Chapter 4

INDUSTRY

4.1 Overall Trend

In 2001, performance in the industrial sector was adversely affected by weak demand, increased cost of production and power cuts. Industrial output, measured as the output of factory industries, declined by 3.9 per cent in 2001 due to a sharp reduction in output of export oriented industries and a considerable slowing down of industries catering to the domestic market. This was the first time during the last two decades where industrial output declined. Output of factory industries grew by 11 per cent in 2000 and 9.5 per cent, per annum, during the last ten years. The major export industries such as the apparel, textiles, ceramics, rubber-based products and processed diamond were the worst affected in 2001. The output decline is mainly attributed to the deepening of the global recession, which worsened after the September 11 attacks in USA, the terrorist attack on the Katunayake International Airport, higher cost of production, power cuts, reduction in business confidence due to political and war related uncertainty and structural impediments. The output of factory industries, which accounted for 83 per cent of the manufacturing sector, contributed 41 per cent to the overall decline of GDP in 2001.

The September 11 attacks in USA that came in the midst of an already weakening global economy, abruptly disrupted global economic activities and business sentiment significantly, resulting in a sharper drop in external demand for exports from Sri Lanka. The growing risks of vulnerability, which intensified with global terrorist activities, contributed to increase transaction costs, reduce efficiency and lower productivity. The terrorist attack on the Katunayake International Airport on 24 July 2001 adversely impacted on export oriented industries. The immediate impact of the Katunayake disaster was that some ships by-passed Colombo harbour and therefore, export cargo could not be shipped on time. Raw materials required for production were unloaded in neighbouring ports, increasing the cost of freight and turn-around time. The imposition of a war surcharge on insurance premia for flights and ships destined for Colombo adversely affected the competitiveness of exports. Although there were some advantages arising from the depreciation of the rupee, it was not sufficient to compensate for cost increases.

The apparel and textiles sector, the largest sub sector in the export-oriented industries, declined by 8.5 per cent in 2001 as compared with a 15.9 per cent increase in 2000. As buyers cancelled orders or demanded high discounts for delays following the attack on the Katunayake International Airport, many firms were forced to accumulate large inventories. Travel warnings and difficulties in getting flights

Chart 4.1
Growth and Composition of Industrial Production

Chart 4.1.1
Growth in Industrial Output

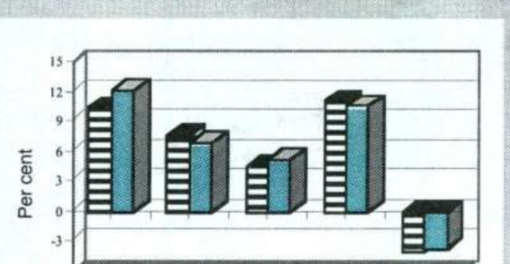
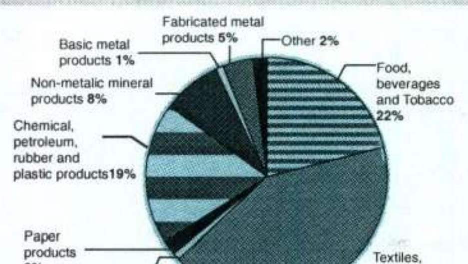


Chart 4.1.2
Composition of Industrial Production - 2001



to and from Colombo resulted in many buyers keeping away from Sri Lanka, particularly at a time when they usually place spring and summer orders for production from September onwards. The reduction in air cargo of high value garments and promotional garments, whose timely delivery is essential, had a severe adverse impact on apparel exports.

In addition, competition on the global apparel and textiles market intensified due to special concessions granted to some African and Caribbean countries by USA and increased supply from low-cost manufacturing countries in Eastern Europe and China. The East European countries were more competitive in terms of lead-time as they are geographically closer to the EU. The low cost manufacturing countries who offered competitive prices attracted more buyers. China, with its own fabric and accessory manufacturing base, massive manufacturing capacity and relatively cheap labour, entered into international markets strongly after its accession to the WTO in 2001, intensifying the competition faced by Sri Lanka.

The output of several industries catering to the domestic market that manufacture intermediate goods such as cement, asbestos, concrete products, cables, animal feed, plastic packing materials and metal products grew moderately in 2001. The output of petroleum products, soft drinks, tobacco, agro-chemicals, fertiliser, coconut products, sugar, paints and glass declined in 2001. The weak consumer spending due to slowing down of economic activities has had an adverse impact on domestic demand. In the depressed market conditions, some manufacturers introduced various sales promotion activities such as easy payment schemes without interest, gift vouchers, lotteries and various forms of incentives, squeezing their profit margins.

In addition to the depressed international and domestic demand,manufacturers also faced several structural impediments. In order to counteract the reduction in demand, manufacturers were not able to scale down the workforce because of rigid labour laws. They also faced high labour turnover, skills deficiency and labour union action. The complex legal system caused long delays in the finalisation of court proceedings. Manufacturers were badly affected by frequent power interruptions and fluctuations in voltage. The competitiveness of domestic market oriented industries was

TABLE 4.1
Value of Industrial Production
(1990 Constant Prices)

Categories	Rs. Million					Percentage Change	
	1997	1998	1999	2000	2001(a)	2000	2001(a)
1 Food, beverages and tobacco products	37,146	40,756	41,742	44,241	45,595	6.0	3.1
Food and other	22,343	24,910	26,330	28,094	29,146	6.7	3.7
Liquor	2,961	3,458	3,327	3,397	3,478	2.1	2.4
Beverages	6,032	6,590	6,432	7,210	7,548	12.1	4.7
Tobacco products	5,810	5,798	5,653	5,540	5,423	-2.0	-2.1
2 Textile, wearing apparel and leather products	69,769	72,943	78,282	90,716	82,996	15.9	-8.5
Apparel	59,780	62,602	67,861	79,126	72,300	16.6	-8.6
Textile	6,926	7,226	7,197	8,140	7,439	13.1	-8.6
Leather	3,063	3,115	3,224	3,450	3,257	7.0	-5.6
3 Wood and wood products	1,334	1,378	1,423	1,544	1,487	8.5	-3.7
4 Paper and paper products	3,561	3,446	3,412	3,624	3,732	6.2	3.0
5 Chemical, petroleum, rubber and plastic products	32,082	36,223	36,281	41,140	38,849	13.4	-5.6
Chemicals, paints and Fertilizers	4,584	5,182	5,571	6,379	6,155	14.5	-3.5
Rubber	5,539	6,015	6,082	6,824	6,104	12.2	-10.6
Plastic & PVC	3,584	3,874	4,292	4,571	5,051	6.5	10.5
Pharmaceuticals, detergent and other	8,797	9,853	10,336	10,956	10,532	6.0	-3.9
Petroleum	9,578	11,299	10,000	12,410	11,007	24.1	-11.3
6 Non metallic mineral products	13,914	14,619	15,740	16,091	16,010	2.2	-0.5
Diamond Processing	4,753	4,360	5,049	5,175	5,056	2.5	-2.3
Ceramic Products	1,926	1,991	2,029	2,053	1,808	1.2	-11.9
Cement	3,896	4,628	4,785	4,823	4,943	0.8	2.5
Building Material and other	3,339	3,640	3,877	4,040	4,203	4.2	4.0
7 Basic metal products	1,671	1,856	1,917	2,024	2,096	5.6	3.6
8 Fabricated metal products, Machinery and Transport Equipment	7,437	8,235	8,680	9,071	9,261	4.5	2.1
9 Manufactured products not elsewhere specified	3,904	4,093	4,375	4,559	4,627	4.2	1.5
Total	170,818	183,549	191,852	213,010	204,653	11.0	-3.9

(a) Provisional

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

weakened by unfair trade practices such as import of used goods and parts, leakage of BOI products to the domestic market and bureaucratic delays. High interest cost of short-term borrowings, higher incidence of cheque returns and delays in payments for goods and services supplied to government institutions created liquidity problems for industrialists. Laws in respect of business restructuring in Sri Lanka did not allow smooth business re-organisation or restructuring. However, a few firms were able to restructure themselves using attractive voluntary retirement schemes.

The low demand for labour that arose from sluggish economic activities was aggravated by low labour productivity as well. The Industrial Survey of 480 non-BOI firms indicates a decline of labour productivity by 2.5 per cent in 2001 on account of lower capacity utilisation, restrictive labour regulations, poor working conditions, insufficient incentives for workers, high labour turnover and absenteeism and strained employer-employee relations. The rising cost of living has exerted upward pressure on wages. The falling productivity growth in Sri Lanka, eroding its long-term competitive advantage, is worrisome because of the increasing tendency for cheaper production bases to emerge elsewhere in the world. To improve labour productivity, there is a need for investment in human capital, improve technology and implement equitable performance evaluation and reward systems.

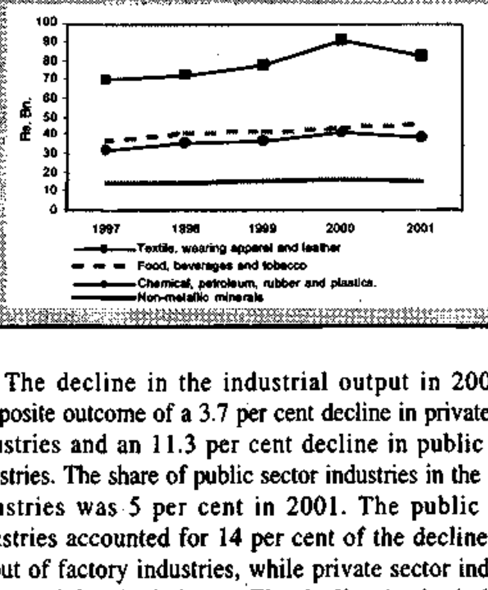
Profitability in the industrial sector, estimated by using non-BOI industry survey data, shows a significant decline from 13.7 per cent in 2000 to 10.4 per cent in 2001. Increased prices of utilities, the increase in the National Security Levy (NSL), together with a surcharge on corporate tax and surcharge on imports, affected the profitability of the industrial sector.

On the policy front, the government continued with its private sector led export oriented policy. During the year, the government took initiatives to harmonise BOI and non-BOI regimes in the apparel sector. Under this,enterprises which are carrying on the business of manufacture and export of apparel products with a minimum of fifty employees have been recognised to receive approval under Section 17 of the BOI Law, provided such enterprise exports a minimum of 90 per cent of its output.The future industrial policy of the country should be directed to removing impediments and unnecessary controls in conducting businesses. Government regulations in certain activities, such as time-consuming reporting requirements and unnecessary approvals, should be eliminated to reap the benefits of the market mechanism. In areas where regulations are necessary, they should be transparent and formulated on a platform based on minimum controls and interference and to encourage delegation and empowerment of officials to take decisions in order to improve the efficiency of the system. The future industrial policy of the government should also focus on facilitating global trade, especially in the areas of trade negotiations, improving business environment and enhancing competitiveness, improving corporate governance and enabling firms to better harness the benefits of investment in knowledge and human capital. There is also a need for a strategy to diversify and widen Sri Lanka's industrial base, as the current narrow base is too vulnerable to external shocks.

