

Sri Lanka
State of the Economy Report 2016

Chapter 6
Labour Market Reforms under Tight Fiscal
Conditions

by
Nisha Arunatilake & Neluka Gunasekera

6. Labour Market Reforms under Tight Fiscal Conditions

6.1 Introduction

The medium-term economic development policy framework presented in Parliament in November 2015 envisaged generating one million jobs and improving living standards of workers. The stated goal of employment creation was to be met by encouraging investments in high employment intensity sectors on the demand side, and by improving skills on the supply side. The policy framework gives special attention to create a sophisticated and modern knowledge-based economy which is able to compete effectively in the global market.

One main challenge faced by the government in achieving the above mentioned labour market objective is limited public finances at its disposal. In order to consolidate public finances - targeting a gradual reduction in both fiscal deficits and the country's debt burden - the room for a significant increase in government expenditure, both recurrent and capital, is limited. Indeed, the fiscal outlook suggests the need for a restructuring of existing expenditures. In this backdrop, funds available to invest towards improving labour market performance are limited.

This chapter examines the policy reforms needed to achieve the stated labour market goals set out for Sri Lanka by government policy pronouncements. Recommendations for

reforms are made drawing on lessons from the other country experiences in reforming employment markets during times of stress in government finances.

6.2 Lessons on Improving Labour Markets under a Tight Fiscal Space

The challenge of improving labour market conditions with limited budgets is not unique to Sri Lanka, or to developing countries in general whose governments often face tight fiscal conditions. Developed countries are also not immune from such challenges. The global financial crisis of 2008 had a devastating impact on global growth and spearheaded an employment crisis, resulting in increased unemployment levels and reduced job creation in many advanced economies. Given the tight fiscal position experienced by these countries at the time, the revival of the employment market was required to be done in the context of limited finances.

6.2.1 Lessons from Advanced and OECD Countries

In the aftermath of the financial crisis, the main objectives of the labour market reforms of the

Organization for Economic Cooperation and Development (OECD) and their five key non-member BRICS countries (Brazil, Russia, India, China, South Africa) was to increase utilization of labour and to enhance productivity.¹

Policies for improving labour utilization were done on several fronts.² First, policies focused on facilitating job creation through relaxing labour regulations. Of the OECD countries introducing labour utilization enhancing policy reforms, Greece, Portugal and Ireland were amongst the most successful.³ This is partly due to the fact that they were forced to introduce previously unpopular policy reforms due to severe fiscal constraints. The labour market reforms introduced by these three countries included, reducing the costs of severance and making collective and individual dismissals easier (Greece and Portugal); measures to enhance temporary employment by extending the period under temporary work agencies (Greece); relaxing legislation to facilitate more flexible working-times (Greece); giving firms more flexibility in determining wages by allowing firms to move out of collective bargaining agreements (Greece and Ireland); and introducing a sub-minimum wage for youth to encourage hiring of young people (Greece).

A second set of policies on improving labour utilization resorted to encouraging labour force participation of older workers. In this regard, several countries raised minimum and statutory retirement ages (e.g., Belgium for females, France, Greece, Hungary and Spain); extended

the contribution requirements to claim full pension benefits (France, Greece and Spain); reduced the generosity of pension benefits (Greece and Hungary); and aligned the retirement age with life expectancy.

Third, several countries that identified increasing labour force participation of females as a priority introduced measures to lower barriers to entry into the labour market. These initiatives included, expanding child care facilities (Germany, Ireland and Switzerland); increasing child care subsidies (Korea, New Zealand and Slovak Republic); lowering compulsory schooling age; and promoting full-day schools (Germany and Switzerland).

Lastly, all countries identifying active labour market programmes (ALMPs) as priorities invested in these in several ways. More than two-thirds of the countries in Europe increased resources for employment services and training programmes to increase employability and re-skilling. South Africa, in addition to increasing funding available for employment services, also improved information on training and employment opportunities. The efficiency of these ALMPs was improved by more regular monitoring and evaluation. The Canada Job Grant is a good example of an ALMP which trains individuals to jobs in demand. Canada Job Grant assists firms and employers to train individuals (new or existing) to fill existing job vacancies.⁴ The programme is designed to help firms of all sizes and industries located across the country. The government contributes two-

¹ This section draws mainly from OECD (2012), "Economic Policy Reforms in 2012 - Going for Growth", available at OECDiLibrary: <http://dx.doi.org/10.1787/growth-en-2012>.

² Only policies that are directly relevant to Sri Lanka are discussed here.

³ OECD, (2012), "Economic Policy Reforms in 2012 - Going for Growth", available at OECDiLibrary: <http://dx.doi.org/10.1787/growth-en-2012>.

⁴ Government of Canada (2013), "The New Canada Job Grant", available at <http://www.budget.gc.ca/2013/doc/themes/skills-eng.pdf>.

third of the training cost, while the firm contributes the rest of the training cost. These grants are given for beneficiaries to undergo short-duration courses conducted by third parties, such as community colleges or private trainers.

Attempts to improve productivity were mainly aimed at boosting innovation policies and reforming education systems in many countries. Other reforms included product market reforms, public infrastructure development, public sector reforms, general tax reforms, and reforms of subsidies given to the agriculture sector. Among these, raising levels of human capital has been recommended as a means of raising productivity in a majority of the OECD countries and in all BRICS countries.

