ECONOMIC REVIEW

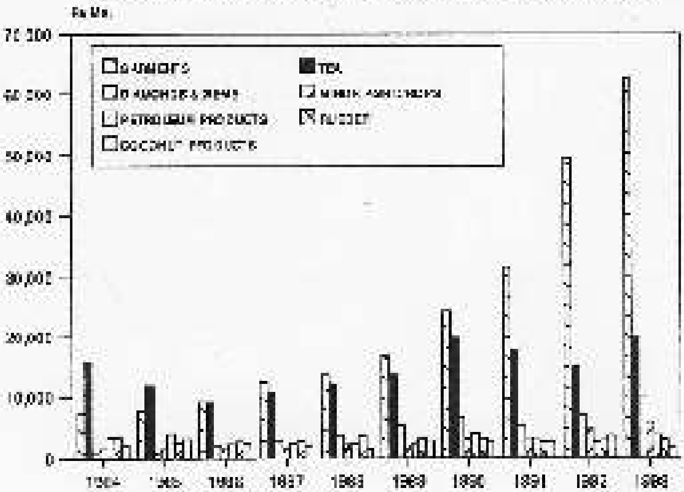
July 1994

FOREIGN INVESTMENT IN SRI LANKA

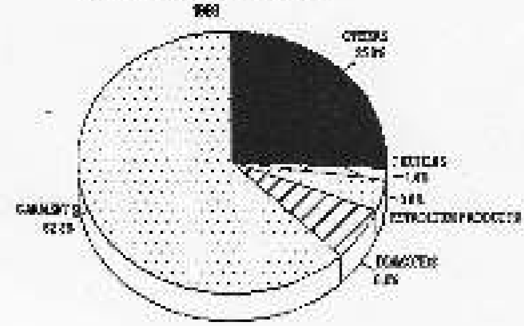
A People's Bank Publication

FTZ - SRI LANKA : VISUAL FOCUS

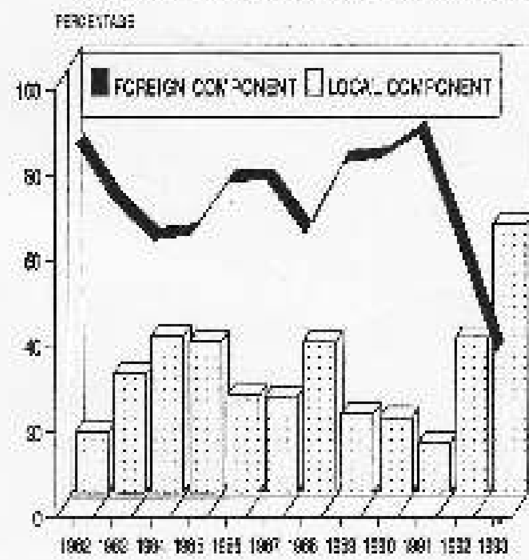
COMPOSITION OF EXPORTS 1984-1993



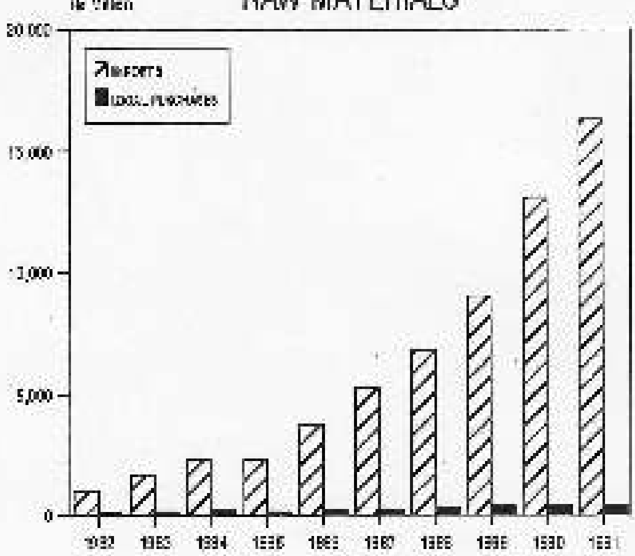
INDUSTRIAL EXPORTS



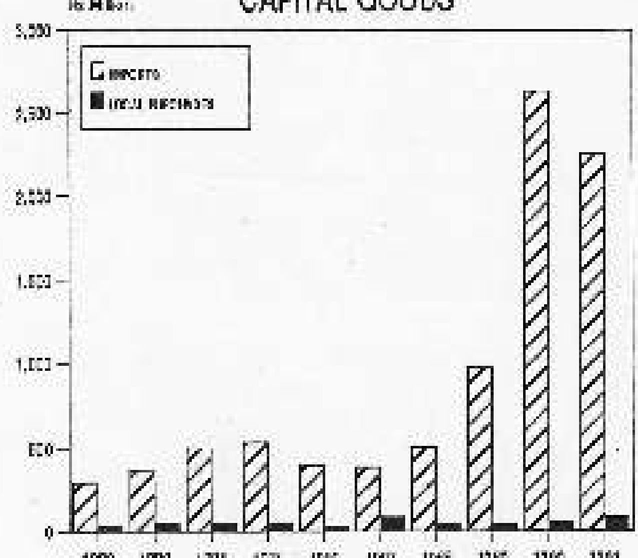
INVESTMENT IN CONTRACTED PROJECTS



RAW MATERIALS



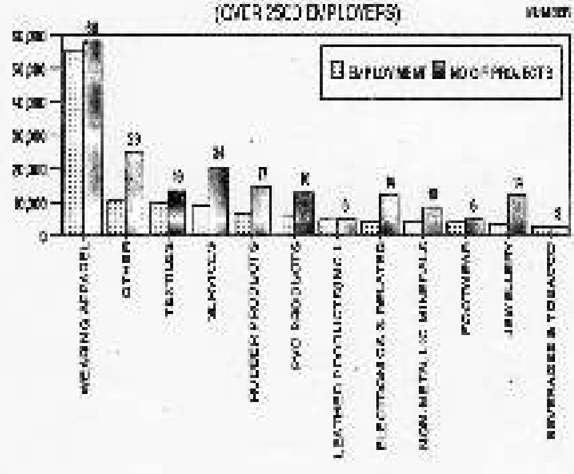
CAPITAL GOODS



NO.OF PROJECTS & ACTUAL EMPLOYMENT

PRODUCT-WISE

(OVER 2500 EMPLOYERS)



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CONTENTS

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COLUMNS

SPECIAL REPORT
Foreign Investment & Export Processing Zones

Next Issue :

Tourism and the Economy of Sri Lanka

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The Economic Review thank the Chairman of the Board of Investment of Sri Lanka, Ms. I. Pesto Senior Manager / Research & Development and Mr. L. D. Dickman, Director / Regional Development for their cooperation.

Diary of Events

March 1978 — *Establishment of the GCEC by an Act of Parliament, the GCEC Law No. 4 of 1978, as an autonomous body functioning directly under the President of Sri Lanka. It is entrusted with the administration of the Area of Authority (?? sq. km.) and the 3 EPZs of Katunayake, Biyagama and Koggala.*

March 1978 — *Inauguration of Sri Lanka's first EPZ, the Katunayake Export Processing Zone.*

1980 — *The passage of the GCEC (Amd.) Act No. 13 of 1980 empowered the President of Sri Lanka to declare "Licensed Zones" outside the Area of Authority to enable the GCEC to exercise its powers and functions in and over any licensed zone and any licensed enterprise.*

Dec. 1986 — *Inauguration of the Biyagama Export Processing Zone, Sri Lanka's second EPZ.*

Jan. 1990 — *Merger of the GCEC and FIAC to form an unified entity for the promotion and approval of foreign investments in the country. This is a major step taken to simplify investment procedures.*

June 1991 — *Inauguration of the Koggala Export Processing Zone. This forms an integral part of the Master Plan for the development of the Southern Province.*

Nov. 1991 — *Introduction of simplified procedures for investment approval and an attractive new package of incentives under the GCEC's new policy and guidelines to encourage investment in specific locations and sectors viz. export oriented garment factories, agro-based, agri-related activities, infrastructure and tourism related projects, Regional companies and sub-contracting.*

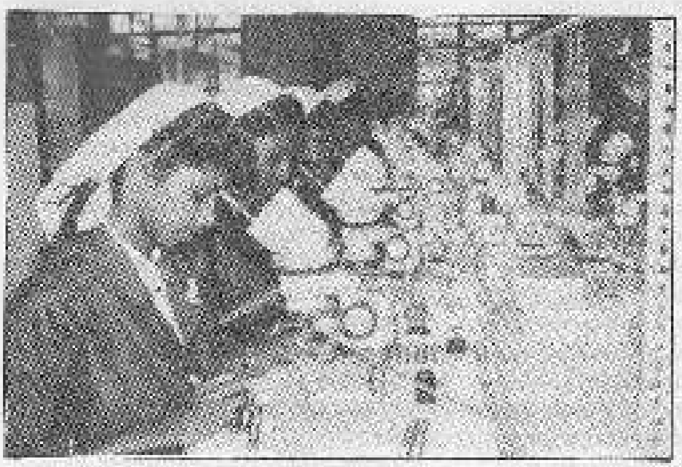
Nov. 1992 — *The GCEC renamed as the Board of Investment of Sri Lanka (BOI) with the amendment of the GCEC law on 2nd November. This important amendment has brought all licensed enterprises, wherever they are located, under the authority of the BOI. By this means, the whole island has been declared an Export Processing Zone.*

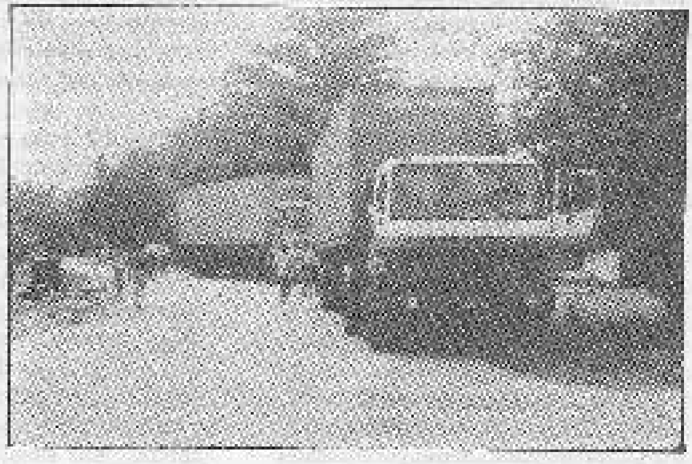
June 1993 — *Mirigama three [illegible] buildings were handed over to BOI to set up the fourth Export Processing Zone.*

Nov. 1993 — *The introduction of preferential treatment of tax was introduced with the budget proposals announced by the Govt. Its aim was to replace the tax concessions extended by the BOI with a rational and preferential treatment of taxation.*

April 1994 — *Inauguration of the fifth Export Processing Zone at Pallekele.*

Courtesy: Board of Investment of Sri Lanka





Foreign Direct Investment and Manufacturing for Export: The Sri Lankan Experience

The promotion of export-oriented foreign direct investment (EOFDI) in manufacturing has been on the national economic policy agenda of Sri Lanka since the mid-1960s. Policy interest in this sphere has received renewed emphasis since 1977, in the context of widespread policy shifts toward export-oriented industrialization. A key promise of the new policy orientation is that foreign firms (multinational enterprises, MNEs)[1] are well placed to play a crucial role in the process of export-oriented industrialization as they have market channel in place, possess experience and expertise in many complex facets of product development and international marketing, and are better able to resist protectionist pressure in their home countries in such a way as to favour imports from their affiliates.

In the absence of hard empirical evidence, unrealistic expectations about what can be achieved with EOFDI and unfair criticism of foreign firms for failing to achieve objective that they were, in fact, never intended or designed to achieve are common in the policy debate. It is common place to draw upon the experience of the newly Industrialized Countries (NICs) in East Asia as a standard in assessing Sri Lanka's achievements/failure. Such practice invariably leads to confusion because the role of foreign investment in export expansion is variable across countries depending on the nature and timing of the policy shifts and the topological characteristics of the host country such as the degree of industrial advancement and the stage of entrepreneurial development and changes in the process of internationalization of production in the global economy.

Export-Oriented Direct Foreign Investments: A Typology

Basically, there are two distinct, but not mutually exclusive, strategies that a developing country (DC) may pursue in order to obtain MNE involvement in its export expansion endeavour: (a) re-orientating import-substituting MNE affiliates (affiliates established with the prime objective of serving the domestic market) towards foreign markets, and (b) attracting "fresh" (green field) investors specifically to produce for foreign markets.

A well-known feature of MNE behaviour is that the parent company strictly controls the performance of its affiliates in the interest of global profit. The export decision of affiliates is, therefore, not simply a matter of responding to domestic export incentives and government directives. In fact, in most cases, exports from import-substituting MNE affiliates take the form of "over-spill" from excess capacity and such exports, cannot reasonably be planned for. Moreover, even if these firms do respond to host Government's "carrot- and-stick" approach, there is no guaranty that the final outcome would justify the overall cost involved. Import substituting production units operating in a small protected market are not usually internationally competitive. Therefore, export incentives have to be introduced and maintained at high levels to generate the anticipaced export push. On the benefit side, there may be little to gain in terms of employment generation because such exports, being simply an extension of import-substitution production, tend to be highly capital intensive (Helleiner 1989). For these considerations, the present day discussion on export expansion from low-income countries is focused almost exclusively on the second alternative, the promotion of export-oriented direct foreign investment (EODFI).

What are the opportunities available to the NECs enticing green field investors to established export oriented ventures in their economies? a crucial point relating to this issues is that FDI involvement in manufacturing for export from DCs is varied in its origin depending on host country economic conditions and policies on FDI. By now, there is enough evidence in the literature which permit us to distinguish among four different categories of exports in terms of the nature and degree of potential DFI involvement.[2] These are:

(1) "resource-based" manufacturing or manufacturing activities involving further local processing of materials previously exported in raw state,
(2) mature technology final products (ships, motor vehicles, radios, TVs, cameras, computers etc.),
(3) component production and assembly within vertically integrated or otherwise tightly controlled production systems,
(4) labour intensive consumer goods (textiles and garments, toys, shoes, sporting goods etc.).

In the first two areas, DFI is of limited relevance to many developing countries which attempt to embark on the export-oriented growth path. As for the first category, resources are, after all, found in particular national locations. Even if resources are available, there are other factors which make policies to entice foreign ivestors ineffective. For instance, some processing activities, particularly those in the mineral and chemical industries, are characterized by high physical and/or human-capital intensity and may not therefore be suitable for locating in a low-income country. A further major deterrent is cascaded tariff structures in industrialized countries (ICs) which provide heavy effective protection to domestic processing industries.

In the area of differential final goods (Category 2), overseas production units of MNEs are almost exclusively located in other ICs or in more advanced NICs. In these products labour costs, while significant, takes second place to the availability of world class operator, technical and managerial skills, a good domestic basis of supplies and services, relatively free access to world-priced inputs including capital, and excellent infrastructure. In other words, the location decisions of MNEs depend on the availability of a wider array of complementary inputs that make their facilities efficient by world standard. Also, given the heavy initial fixed costs, MNEs are hesitant to establish an overseas plan without considerable experience of involvement in the host country. Moreover, in making investment decisions in this sphere investors attach significant weight to the existence of a large domestic market which can absorb a substantial proportion of output at the initial stage of market entry (Guisinger, 1985).

The location in developing countries of relatively labour intensive processes and component production within vertically integrated international industries (Category 3) has been an important feature of international division of labour since about the late 1960s. This development is part of an adjustment process whereby firms in DCs adapt to the increasing pressures of domestic real-wage increases and import competition from low cost sources (Grunwald and Flamm, 1985, ch.8). The transfer abroad of component assembly occurs in many industries where the technology of production permits the separation of labour intensive components from other steps in production. Assembly operations related to high-tech electronic industries, the production of semi-conductor devices in particular, are by far the most important. The other industries with significant assembly operations located in DCs are electrical appliances, automobile parts, electrical machinery and optical products.

Up to about the late 1970s, assembly operations were mostly carried out in the East-Asian NICs and in some low-wage countries specifically advantaged by proximity to the US (Mexico, Haiti and the Caribbean Islands) and to the Western-European industrial countries (Spain, Portugal, Ireland, Greece and Yugoslavia). In recent years, the geographic coverage has widened to include countries such as Thailand, Malaysia, the Philippines, India, Malta, Tunisia and El Salvador. This pattern seems to reflect the impact of both wage increases in the originally-favoured locations and DFI promotion policies in new host countries. As well, given the importance of overseas assembly for their survival, many MNEs have started having a diversified mix of country locations that reflect the optimum combination of risk and return (Grunwald and Flamm 1985:75).

Assembly exports from DCs have grown much faster than total manufactured exports from these countries. For instance, their share in total US imports of manufactures from DCs increased from 4 per cent in the mid-1960s to over 20 percent in the late 1980s (UNCTC, 1992: 127). It can be reasonably expected that overseas production arrangements will continue to remain a dynamic growth area in the foreseeable future. For developed-country firms which operate in industries severely affected by import competition from low cost sources (i.e. electronics, electrical goods and automobile), offshore assembly is crucial for their survival. Governments in these countries also actively encourage such operations through value added tariff provisions and other measures with a view to cushioning domestic economies against disruptions resulting from rapid imports penetration. (DC governments, notably the US government have created a special tariff structure which allows goods that have been exported from the US for further processing to be re-imported suject to ad valorem tariffs which are levied only on the value added abroad, not on the value inclusive of the originally added in the US). While there have been attempts towards assembly automation in developed countries, there is no indication as yet of a trend away from offshore production (UNCTC 1986). In many hightech industries (notably in electronics) rapid innovation and continuous technical change, which bring about a constant cycle of change and obsolescence, is a formidable constraints to rapid automation (Grun- wald and Flamm, 1986:7-9).

In world-wide offshore assembly operation, MNEs from industrialized MNEs also has been gaining importance since the late 1970s. More recently MNEs from more advanced developing countries (or third world multinational enterprises, TWMNEs, as they are popularly known), notably those from the East Asian NIEs have joined this process of internationalisation of production. In response to rapid domestic wage increases, and the growing reluctance of domestic labour to engage in low-paid blue- color employment coupled with stringent restrictions on the importation of labour, firms in electronic industry and other durable consumer goods industries in NICs in East Asia have begun to produce components and sub-assemblies in neighbouring countries where labour costs are still low(Chen 1990; Lall 1992; UNCTNC 1988).

For NECs standardised labour-intensive consumables (Category 4) are the most promising growth area in their export- expansion endeavour. The role of DFI in this sphere, however, remains a controversial issue. On the basis of the experience of East-Asian NICs, it has been argued that DFI involvement is by no means necessary for successful expansion of these exports as they embody well-diffused technology (Hone 1974: 146; Nayyar 1978:61-2; Helleiner, 1988;130). In the spectacular export take-off of East Asian NICs in the 1960s the key role was played by indigenous firms with the help of marketing services provided by foreign buyers- the Japanese trading houses and the large retail buying groups in developed countries. MNEs came only later when the prospects of exports from these countries became clear and their export composition started to shift over to more sophisticated product lines (Westphal et al. 1979).

There are, however, strong reasons to argue that the East-Asian pattern of local entrepreneur dominance in this product area may not be replicated in NECs. There are at least three points relevant to our argument. First, perhaps the most important factor behind the East Asian experience was the unique entrepreneurial background of these countries. Hong Kong, Singapore and Taiwan started with a stock of entrepreneurial and commercial talents inherited from the pre-revolutionary industrialization of China. They also had well established international contacts based upon entrepot trade which involved exporting of manufactures to begin with. Likewise, considerable industrial experience accumulated over the preceding five decades or so under the Japanese occupation laid beneath the foundation of Korea's export take off (Rhee et. al 1988: 132; Lin and Monk, 1985:239). Therefore, there was no vast difference between domestic firms in these countries and foreign firms with regard to knowledge of and access to production technologies and market channels. While there is no empirical evidence to prove so, it may not be unrealistic to surmise that many (perhaps all) of the present-day NECs are not comparable with these countries in terms of the initial level of entrepreneurial maturation. In most NECs, import substitution growth strategy pursued indiscriminately over a long period has thwarted the development of local entrepreneurship; domestic firms are generally poorly oriented towards export markets where competitive pressures are greater.

Second, since about the early 1970s, successful exporting firms in NICs (mostly in the East Asian NICs) have begun to play an important role as direct investors in labour-intensive export industries in NECs. Two main factors, namely the erosion of international competitiveness of labour-intensive export products from their home countries as an outcome of wage increases, and the imposition and gradual tightening of quantitative import restrictions (QRs) by DCs on certain labour intensive exports (mostly textile, garments and footwear), have contributed to this new developments (Wells, 1986a). There are indications that, in line with rapid structural transformations that are being taken place in NICs, the intermediary role of these "new" investors in linking NECs to world markets may become increasingly important in years to come.

