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Actuarial analysis of an unemployment insurance scheme in Sri Lanka

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Abbreviations and Acronyms

ILO	International Labour Organisation
TEWA	Termination of Employment of Workman
EPF	Employees Provident Fund
ETF	Employees Trust Fund
WPP	World Population Prospects
ISSA	International Social Security Association
SSN	Social Safety Nets

Acknowledgements

In 2022, the ILO received an official request from the Ministry of Labour and Foreign Employment in Sri Lanka to provide assistance on the designing new unemployment insurance scheme. The main objective of this report is to assess the cost and financing implications of the introduction of different design options as well as identify factors impacting costs and key considerations for implementation. One of the motivations behind this request was to address the challenges of unemployment issues from both the COVID-19 pandemic and the economic crisis. Additionally, employers have faced burdens related to providing unemployment benefits to their employees during such situations. Therefore, the scope of this report has been expanded to include consideration of these issues.

The project was implemented by ILO Country Office in Sri Lanka and Maldives (ILO-Colombo) in close collaboration with the ILO Decent Work Technical Support Team for South Asia (ILO DWT-New Delhi) and the Regional Actuarial Services Unit of the ILO Regional Office for Asia and the Pacific (ILO-ROAP/BKK). The ILO project team consists of: Mariko Ouchi, Senior Social Protection Specialist of ILO DWT-New Delhi, Simon Brimblecombe, Chief Technical Advisor and Head of the Regional Actuarial Services Unit of ILO-ROAP/BKK and Sriyani Mudiyanselage, National Project Coordinator of ILO-Colombo. This project was implemented under the general guidance of Simrin Singh, Former Country Director of ILO-Colombo and Joni Simpson, Present Country Director of ILO-Colombo.

Concerning this report, the ILO mandated Alexandre Landry, FSA, Social Security Actuary and Modelling Specialist, to undertake this assignment and Simon Brimblecombe assumed responsibility for the review of the report and technical backstopping.

The ILO worked in collaboration with data committee under the Ministry of Labour and Foreign Employment including department of Labour, Employers Federation of Ceylon and Employee Trust Fund Board, Department of Census and Statistics in Sri Lanka for the gathering of data and engaged with them in discussions on various aspects of the project. The authors would like to express special appreciation to Ministry of Labour and Foreign Employment, Department of Labour, Department of National Planning, Employers Federation of Ceylon, Trade Unions, Employees Trust Fund Board and other counterparts providing valuable contributions during two consultative technical workshops organized in August and December 2023.

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▶ Executive summary

The main objective of this report is to assess the cost of the implementation of an unemployment insurance scheme in Sri Lanka, assess different provision frameworks and provide key considerations for the implementation of such a scheme. This report proposes two design options for an unemployment insurance scheme in Sri Lanka. The two proposed design options are derived from findings and observations made by the ILO, as well as discussions held during ILO missions conducted in August and December 2023. This report also discusses three alternative design options proposed by stakeholders during the ILO mission conducted in December 2023.

The primary objectives of the unemployment insurance scheme in Sri Lanka are twofold: to provide appropriate cash payments to the eligible unemployed during periods of involuntary unemployment to maintain a reasonable standard of living; and to provide employment retention benefits and promote reinsertion into the labour market. In the initial stage of its implementation the unemployment insurance scheme will primarily address the income support objective. It is expected that the unemployment insurance scheme will rely on active labour market policies to support the second objective. Social protection and employment policies are indeed coordinated, and active labour market policies are a key component of unemployment insurance schemes.

Table E1 presents an overview of the key parameters of the two design options proposed for Sri Lanka. Design option A is aligned with ILO Convention No. 102 which sets the minimum standards for unemployment benefits. Design option B complies with ILO Convention No. 102 but is also aligned with ILO Convention No. 168, which sets higher standards of unemployment benefits, in terms of covered contingency, qualifying requirement and benefit. The proposed design options also reflect some parameters proposed by participants during ILO missions referred to above. Design options A and B are detailed in Chapter 2.

▶ Table E1 Key parameters of two design options proposed for Sri Lanka

Parameter	Option A	Option B
Coverage	Mandatory coverage for all paid employees (excluding self-employed and voluntary affiliations)	
Contribution requirement for benefit eligibility	6 months in the 12-month period preceding the employment termination	12 months in the 24-month period preceding the employment termination
Eligible reasons for termination of employment and continuation of benefits	– Involuntary termination of employment or forced termination – Able and available for work and actively searching for a job	
Contributory earnings	Monthly salary	
Unemployment benefit	– The unemployment benefit is calculated as 45% of the average contributory earnings declared in the 6-month period preceding the employment termination. – The unemployment benefit is paid for a maximum duration of 3 months	– The unemployment benefit is calculated as 50% of the average contributory earnings declared in the 12-month period preceding the employment termination. – The unemployment benefit is paid for a maximum duration of 6 months
Waiting period	7 days	

Source: Authors' proposals based on discussions with stakeholders.

Due to the administrative and financing challenges of covering the self-employed in an unemployment insurance scheme, especially at implementation, design options A and B do not include coverage for the self-employed. Indeed, it is normally recommended to consider the implementation of a simple unemployment insurance scheme that would provide reasonable benefits as a first step (in line with what is proposed in design options A and B) and improve the benefits and/or extend coverage to target additional groups of workers such as the self-employed thereafter, once the scheme is proven to be efficient and sustainable and the effectiveness of the scheme's control mechanisms is demonstrated. It is recommended that the unemployment insurance scheme be implemented in a simple and efficient manner and its scope expanded based on accumulated experience of operations, monitoring and evaluations.

Under design option A, the unemployment insurance benefit represents 45 per cent of the average insurable earnings declared in the 6-month period preceding the employment termination. The unemployment insurance benefit is paid for a maximum duration of 3 months to all those who become involuntarily unemployed and have accrued a minimum of 6 months of contributions to the scheme in the 12-month period preceding the termination of employment.

Under design option B, the unemployment insurance benefit represents 50 per cent of the average insurable earnings declared in the 12-month period preceding the employment termination. The unemployment insurance benefit is paid for a maximum duration of 6 months to all those who become involuntarily unemployed and have accrued a minimum of 12 months of contributions to the scheme in the 24-month period preceding the termination of employment.

Table E2 presents the recommended contribution rate for the design options A and B. The demographic and financial projections related to design options A and B are presented in detail in Chapter 4, and are based on key projection assumptions presented in Chapter 3.

▶ Table E2 Recommended contribution rate, design options A and B (in % of insurable earnings)

	Option A	Option B
Benefit expenditure	0.30	0.53
Administrative expenditure	0.30	0.30
Minimum contribution rate to ensure the scheme's sustainability over the projection period [(a)]	**0.60**	**0.83**
Additional contribution rate to accumulate a stabilization reserve	0.15	0.22
Recommended contribution rate [(b)]	**0.75**	**1.05**

Notes: (a) Assumes no stabilization reserve at the end of the projection period. (b) Refers to the contribution rate that would be required to allow the scheme to accumulate a stabilization reserve equivalent to at least twice the annual projected expenditures (benefits and administrative expenditures) in the last year of the projection period of ten years. It is important to note that the assumption of administrative expense cost is a prudent estimate and not a 'charge'. If actual expenses are less than what is allowed for then additional reserves will be built up which can be used for enhancing benefits and/or reducing contributions at a later date.
Source: ILO calculations.

The key findings of the financial projections are presented below:

- **Option A:** A contribution rate of 0.60 per cent (0.30 per cent for the benefit expenditure and 0.30 per cent for the administrative expenditure) would be sufficient to pay all the expenditures over the projection period (no accumulation of a stabilization reserve at the end of the projection period). An additional contribution rate of 0.15 per cent is necessary in order to accumulate the stabilization reserve equivalent to twice that of annual projected expenditures (benefits and administrative expenditures) in the last year of the projection period. The recommended contribution rate is therefore **0.75 per cent** of earnings and should be divided equally between employers and employees.

- **Option B:** A contribution rate of 0.83 per cent (0.53 per cent for the benefit expenditure and 0.30 per cent for the administrative expenditure) would be sufficient to pay all the expenditures over the projection period (no accumulation of a stabilization reserve at the end of the projection period). An additional contribution rate of 0.22 per cent is necessary in order to accumulate a stabilization reserve equivalent to twice that of the last year of the projection period expenditures (benefits and administrative expenditures). The recommended contribution rate is therefore **1.05 per cent** of earnings and should be divided equally between employers and employees.

It is worth noting that the above-mentioned recommended contribution rates exclude any cost related to active labour market programmes. Funding for active labour market programmes usually comes from the budget of ministries in charge of labour, job creation and education. However, in some countries, unemployment insurance schemes do finance a portion of such active labour market programmes. If that were to be the case in Sri Lanka, then appropriate allowance in the recommended contribution rate should be made.

Three alternative design options, which reflect the specific views of three different stakeholders, are presented in Chapter 5. It is worth noting that these alternative design options may not fully align with ILO Conventions and Recommendations, and therefore do not constitute ILO recommendations. The cost assessment of the three alternative design options could, however, prove useful for the stakeholders and decision-makers, for example how changes in certain design and eligibility parameters are likely to affect the cost of a unemployment insurance

scheme.

Given the uncertainty of economic forecasts, this assessment cannot project the future with perfect accuracy. Projections are based on actuarial valuation models and assumptions, and the results are sensitive to the assumptions chosen. There is greater uncertainty when a new scheme is costed due to the lack of historical scheme data. However, we believe that the results and recommendations in this report which are based on rigorous actuarial approaches as well as our experience as actuaries, are appropriate.

Assessing the cost of an unemployment insurance scheme does require very specific data and a historical perspective of the context and labour market that is sometimes very difficult to obtain before the scheme is introduced. Although the recommended contribution rates presented above are in our opinion, reasonable, once the unemployment insurance scheme is implemented, it will be important to continue collecting data and statistics on its members and beneficiaries to build a better understanding of the interactions between the demography, the economy and the labour market. Collecting such data and statistics will not only contribute to an improved monitoring of the scheme, but also provide guidance to decision makers for policy design. Regular monitoring is particularly important due to the short-term nature of unemployment insurance benefits. In fact, contribution rates (or premium) of an unemployment insurance scheme need to be reviewed more frequently than the contribution rates of a pension scheme. The ISSA-ILO Guidelines for Actuarial Work[1] (Guideline 26) suggest that unemployment insurance schemes carry out actuarial reviews on an annual basis in order to revise the contribution rate according to a predefined rate-setting mechanism with a full actuarial valuation every 3 years.

Although severance pay is not the focus of this report, special attention has been given to this termination benefit. As detailed in Section 2.7, it is strongly recommended to ensure that the combined programmes (severance pay and unemployment insurance benefit) do not lead to overly generous benefits at termination nor create distortions in the labour market. It is the role of stakeholders to ensure that the combination of the two programmes, even for a limited period, does not defeat one of the main objectives of active labour market policies-based unemployment insurance schemes, which is to reinsert people in the labour market faster and reduce the time that they receive unemployment insurance benefits. In fact, the severance pay in Sri Lanka, when combined with either design options A or B, appears to be overly generous, especially for employees with several years of service with the same employer. In addition to being globally expensive, the overall compensation package on termination makes the combination of the two schemes counterproductive, and a reform or an elimination of the severance pay in Sri Lanka should be considered by stakeholders. It is recommended that additional consultations be held with social partners to determine the most relevant transition approach and the combination of unemployment insurance benefit and severance pay in Sri Lanka to ensure that the unemployed are protected in the best manner and that employees and employers are not impacted negatively by the elimination of the severance pay, or the introduction of the unemployment insurance scheme.

The ILO remains available to provide support to stakeholders, assess additional design options, and provide further assistance to the Government in the development of the unemployment insurance scheme framework in Sri Lanka.

[1] https://www.social-protection.org/gimi/ShowRessource.action?id=54220

Introduction

This report presents the results of the actuarial analysis of an unemployment insurance scheme in Sri Lanka. It includes projections, policy and financing implications. The actuarial analysis is mainly based on the data obtained from the Employees' Trust Fund as well as on the labour statistics data obtained from the Department of Census and Statistics of Sri Lanka.

The report is structured as follows:

- Chapter 1 presents the rationale for the implementation of an unemployment insurance scheme in Sri Lanka, including references to International Labour Standards, as well as Active Labour Market Policies. It also discusses Sri Lanka's current termination benefits and complementary social security benefits.
- Chapter 2 describes the characteristics of the key design options assessed in this report.
- Chapter 3 presents the main economic, demographic and scheme-specific assumptions used to assess the cost of the unemployment insurance scheme.
- Chapter 4 presents the cost assessment of the two design options described in Chapter 2.
- Chapter 5 presents the cost assessment of alternative design options derived from stakeholders' inputs.
- Chapter 6 presents additional considerations, not elsewhere specified in this report, for the implementation of the unemployment insurance scheme.

The Report includes additional information in the annexes as follows:

- Annex 1 presents the general methodology used to assess the cost of the design options.
- Annex 2 presents the ILO social security standards on unemployment protection.

▶ 1. Context

This chapter presents the rationale for the implementation of an unemployment insurance scheme in Sri Lanka, including references to International Labour Standards, as well as active labour market policies. It also discusses Sri Lanka's existing termination benefits and explores the social security benefits often available to workers whose employment has been terminated.

1.1. Rationale for the implementation of an unemployment insurance scheme

The ILO, since its creation in 1919, has been an advocate for the protection of workers in case of unemployment. Unemployment benefits is one of nine branches of social security stipulated in the Social Security (Minimum Standards) Convention, 1952 (No. 102), the flagship of the international labour conventions related to social security. Convention No. 102 describes minimum standards as to the percentage of the population to be protected by social security schemes, the level of minimum benefit, the conditions for entitlement and the period of entitlement to benefits. The Employment Promotion and Protection Against Unemployment Convention, 1988 (No. 168), along with its accompanying Recommendation No. 176, set higher standards for unemployment benefits, mainly but not only applicable to industrialised countries. Convention No. 168 encourages the promotion of full, productive and freely chosen employment, the principles of equality of treatment and of non-discrimination. More recently, the Social Protection Floors Recommendation, 2012 (No. 202) recalls the importance of integrating income security measures and employment support programmes.

Against this backdrop, the ILO has estimated that more than 55 per cent of workers worldwide have no statutory access to unemployment insurance benefits or any type of unemployment assistance. Globally, 96 countries have established an unemployment protection scheme in law, the vast majority (nine out of ten) through social insurance mechanisms. Legal coverage rates for mandatory contributory schemes range from 11.6 per cent of the labour force in Africa to 36.6 per cent in Asia and the Pacific, 46.4 per cent in the Arab States, 64.2 per cent in the Americas and 82.0 per cent in Europe and Central Asia. At worldwide level, only 18.6 per cent of unemployed receive unemployment benefits, with large regional disparities. This shortfall is attributable to the absence of unemployment insurance schemes in many countries, the legal exclusion of certain categories of workers, high rates of long-term unemployment and restrictive qualifying conditions.[2]

A properly designed unemployment insurance scheme will play an important stabilization role during periods of economic slowdown and shocks. Unemployment insurance, by partially compensating for lost earnings, helps to break the negative cycle of increased unemployment which leads to reduced consumption, resulting in a further reduction in economic activity. Active labour market policies complement the unemployment insurance and are designed to improve the functioning of the labour market by matching demand and supply. They also encourage decent work and improve employability of the unemployed, poor and vulnerable groups. The existence of such schemes also strengthens social cohesion, reduce inequalities, support economic growth, and help countries become more robust in the face of external shocks and crises.

With regards to employers' and overall government's objectives, the presence of an unemployment insurance scheme can provide an incentive for unemployed persons to seek covered employment. The protection offered by the unemployment insurance scheme becomes part of the advantages included in salaried, registered employment and can thus contribute to reducing informal employment, by helping employers to offer an attractive and competitive remuneration package vis-à-vis the informal economy and vis-à-vis independent employment. Unemployment insurance schemes that provide partial income substitution also prevent laid off employees from growing the ranks of the unemployed and the informal economy in times of economic downturns. Employers and society at large benefit from the presence of an unemployment insurance scheme, since terminations can then be less difficult to manage, with a reduced likelihood of social disruption. Workers may more easily accept the unpleasant prospect of unemployment, in the knowledge that there is at least a temporary bridge to assist them in their transition to alternative activity. Finally, yet importantly, is the role played by unemployment insurance

[2] World Social Protection Report 2020–22: Social Protection at the crossroads – in pursuit of a better future. ILO, 2021

benefits in preventing individuals from slipping into poverty, and in preserving their dignity, once they become unemployed.

