

- PN-ACT-780 -

NATIONAL PRODUCTIVITY POLICY FOR SRI LANKA

-PRIVATE SECTOR COMPONENT-

PRODUCTIVITY FOR A
PROSPEROUS NATION



Ministry of Employment & Labour
www.slproductivity.org

The cover design, like the notion of productivity, can mean different things to different people.

Our artist has sought to convey the idea that people are at the center or core of the productivity process.

People are the prime movers and the ultimate beneficiaries of a collaborative effort to improve their lives by making their livelihoods more productive and rewarding.

The center or core can also be seen as a seed, a crucible, a key or as a stylized 'C', representing competitiveness.

From within the core or crucible, people work together to create a productivity energy that radiates outward to brighten their future.

Table of Contents

	Page
Background	1
Executive Summary	3
Chapter I	
Why Productivity is Important	7
Chapter II	
Current Economic Crisis	9
II.1 The Recession of 2001	10
II.2 Sri Lanka Lags Behind Other Asian Economies	12
II.3 The Economic Challenge Ahead	
Chapter III	
Sri Lanka's Productivity Record	
III.1 National Productivity Growth	17
III.2 Productivity by Sector	18
III.3 Productivity at the Firm Level	22
Chapter IV	
How to Achieve Productivity Growth: Vision, Goals and Overview of Strategies	29
Chapter V	
Policy Recommendations	
V.1 Establish a Supportive Economic Framework	31
V.2 Encourage More Savings and Better Investment	32
V.3 Improve Labour Market Flexibility	33
V.4 Develop the Workforce	36
V.5 Enhance Enterprise-Level Productivity	38
V.6 Encourage New Businesses and Support SMEs	38
V.7 Encourage a Culture of Quality and Productivity	41
V.8 Implement Policy and Monitor Progress	42
Chapter VI	
Conclusion	45

List of Figures and Tables

	Page
Figure 1: Average GDP Per Capita 1990-99	11
Figure 2: Average GDP Growth Rates 1990-99	11
Figure 3: Average Savings Rates 1990-99	11
Figure 4: Average Productivity Growth 1990-99	12
Figure 5: Composition of Gross Domestic Product	14
Figure 6: Agriculture - Labour Productivity and Minimum Wages	19
Figure 7: Industry - Labour Productivity and Minimum Wages	20
Figure 8: Services - Labour Productivity and Minimum Wages	20
Table 1: Composition of Productivity Growth 1990-99	19
Table 2: Ten Industries with Highest Productivity Growth 1990-99	21
Table 3: Ten Industries with Lowest Productivity Growth 1990-99	21
Box 1: Selected Productivity-Related Rankings for Sri Lanka	13
Box 2: Measuring Productivity	17
Box 3: Case Study: National Labor Relations Board of USA	25
Box 4: Productivity Through Decent Work	28

List of Annexes

Annex 1: Terms of Reference for Formulating a National Productivity Policy and Action Plan	47
Annex 2: Decent work and productivity in Sri Lanka	51
Annex 3: International Labour Organization (ILO) Conventions Ratified By Sri Lanka	55
Annex 4: Advisory Committee Members	57
Annex 5: Team of Consultants	59



Letter from the Advisory Committee

Hon. Mahinda Samarasinghe
Minister of Employment and Labour and
Chief Government Whip

Dear Minister,

Your Advisory Committee on Productivity involved in development of a National Productivity Policy for Sri Lanka is pleased to present this report covering Private Sector Productivity issues.

At your invitation, a group of individuals selected from the ranks of management, labour, and government agreed to undertake the assignment of forming themselves into an Advisory Committee on Productivity to oversee production of a draft policy outlining the measures Sri Lankans must take to increase national productivity on a sustainable basis -- ensuring that the discussion and planning process itself be open, transparent and inclusive.

To this end the committee prepared a draft Terms of Reference that was reviewed in a workshop of more than 150 persons, and then issued to a team of international and local consultants, supported by the United States Agency for International Development (USAID) through the Competitiveness Initiative. That team reported periodically to the Advisory Committee, and in mid-August completed a report that was circulated to the members for comments and a special review session.

It is the consensus view of the Committee that productivity growth is the key to Sri Lanka's future prosperity, that productivity growth is the only engine capable of raising the standard of living of all Sri Lankans, and that productivity growth combined with gain-sharing will create the incentives that can sustain future increases in productivity, insuring attractive work opportunities and better quality of life.

The committee has reviewed the report and included in it a Vision and Mission statement. We believe that the report presents an effective message that needs to be conveyed to the wider public, and it can be a document based on which a final policy can be formulated after further consultation with all stakeholders. The recommendations lay out the key reforms that need to be implemented at the national and enterprise level including a campaign to heighten awareness of the importance of enhancing productivity at all levels of society.

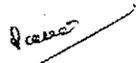
The Committee recognizes the interconnection between this report and the earlier released report, 'Draft National Employment Policy' (DNEP). Many of the proposals for increasing productivity complement and reinforce recommendations from the DNEP, especially in areas related to improving the quality of the workforce and the efficiency of labour markets, and re-defining the nature of management-labour relations. The Committee also notes that issues related to public sector productivity and the efficiency of government services provided to the private sector are to be addressed in a forthcoming study for which the Minister has engaged the services of the Asian Productivity Organization.

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We believe this report is a valuable step in a process whose results will depend on successful implementation efforts by leaders and individuals from all walks of life. The members of your committee look forward to contributing to the all important next phases – broadening national awareness, formulating strategies, action plans and inaugurating successful implementation.

Yours truly,

Members of the Advisory Committee


J. Abeywickrama


N.S. Adihetti


S. Amarasinghe

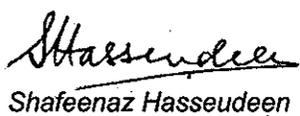

Gotabaya Dasanayake


Leslie Devenra

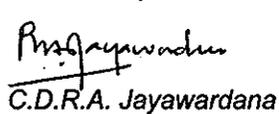

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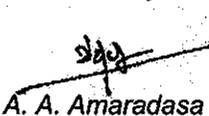

Ranjith Fernando


Malin Goonetilleke

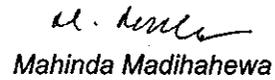

Shafeenaz Hasseudeen


S. S. Hewapathirana


C.D.R.A. Jayawardana


A. A. Amaradasa

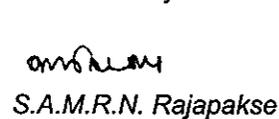

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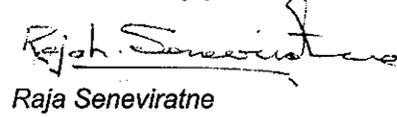

Mahinda Madihahewa


Kumar Mallimarachchi


R.M.I. Padmini

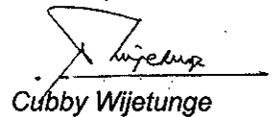

S. W. Pathiraja

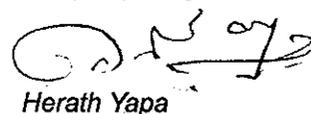

S.A.M.R.N. Rajapakse


Raja Seneviratne

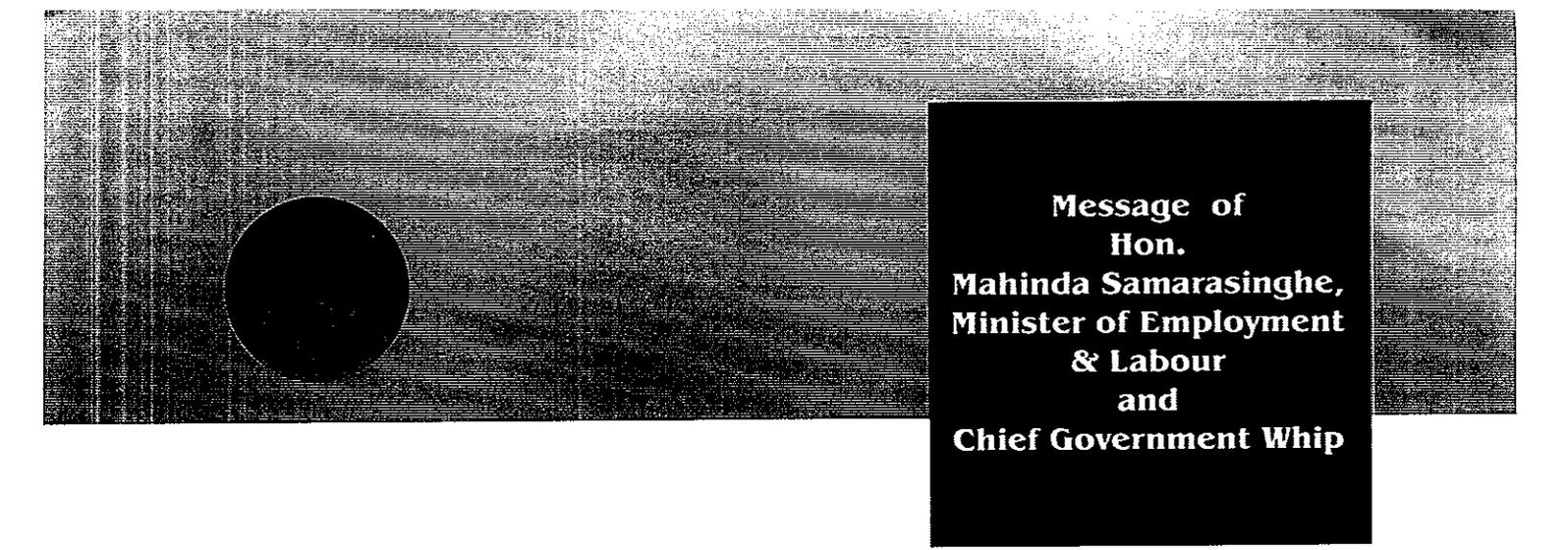

Nathan Sivaganandan


Sunil Wijesinha


Cubby Wijetunge


Herath Yapa


Anton Fernando



**Message of
Hon.
Mahinda Samarasinghe,
Minister of Employment
& Labour
and
Chief Government Whip**

Productivity and its growth is of vital concern to all countries in today's global economy. Sri Lankans from the private and public sector have been urging the government to undertake a comprehensive review of national productivity on a priority basis. At the direction of the Hon. Prime Minister, Mr. Ranil Wickremasinghe, the responsibility of developing a National Productivity Policy was assigned to the Ministry of Employment and Labour recognizing that such a policy would complement the Draft National Employment Policy, also assigned to this Ministry. As a first step towards formulating this policy, a Tripartite Advisory Committee was appointed, composed of leading citizens from private sector companies, the trade unions and the Government. With support from United States Agency for International Development (USAID), The Competitiveness Initiative was commissioned to field a team of consultants, both international and local, to prepare a report focused on private sector productivity using terms of reference developed by the Tripartite Advisory Committee.

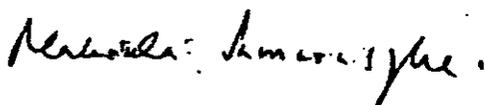
Globalisation has brought new challenges to our economy, chief among them the challenge to increase our productivity. The benefits from meeting this challenge include new investment, higher paying jobs, more opportunities for our children and a better standard of living. The penalty for failure is economic stagnation – an economic cake that never grows fast enough to meet the needs of future generations. Historically this path has led to social stress and soon after to civil strife.

We are an island economy that has played an important role in the development of international commerce and agriculture -- a role far larger than our size alone would suggest. Our contributions rested on a combination of hard work – perspiration, but also on inspiration, innovation and experimentation. Productivity is in our genes. We only have to encourage its development. I believe that this Policy will form the basis for constructive debate that will help us realise a policy that enables us to stimulate productivity growth and thereby improve our quality of life.

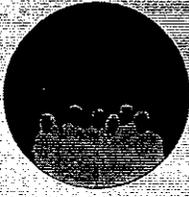
After much study and deliberation, the Advisory Committee has formulated and endorsed a set of initiatives that will help create the conditions for accelerating and sustaining productivity growth. In September 2002, I will present this report to the Hon. Prime Minister. In my endeavour to make this programme transparent and participatory, the Policy will be available on the National Productivity Policy Web page, developed specifically for this purpose, thus enabling further improvements and to build on the recommendation put forward by the Advisory Committee.

Productivity growth is a responsibility that rests on the shoulders of everyone, from the business people and workers in the most advanced branch of computer science, to farmers, bankers, government officials, truck drivers, teachers, homemakers and even school children. The Ministry of Employment and Labour will play a pivotal role in the implementation of the policy recommendations and in the process of monitoring progress. However, the overall success of this endeavour will depend on the collective efforts of all the stakeholders including employers, employees, trade unions, non-governmental organisations, training institutions and the Government. The tripartite approach followed in arriving at the Policy is a testament to successful cooperation among stakeholders. More such cooperation encompassing more stakeholders lies ahead, and I am mindful of the need to work in a coherent manner with other Ministries in order to ensure the Government's overall commitment towards this process.

On behalf of the Ministry of Employment and Labour, I want to thank the Advisory Committee, USAID, and other organisations and individuals who contributed towards drafting this report.



Mahinda Samarasinghe



**Message of
Mahinda Gammanpila
Secretary
to the Ministry of
Employment
and Labour**

Hon. Mahinda Samarasinghe, as the Minister of Employment and Labour embarked on formulation of the National Productivity Policy which is a major policy initiative, considering the critical importance of the enhancement of productivity in the national development effort.

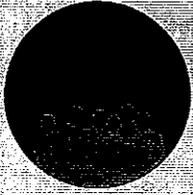
Going by the best traditions of labour sector, of having tripartite consultation, an advisory committee consisting of all three social partners, namely the employers, employees and the government was appointed to begin with this exercise, which was a great strength.

This document focuses on the private sector whilst its parallel focuses on the public sector initiatives.

The cooperation of all parties concerned is envisaged for the implementation of the national policy, once it is formally accepted by the government.

I take this opportunity to thank all those who helped to make this effort a success.

Mahinda Gammampila



'Regaining Sri Lanka - The Way Forward'

- Selections -

"The most important determinants of the high incidence of poverty in Sri Lanka today have been the war that has raged for two decades and a legacy of poor economic management. This Government is fully committed to overcoming both of these challenges and building a country that is at peace and that provides the social and economic opportunities necessary for all of its citizens to meet their needs and lead fulfilling lives.

The poor economic management in the past has to a large extent been the result of the inability to effectively implement change. We have known for a long time what steps were needed to improve economic performance – but too often these steps were not taken. Sri Lanka began the process of liberalization and reform in 1977, seeking to reverse a regime of nearly total state control of the economy and near universal deprivation. This process began well and produced good results, but over time it has lost its momentum, reaching the point where last year Sri Lanka experienced its first serious economic contraction and we found ourselves nearly buried under a rapidly expanding public debt..."

"There is only one way ahead." That is achieving substantially higher economic growth... not just 4 and 5 percent per year but 8 to 10 percent. Not just for the short term, but over a number of years..."

"We must improve productivity in all areas to achieve rapid economic growth. This is possible only if we aggressively seek investment and market possibilities for our goods and services around the world. For too long, significant parts of our economy have remained inefficient and uncompetitive. The burden of this always fell on the productive sectors. But how did countries such as Singapore, Thailand and China succeed in attaining rapid economic development? They embraced comprehensive reforms aimed at increasing productivity in all sectors, including the government and the public sector..."

"Our core strategy involves accelerating economic growth by removing the barriers to productivity and putting in place review mechanisms to ensure that new barriers do not arise. Improved productivity is also essential to increase incomes and attract increased investment..."

Decent Work Agenda

International Labour Organization

~ ~ *Decent Work Works* ~ ~

"The ILO has always emphasized the importance of regulating labour markets, for preventing exploitation, promoting security, building consensus and encouraging social integration. But the organization needs to go beyond the moral high ground and also make a case on economic grounds. Safe and secure workplaces do not just meet vital human needs, they also boost productivity and enable businesses to grow."¹

Increased productivity will be imperative to build up Sri Lanka's economic growth rate. But sustainable growth entails more than adding value to products and services. It is for people that prosperity is created. It is people that make society prosper. Work is a defining element of our material existence, in the sense that it allows us to be consumers and meet our fundamental needs. "Lets remember that it is through work – and work which is accomplished in conditions of freedom, equity, security and human dignity – that people can rise out of poverty, earn a decent living and relate to society and the environment in a truly sustainable way".²

The Decent Work Agenda, promoted by the International Labour Organization (ILO) emphasizes the importance of human and social capital for sustainable growth and productivity. The concept of Decent Work is the product of a very wide process of consultation, and was endorsed by its 174 member states. It is not an abstract intellectual construct, but something that embodies the reality, the aspirations and expectations of men and women throughout the world.

Decent work is about providing access to quality employment. It is also about protecting workers and their rights—an essential goal, if workers are to recognize a personal stake in enhancing competitiveness and productivity. The

decent work agenda includes four main pillars: equal access to productive and remunerative jobs without discrimination; a safe working environment; social protection and workers' rights; and social dialogue.

The fundamental premise is that adopting a decent work agenda is the surest way to sustained productivity in a highly competitive world. Specifically, this high road to development requires that (i) employment promotion is integral to economic growth plans; (ii) both quality and quantity of jobs are equally guaranteed; (iii) the enhancing of skills and employability are primary goals; (iv) the rights of workers are safeguarded and their voice is heard; (v) the workforce has access to basic protection.

"Lets acknowledge that changing unsustainable production and consumption patterns, through environmentally friendly technologies, means a revolution in the way we work and in the things we make. Lets address the fact that the present form of globalization is exacerbating rather than bridging social divisions within and between countries. Many throughout the world are deeply disturbed, and downright angry, at the failure to reverse these trends. To humanize globalization, we need to build a strong synergy between social, environmental and economic policies."³

This is what the Decent Work Agenda stands for. And, contrary to what some may suspect, decent work and better productivity are not mutually exclusive, but instead, go hand in hand.⁴

¹ Decent work, The report of the Director general to the 87th Session of the International Labour Conference.

