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Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka

Ramani Gunatilaka

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FOREWORD

The International Labour Organization (ILO) is pleased to launch the Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka (August 2009), conducted by Dr. Ramani Gunatilaka.

In the aftermath of the global economic crisis, where countries are showing nascent signs of recovery, there is an urgent need to restore confidence in the economy to stimulate investments and credit flows through coordinated action by monetary authorities in order to minimize a negative impact on the real economies. Equally important is the assessment of the social impact the crisis is having on the world of work, in particular the loss of jobs so that quick responses can put systems and institutions in place to address this as a matter of urgency. Accordingly, the ILO has commissioned rapid assessments in a large number of countries, including Sri Lanka, collecting detailed information and providing analysis on the impact of the global economic crisis.

The country assessment in Sri Lanka illustrates that in spite of the relative positive vibes in the economy following the conclusion of the war, coupled with the improving macro-economic situation in the country, a substantial number of jobs have been lost in the manufacturing and construction sectors. Due to the slump in exports, mainly in the apparel sector, companies are left with no option but to reduce labour absorption and resort to wage cuts, inhibiting new job creation. The collective bargaining power has shifted toward employers. The existing social protection system is ill-equipped to address the mounting needs of the unemployed. The effectiveness and the impact of the Government's stimulus packages will be tested for their ability to weather the crisis.

Post-conflict Sri Lanka presents a myriad of opportunities and challenges, in the political, social and economic spheres. Therefore, the scope of action by national and international authorities, employers, workers and organizations of civil society, to restore growth and mitigate effects of the crisis particularly for the most vulnerable groups, should reflect holistic, balanced and flexible policy and programme interventions, putting people first. Sri Lanka's National Decent Work Policy, reflects Sri lankas commitment to the contemporary expression of the ILO's historical mandate which is centered on dignity of work and of the worker. The ILO's recent action in relation to the global financial crisis sets out a vision and a practical programme to confront this crisis, inculcating employment creation and social protection at the heart of the recovery process.

This rapid assessment was coordinated and financed by the ILO in Sri Lanka, with technical backstopping by ILO Sub-Regional Office in New Delhi and ILO Headquarters in Geneva. On behalf of the ILO, I wish to extend my gratitude to Dr. Ramani Gunatilaka for undertaking this valuable assessment and the many organizations and individuals for their contributions.

Tine Staermose
Director
ILO Sri Lanka

EXECUTIVE SUMMARY

The impact of the global economic slump, triggered by the financial crisis, is beginning to have an effect on Sri Lanka's economy. Transmission is mainly through a contraction in external trade volumes and prices. Migrant remittances are also under pressure, the construction industry has been affected, and tourism has been further challenged. Liquidity in the financial sector has been constrained because of the rise in non-performing loans – in turn due to the contraction in export demand, knock-on effects on domestic suppliers, and crowding out of available funds into 'safer' Government bonds. The crisis' impact on existing macroeconomic imbalances was aggravated by some contradictions in the country's macroeconomic policy stance. Sri Lanka's foreign reserves dwindled rapidly as a result of defending an increasingly indefensible soft dollar-peg. Faced with a looming balance of payments crisis, the Government sought an IMF bailout of USD 1.9 billion which was delayed.

The crisis notwithstanding, the successful conclusion of military operations against the LTTE by May 2009 has brightened Sri Lanka's economic prospects. The economy has attracted inflows of foreign funds since the end of the war, which has helped ease the balance of payments crisis. As a result, the tourism sector is also set for recovery. The end of the war has had a positive impact on business confidence and since reconstruction and rehabilitation can now begin in the north of the country, the process of development can provide a much needed fiscal stimulus that will help mitigate the worst effects of the crisis. An IMF facility of USD 2.6 billion has finally been made available for balance of payments support.

Labour force survey data for the first quarter of 2009 show that, compared with the first quarter of 2008, the economy has lost about 30,000 jobs each in manufacturing and trade, and 64,000 jobs in construction. But employment in agriculture has increased by 200,000. The loss of jobs in manufacturing, trade and construction is probably largely due to the impact of the crisis. Since employment in agriculture and services has grown, the crisis has probably encouraged some redeployment of labour from manufacturing, trade and construction to agriculture and services.

Gender-based disaggregation of employment figures shows that, while far more men lost jobs than women, the gains in employment were equally shared between the sexes. In terms of skills – proxied by occupation levels – the higher skilled occupations account for roughly a third of the total number of jobs lost. Unfortunately, the data does not allow us to draw any conclusions about the nature and quality of jobs lost and gained.

Available micro data also suggest that the slump in export markets has given rise to closures and lay-offs in the domestic economy. The apparels sector, the largest in the country, is the worst affected. Many companies have been forced to reduce labour absorption by various means which have had the effect of drastically reducing workers' take home pay. Desperate to hold on to their jobs, workers and unions have largely cooperated with these measures. The labour authorities have also done their best, within the framework of the law, to provide as much flexibility as possible to employers so jobs can be saved. However, it should be noted that while existing jobs are coming under threat, the global economic downturn will depress the rate of new job creation, and this will seriously affect the job prospects of vulnerable groups, such as the young, the disabled, and those with lower human capital as a result of repeated displacement because of conflict.

Employers' responses to the crisis have focused primarily on cutting labour costs. This is to be expected when most operations are labour-intensive. While companies in the corporate sector may have access to information about alternative measures, such as greater functional mobility, multi-skilling, and alternative work schedules, to survive the economic downturn without job losses, the majority of employers, particularly small and medium businesses, may lack both the information and the management skills to follow suit. Smaller businesses, since they operate very close to the margin, may also lack the time and financial space to implement such measures. Therefore, encouraging a proactive approach among this sector by providing the necessary information, either through the chambers of commerce and industry, the banks, or through NGOs involved in entrepreneurship development, such as Sarvodaya's SEEDS, may yield some dividends in terms of both saving jobs and building business muscle for the future.

Even when companies have no alternative other than to terminate jobs, they can ease the trauma for workers by helping them to find alternative employment through their network of contacts and by encouraging these workers to register with job placement agencies, such as JobsNet and Topjobs.

Job losses in urban areas and the closing-up of employment opportunities abroad are likely to impact on poverty levels. The situation in the plantations may become serious, given the high base levels of poverty in this sector, and the lack of transport facilities and other barriers that make it difficult for estate workers to find alternative sources of employment and income.

The crisis has skewed the unequal bargaining power between employers and workers further in favour of employers, even though this is hardly a victory for the latter in the given circumstances. In this lose-lose environment, where employees will lose proportionately far more than their employers, industrial relations are noticeably cooperative. Workers and unions are desperate to save jobs and have stoically complied with various measures taken by employers to reduce labour absorption rates without resorting to dispute. Nevertheless, labour relations are under strain.

Unions report that many employers appear to be taking unfair advantage of the situation and that the adjustment to the crisis appears to be taking place largely at the bottom of the occupational hierarchy. Available QLFS data, however, shows that the higher skilled occupations account for roughly a third of the total number of jobs lost. In companies represented by the Employers' Federation of Ceylon, this figure is more than a half. But this could be because higher skilled grades get much higher remuneration packages in the corporate sector and, therefore, making more of them redundant makes greater economic sense. Even so, substantial numbers of lower skilled workers are being laid-off and the situation makes it incumbent upon the labour authorities to obtain detailed information about costs from employers who have applied to terminate workers, and from others who have terminated workers without complying with the provisions of TEWA. Unions can perform a vital role in bringing to the attention of the authorities, cases of violation by employers.

Anxious to save jobs, the labour authorities are striving to provide employers with as much flexibility as possible within the law to keep their businesses going. Three such measures are significant: temporary layoff; a relaxed working week; and, deferred EPF and ETF payments. While the labour authorities' efforts to be as flexible as possible must be commended, the situation appears to be unhealthy.

It is unclear whether current industrial relations institutions and mechanisms can ensure that the costs of adjustment are distributed more fairly between workers and employers at the level of the enterprise. The processes of complaint, inquiry and decision-making that take place within the Labour Secretariat about granting relief to employers by way of temporary terminations and deferred payment of provident fund payments, appear to be operating less than satisfactorily as both employers and unions seem to prefer to operate through networks of influence rather than through established institutional procedures. A separation of the processes of monitoring/ investigation and decision-making about terminations and other administrative relief measures in the Department of Labour may enable the authorities to insulate themselves from pressures from either side and take a more informed view of the situation.

The process of inquiry also needs to be accelerated so that employers who are forced to retrench workers to adjust to the crisis can do so quickly. Many labour officers are familiar only with the public sector and have very little experience or understanding of the world of business. In the medium term, labour authorities should consider enhancing the human capital of their officers through measures such as industrial placement and training in business administration as part of their human capital development.

The Government has responded to the crisis with stimulus packages for exporters, efforts to reduce interest rates and increase liquidity, and by passing on most of the decline in oil prices to consumers. While glaring anomalies in the stimulus package are still being worked out, it is still not clear how effective these measures will be because of several contrary factors. First, the Government's own macroeconomic policies made it a difficult environment for exporters: the monetary authorities maintained an over-valued exchange rate at least four months into the crisis; the structural fiscal deficit soaked up liquidity in credit markets; and the Government is not paying its bills to contractors who have undertaken construction work for the Government. The end of the war has seen the economy attract foreign currency inflows which may cause Dutch disease effects and upward pressure on the exchange rate again. So long as these effects continue, stimulus measures are likely to be palliatives only. Therefore, the Government urgently needs to attend to these problems if the economy is to weather the crisis as well as it can.

Second, despite the Government's good intentions, it has been clear to exporters and their buyers that the Government is unlikely to have the fiscal wherewithal to make good its promises of financing stimulus measures. Nevertheless, the IMF standby is likely to help enhance the Government's financial credibility and provide some predictability about economic fundamentals.

Third, as many other countries affected by the crisis are beginning to realize, stimulating supply makes little sense when demand has contracted. There are four ways that policy makers can stimulate demand in the domestic economy. One is to simply pay the money Government owes its contractors in the construction sector. Another is to strengthen the commercial divisions of key Sri Lankan diplomatic missions in emerging markets in Asia in order to help Sri Lankan producers find new export markets. The third way appears to have opened up with the defeat of the LTTE in May 2009. Work on reconstruction and rehabilitation for which donor assistance has been pledged already, can now begin in the North and be accelerated in the East. This will provide a Keynesian stimulus that may help mitigate the worst effects of the crisis. Last and most importantly, the Government needs to shore up consumption, but this requires effective mechanisms to transfer incomes to those likely to be worst affected by the crisis: the existing poor whose situation is likely to worsen, and those likely to slip into poverty because of job losses and the drying up of remittances from migrant family members in urban areas and overseas.

However, Sri Lanka's social protection system is patchy and fragmented and does not have the capacity to respond to the needs of those who lose their jobs because of the crisis unless they are in institutions which are covered by and comply with the requirements of the TEWA. Sri Lanka does not have an unemployment benefit insurance scheme while the Samurdhi Programme, the core of the national system of social assistance, provides too little support and still suffers from targeting problems. The system has long-needed reform, and while eligibility criteria have been developed and refined, there has only a little progress in implementation because of a variety of political economy factors.

Much needed reforms in the social protection sector include: setting up an unemployment benefit insurance scheme, consolidating existing social security systems, increasing coverage to certain segments of workers, such as construction workers; and enhancing the effectiveness of Samurdhi. For this, Samurdhi's new methodology for targeting those who really need the support must be implemented and the size of support needs to be increased. But while Samurdhi provides a safety net for those in chronic poverty, other measures to address the issue of poverty dynamics need to be implemented. For example, the cash grant injection scheme operated during the 2004 tsunami can be modified and implemented through personal bank accounts to make it responsive to the needs of people facing sudden shocks, such as natural disasters on the one hand, and economic shocks such as the current economic crisis, on the other hand.

The impact of the global economic slump on Sri Lanka's poor is likely to be a painful reminder of the costs of evading much needed reforms in the social protection sector. Likewise, the crisis demonstrates that the unemployment benefit insurance scheme proposed in the latest amendment to TEWA never saw the light of day. While TEWA may provide an adequate safety net for retrenched workers when times are fair, it cannot be effective in crises such as the present. This is because the crisis is forcing closures and bankruptcies rather than simple retrenchment, with affected companies not having the wherewithal to pay adequate compensation to affected workers.

It is hoped that the crisis will jolt policy makers to grasp the nettle of instituting and implementing effective social protection mechanisms without any further delay.

INTRODUCTION[1]

This assessment provides an initial and rapid stock taking of the impact of the global economic downturn on employment in Sri Lanka around six to eight months into the crisis. Its focus on employment and industrial relations is deliberate: this area has received less attention than have macroeconomic developments, which are more easily identified and monitored by both Sri Lankan (Central Bank) and donor (the World Bank and the Asian Development Bank) agencies. Moreover, decent work for all is the overriding objective of the International Labour Organization in the Asian Decent Work Decade, which commissioned this assessment. Hence the study deals with the macroeconomic situation only as part of the background and as the source from which many of the forces impact on employment derive. The analysis also aims to inform the industrial partners, policy makers, and donors by evaluating measures taken thus far to deal with the fallout of the crisis and by highlighting areas that need more attention.

The analysis is based primarily on information derived from interviews with key respondents between 19 February and 11 March 2009 (see the appendix for the list); from published and other documents shared by them; from newspaper reports; and from statistical data and forecasts about macroeconomic variables published or presented by the Department of Census and Statistics, Sri Lanka, the Central Bank of Sri Lanka, the World Bank and the Asian Development Bank. In particular, this paper has benefited from the publication of the report on the first quarter of the Department of Census and Statistics' Quarterly Labour Force Survey (QLFS) 2009 in July 2009. While the QLFS is the only reliable and comprehensive source of information about job losses at the macro level, this study has also been able to draw on some other micro data sources, qualitative information and anecdotal evidence, for a more detailed analysis. Individuals have been cited as sources for facts more than opinions.

A first draft of the report was circulated for comments among ILO resource persons both in Sri Lanka and abroad, revised accordingly, and then presented to and circulated among participants at a workshop in June 2009. Points arising from the discussion at the workshop and whatever new data available, were then incorporated into the final revision.

The report is structured as follows: Chapter 2 sketches in the macroeconomic background. Chapter 3 looks at the main channels through which the crisis has transmitted to Sri Lanka's economy and the sectors that have felt the impact. Chapter 4 weighs the available evidence on the consequences of the crisis on employment. Chapter 5 looks at the impact on industrial relations and the role of the labour authorities. Chapter 6 assesses the Government's response. Chapter 7 concludes and suggests directions for policy change.

[1] The author wishes to thank all the stakeholders who made themselves available for interview during the course of this assessment. They generously shared their experiences and insights and these form the core of the information on which this study is based. It should be noted, however, that none of these individuals – either those interviewed or officers of the ILO – is responsible for the economic interpretations of the data and the views expressed in this report, for which the author alone remains responsible.

THE MACROECONOMIC SITUATION

The global economic crisis which set in train the current economic slowdown began with the collapse of Lehman Brothers in September 2008. It has set, in reverse, the positive conditions that underpinned Sri Lanka's recent growth performance. The crisis struck only two or three months after the economy had been adversely affected by the twin food and fuel price shocks that peaked in June 2008. This caused Sri Lanka's terms of trade to decline by 10.2 percent as a share of GDP between January 2003 and May 2008. As the international economic crisis worked its way through Sri Lanka's economy, its impact on existing macroeconomic imbalances was aggravated by some contradictions in the country's macroeconomic policy stance. Nevertheless, the successful conclusion of military operations against the LTTE (Liberation Tigers of Tamil Eelam) by May 2009 has improved Sri Lanka's economic prospects since reconstruction and rehabilitation can now begin in the North of the country and provide a much needed fiscal stimulus. The end of the war has also changed Sri Lanka's investment climate.

Sri Lanka's economy maintained a respectable growth rate of 6.8 per cent in 2007, powered by vigorous private sector activity, strong export growth and a resurgent agricultural sector. The onset of the crisis in the fourth quarter of 2008 caused the growth momentum to slide only marginally to 6 per cent. However, inflation had accelerated, driven by high food and energy prices and by fiscal expansion. Real wages, particularly in the private sector, eroded despite declining unemployment. Even though expanded earnings on the services account and increased remittances helped mitigate the inevitable widening of the current account deficit, rising oil prices and food import bills exerted relentless pressures on the trade deficit. Increased FDI, grants and loans to Government helped balance external payments and the Government achieved some fiscal consolidation. But overruns on recurrent expenditure largely fuelled by increased defence expenditure, a higher wage bill and energy subsidies left the Government little fiscal manoeuvrability with which to respond when the crisis hit.

In any case, **Sri Lanka's structural fiscal deficit has averaged between 7 per cent and 9 per cent of GDP over the past decade.** Cuts in Government spending have not led to fiscal improvement, as tax revenues have fallen precipitously. Tax revenue has declined mainly because export taxes have been removed or reduced following economic liberalisation. The ad hoc mix of indirect and import taxes imposed instead failed to make up the shortfall. The fiscal deficit has resulted in mounting public debt, relentless pressure on the exchange rate and the Government's inability to increase social expenditures or investment expenditures. The downturn in trade and economic activity, following the international financial crisis has squeezed revenue even more, further eroding the fiscal space available to the Government. Hence, this year's fiscal deficit is likely to exceed the maximum of 9 per cent of GDP experienced during the last ten years.

