A STRATEGY FOR SKILLS-DEVELOPMENT AND EMPLOYMENT POLICY IN SRI LANKA

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CONTENTS

1. INTRODUCTION 1
- 1.1 Purpose and Scope 1
- 1.2 Premises 1
- 1.3 Preconditions 5
- 1.4 Strategic Goals 7
- 1.5 Procedure 8
- 1.6 Targets 9

2. POLICY REFORMS FOR THE SKILLS DEVELOPMENT SYSTEM 13
- 2.1 Assessment of the Current System 14
- 2.2 Economic Considerations 15
- 2.3 Skills-Development Funds 17
- 2.4 Structure, Organisation 18
- 2.5 Financing 19
- 2.7 Accountability 23
- 2.8 Consolidation of Training Institutions 24
- 2.9 Skill Upgrading within the Public Sector 24
- 2.10 Related Reforms 25

3. POLICY REFORMS TO ENHANCE LABOUR MARKET EFFICIENCY 27
- 3.1 Overview 27
- 3.2 Unit Labour Costs 27
- 3.3 Industrial Organisation 29
- 3.4 Industrial Relations 31
- 3.5 Social Legislation 32

4. CONCLUSIONS 34
- 4.1 Beyond the Year 2000 34
- 4.2 A Systems Approach to Human Resource Development 36
- 4.3 Human Resource Development from the 37
- Perspective of National Policy 37
- 4.4 HRD from the Perspective of Industry 39

REFERENCES 41

A STRATEGY FOR SKILLS-DEVELOPMENT AND EMPLOYMENT POLICY IN SRI LANKA

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Terence F. Kelly[1]

1. INTRODUCTION

1.1 Purpose and Scope

This paper sets out a possible strategy for skills development and labour utilisation in Sri Lanka for the decade of the 1990s. There are two components to the proposed strategy: human capital investment requirements (to upgrade the quality of labour supplied), and required investments in labour market efficiency (to increase the quantity of labour demanded). It is not sufficient merely to invest in skills development; provision must be made to ensure that the resultant skills are ultimately utilised effectively, i.e., that the investment has a payoff. The proposed strategy is decidedly growth-oriented, i.e., designed to minimise the labour market constraint on economic development. The objective is to identify policy reforms necessary to facilitate the transition from moderate to faster growth paths.[2] This contrasts with past policies which seem to have been primarily motivated by equity concerns. The result of this historical, somewhat political, orientation has been continued low growth, low productivity, and an intransigent unemployment problem.

1.2 Premises

The options presented below are based on a number of empirical observations regarding Sri Lanka's labour market operations:

1.2.1 The chronic unemployment problem. Recorded unemployment has never been below 11% in Sri Lanka since Independence. In 1980/81, the

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2 There is a separate office in the Ministry of Policy Planning and Implementation which is exclusively concerned with these equity concerns, i.e., the monitoring of poverty-alleviation efforts.

unemployment rate was 15.3%, in 1985/86 it was 14.1%, and in 1990 it was 14.4%.[3] Both supply- and demand-side developments have contributed to the problem of chronic unemployment. High rates of labour force growth -- mostly due to an influx of youthful, first-job seekers, many of whom were females -- have not been matched with sufficient expansion in the demand for labour to yield significant reductions in unemployment. During the 1980s, the labour force expanded by nearly 25%, in part due to a 3.3% rise in participation rates. Since economic liberalisation in 1977, real GDP has increased only 4.8% per annum, on average.[4] Aggregate economic performance, of course, has been constrained by fiscal and balance-of-payments deficits, low savings rates, and consequent insufficient investment. High levels of unemployment further limit growth prospects, as budgets have to be channeled to the consumption needs of the unemployed in place of savings and investment (Kelly & Gunasekera, 1990).

1.2.2 The concentration of unemployment among youthful first-job seekers. The unemployment problem in Sri Lanka is a problem of youth: one-third of those between the ages of 15 and 19 were reported as unemployed in the first quarter of the 1990 Labour Force Survey and those between 15 and 24 years of age accounted for nearly 60% of the unemployed. They only comprised 26% of the labour force, so the youth share of unemployment was over 2.3 times as large as their share of the labour force.

1.2.3 The high degree of cyclical sensitivity of economic performance. While cyclical instability is partly due to the destabilising effects of periodic internal political conflict, it also reflects the country's narrow export base and continued agricultural reliance on uncertain natural rainfall. For the period 1985-1990, the coefficient of (annual) variation[5] for Sri Lanka's

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3 Data derived from labour force surveys by the Department of Census and Statistics for the years mentioned. The 1990 estimate is for the first quarter of the year only. After that time, civil disorder in the North and Eastern provinces prevented interviews in those areas of the country.

4 Based on the least-squares trend of the logarithms of the annual index numbers of real GDP, 1978-90.

5 The standard deviation divided by the mean over the reference period.

GDP was 36% higher than that for Thailand and 160% higher than that of Malaysia. Over the period 1978-1990, Sri Lanka's coefficient of annual variation in GDP was 2.84 times that of Malaysia's.

1.2.4 The apparent low degree of labour flexibility. In view of the historical volatility of Sri Lanka's aggregate demand, a certain degree of labour market flexibility is required in response. According to the somewhat sketchy available evidence, the requisite flexibility has been absent. Between 1981 and 1985, the elasticity of employment with respect to variations in GDP in Sri Lanka was only slightly more than half that of Malaysia. Between 1985 and 1989, Sri Lanka's employment elasticity was 1% less than that for Thailand and 5% less than that for Malaysia. This likely reflects a relatively high cost of labour adjustment in Sri Lanka, due to severance provisions, the high proportion of fixed costs in total labour costs, and low rates of worker mobility. The Gratuity Provision tends to reduce quit rates while the Termination Act reduces layoff rates. Policies which raise the costs of firing labour tend to raise the costs of hiring labour as well. Reduced flexibility/turnover means a reduced number of job openings for first-job seekers for any level of employment demand. The result is an extremely long duration of unemployment. It has been estimated that nearly one- half the unemployed remain without jobs for over 5 years, on average (Dickens & Lang, 1989).

1.2.5 The generally low productivity and performance of the work force. The income problem in Sri Lanka is largely a problem of underemployment, due to low productivity/job performance.[6] Only about 6% of poor household heads are unemployed (World Bank, 1992), implying that low wages contribute significantly to the problem of low incomes and poverty. While the country has an educated, healthy population, it does not have the requisite skilled labour force. Workers have neither been provided with the latest technology nor exposed to the demanding standards of

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6 Underemployment is often measured statistically in Sri Lanka as the number of persons who indicate they would like to work more hours at prevailing wage rates. A more meaningful definition would include those working at wages below what would be justified by embodied human capital endowments. Underemployment has both a wage and hours dimension.

the international marketplace. The country is relatively strong in knowledge skills, but relatively weak in work skills. Productivity is being constrained by a number of factors: wage policy (absence of incentive pay), distortions in product and factor markets, inferior systems of labour management, an inadequate skills development system, an educational system in need of reform, labour legislation (severance regulations, gratuity allowances, number of public holidays), and certain social conventions (leading to low geographic and occupational mobility). The average worker in the banking sector in Sri Lanka spends nearly 49% of the year away from work. This is due to the number of public holidays (28) and leave policy (45 days).

1.2.6 The relatively high rate of inflation. Between 1980 and 1990, the implicit GDP deflator rose at an average annual rate of 19.8%, and between 1989 and 1990 it rose 19.9%. Inflation is both a cause and consequence of low economic growth. It constrains both savings and investment and limits Government willingness and ability to maintain a competitive exchange rate. Low growth means reduced productivity. Unless this is matched by wage restraint, the result can only be further (cost-push) inflation. Wage restraint is difficult to achieve when prices are rising at nearly 20% per annum and when a significant component of the employed labour force is teetering on the brink of poverty.

1.2.7 While wages are low in Sri Lanka, unit labour costs appear rather high by international standards. Data from the Census Department's National Accounts suggest that the average Sri Lankan worker only earned the Rupee equivalent of $28.38 per month in 1985, and only $22.64 in 1989.[7] The same source suggests that labour costs account for about 44% of value added, largely due to overstaffing to compensate for low productivity and absenteeism (see Section III).

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7 The 1989 figure is a rough estimate based on 1989 GDP and the average interrelation between output and employment 1980/81-1985/86.

1.2.8 Low rates of savings and investment. Sri Lanka's savings rate (14% of GDP in 1990) is about on a par with that of the Philippines, and 7% lower than that of India. Clearly much of this is due to capital outflow in response to the political turmoil of 1988-89, but just as clearly, there are longer term factors involved. While private investment has accelerated from 10.4% of GDP in 1986 to 14.7% in 1990, public investment declined from 14.2% to a meagre 5.7% over the same period. Most of this decline is a response to the need for accelerated expenditures for defence, coupled with constraints imposed by IMF agreements. The fact remains, however, that needed investment in the infrastructure is being curtailed by the diversion of scarce resources to current defence expenditures. This, in turn, will limit future foreign investment.

1.3 Preconditions

Skills-development investments can only be efficient and effective within a conducive economic environment. This implies that the following preconditions be satisfied:

- A conducive macro-economic environment, with flexible exchange rates, an acceptable debt/service ratio, improving trade balances through export promotion, a reasonable degree of price stability with credit availability, and a politically acceptable income distribution. Current Government policy appears to be addressing all of these concerns, albeit with differential success depending on the particular policy reform. The latest World Bank Country Economic Memorandum shows that the Sri Lankan rupee has appreciated considerably against the currencies of such export-competitors as Bangladesh, Malaysia, and Thailand since 1990. (World Bank, 1992).

- An appropriate legal infrastructure, assuring property rights, rights of redress, and appeals. There may be room for improvement on these matters, from the perspective of private- sector business and potential foreign investors.

