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# ASSESSING SRI LANKA'S ECONOMIC TRANSFORMATION PATHWAYS, 1977-2019

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## LIST OF ACRONYMS

ATC	Agreement on Textiles and Clothing
BOI	Board of Investment
CBSL	Central Bank of Sri Lanka
DCS	Department of Census and Statistics
EDB	Export Development Board
EPZ	Export Processing Zone
EU	European Union
FDI	foreign direct investment
FIAS	Foreign Investment Advisory Service
GCEC	Greater Colombo Economic Commission
GDP	gross domestic product
GFP	Garment Factories Programme
ICT/BPM	information and communications technology/business process management
ICTA	Information and Communication Technology Agency
ILO	International Labour Organization
IMF	International Monetary Fund
IT	information technology
ITC	US International Trade Commission
MFA	Multi-Fibre Arrangement
SLASSCOM	Sri Lanka Association of Software and Service Companies
SLTDA	Sri Lanka Tourism Development Authority
TFP	total factor productivity
UNCITRAL	United Nations Commission on International Trade Law
US	United States
WDI	World Development Indicators
WTTC	World Travel and Tourism Council

## EXECUTIVE SUMMARY

**This study analyses Sri Lanka's transformation pathways, particularly the country's shift from an agriculture-based society to a more industrial and services-based economy.** It undertakes a granular exploration of economic transformation at a sectoral level in Sri Lanka from the late 1970s to 2019. It focuses on the garment sector within the industrial sector, and two services sectors – the tourism sector and the information and communications technology/business process management (ICT/BPM) sector. The study adopts a common approach to analysing the transformation pathways of each sector over time by considering sectoral performance (including value addition, employment and exports), key triggers, enabling factors, policies and challenges. By looking at the long-term dynamics of specific sectors, it contributes to the literature on economic transformation in Sri Lanka.

**As the first country in South Asia to liberalise its economy to foreign trade and investment, Sri Lanka embarked on its economic transformation journey in 1977.** Over time, labour resources shifted from agriculture to manufacturing (particularly garments) and services activities, which coincided with an increase in total factor productivity in the country. By 2018, the industrial sector accounted for 28% of employment, services for 47% and agriculture for 26% (DCS, 2019a). Sri Lanka's services sector is the most significant contributor to total value-added (58% in 2018). Despite employing a similar amount of people, the agriculture sector's contribution to total value-added, at 7%, is much lower than that of the industrial sector (26%) (CBSL, 2019a), hinting at lower productivity in agriculture. Sri Lanka's economic transformation has been impeded by a long civil war, which ended in 2009, and more temporary external shocks like the 2004 Boxing Day tsunami and the Easter Sunday bombings in 2019.

**The more granular level reveals that labour resources have shifted increasingly to higher value-added sectors, such as ICT/BPM.** Noting a relative decline in value-added and exports, Sri Lanka's garment sector reached its peak in 2000 and developed into a mature, outward-oriented investor in other developing countries. That said, the sector still plays a key role in export earnings, remaining a major foreign exchange earner for Sri Lanka. Tourism and ICT/BPM services are emerging sectors, which have gained in relative importance over time. Tourism accounts for a significant share in total value-added and exports (see table). Growth in Sri Lanka's tourism sector picked up after the end of the civil conflict, displaying some resilience to external shocks like the tsunami and the Easter Sunday bombings. A newcomer, and operating below potential, the ICT/BPM sector has emerged slowly since 2000, with the potential to become a notable driver of economic transformation in services growth in Sri Lanka.

### Sectoral shares (2018)

	% of GDP	% of employment	% of exports
Garments	3.7*	9.5**	26.2
ICT/BPM	1.2*	1.6	4.9
Tourism	12.5	4.8	21.6

Notes: \* Refers to 2015; \*\* refers to 2017

Sources: Dheerasinghe (2009), CBSL (2018, 2020); DCS (2019b, 2020); ICTA (2019); SLTDA (2019b); IMF (2020), WTTC (2020)

**Sectoral transformations on a granular level have been driven by privatisation and liberalisation efforts alongside foreign direct investment (FDI) promotion initiatives, and have at times been supported by important private sector initiatives.** Sri Lanka's garment sector transformed on the back of the 1977 economic liberalisation and the opening of the sector to FDI. Sri Lanka's initial comparative advantage in cheap labour and access to global markets under the Multi-Fibre Arrangement led to FDI-induced technology and human capital transfer. Strong political leadership and key entrepreneurs furthered sectoral expansion, while the government's 200 Garment Factories Programme

supported rural industrialisation. Growth in Sri Lanka's tourism sector picked up significantly after the end of the civil war and the associated increase in political stability. Targeted government policies such as the Tourism Act (2005) and the Tourism Development Strategy (2011–2016) focused on formalising the sector, while at the same time attracting foreign capital. Successful marketing campaigns and growing international recognition aided sectoral expansion further. Sri Lanka's ICT/BPM sector emerged around the 2000s on the back of liberalisation efforts targeted at opening the domestic telecommunications sector. Sectoral growth has ever since been driven by coordinated efforts by both public and private sector agencies and aided by multinational organisations like the World Bank. The sector has further benefited from its international recognition as a high-quality but low-cost outsourcing destination for BPM. Key policies like the e-Sri Lanka initiative have bolstered sectoral expansion further.

## 1. INTRODUCTION

Sri Lanka is sometimes cited as an example of successful economic transformation and employment creation in South Asia. The trigger for economic transformation was the important shift in national economic strategy from import substitution industrialisation to an outward-oriented trade strategy in 1977 (Lal and Rajapathirana, 1989; White and Wignaraja, 1992). Sri Lanka was the first South Asian economy to liberalise its economy to trade and foreign direct investment (FDI), and its liberalisation experience was closely studied by its neighbours. Although a nearly 30-year civil conflict dating to 1983 held back the process of economic transformation, Sri Lanka did experience a shift away from domestic agriculture to industrial and services sector activities, accompanied by sectoral shifts in employment (Table 1).

**Table 1: Sectoral shifts in gross domestic product (GDP) and employment**

	% of GDP			% of employment		
	1981	2000	2018	1981	2000	2018
Agriculture	28.0	19.9	7.0	46.8	36.0	25.5
Industry	28.3	27.3	26.1	19.4	23.6	27.9
Services	43.8	52.8	57.7	30.7	40.3	46.6

Note: The 2018 GDP shares do not add up to 100% as a result of the exclusion of taxes less subsidies on products. The 1981 shares in total employment do not add up to 100% as a result of activities not being adequately specified.

Sources: DCS (1985, 2019a); CBSL (2019b); WDI (2020)

A shift away from import substitution to manufactured exports and services has taken place over time, with services gaining an increasingly important role from 2000 onwards (Table 2).

**Table 2: Sectoral shifts in exports (% in total exports)**

	1981	2000	2018
Goods	79.2	85.3	58.7
Services	20.8	14.7	41.3

Source: LKI calculations based on IMF (2020)

Until the beginning of the 2000s, the growth in manufactured exports was dominated by the garment sector, with services largely non-traded. In this vein, Sri Lanka did not emulate the case of successful industrialisation and economic transformation of the four East Asian 'dragon' economies (South Korea, Taiwan, Singapore and Hong Kong), which moved early from simple labour-intensive exports like garments to more complex capital- and technology-intensive exports like electronics (Wignaraja, 1998).

The emergence of higher-value-added sectors triggered an increase in total factor productivity (TFP). TFP increased steadily over time (University of Groningen, 2017), with sectors displaying varying levels of productivity increases. Value addition in the services sector (62%) and industrial sector (53%) increased significantly between 2010 and 2019,<sup>1</sup> while value addition in the agriculture sector was comparatively muted, at 26%. That said, labour productivity increased most substantially in the

<sup>1</sup> Pre-2010 data not available.

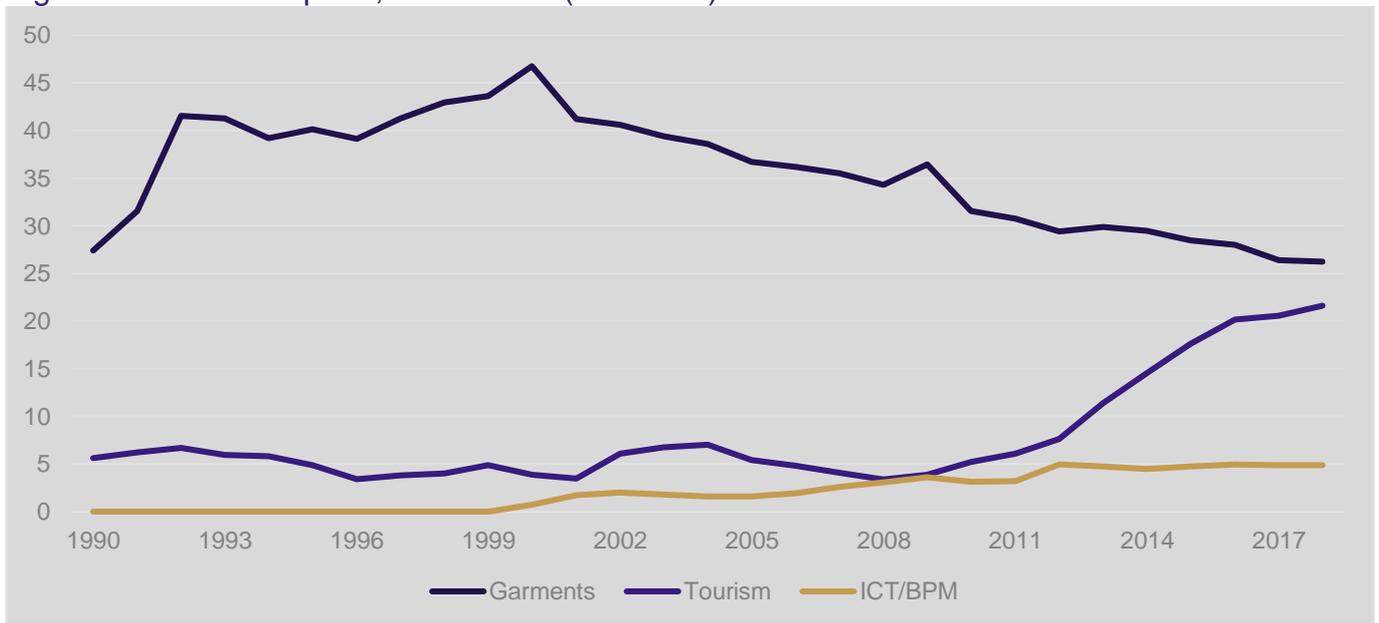
agriculture sector (54%), followed by services (40%) and industry (26%), hinting at recent technological progress in agriculture (Appendix A).

