International Labour Organization

ILO brief

Statistical Brief

December 2023

Sri Lanka's Labour Market during the Economic Crisis of 2022-23[1]

Why the unemployment rate does not tell the full story

Key points

- Sri Lanka's economy has been hit hard by multiple crises, leading to a debt default and severe economic shock in 2022. This resulted in a deep recession in 2022 (-7.8 per cent GDP growth rate) and while some signs of stabilization are evident later in 2023, the crisis continues to hit the economy hard, especially MSMEs.
- The impact of the economic crisis on the labour market has, however, not translated (yet) into a sharp rise in the unemployment rate over 2022-23. Instead, the crisis has resulted in a fall in the labour force participation rate for both men and women, which is particularly concerning given the already low female labour force participation rate. The increase in inactivity accounts for most of the decline in employment witnessed during the crisis.
- Out migration of more than 535,000 Sri Lankans for foreign employment (Jan 2022-Sept 2023) has kept a lid on labour market pressures. Over this period, both the number of passport applications and registrations with the Bureau of Foreign Employment have increased significantly, indicating a shift to external job opportunities.
- Monitoring of these trends and further social dialogue are needed to support a labour market recovery strategy that is both inclusive and sustainable.

Sri Lanka's economic crisis

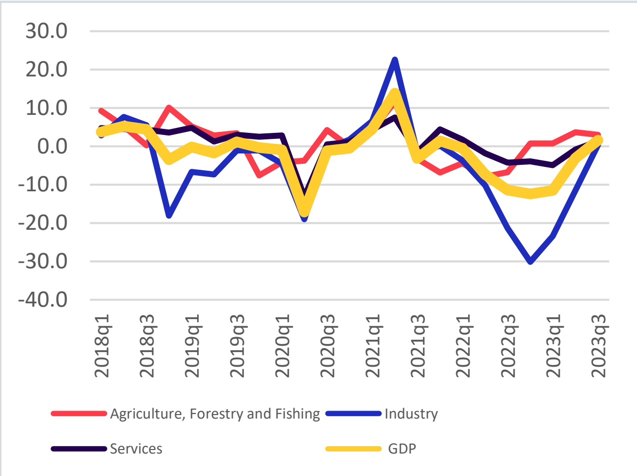
Sri Lanka has been hit hard by a series of shocks since 2018, starting with the Easter bombings in 2019 followed by the COVID-19 pandemic that deeply impacted the economy and labour market before the economic crisis of 2022-23. During the COVID-19 lockdowns, GDP decreased by 17.1 per cent in the second quarter of 2020 (figure 1) before growth returned as lockdown measures were lifted. However, before a full and sustainable recovery from the pandemic could be achieved, the war in Ukraine and subsequent cost-of-living crisis shocked the world in 2022, hitting Sri Lanka particularly hard due to underlying macroeconomic imbalances and structural weaknesses.[2]

[1] This statistical brief has been prepared by Sher Verick, Head of the Employment Strategies Unit, ILO, Geneva.

[2] See Gunatilaka and Chandrasiri (2022) The labour market implications of Sri Lanka's multiple crises (ilo.org) for a deeper discussion on these issues, Colombo: ILO.

Consequently, the Sri Lankan economy faced a severe balance-of-payments and external debt crisis in 2022, leading to a default on its foreign debt in April of last year. The resulting deep recession was accompanied by skyrocketing inflation and limited supply of food, fuel and raw materials, which further hurt economic activity. Overall, the economy shrank by 7.8 per cent in 2022[3], while year-on-year inflation reached a peak of 73.7 per cent in September 2022[4].

▶ **Figure 1. Trends in real GDP growth rate (year-on-year, %), 2018Q1 – 2023Q3**



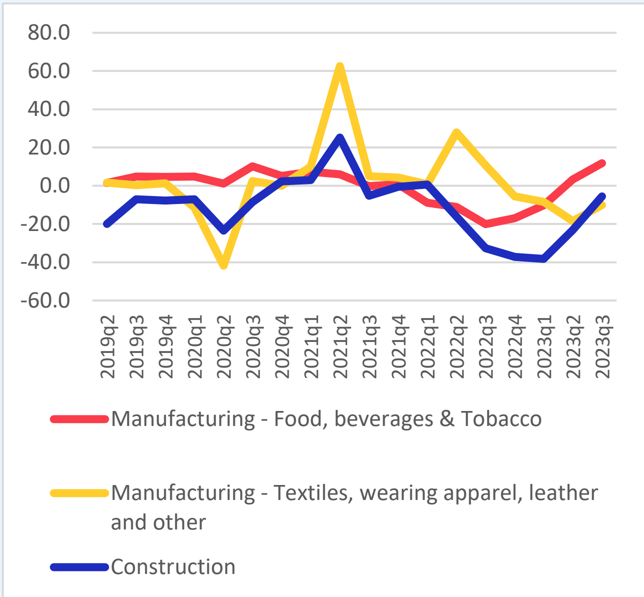
Source: National accounts, Department of Census and Statistics, Sri Lanka.

