4. INDUSTRY

4.1 Overall Trends

The industrial output grew by 7.3 per cent in 1996 despite the adverse impact of the prolonged power cuts from late March to the end of the third quarter. The comparable growth rate in 1995 was 10.2 per cent. The measures put in place to encourage private sector power generation by way of import duty concessions and special credit facilities through the National Development Bank and the Development Finance Corporation to import generators and the indirect subsidies through the purchase of electricity generated by the private sector to the national grid at a premium helped to minimise the loss of industrial output due to power cuts. The growth of industrial output in 1996 was mainly attributed to the increase in manufacturing output in the Export Processing Zones (EPZs) which were least affected by power cuts. The uninterrupted operation of the state-owned petroleum refinery and a moderate growth of industrial production of private sector industries outside the EPZs also made a positive contribution to the overall growth of industrial output. Factory industries, which accounted for 83 per cent of the total manufacturing output , contributed 33 per cent of the economic growth in 1996.

A marked increase of realized investment in the enterprises registered under Section 17 of the Board of Investment (BOI industries) contributed substantially to the expansion of the export oriented industries. The expansion of export oriented industries was also supported by the increased demand in the U.S.A and other western countries, though the full benefit could not be reaped due to the temporary production dislocation experienced in 1996. The moderate depreciation of the Sri Lanka rupee also helped the export sector. Labour unrest in 1996 was less compared to the previous year. Lack of infrastructural facilities continued to be a major barrier for faster growth of the industrial sector.

4.2 Production

The estimated 7.3 per cent growth in overall industrial output in 1996 was based on the Annual Survey of Industrial Production conducted by the Central Bank of Sri Lanka covering 460 non-BOI enterprises, production data of public sector industries and the estimates based on export data for BOI enterprises. Total industrial output at current prices increased by 17.5 per cent yielding an implicit price deflator of 9.5 per cent for factory industries.

The growth in industrial output in 1996 came from three major categories, namely chemical, petroleum, rubber and plastic products; textile, wearing apparel and leather products and food, beverages and tobacco products. These three categories contributed 83 per cent of the growth in overall industrial output.

Chart 4.1
Growth and Composition of Industrial Production

Chart 4.1.1
Overall and Private Sector Growth Rates in Real Terms

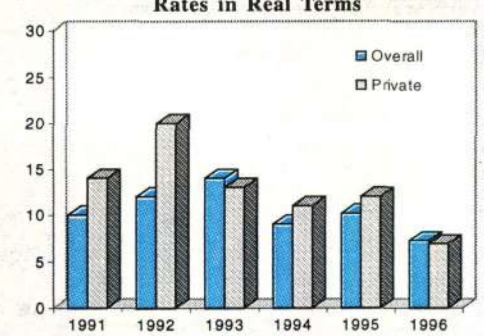


Chart 4.1.2
Composition of Industrial Production 1996

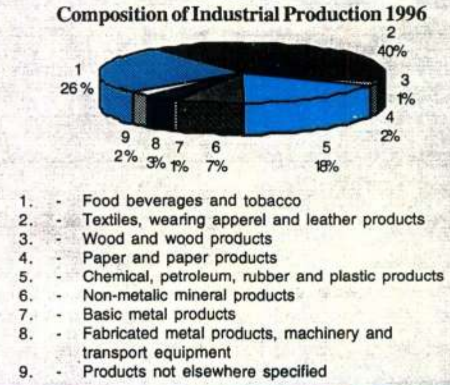


TABLE 4.1
Value of Industrial Production
(1990 Constant Prices)

Categories	Rs. Million					Percentage Change	
	1992	1993	1994	1995	1996 (a)	1995	1996 (a)
1. Food, beverages and tobacco	26,087	28,304	30,445	33,641	35,908	10.5	6.7
2. Textile, wearing apparel and leather products	38,805	45,540	48,333	55,480	58,332	14.8	5.1
3. Wood and wood products	797	939	1,085	1,243	1,321	14.5	6.2
4. Paper and paper products	2,628	3,140	3,565	3,508	3,550	-1.6	1.2
5. Chemical, petroleum, rubber and plastic products	19,752	23,683	25,838	27,543	31,135	6.6	13.0
6. Non metallic mineral products	9,451	10,349	11,643	12,516	13,360	7.5	6.7
7. Basic metal Products	1,294	1,178	1,568	1,377	1,636	-12.2	18.8
8. Fabricated metal products, machinery, and transport equipment	5,314	5,203	5,931	6,139	6,252	3.5	1.8
9. Manufactured products not elsewhere specified	2,124	2,366	2,617	3,005	3,443	14.8	14.6
Total	106,252	120,702	131,025	144,452	154,937	10.2	7.3

(a) Provisional

Source: Central Bank of Sri Lanka
Board of Investment of Sri Lanka

TABLE 4.2
Private Sector Industrial Production Index

1990=100

Categories	1992	1993	1994	1995	1996 (a)	Percentage Change 1995	Percentage Change 1996 (a)
1 Food, beverages and tobacco	120	129	140	155	166	10.4	6.9
2 Textile, wearing apparel and leather products	144	168	179	206	217	14.8	5.1
3 Wood and wood products	106	123	149	170	165	14.1	-2.8
4 Paper and paper products	184	226	263	266	279	1.0	4.7
5 Chemical, petroleum, rubber and plastic products	121	132	159	196	224	23.6	14.2
6 Non metallic mineral products	137	159	212	228	243	7.5	6.7
7 Basic metal Products	167	225	266	305	351	15.0	15.2
8 Fabricated metal products, machinery, and transport equipment	126	124	141	147	150	3.9	1.8
9 Manufactured products not elsewhere specified	127	152	168	193	221	14.8	14.5
All Categories	137	155	172	192	205	12.1	6.9

(a) Provisional

Source: Central Bank of Sri Lanka
Board of Investment of Sri Lanka

Private Sector Industries

The private sector industrial output in 1996 was estimated to have grown by 6.9 per cent, compared with 12.1 per cent in 1995 and accounted for 90 per cent of the total industrial production in 1996. This growth in the private sector industrial output was a combined outcome of 10.1 per cent increase in BOI industries and 3.7 per cent increase in non-BOI industries. The expansion in BOI industries was spearheaded mainly by textile, wearing apparel and leather products and chemical, petroleum, rubber and plastic product categories. The expansion of the non-BOI industries was mainly reflected in the food, beverages and tobacco and basic metal products categories.

Textiles, Wearing Apparel and Leather Products

The textile, wearing apparel and leather products category grew in real terms by 5.1 per cent in 1996, compared with 14.8 per cent growth in 1995. This category, in the case of BOI industries increased by 6.0 per cent and the increase in the case of Non-BOI industries was 1.7 per cent. Although showing a slower growth in 1996, this category still accounted for 39.0 per cent of total industrial production and contributed 33.7 per cent of the growth in the private sector industrial output.