This paper explores Sri Lanka’s economic transformation pathways at a sectoral level from the late 1970s to 2019. It focuses on the garment sector, the tourism sector and the information and communication technology/business process management (ICT/BPM) sector. Transformation pathways are analysed over time by considering sectoral performance (including employment), key triggers, enabling factors and policies as well as remaining challenges. It draws on secondary data sources and insights provided by the Department of Census and Statistics (DCS). Transformation pathways are identified and analysed based on available time series export data from the 1990s onwards, supplemented with more sporadically available data on sectoral employment and value-added. This paper contributes to the scarce literature on long-run sector-level economic transformation in Sri Lanka.

The research revealed a general lack of granular sector-level time series data from the 1970s onwards, for several reasons:

1. Staggered emergence of sectors: The different entry points of certain sectors (such as the late entry of ICT/BPM) mean that certain sectoral data do not date back to the 1970s.
2. Historic lack of coherence in sectoral classifications: Sectoral classifications have been coherently implemented only since 2015, when DCS adopted the internationally recommended classification *International Standard of Industrial Classification* on economic activities (DCS, 2016). This change also led to new services activities (such as ‘information service activities’) being covered from 2015 onwards.
3. Rebasings of constant price estimates: Reference years for constant price estimates on sectoral value-added have changed over time (e.g. 1990, 1998, 2002 and 2010). Original data are not available, impeding the establishment of sectoral trends.

Figure 1: Sectoral exports, 1990–2017 (% of total)



Note: Information on tourism relates to balance of payments category ‘Travel’ as specified by IMF. Travel does not include passenger transport, as domestic and tourist travel cannot be unambiguously differentiated. The sector’s share in exports is therefore likely to be understated. Information on ICT/BPM relates to the ICT sector only. No information on BPM activities is available.

Source: LKI calculations based on IMF (2020)

Despite the above challenges, Sri Lanka’s transformative pathways are analysed based on export data and – where available – employment and value-added data. The research reveals that the three sectors differ in their stage of development and performance. Having been at the forefront of Sri Lanka’s export-led industrialisation for decades, garments have evolved into a mature industrial sector and an outward investor in other developing countries, with their share in exports having gradually declined (Figure 1).

The tourism sector – hamstrung by the 30-year civil conflict – has grown rapidly since the end of conflict in 2009 but has more recently faced political uncertainties in 2018 and the Easter bombings in 2019. The nascent ICT/BPM sector, which emerged in the early 2000s, offered the promise of catalysing the development of modern services in Sri Lanka but has been slow to realise its full potential. For an overview of the development of key economic variables on a sector level, refer to Appendix B.

The paper is set out as follows. Sections 2, 3 and 4 discuss the transformation pathways of garments, tourism and ICT/BPM. Section 5 concludes.

## 2. THE RISE AND INTERNATIONALISATION OF GARMENTS<sup>2</sup>

### 2.1. Background

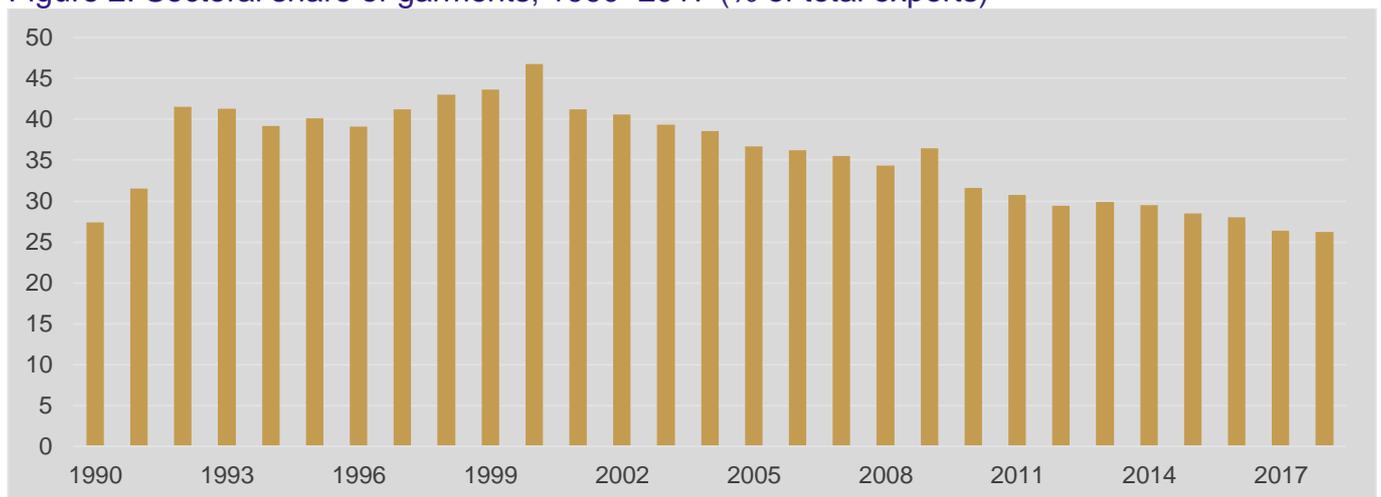
Sri Lanka's garment sector started up in the 1970s but quickly became the country's growth engine in the 1980s/1990s and remained the economy's industrial powerhouse for many decades, providing numerous jobs and important foreign exchange earnings. The garment sector spans the design, manufacture and export of clothing such as sportswear, lingerie, loungewear and bridal, work, swim and children's clothes. Sri Lanka's Export Development Board (EDB) lists leading international brands such as Abercrombie & Fitch, Land's End, Victoria's Secret, Next, Tommy Hilfiger and Nike, which are serviced by Sri Lanka's garment sector (EDB, n.d.). The industry accounts for 17% of all manufacturing value-added and 3.7% of total value-added (2015) (DCS, 2020).

In 1977, the sector's share in total exports stood at 1.9%, a figure that increased rapidly during the 1980s (IMF, 2020; UNCTAD, 1982). Garments' share in total exports rose to 26% in 1990 and reached its height in 2000, accounting for the largest share of Sri Lankan exports (47%). Employment has grown simultaneously to the sector's expansion. In 1979, 54,000 people worked in the industry, a number that had almost doubled in 1990 (102,000) and increased to 258,000 in 2001 (ITC, 1982; ILO, 2009).

From the beginning of the century, the sector continued growing in absolute terms. Sectoral value-added rose by 88% between 2002 and 2015, while exports increased by 99% during the same time. What is more, increasingly more people sought employment in the garment sector, with numbers increasing from around 258,000 (2001) to 565,000 (2015), accounting for 7.3% of total employment (ITC, 1982; Dheerasinghe, 2009; DCS, 2019c).

This said, the sector experienced a decline in relative economic contribution from the 2000s onwards, highlighting the growing importance of other sectors, such as tourism and ICT/BPM. The sector's share in total value-added declined from 4.4% in 2002 to 3.7% in 2015, while its share in total exports fell from 41% to 28% over the same timeframe (Figure 2).

Figure 2: Sectoral share of garments, 1990–2017 (% of total exports)



Sources: LKI calculations based on IMF (2020)

<sup>2</sup> Detailed sectoral time series data across indicators such as value-added and employment are not available, thus this section focuses mainly on more widely available export data.

Nevertheless, the sector continues to be one of the main drivers of the local economy, accounting for a significant share in economic activity and employment, and remains Sri Lanka's number one foreign exchange earner (SLTDA, 2019a). For more data on the development of Sri Lanka's garment sector, refer to Appendix C.

## 2.2. Enabling factors and challenges

The development of Sri Lanka's garment sector can be divided into three phases:

1. a period of economic liberalisation and export orientation up to 1990, triggering substantial sectoral expansion
2. a period of extensive government support and continued sectoral growth between 1990 and 2005
3. a period of consolidation and outward FDI orientation post-2005.

During the first two periods, several factors supported the rise of Sri Lanka's garment sector and are outlined below in more detail. Sri Lanka's opening of the economy in 1977 as well as export-oriented and development-centric policies triggered sectoral expansion. Sri Lanka's status as a developing country and preferential access to key markets like the EU and the US enabled large inflows of FDI and associated skills and technology transfer. Targeted government policies, which promoted the industrialisation of rural Sri Lanka, further aided sectoral growth. Since 2005, a series of factors, such as a decline in Sri Lanka's labour cost advantage and expiry of the country's preferential market access, have triggered a process of consolidation and led to an increasing outward orientation of Sri Lanka's garment sector.

