Chapter 4

INDUSTRY

4.1 Overall Performance and Trends

Industrial output, measured as the output of factory industries, in real terms grew by 4.6 per cent in 2003 compared with 2.8 per cent in 2002. The growth in nominal terms stood at 10.3 per cent resulting in an implicit price deflator of 5.4 per cent for the factory industries in 2003. The output of factory industries, which accounted for 81 per cent of the manufacturing output, contributed 10.5 per cent to overall economic growth in 2003.

The increase in output in 2003 is a composite outcome of a 5.2 per cent increase in private sector industries and a 7.1 per cent decline in public sector industries. The shares of private and public sectors in factory industries were 96 per cent and 4 per cent respectively in 2003. The public sector share of industrial output continued to decline since the 1980s due to the rapid expansion of private sector industries, change in the ownership from public to private sector and the reduction of output in public sector industries resulting from inadequate technological and human capital improvements, administered prices detached from market realities, over staffing, problems in corporate governance and excessive government intervention. In private sector industries, the output growth in BOI industries was estimated at 3.9 per cent in 2003, reflecting a recovery compared with the 1 per cent growth achieved in 2002. The output in the non-BOI sector grew by 6.2 per cent in 2003, compared to 4.4 per cent in 2002. Non-BOI industries contributed 58 per cent to the growth in 2003 and BOI industries accounted for the balance. The impetus for the growth in industrial output in 2003 came mainly from three out of nine industrial categories, viz., textiles, apparel and leather products; chemical, petroleum, rubber and plastic products and food, beverage and tobacco products. These three categories contributed 80 per cent of the industrial sector growth in 2003.

In 2003, the industrial sector benefited from the revival of economic activities with the continuation of peace, international donor support, stable exchange rates, improvements of international markets and favourable weather. The adoption of advanced management techniques, firm level commitment to enhance competitiveness and high investments in modern technology helped the industrial sector to achieve healthy output growth in 2003. Business and investor confidence remained positive with a distinct improvement in the financial performance in the corporate sector, slowing down of inventories, expansion in capacity utilisation, improvement of macroeconomic management and commitment of the government to implementing structural reforms. The resumption of investment in the industrial sector was evident in the steady rise of imports of capital goods and intermediate goods in the latter part of the year. Despite deflationary pressures in some international markets and intense competition from low cost manufacturing countries, export prices improved, particularly during the second half of 2003.

Chart 4.1
Growth and Composition of Industrial Production

Chart 4.1.1
Growth in Industrial Output

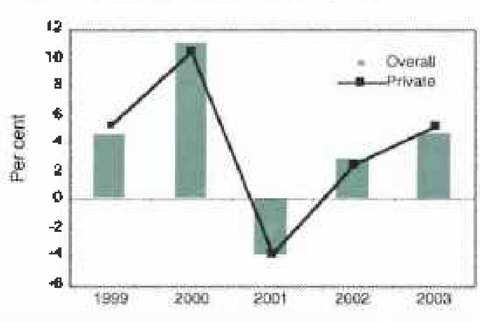
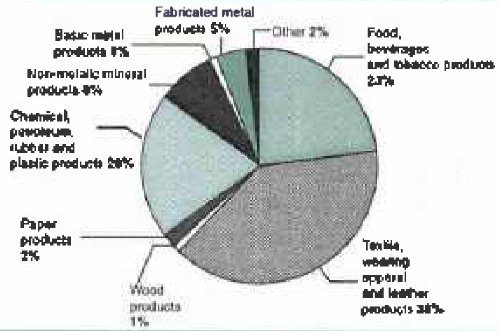


Chart 4.1.2
Composition of Industrial Production - 2003



Output in domestic market oriented industries, which grew only moderately at the beginning of the year, gained broad-based growth momentum in the second half of 2003. The growth momentum was seen across all major categories. The revival was led by the demand for consumer non-durables. In particular, a strong performance was seen in processed food, beverages, liquor, beer, milk powder and other milk products, processed meat, biscuits, animal feed, soap and detergent, and rubber tyres. The demand for these products continued to grow due to higher economic activitiy, the new demand arising from the North and the East benefiting from improved security conditions and distribution capabilities, falling interest rates, moderate inflation, resumption of delayed investment projects, a boom in the share market and increased harvest in agricultural areas.

Major export markets of Sri Lanka improved better than expected in 2003. Export market oriented industries such as rubber based products and processed diamond registered relatively higher growth in 2003. However, output of apparel, textile and ceramic products in volume terms registered only a moderate growth due to the intense competition in international markets. The global competition continued to intensify with the entrance of low cost manufacturers to the international markets, a growing trend of trading under preferential agreements and special concessions granted to some African and Caribbean countries by USA. Preferential trade agreements such as the North American Free Trade Agreement (NAFTA), the Caribbean Basin Initiative (CBI) and the African Growth and Opportunities Act (AGOA) have reduced the marketing opportunities for Sri Lankan products in the US market. China, with its massive production capacity, strong raw material base, continuous improvement of technology, lower utility costs and higher labour productivity, has sharpened its competitive edge in the global market. The East European and South American countries were competitive in terms of lead-time as they are geographically closer respectively, to the EU and USA.

The industrial sector has been undergoing fundamental restructuring since the mid 1990s in order to cope with the changing environment. The process of industrial restructuring continued in 2003 through mergers and acquisitions, changes in ownership, relocation of factories, closing down of non-profitable production units, changes in technology and cost reductions. Initiatives were taken to sharpen competitiveness, gain efficiency and raise profitability in the context of changes in market trends, consumer preferences and technology. The

TABLE 4.1

Value of Industrial Production (1990 Constant Prices)

	Categories	Rs. million					Percentage change	
		1999	2000	2001	2002	2003(a)	2002	2003(a)
1	Food, beverages and tobacco products	41,742	44,241	45,595	47,675	50,656	4.6	6.3
	Food and other	26,330	28,094	29,146	30,428	32,649	4.4	7.3
	Liquor	3,327	3,397	3,478	3,659	4,098	5.2	12.0
	Beverages	6,432	7,210	7,548	7,888	8,409	4.5	6.6
	Tobacco products	5,653	5,540	5,423	5,700	5,501	5.1	-3.5
2	Textile, wearing apparel and leather products	78,282	90,716	82,996	83,985	86,247	1.2	2.7
	Apparel	67,861	79,126	72,300	73,211	75,144	1.3	2.6
	Textile	7,197	8,140	7,439	7,699	7,838	3.5	1.8
	Leather	3,224	3,450	3,257	3,075	3,265	-5.6	5.9
3	Wood and wood products	1,423	1,544	1,487	1,466	1,547	-1.4	5.5
4	Paper and paper products	3,412	3,624	3,732	3,646	3,810	-2.3	4.5
5	Chemical, petroleum, rubber and plastic products	36,281	41,140	38,849	41,057	43,100	5.7	5.0
	Chemicals, paints and fertilisers	5,571	6,379	6,155	6,426	6,805	4.4	5.9
	Rubber base industries	6,082	6,824	6,104	6,519	7,940	6.8	21.8
	Plastic & PVC	4,292	4,571	5,051	5,258	5,705	4.1	8.5
	Pharmaceuticals, detergent and other	10,336	10,956	10,532	10,911	11,556	3.6	5.9
	Petroleum	10,000	12,410	11,007	11,943	11,095	8.5	-7.1
6	Non metallic mineral products	15,740	16,091	16,010	16,316	17,311	1.9	6.1
	Diamond processing	5,049	5,175	5,056	5,304	5,670	4.9	6.9
	Ceramic products	2,029	2,053	1,908	1,977	1,943	3.8	3.5
	Cement	4,785	4,823	4,843	4,869	5,254	-1.5	7.9
	Building materials and other	3,877	4,040	4,203	4,266	4,445	1.5	4.2
7	Basic metal products	1,917	2,024	2,096	2,155	2,254	2.8	4.6
8	Fabricated metal products, machinery and transport equipment	6,660	9,071	9,261	9,446	10,079	2.0	6.7
9	Manufactured products not elsewhere specified	4,375	4,559	4,627	4,720	5,046	2.0	6.9
	Total	191,852	213,010	204,653	210,466	220,050	2.8	4.6

(a) Provisional

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

TABLE 4.2
Value of Industrial Production (a)

	Categories	Rs. million					Percentage change	
		1999	2000	2001	2002	2003(b)	2002	2003(b)
1	Food, beverages and tobacco products	94,687	105,671	120,359	136,173	151,870	13.1	11.5
2	Textile, wearing apparel and leather products	178,844	215,686	224,898	240,712	261,990	7.0	8.8
3	Wood and wood products	2,715	3,064	3,272	3,529	3,978	7.9	12.7
4	Paper and paper products	5,854	6,516	7,369	7,528	8,293	2.2	10.2
5	Chemical, petroleum, rubber and plastic products	62,590	74,670	78,553	90,250	100,113	14.9	10.9
6	Non metallic mineral products	26,830	28,198	31,892	35,108	38,413	10.1	9.4
7	Basic metal products	3,046	3,378	3,888	4,323	4,690	11.2	8.5
8	Fabricated metal products, machinery, and transport equipment	14,305	15,678	17,638	19,358	21,872	9.8	13.0
9	Manufactured products not elsewhere specified	9,002	9,839	10,361	11,450	12,980	10.5	13.4
	Total	397,873	462,720	498,230	548,431	604,199	10.1	10.2

(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

intense application of information technology continued in the areas of order placement, marketing, supply chain management and strategic decision-making. There were attempts to maintain an appropriate balance, between the needs and aspirations of employees and the pursuit of business strategies requiring cost cutting, manpower reduction and enhancing efficiency. The high quality of products, on time delivery, competitive prices and high labour standards maintained by manufacturers created a strong positive image for products manufactured in Sri Lanka among international buyers.

