

**DETERMINATION OF WAGE RATE IN
THE LABOR MARKET IN SRI LANKA**

by

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DECLARATION

The work described in this thesis was carried out by me under the supervision of Dr. W.A. Jayathissa, Senior professor of Social Statistics in the Department of Social Statistics, University of Sri Jayewardenepura, and a report on this has not been submitted in whole or in part to any university or any other institution for Degree/Diploma.

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I certify that the above statement made by the candidate is true and this thesis is suitable for submission to the University for the purpose of evaluation.

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ABSTRACT

In order to study the wage determination in the labor market in Sri Lanka, a sample was selected from the Sri Lanka labor force survey conducted by the Department of Census and Statistics in the year 2002. The dispersion of conditional wage distribution of the total sample, and the sub-samples are investigated by running quantile regressions of Mincerian wage equation with a view to addressing the link between schooling and rate of return to education and wage inequality. Furthermore, generalized linear gamma model fitted for the average of the conditional wage distribution.

In the Sri Lanka labor market, level of education is the most significant factor for wage determination and the substitutability of experience for education is low. In addition, the rate of returns to education increases over the wage distribution in an overwhelming majority of wage groups.

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Chapter 1

INTRODUCTION

1.1 Background Of The Study

Income and consumption inequality in Sri Lanka are among the highest in the world (World Bank, 1999). Wage inequality plays an important role in income and consumption inequality. Wage/Salary is the main income source of the majority of employed population in Sri Lanka. In year 2002, out of total employed population, employees accounted for nearly 60%. The other three categories, employers, own account workers, and unpaid family workers respectively accounted for 2 percent, 28 percent, and 10 percent (Dept. of Census and Statistics, 2002). It shows that wage or salary workers represent the majority of employed population. However, their wage/salary is a function of a number of inputs such as sex, age, level of education, and experience. Many researchers have attempted to study the relationship between wage rate and different variables affecting it. However, in the case of Sri Lanka, this area of study has not been undergone for in-depth statistical analyses. Hence, this analysis attempts to fill this gap.

Human capital accumulation is an important determinant of individuals' earnings capacity and employment prospects, and therefore plays an important role in determining the level and distribution of income in society. In addition, The Department of Economic Affairs of the United Nations (1953) defined investment in human capital as investments made to increase the productivity of the labor factor. In 1960 Schultz wrote: "I propose to treat education as an investment in man. Since education becomes a part of person receiving it, I shall refer to it as human capital"¹. The Free Education Act of 1945 (activated in 1952) provided a landmark in the history of educational development in Sri Lanka. The scheme allowed for universal free education from kindergarten to the university, and had an enormous impact on the general level and distribution of education. However, after fifty years (at 2002), illiteracy rate in Sri Lanka is the lowest in the South Asian Region, and secondary education is well developed. However, retention rates from grade to grade at the primary level in Sri Lanka are lower than those of a number of Asian countries: grade 10 (OL) enrollments are only 45 percent of the enrollment of the same cohort in grade 1, even though education has been free in Sri Lanka. Educational inequality is also present in the labor force of Sri Lanka in spite of the considerable amount of public resources allocated to education since independence. Hence, it is important to identify how far the education of employees has been affected in the determining wage rate.

The literature reveals that labor market experience also plays a significant role in wage determination of employees. In the Sri Lankan case too, experience is taken into consideration as a recruitment criterion especially in the private sector. However, there

¹ Schultz(1993), p.115