DISCUSSION PAPER

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PUBLIC POLICY AND THE EVOLUTION OF THE LABOR MARKET IN SRI LANKA

by

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Revised Version: March, 1986

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ABSTRACT

The present paper examines the evolution of labor market conditions in the recent economic development of Sri Lanka, with special attention to the effects of various government policies. Three facts about the evolution of the labor market in Sri Lanka stand out: a very low rate of urbanization; modest structural changes in the labor market; and a high standard of living in relation to GNP. The derived demand for labor has changed little, because the structure of production in the Sri Lanka economy has changed little. A variety of governmental policies, which include macroeconomic policy, social welfare policy, labor market policy and sectoral policy, have left the existing labor market structure largely intact. Looking ahead, in the absence of fundamental change, the prospects for substantial labor market evolution are not encouraging. Unless the country decides on a clear course of development, it would not be at all surprising to find that the labor market will evolve as little in the next decade as it has in the past years.
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PUBLIC POLICY AND THE EVOLUTION
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"Our government is concentrating on the
development of our resources which will mean
employment for our youth, men, and women. I
place among our priorities Employment First,
Employment Second and Employment Third."

J.R. Jayawardene,
President of Sri Lanka

INTRODUCTION

This is one of several studies on labor markets in developing
countries commissioned by the World Bank. The purpose of these studies is to
survey briefly the evolution of labor market conditions in the recent economic
development of the countries in question with special attention to the effects
of various government policies.

The present paper examines the experience of Sri Lanka. Three facts
about the evolution of the labor market in Sri Lanka stand out: a very low
rate of urbanization; modest structural changes in the labor market; and a
high standard of living in relation to GNP. The derived demand for labor has
changed little, because the structure of production in the Sri Lankan economy
has changed little. A variety of governmental policies have left the existing
labor market structure largely intact. These include macroeconomic policy,
social welfare policy, labor market policy, and sectoral policy. The balance
of this paper reviews these labor market developments and policy actions.
KEY LABOR MARKET DEVELOPMENTS

Continued Ruralness of the Labor Force\(^1\/\)

One remarkable fact about the labor market in Sri Lanka is that the proportion of the labor force found in rural areas is virtually unchanged from what it was a generation ago. Urbanization levels in Sri Lanka are low and growing only slowly. According to the most recent census (1981), the employed population (age 10 and over) breaks down 21.7% urban and 78.3% rural. The percentage urban is only slightly higher than a decade earlier (21.4% urban in 1971) or two decades earlier (19.1% in 1963).\(^2\/) The very slow rate of urbanization in Sri Lanka is in marked contrast to the rapid urbanization taking place in nearly all other Third World countries. Moreover, in some of those countries which have also experienced low levels of urbanization (China and Tanzania, for example), internal mobility of labor is restricted. Sri Lanka has no such restriction, which makes the virtual lack of urbanization all the more remarkable.

Why does Sri Lanka continue as a largely rural economy? The answer is revealed by examining other structural features of the labor market and the ways in which public policy has impinged on the demand and supply of labor.

---

\(^1\/) One significant terminological point should be made. Many of the official statistical agencies in Sri Lanka use the term "rural" to denote the non-estate portion of the rural economy. Consequently, a tripartite taxonomy urban/estate/rural is used in many government publications. This is confusing to readers from other countries, who would be inclined to think of "rural" as pertaining to the entire rural economy and not just to the non-estate sector. To avoid confusion, I shall not use the official terminology in this report.

\(^2\/) Sources: Census of Population 1971, Table 1 and Census of Population 1981, Table 9.
Modest Structural Change in the Labor Market

In some developing economies, the labor market has evolved rapidly, producing marked improvements in the structure of employment and wages. However, in the case of Sri Lanka, the evolution has been much more modest.\(^3\)

It is instructive to compare the evolution of the labor market in Sri Lanka with that of South Korea. Around 1960, the two countries were very similar economically to one another. Per capita incomes were $152 in Sri Lanka and $154 in South Korea. Both were largely rural agricultural countries. 66% of the Korean labor force was agricultural, compared to 58% in Sri Lanka at that time.

Since then, the labor market has changed remarkably little. Most observers would begin by examining changes in the unemployment rate. I would not do this, the reason being that unemployment in Sri Lanka has been shown to be comprised overwhelmingly of new entrants to the labor force. According to the most recent data source (the Report on the Survey of Consumer Finances 1981/82, p. 165), fully 87% of the unemployed were reported as first time job seekers. In my view, the preponderance of first time job-seekers among the unemployed means that the unemployment rate has little validity as a measure of labor market slack. The statistics on which I would place the greatest weight instead are data on the composition of employment.

Relevant data on the mix of employment opportunities are presented in Table 1. Labor market conditions are generally said to improve when agriculture diminishes in importance, because a larger proportion of the work

\(^3\) The characterization of these changes as modest is a matter of interpretation with which others (e.g., Korale, 1985) would disagree.
Table 1
Changing Composition of Employment in Sri Lanka

Change in Industrial Distribution<sup>a/</sup>

<table>
<thead>
<tr>
<th>Year</th>
<th>% in agriculture</th>
<th>% in manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953</td>
<td>53.0</td>
<td>10.0</td>
</tr>
<tr>
<td>1963</td>
<td>53.0</td>
<td>9.0</td>
</tr>
<tr>
<td>1971</td>
<td>50.0</td>
<td>9.0</td>
</tr>
<tr>
<td>1980</td>
<td>46.0</td>
<td>12.0</td>
</tr>
</tbody>
</table>

Change in Occupational Distribution<sup>b/</sup>

<table>
<thead>
<tr>
<th>Period</th>
<th>% professional (old classification scheme)</th>
<th>% professional, technical, administrative, and managerial (new classification scheme)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>5.1</td>
<td>6.0</td>
</tr>
<tr>
<td>1978/79</td>
<td>6.6</td>
<td>7.6</td>
</tr>
</tbody>
</table>