Restructuring efforts of the private sector were facilitated by the government's initiatives to enhance competitiveness. In 2003, the government amended a number of existing labour laws to improve flexibility in the labour market. The government is also planning to introduce an Employment and Industrial Relations Act to increase flexibility in labour markets, promote the upward mobility of labour and raise labour productivity aiming at enhancing job opportunities and increasing remunerations without exerting inflationary pressures. In the telecommunications sector, access to the international gateway was liberalised in 2003, leading to a reduction in the cost of overseas calls and creation of opportunities for a greater use of information and communication technology as the new potential growth area for the country. Other measures implemented in the areas of customs and tax collections reduced business transactions costs. Setting up a permanent Tariff Commission helped rectify certain anomalies and distortions in the tariff structure. Exchange control liberalisation announced in Budget 2003 permitted unlimited rupee credit facilities to BOI enterprises approved under Section 17 of the BOI Act.

Inadequate infrastructure facilities in the areas of roads and energy, frequent interruption to power supply and voltage fluctuations, concerns relating to law and order, absence of a proper bankruptcy legislation and its judicial enforcement remain major impediments to accelerating industrial growth. Unnecessary regulations in certain activities, such as time-consuming reporting requirements and burdensome approval procedures have increased business transactions costs. Increasing competition and sudden shocks in global market indicates a need for a strategy to diversify export markets and widen the production base. The private sector should be assisted with global trade, especially trade negotiations, dissemination of information regarding market opportunities, improving business environment, enhancing competitiveness, skills developments, improving corporate governance and maintaining macroeconomic stability. The focus also should be placed on reforming the power sector as high cost and inadequate capacity expansion in power generation will hinder the future expansion of private investments. New strategies also need to be formulated to assist small industries to improve technologies, enhance managerial capabilities and gain access to international markets.

4.2 Industrial Policy and Institutional Support

The long-run growth of the sector depends primarily on innovation and productivity growth. Hence, a private sector led export-oriented industrialisation has been an integral part of the overall industrial policy of the country since 1977, while the government has supplied complementary public goods and fulfilled the role of a facilitator. In the changing global market environment, the long-term industrial policy has given high priority to developing a globally competitive manufacturing sector that can prosper without protection of tariffs or subsidies. In order to achieve this goal, the government's role in industrial sector development has been changed to move away from being a regulator to a facilitator. Accordingly, the industrial policy of the government in the recent past was directed towards removing impediments and unnecessary controls on business, improving the business environment, facilitating trade, enhancing competitiveness, improving corporate governance, removing restrictions on foreign investment flows and facilitating easy access to foreign technology and foreign direct investment.

Recognising the significant contribution made by the industrial sector in the creation of employment for both unskilled and semi-skilled labour, the government has proposed in its medium-term macroeconomic framework to mainstream poverty reduction in industrial policy. In this context, the industrial sector has to create more employment opportunities at the regional level to accomplish the government's poverty reduction strategy. Considering the potential of Small and Medium Scale Enterprises (SME's) to create more employment at lower investment costs, generate income, alleviate poverty and develop the regions, priority has been given for the development of the SME sector. A White Paper on Small and Medium Sector Promotion, incorporating the vision for the sector, strategies to achieve this vision, an institutional framework that will impact the sector, incentives and assistance to the sector was submitted to the line ministries in 2003.

Promoting foreign investment and improving macroeconomic management are vital to achieve the multiple objectives of the industrial policy. Although successive governments offered a series of incentives and concessions to investors, the country failed to attract adequate investment mainly due to poor infrastructure facilities, regulatory burdens and civil conflict. Rapid technological change, globalisation and heightened competition at national and international levels have changed the business environment in which firms operate. Therefore, with the rapidly changing industrial and business environments, industrial policy should aim at enhancing the industrial competitiveness through improved technology, higher product quality and wider market access, by providing a business environment that enhances the ability of enterprises to be innovative, flexible and competitive.

Some of the existing regulations in the country have unduly increased business transaction costs, slowed down the decision-making process of enterprises and have made room for political interference and patronage. The unnecessary and complex regulations also have encouraged regulators to engage in rent-seeking activities leading to corruption, delays, waste of resources, inefficiencies and revenue loss to the government. To address this problem, the government in 2001, set up a Deregulation Committee under the Industrial Promotion Act No.46 of 1990. The committee has made several recommendations to the government to overcome the identified bottlenecks that affect business activities and competitiveness of domestic products. Recognising the importance of these recommendations, the government has decided to embark on deregulation in the main areas of customs and tariffs, tax administration, labour laws and land and land titles by simplifying and unifying existing procedures. As deregulation is a continuous process, the government has reappointed the Committee to examine other areas that need to be deregulated and to monitor the implementation of the recommendations that have already been made. The government has also announced the introduction of bankruptcy legislation that will protect the interests of the creditors and facilitate an orderly exit of failed firms.

The rigid and highly distorted labour market has been cited as an impediment to investment flows, employment creation and growth of the industrial sector. To overcome these problems, the government took a number of measures to increase flexibility and minimise distortions in the labour market. Section 68 of the Factories Ordinance Act of 1942 was amended to permit a female employee to work 60 hours overtime per month (720 hours per annum) from 100 hours of overtime per annum permitted earlier. During the year, the Industrial Dispute Act, Termination of Employment of Workmen (Special Provisions) Act and Industrial Disputes (Hearing and Determination of Proceedings-Special Provisions) Act were amended to remove rigidity in the labour market. This flexibility in the labour market was necessary not only to protect the jobs of existing workers but also to create more job opportunities in the future. In any growing economy, job creation for future generations should receive highest priority and a conducive environment for employers to hire workers should be created. Prohibitive labour laws prevent enterprises from undertaking restructuring programmes in the face of difficulties and thereby put even the existing labour at the risk of losing employment. These amendments became effective from 31 December 2003. The formula for computation of payment of compensation for laying-off of workmen was gazetted in December 2003. These amendments are expected to give greater flexibility to employers to adjust their workforce to suit business and economic conditions.

To promote active dialogue with the private sector in policy formulation the government has set up Sectoral Task Forces with private sector participation. Task forces were set up in respect of sectors such as rubber, gem and jewellery, coir, plastics, ceramics, spices and allied products, wood and wood based products, leather and leather goods, footwear, packaging, tea and processed food. Each task force was charged with the responsibility of preparing a five-year plan for the respective sector. These task forces have now completed their five-year plans and the Ministry of Enterprise Development, Industrial Policy and Investment Promotion commenced the implementation of the recommendations made in those plans.

Faced with fiscal constraints, the need for eliminating anomalies resulting from discriminatory incentive regimes and to ensure a level playing field for all investors, the government decided to rationalise the prevailing incentive structure. In this regard, Budget 2004 announced the rationalisation of tax exemptions offered under the Inland Revenue Act with effect from April 2004. The industrial sector benefitted from several indirect incentives in 2003, generated by sound macroeconomic conditions. Among these were lower interest and inflation rates, stable exchange rates and the availability of more funds to the private sector from the banking sector resulting from a reduction in government borrowings for budgetary financing. In addition there was increased local demand arising from the continuation of the ceasefire. In contrast, inadequate infrastructure facilities and certain structural rigidities were indirectly responsible for holding back growth in the industrial sector. Therefore, implementing necessary reforms promptly to overcome theses problems will act as attractive indirect incentives for the industrial sector and stimulate industrial sector growth. In this regard, large infrastructure development programmes, including setting up of a coal-fired power plant, announced in Budget 2004 would be a beneficial to the industrial sector, if implemented as planned.

Exchange control liberalisation announced in Budget 2003 permits unlimited rupee credit facilities to BOI enterprises approved under Section 17 of the BOI Act and controlled directly or indirectly by persons resident outside Sri Lanka. Such credit can only be granted by licensed commercial banks, the National Development Bank and DFCC Bank. The liberalisation also permitted credit facilities up to 360 days to buyers resident in Sri Lanka, by a supplier of goods and services not resident in Sri Lanka, at rates of interest not higher than the international markets, if the supplier insisted on payment of interest.

The first state sponsored industrial incubator, 'Nawabima', to assist start up businesses was set up in 2003 at the Moratuwa University. Initially, 12 firms in the leather and IT sectors were selected. The incubator will offer on-site management, low cost business space, flexible leases and technology support under one roof. Other industries, selected after studying their potential and the need for assistance, will be incubated in the near future.

4.3 Value Addition and Capacity Utilisation

Value added in the industrial sector in nominal terms increased by 11 per cent in 2003. In real terms, value added increased by 4.7 per cent compared with 2.9 per cent in 2002. Value added is derived by subtracting the cost of raw materials and power and fuel from the ex-factory value of output. The expansion of capacity utilisation owing to higher domestic demand, improved technology, stable exchange rates, which helped to a contain imported raw material costs, and advances in productivity had beneficial effects on value addition. Firm level structural reforms such as closing down of non profitable production units, changes in technologies, trimming of excess labour and various cost reduction methods also helped to improve value addition. However, interruption of power, higher energy prices and several structural impediments in the economy retarded the growth of value addition in the industrial sector.

Installed capacity in the industrial sector expanded by 3.5 per cent in 2003 as compared with 1.8 per cent in 2002. However, capacity expansion in 2003 slowed as investors deferred the major capacity expansion and new projects until both international and domestic economic conditions improve further. Production capacity in ceramics, food processing, rubber based products and plastic products increased in 2003. Capacity in export-oriented industries such as processed tea, accessories for the apparel industry, artificial flowers, ornamental ceramics, synthetic gemstones and copper wire also expanded in 2003. Overall capacity utilisation in the industrial sector increased from 81 per cent in 2002 to 85 per cent in 2003.