² ILO Director General's Address to the World Summit on Sustainable Development in Johannesburg, August 2002

³ idem

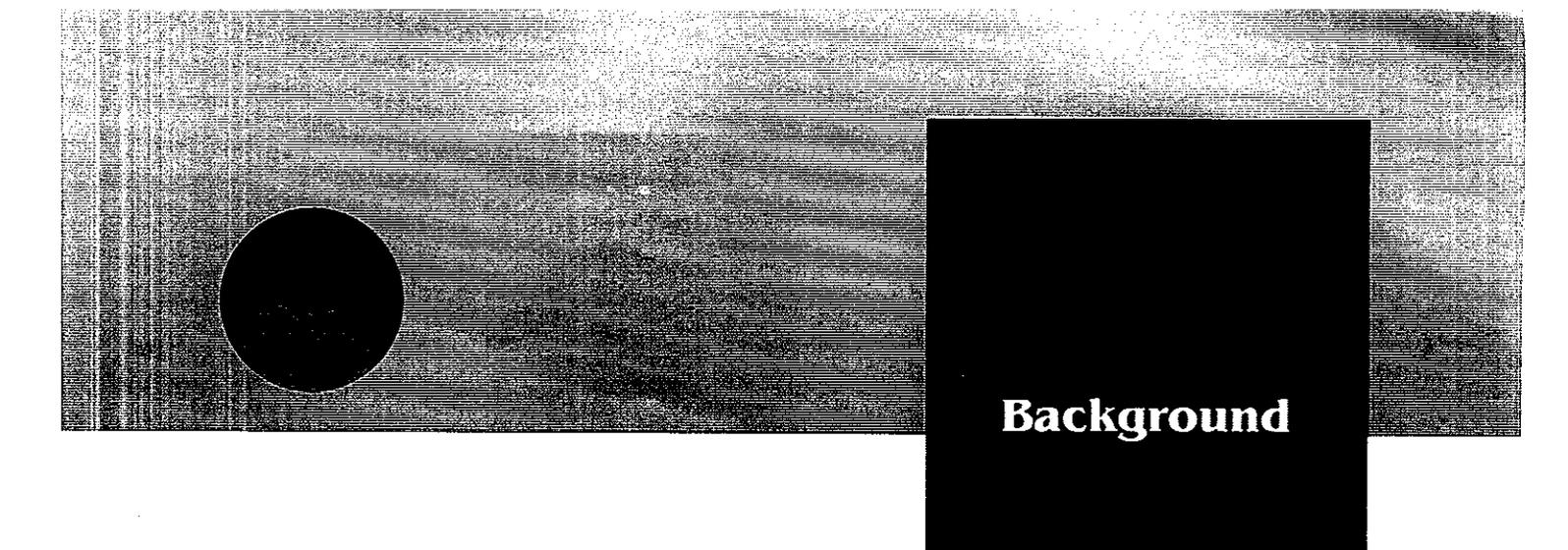
⁴ See Annex 2, *Decent Work and Productivity in Sri Lanka*

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Background

Productivity growth is the most critical factor for improving the future standard of living for Sri Lankans. Yet, Sri Lanka's productivity growth has been significantly less than in other countries in South and East Asia. Low productivity growth is the main reason Sri Lanka's economic growth rate has lagged behind that of leading countries of the region. Behaviour, constraints and policies that have kept Sri Lanka from achieving gains in productivity have to be identified and overcome. The transformation process requires a well thought out policy comprising all spheres of the economy and all sectors of the society.

The Prime Minister has assigned the subject of productivity to the Ministry of Employment and Labour (MEL). In response to the above the MEL established a special Advisory Committee with tripartite representation to undertake the task of formulating a National Productivity Policy. That committee developed a terms of reference for a team of consultants to follow in advising the committee on policy options that will re-energize private sector productivity. This is the report delivered to and reviewed by the MEL special advisory committee. It is purposely titled 'National Productivity Policy - Private Sector Component', because its purpose is to continue the process of a transparent approach to a national level discussion that openly encourages participation and contribution from all sectors.

The Government of Sri Lanka (GOSL) is committed to implementing a transparent and participatory approach to developing a National Productivity Policy embracing both the public and private sectors. The National Productivity Policy - Private Sector Component is one of three cornerstone policy reviews undertaken by the Ministry of Employment and Labour. The other two are the National Employment Policy, and the

National Productivity Policy for the Public Sector. Many of the initiatives discussed below complement or rely upon implementation of initiatives put forth in the National Employment Policy.

In a workshop in March 2002, attended by over a 150 persons from business, labour, government and academia, the participants provided overall guidance for the structure of the productivity policy presented below. Specifically, they recommended the adoption of the vision, objectives and many of the initiatives found below. This paper will now be reviewed by the Government, Employers, Employees and representatives of civil society so as to develop a National Productivity Policy informed by and thus supported by the Sri Lankan society. This support is necessary, as the implementation will require the active cooperation of not only multiple ministries of the Government but also of employers, employees, educators and civil society. The Ministry welcomes your feedback and comments.

At the end of September a tri-partite delegation of Sri Lankan trade union leaders, business managers, and government officials traveled to the United States of America (USA) to meet with counterparts in government, business and trade union groups concerned with issues of productivity and employment. The group returned and formed committees to continue their research into institutions, programs and best practices that have succeeded in enhancing productivity growth over long periods of time. This group and the Ministry also met with staff from the Colombo office of the International Labour Organization regarding Sri Lanka's ratification of ILO conventions and ILO recommendations on labour practices and productivity, in particular unemployment insurance.

Executive Summary

Productivity is the key to prosperity. Improving productivity must be the goal of all Sri Lankans – the government, employers, employees, educators and the broader population. Productivity is the key to our children's future and Sri Lanka's future. Productivity is the key to lifting the poor out of poverty and improving living standards for all Sri Lankans. Productivity is prosperity.

Sri Lanka's economy is currently in crisis. For the first time in history, economic growth fell by almost 1.5% in 2001. Exports fell by 13% and manufacturing output fell by 4% while inflation rose by 14%. Government finances are similarly in crisis. After years of budget deficits, the Government debt currently equals more than the value of all the goods and services produced in Sri Lanka in a full year. Debt service is now greater than our tax revenues. The only way out of this difficult situation is to increase productivity and economic growth even while reining in the Government deficit. Boosting productivity has been made the cornerstone of economic policy. The welcome recovery of 3.5% GDP growth in 2002 can only be sustained by continuing to improve productivity. The transformation strategy requires a well thought out policy with clear responsibilities for all sectors of the society.

The Prime Minister has assigned the subject of productivity to the Ministry of Employment and Labour. The Ministry began immediately by engaging technical expertise and the broader public in a workshop in March 2002. The 150 persons from business, labour, government and academia recommended the adoption of the following Vision, provided an overall framework for the policy and recommended many of the initiatives described below. A team of international and Sri Lankan productivity experts then drafted this initial document based on this guidance. A draft "National Productivity Policy –

Private Sector Component" was then presented to a public workshop for comments and improvements.

The workshop participants recommended the following vision and mission statements:

Vision

A future of peace and prosperity in which all Sri Lankans enjoy a higher standard of living and a better quality of life achieved through steady improvements in productivity at the individual, firm, and national level - with the gains shared equitably across all occupations and walks of life.

Mission

To promote economic growth and social stability through enhancement of productivity in the formal and informal sectors of the economy, through progressive labour-management relations, improved gains sharing, technology, investment, and a sound, supportive legal, regulatory and administrative framework.

The standard definition of productivity is output per worker hour. But productivity is not about making people work harder or longer. It is about investing more and investing better to enable people to create more value for themselves and others.

This report recommends that specific targets be established for productivity, savings, investment and gradual reduction of government deficits. It also presents eight main groups of initiatives for subsequent review and comment. Some of these initiatives will require government leadership; others will require the leadership of employers, employees, trade unions and educators. Many will require joint implementation. The initiatives are summarized below and discussed in more detail in the ensuing chapters.

Initiative 1: Establish a More Supportive Economic Framework

- Reduce the budget deficit, in ways that support productivity gains.
- Eliminate burdensome laws, regulations, permits and rules that restrain investment and economic activity unnecessarily.
- Reform the budget process so that the government has a better idea of its medium and long-term commitments.
- Secure peace; uphold the rule of law; promote domestic tranquillity.
- Resuscitate and expand national infrastructure, issue infrastructure bonds.
- Improve public sector productivity.

Initiative 2: Encourage More Savings and Better Investment

- Offer long-term savings instruments with inflation protection, including infrastructure bonds.
- Promote private retirement saving through tax incentives.
- Reform the pension system.
- Improve efficiency of the banking sector.
- Disseminate technological information to promote new investment.

Initiative 3: Improve Labour Market Flexibility

- Establish an unemployment protection scheme.
- Modernize labour laws.
- Set up employment centres (e.g. JOBSNET) throughout the country and improve labour market information.
- Reform private sector compensation schemes.
- Strengthen outplacement efforts.

Initiative 4: Develop the Workforce

- Encourage life long learning.
- Link unemployment insurance to training.
- Establish regional workforce boards, comprised of representatives from business, labour and academia, to provide oversight to government funded training.
- Issue industry level skill certifications.
- Encourage private firms that provide training and apprenticeship.
- Provide skills training to ex-combatants.

Initiative 5: Enhance Enterprise-level Productivity

- Employers/Owners should demonstrate leadership in raising productivity at the firm level.
- Adopt more effective strategies and management techniques.
- Redefine labour-management relations.
- Invest in productivity enhancing technology.

Initiative 6: Encourage New Businesses and Support Small and Medium Enterprises (SMEs)

- Simplify start up process for new businesses and exit process.
- Reinvigorate technical assistance centres.
- Promote venture capital, encourage patent applications, promote incubators.
- Disseminate information on starting new businesses and resources available for SMEs.
- Incorporate entrepreneurship into the education system.

- Exploit synergies with existing firms.
- Broaden scope of credit guarantees for SMEs.
- Government procurement set asides for SMEs.
- Effective credit background checks, specialized banking services for SMEs.

Initiative 7: Encourage a Culture of Quality and Productivity

- Launch a civic awareness campaign.
- Use creatively the established web site to solicit input on the development of the national productivity policy, and to disseminate the recommendations.
- Hold community meetings to present the national productivity policy and discuss its recommendations.
- Use television, radio and print to increase awareness to the need to improve productivity.
- Disseminate information on 'best practices'.
- Recognize and reward firms making strides in quality and productivity.
- Encourage school programs that increase awareness of productivity and quality.
- Fully implement ILO conventions already ratified by Sri Lanka. (Annex 3)
- Ministry of Labour should provide government agencies representing Sri Lanka in international trade and investment talks with up-to-date information and examples of Sri Lankan compliance with ILO conventions.

Initiative 8: Implement Strategy and Monitor Progress

- Improve collection of economic and labour market data.
- Establish specific targets for debt reduction, savings, investment and productivity growth.
- Reorganize the National Productivity Secretariat to monitor implementation of national productivity strategy recommendations and measure productivity trends.
- Develop the Productivity Advisory Committee.
- Coordinate across government on productivity policy issues.
- Establish a National Competitiveness Council.

Most of these initiatives reach far beyond the specific authorities and implementation responsibilities of the Ministry of Employment and Labour. That is the reason for the initiative calling for an inter-ministerial cooperation in implementation. Indeed successful implementation will require understanding, consent, and dedicated cooperation from agencies and individuals throughout civil society.

By implementing the above initiatives Sri Lankans will see their standard of living begin to improve and continue to improve at rates the country has not enjoyed for many years. The results are visible in other countries in the region and – at the firm level – among leading firms in Sri Lanka. The gains can be accelerated and spread by making the quest for productivity a habit ingrained in society at the national, firm, and individual level.

Why Productivity Is Important

Improving productivity must be the goal of all Sri Lankans – the government, employers, employees, educators and the broader population. Productivity is the key to our children's future and Sri Lanka's future. Productivity is the key to lifting the poor out of poverty and improving living standards for all Sri Lankans.

Productivity holds the answer for the youth of today who are looking for jobs and for those who now must emigrate to find productive work abroad. Productivity growth will enable employers to pay workers more, without contributing to inflation.

What is this productivity? It is the relationship between the products or services produced and the resources used in their production. The potential for economic growth is limited by the availability of our labour, land and capital and the ability to convert those resources into goods and services. The efficiency by which this conversion takes place is called "productivity." Productivity growth then is about creating the same or more goods with less resources or alternatively making superior quality goods with equal or less resources. It does not mean that everyone involved in the process works "harder" but rather that they work "smarter".

Without improving productivity, we stagnate while the world moves ahead. The long-run sustainable economic growth rate of the Sri Lankan economy is limited by increases in the labour force, capital stock and their productivity. Since there is not much that can be done to significantly increase the growth of our capital and labour force in the immediate future, the principal way to stimulate economic growth is to improve our productivity.

Further, the rate at which productivity grows determines the rate of job creation – higher productivity means greater profits, which if invested efficiently, stimulates demand for labour

and attracts more investment. Increasing productivity creates a virtuous cycle that is the only way to achieve sustainable improvements in the standard of living for all Sri Lankans.

Furthermore, productivity preserves peace. Economic stagnation and inadequate job creation are the enemies of social progress and may have played a role in the hostility that developed on this island a generation ago. Productivity and prosperity perpetuate peace by providing more of life's necessities and amenities for all, and creating a sense of shared accomplishment.

Productivity is the key to improving family life because economic tension and long hours take their toll at home. Productivity is the key to dignity because it calls upon each individual to improve himself and herself, to find ways to add value to activities at home and in the workplace.

Increasing Productivity is central to the government's plan for accelerating economic growth.

"Our core strategy involves accelerating economic growth by removing the barriers to productivity and putting in place review mechanisms to ensure that new barriers do not arise. Improved productivity is also essential to increase incomes and attract increased investment." *The Future: Regaining Sri Lanka.*

Increasing productivity in the workplace and throughout society is also an international cause championed by the member countries of the International Labour Organization (ILO), including Sri Lanka. Annex 2, "Decent Work and Productivity in Sri Lanka", is a contribution to this report prepared by the ILO that highlights the importance of investing in human and social capital in order to sustain growth in productivity.

For all these reasons, it is imperative that we work together to boost productivity so that all of our people can have better lives.

The Current Economic Crisis

It is important for all of us to realize that the Sri Lankan economy is currently in crisis. The purpose of the realization is not to attach blame, but rather to bring the country together in an effort to redirect ourselves toward a path that will lead to prosperity instead of stagnation. The Government debt currently exceeds the value of a full year's worth of all goods and services produced in Sri Lanka. We need to borrow money just to make payments on our already outstanding debt, further increasing our debt.

Over the last several years, our government has been running large budget deficits, in part, but not totally due to the increased security burden. Our government has been forced to borrow what little capital has been available to finance those deficits. The pool of available capital has been further limited by the decline in foreign investment, also, due in large part to the security situation. This build up in debt has acted as a brake on the ability of our economy to grow. Resources that were needed for investment and job creation in the private sector were instead diverted to finance our outstanding debt. This has caused interest rates to rise and economic growth to slow. The growing current account deficit has also placed downward pressure on the value of the Sri Lankan rupee relative to other major currencies, thus raising the cost of imported goods and further fuelling inflation.

This crisis is more evident in the country's financial books than on our streets and in our homes. It is also evident in the poor quality of our infrastructure and the outdated equipment in our factories. No society can long afford this kind of stagnation.

If nothing is done soon to reduce this enormous debt overhang, and accelerate economic growth, we will experience the kind of massive unemployment and poverty, which countries like Argentina, Brazil and Indonesia have recently been enduring.

Raising productivity growth is critical in order for Sri Lanka to get out of our current economic crisis. Higher productivity growth will result in higher economic growth, which in turn will help reduce Sri Lanka's heavy debt burden. Strong productivity growth can also improve the ability of Sri Lankan products to compete in international markets.

Increasing the efficiency by which natural resources, labour, capital and technology are used to produce goods and services, keeps prices low. This, in turn, improves the sales of those goods and services in international markets. The increased demand for these goods and services will lead to more jobs at home and higher wages for our workers.

II.1 The Recession of 2001

The Sri Lankan economy is currently recovering from its worst slowdown since its independence from Britain in 1948. Economic growth, which averaged 5 percent a year over the last decade, fell by almost 1½ percent in 2001.

The economic downturn in 2001 was due to several factors:

1. A drought that crippled agriculture;
2. Power shortages that hurt industrial production and overall productivity;

3. An increase in terrorist activities, including an attack on Bandaranaike International Airport that devastated the tourist industry and led to the imposition of a war-risk insurance surcharge on international air and sea transport;
4. Political and policy uncertainty due to the fragile parliamentary coalition that eventually collapsed; and
5. An economic slowdown in the United States and Europe, Sri Lanka's primary export markets.

As a result, exports fell by 13 percent, investment fell by more than 20 percent, industrial output was down 2 percent and tourist arrivals were down by 16 percent, after falling more than 8 percent the previous year.

- After expanding by approximately 8 percent per year over the last decade, manufacturing output fell by 4 percent last year and another 4 percent in the first quarter of 2002.
- The service sector was basically flat, after expanding by about 6 percent per year over the last decade. The tourism industry was devastated.
- Agriculture, Sri Lanka's least dynamic sector, growing by less than 2 per cent per year over the last decade and registered a 3 percent contraction in 2001.
- Inflation, which fell to 6 percent in 2000, rose to 14 per cent in 2001.

The current crisis is due in part to a cyclical downturn in the global economy and in part to unfortunate events of 2001 and in part to structural problems in the Sri Lankan economy that have held back productivity growth and weakened the economy's ability to cope with cyclical problems and recover from occasional shocks.

