7. INDUSTRY

Output in the industrial sector increased by 4.3 per cent in the first half of 2004 reflecting improved performance in both domestic and export market oriented industries. The growth in export-oriented industries is attributed to the recovery in international markets, while the domestic market oriented industries benefited from the continuous expansion of domestic demand. Industrial output is estimated to increase by 6.1 per cent during the second half of 2004, in view of the higher export orders received by leading manufacturers, further expansion of domestic demand and also due to the effect of the lower base in the second half of 2003. The annual growth rate of the industrial sector in 2004 is expected to be around 5.2 per cent.

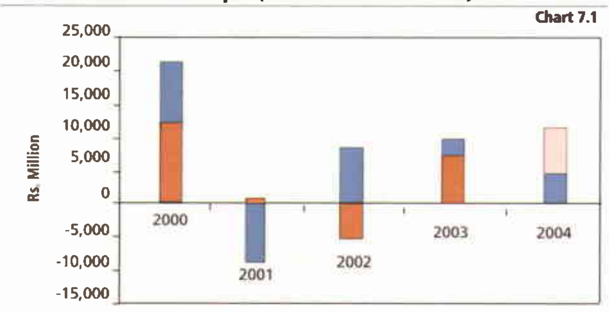
Overall Trends

- The growth in the industrial sector in the first half of 2004 was broad based and balanced across export and domestic market oriented industries. Four industrial categories, namely (a) food, beverages and tobacco products; (b) textile, wearing apparel and leather products; (c) chemical, rubber and plastic products and (d) non-metallic mineral products have led the growth. These categories accounted for over 90 per cent of growth in the industrial sector.

- The growth in the production of rubber gloves, tyres, apparel, textiles, ceramic, plastics and processed diamond was mainly export-driven. These industries have received higher export orders especially from US and EU markets.

Growth in Industrial Output (at 1990 Constant Prices)

Chart 7.1



- The international competitiveness was maintained to a certain degree with aggressive cost cutting and the depreciation of the rupee. However, competition remained high due to the entrance of low cost manufacturers to the international market and growing trade under preferential agreements.

- An increase in domestic investment in the industrial sector was reflected by the sharp rise in the import of capital goods and expansion of private sector credit. The imports of capital goods in US dollar terms increased by 42 per cent in the first half of 2004, while private sector credit grew by 20 per cent.

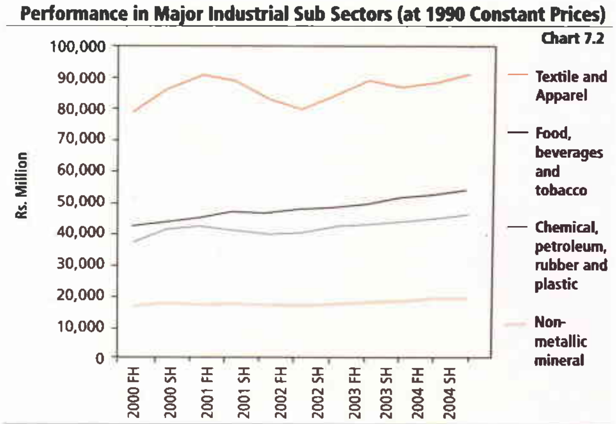
- The growth of domestic market oriented industries was led by the improved performance in the processed food, beverages, beer, wheat flour, milk products, liquor, biscuits, ceramic products, animal feed, soap and detergent, building materials, fabricated metal products and cement industries.

- The low interest rate regime that prevailed during the first half of 2004, encouraged consumer spending and expanded demand for these products.

- The rate of capacity utilisation in the industrial sector remained high at 85 per cent in the first half of 2004, with export and domestic market oriented industries operating at capacities of 84 and 86 per cent, respectively, in the first half of 2004.