The fiscal straitjacket is only part of the macroeconomic crisis that the Government

faces. Before the international crisis hit, the monetary authorities had responded to high inflation and high energy prices by maintaining high interest rates while simultaneously intervening in the market to stabilize the exchange rate against the US dollar. This strategy was implemented against the background of a partially liberalized capital account with the partial opening of the Treasury Bills and Bonds market to foreign investment in 2007. Since the outlay on oil imports is a major determinant of Sri Lanka's exchange rate, the authorities had also entered into a hedging agreement with several commercial banks (Citibank, Deutsche Bank, Standard Chartered and the People's Bank) in 2006 that had the banks bear a relatively low risk associated with a rise in the price of oil, while the state-owned Ceylon Petroleum Corporation (CPC) bore the unlimited risk associated with a drop in its price. [2]

The collapse in the oil price in the second half of 2008 revealed the risks associated with this strategy. The CPC incurred heavy losses which a Supreme Court suspension order (later removed) and a subsequent Central Bank directive, temporarily halted. Deutsche Bank and Citibank have filed arbitration against the Sri Lankan Government with the International Centre for Settlement of Investment Disputes over the CPC's failure to honour its obligations under the agreement. Thus, it is uncertain whether Sri Lanka's balance of payments will be able to benefit in the long term from the decline in the price of oil, as the CPC is locked into a hedging agreement that transfers the advantages of the fall in price to the commercial banks with which it entered the hedging agreement.

Meanwhile, **the large outflow of funds to settle petroleum bills in the last quarter of 2008 and capital flight from Treasury Bills and bonds triggered by the turmoil in global financial markets following Lehman's collapse, exerted tremendous downward pressure on the rupee.** As the Central Bank intervened to maintain the rupee, the country's international reserves fell to 1.7 months of imports by the end of 2008 (the figure had been three months' of exports in August 2008). Exports had also begun to feel the impact of the downturn in demand following the global economic slowdown. On the other hand, to contain imports the Central Bank imposed a 100% margin (deposit) when opening letters of credit for selected imports. This badly affected small and medium scale importers, who generally rely on an advance-against-imports credit scheme and find it difficult to pay up front. In January 2008, when it became increasingly clear that the exchange rate was proving indefensible, the Central Bank allowed the currency to depreciate to Rs. 114.04 to the dollar, but even the new rate appeared to be a punishing one for exporters. However, the decline in inflation during the first quarter of 2009 helped depreciate the exchange rate and made it more competitive for exporters. This encouraged the Central Bank to remove the 100% margin on letters of credit for imports.

The response of currency markets to the Government's victory over the LTTE in May exerted upward pressure on the exchange rate again. Hence the monetary authorities were forced to intervene to mop up excess dollars so that the rupee would not appreciate further. The Central Bank removed the restrictions that were

[2] Under the zero cost collar option, whenever the price rises between $100 and $135 per barrel, the banks pay an agreed amount (up to a maximum of $1.5 million a month) to the CPC. Any fall in prices below $100 (without any restriction unlike on the topside) means the CPC pays the banks.

imposed on forward sales and purchases of foreign exchange since October 2008 and the margin deposit requirements imposed on importation of motor vehicles and selected consumer goods. This intervention created a market surplus in rupees, which is expected to help bring down lending rates, along with recent policy rate cuts of the Central Bank.

Until the LTTE's defeat in May 2009, Sri Lanka's external position was cause for serious concern. The uncertainty associated with the international financial markets saw foreigners withdraw from Treasury Bills and Treasury Bonds. Sri Lanka also failed to attract foreign investors for a syndicated loan of $150 million announced in October 2008. This was because the country faced the highest sovereign bond spread (1300 base points in October 2008) in emerging markets next to Pakistan, demonstrated by data released by JP Morgan.[3] Efforts to attract investment in Sri Lanka Development Bonds from the Sri Lankan Diaspora were less successful than expected. In March 2009 the Central Bank raised USD 184.25 million by selling two-year dollar-denominated bonds - 200 million dollars less than it had planned, even at the much higher interest of 7.28 per cent. By end January 2009, gross official reserves were down to 1.3 months of imports and this figure was maintained until March 2009.[4] Faced with rapidly declining foreign reserves and little prospects of borrowing in the international market, the Government approached the IMF for a standby facility of US$ 1.9 billion. But in an unprecedented move, the US Government pressed for the inclusion of political conditions in the IMF loan agreement, which the Government of Sri Lanka found unacceptable.[5]

However, the end of the war in May 2009 brought Sri Lanka out of an imminent balance of payments crisis. Sri Lanka's reserves received a boost of more than US$300 million in the immediate aftermath of victory and the 2-year Sri Lanka Development Bonds were oversubscribed by 135 per cent, raising UD$ 115.8 million from a US$ 50 million offer.[6] Thus, the delay of the IMF facility did not prove critical for balance of payments management as envisaged at the time it was applied for. Nevertheless, on 24 July 2009 the Executive Board of the IMF approved a 20-month standby facility amounting to US$ 2.6 billion and to be disbursed in seven tranches (the U.S.A. and the U.K. abstained).

The rate of inflation has been declining steadily from the high of 30 per cent in mid-2008. As measured by the revised Colombo Consumer Price Index (CCPI), the inflation rate fell to 10.7 per cent in January[7] and through to 2.9 per cent by April.[8] The fall in inflation is likely to be partly due to the fall in the international price of oil that has been passed on to consumers, initiated by Supreme Court intervention. Increased agricultural production, particularly in Eastern Province, has also helped to bring down food prices. The reduction in inflation enabled the Central Bank to ease its monetary policy further towards the end of the first quarter of this year.

GDP growth in the fourth quarter of 2008 cooled to 4.3 per cent, pulling down the

[3] Shekhar Shah, 'Global Economic Prospects 2009: The unfolding global financial crisis', presented at the IPS Seminar on The Global Economic Crisis and Sri Lanka, Colombo February 18, 2009.

[4] Economic Research Department, Central Bank of Sri Lanka, Press Release, 21-05-2009.

[5] Inaugural address by the Hon. Sarath Amunugama, Deputy Minister of Finance, at the Conference on Protecting the Poor in Sri Lanka in Crisis and Beyond, 24 June 2009, at the Ceylon Continental Hotel, Colombo, organized by the Institute of Policy Studies and the World Bank, Sri Lanka.

[6] Article by Devan Daniel titled, 'Let it come when it comes, there is no urgency – Cabraal' appearing in The Island - Financial Review of 22 June 2009.

[7] Economic Research Department, Central Bank of Sri Lanka, Press Release, 18-03-2009.

[8] Economic Research Department, Central Bank of Sri Lanka, Press Release, 21-05-2009.

annual growth rate from 6.8 per cent in 2007 to 6 per cent in 2008. Growth in the first quarter of 2009 dropped to 1.5 per cent and the Central Bank admitted that the economy may grow only by 2.5 this year.[9] However, since military operations have ceased in the North, reconstruction, resettlement and rehabilitation can begin, for which several donors (for example, India, China and Japan), have already pledged assistance. This will facilitate a fiscal stimulus that will go some way towards mitigating the worst effects of the global slump.

This chapter set out key elements of the macroeconomic background to the crisis to help explain the impact of the global economic recession on Sri Lanka's economy. The next chapter discusses the principal channels through which the global downturn is percolating through to the domestic economy.

[9] Statement by Ajith Nivard Cabraal, Governor of the Central Bank of Sri Lanka, as reported on Lanka Business Online, 6 April 2009. See http://www.lankabusinessonline.com/fullstory.php?nid=188595356. Date accessed 16 April 2009.

TRANSMISSION OF THE CRISIS

In this chapter we look at key economic sectors impacted by the crisis, which themselves act as transmission channels to other sectors of the economy. Companies producing for the domestic sector are undoubtedly affected, for example, the crisis in the construction sector has affected allied industries, such as brick and tile manufacturers and reduced the incomes, of not only carpenters and masons, but also of architects and notary publics. However, in this report we concentrate on the transmission channels only, due to a lack of reliable data on the one hand, and time and space constraints on the other hand.

The discussion to follow focuses mainly on impact. However, we have set out the structure of production, exports and imports in terms of sectoral contributions in Tables 3.1, 3.2 and 3.3 to inform the reader of the relative importance of some of these sectors in Sri Lanka's economy.

3.1 EXTERNAL TRADE

External trade is the main channel through which the international crisis is impacting on Sri Lanka's economy. In January 2009 the trade deficit contracted by 66.5 per cent year-on-year. Exports decreased by 11.6 per cent and imports decreased by 40.5 per cent.[10] In May 2009 the deficit contracted for the fifth consecutive month, recording a decline of 62 per cent: export earnings dropped by 28 per cent and outlays on imports declined by 42 per cent.[11]

The decline in export earnings in May 2009 was reflected mainly in industrial and mineral exports. Agricultural exports which accounted for 26 per cent of total exports grew by 2.5 per cent. Tea prices fetched premium prices in the international market but rubber and coconut prices declined. Among industrial exports, the earnings from the textiles and garments sub sector declined for the second consecutive month: by 23 per cent in May[12] compared with 10 per cent in April 2009.[13] This must be compared with the figures for January this year when textiles and garments (accounting for 43 per cent of total export earnings) grew by 4.5 per cent, and by 6 per cent in March 2009.[14] It is evident that during the first quarter of 2009, apparel exports were still running on pre-crisis orders. In May 2009 exports of textiles and apparels to the European Union declined by 17.9 per cent and to the US by 29 per cent.

[10] Economic Research Department, Central Bank of Sri Lanka, Press Release, 18-03-2009.
[11] EEconomic Research Department, Central Bank of Sri Lanka, Press Release, 13-07-2009.
[12] Economic Research Department, Central Bank of Sri Lanka, Press Release, 13-07-2009.
[13] Economic Research Department, Central Bank of Sri Lanka, Press Release, 22-06-2009.
[14] Economic Research Department, Central Bank of Sri Lanka, Press Release, 13-07-2009.

Table 3.1: Sectoral Composition of GDP, 2003 and 2008

	2003	2008	Contribution to change in GDP 2008
Category			
Agriculture, Forestry and Fishing	**19.0**	**12.1**	**15.1**
Tea	1.3	1.2	0.9
Rubber	0.4	0.2	0.4
Coconut	1.3	1.4	1.2
Paddy	3.2	1.8	6.1
Forestry	1.8	0.6	0.7
Fishing	2.4	1.1	1.8
Industry	**26.5**	**28.4**	**28.3**
Mining and quarrying	1.7	2.0	4.1
Manufacturing	16.3	17.5	14.6
Processing (tea, rubber, coconut)	1.8	0.6	0.6
Factory industry	13.3	15.8	13.3
Small/cottage industry	1.2	1.1	0.8
Electricity, Gas and Water	1.6	2.4	1.1
Construction	6.9	6.5	8.4
Services	**54.5**	**59.5**	**56.6**
Wholesale and retail trade	22.2	24.2	19.4
Import trade	9.9	9.0	7.2
Export trade	2.4	4.4	0.7
Domestic trade	9.3	10.8	11.5
Hotels and Restaurants	0.7	0.4	-0.3
Transport and communication	13.5	13.1	17.5
Transport	8.2	10.9	11.5
Cargo handling – ports and civil aviation	0.9	0.7	0.9
Posts and telecommunications	4.4	1.6	5.1
Banking, insurance and real estate	11.7	8.7	9.5
Government services	4.5	7.7	7.4
Private services	2.6	2.4	2.6
GDP	**100.0**	**100.0**	
GDP at 2002 prices (Rs. Million)	1,733,222	2,312,383	

Source: Central Bank of Sri Lanka (2004, 2009), Annual Report 2004, Annual Report 2008.
Note: Other than for the numbers in bold, shares do not always add up to 100. This is because there are slight differences in classification for the two years and only the items common to both years have been included.

Table 3.2: Composition of Exports 2007 and 2008

	2003	2008
Category		
Agricultural Exports	**19.7**	**22.8**
Tea	13.4	15.6
Rubber	1.4	1.5
Coconut	1.8	2.1
Other agricultural products	3.0	3.5
Industrial Exports	**78.1**	**75.7**
Food, beverages and tobacco	6.7	5.6
Textiles and garments	43.7	42.6
Petroleum products	2.2	3.1
Rubber products	6.3	6.7
Ceramic products	0.6	0.6
Leather, travel goods and footwear	0.3	0.2
Machinery and equipment	7.1	5.7
Diamonds and jewellery	4.8	5.4
Other industrial exports	6.3	5.8
Mineral Exports	**1.7**	**1.5**
Gems	1.4	1.2
Other mineral exports	0.3	0.3
Unclassified	0.5	0.0
Total	100.0	100.00

Source: Central Bank of Sri Lanka (2009), Annual Report 2008.

The global economic downturn and the decline in demand for Sri Lanka's exports appear to be impacting on sectors already affected by the uncertainty about whether Sri Lankan exports will continue to enjoy concessions associated with the Generalized System of Preferences (GSP). The conferring of GSP status by the European Union (EU) in January 2005 benefited Sri Lanka's export industries covered by the agreement. In particular, it enabled the apparels sector to make the transition from a trading environment, protected by the Multi-Fibre Agreement to one where quotas no longer applied. However, when Sri Lanka's GSP came up for review in 2008, questions remained about the implementation of three conventions out of a total of 26 that the Government had ratified. The three related to conventions on civil and political rights, torture and the recruitment of child soldiers (by the LTTE). Implementation of the convention on civil and political rights, in particular, remained contentious. Since the Government refused to allow the EU to carry out an investigation, whether the GSP status is renewed will depend on a decision which has to be taken, based on submissions by interested parties. The process of deciding on the basis of submissions and, if status is revoked, the six months notice required, is likely to take the rest of the year. Thus, while exporters are assured of enjoying GSP concessions for the next eight months at least, buyers have been wary about placing orders for the period after that. This uncertainty probably accounts for the fact that even while export earnings from garments and textiles, for example, grew during the first quarter of this year, the majority of layoffs are taking place in this industry, as will be shown later.

Table 3.3: Composition of Imports 2007 and 2008

	2003	2008
Category		
Consumer Goods	17.7	18.2
Food and beverages	9.4	10.7
Rice	0.3	0.3
Sugar	1.4	1.5
Wheat	2.1	2.7
Other	5.6	6.3
Other consumer goods	8.3	7.5
Intermediate Goods	57.7	59.5
Petroleum	22.1	24.0
Fertilizer	1.7	4.1
Chemicals	2.5	2.6
Textiles and clothing	14.4	12.1
Other intermediate goods	16.9	16.7
Investment Goods	23.8	21.3
Machinery and equipment	11.0	9.3
Transport equipment	3.2	2.9
Building materials	6.9	6.7
Other investment goods	2.6	2.4
Unclassified imports	0.8	1.0
Total	100.0	100.00

Source: Central Bank of Sri Lanka (2009), Annual Report 2008.

An overvalued and increasingly indefensible exchange rate, in addition to uncertainty about whether GSP concessions will be available next year, made it difficult for Sri Lankan exporters to compete in rapidly shrinking export markets six months into the crisis. While the crisis faced by the apparels industry, being the largest industrial exporting sector, is the most visible, smaller export industries, such as export horticulture, tableware and porcelain, gems and jewellery, automobile parts and rubber products are also facing hard times. The tea industry's difficulties during the first half of this year were exacerbated by drought in some areas and frost in others.

The decline in expenditure on imports by 42.1 per cent in May 2009 reflected the slowing down in economic activity amid global recession. Consumer goods declined by 41.2 per cent due to lower commodity prices. Expenditure on sugar increased because of higher prices, but prices of rice, wheat and dairy products declined. Expenditure on non-food consumer items declined by 36.8 per cent, mainly due to the decline in outlay on imported motor vehicles. The imposition of a 100% margin (deposit), when opening letters of credit for selected imports, including vehicles by the Central Bank, obviously had an impact. Import values of intermediate goods contracted by 42.6 per cent in May 2009, mainly due to lower petroleum prices. In April, however, outlay on the import of textiles and diamonds – inputs to the garments and jewellery industries – declined by 26.3 per cent and 35.7 respectively, reflecting the downturn in global demand.[15] In May 2009, expenditure on investment goods declined by 43.8 per cent mainly due to lower expenditure incurred on imports of building materials and machinery and equipment, again on account of reduced economic activity related to these inputs.[16]

3.2 REMITTANCES

Sri Lanka is heavily dependent on remittances from migrant workers to ease the pressure on its current account. For example, remittances in May 2009 amounted to 133 per cent of the trade deficit.[17] The impact of the crisis saw a total of Rs. 2.9 billion remitted through official channels in 2008, marginally less than the Rs. 3 billion targeted.

Even so, the flow of remittances from Sri Lankan migrant workers seems to have largely held up in the first quarter of 2009 despite a year-on-year decline of 6.6 per cent in January 2009.[18] Comparing the figures for the first quarter of this year with that of 2008, it appears that only a decline of 1.7 per cent was experienced as the amount fell from USD 787 million to 774 million.[19] And if the figures for the first five months of 2009 are compared with the corresponding period in 2008, private remittances increased by 2.9 per cent.[20] However, these figures cannot be taken to indicate that migrants are not returning home. Remittances holding up could be due to migrants opting to send more money through official banking channels, rather than through customary informal channels, attracted by the Government's offer of a 20 per cent bonus to boost incoming bank remittances.