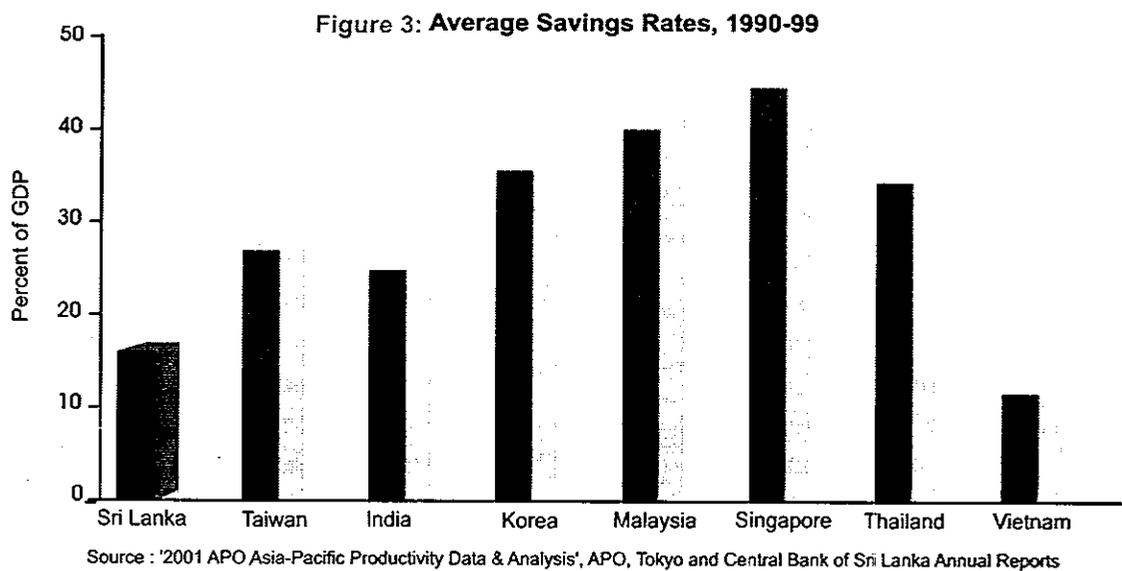
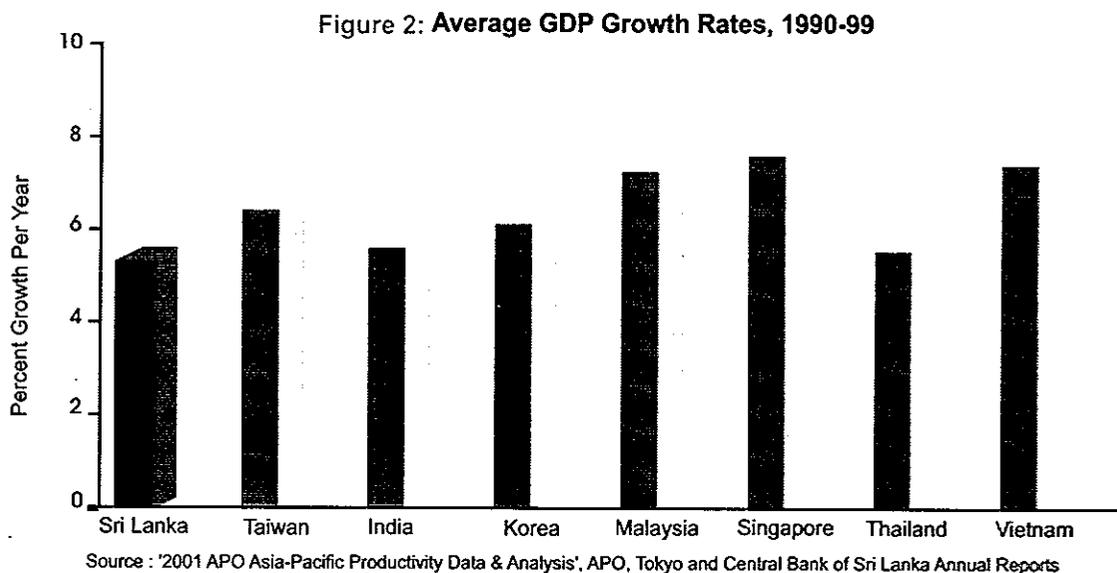
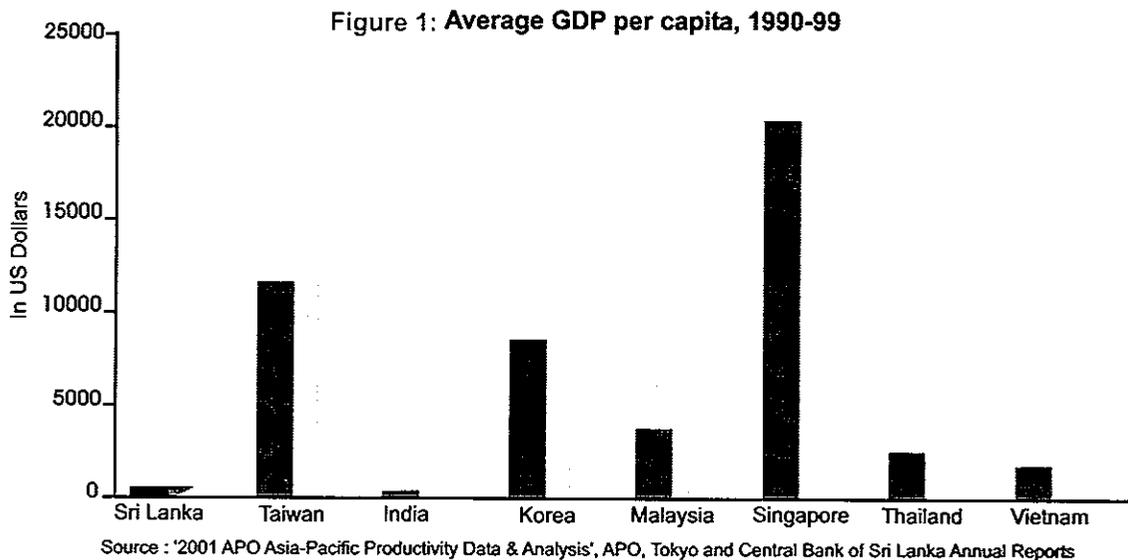
II.2 Sri Lanka Lags Behind other Asian

Economies

Over the last 20 years, several of Sri Lanka's neighbouring countries in Asia have been liberalising their economies, opening their markets to foreign trade and investment and pursuing a high growth economic strategy. As a result, they have become some of the world's strongest economies, referred to as the 'Asia Tigers'.

Sri Lanka not only has to make up for the lost generation of economic development, but it now faces more intense international competition than it did 20 years ago.

- Average per capita GDP in Sri Lanka over the last decade (1991-1999) was less than half that of Thailand, one-fifth that of Malaysia, one twelfth that of Korea and one thirtieth that of Singapore. (Figure 1)
- Average annual GDP growth rates during the 1990s in Korea (6 percent), Malaysia and Singapore (approximately 7½ in each) were 20 to 50 percent higher than in Sri Lanka (5 percent). (Figure 2)
- Sri Lanka's saving rate, high relative to many industrialised countries, is significantly less than in other Asian economies. The average gross domestic saving rate (saving as a percent of GDP) was approximately 17 percent in Sri Lanka over the last decade. By contrast, the gross domestic saving rate was 33 percent in Thailand, 35 percent in Korea, 39 percent in Malaysia and 44 percent in Singapore. (Figure 3)
- The average rate of gross capital formation during the 1990s was 25 percent in Sri Lanka. Those countries with high saving rates tend to invest more. Accordingly, the average rate of capital formation was at least 10 percentage points higher in Korea, Malaysia, Singapore and Thailand.



- More saving contributes to more investment and more investment raises productivity. Average annual productivity growth during the 1990s was 3 percent in Sri Lanka. By contrast, productivity growth rates were approximately 50 percent higher in those Asian economies with higher rates of saving and investment. These data once again confirm that those countries with high saving rates tend to invest more and enjoy a higher standard of living. (Figure 4)
- Incomes in Asia peaked prior to the financial crisis that began in the summer of 1997. During the first five years of the 1990s, per capita income in Sri Lanka grew by approximately 45 percent. Korea, Singapore and Thailand, each with higher saving, investment and productivity growth rates, experienced a doubling of per capita income over that same period.

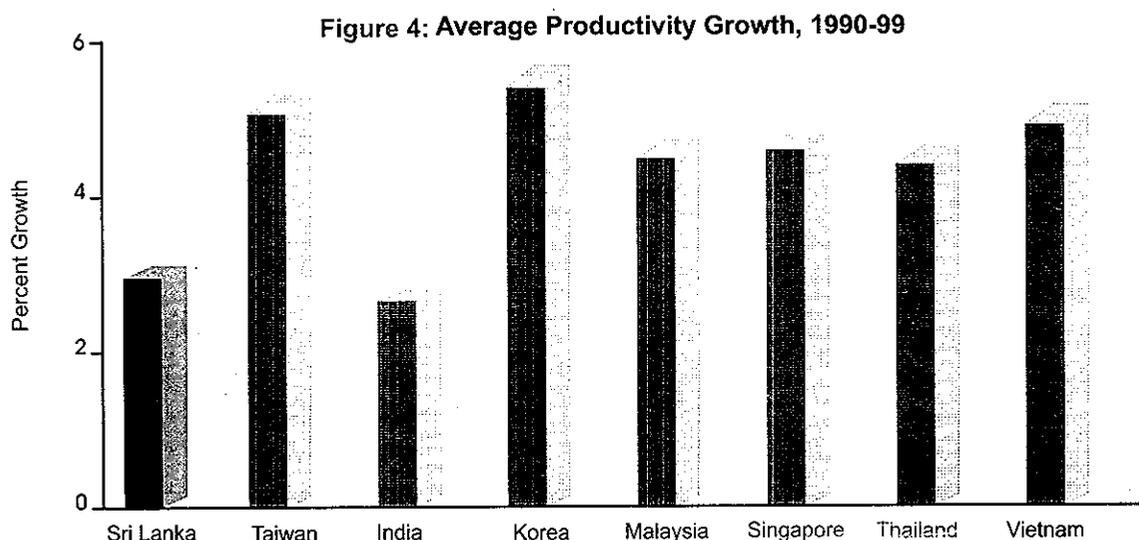
Compared to other Asian economies, Sri Lanka has less capital available, due to lower saving and higher budget deficits. This has resulted in less investment, lower productivity growth, and a lower standard of living in Sri Lanka. (Box 1)

II.3 The Economic Challenge Ahead

Sri Lanka is endowed with many valuable assets. We are a country rich with natural resources. We enjoy a high level of education. Our island is strategically located at the crossroad between the East and the West. We have strong democratic institutions that have served us well.

Sri Lanka has followed a somewhat less traditional path of industrial development. Most economies develop from a heavy reliance on agriculture, to industry – primarily manufacturing – and then onto services. However, Sri Lanka has not yet experienced a serious shift of economic resources out of agriculture and into manufacturing. To the extent there has been a shift out of agriculture, it appears those resources have moved directly into services, skipping over manufacturing. (Figure 5)

Sri Lanka also faces several difficult challenges. Despite our wealth of natural resources, we depend on foreign supplies of crucial raw materials. We also rely on foreign capital to augment the limited amount of domestic capital available for investment. The infrastructure throughout our country is inadequate, or old and in desperate need of repair or upgrading.



Source : '2001 APO Asia-Pacific Productivity Data & Analysis', APO, Tokyo and Central Bank of Sri Lanka Annual Reports

BOX 1: SELECTED PRODUCTIVITY- RELATED RANKINGS OF SRI LANKA

Sri Lanka was included for the first time in the 2001-2002 issue of *The Global Competitiveness Report*. This report, a collaboration between the World Economic Forum and the Centre for International Development (CID) at Harvard University, uses its own survey data as well as published national data to provide qualitative and quantitative indicators of a nation's competitiveness.

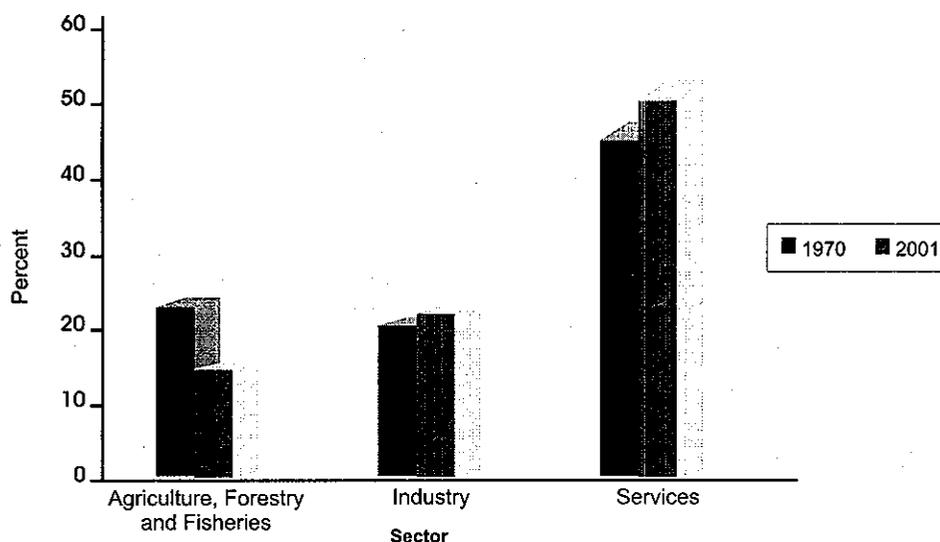
Based on *macroeconomic* data and reflecting a nation's medium term "underlying prospects for growth", the overall Growth Competitiveness Index (GCI) places Sri Lanka 61st among the sample of 75 developed and developing economies. Under the Current Competitiveness Index, an alternative approach based on firm-level *microeconomic* competitiveness indicators, Sri Lanka is ranked 57th.

The information below presents disaggregated productivity-related rankings of Sri Lanka, as well as those of a few Asian economies considered competitors and/or models of development.

GCR#	Indicators	Country Rankings out of 75					
		Sri Lanka	Singapore	Malaysia	Thailand	China	India
Economy-Wide Indicators							
3.01	Country- Level Technological Sophistication	57	13	38	40	42	28
2.09	Venture Capital Availability	36	14	39	51	49	26
5.04	Road Infrastructure Quality	72	40	15	12	48	73
5.05	Railroad Infrastructure Development	50	15	29	38	34	21
5.06	Port Infrastructure Quality	48	1	15	36	51	57
5.07	Air Transport Infrastructure Quality	59	1	23	30	62	47
5.12	Quality of Public Schools	47	7	41	42	49	62
4.06	Quality of IT Training and Education Programs	47	5	38	36	63	9
3.09	Level of University/Industry Research Collaboration	62	3	42	33	28	38
3.11	Availability of Scientists and Engineers	46	14	60	54	59	4
3.12	No Brain Drain Problem. Scientists and Engineer Remain at Home	68	12	45	17	42	65
Firm-Level Indicators							
3.02	Continuous Innovation at the Firm-Level	49	5	14	62	41	34
3.03	Firm-Level Interest in Absorption of New Technology	64	9	47	38	46	31
3.04	FDI is a Strong Source of Technology Transfer	60	1	4	27	53	30
3.06	Company Spending on Research and Development	56	11	33	47	34	42
3.08	Availability of Tax Credits for Firm-Level Research and Development	45	2	8	26	22	9
10.14	High Extent of Incentive Compensation	56	7	50	49	65	47
10.23	Pay and Productivity are Strongly Correlated	64	1	19	37	11	58
10.22	Unions Contribute Positively to Productivity	64	1	15	27	14	55
10.21	High Cooperation in Labour-Employer Relations	67	1	10	29	45	64
10.19	High Flexibility of Hiring and Firing Practices	60	4	46	34	23	73
10.20	Employment Rules Allow Flexibility Regarding Overtime and Cutback of Worker Hours	33	3	7	14	17	51
10.12	High Extent of Staff Training and Development	52	10	24	50	53	54
10.13	High Willingness to Delegate Authority	53	14	32	45	60	49

Source : *The Global Competitiveness Report 2001-2002* (GCR); World Economic Forum and the Centre for International Development, Oxford University Press, 2002.

Figure 5: Composition of Gross Domestic Product



Source : Calculated using data from Central Bank of Sri Lanka

In addition to these economic liabilities, Sri Lanka faces several political impediments. In the past, each government has put in place its own economic program, only to be replaced by subsequent governments. Frequent changes in government have resulted in frequent changes in policy direction, making it difficult for businesses to identify long-term growth opportunities. These frequent policy changes have increased uncertainty and risk for potential investors.

Our citizens have paid a great price due to the security crisis over the last 20 years. The crisis starved our economy of the necessary capital to invest in creating jobs and raising living standards.

Governments have been prone to running budget deficits, which divert limited capital away from productive investment in the private sector. This places upward pressure on interest rates, further hurting the prospect for investment. It also increases borrowing from abroad in order to finance the gap between domestic investment and saving. This enlarges the current account deficit, which in turn puts downward pressure on the value of the rupee, which then raises the cost of imported goods.

Sri Lanka's only option is to sell more of its products in international markets. But in order to do so, Sri Lankan products must match and beat the competition – both in terms of price and quality. Until now, we have been competing on price alone – primarily through low wages.

Improving productivity is the key to competing successfully on price and quality, while at the same time raising the living standards of Sri Lankan workers and their families.

With higher productivity, we can produce more at lower cost. The resulting saving can be shared with workers and used to improve product quality, thereby raising the prospect for even greater sales and exports.

This heavy reliance on international markets also has a downside, as it exposes us to shocks in the international economy, well beyond our control. For example, the recent economic slowdown in the United States and other industrialized countries has caused Sri Lankan exports to fall, which in turn has depressed the Sri Lankan economy. We need to diversify our exports and their markets, in order to reduce our reliance on any one of them.

Currently, the two main exports, garments and tea, make up 62 percent (46 percent and 14 percent respectively) of total exports. (Garment exports are however heavily import dependent, with textile and clothing imports making up slightly more than 50 percent by value of garment exports in 2001.) Almost all garment exports go to the United States (64 percent) and the European Union (30 percent). Likewise with the tea sector, the Middle East and the CIS countries make up two thirds of the export market (43 percent and 23 percent respectively).

Domestic saving has averaged about 16 percent of GDP and Sri Lanka has increasingly relied on remittances from its workers abroad to bolster its national savings by about 7 percentage points of GDP. Gross inflows of private remittances over the last five years, primarily from the Middle East, were 7½ times greater than the total inflow of foreign direct investment.

Reining in persistent and high fiscal deficits has become one of the most

challenging macroeconomic issues facing the nation. Between 1996 and 2000, fiscal deficits averaged almost 9 percent of GDP and reached 11 percent of GDP in 2001.

- The deterioration of the security situation caused defence expenditures to escalate to as high as 6 percent of GDP in 2001.
- In order to contain government expenditures, capital expenditures have been cut. This reduction in public investment has seriously hurt infrastructure development, and thus medium-term growth prospects.
- Interest payments on outstanding government debt amounted to almost 7 percent of GDP in 2001.

As an island economy, Sri Lanka has no alternative but to increase productivity if it is to be competitive in world markets and improve the standard of living of its people.

Results for Calendar Year 2002

Growth in the gross domestic product (GDP) during the first half of 2002 was 1.4 per cent, a turnaround from the economic contraction of 3.5 per cent in the second half of 2001. Provisional annual estimates for 2002 and projections for 2003 are based on data available at end of September 2002. The economy is expected to perform better during the second half of the year (around 5 per cent), enabling an annual growth rate of 3 per cent, compared with a reduction in GDP by 1.4 percent in 2001.