TABLE 4.3
Value Added in Industry (Current Prices)

	Categories	Rs. million					Percentage change	
		1999	2000	2001	2002	2003(a)	2002	2003(a)
1	Food, beverages and tobacco products	44,503	49,031	54,282	61,550	69,708	13.4	13.3
2	Textile, wearing apparel and leather products	55,263	69,451	71,263	77,028	84,623	8.1	9.9
3	Wood and wood products	1,390	1,554	1,638	1,736	1,929	6.0	11.1
4	Paper and paper products	2,664	2,608	3,103	3,124	3,334	0.7	6.7
5	Chemical, petroleum, rubber and plastic products	13,832	17,771	19,245	22,653	25,028	17.7	10.5
6	Non metallic mineral products	13,817	14,240	16,010	17,273	18,477	7.9	7.0
7	Basic metal products	777	959	1,131	1,306	1,463	15.5	12.0
8	Fabricated metal products, machinery, and transport equipment	7,367	7,714	8,731	9,698	11,198	11.1	15.5
9	Manufactured products not elsewhere specified	3,799	3,965	4,164	4,695	5,257	13.0	12.0
	Total	143,412	167,493	179,557	199,063	221,017	10.9	11.0

(a) Provisional

Source: Central Bank of Sri Lanka

Chart 4.2
Value Added Percentages in Industrial Production - 2003

4.4 Cost of Production, Profitability and Employment

The average ex-factory profit ratio of the non-BOI sector increased by 2.3 percentage points to 14.2 per cent in 2003. The profit ratio in the industrial sector was estimated on the basis of the excess ex-factory value of production over the total cost of production of 480 non-BOI firms surveyed in 2003. The improvement of profitability in 2003 is attributed to the expansion in domestic sales than the increases in cost of production. The revival of economic activities with the improvement of consumer and investor confidence, effective pricing policies of manufacturers and new demand coming from the North and the East stimulated domestic sales. The lower interest rates, waste reduction, better management of working capital and optimal use of raw materials helped contain cost of production. The slower depreciation of the rupee against the US dollar resulted in containing the growth in imported raw material costs. This was most relevant in case of industrial items such as milk products, wheat flour processing, apparels, chemicals, fertiliser and paper and paper products. However, the slower depreciation of the rupee adversely affected the profitability of the export oriented and import substitution industries. Profitability in the industrial sub sectors of soap and detergent, food, apparel, fabricated metal, export oriented electronic items, rubber based industries, tea processing and tobacco processing improved significantly during the year.

The wage bill in the industrial sector increased by 9.1 per cent in 2003 owing to an increase in the number of employees by 3.0 per cent and moderate increase in the wage rates. The relatively low inflation rate in 2003 contained the excessive growth in the wage bill. Many companies out-sourced high cost units and resorted to casual or contract labour to reduce the overall wage bill. The introduction of voluntary retirement schemes in a few industries and the reduction of the overtime bill through proper deployment of workers also helped contain the total wage bill. The share of the wage bill in the total cost of production increased marginally from 11.8 per cent in 2002 to 11.9 per cent in 2003. The wage bill, as a percentage of total cost of production, increased in the industrial categories of food, beverage and tobacco products and chemical rubber and plastic products reflecting an increase in the labour force and higher production. A decline in the wage share was observed in the industrial categories of fabricated metal 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. The labour costs were relatively low in the industrial categories of food, beverage and tobacco and fabricated metal products

The total energy cost in the non-BOI industrial sector, in absolute terms, increased by 8.9 per cent in 2003. Increased utilisation of electricity with higher capacity utilisation and the upward adjustment in petroleum prices were responsible for the increase in the energy cost in 2003. However, energy costs as a percentage of the total cost of production in 2003 remained unchanged at 5.5 per cent. The share of energy in

TABLE 4.4
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)	
		2002	2003	2002	2003	2002	2003
1	Food, beverages and tobacco products	67,450	72,905	76,474	85,269	11.8	14.5
2	Textile, wearing apparel and leather products	18,423	19,645	21,547	23,443	14.5	16.2
3	Wood and wood products	1,252	1,398	1,418	1,598	11.7	12.5
4	Paper and paper products	4,074	4,479	4,577	5,044	11.0	11.2
5	Chemical, petroleum, rubber and plastic products	26,216	28,451	29,556	32,778	11.3	13.2
6	Non metallic mineral products	17,145	18,201	19,550	21,388	12.3	14.9
7	Basic metal products	1,928	2,024	2,154	2,337	10.5	13.4
8	Fabricated metal products, machinery, and transport equipment	10,827	11,907	12,084	13,655	10.4	12.8
9	Manufactured products not elsewhere specified	2,941	3,273	3,250	3,686	9.5	11.2
	Total	150,256	162,283	170,610	189,198	11.9	14.2

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

Source: Central Bank of Sri Lanka

Box 10

Need for Productivity Improvement in the Industrial Sector

Productivity is measured as the ratio of output to input. It indicates efficiency in a production process and how effectively inputs are converted into output. More broadly, productivity measures indicate the ability of an economy to harness its physical and human resources to generate output in the most efficient way. For Sri Lanka, the future of its industry crucially depends on raising the productivity of the sector so as to maintain its competitiveness.

Productivity is intimately related to sustained economic growth. It promotes the efficient use of the factors of production. Once growth due to factor accumulation is exhausted, long run economic growth becomes a result of factor productivity. Productivity growth is a result of technological improvements, research and development, good management and other innovative ways of human and physical capital utilisation. While productivity improvement should be at the heart of a firm's strategy, the government could enhance macroeconomic efficiency by providing sufficient infrastructure, ensuring property rights, enhancing quality of governance, providing safety nets and other public goods.

Competition in international markets is becoming fiercer. Domestic products must be able to compete successfully with imports and exports must be able to compete successfully in international markets. Market borders will increasingly becoming more porous and even non-existent. In international markets, enterprises in Sri Lanka need to compete against cost effective and competitive firms in China, India and the other Asian economies. Continuous improvement in productivity is essential to be competitive against these enterprises. A majority of Sri Lankan products in the past have been competing on price alone, because of low wages. Wages cannot and should not remain low in the long run. Therefore, the key to addressing higher wages is higher productivity.

Labour productivity in the industrial sector in Sri Lanka has not grown consistently (Table 1) due to firm specific problems and inefficiencies in the macroeconomic environment. However, since 1996, the government has undertaken a serious drive to improve productivity. The main focus of this strategy is to reach global markets by developing competitive and export-oriented enterprises by providing a conducive environment through key policy reforms. Those include the deregulation of several important sectors of the economy, marked reductions in barriers to trade and foreign direct investment, improving efficiency in critical government functions, maintaining a stable macroeconomic framework, commercialisation or privatisation of government business enterprises, strengthening domestic competition, flotation of the Sri Lanka rupee and increasing labour market flexibility. These policy reforms opened the economy to trade, investment, technology and know-how developed overseas and provided greater flexibility in product and factor markets to improve productivity by strengthening competition from domestic and overseas sources. Enterprises have responded with measures including intensive utilisation of information technology, product development, improved supply chain management, training personnel and utilising advanced management techniques.

Investment in information technology (IT) is widely considered to be the major productivity enhancing innovation in the recent past. The intensive use of information technology during the last decade has ensured consistency in product quality and helped improve marketing, supply chain management and strategic decision-making to achieve greater efficiency. Enterprises also have paid greater attention to improving the skills of their employees and have developed strategies centred around getting the best out of human capital. Increased skills can influence productivity growth in two ways. First, skills can directly raise workers' output per hour. Second a more educated and experienced workforce can promote the absorption and further development of advanced technology, for example the rapid absorption of information technology in the recent past.

There is a need for enterprises to continuously put in place new strategies to develop human capital utilisation through modern management techniques while encouraging innovations through research and developments. They should always compete in international markets since the small size of the domestic market does not generally permit product specialisation or development.

The government should continue to put in place a conducive environment with economic stability, certainty of policies and well-protected property rights. It should also provide the physical, procedural and legal infrastructure and public goods necessary to increase the productivity of enterprises.

Box 10 (contd.)

TABLE 1

Change in the Labour Productivity in non-BOI Private Sector Industries

Percentage Change

Industrial Categories	1999	2000	2001	2002	2003
1 Food, beverages and tobacco products	2.8	4.0	-2.6	3.2	3.5
2 Textile, wearing apparel and leather products	1.1	3.1	-7.1	-0.8	2.2
3 Wood and wood products	0.1	0.3	-3.4	-2.0	1.9
4 Paper and paper products	1.0	1.2	-0.4	-2.5	0.5
5 Chemical, petroleum, rubber and plastic products	0.4	6.7	2.2	2.2	3.3
6 Non metallic mineral products	2.9	1.0	1.5	1.5	2.1
7 Basic metal products	-3.5	1.3	-0.7	-1.5	1.3
8 Fabricated metal products	4.3	4.4	-3.4	1.0	2.0
9 Manufactured products not elsewhere specified	-4.0	1.0	0.6	1.5	1.9
Total	4.1	1.9	3.6	-2.5	2.9

Source: Central Bank of Sri Lanka

the total cost of production in the non-metallic mineral product category increased from 17.9 per cent in 2002 to 18.1 per cent in 2003 due to the increase in the prices of furnace oil and gas. Energy costs are a significant proportion of the cost of production in the cement and ceramic industries. The share of energy costs is low in the industrial categories of food, beverage and tobacco and paper and paper products.

Interest cost, as a percentage of the total cost of production, declined to 2.4 per cent in 2003 from 2.6 per cent in the previous year. A gradual reduction of lending rates of commercial banks following the substantial reduction in policy rates of the Central Bank helped contain interest costs. The reduction of short-term borrowings also helped reduce the total borrowing cost. The reduction in the interest cost was prominent in the industrial categories of wood and wood products; non-metallic mineral products; textile, paper and paper products, chemical, rubber and plastic products and fabricated metal products.