Total textile and wearing apparel exports to the USA in volume terms increased by 7.3 per cent, from 398 million square meter equivalent (SME) in 1995 to 427 million SME in 1996. In value terms, total textile and apparel exports to the USA increased by 11.1 per cent. Apparel exports under quota to the USA market, in volume terms, increased by 6.5 per cent in 1996, while non-quota apparel exports declined by 12.1 per cent as exporters attempted at least to maintain their exports secured under quota by not defaulting on contracts during the difficult period experienced in 1996. Exports of non-apparel products under quota also rose by 8.8 per cent. In 1996, apparel exports to the U.S.A market under quota accounted for 76 per cent of total apparel exports.

TABLE 4.3
Value of Industrial Production
(Current Prices)

Categories	Rs. Million					Percentage Change	
	1992	1993	1994	1995	1996 (a)	1995	1996 (a)
1 Food, beverages and tobacco	34,157	39,709	45,054	54,927	68,209	21.9	24.2
2 Textile, wearing apparel and leather products	53,929	70,057	78,211	89,944	101,627	15.0	13.0
3 Wood and wood products	1,005	1,230	1,601	1,929	2,171	20.5	12.5
4 Paper and paper products	2,586	3,438	4,066	4,595	5,069	13.0	10.3
5 Chemical, petroleum, rubber and plastic products	23,817	28,876	34,017	38,321	46,936	12.7	22.5
6 Non metallic mineral products	10,582	12,351	14,580	16,740	18,997	14.8	13.5
7 Basic metal products	1,424	1,497	1,909	1,736	2,248	-9.1	29.5
8 Fabricated metal products, machinery, and transport equipment	5,948	5,915	7,122	7,977	8,807	12.0	10.4
9 Manufactured products not elsewhere specified	2,658	3,402	4,083	5,271	6,183	29.1	17.3
Total	136,106	166,475	190,643	221,440	260,247	16.2	17.5

(a) Provisional

Source: Central Bank of Sri Lanka
Board of Investment of Sri Lanka

The availability of quota in respect of U.S.A, EU countries as well as Canada showed a substantial increase in 1996. In respect of the U.S. market, the utilization rate reached 100 per cent in the quota categories such as knitted shirts and blouses, trousers, underwear, coveralls and overalls, terry and other pile towels. As in the previous years, low utilization rates were reported in the categories of men's and boys' suit-type coats, women's and girls' suits and sweaters. In respect of EU quotas, the most popular categories were women's and girls' woven and knitted blouses and women's trousers and breeches. The utilization of quota in some categories (parkas, anoraks, windcheaters) showed a decline in 1996.

According to the Ministry of Industrial Development (MID), there were 845 garment factories at end 1996. These factories have provided 251,537 direct employment opportunities. Of the factories started under the Two Hundred Garment Factory Programme (THGFP), 154 factories were in commercial operation, while six factories were closed down or merged during the year, mainly due to managerial problems. These 154 factories employed 76,821 persons, a similar amount as in the previous year. The export earnings of these factories were estimated at Rs.44,659 million in 1996 and showed an increase of Rs.4,300 million.

There were over 140 textile manufacturing firms in the country, with less than 10 large firms accounting for most of the output. As in the previous year, the export oriented manufacturers of textiles performed well in 1996, while those who were catering to the domestic market and thrived under the earlier protective tariffs continued to experience difficulties as they experience marketing problems in the face of import competition. A major improvement of domestically produced textiles would be necessary for them to be attractive as raw material for the domestic export industries. Local textile manufacturers were capable of supplying only less than 10 per cent of the raw material requirements of the country's garment industry.

With the establishment of the World Trade Organisation (WTO) in January 1995, all existing bilateral textile agreements coming under the Multi-Fibre Arrangements (MFA) are due to be phased out by 2005. The quota system is expected to be phased out in 4 stages; 16 per cent in 1995; 17 per cent in 1998; 18 per cent in 2002; and the remaining 49 per cent at end 2004 thus achieving free trade in the textiles and clothing sector by the year 2005. Therefore, it is important to recognise that Sri Lanka, as well as other developing countries, who have been benefitted by the present quota system will have to face effectively a more competitive trading environment in the foreseeable future and to be prepared with necessary structural changes in the industry to meet this challenge.

Food, Beverages and Tobacco

This category grew by 6.9 per cent in 1996 compared with 10.4 per cent growth in the previous year, accounting for 27.1 per cent of the total industrial production and contributed 26.9 per cent of the growth in private sector industrial output. The output of processed tobacco and cigarettes, CTC (Cut, Tear and Curl) teas and tea bags, beer and liquor, dairy products, processed coconut and meat products recorded positive growth rates. The production of processed Tobacco increased by 5.7 per cent despite the higher taxes on cigarettes. The tobacco processing industry was not affected by the power cuts or the strikes at Ceylon Electricity Board (CEB) because major manufactures were equipped with their own power generators. The lowering of excise duties on beer in November 1995 pushed up the domestic demand and raised the domestic production. The production of liquor spirits also reported a notable growth in 1996 as a result of higher domestic demand. The growth of the processing of tea in 1996 was a reflection of an increased level of production as well as the higher prices. The meat products sector which experienced a production loss during the periods of power cuts fully recovered during the second half of the year. There was a strong demand for these products as fish prices remained high. The increase in wheat flour price with the reduction of the wheat flour subsidy reduced the demand for bread and the processing wheat flour. The fruit and vegetable processing industry encountered a heavy setback during the first half of the year due to the drought and power cuts and was not able to recover completely during the year despite the increased domestic demand for these products. The production of poultry feed, which recorded a moderate growth in 1995 reported a decline in 1996 mainly due to the problems faced by breeders during the power cut period.

Chemical, Petroleum, Rubber and Plastic Products

The value of production in the chemical, petroleum, rubber and plastic product category in the private sector grew by 14.2 per cent in 1996, compared with the 23.6 per cent growth in the previous year. The growth came mainly from BOI industries. Significant increases were reported in rubber products such as tyres, tubes, bands, gloves and mittens, PVC pouches and rain wear and synthetic sacks as a result of increased demand from major importing countries particularly those in the EU and the Middle East. The demand for rubber based products in the domestic market also expanded in 1996. The use of domestically produced rubber by 15 major domestic rubber manufacturing industries increased by 20 per cent in 1996. Production of plastic products such as poly bags and woven polypropylene in this category also reported a notable growth due to the increased domestic demand. According to industry sources the output of the pharmaceutical industry showed a noteworthy improvement on account of the improved quality of domestically produced drugs. The soap and toiletries industry had a price advantage over imported items and the domestic production registered a notable growth. Effective advertisement campaigns and improvement of the quality of the products also helped to attract the domestic consumer preference for these items.