4.2 Production

The output of the factory industries in 2001 was estimated on the basis of the Annual Industrial Production Survey-2001 conducted by the Central Bank of Sri Lanka covering 480 non-BOI firms, output of public sector enterprises and export data from BOI firms. According to these estimates, the output of factory industries declined by 3.9 per cent in real terms and increased by 7.7 per cent in nominal terms, resulting in an implicit price deflator of 12.1 per cent for factory industries in 2001. The estimates cover only one sub-sector of the manufacturing industries, i.e., factory industries.Output of the other two sub-sectors of the manufacturing sector, viz., agriculture processing and small industries, was estimated separately.

Chart 4.2
Performance in Major Industrial Sub Sectors
(1990 Constant Prices)



The decline in the industrial output in 2001 is a composite outcome of a 3.7 per cent decline in private sector industries and an 11.3 per cent decline in public sector industries. The share of public sector industries in the factory industries was 5 per cent in 2001. The public sector industries accounted for 14 per cent of the decline in the output of factory industries, while private sector industries accounted for the balance. The decline in the industrial output in 2001 was concentrated in two major industrial categories, viz., textiles, wearing apparel and leather products and chemical, rubber and plastic products. These two categories accounted for over 100 per cent of the decline in the industrial sector output in 2001.

Private Sector Industries

The output of private sector industries declined by 3.7 per cent in 2001 compared to a 10.5 per cent growth in 2000.

Box 6

Industrial Sickness : Causes and Solutions

Industrial sickness is the situation in which an industrial enterprise has accumulated losses exceeding its net worth, and therefore has to depend on frequent infusion of external funds for its sustenance. Industrial sickness and business failures are common phenomena in a market economy. They are often the results of increased competition either due to increased number of suppliers or innovations leading to improved quality, or reduced costs. The sickness could also arise as a result of market rigidities, unfair trading practices, infrastructure bottlenecks and failure in policy co-ordination. The latter class of problems could be solved by active government intervention, but the former is the market's own way of causing natural selection, as Joseph Schumpeter put it, through 'creative destruction'. However, even in the case of creative destruction, the existing rules and regulations should provide flexibility to restructure a firm's operations and reuse its capital effectively and efficiently.

Industrial sickness generally results in losses of production, job cuts and reductions in tax revenue, while locking up scare resources of owners and lenders. The magnitude and incidence of industrial sickness are matters for serious concern for the government and the entire banking and financial system of the country, because a systemic sickness could undermine public confidence in the economy with serious repercussions on the overall investment climate of the economy. Therefore, it is necessary to find out the root cause or causes of industrial sickness and take necessary and suitable remedial measures in time to overcome the sickness. It will be less costly and less damaging, if the symptoms of sickness are diagnosed timely at the incipient stage and treated promptly. Remedial measures should first concentrate on causes that commonly affect all industries and then on specific causes affecting individual industrial units.

Internal factors causing sickness could be broadly categorised into start-up deficiencies and operational constraints and deficiencies. The start-up deficiencies include improper choice of factory location, uneconomic size of the project, over-estimation of demand, lack of proper planning, cost over-runs, under-estimation of financial requirements, lack of initial capital and inability to mobilise adequate finance to meet working capital requirements. The operational constraints and deficiencies include problems related to production, marketing, financial, labour and management areas.

Production problems are the inappropriate production mix, employment of obsolete plant and machinery, lack of raw materials, high customs duty and other government levies on raw materials, high utility charges and frequent power interruptions and poor quality controls. Marketing problems are the lack of domestic and foreign demand, low product quality and intense competition from relatively high quality imports, changes in consumer preferences, lack of a sound marketing strategy and planning, dependence on a single customer or on a single product, defective pricing policy and a lack of market research. Financial problems are financial irregularities, low equity base and high gearing ratio, poor financial planning and management, incorrect costing and accounting methods, siphoning off of funds, insufficient working capital and high cost of funds. Labour problems are high wages and low productivity, poor labour relations, shortage of workers, lack of skills, high labour turnover, stringent labour laws and long delays in dispute settlement, and increased trade union activities including frequent work stoppages. Management deficiencies are the lack of professionalism in management, dissension within management, dishonest management, incompetent management, lack of internal checks and controls, shortage of skilled managers, lack of feed-back to management and over centralisation of management.

A study conducted by a committee to propose solutions for industrial sickness has identified several major problems and proposed a number of solutions.[1] Some of the external problems quoted by industrialists in this survey were the importation of used goods and parts, illegal release of products to local market by industrial enterprises coming under the purview of the Board of Investment of Sri Lanka, under-invoicing, smuggling, dumping, delays and corruption at Customs, non-availability of apparel quota, large number of holidays, lack of continuous supply of raw materials,

1. Survey on Sick Industries (2001) - Report of the committee to make an assessment of industries which have been closed and industries which are vulnerable to economic adjustments and external economic shocks. Members of the committee are Governor of the Central Bank (Chairman), Deputy Chairman-National Development Council, Chairman-Board of Investment of Sri Lanka, Secretary-Ministry of Industrial Development, Commissioner of Labour, Chairman-Export Development Board, Director General- Department of Census & Statistics, Director General- Department of Fiscal Policy and Economic Affairs, Director General- Department of National Planning.

Box 6 (Contd.)

delays in payments for goods and services supplied to government institutions, resorting to parate execution by banks, absence of a state body with powers to resolve sudden crises faced by entrepreneurs, complicated revenue collection system of the government and ad hoc trade policy changes. The solutions proposed by this committee include:

1. Institutions

Promoting a single institution

- Establishment of a strong institution with public-private sector partnership by amalgamating various existing institutions and committees.

2. Labour market

Removing rigidity in labour regulations

- Urgent amendments to labour laws to allow enterprises to reduce labour during crisis periods by paying 50 per cent of basic salary.
- The finalisation of compensation formula for retrenchment as early as possible.
- Restructuring of the National Labour Advisory Council to cover a wider spectrum of representation from private sector, labour unions, Chambers and the Department of Labour to discuss and make policy recommendation on labour issues to the government.
- Popularisation of Collective Agreement concept between the workers and the employers.
- Formulation of an unemployment insurance scheme with contribution to the premium by the employer and, if necessary, a small percentage by the workers.

Resolving high labour turnover after training

- Permission should be given to manufacturers to recruit trainees for a period of at least two years without paying statutory payment such as EPF and ETF.
- Introduction of gain sharing bonus system to employees.

Resolving skill deficiency

- Restructuring existing training institutions to meet the current needs of the industries.
- Reforms in the educational system to supply job oriented training.
- Allow recruitment of foreigners with critical skills necessary to support industry needs.

Minimising labour union activities

- Introduction of law requiring the consent of over 50 per cent of workforce by secret ballots for labour union actions.

Minimising impact of large number of holidays

- Harmonise holidays for commercial sector, public sector and banks.
- Move holidays near weekends.
- Reduce the number of holidays.

Improving management of enterprises

- Private sector organisations to offer management training.
- Encourage private sector to set up training institutions in collaboration with foreign universities.

3. Energy

Resolving high electricity cost and power interruption

- Re-introduce power purchasing schemes.
- Take steps to implement the coal power project.
- Allow sharing of extra power generation by industries.
- Eliminate pilfering of electricity.
- Set a target to reduce system loss from current level of over 20 per cent to 15 per cent within 2 years and to the 12 per cent within 5 to 7 years.
- Educate industrialists to use non-oil based energy such as power generation through renewable energies, industrial waste etc.
- Popularise and encourage the use of energy conservation equipment.
- Changing the restriction of maximum capacity in the case of hydro-power generation by the private sector from 10 MW to 25 MW. However, due consideration should be given to address environmental issues.

4. Raw Material

Ensuring continuous supply of raw material

- Encouraging forward contracts and buyback agreements (outgrower system).
- Remove surcharge on imports of essential raw materials.

Removing duty on raw material

- Zero duty on raw material, if not produced in Sri Lanka and can be identified as raw material.

5. Unfair trade practices

Resolving the problem of importation of used goods and parts

- Ban imports of used goods, including used spare parts.
- Enforce strict standards on imports.

Curtailing release of BOI products to the local market and leakage from BOI factories

- Strengthening existing rules and regulations.

Box 6 (Contd.)

- Enforce high penalties for malpractice.

Curtailing under invoicing and smuggling

- Proper and strict administration of Custom regulations and higher penalties for malpractice.
- Implement the proposed ASYCUDA++ software system.

Resolving delays and alleged corruption at Customs

- Simplified procedures and documentation and adequate notification prior to change of procedures.
- Strong action against corruption.
- Install Closed Circuit Television in departments dealing with public.
- 24 hour service in all areas of operation and introduction of shift systems.
- Electronically linking Customs Department with Inland Revenue Department, banks, shipping lines, freight forwarding companies etc. through ASYCUDA++ software programme.
- Appoint a result-oriented team to implement reforms in the Customs.

Resolving the problem of dumping

- Introduction of anti-dumping law and imposition of countervailing duties.
- Impose tariff and non tariff barriers to restrict low cost and low quality imports.

Remedy for competition from non-registered industries

- Provide incentives for registration.
- Grant incentives to registered industrialists such as inviting industrialists for exhibitions.

6. Financial

Lowering interest charges

- Reduce government borrowing through reduction of non-essential recurrent expenditure.
- Reduction of interest spread through reduction of intermediation cost.
- Venture capital facilities.
- Conversion of some outstanding debt to equity.

Remedy for cheque returns

- Strengthen the law governing returned checks.

Improving payments for goods and services supplied to government institutions

- Improve government payments.
- Mandatory interest penalty after 2 months.

Resolving Parate execution/ foreclosures by banks

- Banks to strengthen loan evaluation and project monitoring activities.
- Effective monitoring of loan portfolios.
- Banks and industrialists to come to a settlement.
- Transform collateral based lending to project based lending.
- Government to establish a mechanism for restructuring.
- Trade ministry to introduce provisions similar to the US Bankruptcy Code and Chapters 7 and 11 in Sri Lanka law.

7. Markets

Ensuring sufficient quota allocation

- Improve quota allocation system.
- Increase quota allocation to small and medium scale industries.
- Explore non-quota marketing and strong lobbying in US/EU markets.
- Negotiate for concessions with USA and other major export destinations.

Enhance knowledge of markets and specific marketing requirements

- Provide information through Chambers and EDB.

Addressing the problems caused by slowing down of the global economy

- Government negotiations with governments of export destinations to have greater access to foreign markets similar to Indo-Lanka Free Trade Agreement.

8. Government Policies

Resolving problems caused by sudden crises

- Ministry of Industries to mediate and resolve crisis.
- Establish a crisis management team in each key institution and inform the public of their contact numbers.

Simplifying revenue collection system of the government

- Introduce more streamlined revenue collecting measures.
- Invite views of private sector in this regard particularly to increase revenue and reduce cost.
- Revision of Port Authority Act and Customs Ordinance to increase revenue and reduce costs.
- Extended working hours at Customs.

Removing disparities between BOI and Non-BOI industries

- Harmonisation of BOI and non-BOI industries.

Box 6 (Contd.)

- Allow duty free imports for non-BOI exporters similar to BOI exporters.

Minimising bureaucratic delays

- Deregulation.
- One stop facilitation by government institutions.

Uniformity in trade policy measures

- Pre-announced policies without sudden changes.
- Adhere to announced policies.

