

4

PRICES, WAGES AND EMPLOYMENT

The general price level as indicated by the Colombo Consumers' Price Index (CCPI) (2002=100), on a year-on-year basis, moved on an accelerating path during the first half of 2008 and reached the peak in June. However, thereafter, it showed a decelerating movement, falling noticeably in the consequent three months. This declining trend is expected to continue in the remainder of the year and during 2009 as well. The increase in consumer price level during the first half of the year was largely due to the low supply of domestically produced agricultural commodities resulting from inclement weather conditions exacerbated by rising demand for food items from consumers with higher nominal incomes caused by a higher monetary expansion experienced during the period of 2005-2006. The upward revisions of the fuel prices, especially in late May 2008, inter alia, mainly caused the level of CCPI to rise substantially by 28.2 per cent on a year-on-year basis in June, 2008. However, from this peak, it gradually declined to 24.3 per cent in September, reflecting the impact of continued tight monetary policy that effectively checked the growth in nominal income, supported by domestic supply factors, and easing of commodity prices in the international markets. Meanwhile, the core inflation, which is derived by excluding food and energy items from the CCPI basket to reflect price changes due to non-seasonal and non-volatile factors, registered a 18.7 per cent rate on a year-on-year basis in September, 2008. The demand side pressure that emanated from wage increases in both the public sector and private sector employees during the first half of the year was contained to some extent by the tight monetary policy pursued by the Central Bank. Notable progress was observed in the employment generation with the unemployment rate continuing to decline to 5.3 per cent in the first half of the year compared to 6.5 per cent for the corresponding period of 2007. Foreign employment, which accounts for more than 20 per cent of the total employed, was also a main source of income generation in terms of foreign exchange earnings and will continue to be a source of employment as well.

Developments in 2008

Prices

- The rate of inflation, as measured by the change in the CCPI, recorded a steady increase from 20.8 per cent at the beginning of the year to reach a peak of 28.2 per cent in June, 2008 and, thereafter, started to decelerate declining to 26.6 per cent in July, and further to 24.3 per cent in September. The increase in inflation during the first half of the year was predominantly driven by price pressures emanating from both domestic and external factors such as disturbances to agricultural food supply, higher prices of consumer and intermediate goods imports, and direct and indirect impact of high international energy prices. Excessive rains in the island that damaged the Maha paddy harvest and vegetable crops caused substantial price increases in rice and vegetables. The low supplies mostly in domestically produced agricultural commodities such as rice, vegetables and coconut led to significant price increases

compared to the corresponding period of the last year. Price of fish increased dramatically during the period mainly due to the increase in cost of fishing and transportation in spite of the increased production of fish. Nearly 60 per cent of the point-to-point inflation was generated through the price increases of domestically produced goods and services registering their dominance in the Index. However, the stable exchange rate, tight monetary policy stance and certain measures adopted by the government to contain price increases in essential food items helped to arrest the price increases to some extent.

- A reversal of the trend in the CCPI was witnessed from July, 2008 due to the impact of tight monetary policy supported by the increased supply of domestic agricultural produce coupled with the moderation of world commodity prices. This was reflected by the decline in the Food sub index by 1.5 per cent, 0.4 per cent and 0.3 per cent in July, August and September respectively, which accounts for 47 per cent of the total index. This deceleration is expected to continue further during the remainder of the year. The annual average inflation rate, however, continued to rise from 16.4 per cent in January, 2008 to 23.2 per cent in September, consequential upon the buildup of price pressure in the index during the preceding 12 month period.

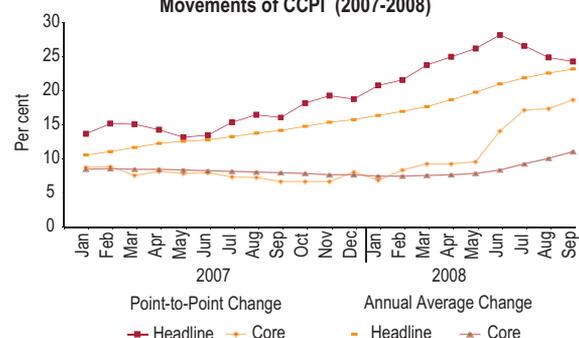
Table 4.1
Movements of CCPI (2007-2008)
2002=100

