

**Trade Liberalization in Sri Lanka: A Case Study of the
Garments Industry**

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1. Introduction

The opening up of the Sri Lankan economy in 1977/78 saw the beginning of rapid changes to the structure of the country's economy. Manufacturing output accelerated, driven by the emergence of garments exports as a driving force in the transformation from a largely export agriculture based economy to an increasingly industrialized one. While the emergence of the garments industry in Sri Lanka was partly due to prevailing global trading rules in the sector – the Multi Fibre Arrangement (MFA) – the policy reforms instituted in 1977/78 no doubt also played a significant contributory role in providing a conducive environment for both domestic and foreign investors.

This case study examines in some detail the linkages between trade policy reforms in Sri Lanka and the emergence of the garments industry. In particular, the focus of discussion will be concentrated in highlighting the net welfare benefits that may have accrued to the Sri Lankan economy and the channels through which the trade policy reforms had a direct bearing on the outcome.

2. Reform Package and Emergence of the Garments Industry

2.1 International Trading Environment in Textiles and Clothing

An important factor which contributed to the growth of the Sri Lankan garments industry was the global trading rules under the MFA. International trade in textiles and clothing (T&C) has passed through a history of protectionism within the framework of consecutive bilateral arrangements. Starting with the Short Term Arrangement for Cotton Textiles in 1961, protectionism traversed through the Long Term Arrangement for Cotton Textiles (1962-73) and finally ended with 20 years of restrictive trade practices under the regime of the MFA (1974-94). Whilst the MFA was intended to provide only “temporary” protection to producers in industrialized economies, in practice it became institutionalized through four successive phases: MFA-I (1974-77), MFA-II (1978-81), MFA-III (1982-86) and MFA-IV (1986-94).

Gradually many importing countries left the MFA (including Sweden, Switzerland, and Australia among them). By 1994, MFA members consisted of the US, EU, Canada and Norway and some 30 developing exporting countries with a total of 1300 T&C bilateral import quotas. It was finally agreed at the Uruguay Round (UR) that the MFA would be brought within the principles governing trade in goods and would be phased out over a ten year period beginning 1995 and ending in 2004 via the Agreement on Textiles and Clothing (ATC). This meant that the T&C sector would then be fully integrated within WTO rules at the end of 2004 (or beginning of 2005).

The garment industry in Sri Lanka has also been subject to quota restrictions since 1974 when a comprehensive system of restricted trade in textiles and garments came into effect. Norway negotiated a bilateral textile agreement to restrict the export of certain items of garments to that country in 1974 and this agreement was followed by similar agreements with Sweden, the EEC, US, Canada and Finland. The most restrictive of the MFAs as far as Sri Lanka was concerned was MFA-III which brought about 30 new product items made

of cotton and wool under quota restrictions. These products typically had a low base and under the restrictions imposed were allowed only low growth rates.

Despite the limitations on the principle of free trade, the bilateral agreements under the MFA have guaranteed small developing countries like Sri Lanka a certain degree of accessibility to foreign markets. It can be argued that smaller producers with comparatively low and underdeveloped technology might not have had the same success in penetrating US and European markets under a fully competitive environment. Whilst a rapid end to the MFA would have been more favourable to the major developing country exporters, the agreed slower phase-out would not be unwelcome to smaller producers like Sri Lanka. In fact, unlike its Asian neighbours such as China, India and Pakistan, Sri Lanka was content to prolong the phase out programme in order to allow itself the necessary time to restructure the industry to meet the new challenges.

2.2 Domestic Policy Environment

The availability of MFA quotas to Sri Lanka also made it an attractive destination for producers of garments in countries that had neared their full quota utilization. Quota exhaustion in garment producing countries in East Asia in particular provided the impetus for them to relocate some of their production bases to Sri Lanka, bringing with them investment and related expertise. Nevertheless, it has to be borne in mind that availability of quotas alone would not have induced the relocation of firms if the country did not offer a conducive policy environment for foreign investment to take place. Despite the availability of quotas from the mid-1970s, the garments industry began its rapid take-off only after the implementation of economic reforms in 1977/78. Thus, there is little doubt that Sri Lanka's liberal economic conditions by the late 1970s played a significant role in encouraging industrial re-location of the garments sector to take place.

The garments industry benefited from trade and payments reforms and specific measures undertaken to promote export oriented industries. These included the dismantling of quantitative restrictions (QRs) and the introduction of a multi-band tariff structure that was lowered progressively; a significant devaluation of the currency and shift to a managed float and removal of foreign exchange restrictions; measures taken to encourage foreign direct investment (FDI) – including the establishment of Free Trade Zones (FTZs) and granting of general tax incentives, etc.¹ The investment promotion policy package offered included 100 per cent foreign ownership of investment projects, a 10 year tax holiday with complete tax exemption on remuneration of foreign personnel employed and on royalties and dividends of shareholders during that period, duty exemption on imported inputs, and unlimited access to foreign currency credit (at interest rates prevailing in international financial markets). Steps were also taken to enter into Investment Protection Agreements and Double Taxation Relief Agreements with the major investing countries. A Constitutional guarantee against nationalization of foreign assets without compensation was also provided for.

¹ The Board of Investment of Sri Lanka (BOI), which was earlier known as the Greater Colombo Economic Commission (GCEC) had its origin in 1978 and was reconstituted in 1992. The BOI is structured to function as a central facilitation point for local and foreign investors.

Thus, the policy reforms undertaken by the government together with the availability of abundant and cheap labour made Sri Lanka an attractive location for labour-intensive industries such as garments.

Despite persistent calls by garments producers for duty free imports of fabrics, the domestic textile industry continued to enjoy relatively high levels of tariff protection close to 35 per cent – albeit a significant decline from the pre-1977 import protection levels. Garments producers argued for zero duty on fabrics on the basis of bottlenecks and delays in clearing goods at the point of entry; low quality of local textiles that made it unsuitable for the export oriented garments industry; and significant leakages that were occurring from Board of Investment (BOI) enterprises.² Taking these concerns into consideration, the government reduced the import duty on textiles from 50 to 30 per cent in 1995 and further to zero per cent in 1997.