- A facilitative service structure. While this refers, in the first instance, to the public sector, there is nothing to preclude greater private-sector participation in provision of social services in the future. Historically, the Government has acted primarily as a control agent in Sri Lanka, with many of its possible service functions being ignored. The area of marketing (market identification and promotion) is one example of required improvement where the private sector has a significant role to play.

- A consistent, competitive micro-economic environment. Employers frequently complain that they are at the whim of external forces: Members of Parliament, Ministers, Secretaries, Commissioners, not to mention international prices. Policy, while attempting to reduce the scope for arbitrary discretion, will nonetheless have to continue to be flexible. Many employers appear to be rent seekers instead of profit makers, and market imperfections permit price distortions in result (Kelly & Culler, 1990, and Kreuger, 1974).

- An accommodating social structure. Certain vestiges of caste/class rigidities remain within the Sri Lankan social fabric. These account for relatively low rates of social, occupational, and geographic mobility, as well as for certain anomalies within the wage determination system. Collective bargaining appears to be significantly influenced by class-induced suspicions. Culture and customs are not matters to be changed by policy, but reductions in impediments to mobility are occurring daily through normal economic and political adjustments. It can be expected that higher growth, spurred by a facilitative social and economic framework, will lead to a further natural reduction in social impediments to labour market efficiency.

- A stable political environment, lack of which has inhibited foreign investment, and promoted labour and capital outflow. Uncertainty about the future has apparently induced producers to shift to low-skilled production techniques, further inhibiting the accumulation of capital and technology.

1.4 Strategic Goals

The basic goal of the proposed strategy is to minimise labour constraints on current and future economic performance through improvements in: (a) the skills development system; (b) the skills utilisation system; (c) the financing system which supports these investments; and (d) the institutional system which operates and monitors them.

Given the policy objective to raise the living standards of the population in general, and of its poorest segments in particular, the country will have to accelerate economic growth. The target for this exercise is an acceleration of annual GDP growth from the current 4-6% rate to a rate above 8% after 1995. This will allow a doubling of real GNP per capita to US$940 by the year 2000.

One of the major constraints limiting growth prospects is low savings/investment. The "savings gap" requires significant foreign investment in response, much of it from private sources. That investment can only be mobilised by the assurance of a conducive business environment and the availability of a skilled, disciplined work force. Strategy must shift away from attempts to substitute labour for capital toward attempts to realise the complementary nature of the two production factors.

Similarly, public investment in the infrastructure must be permitted to increase, as infrastructure is also complementary with private (and foreign) investment. For this to occur, hostilities must subside and public expenditures must be shifted from defence consumption to infrastructure investment.

The strategic goal implies the need for an upgrading of labour productivity through skills development (training or experience), worker performance (reductions in absenteeism, improved incentives and attitudes), and more efficient skills utilisation (management, industrial relations). Wage policy, particularly as influenced by Government wage setting, is likely to prove an important instrument for the attainment of the goal. A fundamental objective of this strategy is to reverse the current state of affairs, so that wages are high but unit labour costs are low, through wage-induced improvements in productivity.[8]

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8 This is precisely what occurred between 1985/86 and 1990: real wages grew by 6.5% but unit labour costs fell by 1.2% due to a 7.7% increase in (real) productivity. See Table 4.

Admittedly, the country will have to continue to pursue its current comparative advantage which is now based on cost- competitiveness. This implies a continuation of low-wage strategy for the coming 3-5 years. After that time, if not before, the (export-competitive) strategy should probably shift to a quality and performance basis. This requires more demanding production standards, attention to scheduling and quality control, and a facilitating higher-wage, productivity/ performance-inducing policy. An additional important requirement is marketing -- identification and promotion.

1.5 Procedure

From an economic perspective, the development of a strategy involves the optimisation of an objective function, subject to constraints, and to the availability of tools or instruments to relax or offset the constraints. This exercise begins with the objective or goal of maximising income growth (GDP), which is dependent on factor inputs (land, labour, capital, technology) and their rates of utilisation. Capital utilisation is assumed to be constrained by labour productivity (skills/performance), so that returns to investments depend on the availability of skilled, motivated labour. Skills and performance, at the same time, are considered to be dependent on wages. Capital and labour are taken to be complementary over time, so that the marginal productivity of the two factors in combination exceeds the sum of the (partial) marginal products when each factor is increased alone while holding the other constant.

Labour quality (skills) is related to a matrix of training inputs: facilities, curricula, instructors, materials, on-the- job training experience, and the productivity of these inputs (which depends on institutional arrangements). That productivity is assumed to be higher when the process is organised within the private sector, or at least when linkages with private-sector employers are strong. While institutional arrangements are important, the key is that market signals be allowed to operate and be read, and that the system has sufficient flexibility to adjust to those signals (Kelly, forthcoming).

Prices of the training inputs are given, except in the case of teachers whose supply and quality are considered to be wage elastic. Given prices and efficiency wages (for teachers), the required skills-development investment budget is given. This budget is constrained to be less than a pre-specified target given by fiscal and balance of payment deficit targets.

The next step is to reduce constraints which currently hinder the efficiency of labour market operations, so as to generate higher wages, productivity, and performance. The demand for labour depends on investment, output, and wages within a simultaneous framework. Prices are given by world markets and internal constraints on trade and domestic producers. It is assumed that the output elasticity of labour demand can be increased by improving worker performance (e.g., reductions in absenteeism) and intra-industry labour mobility; by improving the degree of competitiveness within product markets; by improving information availability; and by reducing possible anti-labour bias in social regulations. That is, labour market efficiency will improve when the economy is better able to emit appropriate signals for necessary change, and when the social agents, including labour, are better able to react to those signals.

From the various assessments which have been carried out on skills development policy in Sri Lanka (Asian Development Bank, 1986, Kelly & Culler, 1990), some of the requisite policy reforms involve the following:

Skills Development	**Labour Market Efficiency**
Privatisation	
Consolidation	Rationalisation of tax/ transfer system
Instructor quality	Severance and gratuity pay
Curriculum development	Annual hours of work (holidays, absenteeism)
Certification	Compensation system, wage policy, incentive pay
Accountability	
Financing (skills development fund)	

1.6 Targets

Specific growth targets are listed in Table 1, which presents targets associated with three different labour-market scenarios: a baseline scenario (continuation of current policy trends), a labour-intensive growth strategy, and a labour- absorptive scenario (higher productivity and growth).[9] The labour-intensive scenario would imply a return to the policies of the 1960's and early 1970's: a continued concentration of employment in agriculture, low wages, and continued low productivity of labour. This further implies low productivity of investment, as reflected in a relatively high and rather constant incremental capital/output ratio. Because of low capital and

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9 Labour intensity of production is measured by the capital/labour ratio at a point in time (along a fixed isoquant); labour absorption refers to the rate of change of employment over time, i.e., the slope of the expansion path of output and employment. Note that a labour-intensive strategy generally implies a low rate of labour absorption as well as low wages to accomodate a decline in the capital/labour ratio.

labour productivity, growth would remain only marginally above 5% per annum up to the end of this century under the assumptions of this scenario. Unemployment would be higher than under Scenario 3, the labour-absorptive strategy (3.9% by the year 2000 in place of 3.0%). The labour-absorptive strategy, moreover, contemplates modest increases in labour force participation in response to improving wages and job opportunities.

The labour-absorptive scenario represents the preferred strategy. The other two are presented primarily as points of reference. Under the preferred strategy, high growth rates are achieved through modest increases in domestic and foreign investment (accelerating from 24% to 30% of GDP over the decade), but large increases in capital and labour productivity. The former is reflected in declining ICOR's over the reference period (a 15% reduction between 1990 and 2000), while the latter is shown by declining unit labour requirements (the inverse of output per employee). The targets for the preferred strategy imply a 4.1% annual rate of increase in worker productivity between 1990 and 2000. Because of (target) productivity increases, the impact of high growth on unemployment is somewhat diminished in relation to the base or labour-intensive scenarios.

All three scenarios were run with the Macbeth model, which was developed by MHConsultants and recalibrated with Sri Lankan data for 1990. All three also included a recently-announced Central Bank growth rate of 4.8% for 1991, and thus all are rather conservative in the sense that targets are modest. A 7.5% rate of GDP growth (average over the decade of the 1990s) is more than sufficient to permit a doubling of GDP by the end of the decade.[10] It is stressed that these are "heuristic" (trial-and- error) calculations, based entirely on the implications of alternative assumptions. They are entirely the consequence of "what-if" questions, and while they are grounded on current trends and observations, results are not considered valid as predictions of likely future outcomes. Results are at least internally consistent, as a consequence of being forced to conform to the accounting identities imposed by the Macbeth model.

The most important implications of these simulation results are as follows:

- The "labour-absorptive" strategy would increase employment and income (GDP) on the order of 11% and 26% respectively, above the "labour-intensive" strategy by year 2000. This illustrates the rather important, often overlooked, distinction between labour-

10 A 7.5% annual growth rate implies a doubling of GDP within 9 years and 4 months.

intensive versus labour labour-absorptive growth strategies. Although unit labour requirements would be 14% higher by year 2000 under the former approach, the rate of employment growth over the decade is higher under the latter approach because of faster GDP growth. If a production process begins with relatively high labour utilisation (a low capital/labour ratio), it is quite likely that output growth will require greater increases in capital than in labour (thus, the expansion path between output and employment will be rather low, but between output and capital utilisation rather high). Moreover, GDP growth is greater under the labour-absorptive than under the labour-intensive strategy (thus, the *length* of the expansion path is greater as well).[11]

- Unemployment would be slightly lower under the labour- absorptive, high-growth approach than under the labour-intensive strategy, but more importantly, under-employment, the more pressing national problem, would likely be significantly lower under the former approach.[12]

- The time patterns of the labour force and employment effects of the different scenarios differ in part due to different assumptions about labour force participation rates. Moreover, separate calculations were made for the sub-periods 1990-95 and 1996-2000; i.e., the parameters were reset after 1995.