6.2.2 Lessons from Developing Countries

Developing countries were also not immune to the contagion impacts of the global downturn and labour market impacts, with some regions hit harder than others. In the case of countries in the North African region for instance, the main labour market benefit to the disadvantaged in the aftermath of the financial crisis was in the form of ALMPs.⁵ However, the ALMPs implemented in North Africa were not successful in creating decent long-term jobs in the private sector for several reasons. First, the programmes were implemented mainly by the government sector providers, who were ill-equipped to deliver quality programmes due to financial, technical, and capacity limitations of their institutions. Further, the programmes suffered from design flaws due to the non-

inclusion of all stakeholders in the planning process. For example, those completing entrepreneurship programmes were unable to start self-employment ventures due to lack of access to credit; wage subsidy schemes were successful in creating jobs only till the subsidies lasted; and the skills taught in vocational training programmes were not those demanded by the market. The North African countries which were less constrained by finances, mainly oil exporting countries, expanded their public sector to create jobs. However, this was a costly means of creating employment, both in terms of the expense of the programme, as well as the labour market distortions created and the long-term issues caused by such initiatives (see Box 6.1).

Research suggests that recommendations to revive labour markets in North African countries in the aftermath of the financial crisis examine labour market policies along four dimensions, namely; (i) ALMPs; (ii) labour regulations; (iii) social protection legislation; and (iv) collective representation.⁶ The research emphasizes the need to take into account all four of these dimensions when making overall policy recommendations as these different aspects of the labour markets are interlinked. For example, relaxing labour market regulations to allow for more mobility between jobs should go hand in hand with measures to safeguard workers who are in-between jobs. Further, any changes to labour regulations should take place only after discussions with all stakeholders to prevent a social backlash. Additionally, the need to be aware of the capacity of a country to implement reforms when making policy recommendations needs to be recognized. This will depend on

¹ Subrahmanyam, G., and V. Castel (2014), "Labour Market Reforms in Post-transition North Africa," African Development Bank Group, Tunis.

² *Ibid.*

Box 6.1**Expanding the Public Sector is Not a Solution for Job Creation**

International experiences suggest that public sector job creation is costly and distorts the labour market in the long-run. In the aftermath of the financial crisis, governments in North African countries were compelled to create jobs. Some countries reacted to this need by creating public sector jobs. For example, Egypt created one million new public sector jobs, Tunisia created 40,000 new direct public sector jobs, and Libya absorbed large numbers of ex-combatants and others into the government forces.

However, Subrahmanyam and Castel (2014) point out that such public sector job creation is not a solution to unemployment for several reasons. First, job creation through expanding the public sector is expensive. For example, in Egypt, the public sector wage bill increased by 15 per cent. This creates additional pressure on the public budget in the long-term. Second, it does not address the real cause of unemployment. Third, it is not sustainable, as governments cannot continue to expand the public sector. Fourth, it creates a perpetual problem of graduate unemployment as future graduates also queue to obtain public sector jobs. The only means of breaking the cycle of unemployment and public sector employment provision is to facilitate private sector led job growth.

Source: Subrahmanyam, G., and V. Castel (2014), "Labour Market Reforms in Post-transition North Africa", African Development Bank Group, Tunis.

many factors, including available fiscal space, level of human capital development in the country, level of diversification and sophistication of the economy, and the strength of institutions in the country.

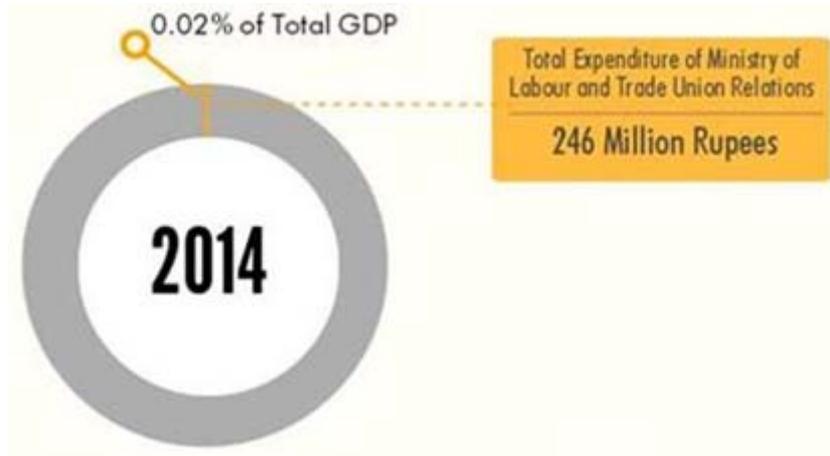
6.3 Public Sector Involvement in Labour Market Activities in Sri Lanka

Total public expenditure on labour market improvement in Sri Lanka is difficult to estimate, as the different functions involved in policy making, policy implementation, vocational and

technical training, career guidance, labour market information provision, and job matching are done by a multitude of institutions in the country. However, available budget estimates show that public expenditure on labour and employment is very low.⁷ The Department of Labour, which is primarily involved in law enforcement, spent Rs. 1,424 million in 2014. The Ministry of Labour and Trade Union Relations (MLTUR), which is responsible for enforcement of labour laws, implementation of social security schemes, provision of labour market information as well as human resource development only spent Rs. 246 million in 2014.⁸ Together, these expenditures amount to less than 0.02 per cent of GDP.

⁷ Estimates from MOFP (2014), *Annual Report 2014*, Ministry of Finance and Planning, Colombo.

⁸ *Ibid.*



In addition to the above, the government is involved in ALMPs such as technical and vocational training, career guidance and job matching activities. The technical and vocational training (TVET) in the country is conducted by an assortment of organizations including most importantly, the Ministry of Youth Affairs and Skills Development (MYASD) and the Department of Technical Education and Training (DTET). Under DTET, 38 technical training institutions operate, of which 9 (one in each province) are operating as Colleges of Technology (COTs). In addition to DTET, several other vocational training bodies come under MYASD. These include the Vocational Training Authority (VTA), National Apprentice and Industrial Training Authority (NAITA), the National Youth Services Council (NYSC) and the National Youth Corps (NYC), which together operated more than 300 vocational training institutes in urban and rural areas. The government expenditure on MYASD and DTET together had fluctuated around 0.1 per cent of GDP from 2000 to 2014.