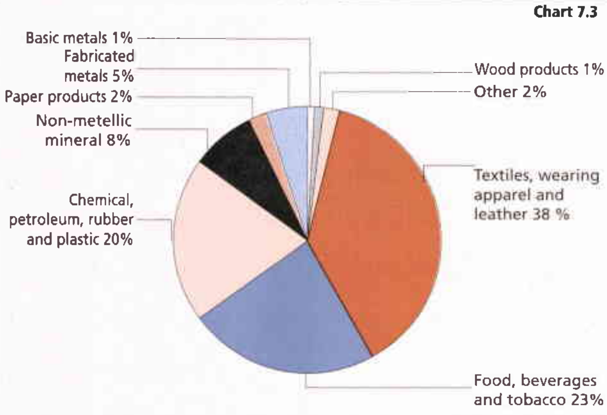
Performance in Major Industrial Sub Sectors (at 1990 Constant Prices)

Chart 7.2



Composition of Industrial Production

Chart 7.3



Performance in Major Sub-sectors

Textiles, apparel and leather products

- The output of textiles, apparel and leather products increased by 4.3 per cent in the first half of 2004, compared with the 11.2 per cent growth recorded in the first half of 2003. On the basis of confirmed export orders received by major manufacturers and the low base in the second half of 2003, the textile and apparel sector is estimated to grow by 7.1 per cent in the second half of 2004. The estimated annual growth in 2004 is 5.4 per cent.

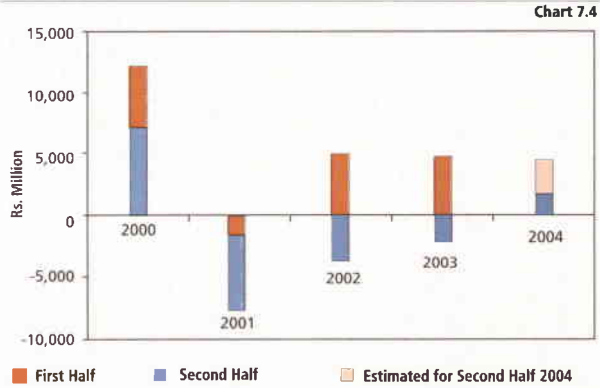
- The apparel industry benefited from the recovery in international markets in spite of intense competition. Various measures such as product specialisation, introduction of modern technologies, better order placement, efficient material sourcing, advanced marketing strategies, improvement in the delivery time and other logistic arrangements helped the apparel industry to withstand the intense competition in international markets and to move to up-market non-quota items.

- A reduction in the prevailing duty rate by 20 per cent by the EU from February 2004 upon recognition of high labour standards maintained by Sri Lankan manufacturers, helped to expand market share in the EU market.

- As the quota system is expected to be completely phased out in 2005, the restructuring activities that that began in the past aiming at preparing for the quota free market environment, were intensified in 2004. In addition to various measures initiated to improve production efficiency, major manufacturers are actively engaged in securing export orders and strengthening existing marketing relationships.

Output Growth in Textiles, Apparel and Leather Products (at 1990 constant prices)

Chart 7.4



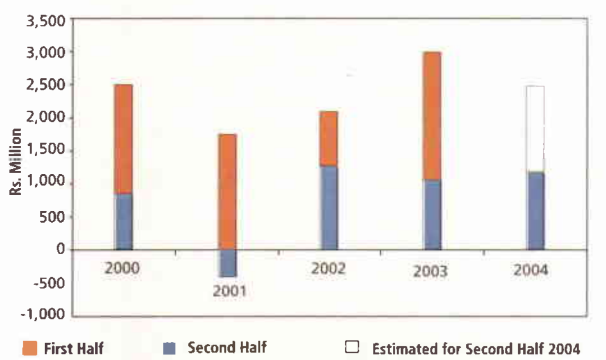
- Several task forces were set up to monitor the various aspects of the implementation of the Five Year Strategy Programme of the apparel industry. The Joint Apparel Association Forum, which functions as the apex body for several apparel associations, established a Market Intelligence Cell to oversee challenges and new opportunities in international markets.

