Law No. 4 of 1978 constituting the Board predecessors tasks it to foster economic development, widen the economic base, promote foreign investment, diversify the sources of foreign exchange earnings, increase export earnings and foster the establishment of industrial and commercial enterprises in Sri Lanka. It operates as an autonomous institution with direct access to the President.

24 The majority of these agreements were signed with developed economies in the 1980s, with some coming into force in the 1990s, but there was a notable shift towards signing agreements with neighbouring countries and other countries in Asia and the Pacific in the 1990s, including Bangladesh, Malaysia, Indonesia and Australia. DTAs were also agreed in the late 1990s with potential new investor countries, including Iran, Saudi Arabia and Russia.

Figure 9: Direct investment into Sri Lanka, 1996 to 2011, and proceeds from privatisation



Sources: Central Bank of Sri Lanka (2006 and 2013).

Much of the investment into the EPZs was foreign and concentrated in the garments sector, taking advantage of the MFA quota for garment exports to EU markets. This then explains part of the structural transformation seen above. Whereas foreign export-oriented manufacturing firms accounted for only 24% of the total in 1977, they accounted for just under 80% of all manufacturing exports in the 1990s. Firms with an agreement with the BOI accounted for half of manufacturing exports by the 1990s. Not only this, but the establishment of manufacturing export firms attracted international buying groups with links to these foreign firms, establishing local offices in Sri Lanka (Athukorala and Rajapatirana, 2000).

Because of these approaches, between 1979 and 2014, approximately 1,500 companies signed agreements with the BOI.²⁵ Nevertheless, the numbers of people employed, as well as the export earnings of these firms, kept growing in this period, partially explaining the employment progress in the industrial sector described in Section 2. BOI companies today employ over 450,000 workers, accounting for nearly 65% of Sri Lankan exports and 86% of the country's industrial exports (Wijesinha et al., 2013). Export-oriented manufacturing employment accounted for more than half of total employment growth from the 1980s and to the 1990s (Athukorala and Jayasuriya, 2012). Two-thirds of new jobs created in Sri Lanka from the 1990s and 2000s were in the export manufacturing sector. Employment in BOI firms grew from approximately 242,000 in 1996 to 451,000 in 2012, despite small declines in 2005 and in

2010 following the global economic downturn (Figure 10). The apparel sub-sector, aimed mainly at the international markets, accounted for between 60% and 70% of BOI enterprises employment throughout the 2000s.

While incentives and policies discussed have helped to create labour demand, there are remaining challenges. Some BOI deals allegedly provided for exemptions that directly affected labour laws, such as those related to unionisation and collective bargaining, affecting labour relations and potentially employment quality. Labour market regulations have been a contested issue in Sri Lanka, as reflected in the performance of firms outside the EPZs discussed here.

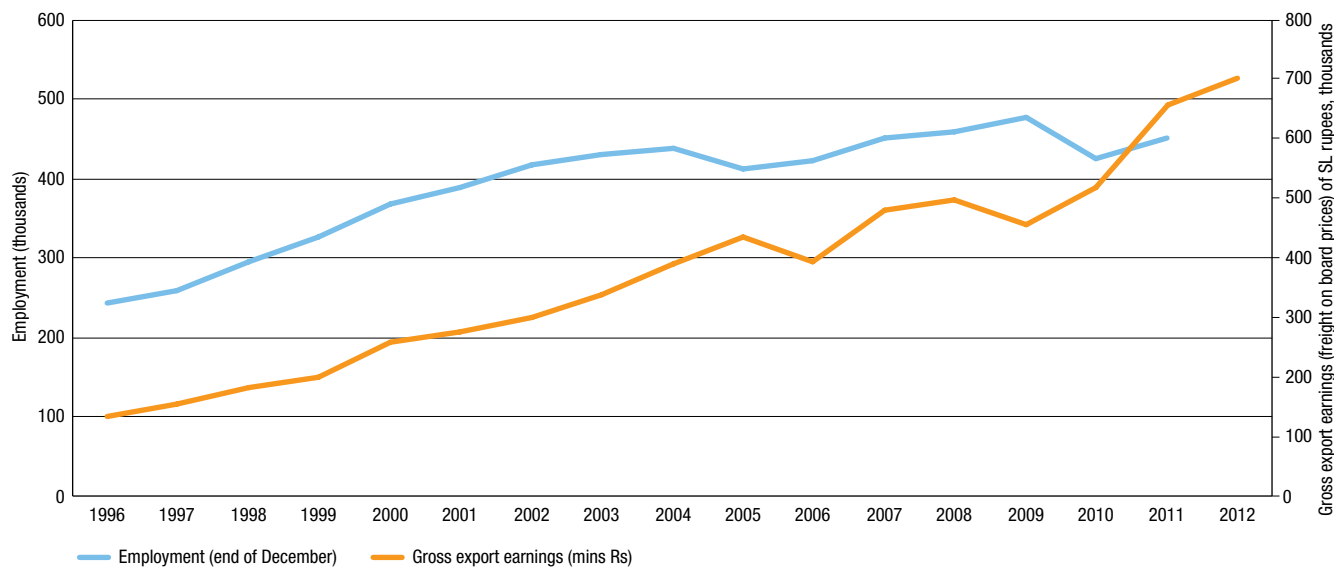
3.2.2 Labour demand from SMEs?

While the above points to the role of increasing investments in promoting employment creation, including foreign and domestic firms, small and medium-sized investors did not enjoy the same supportive regulatory, tax and operating conditions as larger firms receiving BOI incentives (UNCTAD, 2004). Although a national SME authority and a new SME-focused development bank were established to promote linkages between large investors and smaller companies, evidence of the impact of this is not available, while other restrictions on small firms may have had a more important role in hindering growth.

A major restriction that much FDI managed to avoid is the Termination of Employment of Workers Act (TEWA). This requires firms with 15 or more employees to justify

25 Of these, 1,136 firms signed contracts up to 1995, suggesting a slowing down of BOI investments from 1995 to 2012.

Figure 10: Employment and export earnings generated from BOI firms, 1996-2012



Sources: Central Bank of Sri Lanka (2006 and 2013).

layoffs and provide generous severance pay for workers.²⁶ Although it has been subject to various attempts at reform, evidence suggests that the TEWA has limited the expansion of firms beyond 15 employees, thus contributing to the high levels of informal-sector employment reported in Sri Lanka (Abiyode et al., 2008).²⁷ EPZ firms were given special provisions regarding the TEWA, offering further advantages over smaller firms in hiring and firing (Abiyode et al., 2008; World Bank 2004).

Although the EPZ approach was not explicitly aimed at creating employment, the BOI's mandate and activities did take account of the extent of employment creation (Weerakoon and Thennakoon, 2006). The EPZs and the resulting investments were an important driver behind the decline in female unemployment described above, particularly for those with secondary-level education. During the 1980s and 1990s, over 90% of the apparel workforce in Sri Lanka were women, who were also better educated and more skilled than in other Asian countries (Acevedo-Lopez and Robertson, 2012).

3.3 Reforming training and skills education to meet employment needs

Sri Lanka has a long history of prioritising investment in human capital, dating from before independence. Post-independence prioritisation of the national education system has translated into impressive gains in education,

much of which occurred before the period of analysis of this report. Sri Lanka has reached a 91% literacy rate, an almost universal rate of enrolment in primary education (99%) and a high enrolment rate in secondary education (87%). Because of this higher starting point, further improvements after 1990 have been somewhat slower. Still, mean years of schooling for adults has kept rising, from 8.3 in 1990 to 9.3 in 2010, and children today are expected to reach 12.7 years of schooling.²⁸

An increasing share of the population has completed secondary education, and the share of young people having completed a degree is also rising (Figure 11, overleaf), potentially contributing to the productivity growth described above. However, as was shown above, while secondary-educated unemployment rates are declining, unemployment rates for those with a degree increased between 1992 and 2012. Given that professional occupations in the public, semi-public and formal-private sectors are those requiring higher levels of education, and that public and semi-public workers also have the greatest earning potential, monetary incentives point towards educated persons waiting for higher-return, more secure public-sector jobs, as noted in Rama (2003) and confirmed in interviews.