2.3. Rural Industrialization

Decentralization of manufacturing firms from FTZs to rural areas has been gaining increasing attention in policy formulations in Sri Lanka in recent years. Given the lopsided growth pattern resulted from post 1977 industrialization which was biased towards the Western province, rural communities were left out and marginalized from the main stream benefits of export-led growth. Policy makers having identified the inequity in distributional impact of growth, strategies were put forwarded and implemented in order to decentralize garment factories with primary objectives of reducing regional poverty, countering urban migration, combating economic dualism and reducing regional imbalances of unemployment levels. For instance a policy of declaring the whole country as an export processing zone was introduced in 1992; a key feature of this was the launch of the 200 garment factory programme (200 GFP) was launched (PEFDA, 1998)

In 1990, a Cabinet Sub-Committee recommended the establishment of garment factories in the more rural areas of Sri Lanka in the context of very high unemployment in the south of the country. The objective was to link the rural economy to the global market in garments. The programme was launched in early 1992 with the aim of setting up 200 garment factories. The major incentive for investors was the allocation of quotas, with the allocation being greater (and more valuable) the more isolated the site. Sites were classified under most-difficult, difficult and non-difficult. About 40 per cent of sites were classified as most-difficult, another 40 per cent as difficult and under 20 per cent as non-difficult. Besides the inducement of quotas, various other incentives were offered, including tax holidays and credits, duty-free provisions, and access to credit.³ In the early 1990s, there was a significant increase in the growth rate of garment exports related to this initiative.

Although exact numbers are not available, it was estimated that by 1994, 174 factories had been initiated within the 200 GFP (Edwards, 1996). Moreover, it is also evident that the

² Enterprises operating under the BOI were entitled to import fabric at zero-duty for garments to be exported.

³ The incentive package for the 200 GFP was considered to constitute excessive subsidies on exports by the US government, prompting the imposition of a countervailing duty on imports of garments from Sri Lanka in October 1993.

200 GFP has gone beyond its initial objective of generation of substantial employment opportunities for communities in rural areas towards social mobilization. Large scale manufacturing firms have taken on such initiatives as part of their corporate social responsibility and carried out several projects in order to deliver maximum social benefits to rural communities and uplift their social welfare by initiating social infrastructure projects. Box 1 sets out one explicit example of garment factories as enumerated through field surveys which have been successful in setting up of production facilities as well other social services in rural areas.

Box 1
Brandix Lanka Limited

Brandix Lanka Limited is the single largest exporter of apparels in Sri Lanka for the last four years with an annual turn over exceeding US\$ 250 million. Brandix Lanka provides 18,500 direct employment opportunities and equivalent number of indirect employment opportunities. The company has set up over 20 manufacturing factories and strategically located sourcing offices in different parts of Sri Lanka with some of these in remote rural areas. Therefore, the company's factories have contributed towards the Sri Lankan economy by providing livelihood strategies for thousands of rural workers and thereby increasing income generation capacity and living standards of people living in rural areas and making positive distributional impact emanating from export led industrialization.

It has contributed to increase the local value addition of manufactured garments through the supply of raw materials and other inputs where it has been estimated that over 50 per cent of value addition in garments is provided through backward linkages. Besides, the company has taken its social responsibility by undertaking several community infrastructure projects in rural areas with an intention of distributing benefits of export-led growth among the poor and to better integrate them with the rural industrialization and thereby reducing poverty in rural areas. For instance, Brandix Lanka has carried out infrastructure projects such as Rajapakshapura, Desalination Plant and Water Treatment System, Giritala Tube Wells Project and Training Programme on Water Conservation and Management under the theme of "Water in Life" in order to improve the accessibility of clear water and thereby improving the welfare of rural populations.

Source: IPS Interviews.

Although the sentiment behind the 200 GFP was laudable, it has been criticized on a number of grounds. The programme was expected to add at least 40 per cent to garment exporting capacity in Sri Lanka at a time when quotas were already close to full utilization and expanding at a little over 6 per cent.⁴ The reallocation of quotas disrupted operations of existing exporters and created a backlog of problems for the industry. The rapid expansion of garment factories also stretched existing dearth of skilled manpower – particularly at supervisory or middle management level – available in the industry. It has been estimated that nearly 40 per cent of factories opened under the 200 GFP were opened

⁴ In the event, the addition to capacity has been estimated to be around 30 per cent (Edwards, 1996).

by exporters with no previous experience in the garment industry (Kelegama, 1994). This inevitably meant that the quality of production suffered as a result.

A notable outcome of this programme was, however, the decision to establish a minimum wage for garments workers. In addition, moral suasion was used on factory owners to provide a free meal (breakfast) for the workers which in turn also had an impact on many factories outside the GFP (Kelegama and Wijayasiri, 2004).

In line with the underlying concept of the 200 GFP, the Government of Sri Lanka (GOSL) has recently initiated a similar proposal called the 300 factory programme with the intention of encouraging the establishment of manufacturing bases in areas outside the main Western Province of the country. The key objectives are to promote decentralization of firms and rural industrialization. However, the proposed programme has been gaining less attention of manufacturers due to the limited incentives put forward so far. As highlighted by manufacturers interviewed, the government needs to consider the cost associated with poor infrastructure facilities, in particular road networks, power and water in rural areas and compensate potential movers accordingly by providing generous incentives i.e., a similar package that is already given to encourage establishment of new firms in FTZs. Those interviewed believe that the effectiveness of the programme as well as the responses of the garment industry will depend entirely on the final package of concessions given to potential manufacturers. However, as some pointed out, setting up of new production houses in rural areas depends not only on the incentive packages but also on the potential international and domestic market, which will ultimately ensure a continuing demand for their products .

3. Structure of the Garments Industry in Sri Lanka

The garments industry in Sri Lanka had its origins in the mid-1960s on a very modest scale, run primarily by the private sector with almost all of the garments produced for the domestic market. There were hardly any exports during this period with a large share of the industry in the hands of few companies. Since the importation of fabrics was either banned or restricted, the garment industry was mainly fed by locally produced textiles. Manufacturing for export began in the mid-1970s with about 5-6 factories in operation; by 1977, export earnings recorded stood at only about US\$ 10 million.

