

# Chapter 8

## **ASEAN+1 FTAs and Global Value Chains in East Asia: The Case of the Textiles and Clothing Industry in Sri Lanka**

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## CHAPTER 8

### **ASEAN+1 FTAs and Global Value Chains in East Asia: The Case of the Textiles and Clothing Industry in Sri Lanka**

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*The position of Sri Lanka in the value chain of the global textiles and clothing industry is identified in this paper. The paper also examines how economic policies and trading arrangements affect the competitiveness of Sri Lanka in the global supply chain network of the textile and clothing industry. The paper includes a brief discussion of the relative growth and human development performance of Sri Lanka in comparison with selected South Asian and East Asian countries. The paper also discusses the general background of the textile and clothing industry in Sri Lanka and analyses the supply chain network of the industry with a discussion on the production of intermediate and final goods. A map of the supply chain of the industry is presented and trade and foreign investment flows are examined. The extent of vertical integration and the impact of FTAs and other bilateral and multilateral trade agreements on the industry are discussed. Policy implications are also presented.*

## **1. Introduction**

Given the low cost of labor, the comparative advantage for developing countries is in labor-intensive exports as they liberalize and open up their economies. For many low-income countries, exporting of labor-intensive goods such as textiles and clothing has been a first step for industrialization and export-led economic growth.

The textiles and clothing industry is a large and diverse sector that can be subdivided into distinct parts, which offers comparative advantage for countries with different resource endowments. The traditional division of the textiles and clothing industry is between the production of natural fibre, fabrics and finished clothing. The production of natural fibre is the domain of agricultural economies while the production of synthetic fibre requires the ability to innovate or adopt new technologies. Fabric production is a highly automated capital-intensive activity and susceptible to technological advances. The clothing industry is basically labor intensive and requires specialization for competitiveness in the global market.

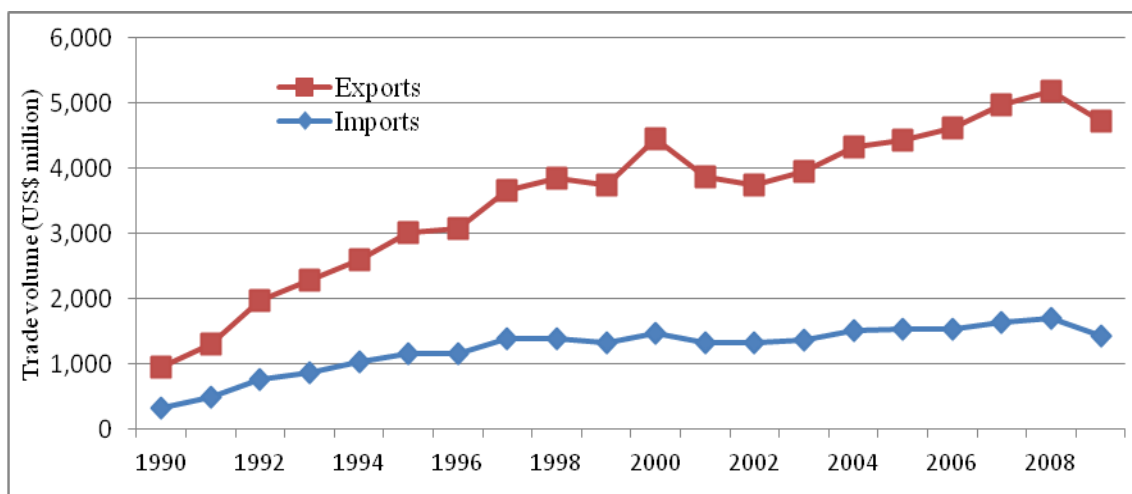
The distribution of production and marketing activities among countries is important in understanding the industry's value chain (Nordus, 2005). After World War II, East Asian countries and many other developing countries experienced a rapid expansion of the textiles and clothing industry and its exports which greatly contributed to their high growth performance. Given the relatively low requirement of capital investment, manufacturing of textiles and clothing is seen as a key opportunity for developing countries to create employment and also to create a foothold in the global export market (Yamagata, 2006; Chan and Sok, 2007).

From the mid-1970s to the mid-2000s, the Multi-Fibre Arrangement (MFA) trade regime imposed quota restrictions on textiles and clothing exports to developed countries which weakened competition among the producer countries. The Uruguay Round Agreement (URA) in 1994 on textiles and clothing envisaged the elimination of the MFA quota system over a 10-year period. In addition, the URA provided for an average tariff reduction of 22 percent on textiles and clothing imposed by developed countries. The removal of the MFA quota system benefited the industry as it led to increased competition which in effect forced producers to reduce the cost of production

and improve productivity. As Deerasinghe (2009) noted, Sri Lanka had fulfilled its commitments relating to the MFA phasing out procedures by 2002. The termination of the MFA quota system at the end of 2004 led the textiles and clothing industry to be liberalized and since then price competition among producer countries has intensified.