Source : Central Bank of Sri Lanka, *'Highlights of 2002 and Prospects for 2003'*, November 2002.

III.1 National Productivity Growth

Output per worker in Sri Lanka grew by approximately 3 percent a year throughout the last 10 years (Box 2). By contrast, productivity growth was 2 percentage points higher in Korea, Malaysia, Singapore and Thailand.

The Sri Lankan labour force has been growing at about 2 percent a year. With productivity growing at an average of 3 percent a year and no increase in available capital, the economy cannot sustain economic growth above 5 percent a year. This is insufficient if we want to end the 20-year trend of stagnant living standards.

BOX 2: MEASURING PRODUCTIVITY

Improvements in efficiency are very difficult to measure accurately and therefore researchers tend to rely on a variety of acceptable methods. At the national level, productivity is traditionally measured by dividing the value of all goods and services by the total number of workers. This produces a measure of output per worker. Similar measures can be calculated at the industry and firm level. Since we look at economy-wide productivity, the output measure we use consistently is value-added or value of output less the value of all inputs except labour, which is the concept used in measuring a nation's gross domestic product.

A more accurate measure uses the actual number of hours worked, since they differ by worker and calendar period. This produces a measure of output per hour worked. However, due to data unavailability and the acceptable assumption that there have not been significant changes to standard working hours per year or to the relative importance of part-time employment in total employment, annual output per employee is a valid measure of productivity in Sri Lanka.

Productivity growth then is measured by the change in output per worker or output per hour worked over a certain period. Similar measures can be calculated at the industry and firm level. The preferred statistical technique for averaging productivity growth figures for several years is least squares regression to yield a trend over time.

Sri Lanka faces three productivity challenges:

- Most of the Sri Lankan economy is concentrated in sectors that exhibit low productivity levels or experience low productivity growth;
- Productivity growth in the sectors with high productivity is not sufficient to help the economy reach the kind of growth it needs to resolve the debt crisis;
- To the extent there is productivity growth, it has not translated into higher living standards for Sri Lankan workers.

III.2 Productivity by Sector

Almost 80 percent of Sri Lankan employment is concentrated in sectors with either low productivity levels or low productivity growth. Output per worker in industry and services is more than twice what it is in agriculture, which formally employs 36 percent of the labour force. Although output per worker is higher in the services sector, due to high-value added, annual productivity growth in that sector is lower than in agriculture and industry. Another 40 percent of the workforce is employed in the service sector.

Industry, traditionally the productivity workhorse in any economy, employs only a quarter of Sri Lanka's workforce and productivity growth averaged a little more than 2 percent over the decade from 1990 to 2001. (Table 1).

Productivity growth enables employers to pay their workers more without fuelling inflation. The increased efficiency by which goods and services are produced, enables firms to produce more at the same or lower cost. This translates into increased profits, which the employer can choose to share with the employees in the form of higher wages.

A cause for concern is the slow growth of real minimum wages. Even where productivity has risen, the data do not show a corresponding increase in real minimum wages. Data on average wages for each

sector is unavailable, but the minimum wage can be used as a proxy, especially for the plantation agriculture sector. It is possible that employees are receiving non-wage benefits, not reflected in this minimum wage data. However, it may also reflect that the process of 'gain-sharing' has not been taking place in Sri Lanka over the last decade.

As seen in Figures 6, 7 and 8, productivity gains in agriculture, industry and services have been positive over the last decade. At the same time, the after-inflation value of the minimum wage in each of those three sectors fell. One thing is clear, the minimum wage is not keeping up with inflation, let alone improvements in productivity.

In manufacturing, productivity grew on average by approximately 3½ percent a year in the 1990s. Average wages, after inflation, grew by less than 1 percent a year over the same period.

Within manufacturing, there is a wide spectrum of changes in productivity and wages and the relationship between the two. Looking at the highly aggregated statistics (2-digit industry level) productivity growth during the 1990s was highest in non-metallic mineral products, such as cement, lime, plaster and clay, averaging almost 7 percent a year, while real average manufacturing wages in the sector grew by less than 1 percent a year. Productivity growth was lowest in 'other manufacturing industries', falling by an average of 6½ percent a year during the 1990s. The real average wage fell by 1½ percent a year over the same period.

Table 2 presents less aggregated data (four-digit level) for the 10 manufacturing industries that recorded the highest rates of productivity growth during the 1990s. Changes in wages and employment are also included. Wages grew in 8 of these 10 industries. Only five of the 10 industries experienced simultaneous improvements in productivity and wages. In two of the ten industries, musical instruments and malt liquors, wage increases tracked well with productivity growth.

Table 1: Composition of Productivity Growth, 1990-99

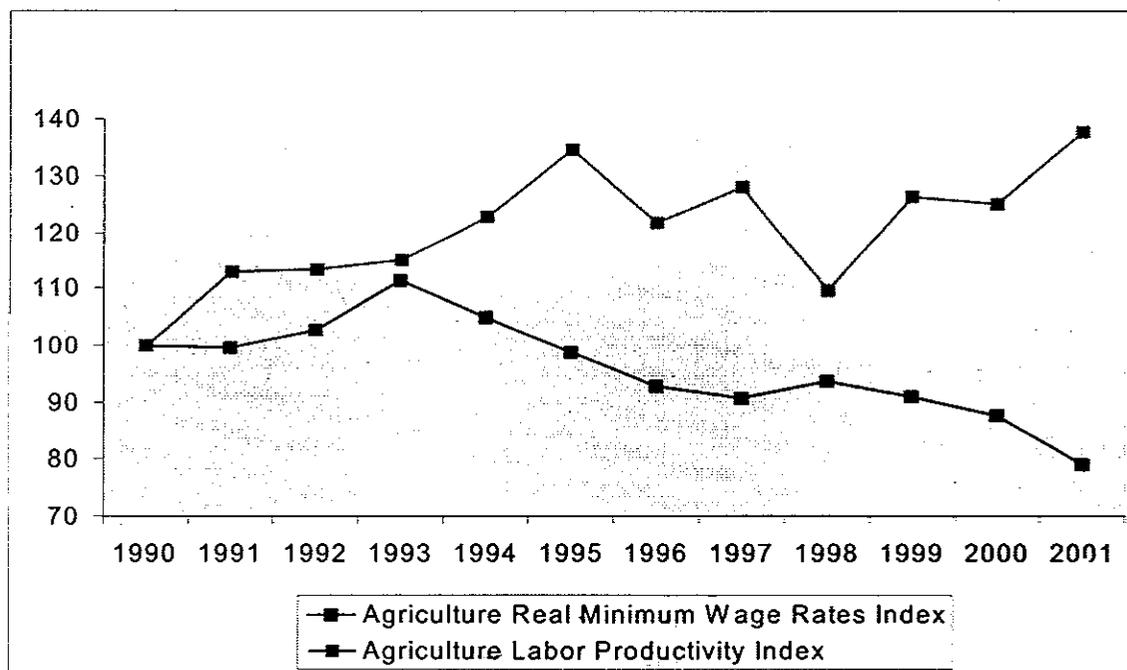
	Real Productivity Level*, 2001	Average Annual Productivity Growth** (% per annum)	Share of Employment (% of total workforce)
Agriculture	Rs. 17, 500	2.1 percent	36 percent
Industry	Rs. 40, 500	2.2 percent	24 percent
Services	Rs. 44,700	1.6 percent	40 percent

* Output per worker, measured as value-added per worker in 2001 Rupees at 1982 prices

** Trend calculated using least squares regression for nine year period to measure average growth rate

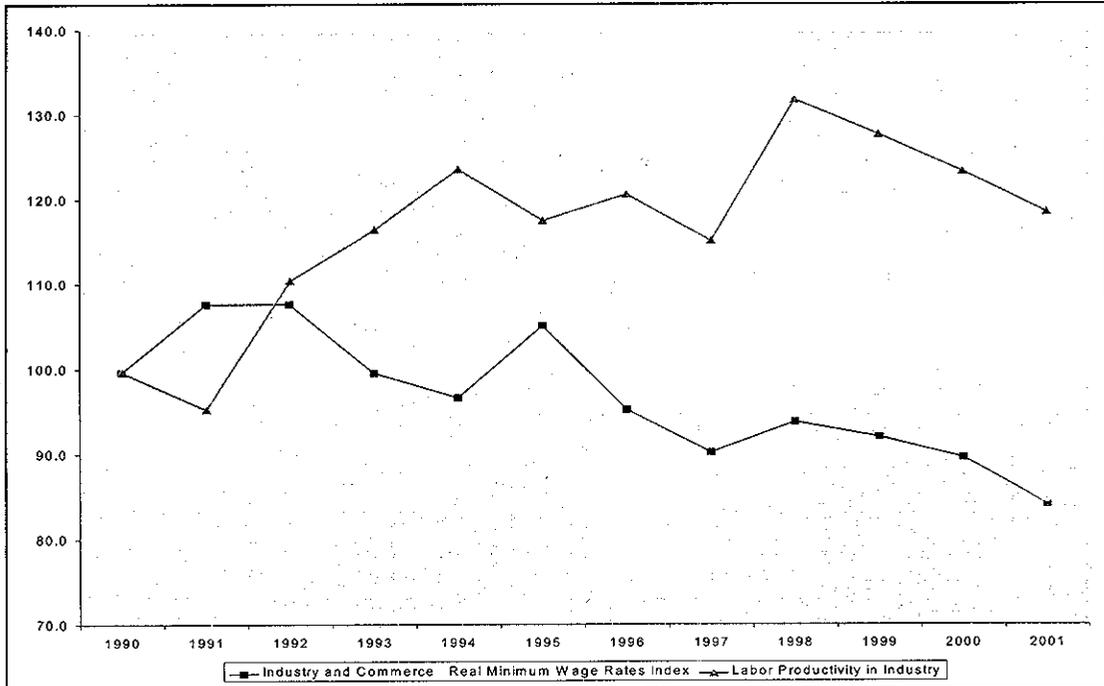
Source: Calculated using data from Central Bank of Sri Lanka

Figure 6: Agriculture - Labour Productivity and Minimum Wages



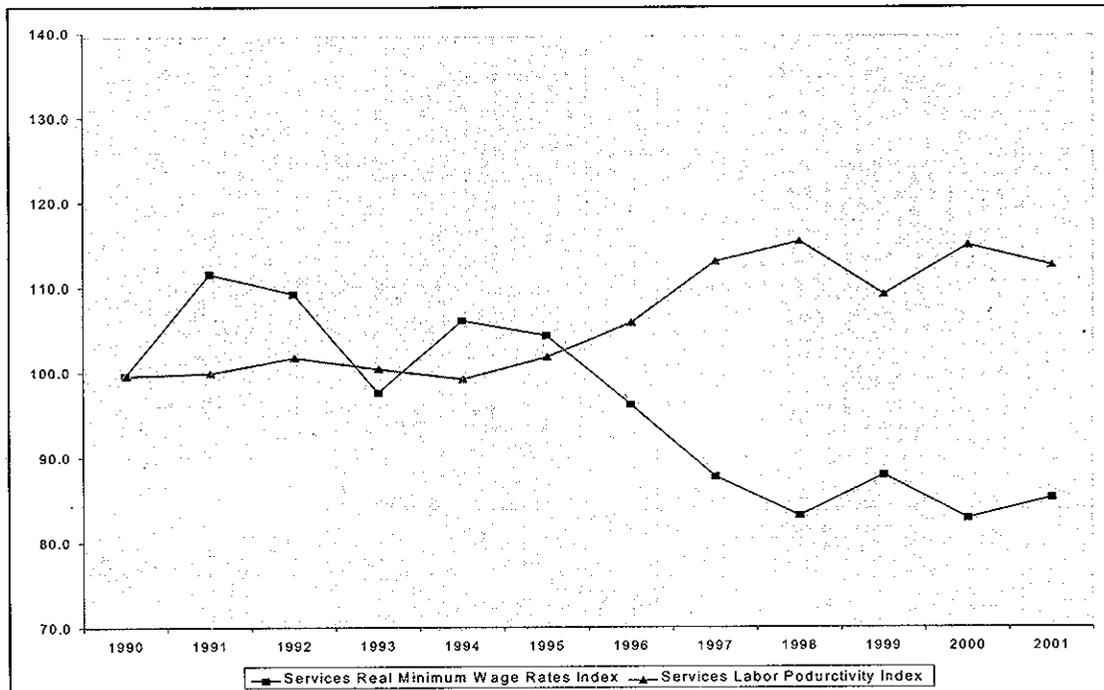
Source: Calculated using data from Central Bank of Sri Lanka

Figure 7: Industry - Labour Productivity and Minimum Wages



Source: Calculated using data from Central Bank of Sri Lanka

Figure 8: Services - Labour Productivity and Minimum Wages



Source: Calculated using data from Central Bank of Sri Lanka

Table 2: Ten Industries with Highest Productivity Growth, 1990-99

SIC	Description	Productivity Index	Wages Index	Employment Index
3902	Musical Instruments*	113.6	74.9	209.3
3692	Cement, Lime & Plaster	88.5	3.4	-5.8
3111	Slaughtering & Preserving Meat	43.5	5.3	24.1
3214	Carpets & Rugs	39.5	10.2	125.9
3903	Sporting & Athletic Goods	38.3	3.0	61.3
3522	Drugs & Medicines	34.2	-1.8	4.2
3122	Prepared Animal Foods	28.2	0.2	-0.1
3133	Malt Liquors & Malt	26.3	26.9	-3.4
3118	Sugar Factories & Refineries	19.5	7.9	-9.3
3115	Vegetable, Animal Oils & Fats	17.3	6.3	-6.2
3311	Saw Mills & Wood Mills	17.1	-0.7	-8.8

Source: Calculated using the Annual Survey of Industries, Department of Census and Statistics.

* Data missing 1991-93

Table 3: Ten Industries with Lowest Productivity Growth, 1990-99

SIC	Description	Productivity Index	Wages Index	Employment Index
3813	Structural Metal Products	-7.6	-4.7	7.2
3821	Engines & Turbines	-7.8	0.0	-10.7
3720	Non-ferrous Metal Basic Industries	-7.8	-4.6	2.7
3411	Pulp, Paper & Paperboard	-8.0	-2.1	-4.1
3843	Motor Vehicles	-9.0	-0.1	-1.3
3132	Wine Industries	-9.8	-12.5	23.3
3320	Furniture & Fixtures	-10.3	-9.0	57.4
3811	Cutlery & General Hardware	-10.7	-8.7	-12.0
3113	Canning Fruit & Vegetables	-11.4	-3.5	-1.5
3901	Jewellery & Related Articles	-14.5	0.4	1.5
3849	Transport Equipment* - NEC **	-25.6	-4.8	3.7

Source: Calculated using the Annual Survey of Industries, Department of Census and Statistics.

* Data 1990-95 only . ** Not elsewhere classified.

Table 3 presents the 10 manufacturing industries that recorded the lowest rates of productivity growth during the 1990s. None of them experienced wage gains and only half of the group experienced employment growth.

Wearing apparel, Sri Lanka's industry with the largest employment, ranks 33 among the 78 industries in trend productivity growth over the 1990s.

The data and this analysis confirm the essential role of productivity growth in creating the potential for wage improvements.

III. 3 Productivity at the Firm Level¹

Detailed firm-level data on labour productivity are not widely kept or readily available in Sri Lanka. Generally firms tend to keep track of basic information on overall company levels of production, waste and absenteeism. However, rarely is individual level productivity monitored (except for high-end apparel manufacturers) and often, even different parts of the production process are not separated for the purpose of evaluating productivity. However, common factors emerge in affecting firm-level productivity across different sectors and industries.

Over the last year, many Sri Lankan companies have been operating under considerable pressure. Sales have fallen due to the general slowdown of the world economy, following the recession and the economic affects of the September 11 terrorist attacks in the United States of America (USA). Renewed inflation, contracting markets, high interest rates and a shortage of capital due to large government deficits, have adversely affected the performance of Sri Lankan companies and their profitability.

Sri Lankan workers have also paid a heavy price. Inflation has eroded their pay.

¹ This section is based on approximately two dozen plant visits that took place the summer of 2002, included interviews with managers and workers.

Bonuses, which constitute a large part of Sri Lankan workers' take home pay, have been cut due to the economic situation. Labour market rigidities made it difficult for companies and workers to adjust to the economic slowdown. In addition, the traditional loan procedures of commercial banks, which tend to place heavy emphasis on collateral guarantees, prevented new start-ups of high value-added small and medium size enterprises (SMEs).

Apparel, Sri Lanka's largest industry, depends heavily on inexpensive local labour and imported machines and raw materials. The industry faces stiff competition from China and other Asian economies, which is likely to intensify with the prospect of the scheduled removal of quotas under the Multi-Fibre Agreement (MFA) in 2005.

Apparel exports, which are subject to the ups and downs of the world market, lack innovative improvement in value generation. These producers also do not tend to support local downstream peripheral industries. The shift from primary to secondary industries has been slow and the emergence of a high value-added service sector has yet to fully develop.

At the other end of the value-added spectrum, high technology industries, such as the opto-electronic and laser devices industry, information technology and communication services, also suffered from the global slow down. These industries exhibit some promise, but they remain too small to have a serious impact on the overall economy.

Against this gloomy backdrop, some Sri Lankan companies are struggling to find a new way of survival and expansion through introduction of modern management techniques that emphasize a teamwork approach to productivity that includes human resource development.

For the most part, managers at these companies tend to be young. Many of them have studied or worked in the United States, Europe, Japan or Singapore, where

they received practical experience with alternative management styles.

Measurement Issues

As mentioned earlier, the practice of productivity measurement in Sri Lanka is inadequate, although there has been an increasing trend in the last two years toward putting into place mechanisms that will facilitate systematic monitoring of productivity.

Banks with financial resources and exposure to the latest information technology, have only recently established comprehensive information and monitoring systems that can keep track of transactions and loan applicants' credit background. In many cases, redundant efforts of keeping manual records and inadequate computer training are resulting in long wait times for transactions.

Financial institutions and large companies are making an effort to improve internal and external information systems. Foreign affiliated companies tend to use most modern information technologies to keep control of material procurements, production, financial accounting and monitoring.