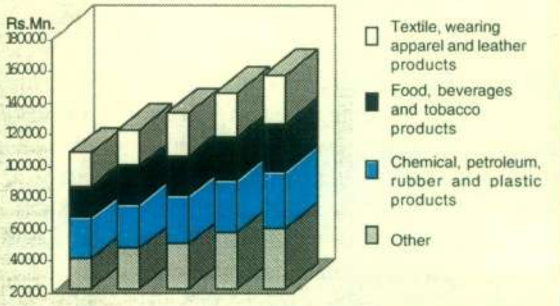
Other Industrial Products

The non-metallic mineral product category achieved a 6.7 per cent growth in 1996 reflecting the higher output growth in glazed ceramic tiles, porcelain figurines, terra-cotta items, processed silica quartz and granite slabs in the BOI industries. The output levels of ceramics tiles, roofing products, and cement also rose in 1996 to meet the increased domestic demand from the domestic construction industry. Labour unrest and loss of trained workers due to their voluntary withdrawal from several diamond manufacturing industries led to a temporary setback in the diamond industry. The growth of output in the fabricated metal product category was reflected in the electronic and electrical components, and transport equipment produced by BOI industries. In the non BOI sector, industries such as agricultural and electrical machinery, cables and metal products reported significant growth rates. The growth in the construction industry helped the cables and metal product sector. However, industries such as fabrication of motor coaches and lorries, refrigerators and bulbs in this category reported a notable decline in the face of increased competition from imported items. Apart from import competition, fabrication of motor coaches and lorries suffered a severe setback due to reduction of government orders as well as a decline in demand by the private sector.

The paper and paper products category reported moderate growth reflected in higher output levels in the BOI industries. The domestic market oriented paper products such as exercise books, labels and corrugated cartons reported a setback, partly due to import competition. The output of the wood products category declined in 1996, despite the total elimination of import duty on timber and reduction of turnover tax from 20 per cent to 6 per cent on timber based industries. The industry was adversely affected by a shortage in the domestic supply of timber.

The basic metal products output of the non-BOI industries increased by 15.2 per cent in 1996, compared with a similar growth in the previous year. The output of iron, steel, and aluminum increased, benefitted by the growth in construction activities.

Chart 4.2
Value of Industrial Production
(1990-Constant Prices)



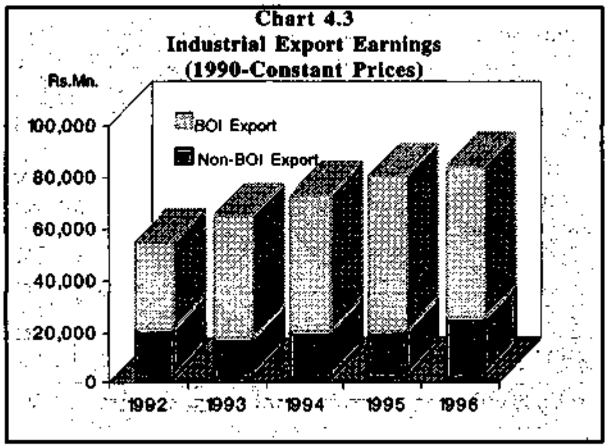


Chart 4.3
Industrial Export Earnings
(1990-Constant Prices)

Public Sector Industries

Public sector industrial output, in real terms, increased by 10.8 per cent in 1996 in contrast to 6.9 per cent decline recorded in 1995. This was largely due to a significant rise in the production of the Ceylon Petroleum Corporation (12 per cent) which accounted for 87 per cent of total public sector industrial output. Public sector industrial output, excluding petroleum, also rose by 3 per cent mainly due to improved performances achieved by the State Timber Corporation and the Ceylon Steel Corporation Ltd.

The enterprises that recorded increases in output in 1996 were Lanka Mineral Sands Ltd. (26 per cent), Ceylon Steel Corporation Ltd. (23 per cent), State Timber Corporation (20 per cent), Ceylon Petroleum Corporation (12 per cent), Lanka Phosphate Ltd. (11 per cent), and Lanka Salt Ltd. (3 per cent).

The value of production of Lanka Mineral Sands Ltd. increased due to favourable external demand for H.T. Ilmenite mainly from Egypt and some developed countries. The Forest Department released a higher volume of logs to the State Timber Corporation for sawing. The output of the Ceylon Petroleum Corporation increased as the petroleum refinery had its normal operations in 1996 and there was increased demand for petroleum products for generation of thermal power.

The output of Sevenagala Sugar Industries Ltd. decreased by 14 per cent due to repairs to machinery and some delays in the availability of sugar cane due to the drought. Increased competition in the domestic market following the reduction of import duty on paper products was mainly responsible for a 12 per cent reduction in the output of the National Paper Company Ltd. A reduction of 3 per cent in output was also recorded by the Sri Lanka Rubber Manufacturing and Export Corporation Ltd.

4.3 Value Added and Capacity Utilization

In nominal terms, the value added in industry increased by 16.6 per cent in 1996, compared with a 17 per cent growth in the previous year, as a result of some increase in the cost of raw material in 1996. The value added in real terms increased by 7.3 per cent.

The value added as a ratio of value of manufacturing output remained unchanged at 37 per cent as in 1995. The value added ratios were above 50 per cent in wood and wood products (57.6 per cent), non metallic mineral products (55.5 per cent) and fabricated metal products (51.2 per cent). The low value added ratios were recorded in chemical, rubber and plastic products (19.1 per cent), basic metal products (20.0 per cent), textile wearing apparel and leather products (30.6 per cent) and food, beverages and tobacco (48.2).

TABLE 4.4
Public Sector Major Industry Output Index

1977 = 100

	Categories	1992	1993	1994	1995	1996 (a)
1	Food, beverages and tobacco	13.4	8.1	9.3	10.2	9.2
2	Textile, wearing apparel and leather products	27.5	10.3	-	-	-
3	Wood and wood products	20.3	25.4	22.0	26.3	31.7
4	Paper and paper products	156.6	174.1	187.8	173.2	152.2
5	Chemical, petroleum, rubber and Plastic products	86.9	121.8	126.3	118.0	134.0
	Petrolium products	91.8	129.4	134.2	124.2	136.9
6	Non metallic mineral products	143.4	120.0	5.5	5.9	6.8
7	Basic metal products	125.7	92.4	130.8	95.0	116.5
8	Fabricated metal products, machinery, and transport equipment	-	-	-	-	-
	All Categories	73.3	87.9	83.8	78.0	86.4
	Excluding Petroleum	52.7	41.7	27.7	24.5	25.1

(a) Provisional

Source: Central Bank of Sri Lanka

TABLE 4.5
Value Added In Industry
(Current Prices)

Categories	Rs. Million					Percentage Change	
	1992	1993	1994	1995	1996 (a)	1995	1996 (a)
1 Food, beverages and tobacco	18,668	21,704	24,373	29,507	32,891	21.1	11.5
2 Textile, wearing apparel and leather products	14,630	18,994	20,660	24,859	31,164	20.3	25.4
3 Wood and wood products	677	831	1,081	1,177	1,250	8.9	6.2
4 Paper and paper products	1,397	1,912	2,301	2,458	2,580	6.8	5.0
5 Chemical, petroleum, rubber and plastic products	3,989	4,723	5,758	6,898	8,957	19.8	29.8
6 Non metallic mineral products	5,918	7,163	9,272	9,726	10,537	4.9	8.3
7 Basic metal products	263	279	356	347	450	-2.5	29.7
8 Fabricated metal products, machinery, and transport equipment	3,629	3,608	4,344	4,547	4,809	4.7	5.8
9 Manufactured products not elsewhere specified	1,196	1,532	1,838	2,319	2,763	26.2	19.1
Total	50,367	60,746	69,983	81,838	95,421	16.9	16.6

(a) Provisional

Source: Central Bank of Sri Lanka

The production capacity of the non-BOI industrial sector increased by 2 per cent. However, the capacity utilization ratio declined slightly from 84 per cent in 1995 to 83 per cent in 1996 mainly due to power cuts. The decline was mainly in the textile, wearing apparel and leather products; food, beverages and tobacco and chemical, rubber and plastic products categories.