Whilst there have been some arguments that unemployment insurance benefits can create work disincentives leading to higher unemployment, evidence seems to indicate that such concerns about moral hazard may be unfounded and exaggerated. Benefits are generally set at a level that encourage beneficiaries to return to the workforce. In addition, the availability of unemployment insurance benefits allows jobseekers to take the time they need to find jobs that are suited to their background and capacities, instead of forcing them to accept the first available employment option. This leads to an improved matching of jobs and workers, a benefit for employers and workers as well as for the overall economy, even if it may extend their time off work. This can be compared to the situation of workers whose employers provide sickness leave and benefits and can thus take time off to deal with illness, instead of having to show up for work in poor health. Whilst evidence suggests that arguments against unemployment insurance are likely to be unfounded, adopting an unemployment insurance scheme that is adequate but not overly generous, with sound enforcement of eligibility conditions and complemented by effective active labour market policies should alleviate concerns about potential disincentive effects of unemployment insurance schemes.

Any disincentive effect depends on the relative generosity of available unemployment insurance benefits, especially on the earnings replacement rate as well as on the absolute maximum value that can be paid for a given week or month of unemployment. The other measure reducing any disincentive effects are the eligibility requirements – i.e. the extent to which the unemployed are required to actively search for work, and the effective monitoring of their job search. In the absence of the latter, unemployment insurance benefits could, in some cases, become passive benefits. What matters the most is the combination of those two factors. Generous benefits should be accompanied by strict job search requirements and lower, though still adequate, replacement rates still do require job search measures but in a less rigorous fashion. Whatever the situation, active job search requirements, which is essential to the proper operation of unemployment insurance schemes, have nowadays become common in most countries.

1.1.1. Principles of social insurance

To build a resilient and effective unemployment insurance scheme, it is crucial to understand and embrace the key principles underlying social insurance. The principles of social insurance include various elements, such as collective financing, risk pooling, universality, solidarity, adequacy, simplicity, sustainability and overall state responsibility for the proper administration of the system and the due provision of benefits. The effectiveness of a scheme responding to the life cycle risk of unemployment increases if it fully adopts these principles.

A scheme that follows collective financing and risk pooling principles is funded through regular contributions paid by workers and employers, and pools together the collected contributions. The resulting fund is used to cover the payment of unemployment benefits. Risk pooling in social insurance is based on the principle of solidarity, with contributions typically related to capacity to pay – that is, proportional to earnings – as opposed to the individually calculated risk premiums of commercial insurance. The advantages of a risk pooling approach are that it reinforces sustainability, safeguards the scheme's long-term viability, improves the adequacy of benefits, and supports redistribution. It is also a more efficient approach than an individually focused one and even more so than an employer liability approach, such as severance payments. Sri Lanka's current termination benefit system is discussed later in this report, in section 1.3.1.

Extending coverage to larger groups of employees has a positive impact by creating wider risk pooling, increasing financial sustainability, promoting solidarity, and reducing the overall contribution rate. In turn, such schemes reduce poverty and inequality and support social cohesion and economic growth as well as more efficient labour markets. The exclusion of employees of smaller enterprises from coverage and the exclusion of employees with fixed-term contracts from coverage go against this goal and therefore reduces the positive impacts of such a scheme. International experience demonstrates that mandatory legal coverage for all employees is the best and most cost-efficient approach, because any voluntary coverage leads to selection against the system, low coverage and cost increases.[3] Employees most at risk of becoming unemployed due to the sector or size of enterprise in which they operate or the type of their contractual arrangement are most in need of protection and to have the national solidarity play in their favour. Furthermore, in order to recognize the higher risk of a person with a fixed-

[3] Comparative studies of international practices support this statement (Peyron Bista and Carter 2017; Bedard, Carter, and Tsuruga 2020a; Tsuruga 2020; Carter, Bedard, and Peyron Bista 2013).

term contract becoming unemployed, certain countries have established higher contribution rates to unemployment insurance for employers having recourse to such contracts which can incentivise employers to offer more stable employment contracts.

The next principles concern the adequacy and simplicity of the benefit formula. Unemployment benefits are designed to ensure an adequate level of benefits, and are typically set as a percentage of the previous earnings of insured workers before becoming unemployed. Most countries set a constant replacement rate between 50 to 60 per cent of earnings for a period of between 3 and 12 months, subject to qualifying conditions. Many countries have also established minimum unemployment benefits (often as a percentage of the minimum wage) taking into account that, for low paid workers, applying a percentage to their previous earnings will inevitably result in inadequate levels of protection. International practice also shows that simple rules are preferable to complex ones when implementing, managing and communicating an unemployment insurance scheme to the public. Varying benefit levels and/or complex eligibility requirements may make the scheme too complicated to explain and administer. There is limited evidence that varying benefit levels contributes to shortening workers' unemployment spells and encouraging workers to return to work.

Financial sustainability with due regard to equity, through collective financing between workers and employers is important for ensuring scheme effectiveness. Such a diversified financing approach reduces financing risk and supports adequate benefits. If the financing approach is not appropriate, sustainability and adequacy may be threatened during difficult economic times. This may make the scheme ineffective or unattractive, leading to the public losing trust in the social security system. Almost all unemployment insurance schemes operate through collective financing by both employees and employers, which facilitates expansion of the scheme to protect workers and guarantees the sustainability of the fund. The ILO have produced a separate policy note which considers the financing of social insurance schemes in the context of current contributions paid to the ETF and EPF[4].

Finally, fairness and equity are essential to achieve the scheme's objective. The principles of social insurance promote risk-sharing among workers with stable and unstable employment, shorter and longer employment, and high and low earnings. A scheme excluding workers most in need of unemployment protection due to their vulnerable employment status or low level of earnings while paying excessively higher relative benefits to those with a better employment status may run counter these principles. Similarly, the scheme should allow insured employees to claim unemployment benefits as long as they satisfy the qualifying conditions.

1.2. Coordination between unemployment insurance and labour market policies

Active labour market policies are powerful policy instruments, as they have the capacity to provide new job opportunities and ensure the continuous upgrade of workers' skills, thereby improving the labour market performance of participants in a sustainable manner. Active labour market policies can therefore enhance the living conditions of workers and their families. They have the potential to reduce poverty and improve equity as well as supporting broader economic transition. A well-articulated link between the unemployment insurance scheme and active labour market policies will therefore create synergies among public policies to protect people and create jobs.

Active labour market policies support the labour market integration of individuals through labour supply- or demand-side measures. On the supply side, active labour market policies are designed to provide assistance and incentives for persons to remain attached to the labour market and actively look for jobs. On the demand side, the main aim of active labour market policies is to stimulate job creation and hiring so that persons ultimately (and as soon as possible) find suitable employment. The supply-side of active labour market policies includes policies such as training and labour market services, while the demand-side active labour market policies comprise public employment programmes (including public works and employment guarantees) and support to self-employment and micro-enterprise creation. Employment subsidies have a dual role depending on whether they constitute recruitment incentives, employment maintenance incentives, or workers' subsidies. A description of active labour market policies is included in Table 1.1.

[4] ILO Policy Brief: Road map to social security reform in Sri Lanka, 2024

▶ Table 1.1 Categories of active labour market policies and their objectives

Training	Public employment programmes (public works and employment guarantees)	Employment subsidies	Start-up incentives	Labour intermediation services
Improve employability and enhance future career paths through acquisition of skills, and support national economic strategy	Compensate lack of employment opportunities to alleviate poverty through temporary jobs with employability enhancing components	Provide incentives for hiring new staff and maintaining jobs by reducing labour costs	Provide financial and logistic support for self-employment or micro-entrepreneurship	Connect jobseekers with employers through career advice, job-search assistance and other measures promoting reintegration into the labour market

Source: Adapted from Delivering income and employment support in times of COVID-19: Integrating cash transfers with active labour market policies. ILO, 2020.

A well-designed unemployment insurance scheme must coexist with and complement active labour market policies to marry income support measures with opportunities for the unemployed to improve their employment prospects. The evidence shows that countries with functional active labour market policies linked to adequate unemployment protection are able to reinsert people in the labour market faster and reduce the time that they receive unemployment benefits. Furthermore, countries are better equipped to cope with shocks, as the COVID-19 pandemic or an economic crisis, and address the decent work deficits, which primarily affect the most vulnerable, because they can rely on active labour market policies to preserve employment relationships and offer alternative jobs available immediately.

Although linkages between the unemployment insurance scheme and active labour market policies are crucial, the governance of both public policies are quite different. Active labour market policies by their nature, are the responsibility of ministries in charge of education (e.g. training), infrastructure (e.g. public employment programmes), employment and labour (e.g. employment services and subsidies) and businesses or entrepreneurship (e.g. start-up incentives). The distribution of responsibilities may change according to mandates of ministries in each country. Financing of active labour market policies typically comes from a range of different government budget sources. Additionally, some countries include contributions and/or levies to support the financing of active labour market policies, which could be paid by employers and/or employees as part of a social security scheme contribution rate.

International labour standards recognize the links between active labour market policies and income support. The Employment Service Convention (No. 88) recognizes cooperation between public employment services and unemployment protection measures. The Employment Promotion and Protection Against Unemployment Convention, 1988 (No. 168) promotes the coordination of unemployment protection and employment policy, including employment services, vocational training and vocational guidance. The Social Protection Floors Recommendation, 2012 (No. 202) and the Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204) also highlights the importance of linking social protection and employment policies to protect people and create exit strategies from social protection programmes and (re)insertion into the labour market.

Different types of interventions to facilitate employment have been implemented in Sri Lanka in recent years. These interventions include career guidance and job search assistance through Public Employment Services. Moreover, the government of Sri Lanka, in collaboration with various stakeholders, organizes job fairs and employment services to connect job seekers with potential employers. These events provide a platform for networking and job matching. Such interventions generally tend to be an important part of the active labour market policies. These interventions can help employers find workers with the required skills quickly and reduce the length of time workers with particular skills remain unemployed. A number of government agencies are also involved in providing technical and vocational trainings in Sri Lanka including the Vocational Training Authority (VTA), the National Apprentice and Industrial Training Authority (NAITA), the Department of Technical Education and Training (DTET) and the National Youth Services Council (NYSC) which operate under the supervision of the Tertiary and Vocational Education Commission (TVEC).

Sri Lanka's existing active labour market policies remain nonetheless limited. It is strongly recommended that, prior to (or in conjunction with) the implementation of an unemployment insurance scheme, a comprehensive analysis of existing active labour market policies in Sri Lanka be conducted, and the introduction of additional and

complementary interventions to those currently in place be contemplated.

1.3. Existing programmes and benefits in Sri Lanka

1.3.1. Sri Lanka's termination benefits

Termination refers to the ending of employment both at the initiative of the employer and for other reasons, such as resignation and bankruptcy of the enterprise. Generally, terminations at the initiative of the employer are referred to as dismissals, except where the national legislation uses a different term, or the context otherwise requires. Within the common law legal tradition, the regulation of termination of employment may be seen as being based on various justifications. The first is a concept of individual justice between the employer and employee, whereby employers are prohibited from making arbitrary dismissal decisions. The second, particularly apparent for collective dismissals for economic reasons, is a market intervention and economic regulation rationale, with legal intervention justified by reference to a desire to minimise the costs and impacts of such dismissals to the employee. Third, legal regulation can be seen as protecting public rights, such as the right to join a trade union and the right not to be discriminated against on certain prohibited grounds such as gender and race. Fourth, in some jurisdictions a clear regulatory framework can be viewed as a mechanism by which employers may be protected from excessive litigation costs that might otherwise arise from employment termination. Finally, to the extent that dismissal regulation promotes employment security, such regulation can be seen as encouraging employers to invest in the training and development of workers. In contrast, in many civil law systems, the right to employment security is seen as an essential element of human rights promotion (see also International Covenant on Economic, Social and Cultural Rights, 1966, particularly Articles 6 and 9). Within this legal tradition, the right not to be unfairly dismissed is part of a broader human right to employment and job security.[5]

In 1982, the ILO adopted standards related to the termination of employment: The Termination of Employment Convention, 1982 (No. 158) and the Termination of Employment Recommendation, 1982 (No. 166). Convention No. 158 is framed in three parts. Part I sets out methods of implementation, scope and definitions. Part II sets standards of general application, including justification for termination, procedures prior to and at the time of termination, procedures of appeal against termination, period of notice, and severance allowance and other income protection. Part III has provisions that supplement those in the previous Parts, where termination of employment occurs for economic, technological, structural or similar reasons, including provisions on consultation with workers' representatives and notification to the competent authority. For instance, Article 12 of Convention No. 158 provides for a worker whose employment has been terminated to be entitled to a severance allowance or other separation benefits; benefits from unemployment insurance or assistance or other forms of social security; or a combination of such allowance and benefits.

Convention No. 158 gives equal recognition to employer-financed severance allowance and social insurance as methods for protecting income in the case of termination. The Committee of Experts on the Application of Conventions and Recommendations (CEACR) has highlighted the fact that the Convention No. 158 allows countries to determine the appropriate income protection system adapted to their own specific conditions. It allows countries to move gradually from a scheme providing only a severance allowance to one in which the protection afforded by the severance allowance is supplemented by partial protection under a social security scheme that is providing unemployment benefits, or to one providing only unemployment insurance benefits.[6]

In 1992, the ILO adopted standards related to the protection of workers' claims in the event of the Insolvency of their Employer: Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173) and the Protection of Workers' Claims (Employer's Insolvency) Recommendation, 1992 (No. 180). The Convention refers to insolvency as a situation in which, in accordance with national law and practice, proceedings have been opened relating to an employer's assets with a view to the collective reimbursement of its creditors. Part II of the Convention sets out methods for the protection of workers' claims by means of a privilege (requiring in insolvency proceedings to treat workers' claims as privileged debts). Part III refers to the protection of workers' claims by a guarantee institution. Articles 9 and 10 of Convention No. 173 provides for general principles of guarantee mechanisms. They are to guarantee the payment of workers' claims against their employer arising out of their employment when

[5] Termination of employment digest: A legislative review. ILO, 2000
[6] Termination of employment instruments. Background paper for the Tripartite Meeting of Experts to Examine the Termination of Employment Convention, 1982 (No. 158), and the Termination of Employment Recommendation, 1982 (No. 166). ILO, 2011

payment cannot be made by the employer because of insolvency. Appropriate measures to prevent possible abuse may be adopted. Contrary to other countries, this guarantee mechanism does not exist in Sri Lanka.

Severance payments and unemployment insurance benefits are distinguished by the fact that one falls under labour law and is not pre-funded, while the other rests, in most countries, on social insurance law and is guaranteed by the State. In addition, severance payments are not linked to active labour market policies and therefore do not seek to reintegrate the unemployed into the labour market.

Box 1.1. Severance payments in Sri Lanka

In Sri Lanka, the Termination of Employment of Workmen Act (TEWA) and Part IVB of the Industrial Disputes Act (IDA) (1982) govern dismissals. In general, TEWA and Part IVB of the IDA apply to private sector employers with a minimum of fifteen employees and govern the termination of workers who have been employed for at least twelve months. Employees subject to TEWA can only be terminated by the employer with either their consent or with approval from the Commissioner General of Labour. When Part IVB of the IDA applies, the employer is required to provide a one-month notice of termination to the employee and notify Commissioner General of Labour.

The severance payment under TEWA is calculated as follows:

- 2.5 months of salary per year of service for the first five years of service, for a maximum compensation of 12.5 months of salary;
- 2.0 months of salary for each year between the 6th and the 14th year of service, for a maximum compensation of 30.5 months of salary;
- 1.5 months of salary for each year between the 15th and the 19th year of service, for a maximum compensation of 38.0 months of salary;
- 1.0 month of salary for each year between the 20th and the 24th year of service, for a maximum compensation of 43.0 months of salary; and
- 0.5 month of salary for each year between the 25th and the 34th year of service, for maximum compensation of 48.0 months of salary.