The public institutions for vocational and technical training mainly evaluate their effectiveness through enrolments and completions. The latest student enrolment and completion data are available for 2012, and they indicate much room for improving performance. For example, the drop-out rates for these institutions for the latest year for which data is available were very high (e.g., DTET- 29.2 per cent (2011); VTA -11.2 per cent (2012) NAITA - 18.4 per cent (2012)).⁹ This suggests that many of these training institutions are not run efficiently. Further, due to lack of proper monitoring, the effectiveness of these institutions in improving employability of youth is not clear.

6.4 Challenges in Meeting Government Employment Goals

This section provides stylized facts on the labour market in Sri Lanka, keeping in mind the policy

⁹ State Ministry of Youth Affairs (2016), "Statistics," available at http://www.youthmin.gov.lk/web/index.php?option=com_content&view=article&id=178&Itemid=233&lang=en.

0.12%

Public expenditure on labour market activities including technical and vocational training in 2014 (as a % of GDP)

goals of the government with a view to identifying policy priorities for the labour market.

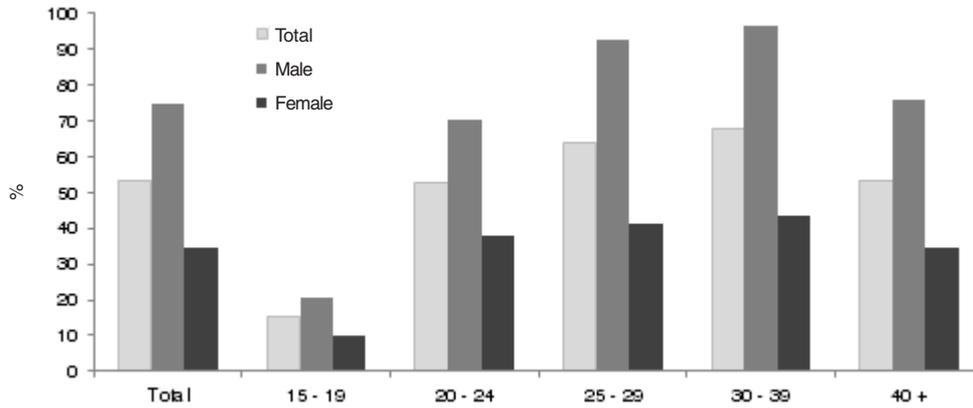
6.4.1 Creating One Million Jobs

The government envisages creating one million jobs in the next five years. In order to achieve this goal, the economy will need to create 200,000 jobs a year, on average. The employed increased by 237,689 from 2011 to 2014, which resulted in an average annual increase of 79,230 employed. This means that in order to meet the policy target, job growth will need to increase by two and a half times its current levels. In 2014, there were 380,554 unemployed persons in the country, which amounted to an unemployment rate of 4.3 per cent. An unemployed rate of around 4 per cent is usual in any economy in the presence of new entrants to the labour market and movement of workers between jobs (frictional unemployment). Given this, workers for the new jobs will need to be sourced mostly from the currently economically inactive.

The currently economically inactive in Sri Lanka are mostly females, youth and elderly. According to 2014 labour force survey data, 75 per cent of the economically inactive were

This means that in order to meet the one million jobs target, job growth will need to increase by two and a half times its current levels.

Figure 6.1
Labour Force Participation Rate by Age Group and Sex (2014)



Source: Estimated from data based on DCS, "Labour Force Survey- Annual Report 2014"; Department of Census and Statistics, Colombo.

females.¹⁰ By age group, 22 per cent of the inactive individuals were aged 65 years or more, and 27 per cent of them were youth (15-24 year olds). By type of activity, 49 per cent were engaged in household duties, 20 per cent were engaged in studies, and 21 per cent were retired or too old to work. As shown in Figure 6.1, labour force participation of prime age (25-40 years) of males is quite high; however, the labour force participation of youth, females and older persons has room for improvement.

The low labour force participation is partly due to the mismatch between the availability of jobs and the types of jobs aspired to by those economically inactive. However, job prospects for females and older persons have improved during the 2011-14 period. Jobs for youth (15-24 year olds), in contrast, have declined. The growth in employment from 2011 to 2014, by nearly 1 per cent annually, is mainly explained by growth in female employment. On average

during the time considered, female employment grew by 1.7 per cent and male employment grew by 0.6 per cent annually. Across age groups, this growth is mainly explained by employment growth of older persons. The average annual employment grew by 2.7 per cent and 2.2 per cent, respectively, for 40 and above individuals and 30-39 year olds between 2011 and 2014. In contrast, employment for those below 30 years declined (at an average annual rate of 5.2 per cent) over the same period.

The disparity between the jobs available and the jobs desired is also reflected by the unemployment rates. The unemployment rates for females and the educated have decreased over the 2011 to 2014 period, but youth unemployment rate has increased (Table 6.1).

The government practice of expanding the public sector to address the unemployment problem is not sustainable. The above

¹⁰ DCS (2014), "Labour Force Survey - Annual Report 2014"; Department of Census and Statistics, Colombo.