Several studies have analyzed the importance of the textiles and clothing industry in terms of macroeconomic indicators such as exports, investment and employment (see Rahman et al., 2008; Kowalski and Molnar, 2009; Harrigan and Barrows, 2009; and Beresford, 2009). Like many other emerging economies, Sri Lanka relies on the performance of its textiles and clothing industry for its export-led growth and employment generation. Before 1977, the textiles and clothing industry in Sri Lanka was dominated by large-scale state-owned enterprises which operated under high protection from the country's infant-industry protection policy. The shift of the country's economic policy from self-sustaining import substitution to export promotion in an open economic policy framework in late 1970s created an industrial base led by the production of textiles and clothing. The industry attracted investment from various multinational companies in East Asia and other countries (Kelegama, 2005). Multinational firms in the industry shifted their operations to Sri Lanka under foreign investment promotion policies which include the creation of Export Processing Zones (EPZs) and the provision of various fiscal incentives. The new economic policy led to a rapid expansion of the textiles and clothing industry in the 1980s, thereby significantly increasing its importance in the economy. Currently, the textiles and clothing industry is Sri Lanka's largest export industry and largest foreign exchange earner. It provides more than 330,000 formal employment positions and creates important backward and forward linkages with other sectors of the economy (Deerasinghe, 2009; Board of Investment (BoI) of Sri Lanka, 2011).

**Figure 1. Exports and Imports of Textiles and Clothing, 1990-2009**



Source: United Nations Commodity Trade Statistics Database, 2011

Initially, Sri Lanka's textiles and clothing industry was heavily dependent on the quota system offered by developed countries, but this high dependency has gradually been lessened. The textiles and clothing industry of Sri Lanka, however, faces the issue of weakening international competitiveness due to rising labor costs relative to other producer countries such as Bangladesh, Vietnam and Cambodia (Kelegama, 2005). Thus, reducing the cost of trade by eliminating barriers to trade is important to maintain the international competitiveness of the industry (Kelegama and Epaarachchi, 2002). This may require evaluating the country's performance at all stages of the production value chain in the industry and concentrating its efforts only on the most efficient stages of production. The distribution of different stages of production of intermediary and final goods across many countries would allow for such specialization in the supply chain network of this industry.

The main objective of this chapter is to identify the position of Sri Lanka in the value chain of the global textiles and clothing industry, which is important in shaping economic policies to maintain its competitiveness in the global market. The chapter also examines how economic policies and trading arrangements help to sustain the competitiveness of Sri Lanka in the global supply chain network of the industry. The rest of the chapter is organized as follows. Section 2 provides a brief discussion of the relative growth and human development performance of Sri Lanka in comparison with selected South Asian and East Asian countries. Section 3 discusses the general

background of the textiles and clothing industry in Sri Lanka. Section 4 analyses the supply chain network of the industry with a discussion of the production of materials and finished clothing. This section presents the map of the supply chain of the industry and analyses trade and foreign investment, vertical integration, the impact of FTAs and other bilateral and multilateral trade agreements on the industry. Section 5 draws conclusions and policy implications.

## **2. Facets of the Sri Lankan Economy**

Despite the prolonged civil war from 1983 to 2009 and occasional political disturbances, Sri Lanka's growth performance has been far from dismal (see Abeyasinghe and Jayawickrama, 2008). As shown in Table 1, in terms of per capita income, Sri Lanka was well ahead of other South Asian countries but behind other countries such as Malaysia, Thailand and China in 2009. Sri Lanka has also succeeded in achieving a high level of human development. The country has reported a high level of life expectancy at birth, adult literacy rate and infant mortality rate among the countries compared in this exercise.

As a result of progressive trade liberalization measures followed since 1978, Sri Lanka's volume of trade increased over time and it reached 90 percent of the country's gross national income in 2000 (see Table 2). Quantitative restrictions and high tariffs on agricultural imports introduced in recent years, however, reduced the country's trade volume to about 49 percent of its gross national income in 2009. In the early stages of trade reform the country's strategy was to improve its trade competitiveness through unilateral tariff rate reductions. The country had eliminated all export tariffs by the mid-1990s and had lowered import tariff rates significantly in the 1980s and 1990s. As shown in Table 2, it reduced its mean tariff rate from 27 percent in 1990 to 7 percent in 2006. Compared to unilateral tariff reduction, less attention was given to the implementation of preferential trade arrangements with Sri Lanka's trade partner countries in the early stages of trade policy reforms that took place during the 1980s (de Mel et al., 2011). However, the government of Sri Lanka started to pay more attention

to preferential trading arrangements to strengthen bilateral trade and investment relations from the mid-1990s onwards. As all competitor countries introduced unilateral trade liberalization measures, establishment of bilateral and multilateral trade agreements was identified as a strategy to enter into and secure foreign markets under special preferential trading arrangements which were beneficial for all partner countries.