The outcomes of the various scenarios are significantly dependent on assumptions about labour force participation rates and the sectoral distribution of aggregate demand. Without increasing participation rates, for example, the labour- absorptive scenario would not even be possible, due to labour shortages, particularly at the low end of the skill spectrum. These assumptions are shown in Table 2. The baseline scenario corresponds to the labour market situation as recorded in the 1990/91 Quarterly Labour Force Survey, first quarter (Department of Census and Statistics, 1992). It also reflects trends and changes from 1985 to 1990. In this and

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11 The garment industry illustrates these somewhat complex points. Garments have rather high unit labour requirements, even though the capital/labour ratio (in value terms) is high as well. Most importantly, increases in production do not generally require large expansions in employment, but are generally achieved through increases in productivity. Thus labour absorption over time is low in garments. Kelegama and Wignaraja (1992) analysed employment trends during the 1980s and concluded, "...the employment-generating potential in most high labour-absorbing industries has fallen, and there has been a shift towards more capital-intensive techniques in most industries." (p. 135)

12 Neither the Macbeth model nor available data permit us to go very far in terms of discerning the impact of wages on labour supply (performance/realised productivity) or the demand for labour, and hence on the income distribution.

Table 1
Growth and Labour Market Targets
for Three Different Scenarios

	Labour		
	Baseline	**Intensive**	**Absorptive**
Annual GDP Growth (% per annum)			
1990-1995	5.6	4.9	6.6
1996-2000	7.2	5.2	8.5
1990-2000	6.4	5.0	7.5
ICOR			
1990	4.4	5.3	4.0
1995	3.7	5.3	3.6
2000	3.6	5.1	3.4
Investment as % GDP			
1990	23.8	23.8	23.8
1995	25.8	25.0	26.0
2000	25.8	26.0	30.3
United labour requirements (No. employed per Rs. Million GDP)			
1990	46.1	46.1	46.1
1995	40.3	41.4	40.0
2000	32.6	35.0	30.8
Labour productivity growth (% per annum)			
1990-1995	2.7	2.2	2.9
1996-2000	4.3	3.4	5.4
Employment growth (% per annum)			
1990-1995	2.8	2.6	3.6
1996-2000	2.7	1.7	3.0
Unemployment rate			
1990	14.0	14.0	14.0
1995	13.3	8.7	10.1
2000	7.5	3.9	3.0

the labour-intensive scenario, it is envisioned that female participation rates will continue to rise and those of males to decline. As mentioned, this reflects the combined assumptions of rising wage rates under the labour-absorptive scenario, and the expansion of job opportunities which should lower the number of discouraged workers.

Table 2 also indicates assumptions about the sectoral distribution of growth and employment over the simulation period. These are not strikingly different from one scenario to the next, and, of course, depend on previously listed targets for labour and capital productivity. The most notable feature is that the labour-absorptive strategy envisions a more rapid decline in agriculture's share of GDP and employment than the other two scenarios, but a corresponding more rapid increase in the importance of manufacturing. This, at least, is the experience of other Asian countries which managed to make the transition from modest to rapid growth.

Table 2
Demographic and Labour Market Assumptions Underlying the Three Scenarios

	Baseline		Labour Intensive		Labour Absorptive	
Population Growth (Annual rate of change)						
1990-1995	1.6		1.6		1.6	
1996-2000	1.4		1.4		1.4	
Female share of labour force						
1990	39.4		39.4		39.4	
1995	49.0		49.3		49.3	
2000	49.4		49.4		49.4	
Sectoral share of GDP	1990	2000	1990	2000	1990	2000
Agriculture	23.3	18.9	25.5	23.4	23.3	17.9
Manufacturing	20.4	29.1	17.7	18.3	20.4	31.1
Construction	6.7	6.7	7.2	7.1	6.7	6.7
Utilities	15.3	14.0	16.0	16.5	15.3	13.8
Trade	20.5	19.2	20.8	21.8	20.5	18.8
Banking	5.1	4.1	4.5	4.8	5.1	4.0
Public Admin.	4.9	4.4	4.6	4.3	4.9	4.3
Other	3.8	3.5	3.7	3.8	3.8	3.4
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Sectoral shares of Employment						
Agriculture	47.8	41.2	49.0	49.5	47.8	39.8
Manufacturing	17.2	22.1	13.4	13.7	17.2	23.4
Construction	3.1	4.6	4.1	4.6	3.1	4.8
Utilities	4.4	4.2	4.7	4.8	4.4	4.1
Trade	8.5	10.0	10.6	11.0	8.5	9.7
Banking	0.8	1.2	1.3	1.3	0.8	1.2
Public Admin.	16.4	13.1	12.6	11.1	16.4	13.1
Other	1.7	3.8	4.2	4.0	1.7	3.8
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

2. POLICY REFORMS FOR THE SKILLS DEVELOPMENT SYSTEM

A growth-oriented economic development strategy, as mentioned, must be supported by improvements in both skills development and labour market efficiency. The latter topic will be addressed in the next section of this paper. In this section, the concern is with the former, i.e., policy reforms necessary to upgrade the skills-development system.

Two fundamental steps are required for the desired upgrading: (a) a transfer of authority and responsibility for skills development, to the extent feasible, from the public to the private

sector; and (b) the introduction of market signals into the public component of skills development. The first objective relates to the privatisation of the skills-development system, the second to improving signals, prices, efficiency and effectiveness within the public sector itself. Both steps imply a need to strengthen linkages between the training and employing sectors, and efforts to reorient systems from supply- to demand-side objectives.

2.1 Assessment of the Current System

Previous assessments of skill-development policy in Sri Lanka have pointed to a number of deficiencies[13]:

- Limited programme effectiveness. Very often, over half of the passed-through graduates of training programmes fail to find employment within one or even two years of programme completion. This is explained, first, by the general scarcity of job opportunities (Kelly & Gunasekera, 1990) and second, by the lack of linkages between programme administrators and potential employers. Training programmes have proliferated in Sri Lanka not because of the needs of the economy but because of a mistaken notion that training creates job opportunities. This "equity orientation" has caused selection criteria to be weighted in favour of unemployed school leavers, rather than in favour of those with an aptitude for technical subjects. It has also caused the system to favour training for first-job entry in place of skill-upgrading for the employed.

- Generally low programme efficiency. Lacking adequate pricing signals, government operations are, in many sectors, clearly inefficient. Decisions are driven by available budgets in place of market requirements. In Sri Lanka, this tendency is manifested by a large number of under-qualified instructors (who are also, incidentally, underpaid and thus poorly motivated), inappropriate curricula, lack of adequate materials and equipment, and a somewhat fragmented, undercapitalised set of duplicative instituions operating with insufficient coordination.

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13 For a review, see Kelly & Culler (1990).

- The entire skills-development system has been oriented by supply-side considerations (remedial skills training for the unemployed), in place of demand-side realities (skill upgrading for the employed work force)[14].

Reform of the system therefore requires the introduction of a demand-side orientation, flexibility, accountability, and efficiency, i.e., the attributes normally associated with smoothly functioning competitive markets.

2.2 Economic Considerations

The demand for skills is a derived demand, in the sense that skills are not valued in and of themselves, but rather, for what they can produce[15]. Unutilised skills have no value -- no intrinsic utility -- since they generate no output. Only when skills are combined with other factors of production do they generate an output which conveys utility to consumers.

There are three sources of demand for skills. Individuals (job seekers, workers) seek skills for the earnings or security they can command. Employers require skills to enhance productivity and profitability. Society at-large looks to skills to promote competitiveness within international markets. Although highly intercorrelated, these three perspectives are not coincidental. Employers and workers often have to bargain over the proceeds of human capital investments, firms generally compete for skilled workers, and neither firms nor workers have much incentive to consider general social objectives.

In a competitive market economy with perfect information and low transaction costs, efficiency is assured through the exercise of preferences, reflecting perceptions of costs and benefits of (skill) investment alternatives. But skill-development markets are rarely so perfectly ordered: there is a lack of information about the availability of training programmes, or their quality, or about the likely future payoff to skill investments. This lack of information hinders both individuals and firms. Moreover, skill- development systems are characterised by numerous

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14 To illustrate, surveys of employers suggest a serious shortage of mid-level managers and supervisory personnel, while the institutional training sector continues to turn out unemployed craftsmen.

15 The same holds for hobby skills. It is not so much the ability to fly which is of interest as it is the thrill of flight.

"externalities" which operate to depress the demand for skills relative to the situation where investment benefits accrue solely to investors or where social costs do not exceed private costs.

One example of externalities in skill development comes from the likely interdependence in productivity among workers. Complementarity among skills suggests that human capital investments can raise group productivity beyond the sum of productivity improvements of individual workers. Complementarity implies a symbiotic, interactive effect. Neither individual workers nor their employers are likely to include this effect in calculations of returns on human-capital investment, and so are induced to underinvest in skills development.

Similarly, firms must contend with the externality of their actions within industry. If only one firm invests in skill upgrading for employees while others fail to follow suit, the latter group may "pirate away" or "poach" the skilled workers through higher wages, in which event the returns will accrue not to the original investing employer, but to competitors and to the fortuitous mobile workers (who might or might not have shared in the costs of the investment).[16] Now if all firms were to invest in concert, this dilemma would be resolved -- replacements for quitters could be found at the going wage rate and at roughly the same level of productivity. Everyone would benefit. It is therefore in the interest of societies to intervene in the skills- development process by expanding opportunities beyond the parochial interests of private-sector employers. The availability of a skilled labour force encourages the development of new firms, technology, and competitive advantage, thus increasing potential growth rates. It also permits greater labour market flexibility and the ability to accomodate external shocks, such as cyclical swings in aggregate demand[17]. By definition, these sorts of externalities are unrecognised or under-appreciated in normal market transactions, resulting in underinvestment in skills from a social perspective. Group action based on group consensus is required to realise these unrecognised investment potentials.