Period	Point-to-Point Change %		Annual Average Change %		
	Headline	Core	Headline	Core	
2007	January	13.7	8.8	10.6	8.5
	February	15.2	8.9	11.1	8.6
	March	15.1	7.6	11.7	8.5
	April	14.3	8.2	12.3	8.5
	May	13.2	7.9	12.6	8.4
	June	13.5	8.0	12.8	8.3
	July	15.4	7.4	13.3	8.2
	August	16.5	7.3	13.8	8.1
	September	16.1	6.7	14.2	8.0
	October	18.2	6.7	14.8	7.9
	November	19.3	6.7	15.4	7.7
	December	18.8	8.1	15.8	7.7
2008	January	20.8	6.9	16.4	7.5
	February	21.6	8.4	17.0	7.5
	March	23.8	9.3	17.7	7.6
	April	25.0	9.3	18.7	7.7
	May	26.2	9.6	19.8	7.9
	June	28.2	14.1	21.0	8.4
	July	26.6	17.2	21.9	9.3
	August	24.9	17.4	22.6	10.1
	September	24.3	18.7	23.2	11.1

Source: Department of Census & Statistics

CCPI - Colombo Consumers' Price Index

Chart 4.1
Movements of CCPI (2007-2008)



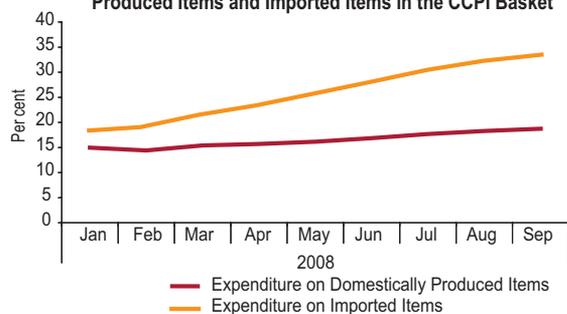
- **Meanwhile, the Core Inflation, covering the price movements of non food and non energy items of the CCPI basket decreased moderately on a point-to-point basis at the beginning of the year, and stabilized at around 9 per cent during March to May, 2008.** However, it accelerated since then, to reach 18.7 per cent by September mainly due to the second round impact of the fuel price hike. The highest contribution to the point-to-point increase in the Core Index was from the increase in transport charges followed by the increased prices of healthcare services. On an annual average basis, core inflation rose marginally from January to May, 2008 even though it increased at a higher pace since then.
- **Price increases of major imported commodities and intermediate goods too contributed to the overall increase in the general price level during the period under concern.** The increases were predominantly driven by high food prices in the global market, which were caused by supply shortages of agricultural commodities in major producing countries owing to bad weather conditions and diversion of major agricultural produce such as sugar, wheat grain and edible oil to bio-fuel production due to high oil prices, and higher demand generated from emerging economies such as India and China, with their faster economic growth. The continued rise in the prices of world food commodities such as wheat grain, milk powder, dhal etc. exerted considerable pressure

on the general price level. Increases in the price of rice were further aggravated by the shortage of rice imports, mainly due to the export restrictions imposed by the major producing countries. Although, the stable exchange rate prevented severity of the adverse impact on the index of these price increases in imported commodities, overall, the import group sub index contributed about 40 per cent to the point-to-point inflation during the first half.

- **Another contributory factor for the increase in general price level was the upward revision of fuel and LP gas prices following the rise in crude oil and gas prices in the international market.** The domestic fuel prices were revised upwards twice during the first half of the year in response to the high international prices of crude oil which rose from 92.71 US dollars per barrel in January, 2008 to 125.85 US dollars per barrel in June, 2008. As a result, the domestic prices of petrol, diesel and kerosene were adjusted upward by 41 per cent, 55 per cent and 19 per cent, respectively in June, 2008 compared to June, 2007. These price revisions adversely impacted on the general price level, both directly and indirectly through high cost of transport and other input costs on key domestically produced as well as imported consumer goods. This raised the overall cost structure of most consumer and intermediate goods.
- **Meanwhile, several measures were adopted by the government to contain the rising cost of living.** In order to bring down the escalating food prices, government imposed price ceilings on rice and milk powder. Similarly, duty waivers were granted to several key food imports such as sugar, dhal, big onion, dried chillies, potatoes, gram and canned fish, at the beginning of the year. With a view to restraining the acceleration in coconut and coconut oil prices, import duty on edible palm oils was reduced. Non removal of the fertilizer subsidy, despite increased price of fertilizer in the international market, also contributed to contain the cost of agriculture

Chart 4.2

The Annual Average Changes in Expenditure on Domestically Produced Items and Imported Items in the CCPI Basket



production, thereby reducing the price pressure emanating from the supply side.