Change in Distribution by Activity Status<sup>c/</sup>

<table>
<thead>
<tr>
<th>Year</th>
<th>% employees</th>
<th>% self-employed or unpaid family workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1963</td>
<td>60.4</td>
<td>37.1</td>
</tr>
<tr>
<td>1973</td>
<td>60.9</td>
<td>37.7</td>
</tr>
<tr>
<td>1978/79</td>
<td>62.1</td>
<td>36.5</td>
</tr>
<tr>
<td>1981/82</td>
<td>66.6</td>
<td>31.3</td>
</tr>
</tbody>
</table>

Sources:
<sup>a/</sup> Ministry of Plan Implementation (1983, Table 29).
<sup>c/</sup> Report on the Survey of Consumer Finances, 1963, Table 21; 1973, Table 25; 1978/79, Table 52; 1981/82, Table 4.11.
force is able to find better-paying jobs in manufacturing, trade, and services. Since 1953, the share of total employment accounted for by agriculture declined by about seven percentage points (from 53% to 46%), while the share accounted for by manufacturing grew by two points (from 10% to 12%). Data on the occupational mix of the labor force are sparse and do not go back very far; but the available information demonstrates an increase of about two percentage points in the last decade in the proportion of the labor force in professional, administrative, managerial, or technical occupations. Yet another indicator of the composition of employment is the distribution of the employed population by activity status. When the proportion of regular employees increases and the proportions of casual employees and unpaid family workers diminish, these changes are taken as evidence that labor market conditions are improving. In two decades, the proportion of the labor force classified as employees increased by six percentage points (from 60% to 66%), with the percentage of self-employed or unpaid family workers declining by a corresponding amount (from 37% to 31%).

Are these changes large or small? Consider the evolution of labor market conditions in Korea which, as already remarked, was at about the same stage of economic development as Sri Lanka thirty years ago.\(^4\) The labor market changed much more in Korea in the twenty years from the early 1960s to the early 1980s (the period for which data are available) than it did in Sri Lanka in thirty years. The unemployment rate in Korea fell in half (from 8%
to 4%); agricultural employment declined from 63% of the labor force to 34% while manufacturing employment rose from 22% to 33%; employees as a percentage of the economically active population increased from 32% to 47%; the share of professional, technical, administrative, managerial, clerical, and sales occupations rose from 17% to 30%; and the proportion of employed workers with no schooling declined from 45% to 16%.

These figures demonstrate that labor market conditions evolved much more rapidly in Korea than in Sri Lanka. What is noteworthy about Sri Lankan experience is not so much the evolution of the labor market but rather the lack of change in labor market conditions. Reasons for the non-change are pursued later in this paper.

Labor Demand

It is a truism that demand for labor is derived from demand and supply of product. The productive structure has changed little in the recent economic development of Sri Lanka. Table 2 presents the structure of GNP in 1970 and 1982. These data show very little change. Construction increased its share of national product by a couple of percentage points while wholesale and retail trade lost two percentage points and manufacturing one percentage point—on the whole, remarkably little change.

The overall stability of the economic structure may be seen as reflecting the intermingling of high growth and low growth components within both the rural and the urban economies. Among the segments of the Sri Lankan economy that grew at above average rates were paddy agriculture, garments, and government services. Among the slower growing segments were plantation agriculture (tea, rubber, coconut), most manufacturing industries and private
### Table 2
Gross National Product at Current Factor Cost Prices, 1970 and 1982

<table>
<thead>
<tr>
<th>Sector</th>
<th>% of GNP, 1970</th>
<th>% of GNP, 1982</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry, &amp; Fishing</td>
<td>28.7%</td>
<td>28.1%</td>
</tr>
<tr>
<td>Mining &amp; Quarrying</td>
<td>0.7</td>
<td>1.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>16.9</td>
<td>15.8</td>
</tr>
<tr>
<td>Construction</td>
<td>5.7</td>
<td>8.9</td>
</tr>
<tr>
<td>Electricity, Gas, Water, Sanitation</td>
<td>0.8</td>
<td>1.4</td>
</tr>
<tr>
<td>Transport, Storage, &amp; Communication</td>
<td>9.7</td>
<td>9.5</td>
</tr>
<tr>
<td>Wholesale &amp; Retail Trade</td>
<td>19.5</td>
<td>17.9</td>
</tr>
<tr>
<td>Services</td>
<td>19.5</td>
<td>18.8</td>
</tr>
<tr>
<td><strong>Less: Net Factor Income from Abroad</strong></td>
<td><strong>1.7</strong></td>
<td><strong>2.2</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Source: Central Bank of Ceylon, *Review of the Economy 1983*, Table 2A.
services. Thus, it was not that the urban economy grew while agriculture contracted, but rather that within the rural and the urban economies, some sectors grew while others stagnated or even declined in importance.

The overall rate of economic growth in Sri Lanka is a matter of some debate. Many casual observers think of Sri Lanka as having pursued distributional goals at the expense of economic growth. The official statistics paint a different picture, however. The World Development Report, 1984 records Sri Lanka's rate of growth as 4.5% per year in real terms over the last two decades. This is the exact average for countries in Sri Lanka's income category. Thus, it would appear that the economy of Sri Lanka has grown modestly but significantly.

Very recently, however, this conclusion has been called into question on two different bases. The first is a calculation of "Internationally Comparable Purchasing Power," also known as the "Kravis-adjusted income figures." These data show that Sri Lanka's per capita GNP fell by 15% between 1970 and 1975, rose by 27% between 1975 and 1980, and was therefore only about 10% higher at the end of the decade than at the beginning. [Summers and Heston, 1984, Data Table: Panel A] The second calculation uses a different deflator from the implicit GNP deflator. Sri Lanka's Department of Census and Statistics has generated a new price index in which food prices and rental housing are entered at market rather than administered levels. If the nominal GNP figures are deflated by the DCS index, a very bleak picture emerges: per capita GNP fell in the early 1970's, rose thereafter, but was unchanged between 1970 and 1982.5/

5/ See Bhalla and Glewwe (1985) for details of the DCS price index and Fields (1986) for the GNP calculation using that index.
A safe conclusion would be that the overall pattern of labor demand in Sri Lanka changed very little. Whether the economy was growing at an average rate or at a slower rate than that, only modest changes in the structure of national product took place. The continued ruralness of the labor force and the relative constancy in the employment mix of the labor force can be attributed to the constant demand structure.