There is little data on layoffs of Sri Lankan migrant workers overseas. Therefore, it is not immediately apparent whether the global slump has caused job losses among Sri Lankan migrant workers. Even though the Sri Lanka Bureau of Foreign Employment collects data on those

15 Economic Research Department, Central Bank of Sri Lanka, Press Release, 22-06-2009.
16 Economic Research Department, Central Bank of Sri Lanka, Press Release, 13-07-2009.
17 Economic Research Department, Central Bank of Sri Lanka, Press Release, 13-07-2009.
18 Economic Research Department, Central Bank of Sri Lanka, Press Release, 18-03-2009.
19 E-mail communication, Mr. L.K. Ruhunage, Sri Lanka Bureau of Foreign Employment.
20 Economic Research Department, Central Bank of Sri Lanka, Press Release, 13-07-2009.

migrating for work, there is no mechanism to collect data on the return of migrant workers as the Bureau and the Department of Immigration is yet to work out an acceptable data collecting arrangement. However, anecdotal evidence suggests that skilled and semi-skilled workers in the garments and construction sectors are returning home. There is little indication from the field of housemaids being sent back but the correct and timely payment of their wages is likely to be affected even more than usual.[21]

There does appear to be a clear falling off in the number of Sri Lankans seeking employment abroad in recent months, indicative of a downturn in demand. Annual labour emigration from Sri Lanka has averaged over 200,000 per year, with half of those for employment as housemaids. Roughly 75 per cent of Sri Lankan overseas workers are in the Middle East. But the fall in oil prices and the impact of the international financial crisis on share equities and exports in destination countries have depressed labour outflows from countries of origin. From a peak of 24,970 in September 2008 labour outflows from Sri Lanka dropped by 15 per cent to 16,811 in December (ILO 2009). Comparing the figures for the first four months of 2008 with those of 2009, the number leaving for foreign employment dropped noticeably from 82, 282 to 73,264 – a decline of 11 per cent.[22]

East Asian countries badly affected by the crisis such as Japan, Korea and Singapore are looking to terminate migrant workers first where retrenchment has become necessary and have instituted freezes on the quota of work permits issued. The Sri Lanka Bureau of Foreign Employment has ceased training workers for the Korean labour market as South Korea terminated its labour contracting arrangements with Sri Lanka following the economic slump.

3.3 CONSTRUCTION

The global economic slowdown has had a critical impact on the construction sector. Many foreign investors in the Colombo-based condominium development sector had financed their purchases by raising mortgages in countries, such as the US and the UK. However, following the impact of the financial crisis and economic slowdown in these countries, many investors have been unable to meet their financial obligations and have been forced to abandon or terminate their investments in Sri Lanka. The knock-on effects on property developers and construction companies, both of existing high-rise apartment blocks, as well as those yet to be built, have been considerable.

The construction industry has also been badly affected by the Government delaying to pay its bills for construction work carried out under Government contract.

Since contractors are unable to get their debtors such as the Government to pay for work undertaken, they have in turn been unable to meet their interest payments on loans taken from banks. This has contributed to the liquidity crisis faced by the banking sector, which we discuss next.

[21] These observations were made by field workers of the Migrant Services Centre which is in turn affiliated to the National Workers' Congress.
[22] E-mail communication, Mr. L.K. Ruhunage, Sri Lanka Bureau of Foreign Employment.

3.4 FINANCIAL SECTOR

Sri Lanka's financial sector has not been directly affected by the international financial crisis because the system is relatively unsophisticated and there has been little exposure to toxic international financial assets.

Even so, the impact of the global economic slowdown has squeezed liquidity in the banking sector which has, in turn, had a domino effect on businesses. Small and medium enterprises are particularly affected.

The number of non-performing loans of commercial and development banks has risen across the board as export industries, import trading enterprises and the construction sector are hit by the prevailing conditions. The economic difficulties faced by downstream enterprises have had a domino effect on their upstream suppliers, throwing them also into crisis because of non-payment of bills for inputs. The credit crunch has forced banks to reschedule loan repayments and in many cases, foreclose defaulting businesses. Not surprisingly, there is little credit available to provide working capital for companies.

Even though the Central Bank, in a reversal of its earlier policy of a tight monetary regime, reduced the Statutory Reserve Ratio (SRR) by 225 points in late 2008 and by a further 75 points in February 2009, the injection of liquidity into the system had little discernible impact. This was probably due to the broad-based nature of the crisis where all sectors, other than agriculture, targeting the domestic market have been affected. Besides, the increased liquidity tended to be mopped up by what is perceived to be 'safer' Government bonds.

Nevertheless, as the Central Bank gradually eased the tight monetary policy stance, interest rates have been slowly declining since the beginning of this year. With inflation and call rates down, the Bank of Ceylon eased its lending rates by two percentage points in the last week of March, with the National Savings Bank following suit. The People's Bank has followed with a rate cut of 3 per cent.[23] The Bank of Ceylon and People's Bank have also expanded their deposits as depositors have moved funds out of many private finance companies, following the Golden Key Credit Card debacle (see below). Moreover, civilians who escaped from the conflict zone after April 2009 and are now living in Government-run welfare camps, have deposited at least Rs. 1 billion with the state-owned banks.[24] The ending of the conflict also resulted in an inflow of foreign investment to Government securities. Consequently, yield rates on Treasury bills declined sharply at the Treasury bill auction held on 22 July 2009 and the yield rate on Treasury bills with a maturity of 91 days declined by 26 basis points to 10.79 per cent, the lowest since early October 2006. This trend was reflected in the yield rates of Treasury bills with the maturities of 182 days and 364 days. A similar trend was observed in the yield rates of Treasury bonds in the secondary market while present levels of call money rates are the lowest observed since the first quarter of 2006.[25]

[23] Interview with Mr. S.R. Attygalle, Director General for Fiscal Policy, Ministry of Finance and Planning, as reported by Devan Daniel in The Island - Financial Review, 4 April 2009. See also, The Island - Financial Review, 7 April 2009.

[24] Inaugural address by the Hon. Sarath Amunugama, Deputy Minister of Finance, at the Conference on Protecting the Poor in Sri Lanka in Crisis and Beyond, 24 June 2009, at the Ceylon Continental Hotel, Colombo, organized by the Institute of Policy Studies and the World Bank, Sri Lanka.

[25] Public Debt Department, Central Bank of Sri Lanka, Press Release, 23-07-2009.

It may take a little longer for these positive developments to filter through to the commercial banking sector. Even the two state banks are experiencing constraints. The People's Bank recorded an after tax profit of Rs. 2.7 billion in 2008, an increase of 14 per cent from the previous year. But its non-performing loans ratio increased from 5.9 per cent to 6.8 percent between 2007 and 2008 and the bank's annual report has studiously avoided reporting its liabilities related to the hedging contract with CPC. On the other hand, while the exact financial arrangements between the troubled Ceylinco Group's loss-making Seylan Bank and the Bank of Ceylon to which management has been handed over, are not in the public domain, this arrangement may constrain the Bank of Ceylon's own operations until a suitable buyer for Seylan is found.

In addition to the commercial and development banking sector, leasing companies appear to be badly affected as declining demand conditions have, in turn, affected the demand for vehicles, machinery and equipment. Nevertheless, with the end of the conflict and anticipated agricultural renewal in the Eastern Province, there appears to be pent-up demand for the leasing of agricultural machinery and equipment in Trincomalee and Batticaloa districts, which may provide a much-needed boost for the flagging leasing sector.

The collapse of the Golden Key Credit Card Limited of the Ceylinco Group of Companies, though not directly linked to the international financial crisis, has contributed to the turmoil in the financial sector. In the immediate aftermath of Golden Key's collapse Ceylinco's Seylan Bank, experienced a run on deposits. The Central Bank was forced to bring it under the management of the state-owned Bank of Ceylon to stabilize the situation and prevent contagion effects on the system as a whole. As criminal proceedings against the holding company's chairman and directors bring to light the financial irregularities and fraud which seems to have been rife, it has had knock-on effects on other companies in the 300-strong Ceylinco Group with at least 42 financial, leasing and property development companies facing closure. In March 2009, yet another Ceylinco venture, Ceylinco Building Society (CBS), moved into severe crisis with investors demanding their money back.

While the Golden Key Credit Card Company owes its depositors Rs. 26 billion and the holding company is to sell its assets to pay back the depositors, the company's collapse has badly affected many businesses and individuals who had invested their funds in it. This had knock-on effects on other businesses that some of them patronized, such as restaurants and spas. The collapse of the Golden Key Credit Card Company has set off a home-grown financial crisis that has added to the general financial turmoil and economic downturn.

3.5 TOURISM

Foreign tourist arrivals have been stagnant or falling for years because of Sri Lanka's conflict. The ceasefire in operation between 2002 and 2005 provided some respite and many hotels undertook ambitious refurbishment programmes during this period. However, with the resurgence of violence in April 2006 tourist arrivals plunged again. Hotels were also affected by rising fuel and other costs and the migration of trained staff abroad.

The international economic slowdown dealt the sector a further blow. Tourist arrivals declined by 32.4 per cent year-on-year in January 2009. Prices came down sharply and the industry was operating under tough conditions, with many hotels operating a skeleton staff and concentrating on attracting domestic tourists. But the decline in February was 21 per cent,[26] and many hoteliers felt that the slump in the tourism sector was bottoming out.

The successful completion of military operations in the North has dramatically changed the security situation and the outlook for tourism almost overnight. From a decline of 20.6 per cent year on year in May 2009, arrivals grew by 8 per cent in June and by 28 per cent in July.[27] The long-beleaguered tourist industry appears to be gearing up for a busy season at last.

3.6 PORT SERVICES AND SHIPPING

Before the global economic slump impacted on Sri Lanka, healthy export and import growth and productivity improvements generated significant growth in port services. Total cargo handled grew by 9 per cent in 2008, though less than the 14 per cent recorded in 2006 (Central Bank of Sri Lanka, Annual Report 2007, 2008).

However, the international crisis has had its impact on the sector. Year-on-year averages for the six-month period January to June show that the total number of ships that arrived in the Port of Colombo declined by 7.9 per cent in 2009, compared with 2008. Container throughput declined by 9.7 per cent, total cargo discharged fell off by 10.3 per cent and total cargo loaded contracted by 8.5 per cent. The total tonnage handled also fell by 9.6 per cent, reflecting the contraction in export and import volumes following the global economic downturn. Nevertheless, from May onwards, a slight bottoming out of the decline is discernible.[28]

In this chapter we examined the channels through which the international economic crisis is impacting on Sri Lanka's economy. While external trade is the main channel of transmission, other economic activities, such as migrant labour, tourism and port services and shipping through which the Sri Lankan economy interacts with international markets have also been affected. Among the domestic sectors affected indirectly are the financial sector and the construction sector. In the next chapter we look at the impact of these forces on employment and labour absorption.

[26] http://www.sltda.lk/monthly_statistics. Date accessed 29 July 2009.
[27] http://www.sltda.lk/monthly_statistics. Date accessed 29 July 2009.
[28] Data from Sri Lanka Ports Authority.

IMPACT ON EMPLOYMENT

This chapter concentrates on the impact of the economic slump on employment. We first set the context with a brief overview of Sri Lanka's labour market in terms of unemployment trends and structure of employment and wages in section 4.1. Section 4.2 sifts through the available evidence on job losses and reduction in labour employment associated with the present crisis. Section 4.3 evaluates the response of employers, while section 4.4 discusses how workers are coping and draws the implications for poverty.

4.1 OVERVIEW OF SRI LANKA'S LABOUR MARKET

Although unemployment rates have been declining over the years, two characteristics of Sri Lanka's labour market remain cause for concern: most of the unemployed are educated youth, and the majority of employed people are in informal work earning low wages. The cessation of the conflict will bring both opportunities and challenges.

Roughly 8 million people make up Sri Lanka's labour force, accounting for a participation rate around 50 per cent. This figure has remained more or less constant during the last decade (Table 4.1). Around two thirds of working age males and a third of working age females are labour force participants. Unemployment rates have declined steadily over the years, more so for males (down to 4 per cent in 2008), than for females (8 per cent). The largest decrease in unemployment has been among young people. Nevertheless, 74 per cent of all unemployed in 2008 were between 15 and 29 years of age. Of them, roughly a third had at least ten years of schooling (Department of Census and Statistics 2009).

The nature of employment is cause for concern: formal sector job creation rates are relatively low other than in the public sector which accounted for 15 per cent of employment in 2008. Two thirds of the employed workforce (66 per cent) was found to be informally employed in 2006. Males, young people, older workers and the less educated, are more likely to be informally employed (Gunatilaka 2008). Better education and skills are poorly rewarded in informal employment, signalling that Sri Lanka has been unable to reap the benefits of its superior education policies because the economy has failed to generate the kind of jobs that can pay educated workers a good wage (ibid.).

Formal job creation in Sri Lanka is likely to have been constrained by many factors: stringent job security regulations raise labour costs and are likely to impede both hiring and firing (Heltberg and Vodopivec 2004; Rama 1994); certain clauses in the Inland Revenue Act operate as a growth trap for businesses; the erstwhile security situation has impacted negatively on the investment climate; and, serious infrastructure constraints in terms of electricity generation and transport have raised production costs and concentrated business activities around the metropolitan hub (World Bank and Asian Development Bank 2005).

Table 4.1: Labour Force Trends 2003-2008

Item	2003	2008
Labour force, '000	7,654	8,151
Labour force participation rate %	48.9	49.7
Males	67.2	67.5
Females	31.4	34.0
Employment status		
Public sector employees	13.5	14.9
Private sector employees	44.4	41.1
Employers	2.6	3.0
Self-employed	29.6	30.2
Unpaid family workers	9.9	10.8
Total	100.0	100.00
Unemployment, % of labour force		
Males	6.0	3.6
Females	13.2	8.0

Source: Central Bank of Sri Lanka (2009), Annual Report 2008; Department of Census and Statistics (2009), Quarterly Report of the Sri Lanka Labour Force Survey, Fourth Quarter 2008.
Note: All data excludes the Northern Province. Data for employment status for 2008 exclude both Northern and Eastern Provinces.

Table 4.2: Share of Employed Persons by Industry Group, 2003-2008

Item	2003	2008
Industry group		
Agriculture, forestry and fishing	34.0	32.6
Manufacturing	16.5	18.5
Construction, mining and quarrying, electricity, gas and water	6.5	7.7
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods.	12.4	12.9
Hotels and restaurants	1.7	1.4
Transport, storage and communication	5.2	5.9
Financial intermediation and real estate, renting and business activities	2.7	3.2
Public administration and defence, compulsory social security	7.7	6.7
Education	3.7	4.3
Health and social work	1.4	1.6
Other community, social and personal service activities, extra-territorial organizations and bodies	1.6	1.9
Private households with employed persons	1.1	1.1
Miscellaneous labour work	4.8	2.2
Industries not adequately described	0.7	0.2
Total	100.0	100.0

Source: Department of Census and Statistics (2009), Quarterly Report of the Sri Lanka Labour Force Survey, Fourth Quarter 2008.
Note: Data excludes the Northern Province.

Agriculture still accounts for a sizeable third of all employed (Table 4.2). Manufacturing accounts for a fifth and this share has increased only marginally over the last five years. The services sector accounts for roughly half of all employed. Disaggregated data relating to the manufacturing sector is only available from the Census of Industries 2003/2004 conducted by the Department of Census and Statistics. The data is presented as employment shares in Table 4.3. It can be seen that the apparel sector accounts for 38 per cent of employment in manufacturing and manufacture of food products and beverages accounts for 18 per cent. Non-metallic mineral products and furniture and other products account for about 7 per cent of total employment each.

Analysis of mean hourly wages of public, formal and informal employees shows a marked wage gap favouring formal workers particularly at higher occupational levels and in the services sector (see Table 4.4). Table 4.5 sets out gender-based differentials by tercile, and it can be seen that, by and large, the differentials favour males by a substantial margin. Formal male employees earn on average 50 per cent more than formal female employees. Only in the first and second terciles in public employment do females earn marginally more than males, thereby causing the overall wage differential in public employment to favour females.

Analyses of real wage trends in the informal sector in the period 1979-1997 show marked differences across sectors and space. For example, Gunatilaka and Hewarathna's (2002) study found that female agricultural workers in Sri Lanka's tea and coconut sectors experienced rising real wages between 1979 and 1997, but that real wages in the residual paddy sector had remained stagnant. There also appear to be considerable differences in regional experiences. An analysis of the data series related to the Central Province showed that real wages in the tea, paddy and masonry sectors have been largely stagnant over the same period other than for paddy in Kandy and masonry in Nuwara Eliya, where real wages have been rising. (Gunatilaka 2003). This suggests pockets of dynamism in certain geographical locations. These analyses are based on the few informal daily wage series relating to the tree crops (tea, rubber and coconut), paddy and construction (carpentry and masonry), sectors published by the Central Bank of Sri Lanka, which is the only source for time series data on real wages.