Of course, justified interventions do not necessarily imply that governments have to provide training. A distinction must be maintained between collectivity in consumption and collectivity in production. In many cases, it may be more efficient to have the public sector tax

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16 Alternatively, but equivalently, the problem may be expressed as a variant of the "free rider problem." Employers may feel that it is not necessary for them to invest in their workers in that they can always poach skills from industry competitors. The result -- underinvestment in industry- specific skills -- is the same whether due to fear of poaching or willingness to poach.

17 This, in turn, provides justification for Government efforts to induce firms to provide retraining for redundant workers.

and transfer in such a way as to ensure the expansion of training within the private sector. In terms of skills development, the public sector turns out to be a better financier than manager.

It is similarly important to recognise that private-sector control of skills development is not necessarily synonomous with market solutions. The economics of markets implies responses to perceived underlying costs and benefits. This requires that there be signals which reflect underlying supply and demand forces, that the signals be read and interpreted, and that they be acted upon. Smaller employers, in particular, often find it difficult to voice their needs to industry representatives. Monopolistic private- sector enterprises often suffer the same bureaucratic limitations as does the public sector, and conversely, there are ways to introduce prices and other response mechanisms into public sector operations.

Finally, the divergence in perspectives regarding human capital investments implies that no single delivery system can be relied on to achieve social objectives. Loan schemes to individuals, for example, will not necessarily ensure the expansion of enterprise-based training or industry productivity, and tax incentives to firms will not cover the problem of training for first-job entry. Similarly, industry-based training programmes can not provide for the needs of newly emerging industries. Therefore, whatever system is devised, it will have to have a variety of component parts, with mixtures of public/private control, institutional and on-the-job training, and incentives for both firms and individuals.

2.3 Skills-Development Funds

The most significant step that a country can take in terms of attempting to "privatise" or to introduce market signals into the skills-development system is the establishment of a separate Skills Development Fund, operated outside the regular public budget. For one thing, such funds permit the internalisation of the types of external costs mentioned above[18] . A great many countries around the world operate such funds -- Brazil, Fiji, Jamaica, Jordan, and Singapore are but a few illustrations. The Sri Lankan Government has already announced its intention to establish such a fund in Sri Lanka (*Daily News*, 1 February 1992, pp. 1, 14), but details have not yet been decided.

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18 In Germany, this sort of internalisation of external costs is achieved through industry-controlled apprenticeship systems, with some financing from Government. The German system is an evolution of the Guild System which dates prior to the 14th century.

The primary advantages of skills-development funds concern flexibility and accountability. Freed from the binding constraints of bureaucratic turgidity (not to mention limited public budgets), fund proceeds can be used to finance vouchers for those seeking training for a first job, or vouchers to firms to permit them to purchase skill upgrading for their workers. Funds can be used to encourage the development of a private-sector training industry, such as electronics or construction training, or computer schools. They can also finance job search or placement services. Where domestic training opportunities are not available, the Skills- Development Fund could be used to finance training overseas (with income-targeted cost recovery). Some of these functions are now performed within the publicly-controlled system, but could no doubt be carried out more cost effectively if market signals could be used to guide decisions -- which is one of the primary advantages of such funds.

An essential component for the successful operation of a Skills-Development Fund is competency-based testing and certification. The ILO is expected to provide technical assistance in this area in the near future, in collaboration with the Tertiary Vocational Education Commission (TVEC). Fund managers need some indication that their investments bear fruit in terms of actual skill accretion among participants.

2.4 Structure, Organisation

The operative legislation for skills development in Sri Lanka is the Tertiary and Vocational Education Act No. 20 of 1990. This Act places responsibility for skills development under the Commission (TVEC), which falls under the authority of the Ministry of Youth Affairs and Sports. Also under this Ministry is the National Apprenticeship and Industrial Training Authority (NAITA), one of the largest supporters and providers of training in Sri Lanka.[19] There is, therefore, a certain logical consistency to locating the TVEC within the Ministry of Youth Affairs and Sports. The authorising legislation provides for tax and transfer authority within the NAITA, such as would be inherent within the Skills Development Fund. In fact, under current regulations, NAITA is the only body which could legally operate such a Fund.

Two questions can be raised about the current organisational arrangement in light of the objectives of this strategy. First, the Ministry of Youth Affairs and Sports is, by definition,

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19 NAITA both operates training institutes directly and provides subsidies to the private sector to encourage apprenticeships.

concerned primarily about skills development for first-job seekers, not about skill upgrading for the already employed. In a growth- oriented strategy, however, the latter would be given priority over the former, assuming cost effectiveness is the investment criterion.

Second, the TVEC is, also by definition, a Government agency, and Government control of the Skills-Development Fund hardly squares with the objective of the "privatisation" of the system. True, private-sector employers are represented on various oversight boards and committees, but these are usually larger, older firms whose problems and solutions differ from those of smaller or recently established concerns. There is a serious problem of information relay from smaller enterprises to employer representatives in that the cost of information exchange is high whenever the number of points of information is large and diverse. Moreover, the mere replacement of a public bureaucracy by a mixed bureaucracy is not likely to enhance the cost-effectiveness of the skills development system significantly.

To achieve the stated objectives, the Skills-Development Fund should probably be seen as a collective effort of private-sector employers, with monitoring by the other social partners. Employers must feel they have a stake in the investment returns to the Fund, and that it is in their self interests to pool resources and time to make their businesses more profitable by underwriting the Fund. There are a number of ways to reinforce this message, including taxation and transfer policy. A presumably painless alternative would be to transform the TVEC into a quasi-autonomous institution, with oversight representation by employers, unions, consumers, and the public sector. The organisation would then function according to normal corporate guidelines, with the rate of return on investments (essentially human capital investments) used as the standard of measurement for success.

2.5 Financing

The Government has suggested an initial target of Rs. 1 billion (one thousand million rupees) for the Fund (*Daily News*, 1 Feb. 1992, pp. 1, 14). This is about one-quarter of the amount currently being spent by the Government on skills development and would comprise less than one-quarter of 1% of expected 1992 GDP (Table 3). However, the margin of flexibility for financing the Fund through the a simple budgetary transfer of current expenditures on skills development appears small. Moreover, there is a question whether such a large capital base

(equivalent to nearly US$ 25 million) is necessary (given intended efficiency improvements in the system) or could even be efficiently absorbed in early years of operation.

It will be noted that many of the budgetary items listed in Table 3 are simply politically or bureaucratically untouchable. Few would wish to finance such a Fund through a reduction of expenditures on Higher Education, for example. Nor would Departments permit the haphazard cutting of budgets for internal training (i.e., training for own employees). Police and military training are included in this skills-development budget, but they are not likely candidates for budgetary reductions. An admittedly subjective assessment of more detailled data suggests that 15% of public skills expenditures was for technical education (Ministry of Education), 28% was for Higher Education (universities), 41% was for internal skill-grading of civil servants or other Government staff, and the remainder, 17%, was for the benefit of society at large, i.e. outside applicants.[20] This 17% represents only Rs. 677 million rupees, i.e., only two-thirds of the target. Although inadequate, the expenditure *does* represent a source of financing for the proposed Fund. The idea would be to consolidate -- and, yes, to cut -- some of these programmes, and to shift responsibility to the Fund under largely private-sector control.

It appears clear, however, that additional monies will be needed for financing the Fund. These might be generated from the following sources:

°General revenue financing;
°A special tax on businesses;
°User fees (cost-recovery);
°Special contributions from corporations or Sri Lankan expatriates;
°Contributions from foreign donors.

In many developing countries, skills-development funds are financed within levy/grant systems. Levies (taxes) are assessed against employers, based on the value of payrolls, sales, value added, or some similar measure of ability to pay. Funds are then rechanneled back to the private sector in the form of loans or grants to underwrite training expenses. Under a common variant, tax credits are provided to firms which can show that they have either provided or

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20 This includes expenditures for NAITA and the Labour Department's mobile training centres, plus such diverse expenditures as vocational training for prisoners, training offered by the Industrial Development Board, training for fishermen and women. The calculation naturally excludes expenditures on private, fee-levying institutions, as well as expenditures by non-Governmental organisations (NGOs).

Table 3
Government Expenditures on Skills Development 1989-1991 (Rs. Mn.)