**Table 1. Indicators of Economic Growth and Human Development**

Country	Economic indicators				Social indicators		
	Per capita Gross National Income (US\$) 2009	Average annual GDP growth rate %, 2005-09	Gross domestic savings as % of GDP 2009	Gross investment as % of GDP 2009	Adult literacy rate (% of population age 15+) 2009	Life expectancy at birth (years) 2008	Infant mortality rate (per 1,000 live births) 2009
Sri Lanka	1,990	6.4	18	24	91	74	13
India	1,180	8.2	30	32	63	64	50
Bangladesh	580	6.2	17	24	55	66	41
Pakistan	1,000	4.9	11	17	54	67	71
China	3,650	11.4	52	46	94	73	17
Indonesia	2,050	5.6	34	31	92	71	30
Malaysia	7,350	4.1	36	20	92	74	06
Thailand	3,760	3.0	32	24	94	69	12
Philippines	1,782	4.4	16	15	94	72	26
Vietnam	930	7.3	28	35	93	74	20

Source: World Bank, Development Indicators, 2010

**Table 2. Indicators of Trade Openness**

Country	Trade share*			Tariff barriers (weighted mean tariff rate) %		
	2000	2005	2009	Year	All products	Manufactured products
Sri Lanka	0.9	0.7	0.5	1990	27.0	24.2
				2006	7.0	6.0
India	0.3	0.4	0.5	1990	56.1	70.8
				2008	6.0	6.0
Bangladesh	0.3	0.4	0.5	1989	88.4	109.9
				2007	11.0	13.0
Pakistan	0.3	0.3	0.3	1995	44.4	49.2
				2008	9.0	12.0
China	0.4	0.7	0.5	1992	32.1	35.6
				2008	4.0	4.0
Indonesia	0.7	0.6	0.4	1989	13.0	15.1
				2007	4.0	3.0
Malaysia	2.2	2.1	1.7	1988	9.7	10.8
				2007	3.0	6.0
Thailand	1.2	1.5	1.3	1989	33.0	35.0
				2006	5.0	6.0
Philippines	1.1	1.0	0.6	1990	15.0	15.0
				2007	4.0	3.0
Vietnam	1.1	1.4	1.5	1994	21.0	13.0
				2007	11.0	11.0

Source: World Bank, Development Indicators, 2010.

Note: \* Trade share is defined as the sum of exports and imports over gross national income



### **3. Sri Lanka's Position in the Global Value Chain of the Textiles and Clothing Industry**

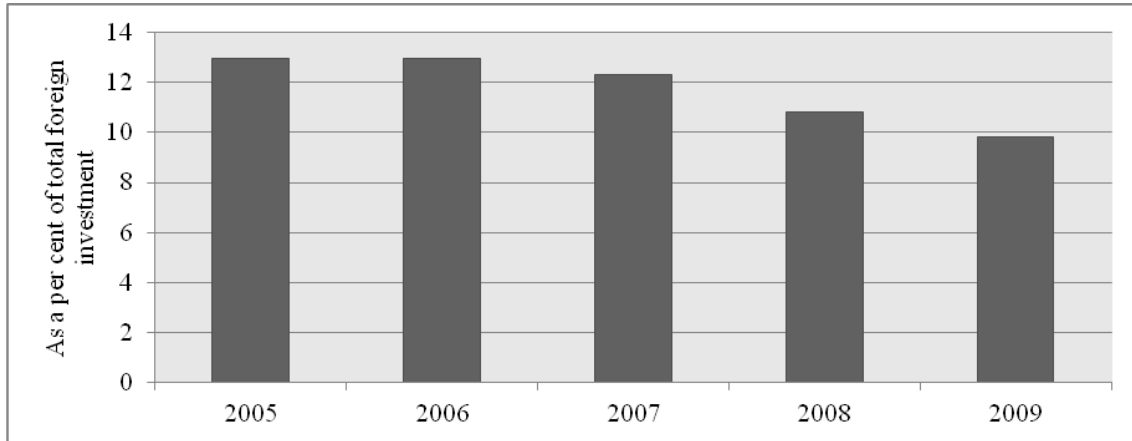
The presence of multinational firms in the country's textiles and clothing industry is an indication of Sri Lanka's integration with the supply chain network of the global textiles and clothing industry. Multinational firms are involved in cross-border transactions in investment, labor, technology, materials and finished products.

From the late 1970s with the liberalization of the economy, the textiles and clothing industry attracted a large amount of foreign direct investment (FDI). The total realized investment in the industry was nearly 56 billion rupees in 2009. More than 66 percent of this total was foreign investment. Major investing countries were: Hong Kong, Germany, UK, Singapore, Belgium, Japan, US, China, South Korea and Australia.

During the 1970s and 1980s, textiles and clothing manufacturers operating in East Asia shifted their production plants to Sri Lanka searching for low cost labor and access to Western markets secured through MFA quotas. Thus, the MFA quota system helped the expansion of the textiles and clothing industry in Sri Lanka. In addition, better infrastructure facilities in EPZs and various fiscal incentives offered by successive governments since 1977 have attracted more investors into the industry. Fiscal incentives and facilities given in EPZs for joint ventures/foreign investment also encouraged domestic entrepreneurs to operate in collaboration with foreign firms. Major multinational companies operating in this industry in Sri Lanka are: MGT Group and Forbes Fashion from Australia; Ahier, Adler, Triumph and ALT United from Germany; Fountain Set and Mega Trend Management from Hong Kong; Indorama Corporation from Indonesia; YKK Zippers from Japan; Kabool, Tongyang, Samdo Corp., Gooryong Co. Ltd and Dae Yong Textile Company from South Korea; Courtaulds, Coats, Christy International, International Trimmings, SR Gents and Textured Jersey from the UK; and Mast, Kellwood, Playknits, Paxar and Shore to Shore from the US. These firms mainly invested in the production of clothing and clothing accessories, fabric and yarn, and other materials and, with their local partners, produce world famous brands of clothing products such as Victoria Secret, Liz Claiborne, Abercrombie and Fitch, Tommy Hilfiger, Polo, Ralph Lauren, Gymboree, Adams,

Tesco, Levi's, Nike, Pierre Cardin, Gap, Marks & Spencer, London Fog, C&A, Next, Calvin Klein, Lucky Jeans, etc.