In their new locations, TWMNEs have a strong competitive edge over local firms because of their product expertise, long-established links with foreign buyers and better access to input supply sources in their home countries. Usually, the host NECs prefer to restrict the entry of TWMNEs into those export sectors so that local firms can benefit from the new market opportunities generated by QRs on NICs. However, in practice, because of the lack of domestic entrepreneurial talents and the natural reluctance of foreign buyers to deal with unknown parties, such a move is bound to run counter to the export expansion objective of the country. The host country approach towards these new investors has, therefore, become increasingly receptive in recent years (Chen 1990). From the point of view of the host DC, a major advantage of TWMNEs is that, unlike ICMNEs they are used to and/or easily adaptable to relatively unsatisfactory business conditions (eg. poor infrastructure, bureaucratic red tape) in these countries (Athukorala and Jayasuriya 1988; Wells 1986a).

Third, there is evidence that some developments since the mid-1970s in ICs' policy towards imports from DCs have brought about some shifts in the geographic pattern of foreign investment by IC firms operating in the related industries (Grunwald and Flamm 1985:7). Of particular importance in this connection are the introduction of various trade preference schemes, regional preferential arrangements, value-added tariff concessions and country-specific import quotas (voluntary export restraints, VERs), and the increase over time in the degree of selectivity (usually in favour of newcomers at the expense of established (NIC) exporters) with which such policies are implemented. Trade preferences (and value-added tariff concessions) can stimulate EODFI when they involve significant cuts in effective protection on goods in which the countries concerned possess a comparative advantage. Likewise, VERs provided opportunities for developed-country firms to exploit quota rent through overseas investment in affect industries.

Foreign Investment Climate

The relative attractiveness of a given country for FDI depends on both its comparative advantage in international production and the general investment climate. The typology developed in this section suggests that, at the present stage of economic development, Sri Lanka's comparative advantage in the international market for investment sites lies mostly in assembly activities in vertically integrated industries and light manufactured goods (Categories 3 and 4). It is generally believed that, in terms of the key country-specific factors (in particularly, the availability of relatively cheap and trainable labour and infrastructure of reasonable quality) which receive emphasis in site selection decision in these product area, Sri Lanka ranks very favourably among countries of her stage of economic development (UNCTC 1978, Ch. 12; ILO/UNCTC 1989). It follows from this that Sri Lanka's relative performance in attracting EOFDI should be explained in terms of relative conduciveness of the investment climate.

The term "investment climate" is used here to cover both policy induced incentives and general business environment. The term "incentives" is used here to cover everything from straightforward incentives such as cash grants, tax holidays and low interest loans to various disguised subsidies such as low public utility rates. "General business environment" is used as a catch all term for various considerations impinging on investment decisions such as political stability and the attitudes of the host countries towards foreign enterprise participation, the regulatory environment, a stable and predictable macroeconomic environment arising from political and policy stability and prudent macroeconomic policies, political and macroeconomic stability, official attitude towards FDI, the ease with which profit can be remitted, stability and clarity of rules governing foreign investment, and fairness and efficiency in administering these rules. Most economists today accept the argument that general investment climate is much more important than specific incentives (Wells 1986b). Tax concessions and other profit-related incentives are relevant only if the general business environment is conducive for making profit. Moreover, as countries compete for attracting investment, the incentives offered by a given country are generally counter-balanced by similar moves by other competing countries.

Thus investment incentives may matter only when other conditions are roughly similar as between alternative host countries. In keeping with this received view, an attempt is made in this section to provide an overview of Sri Lanka's investment climate over the past three decades, paying attention to both investment incentives and the general business environment.

During the first decade or so after independence, Sri Lanka continued as an open trading economy with only relatively minor trade or exchange restriction, and liberal domestic policies. In line with this general policy stance, an extremely liberal policy was pursued in connection with the approval of DFI. In response to deteriorating balance of payments situation, Sri Lanka moved rapidly into a regime of stringent import and exchange restrictions in the early 1960s, but the foreign investment policy continued to remain liberal until the mid-1960s. This policy configuration, paved the way for many MNEs to set up affiliates in Sri Lanka to undertake domestic production of goods which had previously been supplied from overseas production centres (Fernando, 1971 and 1972).

By the mid 1960s, import substitution industrialization strategy of the country had reached a crisis point, in face of an aggravating balance of payments crisis. In this context, the widely-held view among development economists at the time that "import substituting MNEs worsen countries' balance of payments" (Little 1982, 185) began to dominate Sri Lanka's policy towards FDI. Thus, stringent restrictions were imposed on the approval of new import-substituting foreign ventures. At the same time, there was a new policy emphasis on export promotion arising from the need to augment imports of capital goods as development proceeds. The role of DFI in the export development drive received official recognition for the first time in a White paper on Foreign investment issued in 1966 which spelled out "ability to export a greater part of output" the most important criterion of the foreign investment approval procedure and introduces various tax concessions for export oriented ventures. The government also announced the relaxation of the moratorium on the remittance of dividends, interest and profit which had been in force since 1963. A Foreign Investment Advisory Committee (FIAC) was set up at the Ministry of Planning function as the official body in charge of approving and monitoring DFI.

With the change of government in 1970, the foreign investment approval procedure turned out to be more selective and stringent. However, in line with the Government's commitment to the export diversification drive, export-oriented foreign investment was accorded preferential treatment. A package of production and tax incentives for export oriented firms was introduced by the Five-Year Plan 1972-76.

This policy shift in favour of EOFDI since the mid 1960s, however, occurred flouting the cumulative impact of taxes and the overvalued exchange rate, the overall incentive structure of the economy was characterized by a significant "anti-export bias" throughout this period (Cuthbertson and manufacturers with access to global inputs at border prices) in operation since 1964. But, because of stringent performance requirements and bureaucratic red-tape in operation, the missing the anti-export bias of the restrictive trade regime (Athukorala 1984).

The government in power during 1970-77, in compliance with its election promise of "the establishment of a socialistic society", acted to consolidate the dominance of the public sector in the economy. The increased direct government intervention, coupled with various controls effectively marginalized the private sector in the economy. Despite policy rhetoric of promoting EOFDI, in practice the government vacillated between a perceived need and political suspicion. For instance, in 1974 the Ministry of Planning came up with a plan for setting up a Free Trade Zone in Trincomalee, but it did not receive the Cabinet approval because of strong opposition by the centre-left members in the coalition on grounds of threat to national sovereignty. In approving foreign investment in export oriented ventures the Government's preference was for joint-ventures with capital participation of government corporations and foreign manufacturing firms. The perceived crowding out effect on indigenous industry was a major consideration, in approving private sector joint ventures. For instance, according to Ministry of Industry records, at least 17 joint venture proposals to set up export oriented garment factories were rejected during the period 1970-1976 on the ground that purely local owned companies could succeed without foreign capital in this diffused-technology product area.

The year 1977 marked a turning point in the post-independence development policy of Sri Lanka. The new "right-of-centre" government which came into power in May 1977 choose export oriented industrialization within the framework of a liberalized trade regime as the basic tent of its economic policy. A far-reaching policy reform in this line of thinking, was announced by the Budget Speech presented in November 1977 and further changes were affected subsequently. The policy reforms were motivated by the view that the ISI strategies had failed and that an export oriented development strategy needs to be adopted. In this context, the promotion of EOFDI turned out to be a pivotal element in the new policy.

The highest single effort at promoting export-led industrialization was the setting up of the Greater Colombo Economic Commission (GCEC) in 1978 with wide ranging power to facilitate FDI in fully export oriented ventures. The GCEC was empowered to approve foreign investment in Export Processing Zones (EPZs) (which are specifically designed for to serve as a focus for the development of infrastructure to the standards required for export-oriented firms) or in location within an area of authority covering approximately 160 square miles situated north of Colombo.[3] The incentive package offered by the GCEC included allowing complete foreign ownership in investment projects; a tax holiday for up to 10 years with complete tax exemption for remuneration of foreign personnel employed, royalties, and dividends of shareholders during that period; and duty exemption for the importation of equipment, construction material and production inputs.[4]

Subsequently, GCEC enterprises were provided with unlimited access to foreign-currency credit at interest rates prevailing in world financial markets, under the Foreign Currency Banking Scheme introduced in 1979. In addition to these incentives, firms located within EPZs are provided with industrial services to established enterprises, covering serviced sites, building plants,power, water and telecommunication services, at subsidized rates, and assistance with customs clearances. The first investment promotion zone, at Katunayake near the Colombo International Airport (henceforth KEPZ) was opened in June 1978. The success of KEPZ paved the way for setting up of a second EPZ in Biyagama (BEPZ) in 1982 and a third in Koggala (KGEPZ) in June 1991.

While GCEC program was to act as the major instrument of promoting export oriented investment, many elements of the 1977 policy package were aimed at improving the general investment climate in the country for export oriented production by both local and foreign firms. These elements included the removal of most of quantitative restrictions on import trade, considerable relaxation of controls on capital and profit repatriation, exchange rate depreciation. In addition, a wide range of schemes pitched at export promotion was introduced under a newly established Export development Board (EDB). In 1980, the duty rebate scheme (originally introduced in 1964 and revised in 1969) was completely reformulated with a more flexible implementation procedure to cover almost all non-traditional exports which use imported inputs. The coverage of the duty rebate scheme was expanded in 1982 to include sales to EPZs. This decision was intended to provide a inducement to strengthen "backward linkages of EPZ activities. A scheme of manufacture-in-bond for exporters importing material for re-exporting as a part of a finished good, a cash grant scheme based on annual export increments, and concessionary credit for exporters were among the other EDB incentives. A five year tax holiday was introduced in the 1978 Budget Speech for export-orientated companies. With regard to these concessions and incentives, non-GCEC (FIAC- approved) joint venture firms were treated equally with locally owned firms. There was no major change in the policy towards foreign ventures which do not meet the criterion of "full" export orientation. Such project had to go through the normal approval procedure of FIAC. Majority local ownership continued to be the general rule for approving such projects. However, under the new policy emphasis on expert-oriented industrialization, FIAC was empowered to adopt a more liberal ownership criteria (going even up to 100 percent foreign ownership) depending on the export potential of the project.

As an important part of the DFI policy, steps were also taken to enter into Investment Protection Agreements and Double Taxation Relief Agreements with the major investing countries. The former agreements were further guaranteed by Article 157 of the constitution of Sri Lanka.

In addition to these policy initiatives which foreign investors generally found highly attractive,[6] the political climate of the country during the first six years or so after 1977, election was also much in line with investor expectation. After the crushing election defeat in 1977, the traditional opposition was in disarray, and the decline of the left-wing parties was accompanied by a weakening of the trade unions. In July 1980, the government crushed a major public sector strike using emergency powers and the armed forces, and no major trade union challenge emerged in subsequent years. All these developments, coupled with the restructuring of the political system along Gaullist lines created a strong sense of "Political stability".[6] All in all, during the immediate post 1977 years Sri Lanka scored very well on various factors relevant to the foreign investors' perception; the international news media soon dubbed Sri Lankan "the new investment centre of Asia" (**Far Eastern Economic Review**, October 1978).[7]

Unfortunately the investment climate did not remain highly favourably for long. Debilitating elements were to emerge on many fronts. In the sphere of macroeconomic management, the government's commitment to a massive public sector investment program (which was initiated shortly after the liberalization reforms) aggravated the fiscal imbalance, raised the costs of domestic resources and generally increased inflationary pressure in the economy, and gave rise to some of the classic "Dutch Disease" type pressures which adversely affected the incentives for export (and other tradable) industries (Athukorala and Jayasuriya 1994, Ch. 5). In the political arena, signs of policy instability resulting from internal power struggle of the ruling party, partly due to the President's advanced age, were to emerge by 1982 (Kannangara 1983). In a context where two (or three) groups were tussling for power within the UNP hierarchy, political expediency gained priority over policy commitment required for the pursuance of Export led growth strategy. The major blow, however came with the escalation in 1983 of the long-standing political rivalry between the two major ethnic groups in the country (minority Tamil people and majority Sinhalese) into extensive civil war. In 1987 India pursued the Sri Lankan government to grant the traditional Tamil provinces of North and North East limited self-rule. This move proved to be the catalyst for the eruption of an armed threat launched by radical Sinhala extremists in the rest of the country. In the face of continuing political instability there was little role for economic policy (Manor 1984).

In 1989, the Government managed to crush the rebellion in the South and to limit ethnic violence mostly to the Northern and Eastern provinces. The ensuing years have also seen a more vigorous adaptation of market-oriented policy reforms. These policy initiatives included an ambitious privatisation program, rationalisation of tariff structure (by reducing the number of tariff bands from 19 to 4) leading to an overall 30% reduction in nominal rates, removal of all non-tariff controls except those on a limited range of strategic items, removal of exchange controls on current account transactions in successive stages culminating in the abolition of foreign exchange surrender requirement on export transaction in February 1994, permitting all exporters to borrow foreign currencies from FCBUs for the purpose of financing imports required to execute export orders. In the sphere of FDI promotion, FIAC was abolished and its activities were placed under GCEC in January 1990, with a view to creating a "one stop investment promotion centre" which could facilitate and speed up investment approval within a unified policy framework applicable to both import substituting and export-oriented investors. (The enlarged GCEC was renamed Board of Investment (BOI) in November 1992.) A new Investment Policy Statement announced in November 1990 introduced several important changes to the foreign investment policy framework: first, the historical reliance on the case-by-case approval procedure was abandoned and a new system based on the concept of automatic investment approvals was introduced; second, various restrictions on the activities and ownership structures of joint ventures were lifted; third, foreigners were permitted to purchase up to 40 percent of shares of existing quoted companies without approval and forth. GCEC was empowered to provide free-trade-zone status to foreign investors in all parts of the country (in addition to the area demarcated by the original GCEC Act), in order to facilitate the development of close linkages between the FDI activities and the domestic economy at large.

Investor confidence in the long-term continuity of the outward-looking policy stance has been strengthened by overall political changes in the country. Indeed, the most dramatic change in the Sri Lankan political landscape since the mid-1980s has been the convergence in broad economic policies among the major political parties and groupings. There are clear signs that the basic trust of the orientation of economic policies would continue under whatever regime comes to power in the foreseeable future.

These favourable developments notwithstanding, Sri Lanka is still far. There are still many disturbing elements which hinder foreign capita-litical solution, and the economy continues to be burdened by the massive defence expenditures and their consequences for macroeconomic stability. International competitiveness of local production is hampered by continuing domestic inflation fuelled by a massive budget deficit (caused mostly by war financing) and the resultant high interest rates (Jayawardena 1994). Policy inconsistencies, in particular the liberalization of foreign exchange dealing relating to current account transactions (which, together with the removal of restrictions on foreign portfolio investment, amounts to a de facto liberalisation of the capital account) has further aggravated macroeconomic imbalance in the economy. In a context of continued politicisation and disintegration of the administrative mechanism, there are no stable and understood norms which ensure proper functioning of market forces; lack of certainty and temporency in policies remains an endemic feature of the general business environment. The process of institutionalisation of political violence commenced in the early 1980s has not yet come to an end. The adverse international image created by these and other related developments continues to constrain Sri Lanka's attractiveness as a potential location for international investment.[2]

Notes:

1. In line with usual practice in this area of study, the multinational enterprise (MNE) is defined here as an enterprise that owns and controls business ventures in more than two countries (including the one it is based). When this definition is adopted the greater bulk (if not all) of DFI in a given host country can be considered as MNE investment. The terms "foreign firm" and MNE are used interchangeably.

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Cont. on page 11

Proliferation of EPZs in Sri Lanka

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Sri Lanka now has five Export Processing Zones (EPZs) established over a period of 16 years. The fifth EPZ is in the phase of construction and is expected to be operational by September/October 1994. The first two zones are located in the densely populated Western Province where more than a quarter of Sri Lanka's 17 million population live and work. The third zone is located in the deep south of Sri Lanka an area characterised by high unemployment levels. The fourth zone at Mihintale in the Anuradhapura district of the North-Central Province is envisaged to act as the growth centre for the North Western, North Central and North Eastern regions. The fifth zone is located at Pallekelle in the Kandy District and is expected to serve the Central Province.

All five zones are administered by the 'Board of Investment of Sri Lanka'. In addition to the zones, BOI also administers licensed enterprises - projects which enjoy all rights and benefits of zone enterprises, but where for technical or economic reasons, location within the EPZ is not practicable.

Expectations for Establishing EPZs & Licensed Enterprises

The conventional reasons for establishing and operating the EPZs are best described by F. A. Rabbani as:

"(a) Increasing foreign exchange earnings by exporting new products and finding new markets, improving the quality of exportable items and marketing technologies, and providing a shop window, thereby establishing a reputation for the goods of the home country as a whole.

(b) Providing jobs, mainly to the educated unemployed, supplementing the incomes of their families, thereby raising their standards of living.

(c) Upgrading skills of the local manpower in production management and work techniques.

(d) Creating linkages with the hinterland by stimulating the inflow of local raw materials, equipment, components and packing materials and giving an impetus to subcontracting, thus encouraging the growth of support industries and ancillary services.

(e) Transmitting new technology by training local people in the zone enterprises by foreign experts or sending them abroad and obtaining technological co-operation with those enterprises in the tariff area for the supply of equipments and components needed by the zone enterprises.

(f) Developing the under developed regions of the country concerned." (Rabbani : 1980)

Viewed in this light, the expected outcomes of establishing EPZs in Sri Lanka are :

(1) Earning revenue through export expansion rather than through import substitution. The EPZs and licensed enterprises as a general rule are expected to export not less than 90% of their production and only limited access to the local market is permitted.

(2) As bulk of production is exported (often to countries from which the foreign component of equity of the enterprise has originated), market expansion is assured.

(3) At the inception one of the requirements of an EPZ enterprise is that it was required to bring in all working capital in foreign exchange, ie. working capital should be met through foreign currency remittances (Sri Lanka Gazette Extraordinary : 1978). (The resultant effect was that there was an inflow of capital to the country, which is used for the actual operation of the enterprise).

(4) In addition, at the inception of establishing the EPZ concept, the proceeds of all exports of EPZ enterprises were required by law, to be brought into Sri Lanka within 180 days of the date of export (Sri Lanka Gazette Extraordinary 1978). The effects of this regulation were :

* to strengthen Sri Lanka's balance of payment through the inflow of currency; and
* to ensure that export earnings are, infact, remitted back to Sri Lanka a precautionary measure adopted to prevent negotiable transfer practices which are adopted by subsidiaries of multinational companies who manufacture and export components and semi - finished products for other companies of the group.

(It should be noted that over a period of 15 years conditions (3) & (4) were an important part of the checks and balances required to ensure that an inflow rather than outflow of capital occured. However presently with the economy opening upto an unprecedented level and Sri Lanka being effectively an IMF article VIII nations, these two conditions are no longer applicable.)

(5) Providing employment through the opening up of industrial ventures. This also involves the drawing of agricultural workers into industry, upgrading them to higher levels of skill development and the introduction of the factory system of employment.

Incentives and Facilities Offered

There are more than 500 tariff-free zones, free ports, export processing zones and other duty protected enclaves in 76 countries around the world (Journal of Commerce: 1985). Most provide some kind of fiscal or financial incentives.

As regards the grant of incentives to EPZ enterprises, two opposing views prevail. According to S.G. Van "The

	Katunayake EPZ	Biyagama EPZ	Koggala EPZ	Kandy EPZ	M[illegible] EPZ
Location	[illegible] Kms from the Port of Colombo [illegible] the International Airport at Katunayake.	[illegible] Kms from Colombo and [illegible]	[illegible] Kms South of Colombo [illegible] the Port of Galle.	[illegible] Kms East of Colombo. [illegible]	[illegible]
Extent & Development	Approximately [illegible] Phase I ...... [illegible] Phase II ...... [illegible] Phase III ...... [illegible] Work on the infrastructure of the Zone [illegible] and at present development work is almost complete.	The [illegible] Phase I .... [illegible] Phase II .... [illegible] Work on infrastructure [illegible]	[illegible] developed land. Development [illegible] in 1990.	200 acres [illegible] land	1[illegible]
Infrastructure: (i) Internal Roads	Access is available to all factory sites.	A [illegible] highway [illegible]	[illegible]	[illegible]	[illegible]
(ii) Water Supply	The present water supply is from ground water [illegible]. Water is treated [illegible] WHO standards before distribution to the factories. Water treatment and storage facilities [illegible]	Approximately [illegible] gallons of treated water per day [illegible]	Presently [illegible] gallons per day. [illegible] gallons in Capacity.	1.5 million gallons per day	Supply [illegible]
(iii) Environmental Protection	A sewage & effluent collection system [illegible] sewage treatment plant [illegible] The entire area is landscaped to make the surroundings pleasant [illegible]	An environmental control laboratory [illegible]	[illegible]		
(iv) Electricity	[illegible]	Power supply of [illegible] MVA [illegible]	Presently [illegible] MVA [illegible]	[illegible] MVA [illegible]	[illegible] MVA [illegible]
(v) Posts & Telecommunication	A [illegible]	[illegible]	Presently [illegible]	[illegible]	[illegible]
(vi) Warehousing facilities	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
(vii) Security	[illegible]	Security lighting, [illegible]	Security lighting and fencing [illegible]	Security lighting, [illegible]	Security lighting [illegible]
(viii) Services	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

EPZs depend for their success on the level of investment by occupant firms, optimization of their production and the rate of growth of their exports. The incentives offered for the occupant industries is, therefore, a very critical element in the operation of the zones. The inducements offered have a cost benefit angle and affect the decisions of entrepreneurs to set up industries in the zone (B.G. Van in N. Vittal : 1977).