9. Infrastructure

Improving infrastructure

- Market oriented pricing system to encourage private sector investment in infrastructure development.
- Effective implementation of private investment programmes.
- Structural reforms in power, water, transport and port services.

If the magnitude of the sickness is so severe that it is not possible to prevent the collapse of an industrial unit by applying any remedial measures then it may be possible to prevent the collapse only through restructuring of industrial units and infusion of additional funds. As the continuous assistance and infusion of funds to commercially non-viable units would result in scarce funds being diverted from economically productive purposes, which would be counter productive to the nation as a whole, the restructuring should be based purely on economic considerations and not on political or any other considerations. If an enterprise is not deemed to be commercially viable in the long run, then it should be allowed to die a natural death rather than prolonging the life of the enterprise at a high cost to government and society.

Therefore, to facilitate the restructuring of viable enterprises and smooth liquidation of non-viable enterprises, it is necessary to have in place a sound legal and institutional framework. However, Sri Lanka lacks the necessary legal and institutional framework to assist the restructuring of sick industrial units, though ad hoc measures have had been taken from time to time to revive sick industrial units. Hence, it is suggested that Sri Lanka should introduce a comprehensive bankruptcy and re-structuring law with necessary provisions in line with both the Indian Sick Industrial Companies Act and Chapter 11 of the United States Bankruptcy Code, to deal with the systematic reorganisation of financially troubled small, medium and large scale industrial units that could be turned into financially viable enterprises within a reasonable period of time at reasonable cost.

The private sector industries accounted for 95 per cent of the industrial production in 2001. As compared with a 14 per cent growth in 2000, the output of the BOI industries declined by 7.5 per cent in 2001 reflecting a sharp drop in export demand. The output in the non-BOI sector increased by 1.5 per cent compared to 6.2 per cent in the previous year. The rate of capacity utilisation in the industrial sector declined substantially to 80 per cent in 2001 compared to 85 per cent in 2000 reflecting a slowing down of export oriented industries. This reduction is mainly reflected in the industrial categories of textile, wearing apparel and leather products; chemical, rubber and plastic products; and fabricated metal products. Employment in the industrial sector is estimated to have increased marginally in 2001.

Performance in Major Sectors

Textiles, wearing apparel and leather products

The output of textiles, apparel and leather products, which accounted for 45 per cent of the factory industrial output, declined sharply by 8.5 per cent in 2001 compared with a 15.9 per cent growth in 2000. The global demand for apparel and textiles dropped and stocks built up causing a downward trend in export orders as well as in prices. The small and medium scale industries, which sub-contract for large manufacturers, were the hardest hit with a reduction of orders. The output of apparel and textile sub-sectors declined by 8.6 per cent, while leather products declined by 5.6 per cent. Capacity utilisation in the textile and apparel sector declined from 88 per cent in 2000 to 76 per cent in 2001.

The export orders from EU and US markets, which began to decline during the first half of the year with the global economic downturn, contracted substantially during the second half of the year. These two markets account for over 90 per cent of textiles and apparel exported from Sri Lanka. The situation was further aggravated by the increased competition from other overseas suppliers to these markets, the growing trend of preferential trade in the world and increased exports by new low cost entrants to the global market. Several US importers shifted their procurement from Asian countries to Mexico, a beneficiary by way of tariff-free status in garment exports under the North American Free Trade Agreement (NAFTA). Mexico has now become the leading supplier of garments to USA. Similarly, countries in the Caribbean region and more recently, sub Saharan African countries, have been given duty free and quota free access into the US market, thereby reducing the share of Asian countries in that market. As mentioned earlier, the geographical proximity of Eastern European countries to western markets and Turkey's entry into the EU have increased competition for Asian garment exports into the EU market.

The unfavourable developments discussed above were further reinforced by the consumers in the EU market becoming more price-conscious and therefore, importers demanding large discounts from apparel exporters from Asian countries. In the higher value added clothing segment, countries such as Malaysia, Taiwan, Korea, Hong Kong and Singapore continued to be strong competitors for South Asian countries.

To face these challenges, several large manufacturers have successfully created an up-market image for Sri Lankan products in international markets through improved design, price and quality. Closer attention was paid to order placement, product development, quality control, marketing, trade financing and logistics arrangements. The major manufacturers and traders actively participated in international trade fairs led by the Board of Investment of Sri Lanka (BOI) and Export Development Board (EDB). The extensive use of information technology helped in better supply chain management, acquiring information on fashions and developing distribution networks.

The quota restrictions in the EU market were removed in 2001 following the agreement signed by the Sri Lankan government and the European Union. The quota access to the US market increased by 6.7 per cent to 391.3 million pieces in 2001. In the Canadian market, the quota increased by 9.5 per cent to 14.8 million pieces. In 2001, Sri Lanka exported 47 different apparel and textile items to these two markets. The utilisation of quota in the USA market declined by 7.5 per cent from 308.8 million pieces in 2000 to 285.6 million pieces in 2001, reducing the quota utilisation rate to 73 per cent from 84.2 per cent. The utilisation rate of apparel quota declined from 88.8 per cent in 2000 to 80.1 per cent while that of fabrics declined from 28.5 per cent in 2000 to 13.9 per cent in 2001. However, the quota utilisation rate was over 90 per cent in respect of 8 quota items in 2001. The quota items of knit shirts and blouses, sweaters, trousers and underwear were fully utilised during the year. The utilisation rate was below 25 per cent in quota items of playsuits, fabric poplins, suit-type coats, pillowcases, dishtowels, and fabric spun cells due to the higher competition in obtaining orders for these products. The utilisation rate in the Canadian market declined marginally from 43.4 per cent in 2000 to 42.3 per cent in 2001. Most popular quota items in the Canadian market were winter outwear, trousers, overalls and shorts, shirts, blouses and babies' garments.

The demand pattern and fashion in the apparel industry have changed significantly in recent years. The pursuit of a leisurely lifestyle has caused dramatic changes in the fashion industry shifting from structured clothing toward casual items. The spread of relaxed office dress codes has boosted the demand for casual wear. Many companies in US, Europe and Japan now adopt casual Fridays or dressed down Fridays practices allowing employees to come in less formal attire. The recent emphasis on business casual attire has resulted in

TABLE 4.2
Private Sector Industrial Production Index

1990=100

Categories	Index					Percentage Change	
	1997	1998	1999	2000	2001(a)	2000	2001(a)
1 Food, beverages and tobacco products	172	188	193	205	211	6.1	3.1
Food and other	176	196	207	218	225	5.1	3.5
Liquor	177	207	199	203	208	2.1	2.4
Beverages	207	226	221	248	259	12.1	4.7
Tobacco	121	121	118	116	113	-2.0	-2.1
2 Textile, wearing apparel and leather products	258	269	289	335	306	15.9	-8.5
Apparel	283	297	322	375	343	16.6	-8.6
Textile	191	199	198	224	205	13.1	-8.6
Leather	193	196	203	217	205	7.1	-5.6
3 Wood and wood products	165	163	168	178	180	5.8	1.1
4 Paper and paper products	287	289	292	314	324	7.7	3.0
5 Chemical, petroleum, rubber and plastic products	257	286	299	326	318	9.1	-2.5
Chemicals, paints and Fertilizers	212	240	258	292	282	13.1	-3.5
Rubber	253	274	279	313	280	12.1	-10.6
Plastic & PVC	210	227	252	268	297	6.5	10.5
Pharmaceuticals, detergent and other	265	297	312	331	318	6.0	-3.9
6 Non metallic mineral products	254	267	288	294	296	2.2	-0.5
Diamond Processing	260	237	274	281	274	2.5	-2.3
Ceramic Products	189	195	199	201	177	1.2	-11.9
Cement	232	276	285	287	294	0.8	2.5
Building Material and other	221	241	257	268	279	4.2	4.0
7 Basic metal products	359	399	412	435	451	5.6	3.6
8 Fabricated metal products, machinery and Transport equipment	178	197	208	217	222	4.5	2.1
9 Manufactured products not elsewhere specified	250	262	280	292	296	4.2	1.5
All Categories	230	246	259	286	276	10.5	-3.7

(a) Provisional

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

high demand for shirt-jackets, relaxed coats, knitted shirts, twinsets, khakis, deconstructed skirts etc. Some major manufacturers in Sri Lanka have changed their production process to supply these products.

With this changing environment in the global market, Sri Lanka will have to increase its market share in niche markets in Western countries and also tie up with their fashion houses. It is essential to shift to high value added items and focus more on customer segmentation and modern production technology to capture demand in niche markets. There is higher potential in the market segments of clothes for babies and children clothes as parents and relatives often buy in a higher price range. To attract the consumers of these items, more prominence should be given to modern designs. Image building campaigns and strong lobbying would be necessary to obtain more export orders. The selection of fabrics, delivery speed and competitive prices also play a key role in attracting foreign demand.

Major factors affecting the competitiveness of the Sri Lankan garment industry are the low labour productivity and insufficient application of modern technology. It has become evident that Sri Lanka cannot compete on low labour costs alone. Emphasis should now shift to improving total factor productivity in the industry. Improvement in productivity of the garment sector has been hindered by several factors such as absenteeism of factory staff as a result of poor transport and accommodation facilities, inadequate training, frequent power failures and machine breakdowns.

Food, beverages and tobacco products

The output of the food, beverages and tobacco category grew moderately by 3.1 per cent in 2001 as compared with a 6.1 per cent growth in 2000. Increased production was registered in the major sub sectors of food processing (3.5 per cent), beverages (4.7 per cent) and liquor (2.4 per cent). Output in the tobacco sub sector declined by 2.1 per cent. The moderation of growth of this category is mainly attributed to weak consumer demand on account of the slowdown of economic activities. However, despite the reduction in sales, several manufacturers continued to invest in improving distribution methods, innovative sales promotions and in improving product quality with the adoption of advanced technology in production, quality control and packaging.

The output of the food sub sector increased in 2001 with higher production in milk products, wheat flour processing, processed meat products, food processing and animal feed. The growth of the meat processing industry was moderate at 2.5 per cent in 2001 as a result of the slower growth in demand during the second half of the year. The meat-processing industry experienced difficulties during the second half of the year with a drastic reduction in demand following the setback in the tourist industry and reduced domestic consumer demand. Power cuts of up to eight hours a day during the third quarter hampered the growth of the industry through storage problems.

However, large factories in the meat processing industry have been automated to achieve higher productivity through minimum human intervention thereby acquiring internationally accepted standards for hygiene and safety. The product launches in this industry were supported by improved communications, packaging and updated screening systems to minimise risks of product launch failure.