	1989			1990			1991		
	Recurr.	Capital	Total	Recurr.	Capital	Total	Recurr.	Capital	Total
1. Ministry of Defence									
1.1 Training of Manpower	59.4	0.0	59.4	82.4	0	82.4	36.3	0.0	36.3
1.2 Sri Lanka Cadet Corps	5.5	0.0	5.5	9.5	0	9.5	10.2	0.0	10.2
1.3 Training in Security	1.2	0.0	1.2	2.1	0	2.1	0.9	0.0	0.9
1.4 Kotalawala Def. Academy	0.0	34.6	34.6	0.0	30.8	30.8	0.0	28.9	28.9
1.5 Sri Lanka Army Trng.	402.3	0.0	402.3	365.7	0.0	365.7	511.2	0.0	511.2
1.6 Sri Lanka Navy Trng.	89.3	0.0	89.3	70.8	0.0	70.8	74.2	0.0	74.2
1.7 Sri Lanka Air Force Trng.	150.4	0.0	150.4	199.6	0.0	199.6	235.0	0.0	235
1.8 Sri Lanka Police Trng.	34.1	0.0	34.1	47.9	0.0	47.9	54.8	0.0	54.8
2. Ministry of Pol. Plan. & Implem.									
2.1 Cons. Training Project	100.2	0.0	100.2	65.0	0.0	65.0	72.5	0.0	72.5
2.2 Cent. for Trng. of Rur. Lead.	2.0	0.0	2.0	2.7	0.0	2.7	2.1	0.0	2.1
3. Ministry of Land Irri. & Mahaw.									
3.1 Irri. Training Institute	0.0	0.0	0.0	0.0	0.0	0.0	1.5	0.0	1.5
3.2 Inst. of Surveyors Trng.	5.0	9.0	14.0	7.0	14.0	21.0	7.1	9.0	16.1
4. Ministry of Edu. & Higher Edu.									
4.1 Inser. Trng. for Teachers	158.1	0.0	158.1	46.9	0.0	46.9	119.5	0.0	119.5
4.2 Teacher Education	67.6	69.2	136.8	84.0	103.0	187.0	119.6	58.0	177.6
4.3 Technical Education	104.4	347.5	451.9	193.9	453.0	646.9	184.9	396.6	581.5
4.4 University Education	520.0	399.2	919.2	745.0	300.0	1045.0	805.0	295.0	1100.0
5. Ministry of Lab. & Voc. Trng.									
5.1 Skills Dev. Programme	46.2	2.4	48.6	77.7	8.0	85.7	69.6	8.8	78.4
6. Ministry of Pub. Ad., Pro Cou. & Home Affairs									
6.1 Admn. Training Service	9.1	0.0	9.1	12.2	0.0	12.2	14.5	0.0	14.5
6.2 Sri Lan. Ins. for Dev. Admn.	0.0	1.6	1.6	0.0	8.6	8.6	0.0	25.0	25
6.3 Pup. Ser. Training Ins.	0.0	0.0	0.0	0.0	0.0	0.0	3.5	0.0	3.5
6.4 Spec. Trng. for Dis. Ofrs.	12.9	0.0	12.9	13.4	0.0	13.4	13.8	0.0	13.8
6.7 Rur. Dev. Trng. Inst.	10.0	0.0	10.0	12.0	0.0	12.0	14.2	0.0	14.2
7. Ministry of Hous. & Const.									
7.1 Cent. for Hous. plan. & Bldg.	1.0	0.0	1.0	1.4	0.0	1.4	1.5	0.0	1.5
8. Ministry of Ind. Sci. & Tech.									
8.1 Inform. Tech. School	5.0	0.0	5.0	5.0	0.0	5.0	5.0	0.0	5.0
8.2 Natl. Inst. of Bus. Mgmnt.	3.0	0.0	3.0	3.0	0.0	3.0	3.0	0.0	3.0
9. Ministry of Trans. & Hyws									
9.1 Railway Training Centre	1.3	0.0	1.3	2.4	0.0	2.4	2.4	0.0	2.4
10. Ministry of Justice									
10.1 Prisons Dept. Voc. Trng.	7.0	0.0	7.0	7.5	0.0	7.5	10.2	0.0	10.2
11. Ministry of Agriculture									
11.1 Training for Staff	36.8	0.0	36.8	21.8	0.0	21.8	27.2	0.0	27.2
11.2 Minor Ex. Cro. Trng. Cent.	0.7	0.0	0.7	0.8	0.0	0.8	0.9	0.0	0.9
11.3 Voc. Trng. on Lives. Prodt.	6.1	0.0	6.1	3.4	0.0	3.4	4.3	0.0	4.3
12. Ministry of Fish. & Aqua. Res.									
12.1 Training of Fishermen	6.3	0.0	6.3	7.8	0.0	7.8	7.8	0.0	7.8
12.2 Aqua. Dev. & Trng. Cent.	11.7	0.0	11.7	13.6	0.0	13.6	13.6	0.0	13.6

Contd...

Contd.... **Table 3**

	1989			1990			1991		
	Recurr.	Capital	Total	Recurr.	Capital	Total	Recurr.	Capital	Total
13. Ministry of Youth Affa. Sports	187.2	50.3	237.5	234.4	125.7	360.1	378.3	79.9	458.2
14. Ministry of Post & Tel.									
14.1 Telecom. Trng. Cent.	1.5	0.0	1.5	6.0	0.0	6.0	8.0	0.0	8.0
15. Ministry of Health & Women's Affairs									
15.1 Training & Scholarships	254.0	0.0	254.0	278.0	0.0	278.0	209.8	0.0	209.8
15.2 Ayuvedic Trng. Centre	5.0	0.0	5.0	5.0	0.0	5.0	10.0	0.0	10.0
15.3 Women's Bureau	5.0	0.0	5.0	6.0	0.0	6.0	8.0	0.0	8.0
16. Ministry of Tourism & Rur. Dev									
16.1 Indus. Dev. Board Voc. Trng.	3.5	0.0	3.5	3.8	0.0	3.8	3.8	0.0	3.8
17. Ministry of Handl. & Text. Ind.									
17.1 Textile Trng. & Svc. Centr	3.0	0.0	3.0	9.0	0.0	9.0	9.9	0.0	9.9
17.2 Trng. Inst. for Textile Tec	4.0	0.0	4.0	10.0	0.0	10.0	12.5	0.0	12.5
18. Ministry of Food & Co-operative									
18.1 Staff Training	1.8	0.0	1.8	1.7	0.0	1.7	2.0	0.0	2.0
19. Ministry of Rec., Reh. & Social Welf.									
19.1 Voc. Trng. of Dept. of Socl. Svc	16.3	0.0	16.3	12.4	0.2	12.6	12.9	0.2	13.1
20. Ministry of Finance									
20.1 Business Dev. Cent.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.6	2.6
Sub Total	2337.9	913.8	3251.7	2670.8	1043.3	3714.1	3081.5	9;04	3985.5
Donors Contribution			1002.6			na			na
Grand Total			4254			3714.1			3985.5
As % of GDP			1.9			1.3			1.1
As % of Govt. Budget			4.5			3.2			2.9
As % of Budget Deficit			11.3			8.4			6.6

Source: Ministry of Finance, *Budget Estimates 1991*, Vol. 1, and unpublished estimates from UNDP.

purchased some form of training for their employees. An alternative to this variant would be the provision of tax credits or grants in accordance with each of a firm's employees who passes a nationally certified skills examination, regardless whether the firm paid for the training. This would compensate for on-the-job training, the cost of which is sometimes difficult to verify.

Payroll taxes are the most common form of financing for skills-development funds, the justifying logic being that payrolls provide an indication of the potential benefits received from such funds: the larger the payroll, the greater the number of employees and the greater the likehood of benefit for the firm through skills development. Singapore operates a unique system, with a regressive tax structure. There, firms are taxed only on the wages of workers who earn below a stipulated amount. This provides an incentive to firms to raise wages at the lower end of the distribution (to avoid taxation) while at the same time investing in the human capital of their

workers. Of course, if the incentive is effective, there will be a natural erosion of the taxable base over time, so that the tax rate must be periodically revised upward to achieve a target tax yield.

Payroll taxes are generally looked on with disfavour by policy analysts, for the simple reason that they raise the price of labour vis-a-vis capital, and thus encourage the substitution of the latter for the former. There is something incongruous about financing skills-development investments in a way which reduces the demand for labour in the first place. And, while a payroll tax on the order of 1-4% (the amount usually levied) might not appear to be particularly onerous or damaging to employment prospects, it should be recalled that in Sri Lanka, employers also must contribute 12% of payrolls to the Employee Provident Fund, an additional 3% to the Employee Trust Fund, and a further 4 1/2% in reserve for gratuity under the Gratuity Act of 1983. Moreover, because of the large number of legal holidays, employers must also figure in a significant amount of overtime premia. And all this must be considered in light of the prevailing 45% tax (plus surcharge) on corporate income.

This said, there are not that many alternative sources of financing available for the Skills-Development Fund. Tax holidays to lure foreign investment have severely reduced the corporate tax base, and deficit financing is seriously constrained by IMF accords. Therefore, some payroll taxation may be required as a temporary expedient. It is to be noted, however, that the plan would be to encourage mixed sources of funding from the Government, donors, businesses, and even Sri Lankans living abroad. Moreover, the Fund could be built up over time. Initial capital could be invested off-shore, with proceeds allowed to accumulate and later used as matching for foreign donations. In this manner, the Fund could be fully self-sustaining within a five-year period.

2.7 Accountability

An additional advantage of skills-development funds is that they can be structured to require accountability among programme administrators. As a general rule, accountability is lacking within public bureaucracies where indicators of progress are generally limited to the rate of provision of programme inputs, rather than measurement of programme outcomes or impact (placement rates, earning profiles, etc.). Under the proposed system, administrators can be held accountable for achieving a stipulated target rate of return on Fund proceeds, with returns measured by the subsequent employment and earning profiles of subsidised programme completors relative to a control group. On the other side of the equation, one could measure the

rate of decline in unfilled job vacancies in subsidised firms relative to the vacancy situation in unsubsidised firms. This has the additional advantage of requiring Fund operators to carry out programme evaluations, with carefully structured control groups, on a regular basis.[21]

2.8 Consolidation of Training Institutions

There are currently over 3,000 publicly-supported training programmes in the country being operated by 20 different public Ministries.[22] Moreover, with the devolution of decision-making authority to the provincial level (decentralisation), the number seems to be increasing rapidly. Each village and hamlet appears to be establishing training centers for their resident youth. In result, few centres are provided adequate funding and the effectiveness of all in combination is low. As private-sector training is expanded through the Skills Development Fund, the number of public institutions can be contracted. Relocation of facilities might require a residential component to be added in some facilities. The idea would be to create a few "centres of excellence" around the country, geared to local private-market or export requirements. The (fewer) residual public training institutions would be closely linked to private industry and, to the extent feasible, would operate in accordance with market signals (pricing and more realistic budgeting). This requires a more realistic salary structure for instructors, and a reduction in the number of under-qualified instructors.

2.9 Skill Upgrading within the Public Sector

There is currently no office within the Sri Lankan heirarchy which has responsibility for coordinating or monitoring skills upgrading within the public sector.[23] That authority rests within individual ministries or departments. The "system" is consequently rather more reactive than proactive. That is, Division heads are informed of the availability of funding, usually from international donors, and they allocate available opportunities among staff, often with little

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21 While it might be felt that a Fund operated under private-sector control would automatically ensure the highest possible rate of return, imperfect information and lack of communication among private-sector employers could hinder implementation. Even private firms carry out cost/benefit analyses on new product lines or production processes.

