

THE IMPACT OF SRI LANKA'S ECONOMIC REFORMS IN 1977 ON EMPLOYMENT AND INCOME DISTRIBUTION

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1. Introduction

After 1956, Sri Lanka swung away from the relatively free economic arrangements that had prevailed in the Island from the pre- and post independence period to one of increasing restrictions. Thereafter, economic policy tended to become more and more retrospective. The government that was elected in 1956 viewed economic policy as essentially state-controlled. For twenty years thereafter, from 1956 to 1977, the economy was subject to increasing restrictions and controls. Economic policy tended to give weight to the public sector and opportunities for the expansion of private business enterprise were, to a large extent, influenced by political considerations because the government which was largely influenced by socialist and left wing doctrines took hold of administration during these two decades except during the five year period 1965-1970.

In the twenty-year period from 1956, welfare considerations, along with restrictions and controls, dominated economic policy and the objective of successive governments was to increase transfers to all segments of the population. This tended to progressively curtail the volume of resources available for investment. The main negative aspects of these policies were increasing unemployment and under-employment, recurring shortages and a growing black market, reduced economic activity in most sectors and very little evidence of

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diversification and structural change in the economy. On the other side, increasing welfare transfers to the population helped not only to raise real income levels and cushion the people from the impact of inflation, but also contributed to higher standards of health, medical care, nutrition and education. The physical quality of life improved considerably in this period but this happened at the expense of economic growth, while unemployment increased progressively reaching the highest levels since the country became independent.

2. Economic Reforms

The United National Party government came into power in 1977 and realized that policies which previous governments followed in the past twenty-year period have resulted in economic stagnation and social discontent especially among the unemployed youth. Major changes in economic management had to be introduced to reactivate a largely dormant economy and to exhaust the potentials for rapid development through private enterprise. The package of measures worked out by the new government represented a rejection of the earlier inward-looking policies almost in their entirety. This involved dismantling exchange controls, import licensing and other restrictions on foreign trade and investment that had prevailed over a long period of time. The S.L.F.P.¹ government which held office from 1970 to 1977 had not been too enthusiastic about private foreign investment although substantial inflows of official aid had taken place during this period. The new government not only welcomed foreign aid but also private foreign investment. The government was convinced that the resources that could be mobilized internally would not be adequate to support the large volume of investment that had been planned in the public and private sectors.

The government decided to concentrate its own investment effort in three major areas. They were all designed to rapidly stimulate economic activity and employment. The new administration gave foremost priority to opening up new avenues of employment. In order to rapidly build up the infrastructure for raising agricultural productivity and settling people on new land, the

1. The Sri Lanka Freedom Party or coalitions led by the party have been in power from 1956 to 1965 and from 1970 to 1977. The United National Party has been in office from 1965 to 1970 and from 1970 onwards. Elections are due in mid-1983 at the end of a six-year period.

Government proceeded with the Mahaweli development programme, the largest scheme undertaken in Sri Lanka, begun by the preceding administration. The object was to review the Mahaweli river basin development program, which should have normally taken 30 years, into a much shorter period of 6 years by selecting for implementation three of the main projects that were in the original development program. In order to encourage private foreign investment, it decided to set up an Investment Promotion Zone which was devoid of restrictions, controls, taxes and customs duties and welcomed the opening of branches of foreign banks. It also embarked on an ambitious housing and construction program in the urban and rural sectors.

The more important components of the economic measures were the relaxation of controls, the liberalization of trade, the renewed emphasis on the free market system with minimum state interference and the readjustment of the exchange rate. The preceding dual exchange rate was replaced with a unified rate and the rupee was sharply devalued in November 1977. The principal object in liberalizing the economy was to provide a more favourable climate for foreign investment because the trade and exchange restrictions that had prevailed for more than 20 years had kept away a lot of private foreign investment. Whereas many South East Asian countries had prospered in the sixties and seventies with the inflow of overseas investment, foreign investors during this period had felt that Sri Lanka had not provided the right climate. Furthermore, due to very little investment in the private sector, employment opportunities grew very slowly, thus creating an increasingly large backlog of young job seekers, most of whom had at least a secondary education. Much of the new employment generated before 1977 was in the public sector, mainly in the state-owned manufacturing and service corporations. The gem trade and tourism were the only active areas in the private sector, but these did not offer substantial employment prospects for the large numbers who were in the labour market.