**Figure 2. Foreign Investment in the Textiles and Clothing Industry, 2005-09**



Source: Authors' calculation based on BoI of Sri Lanka, 2010

As the BoI of Sri Lanka website reports, major firms in the country's textiles and clothing industry (the country of investment is given in parentheses) are: Brandix Apparel Ltd (Sri Lanka); Smart Shirts Ltd (Hong Kong); Omega Line Ltd (Italy); Slimline (Pvt) Ltd (UK, US, Sri Lanka); Bodyline (Pvt) Ltd (US, Hong Kong, Sri Lanka); Unichela (Pvt) Ltd (UK, Sri Lanka); Shadowline (Pvt) Ltd (Mauritius, Sri Lanka); Linea Clothing (Pvt) Ltd (Maldives, Sri Lanka); Hirdaramani Mercury Apparel (Pvt) Ltd (Sri Lanka); Crystal Martin Ceylon (Pvt) Ltd (Hong Kong); South Asia Textile Industries Lanka (Pvt) Ltd (Singapore, Sri Lanka); and Stretchline (Pvt) Ltd (Hong Kong, Sri Lanka). Many large investors in the textiles and clothing industry of Sri Lanka are from the East Asian region.

Since the country does not have an extensive and efficient industrial base of producing textile materials and clothing accessories, the industry is largely dependent on the import of materials. As Kelegama (2005) noted, the industrial setup of the textiles and clothing industry in Sri Lanka was such that it produced finished clothing by importing most of the materials from various parts of the world. Therefore, it seems that the textiles and clothing industry in Sri Lanka is highly dependent on foreign markets for the sale of finished clothing as well as for the import of materials.

The domestic textile materials industry is not large and is not capable of supplying sufficient quantities of yarn and fabric to the country's clothing industry. Therefore, the government has followed a policy to import textile materials on duty-free or concessionary duty terms since the late 1970s to assist in the promotion of exports of clothing. Zero duty on imported materials made the domestic textile materials industry less competitive. However, during the 1990s the textile materials industry expanded with joint venture investments, as many clothing manufacturers invested in the production of textiles and other materials for use in its own clothing production. Domestic clothing manufacturers set up joint venture fabric plants. One example is Ocean Lanka (Pvt) Limited, fabric knitting and dyeing plant started in 1996. This textiles factory is a joint venture of Fountain Set (Holdings) Ltd – the world's largest knit fabric manufacturer based in Hong Kong – and two leading clothing manufacturers in Sri Lanka. Fountain Set owns 60 percent while two domestic companies have 20 percent each. The fabric plant produces 2-3 million meters of fabric per month. Most of the local clothing manufacturers purchase fabrics from this plant. Owners of one of the factories of major clothing producer stated that their supply agent purchased all of their fabric needs from Ocean Lanka. Ocean Lanka imports raw cotton and other materials and yarn from China, Indonesia and South Asian countries and supply fabrics to local clothing manufacturers. The company re-exports cotton waste and cotton yarn to China and other Asian countries. In addition to Ocean Lanka, many other companies engage in the production of yarn and fabric in Sri Lanka.

### **3.1. The Supply Chain Network**

As discussed above, the world's largest multinational firms in the textiles and clothing industry are operating in Sri Lanka as suppliers of materials, producers of materials, producers of clothing and clothing accessories, trading agencies, etc. These firms are involved in several stages of the supply chain network of the industry. This section analyses the directions of imports of materials and exports of materials and finished clothing. Table 3 shows exports and imports of United Nations Harmonized System (HS) two-digit level product categories in 2009. Product categories from HS50-HS60 are materials of the textiles and clothing industry and HS61-HS63 are finished

clothing products. From total textiles and clothing exports, HS50-HS60 product categories accounted for about 5 percent only, of which about 2 percent was of the HS53 product category which includes exports of coconut fibres. Therefore, Sri Lanka does not export textile inputs and materials on a large scale. However, out of total textiles and clothing imports, more than 95 percent was from the HS50-HS60 product categories. This includes the import of fabric, cotton, fibres and man-made filaments. Therefore, the textiles and clothing industry in Sri Lanka is heavily dependent on the import of textile materials.

The table shows that Sri Lanka heavily exports finished clothing products. HS61 and HS62 product categories accounted for 93.4 percent of the total textiles and clothing exports of the country in 2009. These two product categories mainly cover clothing accessories and finished clothing. Therefore, Sri Lanka mainly exports finished clothing products while it mainly imports textile materials. In the product categories of HS50-HS60, many categories show deficits in the trade balance. These trade deficits are very large in product categories such as cotton, fabrics, man-made fibres and filaments and wool. On the other hand, clothing accessories and finished clothing show large trade surpluses.

