Export-Oriented Manufacturing: A Viable Engine of Economic Growth and Labor Generation for Sri Lanka

Visvanathan Subramaniam

1 Introduction

A review of Sri Lanka's strategies to deliver substantial and equitable growth paints an arresting picture for those interested in understanding the dynamics of development endeavors in emerging Asia. When examined from a broader perspective, the island nation wields a track record antithetical to South Asia's postcolonial developmental woes. It has experienced marked success in raising human development indicators to a standard comparable with that of advanced nations while utilizing resources in a manner that belies its modest income levels.

However, in recent times, Sri Lanka's development story has been shadowed by sizeable growth magnitudes in the economies of regional partners. For instance, while South Asia is projected to experience a collective GDP growth rate of 6.9 and 7.3% per annum for 2017 and 2018, the Sri Lankan economy is expected to grow at a below average 4.5 and 4.8% per annum during a similar window (IMF 2017a, b). Such lackluster growth magnitudes are particularly worrisome given the current scenario; Sri Lanka has only recently emerged from a disastrous civil war that shackled development prospects.[1] Theoretically, the nation is supposed to be in the midst of a "peace dividend" wherein the economy experiences a sustained growth acceleration, much above the 5% threshold (Fonseka et al. 2012).

Contemporary shifts in the demographic composition of the labor force also place Sri Lanka in an unpropitious footing. Unlike most of its South Asian counterparts,

[1] As per a study conducted by Arunatilake et al. (2001), the Economic cost of the Sri Lankan war, as of 2000, was estimated at twice of Sri Lanka's 1996 GDP. This can be equated to roughly around US$26 billion. Given that the hostilities increased over the decade, the cost can only be expected to be much higher.

V. Subramaniam (✉)
Institute of Policy Studies, Colombo, Sri Lanka
e-mail: vishva.subramaniam@outlook.com

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Sri Lanka stands on the adverse end of a demographic dividend. In other words, the nation has already passed its peak inverse dependency ratio and now soon faces the challenge of mitigating the adverse economic effects of an aging population (World Bank 2011). Given this predicament, Sri Lanka cannot continue to compete on labor cost differentials since an aging working population will eventually precipitate a rise in wage rates. Sri Lanka's labor competitiveness can thus only be sustained (if not improved) by an emphasis on strategies that enhance productivity above and beyond any spikes in labor costs.

In such a scenario, it is essential that Sri Lanka implements a policy framework that propels growth while ensuring a sustained labor generation mechanism amenable to an aging, more expensive working population. Sri Lanka's locational advantages can be used as a leverage in this regard. The island's geographic proximity to fast-emerging economies (vis a vis India) and strategic maritime routes linking vital economic corridors makes it an ideal hub for producers wishing to target multiple high-value markets. However, a brief perusal of past history suggests that Sri Lanka has encountered mixed success in implementing liberalization reforms that aid in export orientation. The advancements made in clustered waves of liberalization have been offset by periods of economic uncertainty instigated by nationalist reforms.

This paper argues that it is in Sri Lanka's best interest to gradually and resolutely develop an export-oriented manufacturing sector which maintains an emphasis on inculcating a sophisticated, high-value export portfolio. This will spark a viable growth momentum by expanding export potential and increasing supply capacity. Simultaneously, such a policy will engender a larger shift to capital-intensive production processes that increase labor productivity.

The paper is structured as follows. It first provides an overview of Sri Lanka's experiments with liberalization before providing a review of the nation's manufacturing sector. Thereafter, it analyzes the labor market and provides brief synopses of distortions, especially relating to youth unemployment, skills mismatches, female unemployment, and public sector preferences. It then examines Sri Lanka's interactions with the South Asian region, with an emphasis on utilizing the burgeoning Indian middle class as a viable market for maximizing export potential.

2 Clustered Liberalization Reforms

Sri Lanka's development trajectory over the latter half of the twentieth century was heavily influenced by resolutions enacted by colonial administrators during the Colonial era. Tenets of laissez-faire liberalism were introduced to the island in 1832 through the Colebrooke–Cameroon Commission, which recommended the establishment of an open economy with nominal regulatory reach.[2] Consequently, a great impetus was placed on an export-oriented development strategy whereby—as per the-

[2]In "A History of Sri Lanka" (1981), K. M. De Silva argues that the recommendations made by the Colebrooke–Cameroon bear many similarities to Bentinck's reforms in India. However, according

ory—private sector participation and foreign investments fueled economic growth while state apparatuses ensured administration services (Waidyanatha 2001).

During the colonial period, the secondary sector—manufacturing included—was predominantly focused on home industries such as basket weaving, handlooms, and carpentry. The sector received scant attention as private (mostly British) entrepreneurs remained wary of channeling investments away from lucrative plantation crops to native sectors with scant global demand. Therefore, up until independence, Sri Lanka possessed a dual-sector open economy characterized by the coexistence, albeit in isolation, of an export-oriented plantation system controlled by minority interests, with a subsistence agricultural and traditional home industry sector that served much of the indigenous populace (Amjad et al. 2015).

The arrival of Independence in 1948 did not bring immediate respite to such discrepancies in capital and resource allocation. Strong commodity prices in international markets meant that significant revenue inflows shrouded imbalances in the economic structure. Sri Lanka (then Ceylon) posted substantial gains in per capita income and ensuing stability provided grounds for the establishment of well-accepted state welfare initiatives. Sri Lanka outperformed its regional partners during this period and was even dubbed by many as "the best bet in Asia" (Wriggins 1960). However, the island continued to function as an outward-oriented economy wielding a minimally diversified export basket composed of unsophisticated commodity products. Development was thus inexorably linked with the performance of its exported commodities, namely tea and rubber, in hitherto stable international markets.

Therein, the long-drawn decline in essential commodity prices experienced in the early 1960s had severe ramifications on the Sri Lankan economy. Falling export revenue resulted in a contraction of growth prospects and promulgated a balance of payment crisis. In response, the state increased import restrictions to address current account imbalances. As economic woes continued, the state responded by radically intensifying barriers to market entry. Such repeated interventions gradually induced a shift of economic emphasis away from export orientation toward import substitution.

The veer towards import substitution generated emphasis on the underdeveloped manufacturing sector as policy makers strived to stimulate native industries to produce consumer goods demanded by the domestic market.[3] Over a thousand medium- and small-scale industries commenced operations between 1960 and 1963 alone, compared to 500 operations started during the preceding 15 years (Dias 1987). Furthermore, real manufacturing output increased by 9.5% over the latter half of the decade, the highest increase recorded up to that time (Athukorala and Rajapathirana 2000).

Sadly, such gains were not sustained. Sri Lanka's limited resource base, coupled with the issue of slender investment capacity, meant that manufacturing enterprises

to De Silva, the former was "more far reaching in impact and more consistent in the application of liberalism."

[3]The manufacturing sector was briefly expanded during the Second World War due to the severance of trade routes by axis forces. However, development was quite miniscule as the initiative was state-driven with minimal private sector involvement.

did not have the financial strength to muster and sustain production processes. In addition, the nation possessed a relatively miniscule domestic market insufficient to sustain a large, capital-intensive production process. Crucially, import substitution mechanisms failed to mitigate Sri Lanka's crippling balance of payment deficit.