The maximum compensation under TEWA is set at 2,500,000 rupees.

As an example, if an employee has worked for the same employer for 10 years and earns a monthly salary of 50,000 rupees, the severance payment, governed by TEWA, would amount to 1,125,000 rupees (or 22.5 months of salary).

As opposed to social insurance, the key problems with Sri Lanka's termination benefits are the following:

- There is no financial risk-pooling mechanism, so the costs fall exclusively on the employer. This cost is not shared among stakeholders.
- In case of an employer's lack of compliance or bankruptcy, workers simply do not receive a benefit. This will likely impact workers most in precarious employment situations the most as it is these employers who often do not pay.
- An employer liability approach creates negative incentives for employers to retain workers which impacts the good functioning of the labour market and has negative economic impacts. It may also act as a disincentive to recruit.
- There is no pre-funding with employer liability mechanisms meaning the costs cannot be spread. When the payments are most likely to be required (i.e. in terms of economic difficulty), these are conversely the times when the financial resources are likely to not be there.

Overall, severance payments are a much less reliable and effective instrument than unemployment insurance benefits in protecting workers against the financial impact of job loss, and rather appear to serve as a recognition of long service with the same employer, with no clear link between the amount of payments and the needs of employees. Not only do severance payments apply to a limited number of employers and employees, but their actual payment could depend on the employer's financial capacity, and on workers' capacity to enforce payment, which could often be problematic. The size of potential payments for employers may also be acting as a disincentive to recruit workers, with a consequent negative impact on the formal economy. Furthermore, active labour market policies are not linked to severance payments and therefore do not contribute to increase the employability of the unemployed.

1.3.2. Complementary social security benefits

In Sri Lanka, social security primarily revolves around the Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF). These schemes are well-established and cover most formal sector employees.

The EPF covers nearly all formal sector employees in Sri Lanka, providing them with a source of retirement benefit and offering further financial support such as housing loans and partial withdrawals to cater for housing and medical needs. The contribution rate for the EPF is set at 8 per cent from the employee and 12 per cent from the employer, totalling 20 per cent of the employee's monthly salary. The EPF is a defined contribution scheme, which means that both the employee and the employer make fixed contributions to the fund, and the eventual benefits paid out are based on the total accumulated contributions and the investment returns generated by those contributions. Therefore, the risk of poor investment performance is entirely assumed by the individual beneficiary.

The ETF also covers the formal sector, offering a further, albeit limited, source of retirement income and providing to its members additional benefits such as life insurance, disability benefit, childbirth grants, maternity benefits, loans and financial assistance towards education and medical expenses. The contribution rate for the ETF is set at 3 per cent of the employee's monthly salary and is fully paid by the employer. Unlike the EPF, which requires the employee to have reached the retirement age to access its accumulated contributions, the ETF provides benefits to its members under specific conditions. To be eligible for making a withdrawal, an individual's employment must cease, which can occur due to various reasons, such as retirement, resignation, dismissal, or vacation of the post[7]. Notably, members are not entitled to make a second or subsequent withdrawal claim until five years have lapsed since the date of their previous fund balance withdrawal. However, there are exceptions to this rule, which include reaching the age of 60 years, migrating for permanent residence, joining state service that qualifies for a pension, facing termination of employment due to permanent disability, or in the event of the member's death.

Even though ETF withdrawal benefits can provide some income protection during periods of unemployment, they are a much less reliable and effective instrument than unemployment insurance benefits in protecting workers against the financial impact of job loss. Firstly, a person in need of income protection during unemployment may not be eligible to withdraw his or her accumulated balance under the scheme (members are not entitled to make a second or subsequent withdrawal claim until five years have lapsed since the date of their previous fund balance withdrawal). Secondly, while unemployment insurance schemes generally provide regular, predictable payments to ensure income support during unemployment, ETF withdrawal benefits are not linked to the actual needs of employees and may be substantially insufficient to provide some financial support for an unemployed for a period as short as one or two months (especially if the accumulated balance is withdrawn on a regular basis). Finally, as in the case for severance payments, active labour market policies are not linked to ETF withdrawal benefits and therefore do not contribute to increase the employability of the unemployed.

[7] It is worth noting that such provision may lead to perverse incentives, for example, individuals leaving a job in order to claim benefits.

▶ 2. Description of design options for Sri Lanka

This chapter discusses two design options for an unemployment insurance scheme in Sri Lanka, in the light of findings and observations from Chapter 1 and the discussions undertaken during ILO missions conducted in August and December 2023. As described in Chapter 1, the primary objectives of the unemployment insurance scheme in Sri Lanka are twofold: to provide appropriate cash payments to the eligible unemployed during periods of involuntary unemployment to maintain a substantial degree of standard of living; and to provide employment retention benefits and promote reinsertion into the labour market. In the initial stage of its implementation the unemployment insurance scheme will primarily address the income support objective. It is expected that the unemployment insurance scheme relies on active labour market policies to support the second objective.

Table 2.1 presents an overview of the key parameters of two unemployment insurance scheme design options for Sri Lanka. Design option A is aligned with ILO Convention No. 102 which sets the minimum standards for unemployment benefits. Design option B complies with ILO Convention No. 102 but is also aligned with ILO Convention No. 168, which sets higher standards of unemployment benefits, in terms of covered contingency, qualifying requirement and benefit. These options also reflect some parameters proposed by participants during ILO missions referred to above, most notably:

- Eligibility condition of 6 months of contributions in the 12-month period preceding the employment termination (Option A) and 12 months of contributions in the 24-month period preceding the employment termination (Option B);
- Benefit level of 45 per cent of previous contributory earnings (Option A) and 50 per cent of previous contributory earnings (Option B); and
- Maximum benefit duration of 3 months (Option A) and 6 months (Option B).

Due to the administrative, compliance and financing challenges of covering the self-employed in an unemployment insurance scheme, especially at implementation, design options A and B do not include coverage for the self-employed[8]. Indeed, it is normally recommended to consider the implementation of a simple unemployment insurance scheme that would provide not too generous benefits as a first step (similar as in design options A and B) and improve the benefits or target additional groups of workers such as the self-employed thereafter, once the scheme is proven to be efficient and sustainable and the effectiveness of the scheme's control mechanisms is demonstrated.

▶ Table 2.1 Key parameters of two unemployment insurance scheme design options for Sri Lanka

Parameter	Option A	Option B
Coverage	Mandatory coverage for all paid employees (excluding self-employed and voluntary affiliations)	
Contribution requirement for benefit eligibility	6 months in the 12-month period preceding the employment termination	12 months in the 24-month period preceding the employment termination
Eligible reasons for termination of employment and continuation of benefits	– Involuntary termination of employment or forced termination – Able and available for work and actively searching for a job	
Contributory earnings	Monthly salary	
Unemployment benefit	– The unemployment benefit is calculated as 45% of the average contributory earnings declared in the 6-month period preceding the employment termination – The unemployment benefit is paid for a maximum duration of 3 months	– The unemployment benefit is calculated as 50% of the average contributory earnings declared in the 12-month period preceding the employment termination – The unemployment benefit is paid for a maximum duration of 6 months
Waiting period	7 days	

Source: Authors' proposals based on discussions with stakeholders.

[8] The self-employed are not specially referred to in Part IV of the ILO Convention 102. Articles 20, 21, 23 suggest that self-employed can be excluded from the scheme's coverage.

Sections 2.1 to 2.6 discuss each of the key parameters of the two design options presented above. Section 2.7 discusses some options as to the future of Sri Lanka's existing severance pay after the implementation of the unemployment insurance scheme. Detailed financing modalities related to these two design options are discussed in Chapter 4 of this report. Alternative design options are presented in Chapter 5.

2.1. Coverage

Design options A and B provide mandatory coverage for all paid employees from both the private and the public sectors. It is important that the aim is to cover all workers to encourage labour market mobility, a more efficient labour market and to ensure equity. Consequently, the unemployment insurance scheme is aligned with the provisions of ILO Convention No. 102. For the time being, the self-employed and informal sector workers are excluded from the unemployment insurance scheme coverage and voluntary affiliation to the unemployment insurance scheme is not permitted.

Unemployment insurance schemes mainly target workers in formal employment, which in certain countries still represents a minority of all workers. To ensure social equity and cohesion, and to ensure no one is left behind, it is recommended to complement unemployment insurance benefits with non-contributory schemes that will allow minimum income security among vulnerable workers, including those not covered but also those who have exhausted their unemployment insurance benefits. In doing so, countries close coverage gaps and progressively implement social protection floors in line with the United Nations Sustainable Development Goals.

Unemployment insurance schemes generally cover all private and public sector employees. The inclusion of public sector employees, who sometimes enjoy a form of greater stability in employment than those in the private sector, corresponds to the principles of solidarity and pooling of risks in social security.

The debate concerning the inclusion of the self-employed in unemployment insurance schemes relates to the understanding of the nature of their employment relation and the challenges for social security organizations to ensure compliance. On the one hand, they might be conceived in a similar way as employers, and therefore deemed not in need of unemployment protection in case of termination of activities. On the other hand, a large and growing segment of the self-employed population works in practice under quasi-dependent employment relations and relies on one or two employers for the receipt of (most of the) income. This reality adds weight to consideration of the inclusion of the self-employed in the unemployment insurance scheme. In considering their inclusion or not in unemployment insurance schemes, it should be noted that their exclusion could further aggravate their working conditions and generate even stronger incentives for employers to rely on disguised self-employment to conduct activities which would normally require the hiring of a dependent employee. Policy decisions should also be taken together with appropriate employment compliance measures to ensure that workers with an employee-employer relationship are treated as such, whatever the declared status of such workers is.

The self-employed have very limited unemployment insurance coverage worldwide. Where coverage is provided, it usually takes the form of voluntary affiliation with a number of specific conditions, most notably related to eligibility. Covering workers on a voluntary basis should normally be avoided, or at the very least be subject to a number of constraints to avoid a greater risk of adverse selection for the unemployment insurance scheme. Adverse selection refers to the possibility of high-risk individuals (in this case, workers who are at high risk of becoming unemployed) choosing voluntarily to be covered under the scheme with the same conditions as the others. Employees with high risks of becoming unemployed would have significantly more incentives to join the unemployment insurance scheme than others who have more secure and stable jobs. Allowing members to be covered on a voluntary basis is likely to encourage a pool of high-risk workers and discourage a pool of low-risk workers to join the scheme, increasing at the same time the overall cost of the unemployment insurance scheme, which in itself can create a viscous circle.

Due to the administrative, compliance and financing challenges of covering the self-employed in an unemployment insurance scheme, especially at implementation, design options A and B do not include coverage for the self-employed. Due consideration could nonetheless be given to covering them once the scheme is proven to be efficient and sustainable and the effectiveness of the scheme's control mechanisms is demonstrated. The ILO would be happy to share the experience of other countries as appropriate.

2.2. Contribution requirement for benefit eligibility

Unemployment insurance schemes impose contributory conditions to qualify and receive benefits. Design options

A and B are aligned with what is typically observed in many countries. Under design option A, terminated members are required to have paid at least 6 months of contribution to the unemployment insurance scheme over the 12-month period prior to termination. Under design option B, terminated members are required to have paid at least 12 months of contribution to the unemployment insurance scheme over the 24-month period prior to termination. Design option A can be considered more beneficial to workers with a shorter employment history but a more recent history of contributions whilst design option B can be considered more beneficial to workers with a longer employment history but who may not have worked much in the previous 12 months. ILO Conventions Nos. 102 and 168 require that such qualifying conditions should not be longer than what is considered necessary to prevent abuse.

2.3. Eligible reasons for termination of employment and continuation of benefits

Unemployment insurance schemes are designed to protect workers upon termination of employment that may be considered voluntary or involuntary. Voluntary termination typically includes resignation, retirement, transfers by request and end of service. Involuntary termination includes dismissals, lay-offs, suspensions, and redundancy. Ultimately, national labour law defines the nature of the termination of employment as well as its correspondent compensation, if applicable. Design options A and B require the termination of employment to be involuntary or forced.

A forced termination refers to a situation in which an employee is compelled to leave their job due to various reasons, such as unpaid wages, harassment, dangerous working conditions, or illegal employer action. It may also refer to instances where an employee is compelled to quit their job for personal reasons unrelated to their employment, or relocating to escape domestic violence. In other words, forced termination refers to a situation where an employee feels they have no choice but to leave their job due to circumstances beyond their control.

Each country treats voluntary termination of contracts differently. In most countries, those who leave their job voluntarily are not eligible to receive unemployment benefits. In countries where the voluntarily unemployed are allowed to receive unemployment benefits, benefits tend to differ between those who have left their job voluntarily and those who have lost their job involuntarily. For example, the benefit paid to those who have left their job voluntarily could be reduced through measures such as lowering the benefit rate, shortening the benefit duration, or extending the waiting period. For example, in Thailand, unemployment insurance benefits equal to 30 per cent of previous contributory earnings in case of voluntary terminations (compared to 50 per cent in case of involuntary terminations) and are paid for a period of up to only 90 days (compared to up to 180 days in case of involuntary terminations). Such distinction in the benefit formula is intended to reduce the potential perverse effects that could be created by covering voluntary terminations. Without such a measure, people might leave their job simply to take advantage of the presence of the benefit. If this possibility is coupled with relatively generous benefits and relatively short tenures to qualify for the receipt of unemployment benefits, there is a risk that individuals in the labour market would continuously move in and out of unemployment. Providing some level of coverage for voluntary terminations however encourages some form of labour mobility but also that addresses the issue of what may appear to be voluntary termination may in reality be involuntary termination. We recommend that the scheme does not cover voluntary termination at the outset but the possibility to cover such cases is considered at a later stage.

The issue of coverage of end of contracts may also be complex, as a worker may desire to continue their employment when their contract expires. The use of short-term fixed contracts rather than an ongoing employment relationship may not only be detrimental to the individual's eventual unemployment insurance rights but also in respect of their other employment rights and in general lead to greater precarity in the labour market.

ILO Convention No. 102 prescribes that the contingency covered under the unemployment insurance scheme includes the suspension of earnings, as defined by national laws or regulations, due to the inability to obtain suitable employment, in the case of a person who is protected and who is capable of, and available for, work. To remain eligible for unemployment benefits under the proposed design options A and B, unemployed persons are required to be able and available for work and actively searching for a job. They are required to be registered to an employment services unit (or a similar service, depending on the country's organisation) and report to it on a regular basis. The refusal of an adequate job offer, or a training opportunity may be sanctioned with the loss of the benefit. Indeed, failure to be able and available for work, leaving the country or committing fraud, would result in the suspension of the unemployment insurance benefit.

A number of countries allow beneficiaries to continue to receive partial or full unemployment insurance benefits at the same time as they engage in part-time work. Normal rules still apply to these beneficiaries, who, however, must continue to look for and accept suitable full-time work, as well as continue to follow any training or employment measures for which they were referred. If their part-time earnings exceed certain limits, their unemployment benefits would then either be terminated or reduced. The purpose of these provisions is threefold: firstly, to encourage beneficiaries to remain engaged in the labour market and thus to maintain or improve their work experience, and maybe even use part-time work as a stepping stone to full-time employment; secondly, to allow employers to find workers willing to complete relatively minor tasks; and thirdly, to help workers maintain a reasonable standard of living between jobs. It also ensures there is a financial incentive for individuals to accept a part time job – which may lead to a later full-time position – without them losing more benefits than the salary they earn.

2.4. Contributory earnings

In order to ensure coherence and consistency between the unemployment insurance benefit and other social insurance benefits provided in Sri Lanka, design options A and B reflect the exact same definition of insurable earnings as the one already considered under the EPF and the ETF. This will also simplify the administrative processes of employers who will pay the total required contribution rate for all benefits on the same definition of contributory earnings. At a later stage, when the scheme is established, it may be worth considering a different definition of contributory earnings than for benefit earnings. A higher earnings amount used for the determination of contributions than that used for benefit calculations is used as a redistributive tool in some systems and lowers the recommended contribution rate. However, we recommend that such an approach is only considered once the scheme is established and running for a number of years.

2.5. Unemployment benefit

The duration and the level of benefits are key elements in the benefit formula of unemployment insurance schemes.