Table 6.1
Trends in Unemployment Rates

	Unemployment Rate (%)		Unemployment Rate Relative to Overall Unemployment Rate (%)	
	2011	2014	2011	2014
All	4.2	4.3	1.0	1.0
By gender				
Male	2.7	3.1	0.6	0.7
Female	7.0	6.5	1.7	1.5
By age group				
20-24	17.7	20	4.2	4.7
25-29	7.6	8.3	1.8	1.9
By level of education				
GCE A/L & above	9.0	8.1	2.1	1.9

Source: Estimated from data based on DCS, "Labour Force Survey- Annual Report 2014", Department of Census and Statistics, Colombo.

mentioned decline in the unemployment rate of females and the more educated is partly owing to 51,420 graduates being absorbed into the public sector under the graduate employment programme.¹¹ It is unlikely that the government can continue to provide employment for such large numbers of unemployed graduates. Hence a more sustainable means of creating employment is needed.

A recent survey by the National Human Resource Development Council (NHRDC) suggests that public sector unemployed graduate recruitments are not strategic.¹² About 48 per cent of the interviewed were dissatisfied with the way graduates were recruited. The main reasons for dissatisfaction were political interference (43 per cent), unsystematic methods of recruitment (33 per cent) and recruitment not aligned with degree qualification (8 per cent). The suggestions given by the newly recruited on the means of

A recent survey by the National Human Resource Development Council (NHRDC) suggests that public sector unemployed graduate recruitments are not strategic.

¹¹ NHRDC (2013), "Recruitment of Graduates into the Public Service, and their Contribution to the Productivity vis-a-vis their Job Satisfaction", National Human Resource Development Council of Sri Lanka, Colombo.

¹² *Ibid.*

The main reason for low labour force participation of youth is education, but the education outcomes of youth are mediocre.

improving the recruitment process also reveal that such recruitments are unlikely to enhance productivity in the public sector. For example, 30 per cent recommended avoiding political interference in recruitments; 23 per cent recommended recruiting for existing vacancies; 20 per cent recommended recruiting for a position worthy of a graduate; and, 16 per cent recommended recruitments that match the subject of the degree.

The low labour force participation of youth is partly due to the inefficiencies in the education

system. The main reason for low labour force participation of youth is education, but the education outcomes of youth are mediocre. The youth labour force participation only start to increase in the late twenties (see Figure 6.1). According to DCS data, among inactive youth (15-24 year olds), 84 per cent of males and 61 per cent of females are engaged in studies.¹³ Although youth spend many years in education, the proportion of 25-30 year olds with degrees (5.9 per cent) and tertiary level vocational training (14.7 per cent) is quite low (see Figure 6.3), indicating that although many years are spent in education, the education outcomes of youth are low. A first degree or a tertiary level vocational training course takes only 3-4 years to complete. If young people undertake these education courses soon after leaving school, they should be able to complete their studies and enter the labour market in their early twenties. However, an average Sri Lankan university student takes three years longer to graduate compared to their counterparts in the UK and the US.¹⁴ This is due to late entry into universities as well as longer time spent in universities.

The main reasons for low labour force participation of females and elderly are household responsibilities (mainly females) and retirement (mainly elderly). About 90 per cent of the 25-55 age group females who are not in the labour force are engaged in household duties. A large proportion of 55 and above males (75 per cent) and females (47 per cent) are not active in the labour market due to retirement and old age.

¹³ DCS (2014), "Labour Force Survey - Annual Report 2014", Department of Census and Statistics, Colombo.

¹⁴ Jayasekera, H. (2012), "Lankan University Graduates: Late Birds, No Worms" available at Talking Economics: <http://www.ips.lk/talkingeconomics/2012/08/22/lankan-university-graduates-late-birds-no-worms/>.

Policies for improving employment will have to target jobs mainly for females, youth and elderly. Further, job creation will need to be done strategically and by creating jobs needed for improving production.

6.4.2 Towards a Modern Knowledge-based Economy

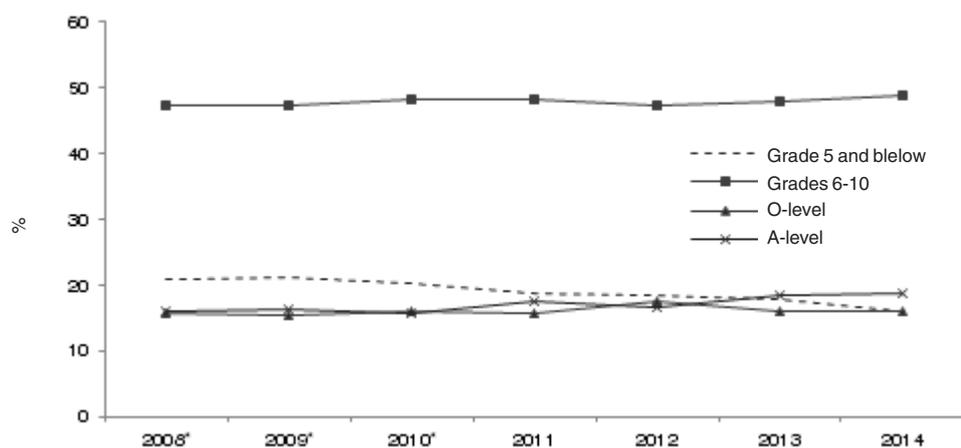
The government envisages creating a sophisticated and modern knowledge-based economy which is able to compete in the global market. One essential prerequisite for creating a modern knowledge economy is a highly educated labour force; in particular, tertiary level science and technology workers are needed for a dynamic knowledge-based economy.