4.4 Cost of Production and Profitability

According to the Central Bank Survey the average factory profit ratio (profit as a ratio of total value of production) of the non-BOI industrial sector declined from 16.2 per cent in 1995 to 14.7 per cent in 1996. The decline was the outcome of 18.2 per cent increase in the cost of production and a 16.8 per cent increase in ex factory value of production. Wages, interest and other costs increased in 1996. The profitability varied from 10 to 23 per cent across the industries. The textile, wearing apparel and leather product category showed the highest profit ratio of 22.9 per cent, though it was slightly lower than the 24.2 per cent of 1995. The cost of raw materials used in the non-BOI industrial sector increased in nominal terms by 25.2 per cent. The largest increase of 32.8 per cent was reported in the food, beverage and tobacco category mainly owing to higher prices of domestic raw materials. In the textile, wearing apparel and leather products category, utilization of domestic raw materials as a percentage of cost of production increased marginally from 10.3 per cent in 1995 to 11.2 per cent in 1996. In the food, beverages and tobacco category, the ratio increased from 45.6 per cent in 1995 to 48.0 per cent in 1996.

The cost of power and fuel used in the non-BOI sector in nominal terms increased by 8.4 per cent in 1996. The share of power and fuel cost in total cost of production declined from 4.1 per cent in 1995 to 3.8 per cent in 1996. Energy formed the principle element in the total cost of production of non- metallic mineral products, while it had the lowest share in the food, beverages and tobacco category.

TABLE 4.6
Ex - Factory Profit Ratios of Non - BOI Private Sector Industries(a)

Categories	Cost of Production (Rs. Mn.)		Value of Production (Rs. Mn.)		Factory Profit Ratio (percentage)	
	1995	1996	1995	1996	1995	1996
1 Food, beverages and tobacco	43,428	54,911	50,439	62,257	13.9	11.8
2 Textile, wearing apparel and leather products	12,893	14,504	17,009	18,812	24.2	22.9
3 Wood and wood products	1,082	1,163	1,270	1,391	14.8	16.4
4 Paper and paper products	2,521	2,713	3,071	3,262	17.9	16.8
5 Chemical, petroleum, rubber and	6,657	7,362	7,643	8,216	12.9	10.4
6 Non metallic mineral products	8,699	9,356	10,430	11,494	16.6	18.6
7 Basic metal products	803	1,039	893	1,161	10.1	10.5
8 Fabricated metal products, machinery, and transport equipment	5,947	6,477	7,226	7,674	17.7	15.6
9 Manufactured products not elsewhere specified	2,565	2,435	3,004	2,941	14.6	17.2
Total	84,595	99,960	100,985	117,208	16.2	14.7

(a) Based on information received from 460 non-BOI private sector firms.

Source: Central Bank of Sri Lanka

TABLE 4.7
Domestic Cost Structure of Non - BOI Private Sector Industries (a)
(As a percentage of total cost of production)

	Categories	Power & Fuel		Wage		Raw Material		Interest	
		1995	1996	1995	1996	1995	1996	1995	1996
1	Food, beverages and tobacco	2.1	1.9	11.4	11.8	45.6	48.0	1.3	1.9
2	Textile, wearing apparel and leather products	5.3	4.7	16.5	15.4	10.3	11.2	2.6	2.6
3	Wood and wood products	3.1	3.3	17.8	19.3	54.7	58.3	3.1	4.9
4	Paper and paper products	2.6	2.8	9.3	9.4	18.1	16.0	4.0	4.7
5	Chemical, petroleum, rubber and	5.9	6.0	10.7	10.5	27.3	24.0	2.8	3.3
6	Non metallic mineral products	11.8	12.7	11.3	12.4	7.3	8.5	3.2	2.7
7	Basic metal products	10.6	7.3	8.5	5.8	10.1	4.4	0.4	6.4
8	Fabricated metal products, machinery, and transport equipment	3.0	3.1	10.8	11.4	17.1	17.5	4.7	5.5
9	Manufactured products not elsewhere specified	5.6	5.1	18.1	20.0	62.6	60.0	1.4	1.3
	Total	4.1	3.8	12.3	12.4	32.3	34.3	2.1	2.6

(a) Based on information received from 460 non-BOI private sector firms.

Source: Central Bank of Sri Lanka

The wage bill in the non-BOI private sector increased in nominal terms by 19.9 per cent in 1996. The total wages and salaries as a percentage of total cost of production increased slightly from 12.3 per cent in 1995 to 12.4 per cent in 1996. The labour share in industries (approximated by the share of the wage bill in the total cost) was estimated at 19.3 per cent in wood and wood products, and 15.4 per cent in textiles, wearing apparel and leather products. The lowest labour shares were shown in the paper and paper products, basic metal products and fabricated metal products, machinery and equipment categories.

Interest cost in the non-BOI private sector increased in 1996 by 41.5 per cent, reflecting the high lending rates and increased roll over of credit by the sector. The interest cost as a percentage of total cost of production also increased from 2.1 per cent in 1995 to 2.6 per cent in 1996. Industries such as fabricated metal products, machinery and equipment, basic metal products, wood and wood products reported the highest share of interest cost in 1996.

Industrial Employment

Employment in the industrial sector increased by about 2 per cent in 1996, reflected in labour absorption by the BOI industries. The BOI industries generated an additional 8,569 employment opportunities in 1996. Employment in the 460 non-BOI firms covered by the Annual Survey of Industrial Production - 1996, declined by 1.7 per cent from 120,298 in 1995 to 118,219 in 1996. The employment in all major categories of industries except the paper and paper product category

TABLE 4.8
Employment in Private Sector Industries

Numbers

Sectors	1995	1996	Change in 1996 %
(i) Non-BOI Private Sector (a)			
1 Food, beverages and tobacco	18,478	18,384	-0.5
2 Textile, wearing apparel and leather products	59,131	58,295	-1.4
3 Wood and wood products	1,322	1,312	-0.8
4 Paper and paper products	6,250	6,392	2.3
5 Chemical, petroleum, rubber and Plastic Products	14,132	13,601	-3.8
6 Non metallic mineral products	9,528	9,096	-4.5
7 Basic metal products	950	902	-5.1
8 Fabricated metal products, machinery, and transport equipment	6,089	5,859	-3.8
9 Manufactured products not elsewhere specified	4,418	4,378	-0.9
Sub-Total	120,298	118,219	-1.7
(ii) BOI Enterprises	233,374	241,970	3.7
Total	353,672	360,189	1.8

(a) Based on information received from 460 non-BOI private sector firms.