Food, beverages and tobacco products

- The output of food, beverages and tobacco products grew by 4.9 per cent during the first half of 2004, compared with a 4.4 per cent growth in the first half of 2003. Increased production was registered in the major sub sectors of food processing (4.7 per cent), beverages (7.1 per cent) and liquor (9.2 per cent). The output of the tobacco sub sector declined by 1.5 per cent. The output of this category is estimated to grow by 4.2 per cent in the second half of 2004, leading to an annual growth of 4.6 per cent in 2004.

Output Growth in Food, Beverages and Tobacco Products (at 1990 Constant Prices)

Chart 7.5



- The turnaround in the tourism industry and the continuous change in food habits of consumers have driven up the demand for processed food and processed meat products. Market segmentation through advanced marketing strategies, effective advertising focused on targeted consumers, continuous improvement of product quality and improved distribution networks would help expand future domestic demand.

- Despite rising domestic prices, the output of milk powder industry continued to grow, responding to growing demand. Supply of other milk products such as butter, cheese and ice cream also has increased to meet additional demand from hotels and bakeries with the expansion in the tourism industry.

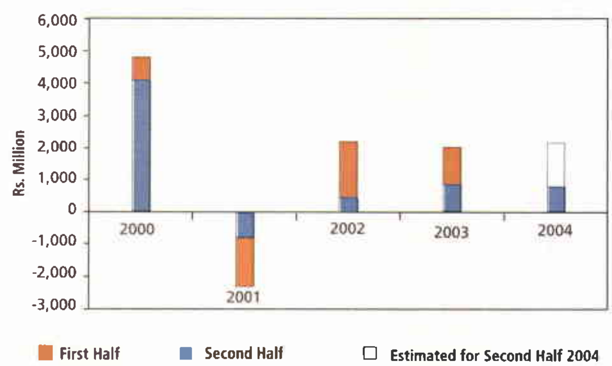
- The output of tobacco products declined in the first half of 2004 due to the continuous decline in demand on account of increased awareness of tobacco related health problems. The illegal production of white cigarettes, which affected the sale of cigarettes produced by authorised manufacturers, was discouraged substantially with the recent revision in excise duties on cigarettes. However, given the high excise duty structure, counterfeits and illegal imports are threatening the future expansion of the cigarette manufacturing industry.

Chemical, rubber, petroleum and plastic products

- The output of chemical, petroleum, rubber and plastic products grew by 5.0 per in the first half of 2004. The increased output was registered in the major sub sectors of rubber-based products (10.0 per cent), plastics and PVC (5.1 per cent), pharmaceuticals and detergents (3.0 per cent) and petroleum (8.5 per cent). The output in the chemical, paints and fertiliser sub sector declined by 4.6 per cent mainly due to the lower demand for fertiliser. The output of this category is estimated to grow by 6.2 per cent in the second half, realising a 5.6 per cent annual growth in 2004.

Output Growth in Chemical, Petroleum, Rubber and Plastic Products (at 1990 constant prices)

Chart 7.6



- The rubber gloves and tyre industry received higher export orders from the EU and the US markets. To withstand the competition from low cost producing countries, major manufacturers have resorted to manufacturing high value products. The close relations with major marketing networks in Europe helped expand market share in the EU market. The exports of tyres to India continued to grow with the elimination of customs duties under the Indo-Lanka Free Trade Agreement in 2003.

- The plastics sub sector continued to experience higher growth, driven by strong domestic demand for food, construction and packaging industries.

- The output of petroleum products increased in the first half of 2004 due to the uninterrupted production in the Ceylon Petroleum Corporation (CPC). The petroleum refinery was closed down for about two months in the previous year for routine maintenance.