Labour – Management Relations

Labour-management relations based upon mutual distrust are prevalent. Many traditional Sri Lankan companies continue to experience disruptive labour relations – reminiscent of early twentieth century struggles between autocratic management and confrontational unions. The fact that most unions are organised and managed by national political parties complicates labor-management relations considerably – militating against approaches or solutions that might be negotiated between management and a single union. The inability to separate management-labour disputes from national political considerations has on more than one occasion made it difficult for both managers and workers to focus on practical solutions at the industry or firm level. As with management – labour relations in most

countries, the majority of grievances in Sri Lanka are related to compensation. Managers that have tried to build some flexibility into compensation plans have not always succeeded. Recently, some unions went on strike when companies announced they could not afford to pay bonuses due to the economic slowdown or increased foreign competition. Management was forced to negotiate separation packages in return for layoffs.

Realising that they could no longer continue paying bonuses, due to the declining economy, incoming new managers and well educated worker representatives began opening lines of communication. Having experienced bitter labour-management relations in the past, jewellery, tobacco and coir companies succeeded in installing co-operative industrial relations at their work sites. They also began developing and implementing productivity programs observed in other Asian countries with better performance records. They are also characterised by a greater flow of information sharing between workers, supervisors and management.

Apparel and electronic manufacturers built modern air-conditioned facilities in the rural areas in order to recruit and train unskilled farm workers. These projects tend to be joint ventures with foreign partners that also bring new technology and manufacturing equipment.

The timing coincided with moves to Sri Lanka by European, USA and Japanese manufacturers with established brand names that could no longer compete against fast-growing Asian producers. With the introduction of new management styles, many companies adopted less hierarchical approaches toward workers, providing them access to facilities also available to executives, e.g. dining facilities, use of gymnasiums and company-sponsored sports events.

Modern labour-saving equipment, such as laser cutters, automatic sewing machines, open kilns, automated printers and numerical and computer controlled machine tools and moulding machines, have been widely introduced. The systems

approach using computers and modern telecommunication devices was introduced in financial and retail companies. However, these companies remain behind their USA and European counterparts in installing comprehensive information and monitoring systems.

Many Sri Lankan companies have formed labour-management councils and consultative mechanisms. Management continues to push for the removal of protective labour laws, especially given the anxiety over the prospect of tougher competition against lower wage countries such as China, Vietnam and Bangladesh as a result of the MFA phase out. These companies use the threat of foreign competition to hold down wage demands.

An increasing number of large and medium size companies have innovative managers and union leaders who believe that co-operative and consultative labour management relations are essential to future survival and growth.

Many union leaders and employees believe that the productivity movement is essential in order for Sri Lanka to catch up to the other high growth Asian economies.

Though some companies use worker council systems as alternatives to collective bargaining, there are just as many companies whose executives genuinely believe that both sides benefit from a participatory management system that includes soliciting voluntary suggestions, quality circle and team programs. Management in some companies has initiated shop floor improvement programs, such as 5Ss, Total Quality Management, Total Preventive Management and Just-in-Time.

Firms have also adopted techniques to circumvent restrictive government labour laws. In particular, due to the difficulties involved in termination on non-disciplinary grounds, firms have resorted to using temporary workers, contract workers and sub-contracting parts of the production process to units not covered by the Termination Act. All these developments

have negative impacts on incentives to train workers on the job and create distrust among the permanent cadre.

Compensation Packages

On average, employee salaries are above the minimum wage level, as set by the government and the Board of Investment. In addition to wages, many companies provide attendance bonuses, welfare benefits, overtime payments, commuter allowances, housing allowances, medical facilities and inflation adjustments. Additional allowances tend to increase total take home pay by approximately 1½ to 2 times. Other non-wage benefits include free transportation, free housing for workers who commute long distances and paid religious holidays.

Many successful companies are adopting productivity-based salary systems that resemble piece-rate output per employee. Others, rather than depending solely upon quantitative output per employee measure, gave some weight to quality and yield. Workers' attitudes tend to be bolstered by awarding attendance and penalising absenteeism, considered a major problem by all sectors. Annual raises tend to be small, but are bolstered by changes in the cost of living allowances measured by changes in the consumer price index. Promotions are generally based upon seniority, a worker's education background and job performance.

Non-wage payments quickly become the norm and workers consider them as entitlements. During the recent recession, there were cases where unions called strikes when companies tried to adjust their bonuses downward. Paradoxically, many of the companies that experienced these strikes tended to pay higher than average industrial wages. Both sides cited a lack of communications and traditional distrust of the other side as the major cause of the dispute rather than compensation or work rule issues.

While some companies, cite a lack of communications between management and labour and lingering abrasive relations,

others have described how co-operative relations have contributed to high productivity performance. These companies also perform social services by supporting local schools, hospitals and road repairs in order to maintain rapport with local communities. Some companies sponsor family outings, sports events and discount foods for family members.

Sri Lanka should consider some of the practices used successfully in other countries to moderate and contribute positively to more peaceful and productive employer-employee relations. The National Labor Relations Board in the United States of America is one example worth studying. (See Box 3)

BOX 3: CASE STUDY: NATIONAL LABOR RELATIONS BOARD OF USA

Role for Government in Employer-Employee Relations

The significance of harmonious Employer-Employee relations in the workplace cannot be over emphasized for productivity enhancement. No country is immune from incidents of labor-management strife, but some countries seem to have fewer problems – and more productive relations-- than others. Because the United States has registered one of the most impressive records of national productivity growth in recent years along with low unemployment rates, its example and institutions for dealing with employee-employer relations are worth studying. In 1935 at the height of the Great Depression, the United States Congress passed the National Labour Relations Act creating The National Labour Relations Board (NLRB). The NLRB administers The National Labour Relations Act, the USA's primary law governing relations between Unions and Employers in the private sector. The Board consisting of five members appointed by the President of the USA is an independent Federal Agency and acts as a quasi judicial body to: (a) determine through (secret ballot elections) the free democratic choice by employees, whether they wish to be represented by a Trade Union in dealing with their employers and if so, by which Union, and (b) prevent and remedy unlawful acts, called "unfair labour practices" by either employers or unions. In effect, the NLRB is an independent Federal Agency responsible for protecting and promoting the Rights of Employees as defined under the National Labour Relations Act and in the process, highlighting obligations of employers and employees to each other. A noteworthy example of such obligations is that a refusal to bargain in good faith by either an employer or employee is, in itself, defined as an unfair labour practice under the National Labour Relations Act.

The NLRB does not act on its own initiative. It proceeds in response to charges of unfair labor practices or petitions for employee elections that are filed with the NLRB at one of its 52 Regional, subregional or resident offices. All parties to unfair labor practice cases have the right to expect that the NLRB will process their case in a fair, judicious, and prompt manner.

More information about the NLRB is available at the website www.nlr.gov

Small and Medium Size Enterprises (SMEs)

Lack of backward integration prevents SMEs from becoming the backbone of the economy, even though there are 50,000 registered and 125,000 unregistered small businesses with fixed assets of Rs.16 million or less. They account for 90 percent of all Sri Lankan businesses, 70 percent of employment and 55 percent of gross value added in the

private sector². In addition, there is an informal sector, which is not included in the tax structure. It is impossible to know exactly, but it is estimated that the informal sector produces roughly a third of the nation's gross value-added. Even though some international financial institutions and technical assistance organisations are funding new business start-ups by providing low interest loans, the otherwise high cost of money and cumbersome loan application

² Development and Review Committee on Small and Medium Scale Industries in the Industrialization Commission

procedures discourage SMEs from moving into new areas or entrepreneurs from starting new businesses. Instead, a large number of entrepreneurs start businesses based upon their own practical experience using their own savings.

Without proper technical training in accounting and management, and without market information, small business entrepreneurs are limited by their own practical experiences. Their businesses are generally described as being low in productivity and poor in quality. In general, they employ old and obsolete machinery and equipment have low equipment utilisation rates, poor sanitary standards and inadequate accounting and management skills. This results in poor working conditions, low wages and a lack of any sense of obligation to meet contractual agreements and delivery dates. There is an urgent need to improve their performance through an upgrading of skill levels of their workers and management.

Many new business start-ups are taking place in beverages and food processing, retail, and wholesale, rather than in traditional manufacturing industries. The result is the absence of peripheral support industries, intermediate parts manufacturers and service providers.

The Asian Development Bank's plan to offer direct loans to SMEs and credit guarantees will undoubtedly enhance a rapid growth of industries with an emergence of new venture capitals, incubator projects and new breeds of innovative business executives.

Investment and Technology

As a result of the unstable security situation, Sri Lankan companies have been denied the benefits associated with foreign direct investment. This investment tends to be accompanied by technology spill over, the formation of supply chains of peripherally supporting industries and exclusive access to international markets provided by their foreign investors and partners. Except for companies that depend upon local supplies of primary products, such as tea, coconut, spice and rubber manufacturing companies tend to depend heavily upon the import of technology, raw

materials, manufacturing equipment, intermediate parts and semi-finished products.

Rapid growth in the apparel sector, disciplined training and close ties to foreign markets (mostly via joint venture partners) helped raise the standards of living of relatively young workers in rural areas. In particular, women compose a majority of the workforce in the apparel sector and are viewed by management as productive workers receptive to new techniques and innovations in the production process.

However, the technology spillovers in the apparel industry have been limited. Heavy dependence on high priced raw materials, existing channels of distribution and design specifications of foreign partners, as well as rising energy costs, have forced the apparel industry to hold down labour costs to an average of 15 percent of the total cost structure. Without local access to intermediate parts and components and a lack of substitution materials, intermediate services and reliable delivery, these companies have not been able to raise profitability. They also have to keep large raw materials and accessories in stock to meet customer demands. Many garment firms consider eliminating raw material waste more important than labour in reducing costs. Labour is still considered to be the least expensive part of the entire cost structure.

Because of their high cost of procurement and installation, most automated, computer control systems are financed by foreign parent organizations. World class manufacturing operations are limited to those companies with foreign ties in injection mould die making, electronic and electrical component manufacturing, mass production apparel industries and tobacco. In these companies, some employees are trained in foreign countries, where the parents companies are located, for a period of three months up to one year in order to acquire necessary skills and technical knowledge.

Prohibitively high interest rates have contributed to low capital investment. The failure to innovate and adopt more energy-efficient modern machinery has been extremely costly for energy-intensive

industries like the ceramics sector, in light of the current energy crisis. Firms that had invested in new plant and equipment tended to have financed it from profits. In many firms, interest payments are a large share of costs.

An increasing number of entrepreneurs in traditional industries, as well as in high technology industries are overcoming restrictive government regulations. They are compensating for shortages of capital and skilled workers both in small, medium and large enterprises by employing innovative means. They are investing heavily in training (e.g. in apparel, coir, and rubber), new product development (e.g. in rubber, coir, apparel, and electronics), exploring new markets (e.g. in ceramics, spices, and apparels), new manufacturing equipment (e.g. in apparel, electronics, die manufacturing and plastic moulding) and improving work environments (e.g. in jewellery and toys). They are also moving into clean production systems, with some hoping to obtain ISO 14000 certifications.

In preparation for a possible future decline of mass produced apparel, some medium size apparel manufacturers are moving into high fashion lines with computerized designing, cutting and sewing operations. Rubber manufacturers are moving into development of static rubber mats, rubberised coir sheets, tiles, specialised conveyor belts and tracks for industrial machinery. Currently domestic investment in research and development (R&D) is low. Hopefully, this will change with the prospect of increased foreign direct investment, and the associated technology transfer.

Enhancing skills and employability

Compared to other developing countries, Sri Lanka enjoys impressive levels of basic education. Estimated adult literacy exceeds 90 per cent, with a high level of gender parity. Such literacy levels, however, have not by themselves translated into employable skills, especially among poor and marginalized communities. Tertiary education suffers serious inadequacies of scale and quality and should be more demand-oriented. Skills training institutes suffer from management deficiencies,

outdated equipment and curricula, and a shortage of capable trainers.

Sustained productivity improvement requires continuous upgrading of worker skills and a policy of encouraging life-long learning. This is a job for each enterprise in the private sector and for the public sector educational institutions. Improved productivity at the firm level means workers must learn efficient production methods and waste reduction. (See Box 4)

The introduction of new technologies requires minds and attitudes responsive to innovation and change, capable of maximizing the potential benefits. The public and private sector have to join forces to create educational offerings that are globally competitive and responsive to local needs. The educational system should strive to create graduates that have learned how to teach themselves and to improve their own skills. Important among such offerings are training programs in entrepreneurship itself.

Protecting workers' rights and social dialogue.

Where people have a participatory voice in their work and the conditions of their work, productivity improves. If workers feel a sense of personal efficacy, sharing in the decisions that affect their lives, they are far more likely to share enterprise- and country-level goals of increased productivity and competitiveness. Industrial peace, itself a boost to productivity, is also much more steadily maintained when all concerned have a voice and feel part of the process.

Employers and workers need to acknowledge and respect each other's rights and obligations. Among issues needing resolution is that of linking productivity to gainsharing, which needs to be agreed upon by both employers and workers. Also on the agenda: a safety net that incorporates both income and retraining.

More basically, workers' rights should include freedom of association; freedom from discrimination; freedom from child labour; and freedom from forced labour. Long-term efforts to improve productivity will be all the more successful where these liberties are protected in law and policy. Sri Lanka has ratified seven of the eight core

ILO Conventions described in the Declaration of Fundamental Principles and Rights at Work, and is in the process of ratifying the eighth (Annex 3). Full implementation of these core conventions will help achieve the national goal of higher productivity. Sri Lanka already presents an exemplary record with regard to child and forced labour.

The international trend is for consumers as well as NGO advocacy organizations in developed countries to pay increasing attention to compliance with international standards for labor rights, workplace safety and

environmental protection. The potential is growing for countries with excellent compliance records to distinguish themselves from those with questionable or spotty records. Good compliance will play a role of increasing importance in decisions by successful international brands marketers, about which countries they select as manufacturing sources and as investment sites. Sri Lanka is in a position to build upon its better than average record to increase its appeal to leading brand marketers and investors in the developed world.

BOX 4: PRODUCTIVITY THROUGH DECENT WORK

A study of 138 South Korean firms (40 locally owned, 41 subsidiaries and joint ventures of American firms, 42 European subsidiaries and joint ventures and 15 Japanese subsidiaries and joint ventures) conducted by Bae and Lawler (2000) found that strong positive links between high involvement HRM strategies (high employee participation, extensive training programme and broad job design) and firms's competitive advantage (product differentiation and speed) as well as over-all business performance (Return on Invested Capital).

Comparing the performance of fifty eight companies identified as the best companies to work for in the USA and eighty five companies belonging to the Standard and Poors top one hundred companies, Lau and May (1998) found statistical evidence of the win-win paradigm: companies with high quality of work life can also enjoy exceptional growth and profitability. Their findings suggest that a proper alignment of management philosophy, business strategy, and human resource policies can actually benefit all the key stakeholders of the enterprise. The findings of this study were further supported by the findings of a follow-up study conducted by May, Lau and Johnson (1999).

Vandenberg, et. al (1999), in a study involving 3,570 employees of 49 life insurance companies found that job "quality" (characterised by good job design that makes jobs more meaningful, provides employee with control to adapt to changing environment, provides adequate feedback, and incentive schemes at different levels, training opportunities, information sharing, and flexibility to provide balance between job and family requirements) is positively related to the Return on Equity.

Using data from 968 firms drawn from 12,000 publicly held US companies, Huselid (1995) found a strong correlation between high performance work practices (HPWP = practices that build employees's knowledge, skills and abilities, participation, information sharing, rewards and compensation systems that recognize and reward performance, etc.) and decline in employee turnover, productivity and corporate financial performance. The returns on investments in HPWP was substantial. A one standard deviation increase in use of such practices was associated with a 7.05 percent decrease in employee turnover and, on a per employee basis, \$27,044 more in sales and \$18,641 and \$3,814 more in market value and profits, respectively.

Source: International Labor Organization

How To Achieve Productivity Growth

*Overview of
Recommendations*

What then creates sustainable increases in productivity? Productivity is *not* simply working longer or harder. Productivity is *not* simply working for less. Productivity is about working better and smarter. It is not about sweat and threat. It is about people and organisations learning how to do things that people value more and to do these things better. Productivity is not doing more with fewer workers.

The most productive countries in the world, such as the USA and Singapore are not the ones with high unemployment.

There are a number of drivers of productivity. Investment in people and capital, improved business strategies and operations, reduced bureaucracy and obstacles for business, improved infrastructure and support services—these are among the main drivers of productivity growth. The efficiency by which we convert investment into economic growth is called 'productivity'. The appropriate measure is productivity per worker hour. Unfortunately, good statistics do not yet exist on productivity per worker hour in Sri Lanka.

Raising productivity requires more savings, more investment and more efficient channelling of investment to the most productive uses. Raising productivity requires investing in plant, equipment and information technology. It also requires investing in people through education, training and workforce development. Raising productivity also requires a good business environment—legal, regulatory and institutional frameworks that support people and businesses and that do not put needless obstacles in the way of people and businesses that are trying to improve their productivity.

Savings come from four main sources: household savings, retained earnings of firms, reductions in the government budget deficit and

foreign sources of capital that can augment domestic savings.

But raising capital -- from domestic or international sources -- is only half of the equation. In order to get the highest return on this capital, it must be channelled into productive investment -- investment in activities that will result in more jobs and higher incomes. This requires an efficient banking sector and capital markets that allocate savings to the best companies and the best projects using the best judgement and criteria available. Sri Lanka's capital market must become more flexible, so that capital can flow to the most productive activities in the economy. Barriers to accomplishing this may be direct or indirect. For example, government regulations can hinder the ability of capital to reach the kinds of investment that are best for the economy as a whole.

The key initiatives that Sri Lanka can take to improve productivity have been grouped under eight main headings:

- Establish a supportive economic framework, which includes reducing the budget deficit;
- Encourage more saving and better investment;
- Improve labour market flexibility;
- Invest in developing the workforce;
- Enhance productivity at the enterprise level;
- Encourage and facilitate the growth of new businesses and SMEs;
- Change public attitudes to encourage a culture of quality and productivity;
- Implement policy and monitor process through strong institutions that have full government and private sector support.

The next section presents a discussion of a variety of recommendations within each of these initiative categories.

V.1 Establish an Economic Framework More Supportive of Growth and Productivity

PUBLIC SECTOR INITIATIVES

Rein In Budget Deficits

The continued expansion on budget deficits and domestic financing of such deficits have pushed interest rates and crowded out private investment. Further, the composition of spending has been away from public investment and toward non-productive current expenditures, including interest payments, pensions, subsidies and wages. Tax receipts need to increase through tax base expansion.