The employed in Sri Lanka has become more educated over time, but improvements are marginal. From 2011 to 2014, the employed with A-levels have increased annually by 3.7 per

cent, while the employed with less than a primary level education has declined by nearly 4 per cent annually. Although the employed are more educated, still a large proportion (65 per cent) of the labour market has less than a secondary level education (i.e., has not passed O-levels) as can be seen in Figure 6.2. Less than 20 per cent of the population has A-levels or a higher level of education. Although there is a slight increase in the proportion of those passing A-levels, this increase has been rather gradual.

The proportion of tertiary educated in the population is low, and those with post-graduate level education are almost non-existent. The highest incidence of tertiary educated are observed for 25-29 year olds in Sri Lanka (Figure 6.3). The proportion of tertiary educated, decreases steadily for older age groups. This could either be because emigration of skilled individuals or the late improvements to the

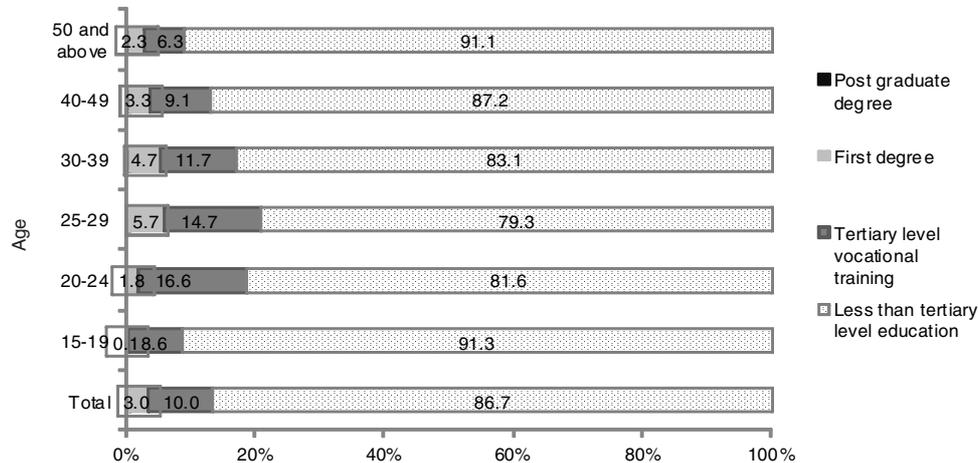
Figure 6.2
Currently Employed by Level of Education



Notes: Data for 2008-10 exclude the Northern Province.

Source: Estimated from data based on DCS, "Labour Force Survey- Annual Report 2014", Department of Census and Statistics, Colombo.

Figure 6.3
Population Aged 15 and Over, by Level of Education and Age



Source: Arunatilake, N., "Census of Population and Housing Thematic Report – Labour Market Characteristics," United Nations Population Fund, Colombo (forthcoming).

tertiary education in the country. The proportion of persons with post-graduate degrees is very low in Sri Lanka; individuals with such qualifications are essential for training and driving innovation.

6.4.3 Increasing Productivity and Competitiveness

It is often argued that "science, technology and innovation promote competitiveness, productivity and growth";¹⁵ as such, the OECD has put in place procedures to monitor progress in science, technology and innovation. A workforce that is highly skilled in science and technology (S&T) are a prerequisite for driving innovation. In recognition of this fact, many

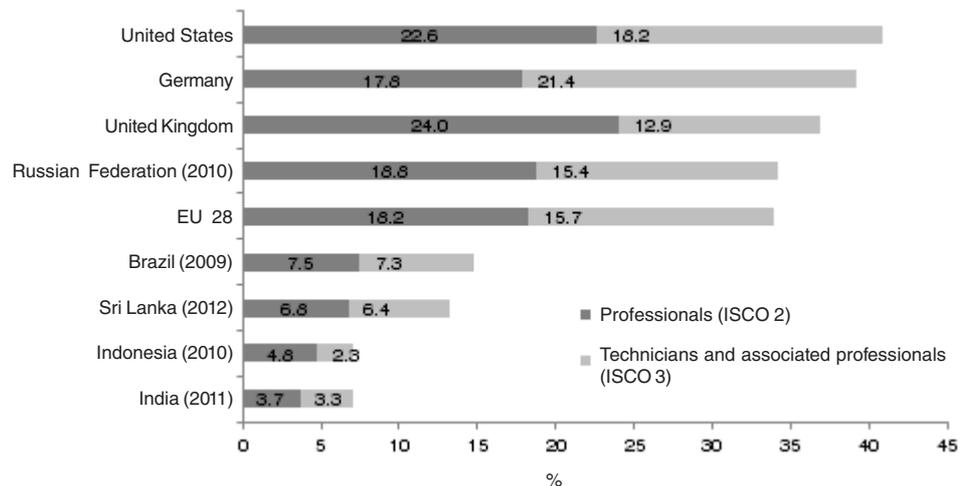
developed countries have re-oriented their policies to train and attract individuals to become S&T workers. More resources given to science education and change of migration policies to attract more skilled workers are some examples of strategies adopted by developed countries to increase the proportion of S&T workers in their countries. In order to monitor the prevalence of S&T workers, the OECD developed a methodology for measuring S&T workers.¹⁶ According to this, science and technology workers are those with a tertiary education,¹⁷ and/or those employed as professionals, associate professionals and technicians. Countries benefit when professional, associate professional and technical level occupations are carried out by

¹⁵ OECD (2015), "OECD Science, Technology and Industry Scoreboard", available at <http://www.oecd.org/sti/scoreboard.htm>.

¹⁶ OECD (1995), "The Measurement of Scientific and Technological Activities - Manual on the Measurement of Human Resources Devoted to S&T: CANBERRA MANUAL," OECD, Paris.