The liberalization of the economy, however, had unfavourable repercussions on domestic industry and some industries, notably the handloom textile industry. The light engineering sector also found it hard to survive. Nevertheless, the government continued to pay a lot of attention to agricultural development. Investment programs and large scale river valley development schemes were designed to vastly improve existing irrigation facilities and to provide hydro-electric

power for industry. The incentives provided for the development of agriculture which included government guaranteed credit to farmers, subsidized inputs, guaranteed prices for farm products and the ready availability of agricultural equipment and machinery all contributed to maintain the impetus that had been generated earlier and progressively increase the output of domestic agricultural crops, particularly paddy yield.

3. Increase in Employment

Opportunities to seek employment abroad were provided to those who could not find work at home. The Government, therefore, adopted a multi-faceted approach to solve the unemployment problem. One, it created employment opportunities as quickly as possible within the country and two, it gave options to those who were more enterprising to seek employment abroad. In the years preceding 1977, travel abroad was considerably restricted and this was ostensibly because foreign travel involved a loss of foreign exchange. Large numbers who were qualified and had options of getting employment abroad, particularly in the Middle East, could not leave the country because the issue of passports was restricted and various other emigration formalities had to be done. After the increase in oil prices and the resulting rise in investment activity in the Middle East, Sri Lanka was perhaps the only country, particularly between 1973 and 1977, that did not encourage its skilled workers to seek employment in the Middle East. The neighboring countries such as India, Pakistan and Bangladesh had fully exploited these opportunities.

By withdrawing the exit permit system and making provision for the free issue of passports, government liberalized foreign travel and encouraged Ceylonese to seek employment abroad. This immediately tended to relieve pressure on unemployment and it has become a very important source of foreign exchange for the country. Remittances from those employed in the Middle East have increased from year to year. Furthermore, the income distributive effects of overseas employment have indeed been very favourable. The breadwinners of a very large number of families who have found employment abroad have made it a point to remit their earnings which have helped sustain their families and dependents. In fact, it was during the years 1980 and 1981 that the largest numbers have sought employment abroad. Thus, the data in the Consumer Finance and Socio-Economic

Survey 1978/79 would heavily underestimate the unemployment figure. However, the Consumer Finance and Socio-Economic Survey 1981/82 which is currently being conducted by the Central Bank will give a more accurate picture of the new employment opportunities that have resulted from the economic reforms.

Before 1977, although migration for employment overseas took place on a limited scale, this had no effect on income distribution and it did not help raise income levels because it was only those who belonged to the upper class, mostly professionals, who left the island in search of employment. Their employment abroad had a negative effect on local income generation and foreign exchange reserves because not only did they retain their earnings overseas but they explored every avenue of taking the maximum amount of foreign exchange out of the country. In the case of the large number of workers who found employment in the Middle East, the converse was true. Every cent that they earned was ultimately remitted to Sri Lanka. This became a major avenue of augmenting Sri Lanka's foreign exchange reserves and gave individual families adequate funds not only for their sustenance but also for investment mainly in land, buildings and small industry.

The major economic gains of the present administration have been in the area of investment, employment and income generation. The policy of the government has been to trade off a higher level of income, employment and production for a reduced level of subsidies and welfare payments. Before 1977, any curtailment of subsidies would have brought large numbers to the brink of starvation because incomes were not rising and new opportunities of employment were not increasing. Since 1977, the government has been committed to a policy of confining subsidies to the most needy and with this objective, it has introduced a scheme of food stamps which are given only to the poor segments of the population. About half the population today gets subsidized food and kerosene oil through food stamps.²

In 1977, when the term of office of the previous government came to an end, unemployment had been conservatively estimated at a very high figure of 1.2 million or about 24 percent of the

2. In March 1982, the scope of the food stamp scheme was widened because of the sharply rising cost of living. Now almost, two thirds of the population are entitled to food stamps.

workforce. The picture has changed considerably since then. Between 1973 and 1978/79, unemployment fell from 24 percent in the former year to 14.8 percent in the latter period. Some 280,000 job opportunities were created in the public and private sectors between 1978 and 1980. This figure, of course, is confined mainly to the formal sector and excludes a large number of additional jobs that have been available in the non-formal private sector, particularly in domestic agriculture and in self-employment. Quite apart from new jobs for wage earners, self-employment has greatly reduced the volume of unemployment. The extensive opportunities for engaging in trade and business have given considerable scope to self-employment in production, in retail trade, or in the service sector.