### **1. A period of economic liberalisation and export orientation up to 1990, triggering substantial sectoral expansion**

This period was characterised by a flourishing garment sector, which benefited from the opening of the economy, a liberal FDI regime and international agreements, which protected Sri Lanka's garment sector from international competition, triggering substantial export growth. The share of garment exports increased from 7.2% in 1979 to 31.6% in 1990, and employment numbers rose from 54,000 to 102,000 (ITC, 1982; Dheerasinghe, 2009; ILO, 2009; IMF, 2020).

#### Export-oriented FDI

As a side bar issue, it is noteworthy that Sri Lanka pursued a gradual approach to economic liberalisation over several decades from 1977. While the Sri Lankan trade regime has been described as export-oriented, research has suggested that periodic import liberalisation efforts have only partially opened up the domestic manufacturing sector to import competition. Accordingly, the anti-export bias in the manufacturing sector was not eliminated even a decade after the 1977 reforms (Abeyratne, 1993).

Against a backdrop of a protected domestic manufacturing sector, the initial impetus for the growth of the garment sector and garment exports came from export-oriented FDI after the shift to an outward-oriented trade strategy in 1977. Unlike the rest of inward-oriented South Asia, Sri Lanka recognised early that export-oriented FDI could be an efficient means of transferring technologies, skills, capital and access to overseas markets. By encouraging the entry of export-oriented FDI, Sri Lanka sought to emulate the industrial success of the East Asian dragons.

An astute finance minister, Ronnie de Mel, opened the country's restrictive FDI regime by liberalising hitherto rigid foreign investment laws, creating the Greater Colombo Economic Commission (GCEC) in 1978 to manage export processing zones (EPZs) and incentives for export-oriented FDI. Between 1978 and 1991, three EPZs were set up in the Western Province in the vicinity of Colombo, where the port and airport infrastructure were most developed. The EPZs provided the following incentives for 100% export-oriented FDI projects: (i) tax holidays of five to fifteen years on profits and salaries of foreign employees; (ii) no import duties on imports of raw materials and machinery; (iii) exemption from foreign exchange regulations for repatriation of capital and profit remittances; (iv) relaxed labour laws; and (v) ready access to land and modern infrastructure within EPZs. Evaluations suggest that Sri Lanka's EPZs

and incentives were an effective tool to attract export-oriented FDI. A cost–benefit approach to estimate the returns to the national economy from Sri Lanka's EPZs between 1978 and 1983 found that the zones were economically efficient, with an economic rate of return of 23% (Jayanthakumaran and Weiss, 1997). According to the Foreign Investment Advisory Service (FIAS) (1993), Sri Lanka's FDI incentives were competitive with most Southeast Asian economies except Singapore. But, 'since Singapore and Sri Lanka are seeking quite different types of investment, the fact that Singapore's cost of capital is much lower is not important.'

#### Introduction of the Multi-Fibre Arrangement

While EPZ incentives mattered on the margin, the bilateral Multi-Fibre Arrangement (MFA) agreements made Sri Lanka particularly attractive for FDI interested in simple labour-intensive exports like garments. The MFA influenced Sri Lanka's garment exports between 1974 and 2005, when it expired. It was a system of export restrictions imposed by developed countries to protect the garment industry in developing countries. Bilateral agreements on the one hand imposed voluntary export restrictions on developing countries, to protect their domestic industries, and on the other hand granted import quotas to established markets such as the EU and US, allowing countries such as Sri Lanka to gain a foothold in developed markets (Kelegama, 2004).

#### Labour cost advantage

Sri Lanka's comparative advantage was relative cheap labour, which is important in garments, where labour typically makes up 15% of the total cost of production. Estimates of EPZ average hourly wage costs suggest that Sri Lanka – with hourly wage costs of \$0.13 for unskilled workers and \$0.19 for skilled workers – was one of the cheapest locations in Asia in the early 1980s (Jayanthakumaran and Weiss, 1997). Apart from being relatively cheap, Sri Lankan workers possessed other advantages, notably high levels of literacy, dexterity and reasonable labour productivity.

#### Skill and knowledge transfer through pioneers

The relocation of East Asian garment exporters to Sri Lanka stimulated local entrepreneurs to enter the production of garments for export markets guaranteed by MFA quotas and facilitated by cheap labour. The learning curve in garments for local firms was short-circuited through foreign investment, person-embodied technology and skills transfer from abroad. For instance, in 1985, Martin Trust – considered one of the pioneers in the development of 'speed-sourcing' for the US fashion retail sector – began working to modernise the garment sector in Sri Lanka (Daily Mirror, 2014). He invested in joint ventures that have led to some of the country's largest garment firms today, such as Brandix Lanka Ltd and MAS holdings. This anecdotal evidence about the role of foreign investors in the garment industry in Sri Lanka is confirmed by statistical analysis. Firm-level econometric analysis of the garment industry indicates that foreign ownership, firm size, human capital, technological capabilities and geographical location are all positively associated with export shares in Sri Lanka (Wignaraja, 2008). Furthermore, higher levels of technological capability are associated with larger firm size, university-level manpower and in-house technological effort.

## **2. A period of extensive government support and continued sectoral growth between 1990 and 2005**

During this period, Sri Lanka's garment sector continued its expansionary path – albeit at a slower pace – aided by targeted government initiatives and underutilisation of the MFA. The sector continued earning important foreign exchange and cemented its position as the single largest exporter in Sri Lanka. Sectoral share in total exports increased from 27% (1990) to 37% in 2005, and its share in manufacturing exports rose by 12 percentage points, to 46% (CBSL, 2019b; IMF, 2020). Employment numbers increased substantially, rising from 102,000 in 1990 to around 580,000 in 2006 (DCS, 2008; ILO, 2009).<sup>3</sup>

<sup>3</sup> No data available for 2005.

Underutilised export quotas

The MFA was succeeded in 1995 by the Uruguay Round Agreement on Textiles and Clothing (ATC), which implemented a gradual 10-year phasing-out of quotas. Sri Lanka did not exhaust its allocation of bilateral quotas with the US and EU – some 20–30% of its overall quota remained unutilised during the period 1995–2002 (Dheerasinghe, 2009). Garment exporters from East Asian countries approaching their quota limits were eager to move garment production into Sri Lanka to take advantage of the situation and gain access to major markets through guaranteed quotas.

The underutilisation of export quotas in Sri Lanka presented an interesting puzzle for research. Firms with some degree of foreign involvement in the form of foreign partners and buyers accounted for most of the export boom in Sri Lanka. Detailed enterprise studies show that, in some instances, foreign firms trained both workers and quality control personnel, and supplied equipment, product design and most current inputs (Lall and Wignaraja, 1995). However, Sri Lanka had not managed to move into higher quality products. Foreign firms, whether German or Italian, had transferred only the simplest stages of production, while keeping more skills-intensive ones in their home countries. Thus, the inability of Sri Lanka to upgrade into higher-quality products was probably a key reason for the underutilisation of export quotas.

200 Garment Factories Programme triggering sectoral expansion

Although the liberal FDI regime of the late 1970s remains in place even today, Sri Lanka began selectively intervening to promote the garment sector in the early 1990s. In 1992, President Ranasinghe Premadasa launched the 200 Garment Factories Programme (GFP), an attractive incentive package to encourage garment firms to move to rural areas. The target was to establish 200 factories exporting garments and employing 100,000 workers. This rural industrialisation programme was motivated by a desire to spread the economic benefits of an expanding garment sector beyond the Western Province and to provide jobs for unemployed rural youth following an abortive youth insurrection in 1988/89. As moving to rural areas inevitably entailed additional costs and challenges, foreign and local investors were enticed through an attractive combination of MFA quotas, tax incentives, cheap credit, infrastructure and streamlined bureaucratic procedures. The GFP was administered by a powerful Board of Investment (BOI) – as successor to the GCEC – as a one-stop shop for promoting and approving investment throughout Sri Lanka.

GFP spread the economic benefits of the garment sector beyond the Western Province by creating about 163 factories by 1995 in rural areas (Byiers et al., 2015). These factories brought notable benefits, including employing rural youth, workers purchasing local goods and services, firms buying some local inputs and improving rural infrastructure. For instance, Brandix Lanka Ltd – the country's largest garment producer at present – more than doubled its number of garment factories across Sri Lanka from five in 1991 to fourteen in 1996 (Brandix, n.d.), employing about 20,000 workers. Brandix also invested in several water infrastructure projects in rural areas (including a desalination plant and a water treatment system) while the government improved rural roads and electricity provision. Additional benefits of the GFP were the setting of a minimum wage (Rs 2,000 in 1992 constant prices) and moral pressure for factories to provide a free breakfast for workers, which contributed to improving living standards for garment workers.

Challenges imposed through the 200 Garment Factories Programme

The GFP also led to some challenges for the garment sector (Kelegama, 2004). Not only did the reallocation of MFA quotas disrupt production of existing garment firms in the Western Province but also a shortage of experienced managers and workers reduced productivity. In addition, some garment firms with close political patronage overextended their factory investments across Sri Lanka. A lack of attention to economics resulted in such factories making unsustainable losses and closing down. A famous example is Tristar Apparel, which rapidly expanded into rural areas spurred by political patronage and GFP incentives like favourable MFA quota allocations. The company had to shut 10 of its 30 factories in the mid-1990s as a result of the withdrawal of quotas for rural factories following the death of President Premadasa and a shortage of skilled workers (Daily News, 2002). Furthermore, the actual push effect of the GFP to rural areas was limited: over two thirds of garment factories remain located in

the Western Province owing to gaps in infrastructure in rural areas that raised the transaction costs of doing business.