Source: Central Bank of Sri Lanka
Board of Investment of Sri Lanka

declined during the year. The paper and paper products category showed a 2.3 per cent increase in employment. The employment in industrial categories such as basic metal products; non-metallic mineral products and chemical, petroleum and rubber products reported a larger decline than other categories.

4.5 Investment

Foreign Investment

Sri Lanka relies on foreign capital inflows to supplement domestic savings. These have helped the development of the manufacturing sector, with new technological know-how and improved market access. The BOI, which is the main institution responsible for promoting foreign investment in Sri Lanka had negotiated and approved an increasing number of projects during the year. In 1996, Sri Lanka was able to attract a substantial volume of foreign capital mainly from Japan, South Korea, Hong Kong, Singapore, Germany, Australia, Italy, India and the USA despite the competition from other developing countries. The realized investments in the BOI industries increased by 56 per cent in 1996, compared with a 46 per cent decline in 1995.

Under Section 17, the BOI approved 254 projects with an investment commitment of Rs.452,600 million, compared to 220 projects with investment commitment of Rs.32,100 million approved in 1995, bringing the total number of projects approved to 1,953 up to end of the 1996. This included three petroleum processing plants with an investment commitment of Rs.394,000 million. The foreign component of approved investment in 1996 was Rs.428,800 million or 95 per cent of the total approved investment during the year. The high foreign component reflected the high foreign capital commitment of the three oil refinery projects. Of the total approved projects up to end 1996, agreements had been signed in respect of 1,277 projects. Among these, 864 enterprises, including 154 projects in the Two Hundred

TABLE 4.9
Realised Investments in BOI Enterprises (a)

	Categories	No of Enterprises		Foreign Investment (Rs. Mn)		Total Investment (b) (Rs. Mn)	
		1995	1996 (c)	1995	1996 (c)	1995	1996 (c)
1	Food, beverages and tobacco	53	77	1,290	2,274	1,974	4,437
2	Textile, wearing apparel and leather products	109	117	11,064	12,351	12,821	15,045
3	Wood and wood products	17	19	488	474	551	564
4	Paper and paper products	9	12	167	326	362	550
5	Chemical, petroleum, rubber and plastic products	52	66	4,945	5,762	5,633	6,877
6	Non metallic mineral products	39	42	774	972	2,345	2,783
7	Fabricated metal products, machinery, and transport equipment	19	20	615	605	978	1,180
8	Manufactured products not elsewhere specified	91	102	2,919	3,499	4,068	4,647
9	Services	217	255	28,108	34,694	43,487	55,539
	Total	606	710	50,370	60,957	72,219	91,622

(a) Cumulative as at end year
(b) Projects approved under Section 17 of the Board of Investment Law
(c) Provisional

Source: Board of Investment of Sri Lanka

TABLE 4.10
Employment and Export Earnings of BOI Enterprises

	Categories	Employment (No.) (at end Dec)		Gross Export Earnings (Rs.Mn) (F.O.B)	
		1995	1996(a)	1995	1996(a)
1	Food, beverages and tobacco	8,166	6,931	3,963	4,857
2	Textile, wearing apparel and leather products	153,664	156,391	73,287	82,050
3	Wood and wood products	2,500	2,449	293	342
4	Paper and paper products	519	733	574	857
5	Chemical, petroleum, rubber and plastic products	19,047	20,509	12,217	15,089
6	Non metallic mineral products	9,160	9,226	6,155	7,068
7	Fabricated metal products, machinery, and transport equipment	1,252	1,399	722	1,132
8	Manufactured products not elsewhere specified	23,734	26,645	9,151	12,822
9	Services (b)	15,332	17,687	7,001	9,272
	Total	233,374	241,970	113,363	133,483

(a) Provisional
(b) Excluding Air Lanka Ltd.

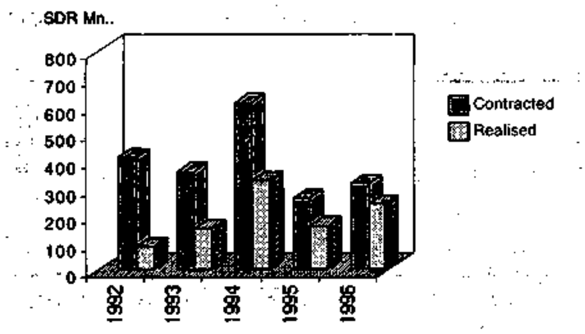
Source: Board of Investment of Sri Lanka

Garment Factory Programme, had invested Rs.97,000 million at end 1996. The foreign component of these investments was Rs.63,000 million or 65 per cent of the total investment. The major industrial categories of these investments were textiles, wearing apparel and leather products; chemical, petroleum, rubber and plastic products; food, beverages and the tobacco and manufactured products not elsewhere specified.

Under the Inland Revenue and Tax Related Laws (normal laws), the BOI approved 85 projects in 1996 as compared with 62 projects approved in 1995. The total envisaged investment in these projects amounted to Rs.4,600 million, of which the foreign component was Rs.3,400 million or 74 per cent.

Total employment in the BOI enterprises including the Two Hundred Garment Factory Programme amount to 241,970, showing only a 4 per cent increase in 1996 compared to 13 per cent in 1995.

Chart 4.4
Contracted and Realised Investment of the BOI



Local Investment

The projects approved by the BOI had a significant volume of local investment. However, the share of domestic investment declined drastically in 1996 to 5 per cent from 57 per cent in 1995 owing to the higher foreign capital component of the three oil refinery projects. Consequently, of the Rs. 452,600 million investment commitments in 1996, only Rs. 23,800 million were expected to be generated from local sources. The share of local investment in 864 projects operated under the BOI amounted to Rs.34,200 million or 35 per cent of the total investment as at end 1996. These investments were mainly in the production of stuffed soft toys, jewellery, knitted fabrics, yarn and gray cloths, wooden handicrafts, processing of fruits and vegetables, kitchen utensils, telecommunication equipment and garment accessories. Furthermore, the local investment component in BOI projects under the General Incentive Scheme, amounted to Rs.1,200 million or 26 per cent of the total investment.

Meanwhile, the total investment in 1,637 enterprises which were registered under the Ministry of Industrial Development, amounted to Rs.618,600 million at end 1996. The investments were in the categories of textiles, wearing apparel and leather products; chemical, petroleum, rubber and plastic products; fabricated metal products and food, beverages and tobacco. These enterprises have generated employment for 301,450 persons, showing a slight increase compared to 300,036 persons in 1995.