A perusal of existent literature suggests that restrictive trade policies were destined for failure as policy makers failed to take the input composition of contemporary and planned manufacturing enterprises into account. Industries producing light consumer goods for the domestic market were heavily dependent on imported raw materials (Athukorala and Rajapathirana 2000). Furthermore, domestic establishments lacked the technical know-how to establish and supply to capital-intensive production processes. Therein, manufacturing firms showed an overwhelming dependency on imported machinery and expertise for production (Dias 1987). Sri Lanka also continued to depend extensively on the three traditional plantation crops for export revenue in international markets. By 1977, nearly two decades into the protectionist era, the manufacturing sector accounted for a mere 15% of aggregate exports (Vidanapathirana 1993).

Concerns pertaining to stagnations in industrial development, retractions in consumption levels, and a persistent dependency on primary sector exports were bought to the forefront during the general elections of 1977. Resolute anti-incumbency brought into power a center-right government set on dismantling restrictions placed on trade policy. Ergo, the state introduced a series of fundamental liberalization policy reforms that marked a decisive break from decades of import substitutionary policies (Yiping et al. 2013).[4] The primary objective of reform initiatives was in achieving export-driven growth driven by a cheap yet skilled workforce and sustained by foreign investments.

Liberalization resulted in a plethora of positive developments. Economic growth surged from an average of 2.9% previously to over 6% during the immediate post-liberalization period (Yiping et al. 2013). The structure of the economy underwent a notable transformation as Sri Lanka gradually swayed from a land-intensive, plantation-dependent export portfolio to a more labor-intensive, manufacturing-oriented basket of goods. Instigated by such reforms, the share of manufacturing in total merchandise trade rose from 5% in the mid-1970s to over 70% by the year 2000 while the contribution of agricultural exports (primarily tea, rubber, and coconut products) recorded a fall from 78.7% in 1975 to 8% by 2016.

A surge of foreign investment into labor-intensive segments provided added impetus to Sri Lankan manufacturing. The textile and apparel sector soon emerged as the most significant manufacturing export, accounting for around 60% of aggregate manufacturing and over 45% of export earnings by 2016. The sector's rapid growth was fueled by the imposition of stringent quotas on apparel exports to developed nations as per the Multifiber Agreement (1977). Sri Lanka proved to be an ideal destination for apparel-led investments following liberalization as it held a comparative advan-

[4] Sri Lanka was the pioneer of policy liberalization initiatives in a South Asian context (at least on a postindependence perspective) with reforms implemented "a decade or more ahead of its neighbors" (Yiping et al. 2013)

tage in unskilled and semiskilled labor while possessing a virtually untouched quota pool (Athukorala and Ekanayake 2014).

Unfortunately, the growth surge proved to be ephemeral as the new government failed to sustain the momentum of liberalization. The new regime continued to divert funds for large-scale investment programs while inefficient state-owned enterprises remained in operation. Issues were further exacerbated by the escalation of conflicts between the armed forces and rebels in the North and East of the island.[5] Prevailing policy uncertainties and lingering socioeconomic issues hampered prospects of considerable progress in the manufacturing sector. Capacity utilization of manufacturing, which increased drastically from 60% in 1977 to 70% in 1980, stagnated over the subsequent years (Kelegama, Liberalization and Industrialization: The Sri Lankan Experience of the 1980s, 1992). In addition, lapses in planning and management resulted in the development of structural sector weaknesses. As Kelegama (1992) notes, the country was plagued by frailness exacerbated by an "erratic growth momentum, lop-sided growth and inadequate export orientation."[6]

Subsequently, to reinvigorate the economy, a renewal of liberalization endeavors was commenced in 1989. Often referred to as the "second wave of liberalization," the initiative involved extensive reforms to industrialization and economic policy. Yiping et al. (2013) provide a detailed perspective of such strategies: they state that "the wave of reforms involved ambitious privatization programmes, a drastic simplification of tariff structure, removal of exchange controls on current account transactions and a lax foreign investment regulations to reinvigorate outward orientation." Reforms also focused on implementing a more equitable development model. For instance, the Industrial Promotion Act, which was passed in 1990, focused extensively on promoting industrial diversification and enhancing the geographical spread of manufacturing industries.

Importantly, the second wave of liberalization had a significant impact on perceptions surrounding the impact of outward orientation on socioeconomic development. As Dunham and Kelegama (1997) state, "such reforms established a de facto consensus across the political spectrum that growth was viable on the basis of a pro-market open liberal economic policy regime." Initiatives that were implemented molded Sri Lanka's development trajectory for the next few decades.

Sri Lanka's manufacturing industry underwent further change following the arrival of a pro-nationalist coalition into political leadership in 2004. The new government's primary objective was to bring the curtains downs on the civil war by convincingly defeating armed rebels. A strong military campaign, reinforced by the international assistance, promulgated in a monumental and seemingly lasting victory for the armed forces. Therein, one of Sri Lanka's debilitating impediments to devel-

[5]The impact of the Sri Lankan civil war on industrial fortunes cannot be overstated. For a more ornate overview of the economic (and therein manufacturing) costs of conflicts, a perusal of Arunatilake et al. (2001) is encouraged.

[6]A contemporary overview of the manufacturing sector suggests that the noted weaknesses continue to persist. Sri Lanka experiences lopsided industrial growth due to a dependency on textile and garments manufacturing. Export orientation has been persistently inadequate with aggregate export revenue steadily declining over the recent past.

opment was resolved. Socioeconomic uncertainties that inhibited investor confidence (especially into the manufacturing sector) were now mitigated and a significant portion of the island's North and East were now open for development activities to commence.[7] Sri Lanka was expected to embark on an accelerated growth period in the backdrop of political stability.

However, in what appears to be a general trend in Sri Lanka's postindependence history, the enthusiasm pertaining to reform initiatives was not sustained. The cessation of conflicts paved the way for a reemergence of state interventions and import substitution schemes under the guise of populist and nationalist rhetoric. As such, large-scale infrastructural programs were implemented in rural areas and the role of state-owned enterprises (SOE) has shown signs of resurgence. Such organizations continue to be a large drain on state resources and have acted as an inhibitor to private sector development, especially in the manufacturing sector.

Moreover, the series of taxes and levies imposed since 2004 seriously hampered, if not reversed, the momentum of liberalization. An extensive study had been conducted by Pursell and Ahsan (2011) which concludes that Sri Lanka's total protection rate (customs duty + para-tariffs) increased marginally between 2002 and early 2004, but doubled between 2004 and 2009. Furthermore, the average protection rate for agriculture increased from 28.1 to 49.6% while the protection imposed for industrial products increased from 10.7 to 24.1%. In aggregate, import protections were increased from 13.4 to 27.9%. As a consequence of multiple stop-gap session of trade reforms, Sri Lanka's protectionist structure has accumulated intricacy to the extent that the island nation can be categorized as "the world record holder for the complexity of tariff system" (Pursell and Ahsan 2011). The authors attribute the spike to an increased use of para-tariffs by state officials to protect domestic industries while additionally gathering revenue for state coffers through non-direct mechanisms (Pursell and Ahsan 2011).

Thus, there was much expectation that new initiatives undertaken by the current government will place Sri Lanka back on the path of liberalization and assure industrial prowess inculcated through foreign investments. Sadly, clear discrepancies between performance and electoral promises have emerged—notable headway has not been made on many fronts.[8] Sri Lanka's economy remains in a precarious state with state activity (and inactivity) compounding issues further. External borrowing has mushroomed, the trade deficit has deteriorated, foreign investments have trickled, and inflation threatens to make serious inroads into consumer welfare.