An estimated 125,000 persons enter the labour force each year and the rate at which new employment has increased has not only helped provide employment for the heavy backlog that existed in 1977, but has also given opportunities to a large number of newcomers in the labour market. The advertisements in the press everyday indicate that for certain types of skills, there are still a large number of vacancies. Unemployment today is structural because those who are in search of jobs do not have the aptitudes and the skills. In the vocational and skilled categories specifically, there are still labour shortages and this is partly due to the exodus of technically qualified persons to the Middle East and other countries.

The Consumer Finance and Socio-Economic Survey 1978/79 shows distinct gains in employment in practically every sector. Not only has there been a substantial broad base of employment opportunities but the volume of employment in each area, whether in new economic activities or in existing sectors, have increased significantly. In 1978/79, the total all island percentage of the employed population was 32.4. This is an increase of 6.6 percent over that of 1973. An increase of the same order of magnitude was found in all sectors of the economy and in the different districts and zones. For the Island as a whole, the percentage of the workforce employed was 83.3 while a third was in regular employment. Another third was in self employment or in the unpaid family worker category.

The rapid changes that have taken place in the economy resulting from new investments in almost every sector and the greater activity in communications, services, transportation, small industry and retail sales sectors have demonstrated that the economy has a high labour

absorptive capacity not only for workers with skills and initiative but also for the less educated workers who are mainly in search of blue collar jobs. Such opportunities, in particular, have increased rapidly in the construction, transport, tourism and banking sectors. Those with less education have shown a willingness to adapt themselves to job opportunities which fall into the blue collar category. However, despite the relatively large supply of labour that has been available, wages for blue collared employees have been high because of the steady demand for skilled labour. Data from 1978/79 Consumer Finance and Socio-Economic Survey shows that 37 percent of those who have jobs were in regular employment, 26 percent had found casual jobs and 23 percent fell into the self-employed category. The ratio of those with regular employment was greater in the case of the relatively more educated groups whereas the incidence of unemployment appeared to be higher in other categories.

4. The Urban, Rural and Estate Sectors

The sectoral distribution of unemployment shows that the highest rate of unemployment has consistently been in the urban sector. The 1978/79 survey gives a figure of 19.7 percent. Unemployment has been less important in the rural sector where the percentage of unemployed was 14.6.

Traditionally, the urban sector has had the highest level of unemployment and this is mainly due to structural factors. In 1963, the percentage of unemployed in the urban sector was 17.8 percent, in 1973, the figure nearly doubled to 32.1 percent, and in 1978/79, it has decreased sharply to 25.7 percent. Yet, it remains above the figure in 1963. A major reason for the sharp increase of unemployment in the urban areas in the early seventies was primarily the inactivation of the private sector which in earlier periods had provided a substantial part of employment in the urban sector. Furthermore, since the bulk of private investment has been in the urban sector, the relatively slow rate at which investment took place up to 1977 tended to reduce the availability of new job opportunities. Furthermore, the controls and restrictions that had prevailed for over two decades had restricted the opportunities for business in the retail and wholesale trade, construction and transport, which have been major private sector activities.

The increase in employment in the urban sector has been broad-based about largely by the steady expansion of business resulting from the economic reforms and liberalization of 1977. Many stagnant areas in the urban sector, particularly construction, wholesale and retail trade, transport, banking and financial services, expanded considerably generating job opportunities and in turn, resulted in higher levels of investment in other sectors.