Labour Productivity in Industry

Labour productivity, estimated on the basis of the change in the real value added per man-hour increased by 2.9 per cent in 2003 compared with 0.9 per cent increase in the previous year. The improvement in labour productivity was seen in many industrial categories. Labour productivity improved significantly in the industrial categories of food, beverages and tobacco (3.5 per cent); textiles, wearing apparel and leather (2.2 per cent); chemical, rubber and plastic (3.3 per cent) and

TABLE 4.5

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	
	2002	2003	2002	2003	2002	2003	2002	2003
1 Food, beverages and tobacco products	3.0	3.1	9.4	9.8	36.9	37.1	1.7	1.5
2 Textile, wearing apparel and leather products	4.2	4.2	14.7	14.8	13.1	13.8	2.7	2.4
3 Wood and wood products	8.9	8.9	15.7	15.4	33.1	33.6	4.2	4.0
4 Paper and paper products	3.5	3.5	12.1	12.0	18.1	18.6	4.1	3.8
5 Chemical, petroleum, rubber and plastic products	5.1	5.2	12.9	12.8	29.1	30.4	3.8	3.7
6 Non metallic mineral products	17.9	18.1	16.2	16.1	27.5	27.8	2.5	2.3
7 Basic metal products	8.9	9.1	10.4	10.2	34.5	34.9	3.9	3.5
8 Fabricated metal products, machinery, and transport equipment	4.1	3.9	11.1	10.8	25.2	25.8	4.0	3.6
9 Manufactured products not elsewhere specified	4.6	4.5	12.5	12.6	33.4	33.9	2.2	1.8
Total	5.5	5.5	11.8	11.9	30.2	30.6	2.6	2.4

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

Source: Central Bank of Sri Lanka

Chart 4.3
Labour Productivity Index in Industry
(1995=100)

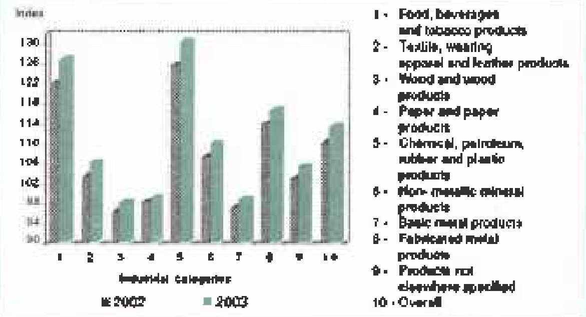


TABLE 4.6
Labour Productivity Index in the Non-BOI Private Sector (a)

1995 = 100

Categories	2002	2003	% Change
1 Food, beverages and tobacco products	122.4	126.7	3.5
2 Textile, wearing apparel and leather products	103.6	105.9	2.2
3 Wood and wood products	96.2	98.0	1.9
4 Paper and paper products	98.3	98.8	0.5
5 Chemical, petroleum, rubber and plastic products	125.9	130.1	3.3
6 Non metallic mineral products	107.4	109.7	2.1
7 Basic metal products	97.1	98.4	1.3
8 Fabricated metal products, machinery, and transport equipment	114.2	116.5	2.0
9 Manufactured products not elsewhere specified	103.3	105.3	1.9
Total	110.1	113.3	2.9

Source: Central Bank of Sri Lanka

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

fabricated metal (2.0 per cent). Rapid expansion of information technology and the installation of automated systems, especially in the industries of ceramics, cement, bakeries, rubber gloves etc. helped improve labour productivity. The improvement in labour productivity in 2003 is also attributed to intense efforts of manufacturers to rationalise operations, most effective deployment of manpower, introduce better management practices and skills developments.

Employment

Employment in the industrial sector increased by 3.4 per cent in 2003 reflecting the creation of more employment opportunities in both domestic and export market oriented industries. Employment in BOI and non-BOI industries rose by 3.5 per cent and 3.0 per cent, respectively, during the year.

The BOI industries created 14,474 new employment opportunities in 2003. The textiles, apparel and leather products category created 21,075 new job opportunities. The new factories established under the Fifty-Garment Factory Programme, Mini Export Processing Zones and Industrial Parks/Estates programmes created most of these employment opportunities. Apparel manufacturers in export processing zones and urban areas were not able to fill all the vacancies in their factories due to lack of skilled and non-skilled labour. Employment in the chemical, rubber and plastic industries decreased by 12.6 per cent during the year.

Employment creation in the non-BOI sector was higher in the industrial categories of food beverage and tobacco products, chemical, rubber and plastic products and non-metallic mineral products. In the chemical, rubber and plastic product category, more employment opportunities were created in fertiliser mixing plants, plastics, chemicals and rubber based industries. The growth of employment by 3.5 per cent in the fabricated metal product industry was marked by the higher absorption of labour in industries in the sub sectors of fabrication of motorcycles, electrical cables and electrical machinery.

TABLE 4.7
Employment in Non-BOI Private Sector Industries (a)

Categories	2002	2003	% change
1 Food, beverages & tobacco products	24,978	25,952	3.9
2 Textile, wearing apparel and leather products	28,050	28,471	1.5
3 Wood & wood products	1,260	1,276	1.3
4 Paper & paper products	5,490	5,605	2.1
5 Chemicals, petroleum, rubber and plastics products	21,532	22,350	3.8
6 Non metallic minerals products	8,648	8,847	2.3
7 Basic metal products	763	797	4.5
8 Fabricated metal products	11,614	12,090	4.1
9 Manufactured products (n.e.s.)	4,147	4,305	3.8
All Categories	106,482	109,694	3.0

Source: Central Bank of Sri Lanka

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

4.5 Investment

Foreign Investment

Foreign investment inflows to Sri Lanka, which increased in the previous year, rose further in 2003. The peace process, reforms in the labour markets, improvements of macroeconomic management, stable exchange rates, further liberalisation of the capital account and relaxation of exchange controls helped to attract more foreign investment in 2003. The BOI, the main foreign investment promotion institution of the government, approved 598 projects under Section 17 and Section 16 of the BOI Act in 2003. The total investment commitments of these projects amounted to Rs.136,121 million in 2003. The foreign investment component of the approved projects under Section 17 of the BOI Act was Rs. 74,979 million (US dollar 776.8 million) in 2003, compared to Rs. 31,672 million (US dollar 328.1 million) in

TABLE 4.6
Realised Investments in BOI Enterprises (a)

	Categories	No. of Enterprises		Foreign Investment (Rs mn)		Total Investment (b) (Rs. mn)	
		2002	2003(c)	2002	2003(c)	2002	2003(c)
1	Food, beverages and tobacco products	143	148	8,732	9,773	14,679	15,774
2	Textile, wearing apparel and leather products	480	500	25,438	26,806	39,977	40,110
3	Wood and wood products	22	24	2,751	3,680	3,161	3,916
4	Paper & paper products	23	25	567	498	1,577	1,638
5	Chemical, petroleum, rubber and plastic products	129	138	11,040	15,058	16,011	19,640
6	Non metallic mineral products	64	66	3,574	6,217	6,763	12,487
7	Fabricated metal products, machinery, and transport equipment	67	75	5,562	6,389	7,230	8,088
8	Manufactured products not elsewhere specified	156	166	6,212	6,763	9,389	9,907
9	Services	559	624	101,019	112,598	142,684	165,921
	Total	1,643	1,766	164,895	186,782	241,471	277,481

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

Source: Board of Investment of Sri Lanka

Chart 4.4
Approved and Contracted BOI Projects

Chart 4.4.1
Approved and Contracted Investments

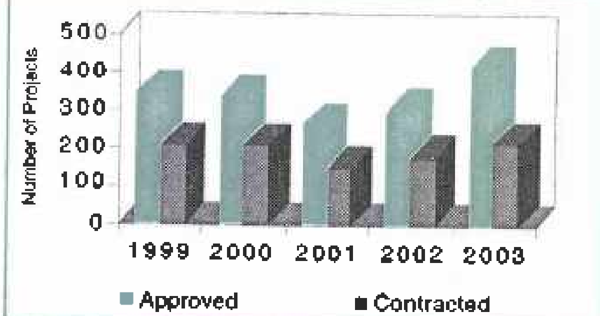
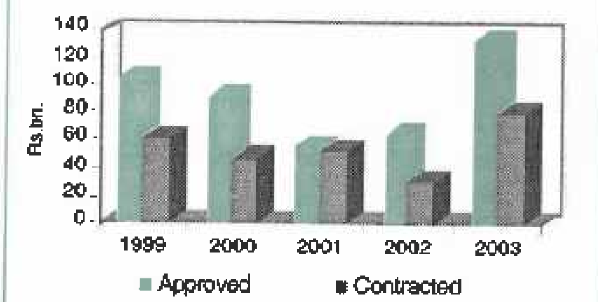


Chart 4.4.2
Approved and Contracted Investments



2002. The accumulated realised investments in BOI projects increased from Rs.241,471 million in 2002 to Rs. 277,481 million in 2003.

Sri Lanka provides various incentives including preferential tax rates, constitutional guarantees on investment agreements, exemptions from exchange control and 100 per cent repatriation of profits to attract foreign investments. Total foreign ownership is allowed in many areas of the economy and only a few areas are limited or restricted to foreigners. The free trade agreements between Sri Lanka and India provide a good opportunity for investors to enter the huge Indian market. In addition to these general incentives, BOI in 2003 undertook a number of investment promotion activities. The outward investment promotion missions with business delegation from Sri Lanka visited a number of countries and conducted investment seminars and one on one business meetings with major investor communities in those countries. The countries visited include Germany, France, Malaysia, China and Japan. In addition, BOI officials participated in overseas investments promotion programmes in India, Japan, Thailand, German, France and Middle East. Meanwhile, several foreign delegations visited Sri Lanka to search for new investment opportunities. Inward missions came from India, Malaysia, China, Singapore, UK, Thailand, Maldives, Nepal, Latvia, Finland, Norway, Hungary and Denmark. These investment missions are expected to generate more capital inflows in the coming years.