ILO Convention No. 102 stipulates that the duration of benefit payments should not be less than 13 weeks each year. Convention No. 168 promotes higher levels of protection and stipulates that the initial duration should not be less than 26 weeks for each spell of unemployment, or 39 weeks over any period of 24 months. The maximum time for which benefits are paid to jobseekers varies among countries. These decisions reflect national contexts, the characteristics of the unemployed in each country, locally held views of fairness and equity, concerns about disincentive effects, other possible sources of financial support, and financial constraints.

The benefit duration may also be linked to the qualification requirements, so that countries with less stringent qualification conditions tend to provide relatively shorter benefit durations for those who qualify. ILO Conventions Nos. 102 and 168 insist on the provision of unemployment benefits in the form of regular payments (as opposed to lump sum payments) as they are more effective to protect the unemployed. A further observation on the payment of benefits is that they are usually paid on a monthly basis, or in accordance with normal or traditional pay periods. Most countries set a benefit duration of between 3 and 12 months. In some countries, benefit duration is graded according to the length of insured employment prior to unemployment. Whilst most countries provide a maximum benefit duration irrespective of contribution history (for example, in Thailand, the maximum benefit duration is 6 months in case of involuntary termination and 3 months in case of voluntary termination), others link the maximum benefit duration to contribution history (for example, Viet Nam) or a combination of age and contribution history (for example, Japan).

In terms of benefit amount, ILO Convention No. 102 recommends a minimum replacement rate of 45 per cent of previous earnings payable for at least 13 weeks within a period of 12 months. ILO Convention No. 168 sets a higher standard, at 50 per cent of previous earnings for at least 26 weeks during each spell of unemployment, or 39 weeks over any period of 24 months. Most countries set a constant replacement rate between 50 to 60 per cent of previous insurable earnings for the full benefit duration. In some countries, the benefit rate decreases with the duration of the benefit.

In terms of duration and level of benefits, design option A is aligned with ILO Convention No. 102 while design option B is aligned with ILO Convention No. 168. Under design option A, the scheme would provide to those eligible a monthly benefit representing 45 per cent of the average insurable earnings over the 6-month period prior to the termination, for a maximum of 3 months. Under design option B, the scheme would provide to those eligible a monthly benefit representing 50 per cent of the average insurable earnings over the 12-month period prior to the

termination, for a maximum of 12 months.

It is normally recommended to consider the implementation of a simple unemployment insurance scheme that would provide not too generous benefits as a first step (similar as in design options A and B) and improve the benefits, or target additional groups of workers thereafter, once the scheme is proven to be efficient and sustainable.

2.6. Waiting period

Once qualification for the unemployment insurance benefit is established, most countries require a short initial waiting period before unemployment benefits are paid. The waiting period is the initial period of unemployment for which no benefits are paid, which requires insured persons to bear a part of the risks of becoming unemployed (this is different to the prescription period to claim the benefit). Waiting periods are set to:

- provide a deductible which, similar to automobile or other insurances, helps to deter individuals from initiating small or frivolous claims;
- eliminate the costs of administering claims for very short periods of unemployment, for which costs would be excessive compared to the benefits to be paid;
- provide time for reviewing claimant applications and establishing their right to benefit; and
- reduce the total costs of the unemployment insurance scheme, by passing on part of the earnings lost to the unemployed persons themselves, on the basis that they should have some capacity and responsibility to provide for themselves during short periods of unemployment.

In brief, unemployment benefits are generally intended to deal with more significant work interruptions that are more likely to cause financial hardship, rather than very short transitions from one job to another. ILO Conventions Nos. 102 and 168 both prescribe a maximum waiting period of seven days. Most countries have a one-week waiting period and, less frequently, no waiting period at all.

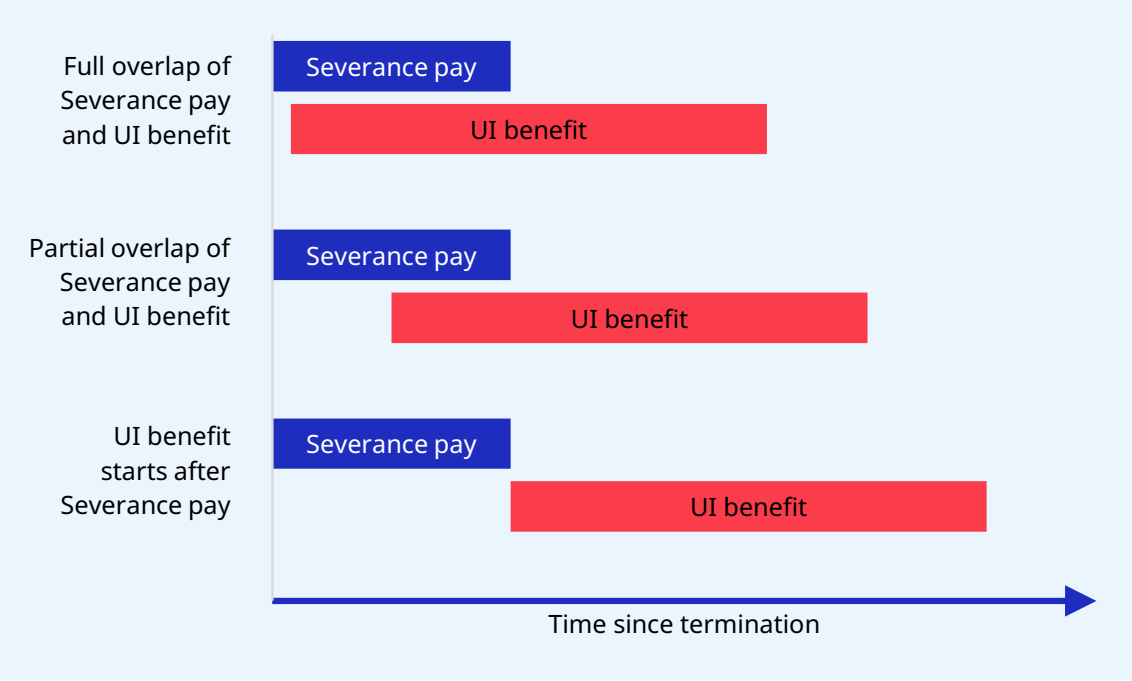
Under design options A and B, a waiting period of seven days is assumed. This is aligned with both ILO Convention Nos. 102 and 168.

2.7. Relation with existing severance pay provision

There are some options as to the future of the existing severance pay arrangements after the implementation of an unemployment insurance scheme:

- Option 1: The existing severance pay could be kept unchanged following the introduction of the unemployment insurance scheme, with or without coordination with the unemployment insurance scheme. Figure 2.1 illustrates possible options to combine severance pay and unemployment insurance benefits, in line with Convention No. 158. It is worth noting that this option will not resolve the key problems related to severance pay provisions referred to earlier in the report.
- Option 2: Existing severance pay could be incorporated into the unemployment insurance scheme, with or without expansion of its coverage, and with or without explicit coordination with the unemployment insurance scheme. Figure 2.1 illustrates possible theoretical options to combine severance pay and unemployment insurance benefits, in line with Convention No. 158. Such integration may address some of the concerns on severance pay raised in Chapter 1, and reduce the employers' administrative procedures on employment termination. Although this option may provide mechanisms to guarantee the payment of workers' severance pay in case of employer insolvency, it is worth noting that it still shares most of the concerns related to Option 1 presented earlier in this report. Indeed, as for Option 1, the ILO remains concerned on the consequences of combining the Sri Lanka's severance pay programme and the unemployment insurance scheme, particularly due to the substantial cost (which will be mainly financed by employers) and the excessive generosity of combining these two programmes. There are also concerns about the effectiveness of combining such programmes.

Figure 2.1 Possible options to combine severance pay and unemployment insurance benefits



Source: Authors' illustration.

- Option 3: The existing severance pay could be gradually removed following the introduction of the unemployment insurance scheme. Removing the existing severance pay will reduce the financial burden on employers compared to the other options described in this section once the unemployment insurance scheme is implemented (indeed, employers will not be required to pay both severance pay and unemployment insurance contributions under Option 2). The elimination of the mandatory severance pay in Sri Lanka can be done reasonably, without adversely impacting the employees' rights at termination since the unemployment insurance scheme intends to offer more widely available benefits, accompanied by employment services adapted to employees' needs. A transitional period may nonetheless be necessary, considering that workers, particularly those with long service, may actually be entitled to more generous severance pay compared to what the unemployment insurance scheme is likely to provide.

If it is agreed that the severance pay is maintained in Sri Lanka on a temporary or transitional basis, it is strongly recommended to ensure that the combined programmes (severance pay and unemployment insurance benefit) do not lead to overly generous benefits at termination. It is the role of stakeholders to ensure that the combination of the two programmes, even for a limited period, does not defeat one of the main objectives of active labour market policies-based unemployment insurance schemes, which is to reinsert people in the labour market faster and reduce the time that they receive unemployment insurance benefits. In fact, the severance pay in Sri Lanka, when combined with either design options A or B, appears to be overly generous, especially for employees with several years of service with the same employer. In fact, as per Box 1.1 in section 1.3.1, an employee with 10 years of service with the same employer may receive up to 22.5 months of salary in severance payment. This employee could receive an additional amount of up to 1.35 months of salary under design option A[9] and 3.0 months of salary under design option B[10]. In addition to being globally expensive, the overall compensation package could make the combination of the two schemes counterproductive, and a reform or an elimination of the severance pay in Sri Lanka should be considered by stakeholders.

It is recommended that additional consultations be held with social partners to determine the most relevant transition approach and the combination of unemployment insurance benefit and severance pay in Sri Lanka to ensure that the unemployed are protected in the best manner and that employees and employers are not impacted negatively by the elimination of the severance pay, or the introduction of the unemployment insurance scheme.

[9] 3 months x 45%.

[10] 6 months x 50%.

▶ 3. Key assumptions of the cost assessment

Sections 3.1 and 3.2 present respectively key demographic and economic assumptions of the cost assessment, which were mainly derived from the data obtained from the Department of Census and Statistics of Sri Lanka. Section 3.3 presents the key scheme-specific data and assumptions, which were also primarily derived from the data obtained from the Department of Census and Statistics of Sri Lanka.

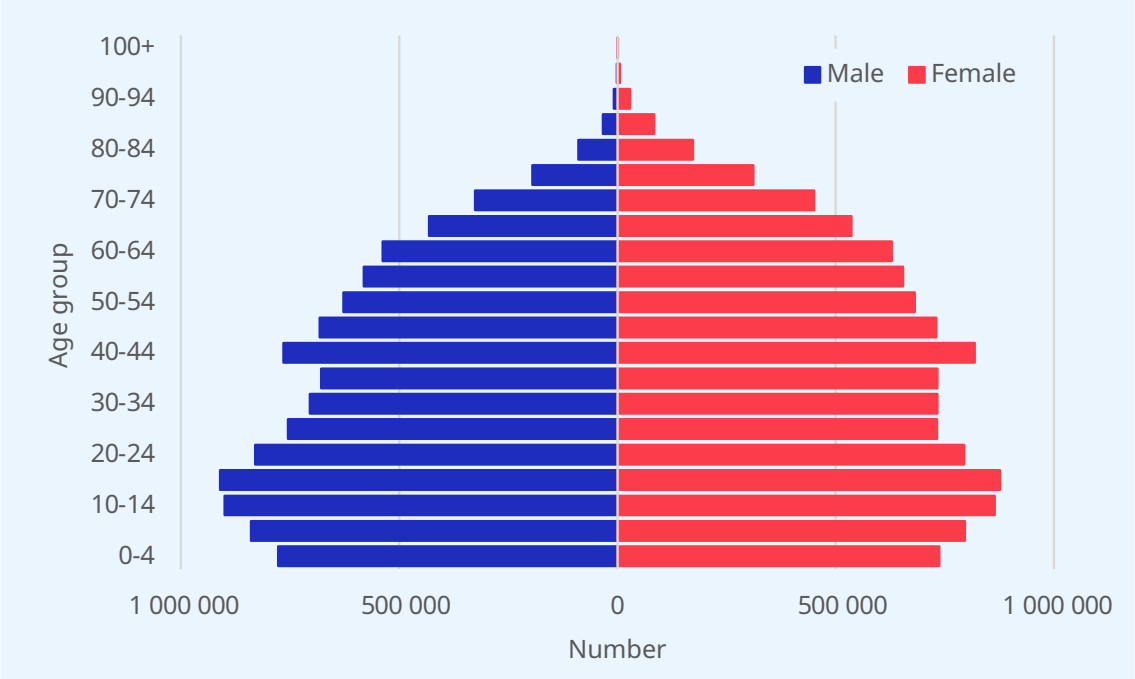
3.1. General population assumptions

A projection of the general population is used for the purposes of determining the evolution of the scheme's members and developing the general macroeconomic framework.

Population projections require specific assumptions on mortality, fertility and migration. Although the age- and sex-distribution of the general population of Sri Lanka is important, it is worth noting that the assumptions on mortality, fertility and migration are not key drivers in the demographic and financial projection of an unemployment insurance scheme. Indeed, mortality, fertility and migration have low to no impact on the projection of formal employment over a projection period of only 10 years (2024 to 2033).

Although the last population and housing census produced in Sri Lanka dates from 2012 (the next population and housing census is planned to be conducted in 2024), the Department of Census and Statistics of Sri Lanka estimates every year the country's population on the basis of administrative data on births, deaths and migration. The general population of Sri Lanka is estimated to 22,037,000 persons in 2023. The structure of the population of Sri Lanka has been assessed based on the statistics made available by the Department of Census and Statistics of Sri Lanka and the United Nations (UN) World Population Prospects (WPP)[11]. Figure 3.1 presents the estimated distribution of the general population of Sri Lanka as of 2023, by age and sex.

▶ **Figure 3.1 Estimated Population structure in 2023**



Source: Authors' estimates based on data provided by the Department of Census and Statistics of Sri Lanka and the UN WPP, 2022-Revision.

The latest statistics on mortality published by the Department of Census and Statistics of Sri Lanka cover the period 2011-2013. At that time, life expectancy at birth was estimated at 72.0 years for men and 78.6 years for women. In

[11] The 2023 mid-year population estimates, as published by the Department of Census and Statistics, mirror the exact same age distribution from the 2012 Census of Population and Housing. The choice to utilize UN WPP, 2022-Revision, estimates was made with the aim of ensuring that the initial population structure reflects the most plausible and up-to-date representation of the evolving demographic landscape in Sri Lanka.

the absence of more recent national statistics on mortality, estimated and projected mortality rates of the general population of Sri Lanka have been determined using the UN WPP, 2022 Revision. The future mortality improvement pattern has been determined so that it matches as closely as possible the UN medium projection over the projection period. The life expectancy at birth is assumed to increase from 73.1 years in 2023 to 75.2 years in 2033 for males and from 80.4 years in 2023 to 81.9 years in 2033 for females. Table 3.1 presents life expectancies at different ages for selected years. Sample mortality rates are presented in table 3.2.

▶ Table 3.1 Estimated and projected life expectancy of the general population of Sri Lanka, at ages 0, 20 and 65, 2023-2033

Age	Males			Females		
	At 0	At 20	At 65	At 0	At 20	At 65
2023	73.1	53.8	14.5	80.4	61.1	19.0
2024	73.3	54.0	14.6	80.6	61.2	19.1
2025	73.5	54.2	14.7	80.7	61.3	19.2
2026	73.7	54.4	14.9	80.9	61.5	19.3
2027	73.9	54.6	15.0	81.0	61.6	19.4
2028	73.8	54.5	14.9	81.2	61.8	19.5
2029	74.3	54.9	15.2	81.3	61.9	19.7
2030	74.5	55.1	15.4	81.5	62.0	19.7
2031	74.7	55.3	15.5	81.6	62.2	19.9
2032	75.0	55.5	15.6	81.8	62.3	20.0
2033	75.2	55.7	15.7	81.9	62.5	20.1

Source: Authors' estimates and assumptions based on UN WPP, 2022-Revision.

▶ Table 3.2 Sample mortality rates of the general population of Sri Lanka, 2023 and 2033 (percentages)

Age	Males		Females	
	2021	2033	2021	2033
0	0.57	0.43	0.49	0.37
10	0.02	0.01	0.01	0.01
20	0.08	0.06	0.05	0.04
30	0.11	0.09	0.06	0.05
40	0.27	0.22	0.11	0.09
50	0.64	0.52	0.25	0.21
60	1.36	1.12	0.57	0.48
70	3.77	3.11	1.75	1.47
80	9.43	8.09	5.28	4.60
90	22.55	20.57	16.35	14.88
100	41.82	40.46	36.03	34.63

Source: Authors' estimates and assumptions based on UN WPP, 2022 Revision.