Like the many tax free zones of the world when the first EPZ was established BOI too provided a range of incentives.

Incentives and other facilities provided were :

1. 100% tax exemption on corporate income for between 5-15 years, reckoned from the first profit making year.
2. Concessionary tax of 2% to 5% for a further 15 years after expiry of the tax holiday.
3. No income tax on the remuneration of foreign personnel during the tax holiday period.
4. Free remittance of earnings of foreign personnel.
5. Double taxation relief on earnings of expatriates from countries with which Sri Lanka has entered into Double Taxation Relief Agreements.
6. Free repatriation of capital and proceeds, on liquidation.
7. Exemption from controls on imports, exports, transfer of shares and dividends, transfer of capital and proceeds of liquidation etc.
8. No tax on royalties and dividends of resident and non resident share holders during the tax holiday period.
9. No ownership restrictions - no limits on the ownership of equity of foreign investors.
10. Free transfer ability of shares within and outside Sri Lanka.
11. No tax on the transfer of shares.
12. Duty free imports of construction materials, raw materials, plant, equipment and other project related goods.
13. Duty free exports.

Subsequently after 15 years of liberalisation the granting of tax holidays was done away with and replaced by a 15% preferential tax for a period of 20 years. Duty free imports and exports to the 'enclave' areas were permitted.

Characteristics of Sri Lanka's EPZs

"Proximity to an airport or harbour is an important factor determining the continual success of an EPZ. This is not surprising, considering the nature of production activities carried out in an EPZ. EPZs perform mainly processing or assembly operations. Material or components are brought in from abroad and processed or assembled. Subsequently they have to be taken out again. This explains the importance of an airport or a harbour. An airport is particularly important if the EPZ wishes to attract electronics firms. Air-transport costs are relatively low for electronic components and materials, so transportation is mostly by air due to the high value to weight ratio for such products. Thus an international airport is extremely important for electronics firms. So EPZs which are located some distance away from an airport will not attract many electronics firms" (ESCAP/UNCTC: 1985). This assessment aptly sums up the locational selection of Sri Lanka's EPZs. A further factor also mentioned is the zones proximity to relatively densely populated areas.

In the case of Sri Lanka's EPZs, Katunayake (KEPZ) and Biyagama (BEPZ) are located in close proximity to Colombo the commerical capital and principal port. KEPZ is, in fact, located adjacent to the International Airport and is thus strongly reminiscent of the world's first Free Trade Zone (FTZ) at Shannon. It is also served by rail facilities. Koggala, in the Southern Province is in close proximity (16kms) to the Port of Galle, is served by rail facilities and is adjacent to a domestic airstrip. Both the Port of Galle and the domestic airstrip are being upgraded to cater to increased industrial activity.

Mirigama has neither port nor airport, but is served by rail facilities and connected by a good network of roads. Pallekelle does not have rail facilities and since it is located in the central hills, is relatively far from port facilities. There is no airport in the vicinity but the road network to the Kandy/Pallakelle region is good.

Cont. from page 8

2. For a comprehensive synthesis of the relevant literature see Helleiner 1989, p. 1472-74.
3. This latter provision for approving projects outside the physical limits of the EPZs was meant for domestic resource based and/or land-intensive production units.
4. See Ramanayake (1984), Table 7.2 for a comprehensive listing of these incentives with the incentives offered for the investors outside GCEC (FIAC firms).
5. "I don't see what more an investor could want than Sri Lanka has to offer", Mr. G. W. Bell, Managing Director of Lehman Brothers (Asia Wall Street Journal, 23 September, 1980). Also a survey in Far Eastern Economic Review (October 1981) identified Sri Lanka's incentive package as "More than attractive".
6. On the occasion of signing the investment agreement with the GCEC to establish a semiconductor processing plant in the KEPZ in 1980, Mr. W. D. Douglas, a vice president of Motorola Corporation stated: "Political stability is number one on our list wherever we go" as quoted in Wijesinghe (1992).
7. Asian Wall Street Journal (23 September 1980) reported the Managing Director of Lehman Brothers as saying, "I do not see what more an investor could want than Sri Lanka has to offer". In a comparison of relative labour productivity (which combined both efficiency and wage cost) of Asian workers appeared in Business Asia (2 June, 1978), Sri Lanka (42) was placed ahead of the Philippines (41), Taiwan (34), Korea (21) and India (12) and only next to Singapore (47) (Business Asia, June 2, 1978).
8. The abolition of surrender requirement gives exporters more flexibility in managing their resources, including greater opportunity to obtain credit offshore at competitive rates.
9. See for instance the country report on Sri Lanka ("Asian Currencies: The Sri Lankan Rupee") in International Currency Review, 22(2), October-December.

Transnational Investments and the Development of Manufacturing Industries in Sri Lanka - An Overview

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The beginnings of significant investments of foreign capital in manufacturing industries of Sri Lanka began in the 1930's when some large international companies set up subsidiaries. Such investments continued even after independence but to a limited extent. The flow of transnational investments showed marked fluctuations since 1948 depending upon the political climate and policy statements. Significant changes however took place after 1977 in the orientation of official economic perspectives and thinking vis-a-vis foreign investments with the ushering in of an open economic policy by the government in power. This led to a surge in transnational investments which were largely directed initially into the Free Trade Zones promoting exports.

This study, in the main, takes an overall view and analyses the impact of transnational investments on the development of manufacturing industries in Sri Lanka. There are two major categories of foreign investments in Sri Lanka: firstly the indirect foreign investments which come through international funding like the World Bank, IDA etc. and secondly the direct foreign investments from individual investors.

The significance of the manufacturing sector in the economy of Sri Lanka is defined initially, followed by an analysis of the transnational investment trends in the development of manufacturing industries in Sri Lanka.

Manufacturing Industries in Sri Lanka

Industries other than those related to mining, quarrying, construction and repairs are considered as manufacturing industries in this study. In the pre-independence and post-independence periods the manufacturing industries in Sri Lanka have been playing a very minor role in the island's economy. It's significance and role however improved subsequently with increased emphasis given to this sector by the Governments in power (Snodgrass, 1966, Karunatilleke, 1971, Rasanayagam, 1972). From the early stages of independence until the latter part of the last decade Sri Lanka's development strategy was largely based upon achieving two main goals: greater equality and 'reasonable rate of growth'. These were achieved through social welfare facilities, export restructuring and import substitution.

With the in-built upper limit discernible in the growth momentum of the agricultural sector, the industrial sector (including the manufacturing industries) was considered as an area that would generate more employment. A growing manufacturing sector was seen to be essential as an engine of growth to the economy. Industrial development was therefore encouraged by all governments since independence. During this process of industrial development foreign investments were encouraged periodically by the state, particularly since the mid 50's leading to the introduction of new production lines.

Foreign investments in the colonial period concentrated more on agricultural, trading and banking sectors. The import - export structure of the economy of Sri Lanka was largely financed by foreign investments. These investments had not penetrated the sector of manufacturing industries per se, to any depth during this period, as it remained less attractive to transnationals. For a long time foreign investments in the manufacturing sector were limited to industries functioning as adjuncts to the plantations. Some of these, in the course of time, came under indigenous control while others continued to remain as sterling companies. Some examples of the latter are Harrisons & Crosfields, Walker and Sons. The first few foreign investments took place as early as 1930's of which Lever Brothers (Sri Lanka), Ceylon Match Company and Ceylon Tobacco Company are some examples. Their parent companies were Unilevers, Svenska Tandstick Aktiebolaget and British American Tobacco Company.

During the first decade after independence the government of Sri Lanka pursued a fairly liberal policy on industries. Transnational investments, though sporadic, continued well into the post-independence era. Such investments were largely by multinationals like the British Oxygen, Bata International etc.

History

It was during the post-independence period that the first pronouncements on state policy regarding foreign capital was made in the Budget Speech of 1949/50. Subsequently in 1955 a more comprehensive policy statement was made by the state, specifying the generation of partnerships between foreign and local capital, the use of local materials, exchange restrictions on the movement of funds, taxation, allocation of raw materials and labour etc.

After a lapse of four years, the policy statements in the ten year plan of 1959/60 became more specific and detailed on transnational investments. The plan refers to political guarantees against unwarranted nationalisation and gives specific incentives and spells out the position regarding adequate compensation that could be freely remitted from the country. The budget speech of 1960 reiterated these statements with some clarifications. These clarifications indicated that certain industrial sectors were reserved for the state sector.

However, with the development of the foreign exchange crisis in the early 60's the state had to device new strategies to save foreign exchange in all the sectors inclusive of the industrial sector. An inward looking strategy named import substitution was thus introduced. During the initial or 'easy phase' of import substitution, Sri Lanka witnessed the growth of a large number of consumer goods industries catering to local demand. Many of the import substituting industries in the private sector during this period began to concentrate on those very items which were earlier restricted or banned on grounds of being non-essentials or luxuries.

In effect this sparked off a spurt in the inflow of transnational investments particularly by well known international groups like Glaxo, Warner Hudnut, Reckitt & Coleman and other new comers in international investments (Fernando, 1971).

The new government which came into power in 1965 brought in its wake another spate in foreign investments in the manufacturing sector in Sri Lanka. A white paper was issued in 1966 by the new government on Private Foreign investments. This policy statement welcomed foreign investment with non-discriminatory treatment along with several tax inducements. This set a new trend in transnational investments in the manufacturing sector in Sri Lanka which continues to date with some alterations in the early seventies. The role of foreign capital in the export development drive too received official recognition for the first time in this White paper of 1966. The Foreign Investment Approval Committee was set up at the Ministry of Planning in 1966 to function as the official body in charge of approving and monitoring direct foreign investment. The foreign investment during this period was only Rs.18.5 million (Senadhira, 1993).

Apart from various tax concessions and facilities to foreign investors stated in the White paper, an important step taken during the late 60's towards the promotion of foreign investment was the initiation of entering into investment guarantee agreements with major capital exporting countries. The first of these was entered with U.S.A. This was followed by a similar agreement with the Federal Republic of Germany.

This change in policy brought in some of the biggest names in multinational investments to Sri Lanka namely, Mitsui (textiles), ICI (Agro-Chemicals), Cheseborough Ponds (Cosmetics), Faber fabriken Bayer (Agro-chemicals), Union Carbide & Berec International (Dry Cells), Leylands Motor Company (Vehicle assembly). The coming of these sources of foreign funding indicated a shift away from the domination of British companies in the past.

Forms

Transnational investments in manufacturing, normally takes a variety of forms. It could be a transfer of money capital or else a transfer of non-monetary assets like capital equipment, manufacturing components or even raw materials, all of which enters the production process one way or other. Whatever the method of transfer the foreign investment results in an increase in the host country's access to foreign resources.

Since 1965 however, foreign investments in kind became more important. During this period the whole of the investment of British Leyland was in the form of machinery tools, know-how etc. Other examples are R. Sarant & Company U. K. Bhor Industries of India, Faber fabriken Bayer Ag of West Germany, and Berec International of U. K. There were others who invested part of their capital in kind. This type of investment in effect tied the host country to the investor's supply sources and did not give a free hand to the host country.

Analysing the distribution of foreign investments in the manufacturing sector during this period as shown in Table 1.1 for 1967, it could be seen that more than 90 percent of the investments are concentrated in three sectors viz, Food, Beverages & Tobacco, Chemicals and Non-Electrical machinery. A noticeable aspect here was the strong bias towards new investments in chemicals.

A closer look at the new trends shows that 87% of the foreign investments in chemicals was confined to firms manufacturing drugs, pharmaceuticals, toilet preparations and cosmetics. The immediate cause of this was the foreign exchange crisis. Being particularly vulnerable to import restrictions this field saw the greatest facility when manufactures from abroad set up factories behind tariff walls to preserve their markets. For technical reasons too this field fitted very well with import substitution because it had greater flexibility in fixing the scale of operation to suit market size i.e. optimum scales can be achieved at fairly low levels so that market size is no constraint.

With the change of government in 1970 the foreign investment approval procedure became more selective and stringent. However, due to the state's commitment to the export diversification drive, export oriented foreign investment was accorded preferential treatment (Athukorala, 1984). The White paper presented by the new government on transnational investments in 1972 improved on the policy statements made in 1966. The idea of the export promoting zone was stated in a more concrete manner with the suggestion that Trincomalee, a natural harbour port in the North-East of the island, could be a possible site.

Another noteworthy feature of the foreign investment policy during this period was the interest shown by the state in establishing export oriented joint ventures with capital participation of government corporations and foreign manufacturing firms. Generally the invitation to foreign investors was conditional; the theme being the investor fades out once he has performed his catalytic function. This did not prove too conducive to the inflow of foreign capital. The number of manufacturing firms set up with foreign capital during this period was only 20. Moreover the unfavourable atmosphere for foreign investment generated by nationalisation attempts and related legal enactments (mainly the Business Undertakings Acquisition Act of 1971) and stringent criteria adopted in approving investment projects are often cited as causes for this decline. Moreover by the 1970's investment opportunities in the activities labelled as import substitutes too had almost exhausted.

The post 1977 policy reforms placed an unprecedented emphasis on the role of foreign investments in achieving the objectives of export oriented industrialisation. It was an outward looking strategy in industrialisation. Several attractive measures were taken to provide a conducive environment to foreign investments. The existing controls and restrictions were abolished and liberal policies introduced particularly with regard to foreign trade and payments. Import licensing was released on 150 items. Importing of machinery upto the value of Rs.100,000 was liberalized. But the BTT rates were re-introduced. The new export development strategy had two basic elements: attracting export-oriented private foreign investment and making non-traditional exports more attractive than import substitution.

For this purpose the Greater Economic Commission (GCEC) entrusted with the task of establishing and operating export processing zones was established. The investment package offered by the GCEC to investors included, allowing 100 percent foreign ownership in investment projects; tax exemption for remuneration of foreign personnel employed; royalties and dividends of shareholders during that period; and duty exemption for the importation of equipment, construction material and production inputs. The first investment promotion zone (IPZ) was set up in 1978 on a 500 acre site alongside the Katunayake International Airport (KIPZ). The second IPZ of 211 acres at Biyagama was commissioned in 1983 to be followed by the establishment of Koggala and Mihintale EPZs.

The initial approvals in the KIPZ area had an overwhelming bias towards textiles and garments. Other types of activity represented in KIPZ included cutting and polishing precious stones, the production of tea bags, cashew production, production of fishing gear and building material.

Table 1.1

Foreign Investment in Manufacturing in 1987

Country of Investors and Industrial Category. (in Rs. Thousands)

Country of Investors and Industrial Category	*U.K.*	*U.S.*	*Japan*	*India*	*West Germany*	*Others*
Food, Beverages, Tobacco	73,830	1,346	1,022	-	5,293	806
Textiles		-	2,296	-	-	-
Chemicals	41,881	1,062	-	-		1,671
Leather/Rubber	-	-	-	-	-	5,347
Non metallic Mineral products	6,543		-	-	-	-
Basic metals	1,440	38	-	220		634
Non Electronic Machinery	58,748	1,343	-	749	-	-
Electrical Machinery	1,016	-	1401		-	-
Total	181,865	3,746	6,984	969	5,838	7,787
%	88.5	1.8	2.8	0.5	2.6	3.8

Source: Fernando, L.E.N. (1971) unpublished Ph.D. Thesis

Table 1.2

Transnational Investments in Manufacturing Industries outside GCEC Area 1971 and 1982

	1971		1982	
	No of projects	*% of foreign capital*	*No of Projects*	*% of foreign capital*
Developed Countries	34	96.0	114	73.03
U.K.	15	72	25	18
U.S.A.	4	5	15	7
Japan	10	12	30	6
a. EEC (excl U.K.)	1	2	7	2
b. EFTA	3	10	18	85
Other	1	2.5	19	4
Less Developed Countries	7	4	47	27
Hongkong	3	11	- 11	23
Singapore	-	-	14	1
India	4	3	12	1
Other	-	-	10	0.7

a. Belgium, France, West Germany, Italy, Luxembourg, Netherlands, Denmark
b. Denmark, Norway, Portugal, Sweden, Switzerland and Australia.

Source: Ministry of Industries and Scientific Affairs.
Company Registrars Department, FIAC.
P. Athukorala - 1984

Upto 1988/89 the GCEC had tapped investments from 27 countries attracting more than 100 manufactures of over 40 production lines.

The other institution was the existing Foreign Investment Advisory Committee (FIAC) established 1966 was allowed to continue its operation in approving and monitoring foreign investment outside the GCEC areas. The FIAC approved 515 projects from 1977 to 1988. These projects envisage an investment of Rs. 21,575 million with a potential to employ 64,673 persons.

As part of the outward looking strategy Investment Protection agreements and Double Taxation Relief Agreements have also been entered into with major investing countries. The first few were with U. S. A, U. K., F. R. G, the Republic of Korea, France, Hong Kong, Romania and Switzerland. During the period 1977 - 82 ninety-nine FIAC projects and fifty GCEC projects had commenced production. (see Table 1.2)

In 1992 the GCEC was re-structured as the Board of Investment by the BOI Law No. 49. The entire country became a single export promotion zone. The BOI introduced the One-Stop-Shop concept to promote and facilitate foreign investment.

Industrial Distribution of Foreign Investments in the Manufacturing Sector

From pre-independence period upto the mid '60's chemicals, Food, Beverages and Tobacco remained the leading industrial sectors among the transnational investments, while textiles and non-electricals machinery lagged behind as the 3rd and 4th sectors of importance. As indicated in Table 1.2 by the year 1967 Food Beverages and Tobacco had become the leading industrial sectors among the transnational investments with the non-electrical machinery sector zooming upto the 2nd place and Chemicals pushed to the 3rd place. The sudden spurt in the non-electrical machinery group is interpreted to be the result of the strategy of import substitution that was adopted since early 60's.

From 1970 onwards however the pattern of industrial distribution among transnational investments had apparently changed with textiles taking the lead. After 1977 textile and clothing (garment) became the major sector attracting foreign capital (see Table 1.3, 1.4, 1.5). This Influx has been largely due to two reasons namely.

Table 1.3

Transnational Investments Sector-Wise Distribution of Manufacturing, 1948 - 1982

	1948-59	1960-70	1970-77	1978-82 FIAC	1978-82 GCEC
Food, drink and Tobacco	1	5	2	8	2
Textiles and Clothing	2	4	12	37	29
Footwear	1	-	-	-	
Wood, pulp, paper and paper products	-	2		5	1
Rubber goods	1	-	-	10	-
Chemicals and chemical products	6	10		16	8
Non-metallic mineral products	-	-	4	6	1
Basic metal products	-	3	2	14	4
Machinery and Equipment		15	-	1	2
Other Industries	-	1	-	3	5
Total	10	40	20	99	50

Sources : Ministry of Industries and Scientific Affairs, 1982, G C.E.C. Records 1984
Ministry of Finance and Planning 1982, CBS Dossier 80-1982
P. Athukorala 1984

the availability of foreign markets on a quota basis and the low cost of labour in Sri Lanka. Multinationals in some developing countries wanting to earn more from foreign markets appear to have devised a way to circumvent the export restrictions in their own countries by investing in other developing countries and using their quotas. In Sri Lanka, Hong Kong Garments, for instance, have sought this method, resulting in several HK foreign firms producing garments for export. Among the FIAC approvals, however, there was greater dispersion of foreign investments among the different sectors within the manufacturing industries. Besides textiles and clothing, chemicals, basic metal and rubber goods were the major areas of investment. This may have been due to the broader criteria used by the FIAC in approving foreign investments. Totally domestic oriented import substituting firms also were therefore approved on the basis of employment generation, transfer of technology and import substitution.

Diversification in Industrial Manufacturing and Export Earnings

The entry of foreign investments into the manufacturing sector of Sri Lanka from pre independence era has contributed significantly to its development and diversification. However, prior to 1977 export earnings from foreign investments was minimal. Within three to four years of the introduction of the open economic policy the export earnings by manufacturing firms with foreign capital rose by more than 5%. By the early '90's export earnings from manufacturing firms with foreign capital rose significantly. Major proportion of the export earnings came from industries which included ventures with foreign capital. Examples: textiles, garments and petroleum products. Other contributions were from canned fruits, vegetables, juices, chemical products etc. These have, in effect, further encouraged direct foreign investments in manufacturing industries and contributed towards increase in employment and transfer of technology.