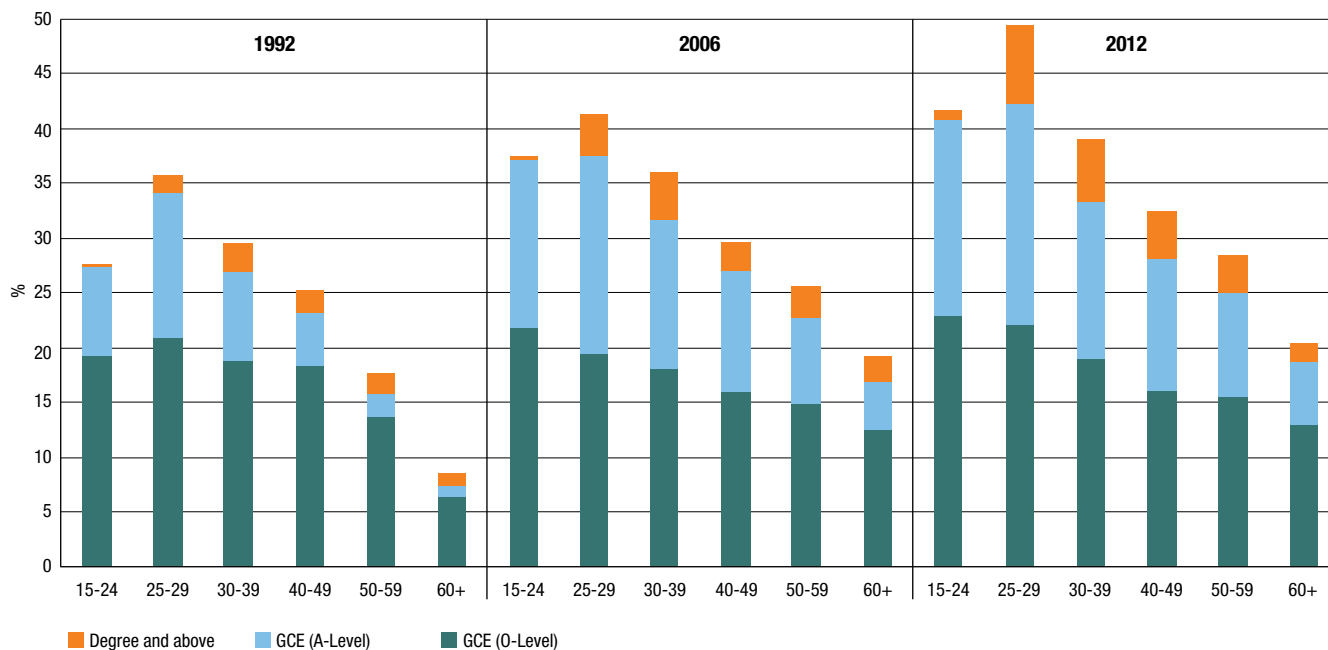
Formal education is free and compulsory in Sri Lanka. While government has traditionally emphasised formal education, persistent youth unemployment, linked to increasing social and ethnic tensions, made it necessary

26 Data for 2003 confirm that the TEWA procedure is a very lengthy one and the compensation under the TEWA is very high compared with other countries in the region (UNCTAD, 2004; Gunatilaka and Vodopivec, 2010; World Bank, 2006).

27 The 1977 reform package originally proposed a number of reforms of labour legislation to increase labour market flexibility, though these were never implemented due to legal action by trade unions (Athukorala and Rajapatirana, 2000).

28 <http://hdr.undp.org/en/data> (accessed May 2014).

Figure 11: Highest level of education completed by age group, 1992, 2006 and 2012



Sources: LFS 1992, 2006, 2012.

to rethink the education system to match labour-market needs.²⁹ Youth unrest in the 1970s, provided the impetus for a more ‘vocationalised’ education system, while the more recent move to an export-led economy raised concern about the quality of human resources in Sri Lanka (Chandrasiri, 2010; Gajaweera, 2010). Further, increasing numbers of graduates from primary and secondary education put pressure on government universities, which were unable to accommodate the additional demand,³⁰ but the technical and vocational education and training (TVET) sector accommodated some of the remaining students.

A large proportion of training is also provided free of charge, mainly funded from the government budget, with some specific projects funded through donor budget support.³¹ Between 2005 and 2010, public expenditure on education in Sri Lanka was 2.1% of GDP (MFP, 2012), slightly lower than in the 1998-2002 period, and lower than for similar countries in Asia (World Bank, 2005). Over the past few years, this has been increasing from LKR 72 billion in 2007 to LKR 95 billion in 2012, including

LKR 4.7 billion and 7 billion for TVET in 2007 and 2012, respectively (MFP, 2012).³²

As part of this, the TVET sector was targeted in the 1990s to make it more responsive to employment needs. For this, Sri Lanka received substantial assistance from a wide range of international donors, totalling \$605.98 million up to 2005 (Table A3.1 in ADB, 2005). Germany and Japan as well as the Asian Development Bank have continuously supported the TVET sector, allowing the government to establish several training institutes with the capacity to provide skills for the young population and to link the TVET and higher-education sectors.³³

Equally importantly, the government enacted successive policy reforms to improve the quality and quantity of training and match it to labour demand. With the establishment of the Tertiary and Vocational Education Commission (TVEC) in 1990 and the Ministry of Youth Affairs and Skills in 1994, the government made efforts to coordinate the policies and activities of the TVET sector to ensure that relevant, quality training was provided

29 Throughout this section, the technical and vocational education and training (TVET) system and the formal education system are treated separately. The education system comprises: schools that provide general education; the university system, which offers degree programmes; and institutions for technical education and vocational training (UNDP, 2012). The formal education system incorporates the first two, while the third type of institutions comprise the TVET sector.

30 More than 80% of youth aged 20-24 are not enrolled in higher education.

31 See a summary of the aid-funded education projects up to 2003 in Table 5 in CED (2008).

32 This is approximately \$552.4 million in 2007 and \$728.9 million in 2012 for the education budget, and \$36.0 million in 2007 and \$53.7 million in 2012 for the TVET budget (at market exchange rates).

33 This includes the Vocational Training Authority in 1995 and the National Youth Services Council, which provide training, job market information and career guidance to rural youth. In addition to TVET providers, the University of Vocational Technology aims to provide progressive upward movement for students from the vocational to the university level and was established to provide links between the TVET and higher education sectors.



A young welder at work in Sri Lanka. Photo: © ILO / M. Crozet.

Table 7: TVET recruitment and completions (public TVET institutions), 2002-2012

	No. recruited			No. completed		
	Male	Female	Total	Male	Female	Total
2002			51,443			39,178
2004			55,426			35,986
2005	36,020	19,508	55,528	20,178	12,237	32,423
2006	43,301	25,170	68,877	20,238	12,153	32,391
2007	37,118	23,080	60,198	19,170	111,325	30,495
2008	54,843	38,479	93,322	37,734	28,753	66,487
2009	50,919	36,914	87,774	37,046	27,327	64,373
2010	49,042	34,104	83,156	37,163	27,058	34,221
2011	56,177	41,747	97,924	33,544	24,916	58,460
2012	64,282	47,205	111,487	48,315	38,532	86,847

Source: TVEC (n.d.).

according to a national plan. A presidential taskforce was set up in 1995 to focus exclusively on the development of the TVET sector, leading to the 1998 Skills and Development Policy.³⁴ Among other things, this led to the reform in 1999 of the Tertiary and Vocational Education Act of 1990, making it law for all of the thousands of training providers to register with the TVEC to be able to provide recognised degrees.

The TVEC also established a National Vocational Qualification (NVQ) framework in 2005, representing not just a training certificate but a certificate confirming that the candidate has skills up to the respective NVQ level in their occupation. This further required the private sector to take an active stake in the TVEC's work, with 10 of the 17 members of the TVEC Board, including its Chairman, representing employer associations and private-sector entrepreneurs, thus ostensibly helping to improve the match between employers and employees.

As a result, the number of people receiving qualifications has more than doubled over the period from 2002 to 2012 (Table 7), boosting the number of people now able to access employment opportunities created through the investments described above.