The international prices of milk products increased significantly in 2001 due to global supply shortages resulting from the wide spread foot and mouth disease. Consequently, the domestic price of milk powder increased significantly during the year as the country depends heavily on imports. Despite these price increases, the milk powder processing industry registered a relatively higher growth in 2001. The domestic milk powder manufacturing industry also grew by 9.2 per cent with the increased availability of fresh milk. In

TABLE 4.3

Value of Industrial Production (a)

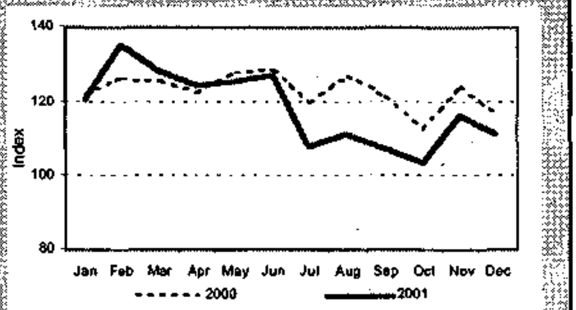
Categories	Rs. Million					Percentage Change	
	1997	1998	1999	2000	2001(b)	2000	2001(b)
1 Food, beverages and tobacco products	75,713	86,994	94,687	105,671	120,359	11.6	13.9
2 Textile, wearing apparel and leather products	146,500	165,443	178,844	215,686	224,898	20.6	4.3
3 Wood and wood products	2,299	2,511	2,715	3,084	3,272	13.6	6.1
4 Paper and paper products	5,462	5,593	5,854	6,516	7,369	11.3	13.1
5 Chemical, petroleum, rubber and plastic products	50,682	59,724	62,590	74,670	78,553	19.3	5.2
6 Non metallic mineral products	21,403	23,830	26,830	28,198	31,892	5.1	13.1
7 Basic metal products	2,439	2,841	3,046	3,378	3,888	10.9	15.1
8 Fabricated metal products, machinery, and transport equipment	11,327	13,241	14,305	15,678	17,638	9.6	12.5
9 Manufactured products not elsewhere specified	7,324	8,137	9,002	9,839	10,361	9.3	5.3
Total	323,149	368,314	397,873	462,720	498,230	16.3	7.7

(a) Value of production is estimated on the basis of ex-factory value of production
(b) Provisional

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

view of increasing prices of imported dairy products, the Estate Infrastructure and Livestock Development Ministry in association with the Agricultural Insurance Board has launched a programme to promote dairy products in the country.

Chart 4.3
Private Sector Industrial Production Volume Index
(1997 = 100)



The production of the animal feed industry continued to grow due to increased demand from the growing poultry farming industry. Continuous growth in the flour based food-processing industry and changes in the food habits, especially in urban areas, boosted the demand for wheat flour. The liberalisation of wheat and wheat flour imports in 2001 paved the way for setting up of new flour mills and expanding the existing processing plant. The output of biscuits declined by 3.7 per cent in 2001 due to labour unrest in a major factory. However, some manufacturers introduced new products successfully to the domestic and international markets in 2001. The beverages sub sector grew by 4.7 per cent with higher production in processed tea and fruit processing. Despite the aggressive advertising campaigns, improved distribution methods and the dry weather condition that prevailed in many parts of the country, the output of the soft drink industry declined by 5 per cent.

The output of liquor grew by 2.4 per cent in 2001 reflecting the expansion of output of beer. The major beer manufacturers exported to Japan, UK, Maldives and USA. During the year, significant investments were made in extensive market research, packaging, promotion and establishment of distribution networks overseas. The output of the hard liquor industry registered a marginal decline in 2001 following the upward revision of prices, which increased the relative prices in favour of illicit liquor. In the hard liquor industry, the introduction of new bottles, labelling and caps has successfully countered the illicit imitation of products manufactured by the leading manufacturers. The output of cigarette declined due to expansion in illicit cigarette production and a sluggish demand resulting from a greater awareness of tobacco related health problems.

Chemicals, petroleum, rubber and plastic products

The output of chemical, petroleum, rubber and plastic products category declined by 2.5 per cent reflecting lower output in rubber based products, pharmaceuticals, soap and detergents, agro-chemicals and fertiliser. With the downturn in the global economy, the output of the rubber-based industry declined by 10.6 per cent in 2001. The cost of production in the rubber based industry increased substantially in 2001. Cost escalations were higher in latex, energy and other imported inputs. However, the depreciation of rupee softened the impact of cost escalations providing some relief to face the pressure from South East Asian competitors. The strategies adopted in advance by manufacturers to meet the challenges posed by the slower growth expected in 2001 helped to counter negative consequences to a certain extent. These strategies included broadening of the product range to high value added items, improvement of product quality to international standards and computerisation of production processes and controls. Attempts by manufacturers to become the most cost-effective manufacturers in the region continued. A large manufacturer of non-medical rubber gloves received a testing and verification certificate from the Geneva based Society Generale de Surveillance (SGS), a world leader in inspection, testing and verification. This provided an assurance to retailers that suppliers conform to internationally recognised standards covering production quality and process controls, personnel safety and environment practices.

Despite the price advantage over imported items, the output in the pharmaceuticals industry declined in 2001. Two large pharmaceutical manufacturing firms merged in 2001 for mutual benefits. This merger is expected to bring in several advantages including pooling of research and development resources, reduction in sales promotion costs and reduction in price competition in the market. The output of the soap and detergent industry also declined in 2001 due to depressed market conditions. In order to encourage consumer demand, manufacturers adopted several strategies. These included, market segmentation, and discounts and sales promotions through aggressive advertising. Some manufacturers in the detergent industry benefited from the market segmentation. Mini-packs of toothpaste, shampoo and perfume, with special prices, were supplied to the market, aimed at lower income consumers. One large firm in the soap manufacturing industry began to export 'soap chips' to India in 2001 for the first time. With the implementation of FTA, Sri Lanka has become a competitive source of soap chips to India, as importers have to pay only 50 per cent of the Indian standard duty rate. In the domestic market, herbal shampoos, soap, lotions and cream have become popular among consumers.

In the chemical and fertiliser sub sector, the output of activated carbon, fertiliser, weedicides and insecticides declined in 2001, while the output of mosquito coils and chemicals grew moderately. The output of the activated carbon industry declined in 2001 reflecting a reduction in export demand and increased competition in international markets. With fiscal protection offered for copra and coconut oil production through high tariff on edible oil imports, more nuts were directed for their use from the desiccated coconut industry reducing the shells available for the activated carbon industry. The lower coconut output due to the drought adversely affected the industry. The Philippines and India are becoming highly competitive producers of activated carbon in international markets. However, the industry saved considerably in energy costs with continuing improvements in the recovery of waste heat for steam generation. The depreciation of rupee also provided some relief.

Despite weak consumer spending, the plastics industry grew by 10.5 per cent with higher output in plastic furniture, household items, building and packing materials. The substitution of plastic products for wood products continued due to the price advantage of plastic products. The major manufacturers of plastic furniture introduced wood finish ranges of plastic furniture. Aggressive advertising also attracted consumers to plastic furniture.

Non-metallic mineral products

The output of non-metallic mineral products declined marginally by 0.5 per cent because of the lower output in ceramics, glass and diamond processing. The output of concrete products, asbestos and cement registered a moderate growth in 2001 in response to moderate expansion in the construction industry. The ceramic industry continued to suffer from increased competition in international markets. There was a considerable oversupply of ceramic products in the world market with the expansion of factories in China and Eastern European countries. The factories in the Eastern European countries had competitive advantages in the EU market due to lower tariff rates, geographical proximity and shorter lead-time. In the US market, there is a new trend where consumers prefer for more casual 'in-glaze' tableware to traditional high standard items. This trend has created a pressure for gold and silver decorated high quality products manufactured in Sri Lanka. With this changing market environment, Chinese manufacturers, with their ability to offer average quality products at lower prices, were at an advantage. Rising costs of electricity, diesel, gas, imported raw material and labour reduced competitiveness, but depreciation of rupee helped the industry to a certain extent. In order to regain export competitiveness, major ceramic manufacturers focused more on entering new markets and reducing costs. Some manufacturers expanded sales in the domestic market through image building campaigns, improving marketing links, introducing sub brands and through other means of sales promotion. As a part of the promotion strategy, manufacturers held a number of workshops and seminars in various parts of the country to educate architects, engineers and contractors on the selection of tiles and grouting materials, preparation of floor and on tile laying.

The output of the glass industry declined by 10 per cent in 2001. The glass industry, a high energy intensive industry, suffered from the steep increase in energy prices. Some parts of these cost increases were passed on to consumers, as prices of imported substitute products also increased with the depreciation of rupee. Major manufacturers in the industry invested in new technology to improve colouring of final products.This enabled manufacturers to produce coloured bottles without changing the colour in the furnace.

The output of the cement industry registered only a marginal growth due to the competition from imported cement following the reduction of tariff to 10 per cent on imports of bulk cement and 15 per cent on cement bags. Under the FTA, tariff on cement imported from India was 9.5 per cent.

Fabricated metal products

The output of fabricated metal products grew by 2.1 per cent in 2001 with increased production in electronic parts, ferrite cores, computer parts and transformers manufactured by BOI industries. Non-BOI industries manufacturing cables, assembling and manufacturing of television sets, aluminium products, light fittings, metal products, wire mesh, fencing, laminated tubes, cans, domestic water pumps and repairing and manufacturing of ships and boats registered higher output levels in 2001. However, the output of batteries, electric and agricultural machinery, bulbs, refrigerators and fabrication of bus bodies declined in 2001.

The output of the shipbuilding and repairing industry increased in 2001 with the new orders placed by the government and neighbouring countries. The shipbuilding and repairing industry continued to improve its infrastructure facilities, technology and skills over the years. The moderate expansion of the construction industry generated the demand for cables, aluminium products and light fittings. The continuous improvement of product quality encouraged builders to use more domestically manufactured cables and light fittings. In the construction industry, there is a growing popularity of substituting aluminium products for wood products. The demand for office and household furniture increased in 2001 due to the switch over from wood furniture to metal furniture on account of price advantage and durability. The output of fabrication of motor coaches declined in 2001 as orders from the regional bus companies and the private sector declined. The reduction of agricultural activity due to the prolonged drought reduced the demand for agricultural machinery and other consumer durable.

Other products

Output of paper and paper products grew by 3 per cent in 2001. Newspapers, books and magazines, labels, posters and exercise books registered relatively higher growth in 2001. The quality of printed materials improved significantly with continuous improvement in technology and the utilisation of modern equipment. There was a higher demand for magazines and tabloids, especially in the fields of politics, languages, business and leisure activities. The growing popularity of posters for advertising stimulated the demand for these products. The demand for corrugated cartons, packing material and labels declined on account of the slower growth in export oriented industries. The output of products such as photo albums, books and periodicals and paper sacks manufactured by BOI firms grew moderately during the year.

The demand for wood and wood products continued to decline with the growing popularity of steel and plastic furniture in place of wood products. The wood and wood products industry also suffered from increased raw material prices and scarcity of skilled labour. The availability of imported furniture also reduced the demand for domestically manufactured furniture. Wood products manufactured by BOI firms for export markets were sports equipment, wooden educational items, wooden toys, handicrafts and gift items. Several major manufacturers installed new machines to replace most manual work in the wood manufacturing industry.

The export oriented coir fibre industry registered a relatively higher growth benefiting from the introduction of products in new forms, improved quality and closer relationships with customers. The fall in coconut production in 2001 increased the basic raw material cost in the industry. A voluminous material like coir fibre was affected adversely by the increase in transportation costs resulting from fuel price hikes. International prices of coir fibre in dollar terms remained unchanged during the reference year. Higher competition for these products came from India and the Philippines. Freight costs, which have a significant impact on export prices of fibre products, did not change significantly in 2001. In the domestic market, the demand for fibre mattresses declined as traditional bedding manufacturers shifted to cheaper textile waste replacing fibre.