### *3.1.1. Imports of Materials*

One of the major issues for Sri Lanka's textiles and clothing industry is its high dependency on foreign inputs. Many people argue this dependence on foreign inputs is associated with very low domestic value content (Kelegama, 2005; Deerasinghe, 2009). Figure 3 shows the composition of textile material imports to Sri Lanka in 2009. Of the total, fibre and yarn accounted for about 73 percent; fabric accounted for 16 percent; and lace, nets, etc, accounted for 4 percent. Textile covering and packing items; sewing thread; and labels, badges etc., each accounted for 2 percent of total material imports. It again implies that the country imports most of its yarn and fabrics necessary for the industry.

**Table 3. Composition of Textiles and Clothing Trade, 2009**

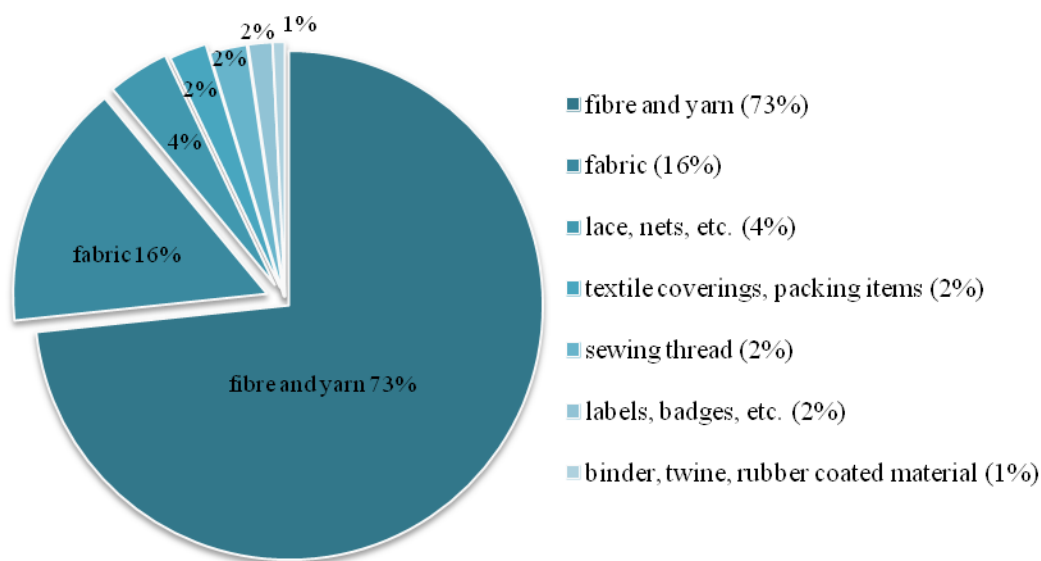
HS Code	Commodity description	Exports		Imports		Trade balance
		US\$mn	%	US\$mn	%	US\$mn
50	Silk	0.0	0.0	5.4	0.3	-5.4
51	Wool; fine or coarse animal hair, horse hair, yarn and woven fabric	0.0	0.0	140.5	6.9	-140.5
52	Cotton	19.2	0.6	605.0	29.8	-585.8
53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn	80.8	2.4	23.5	1.2	57.3
54	Man-made filaments; strip and other like man-made textile materials	5.1	0.1	312.7	15.4	-307.6
55	Man-made staple fibres	20.3	0.6	224.1	11.1	-203.8
56	Wadding, felt and non-woven; special yarn; twine; cordage, ropes and cables and articles thereof	15.3	0.5	22.5	1.1	-7.2
57	Carpets and other textile floor coverings	4.1	0.1	4.0	0.2	0.1
58	Special woven fabrics, tufted textile fabrics; lace; tapestries; trimmings; embroidery	15.4	0.5	139.6	6.9	-124.2
59	Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use	2.4	0.1	51.2	2.5	-48.8
60	Knitted or crocheted fabrics	17.8	0.5	415.8	20.5	-398.0
61	Articles of apparel and clothing accessories, knitted or crocheted	1,581.2	47.4	34.6	1.7	1,546.6
62	Articles of apparel and clothing accessories, not knitted or crocheted	1,538.1	46.1	42.0	2.1	1,496.2
63	Other made up textile articles; sets; worn clothing and worn textile articles, rugs	38.1	1.1	6.2	0.3	31.9
	Total	3,338.1	100.0	2027.1	100.0	1310.8

*Source:* Authors' calculation based on UN Comtrade database, 2011.