The TVEC prepares Vocational Education Training Plans for growing industry sectors,³⁵ with particular attention given to the apparel industry in the context of the phasing out of the MFA in 2005. As a result, Sri Lanka's apparel industry has experienced significant upgrading on various dimensions, including production processes,

product composition, functions performed and, to a lesser extent, supply-chain upgrading (Acevedo-Lopez and Robertson, 2012). A five-year strategy for upgrading has focused on areas such as: strengthening marketing capabilities; creating design capabilities; improving productivity within firms; developing technical competence; enhancing grassroots-level skills; and encouraging a cohesive focus for apparel and textile education.

In addition to formal training courses, apprenticeships are the other main component of TVET in the country. Trade apprenticeships have been formalised through the National Apprentice and Industrial Training Authority (1990), which provides industrial placements for a large number of youths seeking training, lasting from one to three years.

As a result of the above, the TVET sector enrolls approximately the same share of young people (20-24 years old) as universities, although the numbers are still relatively small (3.6% of young people according to UNDP (2012)). The World Bank's Investment Climate Survey notes that a larger share of workers in Sri Lanka receive training than their counterparts in other countries in the region (World Bank, 2008). In particular, over 20% of production workers receive training, compared with fewer than 10% of production workers in India and under 5% in Pakistan and Bangladesh. Within the country, firms that engage in export activities or in research & development are more likely to report training. The World Bank also finds that the proportion of firms providing training is lower for non-export firms (15%) than for exporting firms (40%).

34 There were also attempts to make the education sector more focused on skills development. For example, the 1991 National Education Commission, which gave way to the 1997 education reforms, included the development of practical and technical skills as one of its main pillars. More recently, the government has introduced a Technology stream for the GCE (General Certificate of Education) A-level examinations. (http://www.investsrilanka.com/boi_publications/publications.html)

35 Seventeen sectors were targeted, and specific plans were written for the Sabaragamuwa, Eastern and Southern provinces (see http://www.tvec.gov.lk/pdf/Sabaragamuwa_VET_Plan.pdf, http://www.tvec.gov.lk/pdf/Eastern_Province.pdf and http://www.tvec.gov.lk/pdf/southern_province_vet_plan.pdf)

While the outcomes of improvements in the TVET sector are hard to quantify, Gajaweera (2010) notes that competencies training has been demand-driven, being identified by employers, including foreign employers. An evaluation of the Sri Lankan TVET sector from 2009 notes that the rate of return³⁶ of the TVET sector was 42%, with rates of 50% and higher found for private and village-level institutes (EML Consultants, 2009). About 25% of the trainees obtained permanent jobs and 30%, temporary jobs.³⁷ Chandrasiri (2010) also finds that training was associated with shorter job-search times, and that the returns, in terms of salary, are also positive but highly dependent on employment sector (the public sector valued formal training more highly, while the private sector rewarded formal and informal training equally).

While it is not straightforward to make an estimate of the numbers of Sri Lankans receiving TVET, it appears to be geographically concentrated. It is estimated that 75% of TVET enrolment occurs in the Western, Southern Sabaragamuwa, North-Western and Central provinces, which also together account for 84% of GDP (Chandrasiri, 2010). The TVET sector has offered a useful supply-side complement to Sri Lanka's shift towards export-oriented industries and seems likely to have been part of the growth in investment and productivity, if not a watershed for employment growth.

3.4 Social protection and access to jobs

Social protection systems are a potentially important component of progress in the *access* dimension of employment by helping to mitigate risks of unemployment and helping people to find jobs. Alongside the continuous commitment to the provision of health and education, Sri Lanka has a long history of social protection, although the trend towards a more piecemeal approach means its contribution to employment outcomes is somewhat ambiguous.

However, barring a few exceptions, social protection in Sri Lanka consists more of passive labour market policies and social assistance programmes, rather than active labour

market policies to help integrate the unemployed and underemployed into labour markets. For example, Sri Lanka does not have a public works programme comparable to those of other countries in the region, such as India, although targeted initiatives exist (Box 3, overleaf). While significant in terms of their potential impact at the micro level, these programmes have limited reach so are unlikely to have an impact on broader employment trends.

3.5 The labour migration safety valve

As discussed in Section 2, labour participation grew more slowly than the working-age population from 2006 to 2012. However, unemployment also declined over this period, suggesting that individuals have been exiting the labour market – entering informal employment or potentially migrating.

Outward labour migration has had an important role in Sri Lanka from 1990 onward, growing from under 10% of the total labour force and number of employed persons to roughly a quarter, or 1.8 million people, in 2009. Table 8 and Figure 12 (both overleaf) show the concurrent growth of the labour force alongside a steady increase in departures for foreign employment.³⁸

Low-skilled female workers dominated the migration patterns until the mid-2000s, particularly going to the Middle East to work as housemaids (i.e. domestic employment), where little or no previous work experience or skills are required and where pay is generally low. As Figure 13 (overleaf) shows, the share of male labour migration increases dramatically between 2006 and 2012, with the Middle East still the destination for over 90% of migrants who departed in 2012 (Central Bank of Sri Lanka, 2013), but with a shift towards more skilled migration (Figure 14, overleaf). Male migrants are mainly employed in semi-skilled positions, such as construction workers, waiters, electricians and carpenters – reflected in the 'other' category in Figure 14.

'An interesting feature of Sri Lanka is that it tried to develop a social insurance system for informal workers (fishermen, farmers and self-employed). Although coverage is still small, developing a decent system is hard, it requires high admin and investment costs' – Academic

36 Estimated as the cash flow of estimated incomes and costs of all trainees undergoing training during the period of analysis and annual costs and revenues of vocational training institutes over the same period (http://www.investsrilanka.com/boi_publications/publications.html).

37 Although some of them were in employment before training, only 6% continued in the same job as before.

38 Collection of migration data was made mandatory in Sri Lanka in 1995. However, there are still some important gaps in information collected. Data from the SLBFE capture only those who migrate through recruitment agencies and register with the Bureau. Information on returnees is particularly scarce, which makes the estimates of the stock of migration hard to corroborate. Finally, remittances estimates are also limited to those channelled through the formal system, and informal systems of remittances are excluded from these estimates.

Box 3: Active labour market programmes in Sri Lanka

The following programmes represent examples of active labour market programmes designed to help citizens to improve access to employment and self-employment opportunities.

- The food-for-work or food-for-training programmes funded by the World Food Programme and implemented by the Ministry of Economic Development for improving access to food in selected target groups or resettled people through work in the rehabilitation of community and individual assets.
- The Nanwamu Gammuna programme, targeting female heads of rural households wanting to start a business. Recipients are provided with a one-time cash grant to start a cottage industrial activity based on resources available in the villages (e.g., industries of clay-based products conducted in Thambuththegama and Galen Bindunuwewa, collective farms in Tangalle, handloom industry in Divulapitiya and school-notebook industry in Ruwanwella).
- Numerous public works programmes were set up after the 2004 tsunami, by international organisations, NGOs and community-based organisations trying to help provide work and reconstruction in affected areas. The total value of these programmes to August 2005 was nearly \$6 million. The government also implemented a cash transfer programme of LKR 5,000 per affected family after the tsunami.
- Sri Lanka's Emergency Northern Recovery Project cash-for-work programme (2009), co-funded by the World Bank and Australia's AusAid (\$70.5 million), targets 100,000 people in the process of resettlement. It has been highlighted as integral to peace-building and has community-generated procurement procedures.
- The Local Empowerment through Economic Development project started by AusAid and the ILO in 2011 in collaboration with the Ministry of Labour and Labour Relations. It targets 2,400 conflict-affected households with high vulnerability, including female-headed households, ex-combatants, unemployed youth, people with disabilities and entrepreneurs in the Northern province. It also includes a wage subsidy for job placements for people with disabilities.
- Microfinance has grown considerably in Sri Lanka, with microfinance programmes having some employment impact – they offer alternative productive (self-)employment to those with income restrictions and unable to access employment opportunities in the formal wage sector. Programmes target low-income people working in agriculture or related activities, but also small entrepreneurs as a whole in different sectors. Compared with informal credit providers, credits obtained through microfinance institutions were mostly destined for income-generation activities (58%) or purchasing or improving assets (22%) rather than for consumption (7%) or other uses.
- The government also offers financial assistance of a maximum of LKR 10,000 (\$87) for persons with disabilities in low-income families to undertake self-employment activities.