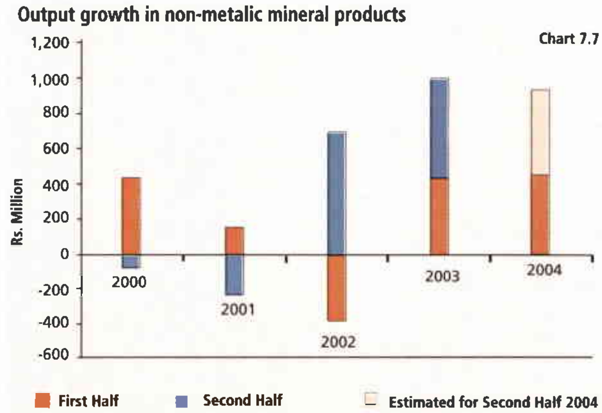
Non-metallic mineral products

- The output of non-metallic mineral products increased by 5.8 per cent in the first half of 2004 reflecting higher production in cement (5.0 per cent), processed diamonds (5.8 per cent), ceramic products (6.3 pre cent) and building materials (6.6 per cent). The output of this category is estimated to grow by 5.7 per cent in the second half realising an annual growth of 5.7 per cent in 2004.

- The growth in the construction industry, particularly the construction of houses and commercial buildings and the commencement of construction activities in the North and the East, generated demand for cement and other building materials such as roofing sheets, wall and floor tiles and concrete works. The cement manufacturing industry also benefited from the reduced tariff on clinker.

Output growth in non-metalic mineral products

Chart 7.7



- The international market for ceramics remained highly competitive with the entrance of new low cost manufacturers. However, with their high quality products and well-established brand names, leading manufacturers have captured niche markets for their products.

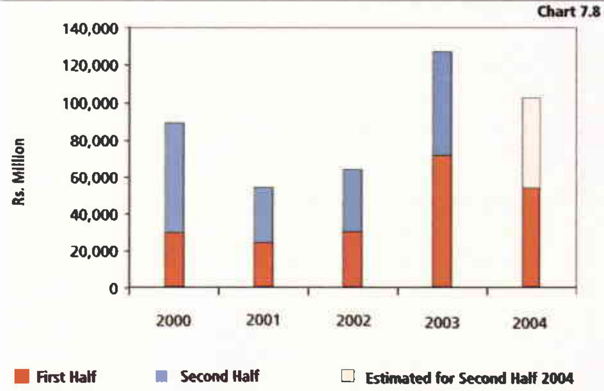
- Despite the availability of low priced imported ceramic tiles in the markets, the demand for domestically manufactured tiles, continues to grow on account of high quality. An expansion of production capacity enabled the industry to meet this increase in demand.

Investment in BOI Industries

- Foreign investments in projects, which have signed agreements with the Board of Investment of Sri Lanka (BOI), have declined in the first half of 2004. The BOI approved 171 projects with an investment commitment of Rs. 54,182 million in the first half of 2004, as compared with 194 projects with an investment commitment of Rs. 72,252 million in the first half of 2003. However, the investment in contracted projects increased from Rs. 26,755 million in 2003 to Rs. 34,123 million in 2004.

Approved Investments in BOI Enterprises

Chart 7.8



- The realised investments of the BOI enterprises were Rs.297,285 million as at end June 2004, compared to Rs. 253,545 million as at end June 2003.

Table 7.1

Approved and Contracted Investment in BOI Projects

Categories	First Half 2003			First Half 2004 (a)		
	Number of projects	Estimated investment (Rs. mn)		Number of projects	Estimated investment (Rs. mn)	
		Foreign	Local		Foreign	Local
Projects approved under Section 17	194	47,692	24,560	171	31,285	22,897
Projects contracted under Section 17	83	17,011	9,744	114	19,222	14,901
Projects approved under Section 16	81	1,486	480	112	1,805	278