[7] Athukorala argues that the civil war was one of the primary reasons for Sri Lanka's virtual absence in Global Value Chains. Integrations into such networks require extensive domestic stability as corporations are wary of issues that disrupt the entire production process.

[8] Many observers consider the composition of the government as one of the primary inhibitors for policy reform. The presiding coalition comprises an uneasy alliance between a center-right party and a center-left party that have traditionally vied for power during much of Sri Lanka's postindependence history. The past two years have been marked by constant intra-governmental tussles and one-upmanships, precipitated by ideological differences.

3 Manufacturing Sector Performance

At the cusp of independence, Sri Lanka possessed an economy superior to that of most Asian states (World Bank 2004). However, seven decades later, the island nation finds itself lurching behind continental partners that now wield considerable economic prowess. Perhaps a primary reason for Sri Lanka's laggard performance is its failure to stimulate ample productivity gains in manufacturing. Staggered liberalization reforms and inconsistent policy advancements, as elucidated in the previous section, have impeded advancements in this sector. This section provides an overview of Sri Lanka's manufacturing sector with an added emphasis on labor generation capacity.

As evinced in Fig. 1, the manufacturing sector has been consistently plagued by instability and has failed to post consistent periods of uninterrupted growth above the national trajectory. Momentum garnered during periods of sustained growth has been counterweighed by bouts of languid performance (Aggregate performance). Since 2004, growth in the manufacturing sector has been eclipsed by economic growth. It was constrained by the civil war that raged until 2009 with cessation of hostilities resulting in a minor albeit staggered surge (1%) in growth over the subsequent period.

Table 1 provides an overview of variations in the sectoral composition of GDP over the past 40 years. As is evident, the share of agriculture in GDP has considerably deteriorated with substantial declines occurring particularly over the last 20 years. Akin to India's experience, Sri Lanka's industrial component—including manufacturing—has effectively leapfrogged as declines in the agricultural sector have been compensated by substantial gains in the service sector. As inferred above, stuttered growth in the manufacturing sector has resulted in minimal gains in GDP composition. Within the given 40-year window, manufacturing sector composition has increased by a mere 2.2%. In comparison, the services sector has expanded by 14.1% within a similar time period.

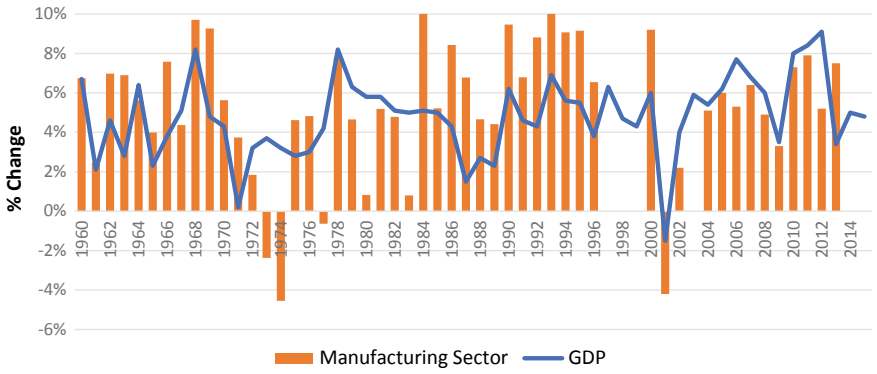

Fig. 1 Comparison of GDP and manufacturing sector growth rates (1960–2015). *Source* Central Bank of Sri Lanka, Annual Reports, various issues (Athukorala and Rajapathirana 2000)

Table 1 Composition of manufacturing in GDP (%)

Year	1975	1980	1985	1990	1995	2000	2004	2010	2015
Agriculture (%)	30.4	27.6	27.7	26.3	23	19.9	12.7	8	8.2
Industry (%)	26.4	29.6	26.2	26	26.5	27.3	30.2	26.6	27.3
Services (%)	43.2	42.8	46.1	47.7	50.5	52.8	57.3	54.6	57.3
Manufacturing[a] (%)	13.1	18.3	18.2	17.4	20.4	15.8	16.3	17.3	15.4

Source Central Bank, Annual Report, Various Issues
[a]Manufacturing is a component of Industry

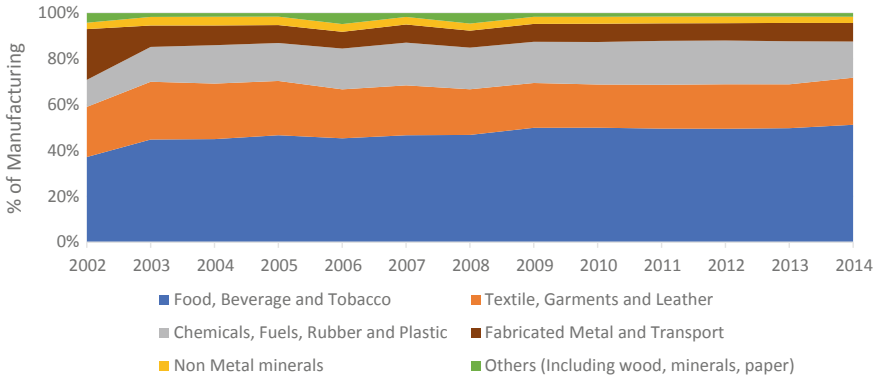

Fig.2 Value added by manufacturing subsectors (2002–2014). *Source* Central Bank of Sri Lanka, Annual Reports

Figure 2 depicts the share of manufacturing subsectors as a percent of aggregate manufacturing output. As is evident, the "Food, Beverages and Tobacco" subsector is the largest contributor to added value in manufacturing over the past decade and half, with the composition in value added increasing steadily from 37% of manufacturing in 2002 to 51% of manufacturing in 2014. Production in this segment is catered towards the domestic market. Meanwhile, export-oriented segments have experienced subdued growth in value addition. For instance, the share in value additions of textile and garments—the largest export-oriented sector—has stagnated between 20 and 25% mark over the last decade.

Table 2 depicts a sectoral breakdown of Sri Lanka's exports for select years over the past two and a half decades. As evinced, total exports have increased by approximately 407% over the given period. However, a closer examination reveals that growth has been staggered; momentum generated during periods of high acceleration has been dampened by durations of stagnation. For instance, aggregate exports doubled between 1991 and 1996 but increased by only 16% over the subsequent 5 year period. Similarly, while exports grew by 53% between 2006 and 2011, the decline in performance over subsequent years resulted in a 2% deterioration in value. Aggregate exports for 2016 stood at US$10.3 billion which, as denoted above, is a decline from previous performance.

Table 2 Sectoral breakdown of merchandise export value and composition for select years

	Export value (US$ Millions)						Composition (%)					
	1991	1996	2001	2006	2011	2016	1991	1996	2001	2006	2011	2016
Agriculture	808	1089	1107	1498	2568	2370	40	27	23	22	24	23
Industry	1226	3006	3710	5383	7991	7940	60	73	77	78	76	77
Total	2034	4095	4817	6881	10559	10310						

Source Central Bank of Sri Lanka, Annual Report, Various Years

Agricultural share of merchandise exports has decreased notably during this period. Declines can be attributed to volatile markets for produce and the gradual movement of capital away from the plantation triumvirate (tea, rubber, and coconut). Moreover, declines can also be ascribed to a step up the value chain. For instance, domestically grown natural rubber has been used to satiate the demands of local manufacturers of rubber products (EDBSL 2012).