Labor Supply 6/

The most important determinant of labor supply in a country is, of course, population growth. Population growth rates have fallen sharply in Sri Lanka and have reached quite low levels: 2.8% per annum from 1946 to 1953, 2.7% from 1953 to 1963, 2.2% from 1963 to 1971, and 1.7% from 1971 to 1981 (the most recent census). Today's population growth rate is estimated at 1.6% per annum. The death rate fell sharply in the late 1940s, due especially to malaria eradication and other public health measures. After a lag, the birth rate fell in the late 1950s and early 1960s. Thus, Sri Lanka has passed well into the third phase of the demographic transition (low birth and death rates).

The rate of population growth is as low as it is partly because the rate of natural labor force increase is believed to be only around 2% today and partly because of emigration. While some part of the emigrant flow consists of highly-educated Sri Lankans (with the consequence that some occupations such as engineering report severe labor shortages), emigration of

educated workers has been overshadowed by emigration of unskilled workers to the Middle East. Many are young females who go to work as domestic servants. Domestics earn on average US$4,000 per year in the Middle East—about ten times what they could earn as unskilled workers in Sri Lanka. These migrants remit substantial sums back home. One way of gauging the importance of this flow is to note that remittances from Sri Lankans abroad are now the second largest source of foreign exchange, nearly matching Sri Lanka's earnings from the export of tea. Another important category of emigrants are Indian Tamils who have been repatriated to India. Finally, some significant number of Sri Lankan Tamils, including many of the most highly-educated and skilled ones, are emigrating in the wake of the communal violence plaguing the country. Emigration undoubtedly serves as a safety valve, ameliorating what would otherwise be an even greater imbalance between demand and supply in the labor market in general and among highly-educated workers in particular.7/

The most recent Census of Population and Housing in Sri Lanka (1981) enumerated 14.8 million people. Of these, 11.3 million were over the age of 10, hence eligible to be counted as economically active. The number recorded as economically active was 5.0 million—4.1 million employed and 0.9 million unemployed but actively looking for work in the 30 days preceding the Census. Of the economically inactive, 2.9 million were houseworkers, 2.3 million students, 0.7 million retired or unable to work, and 0.3 million others. As would be expected, the rate of economic inactivity was higher among females (77%) than among males (35%).

Another notable aspect of labor supply is the differential in labor

7/ For more on emigration, see Korale (1984).
force participation rates across economic sectors. Though at first, the urban and rural economies appear very similar—the rates of economic activity are 43.8% of the urban population over age 10 and 44.6% of the rural population over age 10 [1981 Census]—further disaggregation reveals pronounced differences within the rural sector. The 1981/82 Survey of Consumer Finances reports a much higher labor force participation rate among estate households (53.9% of all estate persons) than among rural non-estate households (33.0%) or among urban households (32.5%). The reasons for the higher rate of participation among estate households are: (i) Wages in the estate sector are lower than elsewhere, which creates a stronger need for additional workers in the estate households to enter the labor force to supplement their families' incomes; and (ii) The estate jobs (tea plucking, weeding, fertilizing, etc.) are of the type that women and children can contribute productively to estate output, for which they are hired as paid employees. As a result, the labor force participation rates of males and females on the estates are virtually identical—a very unusual occurrence.

The labor supply to different sectors of the economy also reflects patterns of internal migration.\(^8\) The workers of Sri Lanka migrate a great deal between one rural area and another. About two-thirds of all moves are rural-rural. While some of this is accounted for by settlers to new land schemes and some by employed workers seeking better-paying or more stable jobs elsewhere, the great bulk of rural-rural migration is thought to be due to landless laborers moving from farm to farm and village to village to supply

\(^8\) See the Survey of Consumer Finances 1981/82, pp. 48–57 for statistics on internal migration patterns and analysis thereof.
their labor to seasonal activities as needed. By contrast, rural-to-urban migration is low.

Wages

A crucial variable in assessing the evolution of the labor market is the time path of real wages. This is important, because given the lack of significant change in the composition of employment, the main way in which labor might have benefited from economic growth in Sri Lanka would have been through increases in real earnings. Various real wage series are published, but they are fraught with difficulties. The problems are that the published annual series cover only selected non-representative segments of the labor force as a whole, that the wage surveys that do cover the labor force as a whole are conducted only at irregular intervals, and that Sri Lanka lacks a suitable consumer price index with which to deflate nominal data. It is thus a frustrating fact about studying the Sri Lanka labor market, but a fact nonetheless, that no reliable annual series on real wages is available for the Sri Lankan labor force as a whole. Still, we are able to reach some conclusions about how real wages in Sri Lanka have changed if we accept irregular data and partial coverage and use a non-standard price index.