Technology Transfer

Transfer of industrial technology during the early stages of growth of the Sri Lankan economy was minimal. The manufacturing enterprises which were

Table 1.4

Sector Wise Distribution of Transnational Investment - 1982

	Food, Drink & Tobacco	*Textile & Clothing*	*Woodpulp & Printing*	*Rubber*	*Chemical goods*	*Non-metallic Mineral*	*Basic metal products*	*Machinery Equipment*	*Other Industries*	*Total*
Developed Countries	9	36	4	9	18	3	3	14	10	11
U. K.	5	4	-	1	11	-	-	3	1	25
U. S. A.	-	4	1	2	3	-	-	3	5	18
Japan	-	13	2	2	-	4	3	6	-	30
E. E. C. 9excl U. K.)	-	2	2	1	-	1	-	2	1	7
EfTA	4	3	1	-	2	3	-	-	2	15
Other	-	10	-	3	2	1	-	-	2	15
Less developed Countries	5	12	3	6	7	3	3	2	6	47
Hongkong	-	6	1	3	-	-	1	-	-	11
Singapore	3	3	2	1	1	-	1	-	3	14
India	-	2	-	1	5	1	1	2	1	12
Other	2	1	-	1	1	2	-	-	3	10

Source : Ministry of Industries, Commpany Registars Department
P. Athukorale 1984.

already established during the colonial period possessed little technology or know-how. After independence besides the government's initiative to obtain the services of foreign countries & consultants for the public sector industries, a major spurt of technology transfer was discernible in the early '60's in the private sector industries.

In general, the process of technology transfer has resulted in positive gains to the local economy. However, the degrees to which enterprises have contributed to technological diffusion, growth of a self generating industrial technology and to the emergence of independent research and development capabilities within the country has varied from one production area to the other.

The types of technology transfer that took place were :

(a) foreign capital participation with complete package of technology transfer.
(b) Participation with specific elements of technology transfer.
(c) Supply of technological know-how on royalty payments, technical services and consultancy arrangements.

Transnational investments transferred technology to subsidiaries established by them in the host country or through ventures. These transfers of technology was very much related to the type and amount of machinery imported by the foreign firm. The

Table 1.5

FIAC Approved Firms - 1977-82

	No. of firms in operation	*No. of exporting firms*
Food, drink & Tobacco	8	5
Textile & Clothing	37	22
Wood, Paper & Printing	5	0
Rubber goods	10	5
Chemicals & Chemical products	15	3
Non-metallic minerals	6	2
Basic metal prods Machinery & group	15	5
Other Industrial	3	3
Total	99	45

Source : FIAC
Fonseka, A. T. (1985)

machinery supplies were normally either supplied by the foreign partner or procured on his advice, thereby restricting the local partner's freedom in the choice of equipment. The results of a survey conducted by the Marga Institute (1985) indicate that technology transfer did not show any typical pattern for different countries or within industrial groups. It was observed that transfer of technology has been inseparably linked to the transfer of capital. Quite often it was observed that with acute scarcity of foreign exchange, the local partners could not involve themselves in hard bargaining with foreign collaborators.

Moreover, in many of the industries, the technology was simple, which the local collaborators could have acquired at lower cost if given a free hand in the choice. Apart from constraints imposed by the total dependence on capital and technology there was hardly any administrative and institutional set up prior to 1978 to service the transfer of technology.

The setting up of the FIAC and the GCEC at the initial stages has helped, in a limited way, to overcome this problem. But in most instances the earlier system of foreign investments is continuing with little benefit to the local industrialists and the economy.

Employment Generation

The creation of employment is one of the urgent needs of an LDC country like Sri Lanka and foreign investments were encouraged with this point in view. Prior to 1977 beginning in the early '60's employment opportunities increased with import substitution. But after 1977 employment in the manufacturing sector declined (Athukorale, 1984) because of the cut price competition encountered by the high labour absorbing import competing industries (with or without foreign investments). This led to the closure of many industries. The experience of Sri Lanka therefore provides a good case study of an attempt to use policies of export led industrialisation to create large scale employment. The example of the east Asian 'Gang of Four', influenced the state decision to develop the manufacturing sector to solve unemployment. After nearly sixteen years of economic liberalisation and increased transnational investments, levels of unemployment remain about the same. In 1971 9.3% of the work force were employed in the manufacturing sector while in 1981/82 only 13.4% were employed by this sector (Kelegama et. al, 1989 and Census Reports).

Although manufacturing industries that export (including transnational investments) tend to absorb more labour than import substituting industries, the Sri Lankan experience has been the reverse. Athukorale (1986) attributes the decline in manufacturing employment, since 1977, to cut price competition. Within the area of authority of the GCEC the actual employment figures showed that by mid 1989 the total employed within their area of operation as 58,643. In addition to this direct employment the GCEC had also opened avenues for indirect employment for several thousands of workers in the field of building, construction and other connected services. This development is claimed to have created a heavy demand for masons, carpenters, plumbers, electricians and unskilled workers. To meet these demands a job bank was maintained by the GCEC and to meet the demand for skilled labour a training centre had been established by these authorities at Katunayake with the help of the National Apprentices Board.

Conclusion

Ostensibly, industrialisation or development of manufacturing industries, is intended to dramatically raise the levels of productivity, wages and employment and, in this manner, to contribute to the general welfare of the population, while coping with balance of payments problem by substituting imports and/or stepping up exports of goods with a high content of domestically generated value added (Sachs, 1979).

Transnational investment of foreign private capital is merely one of a series of alternatives that are available to an LDC country to achieve the development objectives of industrialisation: acquisition of modern technical know-how and managerial skills, diversification of production, foreign exchange earnings and generation of employment opportunities.

These investments in host countries are initiated once the political climate in those host countries become conducive to such ventures. The categories of industries that are finally established on the basis of the host country's priorities, generally emphasise foreign exchange earnings, introduction of new line of production, exports and employment generation. In the case of Sri Lanka, the influx of foreign investments brought in their trail several new lines of production thereby diversifying the products of the manufacturing sector.

In the sphere of foreign exchange earnings there are, indeed, some limitations. It is an accepted fact that transnational investments are normally oriented towards private profits as opposed to the social welfare interests of the host country. These foreign firms are known to use various methods to remit income abroad.

The methods are;

(a) Dividend payments out of declared profits
(b) Payments for the use of technology for patents, trade marks, know-how etc.
(c) Payments for managerial and marketing services
(d) Interest on loans from the parent-firm
(e) Overhead charges levied by the parent firm on all its constituent plants and firms.

In addition to these legal payments a foreign subsidiary can remit money abroad through the manipulation of what is widely known as 'transfer pricing' - over pricing of imported inputs of equipment and/or under pricing of the exports of the output to parent firm.

This could sometimes lead to the 'decapitalisation' of the host country as it happened in some Latin American Countries. As pointed out by Fernando (1971, 1972) and Lakshman, (1979) although adequate data are not available on transactions by foreign investments in Sri Lanka there is ample evidence to believe that valuable foreign exchange is lost through hidden transactions.

In terms of export earnings by these foreign firms the aggregate contribution of these firms to total export earnings has been increasing (For example in 1982 it was 26.44% as compared to 21.88% in 1979). This noteworthy increase in the relative position of manufacturing firms was due to the combined effect of the increased importance of manufactured exports in total exports (from 28% to 42%) and due to the increase in the position of foreign firms in total manufactured exports. The increase in the share of foreign firms in total manufactured exports is closely related to the expansion in production activities of the IPZ.

It is important to note that despite the rapid expansion of foreign firms in manufactured exports, locally owned firms continue to account for a considerable share of manufactured exports. A pertinent point to raise here is would it have been possible for Sri Lanka to achieve the same, if not more, manufactured export earnings without foreign investment ?

In the opinion of local industrialists, Sri Lankan entrepreneurs could have improved their position and brought in more foreign export earnings. It is their firm belief that the only main advantage that they had in cheap labour costs was nullified with the coming in of the foreign industrial giants.

It is also alleged that the new foreign export firms enjoy the quotas and the duty and tax exemptions, sending the local industrialists into a dilemma with heavy income tax and corporate taxes to pay. The off-shore banking facilities available to foreign industrialists is another factor weakening the position of the local counterparts. In the local markets too the Sri Lankan industrial manufacturers find their 'customers pinched' when some of the FIAC firms (with authority) and GCEC Firms (without authority) sold some of their export quality products.

In terms of employment the total employed directly by the foreign investors approximates to only 5% of the total labour force and a small fraction of the total employed in the manufacturing sector. The GCEC had been able to employ only 38,043 by mid 1989 and FIAC approximately 60,000 by 1988. The labour absorption capacity of the foreign firm has therefore been much lower than anticipated. The absorption rates are extremely low when compared to the large outlay on infrastructure facilities and capital invested. In 1985 in the IPZ the capital/labour ratio was approximately Rs.100,800 and in the FIAC projects it was Rs. 390,000 while the national ratio for manufacturing industries was Rs. 86,000.

The indirect employment generated by the foreign concerns is stated as a favourable point; the argument being that foreign export industries stimulate growth in the domestic sectors through their multiplier linkage effects and transfer technology. But Sri Lanka's experience with multinational firms has shown a reluctance on the foreign firm's part to reduce foreign raw material content or to engage in domestic research on material and technology and a marked tendency to prevent the transfer of their technological monopoly by the use of restrictive practices and policies, which in effect nullify the multiplier effects anticipated.

The loss of trained manpower by the local entrepreneurs to foreign investors is often cited as an obstacle to the development of locally owned manufacturing establishments. Several instances have been quoted by the local industrialists where trained manpower was lost overnight to foreign concerns. In the case of the garment industry such instances are alleged to have immobilised the sector for certain periods. The higher salary scales with added perks offered by the foreign investors have sapped the local manufacturing sector of skilled labour. This, in effect, clearly indicates that a section of the employed in the foreign concerns are not 'new' employments.

With regard to the export markets, local industrialists often find themselves directly competing with foreign industrial giants who have invested in export processing concerns in Sri Lanka. The lower prices offered by the foreign concerns have been too stiff for the local entrepreneurs particularly with their heavy burden of taxes. Removal of some of these constraints encountered by the local industrialists may lead the way to the development of a healthy partnership between local and foreign industrialists in the manufacturing sector.

In the area of technology, indiscriminatory approaches adopted by the state, when approving foreign investments, has been cited as a disadvantage to the country and the manufacturing sector in particular. The approved technologies are alleged to be largely capital intensive thereby negating one of the main objectives of inviting foreign investments - namely generating employment. These concerns are also cited as dumping grounds of discarded or superfluous technology by developed countries. To improve the situation and to benefit from foreign investments, it appears prudent for Sri Lanka to use a technology purchasing firm and be discriminatory in the choice of technology offered.

Upto now, since the free play of market forces have failed to fulfill the long term objectives which the government sought to achieve through foreign investments, a comprehensive empirical and theoretical investigation should be initiated in order to formulate policies and strategies that will develop the manufacturing sector with foreign investments forming an important component.

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The catalystic role played by EPZs on regional development

- L. D. Dickman
Director - Regional Development, BOI

Introduction

Since early 1950 industrial estates have become quiet popular as industrialization instrument in economic development. The industrial policy in the recent past of Sri Lanka has been influenced to a great extent by EPZ. Creation of Export Processing Zones was a new concept on our industrialization process.

An **Industrial Zone** is an area of raw land set aside for industry. In general, it is created by a municipal by-law and is part of an urban renewal or development programme. Any promotional effect it may have is dependent on its location in relation to transport and distribution facilities, and the price of land within the zone.

An **Industrial Area** is a parcel of improved land subdivided into plots for the accommodation of industrial establishments and offered for sale or fo lease. It can be effective stimulant to industrial development, specially in the large and medium scale sectors. Its size may allow advantage to be taken of economies of scale in the formation of the infrastructure, which may be passed on to the occupants ".

In 1992 Greater Colombo Economic Commission, was re amed as the 'Board of Investment of Sri Lanka."

The main objectives of the BOI are :-

(a) To foster and generate the economic development of the country by widening and strengthening the base of economy,

(b) To encourage and promote foreign investment, diversify the source of foreign exchange earnings and to increase the export earnings.

(c) To encourage and foster the establishment and development of industrial and commercial enterprises.

(d) To administer the affairs of the Area of Authority which would be required for the functioning of Zones.

Accordingly, to date five Zones have been opened up in four districts, namely, Gampaha, Galle, Kandy and Anuradhapura. The sixth zone would be established in the Trincomalee District.

The table I indicates the extent of land developed for zones and its surrounding areas, location, etc.

The Katunayake Export Processing Zone (KEPZ) was established in 1978 as the first EPZ in the country. It is located near the Katunayake International Airport which has locational advantages for foreign investors who require air transportation for both imports and exports. It is also close to Colombo Port which is only 29 km away from the Zone. From locational point of view, it has more advantages as the zone is more close to Ekala Industrial Estate, large housing complex at Seeduwa, Negombo Town Centre and several beach resorts.

The KEPZ was located near the airport following the model adopted by the Shannon Airport Authority who created the first Free Trade Zone in the world in 1959. Shannon International Airport faced with a problem caused by the advent of the jet airliner which unlike its propeller-driven predecessors, no longer needed to refuel on the transatlantic flight, the Irish Authorities resorted to transform the airport area into a 'Free Trade Zone' thereby attracting foreign investments to set up factories in the area.

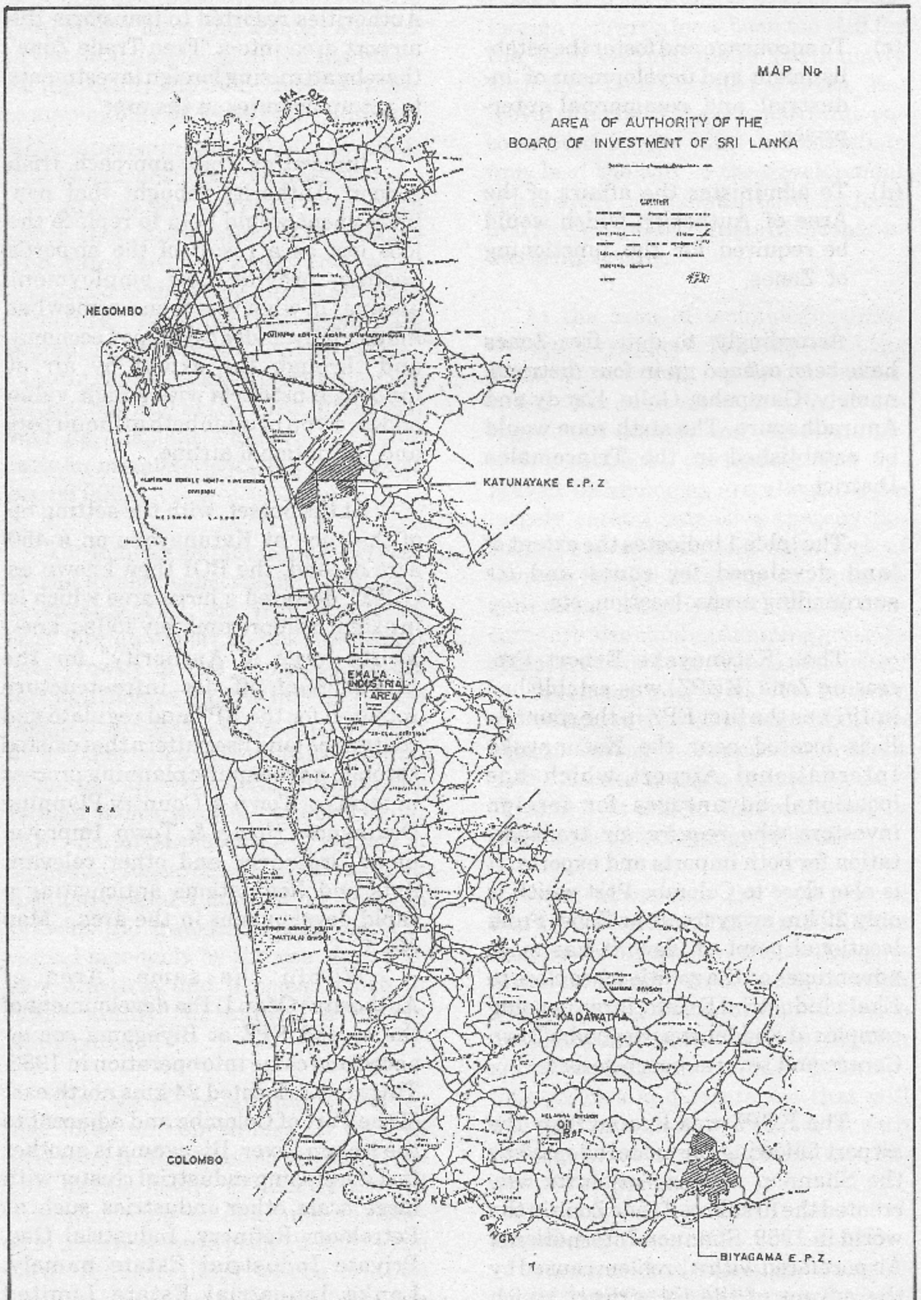
Innovating a new approach, Irish Airport Authority thought that new investment would help to replace the jobs lost as a result of the airport's decline, provide new employment avenues in what was then a somewhat industrially under developed economy and through the export by air of industrial products with a high value added, give a new life both to the airport and the national airline.

At the outset, with the setting up of the zone at Katunayake on a 450 acre of land, the BOI then known as GCEC, declared a large area which is in extent of approximately 450 sq. kms. as its 'area of Authority' for the provision of off-site infrastructure required for the EPZ and regulate and control the land use pattern that existed through a systematic planning process in terms of Town & Country Planning Ordinance, Home & Town Improvement Ordinance and other relevant Acts and Regulations anticipating a rapid development in the area - Map No. 1

Within the same "Area of Authority" (Map I) the development of the second EPZ at Biyagama commenced and came into operation in 1986. This zone is located 24 kms north east of the Port of Colombo and adjacent to the Kelani River. Biyagama is another fast developing industrial cluster with large scale other industries such as Petroleum Refinery, Industrial Gas, Private Industrial Estate namely, Lanka Industrial Estate Limited (LINDEL), etc.

The third zone was established at Koggala in 1991 in terms of Section 22 A of the BOI Act[2]. It is expected to provide a growth centre through the development of this EPZ in the Southern Region centered at Koggala and to supplement those existing economic activities in place, such as at Galle which is the main regional centre of the Southern Province and other development proposals being planned vis-a-vis the "Southern Development Plan" of the Ministry of Policy Planning & Implementation.

One of the objectives of locating the EPZ at Koggala was to increase non-agricultural employment opportunities in the South having observed the large number of educated school leavers from the South who could not find jobs outside the agricultural sector resulting in migration to Colombo and other sub urban areas. It is expected that Koggala EPZ will play a catalystic role and induce development to the areas which has been hitherto neglected.



The Asian Development Bank (ADB) who carried out a feasibility study on Koggala EPZ stated that[3],

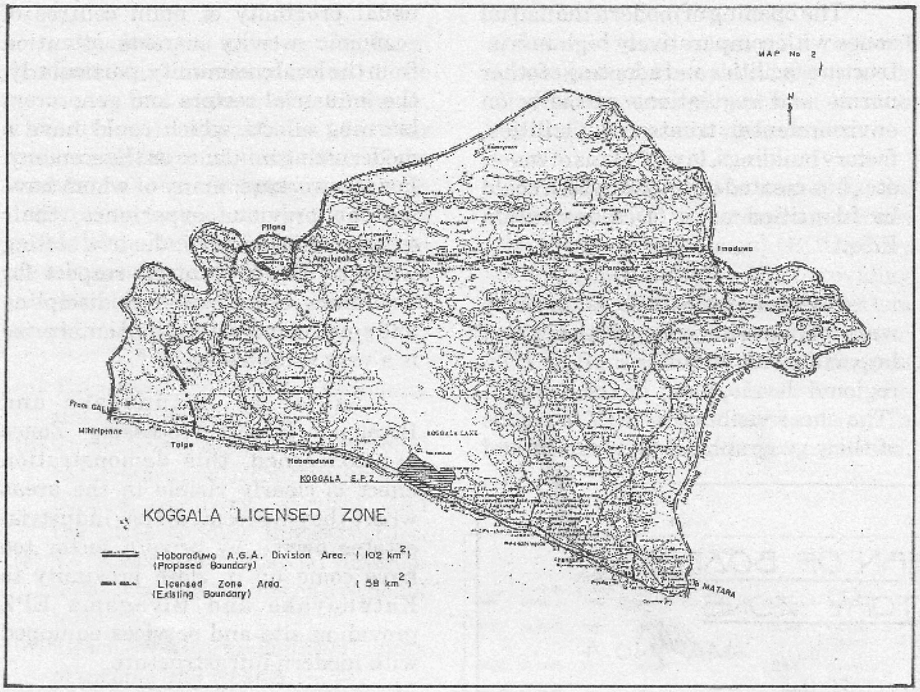
> "If the justification for siting the EPZ in the Southern Wet Zone is based on the regional development it may catalyze, then backward linkages with the region must be encouraged. To this end, it may be useful to favour the selection of industrial processes which are based on regional resources and where much of the production is done at decentralized locations in the region."