4.6 Availability of Credit to the Industrial Sector

In 1996, the two major development banks and commercial banks continued to provide financial assistance to the industrial sector in the form of refinance approvals, direct loans and equity participation. The National Development Bank (NDB) and the Development Finance Corporation of Ceylon (DFCC) approved a total of 1,693 projects in 1996 with a credit outlay of Rs. 10,845 million, as compared with 2,764 projects with investment outlay of Rs. 11,855 million in 1995, recording a further growth of investment in the industrial sector, despite the difficulties experienced in 1996 due to the drought and power cut. There was a moderate growth of the financial facilities to the industrial sector through commercial banks, with bank credit to the industrial sector growing by 16 per cent during the first nine months of the year, as compared with a 25 per cent growth in the same period of 1995.

Under the Small and Medium Scale Industries Credit Scheme IV (SMI IV), the NDB channeled Rs. 794 million as refinancing to 1,141 projects utilising co-financed funds from the International Development Association (IDA) and the Asian Development Bank (ADB). During the year the NDB approved 240 projects with an outlay of Rs. 7,401 million for direct financial assistance, in comparison to 431 projects with an outlay of Rs. 6,519 million in 1995. Further, the NDB participated in 12 projects by providing Rs. 643 million worth of equity as compared with 10 projects with Rs. 477 million worth of equity participation in 1995. The industries in the chemical, petroleum, rubber and plas-

TABLE 4.11
Financial Assistance to the Industrial Sector by the NDB and DFCC - 1996 (a)

Categories	NDB								DFCC						GRAND TOTAL	
	Refinance Approvals SMI IV		Direct Financial Assistance		Equity		Total		Loan Approvals		Equity		Total			
	No.	Amount Rs. Mn.	No.	Amount Rs. Mn.	No.	Amount Rs. Mn	No.	Amount Rs. Mn	No.	Amount Rs. Mn	No.	Amount Rs. Mn	No.	Amount Rs. Mn	No.	Amount Rs. Mn
1 Food, beverages and tobacco	197	125	24	1,126	1	100	222	1,350	106	542	-	-	106	542	328	1,892
2 Textile, wearing apparel and leather products	46	38	25	283	3	59	74	381	44	194	-	-	44	194	118	575
3 Wood and wood products	63	26	11	23	4	104	78	153	27	73	-	-	27	73	105	226
4 Paper and paper products	21	27	2	10	-	-	23	37	21	123	-	-	21	123	44	160
5 Chemical, petroleum, rubber and plastic products	37	49	38	1,388	1	20	38	1,388	47	250	-	8	47	258	85	1,646
6 Non metallic mineral products	63	39	-	-	-	-	63	39	20	216	-	-	20	216	83	255
7 Basic metal Products	69	36	9	210	-	-	78	247	4	7	-	-	4	7	82	254
8 Fabricated metal products, machinery, and transport equipment	-	-	-	-	-	-	-	-	68	643	1	20	69	663	69	663
9 Manufactured products not elsewhere specified	645	453	131	4,361	3	359	779	5,173	-	-	-	-	0	0	779	5,173
Total	1,141	793	240	7,401	12	642	1,355	8,768	337	2,048	1	28	338	2,076	1,693	10,844

(a) Provisional

Sources: Development Finance Corporation of Ceylon
National Development Bank

tic products; food, beverages and tobacco and textiles, wearing apparel and leather products categories benefited from these facilities.

The DFCC approved 338 projects in 1996 with a credit outlay of Rs. 2,076 million, compared with 480 projects with an outlay of 3,424 million in 1995. The industrial categories that received major shares of these facilities were fabricated metal products, machinery and transport equipment; food, beverages and tobacco; chemical, petroleum, rubber and plastic products and non metallic mineral products.

4.7 Industrial Policy

The industrial development strategy of the Government was designed to have minimal government regulations and controls, while providing the necessary fiscal and financial incentives to foster new industries and investments. The main aims of the industrialisation strategy of the Government were to encourage diversification, upgrading and expansion of the industrial base, improve the efficiency of management of physical and manpower resources, create new employment opportunities, enhance income levels of employees, encourage export orientation, and promote regional distribution of industries.

Apart from fiscal incentives offered to the industrial sector to invest in advanced technology, the Government continued several specific projects in 1996 with donor assistance to improve in house technological activities, export promotion and productivity improvement. The Technology Initiative for the Private Sector (TIPS) Project, backed by the United States Agency for International Development (USAID) assistance, was extended for a period of five years from 1995 with added commitments in assisting firms in identifying, sourcing and acquiring technology and management techniques with special emphasis on the development of the SMI sector and environmentally friendly technologies. The Industrial Technology Market Information Network (ITMIN), formed with the United Nations Development Programme (UNDP) assistance, continued to provide assistance to obtain timely information on technology and markets. The Agricultural Machinery Project (AMP) funded by the German government is expected to support improving agro-processing and related technologies. The Private Sector Programme (PSP), also funded by the German government and set up in 1995, continued in 1996. This project assists private sector firms in improving export potential by providing consultancy services in respect of quality improvement, management and marketing capabilities. The project also assists firms to set up joint ventures with German and foreign investors for improving the international competitiveness of private sector enterprises in selected areas such as rubber, footwear, wooden toys, essential oils and food ingredients.

The Presidential Task Force on Science and Technology appointed in 1996 has made several recommendations aimed at improving the market orientation of industrial research institutions. A greater emphasis has been placed on the restructuring and re-organising of science and technology institutions, industrial laboratories and research institutions in order to respond effectively to market demand.

With a view to developing a market friendly industrial sector and bringing the manufacturing industries that developed under heavy tariff protection into the mainstream of industrial growth, the Government expects to move away from the present three-band tariff system towards a uniform import duty rate of 15 per cent as early as possible. The proposed Goods and Services Tax (GST), which is expected to be effective towards end 1997 would help the industrial sector by eliminating cascading effects.

The Government took several measures in the first half of 1996 to minimise the loss of industrial output due to power cuts. Firms were encouraged to use their own generators and the affected industries were granted several relief measures. These measures included duty free import of generators, a 40 per cent subsidy on large generators, purchase of excess electricity generated by the private sector at guaranteed premium prices, a concessionary loan scheme through the DFCC and NDB for purchase of generators over 100 KVA and payment concessions on electricity bills. In addition, commercial banks helped the affected industries on a case by case basis by way of credit re-scheduling and partial waivers of interest on loans outstanding.

Incentives for the Industrial Sector

The utilisation of advanced technology and efficient management have been recognized as essential ingredients of a modern industrial sector. The Government, in its 1996 Budget proposals announced several positive steps to encourage investment in modern technology in existing as well as new industries. The extension of these incentives to cover a wide range of small and medium scale industrial units was announced in the 1997 Budget proposals by reducing the lower limit on the size of investment eligible to be developed under the incentive package. Under these proposals, the existing incentive scheme of duty free imports of approved machinery and equipment for new companies investing over Rs.10 million and for existing companies investing over Rs.2.5 million were replaced with a minimum investment size of Rs.4 million in the case of new companies and Rs.1 million in the case of existing companies. In the case of existing undertakings, if the investment is more than Rs. 4 million within one year from the date of recommendation for introducing advanced technology and employs at least 50 persons within 6 months after commencement of expansion, the enterprises were eligible to receive duty and Turnover Tax (TT) waivers for machinery imports and a five year tax exemption on incremental profit from the date of commencement of the new operation. This incentive scheme will be available to industries and services, including agro-based industries, livestock, fisheries, tourism, and community development.