Under Section 17[1], BOI approved 418 projects in 2003, of which 126 were fully foreign owned, 107 were joint

1 Under Section 17 of the BOI Act, the BOI is empowered to grant special concessions to companies satisfying specific eligibility criteria. The mechanism through which such concessions are granted is the Agreement, which modifies and waives identified laws in keeping with the BOI Regulations. These laws include Inland Revenue, Customs, Exchange Control, Import Control, Companies Registrations, Shipping, Finance and Air Navigations.

TABLE 4.9
Employment and Export Earnings of BOI Enterprises

	Categories	Employment (End Dec.)		Gross Export Earnings (Rs.mn) (fob)	
		2002	2003(a)	2002	2002(a)
1	Food, beverages and tobacco products	14,448	13,485	13,609	15,381
2	Textile, wearing apparel and leather products	280,234	301,309	192,096	207,051
3	Wood and wood products	1,950	2,024	756	1,385
4	Paper and paper products	2,065	2,135	1,266	1,622
5	Chemical, petroleum, rubber and plastic products	31,716	27,696	28,621	33,282
6	Non metallic mineral products	13,547	10,166	8,997	9,126
7	Fabricated metal products, machinery, and transport equipment	5,793	6,740	9,809	17,199
8	Manufactured products not elsewhere specified	32,443	30,448	18,983	21,766
9	Services (b)	34,560	37,047	24,618	29,593
	Total	416,756	431,050	298,755	336,605

(a) Provisional
(b) Excluding SriLankan Airlines

Source: Board of Investment of Sri Lanka

TABLE 4.10
Approved and Contracted Investment and Employment in BOI Projects

Categories	2002(a)				2003(b)			
	No of projects	Estimated Investment (Rs. mn.)		Employment	No of projects	Estimated Investment (Rs. mn.)		Employment
		Foreign	Local			Foreign	Local	
Projects approved under Section 17	297	31,672	32,404	52,024	418	74,979	56,827	65,497
Projects contracted under Section 17	177	15,943	15,625	31,710	215	43,259	37,349	33,156
Projects approved under Section 16	206	4,881	1,136	7,508	180	3,432	884	4,862

(a) Revised
(b) Provisional

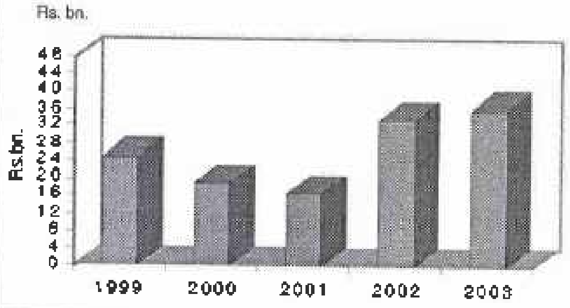
Source: Board of Investment of Sri Lanka

ventures between foreign investors and Sri Lankans and the rest were fully owned by Sri Lankans. The share of foreign investment in approved projects increased to 56.9 per cent in 2003 from 49.4 per cent in 2002. Of the approved projects in 2003, 182 projects, or 44 per cent were in the industrial sector, while the others were in the services and agricultural sectors. Within the industrial sector, 39 projects were approved in the textiles, wearing apparel and leather products category, 35 in the food, beverages and tobacco products category, 28 in the chemicals, petroleum, rubber and plastics category, 27 in the fabricated metal products and 13 in the non-metallic, mineral products category. At end December 2003, BOI had approved 4,322 projects under Section 17 of the BOI Act, since the commencement of operations.

The number of projects as well as the total investment commitments in contracted projects increased in 2003. The share of foreign investment in total contracted projects increased from 50.5 per cent in 2002 to 53.7 per cent in 2003. Of the total contracted investment in 2003, the industrial sector absorbed 27.5 per cent and the services and agriculture sector absorbed 72.5 per cent. Within the industrial sector, the largest share of Rs.10,284 million was absorbed by the food, beverages and tobacco category and Rs.3,956 million was absorbed by the textile, wearing apparel and leather products category.

Of the contracted projects under Section 17 of the BOI Act, 45 projects commenced commercial operation in 2003. Out of these projects, 24 projects were in the industrial sector and the others in the services and agricultural sectors. At end December 2003, BOI had signed agreements in respect of 2,829 projects since the commencement of its operations. Of the total contracted projects up to end 2003, 1,464 projects with an investment commitment of Rs.241,581 million were in commercial operation. The foreign investment commitment of these projects was Rs.129,864 million or 53.8 per cent of the total investment. Out of these operating projects, about 1,209 projects or 82.6 per cent are located outside the export processing zones and 255 projects in the exclusive industrial locations such as Export Processing Zones, Information Technology Park and Industrial Parks. Of the 1,464 projects in commercial operation, 938 were in the industrial sector and the other 526 were in the services and agricultural sectors.

Chart 4.5
Realised Investment of the BOI Enterprises



Among the industrial sector, 357 projects were in the textiles, wearing apparel and leather products category, 128 in the food, beverages and tobacco products category, 122 in the chemical, rubber and plastics products category, 65 in the fabricated metal products. These projects were estimated to generate employment for about 325,945 persons.

BOI also approved 180 projects under Section 16[1] of the BOI Act in 2003, as compared with 206 projects in 2002. Of the approved projects in 2003, 108 projects were entirely foreign owned, while the others were joint ventures between Sri Lankans and foreign investors. Of the 180 approved projects, 149 were in the services sector and the rest in the industrial sector. The foreign investment component of these projects was 79.5 per cent of the total investment. These projects are expected to generate employment for about 4,862 persons. Of the projects approved under section 16, about 691 projects were in commercial operation at end December 2003 with a total estimated investment of Rs.27,526 million. The foreign investment component was 58 per cent of total investment. These projects are expected to generate employment for about 40,015 persons.

Local Investment

The share of local investment in projects approved under Section 17 of the BOI Act increased by 75.4 per cent in 2003, mainly due to a significant increase in the approval of projects owned by Sri Lankan investors. However, the share of local investment of 43.1 per cent in 2003 was lower than 50.5 per cent in 2002 due to the higher increase in foreign investments in 2003. Of the approved local investment component, the services and agriculture sector absorbed Rs.41,981 million, while the industrial sector absorbed Rs.14,846 million with the food, beverages and tobacco category absorbing a large share. The local component of investment in contracted projects also increased sharply in 2003. The local component of the projects approved under Section 16 of the BOI Act declined in 2003,

1 Section 16 of the BOI Act permits foreign investments only under the normal laws of the country; that is, for such enterprises, the provisions of the Inland Revenue, Customs and Exchange Control Laws shall apply.

TABLE 4.11
Enterprises in Commercial Operation under BOI

Zone/Park	2002	2003(a)
Katunayake Export Processing Zone	90	89
Biyagama Export Processing Zone	61	60
Koggala Export Processing Zone	19	20
Kandy Industrial Park	11	11
Mirigama Export Processing Zone	11	12
Malwatte Export Processing Park	7	7
Seetawaka Industrial Park	20	17
Watupitiwala Export Processing Zone	13	13
Mirijawela Export Processing Zone	1	1
Mawathagama Export Processing Zone	4	4
Polgahawela Export Processing Zone	3	4
Horana Export Processing Zone	9	10
Information Technology Park - WTC	6	6
Outside the Export Processing Zone	1,164	1,209
Total	1,419	1,464

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

mainly due to the reduction of joint venture collaborations between the foreign investors and Sri Lankans.

According to the Ministry of Enterprise Development, Industrial Policy and Investment Promotion, 1,588 enterprises had been registered with the Ministry at end 2003. Investment in these enterprises was estimated at Rs.113,977 million and these industries have a capacity to generate employment for about 278,397 persons. A large share of these investments were in the chemical, petroleum, rubber and plastic products category (Rs.29,660 million) followed by the industrial categories of food, beverages and tobacco products (Rs.23,849 million), textiles, wearing apparel and leather products (Rs. 20,727 million), non-metallic mineral products (Rs.12,930 million) and fabricated metal products (Rs.10,110 million). About 1,136 enterprises with an estimated investment of Rs. 101,200 million were located in the Colombo District, followed by 218 enterprises with an estimated investment of Rs.7,684 million in the Gampaha District. Accordingly, these two districts account for 85 per cent of the registered enterprises and for 96 per cent of total investment.

4.6 Availability of Credit to the Industrial Sector

The major source of long and short-term credit to the industrial sector in 2003 was borrowing from commercial banks, development banks and specialised banks, with the issue of commercial paper and debentures contributing a small share. During the year, credit extended by commercial banks to the industrial sector registered relatively higher growth. The long and medium-term credit granted by NDB and DFCC Bank grew by 28 per cent in 2003. The 'Sahanya' credit scheme introduced by the Ministry of Enterprise Development, Industrial Policy and Investment Promotion in 2002 with funding assistance from ADB, amounting US dollars 60 million provided credit to small and medium scale enterprises through Commercial Bank of Ceylon, DFCC Bank, Sampath Bank, Hatton National Bank and NDB. The lending rate under this scheme ranges from 11 to 14 per cent with a maximum repayment period of 10 years.

Credit approved by NDB increased from Rs 3,094 million in 2002 to Rs 4,834 million in 2003 due to the substantial expansion of direct credit assistance. The direct financial assistance granted by NDB increased from Rs. 2,531 million in 2002 to Rs. 4,130 in 2003. However, refinance facilities approved by NDB declined to Rs. 223 million from Rs. 506 million in 2003 mainly due to the utilisation of a large portion of funds in existing credit lines. Under the 'Sahanya' credit line, NDB approved credit facilities amounting to Rs 87 million for the industrial sector. Of the total credit approved by NDB in 2003, 43 per cent was absorbed by 69 projects in the chemical, petroleum, rubber and plastic products category and 44 per cent by 95 projects in the food, beverages and tobacco category.