(a) Provisional

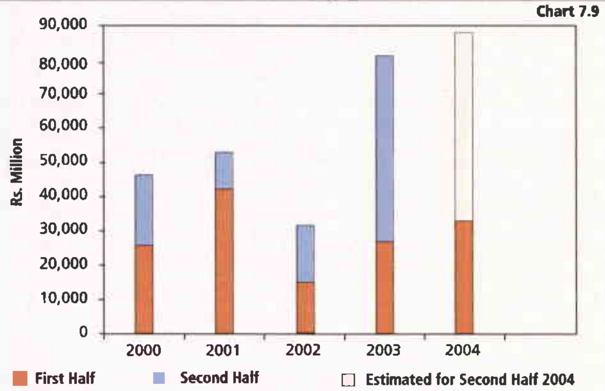
Source : Board of Investment of Sri Lanka

- Investment approvals in the first half of 2004 showed further diversification into various sectors away from the apparel sector. The sectors, which attracted new investments, are food processing industries, information technology, warehousing, education, health facilities, tourism, housing and energy.

- The direct employment potential in approved and contracted projects under Section 17 of the BOI Act was estimated at 19,892 and 20,138 persons, respectively, in the first half of 2004.

Contracted Investments in BOI Enterprises

Chart 7.9



Industrial Policy

- The development of a globally competitive manufacturing sector through the complementary participation of a strong socially responsible private sector and a strong public sector is the main objective of the industrial policy of the present government. In order to achieve this goal, the government will play a key role to provide facilities for market access, enhance competitiveness, improve the business environment, improve corporate governance, remove restrictions on foreign investment flows and facilitate easy access to foreign technology.

- Recognising the significant contribution made by Small and Medium Scale Enterprises (SME) in creation of employment and generating income, the government intends to promote the SME sector through a multi-prong support mechanism. Under this, the government will take measures to streamline bureaucratic procedures and regulations, tax administration, customs regulations and export procedures. The government will also facilitate SME through the provision of necessary training at universities and technical institutions and providing technical support for quality management, productivity improvement, technical services and Internet access. An effective monitoring and evaluation system will be formulated to ensure that SME competitiveness strategies are sustainable in the medium-term.

- The government intended to introduce a legislative framework to facilitate the restructuring of financially troubled enterprises in view of the substantial costs to the economy resulting from the closure of such enterprises . A dedicated agency, consisting of experts from both private and public sectors, will be set up to assist and co-ordinate the re-structuring of industries that could be turned into financially viable enterprises. A framework will be provided for a moratorium on debt payable without interest on such debt, repositioning of the workforce during restructuring and speedy reorganisation. The proposed mechanism for the restructuring of financially troubled enterprises is a salutary step for improving the efficiency of enterprises as it will encourage efficient allocation of resources through entry and exist process and unlocking capital invested in unprofitable sectors.

- The UNIDO Cleaner Production (CP) programme expanded its activities aiming at building national CP capacities, fostering dialogue between industry and the government and enhancing investments for transfer and development of environmentally sound technologies. Through this programme, UNIDO is expecting to bridge the gap between competitive industrial production and environmental concerns.

Prospects for 2005

- The output in the industrial sector is expected to grow by 4.2 per cent in 2005 compared to the estimated growth of 5.2 per cent in 2004. The growth will be a composite outcome of the expansion of output in BOI industries, estimated at 3.9 per cent and non-BOI industries, estimated at 4.6 per cent. The output of public sector industries is expected to decline by 5.9 per cent due to the production interruption at oil refinery on account of the routine maintenance work scheduled for 2005.

- The impetus to growth in industrial output in 2005 is expected to come from four major industrial categories comprising food, beverages and tobacco products (4.6 per cent), textiles, wearing apparel and leather products (3.7 per cent), chemical, petroleum, rubber and plastic products (3.7 per cent), and non-metallic mineral products (6.6 per cent). These four categories will account for 88 per cent of growth in the industrial sector in 2005.

- The impact of the abolition of quota in 2005 will not be substantial as the apparel industry at present is better placed to face the new challenges in a quota free market environment. The early preparation for quota free market environment by large manufacturers, less reliance on quota based exports compared with regional competitors and high labour standards maintained by the industry will cushion the intense competition expected in 2005. However, much of the concern is focused on small-scale manufacturers, who may not have restructured their factories to face new challenges.