Public Sector Industries

The output of public sector industrial enterprises, in real terms, decreased by 11.3 per cent in 2001, when compared with a growth of 24.2 per cent in 2000. The closure of the oil refinery of the Ceylon Petroleum Corporation (CPC) for routine maintenance work for about a month in the early part of 2001, as compared to uninterrupted production in the previous year, was mainly responsible for the decrease in the output of public sector industries. The output of the CPC, which accounts for over 90 per cent of public sector industrial output, decreased by 11.2 per cent in 2001. Public sector industrial output, excluding petroleum products, also decreased by about 5.8 per cent in 2001.

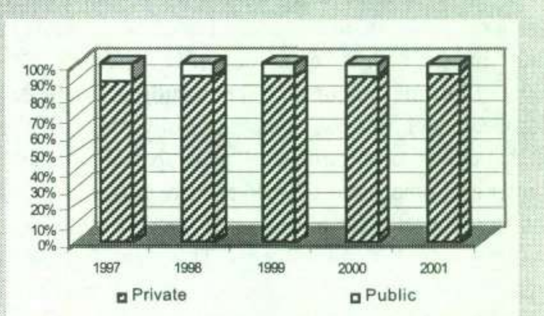
Sri Lanka Rubber Manufacturing and Exports Corporation Ltd., converted some of its factories to manufacture final consumer goods such as moulded products, bicycle tyres and tubes, and three-wheeler tyres for the export market. National Paper Company Ltd., received more waste paper for processing in 2001.

The State Timber Corporation faced lower demand for transmission poles and sleepers from the Ceylon Electricity Board and Sri Lanka Railway. The output of Sevanagala Sugar Industries Ltd. registered a decrease of 20.6 per cent in 2001 due to a drop in crop yield and the sugar recovery rate that resulted from prolonged drought in the sugarcane cultivation areas and destruction of sugarcane plantations by bush fire.

4.3 Value Addition

Value added in the industrial sector in nominal terms increased by 7.2 per cent in 2001. In real terms, the value added was estimated to have declined by 3.8 per cent. Value added, as a ratio of the total value of production, remained unchanged at 36 per cent in 2001. Lower capacity utilisation due to depressed domestic and international markets and structural impediments in the economy adversely affected the value addition in the industrial sector. The increase in the cost of production in the industrial sector and power cuts during the second half of the year reduced the potential growth in value addition in the industrial sector. The value-added ratios of major industrial categories such as textiles, wearing apparel and leather products and food, beverages and tobacco products declined in 2001. The value-added ratios

Chart 4.4
Private and Public Sector Share in Industrial Production



were above 45 per cent in food, beverages and tobacco products; wood and wood products; non-metallic mineral products and fabricated metal products. The lowest value added ratio of 24.5 per cent was in chemicals, rubber and plastic products.

4.4 Cost of Production, Profitability and Employment

The average ex-factory profit ratio in the non-BOI industrial sector declined from 13.7 per cent in 2000 to 10.4 per cent in 2001. The ex-factory profit ratio was estimated on the basis

TABLE 4.4

Public Sector Major Industry Output Index

1997=100

	Categories	Index					Percentage Change	
		1997	1998	1999	2000	2001(a)	2000	2001(a)
1	Food, beverages and tobacco products	100.0	105.6	106.5	139.8	128.1	31.3	-8.4
2	Textile, wearing apparel and leather products	-	-	-	-	-	-	-
3	Wood and wood products	100.0	119.2	126.5	213.3	127.9	68.6	-40.0
4	Paper and paper products	100.0	74.3	38.2	29.6	40.6	-22.4	37.1
5	Chemical, petroleum, rubber and Plastic products	100.0	98.3	84.4	104.9	93.0	24.3	-11.3
	Petroleum products	100.0	95.2	84.4	104.9	93.2	24.3	-11.2
6	Non metallic mineral products	100.0	143.0	70.5	82.6	83.4	17.2	1.0
7	Basic metal products	-	-	-	-	-	-	-
8	Fabricated metal products, machinery, and transport equipment	-	-	-	-	-	-	-
	All Categories	100.0	97.9	83.1	103.2	91.5	24.2	-11.3
	Excluding Petroleum	100.0	93.5	68.5	82.8	78.0	20.9	-5.8

(a) Provisional

Source:Central Bank of Sri Lanka

of excess of the ex-factory value of production over the total cost of production. The rise in the cost of production, caused by the higher costs of imported raw materials, increased fuel, electricity and telecommunication prices and high interest rates adversely affected the profitability of industries. The surcharge on import duties and corporate tax and the increase in the defence levy, exerted further downward pressures on the profit margins. However, a fraction of the cost increases was passed down to consumers. In the case of export oriented and imports substitution industries, the depreciation of rupee softened the pressure on declining profit margins. The pressure on profit margins also eased on account of waste reduction, energy saving, better use of raw materials, improved procurement procedures and outsourcing of production. Manufacturers also paid more attention to improve the efficiency of managing working capital to reduce short-term borrowing and thereby to reduce interest costs. Profitability in the non-BOI industrial sector ranged from 15.1 per cent in the textile, wearing apparel and leather products category to 9.1 per cent in the other manufacturing product category. The profitability of the textile, wearing apparel and leather product category declined from 19.8 per cent in the 2000 to 15.1 per cent in 2001.

The share of the wage bill in the total cost of production remained unchanged at 12 per cent in 2001, as there were no major wage revisions during the year. However, there was a growing pressure for wage increases on account of the rising cost of living. The difficult market environment encountered by the manufacturers reduced the pressure and thereby contained the growth of the wage bill. The overtime bill in the apparel industry declined with lower capacity utilisation. Some manufacturers paid only half a month's salary and requested employees to stay at home due to reduced export orders. Many companies adopted the strategy of out-sourcing of high cost units to reduce the total wage bill. The voluntary retirement schemes introduced by a few companies also had beneficial effects on reducing the total wage bill. Stringent labour laws and seasonal production requirements encouraged manufacturers to recruit contract and casual labour reducing the upward pressure on wage bill. The wage bill as a

TABLE 4.5

Value Added in Industry (Current Prices)

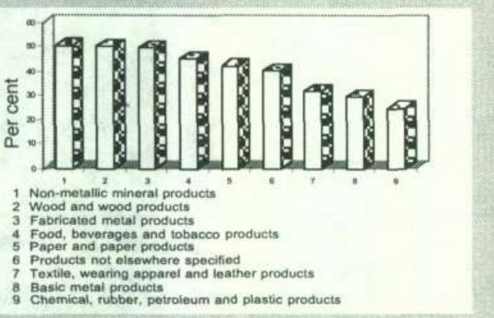
	Categories	Rs. Million					Percentage Change	
		1997	1998	1999	2000	2001(a)	2000	2001(a)
1	Food, beverages and tobacco products	35,515	40,452	44,503	49,031	54,282	10.2	10.7
2	Textile, wearing apparel and leather products	40,581	47,482	55,263	69,451	71,263	25.7	2.6
3	Wood and wood products	1,258	1,313	1,390	1,554	1,639	11.8	5.5
4	Paper and paper products	2,633	2,578	2,664	2,808	3,103	5.4	10.5
5	Chemical, petroleum, rubber and plastic products	10,745	14,274	13,832	17,771	19,245	28.5	8.3
6	Non metallic mineral products	11,600	12,463	13,817	14,240	16,010	3.1	12.4
7	Basic metal products	598	710	777	959	1,131	23.4	17.9
8	Fabricated metal products, machinery, and transport equipment	5,924	6,779	7,367	7,714	8,731	4.7	13.2
9	Manufactured products not elsewhere specified	3,157	3,426	3,799	3,965	4,154	4.4	4.8
	Total	112,011	129,477	143,412	167,493	179,559	16.8	7.2

(a) Provisional

Source: Central Bank of Sri Lanka

percentage of total cost of production increased in the industrial categories of food, beverages and tobacco and other manufactured products. The share of labour cost declined in the industrial categories of textiles, wearing apparel and leather products; chemical, rubber and plastic products; paper and paper products; fabricated metal products and non-metallic mineral products. The share of labour cost was over 15 per cent in the industrial categories of textiles, wearing apparel and leather products, wood and wood products and non-metallic mineral products. Labour costs were relatively low in the industrial categories of food, beverages and tobacco and basic metal products.

Chart 4.5
Value Added Percentages in Industrial Production - 2001



Energy costs as a percentage of the total cost of production increased to 5.3 per cent in 2001 from 4.7 per cent in 2000. The upward adjustment of prices of electricity, gas, furnace oil and diesel was responsible for the increase in the energy cost during this period. The higher energy consuming industries such as cement, ceramics, glass and basic metal were the worst affected industries by the increasing energy prices. The share of electricity cost in the total cost of production increased in all categories in 2001. The share of energy costs in the total cost of production in the non-metallic mineral product category increased from 16.4 per cent in 2000 to 17.9 per cent in 2001. The share of energy costs was low in the industrial categories of food, beverages and tobacco and paper and paper products.

The interest cost as a percentage of the total cost of production also increased to 2.9 per cent in 2001 from 2.5 per cent in the previous year. Although the insignificant share of the interest cost in the total costs nullifies the widely held argument that high interest costs lead to high cost of production, in general, high interest rates deter growth of enterprises and competitiveness. The fact that some manufacturers successfully managed to contain the interest cost through the better management of working capital requirements is a salutary development noted in 2001. It is now time for all enterprises to reduce their interest cost on bank borrowings by resorting to various other market instruments such as commercial paper and debentures. It is the challenge for the authorities to provide an enabling environment, which would facilitate entrepreneurs to shift from the money market to the debt market.