DFCC Bank approved credit facilities amounting to Rs.4,997 million in respect of 494 industrial projects in 2003 as compared with Rs.4,190 million in respect of 315 projects in 2002. In 2002, DFCC Bank approved Rs. 1,903 million in respect of 177 projects in food, beverages and tobacco products; Rs.714 million in respect of 91 projects in textiles, apparel and leather products, Rs. 623 million in respect of 51 projects in chemical rubber and plastic products and Rs. 877 million in respect of 58 projects in fabricated metal products.

According to the Quarterly Survey of Commercial Bank Advances and Deposits conducted by the Central Bank of Sri Lanka, commercial bank credit to the industrial sector increased substantially by 12.2 per cent during the first nine months of 2003 to Rs. 41,501 million from Rs. 37,002 million in 2002.

4.7 Location of Industry

Most of the industries are located in the districts of Colombo and Gampaha. The dispersion of industrial units into all the regions of the country is essential to achieve the declared objectives of industrial policy such as employment generation, income generation and effective use of natural and manpower resources on a uniform basis throughout the country. However, several factors such as lack of basic infrastructure facilities in the regions, poor road network connecting regions with the country's main seaport and airport that cause delays in transporting raw materials and finished goods have discouraged investments in the regions and hindered regional industrialisation. The concentration of industries in urban districts leads to road congestion, environmental pollution, higher property prices, high rent/lease on factory premises and lack of accommodation for factory workers in these districts. Though successive governments have taken several measures to diversify location through fiscal incentives and Industrial Parks, Industrial Estates and Export Processing Zones, they have had only limited success. Until and unless a better road network, especially, highways are constructed connecting all regions to the country's major seaports and airports, the government's initiatives on dispersion of industries into the regions will not fully materialise.

To promote growth and encourage the use of natural resources in the regions, Regional Industry Service Committees were established under the Industrial Promotion Act No 46 of 1990 to examine the requirement of the

TABLE 4.12

Financial Assistance to the Industrial Sector by the NDB and DFCC Bank - 2003 (a)

Categories	NDB								DFCC Bank		Grand Total	
	Refinance Approved		Direct Finance Assistance (b)		Equity		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	38	61	44	1,880	13	3	95	1,944	177	1,903	272	3,847
2 Textile, wearing apparel and leather products	8	2	28	254	14	1	50	257	91	714	141	971
3 Wood and wood products	13	10	7	13	2	0	22	23	31	221	53	244
4 Paper and paper products	4	2	4	3	-	-	8	6	41	307	49	313
5 Chemical, petroleum, rubber and plastic products	13	88	55	1,795	1	0	69	1,884	51	623	120	2,507
6 Non metallic mineral products	8	0	15	2	3	0	26	2	26	241	52	243
7 Basic metal products	10	14	8	7	2	0	20	21	19	111	39	132
8 Fabricated metal products, machinery, and transport equipment	3	3	1	1	-	-	4	4	58	877	62	881
9 Manufactured products not elsewhere specified	43	43	111	175	2	0	156	218	-	-	156	218
Total	140	223	273	4,130	37	4	450	4,359	494	4,997	944	9,356

Sources: DFCC Bank
National Development Bank

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

respective regions to meet the demand of investors and recommend suitable lands to develop as industrial parks. Basic infrastructure facilities such as roads, electricity, water and telecommunication are provided in the parks. According to the Ministry of Enterprise Development, Industrial Policy and Investment Promotion, about 15 industrial parks/estates had been developed in various parts of the country by end December 2003. The total land extent developed under this program amounts to 463 acres. Of the 351 land plots available in these industrial parks/estates 263 blocks have been allocated to potential investors. By end 2003, 125 units were in commercial operations employing over 11,000 persons and further 34 industrial units were in different stage of construction. On completion, these parks/estates are estimated to create both direct and indirect employment for about 31,050 persons. The development of the 16th industrial park under this program commenced at end 2003 in Kalutara and under Phase I, a land area with an extent of 55 acres will be developed with necessary infrastructure facilities. This park is planned to be completed by June 2004 and about 15-20 industrial units will be set up in this site. In addition, an exclusive industrial complex for the leather industry with a land area of 105 acres is being developed in the Bata-atha village and is targeted to be completed in 2004. Three investors have commenced construction of their factory buildings and others are in the process of preparing engineering designs for factory buildings and layout plans.

Industrial enterprises registered with the Ministry of Enterprise Development, Industrial Policy and Investment Promotion and the BOI (section 16,17 and 200 Garments Factory Programme) amounted to 3,902 at end 2003. Of this, 2,104 enterprises or 53.9 per cent were located in the Colombo District, 796 enterprises or 20.4 per cent were in the Gampaha District and the balance 1,002 enterprises in the other districts. About 1,567 industrial enterprises had been registered with the Ministry by end 2003. During the year, 106 new enterprises were established, while 24 enterprises were closed-down. The comparable figures for 2002 were 69 and 169, respectively. Of the total 1,567 enterprises, 1,121 enterprises or 71.5 per cent were located in the Colombo District, 213 enterprises or 13.6 per cent in the Gampaha District and the balance 233 enterprises in other districts.

The BOI operates a number of Export Processing Zones (EPZ) and Industrial Parks (IP) to provide factory lots with basic infrastructure facilities to investors. This includes EPZs such as Katunayake, Biyagama, Koggala, Mini-Industrial Processing Zones at Mawathagama, Polgahawela, Mirigama, Malwatte, Horana and Wathupitiwala, Industrial Parks at Seethawaka, Mirijjawila and Kandy and an Information Technology Park at the World Trade Centre. According to the BOI, by end 2003 around 254 projects were in commercial operation in these exclusive zones and parks with the highest number of 89 units in the Katunayake EPZ followed by 60 in the Biyagama EPZ, 20 in Koggala EPZ and 17 in the Seethawaka IP. These 254 enterprises with an estimated investment of Rs.37,678 million provide direct employment for about 100,850 persons. Another 1,209 projects approved under Section 17 of the BOI Act were operating outside EPZ/IP by end 2003 with an estimated investment of Rs.203,883 million and provide direct employment for about 225,075 persons.

Under the Two Hundred Garment Factories Programme, 180 factories were in commercial operation in 21 districts, at end December 2003 compared to 189 factories at end December 2002. Of the 180 factories, 32 factories were located in both the Colombo and Gampaha districts and the rest were in other 19 districts. Of these 148 factories, 16 factories in the Kandy district, 14 each in the Puttalam, Kurunagala, and Ratnapura districts, 10 each in the Kalutara, Nuwara-Eliya, and Anuradhapura districts and 8 factories in the Badulla District.

4.8 Sectoral Performance

Private Sector Industries

Textiles, wearing apparel and leather products

The output of textiles, apparel and leather products sector, which accounted for 40 per cent of the factory industrial output, increased by 2.7 per cent in 2003 compared with growth of 1.2 per cent in 2002. Apparels accounted for 90 per cent of output in this category. The output in apparel, textiles and leather products sub sectors increased by 2.6 per cent, 1.8 per cent and 5.9 per cent, respectively, in 2003. This category contributed 23 per cent to the growth of output in private sector industries in 2003. The export orders for apparels, which began to increase in the latter part of 2002, improved further after the end of the Iraq war registering a 9.8 per cent output growth in the first half of 2003. However, given the high base in the previous year and intense competition in the international markets, the output declined by 9.9 per cent in the third quarter and registered only a 1 per cent moderate growth in the fourth quarter of 2003.

By 2005, textiles and apparel will be made quota free. Only tariffs, and non-tariff barriers such as labour standards will remain as a market entry mechanism. As there is only one more year for phasing out the quota system, the restructuring activities to prepare for a quota free market environment was intensified in 2003. Manufacturers took measures to improve productivity, rationalise production costs, find new niche markets, streamline manufacturing processes and to build up their own brands. Some factories were merged and brought under a single firm for efficient management, product specialisation and to reap the benefit of the scale of production. In this set up, larger firms handle sales and marketing in foreign markets using their comparative advantage in marketing abilities, and outsourced certain production activities to smaller factories.

TABLE 4.13
Private Sector Industrial Production Index

1990=100

Categories	Index					Percentage change	
	1999	2000	2001	2002	2003 (a)	2002	2003(a)
1 Food, beverages and tobacco products	193	205	211	221	235	4.6	6.3
Food and other	207	218	225	235	252	4 4	7.1
Liquor	199	203	208	219	245	5.2	12.0
Beverages	221	248	259	271	289	4 5	6.6
Tobacco	118	116	113	119	115	5.1	-3.5
2 Textile, wearing apparel and leather products	289	335	306	310	319	1.2	2.7
Apparel	322	375	343	348	357	1.3	2.6
Textile	196	224	205	212	216	3.5	1.8
Leather	203	217	205	194	205	+5.6	5.9
3 Wood and wood products	168	178	180	177	187	-1.6	5.5
4 Paper and paper products	292	314	324	316	330	-2.5	4.5
5 Chemical, petroleum, rubber and plastic products	299	326	318	333	370	4 8	11.1
Chemicals, paints and fertilisers	258	292	282	294	311	4.4	5.9
Rubber	279	313	280	299	364	6.9	21.8
Plastic & PVC	252	268	297	309	335	4 1	8.5
Pharmaceuticals, detergent and other	312	331	318	329	349	3 6	5.9
6 Non metallic mineral products	288	294	296	301	320	1.9	6.1
Diamond processing	274	281	274	288	308	4.9	6.9
Ceramic products	199	201	177	184	191	3.8	3.5
Cement	285	287	294	290	313	-1.5	7.9
Building material and other	257	268	279	283	295	1.5	4.2
7 Basic metal products	412	435	451	463	485	2.8	4 6
8 Fabricated metal products	208	217	222	226	242	2.0	6.7
9 Manufactured products not elsewhere specified	280	292	296	302	323	2.0	6.9
All categories	259	286	276	282	297	2.5	5.2