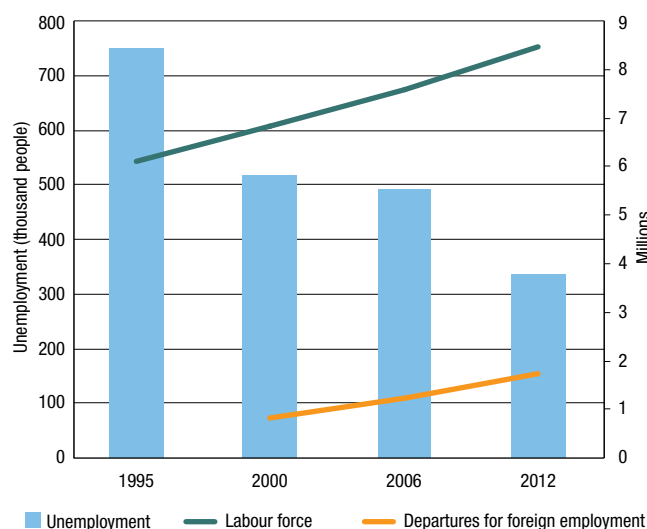
Sources: ADB (2012), GTZ (2009), World Bank (2006), Tilakaratna (2005).

Table 8: Absolute labour force, unemployment and departures for foreign employment, 1995-2012

	Labour force				Unemployment				Departures for foreign employment				
	Total	% change	Male	Female	Total	% change	Male	Female	Total	% change	Male	Female	
1995	6,106,138		4,068,608	2,037,530	749,021		367,656	381,364					
2000	6,827,312	12	4,501,597	2,325,716	517,168	-31	260,120	257,048	1995-1999	824,899		244,272	580,627
2006	7,598,762	11	4,837,308	2,761,454	493,440	-5	226,664	266,775	2000-2005	1,225,813	49	379,432	664,193
2012	8,464,706	11	5,636,947	2,827,759	336,002	-32	159,858	176,144	2006-2012	1,730,831	41	664,554	645,870

Source: Authors' own calculations, LFS (2012) and SLBFE (2012).

Figure 12: Absolute labour force, unemployment and departures for foreign employment, 1995-2012

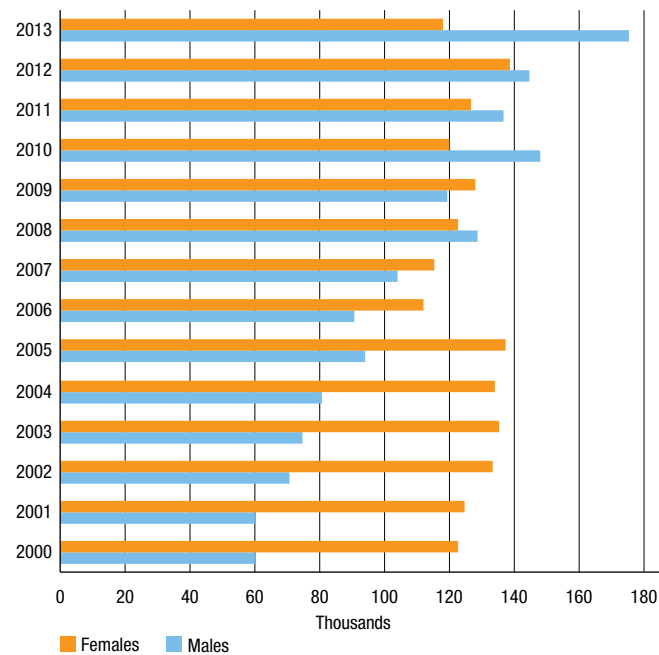


Source: Authors' own calculations, LFS (2012) and SLBFE (2012).

Clearly, this large outflow of workers has played some role in the falling unemployment rate in a country with approximately 8 million workers: Central Bank figures show that while 85,000 jobs were created in Sri Lanka in 1999, more than double that figure reportedly moved abroad for foreign employment (Winslow and Woost, 2004). But the link between outward migration and Sri Lanka's declining unemployment, particularly youth unemployment, is not straightforward, since not all migrants come from the unemployed ranks. Only 27% of migrants overall were officially unemployed before migration. Data in Table 8 and Figure 12 further suggest that the decrease in unemployment has surpassed migration outflows, and thus not all of this decline can be attributed to migration. Still, for some particular groups, the impact may have been stronger. In particular, while 80% of males were employed prior to migration, only around 24% of female migrants had a previous job (ILO, 2013b), suggesting that a large part of the drop in female unemployment may indeed relate to outward migration.

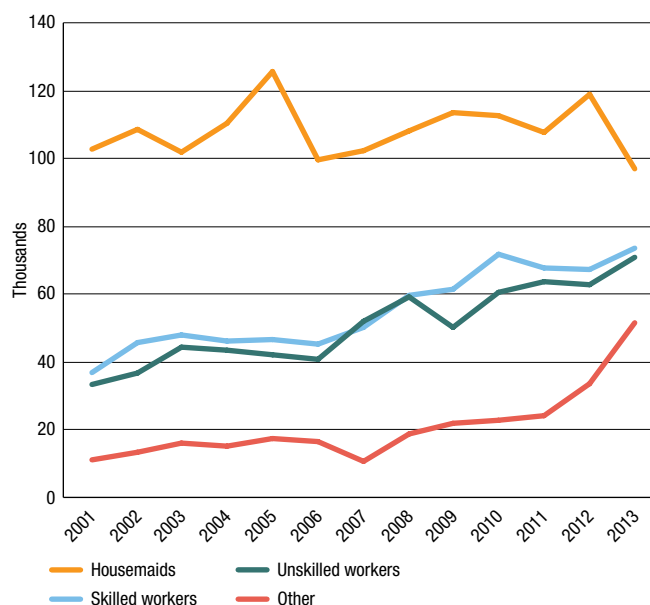
Further, migration to the Middle East for an unskilled worker could bring earnings about eight times greater than could be expected in Sri Lanka (Farrag, 1997, cited in Sriskandarajah, 2003). Rising migrant earnings have led to increasing private remittances, as illustrated in Figure 15 (overleaf). They have risen from around 20% to over 60% of total export income (SLBFE, n.d.), accounting for close to 8% of the country's GDP in 2010 (Arunatilake et al., 2010) and exceeding net receipts of foreign assistance

Figure 13: Foreign employment by gender, 2000-2013



Source: Central Bank of Sri Lanka (2013).