¹⁷ For example, those with an education level of 5 or more according to the International Standard Classification of Education (ISCED); these include post-graduate degree holders (ISCED level 7), graduates (ISCED level 6), and holders of tertiary level vocational training diplomas (ISCED level 5).

Figure 6.4
Incidence of Professionals and Technicians in the Total Employed



Notes: Professionals, and technicians and associate professionals are defined according to the International Standard Classification of Occupations 2008 (ISCO-08) major groups 2 and 3 respectively, except for Brazil, India, Indonesia, and the Russian Federation, for which the corresponding ISCO-88 groups are reported.

Source: For Sri Lanka see Arunatilake, N., "Census of Population and Housing Thematic Report – Labour Market Characteristics"; United Nations Population Fund, Colombo (forthcoming); for other countries see OECD, based on European Labour Force Surveys, Eurostat; ILO Laborsta database; and national sources from (OECD, 2013), http://www.oecd-ilibrary.org/science-and-technology/oecd-science-technology-and-industry-scoreboard-2013/professionals-and-technicians-2012_sti_scoreboard-2013-graph76-en.

tertiary educated individuals as they are trained to conduct these occupations.

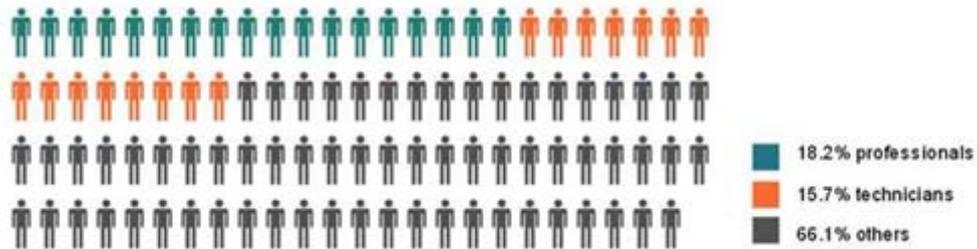
The proportion of professionals, associate professionals and technicians in Sri Lanka are much lower than those in OECD countries. The proportion of professionals and technicians in the total population is used as an indicator for a knowledge economy by the OECD. In 2013, on average 18.2 per cent of the total employed in Europe were professionals and 15.7 per cent of total employed were technicians and associate professionals (Figure 6.4). The corresponding statistics for Sri Lanka were 6.8 and 6.4 per cent, respectively. This indicates that to reach the current incidence of professionals in Europe, Sri Lanka has to

almost triple its proportion of professionals in the economy at present.

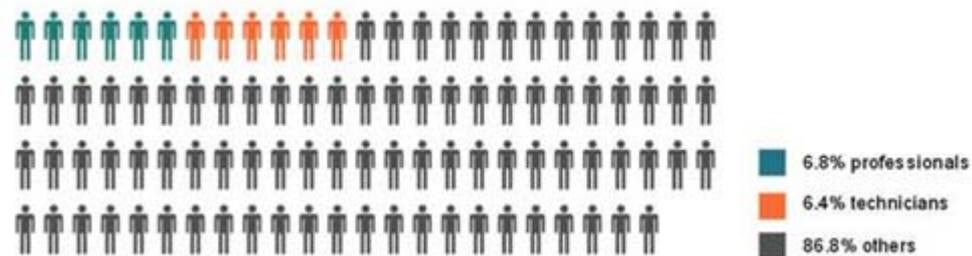
A large proportion of the S&T jobs are done by persons not formally qualified in tertiary education. Even though the proportion of professionals, associate professionals and technicians (International Standard Classification of Occupations (ISCO) 2 and 3) are higher in Sri Lanka compared to India and Indonesia, many of those in these ISCO 2 and 3 occupations do not have a tertiary level education. For example, 35.8 per cent of professionals and 67.6 per cent of technicians and associate professionals were without a tertiary level education in the country (Table 6.2). Further, the proportion of those with post-

Employment in 2013

EUROPE



SRI LANKA



A large proportion of the S&T jobs are done by persons not formally qualified in tertiary education.

graduate degrees was very small; this hampers the ability to conduct R&D in the country.

In Sri Lanka, a large proportion of those with degrees have studied arts subjects. There is an over-supply of university students majoring in social science and humanities and an under-supply of those majoring in science subjects. In 2014, 36.1 per cent of graduates had majored in arts, while a further 20 per cent had majored in commerce (Figure 6.5). Although the proportion of arts graduates have marginally declined from 2011 to 2014 (by 3.2 percentage points) this decline is very gradual. Sri Lanka will need to think about expanding S&T graduates in order to spur innovation.

Table 6.2
Working Age Population in S&T Occupations, by Level of Education

	Units	Total	Post-graduate Degree	First Degree	Tertiary Level Vocational Training	Other (Less than Tertiary Level)
Employed	No. %	7,335,432 100.0	35,530 0.5	323,36 4.4	4858,116 11.7	6,118,422 83.4
Professionals (ISCO 2)	No. %	499,505 100.0	20,834 4.2	175,934 35.2	123,740 24.8	178,997 35.8
Technicians and associate professionals (ISCO 3)	No. %	465,882 100.0	4,205 0.9	53,589 11.5	93,108 20.0	314,980 67.6

Note: 15 and above population.

Source: Arunatilake, N., "Census of Population and Housing Thematic Report – Labour Market Characteristics", United Nations Population Fund, Colombo.