In March 2023, the Government of Sri Lanka entered a 48-month arrangement under an IMF Extended Fund Facility (EFF) of SDR 2.286 billion (about US$3 billion) to restore macroeconomic stability and debt sustainability, while promoting structural reforms to support the recovery.[5] While the process of recovery will be long and arduous, some degree of stabilization has been achieved over 2023.

By September 2023, the year-on-year inflation rate fell to just 0.8 per cent (though supply-side constraints continue to impact the economy). Data for the third quarter of 2023 shows that the Sri Lankan economy is growing again, albeit at just 1.6 per cent (relative to the third quarter in 2022), up from -3.1 per cent in the previous quarter (figure 1). Agricultural output recovered faster over 2023, returning to a growth rate of 3.6 per cent in 2023Q2, which was spurred on by the reversal of the previous policy on fertilizers. Industry has taken a bigger hit, registering a decline of 30.1 per cent in the fourth quarter of 2022 before stabilizing over 2023.

As expected, there is considerable variation within industry: manufacturing of textiles and garments (which accounted for 3.3 per cent of total employment in 2019) had initially held up relatively well over 2022 but has since contracted significantly with output falling by 18.4 and 10.1 per cent in the second and third quarters of 2023, respectively (figure 2). In comparison, manufacturing of food, beverages and tobacco (which represented almost 8 per cent of total employment in 2019) has recovered from deep falls in 2022 to achieve an increasing growth rate, from 3.2 per cent in 2023Q2 to 11.8 per cent in 2023Q3. Construction, which accounted for 8.9 per cent of total employment in 2019, has been badly affected by disruption to supplies and rising input costs that resulted in massive declines in output over 2022-23. The situation in construction has begun to improve though the sector continues to contract (-5.5 per cent in 2023Q3).

▶ **Figure 2. Trends in real GDP growth rate (year-on-year, %) – manufacturing and construction sectors, 2019Q2 – 2023Q3**



Source: Department of Census and Statistics, Sri Lanka.

[3] Data is sourced from the Department of Census and Statistics, Sri Lanka unless otherwise stated – http://www.statistics.gov.lk/.

[4] National Consumer Price Index (base 2013=100), Department of Census and Statistics, Sri Lanka.

[5] IMF Executive Board Approves US$3 Billion Under the New Extended Fund Facility (EFF) Arrangement for Sri Lanka.

The overall impact of the economic crisis has been borne by micro, small and medium-sized enterprises (MSMEs), which accounts for 99 per cent of business enterprises and employs 75 per cent of the labour force.[6] Based on a primary survey, a recent ILO report finds that almost 90 per cent of MSMEs were either severely or very severely affected by the current economic crisis.[7]

▶ **Table 1. Key labour market indicators – Sri Lanka, 2018 - 2023Q2**

Indicator	2018	2019	2020	2021	2022	2021Q2	2022Q2	2023Q2
Labour force participation rate (%)	51.8	52.3	50.6	49.9	49.8	49.8	50.1	48.6
Male	73.0	73.0	71.9	71.0	70.5	71.1	70.9	68.8
Female	33.6	34.5	32.0	31.8	32.1	30.9	32.1	31.1
Unemployment rate (%)	4.4	4.8	5.5	5.1	4.7	5.1	4.6	5.2
Male	3.0	3.3	4.0	3.7	3.7	3.8	3.7	4.1
Female	7.1	7.4	8.5	7.9	6.5	7.7	6.5	7.4
Youth (15-24)	21.4	21.5	26.5	26.5	22.7	30.0	23.8	25.8
Employment-to-population ratio (%)	49.5	49.8	47.8	47.4	47.5	47.3	47.7	46.0
Male	70.8	70.5	69.0	68.4	67.9	68.4	68.3	66.0
Female	31.2	31.9	29.3	29.3	30.0	28.5	30.0	28.8
Distribution of employment by major industry group (%)								
Agriculture	25.5	25.3	27.1	27.3	26.5	27.8	26.0	25.7
Industry	27.9	27.6	26.9	26.0	26.5	25.3	27.7	26.3
Services	46.6	47.1	46.0	46.7	47.0	46.9	46.3	48.1

Source: Various labour force surveys, Department of Census and statistics, Sri Lanka.

The impact of the crisis on Sri Lanka's labour market

Considering the deep economic crisis over 2022-23, a sharp adjustment in the labour market would be expected. However, rather than a steep rise in the unemployment rate, Sri Lanka's labour market has adjusted through other channels, mainly through a fall in the labour force participation rate.