Figure 14: Foreign employment by skill category, 2001-2013

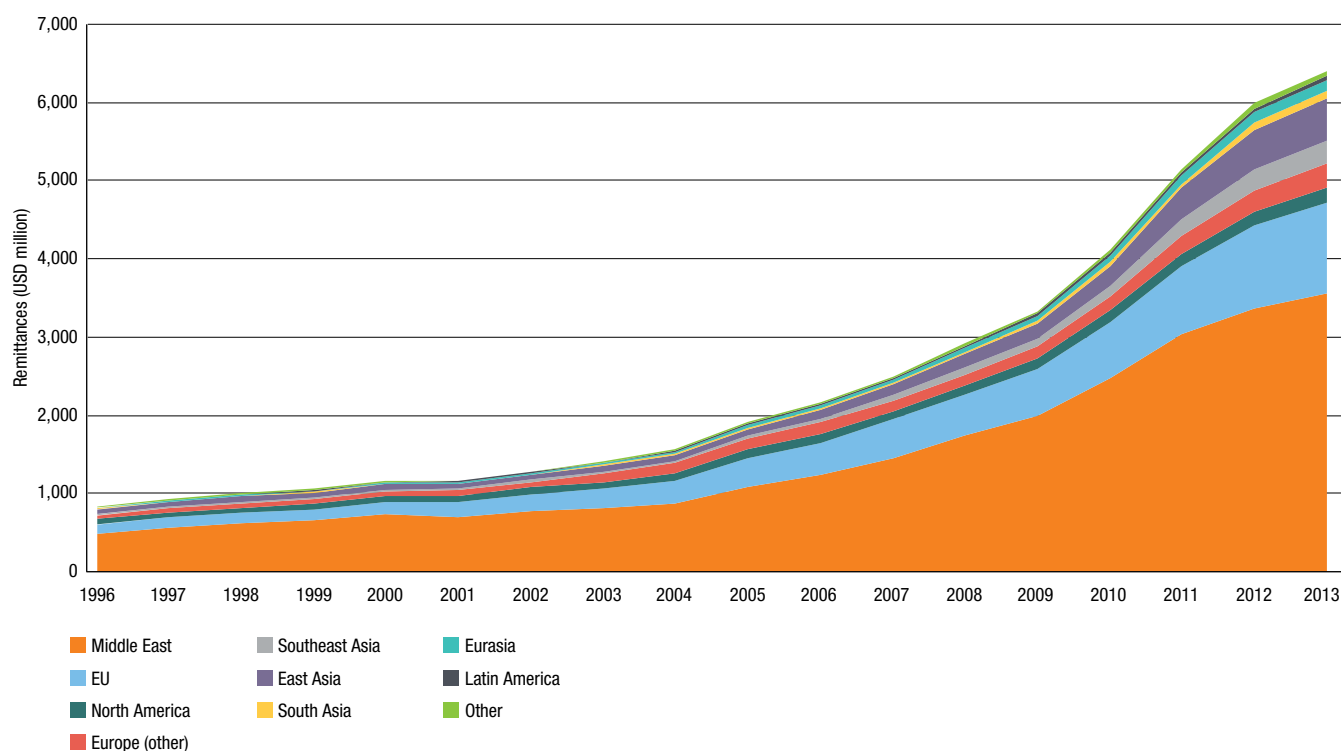


Source: Central Bank of Sri Lanka (2013).

by two or three times (Sriskandarajah, 2003). Figure 15 shows the steep rise in remittances by source region.

By encouraging the channelling of remittances through formal means, the government has tried to promote savings behaviour that could lead to future investment

Figure 15: Private remittances from abroad by destination, \$ million



Sources: Central Bank of Sri Lanka (2006 and 2013).

(Arunatilake et al., 2010).³⁹ That said, as discussed above, small-business job creation appears not to have been an important part of the employment progress story in Sri Lanka. Shaw (2007) finds that migrants prefer real estate investments rather than productive investments. Deshingkar and Aheeyar (2006) find that repayment of loans (including migration loans) was the main use of remittance money, and De and Ratha (2012) find no impact on consumption of durable goods or land holdings. Other positive impacts have been documented in human capital, through investments in children's health and education (De and Ratha, 2012; Arunatilake et al., 2010), potentially feeding through to employment outcomes through improved labour prospects for those who have benefited.

Several factors contributed to the increase in migration: the opening up of the Sri Lankan economy and general relaxation of controls; the economic boom in the labour-scarce oil economies of the Middle East; Sri Lanka's market-responsive exchange rate policy, which turned into a steadily devaluing real exchange rate, and thus more appealing foreign earnings; and the push-factor of ethnic conflict and slow growth in the

agricultural sector (World Bank, 2004). Nevertheless, institutions were also created to facilitate and coordinate migration policy and process. The main one of these, the Sri Lanka Bureau of Foreign Employment (SLBFE), was established in 1985 as the government organisation responsible for the formulation and implementation of foreign employment policies and programmes and to regulate recruitment agencies, including the publicly run Sri Lanka Foreign Employment Agency and the numerous private recruitment agencies that currently operate in the country. While outward migration has not been an explicit employment policy, the institutions set up have facilitated this (Box 4), with large numbers of migrants also lowering the numbers of Sri Lankans looking for work domestically, plus bringing the added benefit of remittances.

³⁹ Sri Lanka has also tried to capitalise on the potential impact of income generated through remittances by promoting formal mechanisms to send remittances or repatriate earnings at the end of the migration period, and by promoting ways to encourage investment of remittances productively, for example by limiting the amount of the remittances channelled through People's Bank in Sri Lanka that can be withdrawn to 20%.

Box 4: Regulation of migration and protection of migrants

It has been argued that Sri Lanka's migration policies have focused mainly on migration promotion, and less on the protection of migrants' rights. More recently, over the past four or five years, however, there has been a shift towards a higher emphasis on protection. In 2008, with ILO support, the country developed the National Labour Migration Policy for Sri Lanka, which included the protection of the rights of migrants. Among the measures to safeguard the rights of migrant workers are:

- Increased power of the SLBFE to control recruitment agencies' activities, including a blacklist system for poor recruitment agencies. Sub-agencies are now registered, although the numbers remain low.
- The SLBFE has tried to increase registration by offering registered migrants access to benefits such as pre-departure loans and transfers.
- Twenty-nine training centres that provide pre-departure orientation for migrants.
- Cooperation with migrant destination countries to protect migrants' rights by signing Memoranda of Understanding (MoUs). Sri Lanka has signed seven of these to date – with Bahrain (2006), Italy (2011), Jordan (2006), Libya (2008), Qatar (2008), South Korea (2008) and the United Arab Emirates (2007) – and expects to complete further MoUs with Kuwait, Lebanon and Oman.
- Sri Lanka and Indonesia began the Colombo Process in 2003, which further led to the Abu Dhabi Dialogue. These regional consultative processes aim to share experiences, lessons learned and best practices on overseas employment and to propose practical solutions for the wellbeing of overseas workers, to optimise development benefits from organised overseas employment and enhance dialogue with countries of destination. The Abu Dhabi Dialogue was the first time that destination countries of the Gulf Cooperation Council (GCC) sat together with migrant-sending countries. This helped to put human rights of migrants on the agenda of GCC states and to develop a common understanding of temporary and circular migration as the predominant form of movement to the region (Hansen, 2010).
- Establishment of Migrant Welfare Funds, a strategy that has been followed by other countries. For example, Bangladesh, India, Nepal and Pakistan also established welfare funds, and Thailand established a streamlined Centre for Overseas Employment, allowing migrants to access passports, medical check-ups and police reports (Hansen, 2010).

‘In the mid-90s, there was an increasing need to regulate migration, as well as a concern for the social costs of migration. The government, with ILO support, got together with trade unions and CSOs to develop a national policy for migration. This was the first of its kind in South Asia’ – International development organisation researcher



A supervisor inspects clay pots in a small factory. Photo: © ILO / Yamuni Rashmika Perera.

4. What are the challenges?

‘The number of ministries is “mushrooming”, thus issues tend to get split between ministries and it is difficult to get consistent policy ownership’ – Sri Lankan expert

While Sri Lanka has shown employment progress, challenges remain in advancing this progress, and in sustaining the results achieved so far. These relate broadly to the need for:

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

These challenges are discussed in turn below.

4.1 Improving equitable access to employment

Despite a better-trained labour force, and the improvements in the TVET sector, there is still a gap between labour supply and labour demand in Sri Lanka. While the quantity and, to a lesser degree, the quality of employment have improved, inequalities in *access* persist for certain geographical and demographic groups of the population.

Participation of young people (aged 15-29) declined from close to 40% of the labour force in 1992 to 24% in 2012, as illustrated in Figure 16. This is partly due to young people staying longer in the education system, mainly in secondary level and, to a lesser degree, tertiary and TVET education, or dropping out of the labour force through 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. The Eastern and Northern provinces, the main conflict-affected areas of the country, also saw persistently high unemployment rates. Employment creation and access to employment opportunities are also subject to considerable regional variation, particularly for women.