22 The TVEC has estimated that there are a total of 3000 institutions, including private proprietary institutions and those operated by NGOs. This is clearly an underestimate, as the ADB constructed an inventory in 1986 and listed nearly 3,200 public institutions or programmes at that time.

23 Final approval for overseas training opportunities must be secured from the Department of External Resources of the Ministry of Finance, but if the funds are available, this approval is usually easily secured.

correspondence between staff responsibilities and course content. The geographic location of the course is generally considered more important than is content. In this way, diligent (or at least loyal) workers are rewarded with travel instead of with incentive pay.

Few agencies have training committees and fewer still have training plans and rarely carry out assessments of training needs. This is far different from the situation in other developing countries. To illustrate, in both Botswana and Indonesia, each public agency (Ministry, Department, etc.) prepares a five-year training plan annually. These are prepared by training committees which oversee and approve submissions prepared at the divisional level. Indonesia, in fact, has created an Overseas Training Office which administers a scholastic achievement test to each applicant. Successful applicants are then provided two years of English- language training, after which they are eligible for one to two years of training at an overseas institution, with donor assistance. The Office also monitors student progress while abroad and after return to Indonesia. The Indonesian model is being examined carefully by other developing countries and will likely be implemented in Malaysia.

Improving the efficiency of public-sector operations is an absolute necessity as an adjunct to a higher growth strategy for Sri Lanka. Organisationally, there are a number of options. The TVEC or its successor as operating authority for the Skills Development Fund could simply add a separate unit to look after the skill requirements of the public sector. This has the advantage of expanding the capital base of the Fund in accordance with donor funding for overseas training/education. Or, a separate unit concerned with training for the public sector could be established within the Ministry of Policy Planning and Implementation. Finally, the Sri Lanka Institute for Development Administration of the Ministry of Public Administration could be expanded to include this broader planning and monitoring function. The exact structure of the system is probably less important than that someone be given responsibility for planning and monitoring public-sector training needs and responses.

2.10 Related Reforms

1. Education. This refers to the need for curriculum and testing reform, improvements in teaching methods (greater problem- solving in place of rote memorisation), and efforts to impart an awareness of the "world of work" (motivation, adherence to scheduling and quality norms, preventive

maintenance, job performance, etc.). Discipline and a willingness to take the initiative are two problems mentioned in surveys of employers (Kelly & Culler, 1990). Educational reform is a broader task than can be addressed in a more narrowly focused examination of impediments to labour market operations, but its completion will condition the chances of successful implementation of a strategy for skills development. It is suggested that a broadly based assessment of the education system is required, perhaps with assistance from UNESCO. In particular, the services of expert educationalists (teachers, curriculum development officers, examination controllers, etc.) would be required. All levels of the educational system -- from pre-school to university and graduate studies -- should be reviewed. Regarding universities, the option of "cooperative education" (formal schooling interspersed with on-the-job internships) should be carefully assessed, as it would merely imply an extension of the "dual apprenticeship" system which is now being implemented for technical skills.

2. Wage Policy. Current wage policy in Sri Lanka has fostered a system with a relatively high fixed component, thus reducing worker performance and the flexibility to adapt to external shocks. Annual holidays, leave, and sickness allowances are high in comparison with international standards, and severance/gratuity provisions reduce mobility. Little allowance is made for productivity differentials in wage setting, partly due to imagined fears about union reactions, but largely due to custom. The need for a more incentive-oriented wage determination process is acute. This topic is discussed in the next section.

3. Structural and administrative reform. While attempts have been made to structure oversight coordinating bodies over the skills development system (Human Resource Development Council, Tertiary and Vocational Education Commission) further improvements are required, particularly when the Skills Development Fund is implemented. Coordination is required not only for the set of publicly-provided programmes, but for private skills development efforts as well, including on-the-job training. A national skills- development testing and certification system has an

important role to play in this regard[24]. It is intended that this coordinative role will be played by the Skills Development Fund itself, in conjunction with the TVEC. Under the proposed system, the TVEC will attempt to ensure the quality of the supply of training, while the Fund will coordinate demand. It would certainly be conceptually feasible to assign both responsibilities to one body, and this is an option for consideration.

3. POLICY REFORMS TO ENHANCE LABOUR MARKET EFFICIENCY

3.1 Overview

How efficiently labour markets operate is important for at least three reasons: macro-economic consequences (trade, foreign investment, international competitiveness); social welfare consequences (earnings, incomes); and human capital consequences (expected returns as signals for skills investments). Labour markets respond to external shocks or internal disequilibria through adjustments in real wages, hours of work, productivity, employment/unemployment, and participation rates. How quickly and what form those adjustments take determines internal competitiveness and growth prospects. Efficiency is lessened when adjustments are constrained, such as when there are internal price distortions or market imperfections (lack of information, low factor mobility). There are a great many constraints on labour market operations in Sri Lanka, ranging from internal market imperfections (monopoly, oligopoly) to the resultant distortions associated with efforts to offset those market imperfections.

3.2 Unit Labour Costs

One way to guage efficiency is by an examination of outcomes. Where unit labour costs are high (relative, say, to international standards), there is a presumption that labour markets are operating at less than maximum efficiency. Unit labour costs measure the total cost of employing labour to produce one unit of output. Total labour costs include both wages and overhead expenses (e.g., contributions to pension schemes, paid holidays, or transportation allowances) and reflect hours paid, regardless of hours actually worked. Unit labour costs also reflect worker

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24 As mentioned, the TVEC is developing a set of competency-based examinations, as well as standards for certification of training institutions.

productivity (output per person hour worked or paid): for any given wage rate, unit labour costs are lower the higher is productivity.

Data in Table 4 show unit labour costs at the national economic level for the years 1980-89, along with component indicators: nominal and real wage rate changes, productivity (value added per worker), prices (implicit GDP deflator), and changes in the values.[25]

The data show declines in real unit labour costs (compensation per unit of value added) during the decade of the 1980s: by 5.4% from 1980/81-85/85, and by 1.2% from 1985/86-89. This was occasioned by increases in productivity in excess of increases in compensation: over the entire period (1980/81-89) real wages increased 23% but productivity rose 32% and unit

Table 4
Unit Labour Costs: 1980/81, 1985/86, 1989

	1980/81	1985/86	1989
1. Current Values			
Compensation (Rs. million)	37624.5	70748.3	110032.7
Value Added (Rs. million)	79337.0	157763.3	248230.0
Comp. as % Valued Added	47.4	44.8	44.3
Employment (thousands)	4738	5175	5460 *
Wage per month	661.75	1139.26	1679.38
Value added per emp.	16744.8	30485.7	45463.4
Unit Labour Cost	4742	4484	4433
2. Constant Values			
GDP Deflator	100.0	148.8	206.0
Compensation (Rs. million)	37624.5	47544.0	53408.5
Value Added (Rs. million)	79337.0	106019.4	120487.7
Comp. as % Valued Added	47.4	44.8	44.3
Employment (thousands)	4738	5175	5460
Wage per month	661.75	765.60	815.15
Value added per emp.	16744.82	20486.84	22067.34
Unit Labour Cost	4742	4484	4433

Percentage changes	1980/81 - 85/86	1985/86 - 1989
% change in v.a./emp.	22.3	7.7
% change in wage/mo	15.7	6.5
Difference	-6.6	-1.2
% change in ULC	-5.4	-1.2

* Estimated on the basis of 1989 GDP and the (output) elasticity of employment, 1980/81-85/86.
Source: Dept. of Census & Statistics, National Accounts, various years.

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25 When data are converted into logarithms, the change in unit labour costs can be shown to exactly equal the difference between the change in productivity and the change in compensation. Percentages are imperfect approximations, and thus there are discrepencies (rounding errors) between changes in the total and in the sum of its components.

labour costs fell 7%. This is a rather poor record in terms of productivity and labour costs. It is partly the outcome of the internal political strife of 1987-89, but it also reflects other conditioning influences of a longer-term nature. Among these additional influences would be: industrial organisation (monopolies), industrial relations and wage settlements, and the social costs of social policy interventions.

Moreover, when the data are adjusted for changes in international exchange rates, the picture appears even more bleak. Using data from a survey of 40 employers in and around Colombo, along with value added data from the Central Bank, the World Bank has shown that "labour cost adjusted for productivity [real unit labour costs] increased substantially in 1987 and 1988 reflecting the sustained wage increase in the export sector ... The resulting adverse effects on competitiveness were offset partially with the large depreciation in 1989 (from Rs. 31.8/US$ in 1988 to Rs. 36.0/US$ in 1989) but the high inflation and the inadequate exchange rate adjustment throughout 1990 quickly aggravated the competitiveness much further. In fact, from 1987 till 1990, the accumulated increase in the unit labor cost has been 22.4%." (World Bank, 1992, pp. 48, 49).

3.3 Industrial Organisation

Sri Lankan labour markets are highly segmented and consist of the following major components:

- The traditional corporate sector. This sector includes large, well-known firms which engage in a great many distributive activities (hotels, real estate, retail trade, banking, financial services, etc.). Many of these firms enjoy certain monopolistic rights by virtue of having been established when Sri Lankan markets were too small to support more than a few competitors and by being able to restrict market entry through political influence. Some of these firms not only dominate particular markets, they are also involved in a great many markets (i.e., they have low specialisation but high concentration ratios).[26]

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26 Specialisation and concentration ratios, in normal international statistical discourse, refer to industry shares accounted for by particular products or services. In the case mentioned in the text, the point of reference is the company or group. The traditional company groups in Sri Lanka cut across a number of business sectors (low specialisation) but dominate a number which they enter (high concentration). This is because they sell in the local market (imports are tradeable, but not exports), and because there continue to be barriers to entry to those markets, not the least of which is the small size of the domestic market.

- Foreign investors and emerging entrepreneurs. These are new entrants to Sri Lankan markets and most concentrate on exports. Many are located in Free Trade Zones or enjoy special tax holidays. Some are highly capitalised (sophisticated machinery and equipment) and most consider lack of infrastructure to be a greater impediment to their operations than they do labour.