The secessionist conflict has left large numbers of young Sri Lankans in the North and east critically disadvantaged in terms of their human capital. The country-wide survey of Internally Displaced Persons (IDPS) in 2002 found that 60.1 % were aged 30 years and less, with the largest age-group – 22 % aged 11-20 years. (Hingst *et al*. 2002). The psychological trauma of being caught up in violence aside, conflict causes displacement and repeated displacement leads to impoverishment and disrupted and discontinued schooling. Literacy rates among displaced young adults have been found to be lower than the national average, indicative of disrupted schooling due to conflict (Health Policy Research Associates (Pvt) Ltd 2006).There will also be disabled ex-combatants and non-combatants who need to be provided with the necessary skills to seek livelihoods that can help them live as independently as possible. The global economic downturn will seriously affect job prospects of vulnerable groups, such as the young and disabled, many of them first-time job seekers.

Table 4.3: Share of Employed Persons by Type of Industry, Manufacturing Sector, 2003/2004

	Small (< 10 employees)	Medium and Large (> 10 employees)	Share of total employed
Food products and beverages	26.85	14.07	17.47
Tobacco products	0.56	0.79	0.73
Textiles and yarn	4.62	7.23	6.53
Apparel	10.60	48.37	38.35
Leather products	1.40	1.83	1.71
Wood and wood and cork products	6.71	1.38	2.80
Pulp and paper based products	0.32	1.04	0.85
Publishing, printing and reproduction of recorded media	1.95	1.87	1.89
Refined petroleum products	0.02	0.14	0.11
Basic chemical and chemical products	1.67	2.58	2.34
Rubber and plastic products	2.75	5.96	5.11
Non-metallic mineral products	17.07	3.49	7.10
Basic metal products	0.48	1.24	1.04
Fabricated metal products	8.73	1.22	3.21
Machinery and equipment	0.29	0.99	0.81
Electrical machinery and equipment	0.14	1.33	1.02
Radio, television and communication equipment	0.08	0.29	0.24
Medical and optical instruments, watches and clocks	0.03	0.03	0.03
Motor vehicles, trailers and semi-trailers	0.21	0.27	0.26
Other transport equipment	0.05	0.34	0.26
Furniture and other products	14.72	4.80	7.44
Recycling	0.03	0.03	0.03
Electricity, gas, steam and hot water	0.09	0.09	0.09
Collection, purification and distribution of water	0.46	0.55	0.53
Not specified	0.14	0.07	0.09
Total (%)	100.00	100.00	100.00
Total (number)	264235	731268	995503

Source: Author's calculations based on Census of Industries 2003/2004 data from Department of Census and Statistics (2006).

Table 4.4: Mean Hourly Wages by Industry, Occupation and Firm Size, Employees Only (Rs.), 2006

	Mean hourly wage			Ratio: Formal/ informal	Share %	
	Public	Formal	Informal		Formal	Informal
Industry						
Agriculture	24.93	24.22	27.85	0.87	29.9	21.3
Manufacturing	65.51	43.91	32.66	1.34	42.6	38.5
Services	79.03	64.43	32.26	2.00	27.5	40.2
Total					100.0	100.0
Occupation						
Managerial	115.83	143.56	56.95	2.52	5.0	0.8
Professional	103.74	103.24	68.91	1.50	3.5	1.8
Technical	77.91	66.87	49.90	1.34	8.1	2.3
Clerical	67.87	54.72	37.39	1.46	7.1	2.8
Service	58.43	42.17	26.86	1.57	3.9	11.6
Agricultural	28.08	28.72	29.57	0.97	0.8	2.1
Production Workers	66.06	36.73	34.51	1.06	28.4	35.2
Elementary	36.37	26.12	26.94	0.97	43.2	43.3
Total					100.0	100.0
Firm size						
< 5		34.94	30.61	1.14	7.4	44.9
5-9		39.88	31.20	1.28	5.2	12.5
10-15		45.27	31.60	1.43	6.0	7.3
16-49		45.75	35.11	1.30	12.9	7.6
50-99		42.29	34.83	1.21	11.3	4.3
100 or more		44.99	32.80	1.37	54.9	10.1
No specific institution		49.97	31.38	1.59	1.1	7.6
No regular employees		31.56	29.09	1.08	1.2	5.8
Total					100.0	100.0
All employees	72.45	55.91	31.47			
Share of employees (% of total employment)					20.3	36.64

Source: Gunatilaka (2008), using Department of Census and Statistics' Quarterly Labour Force Data of 2006.

Table 4.5: Mean Hourly Wages of Formal and Informal Employees by Gender (Rs)

	Public			Formal			Informal		
	Male	Female	Ratio:	Male	Female	Ratio:	Male	Female	Ratio:
Hourly wage (mean)	70.78	74.87	0.95	51.32	33.41	1.54	34.11	23.57	1.45
Mean hourly wage by wage tercile									
Highest	119.34	120.63	0.99	99.28	61.34	1.62	56.84	42.76	1.33
Middle	62.72	74.64	0.84	36.12	24.85	1.45	30.00	18.37	1.63
Lowest	30.07	29.06	1.03	18.41	13.92	1.32	15.41	9.50	1.62
Total (number)	2202	1521		2886	2147		5008	1675	

Source: Gunatilaka (2008), using Department of Census and Statistics' Quarterly Labour Force Data of 2006.

4.2 JOB LOSSES

This section weighs the available evidence on job losses associated with the impact of the international economic crisis. While ballpark figures for job losses have varied from 40,000 jobs lost in the garments sector alone,[29] to 300,000 island-wide,[30] the analysis in this section draws on both survey-based macro-level data, as well as micro-data drawn from administrative sources, in order to assess the employment impact of the crisis.

The first hint of trouble is evident in deferred payment of Employment Provident Fund dues by employers suggesting that a sizeable number of them are facing financial difficulties. Between December 2008 and February 2009, there was a 10.5 per cent drop in the number of employers meeting their monthly EPF dues, from 50,134 employers to 44,855.[31] While some of this shortfall may be due to closure and lay off, the data does not allow us to distinguish between closure and deferred payment. What has been the impact on employment? In what follows we examine data available at both macro and micro level to assess what sectors and categories of workers have been affected.

Macro-level analysis

Macro-level data show no statistically significant increase in the rate of unemployment since when the economic crisis struck, but there is some evidence of the redeployment of labour between sectors.

Macro labour force data from the Quarterly Labour Force Surveys (QLFS) of the Department of Census and Statistics do not show any statistically significant rise in quarter on quarter unemployment in the last quarter of 2008 as well as the first quarter of 2009. The survey remains the main source of unemployment data available in Sri Lanka, unlike in developed countries where the registration for unemployment

[29] Mr. Ajith Dias, Chairman, Joint Apparels Association Forum.

[30] Mr. Wasantha Samarasinghe, General Secretary Inter Company Employees' Union, in an interview with Nadia Fazlulhaq, in The Sunday Times of 29 March 2009.

[31] Mr. D. Wasantha, Employees' Provident Fund Department, Central Bank of Sri Lanka.

benefits provides up to date information. During the first quarter of 2008, unemployment accounted for 5.1 per cent of the labour force. The figure in 2009 had increased to 5.5 per cent, but as the Department of Census and Statistics notes 2008, there is no statistically significant difference between the unemployment rates reported in the two periods when sampling error is taken into account. In fact, in absolute terms, the number of all those in employment rose by roughly 129,000 between the first quarters of 2008 and 2009.

However, there is some evidence to suggest that the crisis may have contributed to the marginal increase in informalization that is observed in the labour market. It may also have helped cause a redeployment of labour between industrial sectors. For example, informal employment accounted for 59.6 per cent of all employed persons in the first quarter of 2008, whereas the figure for 2009 was 61.6.[32] Table 4.6 shows that between the two periods, the number in manufacturing declined by roughly 31,000, in construction by 64,000 and in trade, repair of motor vehicles and household goods, by 30,000. But employment in agriculture grew significantly by roughly 200,000.

Gender-based disaggregation of employment figures shows that while far more men lost jobs than women, the gains in employment were equally shared between the sexes. A total of 179,209 males lost jobs in the manufacturing, construction, trade and other sectors, whereas a total of 34,198 females lost jobs in the manufacturing, construction, and education sectors. This is to be expected as males constitute two thirds of the labour force. Note that a third more of men lost employment in manufacturing as women, and five times as many men lost employment in construction as women. But nearly nine times as many women as men found employment in the public sector while most of the employment created in agriculture (88 per cent) was claimed by males. Indeed, earlier analyses have found that workers tend to move between the agricultural and construction sectors depending on seasonal factors (Gunatilaka and Hewarathna 2002; Gunatilaka 2003). It is quite possible that many workers in construction who lost their jobs as a result of the crisis moved to the residual agricultural sector. Indeed, it is fortunate that the agricultural sector has been growing satisfactorily since 2006 and has been able to absorb these workers.

In terms of skills – proxied by occupation levels – the higher skilled occupations account for roughly a third of the total number of jobs lost (Table 4.7). Note that out of 191,491 jobs lost, 52,955 are in the higher skilled categories of managers, professionals and proprietors. There have been gains in employment in technical, unidentified occupations, clerical and skilled agricultural and fisher workers categories. Female managers have been particularly badly hit, even though females have gained as technical and associate professionals, as plant and machine operators and assemblers, and sale and service workers. Male professionals have experienced marked job losses and so have proprietors and managers of enterprises, and craft and related workers. Here again we see the predominance of agriculture-related work, with

[32] Note that these informal employment figures are based on the definitions used by the Department of Census and Statistics and cannot be compared with the estimates reported in section 4.1 which are derived from

the category skilled agricultural and fishery workers gaining a 13 per cent increase overall, and 18 per cent increase for males alone. In addition, it is significant that the number of males employed as proprietors and managers of enterprises declined by 7 per cent, while the number of females employed in the same occupational category increased by 5 per cent.

Unfortunately, the data does not allow us to draw any conclusions about the nature and quality of jobs lost and gained. It is possible, for example, that while males employed as proprietors and managers of enterprises were more profitably employed, women, newly-finding employment in the same occupational category, do so with far less profitable enterprises. Indeed, in a recent study of the effect of 'treatment' grants on male and female-owned enterprises in three tsunami-affected districts in Sri Lanka, De Mel et al. (2007) have shown that returns to capital were zero among female-owned microenterprises but in excess of 9 per cent per month for male-owned enterprises.

The next section examines the micro-level evidence on job losses drawn from administrative sources for a more detailed picture of the impact of the crisis on employment.

Table 4.6: Change in Employment by Industry Group, First Quarter 2008-2009

	Males	Females	All
Change in employment (numbers)			
Agriculture, forestry and fishing	178965	24078	203,043
Manufacturing	-18638.9	-12845	-31,484
Construction, mining and quarrying, electricity, gas and water	-53023	-10871	-63,894
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods.	-56239	26163	-30,076
Financial intermediation and real estate, renting and business activities	2433	2169	4602
Public administration and defence, compulsory social security	7232	62083	69315
Education	1893	-10482	-8589
Other[a]	-51309	37010	-14,299
Total	113143	117305	128,619

	Males	Females	All
Change in employment (%)			
Agriculture, forestry and fishing	12.45	2.48	8.42
Manufacturing	-2.56	-1.97	-2.28
Construction, mining and quarrying, electricity, gas and water	-9.14	-37.33	-10.48
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods.	-7.37	10.11	-2.94
Financial intermediation and real estate, renting and business activities	1.45	2.95	1.90
Public administration and defence, compulsory social security	1.95	50.00	13.98
Education	1.70	-4.58	-2.53
Other[a]	-6.07	15.65	-1.32
Total	0.23	4.55	1.70

Source: Author's calculations based on Department of Census and Statistics (2008;2009).
Notes: Positive numbers denote an increase in employment in the relevant category.
Data excludes the Northern Province.
[a] Category 'Other' includes hotels and restaurants; transport, storage and communication; health and social work; other community, social and personal service activities; extra-territorial organizations and bodies; private households with employed persons; miscellaneous labour work; and, industries not adequately described.

Table 4.7: Change in Employment by Occupation Group, First Quarter 2008-2009

	All	Males	Females
Change in employment (numbers)			
Senior officials and managers	-14951	-1209	-13742
Professionals	-15657	-17173	1516
Technical and associate professionals	45131	4918	40213
Clerks	25827	11049	14778
Proprietors and managers of enterprises	-22347	-29521	7174
Sale and service workers	-586	-23837	23251
Skilled agricultural and fishery workers	207724	177603	30121
Craft and related workers	-107657	-92346	-15311
Plant and machine operators and assemblers	-3324	-11639	8315
Elementary occupations	-26969	-39869	12900
Unidentified occupations	41429	33339	8090
Total	128620	11315	117305

	All	Males	Females
Change in employment (%)			
Senior officials and managers	-9.34	-1.04	-31.40
Professionals	-3.30	-8.88	0.54
Technical and associate professionals	12.02	1.89	34.69
Clerks	8.53	7.19	9.91
Proprietors and managers of enterprises	-4.14	-7.27	5.40
Sale and service workers	-0.10	-5.98	11.84
Skilled agricultural and fishery workers	12.76	17.92	4.74
Craft and related workers	-8.24	-10.77	-3.41
Plant and machine operators and assemblers	-0.63	-2.39	21.02
Elementary occupations	-1.65	-3.63	2.43
Unidentified occupations	93.97	80.29	315.52
Total	1.70	0.23	4.55

Source: Author's calculations based on Department of Census and Statistics (2008;2009).
Notes: Positive numbers denote an increase in employment in the relevant category.
Data excludes the Northern Province.

Micro-level data

The present study has had access to three other sources of micro data on layoffs collected after the onset of the present crisis by the Board of Investment (BOI), the District Offices of the Department of Labour, and the Inter Company Employees' Union. Given that the information compiled by the Inter Company Employees' Union's list has been refuted on at least two counts,[33] the present analysis has relied on the other two sources instead. We discuss these data sources in what follows before analysing the impact of the economic crisis on employment.

The BOI data refers exclusively to the export sector. It covers the period January 2007 to January 2009 and hence permits a comparison over time. In contrast, the data from the Department of Labour covers both export and domestic industries, although no distinction can be made, and has useful information about the reasons for closure. However, the BOI data is likely to be more complete because of the centralized data base maintained. In contrast, the information from the Department of Labour is based on field observations by district labour officers and may be incomplete. The two data sets cannot be combined, as there may be overlaps, but each provides a unique perspective on the situation.

While the BOI data relates to layoffs associated with closures, the Department of Labour data appears to include data related both to closures and retrenchment, associated with downsizing, although the data does not allow us to distinguish between the two. For example, it is reported that many companies affected by the crisis are closing certain lines and laying off or redeploying workers who had been working on these lines, with casual workers being the first to be laid-off.[34]

Under recent amendments to the Termination of Employment of Workmen's Act (TEWA), companies need not apply to the Department of Labour to retrench workers on non-disciplinary grounds if workers agree to go voluntarily. So many companies pay workers the amount due under the compensation formula, perhaps a month's extra wages as well, and terminate employment with the workers' consent. Some companies pay less than the statutory formula, but workers agree to 'go quietly' fearing that as the crisis gets worse, employers will not be able to pay even the little compensation they are willing to pay now. There is no mechanism to gather data on such job losses as only cases where there are disputes over settlement are referred to the Commissioner of Labour for permission to retrench. By end March 2009, 32 companies had applied to the Commissioner to terminate employees temporarily or on a permanent basis. They are mainly SMEs and the industries worst affected are apparel and textiles, ceramics, leather and tourism.[35] It is possible that there is overlap between these 32 companies and those marked as being affected by the economic slump as reported independently by District Labour Offices.

Many workers have voluntarily given up their jobs as employers have cut allowances and benefits, such as transport, making it not worth their while to continue to work in those

[33] For example, the Inter Company Employees' Union's list states that Ansell Lanka laid-off 600 out of a workforce of 1400, and that Ceylon Biscuits (Munchee) laid-off 450 workers. These figures were refuted by Aruna Jayasekera of Ansell and Nishka Weerasuriya of Munchee, who stated that, as of 30 March 2009, no workers had been laid-off, even though both companies are experiencing difficulties as a result of the economic slump.

[34] Calculations based on the data collected by the Inter Company Employees' Union, for example, suggests that on average, companies have downsized their work forces by roughly 33 per cent, with several apparel industries even halving their workforce. Nevertheless, this figure should be regarded as a ball park figure and is only reported in this footnote as there are problems with the accuracy of this data as noted earlier.

[35] Interview with Mr. M. Madihahewa, Secretary, Ministry of Labour Relations and Manpower, as reported by Devan Daniel in The Island - Financial Review, 3 April 2009.