The estate sector has continued to offer the highest proportion of regular employment to members of the workforce. Unemployment has always been least in the estate sector³ where the percentage was relatively low at 5.6. The estate sector has consistently had a low level of unemployment because the estate working population consisting largely of expatriate Indians tended to diminish due to the repatriation of workers to India. Although the estate sector has a very high birth rate, work continues to be available for both adults and children because children over 14 years of age are allowed to work. Especially in the better tea plantations at higher elevations many estates have experienced labour shortages; the absence of villages in the vicinity means that the local population have not been able to replace or supplement expatriate workers. In the estate sector, self-employed and unpaid family worker categories were almost non-existent while in the rural sector, most the employment consisted of self-employment or fell into the unpaid family worker category.

Between 1973 and 1978/79 in the rural sector, unemployment decreased from 24.5 to 14.6 percent. The liberal economic policies have contributed to the development of the rural sector in many ways. Greater opportunities are available today for the cultivation of a wide variety of crops, and the large new irrigation schemes particularly Stage 1 Phase 1 of the Mahaweli program have now assured cultivators in a considerable part of the Dry Zone with water throughout the year which makes possible cultivation of two crops. It is important to note that the decrease in unemployment in the rural sector has taken place despite the migration of people from the urban to the rural sector. In the past three years particularly, there has been a tendency for people to stay in the villages or for people to

3. The estate or the plantation sector has a working population of about 1.3 million persons and consists mostly of tea, rubber and coconut plantations. The bulk of the workers on the tea plantations are of Indian origin.

the urban areas to move into the rural sector and the suburban areas because of the very high cost of living in the cities.

The underemployment rates in urban, rural and estate sectors were 12.8, 23.5 and 33.4 percent, respectively. One contrasting feature was that the estate sector which recorded the lowest unemployment rate of 5.6 percent had the highest underemployment rate of 33.4 percent. A comparison of the degrees of underemployment between 1973 and 1978/79 shows that in the urban sector, underemployment has, in fact, decreased with the increase in the average number of days worked from 41.68 in 1973 to 47.76 days in 1978/79 during a period of 60 days. In the rural sector, it has also decreased with the average number of working days increasing from 38.59 to 41.54 days in a two month period. In contrast, underemployment in the estate sector has increased slightly with work in a 60-day period falling from an average of 40.66 to 37.10. For the island as a whole, the number of working days in a 60-day period has increased from 39.43 in 1973 to 42.14 in 1978/79.

5. Unemployment, Education and Age

The survey showed that the incidence of unemployment was relatively significant among educated youths who have had formal education without any technical or specialized knowledge. The proportion of the workforce with GCE (Ordinary Level) and (Advanced Level) employment qualifications was 28 and 36 percent, respectively. On the other hand, the corresponding ratios for those with no schooling or with primary education were less than 4 percent and 7 percent, respectively. This has been the pattern even in 1973-1977 when the overall level of unemployment reached the peak figure of 24 percent. The data no doubt indicate that unemployment has been caused mainly by the inflexible aspirations of those who have received a secondary and higher education and who have invariably sought after white collar jobs in the government sector. Furthermore, the lack of technical and other skills have debarred them from certain categories of jobs that needed skills.

The survey disclosed that the percentage of the workforce employed in the categories of 'no schooling illiterates' and 'no schooling literates' was higher than in any other category. But the increase in employment over the 1973 estimates in these two categories was less than 5 percent. However, between 1973 and

1978/79, a substantial improvement in employment was found both in those who had secondary education and those who had passed the GCE Examination. Here, the increase in employment was more than 15 percent.

In the case of those who had passed the degree, gains in employment were very much higher than in any other category. One of the major problems in the period before 1977 was the large number of graduates who could not find employment. But with the economic changes that were brought about in 1977, these problems were, to a large extent, overcome and in the five year period since 1973, graduate employment increased by 11 percent. Furthermore, in the case of graduate employees, a significantly high proportion of them in the workforce was in regular employment rather than in casual employment.

The unemployed classified by age, showed that there was not full employment in the higher age groups. The incidence of unemployment among youths between 14 and 25 years was still very high relative to the older age groups, even though this age group experienced a substantial reduction in unemployment. A comparison with the 1973 data showed that the fall in the incidence of unemployment among the secondary school drop-outs and those who had passed the GCE (Ordinary Level) was 42 percent. Among those who had received a post secondary school education and among graduates, unemployment had decreased substantially from 16.2 percent in 1973 to 5.3 percent by 1978/79, which is a fall in unemployment for this category by 67.5 percent in a five year period.