- The public sector. Although constrained by targeted dimunition, the public sector continues to occupy a position of significance in terms of employment (excluding State-owned corporations, the public sector accounted for about 20% of total employment in 1990 according to the Department of Census & Statistics) as well as by leadership. Wage settlements for the Government, for example, tend to be followed by many private employers. Public-sector overstaffing of the past has contributed not only to low (sometimes even negative[27]) productivity, it has also led to a severe wage compression which has further diminished productivity in the public sector due to an outflow of mid-level management. There is a severe shortage of administrative, analytical, and managerial talent in the Government as a result of retirements and quits. Many of the latter migrate abroad.

- The informal sector. For convenience, the informal sector can be defined as places of employment which are exempted or not included under the Labour Codes. In Sri Lanka, this means establishments employing fewer than fifteen workers. It should also include larger employing establishments which avoid (through falsification) or evade (e.g., through subcontracting or the use of casual labour) coverage under prevailing labour legislation. It is in this sector, which to now has been largely distributive in nature[28], where growth and (tax) revenue enhacement is highest.

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27 This refers to occasional bureaucratic tendencies to create work in order to keep staff busy, thereby causing delays for the public. Licensing or visa staff are particularly prone to such dangers.

28 The informal sector also retards the rate of depreciation of capital stock, through maintenance and repair, which is an import-substitution function.

- The estate sector (tea, rubber, coconuts) has been having a severe time due to world market conditions. State plantations (accounting for 425,000 jobs) will be turned over to private management companies, with ownership remaining in Government hands. This provides the unfortunate incentive of maximising short-term profits in place of longer-term private investment.

- Agricultural and nonfarm rural employment. Agriculture continues to provide over 40% of employment in Sri Lanka, and most off-farm jobs are informal. It is likely, with the Government's objective of decentralising certain budget authority to the provincial level, that priorities will shift to construction, or public works programmes, which are labour absorbing.

Mobility across these industrial components is rather rare, by international standards, even from the informal to the formal sectors (from smaller employers to traditional or export firms).[29] Entry credentials for job seekers differ from one sector to the next as does wage policy and job security. Labour turnover, therefore, is relatively low in the aggregate, which is why youth unemployment is so high and its duration so long.

3.4 Industrial Relations

According to one long-time participant in the collective bargaining process: "It could be stated without fear of contradiction that Labour Management Relations in Sri Lanka are by and large antagonistic. The two parties have not appreciated the need for a social partnership and accepted the need to work with the other." (Amerasinghe, 1992, p.2). Due to a number of historical antecedents, there is a great deal of class-motivated distrust in industrial relations.[30] Because of this, wage settlements are often more politically than economically conditioned, with the result that wages often bear little correspondence with productivity. Moreover, there is sometimes competition among unions themselves, so that wage settlements in one company or industry generally take into account previously negotiated settlements in other companies or

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29 An important exception might be the tourist/hotel industry, where there is a consistent move from smaller to larger, more prestigious employers.

30 This may merely be symptomatic of general distrust of capitalism due to historical influences, or even of a more fundamental manifestation of a tendency toward envy among Sri Lankans. To the extent that such combatitiveness might correctly describe the social character, it implies a loss of social welfare due to competitive rent-seeking behaviour (Kreuger, 1974).

industries. In this way, settlements tend to escalate over time. Finally, because of the combatative relation between management and labour, bargaining is usually limited to wages or conditions of work, with little attention given to the question of how to enhance worker productivity.

The situation differs somewhat in the Free-Trade-Zone (FTZ) export industries, where unions are generally weak or nonexistent, and where management is somewhat more sophisticated in terms of industrial relations than in the traditional corporate sector. Wage schemes, in particular, are highly productivity-oriented, containing both incentives for production above norms and disincentives for nonproductive behaviour (such as absenteeism on the day after a 2 or 3-day holiday period). One observes a great deal more industrial relations experimentation in FTZ firms than elsewhere in the country.

Mechanisms which increase communication between labour and management are sorely needed. These might include employee councils or "quality control" committees which involve workers and management in goal setting and monitoring, providing that unions can be convinced that such mechanisms do not infringe on their collective bargaining rights and management that production decisions remain in their hands. This is difficult in a politicised setting, but it is an essential step to creating a faster growth outlook.

3.5 Social Legislation

Sri Lanka has a number of laws and regulations concerning rights of employment, hours of work, minimum wages, strikes, etc. Some are duplicatory or even contradictory and all, taken together, go beyond operative ILO Conventions.[31] A particularly sensitive piece of legislation is the Termination Act, which requires employers to obtain permission from the Labour Department before dismissing any employee. A recent study prepared for the World Bank analysed a nearly identical policy in India, and concluded that its effect was to lower employment by 18 per cent relative to what would have been the case with freer adjustment permitted (Fallon & Lucas, 1991).

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31 For example, ILO Convention No. 158, adopted in 1982, recognises the right of of an employer to terminate an employee's services on account of economic, technological, structural changes and similar developments, subject to the provision of sufficient notice regarding reasons for contemplated terminations and the time frame for reorganisation. The Termination Act in Sri Lanka is far less understanding of changing economic conditions.

While "established" employers have learned to accomodate the severance provision[32], the Act can be seen as particularly deleterious to the formation of new businesses, and thus an obstacle to foreign investment.

There are three aspects about labour codes in Sri Lanka which are noteworthy. First, the regulatory approach is non- transparent, i.e., the costs and consequences do not show up in any public balance sheet. That is particularly unfortunate, in that the costs of reduced labour mobility are largely shifted to first-job seekers, which is reflected in relatively high rates of youth unemployment.

Second, the system allows a high degree of discretion. There is no schedule of awards which guides the decisions of labour tribunals and variations exist from one labour officer to the next and from one employer to another. Because of this discretion, employers have to accomodate increased uncertainty within their business calculations.

Third, as mentioned, some of the regulations are redundant or contradictory. In addition to the Termination of Employment Special Provisions Act, there is an Industrial Disputes Act. The latter is less stringent than the former, but it requires a two- month notification of an intent to retrench. This would appear to provide ample protection against capricious behaviour by employers, without necessitating the introduction of the possibility of capricious behaviour by labour tribunals.

At the same time, political feelings about labour codes run deeply in Sri Lanka, as worker protection is generally considered one of the crowning achievements of previous administrations. It is not necessary to erode this protection in order to rationalise the system and to minimise its adverse consequences. A contributory system of unemployment insurance would permit compensation for the risk of redundancy without the discretion and uncertainty which now characterise labour codes. Admittedly, an unemployment insurance fund would be a costly and far-reaching step, and not likely one which will be taken in the near future. But it should be an objective for the medium term (viz., within five years).

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32 It may be noted that that "accomodation" likely takes the form of reductions in employment through capital-labour substitution.

In fact, it is probably desirable to consider a general operational review of the entire social welfare system. The informal sector is excluded from many of the social programme benefits in the country, EPF and ETF are insufficient substitutes for a proper pension system, and lack of unemployment insurance forces reliance on more costly legislative controls. The question to be addressed in such a review would be how the system can be reformed to better support economic growth which, after all, is the most effective social safety net which can be devised. Instead of retarding growth through interventions aimed at fixing the primary distribution of income, the Government has the option of accelerating growth by offsetting deficiencies in the secondary distribution of income.

4. CONCLUSIONS

4.1 Beyond the Year 2000

As noted, the strategy outlined in the previous pages of this paper is medium-term in nature, i.e., designed for the decade of the 1990's. It is only logical to then ask, what of the longer term? How can Sri Lanka 'position itself to capitalise on future business and trade opportunities, and to facilitate labour market operations in support of that objective? How may productivity growth be sustained and unit labour costs minimised?

One lesson to be learned from the previous analysis is that micro-management of industrial growth by Government is neither necessary nor desirable. In many cases, it is likely to be counter-productive. Governments have a difficult time in picking winners or in identifying losers within the growth process. In this event, the best that can be hoped is that policy is conducive to the emission of market signals, and complementary with efforts to read and react to those signals. Small, open economies cannot dictate world prices or technological change and so must position themselves to be able to react to external shocks (or opportunities) quickly and with a minimum of disruption to the social welfare.

In the medium term, technology and production processes are more or less given, or at least predictable. The longer the time horizon, the less predictable are these variables and the less productive are interventions at the micro-level. This means that specific skills training, say, for carpenters or electricians, is less likely to be efficacious than is more generic training covering such topics as quality control, or the meaning of technological change, management and

supervision, etc. A longer- term strategy for Government support of skills development must therefore be general and flexible, leaving to the private sector the task of providing specific skills training suitable for the needs of the firm or industry. Most importantly, that strategy must ensure that firms and individuals are not hampered from investing in the specific skills which could further facilitate the growth process. This implies, to reiterate, that appropriate market signals are allowed to guide the investment process and that investors (firms or individuals) are allowed to react to those signals.

This approach differs significantly from the "traditional" approach to manpower planning which consists of attempts to predict the future course of industrial output and the deduction of the associated skills requirements necessary to generate that output. The traditional manpower requirements approach to planning has proved seriously deficient on both conceptual and practical grounds (Kelly, 1991). It considers the demand for skills as a datum to be identified, with supply as the variable to be manipulated by government policy. Thus, the manpower requirements approach is truly a supply-side orientation to skills development. Moreover, it is practically impossible to predict patterns of development, much less the particulars of skills requirements. Malaysia's rapid growth in electronics could not be anticipated on the basis of the Korean or Taiwanese experiences. Israel is a leading exporter of raincoats, not because of any particular comparative advantage, but because someone was able to identify a market niche and to take advantage of the opportunity. More important than planning, in other words, is flexibility -- the flexibility to recognise market opportunities and to capitalise on those opportunities.