Available data suggest that there are currently about 860-890 firms in operation in the garment industry. Of these factories, around 80 per cent are categorized as small and medium according to the value of exports. Even if the distribution of firms is looked at in terms of number of employees, 80 per cent of establishments fall within the category of small and medium. These, however, account for less than 30 per cent of total export earnings. The bulk of revenue (70 per cent) is generated by the remaining 12 per cent of exporters. In fact, it is estimated that 25 garments manufacturers in Sri Lanka account for 52 per cent of total garment export earnings (Kelegama and Wijayasiri, 2004).

Table 1: Distribution of Factories

Category	By Export Value ^a			By Number of Employees ^b	
	Range (Rs mn)	No. of Exporters	Export Value (Rs mn)	Range (No. of Employees)	No. of Factories

Small	0.25-100	549	10335	0-100	282
Medium	101-500	204	48936	100-500	445
Large	Over 500	106	149362	501-1000	131
Extra large				Over 1000	33
Total		859	208362		891

Source: Kelegama and Wijayasiri (2004); UNIDO (2000).

In terms of the geographical distribution of firms within the country, over 70 per cent are found to be concentrated in the Western Province. This is not surprising given the establishment of Sri Lanka's first and largest FTZ within the Province and the superior infrastructure that is available within the Western Province (including access to the international airport and major port) relative to the rest of the country.

Sri Lanka's garments industry is heavily export-oriented. It is estimated that nearly 95 per cent of industrial production is exported and the local market plays only a very minor role (UNIDO, 2000). Given that the industry has been heavily dependent on the quota system from the initial take-off, most enterprises have, therefore, been oriented towards job processing for overseas customers.

4. Contribution of Garments Industry to the Sri Lankan Economy

The rapid expansion of the garments export sector is demonstrated by the figures in Table 1. The rate of export earnings growth recorded during the period 1980-90 was exceptionally high at over 20 per cent per annum, given that the industry for the most part was starting from a very low base. In the 1990s, export earnings growth decelerated somewhat, but still remained well above that recorded for total export earnings.

Table 2: Garments Industry in Sri Lanka: Selected Indicators

			1980-1990	1990-2000	2000-2004
GDP Growth	%		4.4	5.3	3.9
Export Growth	%		7.5	12.6	5.2
Garments Export Growth	%		19.6	18.0	4.5
		1980	1990	2000	2004
Garments/Total Exports	%	10.4	32.8	49.1	46.0
Garments/Manufacturing	%	30.3	58.5	63.3	58.8
Establishments in Garments	No	142	678	891	1061
Cumulative FDI in Garments	US\$ mn.	36	108	158	158
Employment by Garments Industry	'000	102	250	227	330

Source: Central Bank of Sri Lanka, Annual Report, various issues; Kelegama and Wijayasiri (2004).

As a result, there has also been a marked change in the composition of Sri Lanka's exports. The share of the traditional tree crop sector in total export earnings has continued to decline, while that of industrial exports have been rising. The share of exports of the industrial sector, which accounted for just 15 per cent of total export earnings in 1978, had come to account for more than 75 per cent of total exports by the mid-1990s. Garment exports had come to account for more than a half of Sri Lanka's export earnings by the mid-1990s (having accounted for a negligible share of under 4 per cent at the beginning of the liberalization period).

4.1 Garments Industry as a Source of FDI

FDI can be an important source to promote export expansion and economic growth. In the immediate aftermath of the reform programme, FDI inflows to Sri Lanka expanded significantly – albeit from a relatively low base – particularly in the manufacturing sector. The establishment of FTZs that provided superior infrastructure facilities to investors was also a contributory factor.⁵

Studies carried out using unpublished firm level export data to assess the role of foreign capital participation in manufactured exports in Sri Lanka have found a strong positive correlation. According to a study by Athukorala (1986), manufactured exports by firms with foreign capital participation increased by 244 per cent between 1979 and 1982, compared with an increase of 163 per cent between 1977 and 1979. In both periods firms with FDI achieved higher growth rates of exports than those achieved by fully locally owned manufacturing firms. Thus nearly 57 per cent of the total manufacturing export increment between 1979 and 1982 is attributed to firms with foreign capital participation.

Table 3: Role of Firms with Foreign Investment in Manufactured Exports

Growth (%)	1977-79	1979-82	1983-89
Exports by Firms with FDI	162.6	243.6	n.a.
Exports by Fully Locally Owned Firms	151.7	132.6	n.a.
Contribution (%) to Export Increment			
Firms with FDI	35.5	56.7	61.5
Fully Locally Owned Firms	64.5	43.3	38.5

Source: Athukorala (1986) for 1977-82; Kelegama (1992) for 1983-89.

Kelegama (1992) has estimated that the contribution of firms with FDI to the total manufactured export increment between 1983-89 was over 60 per cent. The corresponding figure for fully locally owned firms has been less than 40 per cent. Clearly even the very small inflow of FDI that Sri Lanka attracted in the immediate post reform period – of around 1 per cent of GDP per annum – contributed substantially to the growth of

⁵ The share of exports from FTZs in total industrial exports rose swiftly from 9 per cent in 1979 to around 40 per cent by 1990. Textiles and garments exports from FTZ enterprises had come to account for 40 per cent of total exports of this category in the same period.

manufactured exports from 1977. In terms of its share of total manufactured exports, exports by foreign firms with FDI are estimated to have increased from 24 per cent in 1977 to 46 per cent in 1982 (Athukorala, 1986). In 1989, this share was estimated to be around 55 per cent (Kelegama, 1992).