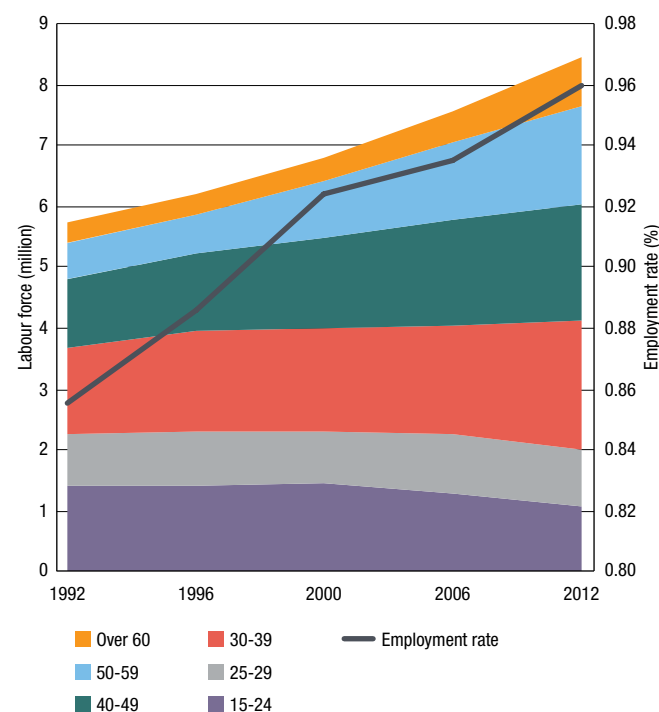
In the agricultural regions – North Central, Uva, Sabaragamuwa and Central provinces – female

labour-force participation was around 40% in 2012, while in the Northern and Eastern provinces it was only half of that (Figure 17, overleaf). One reason behind this variation is the cultural attitudes towards female employment, especially in the Eastern province, which is largely Muslim. Male labour-force participation fluctuates between 70% and 80% of working-age population, and is only slightly lower in the Northern, Western Southern and Eastern provinces.

A significant percentage of the labour force remains in vulnerable employment. This stood at 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.⁴⁰ Clearly these factors help explain the surge in outward migration.

Moreover, Sri Lanka’s social protection system in the aftermath of liberalisation reforms (and budget cuts to the social sectors) indicates a piecemeal approach.

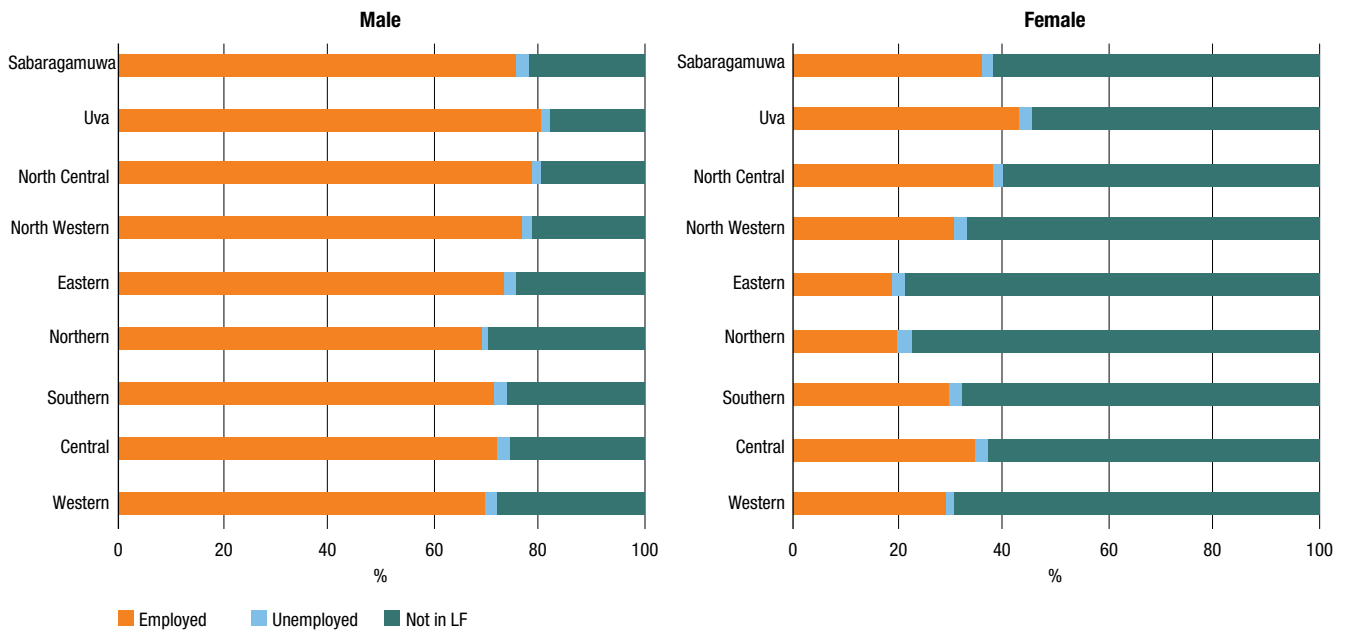
Figure 16: Labour force and employment rate trends, 1992-2012



Sources: Authors’ calculations based on LFS 1992, 1996, 2000, 2006 and 2012 data.

40 Although they are distinct concepts (see definitions in Box 1), informality and vulnerable employment overlap to some extent. In 2012, according to official data, 63% of those in the informal sector were also vulnerable workers (DCS, 2013).

Figure 17: Labour force participation, by province and gender, 2012



Source: Authors' calculations based on LFS 2012 data.

Notably, there is no unemployment insurance that becomes operational as soon as people lose their jobs, although there are plans to develop a system with ILO support. Sri Lanka has provided a safety net for low-income households to progress out of poverty through its poverty alleviation programmes and there are small schemes that offer some relief for employment loss for some specific demographic groups of workers. Still, a strong and comprehensive system to support employment access for vulnerable populations is still lacking.

Many Sri Lankans, especially women, have resorted to foreign employment, which demands lower skills and experience, and provides an alternative source of income, but also involves costs and risks for those migrating. A key limitation has been the availability of sufficient labour market information to make appropriate policy prescriptions and monitor the effectiveness of interventions (Sparreboom and Albee, 2011). In particular, until 2008, the Northern and Eastern conflict-affected areas of the country were excluded from the Labour Force Survey, and only in 2011 was the Northern province first surveyed. Extending labour market analysis and employment policies to these two provinces remains a vital challenge for the consolidation of peace and reconciliation in the country. Ultimately, steps also need to be taken within the country to remove barriers to active female participation in employment, and to ensure that women benefit from economic growth.

As well as employment distribution, current employment challenges relate to skills-matching, with unemployment higher among the better educated. While TVET has helped, inadequate links still exist between

the higher education system and the requirements of the industrial sector, contributing to high unemployment among graduates. Further, the poor image of the vocational training sector needs to be addressed: 'despite the employability aspect of vocational training, parents prefer that their children pursue the highest education level possible, namely university, whether it leads to gainful employment or not' (Koralage and Hewapathirana, 2012: 29). In addition, (young) workers queuing for jobs with artificially high benefits (those in the public sector, those protected by high trade tariffs and those covered by the TEWA labour law) prefer to do so while in higher education, further adding to the high and persistent youth unemployment rate in the country (Rama, 2003).

Any improvements in training require additional public resources, while the model to attract investment has to date been largely based on tax incentives and public infrastructure investments. Estimates indicate that the revenue forgone from tax incentives could amount to close to 1% of tax revenue (Wijesinha et al. 2013). The cost goes beyond the obvious revenue loss and may include distortions to the economy as a result of preferential treatment of specific investments. The benefits are even harder to quantify, as it is difficult to know what the growth and investment performance would have been in the absence of incentives, or what would have happened under another tax reform (Wijesinha et al., 2013). Sustainability is therefore a challenge: even though government expenditure has decreased, from 24% of GDP in 1980 to 16% in 2010, debt remains high, at 78% of GDP in 2011.

4.2 Continuous adaptation for productivity, competitiveness and investment

Sri Lanka is becoming increasingly industrialised, with its GDP share of manufacturing value added on a par with that of Viet Nam. A well-educated and skilled workforce is essential for continued employment progress and to take advantage of the opportunities created in such high-productivity sectors. Following consistent export growth from the 1990s onwards, reaching nearly 33% of GDP in 2000, Sri Lankan goods and services exports as a share of GDP declined to 16% in 2012 (IMF, 2013b). This includes the post-war period, underlining the challenge of maintaining employment progress based on labour-intensive manufactured exports.

Rising labour productivity is part of the progress described in this report, but for Sri Lanka to be globally competitive this must rise further (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 East Asian pioneer countries (Athukorala and Jayasuriya, 2012). Public intervention has not been targeted to improve productivity, but has taken the shape of subsidies and welfare.