Let us begin with household surveys, specifically, the Consumer Finance Surveys. The mean and median incomes of income receivers appear in nominal terms in Panel (A) of Table 3. Next, the Colombo Consumer Price Index, which is used by the government and by many researchers to deflate various nominal income amounts, appears in Panel (B). The Colombo CPI is

Table 3
One-Month Income of Income Receivers (Rs./mo.)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nominal Income:</strong>(^a/)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>108.0</td>
<td>134.0</td>
<td>228.0</td>
<td>616.0</td>
<td>1,111.0</td>
</tr>
<tr>
<td>Median</td>
<td>68.0</td>
<td>83.0</td>
<td>180.0</td>
<td>408.0</td>
<td>612.0</td>
</tr>
<tr>
<td><strong>Consumer Price Index, Colombo, 1952 = 100:</strong>(^b/)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>100.0</td>
<td>108.8</td>
<td>165.4</td>
<td>240.0*</td>
<td>395.7*</td>
</tr>
<tr>
<td><strong>Index of Real Income Using Colombo CPI, 1973 = 100:</strong>(^c/)**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>78.3</td>
<td>89.3</td>
<td>100.0</td>
<td>186.2</td>
<td>203.7</td>
</tr>
<tr>
<td>Median</td>
<td>62.5</td>
<td>85.4</td>
<td>100.0</td>
<td>156.2</td>
<td>142.1</td>
</tr>
<tr>
<td><strong>Adjusted DCS Consumer Price Index, 1970 = 100:</strong>(^d/)</td>
<td>n.a.</td>
<td>79.4</td>
<td>151.5</td>
<td>296.8*</td>
<td>547.7*</td>
</tr>
<tr>
<td><strong>Index of Real Income Using Adjusted DCS Consumer Price Index, 1973 = 100:</strong>(^e/)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>n.a.</td>
<td>112.2</td>
<td>100.0</td>
<td>137.9</td>
<td>134.8</td>
</tr>
<tr>
<td>Median</td>
<td>n.a.</td>
<td>88.0</td>
<td>100.0</td>
<td>115.7</td>
<td>94.0</td>
</tr>
</tbody>
</table>

* Average of annual rates.
** Due to problems with the Consumer Price Index, these indices are unreliable; see text.

n.a.: Not available.

Sources:
\(^a/\) Report on Survey of Consumer Finances, 1981/82, Table 5.3.
\(^b/\) Central Bank of Ceylon, Annual Report, 1974, Table 5.3 and 1983, Table 15.
\(^c/\) Calculated from (a) and (b).
\(^d/\) Bhalla and Glewe (1985, Table A.7).
\(^e/\) Calculated from (a) and (d).
widely viewed as deficient. So severe are its problems that the director of the government's Department of Census and Statistics (which has responsibility for the index) has stated that "the underestimation of the actual price increases by the Colombo consumer's price index is evident..."[Korale, 1985, p.97] and the Central Bank of Ceylon's Department of Statistics has written: "Owing to the lack of a reliable price index the nominal incomes have not been converted to real terms in this report." (Report on the Survey of Consumer Finances 1981/82, p. 92). Consequently, indices of real income using the Colombo CPI, like those in panel (C) of Table 3, ought not to be believed, because price increases are understated and hence wage growth is overstated; these data are calculated purely for comparison with more reliable data, presented below.

When the Colombo CPI was the only price index available, the choice was either to use that index with its known deficiencies, or otherwise to say nothing at all about changes in real wages—neither of which was a very attractive option. Even users of the Colombo CPI realized that it was deficient; they used it because it was available.10/

Now, however, a more appropriate consumer price index is available; it is presented in Panel (D).11/ Using this new index, we obtain the real income figures for Consumer Finance Survey years shown in Panel (E).

These data show different patterns for the mean and the median. When the mean of an income distribution falls relative to its median, the change is taken to signify rising income inequality; this appeared to have taken place

10/ For example, Korale (1985).
11/ See Bhalla and Glewwe (1985) for details.
in Sri Lanka up to 1973. The widening of the mean relative to the median thereafter would signify that income inequality rose at some subsequent point.\textsuperscript{12} As for income levels over time, the median real income in 1981/82 was below the levels of the 1970s and only slightly above the 1963 real level. The mean shows a somewhat larger increase over the last two decades. Even so, mean real income rose by only 1\% per annum.

We thus reach a disappointing conclusion: that the workers of Sri Lanka received at best marginal real wage increases in the last twenty or so years. Coupled with the fact that the employment structure has also changed very little, we can only conclude that very little labor market change took place.

Another aspect of wages that the available data can be used to illuminate is the evolution of wage structure. These data show a pronounced narrowing of skill differentials. Wages in the highest skill grade were 20.7 times as high as wages in the lowest skill grade in 1948, but by 1984, the ratio had narrowed to 4.9 (Korale, 1985, p. 89). Due to a deliberate policy of wage compression, the government is partly responsible. Probably, though, supply and demand play a greater role—in particular, the expansion of the education qualifications of the labor force and unemployment of highly-educated first-time job seekers.

\textsuperscript{12} As described below, the Sri Lanka government changed its economic policies substantially in 1977. Whether the observed patterns reflect the new policy regime is a question of great interest to Sri Lankans and observers of Sri Lanka; but because of the timing of the surveys, nothing can be said about when between 1973 and 1978/79 the observed changes took place.
Unemployment

As remarked earlier, the unemployed in Sri Lanka consist overwhelmingly of first-time job seekers. To my mind, this fact severely limits the validity of the unemployment rate as an indicator of labor market conditions. Not everyone agrees, among them, Korale (1985) and Glewwe and Bhalla (1985), who have written papers analyzing unemployment in detail. I shall summarize some of their main findings.

Statistics on unemployment in different years appear in Table 4. Elsewhere (Ministry of Plan Implementation, 1983), Korale and co-authors have stated that these figures are derived in different ways from different sources and hence are not directly comparable; this non-comparability is apparent from the different reference periods and definitions in Glewwe and Bhalla's Table 16. Nonetheless, these authors have proceeded to discuss and analyze changes in unemployment over time. Glewwe and Bhalla argue that unemployment rose in Sri Lanka "held steady" in the 1960s, "rose dramatically" in the early 1970s, and "finally fell" in the late 1970s and early 1980s. They attribute the increase in unemployment in the early 1970s primarily to "inappropriate policies" (see the section on macroeconomic policies below) and the subsequent reduction in unemployment to "a changed set of policies and heavy emigration." It should also be noted, however, that besides the economic policies introduced by the government which took office in 1970, Sri Lanka experienced serious riots in 1971, which had devastating economic effects. Perhaps the high unemployment at that time was due more to violence-induced disruption and the consequent lack of new hiring, which would affect first-time job-seekers the most, than to policy-induced disruption.