FDI has the advantage of introducing management skills and access to foreign markets. The rapid expansion of East Asian garments exporters operating from Sri Lanka – with already established foreign markets – was a key contributor to the expanding role of FDI related manufactured exports from the country. As previously mentioned, the initial expansion of the garments industry in Sri Lanka was driven by the inflow of FDI into the sector. At the commencement of economic reforms in 1977, the manufacturing sector was host to a total of 70 foreign firms. This total increased significantly in the post-reform period with much of the expansion originating in the garments industry (Table 3). The early surge of FDI came primarily from the traditional East Asian garment producing countries; FDI inflows into the industry were predominantly from Hong Kong and South Korea. In fact, it has been estimated that foreign investors own nearly 50 per cent of total garments factories and account for 90 per cent of total textiles and garments exports from Sri Lanka (USITC, 2004).⁶

Table 4: Sectoral Distribution of Enterprises and Investment: 1990

Industrial Category	Projects in Operation	Cumulative Investment at end 1990 (Rs mn)	
		Foreign	Local
Food, beverages & tobacco	6	2.38	0.05
Textile, garments, footwear	57	68.93	6.53
Textiles	3	24.65	0.15
Garments	44	35.25	5.30
Wood & paper products	7	1.93	1.60
Chemical, rubber & plastics	27	42.93	2.73
Non-metallic mineral products	9	5.73	3.83
Fabricated metal products	24	10.38	1.03
Other manufactures	35	5.13	0.83
Total	165	137.35	16.58

Source: Ministry of Finance, *Public Investment 1989-93*.

Sri Lanka's garments sector, however, is highly import dependent for its inputs. The industry had a value added to output ratio of only 25 per cent in the early 1980s – a low value added component essentially limits 'deepening' of the industrial structure. Although this figure had improved somewhat to stand at 30-35 per cent by the end of the 1990s, the overwhelming dominance of this sector in industrial production has continued to raise concerns about the need for Sri Lanka to diversify its industrial export structure.

⁶ However, this figure is subject to debate. According to the Sri Lanka Apparel Exporters Association (SLAEA), local industrialists are estimated to own about 85 per cent of garment factories (Kelegama and Wijayasiri, 2004).

4.2 Employment Generation in the Garments Industry

One of the key positive impacts of the emergence of the export oriented garments industry in Sri Lanka was that it was to provide an important source of employment, particularly for the rural economy. In fact, it has emerged as the largest industrial employer in Sri Lanka. The industrial sector accounts for about 20 per cent of total employment in the country with manufacturing taking the largest share of 16 per cent. Direct employment in the garments industry – estimated at around 330,000 – accounts for around 30 per cent of total manufacturing employment in the country. It is estimated that the largest employers are the large manufacturers accounting for just over 51 per cent of the total employed, while the small and medium factories account for the remaining 16 and 33 per cent, respectively (SLAEA, 2002).

Table 5: Garments Industry: Gender Composition by Occupational Categories (1998)

Grade	Occupational Category	Total	Male (%)	Female (%)
Management grade	Senior managers	2120	84	16
	Middle level managers	3229	62	38
	Front line managers	6739	28	72
Technical grade	Quality assurance managers	454	52	48
	Cutting managers	391	90	10
	Quality controllers	2950	28	72
	Pattern makers	645	50	50
	Merchandisers	824	50	50
	Work study officers	581	64	36
	Designers	128	50	50
	Operative grade	Mechanics	3041	99
Operators		124444	6	94
Helpers		69255	9	91
Checkers		21572	7	93
Line leaders		3207	11	89
Cutters		2585	68	32
Ironers		6919	30	70
Others		7905	30	70
Total		257026	13	87

Source: Kelegama and Wijayasiri (2004).

As with other comparable countries engaged in the garments under similar conditions, the work force is overwhelmingly dominated by female labour (Table 5). However, while nearly 90 per cent of the work force in the garments industry was female labour, the overwhelming majority are to be found in the less skilled categories.

Table 6: Employment in Garments Enterprises by Skills and Size

	Large Enterprises	%	SME	%	Total
Unskilled	16605	30.9	7153	24.7	23758
Skilled	29381	54.7	19199	66.4	48580
Technicians	1866	3.5	396	1.4	2262
Supervisors	3313	6.2	939	3.3	4252
Engineer/designer	91		97		188
Middle manager	1060	4.7	732	4.2	1792
Senior manager	348		322		670
Sales/marketing	1090		95		1185
Total	53754	100.0	28933	100.0	82687

Source: UNIDO (2000)

A survey of garments enterprises has found that the large enterprises (by number of employees) have a higher percentage of unskilled workers than the small and medium sized firms (Table 6). The relatively limited representation of technicians and supervisors in the small and medium sized firms can have an adverse impact on productivity and quality.

Table 7: Geographical Distribution of Garments Establishment and Number of Employees (1999)

Province	Establishment		Employment	
	Number	Percentage	Number	Percentage
Western	638	72	181329	65
Southern	51	6	19488	7
Central	54	6	17056	6
Eastern	8	1	3512	1
North Western	60	7	22398	8
North Central	21	2	10426	5
Uva	20	2	6559	2
Sabaragamuwa	36	4	15419	6
Northern	3	-	634	-
Total	891	100	276821	100

Source: Kelegama and Wijayasiri (2004).

The geographic distribution of employment is closely aligned to the concentration of factories across the country. It is estimated that around 65 per cent of the total employed in the garments industry are to be found within the Western Province. However, this does not necessarily mean that the major beneficiaries in terms of employment in the garments industry were confined to the Western Province. Much of the work force has been drawn not from the vicinity of factories but from areas outside as evidence by the necessity for most factory owners to provide suitable hostel accommodation for workers in the garments industry. Employment in the garments industry has been found to be an important source of

rural income in the post-liberalization period (Dunham and Edwards, 1997).⁷ Most critically, the garments industry provided employment opportunities for young, unskilled females who were previously for the most part not considered to be part of the labour force (i.e., actively not seeking or available for employment). For example, it is estimated that the expansion of the female labour force during 1981-1985/86 stood at 10.6 per cent compared to a rate of only 0.9 per cent during 1971-81. The corresponding expansion of the total labour force during the same periods are estimated at 3.8 and 1.2 per cent, respectively (Lakshman, 2004).

Similarly, the rate of expansion of female employment during 1981-85/86 was 15.6 per cent as against a rate of expansion of 0.7 per cent during 1971-81. The corresponding figures for the expansion of total employment during the same periods are 4.9 and 1.3 per cent, respectively (Lakshman, 2004). Therefore, there is clear indication that employment opportunities in the garments industry from the early 1980s have had a significant impact on patterns of female employment in Sri Lanka. In total, the female labour force participation rate increased substantially from 25.8 per cent in 1980 to 39.5 per cent by 1990 (Rodrigo, 2001).