### 3. A period of consolidation and outward FDI orientation post-2005

Sri Lanka's garment sector continued growing post-2005, but less so than other sectors. The industry's contribution to total value-added and manufacturing value-added declined slightly from 3.9% to 3.7% and 19% to 17%, respectively, in 2015. Its share in manufacturing exports remained stable at around 46%, whereas its share in total exports fell from 37% in 2005 to 26% in 2018, indicating the advance of the services sector. Despite the sector's relative decline, a rise in employment took place, from 8.2% in 2005 to 9.5% in 2017, hinting at low levels of productivity (DCS, 2008, 2019c).

#### Loss of labour cost advantage

The first decade of the 2000s saw an erosion in Sri Lanka's key locational advantages for FDI. Rising wages for garment workers during the late 1990s and in the 2000s, along with slow growth in labour productivity, meant that Sri Lanka's unit labour costs and hence competitiveness were in a similar bracket as those of emerging competitors like Bangladesh, Cambodia and Vietnam. Such economies had also been highly proactive in providing fiscal and financial incentives to attract FDI in labour-intensive sectors. Furthermore, the ATC expired in 2005, which meant that all garment quotas providing access to the EU and US markets were abolished and trade was governed by the general rules of the multilateral trading system.

Adjustment to a more challenging post-2005 trading environment thus heralded a period of consolidation in Sri Lanka's garment sector (Kelegama, 2009). Some quota-dependent uncompetitive garment firms shut down; their factories and workers were taken over by larger, more competitive firms. Such firms had to leverage on their relations with foreign buyers of output and obtain orders based on superior technical efficiency and standards rather than mere access to quotas.

#### Innovative capabilities

The ATC expiry coincided with a growing preference among US and EU consumers for garments made in the developing world factories according to fair trade practices and codes of conduct. In an innovative move, large garment firms in Sri Lanka adopted Garments without Guilt ethical practices<sup>4</sup> and invested in environmentally friendly green factories with solar power and minimal waste (EDB, 2017). Sri Lanka soon acquired a reputation among foreign buyers as a leading Asian ethical and green garment sourcing destination.

#### Entrepreneurship and internationalisation

A handful of the larger and better-established Sri Lankan garment firms decided to internationalise their assembly operations and became classic 'third world multinational' investors in other developing countries. This outward investment shift was driven by a combination of factors, including foreign buyers' interest in diversifying global supply chains to reduce the vulnerabilities of given locations, access to large markets, special garment quotas for least developed countries and ample suppliers of trainable labour. A striking example is MAS Holdings, which is headquartered in Sri Lanka, with 53 factories in 16 countries, including in North Carolina (US), Honduras and Haiti. Others include Brandix, with factories in Bangladesh and India; and Hirdaramani, with factories in Bangladesh, Vietnam and Ethiopia.

<sup>4</sup> Garments are made with conscience and care by protecting worker's rights, creating opportunities for education and personal growth and helping reduce poverty in local communities (EDB, 2017).

### 3. POST-CONFLICT EXPANSION OF THE TOURISM SECTOR

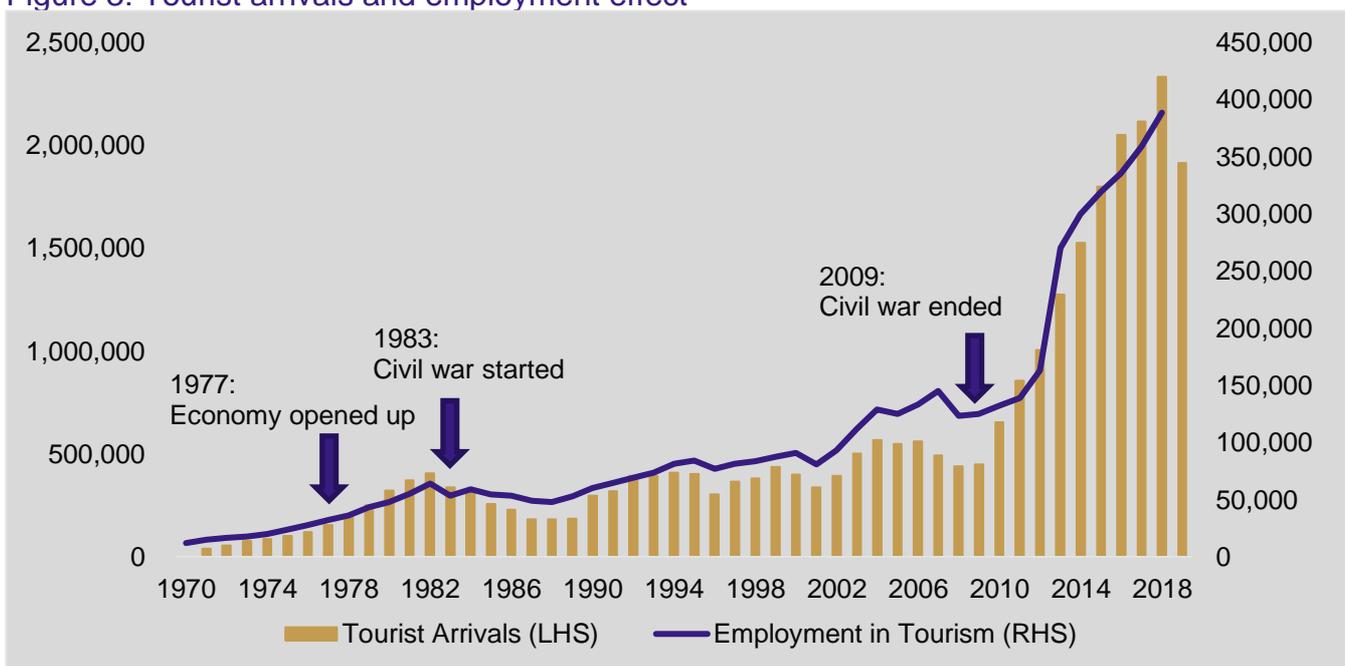
#### 3.1. Background

Post-conflict, Sri Lanka’s tourism sector has emerged as a key driver of services-led growth and has the potential to play a significant role in transforming the country into a more services-oriented economy. Sri Lanka’s tourism industry comprises restaurants, hotels and a wider range of peripheral services offered by transport providers, travel agents and tour guides.

At the end of the civil conflict, the sector’s direct and indirect contribution to GDP stood at approximately 7%.<sup>5</sup> A decade later, this share had risen to 12.6%, making it one of the country’s most important post-war growth engines to date (WTTC, 2020) (Appendix D).

Benefitting from increased political stability and the removal of travel advisory restrictions, tourist arrivals have increased substantially (Figure 3), which has been accompanied by a surge in tourism receipts. Sectoral employment has risen by on average 15% per annum since 2009. According to the Sri Lanka Tourism Development Authority (SLTDA) (2019b), nearly 390,000 people were employed in the sector in 2018, accounting for 5% of Sri Lanka’s total workforce.

Figure 3: Tourist arrivals and employment effect



Sources: SLTDA (2019b, 2020)

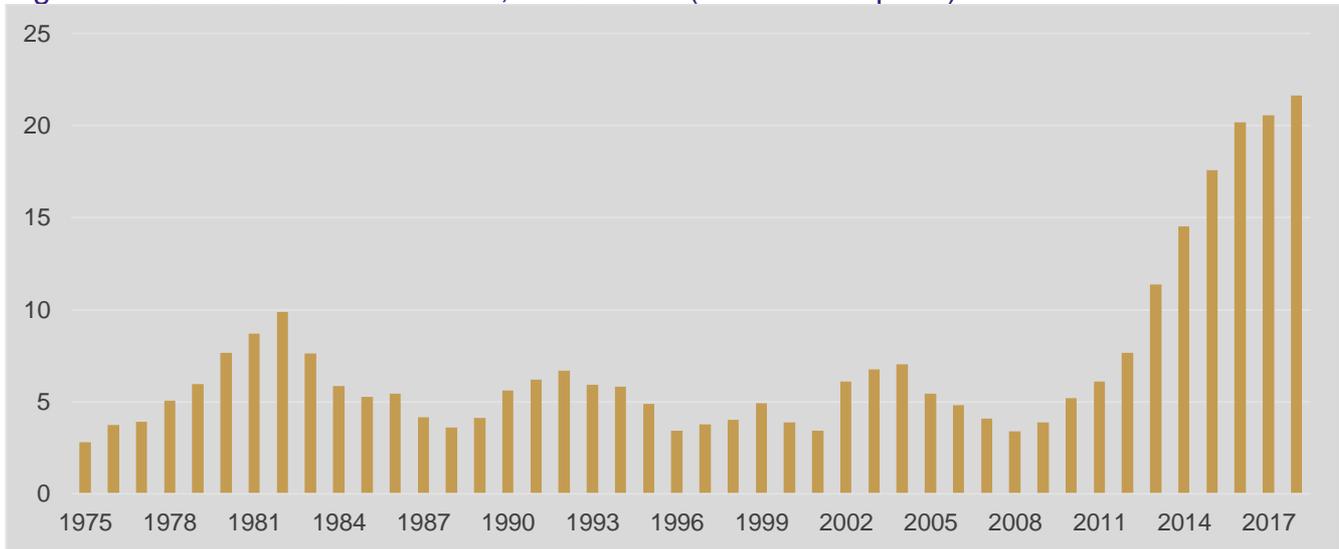
Sri Lanka’s tourism sector is the third most important foreign exchange earner, preceded only by workers’ remittances and garments. Tourism earned \$4,381 million in 2018, accounting for 22% of total

<sup>5</sup> Share in GDP is based on direct, indirect and induced contributions to the economy according to the methodology applied by the World Travel and Tourism Council (WTTC). Total contribution consists of *direct* (e.g. accommodation, transport), *indirect* (e.g. travel and tourism investment spending, sectoral government spending) and *induced* (spending of direct and indirect employees on e.g. housing and food and beverages) contributions. Tourism’s share in GDP will therefore be overstated in comparison with only sporadically available data points on direct contributions (see SLTDA annual reports).

exports (Figure 4) and 52% of all services exports. Since the end of the civil conflict, the sector's share in total exports has risen by 18 percentage points, gaining relative importance over other sectors.