It is precisely this form of human capital -- entrepreneurship -- which is most difficult to develop. The best strategy for the Government, in this case, is to minimise impediments to entrepreneurship, such as lack of information, obstacles to enterprise creation, barriers to industry entry, lack of infrastructure, or hindrances to exports (exchange rate, lack of market identification, licenses, short-term credits, etc.). An active manpower policy for Sri Lanka in the longer term will be one which complements private-sector business development, but with a minimum of selective interventions.

Rather than focussing attention exclusively on either demand or supply sides of labour markets, what is suggested here is that Government should concentrate on the equilibrating mechanism, i.e., prices (or wages, interest rates, etc.). The objective is to ensure that prices are fully adjustable and that they reflect the social costs of resource allocations. Distortions, such as overvalued exchange rates, fixed hours of work, monopolistic pricing, etc., hinder the equilibration

of supply and demand, leading to un- or underemployment, low productivity, and slow economic growth. More importantly, such distortions send precisely the wrong signals for human capital investments. In Sri Lanka, regulations on labour utilisation appear to have induced employers to shift to low-skilled (low productivity, low wages) production processes in which the apparent returns to human capital investments are low. Capital and technology are being substituted for skills so there are few incentives for skills deepening for either firms or individuals.

At the same time, a "reactive" human resource policy -- one which permits labour markets to react to international opportunities, or to adjust to international shocks -- need not be purely passive. East Asia abounds with illustrations where governments have formed productive partnerships with industry by emphasizing service functions (such as marketing) in place of control functions (e.g., export licenses). And it has been noted that the particular paths of development followed by individual countries largely reflect will: the will of Government, of entrepreneurs, or of individuals. If Sri Lanka is truly serious about capitalising on its primary resource base (human capital) and basing its development strategy on higher skills and productivity, steps will have to be taken to attract or develop those industries which are conducive to skills utilisation. To provide one illustration: there is a world-wide demand for research into environmental protection and related matters. Sri Lanka is a natural experimental site for such research. The development of such an industry, however, would require the collaboration of universities, private business, multi-national corporations and donors, and the Government. Note that this would be a *demand-driven* approach to skills utilisation.

4.2 A Systems Approach to Human Resource Development

A "systems approach" to human resource development (or any other problem) means little more than a systematic identification and ordering of inputs, the through-put process, and outputs. This systematic ordering must account for interdependencies among the variables, as well as for possible interactions when they are manipulated in combination. Cost minimisation (efficiency) and revenue maximisation (effectiveness) are integral components of this systems approach.

Human resource development (HRD) -- even when defined narrowly to refer to labour market outcomes -- goes well beyond the simple notion of training, and even beyond the more generic concept of skills development. It includes not only skills preparation, but also provision for skills utilisation. Properly speaking, human resource development should encompass the preparation of career development plans, monitoring/feedback/ adjustment, compensation policy (including incentive and disincentive pay), industrial relations, recurrent education or training, retraining, hiring, firing, and promotion policy. In a country like Sri Lanka, it should also include migration policy, as this affects the pool of skills available at home as well as skills- upgrading opportunities available abroad. A Skills Development Fund, such as outlined in Section II, would be an integral tool for the implementation of such a human resource development policy.

4.3 Human Resource Development from the Perspective of National Policy

Human resource development not only comprises many inputs, it also affects a great many other policy variables: consumption, savings, income, real living standards, productivity, international competitiveness, poverty and unemployment. It is the case that in Sri Lanka, human resources are one of the primary endowments the country has. And it is obvious that future economic growth will depend on how well this resource is nurtured and utilised.

It has been noted that prior approaches to human resource development in Sri Lanka were largely equity-oriented, in which labour was viewed as a problem rather than as an opportunity. Non-market solutions were attempted to offset poor market performance, driving a divisive wedge between growth and equity objectives.[33] The proposed strategy reflects the belief that it is easier to agree on how to slice a large pie than a small one; accordingly, it is weighted in favour of productivity expansion. As this would likely alleviate more poverty than can be financed by cash transfers or loans, it seems to be a high-priority objective. Admittedly, such an approach should be accompanied by changes in the educational system and in the social welfare system, particularly regarding the balance between non- transparent regulatory interventions into the primary income distribution versus budgeted tax and transfer interventions into the secondary income distribution.

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33 In the longer term, growth and equity are not only compatable, they are likely reinforcing. In the short term, the two objectives must compete for fixed budget funds. The strategy presented earlier attempts to reinforce the complementary nature of the growth/equity objectives.

The strategy represents a market approach to human resource development: it contemplates full-cost pricing (with possible subsidisation of lower-income individuals), cost sharing by beneficiaries (Government, firms, individuals), transparency in budgets, less Government involvement in *operational* matters but an increased role in *facilitative* matters -- in other words, a shift in emphasis from control to service functions. It calls for the expansion of training and other aspects of human resource development within firms and industries. It is *industry* or *sector* competitiveness that Government wishes to encourage, as this is the level at which international competition works.

The two most binding constraints on Sri Lanka's current growth -- or, rather, the two most promising for correction -- are trade and foreign investment. Both require the availability of productive labour. How *skilled* that labour must be depends on the types of trade and investment opportunities that ultimately materialise. It depends on prevailing technology and production processes. And it depends on Government influence over these variables. For these reasons, the work force must be not only productive, but also adaptable -- to new technology, competitive market forces, and management techniques.

Increasing productivity at the sectoral or industrial level is a problem extending beyond even the broad confines of human resource development. In most countries, Sri Lanka included, it is a problem of management and touches on such diverse topics as technology, marketing, office equipment, communications, the organisation of production, etc. It doesn't do to allow the skills-development tail wag the profit dog. A systems approach would suggest that the appropriate phrasing of the problem would be: how to maximise industrial competitivity and exports using human resources of different quality and cost, as the instrumental variables.

From the perspective of national policy, therefore, the expansion of industry-specific skills is of the highest priority. Due to considerations of cost effectiveness, that expansion should, to the extent feasible, be effected through increased on- the-job training, with testing and certification as integral, ancillary components. Priority should be given to skills upgrading for the already employed. It is clear, however, that no single mode of skills expansion will be sufficient to satisfy national objectives. Small or newly established firms do not always have the facilities (or equipment) to support significant on-the-job training. Many employers are not even aware of how productivity and profits can be enhanced through improved human resource development efforts. So a mixed system, organised primarily under the Skills Development Fund, financing loans to

firms or individuals, technical assistance, tax credits, and support for a limited number of public or private training institutions, is required.

4.4 HRD from the Perspective of Industry

Beyond the normal constraints on human resource development -- imperfect information, market imperfections, lack of resources -- industry-specific skills development and utilisation are hindered by what has been termed "the employers' dilemma". Employers are hesitant to bear the investment costs of human resource development for fear that the fruits of those investments might accrue to industry competitors (through "poaching" by industry competitors) or, in other cases, to foreign countries through migration.[34] It has been noted that if all employers worked in concert, this dilemma would be resolved in that skills lost through mobility could easily be replaced from the enlarged skills pool available throughout the industry. This is the German system of skills development, based on dual apprenticeship, certification, and mobility. The proposed Skills Development Fund would be a financial mechanism to encourage this internalisation of uncompensated external costs.

The strategy outlined previously is precisely designed to circumvent this employers' dilemma by pooling industry resources in an effort to expand industry-specific skills. By pooling resources and sharing costs, employers can realise the pooled benefits of collective action. It should be noted that "pooling" in this instance refers not simply to financial resources through a Skills Development Fund, but to the pooling of time and expertise in the active management of the Fund. To reiterate, it won't do merely to replace a public with a private bureaucracy. Provision must be made to ensure that employers actively collaborate to bring about the expansion of competitivity and productivity of their respective industries. Again, this goes well beyond the narrow question of human resource development, and includes questions of appropriate technology, management, marketing, quality control, scheduling, etc.

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34 Although it is generally conceded that, in competitive markets, workers pay the costs of general human capital investments and firms the costs of specific-capital investments, it is likely that rent is involved in industry-specific human capital, so market imperfections may dampen the incentives for firms to invest for the benefit of industry. Moreover, such investments, when paid for by the firm, represent loans to be repaid from expected productivity. When labour mobility is high, implicit loans are less likely to be recouped. Becker's seminal treatise (1965) on this point did not deal with the question of industry-specific human capital investments.

4.5 HRD from the Perspective of the Firm

Although the policy objective is to enhance productivity and competitivity at the industry level, the operative point of intervention must be at the level of the firm.[35] It has been mentioned that the level of awareness of the possible benefits of a systematic approach to human resource development appears to be low among Sri Lankan employers, many having already adjusted to the available skills base by shifting to low-skill, low-cost production techniques. In this case, a great deal of technical assistance and exposure to international methods of doing business could be useful. This technical assistance could come from larger, more established businesses to newly established enterprises, or from foreign business executives working with individual firms or industries, e.g., through appropriate Chambers of Commerce. Required assistance includes skills audits, review of management and compensation structures, assessments of marketing practices, the preparation of career plans, accounting procedures, etc. The point is, macroeconomic, structural, or institutional reforms, while *necessary*, are not likely to be *sufficient* to induce the kind of systematic human resource development required by the country's growth objectives. The creation of a Skills Development Fund, while a useful first step, will not have much impact on growth prospects unless employers understand how to access the Fund and to use its proceeds effectively. Much depends, in other words, on how policy reforms are implemented and implementation issues are very much microeconomic matters.

USAID is funding a related effort under the heading, "Technology Initiative for the Private Sector" (TIPS). TIPS is primarily designed to expose Sri Lankan businesses to the latest available technology, and includes grants for capital improvement. However, it also provides for management consultancies of the type mentioned above. It also permits overseas training for corporate executives, supervisors, etc. It would be a simple matter to expand the project to permit greater focus on human resource development within the broader objective of enhancement of industry competitivity.

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35 Obviously, activities can be initiate simultaneously with individual firms and industry representatives, such as the Chamber of Commerce.

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