Under this scheme, 76 new enterprises with an investment value of Rs.7,052 million had been approved by the Ministry of Industrial Development by end 1996. The direct employment potential of these projects is estimated to be around 5,296 persons. Meanwhile, by end 1996, 198 projects in existing enterprises with an investment value of Rs.16,300 million had also been approved under the scheme. These enterprises had a new employment potential of 12,051. The Ministry of Industrial Development estimated the indirect employment potential of these projects at around 42,000 persons. An important feature of the approved investment projects is that a comparatively higher amount of investment has gone into non-traditional industries such as food and beverages, chemical, rubber and plastic products and fabricated metal products, as against the traditional industries such as textiles and garments. Under this scheme, 120 projects had imported machinery and equipment worth Rs.3,600 million by end December 1996.

In the case of existing incentives provided for export oriented industries, the Budget 1997 extended these incentives to cover small and medium scale industries with a view to increasing the participation of SMI in the scheme and improving their international competitiveness. Under these proposals, the 100 per cent exemption from duty and taxes on capital and intermediate goods presently available only to exporters who export over 90 per cent of their production will be replaced with a 100 per cent exemption for exporters who exports over 50 per cent of their production and a 50 per cent exemption for exporters who export between 25-50 per cent of their production. With a view to attracting new investment and encourage existing investors who do not benefit under the Advanced Technology Incentive Scheme, the Government offered tax relief up to 75 per cent for any individual, partnership or company investing in new plant, machinery and equipment on or before March 1998, subject to an upper limit of 50 per cent of assessable income in the year of assessment, with a carry forward facility. In cases where the investment made within the period specified exceeds Rs.250 million or is undertaken in designated backward areas, 100 per cent tax relief was granted subject to a upper limit of 75 per cent of assessable income.

In order to provide further incentives to the industrial sector , the present depreciation rate of 33 1/3 per cent on plant, machinery and equipment has been in-

TABLE 4.12
Projects Approved under the Advanced Technology Incentive Scheme in 1996 (a)

Categories	New			Existing			Total		
	No	Investment Rs.Mn	Potential Employment	No	Investment Rs.Mn	Potential Employment	No	Investment Rs.Mn	Potential Employment
1 Food, beverages and tobacco	10	2,074	760	22	3,900	1,239	32	5,974	1,999
2 Textile, wearing apparel and leather products	14	690	1,007	21	334	1,227	35	1,024	2,234
3 Wood and wood products	1	61	90	4	216	292	5	277	382
4 Paper and paper products	5	174	181	15	945	737	20	1,119	918
5 Chemical, petroleum, rubber and plastic products	18	918	1,345	61	4,002	3,333	79	4,920	4,678
6 Non metallic mineral products	2	245	248	9	1,409	614	11	1,654	862
7 Basic metal Products	3	479	502	6	425	482	9	904	984
8 Fabricated metal products, machinery, and transport equipment	6	411	382	33	1,724	1,423	39	2,135	1,805
9 Manufactured products not elsewhere specified	11	1,533	412	15	440	1,751	26	1,973	2,163
10 Services	6	467	369	12	2,871	953	18	3,338	1,322
Total	76	7,052	5,296	198	16,266	12,051	274	23,318	17,347

(a) Provisional

Source: Ministry of Industrial Development

creased to 50 per cent, enabling investors to write-off the total cost of such items in two years. The national security levy on machinery and equipment, which was reduced from 4.5 per cent to 2 per cent in the 1996 Budget proposals, was further reduced to 0.5 per cent in order to reduce the cost of investment. Non-BOI exporters were also allowed to borrow in foreign currencies to enable them to make better use of financing facilities, as in the case of BOI enterprises.

In addition to the existing concessions for the BOI sector, the 1996 Budget provided a five year tax holiday for export oriented industries utilising advanced technology and investing at least Rs.50 million in machinery and equipment and employing more than 50 persons. Large scale development projects including infrastructure were offered a 10 to 20 year tax holiday depending on the amount of investment and the employment generated. These companies are eligible for exemption from exchange controls, import/export controls and exemption from income tax on capital gains arising from the transfer of shares. Export oriented projects under this category were permitted to import project related machinery, equipment, raw materials, etc. free of import duty, turnover tax and excise duties for the lifetime of those projects.

Labour Productivity in Industry

The labour productivity in non-BOI industries, taken as real value added per man-hour used, decreased by 1.1 per cent in 1996, as employers maintained employment levels at the maximum possible, despite the interruption of production due to power cuts. While the growth of real value added in industries declined to 7.3 per cent from 10.2 per cent in 1995, the number of employees declined only by 1.7 per cent, thus resulting in a reduction in labour productivity. In most cases there was a positive correlation between the reduction in profitability and decline in labour productivity. However, the situation varies across industries with improvement in labour productivity seen in food beverages and tobacco (4 per cent); wood and wood products (3.7 per cent); chemical, rubber and plastic products (5.2 per cent); basic metal products (4.3 per cent) and non-metallic products (4.4 per cent). Labour productivity declined in textiles, wearing apparel and leather products (1.1 per cent), and fabricated metal products (3 per cent).

Productivity is enhanced by the efficient use of resources and by technological improvement. Recognizing that there is an urgent need to improve productivity and that a major improvement in productivity cannot be achieved within a short time, a "Decade of Productivity" i.e. 1997 - 2006 has been declared by the Government. In the first year, productivity awareness is to be created by educating producers, employees and the general public of the urgent need to enhance productivity. The Ministry of Industrial Development, the co-ordinator of this programme, has organised a number of seminars, workshops, meetings and lecture programmes for media personnel, business leaders, executives of enterprises, trade union leaders, NGO's, professionals and school children with a view to propagating the concept of productivity, its applications and benefits. The Ministry also has set up a National Steering Committee and a Productivity Secretariat to guide and monitor productivity related matters. Furthermore, the Government has initiated

TABLE 4.13
Labour Productivity Index in the Non-BOI Private Sector (a)

1995=100

	Categories	Value Added per Man-Hour		Productivity in 1996 (b)	
		1995	1996(b)	% Change	Index (1995=100)
1	Food, beverages and tobacco	342.8	356.6	4.0	104.0
2	Textile, wearing apparel and leather products	56.4	55.8	-1.1	98.9
3	Wood and wood products	56.5	58.6	3.7	103.7
4	Paper and paper products	154.6	152.6	-1.3	98.7
5	Chemical, petroleum, rubber and plastic products	123.6	130.0	5.2	105.2
6	Non metallic mineral products	72.9	76.1	4.4	104.4
7	Basic metal products	139.5	145.5	4.3	104.3
8	Fabricated metal products, machinery, and transport equipment	100.5	97.5	-3.0	97.0
9	Manufactured products not elsewhere specified	57.5	59.9	4.2	104.2
	Total	99.7	98.6	-1.1	98.9