Table 8: Selected Indicators of Female Labour Market Indicators

	Year	Total	Male	Female
Labour Force Participation Rate (%)	1980	46.5	66.8	25.8
	1990	53.3	67.4	39.5
Rate of Expansion of Labour Force (%)	1971-81	1.2	1.3	0.9
	1981-85/86	3.8	1.5	10.6
Rate of Expansion of Employment (%)	1971-81	1.3	1.4	0.7
	1981-85/86	4.9	2.1	15.6

Source: Lakshman (2004); Rodrigo (2001).

In a study by Ramanayake (1982) it was found that for the majority of female workers this was the first job with no previous employment experience in industry. In the same study, it was reported that only 19.8 per cent of female workers reported a previous income. The ratio of previous income to current income of the sample workers ranged between 0.19 and 0.92. The results of the study would, therefore, appear to indicate that there was very little competitive bidding away from similar industries. Nevertheless, there might well have been some bidding away from the rural and informal sector. The implication here is that the newly established FTZ firms have tended to draw their labour force from a special segment of previously non-wage earning female labour. It can, therefore, be argued that the average income generated per worker represents an economic gain in a country where unemployment is high and the marginal productivity of underemployed unskilled female labour is near zero in alternative employment.

⁷ In addition to income generated by migrant employment overseas, particularly in the Middle East and employment in the armed forces subsequent to the escalation of Sri Lanka's internal conflict from 1983.

Nevertheless, field interviews suggest that the decision of most of females to seek employment in export garment industry had been largely induced by their lack awareness of alternative employment opportunities available outside the industry. None of them, except a negligible proportion of the females interviewed, had been actively seeking employment outside the industry prior to entering the workforce of the garment industry (even though they are of the view that the number of job opportunities that are available and better suited to their qualifications is extremely limited). Therefore, the larger number of employment opportunities in the garment industry that emerged after 1977 is not the only the fact that has encouraged them to seek employment in that industry; lack of awareness and poor career guidance that they had received have also played a part in their decision to be employed in the export garment sector.

In a survey of 425 female workers in a sample of 27 factories in the FTZs, Rupasinghe (1985) found that 69.2 per cent were below the age of 24 years and that the majority had at least 10 years of education before they started working. It was found that 75 per cent of the respondents had sat the Ordinary Level Examinations while 10.5 per cent had also taken the Advanced Level Examinations. Therefore, the labour force would tend to have some basic skills when recruited. Nevertheless, given that BOI enterprises typically train their own workforce, it can be argued that such training can contribute in some measure towards the acquisition of new skills by the workforce.

Similarly, it was also reported in the same study that all the females interviewed were literate while the majority were primary school dropouts or secondary school leavers. Besides, all of them belonged to low income families and garment industry employment was their survival strategy to raise household income and be insured against income risk. The majority of female workers interviewed had been willing to move out of their homes to be employed in the factories set up in the Western Province, but were not willing to work in garment factories in their home villages partly due to the negative perception of the attitudes of villagers towards garment sector employments. On the other hand, some of those who are married had indicated a preference to work in rural garment factories that are near to their homes, if they could find the same employment in their villages.

Furthermore, it was found that most of females had joined the industry with the main intention of improving their own living standards as well as of their dependents. They had also been persuaded by reasons such as self improvement and the idea of economic independence. In addition to above reasons, unmarried females sought employment in order to accumulate savings both in monetary and non monetary terms to facilitate their marriages. Most of them had no intention of continuing to work after marriage as they do not wish to continue their work as a machine operator due largely to the long working hours and harsh working conditions. Workers in some factories surveyed have found the work to be monotonous and tiring schedules and had expressed a desire to change their employment if they were able to find alternative income sources. Nevertheless, a majority had expressed pessimistic views on the probability of having another source of income opportunity outside the industry. This again partly reflects their lack awareness of labour market trends and requirements and the availability of relatively more attractive

employment opportunities outside the export garment industry that are less stressful in nature.

In most factories, wages are relatively low and accompanied by poor incentive payment structures that are not based on productivity levels. Nevertheless, wages are set always above the minimum standards and according to the labour legislations in the country. It was mentioned in the study by Jayaweera (2004) that more than 90 per cent received cash benefits which is above the poverty line. However, as wages are low, longer working hours and overtime work are required to maintain a decent living. As such, many workers have found it difficult to maintain healthy lives and have been often subject to occupational health hazards.

Field interviews found that salary scales and working conditions vary widely across industries but tend to converge within the FTZs in the country in order to prevent labour mobilization within the zone. Larger garment industries pay relatively more attractive remuneration package with better working conditions and other related services. Workers attached to the small scale sector on the other hand receive poorly structured payment systems. According to the stakeholder interviews, it was reported that workers employed in factories based in Colombo on the whole and in the FTZs in particular, are paid relatively higher wages than their counterparts in rural based factories.

Factories operating under the same ownership also practice two different salary structures for rural and urban factory workers as a cost minimizing method. High costs associated with poor infrastructure facilities inherent in rural areas has increased the production cost and thereby reduced the wages of workers. However, all the establishments provide at least minimum standards of facilities and amenities largely as a result of the interventions made by the government to set conditions for entrepreneurs at the inception of their set up (Jayaweera, 2005). Therefore, it is reasonable to conclude that new income earning opportunities emerging in the garment industry have ensured income security of those who are employed to a certain extent and providing a survival strategy.

Despite the benefits of employment opportunities created by the garments industry, there have also been some adverse socio-economic problems for the work force. Working conditions, particularly in some of the small and medium enterprises have been subject to criticism (Kelegama and Epaarachchi, 2004). Living conditions, too, have come up for criticism where available accommodation for workers has been found to be of poor quality (CENWOR, 2001).

Table 9: Transport and Hostel Facilities Provided for Garment Workers

Facilities Provided	Large Scale Producers	Middle Grade Producers	Small Scale Operators
Transport	Provided.	Limited availability	Not provided
Hostel	Around 99% of workers in hostels.	Around 80% of workers come from	Around 95% come from own

Some provided by factories.	private boarding places. Some 20% of workers travel from distances of 20-40 km radius. No hostels provided by factories.	residences. No hostel facilities provided by factories.
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Source: Adapted from Kelegama and Epaarachchi (2004).

