

## **EMPLOYMENT GENERATION CAPACITY OF SMALL AND MICRO ENTERPRISES IN THE IMPORT LIBERALIZATION REGIME OF SRI LANKA\***

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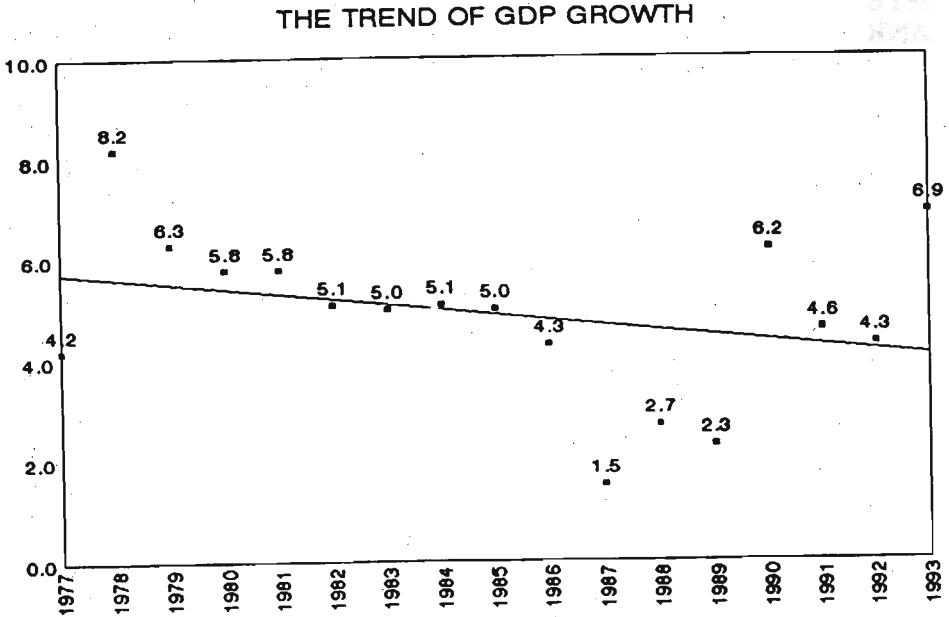
Earlier attempts to develop the industrial sector in Sri Lanka relied on a policy of import substitution where local enterprises were protected through such measures as trade barriers, import controls and exchange regulations. However, a poor performance of the economy, in the 1970s had revealed the weakness of the import substitution strategy to maintain a satisfactory level of growth. The industrial sector could produce only a limited range of products and the level of technology was low in keeping with the limited local demand. Against this background, the government which assumed office in 1977, changed the inward-looking policy and initiated economic reforms aimed at encouraging export oriented industries.

During the last one and half decades, attempts have been made to implement open economic policies based on the Structural Adjustment policies advocated by the World Bank. The focus of practically every aspect of the new economic policy was to create a competitive environment in both the industrial and service sectors in which entrepreneurial decision making would be governed by market forces. With the creation of a level playing field together with easy access to local resources and foreign technology, entrepreneurs were free to invest, expand and modernize in response to the needs of the market. The import liberalization regime opened up substantial opportunities for export industries which were expected to assist small and micro enterprises to take advantage of the opportunities available in the open market. It was also expected that small and micro enterprises would play an active role in manufacturing and supplying the increased demand for farm equipment and other inputs resulting from an improved performance of the agricultural sector.

Policy makers were convinced that the economic liberalization programme would stimulate productive investment and economic growth and that the benefits would seep down to small producers and entrepreneurs enabling them to create more employment opportunities. However, the average annual GDP growth during this period failed to justify this optimism. As shown in Figure I, the GDP growth fluctuated sharply during the last 15 years and in the last decade average annual growth was only 4.1 percent, less than all the other countries of South Asia. Consequently, the slow growth rate was insufficient to create employment opportunities in the major sectors of the economy, including the agricultural sector where employment continued to decline. In 1990, 47.7 percent of the total employed population was in the agricultural sector, but this figure dropped to 38.5 percent in 1993, and the sector's contribution to GDP declined correspondingly from 23.2 per cent to 20.9 per cent during the same period.

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\* Based on a paper presented at the seminar on "Unemployment" held at NARESA on 29th July 1994.



**Figure 1: The trend of GDP growth**

The manufacturing sector, which was expected to grow much faster under the open economy also failed to realise expectations. Its contribution to the GDP increased marginally from 17.3 percent in 1990 to 19.1 per cent in 1993, while the labour force employed declined from 14.1 to 13.2 in the same period. However, the services sector accounted for 49.6 percent of the GDP in 1990 and this increased to 50.6 percent in 1993, while those working in the sector increased from 29.2 percent to 38 percent. However, with the ongoing privatization of public organizations and the reduction of employees in the private sector organizations the labour absorption capacity of the service sector is expected to decline. The problem of unemployment in Sri Lanka therefore has to be solved by creating greater employment opportunities in the manufacturing sector and its main sub sectors, like the processing of tea, rubber and coconuts and the small industries. Of the total labour force engaged in the factory industry, about 80 percent work in the garments industry. The work force engaged in processing of tea, rubber and coconuts is likely to decline further as the prospects of the plantation industry do not appear to be particularly promising.