KgEPZ is located at Koggala by the side of Koggala Lake on a land of 180 hectares (Map II). There are two centres namely Habaraduwa and Ahangama which could be developed as industrial town centres to cater services required by the zone and for its workers. The zone has direct access to Galle main road and the railway line passes through the site. Koggala has an additional advantage of a good airstrip and related facilities adjacent to the site provided by the Sri Lanka Air Force. It should be mentioned here that Koggala is the birth place of the famous writer, Dr. Martin Wickremasinghe. His house has been conserved with the Museum and the industrial layout plan of the zone has been designed in such a manner to create a separate entity with exclusive access to the Museum.

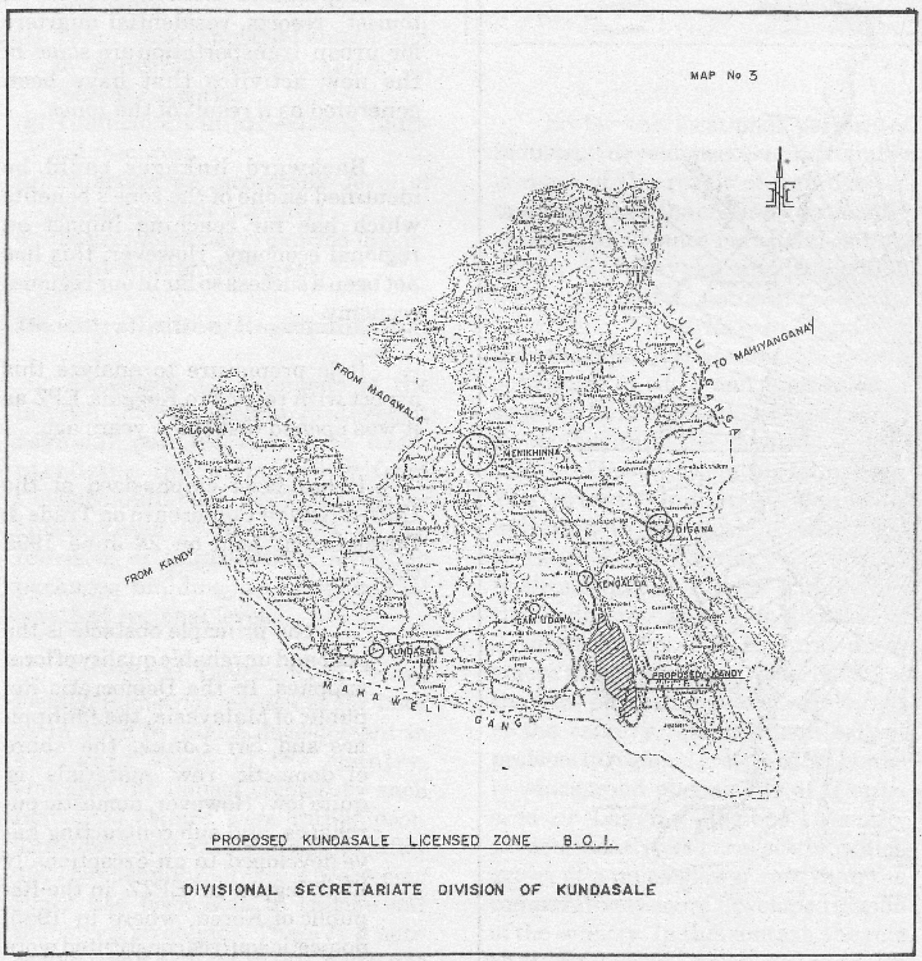
In order to prevent adverse impact on Koggala Lake, beach and other important characterisitics of the area, with the setting up of an industrial zone, a Licensed Zone was gazetted in terms of the Section 22A of the BOI Act. No. 4 of 1978 - vide copy of Map II.

The fourth zone was established at Mihintale in 1993 - the Gam Udawa site as per the directives of the Government use as a Nerve Centre/ Growth Centre for the purpose of investment promotion in the province providing all services to investors, training and research facilities, to facilitate agro-based industries, dairy farming and bee-keeping, etc.

On the 7th April 1994, establishment of the fifth zone was inaugurated by the Government.



KOGGALA LICENSED ZONE



PROPOSED KUNDASALE LICENSED ZONE B.O.I.

DIVISIONAL SECRETARIATE DIVISION OF KUNDASALE

Approximately, 250 acres of land utilized by Silk & Allied Products Development Authority is to be developed for the proposed EPZ. This site is situated at Pallekele about 8 kms away from the Kandy town. (Map No. 3)

As was done in the past, a Licensed Zone will be gazetted covering the entire Pallekele Divisional Secretariat area which would form approximately 87 sq. kms. This would enable BOI to plan the area to provide adequate off-site infrastructure facilities required for the zone and develop backward linkages within the region.

It has also been proposed to establish another zone at Trincomalee to open up the area for new development.

Impact created by EPZ on Regional Development

The current practice in Government spatial development is the adoption of a comprehensive and integrated development approach. Critical infrastructure requirements for setting up of zones have been identified within the framework of regional plans identified by the Urban Development Authority (UDA) and the Ministry of Policy Planning & Implementation.

Export Processing Zones at Katunayake and Biyagama were located taking into account the Master Plan proposals for the Colombo metropolitan region prepared by UDA in consultation with the UNDP - Colombo Master Plan Project. Locational advantage is one of the determinants for the success of the EPZ. Since EPZ's productions are directly for exports, the location of EPZ is not necessarily required to be in urban areas. However, it should be linked with proper transport and communication network. Investors are more attracted to the location where there is evidence of industrial development. It does not mean that the urban areas are only locations appropriate for setting up of zones.

In case of urban location, it is said that the impact of EPZ is difficult to be assessed as an independent variable affecting regional economy concerned. However, this would lead to a rapid concentration of physical development basically increase in the housing stock, service industries transport and other social activities. For example, presently Katunayake EPZ has accommodated about 58,000 workers of which nearly 65% are residing in over 15,000 boarding houses. It has been found that about 79% boarding houses are located within 3 km radius - vide copy of Map No. 4.

Economic planners believe that one job created inside the zone would lead to open up avenues for 3 indirect employment outside zones. The development taken place in the surrounding areas of Katunayake during the last 15 years with the setting up of the zone could be directly attributed to the zone. The increase in the land value is over 500% due to high concentration of activities into the area.

The opening of modern industrial zones with comparatively high infrastructure facilities and adopting of other norms and regulations specially on environmental treatment facilities, factory buildings, layout plans of zones, etc., has created an impact which could be identified as a "Demonstration Effect."

"Demonstration Effects" could be well represent one of the most important contributions of EPZ on regional development in the country. "The sheer visibility of EPZ because of their geographical delineation and usual proximity of main centres of economic activity attracts attention from the local community, particularly, the industrial sectors and generators learning effects which could have a modernizing influence on the economy. For the workers, many of whom have had no previous experience, their exposure to a modern industrial setting with its quality control, respect for deadlines, organizational discipline and spirit of innovators and enterprise is a very valuable asset[4] ".

As far as Katunayake and Biyagama Export Processing Zones are concerned, this demonstration effect is clearly visible in the areas where they are located. New industrial estates owned by private sector too have come up in close proximity to Katunayake and Biyagama EPZ providing site and services equipped with modern infrastructure.

Expatriate housing schemes, tourist resorts, residential quarters for urban transportation are some of the new activites that have been generated as a result of the zones.

Backward linkages could be identified as one of the zone's benefits which has far reaching impact on regional economy. However, this has not been a success so far in our regional economy.

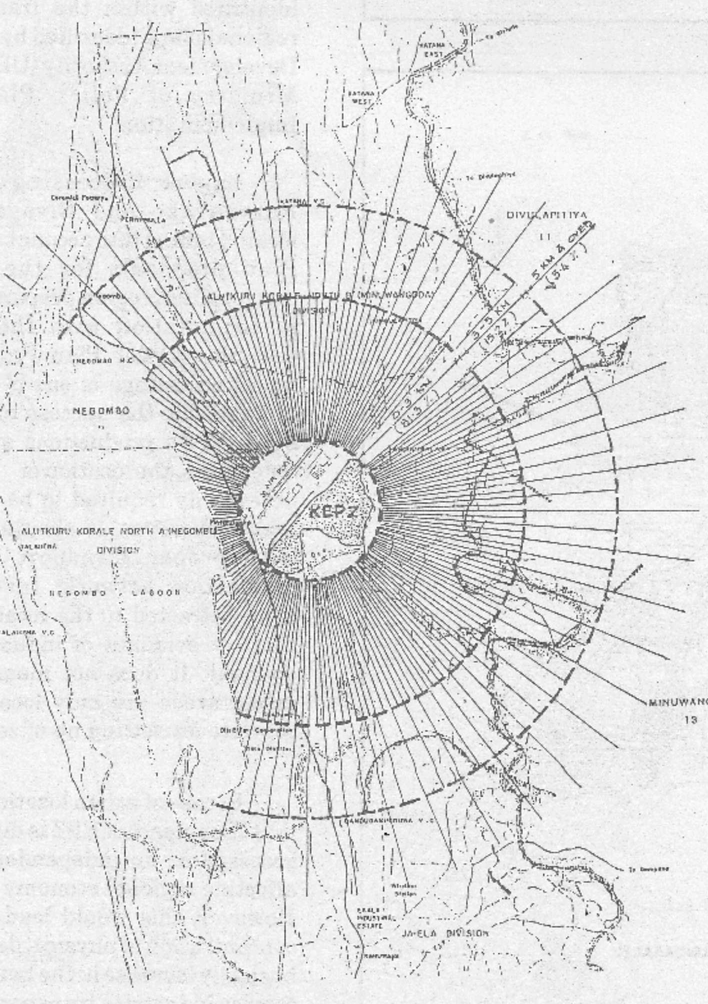
It is premature to analyze this aspect with regard to Koggala EPZ as it was opened just three years ago.

It has been emphasized at the United Nation Conference on Trade & Development held on 28 June 1993 that:-

"...... the principle obstacle is the poor and unreliable quality of local supplies. In the Democratic Republic of Malayasia, the Philippines and Sri Lanka, the share of domestic raw materials is quite low. However, domestic purchases and sub contracting have developed to an exceptionally high degree in EPZZ in the Republic of Korea, where in 1985, domestic sources constituted more than 30% of production inputs and out-zone subcontracting represented 25% of total labour payments[5] ".

DISTRIBUTION PATTERN OF BOARDERS FROM THE FACTORY ZONE

MAP NO. 4



SOURCE : GREATER COLOMBO ECONOMIC COMMISSION , COLOMBO .

Subcontracts have now begun in the immediate vicinity areas of the zones, but not appreciable. However, the overall impact on further industrialization of rural areas of the country has been accepted in principle integrating spatial aspect in it; as it would play a catalystic role in national development more towards balance manner. It is widely accepted that zones would stimulate :-

(a) To increase the GNP and especially the GNP per capita.
(b) To achieve a sectoral and regional balance of growth concerning agriculture, industry, services and the corresponding infrastructure.
(c) To accelerate industrial development on a national and on a regional level.
(d) To achieve a more equal distribution of income and wealth.
(e) To raise the level of technologies and skills.
(f) To increase industrial output and to substitute imports and/or to increase exports.
(g) To efficiently utilize existing natural resources.
(h) To attain an acceptable level of prices (relative stability)
(i) To get industries organized in harmony with environment.

Decentralization/Regionalization

Successive Governments of the last two three decades pursued explicit regional policies aimed at decentralizing industries away from Colombo and its suburbs. These policies encompassed improvements in the provision of infrastruture, incentive packages building up of industrial estate at regional levels.

Industrial Development Board located industrial estates as far back as in 1960 to induce development in backward areas of the country. However the impact created by such industrial estates were rather poor. The subsequent approach adopted after 1977 by opening up of export processing zones has been able to change our industrial strategies. There is a noticeable trend now for many industries to search for locational options outside Colombo and its outskirts. If the Government intends to take a lead role - for e.g. by building up an industrial estate or zones in selected regional growth poles, it would clearly work in line with market mechanism and spatial policies; not against them.

Recent initiatives taken by the Government in this respect includes the Board of Investment (BOI) policy changes introduced in 1992 providing special incentives for regional investors - 200 Garment Projects and locating of EPZ in Kandy, Mihintale and Koggala are some of them. However, the approach to regional planning in general would need to be strengthened.

[illegible]

Location of Zones

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
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[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

So far the locational pattern of industrial development in the country is more of the result of uninhabited market forces than of any rationally designated advance industrial estates except Katunayake and Biyagama EPZ. Optional location will need to be identified for different types of industrial productions, be it to realize economies of scale and economies of scope in the field of high-tech industries or to facilitate the monitoring and control of heavily polluting industries. The present industrial policy as indicated in the booklet issued on 15.12.1989 'A Strategy for Industrialization in Sri Lanka' emphasizes that industries should be disposed of as much as possible to rural areas where the majority live. Nearly 78% of the total population live in rural areas of the country. The common salient problem in regional growth in Sri Lanka is widespread phenomena of 'Depressed or Lagging Regions', usually predominantly the rural sector, which grows at a much slower rate than the comparatively more developed region of the country. In this context, the role that BOI will have to play in establishing zones in distant areas is vital.

Manaus Free Trade Zone in Brazil and Hainan Island EPZ in China are best examples. EPZ at Koggala, unlike the EPZ at Katunayake has much more potential with a variety of untap resources in the Southern Province.

The experience hitherto gathered by BOI shows that EPZ cannot be implemented successfully as an isolated enclaved industrial estates. The success of the zone depends upon the attentiveness of the zone itself and of the quality of infrastructure and the inter-relationships with the level of economic activities of the region and the country. The best result for the region would be if the zone's activities are based on the resource utilization of the region and inter-regions.

Notes :

1. United Nations Industrial Development Organization : Guidelines for the Establishment of Industrial Estates in Developing Countries - New York - 1978 page 5
2. Section 22A (1) of the Greater Colombo Economic Commission Act (amended) No. 13 of 1980 contravenes -
   Where the President is of the opinion that in any area, not included in the Area of Authority, it would be necessary to provide facilities or improvements for the establishment of undertakings by licensed enterprises and for such purpose to enable the Board to exercise certain powers under this Law, he may, by Order published in the Gazette, declare such area to be a licensed zone, and specify the boundaries of such zone.
   (2) Where a licensed zone is declared under subsection (1), no person, body or authority other than the Board shall exercise, perform and discharge any powers, duties and functions relating to the approval of building plans or the planning, development or improvement under any written law, within such zone.
3. Koggala Export Processing Pre-feasibility Demand report - Appendix 12 Page (1)
4. Export Processing Zones : Role of foreign direct investment and development impact - Report by the UNCTAD Secretariat 28-04-1993
5. Ibid - Page 21

Socio-economic effects and linkages of EPZs

- U. L. D. Chandradasa & T. Schokman

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Backward Linkages

The degree of integration of EPZs with the rest of the country has a significant bearing on the attainment of the long term development objectives of the host country. A report by the UNCTAD Secretariat states that "as far as the experience of developing countries is concerned, in the large majority of cases backward linkages have not developed to any significant degree" with the "poor and unreliable quality of local supplies" being identified as the main deterrent to the purchase of local inputs.

In economics there are two types of linkages which are to be created between an industry and rest of the economy :

(a) Forward linkages, defined as the output of one industry which will be utilized by other industry as intermediate goods which are semifinished products used for further processing.

(b) Backward linkages, defined as inputs which are required in the manufacturing process of an industry.

In Export Processing Zones and outside the Zones BOI Enterprises, the linkages with rest of the economy have not been created significantly because the investors are naturally aligned for maintaining the linkages with their own international production network than establishing links with host economies e.g. most of the investors are locating their industries in Sri Lanka for assembling their products utilizing cheap labour. They have not yet come out from their international production network and still are enjoying the cost advantages using imported project related items.

Thus the integration of the BOI Enterprises with the rest of the economy takes place primarily through the purchase of labour and other infrastructural facilities such as construction work and public utilities.

To identify the backward linkages, two methods can be used.

(i) Analysis of net foreign exchange earned by BOI Enterprises.

(ii) An analysis of import data of BOI Enterprises.

The Net Foreign Exchange Earnings (NFEE) is defined as total Sri Lankan Rupee Expenditure less Sri Lankan Rupee Finance and Sri Lanka Rupee Turnover.

Table 1 indicates that the total net foreign exchange earnings at the end of September 1993 was amounting to Rs. 49,096 Mn. The figures indicated in Table 1 are at current prices.

The discussion of EPZs enterprises places considerable stress on the foreign exchange earnings derived from the EPZs firms reflecting the presumption that these earnings have direct welfare relevance to "Sri Lanka". In fact, however, the foreign exchange earnings of foreign owned EPZ firms merely constitute transaction between these firms and firms abroad. However, the total net foreign exchange earnings recorded for the years 1989, 1990, 1991, 1992 and 1993 (up to September 1993) are Rs. 3,780 Mn., Rs.6,562 Mn., Rs. 7,812 Mn., Rs. 10,660 Mn. and Rs. 9,134 Mn. respectively.

The money may be utilized in following form :

1. Keep it in liquid form in foreign

Table 1

Net Foreign Exchange Earnings (Rs.Mn.)

Year	*KEPZ*	*BEPZ*	*KGEPZ*	*Outside the Zone (BOI Enterprises)*	*Total*
1979	30		-	-	30
1980	119		-	01	120
1981	225	-	-	66	291
1982	333	-	-	128	461
1983	625	-	-	110	735
1984	1,057	-	-	194	1,251
1985	1,069	-	-	225	1,294
1986	1,172	11	-	399	1,582
1987	1,644	130	-	572	2,346
1988	1,591	141	-	1,306	3,038
1989	1,756	400	-	1,624	3,780
1990	2,692	777	-	3,093	6,562
1991	2,984	1,107	-	3,721	7,812
1992	3,487	1,680	153	5,340	10,660
1993 (Up to September 1993)	2,735	1,417	145	4,837	9,134
TOTAL	21,519	5,663	298	21,616	49,096

Source : Information System Dept. Board of Investment of Sri Lanka.

exchange accounts, whether inside or outside the host country.

2. It can be used to buy imported capital equipment and raw-materials.

3. It may be converted into the domestic currency to be spent on wages and purchases from the local economy.

From the above, the items two (02) and three (03) have welfare impact, because there may be a net benefit to the host country from those purchases. On the one hand, burden on the Central Bank of Sri Lanka to release foreign exchange to import capital equipments and raw-materials required for Export Processing Zone's Enterprises will be reduced. On the other hand, to purchase raw materials and services from the domestic economy and to hire local workers, EPZs firms must convert their foreign exchange into domestic currency.

Salaries paid to the local staff and the cost of labour accounted for a significantly large proportion of the Net Foreign Exchange Earnings (NFEE). Apart from salaries, the rest were ground rent, water bills, electricity bills, import clearing charges, security charges, advertisement charges, communication charges, legal fees and etc. Some industries which have linked at considerably high with domestic resource base (e.g. rubber based industries) have generated significant amounts of NFEE. Nevertheless, under BOI there are only sixty six (66) ongoing companies linked so with local resource base.

Table 2 shows to what extent EPZ industries were dependent on imports and domestic sources for exports.

The figures in table 2 indicate the low linkage to the local economy, with only a negligible 5% of the capital goods, intermediate goods and raw material requirements of zone enterprises being sourced from the domestic market.

In the initial phase of the KEPZ for instance, virtually all the requirements of capital and intermediate goods, as well as raw materials were procured from overseas markets - a trend visible in EPZs of developing nations.

Table 2

Share of Local Purchases in Total Purchases by EPZs (1978 -1992)

Year	*Imports (Rs.Mn.)*	*Local Purchases (Rs. Mn.)*	*Total Purchases (Rs. Mn.)*	*Local Purchases as a proportion of total purchases (%)*
1978	27.9	-	27.9	-
1979	252.8	-	252.8	-
1980	497.4	-	497.4	
1981	1192.0	53.9	1245.9	4.3
1982	1097.9	104.2	1202.1	8.6
1983	1424.9	129.2	1554.1	8.3
1984	2068.2	229.7	2297.9	10.0
1985	2129.8	143.2	2273.0	6.3
1986	3458.1	180.7	3651.8	4.6
1987	4890.2	269.4	5149.6	5.2
1988	5905.4	304.6	6379.8	4.7
1989	7694.2	430.3	8124.5	5.3
1990	12,724.6	517.7	13,242.3	3.9
1991	15,880.7	741.9	16,622.6	4.5
1992	21,526.9	371.3	21,898.2	1.7

The analysis given above shows that as much as 83.28% of raw materials/intermediate goods and 12.58% of capital goods utilised in EPZ manufacture, are imported. No government regulations exist stipulating values of local inputs for EPZ manufacturers. Moreover bonded warehousing, duty-free and custom-fee imports contribute to the ease with which importation of goods can be done. As a result purchases from the domestic economy are characteristically low.