(a) Based on information received from 460 non-BOI private sector firms.
(b) Provisional

Source: Central Bank of Sri Lanka

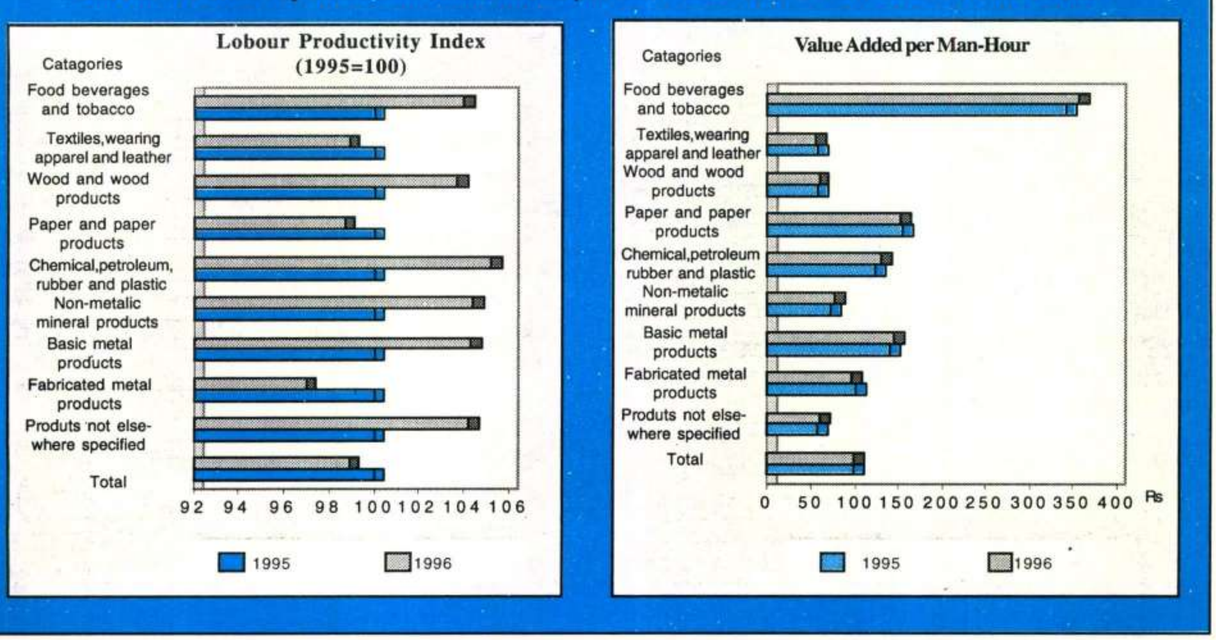
action to set up a "Skills Development Fund" to function in collaboration with the private sector.

Indutrial Labour Relations and Labour Productivity

As harmonious labour relations and improvement in labour productivity were considered critical in promoting industrial growth, the Central Bank recently conducted a survey to ascertain the views of employers on labour issues. The information gathered from this survey and the information currently available in the Department of Labour revealed that strikes in the manufacturing sector had escalated in 1994 and declined in 1995, although the number of strikes remained high. It was an encouraging sign that more than half of the manufacturers covered by the survey believed that labour relations were improving.

Demands related to higher wages and more financial benefits were the dominant motivating factors for strikes. These strikes exerted upward pressure on the cost of production in the manufacturing sector. Apart from demands for financial benefits, issues such as transfers, interdic-

Chart 4.5
Labour Productivity Index and Value Added per Man - Hour in the Non - BOI Private Sector



tion of workers, disciplinary action against workers, problems related to EPF/ETF payments and sympathy with other strikes were the other major factors behind these strikes.

In addition to loss of production, the manufacturing firms suffered due to strikes through permanent loss of buyers, loss of sales, waste of raw materials and reduced export earnings. Furthermore, a substantial loss of employment opportunities was recorded in some cases.

Most employers believed that a clear specification of the rights and obligations of both employers and employees, and the education of workers and management on their duties and responsibilities would be effective as corrective measures in improving labour relations.

Most firms had taken a number of measures to improve labour productivity, but only about half of these reported that their labour productivity had increased recently. According to the survey results, the most crucial factors undermining labour productivity were employees' attitudes, deterioration of work ethics, lack of patience and dedication to achieve long-term productivity goals, lack of motivation, lack of flexibility in labour laws, poor public transport facilities, lack of accommodation facilities and political interference. Linking wage increases to productivity improvements, educating the workers on the possible gains to them from high productivity, improving work ethics, redirecting training facilities, improving transport facilities and expanding accommodation facilities were the major proposals among those suggested as corrective measures by the manufacturing firms to improve labour productivity.

4.8 Industrial Location

Most industries were concentrated in the districts of Colombo and Gampaha. Of the 1,637 factories registered under the Ministry of Industries, 87 per cent were located in the Colombo and Gampaha districts. In the case of the 979 enterprises registered under Sections 16 and 17 of the BOI Law, 78 per cent were in these two districts. (Appendix Table 25). The need to promote regional industrialisation had been recognized by successive governments and there had been serious attempts to regionalise industries in the recent past. These efforts included the 200 Garment Factory programme, the Koggala Export Processing Zone and the Industrial Park at Pallekelle. Under the present regime, a greater emphasis has been placed on the promotion of regional industrial parks, the Southern Area Development Project and setting up Regional Development Banks as part of the overall regional development strategy. Fiscal incentives have been announced in the 1997 Budget for industries in remote areas.

The industrial estate development programme was launched in 1995 with a view to promoting industrial activities in less developed areas by making the necessary infrastructure available at regional centers and minimising the pressures and problems associated with environmental pollution, health, etc. due to the excessive concentration of industries in a few locations. This programme covers an extent of over 1,700 acres in totality and includes the establishment of two international standard industrial parks at Seethawaka and Kalutara and 23 other regional industrial estates.

Detailed engineering designs in respect of the Seethawaka Industrial Estate were completed in 1996. The Katana site had to be abandoned due to the need for airport expansion, and an alternative site in the Kalutara district has been identified. The initial investigations, feasibility studies and land acquisition work commenced in 1996. Initial work such as engineering designs, provision of basic infrastructure facilities and physical development work in respect of nine industrial estates was also commenced in 1996. Development work with regard to the Dankotuwa Industrial Estate located in the Puttalam district was completed and the industrial blocks were distributed among identified industrialists in 1996.

Regional industrialisation can be a success if it is supported by a well integrated development of the overall infrastructure such as roads, telecommunication, ports and harbours, in addition to a coherent skills development programme. Some of these may be feasible under Build, Operate and Own / Build, Operate and Tranfer (BOO/BOT) arrangements. However, launching a large scale infrastructure development programme may not be feasible without government involvement for mobilising donor support. This should be done without compromising the need to develop infrastructure on a BOO/BOT basis wherever possible.