Figure 3 illustrates the performance of Sri Lanka's key exports since the turn of the millennium. As evident, the island nation continues to wield a minimally diversified export basket with only two products—both from the apparel sector—wielding export revenue above the US$1 billion thresholds. As of 2016, approximately 59% of Sri Lanka's export revenue was derived from the apparel sector alone. [9] Therein, it can be surmised that heavy reliance on plantation crops has been replaced by a concerning dependence on apparel exports. On the bright side, processed rubber products—pneumatic tires and industrial gloves in particular—witnessed a surge in export revenue in the latter half of the previous decade. Subsequent drops in exports can be explained by steep declines in the price of natural rubber (HS 4001) which resulted in a contraction in the value of agricultural exports.

As evident in Fig. 4, Western regions—namely the United States and the European Union—are the primary markets for produce manufactured in Sri Lanka. This comes as no surprise. Sri Lanka's apparel sector is order-driven and caters to the tastes and preferences of affluent Western economies. Therein, given the sector's dominance in aggregate manufactured exports, export destinations are bound to be skewed towards the Occident. However, it can be inferred that Sri Lanka has increasingly moved toward Asian markets since the turn of the millennium. The principal export to these destinations includes pneumatic tires, electronics, and select articles of apparel.

Sri Lanka's failure to develop a comprehensive export basket can be elucidated when examining Table 3. The table provides a comparison of the aggregate "number of export products" (3 digit SITC) and export diversification as per the "Diversification Index," relative to select competitor states. In this regard, the "Diversification Index" calculates the "absolute deviation of a country's trade structure from contemporary world structure" with a higher index suggesting a greater divergence from

[9] This composition statistic denotes a decrease when compared with the export performance in 2001. In that year, apparel's composed approximately 59% of Sri Lanka's export revenue for the year 2016 was generated by the apparel sector alone

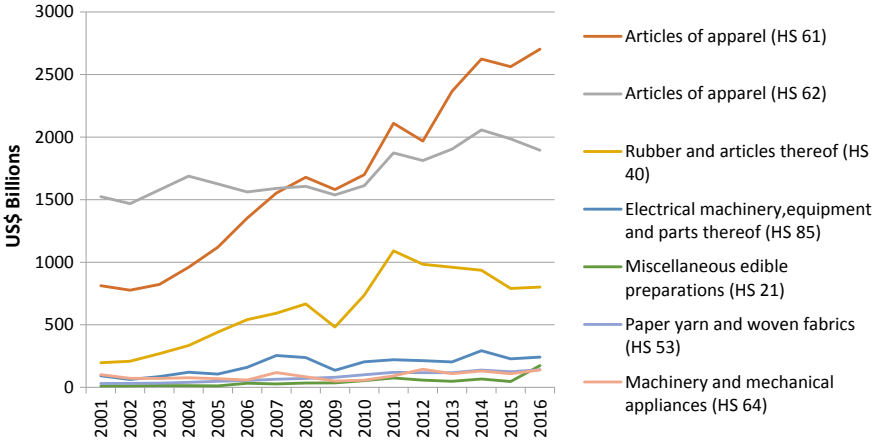

Fig. 3 Primary manufacturing exports as per 2 digit HS code (2001–2015). *Source* UN COMTRADE statistics. https://comtrade.un.org/data/

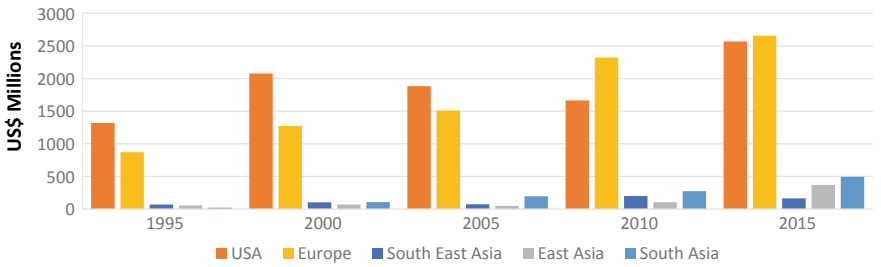

Fig. 4 Primary export destinations for manufactured products (select years). *Source* UNCTAD 2016, UNCTAD statistical database, merchandise trade matrix—product groups, exports in thousands of dollars, annual. http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx

world patterns (UNCTAD 2012). Malaysia and Vietnam are utilized as comparator states given their past similarities with Sri Lanka's economic structure and their emphasis on manufacture-driven export-orientated strategy for development.

Over the given 20-year period, Sri Lanka has been able to expand its export portfolio by 13%. In comparison, Malaysia and Vietnam have enlarged export baskets by 2% and 26%, respectively. However, as evinced from the Table 3, the island nation has made miniscule headway in diversifying its export portfolio; in two decades, the index has improved by a mere 0.02 points. In comparison, Malaysia and Vietnam's export diversification initiatives have led to a drop amounting to 0.07 and 0.11 points, respectively.

Further due to a deficiency in product diversification, the Sri Lankan manufacturing sector also faces a dearth of high skilled labor and technology-intensive industries. Figure 5 provides a comparison between Sri Lanka's current and past labor, resource, and technology intensiveness. As indicated, the change in composition has been quite

Table 3 A comparison of diversification

	Number of export products		Diversification index	
	1995	2015	1995	2015
Malaysia	248	254	0.517	0.440
Sri Lanka	173	196	0.749	0.730
Viet Nam	199	251	0.670	0.551

Source UNCTAD 2016, UNCTAD statistical database, product concentration and diversification indices by economy http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx

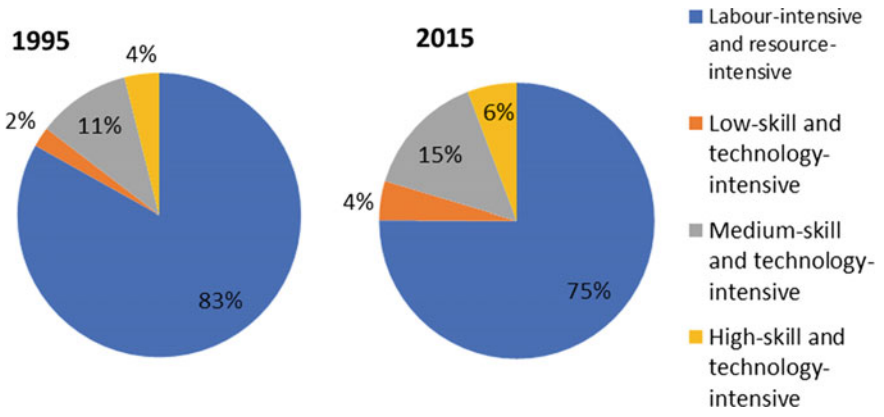

Fig. 5 Comparison of labor, resource and technology intensiveness of manufacturing exports (select years). *Source* UNCTAD 2016, UNCTAD Statistical Database, Merchandise trade matrix—product groups, imports in thousands of dollars, annual. http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx

modest. "Medium-skilled and technology intensive" industries have expanded over the 20-year period, but the change is insufficient to swerve the dependency on labor- and resource-intensive industries.