The unemployment rate for the working-age population (15 and above) peaked at 5.5 per cent in 2020 (table 1), which was driven by the COVID-19 pandemic lockdowns and subsequent economic downturn. As lockdown measures were lifted over 2021, the total unemployment rate fell, which, surprisingly, continued during 2022 despite the deep economic crisis.

Overall, the unemployment rate for women, which is significantly higher than for men (a differential of around four points), reached 8.5 per cent in 2020 before dropping to 6.5 per cent in 2022. The youth employment rate, which is more than four times higher than for the total population, rose substantially to 26.5 per cent in 2020, before also declining over 2022.

While there wasn't a significant impact on the unemployment rate in 2022 (which, in fact, declined to 4.7 per cent in 2022), the trend has since partially shifted. The latest available quarterly data shows that the unemployment rate across all demographic categories has risen in the second quarter of 2023, though, in general, it remains lower than the peak reached during the pandemic (2020).

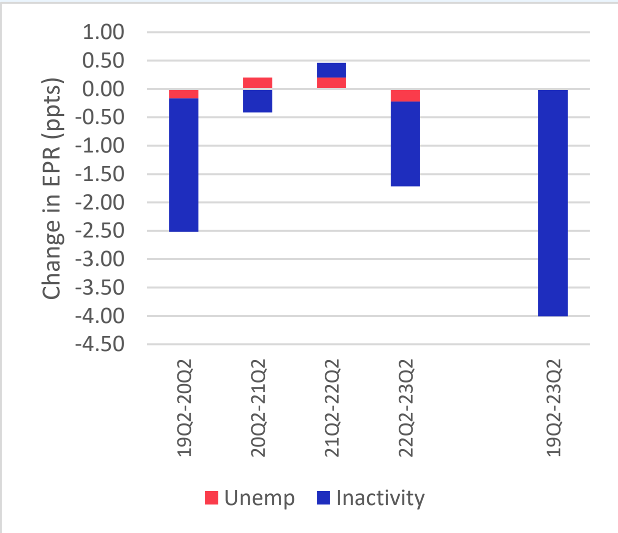
A stronger effect of the economic crisis is evident in changes to the employed population. The employment-to-population ratio (EPR) fell in 2020 by 2 percentage points (relative to 2019) before declining further in 2021 to 47.4 per cent. In response to the economic crisis of 2022-23, the ratio dropped further and by the second quarter of 2023, the EPR had fallen to a low of 46 per cent. The decline in the EPR is evident for both women and men – in the case of the female ratio, Sri Lanka's already low share of women in employment has taken a further hit during both the COVID-19 and economic crises.

[6] Chandrasiri, S. and R. Gunatilaka (2023) Impact of multiple crises on Sri Lanka's micro, small and medium-sized enterprises (ilo.org), Colombo: ILO.

[7] Chandrasiri and Gunatilaka (2023)

In terms of structural changes, trends in the distribution of employment by major industry group reveal a decline in the share in industry during the pandemic before a recovery by the second quarter of 2022 (reaching 27.7 per cent) (table 1). However, by 2023Q2, the share in industry fell again to 26.3 per cent, reflecting the deteriorating situation in both construction and (parts of) manufacturing, while the corresponding share in agriculture rose to 48.1 per cent (see figure 1).

▶ Figure 3. Decomposing the change in the employment-to-population ratio into unemployment and inactivity, 2019Q2 to 2023Q2



Source: Department of Census and Statistics, Sri Lanka.
Notes: Changes in the employment-to-population ratio can be broken down into changes in unemployment and inactivity using the following simple decomposition: Working-age population = Employment + Unemployment + Inactivity, which can be transformed into, -Δ(E/WAP)_t=Δ(U/WAP)_t+Δ(I/WAP)_t, where Δ denotes change from t to t+1, WAP = working-age population, E = employment, U = unemployment, and I = inactivity (persons outside the labour force).

Taken together, these trends imply that adjustment has occurred elsewhere. A decomposition of the employment-to-population ratio (EPR) into changes in unemployment and inactivity (out-of-the labour force) shows that, indeed, that it is the latter that has moved with employment. This phenomenon was highlighted by various ILO Monitors over 2020-23[8] and is evident also in the case of Sri Lanka: during the COVID-19 pandemic the 2.5-point fall in the employment-to-population ratio in Sri Lanka translated into a 2.35-point increase in the inactivity rate (ratio of inactive persons to the working-age population) compared to just a 0.15-point rise in the unemployment-to-population ratio (figure 3).

This pattern was also evident during the economic crisis of 2022-23: the EPR dropped by 1.7 points from the second quarter of 2022 to the same quarter this year, which was associated with a 1.5-point increase in the inactivity rate (and, hence, only a 0.2-point rise in the unemployment ratio). Overall, the change in the EPR from 2019Q2 to 2023Q2 (a decline of 4 percentage points) was almost entirely paralleled by a rise in inactivity as opposed to unemployment.