(a) Provisional

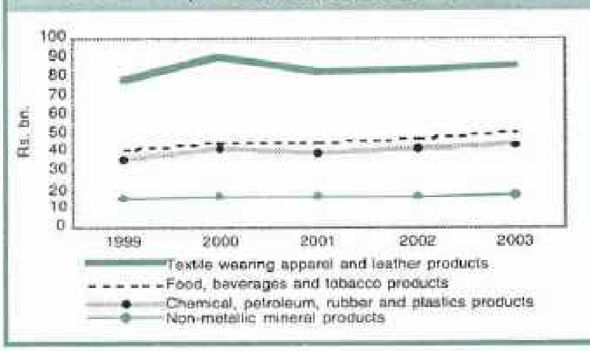
Sources: Central Bank of Sri Lanka
Board of Investment of Sri Lanka

Vertically integrated and assembly line manufacturing units using updated machinary, technology with in-house knitting, stitching and finishing helped manufacturers to maintain consistency in quality and competitiveness of prices. Improvements in supply chain management helped to reduce working capital tied up in inventories, stock handling cost and delivery time. Major manufacturers and traders actively participated in international trade fairs led by the government and chambers to search for new orders. They have also strengthened relations with international buyers and several international manufacturers renowned for manufacturing technology established partnerships with Sri Lankan producers. The apparel industry took several steps to improve delivery time in collaboration with the Ports Authority and Customs.

Duty concessions expected under the Trade and Investment Framework Agreement (TIFA) with USA and special duty concessions received from EU beginning February 2004 will help maintain the competitiveness of Sri Lankan products in the quota free market environment. Re-negotiations of the FTA with India increased the garment quota to India from two million pieces to four million pieces under new terms. The Comprehensive Economic Partnership Agreement (CEPA) to be signed with India will relax barriers on movement of goods and services and increase investment between the two countries. Countries like India, Pakistan and East Asian countries were tapped as fabric bases to support the local industry and attempts were made to develop backward linkages.

The government in cooperation with the private sector prepared a five-year strategy plan to enable the apparel industry to face future challenges. Under this plan, apparel exports are expected to increase from the present level of US dollars 2.3 billion to US dollars 4.5 billion by 2007. The major

Chart 4.6
Performance in Major Industrial Sub Sectors (1990 Constant Prices)



objectives of the plan are to transform the industry from a mere manufacturer to a provider of fully integrated services, increase market penetration by supplying value added garments and become an internationally recognised manufacturer of specific product categories such as sportswear, casual wear, children's wear and intimates. The Eight Task Forces were set up to drive a five-year strategy forward in key areas of logistics, backward integration, technology upgrading, labour, trade agreements, development of small and medium scale industries, image building and financial reforms. To increase productivity and enhance the competitiveness in the garment sectors, Budget 2004 proposed to introduce a garment sector productivity improvement programme through the Joint Apparels Association Forum. This programme will include a grant towards an international campaign to promote the industry and an interest free loan for manpower training and development.

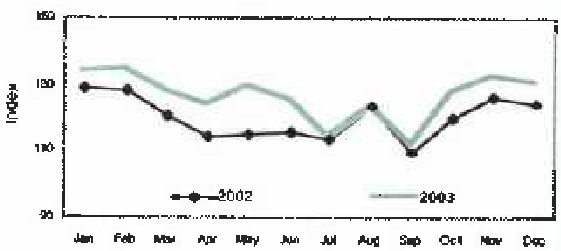
It seems that the abolition of the quota system under the Multi Fibre Agreement by end 2004 will bring more risks, more challenges and, at the same time, new opportunities. Therefore, a comprehensive plan is a necessary prerequisite to minimise these risks and obtain the maximum benefit from the new opportunities. Further concentration on quality, price, speed of delivery, developing own brands and transforming from being mere manufacturers to fully integrated service providers would be helpful to face future competition. The promotion of Sri Lanka's image in the industry through launching intense international marketing campaigns in targeted markets and obtaining recognition for high labour standards in Sri Lanka would also be vital to capture competitive markets. Specialisation in identified product categories to gain a reputation as a superior manufacturer of specific product categories would be an important strategy to consolidate existing markets. The establishment of business links with international fashion designers and obtaining feedback from buyers on sourcing strategies would be vital to meet rapidly changing designs in international markets. In a highly competitive market after 2005, the industry would need to consist of either more efficient large factories or very lean smaller factories in order to be cost effective and competitive. The industry also needs to be well supported by backward linkages. This is an issue that need to be addressed as early as possible since Sri Lanka does not have an established fabric base like other competitors in East Asian countries.

The quota availability in the US market increased by 9.3 per cent to 393.8 million pieces in 2003. The quota access to the Canadian market increased by 11.9 per cent to 15 million pieces in 2003. Sri Lanka exported 30 different apparel and textiles items to the US market and 11 items to the Canadian market in 2003. In the US market, the utilisation of quotas in absolute terms increased marginally by 2.1 per cent from 257.2 million pieces in 2002 to 262.6 million pieces in 2003. However, with the increased in quota in 2003, the utilisation rate declined to 65.4 in 2003 from 71.4 in 2002. The quota utilisation in respect of dresses, knit shirts and blouses, skirts, trousers was over 90 per cent during the year. The utilisation rate was below 25 per cent in of playsuits, fabric poplins and spun cell, gloves, suit-type coats, coats non suits, coveralls, overalls and coats due to the slower recovery in the US market. The quota utilisation rate in the Canadian market declined marginally from 32.8 percent in 2002 to 31.3 percent in 2003. The most popular quota items in the Canadian market were trousers, overalls and shorts and underwear. In the Canadian market, the quota utilisation rate was below 5 per cent in respect of coats, fine suits, swimwear, baby garments and bed sheets.

After the liberalisation of fabric imports in 1998, some domestic fabric manufacturers still face difficulties in competing with imports because of outdated technology, low quality of products and limited product range. In order to resolve these problems and to improve the textile industry's international competitiveness, the government introduced the Textile Restructuring Program in 1998. Under this over 130 firms have submitted modernisation proposals for updating technology in the textiles industry as at December 2003. As backward integration is vital for future expansion of the apparels industry, the five-year strategy plan of the apparel industry has paid close attention to developing the textile industry. Pugoda was earmarked as the dedicated textile site for future development. The site at Pugoda has the basic infrastructure such as electricity, water, roads and a water treatment plant. In 2003, the Joint Apparel Association Forum began discussions with the industry associations in Hong Kong, USA, India and EU countries to search for possibilities for establishing fabric mills in Sri Lanka by manufacturers in those countries.

The output of the leather goods industry increased by 5.9 per cent in 2003 reflecting higher performance of both domestic and export market oriented industries. The domestic market oriented footwear industry benefited from the higher tariff protection. The tariff on every pair of imports rose to Rs. 100 in 2003 to protect the industry from cheap imports. The government also recently brought down tariffs on major raw materials used for manufacturing of footwear. Although the

Chart 4.7
Private Sector Industrial Production Volume Index
(1997 = 100)



domestic demand for footwear has been growing recently with improvements in living standards of consumers, manufacturers have not exploited the full potential of this trend due to insufficient product development.

Food, beverages and tobacco products

Output in the food, beverages and tobacco category grew by 6.3 per cent in 2003 compared with 4.6 per cent in 2002 and contributed 31 per cent to the industrial sector growth in 2003. The increased production was registered in the major sub sectors of food processing (7.1 per cent), beverages (6.6 per cent) and liquor (12.0 per cent). The output of tobacco sub sector declined by 3.5 per cent in 2003.

Growth in the food sub sector in 2003 is attributed to the improved performance in processed food products, biscuits, milk products, fruits and vegetable processing, sugar and animal feed. The continuous change in food habits, turnaround in the tourism industry and growing consumer demand for fast food are driving up the demand for processed food and processed meat products. Manufacturers of processed meat introduced new varieties to the market and improved quality of existing products on the basis of the findings of consumer surveys. With this advancement, major manufacturers have begun to export their products to India, the United Arab Emirates and the Maldives under their own brands. The output of biscuits continued to grow due to higher domestic demand and penetration into new foreign markets. Domestic demand increased with continuous improvements in product quality, the introduction of smaller packets and improved distribution methods. Attractive advertising campaigns launched by major manufacturers helped to expand the domestic market size.

The animal feed industry continued to grow due to the growing poultry farming industry. The milk powder packing industry grew by 4.2 per cent in 2003. Milk powder prices in the domestic market increased with international prices. However, the demand for milk powder grew responding to the non-availability of fresh milk at reasonable prices, rapid urbanisation and aggressive advertising. Several new brands of milk powder were introduced to the market during the year. The output of domestically manufactured milk powder registered only a moderate growth in 2003. The growth in the domestically manufactured milk powder industry was constrained by non availability of adequate amounts of fresh milk. Demand for other milk products such as butter, cheese and ice cream also increased in 2003 to satisfy demand from hotels and bakeries with the revival in the tourism industry.

Despite price increases arising from excise duty, the soft drink industry continued to grow. The growth was facilitated by the ceasefire that enabled access to those markets. The application of better work practices and effective management techniques at factories helped to improve production volumes. Despite the increase in excise duties, the output of beer and hard liquor grew by 12.0 per cent in 2003 responding to increased domestic and foreign demand. Beer manufacturers were able to consolidate their market share in the Maldives, UK, Japan, Australia and USA through improved packaging and strengthening of distribution channels. New features in bottling and packaging, and the strict enforcement of excise laws helped the authorised hard liquor industry to reduce counterfeits to a certain degree. With the recent revision to the excise duty on the tobacco, licensed cigarettes manufacturers could regain market share lost to illicit producers. However, overall demand for tobacco products declined by 3.9 per cent in 2003, partly as a result of awareness of tobacco related health problems.