The apparel domination of exports is a principal reason for the lack of progress in this regard. Indeed, Sri Lanka's major apparel manufacturers have made great strides in expanding into new lucrative and technology-intensive industries, but the industry, especially in the lower rungs, has not made enough progress to instigate sharp swings.

For the manufacturing sector to expand further, stakeholders from all industries should attempt to venture into higher value market segments.

4 Labor Market: Overview

An examination of Sri Lanka's labor market reveals paradoxes and conundrums dissimilar to those faced by other South Asian nations. While the nation has been able to rapidly develop socioeconomic conditions during the postindependence era, it has posted minimal success in eradicating certain labor market distortions and inadequacies that inhibit sector mobility. Particularly, the Sri Lankan labor force is plagued by issues arising from rigid labor laws, a skills mismatch, public sector dependency, and languid labor force participation rates for women.

As inferred to in the previous sector, there are signs that Sri Lanka is drifting toward sector-driven development akin to Singapore. However, policy makers should bear in mind that this model does not engender labor generation like the manufacturing sector. This is attested to by Chandrasiri (2011) who affirms that the manufacturing sector maintains the highest labor elasticity of demand and therein, considering Sri Lanka's relatively low manufacturing base, provides a larger chance of success in attracting high-value labor at the shortest possible interval.

4.1 Labor Market: General Overview

Table 4 provides contemporary statistics on the Sri Lankan labor force.

Table 4 Overview of Sri Lanka's labor market for 2016

Indicator	Total	Male	Female
Population (15 years and over)	15,468,203	7,168,508	8,299,695
Labor force in age group	8,354,841	5,369,143	2,985,698
Labor force participation rate (%)	54	75	36
Employed population	7,830,976	5,097,798	2,733,178
Employment rate (%)	94	95	92
Unemployed population	350,903.32	144,966.86	203,027.46
Unemployment rate (%)	4.20	2.70	6.80
Not in labor force	7,113,362	1,799,365	5,313,997
Average wage (US$)	190.4		

Source Department of Census and Statistics (2017)

As indicated in Table 4, Sri Lanka's participation rate hovers close to 54% of the working population which as per the World Development Indicators database places the nation slightly below the South Asian average of 55% (World Bank 2017). While aggregate unemployment hovers close to natural rates, the substantial gender disparity evident in participation rates is of particular concern, and will be expounded upon in a subsequent section.

Examining the sectoral breakdowns of Sri Lankan labour over a lengthened time horizon reveals trends paralleling fluctuations in economic priorities. For instance, agricultural activities were the primary employment provider over the decades following independence. However, the subsequent emphasis on domestic industry (including manufacturing) coupled with wavering fortunes of agriculture production led to increased labour flows from the latter to the former sector. Contrastingly, the labour composition in services deteriorated slightly over the initial liberalization period, only to increase substantially since the onset of the current century. The above shifts can be observed in Fig. 6 given below.

4.2 Youth Unemployment

Sri Lanka has been a poster child for educational advancement initiatives in Asia. Due to the success of focused policies spanning decades, the island nation possesses a highly literate populace without significant gender disparities. National surveys indicate an aggregate literacy rate of 93.2% with 94.1% of men and 92.4% of women estimated to wield basic language proficiency as of 2015 (Central Bank of Sri Lanka

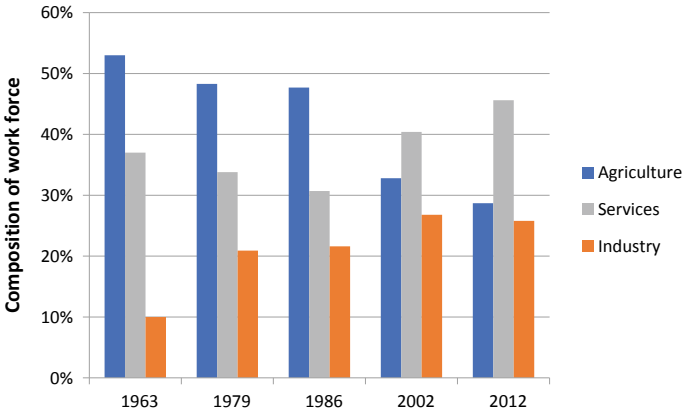

Fig. 6 Employment by economic sector (select years). *Source* Central Bank of Sri Lanka, Annual Report: 2016

Table 5 Employment and value added by subsector (2012)

Industry	Persons engaged	Value added (LKR. billions)
Apparel	266,750	177.9
Food product and beverages	115,890	208.4
Rubber and plastic products	52,413	62.9
Textiles	40,711	43.3
Furniture, manufacturing	20,330	22
Other	127,160	
Total	623,254	

Source Department of Census and Statistics (2015)

2017).[10] In addition, mean years of schooling in Sri Lanka were approximated at 10.8 years, a significantly higher value when compared to the South Asian average of 5.5 years (UNDP 2015). Such statistics place Sri Lanka on par with developed nations, with progress especially exemplary when examined on a regional perspective.

However, despite posting strong educational indices, Sri Lanka has failed to tackle the issue of persistent unemployment among younger segments of the working population. While many South Asian states face a similar challenge, Sri Lanka's problems appear more acute given the complexity and persistency of the issue. For instance

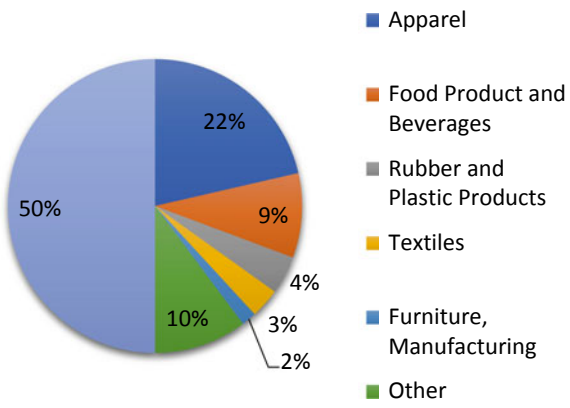

Fig. 7 Employment composition in manufacturing sector. *Source* Annual Survey of Industries, Department of Labor of Sri Lanka

[10] A UNESCO Institute of Statistics study estimates that the literacy rate for South Asia was 67% in 2013 with only 57% of women being able to read and write.

Table 6 Unemployment by select age groups

Age group	1990	1995	2000	2005	2010	2015
20–24	40.3%	38.2%	44.4%	24.6%	20.0%	19.8%
25–29	19.3%	20.1%	18.4%	9.5%	9.8%	9.7%

Source Department of Census and Statistics, Labor Force Survey, Various years

while aggregate unemployment rates for 2015 hovered at around 4.7% (Table 4 above), unemployment rates for citizens within the 25–29 age bracket stood at 9.7% during the same year. Furthermore, census data for that particular year reveals that 33% of the total population within this segment was categorized as economically inactive (Department of Census and Statistics 2016).[11]

To exacerbate issues further, statistics reveal that further education is not correlated to employment in Sri Lanka. As of 2015, the rate of unemployment for citizens who have completed the advanced level (Higher Secondary) examinations stands at 9.2%, while unemployment rates of those who have not completed the ordinary levels (Lower Secondary) examinations are measured at 2.7% (refer Table __ below). High rates of unemployment among the qualified workforce are affirmed by Vodopivec and Withanachchi (2010), who find that "in the first four years after university graduation, the proportion of unemployed graduates who found a job remained below 20% per annum." Therefore, in Sri Lanka's context, educational progress appears to be persistently correlated with medium-term unemployment.