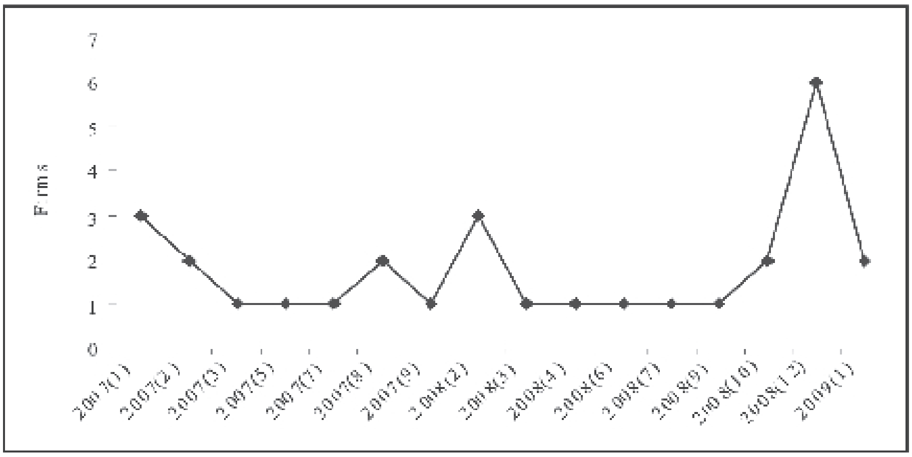
enterprises. Job losses like this would be regarded by companies as part of the natural attrition of the workforce. They would be captured as employment losses only by the national labour surveys – the QLFS - discussed above. Likewise, job losses in companies without trade unions and which manage to evade inspection by the enforcement authorities will be accounted for in the QLFS estimates. There is anecdotal evidence to suggest that such companies are laying-off workers without paying any compensation.

We present the analysis based on the micro data in what follows.

Micro-level data analysis

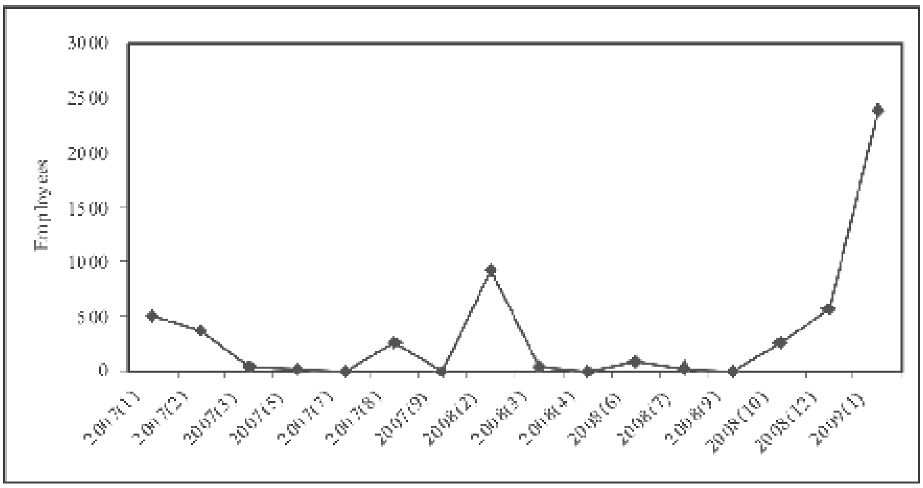
There appears to be a noticeable rise in the number of layoffs after September 2008, going by the BOI data relating to companies in the Export Processing Zones (see Figures 1 and 2). Between September 2008 and January 2009, a total of 11 companies closed, laying-off 3198 workers. In comparison, only one firm in the Zones had closed between September 2007 and January 2009. However, the sharp peak in the number of employees laid-off in January 2009 is largely due to the closure of Sinotex Lanka Limited which laid-off 2358 workers on closure.

Figure 1: Closure of BOI Enterprises in the Export Promotion Zones, January 2007-January 2009.



Source: Author's calculations from data collected by the Board of Investment, Sri Lanka.

Figure 2: Layoffs Associated with the Closure of BOI Enterprises in the Export Promotion Zones, January 2007-January 2009.



Source: Author's calculations from data collected by the Board of Investment, Sri Lanka.

Lack of orders is cited as the predominant reason for closure or layoff between September 2008 and July 2009. This is evident from the data collected by the District Labour Offices of the Department of Labour, which covers BOI, as well as non-BOI companies. Since the information gathering tool has asked open-ended questions, rather than closed-ended options, the data presents a variety of reasons for closure and relatively few companies have cited the economic crisis as the main reason for the difficulties faced by them. Furthermore, unfortunately, no reasons for lay-off are given for roughly 60 per cent of 129 companies found to have laid-off workers either due to closure or retrenchment (Table 4.8). Even so, we can see that at least 35 per cent of companies have closed because of factors associated with the crisis, such as the lack of orders, reduction in orders, low demand or price fall. The same data analysed in terms of job losses is presented in Table 4.9. There we see that at least 44 per cent of the 35,705 workers laid-off lost their jobs because of the lack of orders.

The spatial impact of the crisis appears to be felt most strongly in Gampaha district. More than 50 per cent of employees have been laid-off in Gampaha, 14 per cent in Kurunegala and 12 per cent in Colombo (see Table 4.10). This stands to reason as Gampaha, Kurunegala and Colombo districts are closer to the Western seaboard and have heavy industrial concentrations compared to districts in the hinterland. The row island-wide refers to job losses in the Golden Key Group, whose operations are located island-wide. The crisis faced by this conglomerate is not related to the global financial crisis. Nevertheless, we include it in this analysis because of the welfare consequences associated with such a large number of job losses. The districts not listed in the table did not report any job losses associated with the impact of the financial crisis.

Table 4.8: : Share of Affected Companies by Reason for Closure/Layoff, September 2008-March 2009

Reason	Number of companies	Share of total number of companies (%)
No reason given	74	57.36
No orders	29	22.48
Buyers haven't paid up	5	3.88
Fall in price	4	3.10
Financial difficulties	4	3.10
Investors pulled out	3	2.33
Management problems	3	2.33
Economic crisis	2	1.55
Fall in demand	2	1.55
No quota	1	0.78
Couldn't pay wages	1	0.78
No foreign investment	1	0.78
Total	129	100.02

Source: Author's calculations from data collected by the District Labour Offices of the Department of Labour.

Table 4.9: Share of Job Losses by Reason for Closure/Layoff, September 2008-July 2009

Reason	Number of employees	Share of total number of employees (%)
No reason given	17626	49.37
No orders	15564	43.59
Management problems	783	2.19
Investors pulled out	735	2.06
Financial difficulties	291	0.82
Buyers haven't paid up	221	0.62
Fall in price	176	0.49
Economic crisis	101	0.28
No quota	64	0.18
Fall in demand	62	0.17
No foreign investment	42	0.12
Couldn't pay wages	40	0.11
	35705	100.00

Source: Author's calculations from data collected by the District Labour Offices of the Department of Labour.

Table 4.10: Share of Job Losses by District, September 2008-July 2009

District	Number of employees	Share of total number of employees (%)
Gampaha	17766	52.2
Kurunegala	4851	14.3
Colombo	4030	11.9
Galle	2178	6.4
Badulla	2164	6.4
Mannar	1143	3.4
Ratnapura	529	1.6
Nuwara Eliya	508	1.5
Anuradhapura	350	1.0
Kandy	276	0.8
Hambantota	139	0.4
Moneragala	64	0.2
Ampara	7	0.0
Total	34005	100.0
Island-wide	1700	

Source: Author's calculations from data collected by the District Labour Offices of the Department of Labour.

The garments sector is the largest in terms of both industrial and export sectors, and it appears to be the worst affected by the present crisis. Data from the District Offices of the Department of Labour confirms that out of 129 companies affected by the crisis, 40 per cent are in the apparel sector (Table 4.11). This is to be expected as the apparel sector dominates Sri Lankan industry.

In terms of employment, too, the apparels sector is the worst affected: as Table 4.12 shows, 73 per cent of workers laid-off are from the garments sector. Data from the Export Promotion Zones confirms: as Table 4.13 shows, the garments and textiles sector has dominated lay-offs between September 2008 and January 2009.

However, even between September 2008 and March 2009, 77 per cent of companies affected were in the apparel sector, which is hard to reconcile with the fact that export earnings from this sector grew during the first quarter of this year and experienced a decline only in April. Several hypotheses may be advanced to explain why the sector experienced acute job losses, even when earnings were still growing. For example, the economic slump may have first impacted on companies that were already in trouble; partly due to the challenges the sector has been facing over the past few years and partly due to inefficiencies within the organisations. For example, the uncertainty associated with GSP status prior to the crisis may have made some organizations collapse with the onset of the most recent crisis. On the other hand, there is substantial anecdotal evidence that apparel sector companies have been downsizing across the board, and this could be due to a crisis in business confidence in the sector. This, in turn, may have encouraged employers to anticipate the cutting back of orders and prompted them to trim their workforces, while the going was still good, so that they could survive in a period of economic slump, bereft of the protection afforded by GSP.

Unions allege that the majority of workers losing their jobs are skilled, semi-skilled and unskilled operatives, rather than those in executive positions, and this is confirmed by the QLFS data presented in Table 4.7. Even so, a ratio of one managerial, professional or proprietary job lost in every three jobs lost economy-wide, as revealed by the QLFS data, is better than one would expect. However, the situation in individual companies may be different. While the micro-data discussed above does not detail what occupational or skill categories of workers are being laid-off, a survey of members of the Employers' Federation of Ceylon which represents the more responsible of employers with more modern management practices, found that the costs of adjustment to the crisis in terms of job losses have been shared equally between executives and other grades. For example, of 129 companies which responded to the questionnaire by end-June 2009, 614 employees resigned after accepting a voluntary retrenchment scheme, and of this number, 57 per cent were at least executives while the rest belonged to supervisory/clerical or factory worker grades.[36]

[36] Comment by Mr. Ravi Peiris, Director General, Employers' Federation of Ceylon at the workshop to present the preliminary findings of the ILO Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka, The Palm Lounge, Galle Face Hotel, Colombo, 16 June 2009.

Table 4.11: Share of Affected Companies by Industrial Category, September 2008-July 2009

Category	Number of companies	Share of total number of companies (%)
Garments	52	40.31
Not specified	18	13.95
Tea	6	4.65
Gems	6	4.65
Tyres	5	3.88
Rubber	4	3.10
Boats and fishing equipment	4	3.10
Cartoons	3	2.33
Palm oil	3	2.33
Tiles	2	1.55
Electronics	2	1.55
Towels	2	1.55
Rubber products	1	0.78
Fasteners	1	0.78
Toys	1	0.78
Aluminium	1	0.78
Tents	1	0.78
Paint	1	0.78
Components for motor industry	1	0.78
Detergents	1	0.78
Horticulture	1	0.78
Pharmaceuticals	1	0.78
Padding	1	0.78
Footwear	1	0.78
Textiles	1	0.78
Wire and cables	1	0.78
Fruit	1	0.78
Financial services	1	0.78
Printing	1	0.78
Warehouse	1	0.78
Plastic	1	0.78
Electrical	1	0.78
Stones	1	0.78
Animal feed	1	0.78
Total	**129**	**100.11**

Source: Author's calculations from data collected by the District Labour Offices of the Department of Labour.

Table 4.12: Share of Laid-off Employees by Industrial Category, September 2008-July 2009

Category	Number of employees	Share of total number of employees (%)
Garments	26075	73.03
Financial services	1700	4.76
Not specified	1433	4.01
Tyres	873	2.45
Gems	785	2.20
Electronics	610	1.71
Footwear	554	1.55
Electrical	472	1.32
Boats and fishing equipment	463	1.30
Tiles	404	1.13
Tea	403	1.13
Cartoons	370	1.04
Tents	260	0.73
Components for motor industry	222	0.62
Fasteners	190	0.53
Textiles	185	0.52
Palm oil	123	0.34
Aluminium	90	0.25
Fruit	70	0.20
Towels	67	0.19
Paint	50	0.14
Toys	48	0.13
Horticulture	42	0.12
Stones	41	0.11
Padding	41	0.11
Rubber products	39	0.11
Rubber	34	0.10
Animal feed	15	0.04
Pharmaceuticals	14	0.04
Printing	11	0.03
Wire and cables	10	0.03
Plastic	5	0.01
Warehouse	4	0.01
Detergents	2	0.01
Total	35705	100.00

Source: Author's calculations from data collected by the District Labour Offices of the Department of Labour.

Table 4.13: Share of Laid-off Employees by Industrial Category in Export Promotion Zones between September 2008 and January 2009

Category	Number of employees	Share of total laid-off (%)
Garments	2884	90.18
Knitting	158	4.94
Terry towels	67	2.10
Toys	48	1.50
Latex bladders and sports goods	26	0.81
Wire and cable equipment	10	0.31
Bags and luggage	3	0.09
Palm oil	2	0.06
Total	3198	100.00

Source: Author's calculations from data collected by the Board of Investment, Sri Lanka.

In fact, in many companies, the crisis has exposed inefficiencies created by a top heavy structure and forced companies to restructure. For example, Hayley's MGT is involved in the lucrative business of dyeing grey cloth and it is one of two such enterprises in Sri Lanka. There were 80 executive positions and 300 operatives. The economic slump has forced it to rationalize its employment structure so as to remain competitive.[37] However, it must be remembered that the majority of companies are not members of the Employers' Federation of Ceylon, do not have unions, and successfully evade inspection by the labour authorities. It is possible that in such companies, the costs of adjustment fall on the lower rungs of the occupational hierarchy, as trade unions and civil society organizations working in the field allege. Nevertheless, even though taken as a whole, a ratio of one executive job lost to two non-executive jobs economy-wide, as suggested by the QLFS data, is much better than one would usually expect in the circumstances.

However, it is very likely that compensation for retrenchment is not shared as fairly, with executive employees in a better position to bargain for compensation and ensure that they get it, than workers in other categories. Many non-executive workers may not even be entitled to any compensation, working as they do in small companies not covered by TEWA.

Retrenchment and closure is only the last option in a list of strategies deployed by companies to deal with the crisis. There is evidence that many companies have begun to reduce labour absorption rates in a bid to cut costs in the face of falling demand. We turn to these strategies in the next section.

[37] Verbal communication, Mr. Leslie Devendra, General Secretary, Sri Lanka Nidahas Sevaka Sangamaya.

4.3 STRATEGIES TO REDUCE LABOUR ABSORPTION

Companies are reported to be using a variety of methods to reduce labour costs in the face of falling output demand. They are as follows: freeze on recruitment, rationalization of factories, no overtime, reducing number of days of work, eliminating or reducing special allowances and facilities such as food, and travel, no increments or bonuses, and offering work only at half pay.

There is a freeze on employment almost across the board so that the workforce gets downsized automatically with the natural rate of labour attrition. For example, in the apparel sector, the natural rate of labour attrition is between 4 and 6 per cent per month. But with the freeze on recruitment that has been in place since September 2008, the workforce naturally downsized by 15-20 per cent by March 2009.[38] As their workforces shrink, production lines close down. Those companies with several factories have closed down some production lines and operate only what they can with incumbent workers, and with workers who are willing to move.

Employers are also offering less work. Formerly overtime work was offered on weekdays, on Saturday afternoon and on Sundays (frequently in excess of the statutory maximum). With the onset of the economic crisis, overtime work has been slashed and in a bid to cut costs further, employers have sought the permission of the Department of Labour to have a five day working week with the factories closed on Saturday, but the usual Saturday morning working hours distributed over the week. While the Department of Labour and unions have agreed to this, provided both employers and workers in individual factories are agreeable, employers are unable or unwilling to pay overtime rates for re-distributed hours as required by law.[39] While this stalemate goes on, anecdotal evidence suggests that many employers are working their factories five days a week anyway and are not paying overtime rates for the extra hours worked in a day. There are also reports that in some factories workers are being required to take their holiday leave. In other factories workers are being asked to simply not turn up for work for the next two months. This situation is particularly critical in the plantations sector, where employers have been unable to offer workers even 16 days of work per month when prices have been low, particularly during the first few months of this year.

Companies are also reducing or eliminating special allowances and facilities. Since the statutory minimum wage is too low to attract workers, employers have been accustomed to keeping the statutory minimum as the base wage and making up the shortfall between the minimum and the market-determined rate with attendance allowances, overtime and holiday payments, which are within the discretion of the employers. As a result, a machine operator's take home pay would be, typically, at least twice as much as the base wage. Moreover, the majority of factories provided at least one free or heavily subsidized meal and many factories provided transport. However, with the onset of the economic downturn and the need to cut costs,

[38] Verbal communication, Mr. Ajith Dias, Chairman, Joint Apparel Association Forum.

[39] The employers' position is that given that the enterprise seeking flexible hours of work is struggling for survival, it is only fair that permission be given to spread over the hours of work without any payment of overtime from Monday to Friday. Employers also cite the now repealed Fuel Conservation Law of 1978 which set out this work arrangement without payment of overtime. This position was articulated by Mr. Ravi Peiris, Director General, Employers' Federation of Ceylon at the workshop to present the preliminary findings of the ILO Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka, The Palm Lounge, Galle Face Hotel, Colombo, 16 June 2009.

employers have reduced these allowances and cut costs on food and transport. This has effectively translated into a drastic wage cut – sometimes up to a half – which has forced many workers to give up their jobs voluntarily. The closure of factories and redeployment of workers in other factories have also forced workers to resign, as they have been unable to commute to the new location.[40]

Many companies have notified workers that they will not be able to pay bonuses or increments this year. In fact, many employers have requested unions that they continue with the Collective Agreements signed last year as they cannot afford to pay any increments.