The output of the fruits and vegetable processing industry registered an 8.0 per cent growth in 2003. The recent introduction of plastic crates and other improved packaging for handling fruits and vegetables helped reduce wastage. Although there is growing demand, only a few varieties of fruits and vegetables are being exported due to irregular supply and lack of standards.

Chemicals, petroleum, rubber and plastic products

The output of chemical, petroleum, rubber and plastic products grew by 11.1 per cent in 2003 compared with 4.8 per cent in 2002. This category contributed 28 per cent to the growth in private sector industries in 2003. The increased output was registered in the major sub sectors of rubber based products (21.8 per cent), chemical and fertiliser (5.9 per cent), plastics and PVC (8.5 per cent) and pharmaceuticals and detergents (5.9 per cent).

Despite severe price competition, especially from China and Malaysia, the output in rubber-based industries grew by 21.8 per cent in 2003. Rubber gloves and tyres received higher export orders, as demand surged in the aftermath of the Iraq war. Testing and verification certificates for non-medical rubber gloves received in 2001, the establishment of direct marketing links with foreign markets and acquisitions of the controlling power in a major distribution network in Europe by a Sri Lankan manufacturer helped the glove industry to popularise its brands in the European market. Rubber glove manufacturers, who export their products to the EU also benefited from rising prices and the appreciation of the euro during the year.

The elimination of customs duties under the Indo-Lanka Free Trade Agreement in 2003 helped to establish a market for commercial tyres in India. Tyre manufacturers expanded their market to SAARC countries, as well as other Asian and African countries in 2003. The openings up of the Northern Province and increased economic activity have resulted in a rapid increase in local road transportation needs, generating greater demand for tyres, especially tyres used for commercial vehicles, bicycle tyres and tubes. The increase in rubber tyre and glove prices in international markets cushioned the impact of higher latex prices in the domestic market and provided some relief from the pressure from South East Asian competitors.

The output of soap and detergents grew by 5.9 per cent in 2003 as a result of the growing domestic demand and price advantage over imported items. Increased use of washing machines stimulated the demand for detergent powder. During the year, new varieties of detergents were introduced to the market at substantially lower prices. The growing popularity of herbal products, coupled with improvements in product quality and packaging, stimulated the demand for domestic herbal soap, toothpaste, lotions and cream. The industry was able to withstand the competition of imports of herbal products from India.

Output in the plastics industry grew by 8.5 per cent in 2003. The relative price advantage and ease of handling stimulated the demand for plastic furniture and packing material. In addition to growing domestic demand, there was an increasing overseas demand for plastic furniture, especially from India. In the chemical sub-sector, output of paints, chemicals, insecticides and mosquito coils grew in 2003. The output of activated carbon declined in 2003 due to insufficient availability of coconut shells and higher competition in international markets.

Non-metallic mineral products

The output of non-metallic products grew by 6.1 per cent in 2003 with improved performance in cement, processed diamonds, roofing sheets and concrete products. Domestic demand for cement, roofing sheets, glass, asbestos and concrete products increased owing to the expansion in construction of houses and commercial buildings with the revival of economic activities in 2003. The international market for ceramics remained highly competitive with the entrance of new low cost manufacture from China and East Asian countries. Sri Lanka at present exports a range of high quality products such as porcelain tableware, ceramic and porcelain wall and floor tiles and a variety of ornamental products and has captured niche markets. The industry has high operational capabilities, including a highly trained workforce, relatively competitive labour costs and designs. The leading manufacturers of tiles have well established brand names both in the domestic and overseas markets. With the tendency to use more environment friendly natural products the ceramic industry has high growth potential in western markets.

The commencement of construction activity in the North and East stimulated the demand for cement and other building material. The cement industry benefited from reduced tariffs on clinker and lower depreciation of the rupee against the US dollar. Responding to customer needs, leading cement manufacturers introduced several new products to the market in 2003. The glass industry invested substantial amounts to improve efficiency and product quality. With this advancements, the industry was able to supply high quality glass bottles to leading beer manufacturers in the country.

Fabricated metal products

The output of fabricated metal products category grew by 6.7 per cent in 2003 compared to 2 per cent in the previous year. This category contributed 6 per cent to the growth of factory industries in 2003. The products that registered higher growth in this category are agricultural machinery, transformers, water pumps, steel furniture, electrical items, kitchen appliances, assembling of motor cycles, manufacturing and repairing of ships and boats, aluminium products and light fittings. The output of batteries and fabricated bus bodies declined in 2003.

The expansion in the construction industry generated higher demand for aluminium products, cables, and light fittings. In the construction industry, there is growing popularity of aluminium window frame and steel products, spurred by price, durability and easy handling. The output of the shipbuilding and repairing industry grew by 5.5 per cent in 2003. The industry has continued to improve its infrastructure facilities, technology and skills over the years. The output of motorcycle assembling industry grew by over 15 per cent in 2003.

Expansion of rural electrification and improvement in rural incomes boosted the demand for television sets, electrical items and kitchen appliances. The new demand arising from war-affected areas following the ceasefire also helped these industries. Increased agricultural activity, with the favourable weather stimulated demand for agricultural machinery and water pumps. The expansion of soft drinks and processed food industries and stimulated the demand for refrigerators. Higher export orders received from western countries boosted the output of electronic products and electrical machinery. The output of fabrication of motor coaches declined in 2003 due to the reduction of domestic demand.

Other Products

The paper and paper products industry grew by 4.5 per cent in 2003 to meet the demand from export markets for paper products such as corrugated cartons, paper sacks and paper bags, photo albums, file covers, container packs, gift bags, stickers, brochures and paper boards. The paper products catering to the domestic market such as writing pads, brochures, leaflets, labels, and exercise books also registered relatively higher growth in 2003. Domestically manufactured corrugated cartons, labels, and paper boxes for packing developed as backward linkage for exports. The government took steps to establish the first ever specialised industrial park for printing in the Western Province providing basic infrastructure.

Output in the wood and wood products category grew by 5.5 per cent in 2003 with increased exports. Major exports were sports equipment, educational items, wooden toys and decorative items, wooden handicrafts and gift items. Revival in the tourism industry stimulated the demand for wooden ornamental products. However, the demand for domestically manufactured wooden furniture grew only a moderately, as

TABLE 4.14
Public Sector Major Industry Output Index

1997=100

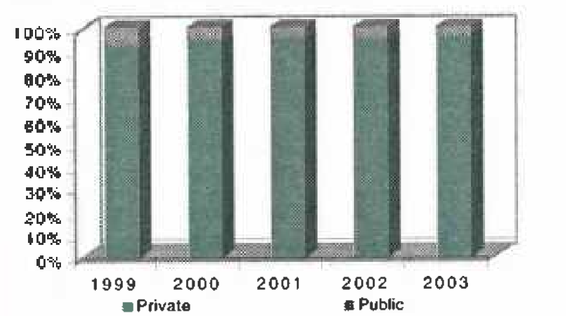
	Categories	Index					Percentage Change	
		1999	2000	2001	2002	2003(a)	2002	2003(a)
1	Food, beverages and tobacco products	106.5	139.8	128.1	91.8	121.1	-28.3	31.9
2	Textile, wearing apparel and leather products	-	-	-	-	-	-	-
3	Wood and wood products	126.5	213.3	127.9	143.8	136.2	12.4	-5.3
4	Paper and paper products	38.2	29.6	40.6	26.0	12.8	-36.0	-50.8
5	Chemical, petroleum, rubber and plastic products	84.4	104.9	93.0	101.6	94.3	9.2	-7.2
	Petroleum products	84.4	104.9	93.2	101.1	93.8	8.5	-7.2
6	Non metallic mineral products	70.5	82.6	83.4	86.7	94.8	4.0	9.3
7	Basic metal products	-	-	-	-	-	-	-
8	Fabricated metal products, machinery, and transport equipment	-	-	-	-	-	-	-
	All Categories	83.1	103.2	91.5	98.4	91.4	7.5	-7.1
	Excluding Petroleum	68.5	82.8	78.0	61.0	63.2	-21.8	3.6

(a) Provisional

Source: Central Bank of Sri Lanka

consumers preferred steel and plastic furniture due to price advantage. Imports of furniture from Europe and East Asian countries also adversely affected the local furniture manufacturing industry. Insufficient availability of timber and scarcity of skilled labour are becoming an impediment for the expansion of the industry.

Chart 4.8
Private and Public Sector Share in Industrial Production



Public Sector Industries

Output in public sector industrial enterprises decreased by 7.1 per cent in real terms in 2003, when compared with a growth of 7.5 per cent in 2002. The closure of the oil refinery of the Ceylon Petroleum Corporation (CPC) for routine maintenance work for about a month in 2003 was mainly responsible for the decrease the output in public sector industries. The output of the CPC, which accounts for over 90 per cent of public sector industrial output, decreased by 7.2 per cent in 2003. Public sector industrial output, excluding petroleum products, increased by 3.6 per cent in 2003.

The output of Sevanagala Sugar Industries Ltd increased by 37 per cent in 2003 due to the increase in crop yield and the sugar recovery rate benefited by favourable weather in the sugar cane cultivation areas. The output of Lanka Phosphates Ltd. grew by 12 per cent in 2003 with the higher demand for fertiliser from the coconut, tea, rubber and paddy sectors. The favourable weather that prevailed particularly during the harvesting period, increased the output of salt in 2003. The State Timber Corporation faced lower demand for transmission poles and sleepers from the Ceylon Electricity Board and Sri Lanka Railways.