This anomaly has been well studied, with contemporary literature attributing discrepancies to distortions in private sector and labor market expectations. Roughly surmised from a supply perspective, the low rates of labor absorption in Sri Lanka, particularly into the manufacturing sector, can be attributed to (i) a skills gap and (ii) a reduced enthusiasm among the younger segments of the populace to search for employment opportunities within the private sector. The paper examines these issues in closer detail.

4.3 Skills Mismatches

While Sri Lanka has registered success in attaining high primary and secondary enrollment, insufficient progress has been achieved in improving the quality of education. This issue has been noted in a World Bank study, which stresses that "although Sri Lankans spend more time in the education than neighbors in South Asia, questions regarding the system's quality and relevance seem to arise" (Dundar et al. 2014). The situation has been compounded by a lack of state funding into public education. As

[11] While this statistic does reveal discrepancies in participation rates, a closer examination suggests that an overwhelming majority—roughly approximated to around 65%—of this inactive population are women. Perhaps this is a symptom of a much larger issue elaborated in another section.

Central Bank reports, state expenditure into education averaged at 1.935% of GDP over the past 10 years which, per World Bank Development Indicators (WDI), falls below global and regional averages.

To exacerbate issues further, capital expenditure in education has been constricted to a miniscule 0.43% of GDP over the past 5 years. Such constrained allocations have forced authorities to continually forego development in certain avenues to balance budgets. Therein, persistent underinvestment has taken a toll on the public education system, with higher education and vocational training institutions bearing the brunt of the damage. Since the turn of the decade, capital expenditures into higher education and vocational training averaged approximately 8–10% of the aggregate budget allocated for educational activities.[12] It can thus be inferred that over the past six years, the state has spent a miniscule 0.18% of GDP on postsecondary education. Such paltry levels of investments are extremely unfortunate given the virtual absence of private universities in Sri Lanka. It has led to an abatement of capacity enhancement initiatives which in turn has aggravated a bottleneck constraining the transition from secondary to tertiary education. As a consequence, an increasing number of youth find themselves squeezed out of formal education after the completion of secondary level examinations. As of 2014, only 17% of students passing secondary level examinations gain entrance into universities while a further 30% proceed to technical and vocational training. Thus, in that year alone, approximately 140,000 youth—53% of new entrants—entered the labor market with no more than general secondary education and lacking job-specific skills (Dundar et al. 2014).[13]

Furthermore, an examination of the tertiary education, specifically focusing on Sri Lanka's halls of higher education, reveals discrepancies that inhibit skills development. Stagnation in standards and an imbalanced departmental emphasis have led to a system that produces graduates with skills not in sync with employee expectations. For instance, Sri Lanka's higher education system produces an abundance of students focused on the social sciences and humanities. As per the Department of Census and Statistics reports, 57% of the total graduates from the class of 2014 were from the "Arts" and the "Commerce" streams. These disciplines lack depth in the quantitative and technical skills required by manufacturing firms.

Technical and Vocational Education and Training (TVET) services are provided by a plethora of public and private institutions under the auspices of a central Tertiary and Vocational Education Commission (TVEC). As opposed to Sri Lanka's tertiary education sector, TVET initiatives place emphasis on delivering programs that match employer expectations. Thus, TVET programs and apprenticeships are well received by private sector institutions which utilize these initiatives to bolster workforce quality. As a result, over 20% of production workers in Sri Lanka receive training, compared with fewer than 10% of production workers in India and less than

[12]Figures have been derived from budget estimates provided by the Ministry of Finance. Capital expenditures into higher education and vocational training have been computed by referring to budgetary allocations to the Ministry of Higher Education and the Ministry of Skills Development and Vocational Training.

[13]Given the constraints to capacity, Dundar et al. (2014) estimated that approximately 10,000 students leave to study in halls of education outside the country.

5% in Pakistan and Bangladesh (Byiers et al. 2015). The wide acclaim of TVET, coupled with constricted university level admissions, has led to a higher cohort of youth enrolling in TVET programs when compared to other forms of the tertiary education sector.

However, such successes do not entail that TVET has been universally accepted as a substitute for higher education. For instance, despite orchestrating several promotion campaigns to raise the image of vocational training, the state has made minimal headway in increasing allure of TVET initiatives in the eyes of citizens. As Koralage and Hewapathirana (2012) state, "regardless of the employability aspects of vocational training, parents prefer that children pursue the highest education level possible, whether it leads to gainful employment or not" (quoted in Byiers et al. 2015).

Furthermore, several critics argue that TVET initiatives are designed to accommodate for labor-intensive sectors that require a large pool of low skilled labor. Such claims are not unfounded, a significant proportion of training programs focus upon the influential Textile and Garments (T&G) sector which has traditionally been labor intensive.[14] This emphasis is viewed with vexation in some corners as it is said to restrain focus on middle to higher level skills and therein promulgate a deficit in adept middle-management cadre. Shortages in higher level learning are affirmed by ILO reports, which indicate that only 2.2% of the workforce is trained in middle-level skills (cited in ADB 2016a, b).

4.4 Female Labor Force Participation

A perusal of existent literature and available data reveals that Sri Lanka, just like its regional partners, has failed to substantially increase decrepit female labor participation over the past three decades. The island nation's oversight is perplexing given the vast strides in educational parity achieved within this period. As per the most recently available census (2012), 13.6% of women completed advanced level examinations while 2.7% obtained a university degree. In comparison, 10.9% of men passed advanced level examinations while 2.6% obtained a degree. Despite women possessing a marginally better educational profile in the higher tier, their presence in the workforce is lacking—as of 2016, female labor force participation rates stood at 35.9%. While this compares well within the participation rates posted by fellow South Asian states, it falls below world (53§) and East Asian (65%) averages.[15] To compound issues, unemployment rates have traditionally been much higher for females than male counterparts. As per the most recent labor force survey (2016), the unemployment rate for females stood at 6.8% in comparison to 2.7% for males.

[14] Chandrasiri (2010) states that prominent TVET institutions construct programs designed for those with a lower secondary level of education. Thus, the depth of training tends to be quite low.

[15] Statistics given for World and East Asian states are derived from ILO databases where national statistics are adjusted to account for discrepancies.

In addition, census estimates indicate that approximately 74.7% of the economically inactive population in Sri Lanka is composed of by women. Family duties are the underlying cause for economic inactivity, with 61.4% of surveyed women indicating that engagements in housework render them unable to enter formal employment. However, this belies the actual impact that this segment of the population has on the economy. Approximately 24.2% of Sri Lankan households are headed by women with this proportion more pronounced in the war-torn regions of the North and East. Many remain statistically unemployed and depend on the informal sector for jobs to sustain households.