- **The demand side pressure exerted by wage increases in both the public sector and private sector was contained to some extent by the continuous tight monetary policy stance adopted by the Central Bank.** During the first half of the year, wages of public sector employees increased by 6.6 per cent on a point-to-point basis, while minimum wages of workers in Wages Boards Trades rose by 33.2 per cent. The increase in nominal wages for workers in the informal sector, whose salaries are determined in a more market oriented manner than the formal sector wages, was reported to have increased by 13.7 per cent compared to the first half of 2007.
- **The anticipated growth in agricultural production in Yala 2008, compared to that of 2007, especially paddy and certain subsidiary food crops would increase the domestic supply and ease the pressure on prices.** With the favourable Yala harvest and the seasonal vegetable harvest in August and September 2008, the rate of inflation during the rest of the year is expected to further decelerate. Agricultural drive initiated by the government and more production expected from the Eastern and Northern provinces will contribute to enhance domestic supply and thereby contain the pressure on prices towards the end of the year. The fish production is also expected to be favourable in rest of the year, with increased contribution particularly from the Eastern province. Since world oil prices have steadily declined, there is no necessity for an increase in domestic fuel prices during the remainder of the year. With the prevailing stable exchange rate, import prices are expected to remain at current levels. The overall impact of the expected price movements during the second half may not be as sharp as that in the first half of 2008. Hence, the decelerating trend in the rate of inflation could be expected further with the CCPI reaching around 20 per cent on a point-to-point basis by the year end.

Wages

- **The increase in the monthly cost of living allowance (COLA) for public sector employees by Rs. 375/- in January 2008, resulted in a slight gain in the nominal wage rate indices during the first half of the year.** However, there was a drop in real wage rate indices of all categories of public sector employees, as reflected in the wage rate indices for non-executive employees, school teachers and minor employees. Following the 2006 Budget proposals of the government, public sector employees were initially granted a COLA of Rs. 1,000/- per month in January 2006, which was revised upward every six months by Rs. 375/-. Accordingly, the upward revision in the monthly COLA was the only increase in nominal wages enjoyed by public sector employees during the first half of the year. Consequent to this revision, the nominal wage rate indices of public sector employees increased marginally by 2.3 per cent during the first half of 2008. However, they suffered real wage losses by 10.2 per cent, since their wages did not increase sufficiently to compensate for the increase in price level.
- **Meanwhile, wages of public sector employees were raised by Rs. 1,000/- in July, 2008.** In terms of the Public Administration Circular No. 15/2008 dated July 21, 2008 issued with regard to the payment of COLA to Public Servants, the monthly COLA of Rs. 2,500/- (which had been paid up to June, 2008), was increased by Rs. 1,000/- with effect from July, 2008. It is applicable for the officers who are serving in the posts with initial monthly salary below Rs. 22,935/-. Accordingly, the revised monthly COLA payable to employees in the eligible categories of Public Service, Provincial Public Service and Armed Forces with effect from July, 2008, rose to Rs. 3,500/-. Meanwhile, a monthly COLA of Rs. 2,875/- would be paid to the officers whose initial monthly salary is Rs. 22,935/- or above. It was further decided that the allowance at the rate of Rs. 116.66 per

working day to be paid for employees who are drawing daily paid emoluments.

- **The wage increases in the formal private sector were influenced by the wage increases of individual contracts, collective agreements, unilateral decisions by employers and minimum wage decisions of Wages Boards.** In nominal terms, the Minimum Wage Rate Index of workers governed by the Wages Boards Trades in the first half of 2008 rose by 8.4 per cent over the second half of 2007 as a result of the combined impact of increases of wage rate indices for workers in Agriculture sector by 11.4 per cent, and Industry and Commerce sector by 0.5 per cent. The increase was mainly attributed to the rise in the wage sub index of workers in Agriculture sector by 17.2 per cent in March, 2008 over the previous month, as wages for Tea Growing and Manufacturing Trade, and Rubber Growing and Manufacturing Trade were increased from March, 2008. However, when adjusted for inflation, real wage index of the private sector workers decreased by 4.9 per cent during the first half of 2008 when compared with the increase of 12.6 per cent during the second half of 2007.
- **The wage information collected on major economic activities revealed that the Informal sector wages in the Agriculture sector and Construction sector in the first half of 2008 have increased by 14.5 and 12.6 per cent, respectively over the same period of 2007.** Nominal wages in the Informal sector are determined in a more market oriented environment than the formal sector wages. The average daily wages of sub categories in the Agriculture sector, viz. Paddy, Coconut, Rubber and Tea increased by 17.2 per cent, 14.6 per cent, 15.8 per cent and 9.7 per cent, respectively in the first half of 2008. The increase in wages of these sub sectors was partly due to the upsurge in respective commodity prices in the market, which in turn enabled the producers to

make higher payment for the service of labour. Within the Agricultural sector, the rate of increase in daily wages of most of the sub categories varied partly due to the diversity among the different activities.