According to the Department of Census and Statistics, the total fertility rate in Sri Lanka decreased significantly between 2012 and 2016, from 2.4 children per woman in 2012 to 2.2 children per woman in 2016.[12] Although the Department of Census and Statistics publishes regularly statistics on births, it does not regularly publish estimates of the total fertility rate. This is probably due to the fact that the Department of Census and Statistics does not have a clear picture of the age structure of the population of Sri Lanka for the years following the last census. In the absence of more recent national statistics on fertility, estimated and projected total fertility rates have been determined using the UN WPP, 2022 Revision It is assumed that the total fertility rate will continue to decrease throughout the projection period, from 2.00 children per woman in 2023 to 1.91 children per woman in 2033. The ratio of male births to female births was assumed constant at 1.044 over the projection period. Sample age-specific fertility rates are presented in table 3.3.

[12] These figures were derived from the Census of Population and Housing of 2012 and the Demographic and Health Survey Report of 2016.

▶ Table 3.3 Age-specific fertility rates, selected years

Age of the woman	Fertility rate		
	2023	2028	2033
15-19	0.0157	0.0146	0.0139
20-24	0.0776	0.0758	0.0747
25-29	0.1243	0.1184	0.1142
30-34	0.1141	0.1141	0.1151
35-39	0.0536	0.0522	0.0514
40-44	0.0133	0.0124	0.0118
45-49	0.0015	0.0014	0.0013
Total fertility rate	**2.00**	**1.94**	**1.91**

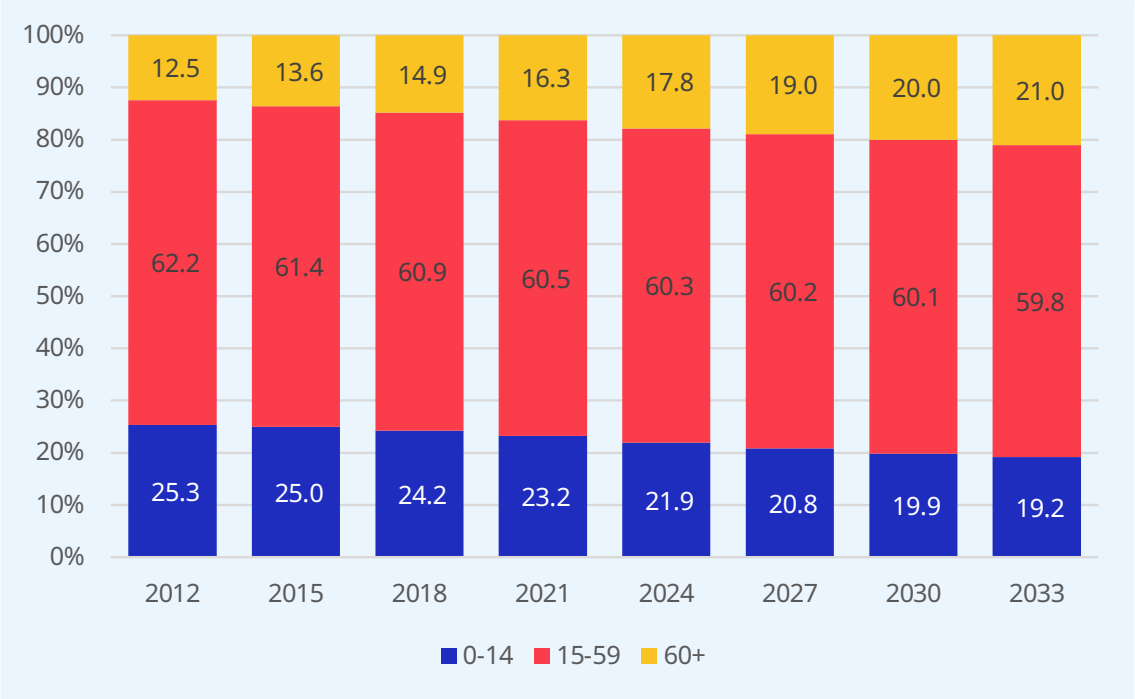
Source: Authors' estimates and assumptions based on the UN WPP, 2022 Revision.

According to the Department of Census and Statistics, the net migration rate in Sri Lanka varied annually between -10.1 and 3.5 migrants per 1,000 persons during the period 2013 to 2023. Over the period 2013-2023, the net migration rate averaged at -1.4 migrants per 1,000 persons.[13] For the cost assessment, the net migration rate is assumed unchanged over the projection period, at -3.5 migrants per 1,000 persons. This assumption is consistent with that of the UN WPP, 2022 Revision, and reflects the recent trends observed by the Department of Census and Statistics.

The population is projected to increase from 22,037,000 persons to approximately 22,320,000 persons between years 2023 and 2033, resulting in an average annual growth rate of about 0.1 per cent over the projection period of 10 years. This is slightly lower than the average growth experienced in the period 2018-2023 (0.3 per cent).

The evolution of the structure of the population over the period 2012-2033 is illustrated in figure 3.2. The working-age population (those aged 15 and over) increased as a percentage of the total population between 2012 and 2023, from 74.7 per cent in 2012 to 77.7 per cent in 2023. This ratio is projected to continue to increase in the future: the working-age population is projected to represent 80.8 per cent of the total population by 2033.

▶ Figure 3.2 Structure of the population, estimates (2012-2023) and projections (2024-2033)



Source: Authors' estimates based on data provided by the Department of Census and Statistics of Sri Lanka and the UN WPP, 2022-Revision, for years 2012-2023 and authors' projections for years 2024 to 2033.

Table 3.4 presents the estimated evolution of Sri Lanka' population aged 15+ (the working-age population) between

[13] Authors' estimates based on the Mid-Year Population release of September 2023 published by the Department of Census and Statistics.

2023 and 2033. The working-age population is projected to increase from about 17.1 million to approximately 18.0 million between 2023 and 2033, resulting in an average annual growth rate of about 0.5 per cent over the projection period of 10 years.

▶ Table 3.4 Estimated and projected working-age population of Sri Lanka, by age-group, selected years

Age	2023	2025	2027	2029	2031	2033
15-19	1,786,239	1,779,101	1,751,967	1,720,666	1,673,688	1,603,082
20-24	1,623,677	1,669,774	1,710,321	1,726,903	1,706,947	1,680,721
25-29	1,486,238	1,489,497	1,525,543	1,575,140	1,622,316	1,656,291
30-34	1,437,096	1,446,637	1,432,168	1,424,058	1,447,244	1,494,220
35-39	1,411,423	1,368,869	1,380,342	1,397,704	1,397,809	1,382,395
40-44	1,583,820	1,508,996	1,409,056	1,347,412	1,334,366	1,355,576
45-49	1,411,547	1,504,241	1,554,317	1,516,392	1,421,370	1,340,530
50-54	1,308,946	1,313,262	1,336,511	1,416,689	1,499,758	1,505,497
55-59	1,235,097	1,241,956	1,261,849	1,264,951	1,275,189	1,327,922
60-64	1,166,533	1,171,409	1,170,515	1,177,159	1,195,554	1,206,438
65-69	967,251	1,020,325	1,062,979	1,081,534	1,083,628	1,091,326
70-74	776,588	800,934	832,109	872,204	921,826	954,406
75-79	506,212	567,200	613,163	642,412	668,807	699,846
80-84	262,642	296,855	336,138	383,835	426,270	457,346
85+	161,164	172,137	191,653	216,319	244,996	284,592
Total 15-59	**13,284,084**	**13,322,335**	**13,362,073**	**13,389,916**	**13,378,687**	**13,346,234**
Total 15+	**17,124,474**	**17,351,195**	**17,568,630**	**17,763,380**	**17,919,767**	**18,040,188**

Source: Authors' estimates based on data provided by the Department of Census and Statistics of Sri Lanka and the UN WPP, 2022-Revision, for year 2023 and authors' projections for years 2025 to 2033.

3.2. Macro-economic assumptions

The base scenario incorporates economic indicators published by the Department of Census and Statistics of Sri Lanka. The latest economic forecasts published by the Economist Intelligence Unit have been used as the starting point for the base economic scenario.[14] The views of the ILO on the future development of the economy in the short, medium, and long terms have also been reflected in the base scenario.

The economic landscape of Sri Lanka has faced significant challenges in recent years. The country is going through its worst economic crisis since its independence in 1948. The Sri Lankan economic crisis has led to unprecedented levels of inflation, which reached 45.2 per cent in year 2022. Data from the Department of Census and Statistics, however, suggest that inflation started to decelerate in the first three quarters of 2023. In the base scenario, the annual inflation rate is estimated at 18.3 per cent in 2023. The annual inflation rate is projected to gradually reduce to 5.0 per cent from year 2026, a level similar to that observed prior to the economic crisis.

According to the Department of Census and Statistics of Sri Lanka, the national economy shrank by 7.8 per cent in 2022. In the base scenario, the real GDP is projected to contract again by 4.8 per cent in year 2023. The economy is then projected to recover slowly from year 2024. The real GDP is not expected to return to pre-debt default levels until after 2026, highlighting the long-lasting effects of the crisis.

The official unemployment rate is projected to increase from its estimated level of 4.7 per cent in 2022 to 6.4 per cent in 2023. Then, as the economy slowly recovers, the unemployment rate is projected to decrease gradually over the projection period, reaching 6.0 per cent in 2024, 5.7 per cent in 2025, 5.3 per cent in 2026 and 5.1 per cent in 2027. The unemployment rate is then assumed unchanged at 5.0 per cent from 2028 onwards.

The productivity growth rates are based on the assumed real GDP and employment growth rates over the projection period.

Table 3.5 presents the main economic indicators pertaining to the base scenario.

▶ Table 3.5 Main economic indicators, 2023–2033, base scenario (in %)

Year	Real GDP growth rate	Employment growth rate	Productivity growth rate	Annual inflation rate	Unemployment rate
2023	-4.8	-1.3	-3.6	18.3	6.4
2024	5.0	1.6	3.3	6.0	6.0
2025	4.2	1.5	2.7	5.5	5.7
2026	3.6	0.8	2.8	5.0	5.3
2027	3.5	0.6	2.9	5.0	5.1
2028	3.4	0.5	2.9	5.0	5.0
2029	3.3	0.3	3.0	5.0	5.0
2030	3.3	0.3	3.0	5.0	5.0
2031	3.3	0.3	3.0	5.0	5.0
2032	3.2	0.2	3.0	5.0	5.0
2033	3.2	0.2	3.0	5.0	5.0

Source: Authors' estimates and projections.

In this valuation, it is assumed that labour force participation rates, by age and sex, will gradually return to their pre- COVID-19 levels by 2025 and remain unchanged thereafter over the projection period. Table 3.6 presents a sample of the working-age population, labour force and employed population assumed in this valuation. This table focuses on persons aged 15 to 59, and therefore allows for the drawing of parallels between the labour force and employed population projections assumed in this valuation and the projected evolution of the active insured members below retirement age in Sri Lanka.

[14] Economist Intelligence Unit, October 2023.The October 2023 edition of the International Monetary Fund's World Economic Outlook contains no forecasts for Sri Lanka.

▶ **Table 3.6 Working-age population, labour force and employed population (ages 15-59), selected years, base scenario**

	2023	2025	2027	2029	2031	2033
Working-age population	**13,284,084**	**13,322,335**	**13,362,073**	**13,389,916**	**13,378,687**	**13,346,234**
Male	6,532,544	6,562,666	6,594,506	6,622,165	6,630,019	6,628,088
Female	6,751,540	6,759,669	6,767,567	6,767,751	6,748,667	6,718,146
Labour force participation rate (%)	**59.4%**	**60.5%**	**60.7%**	**60.8%**	**61.1%**	**61.4%**
Male	79.9%	80.7%	80.8%	81.0%	81.3%	81.7%
Female	39.5%	41.0%	41.1%	41.2%	41.3%	41.4%
Labour force population	**7,892,934**	**8,066,137**	**8,107,101**	**8,146,297**	**8,174,900**	**8,194,613**
Male	5,222,739	5,293,603	5,327,067	5,360,784	5,389,113	5,413,117
Female	2,670,195	2,772,534	2,780,034	2,785,514	2,785,787	2,781,497
Employed population	**7,326,659**	**7,550,116**	**7,642,049**	**7,687,375**	**7,713,449**	**7,731,362**
Male	4,949,323	5,053,305	5,110,122	5,146,488	5,173,367	5,196,197
Female	2,377,335	2,496,812	2,531,927	2,540,886	2,540,082	2,535,165
Unemployed population	**566,275**	**516,021**	**465,053**	**458,923**	**461,451**	**463,251**
Male	273,416	240,298	216,945	214,295	215,746	216,920
Female	292,859	275,723	248,107	244,628	245,705	246,332
Unemployment rate (%)	**7.2%**	**6.4%**	**5.7%**	**5.6%**	**5.6%**	**5.7%**
Male	5.2%	4.5%	4.1%	4.0%	4.0%	4.0%
Female	11.0%	9.9%	8.9%	8.8%	8.8%	8.9%

Source: Authors' estimates and projections.

3.3. Scheme-specific assumptions

Sections 3.3.1 to 3.3.8 discuss the scheme-specific assumptions used to assess the cost of an unemployment insurance scheme in Sri Lanka.

3.3.1. Active insured members

The distribution of the active insured members of the unemployment insurance scheme, disaggregated by age and sex, has been estimated based on the ETF data obtained for year 2022 as well as on the labour statistics data obtained from the Department of Census and Statistics of Sri Lanka. The ETF covers all employees in public and private sectors, including those employed on a casual, temporary, contract or piece-rate basis and any apprentice or learner who is paid a remuneration, irrespective of age. The coverage rate of the unemployment insurance scheme, by age and sex, is projected to remain unchanged throughout the projection period. In other words, the number of active insured members is projected to increase in line with the employed population aged 15 to 59 over the projection period.

Table 3.7 presents the estimated and projected number of active insured members in 2023, 2028 and 2033, by age and sex.

▶ **Table 3.7. Estimated and projected number of active insured members, by age and sex, 2023, 2028 and 2033**

Age	Males			Females		
	2023	2028	2033	2023	2028	2033
15–19	18,452	22,216	21,062	23,703	29,900	27,878
20–24	169,427	195,950	191,495	140,697	180,080	175,839
25–29	261,396	283,897	302,717	199,145	220,579	235,936
30–34	223,397	230,931	244,164	169,364	169,911	176,776
35–39	177,374	179,321	184,541	130,093	132,519	126,954
40–44	175,788	151,359	152,459	124,643	116,048	112,644
45–49	139,602	152,608	131,032	97,896	111,833	97,862
50–54	121,062	126,658	137,796	74,995	81,538	89,556
55–59	82,764	85,582	90,122	48,106	50,170	53,169
Total	**1,369,262**	**1,428,523**	**1,455,387**	**1,008,642**	**1,092,580**	**1,096,614**

Source: ILO estimates derived from ETF data as well as data obtained from the Department of Census and Statistics of Sri Lanka.

3.3.2. Density of contribution

The density of contribution refers to the number of months during which active insured members contribute to the scheme in a year. The densities of contribution are used to project the contribution income of the scheme, as well as to assess the ratio of members who would meet the contribution requirement for benefit eligibility. The densities of contribution, by age and sex, have been estimated based on the ETF data obtained for year 2022 as well as on the labour statistics data obtained from the Department of Census and Statistics of Sri Lanka.

An increase or decrease in the density of contribution of members may impact the cost of the scheme. As an example, an increase in the density of contribution will normally result in an increase in the scheme's contribution income but may also result in an increase in the number of eligible claimants (and therefore, in the scheme's benefit expenditure), depending on the scheme's contribution requirement for benefit eligibility.

Table 3.8 presents the estimated densities of contribution, by age and sex. These values are assumed unchanged throughout the projection period.