Unemployment among the young is of remarkably long duration. The
proportions of the unemployed who had been without jobs for more than two years were 70% in 1971, 59% in 1973, and 45% in 1980/81 (Gleewe and Bhalla, 1985, Table 18). Furthermore, as education rises, at least up to the secondary level, so too does the incidence of unemployment; this has been noted in the ILO's Ceylon Report (1971); in the classic study of unemployment in Ceylon by Richards (1971), and in subsequent work by Richards and Gooneratne (1980) and Richards and Leonor (1981). A consensus has formed around the following interpretation of unemployment. In Gleewe and Bhalla's words:

> When young people leave school they do not immediately take any job that is available, but instead they search for long periods of time for "desirable" jobs. This is possible because they continue to live with and receive the support of their parents. However, after several years of searching they either find a job which matches their aspirations or resign themselves to taking whatever "less desirable" jobs are available.

That is, unemployment in Sri Lanka is primarily a matter of searching for the "right" job in an economy with a distorted wage structure.

The estate sector exhibits a lower unemployment rate (5%) than in the non-estate rural economy (12%) or the urban economy (14%) [Survey of Consumer Finances, 1981/82]. For this reason, and because the estate labor market is commonly viewed as an enclave independent of the rest of the rural economy, a few remarks on the nature of that labor market are in order.
The Special Position of the Estate Sector

The estate labor force comprises some 15% of total rural employment. The estate sector consists of large holdings of tea, rubber, and coconut lands. Most of the tea and rubber lands and a significant fraction of the coconut lands were nationalized by the government between 1972 and 1975. Hence, it is the government that has the major responsibility for setting the terms and conditions of employment for these workers.

Estate wages are low. On a per worker basis, wages in the estate sector are one-half what they are in the rural non-estate sector and one-third of what they are in the urban sector. These low earnings have led to high labor force participation rates, as women and children take up jobs on the estates (which are available year-round) to add to their families' incomes.

More than 80% of the workers on the estates are Indian Tamils. Indian Tamils are persons whose ancestors were brought into Sri Lanka from Tamil Nadu state in India in the late nineteenth century and early twentieth century to work on the estates. These Tamils are to be distinguished from Sri Lanka Tamils, whose ancestors came to Sri Lanka many centuries ago. Many of the Indian Tamils are non-citizens of Sri Lanka, some being citizens of India and some being stateless.

These workers face a number of barriers in the labor market, some legal and some de facto. Those who are non-citizens are subject to deportation, under an agreement reached between Sri Lanka and India in 1964. Of an original 1.1 million Indian Tamils, about 300,000 have been repatriated to India. Even if permitted to stay, they face other barriers. It has long

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13/ This section is drawn from Fields (1986).
been the custom of the estate management to house the workers in barrack-type accommodations on the estates. Should they seek employment elsewhere, they would have to leave the estates and uproot their families. As non-citizens, the Indian Tamils are not permitted to take government jobs or to own land. Because they speak a different language and have a different religion from the majority Sinhalese, they cannot easily integrate themselves into other parts of the economy. And because their educational attainments are only about half the national average, their job opportunities are even fewer. For all these reasons, although the Indian Tamils are legally free to move off the estates, it is difficult for them to do so, and few do.

The repatriation program led to shortage of labor on some estates and the need to look outside the estates to meet their labor requirements. Increasing numbers of Sinhalese villagers are being attracted to the estates; though unwilling to reside on the estates and live among the Tamils, these villagers have shown themselves willing to take up employment as day laborers, provided they can return home at night.

Estate wages have moved in response to product market conditions. In the late 1970s, when the world price for rubber suddenly picked up, so too did the wages of rubber workers. Similarly, in the early 1980s, when tea prices were high, the tea estate workers won very large real wage increases. The estate management has endeavored to raise estate wages to the extent possible, using their influence with the wages boards in the tea, rubber, and coconut trades to bring this about. But given the severe external squeeze on the estate sector due to export duties and other taxes, the proceeds of which help support public spending in other areas, estate wages still lag behind.
Regional Labor Market Differences

Sri Lanka has two distinct agro-climatic zones. The southwestern third of the country has an abundance of rainfall and is known therefore as the "wet zone." The remainder of the country, known as the "dry zone," must be irrigated if agriculture is to succeed.

Differences in labor market conditions between the wet zone and the dry zone have resulted in substantial seasonal migration between the two. An interesting and careful study of seasonal migration has been undertaken by Crooks and Rabanda (1981). They found that labor is generally in surplus in the wet zone but that in the dry zone severe shortages of labor were experienced in the peak seasons (land preparation, transplanting, harvesting and threshing). The peak seasons in the dry zone occur about two months later than the peak seasons in the wet zone. Consequently, the peak demands for labor in the dry zone correspond with slack labor demand periods in the wet zone. Accordingly, wages are 50-100% higher in the dry zone than in the wet zone at those times, creating a strong inducement for migration. Both landless laborers and landed households whose labor requirements are slack offer their labor. Workers are recruited from specific "donor villages" in the wet zone to work in specific "recipient villages" in the dry zone. Most come as daily workers, though some are on contract basis. The average length of stay in the dry zone is about 20 days. The wages earned form a substantial part of those households' labor incomes.

Land in the wet zone has become very scarce. Small farmers and landless laborers have been clamoring for more land to cultivate. In addition, Sri Lanka has set as its number one socio-economic goal the attainment of self-sufficiency in food, the main staple being rice. Paddy is
very sensitive to the availability and timing of water. The desire of the people for more land and the social objective of food self-sufficiency have resulted in an ambitious public program of irrigation and settlement schemes. The largest and most ambitious of these schemes is the Mahaweli project. This shall be discussed further in the policy section, to which we now turn.