The few sectors which have developed linkages are raw material based - viz rubber products and cutting/polishing of indigenous gem-stones. The only other form of linkage that has taken place is in the packaging, transportation and construction sectors.

Special incentives are now being granted by BOI to linkage industries such as integrated textile mills, agricultural units and infrastructure such as establishment of cold-room chains, ware housing etc.

As a result of the grant of incentives, several companies have come forward with project proposals, which could result in the development of linkages with the EPZ manufacturers. The grant of incentives commenced only in 1991/1992 and it is as yet too early to analyse the linkage effect which has occurred.

An attempt is also made to determine the level of backward linkages through and analysis of import data of BOI enterprises. Accordingly, it appears that imports were relatively low for the following industry sectors :

(i) Activated Carbon Projects
(ii) Rubber based Products
(iii) Coir products
(iv) Non - Metallic Mineral
(V) Horticulture
(Vi) Food, Beverages and Tobacco

The domestic value added component of these industry sectors was relatively high. It was revealed that the linkages for these industrial sectors were created on the basis of the supply of raw-materials and not by links created with domestic manufacturing industries.

The Board of Investment (BOI) of Sri Lanka has several projects utilizing rubber as the main raw-material and for these industries the rubber is supplied locally. For eg. there is an Australian venture (Ansell International Ltd., a subsidiary of the Multi National Pacific Dunlop) buys approximately 500 dry metric tons of locally produced latex per month for their production process. Another project, a Korea - Sri Lanka joint venture for the manufacture of foot wear has a relatively high level of local inputs. This company purchases its main raw-materials, rubber, locally.

The analysis of import data revealed that imports were high in the following industry sectors :

(i) Textiles
(ii) Wearing Apparel
(iii) Electronics and Electrical Goods
(iv) Fabricated Metal
(v) Transport Equipment
(vi) Footwear
(vii) PVC Products
(viii) Printing & Paper Products
(x) Chemical Products
(ix) Leather Products

At present, the wearing apparel industry is a significant industry accounting for approximately 21% of the industries in commercial operation under BOI. The net foreign exchange earned by this sector is however relatively small; indicating that the majority of the production inputs required for the industry are imported. While the bulk of the textiles required are imported most of the other accessories are also purchased from abroad. These include items such as needles, labels, pins, tags, stickers, hangers, rubber thread, padding and zippers. Though some of these items are produced in Sri Lanka, Zone Industrialists appear to find it more cost effective to import these items.

With reference to other industry sectors where import content is high it was revealed that several items not requiring sophisticated or precision technology are being imported in relation to the PVC and foot wear industry where import content is high are listed below :

(1) PVC Industry - Strapping Tapes, Polyethylene Granulates Earthwire, Plastic Moulds
(2) Footwear - Metal Eyelets, Cotton Canvas Lining.

The local market plays a significant role in supplying basic packaging materials required for industries. The demand for packaging is directly related to the level of production achieved by an enterprise. As the enterprise reaches higher production levels the demand for packaging increases.

Corrugated Cartons are used as packaging by several enterprises. And there are several local manufacturers producing this type of packaging. Suppliers have in most cases been able to meet quality standards. In addition the National Paper Corporation is the main supplier of Cardboard and Craft Liner, also required for packaging. The price offered by the Paper Corporation is said to be competitive and the paper is of a superior quality. With the rapid increase in the number of projects in the Zones however, the demand for packaging has increased and suppliers have in certain instances

Table 3

Value of Imports & Local Purchases of Raw Materials & Capital Goods of BOI's Enterprises in Rs. Mn.

Year	*Imports*		*Local Purchases*		*Total*
	Raw Materials	*Capital Goods*	*Raw Materials*	*Capital Goods*	
1978	7	21	-	-	28
1979	183	70	-	-	253
1980	396	120	-		516
1981	843	476	75		1,394
1982	1,009	288	108	31	1,436
1983	1,649	368	140	39	2,196
1984	2,331	495	235	42	3,103
1985	2,326	525	160	41	3,052
1986	3,678	388	195	32	4,293
1987	5,276	385	197	84	5,942
1988	6,781	499	306	37	7,623
1989	8,999	980	391	39	10,409
1990	13,060	2,627	407	51	16,145
1991	16,296	2,251	428	83	19,058
1992	28,729	5,586	n.a.	n.a.	
TOTAL	62,834 *	9,493*	2,642	479	75.448

* exludes 1992 figures

Source : BOI (primary data)

Table 4

Cost of Infrastructure Development

	KEPZ (Rs.M.n.)	*BEPZ (Rs. M.n.)*	*KGEPZ (Rs. M.n.)*
Land	16	36.5	49.40
Site Works	1.1	55.0	28.62
Roads	27.5	113.0	95.52
Water	74.0	123.0	22.72
Electricity	88.0	46.0	70.88
Sewerage, Treatment & collection system	27.3	120.0	39.04
Telecommunications	122.0	10.5	-
Buildings	29.3	42.0	38.30
Others	36.8	45.0	46.35
TOTAL	424.0	591.0	391.03

NB: All of the above figures are at current prices.

Source : Engineering Department of BOI not been able to meet delivery schedules. In such cases industrialists have been compelled to import the relevant types of packaging.

Therefore, it can be argued that the linkages between the BOI Enterprises and rest of the economy are created through the supply of labour and the purchases of infrastructural facilities such as public utilities and domestic transport and income derived from the domestic service sector and to some extent supply of packaging materials.

The linkages created in Rubber based products, Coir, Horticulture, Food, Beverages and Tobacco and Non-metallic Mineral Products are high.

The Possible Employment Effect Through Investment on Infrastructure Development

Due to lack of information, in this study, the labour cost is arbitrarily calculated as 40% of the total cost of infrastructure development.

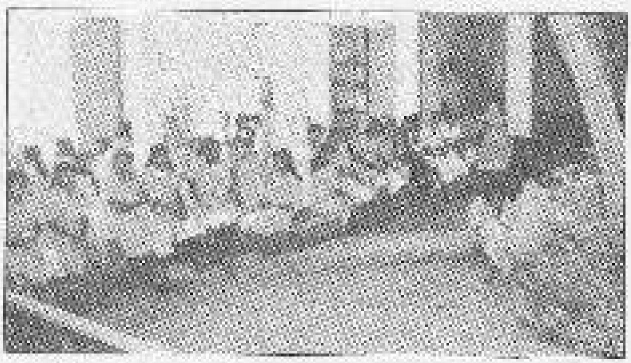
The expenditure figures in table 2 cover the period from 1978 to 1993 but most of the expenditure was incurred at KEPZ between 1978 and 1981 and that at BEPZ between 1983 and 1993 and that at KGEPZ between 1990 and 1993.

Using arbitration figure of 40% of total cost of infrastructure development, labour cost incurred for KEPZ was roughly Rs. 169.6 Mn. and for BEPZ was about Rs. 236.4 Mn. and for KGEPZ was about Rs. 156.4 Mn.

Recognising the crucial importance of forging greater integration between the EPZs and the domestic/export sector, the BOI has introduced attractive incentives to local suppliers/manufacturers who supply goods or components/parts to zone enterprises viz. customs duty rebate and BTT exemption.

A study on the development of linkages in the Katunayake Export Processing Zone has drawn attention to the sub-contracting work undertaken by various enterprises and the measures that need to be adopted to forge closer links with out zone enterprises.

Relaxing employees in a garment factory



Sub-contracting undertaken by enterprises in the KEPZ has led to the utilisation of under-utilized capacity in out zone enterprises - especially in embroidery work, washing of garments and finishing of textiles. In addition to the potential for the manufacture of garment accessories, the study has also highlighted the scope for subcontracting in the footwear industry - specially the manufacture of shoe eyelets and stitching of shoe uppers, as well as mixing of chemicals and rubber for rubber soles. The production of handles by small units for brush making factories in the zones was also identified as another industry which has scope for creating linkages to the domestic economy.

Some of the constrains facing local suppliers in the implementation of a linkage programme - as indicated in the study are listed below :

- Lack of knowledge of the products required by zone enterprises.
- Lack of technology, equipment etc. to manufacture products to meet the stringent quality requirements of zone enterprises.
- High price of raw materials.
- The time - consuming verification procedure involved in the movement of parts/components between zone enterprises and those undertaking subcontracting work outside the zone.
- Inadequate availability of credit facilities.

The study emphasises the urgent need for developing trade links between the big investor and the small producer and underlines the pivotal role to be played by concerned state agencies viz. the Industrial Development Board, Department of Small Industries, Sri Lanka Export Development Board and the universities in the implementation of this operational strategy.

It is pertinent to note that any programme to build domestic linkages should pay special attention to the development of economically appropriate links. In a study of the EPZs in Korea Prof. Derek T. Healey comments that 'Korea's Export Processing Zones would never have survived if they had been obliged to use as inputs the intermediate products of high-cost domestic industry, protected under a policy of import substitution'. The availability of regular supplies of materials/components of the required quality and specification is of crucial importance to zone enterprises, for in the words of Prof. Healey 'any attempt to force zone enterprises to buy materials locally will frustrate the export objective'.

Due to the lack of response in creating linkages with the rest of the economy by the existing manufacturing activities, now it is decided to promote projects in the following activities too :

a. Cultivation of fruits, vegetables, grains, pulses, oil seeds and spices.

b. Processing and value addition of agricultural produce such as dehydration, preservation, canning etc.

c. Establishment of nucleus farms with modern agricultural techniques and outgrower contract farms.

d. Storage and packaging of agricultural produce using modern techniques.

Impact of the EPZs on the economy

- Ms Y. Schokman & R de Alwis

The performance of Sri Lanka's EPZS needs to be assessed in terms of;

(i) Significance of EPZ Exports vis-a-vis Exports of the country,
(ii) Impact on the balance of payments,
(iii) Market expansion,
(iv) Inducing investment, through promotion of foreign investment,
(v) Employment generation effect,
(vi) Technology transfer, and
(vii) Degree of linkage effects with the domestic economy.

The Table 1 clearly indicates the growing contribution of the BOI approved export-oriented enterprises, to the industrial export sector of the entire country, since within a decade from inception, the percentage of these exports vis-a-vis total industrial exports has reached a high of 42.31%. At present, since 46.33% of the country's industrial exports originated from EPZ and licensed enterprises undue reliance has been placed upon the EPZ producers and foreign investors rather than domestic entrepreneurs.

Ratio of investment to exports

In Table 2 the ratio of investment to exports is analysed. The analysis gives some idea of the kind of return on investment which is achievable by the zonal enterprises. Possibility of high returns on investment is one of the reasons why foreign investment and location in EPZ is so attractive to profit oriented/expansion oriented enterprises.

From the Table 2 it could be seen that for the first 5 years a single unit of investment did not yield satisfactory ratios of exports. However, in 1983/84 the break-even point between

Table 1

EPZ Exports as a % of Total Industrial Exports (in Rs. Mn.)

Year	*Total Industrial*	*EPZ Exports*	*% of Total*
1978	1,944	-	-
1979	3,737	152	4.07%
1980	5,955	529	8.88%
1981	7,456	1,163	15.60%
1982	8,271	1,655	20.01%
1983	8,821	2,419	27.42%
1984	12,917	3,553	27.51%
1985	14,295	3,827	26.77%
1986	15,878	5,396	33.98%
1987	20,004	7,534	37.66%
1988	22,674	9,544	42.31%
1989	28,470	11,852	41.63%
1990	41,510	17,526	42.22%
1991	50,736	22,196	43.75%
1992	123,157	49,130	39.89%
1993	165,647	76,741	46.33%

Source : Central Bank Annual Reports 1978 - 1988
BOI primary data.

Table 2

Ratio of Investment in Contracted Projects to Exports - 1978 to 1991

Year	*Cumulative investment (Rs. Mn.)*	*Cumulative export earnings (Rs. Mn.)*	*Ratio of inv. to exports (exp. over inv.)*
1978	377	-	-
1979	1,003	152	1 : 0.15
1980	2,269	681	1 : 0.30
1981	2,762	1,844	1 : 0.67
1982	5,058	3,499	1 : 0.69
1983	6,370	5,918	1 : 0.93
1984	6,967	9,453	1 : 1.35
1985	7,167	13,280	1 : 1.85
1986	7,310	18,675	1 : 2.55
1987	7,777	26,209	1 : 3.37
1988	9,192	35,753	1 : 3.89
1989	10,799	47,605	1 : 4.41
1990	11,864	65,130	1 : 5.49
1991	15,266	87,218	1 : 5.71
1992	40,376*	136,348	1 : 3.38
1993	64,465	213,089	1 : 3.31

* Provincial value of KEPZ & BEPZ only.

Source : Computed from statistics obtained from the BOI.

investment & exports was reached. From this point onwards, a single unit of investment is shown to yield an increasing return from exports, as more and more of the factories attained full scale production.

This increasing trend reached a highest point in 1991 and thereafter has been declining in the years 1992 and 1993.

It should be noted that cumulative values have been used in the above calculation because investment made in a particular year does not necessarily represent exports of the same year. Export figures, will necessarily include investments made in preceding years.

Table 3 indicates the ratio of Imports to Exports, from which a rough idea of the time taken for the value of exports to equal and then exceed the value of imports, can be seen.

Table 3

Ratio of Imports to Exports

Year	Imports raw materials	Imports capital goods	Annual total	Cumulative total	Exports (cum. in Rs. Mn.)	Ratio of imports to exports
1978	7	21	28	-	-	-
1979	183	70	253	281	152	1 : 0.54
1980	396	120	516	797	681	1 : 0.85
1981	843	476	1,319	2,116	1,444	1 : 0.67
1982	1,009	248	1,257	3,413	3,498	1 : 1.03
1983	1,619	388	2,007	5,420	5,918	1 : 1.09
1984	2,831	495	2,826	8,256	9,453	1 : 1.15
1985	2,026	825	2,851	11,107	13,280	1 : 1.20
1986	3,678	338	4,066	15,173	19,075	1 : 1.33
1987	5,276	385	5,661	20,834	28,209	1 : 1.28
1988	6,781	499	7,280	28,114	35,753	1 : 1.27
1989	8,999	980	9,979	38,093	47,685	1 : 1.25
1990	13,060	2,627	15,687	53,780	65,190	1 : 1.21
1991	16,296	2,251	18,547	72,327	87,218	1 : 1.29
1992	28,729	5,586	34,315	106,642	136,348	1 : 1.28
1993	n.a.	n.a.	n.a.	n.a.	213,089	-

Source : BOI primary data 1992.

Table 4

Composition of Exports 1982 to 1992

	1982 Value Rs. Mn.	1982 % of Total	1983 Value Rs. Mn.	1983 % of Total	1984 Value Rs. Mn.	1984 % of Total	1985 Value Rs. Mn.	1985 % of Total	1986 Value Rs. Mn.	1986 % of Total	1987 Value Rs. Mn.	1987 % of Total
1. Agricultural Exports	11,896	64.2	14,544	56.2	22,573	60.4	19,086	55.5	15,714	47.0	17,337	42.4
1.1 Tea	6,249	33.6	9,396	35.[illegible]	15,794	42.2	12,008	35.1	9,251	27.2	10,584	25.8
1.2 Rubber	2,261	10.5	2,858	11.4	2,501	6.8	2,566	7.[illegible]	2,522	7.5	2,903	7.1
1.3 Coconut	1,406	7.6	1,553	6.2	2,116	5.7	2,220	6.5	2,199	2.6	5,141	7.9
1.4 Minor Agri products	1,895	6.9	1,466	5.2	1,790	7.2	1,702	7.3	1,777	4.6	1,713	4.2
2. Industrial Exports	3,871	20.6	3,851	22.3	12,918	31.6	12,596	36.7	16,578	46.8	20,014	46.8
2.1 Textiles, Garments etc.	3,000	10.8	4,786	18.5	7,386	22.8	7,980	22.8	9,824	28.3	12,412	17.4
2.2 Petroleum Products	1,860	15.7	2,763	10.5	3,266	7.8	2,777	10.7	2,352	3.9	2,299	5.8
2.3 Others	1,480	5.2	1,414	5.2	2,164	5.5	2,475	1.4	3,817	11.7	4,513	7.5
3. Mineral Exports	679	4.7	1,138	4.7	934	2.9	964	3.1	1,320	3.6	1,509	4.8
3.1 Gems	680	3.2	540	3.2	537	1.8	254	1.8	722	2.2	1,447	3.5
3.2 Others	179	1.1	198	1.8	277	2.6	110	1.1	522	1.3	311	7.3
4. Unclassified	688	3.1	539	3.1	1,070	2.7	2,021	1.3	1,235	3.7	1,988	4.7

	1988 Value Rs. Mn.	1988 % of Total	1989 Value Rs. Mn.	1989 % of Total	1990 Value Rs. Mn.	1990 % of Total	1991 Value Rs. Mn.	1991 % of Total	1992 Value Rs. Mn.	1992 % of Total
1. Agricultural Exports	21,104	42.8	22,146	38.2	24,288	36.7	31,515	31.8	37,085	31.1
1.1 Tea	13,864	27.8	15,774	24.3	19,955	29.6	21,957	21.2	14,205	18.5
1.2 Rubber	3,706	7.5	3,775	5.7	3,060	3.6	3,311	3.1	2,980	2.2
1.3 Coconut	1,285	3.3	3,993	6.2	2,588	3.8	4,212	4.1	1,920	1.4
1.4 Minor Agri products	2,062	3.4	2,425	4.1	1,895	4.0	5,708	4.1	3,801	4.1
2. Industrial Exports	22,654	46.1	28,473	50.7	37,300	58.5	77,030	69.1	73,773	62.9
2.1 Textiles, Garments etc.	19,891	37.4	17,771	31.1	21,100	31.0	72,241	39.6	52,088	41.6
2.2 Petroleum Products	2,286	4.6	2,442	4.2	1,556	8.0	3,242	1.9	2,771	5.5
2.3 Others	5,103	10.1	5,797	10.3	12,844	10.2	14,123	16.8	20,417	16.2
3. Mineral Exports	2,864	5.8	2,812	4.5	1,884	4.4	4,392	1.0	2,548	2.5
3.1 Gems	2,050	4.4	2,234	3.8	2,803	3.7	2,125	7.8	7,287	5.3
3.2 Others	763	1.3	456	0.5	661	0.7	224	0.2	287	0.2
4. Unclassified	1,088	3.8	2,222	5.1	5,691	7.3	4,561	5.4	5,192	4.4

Source: Central Bank of Ceylon, Annual Report & Review of the Economy 1982 to 1992
(a) Provisional

From the above data two observations could be easily made: firstly, the value of raw material imports greatly outpaces that of capital goods. From this it could be inferred that the projects are not very capital intensive.

Secondly from the ratio of imports to exports, we can see that the break even point between imports and exports is achieved within four years; that is, in 1982, and thereafter the value of exports shows an increasing trend to exceed the value of imports.

The year 1990 is an exception, when further deregulation of the economy and trade resulted in an influx of imports to service industrial production. Significantly, the following year - as a result of increased imports of raw materials and increased production - exports rebounded. Although the quick rebound of exports is positive in effect, the heavy reliance on imported inputs is negative.

The Table 4 gives the composition of Sri Lanka's total exports from 1982 to 1992. From this table a very clear trend is evident. The total value of agricultural exports reaches its peak in 1984 (60.4% of Exports) and then declines. Although a decline occurs in agricultural exports, the value of industrial exports shows a consistent rise, particularly after 1984 when it was 34.6% exceeding agricultural exports in 1986 at 46.8% and reaching 68.9% of total exports in 1992.

The year 1986 is particularly significant in that it is the year in which the percentage of industrial exports exceeded that of agricultural exports. It is also in this year that the textile and garment sector, accounting for 28.3% of exports became the leading export sector of the Sri Lankan economy, overtaking the traditional export leader - tea, which accounted for 27.2%.

In regard to the role which the EPZ played in paving the way for industrial exports to overtake agricultural exports, the EPZs largest export sector is, undoubtedly the textile, wearing apparel and leather products sector. From the year 1986 and 1987 onwards the values relating to this sector, from EPZ enterprises, taken as a percentage of total exports of Textiles etc., are given in Table 5.