6. Impact on Income Distribution

The data obtained from the Consumer Finance and Social Economic Survey over a twelve-month period in 1978/79 show certain significant changes in the household size, size of spending unit, number of income receivers and dependents. All these indicate that incomes, wages and employment have shown favourable trends after 1977. Over the years, the average size of the household has been decreasing from 5.75 persons in 1963 to 5.62 persons in 1973 and to 5.40 persons in 1978/79 and the decline in the average household size could be partly attributed to a fairly significant drop in the birth rate. As seen in Table 1, the average number of spending

units in a household had increased between 1963 and 1978/79; in 1963, the average number of spending units in a household was 1.08, in 1973, 1.05 and in 1978/79, 1.10. A spending unit consists of one or more persons who are members of a household and who share expenditure on major items. The main reason for the reduction in the number of spending units in a household in 1973 was the progressive decline in employment opportunities during this period.

Table 1 — Average Size of Household, Number of Spending Units, Income Receivers and Dependents Per Household, 1963, 1973 and 1978/79.

Average	1963	1973	1978/79
Average size of household	5.75	5.62	5.46
Average number of spending units per household	1.08	1.05	1.10
Average number of income receivers per household	1.56	1.44	1.63
Average number of dependents per household	4.19	4.18	3.83

Source: Consumer Finance and Socio-Economic Survey 1978/79.

The increase in spending units between 1973 and 1978/79 shows that employment opportunities have been increasing and that there have been more income earners in each family. There has been an increase in the number of income receivers per family from 1.56 in 1963 to 1.44 in 1973 and to 1.63 in 1978/79. This is consistent with the increase in spending units. Invariably, an increase in income receivers tends to add to the number of spending units. At the same time, the increase in employment opportunities has also made a fairly significant reduction in the average number of dependents per family. In 1963, the number of dependents per family was 4.19, in 1973, 4.18 and in 1978/79, 3.83. All these figures reflect not only the growth of new income and employment opportunities but also the broad base of income earning options open to members of the households.

The comparison of income distribution between the four Consumer Finance and Socio-Economic Surveys that have been

conducted so far in 1953, 1963, 1973 and 1978/79, respectively become meaningful because the definitions of spending unit and income receiver remained unchanged.⁴

Table 2 gives the estimate of mean and median incomes of income receivers in the four surveys examined. However, these incomes are not comparable as they are not expressed in constant rupee values. For comparability, these incomes will have to be deflated by a price index. However, in the absence of a satisfactory price index, this has not been possible. One important consideration is the sharp increase in money prices in 1973 and 1978/79. Even in 1973, there was a fair degree of inflation in the country following the sharp increase in the price of crude oil. However, in 1973, basic essential goods were available at subsidized prices and to some extent, the consumer was insulated from inflation. Between 1973 and 1978/79, mean incomes have gone up by more than 250 percent from Rs 228 in 1973 to Rs 616 in 1978/79. In 1978/79, although the country experienced substantial inflation, the worst inflationary pressures began after 1979, particularly in 1980 and 1981. In this context, the increase in incomes between 1973 and 1978/79 would have a greater degree of comparability than with the money incomes that would be recorded in the survey that is at present being conducted for 1981/82.

The median monthly income between 1973 and 1978/79 rose from Rs 180 in 1973 to RS 408 in 1980. The figures in Table 2 show that the mean income increased faster than the median income, moving towards greater concentration of income. One major drawback of the present economic policy package is the rising disparity between income growth and distribution.

4. However, in the most recent survey undertaken in 1978/79, a more rigorous definition of income receiver was made. If an individual received an income below Rs 30 for a month and Rs 180 for the six-month reference period, he was not treated as an income receiver. However, there was one major difference: the 1978/79 survey was conducted in four rounds spread over a period of one year to enable the seasonality of incomes to be recorded unlike in the previous Consumer Finance Surveys where the seasonality of income was not recorded.

In 1973, the income for the two months as well as the six months immediately preceding the survey period was sought. The longer reference period of six months was retained in the current survey mainly to capture the incomes of a seasonal nature such as incomes from paddy farming.