POLICIES AFFECTING THE LABOR MARKET

Macroeconomic and Social Welfare Policies

The reasons for Sri Lanka's poor to moderate economic growth record have been extensively debated. Briefly to indicate the terms of the debate, many observers take note of Sri Lanka's substantial expenditures on social welfare programs. Sri Lanka has been a leader among developing countries in the area of social welfare policy. Government hospital and health clinics provide medical care free of charge. Free universal education is provided through the secondary level and higher education is free as well for those who are able to gain admission to the universities. A free rice ration, universal in coverage, was in effect until 1979, at which time it was replaced by a food stamp program targeted at the poor. Not only are the levels of social expenditure high, but the social welfare facilities are dispersed widely throughout the country.

It is argued that these heavy social welfare expenditures diverted resources toward consumption and had a negative impact on investment and growth. Others see different reasons for the moderate economic growth experience. They point to such problems as declining world prices for key
export items (tea, rubber, coconut), rising world prices for energy and other imports, and administrative difficulties in executing public policy. For more information, see the World Bank Country Economic Memorandum (1984) and Richards and Gooneratne (1980).

The macroeconomic policy environment in Sri Lanka has undergone a number of changes since 1960. Thorbecke and Svejnar (1984) divide the intervening years into four policy regimes: I - 1960-1965; II - 1965-1970; III - 1970-1977; IV - 1977-present. Aggregate economic growth was several percentage points higher in periods II and IV than in periods I and III. The high-growth phases took place during the governments of the United National Party. The UNP is more oriented toward free enterprise than is the Sri Lanka Freedom Party, which governed in periods I and III.

1977 marked a major economic reform. The UNP government at that time freed up the price of rice and other key products, removed import controls, lowered tariffs, unified the exchange rate, devalued the currency, and reduced the share of government expenditures going to social services, largely by replacing the universal free rice ration by a program of food stamps. Overall, the policy package was intended to raise economic growth at the expense of current consumption. The World Bank Country Economic Memorandum (1984) is not alone in seeing these reforms as the cause of the more rapid economic growth since 1977.

Unfortunately, it is impossible to assess what changes took place in labor market conditions in the different policy regimes. This is because coverage of the available labor market data is sporadic and not in conformity with changes in policy regime. This has not deterred some observers from trying to draw inferences. Possibly of greatest interest is the question of
how labor market conditions changed as a result of the macroeconomic liberalization of 1977. Consumer Finance Surveys were conducted in 1973 and 1978/79; data are not available for the years in between. Some individuals and organizations, including the government's own Ministry of Finance and Planning (1980), have looked at the 1978/79 data and attributed changes in labor market conditions between 1978/79 and 1973 to the 1977 policy reform. Not only is this procedure indirect and therefore dubious; it is also highly unlikely that the change in policy could have affected labor market conditions so drastically in so short a time. The unemployment rate reported in the Survey of Consumer Finances fell from 24% to 15% between 1973 and 1978/79. It is unimaginable that so large a reduction could have taken place between the 1977 policy reform and the time of the 1978/79 Survey of Consumer Finances. It is much more likely that the unemployment rate was unusually high in 1973 due to economic recession and a very high rate of educated unemployment in the early 1970s,\textsuperscript{14} and that the economy adjusted gradually over the next five or six years to these and other phenomena. I just don't think it's possible to do as some observers have and use the changes reported from 1973 to 1978/79 to infer what effect the 1977 policy liberalizations had, and would caution outsiders reading about the changes that took place in the Sri Lankan economy to scrutinize carefully the data on which claims about the effects of the 1977 policy liberalization are based.

\textbf{Sectoral Policies}

Policies in Sri Lanka typically are formulated on a sectoral basis.

\textsuperscript{14} On the latter, see Richards (1971) or ILO (1971).
Estate (or plantation) agriculture, domestic agriculture, and industry are the main distinctions usually drawn. The discussion here follows along those lines.\textsuperscript{15/}

The estate sector consists of the tea, rubber, and coconut industries. This has been the traditional focal point of the Sri Lankan economy. The estate sector has been stagnating since the mid-1960s. Real economic growth has been at best nil, in both physical and value terms; volume indices for tea, rubber, and coconut in 1982 were respectively 89\%, 79\%, and 100\% of their 1970 levels (Thorbecke and Svejnar, 1984, Table II.2). Lack of growth of production would be expected to produce lack of growth of employment. In fact, employment in the estate sector has actually declined. According to Census information, employment in plantation activities fell by nearly 15\% between 1953 and 1971. Statistics from the 1981 Census are not yet available, but we know from Department of Labour data that employment on the estates reporting to them had declined by another 25\% during the 1970s. Clearly, estate employment has fallen considerably. Reasons for the estate sector's poor performance include: (1) Major land reforms and nationalization in the tea and rubber sectors, the anticipation of which led to lack of investment in replanting, etc.; (2) Falling world prices, which reduced the attractiveness of these crops relative to others; (3) Redirection by the government of inputs such as fertilizer away from the estate sector in favor of domestic agriculture; and (4) Heavy taxation, particularly in the form of export duties and special levies, in order to finance the country's social

\textsuperscript{15/} The discussion of policies in the estate agriculture and domestic agriculture sectors draws heavily on the work of Thorbecke and Svejnar (1984).
welfare system and drive for food self-sufficiency.

Domestic agriculture consists of paddy and other domestic crops. Paddy is the single most important crop and is central to national economic development. This is because rice is the staple food, self-sufficiency in rice is a national goal, and paddy farmers constitute a formidable political force. Paddy production has increased overall at the rate of 4.6% per annum in the last two decades, matching Sri Lanka's overall growth performance. Growth in the paddy sector was higher during those periods in which the price mechanism was permitted to play a greater role. The success of the paddy sector in those years has been attributed to a number of sectoral policies including the guaranteeing of adequate prices to farmers rather than maintaining artificially low prices for the benefit of consumers, the channeling of fertilizer and other inputs into the paddy sector, and the bringing of new lands into cultivation. The small farmers who dominate the paddy sector apparently responded well to these incentives. Sri Lanka has moved from dependence on imported rice to virtual self-sufficiency as a result.