This means that further education and skills improvements are central to Sri Lanka's economic growth and competitiveness (UNDP, 2012). In the post-MFA era, Sri Lanka dealt with the challenge of reduced trade preferences by innovating and training to increase productivity and upgrade the value added of its products. This challenge comes back again in the context of the withdrawal of the EU GSP+ trade preferences and competition from other regional producers. With rising wages and other input costs, Sri Lanka can no longer compete at the lower end of the spectrum, yet it is also struggling to move higher up the spectrum (Wijesinha, 2014).

The end of the conflict with the Tamil Tigers in 2009 has been accompanied by a boost in economic activity, despite limited policy changes in other areas since 2006. As Athukorala and Jayasuriya (2012) underline, key drivers of growth since the end of the war have been in the non-tradable sector – construction, transport, utilities, domestic trade and other services such as tourism and real estate. '[If] there is one noticeable trend in Sri Lanka's post-war FDI trend, it is that the majority of investments have been in projects related to real estate (including mixed-use property development) and tourism' (Wijesinha, 2014), which

rebounded sharply after the war in terms of numbers as well as the origins of tourists (Athukorala and Jayasuriya, 2012). This may reflect a peace dividend, but there has not been a substantial flow of FDI into industrial activities.

While Sri Lanka's rise in wages and input costs make the country less able to compete with other manufacturing hubs in the region, the continued struggle to push towards advanced manufacturing (Wijesinha, 2014) is increasingly challenging. Sustaining investments into manufacturing and diffusing the 'peace dividend' to other sectors in the economy offering more opportunities for high productivity and formal employment will require addressing remaining barriers to investment and job creation. This is likely to take place in the high-quality, niche manufacturing sector, and in the high-value services sector, where Sri Lanka is already taking steps. Examples of these industries include making surgical equipment and high-performance sports garments, and manufacturing trigger seatbelts and airbags for motor cars. Examples of high-value services include ship and aircraft maintenance, and design and process innovation in the apparel industry.

Underlying all of the above, working conditions and national reputation in the apparel industry have improved and are better in Sri Lanka than in other Asian countries. While not victim to disasters such as in Bangladesh's Rana Plaza, nonetheless the apparel industry has suffered from a poor image and has consequently struggled to attract workers (Kelegama and Wijayasiri, 2004, cited in Acevedo-Lopez and Robertson, 2012). The government launched international and national image campaigns, such as 'Garments without Guilt' in 2006, while some large private companies have also launched corporate social responsibility programmes (Staritz and Frederick, 2012). However, such strategies need to be coupled with increasing efforts to enforce the many decent work conventions signed by Sri Lanka⁴¹ to improve working conditions so that managers and CEOs see the pay-offs in terms of better price points, more orders or more buyers.

Finally, parallel to the upgrade of Sri Lanka to middle-income status in 2010, the end of the civil war in the same year and the withdrawal of the GSP+ trade preferences in 2010, there have been rising concerns about the government's debt and pervasive fiscal deficit. The so called 'never-never' money⁴² is running out, and the country needs to face the tough questions about how to finance its development needs and the productivity upgrades required for the future (Wijesinha, 2012). The twin policy track of

'[Compared with other countries] definitively the conditions are better in Sri Lanka... it is not perfect but better' – International development organisation researcher

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

42 In reference to a never-ending flow of resources (mainly from foreign aid) that allowed Sri Lanka to avoid some of the tough structural reforms that have to be made to address the budget deficit.

promoting a market economy alongside a large state-led economy has proven beneficial for employment growth, but has yet to prove financially sustainable.

4.3 Bringing job creation and employment promotion to the centre of policy

Many policies adopted in Sri Lanka have been consistently maintained through various changes in governments, and despite economic and political crises. However, until recently, job creation and employment promotion have not been at the centre of the national policy debate. This was highlighted by several interviewees, who noted that the focus is often on investment, exports and foreign exchange, with employment almost an afterthought.

The current document guiding government policy is the ‘Mahinda Chintana: Vision for a New Sri Lanka 2006-2016’. This sets the ambitious policy goals of: (1) increasing per capita income from \$2,400 in 2010 to \$4,000 by 2016; and (2) achieving 8% growth. Again, there is little explicit mention of employment creation, quality or access. Growth will be achieved by developing Sri Lanka’s maritime, aviation, commercial, energy and knowledge sectors into regional hubs through policies

similar to those seen in the past for infrastructure, promotion of SMEs, and a continued important role for the state (Goodhand et al., 2011; Athukorala and Jayasuriya, 2012). This raises concerns about the sustainability and suitability of this approach to ensure a positive cycle of rising employment, incomes and demand for domestic production. Further, it offers no clear indication of how revenue generation can be ensured to match proposed infrastructure and social expenditures, raising concerns among some that past employment progress may yet be undermined.

A recent exception is the 2011 National Human Resource and Employment Policy. This aims to be a comprehensive and overarching policy document to ensure coherence across the different existing policy documents that have human resources and employment as cross-cutting issues. Different ministries in the cabinet, as well as members of employers’ and workers’ organisations and of academia were involved in its formulation, and 10 thematic committees developed background material for the final policy document. While a positive step, anecdotal evidence suggests that this document has had little impact in refocusing the policy debate.

‘The practicalities are so complex’ – International development organisation researcher



Attaching lids to fruit juice bottles. Photo: © ILO / Yamuni Rashmika Perera.

5. What lessons can we learn?

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

Over the past two decades, economic transformation and job creation in Sri Lanka have dramatically reduced unemployment. Key sectors have been supported through market liberalisation reforms accompanied by public expenditures to promote domestic and foreign investment in manufacturing, particularly in export-oriented sectors. The use of tax incentives and EPZs appear to have been important in this regard, while public employment has also remained high, and the country has experienced a large and growing outward migration flow. Further, efforts to upgrade the labour force to meet the demands of the newly created employment opportunities have met with some success. This has all occurred in a context of civil war until 2009, economic fluctuations and a restricted financing environment, while the 2004 tsunami and the ‘twin shocks’ of rising food and oil prices in 2007 and 2008 all affected government spending while also damaging the attractiveness of the newly liberalised economy.

This case study touches on some of the trade-offs and tensions faced in achieving employment progress:

- What is an appropriate level of government intervention in the economy?
- How can an economy sustainably attract investment and promote employment through incentives?
- What is needed to develop effective systems for upgrading human capital and matching skills to jobs?
- How can an economy capitalise on labour migration while promoting inclusive labour markets?

Sri Lanka’s experience in designing policy responses for these areas may serve as an illustration for other countries seeking to address their own employment challenges.

- **Hybrid policy approaches, combining market liberalism with a strong role for the state, can help to expand employment opportunities.** There is a general consensus that outward orientation is more favourable to growth in the long run than having an inward-looking economy (WTO and ILO, 2007), and the case of Sri Lanka

seems to support this idea. Employment progress has emerged from a complex process of economic, political, ethnic and military processes where the government has adhered to long-term market-focused policies but also continued to intervene in the economy. While the civil war itself was responsible for part of public employment, SOEs have also remained prominent employers. Public investment in infrastructure and, particularly, EPZs and industrial parks also appears to have had a role in promoting investment and attracting garment producers for export markets.

While not without its distractions and detractors, the commitment to outward-oriented economic policies spanning multiple (opposing) governments has also been a salient characteristic of employment progress in Sri Lanka, helping to transform the economy towards more productive and diverse economic activities. It has also been fundamental in attracting investment in a highly volatile economic and political context of civil war. Importantly, it also highlights that in practice a hybrid approach may emerge as a compromise between opposing views, and indicates the difficulties of sustaining such a balance.

As noted, this progress has not been without challenges. Protected public-sector jobs and strict employment regulation have contributed to structural youth unemployment issues, particularly among the higher educated, and potentially fuelled outward migration. Despite efforts to encourage investment beyond Sri Lanka’s economic hub around Colombo, employment benefits have not been felt equally around the country. To sustain employment progress, there needs to be greater emphasis on putting employment at the centre of the economic transformation of the whole country, and a focus on the broad inclusion of all Sri Lankans in national employment progress.

- **Countries need to reflect on the sustainability of incentives and funding necessary to attract private investment and employment.** Tax incentives, concessional financing, export credit insurance and other instruments were widely used to promote foreign investment into EPZs, thus forgoing potential government revenue and accumulating large public debts. Such a strategy contributed to the structural transformation of

the economy and the development of key sectors, particularly the apparel sector.