The exit from the labour force means that more Sri Lankans are neither employed or unemployed and searching for jobs but are inactive. Inactivity is made up of different categories of people who don't meet the criteria for being employed or unemployed including: 1) potential labour force which encompasses both the available potential jobseekers (jobless, available but not looking for a job) and the unavailable jobseekers (jobless, looking for a job but not available); 2) others not included in the potential labour force such as pensioners, students, carers and those who are invalid or with disabilities. While further analysis of these different dimensions (discouraged workers, etc.) is needed, available figures show that the number in the first category has fallen from 2021 to 2022 (from 227,858 to 184,998), while the second has increased.

In addition to the rise in inactivity, the other key adjustment mechanism in response to the economic crisis has been migration, which is not captured by the labour force survey numbers. However, while precise figures are not available on the total number of Sri Lankans that have left for work, trends in passport applications and registrations with the Sri Lankan Bureau of Foreign Employment (SLBFE) both show a sharp increase in 2022, surpassing not only the 2020 pandemic low but also the pre-crisis level in 2018 (figure 4).

The number of passport applications have more than doubled, rising from around 329,000 in 2018 to more than 910,000 in 2022.[9] At the same time, the number of registrations with the SLBFE increased by almost 50 per cent, from more than 211,211 in 2018 to 311,056 in 2022.[10] This trend continued over 2023 with the number of

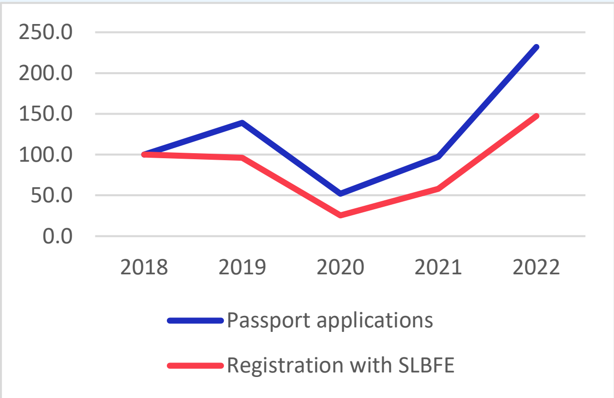
[8] E.g., [COVID-19 Pandemic in the World of Work: ILO Monitor. 7th edition](#)

[9] Passport applications: Performance Report 2022, Department of Immigration and Emigration

[10] cbsl.gov.lk/en/quarterly-bulletin-of-workers-remittances-and-labour-migration

departures for foreign employment reaching 224,133 in the year to September 2023 (monthly average of almost 25,000). The SLBFE figures, however, do not capture all the Sri Lankans going abroad to work (including those searching for employment without registration). Reflecting out migration, the working-age population, which is normally driven by demographic trends, increased by just 28,314 from 2021 to 2022 compared with a rise of almost 228,000 over 2018-2019.

▶ **Figure 4. Out migration has increased – evidence from passport applications and registration for foreign employment, 2018=100.0**



Source: Passport applications: Performance Report 2022, Department of Immigration and Emigration; Registration with Sri Lanka Bureau of Foreign Employment, Outward Labour Migration in Sri Lanka, SLBFE.

Further research is needed to fully understand the implications of these labour market trends, along with analysis of other dimensions, including the effects of the large fall in real wages and incomes and changes in working hours.

Towards an inclusive and sustainable labour market recovery

The road to an inclusive and sustainable labour market recovery in Sri Lanka is long and arduous. While some signs of macroeconomic stabilization have been achieved, much more remains to be done in terms of debt restructuring, revenue mobilization and tackling inflation. From an employment perspective, it is critical that the effects on the labour market are carefully analysed and monitored.

Ongoing stabilization and reform measures can intensify the lingering effects of the crisis on the labour market through 1) the consequences of fiscal adjustment and debt consolidation on jobs and incomes, and 2) the impact of "growth-enhancing" structural reforms. Their impacts can be severe for MSMEs, women and young people who have already been badly hit by the crises, as well as for workers retrenched by impending state-owned enterprise (SOE) reform.

The labour market recovery will depend critically on how businesses recover, transform and expand, and how workers' employability and productivity improve. As Sri Lanka's population ages and the crisis pushes youth to migrate, policy needs to double down on efforts to help transition women and young people into decent and productive employment. Workers retrenched from SOEs will need income support, re-training and help in finding work again.

A relevant policy agenda has been highlighted in both The labour market implications of Sri Lanka's multiple crises and Impact of multiple crises on Sri Lanka's micro, small and medium-sized enterprises. Beyond the ongoing analysis of the issues highlighted above, especially the falling labour force participation rate and effects of outmigration, finding effective policy solutions will require further dialogue within government and with representatives of employer and worker organizations, along with development partners.

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