Of the total material imports of US\$1,944 million in 2009, nearly 40 percent was of imports of cotton, cotton yarn and cotton fabric (see Figure 4). Major source countries for these products were China (36%), India (30%), Pakistan (16%), Indonesia (6%) and the US (2%). These five countries accounted for 90 percent of Sri Lanka's supply of cotton, cotton yarn and cotton fabric in 2009. The other largest material import category is synthetic fibre, yarn and fabric. It accounted for about 21 percent of total textile material imports in 2009. Major source countries were China (21%), US (11%),

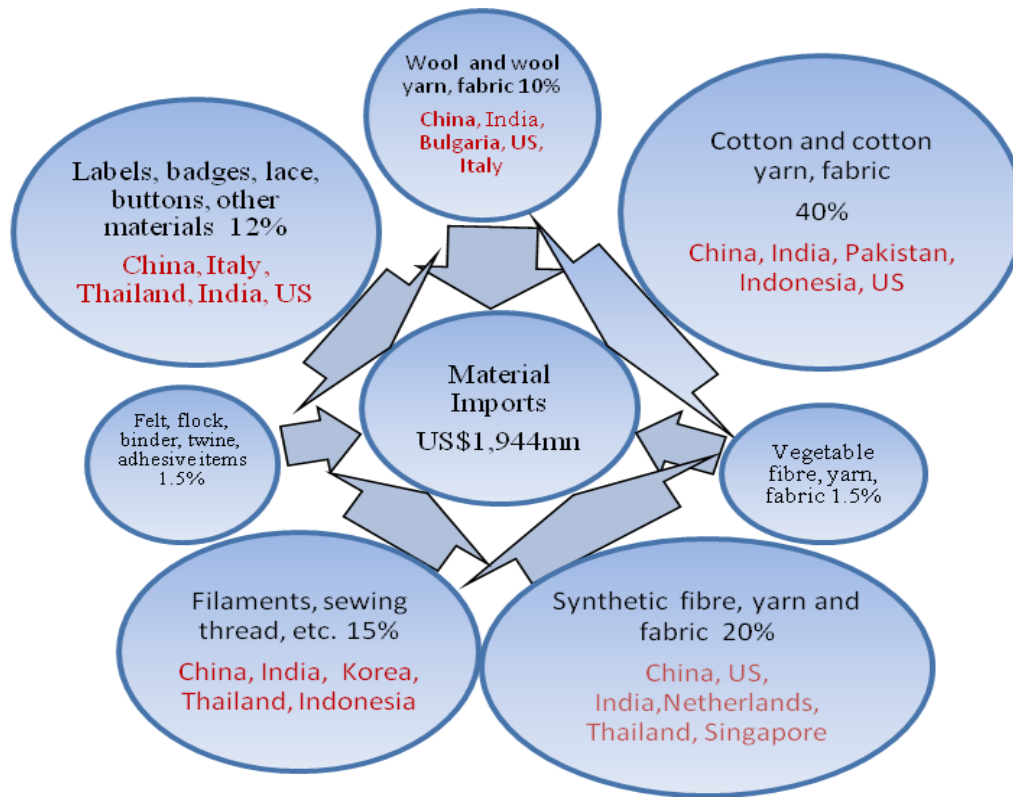
India (9%), Netherlands (7%), Thailand (7%) and Singapore (7%). Imports of man-made filaments, sewing thread, etc. Accounted for nearly 15 percent of total textile material imports. Sri Lanka imported these materials mainly from China (33%), India (15%), South Korea (9%), Thailand (8%) and Indonesia (4%). Labels, badges, lace, buttons and other materials constituted 12 percent of total textile material imports. Sri Lanka imported these items mainly from China (46%), Italy (15%), Thailand (9%), India (5%) and the US (3%). Wool, wool yarn and wool fabric is another important category of textile material imports. It accounted for nearly 10 percent of total textile material imports in 2009 and was mainly imported from China (30%), India (18%), Bulgaria (12%), US (11%) and Italy (7%).

**Figure 3. Imports of Textile Materials to Sri Lanka, 2009**



*Source:* Authors' calculation based on UN Comtrade database, 2011.

**Figure 4. Composition of Textile Material Imports to Sri Lanka, 2009**



*Source:* Authors' calculation based on UN Comtrade database, 2011

*Note:* Vegetable fibre, yarn, fabric are imported from mainly China, India, Bangladesh, Pakistan and Italy. Felt, flock, binder, twine, adhesive items are mainly imported from China, India, Malaysia, Germany and Thailand.

The five main categories of textile materials shown in Figure 4 accounted for nearly 97 percent of the total textile material imports in 2009. In all categories of material imports, China has been the dominant source country. As shown in Figure 5, in all textile material imports China accounted for nearly 40 percent while India accounted for about 18 percent and the US for 2.5 percent.

With regard to trading blocs, EU countries accounted for about 12 percent of total material imports, and South Asian countries accounted for 24 percent of which India's contribution was about 18 percent. ASEAN countries accounted for about 10 percent of the total. Interestingly, ASEAN+1 countries have significantly high backward linkages with Sri Lanka's textiles and clothing industry. About 70 percent of total textile materials required for the clothing industry are imported from the ASEAN+1 countries.

Therefore, trade regimes and policy regimes of ASEAN+1 countries will have the greatest impact on the textiles and clothing industry in Sri Lanka compared to the regimes of other countries.

**Figure 5. Major Trading Partners in the Sri Lankan Textiles and Clothing Industry, 2009**

Import of textile materials (per cent)		Export of clothing (per cent)		Export of textile materials (per cent)	
•China	37.8	•US	41.1	•China	17.1
•India	17.6	•UK	26.9	•India	7.5
•US	2.5	•Italy	11.1	•US	6.0
•EU	11.6	•EU	51.7	•EU	20.2
•ASEAN	9.5	•ASEAN	0.3	•ASEAN	10.6
•ASEAN+1	70.3	•ASEAN+1	1.8	•ASEAN+1	54.8
•South Asia	24.4	•South Asia	0.3	•South Asia	14.5

Source: Authors' calculation based on UN Comtrade database, 2011.