Some companies have denied bonuses and increments for executives and have instituted wage cuts progressively. For example, Brandix Group is reported to have pruned the wages of executives by 40 per cent and those of lower occupation groups by 20 per cent.[41] MAS Holdings Ltd. has instituted similar progressive measures. But unions allege that in many companies the axe has fallen regressively, with the decision-making executive staff jealously guarding their customary levels of remuneration and allowances while workers have had to bear the full brunt of adjustment through wage cuts and job losses. This last fact has been attested to not only by unions but by many individuals interviewed during the course of this assessment.

4.4 EVALUATION OF EMPLOYERS' RESPONSE TO THE CRISIS

Employers' responses to the crisis have, by and large, been reactive rather than proactive and appear to have focused primarily on cutting labour costs. This is to be expected as most employers are running labour-intensive operations and labour comprises a large share of total costs. In fact, in labour-intensive industries, the number of employees is directly linked to the volume of business and if the volume of business contracts, then it is inevitable that a commensurate number of employees become redundant.[42] At the same time, as news of retrenching in one company spreads, others may follow suit, without considering whether they really need to cut jobs themselves, or whether they can institute alternative cost-cutting and productivity enhancing measures.

It has been pointed out that retrenchment can be more costly than it appears at first glance. The hidden costs of retrenchment can include losses of skills, institutional memory, employee morale, efficiency, quality and goodwill. It can also enhance administrative time and legal costs.[43] Some companies, which hurriedly implemented voluntary retrenchment schemes with the onset of the crisis, are now said to be looking for ways to re-hire some of the workers laid-off as they have found that they are vital to their operations.[44] Downsizing can also set off a spiral of labour shedding and has been likened to corporate anorexia which can make the firm leaner and thinner, but not necessarily healthier (Hamel and Prahalad 1994).

[40] Verbal communication, field workers of the National Workers Congress and Mr. Wasantha Samarasinghe, General Secretary Inter Company Employees' Union.

[41] The Inter Company Employees' Union's report to the Department of Labour on institutions where various disputes have arisen, as a result of the economic slump.

[42] Comment by Mr. Ravi Peiris, Director General, Employers' Federation of Ceylon at the workshop to present the preliminary findings of the ILO Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka, The Palm Lounge, Galle Face Hotel, Colombo, 16 June 2009.

[43] Presentation by Mr. Gotabhaya Dasanayake, , Senior Specialist on Employers' Activities, ILO-SRO, New Delhi, at the Symposium on Global Recession and Strategic Options for Employment Restructuring, 14 May 2009, Water's Edge, Colombo

[44] Presentation by Mr. Ravi Peiris, Director General, Employers' Federation of Ceylon, at the Symposium on Global Recession and Strategic Options for Employment Restructuring, 14 May 2009, Water's Edge, Colombo.

The challenge is to adopt a pro-active approach to adjusting to the crisis and consider alternatives to shedding labour which would not simply cut the corporate fat, but build future muscle (ibid.). Elements of such an approach could focus on alternative cost saving measures, greater functional mobility and multi-skilling, and alternative work schedules.[45] Focus on productivity and quality enhancement measures have also been proposed. However, any measures that increase the load of existing workers is likely to be resisted since the laying off of casuals, on the one hand and trimming of allowances, on the other hand, have had a pincer effect on employees.

There is some evidence that members of the Employers' Federation of Ceylon are looking to methods other than labour retrenchment to adjust to the crisis. Preliminary results of the survey of employers conducted by the Employers' Federation of Ceylon show that many employers are deploying methods such as job rotation, re-location, multi-skilling, changes in work arrangements, reducing the hierarchical structure and assigning direct responsibility to employees, effective management of overtime and improvement of productivity through goal setting, to cope with the economic downturn.[46]

While the corporate sector may have access to information about alternative measures to survive the economic downturn without job losses, the majority of employers, particularly small and medium businesses may lack both the information and the management skills to follow suit. Smaller businesses, since they operate very close to the margin, may also lack the time and financial space to implement such measures. Nevertheless, encouraging a proactive approach among this sector by providing the necessary information, either through the chambers of commerce and industry, the banks, or through NGOs involved in entrepreneurship development, such as Sarvodaya's SEEDS, may yield some dividends both in terms of saving jobs and building business muscle instead of fat.

Even when companies have no alternative other than to lay-off workers, they can ease the trauma for workers by helping them to find alternative employment through their network of contacts and by encouraging laid-off workers to register with job placement agencies such as JobsNet and Topjobs.[47] Furthermore, the Employers' Federation of Ceylon has offered to provide Entrepreneurship Training to retrenched employees of their member companies. However, none of the companies had taken-up this offer as of mid-June, 2009.[48]

4.5 COPING STRATEGIES OF LAID-OFF WORKERS AND IMPLICATIONS FOR POVERTY

Many factory workers laid-off because of the crisis are migrants from rural homes and avoid going back if possible. Field workers of trade unions working in and around the Katunayake and Biyagama Zones report that the majority of laid-off workers try to find informal work in the area, rather than go back to their villages and be a burden to their families. Besides, these workers are used to sending home part of their wages in order to support their

[45] Presentation by Mr. Gotabhaya Dasanayake, Senior Specialist on Employers' Activities, ILO-SRO, New Delhi, at the Symposium on Global Recession and Strategic Options for Employment Restructuring, 14 May 2009, Water's Edge, Colombo.

[46] Observations by Mr. Ravi Peiris, Director General, Employers' Federation of Ceylon at the workshop to present the preliminary findings of the ILO Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka, The Palm Lounge, Galle Face Hotel, Colombo, 16 June 2009.

[47] Presentation by Mr. Gotabhaya Dasanayake, Senior Specialist on Employers' Activities, ILO-SRO, New Delhi, at the Symposium on Global Recession and Strategic Options for Employment Restructuring, 14 May 2009, Water's Edge, Colombo.

[48] E-mail communication, Dr. Dr. K L Chandratilleke, Head of Training, The Employers' Federation of Ceylon.

families and do not want to face the humiliation of returning to their villages as dependents.[49]

There are reports that factories which lay-off workers to cut costs are increasingly outsourcing to small sub-contracting units. Workers who had been skilled machine operators in the factories and who had been getting a take home pay of about Rs. 18,000, are now employed as trainees in sub-contracting units earning about half this amount. In addition, they do not enjoy any of the other facilities that they had when working in formal employment. Others are taking up casual, informal work in enterprises, such as bakeries.[50]

Compared to such workers, construction workers who have been laid-off probably do go back to their rural homes. It is possible that the sudden return of large numbers of construction workers into the agricultural labour market may push down wages there. There is some anecdotal evidence in support of this trend in certain areas such as Polonnaruwa.[51]

However, while laid-off formal workers in urban areas try to survive in informal employment and construction workers move to agriculture, many workers affected by the crisis have no other options. A traditional safety valve for rural distress is, for example, migration of some family members to urban areas and overseas for employment. With the crisis cutting off both these safety avenues, the rural poor could be in desperate straits. Of particular concern is the plight of plantation workers, who work on estates, as well as undertake casual labour in small holdings in adjoining villages. The fall in price associated with the crisis wiped out both local avenues of employment and income. Faced with usual barriers to labour mobility, such as geographic isolation, language barriers and the lack of identity cards, the poverty situation of plantation households could have been dire if the price slump had continued. However, by June 2009 prices had recovered to some extent and the impact of the crisis on poverty may not be as severe as feared at the beginning of the year.

While we can expect poverty to increase in all three sectors, the rise in poverty in the plantations sector gives rise to concern because poverty rates in the plantations have increased significantly since 1990, whereas they have decreased in urban and rural areas. Sectoral poverty estimates set out in Table 4.14 show that between 1990 and 2007 urban poverty incidence dropped from 16 per cent to 7 per cent, and rural poverty dropped from 30 per cent to 16 per cent. But poverty on the estates increased from 21 per cent to 32 per cent.

Greater job losses among males are likely to have a bigger impact on the welfare of households, than job losses among females. The analysis in section 4.2, based on QLFS data revealed that the majority of laid-off workers are males. This is to be expected as males make up two thirds of the workforce. However, this has more serious implications for poverty as the majority of these males are their families' principal and sometimes only, breadwinners.

In the next chapter we look at the impact of the crisis on industrial relations.

[49] Verbal communication, field workers of the National Workers Congress.
[50] Verbal communication, field workers of the National Workers Congress.
[51] Verbal communication, Mr. Wasantha Samarasinghe, General Secretary Inter Company Employees' Union.

Table 4.14: Poverty in Sri Lanka (% of Total Population), 1990-2007

Poverty Indicators	1990-91	1995-96	2002	2006-7
Poverty incidence	26.1	28.8	22.7	15.2
Poverty gap	0.056	0.066	0.051	0.031
Poverty severity	0.018	0.022	0.016	0.009
Poverty incidence by sector				
Urban poverty	16.3	14	7.9	6.7
Rural poverty	29.4	30.9	24.7	15.7
Estate poverty	20.5	38.4	30.0	32.0
Poverty incidence by region				
Western	21	18	11	8
North Central	24	24	21	14
Central	28	37	25	22
Northwest	25	29	27	15
Southern	30	33	28	14
Sabaragamuwa	31	41	34	27
Uva	33	49	37	24

Source: World Bank (2007) for 1990 to 2002; Department of Census and Statistics (undated) for 2006-7. Data excludes Northern and Eastern Provinces.

IMPACT ON INDUSTRIAL RELATIONS

5.1 INDUSTRIAL RELATIONS

Historically, industrial relations in Sri Lanka have been fractious and confrontational. The main reason for this is the weak institutional base of an industrial relations system founded on the premise that a sound labour relations system can be prescribed through law. Hence the system emphasizes the settlement of disputes rather than their prevention (de Silva 2004).

The system has also been described variously as (a) lacking in flexibility since the legal framework is rigid, giving rise to a rights-oriented work ethic; (b) lacking in transparency and characterized by a lack of trust, with industrial partners adopting adversarial approaches to interaction; (c) one where training and development is confined to qualification acquisition; and, (d) one where measures to enhance productivity are limited to policy papers and documents.[52] However, the amendment to the Industrial Disputes Act in the early years of this decade which made anti-union discrimination an offence, has seen a falling off of industrial action from the extraordinary levels experienced in the early 1990s, when a change of political regime ended the repression of the 1980s. It could also be argued that since the 1990s, enhanced rates of economic and social mobility have blurred old class distinctions and given rise to a new generation of employers and workers who have a more democratic view of the employer-employee relationship.

Despite this backdrop, the global economic downturn has further skewed the traditional unequal bargaining power between workers and employers[53] in favour of employers. Of course, this is no victory for employers anxious to save their businesses and their own livelihoods. Even so, employers are certainly better placed in terms of savings and assets to weather the crisis, unless their assets have been invested with the Golden Key Group.

In this lose-lose environment, where employees are set to lose proportionately far more than employers, industrial relations are noticeably cooperative. Workers and unions are desperate to save jobs. Through the media they are well-informed about the global crisis and are anxious not to precipitate any situation that will bring down the sword of Damocles hanging over their heads.[54] Therefore, they have stoically complied with various measures taken by employers to reduce labour absorption rates without resorting to dispute. Nevertheless, relations are under strain. In many factories the retrenching of casual workers has increased the work load of remaining workers. For example, where earlier a worker had to carry one load up a flight of stairs, now she has to carry two such loads or three.[55] This sort of situation is certainly not sustainable in the medium-term.

With the unequal bargaining power shifting further in favour of employers, it becomes incumbent on the state to step in to redress the balance, and we will discuss the response of the labour authorities in the next section. However, the media and non-Governmental organizations other than unions could also play a role in investigating and exposing cases of abuse by employers. Nevertheless, by and large the panic,

[52] Presentation by Mr. Ravi Peiris, Director General, Employers' Federation of Ceylon, at the Symposium on Global Recession and Strategic Options for Employment Restructuring, 14 May 2009, Water's Edge, Colombo.

[53] It should be noted that legislation protecting workers' rights and conditions of work the world over is based on a tacit recognition of the unequal bargaining power that exists between employers and workers in the employment relationship.

[54] As Mr. Wasantha Samarasinghe, General Secretary of the Inter Company Employees' Union put it in the pithy Sinhala idiom, 'We don't want to poke the eye of the child who is about to cry'.

[55] Verbal communication, Mr. Leslie Devendra, Sri Lanka Nidahas Sevaka Sangamaya.

confusion and intensity of the crisis are likely to cause many workers to fall through the cracks. This underlines the need to provide safety nets for laid-off workers by some other means. The crisis has also painfully highlighted the fact that despite periodic attempts to reform Sri Lanka's social protection infrastructure, little has changed over the past two decades. These issues will be discussed in more detail in Section 6.

5.2 RESPONSE OF THE LABOUR AUTHORITIES

Anxious to save jobs, the labour authorities are striving to provide employers with as much flexibility as possible within the law to sustain their businesses. Three such measures are worth noting: temporary layoff; a relaxed working week; and, deferred EPF and ETF payments.

First, companies are permitted temporary lay-off for a period of 3 months on half pay if they apply to the Commissioner General of Labour and he grants approval. If, after the three months, the employer is still unable to resume operations as normal, he or she would need to apply for temporary lay-off again. However, if workers are to be laid-off permanently and a voluntary retrenchment package cannot be agreed upon, then companies would need to apply to the Commissioner of Labour for permission to retrench.

Second, as discussed in section 4.3 above, the Department of Labour has been willing to administratively relax the working week in workplaces where both employer and unions have agreed to shift the hours usually worked on a Saturday to the five working days of the week. Unions have agreed to this policy but no agreement has been reached on the issue of overtime due on extra hours worked. Therefore, the issue is still outstanding.

Third, the labour authorities have permitted employers to pay all EPF and ETF dues other than the contribution of employees in installments during a period of 36 months compared to the 6 months permitted earlier. The surcharge on deferred payments continues to apply. Employers are obliged to forward employees' contributions to EPF, since these payments are deducted from employees' pay regardless of whether or not the employers' contributions have been deferred.[56]

While the labour authorities' efforts to be as flexible as possible must be commended, the situation appears to be unhealthy, to say the least. While companies are certainly facing very hard times, the impact of the global slump on the unequal bargaining power between employers and workers may provide employers with a carte blanche which may be abused. There is certainly anecdotal evidence presented by unions that employers are taking advantage of the crisis and the resource constraints that the Labour Department faces (the department does not have the time nor the resources to go into each and every case in detail), in order to rid themselves of workers that they would have found hard to lay off earlier.

It is unclear whether current industrial relations institutions and mechanisms can

[56] Verbal communication, Mr. W.J.L.U. Wijayaweera, Commissioner General of Labour.

ensure that the costs of adjustment are distributed more fairly between workers and employers at the level of the enterprise.

For example, even though the labour authorities have set up committees to take decisions on granting temporary layoffs, the processes of complaint, inquiry and decision-making that take place within the Labour Secretariat remain vulnerable to pressures brought to bear by various parties. In fact, both employers and unions seem to prefer to operate through networks of influence, rather than through established institutional procedures. This is possibly because decades of political interference have distorted those same institutional procedures and made them less effective than seeking solutions through one's contacts and flexing one's political muscle when necessary.

A clear separation of the processes of lodging complaints, of monitoring/investigation and decision-making about terminations and other administrative relief measures within the secretariat, may enable labour authorities to insulate themselves from pressures from either side and take a more informed view of the situation. For this, the department also needs to enhance its monitoring activities in the field, and concentrate much more on enterprises which are non-unionized. The department may need to require employers to submit detailed information on proposed cost adjustments on several fronts in response to the crisis, when seeking relief from the authorities. It may also need to deploy its field staff to investigate further, in order to have more independent information on which to base its decisions.

However, the process of inquiry does need to be speeded up so that employers who are forced to retrench workers to adjust to the crisis can do so quickly. Out of 191 applications received this year to terminate 1144 employees, 60 inquiries were completed by end June 2009. One reason why the process can take long is that lawyers appearing for workers and employers can delay proceedings.[57] However, many labour officers are familiar only with the public sector and have very little experience or understanding of the world of business. Hence they are unable to respond quickly with realistic measures to provide relief to employers. In the medium term, labour authorities should consider enhancing the human capital of their officers through measures, such as industrial placement and training in business administration. The Universities of Colombo and Sri Jayawardenapura, as well as the Postgraduate Institute of Management, offer postgraduate courses in business management, and the labour authorities can consider encouraging their officers to follow such courses as part of their human capital development.

While the intensity of the current crisis has made it necessary for the labour authorities to provide flexibility to employers about paying Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF) dues, it should be noted that many companies in difficulties have been allowed to defer payment (subject to a surcharge) of such dues other than for employees' contributions, even when times were good. It is likely that this policy may have done more harm than good as it helped to lock resources, including labour in companies that were inefficient and

[57] Observations by Mr. D. L. Kumaradasa, Additional Secretary, Ministry of Labour Relations and Manpower, at the workshop to present the preliminary findings of the ILO Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka, The Palm Lounge, Galle Face Hotel, Colombo, 16 June 2009.

uncompetitive, making them even more vulnerable to closure when the present crisis hit. Rather than striving to save jobs all the time, labour authorities should allow companies to fail and resources be redeployed in the economy when the economy is expanding as it did before the crisis hit, so that companies become better able to adapt and survive when times are hard.