Rent payments can constitute a significant proportion of workers salaries. A combination of congested living conditions and socio-economic stigma attached to being a 'factory worker' has increasingly led to a reluctance to seek employment in the garments industry, particularly those located in FTZs. Since mid-2000, there has reportedly being vacancies in the region of 12,000-18,000 in the industry, particularly in the FTZs of the Western Province.

Furthermore, it is said that even though the industry provided significant employment opportunities for females in the labour force, opportunities for upward mobilization of labour, particularly at machine operator level is extremely limited or almost non existent. Even though low skilled workers are provided short term training programmes and large factories provide salary increments, it was obvious that female career development has been trapped at low level employment categories whereas male workers have more opportunities for upward mobility and access to upper or middle level employment categories (Jayaweera, 2005).

5. MFA Phase-out and Future Challenges for the Garments Industry

For Sri Lanka, the removal of quotas under the ATC in 2005 is likely to pose many challenges for the industry and for the economy as a whole in the future. The garments industry in Sri Lanka is characterized by both product and market concentration making it more vulnerable to the pressures of heightened global competition in a quota-free environment. The majority of Sri Lanka's total export earnings from garments are concentrated in casual wear for women and men. The vast majority of its quota exports are standardized low or medium priced items, requiring relatively low technology and based on low priced labour where market entry is easiest (Weerakoon and Wijayasiri, 2000). Sri Lanka was subject to quotas under approximately 50 categories in the US market, and 4 categories in relation to the EU. Nearly 90 per cent of total garment exports to the USA consisted of quota items by the late 1990s. In the case of total garment exports to the EU, however, only around 25 per cent were quota items. For total garment exports, it is estimated that approximately 65 per cent of the total volume of garment exports were quota items in the late 1990s. With its overwhelming dependence on quota exports, Sri Lanka's ability to maintain and expand on its market share in a quota-free environment, competing with large-scale, low cost suppliers, is subject to concern.

With the imminent phase out of the MFA, Sri Lanka sought relief for its industry through engagements in various trade initiatives. One of the key initiatives that Sri Lanka like many other small garment exporters has benefited from is gaining preferential market access to

the EU. Sri Lanka's garments industry was provided quota free entry to the EU with effect from 2001, but still continued to face an average duty of 12 per cent. In 2004, Sri Lanka became eligible for the labour incentive of the Generalized System of Preferences (GSP) scheme of the EU, which provided 40 per cent duty concession for Ready Made Garments (RMGs). Given the significance of the apparel sector in Sri Lanka's total export composition, the government called for more duty preferences to effectively compete in the EU market (Kelegama, 2005). As a result, Sri Lanka has since qualified for the GSP-Plus scheme with duty free entry into EU market from July 2005, conditional on several criteria with the rules of origin (ROO) being the most important among others.

It has been argued that utilization of the GSP scheme has been limited due to the existing ROO restrictions even with the use of SAARC country inputs in the production process under the Regional Cumulative Criteria. As a result, Sri Lanka has been able to use only 32 per cent of GSP quota for 'apparel knitted and crocheted' (Chapter No 61) and 11 per cent for 'apparel not knitted and crocheted' (Chapter 62) in 2002 (Kelegama, 2005). Therefore, Sri Lanka is pursuing the idea of gaining Super Regional Cumulative Criteria for the GSP scheme to include SAARC and the ASEAN.

In an earlier study by Kelegama and Epaarachchi (2004), it was mentioned that 50 per cent of the industry would be forced to closed down under the phasing out of MFA given the industry's heavy dependence of garment exports on quota based items (60 per cent of total) and the production of the larger majority of SMEs (80 per cent) are not based on demand driven supply mechanism. The main factor that can be attributed to sudden downfall of the industry is the low productivity associated with poor working conditions, poor incentive structures, labour turnover and absenteeism, inadequate training, strained employee-employer dialogue, restrictive labour regulations, low investment in technology, slow turn-around time, low garment factory standardization and lack of professionalism in the industry (Kelegama and Epaarachchi, 2004). Also, highlighting the likely impacts of removal of quota system, the study further mentions that there may be some unemployment in the short run whereas some unemployed will be absorbed into the remaining establishments in the industry in the medium and long run.

It was evident from the discussions with a range of garment manufacturers that the larger firms in the industry have resources to improve their competitiveness and face the challenge of exposure to MFA phase out situation as they are financially steady and equipped with skilled man power to shape their industry to meet global trends. Most believe that the removal of quotas is a new challenge as well as an opportunity for the local garment industry to keep up with external markets and obtain benefits from international linkages. In contrast, the small and medium scale garment manufacturers who have not been able to create direct supply links with overseas buyers during the last couple of decades have become increasingly vulnerable largely due to their small scale production, low profit margins and limited financial viability. As highlighted by some of the big exporters, the one and only option that small industries have is to rely on to merge with large companies or to be sub-contractors for large companies for their survival in the industry. According to them, small scale industries must have a bigger base to compete with similar and low priced exports of other countries. Some of the several small scale

manufacturers mentioned that the number of employment opportunities in their establishments has been drastically reduced in recent years as small players do not have resources to cope with rising costs of labour which has become a potential threat to their products in competing with low price and high quality products in external markets. Besides, low productivity of small scale industries also has significant implications for their existence in the industry.

Even though the Sri Lankan economy is faced with a high incidence of unemployment among young school leavers over the past several decades, the major constraint highlighted by almost all the stakeholders in the field interviews is the scarcity of labour. Small and medium scale industries are particularly vulnerable to shortage of skilled labour where the provision of training programmes for new entrants is an additional cost to them in a highly competitive environment. Large export manufacturers interviewed also face severe shortage of labour, even at sewing operator level. According to them, even though they are willing to train unskilled workers and provide stable employment opportunities for them subsequently, export garment industry at present has become unattractive to young school leavers as alternative income opportunities with relatively high social status are emerging elsewhere.