Because "Textiles" appears to be the lead sector of the EPZ the point was reached in 1989 where almost a half of textile exports originates, or ,is attributable to production in the EPZs. As the methodology/technology in the zones matures filters out of the zones, production/exports from companies outside the zones increased. Moreover the years 1990/1991 were a period when a conscious decision was taken to move garment manufaturing units, outside the EPZs, into provincial areas, with a view to creating employment in rural areas. As these garment factories came on stream and commenced exports, the percentage of "BOI approved textile/ garment exports as against total exports rose steeply from a low of 40% in 1991, to a high of 92.41% in 1993. It is therefore quite apparent that BOI approved ventures dominate the textile/garment exports trade.

Table 1 indicates quite clearly the role played by EPZ enterprises in the industrial exports. Where it could be seen that 46.33% of total industrial exports originates from zone industries. As these products are exported either to countries from which foreign investment has originated (through buy-back agreements) or to third parties - it could be assumed that market expansion has taken place.

Table 5

EPZ Textile Exports vis-a-vis Total Textile Exports

Year	*Total textile / garment exports (Rs. Mn.)*	*EPZ textile / garment exports (Rs. Mn.)*	*% of total*
1986	9,629	4,202	43.64%
1987	12,897	5,724	44.38%
1988	14,260	6,541	45.87%
1989	17,631	8,370	47.47%
1990	25,163	10,764	42.78%
1991	33,261	13,466	40.49%
1992	44,925	29,249	65.11%
1993	60,141	55,578	92.41%

Table 6

Investment in Contracted Projects

Year	*No. of Units*	*Foreign Investment Component in Rs. Mn.*	*Foreign Investment Component as a %*	*Local Component in Rs. M.n.*	*Local Component as a %*	*Total Investment in Rs. Mn.*
1978	30	249	58.04	169	39.39	429
1979	13	561	84.23	105	15.77	666
1980	25	1,132	74.13	395	25.87	1,527
1981	9	261	60.98	167	39.02	428
1982	12	1,990	86.15	320	13.85	2,310
1983	10	871	72.34	333	27.66	1,204
1984	13	358	63.82	203	36.19	561
1985	7	120	64.86	65	35.13	185
1986	7	137	77.40	40	22.60	177
1987	12	360	77.75	103	22.25	463
1988	26	951	65.05	511	34.95	1,462
1989	14	1,313	81,76	293	18.24	1,606
1990	16	881	82.72	184	17.28	1,065
1991	52	3,015	88.62	387	11.38	3,402
1992	152	16,061	63.96	9,049	36.09	25,110
1993	324	9,093	37.68	15,039	62.32	24,132
	722	37,353	57.71	27,374	42.29	64,727

Inducing Investment through Promotion of Direct Foreign Investment

Sri Lanka's EPZs were established at a time when private sector investment was at an all time low. Flight of capital, as a result of nationalisation and protectionism in preceding years, resulted in a dearth of funds for investment in industries. EPZs have been successful to the extent that a total of Rs. 64,727 Mn. (actual investment) has been mobilised into the production process. Of this investment 57% (Rs. 37,353 Mn) was generated from foreign sources while the balance Rs.27,374 Mn (42.29%) was mobilised from local sources. (see Table 6).

This would indicate that local investment has a fairly big stake in the success/failure of many projects. .It would also indicate that while to some extent there has been success in attracting foreign investment, a greater success lies in the fact that domestic capital has been mobilised into the industrial sector.

As regards sourcewise distribution of foreign investment, 57.12% of investment and 29.31% of projects originated from the NIEs and Japan, while only 15.60% of projects and 14.32% of investment originated from other major investors from the west. (Table 7).

High Concentration of investment is in the Textile and Wearing Apparel industry.

However, within a 10 year period (1982 to 1993) the quantum of projects in the textile/garment industry vis-a-vis total projects contracted has decreased from 43.82% in 1982 to17.15% at end December 1993.

Thus it could be assumed that in recent years there has been an increasing tendency to shift away from the Textile industry into more diversified, but labour utilising sectors. Investment too is gradually moving away from the textile and garment sector (from 21.88% at end 1982 to 17.13% at end 1993), whereas the 'Services' sector, which includes infrastructure projects (multistorey buildings, warehousing facilties, hotels etc.) shows the largest increase (from 47.98% in 1982 to 55.23% of investment in 1993). This is closely followed by the "Food & Beverage Sector" which has increased from 0.69% to 5.28% over a decade (Table 8).

Employment Generation

As at end December 1993, 122,165 persons had secured employment in the BOI's zones & licensed enterprises. Details of employment as per the 3 categories of approved, contracted & actual are:

(i) Emp. Potential in Approved Projects 204,923 persons
(ii) Emp. Potential in Contracted Projects 177,979 persons
(iii) Actual Employment 122,165 persons.

Employment in the garment industry which is largely labour intensive, predominates, with 53.86% of total employment. Miscellaneous manufacture of items such as porcelain figurines, security printing etc. accounts for 8.57% of total employment.

Level of skills is relatively low, with nearly 40% of total workforce being in the semi-skilled category. Taken together "trainees", 'unskilled workers' and "semi-skilled workers" account for more than three-quaters of the workforce.

Gender-wise, nearly 80% of EPZ and licensed enterprise workers are female and only 20% are males. Although it was found that male workers were small in number, they accounted for a very high percentage of technical jobs in both the executive grade (more than 80%) and non-executive grade (85%). Even at supervisory level, technical jobs are male dominated - nearly 60% - as opposed to 30% males in a non-technical supervisory capacity. Administrative work was also dominated by male employees (nearly 75%).

Trade Unionism, though permitted, had been effectively controlled

Table 7

Approved investment from selected countries (as at end December 1993)

Country	Units Nos.		as a % of total no. of projects		Foreign Inv. (Value) In Rs. Mn.		As a % of total for. inv.	
1. (a) Hong Kong	30		3.02%		2890.4		4.95%	
(b) J.V. with majority investment is from Hong Kong	23	53	2.32%	5.34%	2025.4	5315.8	4.88%	9.78%
2. (a) Singapore	16		1.61%		1488.8		2.76%	
(b) J.V. where majority investment is from Singapore	29	45	2.92%	4.53%	9937.7	11426.5	18.29%	21.04%
3. (a) Korea	66		7.65%		7382.0		14.40%	
(b) J.V. where majority investment is from Korea	30	106	3.02%	10.67%	1869.8	9251.8	3.58%	17.02%
4. (a) Taiwan	9		0.91%		316.5		0.59%	
(b) J.V. where majority investment is from Taiwan	14	23	1.11%	2.32%	285.0	601.5	0.52%	1.11%
Total - NIE		227		22.86%		26605.6		48.95%
5. (a) Japan	32		3.22%		3528.0		6.67%	
(b) J.V. where majority investment is from Japan	32	64	3.22%	6.45%	807.7	4135.7	1.49%	8.16%
Total-JAPAN & NIES		291		29.31%		31042.3		57.12%
6. (a) Germany	23		2.32%		1276.5		2.35%	
(b) J.V. where majority investment is from Germany	34	57	3.42%	5.74%	1955.4	3232.9	3.60%	5.95%
7. (a) UK	11		1.11%		337.7		0.62%	
(b) J.V. where majority investment is from UK	35	46	3.52%	4.63%	1915.9	2253.6	3.53%	4.15%
8. (a) USA	18		1.81%		1413.5		2.60%	
(b) J.V. where majority investment is from USA	26	44	2.62%	4.43%	704.1	2117.6	1.30%	3.90%
9. (a) France	1		0.10%		21.2		0.04%	
(b) J.V.	7	8	0.70%	0.80%	157.0	179.2	0.29%	0.33%
	155		15.60%		7,783.3		14.32%	

Table 8

Sectoral Classification of Contracted Projects in EPZ & Licensed Enterprises

		Units				Total Investment			
		as at 31 Dec. 93 (cumulative)		(end '82) (cumulative)		(31 Dec. 93) (cumulative)		(End '82) (cumulative)	
		Nos.	%	Nos.	%	Rs.Mn.	%	Rs.Mn.	%
1.	Food, Beverages & Tobacco	53	7.33%	1	1.12%	3,385	5.23%	243	0.69%
2.	Textiles, Wearing Apparel Leather Products	124	17.15%	39	43.82%	11,094	17.13%	7,702	21.88%
3.	Wood & Wood Products	14	1.94%	1	1.12%	437	0.67%	6	0.02%
4.	Paper & Paper Products Printing & Publishing	9	1.24%	-	-	457	0.71%	153	0.43%
5	Chemicals, Petroleum, Coal Rubber & Plastic Products	63	8.71%	12	13.48%	3,449	5.33%	2,582	7.33%
6.	Non-Meneral Products	61	8.44%	11	12.36%	2,886	4.46%	1,838	5.22%
7.	Fabricated Metal Products Machinery & Transport equipment	20	2.77%	4	4.49%	1,106	1.17%	544	1.55%
8.	Manufactured Products	119	16.44%	18	20.22%	6,273	9.69%	5,241	14.89%
9.	Services	260	35.96%	3	3.37%	35,770	55.23%	16,899	47.98%
	Total	723		89		64,766		35,207	

to prevent worker unrest. As a result unionism was minimal and workers were only able to negotiate for benefits and better conditions through enterprise-related joint consultative committees.

As regards EPZ and licensed enterprise contribution to overall employment, one year after Sri Lanka's first EPZ was established, contribution to total employment stood at 0.16%.

Over a five year period this increased to 0.87%. by 1993, this had increased to 2.35% of total employment of EPZ and licensed enterprise contribution to employment in manufacture is more significant. From contributing 1.73% of employment in manufacture in 1979, EPZ and licensed enterprises increased their share of employement to 8.76% by 1985. By 1993, 17.85% of employment was in BOI approved manufacturing projects. The trend shows an inreasing number of job opportunities in the export oriented manufacturing sector and increased reliance on foreign owned subsidiaries for employment provision.

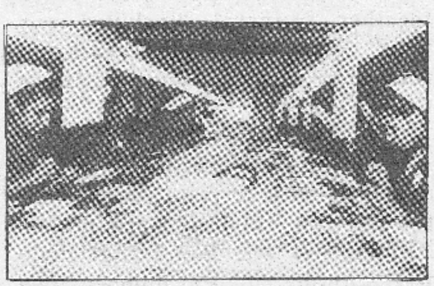
A total of 122,165 persons have obtained direct employment within the EPZs and if indirect employment at the ratio 1:2 is considered a futher 244,330 persons would have received indirect employment benefits. In this way it could be said that the government's objective of generating employment has been achieved.

Transfer of Technology

The technology spin-offs resulting from zone activities are expected to have a positive impact on the domestic economy. However, the predominance of low technology, labour-intensive industries such as garments and assembly of electronics in the initial stages of EPZs - particularly in the developing world - provides limited opportunities for upgrading the level of local skills. Knowledge - intensive activities which provide opportunities for the adoption of sophisticated processes of production would lead to an advancement of knowledge, expertise & skills. The formation of manufacturing facilities of this nature would however be in conflict with the employment objectives, since the adoption of more advanced production process and techniques would entail the employment of fewer workers, particularly in the unskilled and semi-skilled catergories.

Given the dominant position occupied by the garment industry, particularly in the formative years of the first EPZ, it could be stated that the transfer of know-how would have been in the spheres of management skills, quality control techniques and marketing. Subsequently however, with setting up of a wider range of industries in the EPZs, a fairly high degree of automation has been introduced - as it is evident in the textile, gems and rubber and plastic industries.

An examination of data on employment distribution according to skills indicates that 3/4 of the workers both within & outside the EPZs are in the semi-skilled, unskilled and trainee categories - a reflection of the level of skills of the majority of work force. However, the training programmes initiated by zone enterprises both in Sri Lanka and abroad has led to the progressive build up of local counterpart skills. Furthermore, the movement of qualified and trained man-power from zone enterprises to non-zone enterprises could be regarded as an indicator of the intra-national spread of techniques and skills.



Female Labour Force at Katunayake Export Processing Zone : Social Impact of the Coping Behaviour Patterns

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The female labour force at the Katunayake Export Processing Zone is not a special breed. The workers are drawn from Sri Lankan society and have grown up with the values and norms of that society. In general, the young women are from rural poor communities and have a traditional background. How, then, have they come to represent a society which shows such marked difference from the traditional Sri Lankan society in which they were raised? How can such differences be so marked that it is possible to identify them as a subculture? Our assumption is that the sub culture has emerged because of the problems these working girls face in their new working/ living environment and the coping behaviour they have adopted to meet the challenges of such a situation.

First, let us look at their problems one by one. The most important aspect, to my mind, is the heavy concentration of young females in a very restricted locality which has completely upset the sex ratio of the community surrounding the Free Trade Zone. Current estimate are that close to 70,000 young females are concentrated in the vicinity of the Free Trade Zone. Falling within the category of 18-25 years of age, less than 10 percent are married and the majority live in lodging houses. Even though, at the commencement of the Free Trade Zone the required labour was recruited from surrounding areas, today the workers come from all over the country, from places as far away as Anuradhapura, Matara and Badulla.

The result is that, even though many girls send a small remittance back home to support their parental families, it is almost impossible for them to maintain meaningful contact. On the one hand there are the working girls who are entitled to such a limited number of annual holidays that it is not possible for many to make even a single trip home to their parental families within a twelve-month period.

More specifically, during the first few years of their stay at the Export Promotion Zone they are placed on a temporary basis for six months, which often is either extended or their service terminated. If terminated, they are forced to find temporary employment elsewhere and undergo a further probationary period. Consequently, these young women have no opportunity to visit their parental families.

On the other hand are parents of these girls. Poor as they are, they have no economic capability of travelling to see their children more than once or twice a year. As a result, the close bond which existed between the girls and their parental families dwindles away. In addition, the female workers receive little support from the community among whom they have come to live and work.

In their lodgings they are herded like cattle and in the factories like parts of a machine - inanimate, without emotion and expected to attain impossible targets. Within the wider society they are treated no better. At every point men try to take advantage of the girls, knowing well their vulnerability. The general public treat them with disdain, openly jeering at them and calling them names such as "juki keli' 'badu keli' and 'machine keli'

The working girls respond to this situation in different ways. In the initial stages a large number break down and are repeatedly consoled by their fellow workers. Later, many accept the situation and adapt themselves to their new environment. It is this adaptation which brings about a drastic change in their attitudes and behaviour and makes it possible to identify them as a sub-culture. Some take on the subculture to such an extent that it appears as if they are determined to wreak vengeance on the society responsible for placing them in such a situation.

At the work place they face a multitude of problems, unattainable targets, frequent abuse and assaults from supervisors sometimes sexual assaults by male workers, supervisors or even managers, regimentation and being forced to work a second shift when urgent orders have to be met. These are some of the main problems encountered in the factories.

As the workers walk from factory to boarding house they face the problem of insecurity. Work in many factories is over by 5-5.30 p.m. but the majority of girls work two-three hours' overtime in order to supplement their poor salary. A recent study shows that for many workers their overtime amounts to approximately 20 percent of their take home pay. Because of the need to work overtime, by the time many workers leave the factory complex it is arround eight o'clock at night. Even though the main roads are lit, the small path leading to boarding houses are always dark. In these area the girls are very often molested.

In factories where the supervisory grade consists of males, working girls come under various kinds of pressure. The main cause of their utter helplessness and their inability to resist all kind of demands made on them by management stems from the absence of trade union within the Free Trade Zone. The prohibition of trade unionism, though not written, is understood by everybody who has anything to do with the Export Processing Zone.

Traditional trade unionism has made no efforts to organize within the Free Trade Zone. They have not even challenged, openly or covertly, the deprivation of the right of workers to organize themselves to safeguard there rights. Traditional trade unions have not seen the situation as a problem. Is this because traditional trade unions in this country are more interested in playing second fiddle to national politicians rather attempting to safeguard and win rights for workers? Because of the existing situation, even among the workers in the Free Trade Zone who have a highlevel of educational attainment, the awareness of their rights is extremely low. Less than half the workers in the Export Processing Zone are aware of the existence of labour laws which provide them with protection from exploitation.

The result is that the overriding fear of losing their job becomes the one guiding factor which governs their behaviour at the factories. Very often workers are not given letters of appointment and they can be discontinued at will by management. (Sri Lanka, p.295) Because of this situation, when faced with harrassment in the factory, they are either compelled to leave their job and look for placement in another factory or to accede to the demands made by male superiors.

One way which the female employees have found to deal with this situation is to have a "boyfriend" who is capable of protecting them from any sexual demands made by fellow male workers or supervisors. This may be another reason why personnel from the armed services play a leading role as boyfriends to factory girls.

Allocation of overtime work is another weapon which management, supervisors and junior managers use to control the female workforce. Almost all the female workers like to do extra hours of overtime each week in order to supplement their meagre salary. However, overtime work is not evenly spread throughout the year in any factory. Sometimes, management is forced to use as many hours of overtime as possible in order to meet deadlines on overseas orders. At other times, the number of available overtime hours is inadequate to distribute among all the employees in order to meet their expectations of overtime.

In both these instances, management use overtime as a weapon to control employees: by forcing them to work more hours than they can cope with, by giving them fewer hours than they desire, or by not giving them any overtime work at all. Consequently, workers are forced at all times to oblige management in order to retain their employment and to earn enough money to survive.

In summary, there is within the Katunayake Free Trade Zone concentration of around 60,000 or more female workers, aged, in the main, between 18-25 years, who are extremely poor, whose parents expect some form of support from them for their families, who are herded into boarding houses which are no better than cattle sheds, who work more than ten hours a day, who are sometimes forced to work a second shift and who are being exploited economically and physically by factory management as well as by the rest of the community.

Leading on from this summary, the question is posed: how is the rest of the community affected by the presence of this large female labour force among them? One might wonder why there is no protest from the general public in the region of the Katunayake Free Trade Zone with regard to what is happening. The answer is obvious. The community around Katunayake has derived enormus economic benefit from the presence of the workforce.

By the end of 1989 there were more than 1200 registered boarding houses in the area surrounding the Free Trade Zone. Running boarding houses for working girls has become a major economic activity in the area. Most boarding houses earned more than Rs. 6000 a month in early 1990 by renting mere sleeping space to working girls.

Apart from boarding houses, many bazzars, boutiques, cheap eating houses, grocery shops, tailoring shops and numerous other centres of economic activity which are directly related to the presence of female workers have sprung up in the area. Building activity is extremely high as more and more boarding houses are made available for worker's accommodation. Additional economic activities are also generated such as musical evenings which take place almost every weekend.

The current average income of workers, including overtime, is supposed to be approximately Rs. 2000 a month.

According to the latest official figures, there are over 70,000 female workers in the Katunayake Free Trade Zone. When these two figures of income and workers are put together they lead to an estimate that the working girls, by their very presence in the area, generate economic activity to the tune of Rs. 1.4 billion a month. It is known that approximately onethird of the working girls send a small remittance of about 20 percent of their income to their parental families. However, even with this amount deducted, the economic activity generated within the area of the zone is in the region of Rs. 1.2 billion a month.

No comparative statistics are necessary to establish the economic prosperity which the resident community derives from the concentration of factory workers in their vicinity. A visual comparison of the area surrounding the Katunayake Export Processing Zone with any other similar suburb will bear testimony to this.

Because of the economic benefit they derive, the attitude of the community around the Katunayake Export Processing Zone towards the working girls is quite schzopherenic. They want them to stay, and even to come in greater numbers, so that their own economic prosperity will be further improved. At the same time, the resident community is unequivocal in condemning the girls for their "easy behaviour' and their lack of restraint. Such condemnation is sometimes made in public and invariably made in private conversations.

The reasons which members of the resident community find for condemning the girls are multifarious. The most commonly used allegation is that they 'misbehave' with boyfriends and as a result set a bad example to the children in the community. Residents who have grown-up children are very concerned about this matter. Their attitudes have changed to such an extent that misbehaviour among teenagers is refered to as 'kalape kello vage hesirenawa' meaning 'behaving like girls in the zone'. Becoming a working girl at the Free Trade Zone is regarded as the most degrading future prospect any girl can envisage. When teenage girls neglect their education, parent often threaten them, stating 'kalapete yaigyalla" - 'you may find your place in the zone.'

As a result of this attitude, there is a gradual process taking place of boarding houses becoming completely separated from the living quarters of the resident population. More prosperous landlords build separate new houses for themselves on their property. Others completely separate their living sections from those of the boarders through erecting partitions. In this way, the working girls are treated as unwanted guests but very much wanted because of the income they bring.

Constant expansion of industries at the Zone has also worked to the advantage of boarding house keepers. The demand for boarding houses always exceeds the supply, therefore

Emergency treatment in a factory

maintaining the advantage with boarding house masters in any negotiations with boarders.

Stories of family disruptions due to the involvement of married men, especially boarding house masters, with working girls are quite frequent. This has added another dimension to the problems of the resident community and is a reflection of the artificially-created imbalance in the sex-ratio of the area. The resident population, especially the families, are very suspicious of the behaviour of working girls.

The unrestrained behaviour of young female workers who, according to residents of the area, vie with one another to have a boyfriend is supposed to be influencing teenagers in the area. This has caused much concern among parents, particularly with recent police raids on brothels and the surfacing of the involvement of schoolgirls in some of them. The teenagers also visit musical evenings which are meant for working girls and they absorb the pattern of behaviour which they observe around them.