The other domestic crops include subsidiary crops (coarse grains, pulses, oilseeds, spices, roots and tubers), livestock, and minor export crops (pepper, cinnamon, coffee, cocoa, tobacco, fruits, vegetables, and flowers). The other domestic crops together account for half of agricultural GDP, the remaining half being divided almost equally between paddy and estate crops. Despite the importance of these miscellaneous agricultural crops, public policy has largely left this sector alone. Production in this sector appears to be highly responsive to relative prices.

The most important aspects of policy with respect to domestic
agriculture are land reforms, settlement schemes, and irrigation activities. The Land Reform Act of 1972 vested privately-owned paddyholdings in excess of 25 acres in the Land Reform Commission; but only about 16,000 acres of paddy land (1.5% of the total) were affected. Land settlement and irrigation schemes have taken up huge amounts of resources. The Accelerated Mahaweli River Development Programme alone accounts for some 40% of Sri Lanka's capital budget. Although more than 80,000 families have been settled under these colonization schemes in the last twenty years, the costs have been very large, yields lower than expected, and the employment impact disappointing. In particular, benefit-cost ratios have been estimated at 0.5-0.7 for several major irrigation and resettlement programs, the lowest figure being reported for one of the oldest and largest, Gal Oya. Many plots have been underutilized, due in part to inefficient water use, inadequate agricultural extension, lack of supporting services, and poor management. As for employment, in the planning phases, it was estimated that three off-farm jobs would be generated for each new job on the land. But thus far, not even one off-farm job has appeared for each farm job. It is clear that the major land settlement and irrigation programs have produced benefits; but the costs of producing these benefits have been so high that it is unclear whether these programs have been worthwhile.

As for the industrial sector, Sri Lanka presents a very different picture from that in most other developing countries. Elsewhere, the urban and industrial sectors are extensively studied and the agricultural sector is given short shrift. In Sri Lanka, the reverse is the case. No serious

16/ The data in this paragraph are taken from Richards and Gooneratne (1980).
overall study of the non-agricultural labor market is to be found, though there are studies of specific educational or occupational groups. Manufacturing sector output has increased at a somewhat above average rate due to the devaluation of the rupee in the initial phases of the post-1977 economic liberalization, the reduction in controls on foreign exchange transactions, and incentives for foreign investors, among which are the creation of the Investment Promotion Zone and tax concessions. But, as we have already seen, the share of manufacturing employment in total employment grew only a bit.

In sum, the various sectoral policies in Sri Lanka have brought about relatively little structural change in the labor market. Successive governments in Sri Lanka have achieved a much more balanced sectoral distribution of resources, with much less concentration on the urban industrial sector, than is usually found.

**Labor Market Policies**

In some developing economies, the government plays a central role in regulating vital aspects of the labor market, while in others, it is government policy to let market conditions dictate wages and employment. I would characterize Sri Lanka as tending toward a market orientation. The main areas of possible labor market intervention and the practices in Sri Lanka are:

**Unions.** Public policy towards unions in Sri Lanka is actively to limit their activities in collective bargaining and other areas. Workers have the right to join trade unions but they lack job protection in connection with union activity. For example, workers may be dismissed from their jobs if they
incite a strike or join in one. This is rationalized on the basis of large numbers of workers wishing to take the available jobs and the perceived need to channel more development resources toward growth and capital formation. As a sign of the weakness of the trade union movement, we may note that in a country of 5.5 million workers, only 175 collective bargaining agreements have been concluded since 1953 (Thiagarajah, 1981). As a consequence of government policy, the labor union movement as a whole has little role to play in the wage-setting process in Sri Lanka.

Minimum Wages and Wages Boards17/. Thirty-four different wages boards in Sri Lanka set minimum wages, hours of work, holidays, and other terms and conditions of employment for 1.5-2 million of Sri Lanka's 5.5 million workers. These wages cover the bulk of the modern sector and the plantations; excluded are agricultural workers, domestic servants, and casual laborers. Apparently, the wages boards have succeeded particularly well in raising wages in the estate sector, where employment units are large (the great majority of tea and rubber workers are employed on large estates) and the labor force is regular. Nonetheless, it appears that the minimum wages do not have a very large overall effect on wage levels for a variety of reasons, among them: coverage is partial; enforcement is incomplete; workers are fearful of complaining about underpayment, lest they lose their jobs as a result; and wages are set to reflect the "going wage" in a particular trade or industry, because "to raise the level of wages far above the prevailing level would unduly disturb the price, cost and wage structure of the economy in a manner detrimental to the national interest" (Weerakoon, 1981). In sum,

17/ This paragraph is based on information presented in Weerakoon (1981).
although minimum wages may be of some importance in some sectors such as estate agriculture, in the bulk of the Sri Lankan economy, minimum wages do not have much if any effect on wage levels.

**Pay for Public Sector Workers**. In some countries, the government pays substantially higher wages than does the private sector, particularly in the urban economy. Not so in Sri Lanka. In the urban economy, all sectors pay similar amounts. In fact, the opposite complaint is frequently voiced—that the government has compressed the earnings structure to such a degree that it lags behind the private sector and has trouble attracting and retaining technical and educated personnel. In the rural areas, government wages are higher on average than those in the private sector. However, these average wage figures are unstandardized and disregard differences in education and occupation, and government employs disproportionate numbers of well-educated workers as teachers or public administrators. It remains for a multivariate earnings function analysis to be done to sort out whether government wages are higher than for comparable labor. In sum, it does not appear that public sector pay policy has any major distortive effect on the overall wage structure.

**Public Sector Employment.** The government employs half a million workers directly and another three-quarters of a million in public sector corporations and state-aided institutions—most importantly, tea and rubber estate workers on the nationalized plantations. This is one-fourth of total employment and more than 40% of all paid employees in the country.

Although so large a public sector creates the possibility of a

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18/ This paragraph is based on data in the *Survey of Consumer Finances, 1981/82*, pp. 148-151.
distortive situation, there is little evidence that it actually is. Unlike in other developing countries, complaints are not heard about a bloated, inefficient civil service. Nor is public sector pay out of line with pay in the rest of the economy. It appears that government and quasi-government employment are so large because so many economic sectors are under public control.