Eliminate Burdensome Laws

The government role must be cast as an enabler of economic growth and social development, productivity and job creation. In this respect, it needs to review and eliminate unnecessary or burdensome laws, permits, licenses and rules that impose obstacles to investment and economic activity. Further, it should streamline procedures for those regulations that are necessary (e.g. health, safety, taxes etc). Government policy must reflect a consistency such that business and labour are willing to make long-term investment commitments. Policy uncertainty, particularly fluctuations in trade policy, creates frequently changing price signals which hinder decision-making on investment.

Reform the Budget Process

The government should reform the budget process by preparing multiple year budget projections based on existing commitments. In addition, government expenditures should be classified as discretionary or non-discretionary,

making it easier to identify where cuts can be made in the budget. These projections should be based on realistic economic assumptions about economic and demographic trends. This would strengthen the government's initiatives on fiscal responsibility that aim to reduce the budget deficit to at least 5 per cent of GDP by 2006.

Peace, Law and Order, Domestic Tranquillity

Achieving a permanent settlement to the civil conflict is likely to have the greatest effect on increasing the amount of capital available for investment in Sri Lanka and hence productivity. Over the long run, a permanent settlement will enable government expenditures on security to be significantly reduced, thereby reducing the budget deficit. Resolving the conflict will also help attract foreign investment to Sri Lanka, which will augment the pool of domestic saving available for investment.

Along with peace, the respect for the rule of law is crucial to provide an environment conducive to productivity growth. In particular, it reduces a degree of uncertainty faced by workers, management and potential new investors. Campaigns that focus on promoting domestic tranquillity are also useful for increasing productivity by unifying society on the goal of national development.

Infrastructure Development and Infrastructure Bonds

Inadequate and outdated infrastructure is a major handicap to increasing productivity in Sri Lanka. Government spending on infrastructure has been severely constrained by the large budget deficits and increased security needs. Modern infrastructure provision, at reasonable cost is vital to attracting investment that achieves productivity gains.

The government should consider authorizing the issue of long-term bonds for the explicit purpose of financing infrastructure. Interest rates on these bonds could be set rather high, or linked to the inflation rate, given the long-term nature of the investment. Interest could be non-taxable in order to increase the attractiveness of the bonds. The government can either issue such bonds directly or authorize issues by public-private partnerships undertaking infrastructure investments.

Increase Public Sector Productivity

Efficient delivery of public services is crucial to facilitate productivity gains in the private sector. Recommendations from the public sector component of the National Productivity Policy should be implemented.

V.2 Encourage More Savings and Better Investment

PUBLIC SECTOR INITIATIVES

Promote Long - Term Saving

Although the average Sri Lankan saves more than the average American, German or French, we save less than the average person in Singapore, Thailand or Korea. Even in India where per capita income is less than half what it is in Sri Lanka, people save approximately 40 percent more of their income than Sri Lankans. This is particularly troublesome, since the government eats up more of the domestic pool of capital in Sri Lanka than in India.

Many Sri Lankans already contribute a large share of their wages to the Employees Provident Fund (EPF) and Employees Trust Fund (ETF)- higher than most workers do in other countries. But most workers in other countries save additional money to complement the amount they expect to receive from their formal pensions. The absence of a premium for longer-term saving in Sri Lanka discourages people from saving for their retirement.

The Central Bank should issue tradable securities with 10 and 30-year durations in order to encourage more private saving. These investments should be inflation protected, and would then create a benchmark long-term interest rate. Infrastructure bonds mentioned in the previous initiatives should play a role as a long-term savings product.

Encourage Private/Individual Retirement Saving

In addition to existing pension schemes, the government should encourage private savings by individuals for retirement years. This can be done by providing tax relief to people willing to save for their retirement. For example, interest on this saving could be tax-exempt, if held until retirement. Persons making withdrawals prior to retirement would have to pay a penalty, plus all the tax on the interest that had been exempt until then. This would encourage people to save more and for a longer period of time.

Pension Reform

The formal government pension scheme is in desperate need of reform. Pension reform would both strengthen the system and also increase the pool of capital available for investment - thereby further stimulating economic growth and improvements in living standards. There is scope for private sector participation in fund management, once appropriate safeguards are put in place.

The government is borrowing almost all the money in the EPF/ETF. Pension reform should address the current low rate of return on contributions and the impending demographic time bomb. Currently 9 percent of the population is over 60 years old. This is expected to rise to 20 to 25 percent of the population within the next 25 years. Efforts should be made to expand coverage of the EPF/ETF, which is currently at only about half of the workforce.

Increase Banking Sector Efficiency

High intermediation costs of state banks have been a severe hindrance to capital investment by firms. As a result, government reductions in interest rates do not get effectively transferred to the private sector because higher interest rate spreads maintained by the state banks (to compensate for large amounts of non-performing loans) are used as a benchmark by other commercial banks.

Technology Extension Centres

All investment is not equal. In order to raise productivity, it is important for capital to be invested in activities with the highest long-term returns. This includes investment in new plant and equipment. In particular, investment in new technology will tend to have a higher return on productivity, since the aim of the new technology

is to be able to either do something new or do something more efficiently.

Because of prohibitive start-up costs, very little basic R&D takes place in Sri Lanka. Instead, most Sri Lankan firms license technology developed abroad, with local research institutes providing some pilot testing or specific customisation. The government can increase the assistance given to dissemination of technology. This could be achieved by upgrading regional facilities to serve as centres for technology development and dissemination, such as those of the Industrial Development Board (IDB) and the Industrial Technical Institute (ITI).

This regional approach will be particularly important in disseminating new knowledge to the agriculture sector. These facilities would operate similar to the Employment Centres being proposed by the Minister for Employment and Labour. These two facilities should be closely linked and should be consistent with efforts of the regional development ministries and the regional economic zones of the Board of Investment (BOI).

PRIVATE SECTOR INITIATIVES

Industry Clusters

Over the last few years The Competitiveness Initiative, a project sponsored by the United States Agency for International Development (USAID), has brought together people from eight industries representing various stages of the 'value chain' to identify barriers and opportunities to compete more effectively in the global marketplace. Organised to be representative of the 'value chain', these industry clusters have undertaken a variety of initiatives to improve the competitiveness of the overall industry. Initiatives have included technology sharing, joint procurement and basic training programs, R&D studies with national universities, shared development of web portals to advertise industry products and designs, campaigns to upgrade the image and quality of export products. The cluster approach has served as a model to other industries interested in a collaborative approach to competing in global markets or with highly competitive imports. These cluster groupings could be expanded to other industries to include opportunities for joint R&D, joint procurement or shipping, branding or workforce training, as well as serve as a mechanism to provide technical assistance to individual firms.

V. 3 Improve Labour Market Flexibility

Unlike capital, it is much more difficult for workers to move around in an economy. First of all, most jobs require specific skills. Accordingly, workers' skills tend to be rather specific to the work they perform. Changing jobs may have implications for wages and other forms of compensation and may also entail changing locations, which places an additional burden on workers and their families. As a result, workers tend to be reluctant to change jobs. Government rules aimed at protecting workers and at shifting some of the adjustment burden onto employers and society as a whole can also hinder the adjustment process.

By contrast, labour market flexibility can enhance an economy's productivity and prospects for long-term growth. Labour market flexibility enables workers to move out of low productivity sectors, or sectors facing increased competition and move into higher productivity, leading edge sectors. Without this movement, economies run the risk of missing out on new industries that bring with them the prospect of raising living standards. In order for economies to benefit from labour market flexibility, many industrialised countries have safety nets in place to assist workers as they make their transitions. The importance of labour market flexibility and its related issues are also highlighted in the National Employment Policy.

Sri Lanka is fortunate to have an educated workforce that enhances labour market flexibility. Many Sri Lankans speak English in addition to Sinhala and Tamil, thereby making it easier to adopt innovative foreign technologies and develop these new skills. Most Sri Lankan workers are covered by universal health care and about half are covered by the EPF (pension plan); thus there is little risk of losing these important coverages when changing jobs.

Currently, the greatest barrier to job mobility in Sri Lanka is the shortage in employment opportunities. The Sri Lankan economy does not create sufficiently many new enterprises or new jobs for rapid economic take off. Total employment in Sri Lanka increased by 19 percent over the last decade (1990-2001), while the labour force grew by 13 percent over the same period.

Labour market flexibility depends not only on the number of jobs, but also on the kind of jobs available. Workers formerly employed in agriculture need very different skills to work effectively in services or manufacturing.

PUBLIC SECTOR INITIATIVES

Develop an Unemployment Protection Scheme

Currently only a minority of Sri Lankan workers receive transitional assistance and the level of that assistance is not determined on the basis of need, but rather on a firm's finances. Since this system is ad hoc and discriminatory, workers cannot expect assistance to be available if and when they need it. This kind of system simply compensates workers who lose their jobs rather than serve to enhance labour market flexibility.

Putting in place a credible system of worker adjustment assistance, which includes income support, training and job search assistance, should accompany any changes in existing labour laws. Given the cost and administrative requirements, a program might be established in stages, beginning with limited coverage. Eventually, the goal should be to provide adequate assistance to as many workers as possible.

Program eligibility can be broad to cover all workers, or more limited. Eligibility can be targeted to include only those workers who pay some kind of program premium. Alternatively, eligibility can be limited by cause of dislocation, i.e. permanent plant shutdown, or by other special factors, such as location, industry or timing, i.e. during a recession.

It is important to differentiate between transitional unemployment and a permanent move from one industry or skill-set to another. Workers who leave jobs with no prospect of return have very different needs from those workers experiencing a short-term transition. Initially, any program should focus on long-term dislocations, since the needs of those workers are greater.

Assistance can include a mix of income support, worker training and job search assistance. The income support can be a fixed amount for everyone, or can be based on factors, such as previous income level, need and job

tenure. Income support can also be calculated based on premium payments, like other traditional forms of insurance. Receipt of income support can be unconditional or conditioned on enrolment in training or some other requirement.

The training provided as part of any unemployment insurance scheme can also take on different characteristics. The training can be government financed and government provided or government financed and provided by the private sector. Alternatively, the government can provide incentives for on-the-job training (OJT) in the private sector. Training can include basic education or can be limited to developing job related skills.

Experience in other countries suggests that OJT is the most effective form of training. Any unemployment insurance program should provide some form of tax incentives to encourage OJT.

Job search assistance is critical to the success of any unemployment insurance program. High quality labour market information must be at the centre of this assistance. The government may have an advantage in collecting this information, although not a monopoly. Job search assistance can also include career counselling, resume writing and job interviewing assistance and relocation assistance.

The greatest challenge to any unemployment system is identifying adequate financing. At one extreme, the government can finance all the costs as part of its general expenditures. This is unrealistic for most governments. Financing for an unemployment insurance system can be offset, in part or in full, by a voluntary or mandatory premium or some kind of payroll tax. Some sharing of costs between employers and employees could be devised.

The most responsible means of financing would be through a trust fund, with a regular stream of contributions. These contributions would have to be based on some actuarial assumptions in order to ensure that the trust fund always had enough money to cover projected expenditures. The trust fund would also have to be safe from any borrowing by the government. An alternative would be to finance the program on a 'pay-as-you-go' basis. Under this system, current contributions would finance current expenditures. This type of system can only work if the demand for assistance is always less than

the amount of money collected. This is not always a realistic assumption, especially in the case of unemployment, which tends to follow a cyclical path.

Modernise Labour Laws

The conventional wisdom in certain sectors of the economy is that Sri Lanka's labour laws place a significant burden on the ability to create jobs. However, the greatest barrier to labour market flexibility is the lack of high wage jobs.

Although a lot of attention is focused on the Termination of Employment Act, it is not clear that just removing it, would make a significant difference in the creation of new jobs. The Termination Act provides a mechanism for assisting workers who lose their jobs. Unfortunately, this assistance is not afforded to all workers. Establishing a formal unemployment insurance system would remove this discrimination, thus opening up the possibility of liberalising the Act.

Another example is the Gratuity Act, which requires employers to pay their workers who remain on the job for more than 5 years, half of their last monthly salary multiplied by the number of years employed. Although this system was designed to reward workers for staying on the job, some workers take advantage of this bonus and leave their jobs after 5 years. As a consequence, the Gratuity Act has led to higher turnover and increased employers' training cost.

Improve Labour Market Information

Providing assistance to workers can help ease the adjustment burden. This assistance can include training and skill development, job search assistance and temporary income support during the period of transition. High quality labour market information is at the centre of any transitional assistance. Workers need to know about job opportunities and what skills are required for those jobs. The government can make a significant contribution to easing the adjustment burden by collecting this information.

At a minimum, the government should try to minimize the extent to which policies inhibit the ability of workers to move out of low productivity sectors and into high productivity ones. Labour protections should be balanced with worker assistance. Workers should not be prevented from moving into higher wage jobs, at the

expense of maintaining employment in low wage sectors.

Employment Centres

Inadequate labour market information and poor access to that information severely handicap the ability of Sri Lankan workers to obtain appropriate employment. In response, the Minister of Employment and Labour has proposed the establishment of employment centres (JOBSNET) around the country. Workers can visit these centres to learn about employment opportunities and their associated skill requirements. These centres might also provide career counselling and training. A national network of employment centres is described in more detail in the Draft National Employment Policy developed by the Ministry of Employment and Labour.

The effectiveness of these centres will depend on the quality of the labour market information. The government should take immediate steps to improve labour market information and establish Employment Centres. Within a few years, Employment Centres should be located within a two-hour journey from every Sri Lankan worker. Co-ordination efforts should be made with the regional development ministries and the regional economic development commissions of the Board of Investment (BOI).

PRIVATE SECTOR INITIATIVES

Reform Private Sector Compensation Schemes

The current compensation schemes are convoluted and insufficiently linked to productivity. Companies have tried incentive pay schemes, such as the Scanlon Plan, the Rucker Plan and the Impro-Share program and other multi-factor schemes, with varied results. During times of economic growth and expanding markets, workers enthusiastically accept productivity pay programs.

Irrespective of the workers' performance, extra-wage compensation (which tends to be significant) is affected by fluctuations of market prices for their products, energy and materials, as well as the company's performance. In a highly competitive environment, where labour flexibility becomes important, management and unions should negotiate and agree on the salary and

wage formula, leave entitlement, retirement packages and layoff procedures.

To sustain continuous productivity growth, a fair and equitable distribution of gains is essential. Shared gains provide workers an incentive for contributing to and maintaining the environment of productivity improvement.

Under such an environment workers may voluntarily participate in the participatory programs such as Quality Circle, 5S and other participatory programs.

Severance Pay and Outplacement Effort

Organisations should be encouraged to assist workers laid off due to a plant closing. This assistance should complement any unemployment insurance workers might receive from the government. Workers might be given the option to receive their severance in the form of an annuity, with a payment stream based on the amount. This would help workers better manage their finances during a period of unemployment and might reduce the incentive for workers to leave jobs in order to get the severance pay.

Companies facing unavoidable retrenchment of a large numbers of workers should consider providing outplacement assistance at the workplace. The Ministry of Employment and Labour should be willing to provide resources, similar to those that will be available in the Employment Centres.

V. 4 Develop The Workforce

Investment in Sri Lankan workers is essential to improving productivity and raising living standards. No amount of physical capital will increase productivity unless educated and skilled workers and managers are able to use it. International competition makes workforce development even more important, since it is the one thing that differentiates economies from one another. This investment in human capital maximises the national return on investment. To survive in a highly competitive environment and generate high-wage jobs, a country's workers must add more value to products than other nations' workers.

Lifelong Learning

The bottom line is simple: if we want a higher standard of living, we will have to earn it by improving the education and training of our workforce. Otherwise, we will end up competing on price alone – by maintaining low wages and steadily depreciating the value of our currency. Development of Human Capital is a major theme running through the Draft National Employment Policy and 'Training for Life - Long Employability' is a key initiative in that report. That strategy is an essential complement to steadily improving productivity. None of the strategies for raising productivity outlined in this report can be effective without an enlightened citizenry and a workforce that is involved in continuous learning.

A system of life-long learning includes the following steps:

- Basic education
- School-to-work transition
- Active worker training
- Dislocated worker training

Each Sri Lankan must commit himself or herself to this system of life-long learning. The government, employers, labour unions and centres of education all must play a role in contributing to this system. Developing a high-skilled Sri Lankan workforce will require effort from all parts of society.

A sound basic education must be at the foundation of building a high-skilled workforce. Students must master basic language and math skills in order to be able to use the tools of the workplace. Analysing the nation's basic education system is beyond the scope of this report. Nonetheless, basic education is fundamental to having a skilled workforce. Therefore, the Ministry of Employment and Labour should work together with the Education Ministries to ensure that students are receiving the quality of education they need to become a world-class workforce.

PUBLIC SECTOR INITIATIVES

Link Unemployment Insurance to Training

Training dislocated workers is another means of improving workers' skills. In the unfortunate event when a worker loses his or her job, there is an opportunity for a worker to acquire new skills in order to find a job in a different industry from which he or she was previously

employed. This training could be part of an unemployment insurance system, as discussed above.

JOINT PUBLIC / PRIVATE SECTOR INITIATIVES

Private Firms Providing Training and Apprenticeship

Organisations should be encouraged to assist workers continue along the path of life-long learning. Although it is in the employer's interest that his or her workers embody the latest skills, very few employers provide such training. For some, it is an issue of money. For others, they argue that workers do not stay on the job long enough to make the investment worthwhile. A solution to this predicament is to encourage a more universal system of worker training. One possibility would be for the government to provide some kind of tax incentive to encourage employers to train their workers. Joint initiatives between the business community and the ministries involved with tertiary education and vocational training, must be fostered.

PRIVATE SECTOR INITIATIVES

Education – to – Work Transition

More attention needs to be paid to ensuring a smooth transition from school to work. This means that students must be prepared to enter the workplace by the time they leave their formal education. Secondary schools, vocational institutions and universities should play an active role in preparing students for this transition.

There are a host of program that schools can establish to enhance a student's school-to-work transition. Apprenticeship programs, internships and work-study arrangements are just a few examples. Teachers should encourage and supervise students to develop their own study programs to explore and learn more about different careers and occupations and the skills required to become a productive worker. Programs such as Young Entrepreneurs in Sri Lanka, the Junior Achievement International affiliate in Sri Lanka should be encouraged. Increased communication and a better rapport is needed between students, undergraduates and the business community.