In this chapter we have looked at how the tripartite constituents of the industrial relations system are responding to the impact of the global economic crisis. In the following chapter we look at the measures taken by the Government to deal with the crisis.

6

GOVERNMENT'S RESPONSE

The crisis has caught the Government unaware and unprepared, as it has governments all over the world. Besides, the political leadership has been preoccupied with the considerable demands of military and humanitarian operations in the North, provincial council elections in the south and diplomatic manoeuvres abroad. The task of directing the economy has fallen to the monetary authorities at the Central Bank and to the Ministry of Finance. However, as the oil price began to fall, the Central Bank's macroeconomic strategy began to come apart and the monetary authorities spent most of the last quarter of 2008 denying that Sri Lanka would be affected by the international financial crisis. By December 2008 it had become clear that exporters were in trouble, prompting the Ministry of Finance to come up with a stimulus package to be implemented through the Export Development Board. A couple of months later it became apparent that notwithstanding the sincerity of its intentions, the Government could not finance it. Until February 2009 the Government denied that IMF assistance would be sought to address the unfolding balance of payments crisis, but by March it was forced to begin negotiations for a bailout of USD 1.9 billion. As the IMF succumbed to pressure from the US Government and delayed the loan,[58] the Government sought credit lines from India, China and Libya. However, Government's defeat of the LTTE in May saw the economy attract foreign exchange inflows which helped ease the balance of payments crisis. By 24 July 2009, the IMF standby also came through.

In what follows we review the measures the Government has taken thus far to respond to the crisis. We also highlight constraints that policy makers are likely to face in providing relief to those affected. In particular, we underline the lack of an effective income support mechanism to provide assistance to those likely to fall into poverty or to those whose poverty is likely to be aggravated as a result of the international economic downturn.

6.1 STIMULUS MEASURES

The Government's response to the crisis consists in the main of four measures to stimulate the economy. While we describe them in what follows, it will be apparent that some of these measures aimed to compensate for the negative consequences of certain macroeconomic policies on exporters.

It is uncertain how effective these stimulus measures could have been against a backdrop of macroeconomic imbalances that worked against export competitiveness. In particular, the costly defence of an over-valued exchange rate, the failure to pass on the full effects of the decline in oil prices in world markets to producers and consumers, and the Government's failure to pay contractors for construction work, caused major distortions. Besides, supply-side measures, such as export stimulus packages can achieve results only in a climate of expanding demand, not in an economic slump. It may make more sense for the Government to correct the macroeconomic distortions and leave the rest to exporters, and use whatever fiscal wherewithal it has to shore up consumption so that at least enterprises

[58] Inaugural address by the Hon. Sarath Amunugama, Deputy Minister of Finance, at the Conference on Protecting the Poor in Sri Lanka in Crisis and Beyond, 24 June 2009, at the Ceylon Continental Hotel, Colombo, organized by the Institute of Policy Studies and the World Bank, Sri Lanka.

producing for the domestic market can maintain production and employment levels. Paying local contractors for the construction work that they have undertaken on the Government's behalf is likely to achieve much in this regard and can act as a classic Keynesian fiscal stimulus. The change in the security situation brought about by the defeat of the LTTE in May this year is also likely to create the conditions for such a stimulus, as work on rehabilitation and reconstruction, for which donors have already pledged funds, systematically begins.

Export Development Reward Scheme

The scheme implemented by the Export Development Board will grant a reward of 3 per cent of quarterly export earnings to exporters trading continuously since January 2006 if, (a) they can maintain at least 90 per cent of their export values for each quarter compared with the corresponding quarters of 2008; and (b) if they maintain employment levels as declared by the EPF and ETF returns as at the third quarter of 2008. The reward will be increased to 5 per cent of export values for exporters who equal or exceed their quarterly export proceeds.

Exporters have welcomed the policy measure but have pointed out the impossibility of meeting eligibility criteria in a shrinking export market.[59] Since world commodity prices are also down, exporters have pointed out that it will be very difficult to maintain export volumes at last year's levels. Besides, it appears that exporters were looking to the export reward scheme to partly compensate for the effects of the over-valued exchange rate.[60] While the National Council for Economic Development (NCED) is still working out a suitable formula to calculate the component of value addition for determining eligibility, many exporters have pointed out that the one-size-fits-all package fails to target assistance to those who really need it. For example, it has been pointed out that while the earnings of apparel exporters continued to grow during the first quarter of this year, they would stand to benefit from the stimulus package without really needing it.[61] In any case, the Government has yet to raise the finances needed to implement the package. For example, even by the first week of July 2009, the Department of Commerce was looking to receive Rs. 8 billion from the Government to finance the reward scheme. The funds are to be raised through a supplementary budget.[62]

It is clear that the export reward scheme is predicated on exporters finding new markets in order to meet the eligibility criteria of maintaining export earnings at 2008 levels. As traditional markets in Western trading partners are hit by recession, exporters need to find new buyers in emerging markets such as India, China, and other Asian countries which have not been affected as badly by the crisis. However, exporters are at present fire fighting, with little energy, time or resources left over to undertake the work involved in finding new markets.[63] Since finding new markets is something which has to be undertaken anyway, regardless of crisis, and since individual exporters do not have the time and resources to do it, it would make more sense for the Government to facilitate the process by strengthening the commercial sections in Sri Lanka's diplomatic missions in

59 Verbal communication, Mr. Ajith Dias, Chairman, Joint Apparel Association Forum (JAAF) and as reported in an interview with Devan Daniel appearing in The Island - Financial Review of 2 and 4 March 2009. According to these reports Mr. Rohan Fernando, President of the National Chamber of Exporters (NCE) had made the same point.

60 Verbal communication, Mr. Ajith Dias, Joint Apparel Association Forum (JAAF).

61 Participant's comments at the Symposium on Global Recession and Strategic Options for Employment Restructuring, 14 May 2009, Water's Edge, Colombo

62 Devan Daniel in 'Rs. 8 bn for EDRS' appearing in The Island - Financial Review - of 8 July 2009.

63 As Mr. Ajith Dias, Chairman, Joint Apparel Association Forum (JAAF), put it, 'Every day we struggle to keep our businesses going, and every night we pray for a devaluation.'

potential export markets abroad. The Ceylon Chamber of Commerce has repeatedly requested the Government to do this.[64] The present context may be appropriate, so that once the economic crisis bottoms out, Sri Lankan exporters will be well poised to steal a march on competitors and penetrate new markets.

Reducing fuel costs

The Government has passed on much of the drastic reduction in fuel and furnace oil prices to industry to help reduce costs of production. In September 2008, furnace oil cost Rs. 70 per litre, and by February 2009, the price had fallen to Rs. 35 a litre. The Government has also passed on some of the benefits of the drop in oil prices to the Ceylon Electricity Board so that the latter was able to remove the fuel adjustment charge of 30 per cent imposed when oil prices were high.[65] Nevertheless, it is apparent that the Government is not passing on the full reduction in the international price of oil to the domestic market, as it is using some of it to bolster its own precarious revenue position.

Increasing liquidity in the financial sector

Aiming to inject liquidity into the financial system, the authorities cut the Statutory Reserve Ratio (SRR) by 75 basis points to 7.0 per cent in February 2009 releasing Rs. 9 billion to banks. This followed an earlier cut of 225 base points in October 2008 which also released tens of billions of rupees to the banks. The Central Bank also allowed banks to borrow one month's liquidity requirement in March 2009 in order to ease the credit crunch.

However, such measures could have little effect when the Government was simultaneously defending the exchange rate as it was at least four months into the crisis. This caused a significant outflow of foreign reserves with knock-on effects on the liquidity situation in the domestic financial system. But just as inflation rates declined and the Central Bank allowed the rupee to slide, the Government's military victory in May 2009 saw confidence in the rupee soar. The monetary authorities may now have to think of ways to prevent a Dutch Disease effect that may exert upward pressure on the exchange rate again, as funds flow in for rehabilitation and reconstruction. In fact, by the end of July 2009 the Central Bank auctioned off Rs. 7 billion worth of short term bonds to buy up dollars in order to prevent the rupee from appreciating and to build up Sri Lanka's foreign currency reserves.[66]

With the economic crisis raising the banks' non-performing loans across the board, investors are looking to less risky assets, such as Treasury Bills and fixed deposits to invest their funds. Credit is being rationed credit to individuals and corporate clients with high net worth. It has become very difficult for small and medium enterprises to access credit for working capital.

While the state-owned banks reduced lending rates by 2-3 percentage points at the beginning of April, it remains to be seen if other banks will follow suit and whether it will have a significant impact on the availability of credit. Contractual obligations on high interest paying deposits may inhibit private commercial banks from making substantial rate cuts.

[64] Verbal communication, Ms. Subhashini Abeysinghe, Economic Intelligence Unit, Ceylon Chamber of Commerce.
[65] Verbal communication, Mr. S.R. Attygalle, Director General Fiscal Policy, Ministry of Finance.
[66] Devan Daniel in The Island - Financial Review - of 8 July 2009.

Tax relief

In order to help cash flows of companies affected by the crisis, the Government has exempted companies in the manufacturing and hotels sectors from paying the economic service charge during the calendar year of 2009.[67]

6.2 SOCIAL PROTECTION

Sri Lanka's social protection system is patchy and fragmented and does not have the capacity to respond to the needs of those who lose their jobs because of the crisis, unless they are in companies which are covered by and comply with the requirements of the TEWA. The system has long-needed reform, and though the necessary technical analyses have been carried out, implementation of reforms has been very slow.

The Government's attention thus far has been focused on efforts to protect jobs by promising stimulus measures to companies. This is to be expected because, as demonstrated in other countries affected by the crisis, businessmen and women form highly visible and highly vocal lobby groups, demanding attention and assistance. However, as noted earlier, and as policy makers in other countries have begun to realize, stimulating supply is no solution for a crisis marked by a collapse in consumer demand. Measures to deal with the crisis in other countries such as the US, Australia and China have now been extended to shore up consumption and facilitate future growth through cash grants and classic Keynesian-type stimuli, such as public sector infrastructure projects.

Sri Lankan policy makers are yet to pay attention to the likely social consequences of the international economic crisis. The lack of fiscal space, even for the promised help to businesses, could be one reason. The other could be that in Sri Lanka, the impact on consumers through the unemployment channel is only just beginning and has yet gone unnoticed. Nevertheless, the months to come are likely to see more people fall into poverty, while the traditional safety valves, such as migration to urban areas and abroad close up.

Sri Lanka lacks an effective mechanism to provide social protection for those who really need it. Formal employees in the public and private sectors have access to standard types of social protection. For example, public employees are entitled to pensions funded by the state, while private sector workers in formal employment have provident funds (EPF and ETF) paid out in a lump sum financed through employer-employee contributions. While the ETF is more flexible about allowing members to withdraw their balance on change of employment status, the EPF is not.

Three public social security schemes provide benefits for farmers, fishermen and self-employed persons in the informal economy. But the schemes are voluntary and limited in personal coverage ((International Labour Office 2008).

At present, the only social protection that retrenched formal employees in the private sector are entitled to is the retrenchment payment set out in TEWA. And note that those

[67] Verbal communication, Mr. S.R. Attygalle, Director General Fiscal Policy, Ministry of Finance.

entitlements are limited to employees of companies employing more than 15 workers. However, there are no guarantees that working in larger companies will ensure compensation: as noted in Section 4.2, while some employers are able and willing to pay compensation according to the formula, others are not. Those who cannot pay the formula pay only what they can, and in many cases workers accept it, fearing that as conditions worsen they might not get even that. Employees of larger establishments whose owners evade the law as they are not monitored by unions or the labour authorities, and employees in establishments not covered by the size restriction of TEWA, cannot count on compensation.

Besides, while the provisions of TEWA can provide retrenched workers with a cushion when the economic climate is fair to good and retrenchment takes place in a fairly orderly way, it cannot be relied on to provide a safety net in times of severe economy-wide crisis. This is because such crises can deal a crippling blow to the bottom lines of companies, forcing closure. In such a situation, companies may just not have the wherewithal to pay retrenchment compensation. In other words, TEWA, since it relies entirely on the employer's ability to pay compensation, cannot be depended on to provide a safety net in times of covariate shock and cannot play the role of an unemployment benefit insurance scheme. Thus, **TEWA cannot substitute for an unemployment benefit insurance scheme during economic shocks such as the present crisis** which can drastically affect a firm's ability even to maintain operations, let alone pay compensation to retrenched workers.

The onset of the crisis has prompted labour authorities to revive moves to set up an unemployment benefit insurance scheme. Admittedly, the last amendment to the Termination of Employment of Workmen's Act (TEWA) provided for such a scheme: retrenched workers were to receive compensation from employers according to a formula as well as 12 months unemployment insurance at 50 per cent of the last month's pay. But this measure was not implemented at the time due to lack of funds. When unions demanded the repeal of the amendment of TEWA since the unemployment benefit insurance scheme was not implemented as promised, the authorities' response was only to enhance the compensation formula and forget about the insurance scheme.[68]

Setting up an unemployment benefit insurance scheme would require a substantial injection of funds as seed capital. Even if these funds were found, employers and employees would need to contribute towards the fund in order for it to be sustainable and both parties have refused to do this. Employers, in particular, object to the fact that they already contribute towards both EPF and ETF and argue that they cannot be expected to contribute even more. The alternative is to reduce the contribution to the ETF and divert the remainder towards an unemployment benefit insurance scheme and have the funds managed independently of the Government's administrative bureaucracy so that both employers and employees have a sense of ownership over the fund. For example, the present arrangement where the Ministry of Finance handles ETF funds and uses it as a captive source of funds for its own budget

[68] Observations by Mr. T.M.R Rasseedin, General Secretary, National Association for Trade Union Research and Education (NATURE), at the workshop to present the preliminary findings of the ILO Rapid Assessment of the Impact of the Global Economic Crisis on Employment and Industrial Relations in Sri Lanka, The Palm Lounge, Galle Face Hotel, Colombo, 16 June 2009.

management, and employees are forced into the role of supplicants and have to navigate bureaucratic red tape to obtain their dues, is unsatisfactory. While the crisis has made many realize how important it is to have such a scheme, the process of setting it up needs to be started even now if Sri Lankan workers are to benefit from such a scheme at least in the future.

Meanwhile, the Samurdhi programme, the core of the national system of social assistance, can provide only limited assistance due to reasons we discuss below.

The Samurdhi Programme

Even as a poverty alleviation programme Samurdhi has long suffered from many weaknesses. For example, until very recently, the programme lacked explicit selection criteria which resulted in glaring targeting errors. In 2002, the programme was found to exclude about 40 percent of households in the poorest consumption quintile while spending 44 percent of the budget on households in the top three quintiles (World Bank 2007). It covered 33 percent of the population in 2008 (Central Bank of Sri Lanka 2009), and since only 15.2 per cent of Sri Lankans are poor, spreads the benefits too thinly to have much impact. For example, the maximum cash grant a household can get under Samurdhi is Rs. 1500 per month and that only for a household with at least 6 members. But so long as ineligible individuals remain such a large proportion of beneficiaries, it becomes difficult to increase the size of the grant in any meaningful way. At the same time, the real value of the income transfer has eroded over the years and although in 2006 the Samurdhi cash grants were increased by 50% (Central Bank of Sri Lanka 2007), this one-off increase was hardly sufficient when inflation increased by 142% (Colombo Consumers' Price Index) over the preceding decade.

Policy makers have been aware of these weaknesses and some effort at reform was made beginning in the early 2000s. But it has been difficult to maintain the momentum of reform because of vested political interests, particularly at grass-roots level. Initially, the World Bank provided technical assistance to develop eligibility criteria for the income transfer which was to be implemented through the Welfare Board set up by the Welfare Board Act. While the World Bank developed a proxy means test formula (PMTF) to select beneficiaries, this proved impractical on implementation as the formula adopted a one size fits all approach and did not take into account variations in local conditions. For example, the formula considered the size of land owned rather than productivity of the land as a criterion. Thus, while the PMTF may not be an appropriate methodology for heterogeneous communities, high rates of economic growth of the sort Sri Lanka has been experiencing in recent years, can make it unreliable.[69]

Given the limitations of the PMTF methodology, officials of the Samurdhi Commissioner General's Department in charge of implementing the income transfer component are developing more appropriate eligibility criteria through community participation and screening methods. The first

[69] E-mail communication, Dr. Nimnath Withanachchi, independent consultant and formerly Social Protection Economist, World Bank, Colombo.

phase of methodology development (2006/2007) had communities develop their own poverty indicators according to local conditions. The community then categorized members into five groups according to these criteria: chronic poor, destitute, poor, middle income earners and high income earners. This was called 'New Methodology of Family Categorization'. A comparison of those receiving Samurdhi with the community's own classification enabled the authorities to weed out 133,000 recipients and reduce numbers receiving the grant from 1.9 million to 1.6 million. In a second phase of development (2007/2008), officials added a wealth ranking system (New Methodology of Family Wealth Ranking) and implemented it in Eastern Province. The Centre for Poverty Analysis (CEPA) provided on-hand technical support while the methodology was being developed in the field and later helped train 50 Samurdhi managers in the new methodology, who in turn trained 500 more. Technical assistance was also obtained from the highly successful, World Bank-funded Gemidiriya Programme.