### 3.1.2. Exports of Clothing

Sri Lanka's textiles and clothing industry is mainly restricted to the export of finished clothing products. In 2009, finished clothing products accounted for about 94 percent of the total textiles and clothing exports of Sri Lanka, as shown in Figure 6. As shown in Figure 7, of the total textiles and clothing exports, knitted and crocheted clothing products and clothing accessories (HS61) accounted for 47 percent while articles of non-knitted and non-crocheted clothing products and clothing accessories (HS62) accounted for 46 percent. Other made-up clothing products (HS63) accounted for only 1 percent of total exports of the textiles and clothing industry. As shown in Figure 5, major destinations of Sri Lanka's clothing exports in 2009 were the US (41 percent) and EU (52 percent). The major importers of Sri Lanka's clothing products in the EU were the UK, Italy, Germany, Belgium and France. Sri Lanka exports a very limited amount of its clothing products to ASEAN and South Asian countries. ASEAN+1 countries accounted for only about 2 percent of total clothing exports from Sri Lanka. Therefore, the finished products of Sri Lanka's clothing industry are not dependent on the markets of ASEAN and ASEAN+1 countries.

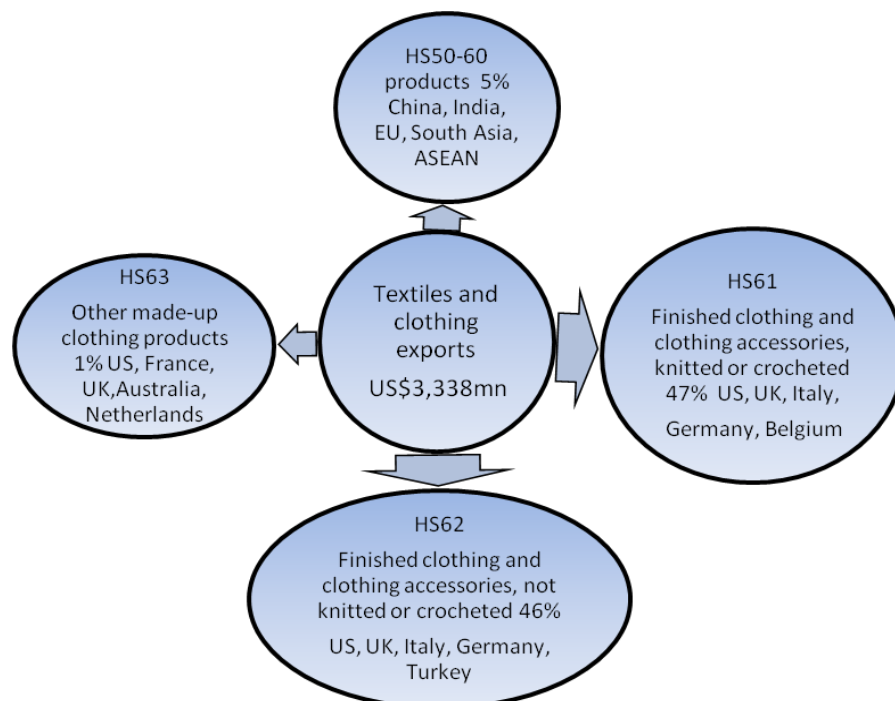


**Figure 6. Exports of Textile-Related Products, 2009**



*Source:* Authors' calculation based on UN Comtrade database, 2011.

**Figure 7. Composition of Sri Lankan Exports of Textiles and Clothing, 2009**



*Source:* Authors' calculation based on UN Comtrade database, 2011.