Labour Productivity in Industry

Labour productivity, estimated as the change in the real value added per man-hour in the 480 non-BOI enterprises, declined by 2.5 per cent in 2001 in contrast to the 3.6 per cent growth in 2000. The reduction in labour productivity was observed in many industrial categories. Labour productivity declined significantly in the industrial categories of textiles, wearing apparel and leather (7.1 per cent); food, beverages and tobacco (2.6 per cent); and wood and wood products (3.4 per cent). Lower capacity utilisation on account of depressed domestic and international markets was the major reason for declining labour productivity. Restrictive labour regulations, poor working conditions, insufficient incentives for workers, high labour turnover and absenteeism and strained employer-

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

	Categories	Total Cost of Production (Rs. Mn.)		Total Value of Production (Rs. Mn.)		Factory Profit Ratio (percentage)	
		2000	2001(b)	2000	2001(b)	2000	2001(b)
1	Food, beverages and tobacco products	50,311	60,507	58,230	67,081	13.6	9.8
2	Textile, wearing apparel and leather products	16,103	16,620	20,078	19,576	19.8	15.1
3	Wood and wood products	985	1,126	1,140	1,268	13.6	11.2
4	Paper and paper products	3,546	4,074	3,989	4,551	11.1	10.5
5	Chemical, petroleum, rubber and plastic products	21,927	25,252	25,232	27,780	13.1	9.1
6	Non metallic mineral products	13,920	15,843	15,432	17,623	9.8	10.1
7	Basic metal products	1,554	1,825	1,758	2,023	11.6	9.8
8	Fabricated metal products, machinery, and transport equipment	10,144	11,464	11,540	12,752	12.1	10.1
9	Manufactured products not elsewhere specified	2,238	2,644	2,540	2,908	11.9	9.1
	Total	120,728	139,355	139,939	155,562	13.7	10.4

(a) Based on information received from 480 non-BOI private sector firms
(b) Provisional

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	Domestic Cost (percentage)							
	Power & Fuel		Wage		Raw Materials		Interest	
	2000	2001(b)	2000	2001(b)	2000	2001(b)	2000	2001(b)
1 Food, beverages and tobacco products	2.3	2.8	9.2	9.6	35.2	36.1	1.6	1.9
2 Textile, wearing apparel and leather products	3.5	4.0	16.0	15.2	13.5	13.8	2.6	2.9
3 Wood and wood products	8.3	8.8	16.6	16.1	37.1	35.2	4.2	4.8
4 Paper and paper products	2.5	3.0	13.1	12.6	15.2	16.1	3.9	4.3
5 Chemical, petroleum, rubber and plastic products	4.6	5.0	12.8	12.9	29.2	27.1	3.2	4.3
6 Non metallic mineral products	16.4	17.9	16.3	16.3	28.3	28.1	3.1	2.8
7 Basic metal products	7.9	8.5	10.8	10.9	33.5	34.2	3.8	4.0
8 Fabricated metal products, machinery, and transport equipment	3.2	3.8	10.8	11.5	23.2	23.9	4.2	5.0
9 Manufactured products not elsewhere specified	4.2	4.9	14.0	13.1	34.5	34.2	2.1	2.3
Total	4.7	5.3	12.0	12.0	28.8	29.2	2.5	2.9

(a) Based on information received from 480 non-BOI private sector firms
(b) Provisional

Source: Central Bank of Sri Lanka

employee relations also adversely affected labour productivity in 2001. Positive developments in 2001 towards the improvement of labour productivity were the implementation of voluntary retirement schemes and the signing of collective agreements with labour unions by a few manufacturers.

Employment

The employment in the non-BOI industrial sector declined marginally by 1 per cent, reflecting the reduction of capacity utilisation on account of depressed domestic and international markets. With the reduction of output, manufacturers were not able to reduce their permanent labour due to stringent labour laws. However, some manufacturers offered attractive voluntary retirement schemes to retrench excess labour while others removed excess contract and casual labour in order to face the difficult market environment. The modernisation of factories with automated systems also reduced the labour requirement of the industrial sector. The employment in the industrial categories of textiles, wearing apparel and leather products; chemical, rubber and plastic products and non-metallic mineral products declined in 2001 reflecting the lower capacity utilisation. Employment creation was higher in the industrial categories of food, beverages and tobacco products and fabricated metal products.

4.5 Investment

Foreign Investment

Foreign investment inflows to Sri Lanka continued to decline despite aggressive promotional campaigns by BOI. The downturn in world economic activities, slowing down in capital inflows to developing countries, deterioration of investor confidence due to the civil war and politics related uncertainty and the stagnation of the Japanese economy adversely affected the investment inflows to Sri Lanka. The recipient countries in sub Saharan African and the Caribbean of preferential trading treatments from USA and the EU attracted more investments, reducing the investment flows to other developing countries including Sri Lanka. The realised investment of the BOI industries as well as the investment commitments in the approved and contracted projects also declined in 2001.

The BOI, the main government institution responsible for promoting foreign investment, organised several inward and outward delegations for investment promotions, conferences and exhibitions in 2001. It organised investment promotion missions to Bangladesh, Denmark, France, Israel, Norway, Malaysia, Sweden, Singapore, UK and USA in 2001. In collaboration with the Sri Lanka High Commission in UK, BOI organised an investment promotion programme in London. The main objective of this programme was to attract investors for textiles, garment accessories and IT industries in Sri Lanka. An investment delegation visited USA and met key members of the American Apparel Manufacturers' Association, US Apparel Importers Association, the Deputy Secretary of State and senior executives of leading companies and the US Chamber of Commerce. Several foreign delegations including a Swedish investment promotion delegation and a British trade mission organised by the London Chamber of Commerce visited Sri Lanka in 2001 in search of new investment opportunities. A

Chart 4.6
Labour Productivity in Industry (1995=100)

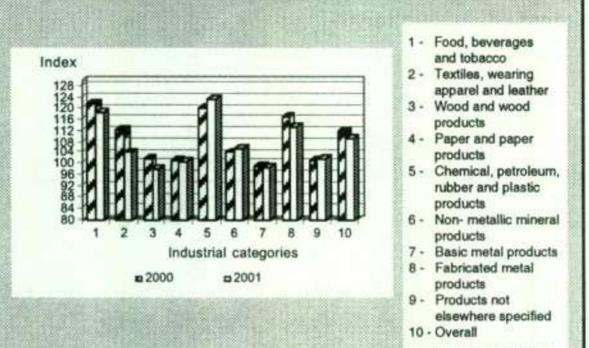


TABLE 4.8
Labour Productivity Index in the Non-BOI Private Sector (a)

1995 = 100

	2000	2001(b)	% Change
1 Food, beverages and tobacco products	121.8	118.6	-2.6
2 Textile, wearing apparel and leather products	112.4	104.4	-7.1
3 Wood and wood products	101.7	98.2	-3.4
4 Paper and paper products	101.2	100.8	-0.4
5 Chemical, petroleum, rubber and plastic products	120.6	123.2	2.2
6 Non metallic mineral products	104.2	105.8	1.5
7 Basic metal products	99.3	98.6	-0.7
8 Fabricated metal products, machinery, and transport equipment	117.0	113.1	-3.4
9 Manufactured products not elsewhere specified	101.2	101.8	0.6
Total	111.9	109.1	-2.5

Source: Central Bank of Sri Lanka

(a) Based on information received from 480 non-BOI private sector firms.
(b) Provisional

TABLE 4.9
Employment in Non-BOI Private Sector Industries (a)

Categories	2000	2001(b)	% change
1 Food, beverages and tobacco products	25,350	26,190	3.3
2 Textile, wearing apparel and leather products	30,250	28,950	-4.3
3 Wood and wood products	1,359	1,376	1.3
4 Paper and paper products	5,374	5,560	3.5
5 Chemicals, petroleum, rubber and plastics products	21,650	20,800	-3.9
6 Non metallic minerals products	9,300	8,908	-4.2
7 Basic metal products	785	772	-1.7
8 Fabricated metal products, Machinery and Transport equipment	11,625	11,792	1.4
9 Manufactured products (n.e.s.)	3,935	4,194	6.6
All Categories	109,628	108,542	-1.0

Source: Central Bank of Sri Lanka

(a) Based on information received from 480 non-BOI private sector firms.
(b) Provisional

trade and investment delegation from Belgium, comprising potential investors in various sectors in food and beverages, maritime engineering and waste management also visited Sri Lanka in March 2001. The investment promotion fair in Colombo on 'Sri Lanka-Malaysia Business Promotion Investment Fair' attracted investors from Malaysia. Over 25 Malaysian companies representing various National and Chinese Chambers in Malaysia participated in this trade fair.

The number of projects approved and their investment commitments declined in 2001. The number of projects approved by BOI under the Section 17 of the BOI Law declined to 262 in 2001 as compared with 333 in the previous year. The investment commitments of these projects also declined by 38 per cent from Rs.89,622 million in 2000 to Rs.55,285 million in 2001. However, the foreign investment component in the approved projects increased to Rs.30,606 million (US dollar 342.5 million) in 2001 from Rs.25,084 million(US dollar 331.1 million) in 2000. The foreign component of the approved investments in 2001 was about 55.4 per cent of the total approved investment. Of the approved projects in 2001, 64 were entirely foreign owned, 76 were joint venture collaborations and 122 were entirely domestic owned ventures. The expected employment generation of these projects was estimated at 34,502 persons. A category-wise breakdown of approved projects in 2001 reveals that 27 projects were in the textiles, apparel and leather product category, 20 in the fabricated metal product category, 17 in the food, beverages and tobacco category and 13 in the chemical, petroleum, rubber and plastics category. The number of projects approved in the service sector was 145, a majority of which were software development projects. This could be attributed to the recognition of IT as a priority sector by the government and the attractive incentives granted in the budget proposals both in 2000 and 2001. As at end December 2001, the number of projects approved under Section 17 of the BOI law amounted to 3,594.

The number of projects contracted with the BOI declined from 204 in 2000 to 149 in 2001. However, contracted investments of these projects increased to Rs.51,682 million in 2001 from Rs.46,829 million in the previous year. The foreign investment component of the contracted projects declined from Rs.18,407 million (US dollar 242.9. million) in 2000 to Rs.8,408 million (US dollar 94.1 million) in 2001. The foreign component of the contracted investment was 16.3 per cent of the total investment of contracted projects in 2001. The employment generation capacity of these projects was estimated at 20,413 persons. The service sector industries including software industries absorbed a significant share of these investments. The BOI signed agreements in respect of 78 projects in the service sector with an investment commitment of Rs.40,300 million in 2001.

As at end December 2001, BOI had signed agreements in respect of 2,237 projects. Of the total contracted projects up to end 2001, 1,199 projects with an investment commitment of Rs.211,539 million were in commercial operation. The foreign investment commitment of these projects was Rs.122,915 million or 58.1 per cent of the total investment in projects in commercial operation. The employment generation capacity of these projects was estimated at 337,170 persons. The majority of these projects were in textiles, wearing apparel and leather products (273 projects), food, beverages and tobacco products (123 projects) and chemical, rubber and plastic products (114 projects). There were 417 projects in the service sector including power, telecommunications, trading houses and software development. There were 196 enterprises located in the main Export Processing Zones (EPZ) and mini EPZ, while 1,199 enterprises were outside the export processing zones.

BOI also approved 119 projects under Section 16 of the BOI Law (normal law) in 2001, as compared with 143 projects in the previous year. Of the approved projects in 2001, 55 were entirely foreign owned and 64 were joint venture collaborations. The investment potential of these projects amounted to Rs.2,495 million in 2001 compared to Rs.2,617 million in 2000. The foreign investment component of these projects was Rs.2,018 million or 81 per cent of the total investment. The employment potential of these projects was estimated at 3,627 persons compared to 6,551 persons in the projects approved in the previous year. These investments were in the industrial categories of food, beverages and tobacco products and chemical, petroleum, rubber and plastics products and services sector. Of the approved enterprises, 436 projects were in commercial operation as at end 2001. The estimated total investment of these enterprises was Rs.19,389 million, of which Rs.11,090 million or 57 per cent was from foreign sources. The total employment generation capacity of these projects was 36,657 persons.

Local Investment

Local investments were also adversely affected by deteriorating investor confidence owing to several domestic and international terrorist-related incidents and depressed economic conditions. The share of local investment in projects approved under Section 17 of the BOI Law declined substantially from 72 per cent in 2000 to 45 per cent in 2001. The local investment commitment of these projects in 2001 was Rs.24,679 million compared to Rs.64,537 million in the previous year. However, the local investment commitment of the contracted projects increased by 52 per cent to Rs.43,274 million in 2001. The share of local investment in the 1,199 commercially operated projects under the BOI amounted to Rs. 88,624 million or 42 per cent of total investment as at end 2001. The local investment component of the projects approved in 2001 under Section 16 of the BOI Law (normal law) amounted to Rs.477 million or 19 per cent of total investment.