FDI in Sri Lanka's hotel industry has also picked up significantly post-conflict, surging from \$6 million in 2009 to \$182 million in 2015 (Sirisena, 2016).

Figure 4: Sectoral share of tourism, 1975–2017 (% of total exports)



Note: Information on tourism relates to balance of payments category 'Travel' as specified by IMF. Travel does not include passenger transport, as domestic and tourist travel cannot be unambiguously differentiated. The sector's share in exports is therefore likely to be understated.

Source: LKI calculations based on CBSL (2019b); IMF (2020)

### 3.2. Enabling factors and challenges

The development of Sri Lanka's tourism industry can be broadly divided into three distinct phases:

1. a peaceful and politically stable period leading up to 1983 with moderate sectoral expansion
2. a period of civil conflict between 1983 and 2009 with subdued sectoral development
3. a post-war era of increased political stability and targeted government policies driving substantial sectoral growth.

During the above periods, various factors influenced the development of Sri Lanka's tourism industry. The civil conflict is one of the major reasons why Sri Lanka's tourism sector lagged regional competitors like Thailand in size and sophistication. The end of Sri Lanka's civil war kick-started significant sectoral expansion. The formalisation of the tourism industry through the establishment of government offices, a promotion bureau and human resource development facilities provided an important tailwind to sectoral development. Successful marketing campaigns reinstated Sri Lanka's image abroad and were met with the global recognition of Sri Lanka as a top travel destination. The pace of sectoral expansion, however, temporarily halted following external shocks such as the 2004 Indian Ocean tsunami and the 2019 Easter bombings.

#### 1. A peaceful and politically stable period leading up to 1983 with moderate sectoral expansion

During this time, Sri Lanka's tourism sector flourished under a peaceful, democratic and politically stable environment, aided by government initiatives. International visitation numbers increased by on average 21% per annum between 1970 and 1982, growing from less than 50,000 to 407,000 in slightly more than a decade. Sectoral employment rose from 12,000 to more than 64,000 (SLTDA, 2019b). The sector's share in total exports increased from 2.8% in 1975 to 9.9% in 1982 (Figure 3).

### Sri Lanka's natural and cultural endowments

Since the beginnings of Sri Lanka's tourism sector, the island's natural and cultural endowments have drawn in tourists from around the globe. Titled 'Pearl of the Indian Ocean', the country is rich in natural, cultural and heritage-related sights. Visitors have long appreciated Sri Lanka's natural and cultural diversity, accompanied by its renowned hospitality and culinary highlights. The country is home to eight United Nations Educational, Scientific and Cultural Organization World Heritage sights and offers a plethora of wildlife, beaches, hills and rainforests to explore, appealing to a wide range of tourists.

### Targeted government efforts and political stability

Up to the 1980s, Sri Lanka's tourism sector grew on the back of targeted government policies. In 1967, policy-makers took their first real interest in the sector and launched the first Tourism Management Plan, in which the government committed itself to the development of transportation and utility infrastructure. In addition, the government implemented fiscal incentives to promote backward linkages with the local economy (Richter, 1989) and offered land on concessional rates (Fernando et al., 2013). During this time, the country also opened its doors to international charters (mainly from Europe).

## **2. A period of civil conflict between 1983 and 2009 with subdued sectoral development**

During this period, annual growth in tourist arrivals and employment disappointed, at an average 1.8% and 3%, respectively (SLTDA, 2019b). The sectoral share in total exports fell from 9.9% in 1982 to 3.9% in 2009. Towards the end of the conflict, hotel occupancy rates were below 50%.

### Civil conflict and limited government interventions

In 1983, a full-scale separatist war arose between government security forces and the Liberation Tigers of Tamil Eelam, which sought to create an independent Tamil state ('Tamil Eelam') in the Northern and Eastern Provinces. A youth rebellion erupted towards the end of the 1980s. These twin wars cost the country in terms of human casualties and stalled economic development. Despite several multi-million-dollar campaigns to counter negative publicity (Richter, 1989), Sri Lanka found it difficult to escape the negative image attached to the long civil conflict. Tourist arrivals fluctuated along ceasefire agreements and spikes of violence but generally remained below potential. Important structural reforms did not take place, rendering these the three lost decades for Sri Lanka's tourism sector.

### Indian Ocean tsunami

Sri Lanka's tourism sector was hit in December 2004 when a tsunami – following an earthquake in the Indian Ocean – led to approximately 40,000 deaths island-wide, many of them tourists, and destroyed important domestic infrastructure. The following year recorded a drop in tourist numbers of 3%, which was, however, followed by a 1.8% increase in tourism numbers in 2006. The tsunami's impact therefore appears more temporary in comparison with the civil conflict, which weighed on tourist arrivals and sectoral development for more than 25 years.

## **3. A post-war era of increased political stability and targeted government policies driving substantial sectoral growth**

Since the end of the civil conflict, tourist numbers have increased by on average 15% annually. In 2012, tourist arrivals surpassed a million for the first time, only to be doubled four years later, when Sri Lanka welcomed 2.05 million visitors to the island. The influx of tourists was accompanied by strong sectoral employment growth (on average 13% per annum) (SLTDA, 2019b). Within less than a decade (between 2009 and 2018), the sector's share in total exports increased from 3.9% to 21.6%, and its contribution to GDP rose to 12.5% (IMF, 2020; WTTC, 2020).

### Targeted government efforts and political stability

Benefiting from the end of the civil war, the associated peace dividend-related infrastructure investments and increase in political stability, Sri Lanka's tourism sector experienced a post-war renaissance. The expansion of the tourism industry was facilitated through various government initiatives under Sri Lanka's new Tourism Act (2005) and Sri Lanka's Tourism Development Strategy (2011–2016). A tourism development fund was established, and several institutions – including the Sri Lanka Tourism

Development Authority (SLTDA) as apex body of the sector and a Tourism Promotion Bureau – were established. In addition, the government set up the Sri Lankan Institute of Tourism and Hotel Management to address staff shortages (Buultjens et al., 2015). The government also engaged in tackling infrastructure deficiencies and developed airports, ports, roads and power plants. Under the new Tourism Act, the BOI simplified tax and licensing procedures and provided tax holidays conditional on minimum investments. Alongside the establishment of a one-stop shop government office, these measures triggered an increase in investor interest and opened doors to FDI inflows. Sri Lanka's Tourism Development Strategy, with private sector participation, sought to distribute gains from tourism 'spacially, socially and ethnically' by spreading international as well as domestic tourism – which previously had been centred in the Southern and Central Provinces – to Northern and Eastern parts of the island (Kamble and Bouchon, 2014). As part of the strategy the government established several tourism zones across the country, aimed at the high-end market and providing specific guidelines as to the development of the zones (Buultjens et al., 2015).

The above efforts were accompanied by government-led marketing campaigns such as Visit Sri Lanka 2011 and the 'Sri Lanka – The Wonder of Asia' campaign (Fernando et al., 2013; Kamble and Bouchon, 2014). A collaboration with CNN followed, broadcasting the 'So Sri Lanka' campaign across channels in Europe, the Middle East, Africa and Asia (Daily FT, 2019).

#### International recognition

Reflecting the success of the marketing campaigns, international media coverage of Sri Lanka as a top travel destination increased, drawing in tourists from across the globe. The island was repeatedly recognised as a number one travel destination by Lonely Planet (2019, 2018 and 2013), one of the world's top travel magazines. The news platform Bloomberg ranked Sri Lanka in the top 20 luxury tourism destinations in 2017 and the World Travel Awards has named the country Asia's leading adventure tourism destination (2017 and 2018) and Asia's leading destination (2018).

#### The Easter bombings

Sri Lanka's tourism sector took a temporary blow in 2019 following the Easter Sunday bombings, which were targeted at churches and high-end hotels, taking the lives of more than 250 civilians, many of them tourists. In the direct aftermath, tourist numbers plummeted. Towards the end of the year, arrivals recovered slightly, with the overall number 18% lower than a year prior (de Silva, 2020).

### 3.3. Remaining challenges

Post-conflict, sectoral contributions in terms of economic value-added, exports and foreign exchange earnings have risen substantially, accompanied by an increase in sectoral employment. That said, the prolonged period of violence and uncertainty during the civil war, alongside external shocks such as the Indian Ocean tsunami in 2004 and the Easter bombings in 2019, has meant that the sector has developed below potential. An inadequately developed infrastructure, owing to a decade-long neglect to the benefit of war-related investments, continues to prevent higher sectoral growth and transmission into other economic sectors. Sectoral growth is further curtailed through less competitive prices compared with Sri Lanka's immediate South Asian rivals. A lack of well-trained human resources depicts another important bottleneck limiting sectoral growth and investor interest. In fact, many of Sri Lanka's workforce emigrate to the Middle East in pursuit of higher wages.

The island's tourism sector faces various challenges in realising its potential and in developing into a resilient and sustainable industry that can adapt quickly to internal changes and external shocks. Addressing the above-mentioned challenges is therefore imperative to help the sector drive services-led development and realise a wider economic impact through leveraging its backward linkages with local industries.