▶ **Table 3.8. Sample of average density of contribution, by age and sex (in month)**

Age	Males	Females	Total
20	4.1	3.9	4.0
25	5.2	4.9	5.1
30	7.7	7.3	7.5
35	10.0	9.3	9.7
40	10.4	9.7	10.1
45	10.6	9.9	10.3
50	10.8	10.0	10.5
55	10.6	9.8	10.3

Source: ILO estimates derived from ETF data as well as data obtained from the Department of Census and Statistics of Sri Lanka.

3.3.3. Contributory earnings and salary growth rate

The average contributory earnings, by age and sex, have been estimated based on the data obtained by the ETF for year 2022 as well as on the labour statistics data obtained from the Department of Census and Statistics of Sri Lanka. contributory earnings have been projected to 2023, the initial projection year, using the inflation and productivity growth rates presented in section 3.1.

Table 3.9 presents the estimated average monthly contributory earnings of the unemployment insurance scheme's members, by age and sex, for financial year 2023.

▶ Table 3.9. Average monthly contributory earnings, by age and sex, 2023 (in rupees)

Age	Males	Females	Total
15–19	38,777	32,918	35,483
20–24	46,839	37,476	42,591
25–29	59,373	49,551	55,125
30–34	65,296	52,839	59,925
35–39	65,815	50,546	59,355
40–44	66,915	50,090	59,934
45–49	67,762	51,480	61,051
50–54	69,264	56,106	64,231
55–59	73,596	64,139	70,120
Total	**62,903**	**49,593**	**57,257**

Source: ILO estimates derived from ETF data as well as data obtained from the Department of Census and Statistics of Sri Lanka.

The annual increase in the remuneration of an insured person normally consists of three components: changes in the cost of living (e.g. the consumer price index); the productivity increase; and the increase in personal productivity for work experience and seniority. Under normal circumstances, real wages may grow at a rate more or less similar to productivity. In this study, annual real wage growth was assumed consistent with the productivity growth rates assumed over the projection period. The salary scale has been assumed unchanged over the projection period.

Table 3.10 presents the assumed nominal salary growth rate over the projection period.

▶ Table 3.10. Assumed nominal salary growth rate, 2023–2033, base scenario (in %)

Year	Salary growth rate
2023	15.0
2024	9.5
2025	8.3
2026	7.9
2027	8.0
2028	8.1
2029	8.1
2030	8.1
2031	8.2
2032	8.2
2033	8.2

Source: Authors' estimates and projections.

3.3.4. Termination rates

The termination rates, by age and sex, have been estimated based on the data obtained by the ETF for year 2022 as well as on the labour statistics data obtained from the Department of Census and Statistics of Sri Lanka.

Termination rates in Sri Lanka, derived from labour force surveys conducted by the Department of Census and Statistics for the years 2010 to 2020, have remained generally stable year-on-year, by age and sex. These rates are however well below those suggested by the ETF data obtained for year 2022.

The higher termination rates suggested by the ETF data may be attributed to the few restrictions imposed on members to withdraw their accumulated contributions. While ETF members are not allowed to make a second or subsequent withdrawal claim until five years have passed since their last fund balance withdrawal, members may choose to withdraw their accumulated contributions from the scheme between two jobs without strict conditions or obligations (such as being able and available for work and actively searching for a job), as is typically the case with unemployment insurance schemes. Another explanation for the high termination rates in the ETF is the fact that its withdrawal benefits can be used for various purposes, and not limited solely to employment termination.

Indeed, withdrawal benefits can be used for various purposes, including reaching the age of 60, permanent residence migration, joining state services that qualify for a pension, facing termination of employment due to permanent disability, or in the event of a member's death (although these risks are generally relatively low at younger ages).

For this study, the termination rates, by age and sex, have been based on a combination of the data obtained by the Department of Census and Statistics as well as the data obtained by the ETF[15]. This approach allows to take into account the latest labour statistics in Sri Lanka, while reflecting the high utilization of withdrawal benefits by formal sector employees. An adjustment of 50 per cent on the resulting termination rates has also been applied for prudence in the context of limited data to support the setting of the termination rates assumptions, and to better compare with regional and international experience.

Table 3.11 presents the assumed termination rates over the projection period, by age and sex.

▶ Table 3.11. Annual termination rates, by age and sex (in percentage)

Age	Males	Females
20	6.10	6.68
25	5.15	7.11
30	4.50	6.67
35	3.52	6.45
40	3.27	5.48
45	2.93	4.94
50	2.97	3.98
55	3.10	3.90

Source: ILO estimates derived from ETF data as well as data obtained from the Department of Census and Statistics of Sri Lanka.

3.3.5. Ratio of involuntary terminations

Although there appear to be numerous employers subject to the TEWA, the number of employees who have claimed compensation under this regulation in recent years remains low as a proportion of formal sector employment. Indeed, between 2015 and 2020, only approximately 1,200 employees annually filed a claim under TEWA.[16] This is very low compared to the annual number of withdrawal benefits paid by the ETF, which ranged between 150,000 and 200,000 during the same period. It is, however, difficult to compare these number objectively. First, there could be under declaration of involuntary terminations from employers. Indeed, employers will often decide not to declare involuntary terminations in order to avoid paying the statutory severance payment to the terminated employee. Furthermore, employers using more flexible types of contracts, such as temporary contracts, could avoid paying severance payment simply by not renewing contracts when they expire.

In this study, an involuntary termination rate of 60 per cent was assumed. This rate is significantly higher than that suggested by the data obtained from the Department of Labour of Sri Lanka, but is closer to the experience observed in other countries having an unemployment insurance scheme in place.

3.3.6. Duration of unemployment

In the design options discussed in Chapter 2, the unemployment insurance benefit will be paid for a maximum period of either 3 months (Option A) or 6 months (Option B).

For this cost assessment, the unemployment duration has been assumed consistent with the labour statistics obtained from the Department of Census and Statistics, and more specifically the microdata on the labour force surveys carried out between 2010 and 2020 in Sri Lanka. Extrapolation has been made from the data obtained. The following assumptions have been retained:

[15] In this valuation, more weight (75%) is placed on the ETF withdrawal rate experience compared to the weight (25%) of unemployment rates.

[16] Includes complaints received from employees.

- Assuming a waiting period of 7 calendar days, male and female beneficiaries will receive, on average, respectively about 2.7 and 2.8 months of benefits under Option A (benefits paid for a maximum of 3 months); and
- Assuming a waiting period of 7 calendar days, male and female beneficiaries will receive, on average, respectively about 4.4 and 4.7 months of benefits under Option B (benefits paid for a maximum of 6 months).

3.3.7. Administrative expenses

Unemployment insurance schemes are among the social security schemes that are the most difficult to administer, particularly because of the annual volume of claims and the need for the scheme to carry out regular controls to prevent fraud. Claims must be carefully reviewed and linkages with active labour market policies promoted and monitored.

Since no precise budget exists yet for the new scheme, it was necessary to make an assumption regarding administrative expenses. The administrative expenses of unemployment schemes can vary between 5 and 15 per cent of benefit payment amounts. For this valuation, it is preferable to express the administrative expenses as a percentage of the total insurable earnings, which are projected to be more stable over time, in particular for new schemes. In the base scenario, it was assumed that administrative expenses would be equal to 0.30 per cent of the total insurable earnings of the contributors. This rate excludes any additional cost that could be required to set up active labour market policies. Such a level of expense would be comparable to other unemployment insurance schemes managed by social security organizations in other countries.

It is important to note that initial expenses in setting up the mechanisms of a new scheme may be significant. However, part or all of these initial expenses may be met from other financing sources, and further clarification would be needed for a more detailed analysis of scheme costs.

3.3.8. Rate of return of the fund

Short-term benefits schemes, such as unemployment insurance schemes, require higher levels of liquidity than long-term ones. As a consequence, such funds tend to focus on short-term investments as compared to pension schemes and therefore tend to experience lower investment returns. As a base scenario, it was simply assumed that the fund would generate a real return of zero per cent per year over the projection period. This means that the reserve will just maintain its real value against inflation.

It is worth stating that the cost of the scheme is not very sensitive to this assumption since the scheme has no accumulated reserve at the start of the projection period and the reserve of the fund is projected to remain relatively low over the projection period (this is normally the case for schemes providing short-term benefits).

▶ 4. Cost assessment of proposed design options

Section 4.1 of this chapter presents the demographic and financial projections of the unemployment insurance scheme under the two design options described in Chapter 2 while considering the key projection assumptions presented in Chapter 3. Section 4.2 also presents the recommended contribution rate under various sensitivity tests. The general methodology of the valuation is described in Annex 1.

In this report, it is assumed that the unemployment insurance scheme will be implemented on 1 January 2024. It should be noted that, however, the implementation date of 1 January 2024 has been adopted for illustration purposes only. If the Government decides to implement the scheme later on, e.g. in 2025 or 2026, and the country's economic context and the characteristics of the labour market remain relatively similar to that observed and projected in this report, then the findings and conclusions from this section will remain appropriate. As mentioned in Chapter 3, a projection period of 10 years has been retained in this cost assessment. Such a period of projection not only allows the drawing of conclusions on the sustainability of the scheme, but also contributes to providing a good picture of the scheme's sensitivity to assumptions or changes to benefits. The assumed implementation date of the scheme being on 1 January 2024, the fund was projected until 31 December 2033.

It is worth noting that the main purpose of the cost assessment is to determine the most likely range of contribution rate that will be sufficient to finance an unemployment insurance scheme under different design options over the selected projection period, and not to forecast exact numerical values. Subsequent actuarial valuations are important to assess the development of the scheme.

4.1. Demographic and financial projections

Table 4.1 presents the average number of monthly contributors and the average annual insurable earnings over the projection period (2024 to 2033) for design options A and B.[17] The average number of monthly contributors refers to the total number of contributors of the scheme, adjusted to reflect the density of contribution of the members during each year. The total number of contributors of the unemployment insurance scheme is projected to increase from approximately 2.4 to 2.6 million between 2024 and 2033; the average number of monthly contributors is projected to increase from about 1.6 to 1.7 million over the projection period.

▶ Table 4.1. Projected number of contributors and contributory earnings, 2024-2033

Year	Total number of contributors (A)	Average density of contribution (in months) (B)	Average number of monthly contributors (C = A x B / 12)	Average monthly contributory earnings (in rupees) (D)	Total annual contributory earnings (in millions of rupees) (C x D)
2024	2,420,687	8.18	1,650,985	64,856	1,284,915
2025	2,465,851	8.14	1,673,617	70,080	1,407,436
2026	2,490,865	8.11	1,684,129	75,549	1,526,808
2027	2,507,963	8.09	1,691,165	81,586	1,655,707
2028	2,521,103	8.08	1,696,672	88,156	1,794,853
2029	2,529,755	8.07	1,700,503	95,327	1,945,248
2030	2,537,653	8.06	1,704,318	103,110	2,108,784
2031	2,543,921	8.06	1,707,609	111,581	2,286,431
2032	2,548,765	8.05	1,710,705	120,768	2,479,186
2033	2,552,001	8.06	1,713,644	130,738	2,688,462

Source: ILO calculations.

Table 4.2 presents the annual number of involuntary terminations and the number of eligible claims (or new beneficiaries) under each design option. The number of involuntary terminations is projected at around 77,000 per

[17] Design options A and B consider the exact same definition of coverage and insurable earnings.

year on average.

The time required for an unemployment insurance scheme to reach maturity depends mainly on its contribution requirement, maximum benefit duration and waiting period. While the same waiting period of 7 days is considered in the two design options assessed, contribution requirement and maximum benefit duration differ from an option to another.

Under *design option A*, terminated members are required to have accumulated at least 6 months of contributions in the unemployment insurance scheme over the 12-month period prior to an involuntary termination. Therefore, no benefit payment is projected to be paid in the first half of 2024 under this design option. Design option A is projected to reach its maturity in its second year of implementation. From then on, it is projected that about 72 per cent of involuntarily terminated members, or 55,500 persons per year on average, will meet the contribution requirement of the scheme and receive an unemployment insurance benefit for an average period of approximately 2.7 months.

Under *design option B,* terminated members are required to have accumulated at least 12 months of contributions in the unemployment insurance scheme over the 24-month period prior to an involuntary termination. Therefore, no benefit payment is projected to be paid in 2024 under this design option. Design option B is projected to reach its maturity in its third year of implementation. From then on, it is projected that about 75 per cent of involuntarily terminated members, or 57,900 persons per year on average, will meet the contribution requirement of the scheme and receive an unemployment insurance benefit for an average period of about 4.5 months.

▶ Table 4.2. Projected number of involuntary terminations and eligible claims, design options A and B, 2024-2033

	Average number of monthly contributors	Involuntary termination rates (in %)	Annual number of involuntary terminations	Option A		Option B	
Year	(A)	(B)	(C = A x B)	Eligibility rates (in %) (D)	Number of new beneficiaries (C x D)	Eligibility rates (in %) (E)	Number of new beneficiaries (C x E)
2024	1,650,985	4.53	74,865	35.02	26,220	-	-
2025	1,673,617	4.55	76,137	72.16	54,938	65.83	50,119
2026	1,684,129	4.56	76,743	71.92	55,197	74.90	57,483
2027	1,691,165	4.56	77,135	71.76	55,349	74.76	57,663
2028	1,696,672	4.56	77,429	71.62	55,456	74.64	57,795
2029	1,700,503	4.56	77,618	71.53	55,517	74.56	57,875
2030	1,704,318	4.57	77,808	71.44	55,588	74.50	57,966
2031	1,707,609	4.57	77,979	71.38	55,658	74.45	58,054
2032	1,710,705	4.57	78,139	71.34	55,742	74.42	58,153
2033	1,713,644	4.57	78,284	71.33	55,844	74.43	58,266

Source: ILO calculations.

Table 4.3 presents the projected benefit expenditure related to eligible claims (or new beneficiaries) under each design option.

▶ Table 4.3. Projected benefit expenditure related to new beneficiaries, design options A and B, 2024-2033

	Option A				Option B			
Year	Number of new beneficiaries (A)	Average monthly benefit of new beneficiaries (B)	Average benefit duration (in month) (C)	Benefit expenditure (in million of rupees) (A x B x C)	Number of new beneficiaries (D)	Average monthly benefit of new beneficiaries (E)	Average benefit duration (in month) (F)	Benefit expenditure (in million of rupees) (D x E x F)
2024	26,220	28,104	2.72	2,004.1	-	-	-	-

2025	54,938	30,481	2.72	4,554.8	50,119	33,221	4.53	7,524.0
2026	55,197	32,902	2.72	4,939.8	57,483	35,677	4.53	9,271.5
2027	55,349	35,531	2.72	5,349.1	57,663	38,514	4.53	10,039.8
2028	55,456	38,398	2.72	5,791.8	57,795	41,617	4.53	10,872.7
2029	55,517	41,522	2.72	6,269.8	57,875	44,998	4.53	11,771.3
2030	55,588	44,913	2.72	6,790.2	57,966	48,671	4.53	12,751.2
2031	55,658	48,598	2.72	7,356.4	58,054	52,661	4.53	13,816.7
2032	55,742	52,598	2.72	7,973.7	58,153	56,996	4.53	14,978.9
2033	55,844	56,937	2.72	8,647.0	58,266	61,700	4.53	16,245.4

Source: ILO calculations.

Contrary to a pension scheme, which provides for long term benefits accruing over 20 to 30 years and thereafter payable for 20 to 30 years, an unemployment insurance scheme provides for short-term benefits paid over a period of generally less than one year. Pension schemes require a funding policy, either formal or informal, to determine the level of pre-funding of their long-term liabilities, from pay-as-you-go (PAYG) to full funding. By nature, short-term benefits are financed on a broadly PAYG basis and, normally, short-term benefit schemes (and particularly unemployment insurance schemes) keep a contingency reserve in order to absorb unexpected increases in benefits and/or fall in contributions as well.

Due to the short-term nature of the benefits and the fact they are influenced by economic conditions which can be volatile (for example, during Covid-19), the PAYG cost of an unemployment insurance scheme vary more and over shorter periods than the PAYG cost rates of a pension scheme. The ISSA-ILO Guidelines for Actuarial Work[18] (Guideline 26) suggest that unemployment insurance schemes carry out actuarial reviews on an annual basis in order to assess the appropriate contribution rate according to a predefined rate-setting mechanism and principles. It is recommended that a full actuarial valuation be carried out every 3 years. Whilst this doesn't mean that contribution rates to the scheme need to change regularly – indeed, the aim of building up reserves and the use of prudent assumptions is to avoid this occurring – it is important that an evaluation of the financial situation of the scheme is monitored regularly. This is particularly important for a new UI scheme such as this one.