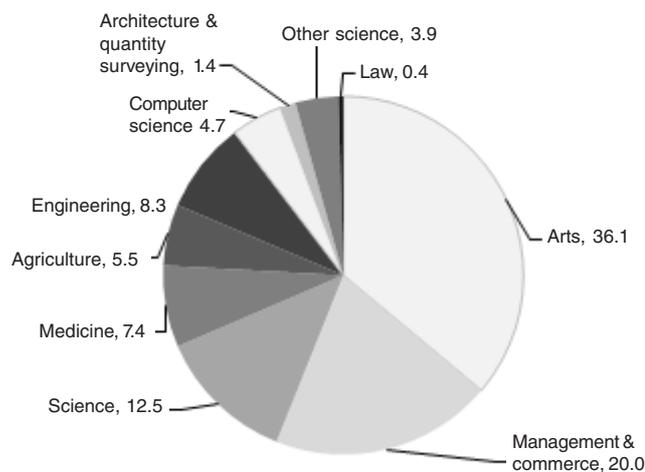
6.5 Policy Priorities

6.5.1 Improving Labour Utilization

The above discussion shows that policies for improving labour utilization will need to look at means of improving labour force participation of youth, females and the elderly, and reduce the unemployment rate of youth. This section discusses policy options available for achieving these goals.

In the case of females, these mainly aim to improve social support to families, in order to reduce barriers to female labour force participation. Policy measures in this regard include expanding child care facilities and increasing child care subsidies and allowing more flexible work-time arrangements. Sri Lanka could also learn from these experiences to increase female, youth and elderly labour force participation. Policies to be considered

Figure 6.5
Distribution of Graduate Output by Higher Education Programme (%) 2014



Source: UGC, "Sri Lanka University Statistics 2014", University Grants Commission, Colombo.

include relaxing legislation to reduce disparities between part-time workers and full-time workers, and policies aimed at building the capacity of human resource managers to manage a mix of part-time and full-time workers. Again such policies can be implemented without much public expenditure.

As shown earlier, the most economically inactive youth are involved in education. However, the education outcomes of tertiary educated 25-30 year olds are low. Improving efficiency of the education market plays an important role in improving youth labour force participation. The transition time from O-Levels to A-Levels and from O-Levels and A-Levels to higher studies or vocational training should be minimized. Universities and vocational training institutes should function according to a set calendar in order to avoid unnecessary delays. Improving the quality and relevance of education, and improving services for matching job seekers to jobs can help to minimize the school to work transition. Again, improving the efficiency of transition between different levels of education can improve labour market outcomes without increased spending.

Studies may be needed to identify the reasons for long delays between different levels of education and take corrective action to minimize them. Computerizing exam taking and paper marking, and selection of candidates to universities may help to improve the efficiency of transition between different levels of education. Some of these measures may be costly to implement, but the likelihood of negotiating multilateral aid for such efficiency improvements are likely to be high.

Improving efficiency of the education market plays an important role in improving youth labour force participation.

6.5.2 Improving Employability and Employment Services

As discussed earlier, government expenditure on technical and vocational training, career guidance and job placements is very small. Even available funds are distributed amongst a multitude of institutions. The high drop-out rates in these institutions suggest inefficiencies in the management of these institutions.

International experience suggests that the success of the ALMPs depend largely on several factors.¹⁸ These are: (i) inclusion of multiple stakeholders in the design; (ii) involvement of the private sector to ensure that correct skills

¹⁸ Subrahmanyam, G., and V. Castel (2014), "Labour Market Reforms in Post-transition North Africa," African Development Bank Group, Tunis.

are taught; (iii) availability of reliable information on the labour market to make correct policy decisions; (iv) proper targeting aimed at the most disadvantaged; and (v) comprehensive programmes that link training to job placement. Training programmes which directly target 'skilling' workers to fill available vacancies are more efficient, and can be less costly.

The TVET sector in Sri Lanka can also benefit from reforms that aim to involve more stakeholders in the design, involvement of the private sector, better labour market information for making decisions, proper targeting, and programmes that are linked to employment placements. Among these, improving labour market information will be most costly to implement. But, rationalizing the existing TVET sector can free resources for developing a system to collect better labour market information.

6.5.3 Policies for Improving Job Creation and Productivity

Past governments resorted to public sector job creation to reduce unemployment amongst graduates. However, this is not a sustainable solution (see Box 6.1). The way forward is to facilitate private sector job creation. Highly regulated labour markets make access to employment harder for vulnerable groups such as youth and females, as prime age individuals who secure jobs enjoy long job tenures. There is increasing evidence that more flexible labour markets facilitate more efficient worker allocation, job creation and productivity (see Box 6.2). In the aftermath of the financial crisis,

many policy reforms adopted by OECD countries were aimed at allowing more flexibility for firms to hire and fire workers. These include, reducing the severance payments, simplifying judicial procedures related to firing procedures, allowing longer term temporary work arrangements, subsidizing social welfare payments linked to wages to reduce the costs of hiring and increase the flexibility of adjusting the workforce to suit market requirements.

Sri Lanka also has highly stringent labour market regulations where hiring and firing of workers is costly and cumbersome, and the costs involved are uncertain. Relaxing these regulations by reducing the costs of social protection to firms and ensuring income protection, rather than job protection,¹⁹ can benefit job creation. For example, in many OECD countries firms have greater freedom in hiring and firing workers. But, workers' incomes are protected during times of unemployment through unemployment insurance or stipends paid during times of unemployment. This is beneficial to both the firms and the workers. Firms are able to adjust their work forces to match the current economic and technological requirements of the market, while workers are able to get re-skilled and re-enter the labour market. In many countries, unemployment insurance schemes are coupled with policies for training unemployed workers, so that they can acquire new skills and improve their employability. But, any policy reform will need to be carefully evaluated for their social consequences before implementation. This entails introducing social security programmes to support workers in-between jobs as well as

¹⁹ Job protection usually refers to legislation, collective agreements or other policies that restrict the hiring and firing practices of firms. Income protection usually refers to protecting the incomes of workers so that they do not have to face hardships even when they are laid-off (e.g., through unemployment insurance). Job protection is a form of income protection as workers are paid as long as they are employed. But, excessive job protection is criticized, as it lowers productivity of workers and hinders the creation of more and better jobs.