Business Input to Academic Curricula

The business community should have some input into curricula development to ensure that students have the skills they need to be productive workers by the time they leave school and are aware of the expectations of them at the workplace. It is the responsibility of the private sector to identify which skills are required and to communicate them to the institutions that develop school curricula.

Skills Certification

Individual industries should seek to identify the specific skills they require. Some industries may choose to certify that its workers have the necessary skills. Certifying skills also enhances the ability of workers to move from job to job. The 8 USAID supported industry clusters, as well as the industry working groups established by the Ministry of Enterprise Development can play an important role in identifying and certifying the skills needed for specific jobs. Skills identification and certification can help in designing skill-specific training.

Skills Training for Ex-Combatants

With the hopeful resolution of the security crisis, Sri Lanka faces a great opportunity and challenge. Over the last several years, thousands of ex-combatants have been involved in the conflict. It is now time for these people to return to their homes, begin or restart their careers and contribute in new ways to raising Sri Lanka's productivity.

The government should begin planning a medium-term transition of some ex-combatants back into the civilian labour force. Clearly, discharging thousands of ex-combatants would create a major problem, since the Sri Lankan labour market is not large enough to absorb all of them at the same time. In addition, the government might use this opportunity to provide these individuals with skills they may use once they return to private life. Temporary Employment and Training Centres – as recommended in the National Employment Policy – could be set up at military bases to assist in identifying employment opportunities and providing training.

The government might also consider mobilizing these ex-combatants to assist in a national effort to build and repair Sri Lanka's infrastructure. As a result, Sri Lanka's infrastructure would receive the upgrading it so desperately requires. Such a program would also ease the pressure on the labour market.

V. 5 Enhance Enterprise-level Productivity

PRIVATE SECTOR INITIATIVES

Employer / Owner should demonstrate leadership in raising productivity

Management and owners must acknowledge the importance of productivity improvement and commit the required time and resources to effectively implement productivity enhancing 'best practices'. Investing in productivity and recognising and rewarding workers with high productivity levels as well as those that show the greatest improvements in productivity is crucial.

Adopt more effective strategies and management techniques

In improving productivity, the Management of an enterprise must focus simultaneously on increasing the value of the output as well as on techniques that improve the efficiency with which its resources are used. A strategic review may be required in terms of improving quality of the products and the services associated with them, re-defining the marketing strategy, distribution methods etc. to obtain a higher value for the products or services.

At the same time, the enterprise management should implement programs to improve labour productivity, material productivity, energy productivity and capital productivity using a two-pronged approach. The first is the adoption of effective techniques such as the 5S method, Total Productive Maintenance, lean (Just-in-time) manufacturing, Industrial Engineering, Ergonomics and Value analysis. The other angle is the management philosophy and the management style to create a workplace with high morale, through a more democratic and participative management culture, coupled with employee involvement techniques, such as quality circles, employee suggestion schemes, cross-functional teams and continuous improvement teams.

Redefine labour-management relations

Management and labour in enterprises must acknowledge and recognise the need for healthy relations based on mutual respect and trust, for progress and growth. Labour-management co-operation through dialogue

focused on arrangements geared towards productivity enhancement based on equitable gain sharing, will lead to improvement of confidence and trust between parties. Participation in setting productivity goals and gain sharing from achieving those goals will overcome a legacy of mistrust. Such confidence and trust will give rise to a sense of shared destiny between management and labour, which is an important element for enterprise stability and growth. For more discussion of this issue, see Initiative 6 "Partnerships Re-aligned" in the Draft National Employment Policy.

Invest in productivity enhancing techniques

It is up to the enterprise owner as entrepreneur to assume the risks and take the lead in researching and investing in new technology. Owners and managers have to stay abreast of technological change to make certain their enterprise, their staff and the nation have a competitive edge.

V.6 Encourage New Businesses and Support SMEs

A. Encourage Entrepreneurship

The government and private sector should welcome and encourage establishment of new businesses by individuals. The government should consider broadening the scope of set-aside programs for new small businesses by assigning government procurement orders, particularly for those who locate operations tied to foreign operations. They may become the first ones to benefit from the spillover effects of foreign technology.

B. Support Small and Medium Enterprises

Widening Sri Lanka's employment base through SMEs can help the workforce shift out of low productivity jobs in primary agriculture into higher skilled, higher wage jobs in higher value horticulture, agro-enterprises, manufacturing or service sector.

PUBLIC SECTOR INITIATIVES

Simpler, more supportive legal framework

The government should simplify corporate organisation and registration laws, and relax restrictive bankruptcy laws.

Laws that simplify the 'exit' process are also important. A key part of SME development is the ability to experiment, to use a trial and error approach to new enterprises, to quickly end unsuccessful ventures as well as expand successful ones.

Reinvigorate technical assistance centres

The government should upgrade regional centres and universities that provide technical assistance on starting small businesses, like those of the Industrial Development Board (IDB). Corporations should be staffed with local and national experts in the area where entrepreneurs have expertise and practical experience so that the staff can provide technical advice and management guidance. These initiatives should be consistent with efforts of the regional development ministries and the regional economic zones of the Board of Investment (BOI).

Promote venture capital

Formation of more venture capital should be encouraged to offer loans or take interests in new high technology entrepreneurial business start-ups. They should be formed by investors with expertise in technology. The government should start a worldwide campaign to invite the venture capitalists in the United States, Europe, Japan and fast growing newly industrialised economies in Asia by reciprocal observation and study tours.

Encourage patent applications

Offer incentives to patent attorneys and agents who assist patent applications for new entrepreneurs in order to encourage them to file patent applications with which entrepreneurs may create new firms.

Promote incubators

Encourage the use of incubators by academic faculty members, researchers and students who start new businesses utilising their skills and expertise.

Broaden scope of credit guarantees

The scope of credit guarantees should be expanded on loans extended to small businesses that cannot qualify for

commercial loans. A better guarantee system, with the backing of domestic or international financial institutions such as the Asian Development Bank or the Central Bank should be in place to share the risk of providing capital to small businesses. Interest rates on these guaranteed loans would be a few percentage points above the prevailing prime rate. The government could guarantee up to 75 percent of the loan for a fee of about 2 or 3 percent on medium term development loans, in addition to the regular guarantees available under co-financing plans of commercial banks. Credit guarantees can be used to lower collateral requirements to more manageable levels for borrowers without materially increasing the risk of exposure of lenders. With a 2 or 3 percent guarantee fee, bad loan loss rate can be reduced to a few percentage points.

Government procurement

The government should set aside a percentage of the Ministries' procurement budgets to finance purchases of products and services from legitimate small businesses. Some of that money could also be budgeted for supporting small business innovation and research.

Information accessibility and dissemination

Each relevant Ministry should be required to brief small businesses on laws concerning establishing businesses, registration, financing, accounting, bookkeeping, auditing, filing tax reports, labour laws, compensation and benefits, prevention of accidents, health and safety and unemployment. In addition, the government might contract the private sector to provide seminars on business management, quality improvement, productivity improvement, marketing and other essentials. There is a great demand for support on financial, technical, marketing and public procurement issues.

More public support should be given by various government ministries, research institutions, universities, vocational training institutions, local chambers of commerce and industry to small businesses on production design, productivity and quality improvement, engineering, business

management and marketing. A comprehensive nation-wide and global network should be structured to help SMEs in Sri Lanka on available technical assistance.

It is also important to build a comprehensive electronic network of organisations working on SME assistance projects such as the Ministry of Enterprise Development, Asian Development Bank, university schools of business administration, national and local chambers of commerce and other organisations, so that SMEs can seek assistance from their own computers. The government should encourage consultants' organizations and fee-charging institutions to donate their time to contribute to the 'frequently-asked-questions' (FAQ) section on the network and on-demand response services.

Establishing a comprehensive electronic network of foreign, international and national organisations offering financial assistance to SMEs, as well as commercial banks offering co-financing loans to SMEs would be very useful. This would provide small businesses with a one-stop window for applying for financing, co-financing, loan guarantees and other financial assistance programs.

PRIVATE SECTOR INITIATIVES

Exploit synergies with existing firms

Existing businesses should be encouraged to offer their facilities and equipment to entrepreneurs so that they may develop technologies for their own use or establish a joint entity with the benefactors.

Further, existing businesses need to be encouraged to fund high technology start-ups that can be affiliated with the business, either in upstream or downstream processing. Such linkages can make the core business more productive. Businesses may acquire or encourage such start-ups so that they may make a transition to higher value added operations on their own.

Larger businesses should be encouraged to invite their subcontractors, vendors, suppliers and other affiliated companies to participate in in-house seminars, workshops and training programs in order to build new supply chains in support of their own businesses.

Specialized banking services

The banks should improve their internal capacity to assist SMEs in business and financial management, application of emerging new technology, building alliances in the industrial clusters and marketing guidance through the network of their client services staffed with internal consultants with expertise in the major business fields. They may choose a niche industry or service area so as to excel in servicing their clients. The banks should also run seminars, workshops and consulting services in the area where they have strong internal expertise, such as accounting, taxation and audit practices.

JOINT PUBLIC / PRIVATE SECTOR INITIATIVES

Information dissemination and the education system

Academic institutions, vocational schools, local chambers of commerce, private companies, international institutions, management development organisations and the government should sponsor public seminars on all aspects of starting new businesses.

Universities should be encouraged to offer courses on entrepreneurship. Business schools, in co-operation with local business organisations, should develop internship and apprenticeship programs and give students course credits for on-the-job training. During the course of the study, students should be encouraged to start business on their own, under the guidance of faculty members. Sri Lankan universities should be encouraged to enter into co-operative agreements with foreign universities that offer courses on how to start new businesses, so that local counterparts may gain from other countries'

experiences and improve the quality of management.

Primary and secondary school children should be encouraged to participate in courses that expose them to business culture. Students should be encouraged to participate in the Young Entrepreneurs of Sri Lanka, affiliate of the Junior Achievement International and other similar school-to-work programs. Schools, local communities and the national government should recognise and give awards to those students and schools who participate in these programs.

Effective credit background checks

As the primary lenders, commercial banks should strengthen their ability to conduct thorough background checks of loan applicants. The government should help commercial banks develop comprehensive electronic credit background search systems so that loan applications can be expeditiously processed. This may also result in fewer cases of bad loans. The database of loans should be constantly updated and performance of the loan recipients needs to be monitored.

V.7 Encourage a Culture of Quality and Productivity

JOINT PUBLIC / PRIVATE SECTOR INITIATIVES

The government should work together with the business community, labour unions and academic institutions to raise popular awareness to the importance of improving Sri Lankan productivity in order to stimulate broad-based economic growth, raise living standards and improve the quality of life. Such a campaign should be directed at every segment of Sri Lankan society and everyone should consider how he or she personally could contribute to raising Sri Lankan productivity.

The Ministry of Employment and Labour created a web site to solicit input on the development of this national productivity strategy. This report will be included on the

web site and everyone is encouraged to comment on the specific recommendations included herein. Additional material on productivity and its importance to raising Sri Lankan living standards will also be included on the web site. Community meetings to present the national productivity policy and discuss its recommendations should also be held.

- Launch a civic awareness campaign on productivity that targets not only workers and management, but also the wider community of households, academia, government and non-government organisations. The idea is to nurture a productivity mindset in the population.
- Employers should be interested in improving productivity and commit the necessary resources to adopt new management techniques aimed at raising productivity at their individual organisations.
- Labour unions should help their members appreciate that raising productivity is the only way to achieve long-term sustainable improvements in wages.
- Foster co-operative labour-management relations.
- Recognize and reward organisations and individuals making valuable contributions to quality and productivity.
- The media should present success stories on individual and organisational efforts to enhance Sri Lankan productivity. Hopefully, others will be inspired by these reports of 'best practices' and adopt them. A 'media watch' could also highlight procedures and situations in serious need of productivity improvements.
- The government must take the lead in setting an example by improving productivity in the public sector. To that end, a separate report will be devoted entirely to addressing public sector productivity issues.

- Fully implement ILO conventions already ratified by Sri Lanka. (Annex 3)
- Ministry of Labour should provide government agencies representing Sri Lanka in international trade and investment negotiations with up-to-date information and examples of Sri Lankan compliance with ILO conventions.

V. 8 Implement Policy and Monitor Progress

PUBLIC SECTOR INITIATIVES

Improve Data Collection and Analysis and Set Targets

Unfortunately, not enough attention or resources have been devoted to measuring trends in Sri Lanka's labour market, including changes in productivity.

Improving data collection and analysis must be part of any national strategy to improve productivity. The government should take aggressive steps to rectify this problem.

Collecting the appropriate data is the first necessary step toward improving measurement. The government should move aggressively in improving data collection and analysis. Technical assistance from such international agencies could be solicited, particularly for addressing difficulties involved in measuring productivity in the services sector. Benchmarking exercises should be carried out with no-disclosure mechanisms that will facilitate sufficient information sharing by firms. Results of productivity analyses should be published in an annual report.

Further, specific targets should be established not only for the gradual reduction of government budget deficits, but also for productivity, debt reduction, savings and investment.

National Productivity Secretariat

The Minister of Employment and Labour has established a National Productivity Secretariat (NPS) within the Ministry. The Secretariat will be responsible

for monitoring progress in implementing the recommendations outlined in this strategy, as well as analyse trends in Sri Lanka's productivity – at the national, sector and firm levels.

The Secretariat might consider periodically issuing Productivity Impact Assessments (PIA) analysing the potential impact a government action might have on productivity. In particular, the Secretariat might issue PIAs evaluating the impact of Board of Investment (BOI) decisions on Sri Lankan productivity. These assessments would encourage the BOI to base its investment decisions on economic, rather than political criteria. A detailed analysis of the structure and functions of the NPS is covered in the Public Sector Component of the National Productivity Policy.

Co-ordinate Productivity Issues Across Government

Any strategy to raise productivity will need to be comprehensive in order to be effective. Productivity is not just a labour issue. As has already been discussed, a strategy to raise productivity must address a broad spectrum of issues, including capital accumulation, fiscal policy, investment, education, training and technology, to name a few. It is therefore important that the government coordinate its efforts. One option for achieving coordination would be a sub-committee at the Cabinet level, chaired by the Minister in charge of productivity. The sub-committee would meet periodically to coordinate efforts by individual Ministries and to monitor progress in the overall strategy.

JOINT PUBLIC / PRIVATE SECTOR INITIATIVES

Productivity Advisory Committee

The Minister for Employment and Labour has invited representatives from business, labour unions, academia and the government to provide input into the development of this National Productivity Policy. With the publication of the strategy, the Productivity Advisory Committee should advise the Minister, and the NPS should turn its efforts to co-ordinating public and private sector efforts to raise Sri Lankan

productivity. The Productivity Advisory Committee can also serve as a forum for discussing 'best practices', along with other relevant associations or agencies such as the proposed National Competitiveness Council.

National Competitiveness Council

The government does not have a monopoly on developing a strategy to improve productivity. In order to be effective, any strategy must be based on an equal partnership between the public and private sectors. The government, employers, workers and academic

institutions each have an important role to play in taking steps to improve Sri Lankan productivity.

Many countries have brought together representatives of these various groups in a single organization to enhance coordination and improve monitoring. These organizations are commonly known as productivity centres or competitiveness councils. The Government of Sri Lanka should consider establishing a National Competitiveness Council or equivalent apex body, chaired by the Prime Minister.

It is imperative that individuals, companies, civil society and the Government of Sri Lanka work together to implement this policy because productivity *is* prosperity. Sri Lanka is mired in an economic crisis and faces grave challenges. How we respond to these challenges will determine the future we give to our children.

The program outlined above is ambitious. It requires establishing a supportive economic framework, encouraging savings and investment, improving labour market flexibility, developing the workforce, encouraging new firms and support for SMEs, encouraging a culture of quality and productivity and monitoring progress of implementation.

The road ahead is not an easy one. These initiatives involve changing the attitudes and actions of people, businesses and government. But if we succeed in doing these things we can hope for great rewards.

The standard of living of the average person will increase by about the same rate as productivity growth. People will be able to provide better for their families. There will be more to go around. Employers will invest more in capital and technology, making their employees more productive. In turn this encourages them to invest more in their employees to upgrade their skills and training. The average wage will increase. Businesses will find fewer obstacles in their path and government officials who are more service oriented. People will find it easier to get access to training and skills. Sri Lanka will again be seen as an attractive home for those wishing to invest and start businesses, or expand their operations. Productivity will then lead to prosperity, and a better quality of life for all Sri Lankans.

Terms of Reference for Formulating a National Productivity Policy and Action Plan

Sri Lanka ranks itself in a relatively low position in terms of national productivity among the countries in the South and East Asia region. In order to achieve rapid economic growth and improvement in the living standards of citizens on a sustainable basis, increasing productivity is considered imperative. Thus a well thought out policy comprising all spheres of the economy and all sectors of the society should be in place. The Prime Minister has assigned the subject of productivity to the Ministry of Employment and Labour. The following indicate the overall principles governing the process by which the National Productivity Policy (NPP) will be developed. The GOSL is committed to implementing a transparent and participatory approach to policy development. In evolving a National Productivity Policy and plan of action for both the formal and informal sectors, it should be borne in mind that the government is the largest employer in the economy.

The following 'Vision Statement' and 'Mission Statement' are recommended for the NPP.

Vision **Contributing towards a better Sri Lanka**

Mission

To promote economic growth and social stability through enhancement of productivity in the formal and informal sectors of the economy, through progressive labour management relations, technology, investment and a sound, supportive legal and regulatory framework.

The following are recommended strategies and areas to be addressed.

Strategies

1. Adopt a tripartite approach for reaching consensus among stakeholders (employees, employer/managers, and government)
2. Share leadership responsibility on development of policies among employees, employers, and government with inputs from education and training sectors.

3. Harness the support of national and international agencies to bring appropriate business, labour and other expertise.
4. Build consensus on major issues to be addressed in developing productivity policy among all stakeholders.
5. Consider recommendations made at the Round Table Conference held by the Productivity Division of the NIBM in 1995 and 2001 under the sponsorship of APO Japan.
6. Strive to make the process organized, transparent and timely including workshops, use of web site, use of expert consultants and study tours.

Areas to be addressed in Policy

The following are recommended areas to be addressed in policy reforms.