Employment

- **According to the Quarterly Labour Force Survey (QLFS) conducted by the Department of Census and Statistics (DCS), the labour force excluding Northern and Eastern Provinces, increased by 2.0 per cent to 7.5 million in the first half of 2008 compared to 7.4 million in the corresponding period of the last year.** During the last two years, the Northern and Eastern provinces were not covered by the QLFS. Though it was planned to cover Northern and Eastern provinces in the first half of 2008, only the Eastern Province was covered fully, due to the prevailing uncertain conditions in some districts of Northern Province. However, for the comparison purposes, the labour force data excluding these two provinces was used in the analysis. On the basis of the recent developments in the labour market with the projected expansion in the economy and the full implementation of new infrastructure projects proposed by the government, a further enhancement of the employment opportunities in the domestic economy is expected. Meanwhile, the labour force participation rate is estimated to remain more or less at the current level of around 50 per cent in 2008.
- **According to the DCS, the unemployment rate dropped to 5.3 per cent during the first half of 2008, indicating the steady declining trend observed over the past few years.** The total number unemployed was estimated at 400,000 for the first half of 2008 which was lower than that of 482,000 in the corresponding period of the previous year. This decrease was mainly due to the implementation of several programmes and projects such as Employability Development

Table 4.2
Labour Force, Employment and Unemployment ^(a)

Item	2006	2007			2008 ^(b)		
		Year	H1	H2	Q1	Q2	Projections
Household Population, ' 000 (Age 10 years and above)	14,834	15,048	15,029	15,150	15,112	15,141	15,230
Labour Force, ' 000	7,599	7,489	7,362	7,598	7,531	7,506	7,550
Employed, ' 000	7,105	7,042	6,880	7,177	7,148	7,106	7,158
Unemployed, ' 000	493	447	482	421	382	400	392
Labour Force Participation Rate (% of Household Population)	51.2	49.8	49.0	50.1	49.8	49.6	49.6
Unemployment Rate (% of Labour Force)	6.5	6.0	6.5	5.5	5.1	5.3	5.2

(a) Excluding Northern and Eastern provinces
(b) Provisional

Sources : Department of Census and Statistics
Central Bank of Sri Lanka

Programme, and Employment Creation and Promotion Programme, which created new employment opportunities in the labour market. The improvement in dissemination of labour market information and career guidance programmes also contributed to lessen the rate of unemployment.

- **Consequently, the employment increased by 3.3 per cent to 7,106,000 as compared to 6,880,000 during the same period of the previous year.** However, the employment in the private sector, which has the major share of 41.0 per cent as against 15.3 per cent in the public sector, recorded a contraction during the period under review. In terms of the status of employment, increases were recorded in the employment of Public sector and Unpaid family workers, while decreases were reported under the categories of Private sector employees, Self employed persons and Employers. Of the total employment, 42.6 per cent was occupied in the Service sector followed by Agriculture (30.1 per cent) and Industry sectors (27.3 per cent), indicating the continued dominance of service sector in producing employment opportunities in the labour market.
- **The continuation of youth unemployment, especially among educated females, was evident from the QLFS.** The unemployment rate which was more acute among the age

group of 15-19 years as observed during the last few years, however, decreased to 20.8 per cent in the reference period compared to 24.6 per cent in the first half of 2007. Meanwhile, it recorded further decreases among the age groups of 20-39 years between these two periods. The more severe and notable feature was the higher unemployment rate among the educated youth than the others while the problem was even more acute among the educated females than the educated males. The persistent mismatches between job opportunities in the market and aspirations of the unemployed have partly caused this problem.

- **There has been a steady increase in foreign employment over the years contributing significantly to foreign exchange earnings and to reduce the pressure on the unemployment problem in Sri Lanka.** In the first half of 2008, foreign employment placements increased remarkably by 23.3 per cent compared to the corresponding period of 2007. The total number of departures for foreign employment was 127,224 during this period compared to 103,188 of the same period of the last year. The increase in overseas employment was observed in all categories of manpower namely, housemaids, skilled and unskilled labourers. The efforts to streamline procedures and prepare job aspirants to suit

labour market requirements abroad would lead to further improvement in overseas job opportunities in the near future. Being a major source of foreign exchange earnings of the country, US Dollars 1,467 million of foreign remittances were received during the first half of 2008, recording a 23 per cent growth over the corresponding period of last year.