In order to assess the level of the contribution rate that would be required for the design option assessed, the following mechanism was used:

- The contribution rate is established based on a projection of the revenue and expense over a ten-year period, with the objective to accumulate a stabilisation reserve equivalent to at least twice the last year of the projection period expenditures (benefits and administrative expenditures) at the end of the projected period. The mechanism used also provides that over a ten-year projection period, the ratio of the reserve to annual expenditures will never be less than zero. In other words, the reserve will remain positive for the entire projection period.

Economic studies have shown that abrupt changes in contribution rates are detrimental to job creation and retention, so should therefore be avoided during a recession (but also during economic boom periods where reserves should be built up). This leads to the necessity of establishing sufficient contingency reserves, to allow contribution rates to remain level, when economic downturns occur. However, the size of such reserves can become a political issue. Groups that would want to reduce benefits or fraglise a system may see large reserves as a justification for pressing their demands, while some public authorities may see large unemployment insurance reserves as a convenient source of funding for other projects. In both cases, there would be the risk of depleting reserves below safe levels. A rate setting mechanism would provide guidance in order to define the appropriate level of contingency reserve and contribution rate for the systems.

Table 4.4 presents the recommended contribution rates for design options A and B. The key findings of the financial projections are presented below:

- **Option A:** A contribution rate of 0.60 per cent of earnings (0.30 per cent for the benefit expenditure and 0.30 per cent for the administrative expenditure) would be sufficient to pay all the expenditures over the projection period (no accumulation of a stabilization reserve at the end of the projection period). An additional contribution rate of 0.15 per cent is necessary in order to accumulate a stabilization reserve equivalent to twice

[18] https://www.social-protection.org/gimi/ShowRessource.action?id=54220

the annual projected expenditures (benefits and administrative expenditures) in the last year of the projection period. An additional contribution rate of 0.15 per cent of earnings is necessary in order to accumulate the stabilization reserve equivalent to at least twice that of the last year of the projection period expenditures (benefits and administrative expenditures). The recommended contribution rate is therefore **0.75 per cent** of earnings and should be divided equally between employers and employees.

- **Option B:** A contribution rate of 0.83 per cent (0.53 per cent for the benefit expenditure and 0.30 per cent for the administrative expenditure) would be sufficient to pay all the expenditures over the projection period (no accumulation of a stabilization reserve at the end of the projection period). An additional contribution rate of 0.22 per cent is necessary in order to accumulate a stabilization reserve equivalent to twice the annual projected expenditures (benefits and administrative expenditures) in the last year of the projection period. The recommended contribution rate is therefore **1.05 per cent** of earnings and should be divided equally between employers and employees.

Table 4.4 Recommended contribution rate, design options A and B (in %)

	Option A	Option B
Benefit expenditure	0.30	0.53
Administrative expenditure	0.30	0.30
Minimum contribution rate to ensure the scheme's sustainability over the projection period [(a)]	**0.60**	**0.83**
Additional contribution rate to accumulate a stabilization reserve	0.15	0.22
Recommended contribution rate [(b)]	**0.75**	**1.05**

Notes: (a) Assumes no stabilization reserve at the end of the projection period. (b) Refers to the contribution rate that would be required to allow the scheme to accumulate a stabilization reserve equivalent to at least twice the last year of the projection period expenditures (benefits and administrative expenditures) over a projection period of ten years.
Source: ILO calculations.

It is worth noting that the above-mentioned recommended contribution rates exclude any cost related to active labour market programmes. Funding for active labour market programmes usually comes from the budget of ministries in charge of labour, job creation and education. However, in some countries, unemployment insurance schemes do finance a portion of such active labour market programmes. If that were to be the case in Sri Lanka, then appropriate allowance in the recommended contribution rate should be made.

4.2. Sensitivity tests

Given the uncertainty of economic forecasts, the actuarial valuation of an unemployment insurance scheme cannot, of course, pretend to project the future with perfect accuracy. Projections are based on actuarial valuation models and assumptions, and the results are sensitive to the assumptions chosen There is greater uncertainty when a new scheme is costed due to the lack of historical scheme data. When using a deterministic model, sensitivity analysis is the only way of showing the potential variability of results. This can be performed on assumptions that have the most impact on future costs or, alternatively, on assumptions that present a lower level of credibility because of a lack of data.

In this study, the following sensitivity tests have been performed to better understand the risks related to the unemployment insurance scheme under design options A and B:

- **Real salary growth rate:** the sustainability of a short-term benefit scheme is largely unaffected by real wage growth. One of the reasons for this is that both benefit payment amounts and the level of contributions paid in the future are influenced by this factor. This sensitivity test presents the impact of an increase in the real salary growth rate by 1.0 per cent throughout the projection period as well as the impact of a decrease in the real salary growth rate by 1.0 per cent throughout the projection period.
- **Termination rates:** the assumption on termination rates is sensitive, that is, results are significantly impacted by changes in this variable. The sensitivity tests performed present the impact of assuming termination rates that are up to 25 per cent higher (or lower) than that assumed in the base scenario. These sensitivity tests show that an under-estimation of the termination rates throughout the projection period should not, alone, compromise the scheme's sustainability (as long as the recommended contribution rate is applied).
- **Ratio of involuntary terminations (as a proportion of all terminations):** this assumption is sensitive, that is, results are significantly impacted by changes in this variable.. In the base scenario, the ratio of involuntary

terminations is assumed at 60 per cent. This sensitivity test presents the impact of an increase in the ratio of involuntary terminations to 70 per cent and a decrease in the ratio of involuntary terminations to 50 per cent. These sensitivity tests show that an under-estimation of the involuntary termination rates throughout the projection period should not, alone, compromise the scheme's sustainability (as long as the recommended contribution rate is applied).

- **Average benefit duration:** this sensitivity test presents the impact of an increase in the average benefit duration by 1 week and a decrease in the average benefit duration by 1 week over the projection period. The sensitivity tests show that an under- or over-estimation of the average benefit duration over the projection period should not, on its own, compromise the scheme's sustainability (as long as the recommended contribution rate is applied).
- **Administrative expenses:** this sensitivity test presents the impact of an increase in the administrative expenses by 0.05 per cent of the total insurable earnings to 0.35 per cent as well as decrease in the administrative expenses by 0.05 per cent of the total insurable earnings to 0.25 per cent.
- **Real rate of return of the fund:** this assumption is not very sensitive since the scheme has no accumulated reserve at the start of the projection period and the reserve of the fund is projected to remain relatively low over the projection period (this is normally the case for short-term benefit schemes). This sensitivity test presents the impact of an increase in the real rate of return of the fund by 1.0 per cent throughout the projection period and a decrease in the real rate of return of the fund by 1.0 per cent throughout the projection period.

Table 4.5 presents the results of the above-mentioned sensitivity tests. The sensitivity tests show that a change in one assumption does not undermine the scheme's sustainability with the recommended contribution rate being paid. This confirms the robustness of the recommended contribution rates.

▶ Table 4.5 Sensitivity tests, design options A and B

Sensitivity test	Option A		Option B	
	Recommended contribution rate (in %) [1]	Reserve ratio at the end of the projection period assuming a contribution rate of 0.75% [2]	Recommended contribution rate (in %) [1]	Reserve ratio at the end of the projection period assuming a contribution rate of 1.05% [2]
Base scenario	**0.75**	**2.0**	**1.05**	**2.0**
Real salary growth rate				
- Real salary growth rate + 1.0%	0.75	2.0	1.05	2.0
- Real salary growth rate - 1.0%	0.75	2.0	1.05	2.0
Termination rates				
- Termination rates + 25%	0.85	0.9	1.20	0.8
- Termination rates - 25%	0.65	3.7	0.90	4.2
Ratio of involuntary terminations				
- Ratio of involuntary terminations + 10%	0.80	1.3	1.15	1.2
- Ratio of involuntary terminations - 10%	0.70	3.1	0.95	3.5
Average benefit duration				
- Average benefit duration + 1 week	0.80	1.7	1.10	1.9
- Average benefit duration - 1 week	0.75	2.6	1.00	2.5
Administrative expenses				
- Administrative expenses + 0.05%	0.80	1.3	1.10	1.6
- Administrative expenses - 0.05%	0.70	3.1	1.00	2.9
Real rate of return of the fund				
- Real rate of return of the Fund + 1.0%	0.75	2.0	1.05	2.0
- Real rate of return of the Fund - 1.0%	0.75	2.0	1.05	2.0

(1) Refers to the recommended contribution rate under each scenario highlighted. (2) The accumulated reserves at the end of the projection period for each scenario if the recommended contribution rate under the specified design option, under the base scenario is paid.
Source: Authors' calculations.

▶ 5. Cost assessment of alternative design options

This chapter discusses three alternative design options proposed by stakeholders during the ILO mission conducted in December 2023.

It is worth noting that, although alternative design options have been derived from and based on stakeholders' inputs, they may not perfectly align with their actual suggestion. Some parameters are difficult, if not impossible, to model with the limited data obtained as part of this project, and therefore suggestions from stakeholders have sometimes been simplified. The essence of stakeholders' suggestions is nevertheless, in our opinion, properly reflected in this chapter and proposed parameters that were either difficult or impossible to assess quantitatively are discussed qualitatively in Section 5.4.

It is also important to note that the three alternative design options reflect the specific views of three different stakeholders, and therefore may not fully align with ILO Conventions and Recommendations. As mentioned in Chapter 2, it is normally recommended to consider the implementation of a simple unemployment insurance scheme that would provide not too generous benefits as a first step (consistent with design options A and B presented in Chapter 2) and improve the benefits or target additional groups of workers such as the self-employed thereafter, once the scheme is proven to be efficient and sustainable and the effectiveness of the scheme's control mechanisms is demonstrated.

Table 5.1 presents an overview of the key parameters of the three alternative design options.

▶ Table 5.1 Key parameters of three alternative design options for Sri Lanka

Parameter	Alternative option 1	Alternative option 2	Alternative option 3
Coverage	Mandatory coverage for all paid employees (excluding self-employed and voluntary affiliations)		
Contribution requirement for benefit eligibility	12 months in the 24-month period preceding the employment termination	24 consecutive months preceding the employment termination	6 months in the 12-month period preceding the employment termination
Eligible reasons for termination of employment and continuation of benefits	– Involuntary termination of employment or forced termination – Able and available for work and actively searching for a job		
Contributory earnings	Monthly salary		
Unemployment benefit	– For the first 3 months, the unemployment benefit is calculated as 50% of the average contributory earnings declared in the 12-month period preceding the employment termination. The unemployment benefit reduces to 40% after 3 months. – The unemployment benefit is paid for a maximum duration of 3 to 6 months, depending on the past service recognized under the scheme	– The unemployment benefit is calculated as 50% of the average contributory earnings declared in the 12-month period preceding the employment termination. – The unemployment benefit is paid for a maximum duration of 6 months	– The unemployment benefit is calculated as 60% of the average contributory earnings declared in the 6-month period preceding the employment termination. – The unemployment benefit is paid for a maximum duration of 24 months
Waiting period	7 days		

Source: Authors' proposals based on discussions with stakeholders.

5.1. Alternative design option 1

This option is similar to design option B presented in Chapter 4, but proposes a different formula for the calculation of the unemployment benefit. Under this alternative design option, the unemployment benefit is reduced from 50

per cent to 40 per cent of the average contributory earnings after 3 months. In addition, this option suggests the following:

- Members with up to 24 months of contributions[19] in the scheme prior to termination will be eligible to receive an unemployment benefit for a maximum period of 3 months;
- Members with 24 to 36 months of contributions in the scheme prior to termination will be eligible to receive an unemployment benefit for a maximum period of 4 months; and
- Members with more than 36 months of contributions in the scheme prior to termination will be eligible to receive an unemployment benefit for a maximum period of 6 months.

The data obtained do not allow to estimate precisely the cost of an unemployment insurance scheme whose maximum benefit duration is linked to the service accumulated in the scheme prior to termination. To assess the cost related to this alternative design option, a range for the recommended contribution rate is presented. The lower value assumes that all new claimants will have less than 24 months of contribution at termination (best case scenario); the higher value assumes that all new claimants will have more than 36 months of contributions at termination (worst case scenario). The actual cost of this design should be between these two values. It is however impossible with the data obtained to know if the actual cost will be closer to the higher or lower contribution rate stated in Table 5.2 below. Collecting data and statistics on the scheme's members and beneficiaries, once the scheme is implemented, will allow to precise the actual cost of this alternative design option.[20]

Table 5.2 presents a range for the recommended contribution rate for this alternative design option.

▶ Table 5.2 Recommended contribution rate, alternative design option 1 (in %)

	Alternative design option 1
Benefit expenditure	0.32–0.49
Administrative expenditure	0.30
Minimum contribution rate to ensure the scheme's sustainability over the projection period [(a)]	**0.62–0.79**
Additional contribution rate to accumulate a stabilization reserve	0.18–0.21
Recommended contribution rate [(b)]	**0.80–1.00**

Notes: (a) Assumes no stabilization reserve at the end of the projection period. (b) Refers to the contribution rate that would be required to allow the scheme to accumulate a stabilization reserve equivalent to at least twice the last year of the projection period expenditures (benefits and administrative expenditures) over a projection period of ten years.
Source: ILO calculations.

As presented in the above table, a contribution rate ranging from 0.62 to 0.79 per cent would be sufficient to pay all the expenditures over the projection period (no accumulation of a stabilization reserve at the end of the projection period). An additional contribution rate ranging from 0.18 to 0.21 per cent is necessary in order to accumulate the stabilization reserve equivalent to at least twice that of the last year of the projection period expenditures (benefits and administrative expenditures). The recommended contribution rate for this alternative design option ranges from 0.80 to 1.00 per cent and should be divided equally between employers and employees.

5.2. Alternative design option 2

This option is similar to design option B presented in Chapter 4, but is significantly more strict in terms of eligibility. This alternative option requires members to have paid at least 24 consecutive months of contribution prior to termination. It is worth noting that such contribution requirement is longer than what is considered necessary to prevent abuse, and therefore does not comply with ILO Conventions Nos. 102 and 168. In fact, it is projected that less than 55 per cent of involuntarily terminated members will meet the contribution requirement of the scheme under this alternative design option. This compares with eligibility rates of approximately 72 per cent under Option A and 75 per cent under Option B.

[19] Total contribution history – the requirement is not for the 24 months to be consecutive; this applies for those with 24 to 36 months and over 36 months respectively

[20] This is also discussed in section 6.1. of the report.

Table 5.3 presents the recommended contribution rate for this alternative design option.

▶ Table 5.3 Recommended contribution rate, alternative design option 2 (in %)

	Alternative design option 2
Benefit expenditure	0.36
Administrative expenditure	0.30
Minimum contribution rate to ensure the scheme's sustainability over the projection period [(a)]	**0.66**
Additional contribution rate to accumulate a stabilization reserve	0.19
Recommended contribution rate [(b)]	**0.85**

Notes: (a) Assumes no stabilization reserve at the end of the projection period. (b) Refers to the contribution rate that would be required to allow the scheme to accumulate a stabilization reserve equivalent to at least twice the last year of the projection period expenditures (benefits and administrative expenditures) over a projection period of ten years.
Source: ILO calculations.

As presented in the above table, a contribution rate of 0.66 per cent (0.36 per cent for the benefit expenditure and 0.30 per cent for the administrative expenditure) would be sufficient to pay all the expenditures over the projection period (no accumulation of a stabilization reserve at the end of the projection period). An additional contribution rate of 0.19 per cent is necessary in order to accumulate the stabilization reserve equivalent to at least twice that of the last year of the projection period expenditures (benefits and administrative expenditures). The recommended contribution rate for this alternative design option is 0.85 per cent and should be divided equally between employers and employees.

5.3. Alternative design option 3

This alternative design option considers the same exact contribution requirement as under design option A but proposes a different formula for the calculation of the unemployment benefit: the unemployment benefit is calculated as 60 per cent of the average contributory earnings declared in the 6-month period preceding the employment termination, and the unemployment benefit is paid for a maximum duration of 24 months. This scenario assumes that males and females will receive, on average, respectively about 13.7 and 15.5 months of benefits.