1. Policies related to Macro-economic stability
 - a. Sound fiscal and monetary policies.
 - b. Strengthening and expanding the social safety net.
2. Policies related to investment and capital
 - a. Encouragement of capital formation.
 - b. Access to capital.
 - c. Improving the efficiency in the financial sector.
 - d. Facilitating the ability to borrow internationally.
 - e. Risk mitigation.
 - f. Encouragement of investment in more productive plant, equipment and technology.
 - g. Creation of a conducive environment to greater investment.
 - h. Effective/Productive and sustainable use of Natural Resources.
 - i. Research and Development.
3. Policies related to entrepreneurship and management in Investment and Development.
 - a. Setting in place systems for good governance incorporating transparency and accountability.
 - b. Reducing/eliminating wastage and inefficiency.
 - c. Standards on worker health and safety
 - d. Employer and employee rights and obligations.

- e. Encouragement of investment in training and education, both on the job and from external education and training providers (see # 4 below)
 - f. Adoption/adaptation of innovative practices for labour management (flexitime, working at home, telecommuting accommodation of needs of working mothers, etc.)
 - g. Social safety net provisions including retraining opportunities.
 - h. Carry out a public relations programme to involve all stakeholders in productivity enhancement.
 - i. National Productivity Secretariat to be strengthened and making recommendations relating to other institutional mechanisms.
 - j. Recognition schemes to acknowledge exceptional contributions to productivity and innovation.
4. Policies related to human capital
- a. Productive social dialogue leading to effective labour-management co-operation including collective agreements, prevention of disputes and speedy dispute resolution.
 - b. Conformity of Sri Lankan labour practices and law with international labour standards (such as those of the ILO) and positioning of Sri Lanka as a responsible labour-practice country for maximum competitive advantage in world markets.
 - c. Fostering increased efficiency and effectiveness of labour, including product quality and productivity monitoring and measurement.
 - d. Labour market reforms similar to those in other high growth countries regarding management of redundant labour, use of overtime, flexible work rules, and review of public sector and private sector holidays.
 - e. Recommendation related to unskilled labour and those in the informal sector (e.g. housewives, farming community, self employed)
 - f. Incentives for training.
 - g. Concern for employee welfare such as safety, health, accommodation and transport.
 - h. Encouragement of productivity gain sharing as part of productivity improvement strategy.
 - i. Make employees stakeholders - introduce "Profit Sharing" schemes.
 - j. Employee participation in management efforts to improve quality and productivity.
 - k. Re-definition of Labour-Management relations.

5. Policies related to education and training.

- a. Improved responsiveness of education and training providers to needs of the private sector and the self-employed.
- b. Encouragement of greater private sector involvement with educational/training and retraining providers ensuring quality and relevance.
- c. Curriculum reform to improve basic communication skills (including English and other foreign languages important to Sri Lanka markets), computer skills, basic business skills, science and technology and other appropriate job skills and attitudes.
- d. Improving sector linkages between industry and specialized training providers (e.g. tourism, agriculture, apparel, I.T., etc.)
- e. Training for unskilled/ manual workers to increase their efficiency.
- f. Productivity to be included as a subject in the school curriculum and training of teachers where necessary.

6. Policies related to Public Sector efficiency and support to employers.

- a. Civil service productivity and service orientation and systems for good governance.
- b. Improved efficiency transparency and accountability in public sector transactions and decisions.
- c. A productivity measurement unit within each Ministry.
- d. Infrastructure: major improvements required, using Public Investment and Private Sector Partnerships arrangement.
- e. Encourage new spirit of public service support for and cooperation with the private sector on creating economic growth.
- f. Government assistance in identifying and developing new markets.
- g. Government support and involvement in the field of Research and Development.
- h. Improved services in intellectual property rights.

DECENT WORK AND PRODUCTIVITY IN SRI LANKA

Prepared by the International Labour Organization

People, people and people!

This is what it takes to make any society prosper. It is for the people- men and women alike - that the society wants and needs to create prosperity. It is only through the people – the human capital of the society – that prosperity can be created. The crucial factor is productivity. To create prosperity through people the private and the public sectors must focus on productivity. This is a search for excellence that must be the core vision of both the private and the public sector of Sri Lanka. In operational terms – as set out in the initiatives spelled out in the National Productivity Policy – this is a constant search for productivity improvement. Such improvements are fundamental to ensure a sustainable economic growth that has a lasting impact on the standard of living of people. Any economic entity, private, public, formal, informal, has a role and a responsibility in building a society that can bring prosperity to all its citizens.

1. Competitiveness and productivity

The Future: Regaining Sri Lanka outlines a national programme to transform the country into a thriving modern economy. More investment, improved efficiency, and greater productivity are necessary to sustain an annual growth rate of 8-10 per cent.

The cornerstone of the growth strategy is reaching global markets through developing competitive, export-oriented enterprises; removing barriers to productivity; and establishing review mechanisms to ensure that new barriers do not arise. Key programme elements include accelerating privatization, reforming the legal foundation of the economy, and improving efficiency in critical government functions.

Aside from tourism earnings and remittances from migrant workers, the Sri Lankan economy currently depends largely on the export of only a few products, including garments and tea. The *Sri Lankan Competitiveness Study* (USAID, 1998), which ranked Sri Lanka fifty-third in composite competitiveness, observed that competitiveness is not simply about cheap labour or better incentives. More fundamentally, it is about sustainable growth in productivity. Sri Lanka's regional and global competitiveness, then, will lie in its ability to add value to its products and services.

But sustainable growth entails more than adding value to products and services. If these goals are to be realized in the longer

term, they presuppose “adding value” to the jobs of those workers who will produce the goods and services. In other words, national policy must aim to extend “decent work” to as large a part of the population as possible.

While globalization and liberalization present new opportunities, many countries have been adversely affected. Eroding competitiveness has led to job losses, deteriorating job quality, casualization of labour, and increases in informal work and child labour. Sri Lanka—the more so in view of the high expectations encouraged by current peace talks—expects instead to capitalize on the opportunities by adopting a people-oriented approach, combining economic growth with social responsibility. This is the key to the decent work agenda.

2. What is “decent work”, and why is it important?

The decent work agenda¹, promoted by the International Labour Organization (ILO), emphasizes the importance of human and social capital for sustainable growth in productivity. Every man and woman in any country aspires to engage in decent work. Such employment nurtures self-esteem, permits self-fulfillment, and provides for the voice of workers to be heard. These, in turn, are the prerequisites for full worker participation in enhancing productivity.

The decent work agenda applies to all work—public sector and private, formal sector and informal. It aims to raise the social platform of people—including those who are too often disadvantaged, such as women, the young, and the disabled—to ensure that all can benefit from productive activities in an era of increasing globalization and liberalization.

Decent work is about providing access to quality employment. It is also about protecting workers and their rights—an essential goal, if workers are to recognize a personal stake in enhancing competitiveness and productivity. The decent work agenda includes four main

pillars: equal access to productive and remunerative jobs without discrimination; a safe working environment; social protection and workers’ rights; and social dialogue.

The fundamental premise is that adopting a decent work agenda is the surest way to sustained productivity in a highly competitive world. Specifically, this high road to development requires that (i) employment promotion is integral to economic growth plans; (ii) both quality and quantity of jobs are equally guaranteed; (iii) the enhancing of skills and employability are primary goals; (iv) the rights of workers are safeguarded and their voice is heard; (v) the workforce has access to basic protection.

3. Full employment is the goal

Currently estimated at about 8 per cent, unemployment has been gradually declining. It remains relatively higher, however, among youth, females, and the disabled. Underemployment, at around 20 per cent of the total workforce, is very high. The “employed”, meanwhile, include unpaid family workers and 1.2 million public sector workers, including employees of state-owned enterprises that are often identified as being overstaffed and inefficient. In addition, the manufacturing sector continues to contract. Prospects for employment expansion in both large-scale manufacturing and the public sector have remained limited, with privatization of public enterprises further eroding job opportunities in the public sector.

Productive job creation, however daunting a task, is vital. The challenge is to use *all* of a country’s female and male human resources, fully realizing the national potential in a bid to be optimally competitive. While understanding that some transitional unemployment may be inevitable, this means providing employment opportunities and decent work for everyone including displaced workers, youth, women, people affected by conflict, and the disabled.

In response to the challenges, the Government is adopting policies aimed at optimizing the country’s economic growth. Measures include improving the policy and

1. *Decent work*, report of the Director General, International Labour Conference, 87th Session, 1999.

regulatory environment to enable the private-sector to operate more efficiently; and deliberating on the appropriate choice of new technology. In themselves, however, improved technology and investment capital are not enough. Competitiveness in this age of globalization also demands full development and employment of a nation's human capital. No country can compete successfully while much of its labour force remains idle or unproductive. Underemployment means human resources are under-utilized.

Economic growth policies must be people oriented and full employment must be the overall goal. This includes the pursuit of labour-based employment, especially in large infrastructure projects as part of the post-conflict reconstruction process. Similarly, development policies cannot focus only on formal sector growth, since much of the employment creation takes place in the informal economy.

The National Employment Policy as well as the Productivity Policy are rightly designed to address unemployment and to make productive employment available to all. They aim at optimising the countries' human resources and employing labour more productively. What is critical is that these policies are integral elements of the overall development policies of the country, including the poverty reduction strategy.

4. Quality jobs contribute to productivity

Job creation in small enterprises remains the most promising avenue for expansion of employment opportunities. Entrepreneurship training assumes a vital importance, in this light. Modern and efficient small enterprises can provide the foundation upon which Sri Lanka competes in the world market. Many decent work deficits, including low skill levels and rudimentary technology persist in micro- and small enterprises as they operate in the informal economy. By addressing these deficits, the work environments will become more conducive to productive work and enhance overall competitiveness. This is so both for the formal and the informal economy.

Small enterprises, furthermore, are increasingly required to complement larger enterprises in the latter's quest for increased competitiveness in world markets. But poor job quality in small enterprises leads to uncertain quality and unreliable delivery of components and services. Poor job quality also results in high costs in terms of inefficiency, wastage, and lost working hours.

Employment creation policies and programmes should take into account both job quantity and job quality. Good job quality benefits workers. It also makes good business sense for employers. Moves to improve working environments and job quality are often considered a burden on enterprises. On the contrary, improved working environment and job quality, with proper attention to health and safety hazards, contribute to both higher income and higher productivity, thereby reversing the vicious cycle of poor job quality leading to low income. Low-cost improvements are within reach of small enterprises.

Improving job quality, finally, entails more than merely improving work methods and conditions. It also involves skills enhancement, social protection and workers' rights.

5. Enhancing skills and employability

Compared to other developing countries, Sri Lanka enjoys impressive levels of basic education. Estimated adult literacy exceeds 90 per cent, with a high level of gender parity. Such literacy levels, however, have not translated into employable skills, especially among poor and marginalized communities. Tertiary education suffers serious inadequacies, and should be more demand oriented. Skills training institutes suffer from management deficiencies, outdated equipment and curricula, and a shortage of capable trainers.

Government strategy aims to promote the private sector as the main provider of post-secondary skills training. The decent work agenda emphasizes the need for joint involvement of employers and workers in pursuing improved employability.

Sustained productivity improvement requires continuous upgrading of worker skills and a policy of encouraging life-long learning. Improved productivity at the firm level means workers must learn efficient production methods and waste reduction. The introduction of new technologies requires human resources capable of maximizing the potential benefits. In the final analysis, it is skilled and knowledgeable workers that make enterprises competitive. Equally important are entrepreneurship training programmes, which are especially beneficial for productivity in the informal economy.

6. Protecting workers' rights and social dialogue.

Where people have a participatory voice in their work and the conditions of their work, productivity improves. If workers feel a sense of personal efficacy, sharing in the decisions that affect their lives, they are far more likely to share enterprise- and country-level goals of increased productivity and competitiveness. Industrial peace, itself a boost to productivity, is also much more surely maintained when all concerned have a voice and feel part of the process.

Employers and workers need to acknowledge and respect each other's rights and obligations. Among issues needing resolution is that of linking productivity to gainsharing, which needs to be agreed upon by both employers and workers. Also on the agenda: a safety net that incorporates both income and retraining.

More basically, workers' rights should include freedom of association; freedom from discrimination; freedom from child labour; and freedom from forced labour. Long-term efforts to improve productivity will be all the more successful where these liberties are protected in law and policy. Sri Lanka has ratified seven of the eight core ILO Conventions described in the Declaration of Fundamental Principles and Rights at Work, and is in the process of ratifying the eighth, with Cabinet approval already granted to ratify Convention 105 on Forced Labour. Full implementation of these core conventions will help achieve the national goal of higher productivity.

Sri Lanka already presents an exemplary record with regard to child and forced labour.

7. Providing social protection

National labour legislation is now under review. Reform will necessarily involve, in the modern context, a tripartite dialogue between workers, employers, and the Government. A balance must be struck between labour-market flexibility and the protection of basic rights. Safety nets that incorporate both income and retraining are important elements that will be addressed in the process.

Where workers feel protected, they perform more effectively, and are less inclined to fear change. Productivity thus improves in an environment of worker security and protection, as this allows each individual – throughout the life cycle – to reduce vulnerability to risks imposed by e.g. unemployment, sickness, or retirement. One of the pillars of decent work is the availability of social protection for all. Sri Lanka has had a long tradition of providing income support and social protection. Affordability is an issue in many countries. Savings and investment associated with the provision of social protection and insurance has in fact been an important element in the economic growth of some countries.

8. Conclusions

Imminent national peace presents Sri Lanka with new prospects for social and economic development. A people-oriented approach to improving productivity and expanding exports promises to take full advantage of this opportunity. Comprehensive realization of the country's human resources, including all national sectors and groups within a sustainable, long-term development plan, can optimize economic competitiveness while fully realizing a rich national potential.

International Labour Organization (ILO) Conventions Ratified By Sri Lanka

Core Conventions

Eight ILO core conventions and Sri Lanka's ratification dates:

- C29 Forced Labour Convention (5 April 1950)
- C87 Freedom of Association and Protection of the right to organise Convention (15 Nov 1995)
- C98 Right to organise and collective bargaining Convention (13 Dec 1972)
- C100 Equal remuneration Convention (1 April 1993)
- C111 Discrimination (employment and occupation) Convention (27 Nov 1998)
- C138 Minimum age for admission for employment (11 Feb 2000)
- C182 Prohibition and immediate action for elimination of worst forms of child labour Convention (1 March 2001)
- C105 Abolition of Forced Labour Convention (Cabinet approval given on 7 Jan. 2003. Ratification pending)

Other Conventions ratified by Sri Lanka

- C8 Unemployment indemnity (shipwreck) Convention
- C11 Right of Association (agriculture) Convention
- C16 Medical examination of young persons (sea) Convention
- C18 Workmen's compensation (occupational diseases) Convention
- C26 Minimum wage fixing machinery Convention
- C45 Underground work (women) Convention
- C58 Minimum age (sea) Convention - revised
- C63 Convention concerning statistics of wages and hours of work
- C80 Final articles revision Convention
- C81 Labour inspection Convention
- C90 Night work of young persons (industry) Convention - revised
- C95 Protection of wages Convention
- C96 Pre-charging employment agencies Convention - revised
- C99 Minimum wage fixing machinery (agriculture) Convention
- C103 Maternity protection Convention - revised
- C106 Weekly rest (commerce and offices) Convention
- C108 Seafarers identity documents Convention
- C110 Conditions of employment of plantation workers Convention
- C115 Radiation protection Convention
- C116 Final articles revision Convention
- C131 Minimum wage fixing Convention
- C135 Workers representatives Convention
- C144 Tripartite consultations to promote the implementation of ILS Convention
- C160 Labour statistics Convention

Advisory Committee Members

J. Abeywickrama, *Additional Secretary*,
Ministry of Employment and Labour

N.S. Adihetti *Director General*, National
Institute of Business Management

Mahesh Amalean, *Chairman*, MAS
Holdings (Pvt) Limited

S. Amarasinghe, *General Secretary*,
Inter -Company Employees' Union

Palitha Athukorala, *Chief Organiser*,
Jathika Sevaka Sangamaya

Gotabaya Dasanayake, *Director General*,
Employers' Federation of Ceylon

Renton de Alwis, *Secretary General*,
Ceylon Chamber of Commerce

Leslie Devendra, *General Secretary*,
Sri Lanka Nidahas Sewaka Sangamaya

Ranjith Fernando, *Secretary*, Ministry of
Enterprise Development, Industrial Policy and
Investment Promotion

Susantha Fernando, *Chairman*, Sri Lanka
Bureau of Foreign Employment

Malin Goonetilake, *Secretary General*
Designate, The Planters Association of
Ceylon

H.M. Gunasekara, *Director*,
Department of National Planning

Shafeenaz Hasseudeen, *Senior Programme*
Officer, ILO, Colombo Office

A. A. Amaradasa, *Management Consultant*,
Quality Institute

Anton Fernando, *Chairman*, Business
Management Bureau Lanka

S. S. Hewapathirana, *Senior Assistant*
Secretary, Ministry of Employment and
Labour

C.D.R.A. Jayawardana, *Director General*, Sri
Lanka Standards Institution

A. Kahanda, *Deputy Director / Statistics*,
Department of Labour

Mahinda Madihahewa, *Commissioner*
General of Labour, Department of Labour

Kumar Mallimarachchi, *President*, Tourist
Hotels Association

N. Meegahawatte, *Consultant*, National
Institute of Business Management

R.M.I. Padmini, *General Manager*, Sri Lanka
Bureau of Foreign Employment

S. W. Pathiraja, *Director*, Industrial
Restructuring Unit

S.A.M.R.N. Rajapakse, *Director*, Planning
Research and Development,
Ministry of Employment and Labour

Raja Seneviratne, *General Secretary*, Lanka
Estate Workers Union

Nathan Sivaganandan, *General Manager*,
Bodyline (Pvt) Limited

Sunil Wijesinha, *Managing Director / CEO*,
Merchant Bank of Sri Lanka, Ltd.

Cubby Wijetunge, *Director*, Corporate
Affairs, Nestlé Lanka Ltd

Herath Yapa, *Commissioner of Labour*
(Workers Education Division), Department of
Labour

Annex 5

Annexes

Team of Consultants

The Core Team:

Howard Rosen, Team Leader and former Executive Director of the U.S. National Competitiveness Council

Joji Arai, Secretary General, International Productivity Service, Washington, D.C.

Dr. Ravi Yatawara, Assistant Professor, Department of Economics, University of Delaware

Designated Reviewers:

Leslie Devendra, General Secretary, Sri Lanka Nidahas Sewaka Sangamaya

Gotabaya Dasanayake, Director General, Employer's Federation of Ceylon

Sunil Wijesinha, Managing Director/CEO, Merchant Bank of Sri Lanka.