Box 6.2**Effect of Labour Market Institutions on Job Growth and Productivity**

Economic growth requires the reallocation of productive resources from low growth sectors to high growth sectors. Reviewing the literature on firm growth, Henrekson (2014) finds that younger high growth firms have higher productivity and grow more rapidly, thereby contributing to job growth more. Regulations that provide high job security restrict job mobility and are detrimental to the growth of young high growth firms, as they restrict the ability of firms to secure skilled workers. Stringent labour markets can dampen job creation. High job protection increases the opportunity cost to workers of changing employers or becoming self-employed. As such, in highly protected labour markets, worker mobility is low. When formal employment is highly regulated, employers tend to circumvent the regulations by hiring temporary workers. Although this reduces the costs of worker adjustment, it restricts the ability of firms to attract highly skilled workers. International experiences suggest that more flexible labour markets assist job growth. A study evaluating the relationship between productivity and firm size in the US and seven European countries using harmonized firm-level data find that the relationship between productivity and firm size is much stronger in the US, where labour markets are less stringent.

Source: Henrekson, M., (2014), "How Labour Market Institutions Affect Job Creation and Productivity Growth", Institute for the Study of Labour (IZA), Bonn.

social dialogues to minimize adverse social reactions. If carefully designed, social security programmes can be created without much public funds, financed by contributions from employers and employees. Such policies may increase job creation and benefit females, youth and elderly without stretching the public budget.

6.5.4 Labour Market Reforms for Creating a Knowledge-based Economy

Improving human capital, especially tertiary level educated S&T workers is seen as an essential element for boosting innovation, which is needed for improving productivity and competitiveness. As shown, although the education level of employed in Sri Lanka have improved over time, the proportion of tertiary educated in the country is very low. Many who are in professional, technical and associate professional occupation categories are without

a tertiary education. A large proportion of those who are tertiary educated have done their studies in arts and humanities subjects. The country will need to expand access and improve the quality of the tertiary educated to promote innovation and competition. In this regard, in the face of tight budget constraints, Sri Lanka will need to bring in policies for giving tertiary education institutes more autonomy to function independently, more autonomy to generate funding, and at the same time making tertiary education institutions more accountable.

6.6 Conclusions and Policy Recommendations

The government envisages creating one million jobs and improving Sri Lanka's living standards. To reach one million workers in five years, the economy will have to increase its current trends

Improving human capital, especially tertiary level educated S&T workers is seen as an essential element for boosting innovation; the proportion of tertiary educated in Sri Lanka is very low.

in employment by two and half times. With a very low unemployment rate already, the majority of workers for the envisaged new jobs will have to come from the currently economically inactive population. These consist mainly of females, old persons and youth. Hence, policies to creating one million jobs will need to especially target these population groups.

International experience suggests a variety of ways to increase labour force participation of youth, females and elderly without relying much on public expenditure. The main means of doing this is by relaxing legislation that inhibits the natural growth of firms due to statutory requirements. Such incentives need not be financial. For example, they can take the form of reducing the severance payment requirements, simplifying firing procedures, and allowing longer-term temporary work arrangements that encourage firms to expand employment. Reducing job protection through lowering the costs of severance pay and allowing firms more flexibility to hire and fire workers can benefit the young and females. Further, better child care facilities and more flexible work arrangements are the main policies adopted by OECD countries to improve female labour force participation. If done with private sector participation, providing better and more affordable child care may not be an extra burden on government finances.

Youth enter the labour market quite late in Sri Lanka. This is partly due to the longer time spent in education by youth. However, the education outcomes of youth are not very good. Increasing youth labour force participation can be brought about by improving the education system. Policies should aim at reducing the transition time between general and tertiary education and ensuring that the education courses are completed according to a schedule. Improving the efficiency of education will also help to increase female labour force participation indirectly. If females enter the labour market in their early twenties, they are more likely to gain several years of experience before their reproductive years. With prior experience in the labour market, they are more likely to resume work after their reproductive years than those

who never work. On the other hand, engaging in education till the late twenties allows females very little time to gain experience before starting a family.

Improving the quality of tertiary and vocational training, and making them more relevant to the market place can improve the employability of young people. Further, job-search assistance can facilitate job matching and ensure that young people receive training that is in demand in the market. Given budget constraints, expanding publicly provided vocational training may not be an option. Further, already a variety of institutions are involved in providing vocational and technical training in the country. The way forward would be to streamline the publicly funded vocational and technical training sector, and encourage more training that are linked to existing vacancies, through partnerships with firms, training providers, and the government.

The current development policy framework gives special attention to create a sophisticated and modern knowledge-based economy. Countries that envisage promoting their knowledge-based industries promote innovation and invest in S&T workers. However, as discussed, the proportion of professionals in Sri Lanka is quite low. Further, a majority of the professionals, associate professionals and technicians do not have the education levels at the tertiary level required by their jobs. Reforming the tertiary education sector to expand education courses in S&T fields and improving the quality of education is crucial for creating a knowledge-based economy. Again, in the absence of funding, the way forward would be to do this through PPPs. Earlier attempts at expanding higher education concentrated more on expanding numbers. The need is not only to increase the number of tertiary educated, but to ensure that they come out with the proper skills needed to spearhead innovation.