Table 2 – Consumer Finance Survey Estimates of Average One Month Income (Rs) per Income Receiver, 1953, 1963, 1973 and 1978/79

Average	Year			
	1953	1963	1973	1978/79
Mean Income	108	134	228	616
Median Income	68	83	180	408

Source: Consumer Finance and Socio-Economic Surveys.

Using the Gini Coefficient to indicate the distribution of income, it will be seen from Table 3 that the Gini Coefficient has risen significantly from 0.41 in 1973 to 0.49 in 1978/79, an indication of a significant increase in the inequality of income distribution. This takes the situation back to the pattern of income distribution which prevailed in 1963 when the Gini Coefficient was 0.49. The distribution of income analyzed according to deciles also shows that the income shares of the lower deciles decreased while those of the higher deciles, especially the highest, moved up significantly. Table 4 shows that the redistribution of income from 1953 to 1963 leaned towards the middle income receivers at the expense of the richest 1/10th and the poorest 2/10ths. Between 1963 and 1973, there has been a significant redistribution in favour of the lower and the middle income groups at the expense of the highest decile.

Table 3 – Consumer Finance Survey Estimates of the Gini Coefficient for Income Receivers, 1953-1978/79

Year	Gini Coefficient
1953	0.50
1963	0.49
1973	0.41
1978/79	0.49

Source: Consumer Finance and Socio-Economic Surveys.

**Table 4 — Percentage of Income Received by Deciles
All Island**

Decile	Percentage of Total Income		
	1953	1963	1973
Lowest	1.51	1.17	1.80
Second	3.56	2.70	3.17
Third	3.56	3.56	4.38
Fourth	4.37	4.37	5.70
Fifth	5.71	5.55	7.10
Sixth	6.31	6.82	8.75
Seventh	7.94	8.98	10.56
Eighth	10.39	11.46	12.65
Ninth	14.16	16.01	15.91
Tenth	42.49	39.24	29.98

Source: Consumer Finance and Socio-Economic Surveys.

The situation that prevailed in 1978/79, however, was quite different. With the exception of the highest decile which gained 10.56 percent over a five-year period, all other deciles experienced a reduction in their proportionate shares of total income. Taking the lowest decile, its share dropped from 1.80 percent to 1.20 percent. For the next decile, from 3.17 to 2.56 percent, the third decile from 4.38 to 3.57 percent. The lowest decrease was in the 9th decile where the figures descended from 15.91 to 15.27 percent. The evidence of the less favourable distribution in incomes is seen in Table 5 which shows the mean income per income receiver by decile as between 1973 and 1978/79.

While it is true that incomes increased in all deciles, relative speaking, there is a much higher percentage increase in the higher than lower deciles. The mean income for the lowest decile moved up to only 101 percent while in the 8th to 10 decile, increase ranged from 141, 161 and 254 percent, respectively. A remarkable mean income change is viewed in the 10th decile where the figure shot up to as high as Rs 2,411.03 in 1978/79.

It is premature at present to pass judgment upon the distribution trends particularly for the years 1978-79. These are the

Table 5 — Mean Income Per Income Receiver by Deciles
All Island, 1973 and 1978/79

	Mean Income per Month (Rs) 1973	Mean Income per month (Rs) 1978/79	Percentage change from 1973 to 1978/79
1st	41.17	82.79	101
2nd	72.03	161.04	123
3rd	99.79	227.64	128
4th	129.67	296.65	129
5th	161.28	369.26	129
6th	198.97	452.60	127
7th	240.38	565.37	135
8th	287.88	693.83	141
9th	361.95	945.80	161
10th	681.61	2411.03	254
All India	227.50	616.19	171

Source: Consumer Finance and Socio-Economic Surveys.

When new economic policies have been introduced into the economic system and have produced results. It is a general case that during the initial stage of economic growth, incomes tend to move to the higher deciles. This is true because entrepreneurs who invest their money in the economy are given financial incentives to invest in their industries which results in substantial surpluses for investment in other profitable ventures. The sharp increase in income, particularly in the higher deciles, are incomes that accrue as a result of economic liberalization and the freedom to undertake whatever kind of business one wants.