In addition, high labour turnover and absenteeism are yet other issues attributed by many stakeholders to recent downfall of productivity in the industry on the whole. Young female workers have a tendency to leave the industry after a short period of time largely due to long working hours, harsh working conditions and schedules, uncomfortable and low quality living arrangements. As mentioned in the study by Kelegama and Epaarachchi (2005), the garment industry has recorded annual turnover rates of around 55 per cent per annum, with the highest rate of 60 per cent being recorded by factories in the Western Province. This has been further induced by other social and individual factors such as family commitments, marriage and low social status, etc. Losing a skilled worker is an additional cost to a firm because replacement of workers for similar tasks needs time to acquire the required level of skills. Meantime, overtime wages which are higher than the normal wages have to be paid to existing skilled workers in order to meet tight deadlines. Therefore, absenteeism and turnover put additional burdens on resource strapped firms. As conceded by leading domestic garment manufacturers, Sri Lanka may already have lost virtually the ultimate advantage on labour costs. Even by the mid-1990s, labour costs in Sri Lanka were much higher than in neighbouring countries such as India, Pakistan, China, Vietnam and Bangladesh (Fonseka and Fonseka, 1998).

The problem of product concentration is compounded by market concentration. Sri Lanka's major market for garment exports is the US. From exporting nearly 55 per cent of all garments exports to the US in 1980, the ratio had increased to nearly 65 per cent by the late 1980s.⁸ The other major market is Europe, which continued to account for nearly a quarter of Sri Lanka's total apparel exports for much of the 1980s, increasing its share to over 30 per cent over the same period (Weerakoon and Wijayasiri, 2000).

⁸ In terms of Sri Lanka's total exports, the US accounts for nearly 40 per cent of all exports, while the EU absorbs a further 20 per cent.

The lack of a fabric base is also seen as a potential weakening factor in Sri Lanka's competitive position vis-à-vis its main competitors in Asia. It is estimated that 80-90 per cent of fabrics and 70-90 per cent of other accessories required for the garment export industry are imported (Kelegama and Foley, 1999). Since fabrics amount to 65-70 per cent of the value of finished products, the lack of backward linkages from the garment industry continues to be a source of concern regarding the future competitiveness of the industry. Improving backward linkages is largely inhibited by the fact that Sri Lanka does not produce the raw materials – such as cotton and raw materials to make synthetic fibres – used in the production of fabric and some accessories. It was apparent from field interviews that almost all the garment exporters prefer local purchases than imported raw materials if they are in line with the quality standards required by the garment industry and available at competitive prices. As some of the leading garment exporters interviewed in the survey mentioned, development of backward linkages has been poor largely due to the high cost of investments required to set up a domestic raw material base in a relatively small domestic market. Sri Lanka is thus at a disadvantage vis-à-vis competitors such as China and India which are well supported by backward integrated industries. Besides, high import dependence on raw materials has also resulted in longer lead time, which in turn adversely affects the competitiveness of the industry. Capital costs in fabric production are significantly higher than in garment production – constraining the extent to which comparative advantage in low labour costs can be translated into a competitive advantage in terms of output price – and placing domestic entrepreneurs at a disadvantage.

Other more serious constraints faced by most garment manufacturers is the increasing cost resulting from poor infrastructure, in particular telecommunication, power, water and road networks. Manufacturing firms in the industry are not currently provided any concessions for electricity and water, which constitute significant magnitude of the total cost. The problem is particularly severe for factories operating outside and far away from Colombo. As revealed by many stakeholders, cost associated with infrastructure has limited the potential of small and medium scale industries to earn an attractive return on investment and to enhance competitiveness. Also discussions with manufacturers found that garment industries operating within the premises of FTZs are also not provided such infrastructure facilities at concessionary rates.

Furthermore, limited access to finance in terms of medium to long term loans, short term financing facilities and other banking facilities has impeded the ability of some of small scales manufactures to expand their operations or establishment of new ventures. Yet, lack of access to finance is not a major constraint attributed by most of the manufacturing firms for loss of competitiveness and limited capacity of their scales of production and expressed satisfaction with the existing provisions of financial arrangements in the country.

According to the available data as well as stakeholder interviews, the garment industry in Sri Lanka is not faced with the issue of technological up-gradation as the industry on the whole has managed to invest in the latest technologies which are equivalent to those used by other competitors in the region. Also Sri Lanka has created a reputation for its supply of good quality garments, reliability of supply and relatively low prices of products. As such, educated and literate work force will contribute enormously to the future success of the

industry. Therefore, the need is to invest in training and human resource development rather than physical capital to enhance productivity of the sector because the competitiveness of the industry to face the challenge of removal of MFA has been largely affected by low level of skills and productivity of the workers. Scarcity of skilled workers such as pattern makers, technologists, fabric technicians is a main weakness of the industry. Therefore, it has been suggested by the industry leaders that Sri Lankan export garment industry needs to focus on development of specific product categories and specific customers, which are critical in order to survive in the world export market (JAAF, 2005).

Even though there are 189 vocational training centres located across the country, most of them are not equipped to provide apparel related training programmes. Proposals for vocational training centres have already been put forward to develop training curriculum according to the needs of the industry. These programmes are expected to produce skilled workers such as mechanics, cutters, pattern makers, supervisors, quality inspectors, machine operators and technicians according to the requirements of the industry.

One common complaint made by almost all the stakeholders interviewed was the sluggish manner of public sector institutions related to export and import trade in Sri Lanka. As mentioned, direct cost associated with wide spread bureaucratic practices such as rent seeking activities practised in key government institutions and indirect cost related to long delays, long procedural requirements, etc., have adversely affected the competitiveness of the sector, in particular the small sector entrepreneurs, who are not equipped with professionals to handle trade procedures and formalities related to international trade in Sri Lanka.

As was mentioned, even though the stakeholders attached to the apparel industry are not consulted individually in policy formulations, constraints and preferences of individual garment industries in recent times have been successfully represented by the Joint Apparel Association Forum (JAAF) which was established in 2002 as the apex body of all textile and apparel related associations in Sri Lanka in order to implement the strategic initiatives of the five year plan.⁹ JAAF has addressed specific concerns of SMEs to ensure their sustainability and made notable efforts to enhance resource constraints of those industries in order to enable them to be commercially and technically viable to survive in the industry after the phasing out of quotas. Programmes carried out focusing on SMEs included market development projects, marketing training programmes, international image building programmes, etc., and these programmes were aimed to provide competitive edge to these establishments. JAAF has been successful in lobbying the government to address the needs of the industry to a certain extent. Besides, JAAF acts as a facilitator as well as a negotiator and policymaker in development and promotion of trade relations related to the apparel sector in Sri Lanka at bilateral, regional or multilateral levels. For instance, as a result of significant lobbying by JAAF, Sri Lankan government initiated a case for a bilateral Free Trade Agreement (FTA) with USA (Kelegama, 2005).