Other Policies Affecting the Labor Market. Another possible area of public policy affecting the labor market is non-wage regulation of employment conditions. Sri Lanka has refrained from some of the highly-interventionist policies found elsewhere. Panama, for instances, has imposed a labor code which mandates heavy social security and other contributions by employers and makes it difficult if not impossible for employers to lay off or discharge workers. Employers in Sri Lanka face no legal barriers to discharging workers. Sri Lankan employers are compelled to make payments into a provident fund to provide pensions and other worker benefits, but the amounts are not nearly as large a percentage of payroll as they are, say, in Singapore. On the whole, then, the operation of the labor market in Sri Lanka reflects forces of supply and demand; non-market intervention in the labor market is not a major factor.

AN OVERALL ASSESSMENT OF PUBLIC POLICY AND THE EVOLUTION OF THE LABOR MARKET

We have seen that the rural-urban division of the labor force in Sri Lanka is effectively unchanged from what it was twenty years ago and that other changes in the structure of the labor market in Sri Lanka have been relatively modest. The interpretation I wish to offer for the non-change in Sri Lanka is that various aspects of public policy have had the effect of
reinforcing the existing structure.

The aforementioned features of structural change or non-change in the labor market are best understood in terms of the constrained choices of workers. That is, the level of economic development and the structure of earning opportunities are the constraints, and workers make labor market choices within the opportunity sets open to them. When publicly-provided goods and services are made available to residents throughout the country and not just to city-dwellers, workers have less incentive to migrate to the cities. And when the structure of production and the consequent structure of demand for labor are changing little, workers will supply their labor in more or less the same ways as they did before. Therefore, to the extent that private sector developments and public policy actions perpetuate or reinforce the existing industrial and geographical structures without a clear bias in favor of one part of the economy at the expense of the rest, the changes that take place in the labor market will appear primarily within the prevailing structure of demand and supply rather than being manifested as changes in labor market structure.

The primary way in which public policy in Sri Lanka is concerned with the labor market is through attempting to upgrade employment conditions and earnings within the existing sectoral distribution of the work force. Paddy growers receive subsidized fertilizer and other inputs, new lands are opened up through irrigation and settlement schemes such as the Mahaweli project, etc. This contrasts with the predominant policy concern in many other developing countries: to effectuate a structural shift in employment patterns so that growing numbers of workers can move out of relatively low-paying "traditional" kinds of activities into better-paying "modern" kinds of
activities. This is not to say that government fails to encourage growth of the modern sector; witness, for example, the creation of the Investment Promotion Zone as a means of stimulating exports and employment. The point, rather, is that the emphasis of policy is on traditional sector enrichment kinds of activities.

Some policies have been large in monetary terms but small in terms of effects on labor market structure. The Sri Lankan labor force consists of more than 5 million persons. Land settlement and irrigation schemes account for more than 40% of the government's capital budget. Yet, after more than 20 years, only 80,000 families have been settled onto new lands—perhaps 2-3% of the total labor force. Land reform was promulgated but only landholdings in excess of 50 acres (25 acres in the case of paddy) were taken over and redistributed. Around one million acres were subject to the reform, but most of this was a transfer of large tea and rubber estates from private to public control. The tea and rubber estates were nationalized, but the structure of production changed little; production on very large units remains the norm.

And the Investment Promotion Zone, despite all the attention paid to it, has created only about 40,000 jobs—enough for not even 1% of the labor force. This would make only a dent in the overall labor force situation and certainly not be enough to stimulate massive rural-urban migration. In sum, these policies have brought about only limited structural change and have had no obvious bias in stimulating urban growth at the expense of the rural sector.

By contrast, the one area of public policy that appears to have had a very substantial effect is social welfare policy. As a result of the high level of these expenditures and the decentralized distribution of the benefits, a strong inducement is provided to rural workers to remain in the
countryside. Unlike so many other countries, rural workers in Sri Lanka don't need to migrate to the cities to find health clinics or food subsidies for themselves or schools for their children.

Sri Lanka's labor market policies have also had the effect of perpetuating the rural-urban balance. By avoiding the gross imbalances found in so many other economies, the incentives for workers to migrate to the cities in pursuit of high wage jobs are lessened.

On the whole, although the labor market in Sri Lanka has been allowed to adjust to supply and demand conditions in various sectors and localities, not too much evolution of labor market conditions has occurred. Demand conditions have changed little. Workers have been free to supply their labor within the country or abroad without undue interference. Wages are and have been largely market-determined. As a result, the structure of constrained choices facing the workers of Sri Lanka and the consequent choices made are little different from what they were ten or twenty years ago.

Looking ahead, in the absence of fundamental change, the prospects for substantial labor market evolution are not encouraging. Improvements in labor market conditions in the estate sector are not likely. Tea and rubber are sold in highly competitive world markets; there is not much Sri Lanka can do to improve her position dramatically. The agricultural sector is plagued by severe seasonality. Off-farm industrial activities are not emerging to provide full-year employment. Paddy has been the fastest-growing agricultural sector. But though the rice produced is suitable for domestic markets, nearly enabling Sri Lanka to attain self-sufficiency in the staple food, the rice is not of high enough quality to be viable in world markets. As for the industrial sector, it has been growing slowly. Domestic investment is
limited. Foreign investors continue to be wary of Sri Lanka. Their caution is due in part to past nationalizations and to an unwillingness of Sri Lankans to embrace multinationals as partners in development. The investment climate is also an uneasy one due to the ethnic conflict which threatens to erupt into full-scale civil disturbance at any time.

This is not to say that the situation is hopeless or that improvements in labor market conditions in Sri Lanka are out of the question. What it does say is that unless communal conflicts subside and the country decides on a clear course for development in either a capitalist or a non-capitalist format, it would not be at all surprising to find that the labor market will evolve as little in the next decade or two as it has in the past years.
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