Finally, there is one major threat to the entire community in the area of which many people are hardly aware. This is the very vulnerable position the girls are placed in with relation to HIV infection and contraction of AIDS. On the one hand, by choice or by necessity, a large number of working girls have become part-time sex workers providing services both to local men and to foreign tourists. Some of these girls are frequently visited by men who are married and have families elsewhere. Girls are also being enticed to visit tourist hotels by 'Madams' who pose as working girls in the area. Negombo is a tourist area which already has some problems of suspected HIV carriers.

The Free Trade Zone may, in the near future, also become an area which will be categorized as a high risk area for AIDS and HIV infection. This is even more likely when one considers the very low level of health care facilities provided by various clinics. Often the advice given to the girls is to have their 'menstrual periods regularized' or, in short, to have abortions. The immensity of the problems can be gauged by a comment made by one of the medical officers in the area that his clinic is visited by about 300 working girls every day to get their 'menstrual periods regularized.'

We are left with a plethora of problems which need to be addressed. Those requiring urgent attention are: safety measures for workers, both within their factories and within the zone generally; labour laws which protect and enforce the workers' rights; health care and education on health matters, especially relating to sexually transmitted diseases and AIDS; and more humane living conditions.

Solutions to all these problems will be of benefit not only to the female workers but also to the whole of Sri Lankan society. To neglect these problems is to neglect the future well-being of our society.

Courtesy: Working in the zone - Asian Human Rights commission, Hongkong.

EXPORT PROMOTION ZONE
— an Entrepreneur's view point

A representative of the Economic Review in conversation with Neil Umagiliya, President, Manufacturers' Association, of the Katunayake EPZ.

Economic Review : The Government of Sri Lanka has been giving foreign and local investors many incentives and supports to enable them to enhance their performance in the production and processing of goods for export. Given all these facilities and advantages, do you still experience any difficulties , any problems?

Neil Umagiliya: In 1977 when the Katunayake Zone was established its main scenario for the foreign investor was that it was to be a one stop shop. Actually this was so till about two or three years ago. Two years ago when the Board of Invesment was formed, the whole country was said to be a Free Trade Zone and these facilities were given to very many investors. Consequently, the entire concept of the Free Trade Zone got eroded. Every one was a BOI concern and every one had all the facilities. The old investors who were there i.e. the real foreign investors found that the Zones had got neglected. This was about two years ago, but all this has now been corrected.

In those days when you said you were a GCEC enterprise person everyone took notice of you - when I say everyone, I am reffering to other governmental authorities. There was then no question of our being monitored except by the GCEC, now the BOI. But it is different now, we have too many masters; the Labour Department, and Immigration and Emigration asking us so many questions. Fortunately, the Customs does not come into it any more. So the old foreign investors in the Zone were greatly inconvenienced. But corrective action has been taken in the last six months, and we feel things are getting back to normal. Let's wait and see.

E.R. Are you satisfied with the operational autonomy given to you and the removal of regulatory measures? Have the Zone authorities been quite supportive of your business promotion activities?

N.U. We are more or less free I would say, and there aren't so many constraints as such, and wherever there were constraints in the past, we were able to speak to the authorities and get them resolved. The authorities have extremely responsive to our requests.

E.R. Does a suitable business climate exist now in Sri Lanka, making it quite conducive for industries to flourish specially those with foreign investments?

N.U. Yes. Of course it is a very relative thing when you speak of suitable business climate. For some it may be suitable, for others it may not be, but in general for a foreign investor interested in a genuine business to make profits and to give something back to this country, I think it is very encouraging.

E.R. We have been having experience of Export Zone for about sixteen years now, we should be able to attract foreign investors. Regarding our Zones, how far have they been able to compete with other Zones in the world. What do you feel about this?

N.U. When you talk of attracting foreign investors and when you ask about the competitiveness of this Free Trade Zone compared with the other Free Trade Zones, the foreign investor looks for a number of things. The most important is the political and economic stability of the country. Also labour rates, the labour laws, legislation, industrial relations, business climate, and so on. In the past there has been political satability, and economic stability, there has been basically industrial relations stability, labour rates I would say have not been rising, and have now levelled out. So if you are talking about our competitors like Bangladesh and Vietnam yes, their labour rates are very much lower now. But their infrastructure facilities may not be as good as ours, especially Vietnam, you know is getting a lot of investments from outside which were supposed to or should have come to Sri Lanka. The large investors go there. Even Bangladesh, if you look at the garment industry of that country, it is far ahead of ours.

E.R. Certain investors who were to have come are said to have gone elsewhere, why is that?

N.U. Quota reasons, and cheap labour, and also one thing that we lack very badly management and middle-management skills. It's a big problem.

E.R. I beleive, our training institutions and universities and other places were unable to produce a sufficient number of these grades.

N.U. The universities, the training institutes etc. did produce people, but did not focus on the needs of the country or the industry and it's only now that they are becoming aware of it.

E.R. In selecting people to be trained as Managers, were there any limiting factors, any problems?

N.U. The most serious limitation is the language problem, so essential for good communication. The people are intelligent but lack communication skills. I have found that all our factories are run by Sri Lankan nationals.

E.R. Now, there are more and more new Free Trade Zones coming up in various parts of the country, Pallekelle, Mihintale etc. Do you think there are too many of them? Are they beneficial to the nation, and more especially to regional development?

N.U. Taking industry to the rural areas is one of the best things that happened during the late President's time. But we must now look at industries other than the garment industry. We must attract investors in other areas because, of the garments industry, we have had enough and more. If you bring in more, you are sure to kill the existing ones. We have to look at other types of industries, like electronics. There should be more marketing of our zones for those types of industries, and we should try to attract investors in a variety of goods and services.

E.R. Many countries are going to establish zones to develop their economies. Do you feel there will be an excess of Zones in the global context?

N.U. I don't think so because it all depends on each country's environment. A zone is only a place where they can come in and feel very secure because there is something like a parapet wall or a fence going round, and there are certain rules and regulations that can be changed. So even if there are zones everywhere in the world, it all depends on the political climate, the political stability. That is where the investor goes.

E.R. In your opinion, what are the actual benefits a country can gain from a Free Trade Zone?

N.U. A country can certainly gain by technical know-how brought in by the foreign companies.

E.R. Has this actually happened?

N.U. Oh yes, there is no question about it. Of course this is a relative thing, but if you take the base as nil and even if you get 10 percent, we have got something. It is not minus it's a plus point. There may be some people who say that we have not gained anything. It's not so.

Then there is the employment factor. Take the foreign exchange coming in. You must understand that the money is spent in this country. Many people say that we don't get foreign exchange because dividends are not declared and the foriguers take all the profits. That is incorrect. Look at the amount of money spent in the country by firms, whether you look at the foreign firms or any firms in the zones. I am sure you must be having the statistics of what the employment figure was in 1982 and the employment figure today, and what the nett foreign exchange figure was in 1982 and what it is today. These speak for themselves. There are today 55,000 directly employed in this Free Trade Zone. Katunayake is full. Biyagama is also getting full. And not only that, when any prospective foreign investor comes and speaks to the other investors who are already operating, he gets confidence. Now in this zone there are German, Hong Kong, Chinese and Danish companies, all types of companies that have come here, invested and operated for the last ten, twelve, fifteen years. So any investor coming here with five million dollars to invest, has the choice of many places without too many problems anywhere.

Sri Lanka may have one type of problem, Vietnam another, and Bangladesh still another set of problems. The investor has to wiegh the pros and cons and see what is best, and speak to the people who have already invested and are operating here. Then there is the question of the infrastructure. We have to develop our infrastructure more. Today, when an investor comes to Colombo and disembarks at Katunayake, it takes him about an hour and a half to get to his hotel in Colombo. What happened in Bangkok may well happen to us, if we don't think of proper motor ways.

E.R. There is a proposal to build a super highway.

N.U. There has been much talk about it, but nothing much seems to be happening.

E.R. Now, in different parts of the world, especially in the USA and in Europe there are Free Economic Zones already expanding. Will they affect us?

N.U. You know, there are different opinions, some say it will affect, others disagree. I think this a test, we have to wait and see. I don't think anybody can say with any degree of certainty. It is very unpredictable. But the type of investor who might come here may not be the type who will think of investing in Mexico or in the NAFTA country. I think there are enough investors that we can still attract. This is where we have to have political stability. However much we say that the war in the North is not affecting the people, that is not what the international media report. Now if we really look at the question, have we succeeded in getting big Japanese investors?

Contd. on page 41

Sweep stakes at York Street

M. H. E. Shariff

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Buying and selling shares is more than a habbit for many Sri Lankans today. Little was known about Colombo's emerging bourse four years ago. It was in June 1990 that its screen was opened to the international audience by removing restrictions on foreign investments. In more recent times the market earned for itself an international reputation as the best performing market in the world.

Now things are quiet again at the bourse which was once known for price volatility and rich dividends. The thriving market has seen a sharp decline in turnover during the latter part of May and early June 1994. The market's first setback was seen in March 1994 after touching an all time high of 1378.8 points on 1st March 1994 it began to retrace considerably and the cause was popularly attributed to a price correction by fundamental analysts. From a fundamental stand point share prices must meet a "price to earnings" (p/e) ratio criteria which is computed for a particular stock or share, the sector the share belongs to, and the whole market. The sectoral p/e released by the Colombo Stock Exchange (CSE) continued to scream out a possible decline for some time but enthusiastic investors paid little heed to this two digit figure which read 30.2 times on 1st March 1994.

Technical analysis on the other hand also showed a possible retracement as the bullish rally was speedily steering itself upwards on the charts. The important symptom was that share prices began to rise much faster during the end of February than it did before. This was chiefly because of the speculative notion that made investors believe the bull run will persist forever. Technically such a phenomenon is viewed as a weak bullish run on its last legs.

Then came the next bout of disappointments with the UNP defeat at the provincial Council Elections in the Southern Province. Less attention would have been paid by investors had it not been a year of elections in 1994. With the Presidential Elections due late in the year foreign investors and local investors who had been dealing big on our boards began to draw a line of caution. This naturally saw a major decline in volumes and turnover despite all the encouraging corporate results that began to surface from around this time.

The ups and downs in a sharemarket are a common feature in any market. When markets are depressed it provides a good hunting ground for equities which are undervalued relative to competing stocks both here and abroad. An election cycle investment pattern would suggest stock picking during the final quarter in 1994 and selling after the election is over. Election years are generally associated with high inflationary pressures. Although stocks can be an ideal hedging mechanism for local investors who select stocks with a good asset backing. It is generally not seen as conducive by foreign investors as Sri Lankan stocks have to compete with international or regional stocks which may be able to offer a superior real earnings growth. Such reasons eventually led to the gradual slimming of turnover at the CSE from around Rs. 200 million during the months January to March 1994 to Rs. 50 million in the past few weeks (end May and early June). Those with grit and determination have decided to stay invested in a large number of stocks already. Such investors have the holding power needed to tide through the current 'bear run' in the market.

An encouraging development in the primary market was also seen. New issues continued to be successfull despite secondary market adversities seen so far. This phenomenon is different from what it used to be in 1988 which was also an election year. That year when United Motors Shares were offered via the primary market it was not taken up fully and as a result the underwriters were saddled with its stock for a while. In the contrary every new issue nowadays are subscribed many times over. A historic high in terms of subscriptions received was that of Lanka Walltiles Ltd which was oversubscribed 45 times over. This shows that money for shares is continuing to increase but investors are being cautious when it comes to buying stocks in the secondary market.

Economic overview for stocks

The macro picture is favourable for investments with Sri Lanka's GDP growth in real terms achieving 6.9% in 1993 in contrast to the previous year's growth of only 4.3%. This was possible despite the conflicts in the North. The market capitalisation continued to grow in importance registering a figure of the market capitalisation in 1993, 87% higher than the previous years figure of Rs. 66.2 billion. This was because of the several rights issues, new issues and as well as the enormous capital gains that was possible due to the massive influx of foreign remmittances for share portfolio investments by regional and country funds and as well as the increased local participation by Unit Trusts, Insurance Companies and the Employees Trust Fund.

The year 1993 has seen a favourable growth in the private sector. The rate of growth in private sector manu- facturing was 13% in 1993 as opposed to the public sectors growth of only 20%. The promising sectors in Sri Lanka's stock market are :

Banks' Finances & Insurance
Manufacturing
and Hotel & Travel

Many large investments have been made in these sectors and these include Eden Hotel Lanka, Blue Diamonds Jewellery Worldwide, Royal Ceramics, Vanik and Seylan Merchant Bank. These companies are likely to do very well in Colombo's Bourse in the years ahead and their stock prices are now going at give away rates. (See Table 1)

Blue Diamonds Jewellery has rewarded astute investors with a recent bonus issue of 1 for 10 and a rights issue of 1 for 5 plus a 5% dividend. Sampath Bank Ltd which had initial teethining problems has been able to sweep through with very good company fortunes; its profit after tax for 1993 was Rs. 85.3 million in 1993. Vanik has also been able to impress investors with an amazing profit after tax of Rs. 52 million for the year 1993. Eden Hotel will be Sri Lanka's second "5 - star" on the coast line. The first "5 - star" resort hotel was Ahungalla Hotel in 1978.

Table 1

Performance of selective new issues

Stock	*Primary Market*		*Secondary Market*		
	Issue Price (Rs)	*Size of Issue (Rs. Million)*	*High (Rs)*	*Low (Rs)*	*Closing (Rs) (3/5/94)*
Blue Diamonds	12.00	108	45.50	9.50	39.75
Vanik	20.00	170	110.00	58.00	67.00
Seylan Merchant	15.00	57	53.00	20.25	26.25
Eden Hotel	10.00	70	36.00	15.00	20.75
Royal Ceramic	30.00	192	49.00	35.00	42.50

Source: Forbes Research.

Table 2

Market Parameters

Item	*1992*	*1993*
GDP growth in real terms (%)	4.3	6.90
CSE All Share (December close)	605.31	978.97
CSE Sensitive (December close)	826.57	1442.44
Turnover per day (average for July-Dec) Rs. million	14.56	121.17
Total turnover (Rs million)	5.07	18.57
Market Capitalisation (Rs. billion)	66.20	123.78
Market p/e ratio	12.52	19.56
Number of listed companies	190.00	201.00

Source : CSE Fact Books 1993 and Central Bank Annual Report 1993.

Share Swaps

This is an emerging new trend in Sri Lanka. Swaps are preferred over amalgamation of companies which usually result in the closure of one of the companies. One of the first swaps to be done was between Forbes & Walker Ltd and the Ondaatje Corporation of Canada. More swaps are contemplated and these include those of Ahungalla Hotel and Aitken Spence Hotels Ltd where shares in Ahungalla were swapped for shares in Aitken Spence Hotels Ltd in March this year. Others to follow would include shares in Nestle Lanka Ltd for shares in Ceylon Nutritional Foods Ltd. Asian Hotel (Oberoi) shares may also be swapped for shares in Trans Asia Hotels (Ramada) and shares in Hotel Services Ltd (Intercontinental).

Global Depository receipts

An entry mode for Sri Lankan companies was discovered in 1993 when John Keels Holdings Ltd took the initiative by listing its stock in the Luxemberg Stock Exchange. Through this instrument it was able to raise a sum of Rs. 1.5 billion in foreign equity funding to finance its expansionary programme, re-pay loans and invest in strategic areas of activities such as the hotel sector.

Risk and Beta Factors

Academics will tell you that a plausible measure of risk is to determine the beta factor of stocks. Certainly, local equities have enticed investors with very high beta factors. Stocks which yielded high returns both in 1993 and 1994 include NDB, Ceylon Holiday Resorts, Kelani Tyres, Richard Peiris Exports, Hayleys Exports, Sampath Bank, Union Assurance, Merchant Bank and Ceylon Grain Elevators.

Performance of the Conglomerates

In the Trading sector Hayleys Ltd which has a diversified and a vast industrial base passed through a phase of modest performance during the year 1992 therefore a growth in earnings of only 5% is anticipated for the year 1993/94. The reason attributed to a slowed growth in earnings has been the recession in Europe and America which have been major markets for the groups exports.

John Keells Holdings Ltd has grown even bigger due to the acquisition of the Whittalls Group in 1992. Its real estate base saw a massive rise after the acquisition of the property belonging to Galaha Estates in 1990. The Group's main interest is in the Services Sector of the Economy particularly Leisure. The earnings growth for 1993/94 will be in the range of 25% to 30%.

Aitken Spence & Co. Ltd is continuing to consolidate its stake in the leisure sector and in viable areas such as inland container handling and shipping.

Forbes Ceylon Ltd will offer to the public a stake in the company. The total issued capital will be the highest once listed. A year ago the Forbes & Walker group listed one of its subsidiaries namely Soy Foods (F & W) Ltd.

The Ceylinco Group has been consolidating its position in the real estate sector, merchant banking, commercial banking and the diamond cutting industry. Seylan Bank has posted a profit after tax of Rs. 114 million while Blue Diamonds Jewellery Worldwide Ltd has posted a profit after tax of Rs. 35.3 million. The newest addition to its chain of listed firms in the bourse is Ceylinco Securities Ltd.

Ceylon Tobacco Co Ltd has been downsizing operations cutting down operations, confining itself to its core activities such as tobacco cigarette manufacturing and financial services. CTC Eagle Insurance Co. Ltd is leading the private sector owned insurance business through the introduction of innovative insurance products.

Property Development

The largest BOI project is the construction of the high rise building in Echelon Square by Overseas Realty which is expected to be completed in the year 1997. A massive amount of US $ 20,000,070 has been raised via the stock market. The instrument sold were cumulative convertible unsecured loan stocks.

Market for Corporate Bonds

The market for corporate bonds is just picking up in Sri Lanka. Debentures have already been packaged and sold by Puttalm Cement and Kelani Tyres. The smaller issues were made by Chemanex and LOLC some years ago. The new trend is short term instrument where Bank of Ceylon and MKFSL have taken the initiative by selling commercial paper.

Treasury Bills

Treasury Bills which will eventually become the investment commodity of the ordinary investor saw a major fall in the months November 1993 to March 1994 with rates falling from 19.2% to 13.2% for 3 month T-Bills. The reason attributed for the decline was to keep private sector borrowing rates low after lobbying by Chambers. The rates are now once again on the rise and could reach 16% per annum for 3 month T-Bills. Withholding tax has been totally removed for these invesments.

Infrastructure

The capital market has seen a major impetus with the implementation of the CDS. This sysem provides a book entry system replacing the manual system that was in existence since inception upto June 1992. The trading floor of the CSE has also devised a two part ticket system to enable speedy trading.

Peoplisation

Peoplisation in respect of several companies have already been successfully carried out. These include those of NDB, Kelani Tyres, Pugoda Textile, Sathosa Motors, Bogala Graphite, Distilleries, Ceylon Oxygen and Peoples Merchant Bank.

Outlook for the market in the year 1995 onwards

Much depends on government policy. So far the ingredients have been in place. Achieving NIC status has been discussed at several fores. With this in focus it is reasonable to assume that a share owning democracy will persist whereby capital can be tapped from the public and put into productive use perhaps with a view to making re-invesment of as much as 7% of GDP or more. Inorder to encourage this the incentives for invesments must be made available and growth encouraged whilst ensuring a stable economy.

Cont. from page 37

E.R. The Japanese, I think, are more interested in investing in developed countries, isn't that so?

N.U. They are also interested in places like India, because the local market is very big. They are concentrating on the local markets of those countries.

E.R. What is your opinion on the steps that should be taken for the further development of the Export Zones? Your general comments and suggestions.

N.U. The Katunayake Zone is run very well. Basically we have no big industrial relations problems. The BOI officials are doing an excellent job of monitoring the Zone. Even during the height of 1989 insurgency, we in this Zone, worked everyday. The Zone was never affected, that itself gave a lot of confidence to the foreigners that the Zones are very secure. That is most important. So if you have dedicated officers like this, if the infrastructure is good and industrial relations are stable, there is no reason why the Export Zones should not be extremely successful.

E.R. The Only problem is that there should be development of the infrastructcure facilities.

N.U. And divisive polities should be kept out of the work places as far as possible.

E.R. Is there a problem of political interference at the moment?

N.U. At the moment, No. Absolutely No. There are no political trade unions in the Zones, but there are joint Consultative Councils in every firm. They are very successful. That is why although we have had strikes, they are not politically motivated ones. Its upto the authorities to see if certain companies are not providing basic facilities, and for them to take corrective action before a third part can come in and speak on behalf of the work force.

E.R. There is a clear differenece between trade unions elsewhere and these Joint Committeess.

N.U. If you have a continuing dialogue with your children, they will never go astray and this will be an example to others as well. It is like that with the work force. When they know they have some person or persons in the establishment they can talk to and trust, they will not look elsewhere for leadership.

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