⁹ To meet the challenges arising from MFA phase out a specially appointed Task Force on the Apparel Industry developed a “Five Year Strategic Plan” with the participation of all stakeholders - Industry, Government and Industry Associations

It is fairly obvious that in order to compete in the post-MFA phase, Sri Lanka's garments manufacturing industry needs to urgently address the issue of restructuring its operations to survive in the new trading environment. There is a degree of justifiable optimism that the larger manufacturing firms in the industry, which have by and large established direct links with overseas buyers, will be in a position to compete successfully in a quota free environment. Much of the concern regarding the future of the industry is largely a reflection of the perceived weaknesses of the majority of small sized firms operating in a quota 'protected' environment. Their ability to compete with large producers from countries such as China and India are highly questionable. Moreover, garment factories that received special treatment for establishing manufacturing units in rural areas will face considerable difficulties as quotas are withdrawn. In a highly competitive environment, access to ports and other infrastructure will become even more critical and factories located in rural areas will be disadvantaged.

6. Summary and Conclusion

The garments industry in Sri Lanka experienced a rapid expansion after 1977 due largely to the country's adoption of economic liberalization with the primary focus on encouraging export-led industries. The expansion of the industry was also assisted by the prevailing global trade environment in textiles and clothing under the MFA which provided guaranteed markets in the form of quota. As a result, Sri Lanka became an attractive destination for investments from quota hoping foreign manufacturers, particularly from East Asia. The rapid take-off of the industry, which was primarily triggered by external factors, was further facilitated by the conducive domestic policy environment which took place after 1977 with progressive tariff liberalization, removal of foreign exchange controls, removal of quantitative restrictions, incentives granted to attract foreign direct investment and other institutional arrangements. Decentralization of manufacturing firms, which were more concentrated in the Western Province during the first decade of liberalization, has been gaining increasing attention since early 1990s with the policy of rural industrialization. Subsequently, the garment industry today has become the single largest industrial employer in Sri Lanka and a significant contributor to foreign exchange earnings. As such, the industry has had considerable implications for the domestic economy through its direct impact on employment, export earnings, foreign direct investment as well as indirect impacts on infrastructure development.

One of the key impacts of the rapid expansion of garment industry was the generation of employment opportunities for large number of the labour force in Sri Lanka, in particular for young unskilled female unemployed, providing a survival strategy against income risk. The majority of female workers attached to the export garment industry are mainly unskilled and belong to low income segment of the country and therefore, the industry has made significant improvements in their living standards as well as of their dependents. Yet, despite the beneficial impacts of employment generation, the garment industry has also brought some adverse socio-economic problems for the work force in the form of harsh working conditions, poor living styles, occupational health hazards and low or non existent upward movement in career development.

The phasing out of quotas in 2005 is likely to hold significant implications for the industry. Despite divergences in views amongst garment sector stakeholders, it is generally accepted that the export garment industry on the whole will suffer with phasing out of MFA, with the SMEs in particular being more vulnerable to increased exposure to international competition. Even though the industry is basically equipped with necessary resources to cope with the challenge, the competitive strength of the export garment industry remains limited mainly due to the low productivity inherent in the industry as a result of several constraints faced by the industry in recent times such as severe shortage of labour at both skilled and unskilled levels, low garment factory standardization, low investments in technology, poor infrastructure facilities outside the Western Province, etc. Thus, restructuring and re-organization of the industry will be critical if the garment industry is to maintain its vital role in the Sri Lankan economy, both as a source of export earnings and more critically as an important source of industrial sector employment.

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Appendix 1: List of Names of Stakeholders : Garment Industry in Sri Lanka

Name	Designation /Position	Institution /Sector
1. Mr. T. G. Ariyaratne	Deputy Secretary General	Joint Apparel Association Forum (JAAF)
2. Mr. Channa Palansooriya	Managing Director/ Chairman	Orit Apparels Lanka (Pvt) Ltd
3. Mr. Mahesh Rodrigo	General Manager	Scan Lanka (International) Ltd
4. Mr. T.B.R.B. Tennakoon	Associate General Manager	Mandarin Knits Garments (Pvt) Ltd
5. Mr. Jagath Ranawaka	Merchandizing Manager	Gabo Apparels (Pvt) Ltd
6. Mr. Charaka Chandrasekera	Assistant Technical Manager	Courtaulds Clothing (Pvt) Ltd
7. Mr. Rohana Kalukapuge	Finishing Executive	Brandix Casual Wear (Pvt) Ltd
8. Mr. Tissa Gamage	Managing Director	Brilliant apparels (Pvt) Ltd
9. Mr. U.P.D. Lakshman	Management Accountant	Linea Intimo (Pvt) Ltd
10. Mr. Kapila Basnayake	Work study Manager	North Western Apparel (Pvt) Ltd
11. Mr. Indunil Pathiraja	Merchandiser	MAS Slimline (Pvt) Ltd
12. Ms. H.M. Wasanthi	Machine Operator	International Garments (Pvt) Ltd
13. Ms. Nalika Priyadarshani	Machine Operator	International Garments (Pvt) Ltd
14. Ms. Priyadarshani Jayasekera	Machine Operator	International Garments (Pvt) Ltd
15. Ms. Chandrika Basnayake	Machine Operator	International Garments (Pvt) Ltd
16. Ms. Ramya Basnayake	Machine Operator	International Garments (Pvt) Ltd
18. Ms. Sriyani Mallawarachchi	Machine Operator	Brandix Casual Wear (Pvt) Ltd
19. Ms. Rupa Disanayake	Helper- Washing Section	DNP Garments Lanka (Pvt) Ltd
20. Ms. L.R.M. Nandawathi	Machine Operator	Fashion Lanka (Pvt) Ltd