## 4. CATCH-UP OF A NASCENT ICT/BPM SECTOR

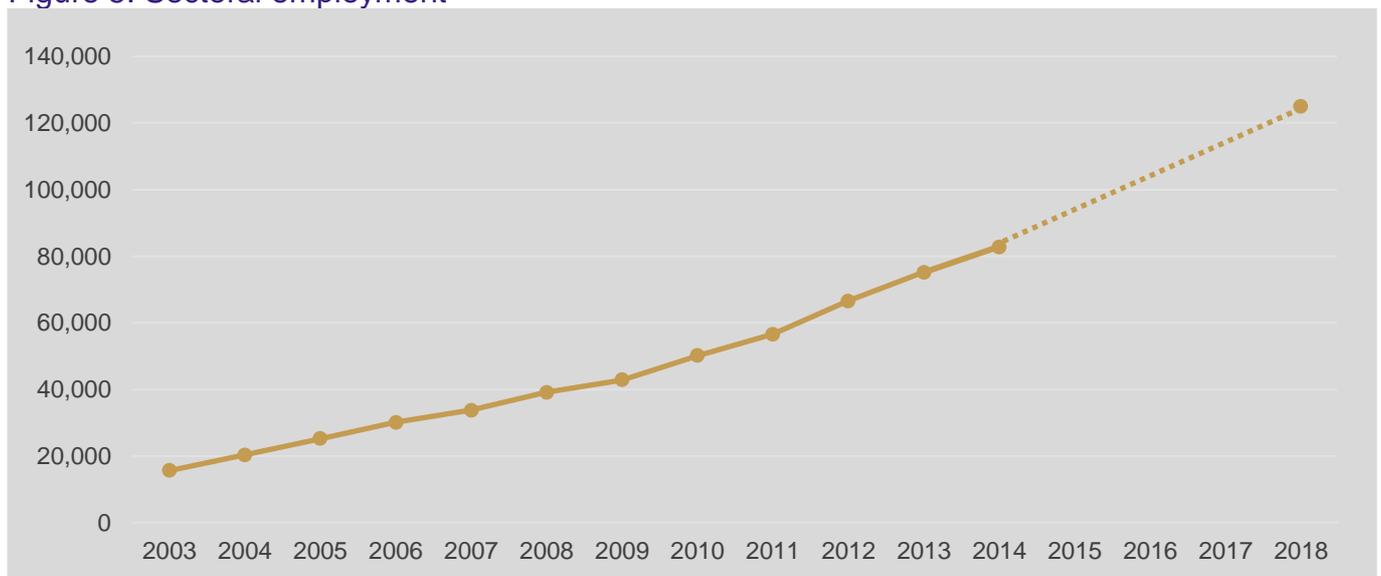
### 4.1. Background

Sri Lanka’s ICT/BPM sector emerged at the start of the new century and is believed to be one of the country’s growth engines going forward. The ICT sector covers information, computer and telecommunication services, whereas the BPM sector relates to the delivery of a variety of established services, such as financial, accounting, legal, insurance, education and administration services as well as any other business services that can be delivered remotely.

Sectoral data are still comparatively scarce, particularly with regard to value addition. That which is available indicates a sectoral contribution of 1.9% to total value-added in 2016. In absolute terms, the sector ranks among the top three contributors to services value-added, preceded only by food/accommodation services and wholesale/retail trade (DCS, 2019b).

The sector’s expansion has been accompanied by a steady increase in sectoral employment (Figure 5), which grew by on average 17% per annum between 2003 and 2014. A total of 125,000 people worked in 600 ICT/BPM companies in 2018, accounting for 1.6% of total employment and 3.4% of total services employment. Over time, the sector has attracted more female workers, and their share in sectoral employment grew from 21% in 2010 to 34% in 2018 (Salt.lk, n.d.). Nevertheless, the sector to date remains male-dominated.

Figure 5: Sectoral employment



Note: No data were available between 2015 and 2017 and past trends were extrapolated forward in the dotted line.

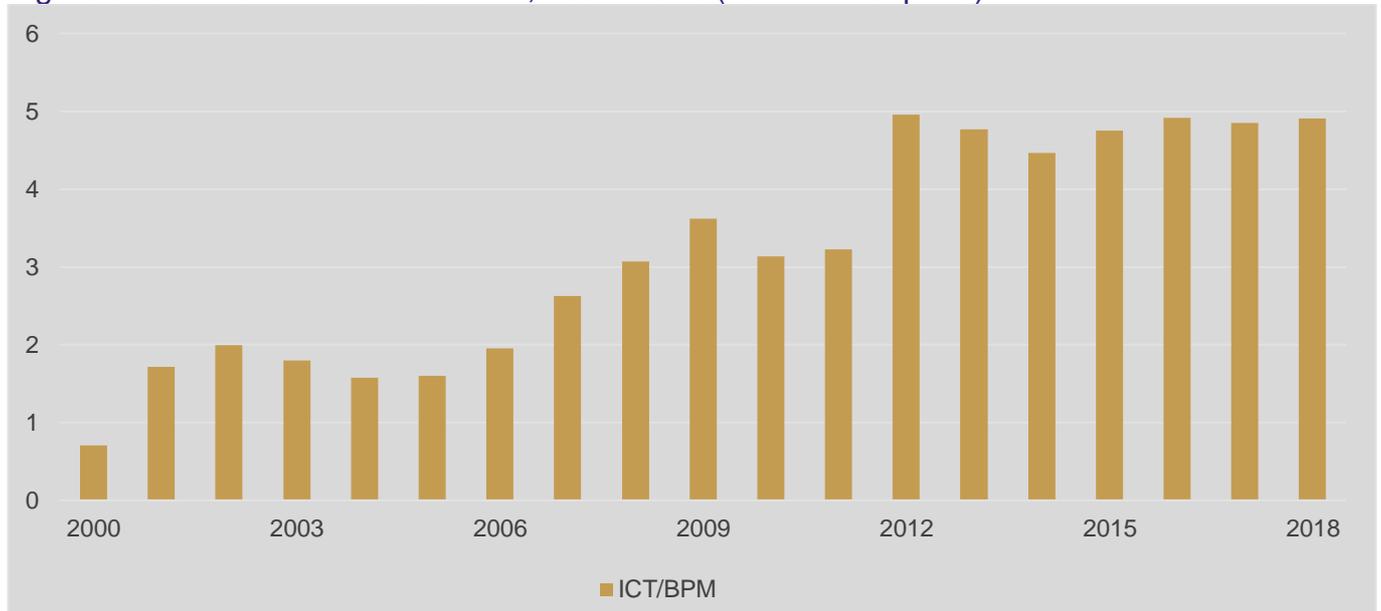
Source: ICTA (2019)

The ICT/BPM industry shares important vertical links with other sectors such as agriculture, engineering, health care and logistics. It is estimated that, for every job in the ICT/BMP sector, an additional 2.5 indirect jobs are generated in other sectors, highlighting the sector’s importance for the rest of the economy (Government of Sri Lanka, n.d.). Labour productivity in the ICT/BPM sector is three times higher than average productivity in the services sector, with annual value-added standing at around \$27,300 per worker/annum, followed by wholesale/retail trade (around \$15,500) and real estate activities (around \$14,900)<sup>6</sup> (CBSL, 2018; DCS, 2019b).

<sup>6</sup> Conversion according to Bloomberg exchange rate of LKR/USD 186.61 (as at 24 March 2020).

Total export earnings amounted to \$995 million in 2018, with the ICT sector accounting for the majority of earnings (85% vs. 15% of BPM activities) (Salt.lk, n.d.). The overall sector's share in total exports increased from 0.7% in 2000 to 4.9% in 2018 (Figure 6), while its share in total services exports has grown by 7 percentage points, accounting for 12% of all services exports in 2018 (IMF, 2020).

Figure 6: Sectoral share of ICT/BPM, 2000–2018 (% of total exports)



Source: LKI calculations based on IMF (2020)

## 4.2. Enabling factors

The development of Sri Lanka's ICT/BPM can be divided into two phases:

1. a period of privatisation and regulatory reforms in Sri Lanka's telecommunications sector between 1990 and 2000 as a basis for later expansion of the ICT/BPM sector; and
2. a period of targeted public–private sector initiatives enabling significant growth of the ICT/BPM industry from 2000 onwards.

Sri Lanka's ICT/BPM sector has increased its contribution to the domestic economy over the past two decades and has significant growth potential. The liberalisation of Sri Lanka's telecommunications sector pre 2000 laid the foundation for the emergence of the ICT/BPM sector. In 2002, and under a comprehensive policy framework, public and private sector bodies collaborated to drive digitalisation and the spread of ICT/BPM services across the island, boosting sectoral growth. An increase in international recognition of the sector's high skills base coupled with cost advantages to other outsourcing destinations enabled further sectoral expansion.

### 1. A period of privatisation and regulatory reforms in Sri Lanka's telecommunications sector between 1990 and 2000 as a basis for later expansion of the ICT/BPM sector

One of the most important cornerstones for the later development of Sri Lanka's ICT/BPM sector was laid during this period. Up to the 1990s, Sri Lanka's telecommunications sector was underdeveloped and backward as a result of a lack of infrastructure spending. It was characterised by low transmission quality and system reliability and high unmet demand for telecommunication facilities (Jayasuriya and Knight-John, 2002). In the late 1990s, the Sri Lankan government liberalised the telecommunications sector and implemented a regulatory framework to reduce sectoral inefficiencies and drive Sri Lanka's development into a financial, commercial and communications hub. The sector transformed from a monopoly structure

to a more competitive industry with improved operational efficiency and service delivery. A partial privatisation and restructuring of the government-owned telecommunications entity Sri Lanka Telecoms took place alongside pro-competitive measures and deregulation efforts.