Literature pertaining to this issue has been shallow for much of the twentieth century owing to a larger emphasis on other contributors to unemployment in Sri Lanka. However, heightened enthusiasm since the turn of the millennium has precipitated into the denser contribution of research into this disparity. Such works suggest that much of the discrepancies in participation rates are funneled by a series of discriminatory tendencies akin to those experienced in much of Greater South Asia. For instance, rigid societal norms in the form of marital and household duties encumber women's participation in formal employment as the Sri Lankan work culture rarely accommodates to extraneous expectations. Past Governments have attempted to correct this imbalance by introducing new legislations that require establishments to provide paid maternity leave. However, these laws have proven to be counterproductive; as Maduruwala (2014) states, many employers believe that "providing maternity and child care benefits are an additional cost burden in a profit maximizing environment." Furthermore, the duties and responsibilities of those on maternity leave tend to be redistributed within the workforce thus resulting in an increased burden for fellow workers. This kindles animosity and propagates negative perceptions regarding female employment among middle and lower level cadre (Madurawala 2014). Such aversions precipitate to form a nascent discrimination against female recruitment as this labor cohort is often considered too expensive while wielding reduced productivity.

Female labor force participation is also hindered by sectoral bias wherein only select industries welcome enrollment. This is particularly true in manufacturing,

4.5 Public Sector Preference

As per contemporary norms, the appeal of public sector employment generally falls below that of the private sector due to the provision of a lower pay scale in the former. However, in the case of Sri Lanka, public sector pay "exceeds privates sector wages at the lower levels of employment" (Kelegama, Development Under Stress, 2006).[16] Given the additional benefits such as higher job security, pension eligibility,

[16]The existence of this preference is affirmed by a report prepared by (Arunatilake and Jayawardena, Explaining Labor Market Imbalance in Sri Lanka, 2014), which examines Jobsnet data to analyze labor market tendencies.

and mitigated work stress, new graduates are incentivized to solely apply for public sector vacancies. Kelegama (2006) states that this tendency—often referred to as the "Queuing Hypothesis"—has been pandered to by the Government, which in the past has initiated various schemes to enroll graduates into the public sector. Therefore, unemployed graduates prefer to wait for "good" job openings within the establishment as opposed to readily available "bad" jobs within the private sector (Rama 2003). Private establishments, particularly in the manufacturing sector, are severely affected by this distortion as they are plagued with further shortages in skilled labor, arising from reduced recruitment pools.

This phenomenon appears to be a relic of Sri Lanka's import substitution era. Yiping et al. (2013) believe that the constant interventions into the labor market during this period led to an increased dependency on the state as an "employer of last resort." In addition, the hostility towards foreign investments retarded labor returns in the private sector and further incentivized a switch in employee preference. The public sector soon outpaced the private sector in employment creation and by 1977 (dawn of liberalization initiatives), accounted for over 50% of employment in the manufacturing sector alone. Thereafter, subsequent stop-gap liberalization initiatives gradually eroded the importance of the public sector as a heightened inflow of investments elevated returns to labor in the private sector.

However, as explained earlier, the emergence of a populist–nationalist coalition to the helm of leadership in 2004 promulgated in a backtrack of liberalization reforms and increased state interventions. This facilitated a new wave of state enterprise expansion; the number of state-owned enterprises mushroomed from 107 to 245 while the number of employed in such institutions rose from 140,500 to a "staggering" 261,683 between 2009 and 2014 (Advocata Institute 2016). The fact that a large proportion of those employed were recent graduates is affirmed in an IPS report (2016) which asserts that 51,420 graduates were absorbed into the public sector under the "Graduate Employment Program" introduced by the previous government in 2014 alone (IPS 2016).[17]

Furthermore, the notion that public sector employment provides higher job satisfaction does not hold sway in recent times. Surveys conducted by the National Human Resource Development Council find that graduates employed (as of 2013) did not receive much satisfaction due to persistent political interventions and a misalignment between degree qualifications and job descriptions (NHRDC 2013).

5 Regional Integration—Expanding Indian Trade to Stimulate Manufacturing Capacity

The paucity of intra-regional trade within the South Asian region is a documented issue that has been well discussed in contemporary development parlance. As per

[17] Such recruitment drives tend to be staggered with employment provided in batches over a time period.

recent World Bank findings, intra-regional trade and investment among regional partners only constitute for approximately 5 and 4% of aggregate trade and investment conducted by regional partners (Kathuria and Shahid 2017). While attempts to foster integration and connectivity have been attempted frequently, their success has been largely mitigated by incessant political tensions, insufficient dissemination of regional opportunities, and a lack of infrastructural connectivity that impedes trade and investment mobility.

In further, discourses revolving around South Asian integration cannot discount the importance of India in fostering regional cooperation. India's sheer demographic and geographic scale, its strategic presence in the heart of South Asia, and its rapid growth acceleration over the last three decades places it in a position of influence within the subcontinent. Ideally, the nation's influence within the regional sphere can be leveraged to construct a symbiotic South Asian bloc wherein partners gain access to a large market base, share essential resources, and enhance technology transfers sans boundaries.[18] This has however not been the case. As eluded to above, various factors have permeated a cycle of mistrust among South Asian nations. Furthermore, while India's sheer comparative advantage, across several product lines, has enhanced its penetration into neighboring markets (on a bilateral level), its inability to curb age-old protectionist mechanics has caused distortions detrimental to the trade balance of its regional partners. Therein, given the difficulties in establishing a fluid and fruitful regional trade zone, the interests of many South Asian nations have gravitated towards distant international markets as a means to maximize export potential. Sri Lanka is no exception to this trend. Trade history shows an increased proliferation of imports from India, while aggregate exports to the region remain subdued.

An examination of Sri Lanka's postmillennial trade patterns suggests a preference to Western markets as a viable export destination. As of 2015, aggregate merchandize outflows to Europe and the United States accounted for approximately 58% of annual exports while exports to South Asia, despite locational proximity, encompassed a mere 9.7% of annual exports (Simoes and Hidalgo 2017). Conversely, South Asia has been a major import source, with the region accounting for 28% of aggregate imports for a similar period. However, imports from India alone accounted for 26% of aggregate imports for 2015, thereby indicating that a lion's share of Sri Lanka's intra-regional trade was accounted for by the Indo-Lankan bilateral partnership. This observation is elucidated in Figs. 8 and 9, which further elaborates on Sri Lanka's trade interactions with India and the rest of South Asia. As is evident, there appears to be a clear disparity in exports and import values between the two sectors over a 10-year period.

Such disparities will come as no surprise given India's geographic and cultural proximity to the island nation. Peninsular India is Sri Lanka's gateway to mainland South Asia, and both regions possess cultural similarities owing to shared religious beliefs, migration flows, and burgeoning trade ties stretching to the precolonial era. Furthermore, the two nations are inexorably linked due to a distinct topographic

[18]The region is home to approximately 1.76 billion citizens which surmounts to 24% of the world's population (World Bank 2017).

anomaly often referred to colloquially as the "Adams Bridge." The "bridge," a collective chain reef shoals and small islands, creates a quasi-isthmus in the Palk Bay that prevents large maritime vessels from traversing around the Indian peninsula. Therein, vessels traveling from the Eastern to the Western seaboards (and vice versa) of both nations are required to traverse around southern Sri Lanka to reach either coastline. Thereby, the establishment of sound, immutable bilateral ties is an essential task necessary to maintain the economic and military interests of both nations.