The total investment in 1,605 enterprises registered under the Ministry of Industrial Development, amounted to Rs.115,760 million at end 2001. These investments were in the categories of textiles, wearing apparel and leather products; chemicals, petroleum, rubber and plastic products and fabricated metal products. The Colombo and Gampaha districts attracted the major portion of these investments. The employment generation capacity of these industries is estimated at 280,225 persons.

4.6 Availability of Credit to the Industrial Sector

The industrial sector continued to receive credit facilities from commercial banks and development banks to meet working capital requirements as well as medium and long-

TABLE 4.10

Realised Investments in BOI Enterprises (a)

	Categories	No. of Enterprises		Foreign Investment (Rs. Mn)		Total Investment (b) (Rs. Mn)	
		2000(c)	2001(d)	2000(c)	2001(d)	2000(c)	2001(d)
1	Food, beverages and tobacco products	141	146	4,301	5,058	10,612	11,088
2	Textile, wearing apparel and leather products	439	458	20,463	22,006	30,779	32,823
3	Wood and wood products	22	22	458	1,300	830	1,648
4	Paper and paper products	22	21	521	517	755	744
5	Chemical, petroleum, rubber and plastic products	121	126	8,340	10,178	12,414	14,101
6	Non metallic mineral products	61	57	3,581	3,183	6,631	6,642
7	Fabricated metal products, machinery, and transport equipment	41	41	3,873	3,769	5,093	5,116
8	Manufactured products not elsewhere specified	159	155	6,253	5,924	8,937	8,322
9	Services	497	535	84,025	89,355	118,675	127,595
	Total	1,503	1,561	131,815	141,290	194,726	208,079

(a) Cumulative as at end year

(b) Projects approved under Section 17 of the Board of Investment Law

(c) Revised

(d) Provisional

Source: Board of Investment of Sri Lanka

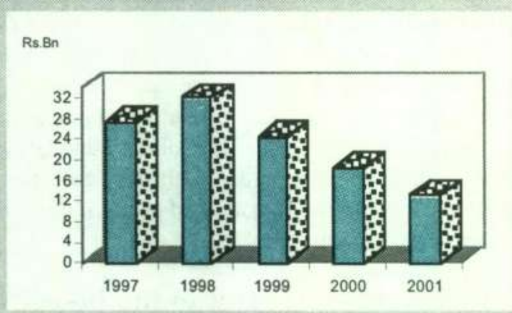
TABLE 4.11
Employment and Export Earnings of BOI Enterprises

	Categories	Employment (End Dec.)		Gross Export Earnings (Rs.Mn) (fob)	
		2000	2001(a)	2000	2001(a)
1	Food, beverages and tobacco products	15,207	15,112	12,433	12,861
2	Textile, wearing apparel and leather products	242,435	257,515	162,533	174,527
3	Wood and wood products	1,822	1,857	411	420
4	Paper and paper products	1,618	1,605	1,270	842
5	Chemical, petroleum, rubber and plastic products	29,675	31,880	28,838	30,288
6	Non metallic mineral products	13,061	12,598	8,662	9,605
7	Fabricated metal products, machinery, and transport equipment	4,182	4,466	1,961	2,375
8	Manufactured products not elsewhere specified	33,394	32,449	24,069	20,384
9	Services (b)	26,455	28,552	18,796	23,912
	Total	367,849	386,034	258,973	275,214

(a) Provisional
(b) Excluding SriLankan Airlines

Source: Board of Investment of Sri Lanka

Chart 4.7
Realised Investment of the BOI



term investment requirements. The National Development Bank (NDB), DFCC Bank and commercial banks provided long and medium-term credit facilities under special loan schemes, direct loans and equity participation.

During the year, NDB provided refinance facilities under the second stage of the Small and Micro Industries Leader and Promotion Project (SMILE 2) launched in April 2001. Under this programme, NDB received financial assistance amounting to Rs.3.2 billion from the Japan Bank for International Co-operation (JBIC) of Japan in 2001. Of the total credit approved by NDB, 13.4 per cent was granted in respect of 592 projects in the food, beverages and tobacco products category, 14.3 per cent in respect of 253 projects in the basic metal products category and 14.5 per cent in respect

Chart 4.8
Approved and Contracted BOI Projects

Chart 4.8.1
Approved and Contracted Investments

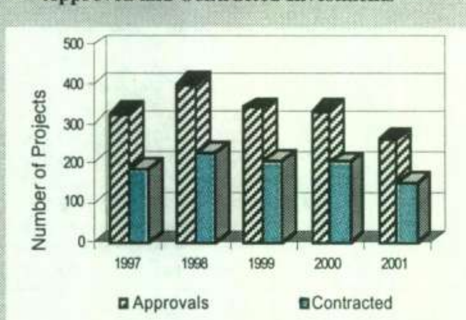
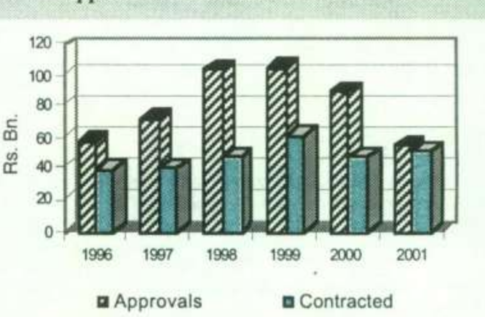


Chart 4.8.2
Approved and Contracted Investments



195 projects in the textiles, wearing apparel and leather products category. Although the amount of credit approved by NDB declined significantly in 2001, the number of projects approved in 2001 increased to 3,283 form 1,238 in 2000 mainly due to a large number of refinance facilities approved for micro, small and medium scale industries by NDB under its specific credit scheme.

According to the Quarterly Survey on Commercial Bank Advances and Deposits conducted by the Central Bank of Sri Lanka, commercial bank credit to the industrial sector decreased by 1.8 per cent during the first nine months of 2001 to Rs. 26,995 million from Rs.27,490 million in 2000 mainly due to lower demand for credit on account of lower level of economic activities and higher interest rates.

TABLE 4.12

Enterprises registered under BOI

Zone/Park	2000	2001(a)
Katunayake Export Processing Zone	98	87
Biyagama Export Processing Zone	63	60
Koggala Export Processing Zone	10	10
Kandy Industrial Park	4	4
Mirigama Export Processing Zone	8	9
Malwatte Export Processing Park	4	4
Seethawaka Industrial Park	9	11
Watupitiwala Export Processing Zone	7	9
Mirijjawela Export Processing Zone	1	1
Mawathagama Export Processing Zone	-	2
Polgahawela Export Processing Zone	-	2
Horana Export Processing Zone	-	3
Information Technology Park - WTC	3	4
Outside the Export Processing Zones	1001	999
Total	1208	1205

(a) Provisional   Source: Board of Investment of Sri Lanka

The credits approved by DFCC Bank decreased by 47 per cent in 2001. However, the number of projects approved by the DFCC Bank increased to 367 from 303 projects approved in 2000. DFCC Bank approved direct loan facilities amounting to Rs.737 million in respect of 91 projects in food, beverages and tobacco products; Rs.505 million in respect of 159 projects in fabricated metal products and Rs.417 million in respect of 38 projects in textiles, wearing apparel and leather products.

4.7 Industrial Policy

The government continued with the private sector-led export oriented industrialisation strategy for expansion, diversification and upgrading of the domestic industrial base and export base, creation of new employment opportunities, efficient management of physical and manpower resources and the promotion of regional industrialisation. In addition, the government offered a wide range of incentives to both local and foreign investors to encourage investment in the industrial sector and raise productivity with the objective of improving competitiveness of industries.

Recognising the need for a sound mechanism to resolve the problems of the entrepreneurs promptly and efficiently to enable them to enhance productivity and competitiveness, the government in 2001 appointed a high powered Industry Facilitation Forum (IFF) under the aegis of the Ministry of Constitutional Affairs and Industrial Development (now Ministry of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs). This Forum will report to the Prime Minister and seeks to

TABLE 4.13

Financial Assistance to the Industrial Sector by the NDB and DFCC Bank - 2001(a)

Categories	Refinance Approved under SMAP &SMILE		NDB						DFCC Bank		Grand Total	
			Direct Finance Assistance (b)		Equity		Total		Total Loan Approvals			
	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 products	483	416	109	384	-	-	592	801	91	737	683	1,538
2 Textiles, wearing apparel and leather products	123	123	70	677	2	71	195	870	38	417	233	1,287
3 Wood and wood products	163	120	8	12	-	-	171	132	32	120	203	252
4 Paper and paper products	73	74	61	112	-	-	134	186	15	59	149	245
5 Chemical, petroleum, rubber and plastic products	91	148	61	414	3	460	155	1,022	19	208	174	1,230
6 Non metallic mineral products	167	113	-	-	-	-	167	113	6	346	173	459
7 Basic metal products	159	153	94	706	-	-	253	859	7	40	260	899
8 Fabricated metal products, machinery, and transport equipment	-	-	-	-	-	-	-	-	159	505	159	505
9 Manufactured products not elsewhere specified	990	610	626	1,390	-	-	1,616	2,000	-	-	-	-
Total	2,249	1,757	1,029	3,695	5	531	3,283	5,982	367	2,432	2,034	6,414

(a) Provisional
(b) Project and equipment finance loans only

Sources: DFCC Bank
National Development Bank

establish a continuing dialogue between private and public sectors on bottlenecks and problems encountered by the private sector in their day to day operations. Problems that are not resolved expeditiously and those requiring Cabinet sanction will be submitted to Cabinet by the Minister of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs or by the Prime Minister. The IFF comprises the Minister of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs and the Secretaries to the Treasury, Ministry of International Trade and Commerce and Shipping Development, Ministry of Urban Development, Construction and Public Utilities, Ministry of Power and Energy, Ports and Southern Development and Ministry of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs.

During the year, a Committee on Deregulation was formed under the Industrial Promotion Act. No.46 of 1990 to study and make proposals to remove bottlenecks that hinder the flow of both domestic and foreign investment to the industrial sector and to improve the country's competitiveness. The deliberations of this committee with the active participation of the public sector, private sector and international agencies such as the Asian Development Bank is expected to have far reaching implication on tax regimes and other regulatory mechanisms affecting manufacturing sector activities. The committee has commenced studies on regulatory impediments to business progress, regulations and transaction costs, Customs regulations, regulations for a modern and efficient energy sector, regulatory problems from an international perspective and regulations in the tea sector.

With the objective of creating a dynamic SME sector to enhance its capabilities and competitiveness through strengthening the enabling environment, improving access to finance through commercial channels and enhancing capacity of the business development services sector to deliver services efficiently and effectively, a SME Development Programme has been launched in 2001 with the financial assistance from the ADB. It has been proposed to prepare a SME White Paper setting out the vision and strategy for the SME sector for the next three years based on Sri Lanka's experience and international best practices. A Presidential Task Force on SME development and supporting working committees have been set up. Another programme named 'Wasanthaya' was also introduced during this period with the objective of promoting small and medium industrial enterprises. This programme targets youth who possess entrepreneurial ability or who have initiated small enterprises, which have potential for development. In addition, a Business/Industry Incubators Programme launched by the Ministry of Industrial Development during the year provided infrastructure facilities and communication facilities to small and medium scale industries. Within a period of two years the established and healthy businesses will have to move out of the incubator to a more permanent setting, paving the way for new entrants to the incubator.