## **2. A period of targeted public–private sector initiatives enabling significant growth of the ICT/BPM industry from 2000 onwards**

### Collaboration between public and private sector agencies

Driven to emulate the success story of India's burgeoning software industry (Dissanayake, 2011), Sri Lanka's government and private sector agencies joined forces to drive the development of Sri Lanka's ICT/BPM sector. In 2002, a large-scale and arguably one of the most comprehensive ICT development strategies in the South Asian region took place, in cooperation with development partners such as the World Bank. Together, the e-Sri Lanka initiative was launched, aimed at improving access to ICT to further economic and social development and to work towards a digitally inclusive Sri Lanka. As part of the initiative, public–private sector collaborations worked on taking 'the dividends of ICT to every village, every citizen, to every business and also transform the way Government works' (ICTA, 2010), by digitising various government services and improving ICT access in rural areas (Dissanayake, 2011).

The e-Sri Lanka initiative resulted in implementation of the Information and Communications Technology Act (2003), which gave rise to Sri Lanka's Information and Communication Technology Agency (ICTA). As the sector's apex body, ICTA is responsible for implementing all ICT-related and government-initiated projects and improving ICT accessibility island-wide. In 2008, establishment of the private sector body Sri Lanka Association of Software and Service Companies (SLASSCOM) followed. As the country's national chamber for the ICT/BPM industry, this is responsible for facilitating trade and business and fostering education and employment in the sector. In 2013/14 ICTA and SLASSCOM jointly formulated Vision 2022, a strategy targeted at increasing international visibility of the sector and Sri Lanka becoming a centre of excellence in both ICT and BPM by 2022 (Agarwal, 2019).

The Sri Lankan government has over time engaged in various initiatives to create a conducive operating environment, encompassing legal and fiscal aspects, for ICT/BPM companies. As an example, it provides fiscal incentives and concessions to companies operating in the sector. What is more, the government has signed various e-laws, which regulate the use of electronic data and transactions as well as computer crimes, and enforces rigorous intellectual property protection schemes. Sri Lanka is so far the only South Asian country to have signed the Budapest Convention on Cybercrimes and ratified the United Nations Convention on the use of Electronic Communications in International Contracts, highlighting the government's efforts to establish a secure and conducive operating environment (UNCITRAL, 2005; Council of Europe, 2020).

### High-quality services and cost advantage

Sri Lanka's ICT/BPM sector offers high-quality and specialised services such as high-end research and development, enterprise resource planning, cloud technology and mobile applications for domestic and international clients. Around 85% of employees have at least an undergraduate degree (ICTA, 2019). Since its beginnings, Sri Lanka's ICT/BPM sector has not seen the same demand growth as competitor countries such as India and the Philippines, which has resulted in lower wage pressure and provides the country with a cost advantage. What is more, average domestic broadband costs are comparatively lower than in major competitor countries such as China, Malaysia and the Philippines. Regionally, only India and Thailand offer cheaper access to broadband than Sri Lanka (Cable.co.uk, 2020).

### Increased global recognition

The development of the sector has been accompanied by increased global interest in Sri Lanka as an outsourcing destination for ICT/BMP services. In 2017, the country ranked 11th on the A.T. Kearney Global Services Location Index, having moved up from its initial position (29) in 2007. What is more, Sri Lanka was named Offshoring Destination of the Year in 2013 and 2014 by the UK's National Association for Outsourcing (Daily FT, 2014). Indeed, the country has found recognition in many developed countries and over time has emerged as an international ICT/BMP destination for the holiday-booking sections of

Qatar Airways and Emirates, and other well-established companies such as the London Stock Exchange, Pearson and Navantis (Government of Sri Lanka, n.d.).

### 4.3. Remaining challenges

The government has undertaken various legal and regulatory changes to further the sector and strengthen its international competitiveness as an economic hub. Twenty years after its emergence, however, the sector still operates below potential, with its relative contributions to economic value addition, exports and employment remaining comparatively small.

The sector faces various constraints, which have in the past impeded growth and may in future continue to curtail sectoral expansion. One of the most pressing challenges is the limited availability of industry-relevant labour and the widening of the supply–demand gap, which is aggravated by sectoral attrition to countries with higher wages. In 2018, the industry lacked 8,900 employees (7% of the sector's total workforce), a number that is expected to increase further in future (ICTA, 2019). Tertiary school enrolment rates are lowest in Sri Lanka compared with regional competitors such as India (28%), the Philippines (35%) and Malaysia (45%) (World Bank, 2020).

Rigid and out-dated labour regulations further obstruct the process for visa applications of non-nationals seeking employment in the sector (SLTDA, 2020; Government of Sri Lanka, n.d.). What is more, the sector is small in comparison with competing countries, and lags high-volume players such as China and the Philippines. Owing to its limited size, the sector lacks international visibility, which is further exacerbated by the absence of a single, widely adopted brand.

A joint response from both public and private sector agencies is required to address the above challenges to establish Sri Lanka's ICT/BPM sector as a global outsourcing destination for specialised operations. Initiatives focusing on training and retaining sector-relevant labour, while simultaneously conducting targeted international promotion campaigns, can lay the foundations for turning the sector into Sri Lanka's key economic growth engine going forward.

## 5. CONCLUSION

This study has examined Sri Lanka's shift from an agriculture-based and labour-intensive manufacturing society to a more services-oriented economy based on key economic variables such as value-added, employment and exports. Over time, employment has shifted from agriculture to the services and industrial sectors, which have noted a significant increase in value addition. In 2019, Sri Lanka's services sector accounted for \$32 billion value-added, followed by the industrial sector (\$16 billion) and the agriculture sector (\$4 billion) (CBSL, 2020) (gross value-added at basic prices).

Like many developing countries, Sri Lanka's garment industry was the first step towards industrialisation. Over more recent decades, the sector has matured, following a process of consolidation and internationalisation. In contrast, traditional (tourism) and modern services (ICT/BPM) activities have increasingly gained importance relative to other sectors. A series of factors have influenced sectoral development on a granular level (Table 3) and are summarised below.

Table 3: Identified triggers, enablers and policies driving sectoral growth

	Garment	Tourism	ICT/BPM
Triggers	Opening of economy in 1977, liberalisation of FDI regime and focus on export orientation.	End of Civil War in 2009, improved political stability and the removal of global travel advisory restrictions.	Liberalisation of telecoms sector, partial privatisation of telecoms monopoly and deregulation efforts.  Prioritisation of ICT sector driven by aim to emulate India's successful and burgeoning software industry.
Enablers	Cheap and abundant labour resources (in the beginning) and access to key markets through MFA, attracting FDI.  FDI-related skill and technology transfer.  Entrepreneurial expertise from industrial heavyweights.	Post-conflict policy directive targeted at sectoral development.  Successful government-led campaigns and international recognition of Sri Lanka as top travel destination.  Peace dividend-related investments in infrastructure.	Strong public-private sector collaboration supported by international development partners.  Highly skilled workforce and competitive prices.
Policies	Set-up of EPZs and granting of fiscal and non-fiscal incentives for export-oriented investment.  200 GFP to promote rural industrialisation.  Privatisation efforts and (later) internationalisation of garment sector.	New Tourism Act and Tourism Development Strategy formalised and developed the sector.  Provision of regulatory and fiscal incentives to increase FDI inflows.	Partial privatisation of state-owned telecoms providers.  e-Sri Lanka initiative spread digitalization across Sri Lanka and improved ICT infrastructure.

Sectoral expansions occurred on the back of *trigger events*, which started the transformative process. These include (i) liberalisation of the economy in 1977 and opening-up to export-oriented FDI, which drove the rise of garments, (ii) a period of post-conflict political stability, which provided the impetus for tourism expansion and (iii) privatisation of Sri Lanka's telecoms monopoly alongside a mind-shift of public and private sector agencies to recognise ICT/BPM as a key national industry from around 2000 onwards.

*Enabling factors* that sustained the sector's transformative process were targeted government initiatives, aimed at liberalisation and FDI promotion, which were often complemented by private sector initiatives. Sri Lanka's cost advantage in labour was a key factor that initially attracted FDI into the garment sector and, combined with a highly skilled labour force, raised international interest in the ICT/BPM sector. What is more, the development of Sri Lanka's garment sector was influenced by key politicians, whose targeted policies were complemented by the efforts of foreign investors and catalysts. On a broader level, an increase in international recognition of Sri Lanka as a manufacturing, tourism and outsourcing destination was an important underlying factor of sectoral transformations.

*Key policies* that influenced sectoral transformation were Sri Lanka's 200 GFP and the set-up of various EPZs across the island that granted fiscal and non-fiscal incentives to investors in the garment sector. The Tourism Act (2005) and Tourism Development Strategy (2011–2016) established a series of government bodies to further the tourism industry, while the e-Sri Lanka initiative, which improved access to technologies for households and businesses across the island, sped up digitalisation. The COVID-19 global pandemic is negatively affecting the global economy and Sri Lanka in 2020. The latest International Monetary Fund (IMF) World Economic Outlook is projecting a V-shaped recovery in 2021 clouded by global risks. If a global recovery occurs, it is likely to speed up economic transformation pathways internationally including in Sri Lanka. Past trends are likely to be reinforced and accelerated through COVID-19 and may give rise to a new economic structure in Sri Lanka. The lockdowns induced by the pandemic, which shut down trade and inbound tourism, have had a negative initial impact on the garment and tourism sectors in Sri Lanka. The latter has seen a contraction in arrivals as a result of international travel restrictions and airline suspensions. Plans are underway to open the airport before the end of 2020 and to attract long-term tourists willing to be subject to testing on arrival and a strict quarantine regime. The garment sector is also facing headwinds and new business opportunities. Supply chain disruptions, weaker global demand and a 20–30% anticipated drop in orders are affecting it. A few large garment companies have attempted to shift production to making a variety of types of personal protective equipment but are operating below normal capacity. The recovery in garment exports is tied to a recovery in export orders from the US and the EU. In contrast, Sri Lanka's ICT/BPM sector appears to be better positioned in overcoming this external shock, given the drive towards e-commerce and its ability to operate remotely; this positions the sector to emerge as a potential driver of economic transformation in Sri Lanka post-COVID-19. When the data are available, further research is needed on the unfolding impact of COVID-19 on the story of sectoral transformation in Sri Lanka.