India and Sri Lanka are signatories to a bilateral "India-Sri Lanka Free Trade Agreement" (ISFTA) that came into effect in 2000 and recognized as the first treaty of its kind in the South Asian region (Kelegama and Karunaratne 2013). Furthermore, both nations are also signatories to the South Asian Free Trade Agreement (SAFTA), a Regional Trade Agreement signed in 2004 but whose performance has been shackled by circumspect trading lists and persistent conflicts among member states (De Mel 2007). As of 2016, India is Sri Lanka's the second largest import source, behind China, and the third largest export destination, behind the United States and the European Union (United Nations 2017).

However, such rankings and treaties belie the burgeoning trade imbalance inferred to earlier. As of 2016, aggregate merchandise imports from India were estimated at approximately US$3.8 billion while aggregate merchandise exports for the same year were valued at approximately US$750 million. The trade deficit for 2016 thus stood at a mammoth US$3.07 billion for 2016.

While a trade deficit should not necessarily be treated as an adverse phenomenon (since imports might consist of vital consumer goods and resources not available in the domestic market), the above imbalance in trade has received much attention given the somber growth in export penetration into India over the past decade. Such stagnations have been induced by a continued reliance on a low-value basket of exports that exhibits minimal diversification and sophistication (refer Fig. 10). For instance, as of 2015, primary products such as "Coffee, tea, mate and spices" (HS

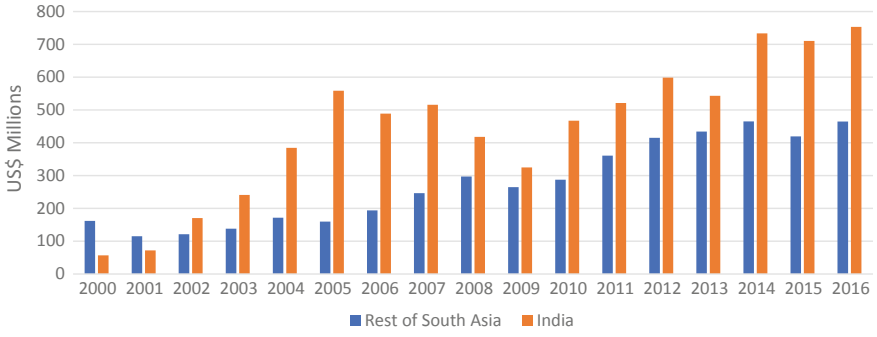

Fig. 8 Aggregate merchandize exports to India and Rest of South Asia (excluding India) for the period 2000–2016. *Source* UNCTAD 2016, UNCTAD statistical database, merchandise trade matrix—product groups, exports in thousands of dollars, annual. http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx

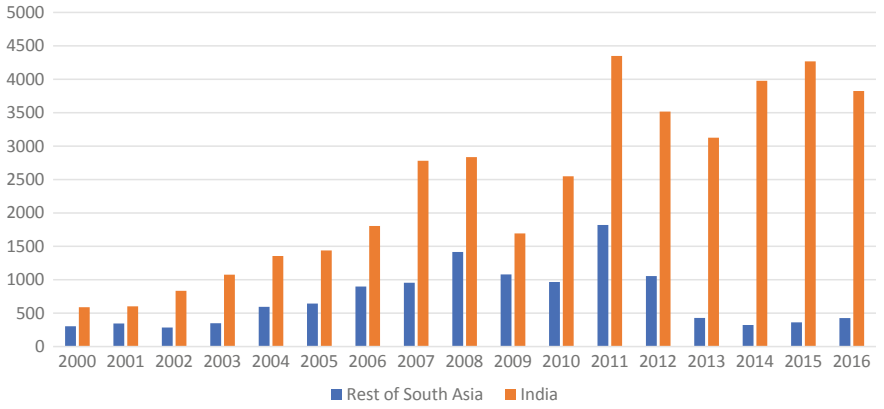

Fig. 9 Aggregate merchandize imports from India and rest of South Asia (excluding India) for the period 2000–2016

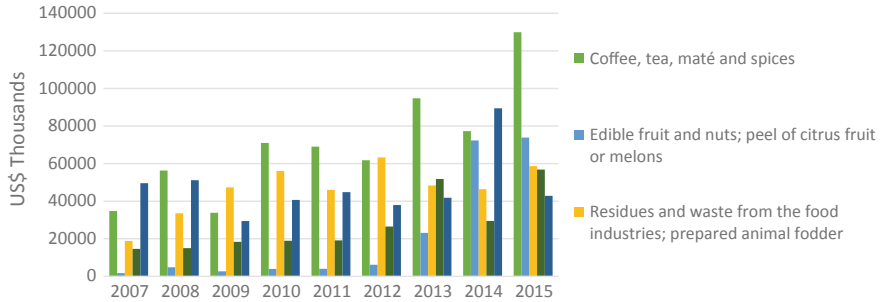

Fig. 10 Significant exports to India (2007–2015)

09), "Edible fruits and nuts" (HS 08), and "Animal fodder" (HS 23) are Sri Lanka's top exports to India. This is a concerning predicament given the limited scope of such products when attempting to expand export penetration at a hastened pace. With this being the case, Sri Lanka's best bet in maximizing trade potential, while simultaneously enhancing labor generation prospects, is to expand its bilateral export portfolio to include a wider plethora of manufactured goods catered to an Indian demographic.

This strategy serves a twin benefit to the Sri Lankan economy. For starters, domestic producers will now be able to tap into the consumer base of a nation often dubbed as one of the fastest growing major economies in the world (IMF 2017a, b). This is particularly advantageous given India's mushrooming middle class in its post-liberalization era. As per a recent study, India's middle class doubled in size between 2004–05 and 2011–12 and now amounts to nearly half of the entire population (Krishnan and Hatekar 2017). Targeting such a large cohort of consumers, in a rapidly emerging market close to home, will not only help producers garner

additional revenue, but will help to mitigate risks induced by a lackluster economic performance in several Western nations. Heightened revenue yields will, in turn, incentivize producers to enhance supply capacity which consequently will stimulate labor generation and enhance economic growth prospects.

In addition, a concerted drive to penetrate the Indian market will help to lure inward Foreign Direct Investments (FDI) necessary to induce the scaling up of domestic industries and promote technology transfers. Sri Lanka's strategic location (nestled in the precipice of India, straddled by pivotal maritime routes), coupled with its efficient and educated workforce (when compared to other South Asian states), makes it an ideal destination for Indian investments looking to set up production centers catering to both the Indian and international markets. Evidence of such positioning already exists. Ceat, an Indian tire manufacturer, initially entered into Sri Lanka through a joint venture before acquiring a prominent Sri Lankan tire manufacturer. It has now significantly broadened its consumer base and now supplies pneumatic and non-pneumatic tires to 15 countries around the world, including India (Athukorola 2014).

However, potential forays into the Indian market has to be met. As mentioned earlier, the Indian market continues to be protected by archaic protectionist law of tariff and nontariff nature. Private sector stakeholders need to work in close tandem with the government to identify precise means in which markets can be opened.

6 Future Prospects

The creation of one million jobs by 2020 was a defining promise given by the current government during its successful election campaign. An examination of recent history suggests that this objective is wildly optimistic. From 2011 to 2014, the total number of employed increased by 237,689 which amounts to an increase of 78,230 per annum (IPS 2016). Thus, for the government to attain set targets, job growth rates have to be tripled within the shortest possible time period. Therein, given the heightened labor elasticity of the manufacturing sector, increased emphasis on the same will help increase labor generation rates and facilitate fulfilling the target.

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