The Competitiveness Initiative Project that commenced in 1999 with funding by the U.S Agency for International Development continued into 2001. This project provides technical assistance, both local and expatriate, to develop strategies to enhance the competitiveness of the industry. The focus of attention is the industrial sector and so far eight industry clusters such as information and communication technology, jewellery, rubber, tea, tourism, ceramics, coir and spices and allied products have been formed. The strategies for all clusters have been completed except for rubber and jewellery, which are being completed.

An industrial sub-contracting and partnership exchange (SPX) was launched in 2001 with the assistance of the United Nations Industrial Development Organisation (UNIDO). The aim of this programme is to provide assistance to small and medium scale industrialists to acquire appropriate knowledge and contacts that would enable them to establish co-operation with large-scale manufacturers who are interested in outsourcing the production of parts, components or processes. The Sri Lanka SPX would be linked to the network of 60 SPXs that UNIDO has established world-wide in 30 countries. Initially, the exchange will concentrate on the sub-sectors of rubber, plastics, electrical and electronics, engineering and coir. This project aims to cover 300 enterprises and had covered about 125 enterprises by end 2001.

The Industrial Re-structuring Unit at the Ministry of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs, which was responsible for identifying incipient sick, sick and defunct industrial enterprises and suggesting remedial measures, received proposals from 250 sick industrial enterprises in 2001. They are currently being processed. There are about 15 sick industrial enterprises undergoing an intensive re-structuring exercise under this Unit. It is reported that the Ministry of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs is contemplating to create an Industrial Re-structuring/ Rehabilitation Authority in keeping with the requests made by various chambers representing industries and recommendations made by various committees regarding the revival of sick industries.

Incentives to the Industrial Sector

The fiscal incentives scheme introduced in 1996 to encourage domestic manufacturers to adopt advanced technology in production processes to improve quality, productivity and competitiveness of the domestic manufacturers was extended for a further period of two years in Budget 2001. This scheme offered duty free import of approved machinery and equipment for both new and existing enterprises and a five year tax exemption on incremental profits. During the year,18 new projects and 46 existing projects were given approval to import modern machinery and advanced technology with a total investment commitment of approximately Rs.443 million and Rs.1,740 million, respectively, compared to approvals given for 18 new projects and 26 existing projects in 2000. These approved projects were estimated to create new employment for about 2,543 persons.

A Restructuring Programme for the Domestic Textile Industry was introduced in 1998 to encourage domestic textile manufacturers to undertake the modernisation of their textile mills and to introduce new technology generation. According to the Department of the National Budget of the Ministry of Finance as at end December 2001, a total of 130 applications had been received under this programme. Of these, 127 applications had been considered for relief measures, while 3 applications were being processed. By end 2001, the total debt outstanding of around Rs.4,003 million had been identified for transfer to the Textile Debt Recovery Fund (TDRF). Upon finalisation of the Tripartite Agreement for Debt Recovery, the total debt outstanding of 108 manufacturers amounting to Rs.3,381 million, was transferred to theTDRF, by the end of the year. By end 2001, 111 enterprises had submitted restructuring/modernisation proposals, of which 34 enterprises have been endorsed by their banks for financial facilities required for the implementation of restructuring/modernisation proposals. The banks/financial institutions granted loan facilities amounting to Rs.222.5 million to these 34 enterprises to implement their restructuring/ modernisation proposals. During the year, the Domestic Textile Allocation Committee, functioning under the Ministry of Enterprise Development, Industrial Policy and Investment Promotion and Constitutional Affairs, allocated textile quota among four domestic textile manufacturers including a BOI approved manufacturer for about 7.5 million meters of fabric materials. Under this programme, steps were taken to implement an interest subsidy scheme for eligible textile manufacturers and to set up a committee to monitor the restructuring/modernisation programmes undertaken by the enterprises. Domestic textile manufacturers who did not qualify for any relief measures under the restructuring programme were permitted to import project related machinery, equipment, spare parts inputs and accessories for the textile industry, on a duty free basis.

The Budget 2001 also proposed to streamline and harmonise the BOI and non-BOI regimes for the apparel industry to provide a level playing field. As a result, in future, all regulatory functions will be handled by the Ministry of Enterprise Development, Industrial Policy, Investment Promotion and Constitutional Affairs, while tax and customs matters will be handled by the Inland Revenue Department and Customs Department, respectively. Thereafter, the BOI will focus entirely on investment promotion and investor facilitation with the assistance of relevant agencies. Consequently, all BOI enterprises other than those located within export processing zones were proposed to be brought under the direct supervision of the Customs Department. These measures were expected to streamline the activities of the BOI and prevent revenue leakage and the abuse of various concessions and facilities. Enterprises currently engaged in the apparel sector, which do not enjoy concessions under the BOI law, would be given such concessions provided the enterprise had an accreditation from an internationally reputed buyer and has an annual turnover of US dollar 1 million or employed a minimum of 150 persons.

National Productivity Improvement Programme

The Decade of National Productivity Programme (1997-2006), which was launched in 1997 with the objective of improving productivity in both private and public sectors continued during 2001. In order to assess the impact of the National Productivity Programme, the National Productivity Secretariat (NPS) conducted a survey to measure the level of awareness of productivity concepts and the nature of changes in attitudes in eight districts. With a view to implementing effectively productivity related activities at the national level, NPS appointed Productivity Liaison Officers in almost all the ministries to co-ordinate productivity improvement activities in ministries as well as departments coming under the purview of those ministries. NPS also initiated a programme to collect information through case studies in selected public and private sector institutions regarding the level of success in the implementation of productivity programmes. The monthly lecture series on productivity that gained wide popularity among private sector managers provided an opportunity to share hands-on experience on widespread application of productivity concepts. Recognising the importance of educating school children on productivity, the National Institute of Education in consultation with the NPS formulated a Teachers' Guide Book to introduce productivity concepts into the school curriculum. Advanced approaches for productivity improvement such as Total Quality Management (TQM), Bench Marking, Change Management, and Business Process Re-engineering are being contemplated and designed by the NPS to enhance individual and institutional capabilities to achieve high total productivity.

4.8 Industrial Location

The promotion of industries in regions outside the Western Province has been identified as one of the main objectives of the industrialisation strategy of the government. Several policy measures were taken and fiscal incentives were granted to achieve this objective. Generally, industrialists prefer to locate their factories in the Western Province because of close proximity to the harbour and the airport and the availability of relatively better infrastructure facilities. Of the enterprises registered under the Ministry of Enterprise

TABLE 4.14

Projects Approved under the Advanced Technology Incentive Scheme as at end 2001 (a)

Categories	New			Existing			Total		
	No	Invest-ment Rs.Mn	Potential Employ-ment	No	Invest-ment Rs.Mn	Potential Employ-ment	No	Invest-ment Rs.Mn	Potential Employ-ment
1 Food, beverages and tobacco Products	29	2,715	2,553	85	7,380	5,136	114	10,095	7,689
2 Textiles, wearing apparel and leather products	15	768	1,188	47	1,895	2,948	62	2,663	4,136
3 Wood and wood products	8	283	665	11	565	574	19	848	1,239
4 Paper and paper products	12	737	825	40	2,218	1,830	52	2,955	2,655
5 Chemical, petroleum, rubber and plastic products	66	3,071	3,904	158	6,150	7,928	224	9,221	11,832
6 Non metallic mineral products	13	2,665	1,261	15	2,492	1,314	28	5,157	2,575
7 Basic metal Products	8	1,094	841	22	1,225	1,228	30	2,319	2,069
8 Fabricated metal products, machinery, and transport equipment	26	1,229	1,702	56	2,833	3,197	82	4,062	4,899
9 Manufactured products not elsewhere specified	22	1,779	1,843	25	837	1,005	47	2,616	2,848
10 Services	18	629	1,003	35	4,251	1,775	53	4,879	2,778
Total	217	14,969	15,785	494	29,845	26,935	711	44,814	42,720

(a) Provisional

Source: Ministry of Enterprise Development, Industrial Policy and Investment Promotion and Constitutional Affairs

Development, Industrial Policy, Investment Promotion and Constitutional Affairs, about 86 per cent were located in the Gampaha and Colombo districts at end December 2001. Excessive concentration of industries in these two districts has created several problems including scarcity of labour, road congestion, escalation of real estate prices, environmental pollution and congestion in the main cities of the province. In view of these problems, the government took measures to improve infrastructure facilities in other areas under the Industrial Parks/ Estates Development Programme, Dedicated Economic Centre Programme, Industrial Township Programme and Mini-EPZ Programme.

BOI took measures to develop infrastructure facilities in the regional mini-EPZs in Mirigama, Watupitiwela, Mirijjawela, Mawathagama, Polgahawela, Horana and export procesing parks in Malwatte, Seethawaka and Kandy. The total investment in projects under mini EPZ's is estimated at Rs.2,771 million and employment generation is estimated at 5,814 persons by the end of 2001. The total investment in projects under the industrial parks programme is estimated at Rs.4,300 million. These projects are expected to create 12,600 employment opportunities by end 2001. The Seethawaka Industrial Park, located in Avissawella, provides facilities to 71 factory lots including 10 international standard factories. As at end 2001, 31 factories were in commercial operation, providing direct employment to about 7,000 persons. Total employment potential in this park is estimated at 50,000 persons.

BOI established an Information Technology Park at the World Trade Centre to support IT development. The main objective of the project is to facilitate software development. The Ministry of Enterprise Development, Industrial Policy,Investment Promotion and Constitutional Affairs launched a programme to develop several industrial estates outside Colombo by providing basic infrastructure facilities. Under this programme, the Ministry set up 13 industrial estates in various parts of the country with a view to creating employment opportunities in regions. Physical infrastructure facilities for 13 industrial estates have been completed. Another 4 sites have been earmarked for development in the near future. These industrial parks have the capacity to accommodate 400 industrial units. Allocation of blocks of land to potential investors to set up industries in some industrial estates such as Dankotuwa, Makandura, Kuruwita (Paradise), Belliatta, Madawala–Ulpatha (Nalanda), Lakshauyana, Nawagampura, Kollonnawa and Ratmalana has been commenced. Nearly 155 blocks of land were allocated to potential investors. About 49 industrial projects in these estates are now in commercial operation employing 6,062 persons.

Under the Two Hundred Garment Factory Programme, 162 garment factories were in commercial operation in 21 districts as at end December 2001. Of these 162 factories, 141 factories (or 87 per cent) were located outside Colombo and Gampaha districts. A notable feature of this programme was the establishment of factories in difficult areas such as Vavuniya, Batticaloa, Trincomalee, Ampara, and Polonnnaruwa. Under the Fifty Garment Factory Programme introduced in 1998, approval had been given for 67 garment factories by end 2001. The criteria for the selection of these projects were based on the intensity of unemployment in the areas where the projects were to be located. Under this programme, 60 factories were in commercial operation in 19 districts.