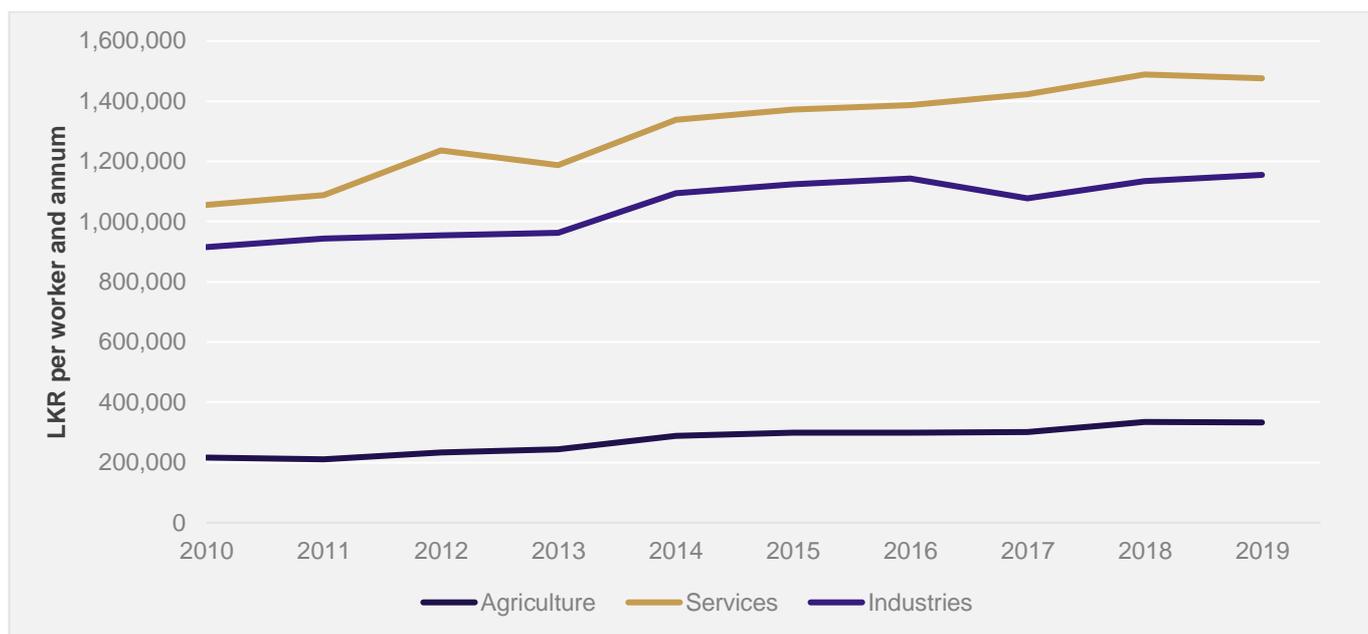
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## APPENDIX A: SECTORAL VALUE-ADDED



Note: Data based on 2010 constant prices. 2010 employment data exclude Northern Province. 2018 and 2019 data on value-added are provisional.

Sources: LKI calculations based on CBSL (2015, 2017, 2020)

## APPENDIX B: SECTORAL SHARES

### % of GDP

	1990	1995	2000	2005	2010	2015	2018
Garments	N/A	N/A	N/A	3.9	3.5	3.7	N/A
ICT/BPM	N/A	N/A	N/A	N/A	N/A	1.2	N/A
Tourism	N/A	6.6	6.0	8.2	6.9	10.8	12.5

Note: Data on ICT/BPM value-added refer only to the ICT sector. No data available for BPM sector.

Sources: CBSL (2018); DCS (2019b, 2020); WTTC (2020)

### % of total employment

	1990	1995	2000	2005	2010	2015	2018
Garments	N/A	N/A	N/A	8.2*	4	7.2	9.5*
ICT/BPM	N/A	N/A	0.2	0.3	0.7	1.1*	1.6
Tourism	N/A	N/A	1.6	1.7	1.7	4.1	4.8

Note: \* Data available only for (year – 1). Note that sectoral classifications for the garment sector as specified by DCS changed over time: 2006 and 2010 data relate to *Manufacturing of textiles and manufacturing of wearing apparel, dressing, dyeing of fur*, whereas 2015 and 2017 data refer to *Manufacture of textiles and wearing apparel*. Data capture establishments with five or more persons engaged.

Sources: DCS (2008, 2010, 2013, 2018, 2019b); ICTA (2019); SLTDA (2019b)

### % of total exports

	1990	1995	2000	2005	2010	2015	2018
Garments	27.4	40.1	46.8	36.7	31.6	28.5	26.2
ICT/BPM	N/A	N/A	0.7	1.6	3.1	4.8	4.9
Tourism	5.6	4.9	3.9	5.4	5.2	17.6	21.6

Note: Information on tourism relates to balance of payments category 'Travel' as specified by IMF. Travel does not include passenger transport, as domestic and tourist travel cannot be unambiguously differentiated. The sector's share in exports is therefore likely to be understated. Information on the ICT/BPM sector relates to the ICT sector only. No information on BPM activities available.

Sources: Dheerasinghe (2009); CBSL (2020); IMF (2020)

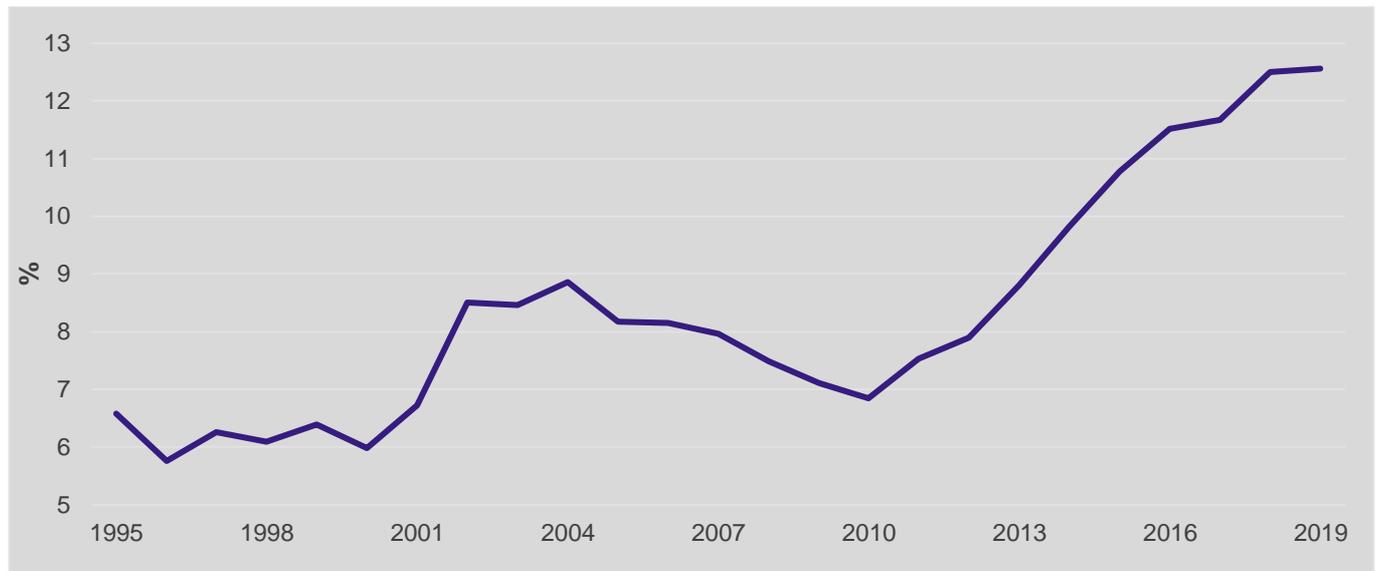
## APPENDIX C: TIMELINE OF THE GARMENT SECTOR

Year	Sectoral share (%) in total value-added*	Sectoral share (%) in manufacturing value-added*	Sectoral share (%) in total exports**	Sectoral share (%) in merchandise exports**
2002	4.4	18.5	40.6	51.6
2003	4.1	18.1	39.4	50.2
2004	3.9	18.1	38.6	48.8
2005	3.9	18.1	36.7	45.6
2006	3.8	17.7	36.2	44.8
2007	3.8	17.7	35.5	43.7
2008	3.7	17.5	34.3	42.8
2009	3.6	17.4	36.5	46.2
2010	3.5	17.3	31.6	40.6
2011	3.6	17.3	30.7	39.7
2012	3.5	17.1	29.4	40.8
2013	3.6	17.1	29.9	43.4
2014	3.7	17.2	29.5	44.3
2015	3.7	17.0	28.4	45.7
2016	N/A	N/A	28.0	47.4
2017	N/A	N/A	26.4	44.3
2018	N/A	N/A	26.2	44.7

Note: \* 2015 provisional data. Data refer to *Textile, wearing apparel and leather sector* as specified by DCS. \*\* Data refer to *Textile and garment sector* as specified by CBSL.

Source: DCS (2020)

## Appendix D: TOURISM SHARE IN GDP



Source: WTTC (2020)