The import liberalisation policy and an undue concentration on export-oriented economic growth have led to constraints that have inhibited the growth of the main sectors of the Sri Lankan economy, thereby reducing their potential for creating employment. It is therefore essential to envision how small and micro enterprises could create employment making fuller use of the opportunities provided by the open economic policies.

Table 1

Item	Composition of GDP constant (1982) factor cost prices Amount (Rs. Million)				Percentage distribution of employed population (by industrial group)			
	1990	1991	1992	1993	1990	1991	1992	1993
1. Agriculture, Forestry & Fishing	30,011 23.2	30,570 22.6	30,090 21.3	31,554 20.9	47.7	41.6	46.1	38.5
2. Mining & Quarrying	3,901 3.0	3,511 2.6	3,300 2.3	3,693 2.4	1.6	0.9	1.0	2.2
3. Manufacturing	22,427 17.4	23,949 17.7	26,059 18.5	28,806 19.1	14.1	13.4	12.3	13.2
4. Construction	8,761 6.8	9,033 6.7	9,765 6.9	10,400 6.9	4.0	3.9	4.8	4.9
5. Services	64,144 49.6	68,141 50.4	71,776 50.9	76,330 50.6	28.3	33.2	31.5	37.4
6. G.D.P.	129,244 100.0	135,204 100.0	140,990 100.0	150,783 100.0				

Source: Central Bank Annual Reports-Labour Force Survey-Census and Statistics 1993.

The share of manufacturing value added contribution by small units declined during the import liberalization regime and several studies have shown that the main reason for this down turn has been that small industries, far from capitalising on the opportunities opened up by liberalization, have actually been adversely affected in many cases.

Broadly speaking the incentives offered and the economic environment created by the import liberalization regime favoured only the large local and foreign firms leaving the small and micro enterprises out in the cold. The large entrepreneurs were able to import raw materials and capital goods in bulk while the small and micro enterprises were disadvantaged because they had to depend on a number of intermediaries like traders and commission agents who supplied the imported raw materials at unconscionable prices. Most of the domestically produced goods which had a high import component, lost out to imported goods which were available at the same prices and many local manufacturers of plastic and chemical related goods, for example, were compelled to abandon their enterprises. Large companies, on the other hand, established their own collecting centres of locally available raw materials to cut down the cost of imports. Scrap metal and aluminium became very scarce and expensive as a result of bulk buying by large export factories.

The so called level playing field did not ensure equal access to productive resources as in the highly competitive environment of the open economy, the small and micro enterprises were at a distinctive disadvantage as regards credit

and marketing. Further the devaluation of currency increased sharply the cost of imported raw materials and equipment, discouraging small entrepreneurs in their attempts to diversify their activities with imported technology and new products. The dumping of imported products below cost price added to the difficulties of the small entrepreneur who was compelled to reduce staff as a last resort to cut operational costs.

The expectation that small entrepreneurs could become a vital force behind the development of export industries by being sub-contractors to large factories also did not materialize. The small enterprises were often left out of the equation once the large firms began to face fierce competition among themselves.

A shortfall in demand has affected most small enterprises as the purchasing power of the majority of Sri Lankan households continued to decline during the import liberalization regime. The demand of the main clientele consisting of small farmers and the working class was restricted to basic food and clothing. The demand for the manufacture of these goods progressively dwindled and shifted to the repairing of goods like shoes, furniture, household equipment and agricultural implements.

Although large factories including those in the Free Trade Zone have employed about 150,000 workers, this had little impact on easing the ever growing problem of rural unemployment. Also the cost of establishing factories in the Free Trade Zones and elsewhere in the form of infrastructure, port facilities and allocation of land was extremely high compared to the cost of maintaining the small and micro enterprises. In the process of promoting large scale garment factories for export, large numbers engaged in the cottage industries, particularly the handloom industry, were sent out of employment and lost their jobs.

### **Small Sector Financing**

Access to finance on relatively easy terms is crucial for the development particularly of small enterprises. Financial restructuring as a part of the economic reforms programme had made it incumbent on the commercial banks, including the two State Banks, to establish new criteria of lending based on the level of profitability. The existing lending schemes therefore reached only the higher end of the small sector as the majority of micro enterprises have failed to maintain the minimum level of viability for credit worthiness. However, the Government had intervened in providing the two State Banks with some re-financing facilities to promote start-up enterprises and self employment projects. The Janasaviya Trust Fund, which was created under the World Bank assistance for poverty alleviation, was also involved actively in supporting "partner organizations" to initiate special finance schemes for the poor. Both banks have up to the end of 1993 financed about 150,000 small and micro enterprises under the start-up self employment and other new enterprise schemes. Under the Janasaviya (Poverty Alleviation) Trust Fund about 60,000 jobs have been created through financing self employment projects. If a small

enterprise is defined as one employing 5 - 10 workers and a micro enterprise as one with less than five workers, more than 60 percent of the borrowers have established micro enterprises either as a 'last resort' or as a supplementary source of income. These enterprises require minimal skills resulting in low productivity and low quality products. However, there were some small enterprises that performed well in a competitive market environment, but their overall impact was not sufficient to compensate for the decline in most of the small and micro enterprises.

Unemployment and the problem of poverty have increased to a greater extent than the benefits that were expected to accrue from the open economic policies. The challenge therefore facing policy makers and development administrators is to create an environment where large scale and small and micro enterprises can co-exist, and to enhance their capacity to create employment and wealth.

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