- According to the Sri Lanka Bureau of Foreign Employment (SLBFE), Sri Lankan migrant population is approximately 1.6 million and the annual outflow at present is over 200,000. There was a significant growth in departures in the first half of the year, over the same period of the previous year. The SLBFE jointly with the Ministry of Foreign Affairs and the Ministry of Labour Relations and Man Power explores job potentials outside the Middle East, which would impact on the improvement in overseas employment.
- The Middle Eastern region continued to dominate the foreign employment market, accounting for more than 90 per cent of the total migrant work force, with the majority consisting of housemaids. However, this dominance has gradually declined over the years, with increased opportunities for other categories of labour, from several other countries such as Korea, Singapore, Malaysia and Maldives. As a result, the share of housemaids has declined from 66 per cent in 1997 to 41 per cent in the first half of 2008. Consequently, the share of female participation in the foreign employment too has dropped from 75 per cent to 51 per cent between these two periods. Positive steps taken for skill development in certain trades such as the apprenticeship training programme in construction leading to an internationally accepted certification and similar training in hospitality trade would enhance the employability of the workforce in catering to these sectors in the global market.

Hence, further improvement in overseas employment could be expected during the second half of 2008. In view of the benefits that the country gains from foreign employment, further efforts to address issues of health and occupational safety of migrant workers, while addressing social implications, are needed.

- The number of strikes in the private sector increased only marginally to 13 in the first half of 2008 compared to 12 in the corresponding period of the last year. Continuation of collective agreements between employers and trade unions has helped bring down the number of strikes. The total man-days lost in the first half of 2008 also declined significantly to 12,613 compared to 22,329 in the same period of 2007 creating more industrial harmony.

Prospects for 2009

Prices

- A deceleration in inflation is expected to continue on a gradual path in 2009 resulting from developments in domestic and external fronts. The continued focus of tight demand management policy, aided by fiscal consolidation policies to complement it, would help maintaining the price stability preventing any pressure emanating from the demand side. The expected growth in domestic agricultural production benefiting from favourable weather conditions and stable or less volatile import prices are likely to contain inflationary pressure from the supply side. This may be further complemented by improved distribution and transportation activities, with the likely favourable developments in the security front. Lowering world food prices resulting from higher food production and some dampening of international oil prices are likely to reduce external pressures on domestic prices in 2009.

- **Despite above positive factors, there are some risks of concerns which could disturb the trend of moderate inflation that is otherwise expected to continue in 2009.** Any unforeseen upward price changes in the international market, especially crude oil and essential food items which, however, are expected to be less volatile, coupled with any adverse movement of exchange rate, would result in a deviation from this expected path.

Wages

- **Subsequent to several wage increases in the public sector at different stages since 2005, a further hike in 2009 is unlikely, despite agitation in certain public sector institutions.** Public sector wage increases resulting in higher real wages without an effective programme to promote commensurate improvements in productivity will have adverse fiscal implications. Any salary revision will place upward pressure on domestic prices, especially of consumer goods, through the wage-price spiral posing some threat on inflation. It could also instigate upward revisions to inflationary expectations.
- **The wage revisions in the private sector will be based on the outcome of negotiations.** Meantime, the government has decided to formulate a national wages policy for the private sector in line with international standards from the next year by the Ministry of Labour Relations and Manpower, in order

to ensure that private sector employees receive a salary in accordance with their educational qualifications and the nature of their work. Since the government announced a minimum wage increase for workers governed by the Wages Board Trades, (except those governed by collective agreements like the plantation sector), retrospective effect from July, 2008, a further increase in their wages during 2009 is unlikely.

Unemployment

- **In line with the declining trend experienced in the past few years, a similar downward movement in unemployment is expected to continue in 2009 too.** The implementation of various infrastructure projects and the efforts made by the government to streamline procedures and prepare job aspirants to suit labour market requirements abroad are expected to stimulate more job opportunities in the domestic and international labour markets, thereby reducing unemployment further in 2009. The agricultural drive initiated by the government, investment expansion in certain mega projects and the liberation of the agricultural zones in the Northern and Eastern provinces may contribute to a more productive environment which would generate more employment opportunities in 2008 and 2009, enabling a further reduction in unemployment. However, the emerging global economic situation could have a down side risk on the expected outcomes.