At the same time, the government has tried to retain public investment in large-scale infrastructure programmes as well as maintaining Sri Lanka's long history of social protection and welfare policy. While these efforts had positive effects, the lack of sustainable fiscal incentives for investment has led to restricted fiscal capacity, limiting the potential of social-protection investments in particular to reach the most vulnerable.

Moreover, while economic success has been reflected in the country's promotion to 'middle-income-country' status in 2010, the implications of the possible change in some donor countries' attitudes towards Sri Lanka may have further budgetary implications for the programmes and policies supported by international aid. In the coming years, Sri Lanka may have to find other means to attract investment that involve wider policy and regulatory reform beyond the realms of the EPZs.

- **One strategy for a more sustainable path to attract private investment that supports the economic transformation of the country is to scale up investment in human capital.** While Sri Lanka has maintained its high achievements in literacy and in formal-education participation, a more responsive skills system is fundamental in matching employment opportunities with the skills of the labour force.

While the reforms to the TVET sector have had a positive impact, more needs to be done to ensure a wider reach and to enable the formal education system to support the upgrading of the country's human capital with skills relevant to the needs of a changing economic environment. Looking forward, this process needs to continue, and to be supported to ensure youth, women and those in the less-integrated geographic areas of the country benefit from the economic success.

High youth unemployment is typically a phenomenon of economies unable to match employment creation with growing populations. In Sri Lanka, a slow school-to-work transition and the 'queuing' for protected jobs in the public sector are immediate challenges, given the rapidly ageing workforce and the competition from more labour-intensive economies in the region. Again, a more responsive skills and education policy which

increases labour productivity may be useful to ensuring continued employment progress.

- **Population movements and trends affect employment outcomes.** Employment progress in Sri Lanka is partly explained by the voluntary, and subsequently encouraged, outward labour migration. This phenomenon has undeniably contributed to easing 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 migrants' protection and the productive use of remittances.

Economic reforms in Sri Lanka have been crucial to progress in the quantity and, to some degree, in the quality dimensions of employment. However, the large flows of labour migration show that greater effort is required to ensure access to employment opportunities for excluded groups, as well as opportunities for the university educated. Some of the most recent policies point in this direction, but efforts need to be sustained by focusing on inclusive employment as the key outcome of future reforms.

Whereas Sri Lanka is already developing an established unemployment insurance scheme – a policy initiative that should be continued – income-risk protection should also be considered. Furthermore, the current social protection systems could be strengthened by integrating the multiplicity of providers and schemes available, and by endeavouring to expand the coverage of social insurance to the informal economy. The latter would include also pension systems for migrant workers.

The present government vision is to reposition Sri Lanka in the global arena as a knowledge-based middle-income country with improved living standards. With the end of the conflict in 2009, better security and other government incentives, the country is already seeing improved investor confidence and higher living standards. The end of the conflict also underlines the need for employment that can promote social cohesion, citizen empowerment and personal dignity. This is the challenge now facing government – to ensure that it can build on existing employment progress.

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Annexe

Table A1: Employment share by sector and sub-sector, 1992-2012

	Employment share (%)				Share of GDP (%)
	1992	2000	2006	2012	2012
Agriculture sector	41.3	35.9	32.1	31.0	11.1
Agriculture and forestry	40.6	35.1	30.9	29.1	9.7
Fishing	0.7	0.8	1.2	1.8	1.3
Industry sector	20.4	23.7	26.7	26.1	30.4
Mining and quarrying	1.6	1.1	1.0	1.1	2.8
Manufacturing	13.7	16.6	19.3	17.7	17.1
Electricity, water and sanitation	0.4	0.5	0.2	0.3	2.4
Construction	4.7	5.5	6.3	7.0	8.1
Services sector	38.2	40.5	41.2	43.0	58.5
Wholesale and retail trade	10.7	11.1	13.5	14.0	23
Hotels and restaurants	0.9	1.6	1.8	1.6	0.7
Transport, storage and communications	4.2	4.9	6.1	6.5	14.3
Financial intermediation	0.8	1.3	1.5	1.6	8.9
Real estate, renting and business activities	0.6	0.8	1.7	1.9	
Public administration and defence	6.3	6.0	5.7	7.0	11.6
Education and health services	14.7	14.8	5.5	5.8	
Other services	n/a	n/a	5.4	4.6	

Source: Sri Lanka Labour Force Survey 1992-2006.

Table A2: Employment status by gender, 1992-2012

Male								
Employment status	1992		2000		2006		2012	
	Qty	%	Qty	%	Qty	%	Qty	%
Employee - public	659,126	18.3	534,426	12.6	567,109	12.3	623,101	12.8
Employee - private	1,451,517	40.3	1,866,250	44	2,014,851	43.7	2,132,173	43.8
Employer	72,036	2	131,486	3.1	202,868	4.4	184,983	3.8
Own-account worker	1,159,773	32.2	1,433,619	33.8	1,622,946	35.2	1,747,603	35.9
Contributing family worker	259,328	7.2	275,696	6.5	202,868	4.4	180,115	3.7
Total	3,601,779	100	4,241,477		4,610,643		4,867,975	

Female								
Employment status	1992		2000		2006		2012	
	Qty	%	Qty	%	Qty	%	Qty	%
Employee - public	385,526	24.1	310,300	15	389,170	15.6	490,865	19.9
Employee - private	630,280	39.4	837,810	40.5	977,914	39.2	892,929	36.2
Employer	11,198	0.7	16,549	0.8	19,957	0.8	22,200	0.9
Own-account worker	236,755	14.8	355,811	17.2	566,292	22.7	582,131	23.6
Contributing family worker	335,936	21	548,197	26.5	541,345	21.7	478,531	19.4
Total	1,599,695		2,068,667		2,494,679		2,466,656	

Total								
Employment status	1992		2000		2006		2012	
	Qty	%	Qty	%	Qty	%	Qty	%
Employee - public	1,044,652	20.1	844,726	13.4	956,279	13.5	1,113,965	15.2
Employee - private	2,081,797	40.0	2,704,060	42.9	2,992,765	42.1	3,025,103	41.2
Employer	83,233	1.6	148,035	2.35	222,826	3.14	207,183	2.82
Own-account worker	1,396,528	26.8	1,789,430	28.4	2,189,238	30.8	2,329,734	31.8
Contributing family worker	595,264	11.4	823,893	13.1	744,214	10.5	658,646	8.98
Total	5,201,474		6,310,144		7,105,322		7,334,631	

Source: Sri Lanka Labour Force Survey 1992-2012.

Table A3: Average monthly earnings, 2006 and 2012

	2006	2012	Percentage increase (decrease), 2006-2012
All	13,654	16,364	19.8
Gender			
Male	14,751	17,250	16.9
Female	11,575	14,516	25.4
Employment sector			
Public	22,235	22,770	2.4
Semi-government (government-owned corporations, boards, authorities and partly government-owned companies)	17,084	18,563	8.7
Formal private	13,757	16,766	21.9
Informal private	9,057	12,306	35.9
Occupation*			
Legislators and senior officials	39,530	33,856	(14.4)
Professionals	24,965	25,629	2.7
Technicians and associate professionals	20,935	21,699	3.6
Clerks	16,983	18,927	11.4
Service workers, shop and sales workers	12,238	15,760	28.8
Skilled agriculture and fishery workers	9,730	10,492	7.8
Craft and related workers	11,194	14,157	26.5
Plant and machine operators and assemblers	12,998	15,919	22.5
Elementary occupations	8,109	11,527	42.1
Armed forces	25,718	27,192	5.7

Source: LFS 2006, 2012 microdata.

Notes: LKRs in 2012 prices; *as classified according to the ILO's ISCO-88 categorisation (<http://www.ilo.org/public/english/bureau/stat/isco/isco88/publ4.htm>).



A woman prepares handicrafts from dried sedges plants. Photo: © ILO / Yamunia Rashmika Perera.

This is one of a series of Development Progress case studies. There is a summary of this research report available at developmentprogress.org.

Development Progress is a four-year research project which aims to better understand, measure and communicate progress in development. Building on an initial phase of research across 24 case studies, this second phase continues to examine progress across countries and within sectors, to provide evidence for what's worked and why over the past two decades.

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