Table 5.4 presents the recommended contribution rate for this alternative design option.

▶ Table 5.4 Recommended contribution rate, alternative design option 3 (in %)

	Alternative design option 3
Benefit expenditure	2.04
Administrative expenditure	0.30
Minimum contribution rate to ensure the scheme's sustainability over the projection period [(a)]	**2.34**
Additional contribution rate to accumulate a stabilization reserve	0.56
Recommended contribution rate [(b)]	**2.90**

Notes: (a) Assumes no stabilization reserve at the end of the projection period. (b) Refers to the contribution rate that would be required to allow the scheme to accumulate a stabilization reserve equivalent to at least twice the last year of the projection period expenditures (benefits and administrative expenditures) over a projection period of ten years.
Source: ILO calculations.

As presented in the above table, a contribution rate of 2.34 per cent (2.04 per cent for the benefit expenditure and 0.30 per cent for the administrative expenditure) would be sufficient to pay all the expenditures over the projection period (no accumulation of a stabilization reserve at the end of the projection period). An additional contribution rate of 0.56 per cent is necessary in order to accumulate the stabilization reserve equivalent to at least twice that of the last year of the projection period expenditures (benefits and administrative expenditures). The recommended contribution rate for this alternative design option is 2.90 per cent and should be divided equally between employers and employees.

5.4. Qualitative assessment of specific parameters

The data on which contributory earnings have been estimated in this study remain limited and, as a result, it is impossible to assess precisely the cost related to a minimum or a maximum benefit in the unemployment insurance scheme, nor comment on or recommend minimum and maximum benefit levels. Setting up a minimum or a maximum benefit involves careful considerations to strike a balance between providing adequate financial support for unemployed and ensuring the financial sustainability of the system.

The introduction of a minimum benefit (e.g. equivalent to the minimum wage) is likely to increase the cost of the scheme, while the introduction of a maximum benefit could contribute to reduce the cost of the scheme. Additional data must however be collected to assess the impact of introducing a minimum and/or a maximum benefit. This could be considered at the next actuarial valuation.

As previously mentioned, it is normally recommended to consider the implementation of a simple unemployment insurance scheme that would provide not too generous benefits as a first step (similar as in design options A and B) and improve the benefits, or target additional groups of workers thereafter, once the scheme is proven to be efficient and sustainable. After a few months of the scheme's operation, with data and statistics collected on members and beneficiaries it will be significantly easier to assess the cost of such additional provisions and provide guidance to decision makers for policy design. On this basis, the ILO would support the consideration of a minimum benefit amount.

6. Additional considerations and recommendations

This section presents additional considerations and recommendations, not elsewhere specified in this report, for the implementation of the unemployment insurance scheme in Sri Lanka.

6.1. Proper monitoring and data collection

Assessing the cost of an unemployment insurance scheme does require very specific data and a historical perspective of the economic and demographic context and the labour market. Once the unemployment insurance scheme is implemented, it will be important to continue collecting data and statistics on its members and beneficiaries to build a better understanding of the interactions between demography, economy and the labour market. Collecting such data and statistics will not only contribute to an improved monitoring of the scheme, but also provide guidance to decision makers for policy design.

Regular monitoring is particularly important due to the short-term nature of unemployment insurance benefits. In fact, contribution rates of an unemployment insurance scheme typically need to be assessed more frequently than the contribution rates of a pension scheme. The ISSA-ILO Guidelines for Actuarial Work[21] (Guideline 26) suggest that unemployment insurance schemes carry out actuarial reviews on an annual basis in order to revise the contribution rate according to a predefined rate-setting mechanism with a full actuarial valuation every 3 years. This is particularly important in the first few years of the scheme's operations.

6.2. Administration of the unemployment insurance scheme

The administration of unemployment insurance schemes shares many of the general characteristics of other social security branches. Nonetheless, it includes the challenge to prevent the simultaneous receipt of unemployment benefit and earnings from work, which is aggravated in a context of high levels of informality in the labour market. Consequently, the institution administering the unemployment insurance scheme must embrace good governance principles to deliver the benefits effectively and according to legislation. The principles of accountability, transparency, predictability, participation and dynamism apply to unemployment insurance schemes. [22]

International labour standards on social protection set out common rules of collective organization, financing and management of social security, as well as principles for the good governance of national systems. These include:

- the general responsibility of the State for the due provision of benefits and proper administration of social security systems;
- solidarity, collective financing and risk-pooling;
- participatory management of social security schemes;
- guarantee of defined benefits;
- adjustment of pensions in payment to maintain the purchasing power of beneficiaries; and
- the right to complain and appeal.

ILO Convention No. 102 also prescribes that where the administration of the unemployment insurance scheme is not entrusted to an institution regulated by the public authorities or to a Government department responsible to a legislature, representatives of the persons protected shall participate in the management, or be associated therewith in a consultative capacity, under prescribed conditions; national laws or regulations may likewise decide as to the participation of representatives of employers and of the public authorities.

[21] https://www.social-protection.org/gimi/ShowRessource.action?id=54220
[22] See ISSA guidelines on good governance of social security institutions.

Worldwide, unemployment insurance schemes are administered by different organizations that have been established considering historical developments and national contexts, as follows:

- social security organizations;
- autonomous employment agencies;
- department within the ministry in charge of labour or employment;
- unemployment fund managers - public or private - (individual account schemes);
- private funds/associations of workers (employees and the self-employed); and
- decentralized to organization in administrative/regional divisions.

In the case of Sri Lanka, it is recommended to study which would be the most efficient institution to administer the unemployment insurance scheme. This institution will have the key role to administer the scheme, and build partnerships to link the unemployment insurance scheme with active labour market programmes.

6.3. Case management and linkages with Active Labour Market Programmes

Unemployment insurance is probably one of the most challenging social security benefits to administer, in view of the need to prevent the simultaneous receipt of unemployment benefit and earnings from work. Benefit claims must be carefully checked and efforts of jobseekers to find employment closely monitored, necessitating a well-staffed employment services unit. Limited government administrative capacities to manage an unemployment insurance scheme and monitor job-search could add to the concerns. Restricting the access and generosity of unemployment benefits might limit these leakages, but at the cost of reducing the reach and potential benefit of unemployment insurance schemes.

In order to achieve one of the main goals of the unemployment insurance scheme, which is to increase employability and help employees find suitable jobs, case management and employment services play a crucial role. It is therefore strongly recommended to study how the case management and employment services can be efficiently handled in Sri Lanka.

6.4. Social dialogue for effective implementation

The principles of tripartism and social dialogue are key for social protection development, reforms and governance. Social dialogue is a mechanism for participation and consensus building in the world of work and it is key for designing and implementing social protection policies, including in contexts of crisis. Countries that have well-established social dialogue structures are better equipped to integrate the voices of workers' and employers' organizations in their response efforts. It is important to ensure that the concerns of all types of enterprises and businesses, all categories of workers, including those (economic units and workers) in the informal economy, and representative of beneficiaries are represented in order to build more balanced responses, including better-adapted social protection measures.

ILO Conventions Nos. 102 and 168 address social dialogue and tripartite participation in the policy design and implementation phases, as follows:

- Social partners should be enabled and empowered to participate effectively in national social protection policymaking and implementation of social protection systems, such as the UI scheme.
- Representatives of workers and employers should participate in the tripartite boards of social security schemes.
- Policy development and reforms should be based on a transparent, inclusive and open process.
- Broader social dialogue and partnerships with representatives of specific groups of the population and other relevant stakeholders should be promoted.
- In the interests of accountability and transparency, particular attention should be paid to monitoring the implementation and impact of social protection measures in order to ensure the effective delivery of benefits. This will contribute to the formulation of appropriate, adequate and relevant policies, and will enable potential shortcomings and gaps to be addressed.

Governments, together with social partners and other stakeholders, where appropriate, should strive to strengthen social protection systems, including floors, as a cornerstone of national policy architecture that is essential during and outside moments of crises. A crisis response based on national dialogue and consensus building is more human-centred because it takes into account the views of various stakeholders. This approach to crisis response will allow countries to develop a more efficient, sustainable and prudent recovery from economic shocks. The integration of social partners in the process of formulating policy responses will help to accelerate the recovery towards more socially just societies and to build shock-responsive social protection systems.

Social dialogue is not only key for building the preparedness of social protection systems for future crises and formulating immediate responses to shocks, but it should also be pursued continuously as countries address the various phases of the crisis and tackle the particular social and economic challenges arising in the medium and long term. Where social dialogue structures are absent, governments should seize the opportunity to establish, strengthen or restore social dialogue channels by progressively providing the enabling conditions and environment. This includes reinforcing the capacities of workers' and employers' organizations and consulting other relevant and representative organizations of persons concerned.

Annex 1. General methodology of the actuarial valuation

This cost assessment makes use of a comprehensive methodology developed at the Actuarial Services Unit of the Social Protection Department of the ILO and at the Regional Actuarial Services Unit for reviewing the financial situation of unemployment insurance schemes.

A2.1. Purpose of projections

The purpose of the unemployment insurance model is twofold. First, it is used to assess the financial viability of the scheme over the projection period. This refers to comparing and balancing between the scheme's income and expenditure. In case of an imbalance, a revision of the contribution rate, or the benefit structure, or both, is recommended. Second, the model may be used to examine the financial impact of different reform options, thus assisting policymakers in the design of benefit and financing provisions. More specifically, the model is used to develop projections of the scheme's income and expenditure, for the purpose of:

- assessing the options for building up a contingency or technical reserve;
- proposing contribution rates that are consistent with the funding objective; and
- testing how the system reacts to changing economic, labour market and demographic conditions.

A2.2. Projection approach

The model focuses on the main characteristics of the scheme's current and future active members and beneficiaries.

The main characteristics of the scheme's current active members, by age, sex and sector, have been derived from ETF data and labour statistics data obtained from the Department of Census and Statistics of Sri Lanka, and include their densities of contribution and their monthly insurable earnings. The main characteristics of the scheme's beneficiaries, by age, sex and sector, have been derived from labour statistics data obtained from the Department of Census and Statistics of Sri Lanka, taking into account the scheme's provisions. Additional scheme-specific assumptions such as the projected evolution of contributory earnings, the rate of return of the fund, and the administrative expenses have been formulated on the basis of the scheme's framework and the authors' view on the projected evolution of the economy. Assumptions are presented in detail in chapter 3.

Projections are made following a year-by- year methodology:

- The contribution income of the scheme reflects the projected evolution in the number of active insured members, by age and sex, their projected densities of contribution and their projected monthly contributory earnings.
- The number of new beneficiaries of the scheme is based on the evolution in the number of active insured members, by age and sex, their projected densities of contribution and their projected employment termination rates.
- The benefit expenditure of the scheme reflects the number of new beneficiaries of the scheme, by age and sex, their estimated contributory earnings and their projected benefit duration.

It is not the objective of unemployment insurance projections to forecast the exact progression of a scheme's income and expenditure, but to verify its financial viability. This entails evaluating the scheme with regard to the relative balance between future income and expenditure, under different possible economic scenarios.

Annex 2. ILO social security standards on unemployment protection

ILO social security standards have come to be recognised globally as key references for the design of rights-based, sound and sustainable social protection schemes and systems. They also give meaning and definition to the content of the right to social security as laid down in international human rights instruments (notably the Universal Declaration of Human Rights, 1948, and the International Covenant on Economic, Social and Cultural Rights, 1966), thereby constituting essential tools for the realization of this right and the effective implementation of a rights-based approach to social protection.

Guiding ILO policy and technical advice in the field of social protection, ILO social security standards are primarily tools for governments which, in consultation with employers and workers, are seeking to draft and implement social security law, establish administrative and financial governance frameworks, and develop social protection policies. More specifically, these standards serve as key references for:

- the elaboration of national social security extension strategies;
- the development and maintenance of comprehensive national social security systems;
- the design and parametric adjustments of social security schemes;
- the establishment and implementation of effective recourse, enforcement and compliance mechanisms;
- the good governance of social security and improvement of administrative and financial structures;
- the realization of international and regional obligations, and the operationalization of national social protection strategies and action plans; and
- working towards the achievement of Sustainable Development Goals, particularly goals 1, 3, 5, 8, 10 and 16.

The ILO's normative social security framework consists of eight up-to-date Conventions and nine Recommendations. The most prominent of these are the Social Security (Minimum Standards) Convention, 1952 (No. 102), and the Social Protection Floors Recommendation, 2012 (No. 202). Other Conventions and Recommendations set higher standards in respect of the different social security branches, or spell out the social security rights of migrant workers.

ILO standards establish qualitative and quantitative benchmarks which together determine the minimum standards of social security protection to be provided by social security schemes when life risks or circumstances occur, with regard to:

- definition of the contingency (what risk or life circumstance must be covered?);
- persons protected (who must be covered?);
- type and level of benefits (what should be provided?);
- entitlement conditions, including qualifying period (what should a person do to get the right to a benefit?);
- duration of benefit and waiting period (how long must the benefit be paid/provided for?).

In addition, they set out common rules of collective organization, financing and management of social security, as well as principles for the good governance of national systems. These include:

- the general responsibility of the State for the due provision of benefits and proper administration of social security systems;
- solidarity, collective financing and risk-pooling;
- participatory management of social security schemes;
- guarantee of defined benefits;
- adjustment of pensions in payment to maintain the purchasing power of beneficiaries; and
- the right to complain and appeal.

Tables A2.1 provide a summary overview of the key requirements set out in ILO standards on unemployment protection.

▶ Table A2.1 Main requirements: ILO social security standards on unemployment protection

	Convention No. 102 Minimum standards	Convention No. 168 and Recommendation No. 176 [1] Higher standards	Recommendation No. 202 Basic protection
What should be covered?	Suspension of earnings due to inability to find suitable employment for capable and available person.	C.168: Loss of earnings due to inability to find suitable employment for capable and available person actively seeking work. Protection should be extended to loss of earnings due to partial unemployment, suspension or reduction of earnings due to temporary suspension of work, part-time workers seeking full-time work. R.176: Provides guidance for assessing suitability of potential employment.	Basic income security for those who are unable to earn sufficient income in case of unemployment.
Who should be protected?	At least: – 50% of all employees; or – all residents with means under prescribed threshold.	C.168: At least 85% of employees, including public employees and apprentices; all residents with means under prescribed threshold. Coverage should be extended to persons seeking work who have never been, or have ceased to be, recognized as unemployed or covered by unemployment protection schemes. R.176: Coverage should be extended progressively to all employees as well as to persons experiencing hardship during waiting period.	At least all residents of active age, subject to international obligations.
What should the benefit be?	Periodic payments; at least 45% of reference wage.	C.168: Periodic payments: at least 50% of reference wage; or total benefits must guarantee the beneficiary healthy and reasonable living conditions. R.176: For partial employment: total benefit and earnings from the part-time work should reach the sum of previous earnings from full-time work and the amount of full unemployment benefit.	Benefits in cash or in kind at a level that ensures basic income security, so as to secure effective access to necessary goods and services; prevents or alleviates poverty, vulnerability and social exclusion; and enables life in dignity.
What should the benefit duration be?	For schemes covering employees: at least 13 weeks of benefits within a period of 12 months. For means-tested (non-contributory) schemes: at least 26 weeks within a period of 12 months. Possible waiting period of maximum seven days.	C.168: Throughout the unemployment period; possibility to limit initial duration of payment of the benefit to 26 weeks in case of unemployment or 39 weeks over any period of 24 months; possible waiting period of maximum seven days. R.176: Benefit duration should be extended until pensionable age for unemployed persons who have reached a prescribed age.	As long as the incapacity to earn a sufficient income remains.
What conditions can be prescribed for entitlement to a benefit?	Qualifying period may be prescribed as necessary to prevent abuse.	C.168: Qualifying period may be prescribed as necessary to prevent abuse. R.176: Qualifying period should be adapted or waived for new jobseekers.	Should be defined at national level, and prescribed by law, applying principles of non-discrimination, responsiveness to special needs and social inclusion, and ensuring the rights and dignity of people.

Notes: 1 Employment Promotion and Protection against Unemployment Convention, 1988, and Recommendation, 1988.