The new methodology has the key advantage of having a high degree of community acceptance as the indicators are first developed by the community and then used to decide who is poor and who is not. But how successful it is largely depends on the capabilities of the facilitator who has to be able to withstand pressures from community elites. There also need to be proper guidelines to support the process. Another disadvantage is that it has poor 'inter-rater reliability'. That is, the ranking or the classification of households according to wealth/ income/ socioeconomic status is likely to change if the process is repeated using a different facilitator. Nevertheless, it has been suggested that community screening methods of the sort that the Commissioner General's Office has been developing, backed by sound guidelines and the process implemented by trained facilitators, may be the most appropriate targeting methodology for the Sri Lankan context.[70]

Nevertheless, the methodology has proved difficult to implement outside the Eastern Province because of political economy factors. Resistance to reform comes from three sources: local level politicians who do not want their key supporters to be ejected from the programme; Samurdhi development officers who feel that they may lose their jobs if numbers decrease; and, Samurdhi Bank officers who are resisting change because the viability of the banking system depends on the participation of the non-poor who have threatened not to repay their loans if they are removed from the income-transfer programme. Therefore, while Samurdhi officials have been able to insist that new entrants to the programme need to satisfy the new eligibility criteria, it has been difficult to apply these criteria to weed out undeserving beneficiaries who are already in the system. Nevertheless, some progress and streamlining targeting overall has been made with the proportion of community members getting Samurdhi being roughly equal to the poverty ratio in 80 out of 340 Divisional Secretary's Divisions. [71]

Technically, workers who are laid-off because of the economic crisis can apply to receive

[70] E-mail communication, Dr. Nimnath Withanachchi, independent consultant and formerly Social Protection Economist, World Bank, Colombo.
[71] Mr. W.L.J.S. Wijayaweera, Commissioner General, Samurdhi.

Samurdhi. However, as of 10 June 2009, not a single such worker has applied for the income transfer.[72] This may be because the grant is too small to make a significant difference to the circumstances of such workers, whereas working in almost any sort of informal employment will enable them to earn much more. Secondly, families of such workers may already be receiving Samurdhi benefits, considering the targeting issues that the programme faces, and hence cannot apply for more support. **Therefore, the Samurdhi Programme in its present form is not a suitable mechanism to provide support to those who are likely to experience critical consumption shortfalls as a result of the economic slump.**

The likely social consequences of the global economic crisis have underlined the costs of delaying much needed reforms in the social protection sector: these reforms include setting up an unemployment benefit insurance scheme, consolidating existing social security systems, increasing coverage to certain segments of workers such as construction workers, and enhancing the effectiveness of Samurdhi. Donors, including ILO have provided substantial technical support for reform over the years. The 2004 tsunami also provided added impetus, but progress has been very slow, while systems put in place during the tsunami, such as emergency cash grants, were not maintained.

Policy makers urgently need to grasp the nettle of social protection reform. Among the reforms urgently needed are the integration and consolidation of existing schemes; addressing gaps in coverage, such as the lack of an unemployment benefit insurance scheme, and addressing the special needs of construction workers; implementing Samurdhi's new targeting criteria and increasing the size of support. For example, the cash grant injection scheme operated during the tsunami and disbursed through bank accounts set up for victims in the state-owned banks can be modified and deployed as a general social protection scheme for people facing sudden shocks, such as natural disasters and economic shocks, such as the current one. Social protection measures also need to address the needs of currently internally displaced and disabled ex-combatants and non-combatants once they are resettled in their places of origin. If policy makers can quickly work out a credible mechanism for disbursement, it may be possible to solicit donor assistance to provide emergency relief to those affected by the crisis and needing support.

There does not seem to be much in the way of interagency donor action as yet on the part of donors to assist with the impact of the crisis. Both the World Bank and the ADB offices in Colombo appear to be concentrating on macroeconomic analyses and sector-oriented assistance based on their country lending programmes. Since reconstruction and rehabilitation is about to begin in the North, the two organizations are likely to be committed to provide assistance for these programmes. While representatives of both agencies were very interested in the focus of the present assessment, the representative of the World Bank indicated that the Bank's social protection work is likely to follow its pre-crisis programme. On the other

[72] Mr. W.L.J.S. Wijayaweera, Commissioner General, Samurdhi.

hand, the ADB's representative indicated that if there is a strong case for assistance to be provided for emergency consumption assistance, the ADB may be able to provide some support. Therefore, it appears that there exist opportunities for joint action by the ILO and the ADB to provide assistance to those affected by the crisis.

CONCLUSIONS AND DIRECTIONS FOR POLICY

The impact of the global economic slump triggered by the financial crisis is making its way through Sri Lanka's economy. Transmission is mainly through a contraction in external trade volumes and prices. Migrant remittances are also under pressure, the construction industry has been affected, and tourism has been further challenged. Liquidity in the financial sector has been constrained because of the rise in non-performing loans – in turn due to the contraction in export demand, knock-on effects on domestic suppliers, and crowding out of available funds into 'safer' Government bonds. The crisis' impact on existing macroeconomic imbalances was aggravated by some contradictions in the country's macroeconomic policy stance. Sri Lanka's foreign reserves dwindled rapidly as a result of defending an increasingly indefensible soft dollar-peg. Faced with a looming balance of payments crisis, the Government sought an IMF bailout of USD 1.9 billion which was delayed.

The crisis notwithstanding, the successful conclusion of military operations against the LTTE by May 2009 has brightened Sri Lanka's economic prospects. The economy has attracted inflows of foreign funds since the end of the war which has helped ease the balance of payments crisis and the tourism sector is set for recovery. The end of the war has had a positive impact on business confidence and since reconstruction and rehabilitation can now begin in the North of the country, the process of development can provide a much needed fiscal stimulus that will help mitigate the worst effects of the crisis. An IMF facility of USD 2.6 billion has finally been made available for balance of payments support.

Labour force survey data for the first quarter of 2009 show that compared with the first quarter of 2008, the economy has lost about 30,000 jobs each in manufacturing and trade, and 64,000 jobs in construction. But employment in agriculture has increased by 200,000. The loss of jobs in manufacturing, trade and construction is probably largely due to the impact of the crisis. Since employment in agriculture and services has grown, the crisis has probably encouraged some redeployment of labour from manufacturing, trade and construction to agriculture and services.

Gender-based disaggregation of employment figures shows that while far more men lost jobs than women, the gains in employment were equally shared between the sexes. In terms of skills – proxied by occupation levels – the higher skilled occupations account for roughly a third of the total number of jobs lost. Unfortunately, the data does not allow us to draw any conclusions about the nature and quality of jobs lost and gained.

Available micro data also suggest that the slump in export markets has given rise to closures and lay-offs in the domestic economy. The apparels sector, being the largest, is the worst affected. Many companies have been forced to reduce labour absorption by various means which have had the effect of drastically reducing workers' take home pay. Desperate to hold on to their jobs, workers and unions have largely cooperated with these measures. The labour authorities have also done their best, within the framework of the law, to provide as much flexibility as possible to employers so jobs can be saved. However, it should be noted that while existing jobs are under threat, the global economic downturn will depress the rate of new job creation, seriously affecting the job prospects of vulnerable groups, such as the young, the disabled, and those with lower human capital, as a result of repeated displacement caused by conflict.

Employers' responses to the crisis have focused primarily on cutting labour costs. This is to be expected when most operations are labour-intensive. While companies in the corporate sector may have access to information about alternative measures, such as greater functional mobility, multi-skilling, and alternative work schedules to survive the economic downturn without job losses, the majority of employers, particularly small and medium businesses may lack both the information and the management skills to follow suit. Smaller businesses, since they operate very close to the margin, may also lack the time and financial space to implement such measures. Therefore, encouraging a proactive approach among this sector by providing the necessary information, either through the chambers of commerce and industry, the banks, or through NGOs involved in entrepreneurship development such as Sarvodaya's SEEDS, may yield some dividends in terms of both saving jobs and building business muscle for the future, rather than just cutting fat.

Even when companies have no alternative other than to lay-off workers, they can ease the trauma for workers by helping them to find alternative employment through their network of contacts and by encouraging laid-off workers to register with job placement agencies, such as JobsNet and Topjobs

Job losses in urban areas and the closing up of employment opportunities abroad are likely to impact on poverty levels. The situation in the plantations may become serious, given the high base levels of poverty in this sector, and the transport and other barriers that make it difficult for estate workers to find alternative sources of employment and income.

The crisis has skewed the unequal bargaining power between employers and workers further in favour of employers, even though this is hardly a victory for the latter in the given circumstances. In this lose-lose environment, where employees are set to lose proportionately far more than employers, industrial relations are noticeably cooperative. Workers and unions are desperate to save jobs and have stoically complied with various measures taken by employers to reduce labour absorption rates without resorting to dispute. Nevertheless, relations are under strain.

Unions report that many employers appear to be taking unfair advantage of the situation and that the adjustment to the crisis appears to be largely taking place at the bottom of the occupational hierarchy. Available QLFS data, however, shows that the higher skilled occupations account for roughly a third of the total number of jobs lost. In companies represented by the Employers' Federation of Ceylon, this figure is more than a half. But this could be because higher skilled grades get much higher remuneration packages in the corporate sector and, therefore, laying-off more of them makes greater economic sense. Even so, substantial numbers of lower skilled workers are being laid-off and the situation makes it incumbent upon the labour authorities to obtain detailed information about costs from employers who have applied to terminate workers, and from others who have terminated workers without complying with the provisions of TEWA. Unions can perform a vital role in bringing to the attention of the authorities, cases of violation by employers.

Anxious to save jobs, the labour authorities are striving to provide employers with as much flexibility as possible within the law to keep their businesses going. Three such measures are worth noting: temporary layoff; a relaxed working week; and, deferred EPF and ETF payments. While the labour authorities' efforts to be as flexible as possible must be commended, the situation appears to be unhealthy, to say the least.

It is unclear whether current industrial relations institutions and mechanisms can ensure that the costs of adjustment are distributed more fairly between workers and employers at the level of the enterprise. The processes of complaint, inquiry and decision-making that take place within the Labour Secretariat about granting relief to employers by way of temporary terminations and deferred payment of provident fund payments appear to be operating unsatisfactorily, as both employers and unions seem to prefer to operate through networks of influence rather than through established institutional procedures. A separation of the processes of monitoring/investigation and decision-making about terminations and other administrative relief measures in the Department of Labour may enable the authorities to insulate themselves from pressures from either side and take a more informed view of the situation.

The process of inquiry also needs to be speeded up so that employers who are forced to retrench workers to adjust to the crisis can do so quickly. Many labour officers are familiar only with the public sector and have very little experience or understanding of the world of business. In the medium term, labour authorities should consider enhancing the human capital of their officers through measures such as industrial placement and training in business administration as part of their human capital development.

The Government has responded to the crisis with stimulus packages for exporters, efforts to reduce interest rates and increase liquidity, and by passing on most of the decline in oil prices to consumers. While glaring anomalies in the stimulus package are still being worked out, it is still not clear how effective these measures will be because of several contrary factors. First, the Government's own macroeconomic policies made it a difficult environment for exporters: the monetary authorities maintained an over-valued exchange rate at least four months into the crisis; the structural fiscal deficit soaked up liquidity in credit markets; and the Government is not paying its bills to contractors who have undertaken construction work for the Government. The end of the war has seen the economy attract foreign currency inflows which may cause Dutch disease effects and upward pressure on the exchange rate again. So long as these effects continue, stimulus measures are likely to be palliatives only. Therefore, the Government urgently needs to attend to these problems if the economy is to cope with the crisis.

Second, despite the Government's good intentions, it has been clear to exporters and their buyers that the Government is unlikely to have the fiscal wherewithal to make good its promises of financing stimulus measures. Nevertheless, the IMF standby is likely to help enhance the Government's financial credibility and provide some predictability about economic fundamentals.

Third, as many other countries affected by the crisis are beginning to realize, stimulating supply makes little sense when demand has contracted. There are four ways that policy makers can stimulate demand in the domestic economy. One is to simply pay the money Government owes its contractors in the construction sector. Another is to strengthen the commercial divisions of key Sri Lankan diplomatic missions in emerging markets in Asia in order to help Sri Lankan producers find new export markets. The third way appears to have opened up with the defeat of the LTTE in May 2009. Work on reconstruction and rehabilitation for which donor assistance has been pledged already, can now begin in the North and be accelerated in the East. This will provide a Keynesian stimulus that may help mitigate the worst effects of the crisis. Finally, and most importantly, the Government needs to shore up consumption, but this requires effective mechanisms to transfer incomes to those likely to be worst affected by the crisis: the existing poor whose situation is likely to worsen, and those likely to slip into poverty because of job losses and the termination of remittances from migrant family members in urban areas and overseas.

However, Sri Lanka's social protection system is patchy and fragmented and does not have the capacity to respond to the needs of those who lose their jobs because of the crisis unless they are in companies which are covered by and comply with the requirements of the TEWA. Sri Lanka does not have an unemployment benefit insurance scheme while the Samurdhi Programme, the core of the national system of social assistance, provides too little support and still suffers from targeting problems. The system has long-needed reform, and while eligibility criteria have been developed and refined, there has only been a little progress in implementation because of a variety of political economy factors.

Much needed reforms in the social protection sector include: setting up an unemployment benefit insurance scheme, consolidating existing social security systems, increasing coverage to certain segments of workers such as construction workers, and enhancing the effectiveness of Samurdhi. For this, Samurdhi's new methodology for targeting those who really need the support must be implemented and the size of support needs to be increased. But while Samurdhi provides a safety net for those in chronic poverty, other measures to address the issue of poverty dynamics need to be implemented. For example, the cash grant injection scheme operated during the 2004 tsunami can be modified and implemented through personal bank accounts to make it responsive to the needs of people facing sudden shocks, such as natural disasters on the one hand, and economic shocks such as the current economic crisis, on the other hand.

The impact of the global economic slump on Sri Lanka's poor is likely to be a painful reminder of the costs of evading much needed reforms in the social protection sector. Likewise, the crisis is a reminder that the unemployment benefit insurance scheme proposed in the latest amendment to TEWA never saw the light of day. While TEWA may provide an adequate safety net for retrenched workers when times are fair, it cannot be effective in crises, such as the present. This is because the crisis is forcing closures and bankruptcies, rather than simple retrenchment, with affected companies not having the wherewithal to pay adequate compensation to affected workers.

It is hoped that the crisis will jolt policy makers to grasp the nettle of instituting and implementing effective social protection mechanisms without any further delay.

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APPENDIX

Individuals interviewed during the course of the assessment

1. Abeyratne Banda, A.R.M., Deputy Director of Merchant Shipping, Merchant Shipping Division, Ministry of Ports and Aviation.
2. Abeysinghe, Subhashini, Economist, Ceylon Chamber of Commerce.
3. Ariyaratne, H.A., Executive Vice President, Development Finance Corporation of Ceylon.
4. Astrup, Claus, Senior Country Economist, World Bank Office, Colombo.
5. Attygalle, S.R., Director-General Fiscal Policy, Department of Fiscal Policy, Ministry of Finance and Planning.
6. Devendra, Leslie, General Secretary, Sri Lanka Nidahas Sevaka Sangamaya.
7. Dias, Ajith, Chairman, Joint Apparel Association Forum.
8. Ekanayake, Anura, Vice Chairman, Ceylon Chamber of Commerce.
9. Fernando, Norton, Commissioner of Labour, Department of Labour.
10. Gunaruwan, Gayathri, Consultant Economist, Ceylon Chamber of Commerce.
11. Gunathilleke, K., Acting Additional Superintendent, Employees' Provident Fund Department, Central Bank of Sri Lanka.
12. Lodwick, Gerald, Deputy Secretary-General, National Workers' Congress.
13. Madihahewa, Mahinda, Secretary, Ministry of Labour Relations and Manpower.
14. Menike, U.R.K., Consultant, Migrant Services Centre.
15. Pathmapriya, K.R., Deputy Commissioner, Department of the Commssioner General of Samurdhi.
16. Peiris, Ravi, Director General, Employers' Federation of Ceylon.
17. Ranasinghe, K.D. Acting Additional Director, Economic Research Department, Central Bank of Sri Lanka.
18. Rao, Narhari, Lead Economist, Sri Lanka Resident Mission, Asian Development Bank, Colombo.
19. Ravisinghe, M.J.S., Assistant Commissioner, Department of the Commssioner General of Samurdhi.
20. Ruhunage, L.K., Additional General Manager, Sri Lanka Bureau of Foreign Employment.
21. Samarasinghe, Wasantha, General Secretary, Inter Company Employees' Union.
22. Silva, U.H.E., Acting Additional Superintendent, Employees' Provident Fund Department, Central Bank of Sri Lanka.
23. Wasantha, D., Superintendent, Employees' Provident Fund Department, Central Bank of Sri Lanka.
24. Weerasinghe, P.N., Director and Chief Economist, Economic Research Department, Central Bank of Sri Lanka.
25. Wickremasinghe, Hasitha, Economist, Sri Lanka Resident Mission, Asian Development Bank, Colombo.
26. Wijayaweera, W.J.L.U., Commissioner General of Labour, Department of Labour.
27. Wijayaweera, W.J.L.S., Commissioner General of Samurdhi.

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