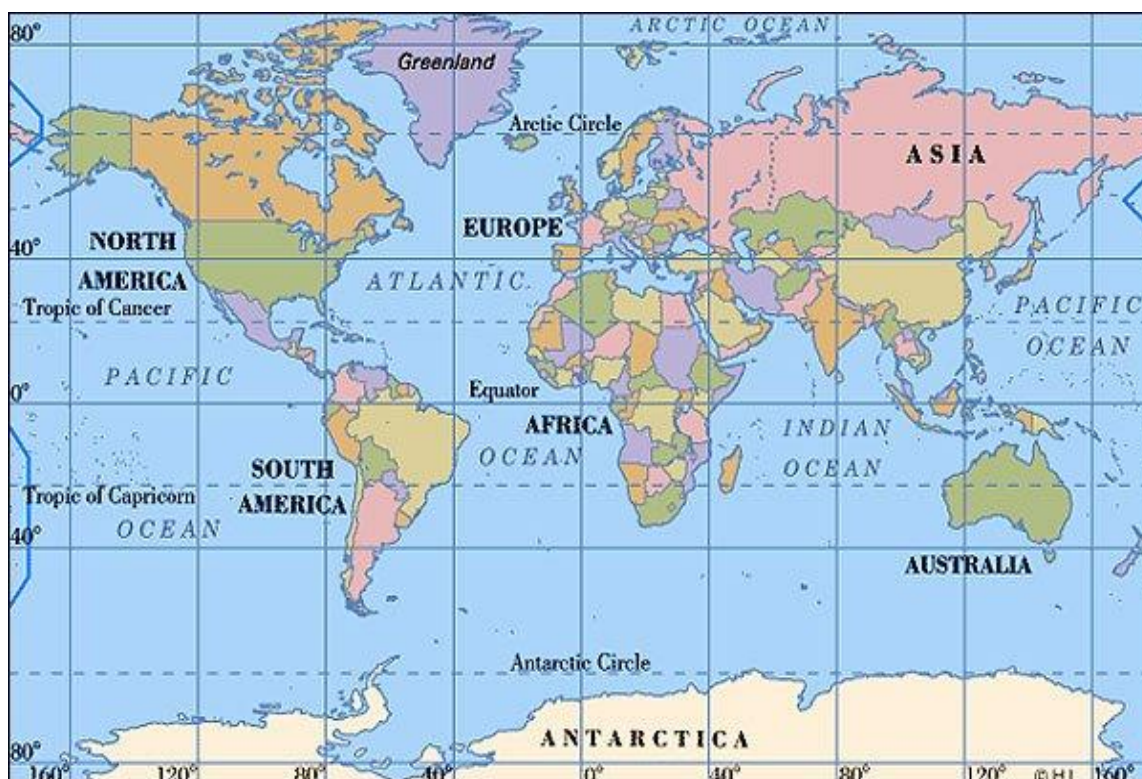
### *3.1.3. Textile Material Exports*

In 2009, Sri Lanka exported textiles and clothing products worth US\$3,338 million. Around 5 percent of this was textile materials (HS50-60 categories). Sri Lanka mainly exports these products to countries such as China, India and the US. In terms of trade blocs, EU countries received 20 percent of these exports, South Asian countries received 14 percent and ASEAN countries received 11 percent. ASEAN+1 countries accounted for 55 percent of total textile material exports from Sri Lanka. The high ASEAN+1 share is mainly bought by China and India which are major sources for textile materials for Sri Lanka's clothing industry.

### **3.2. Supply Chain Map**

Figure 8 illustrates the supply chain network of Sri Lanka's textiles and clothing industry. The dark arrows represent the flow of textile material imports into Sri Lanka's clothing industry. China, South Asia, the EU and the ASEAN countries are the major outsourcing destinations for the industry. Sri Lanka mainly exports its final clothing products to the EU and the US. Within Asia, China and India are the dominant buyers for certain materials from Sri Lanka (see Figures 5 and 7). Some EU countries which produce clothing outsource materials from Sri Lanka. The links between Sri Lanka's textiles and clothing industry and ASEAN countries is important as Sri Lanka outsources a significant quantity of materials from ASEAN countries. Sri Lanka exports a sizable amount of textile materials to ASEAN countries such as Vietnam and Cambodia that are expanding their clothing industry at present. The final market for the clothing products of Sri Lanka in 2009 was dominated by the EU countries and the US. The bulk of the finished clothing is produced for the markets in these Western countries. The clothing industry in Sri Lanka has no strong links with Asia and East Asia and therefore there are substantial opportunities to explore that market.

**Figure 8. Supply Chain Network of the Textiles and Clothing Industry in Sri Lanka, 2009**



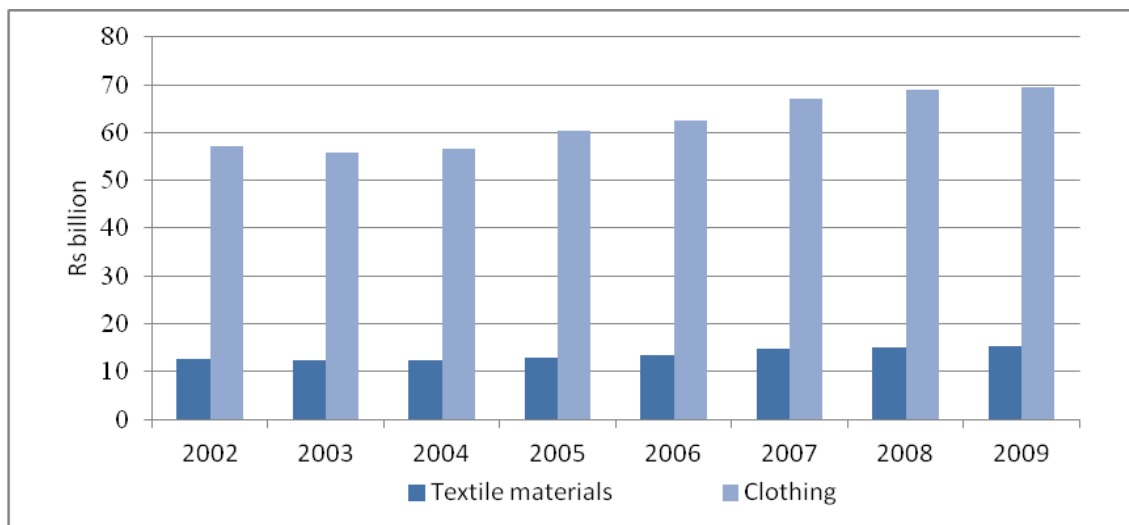
*Source: Prepared by authors.*

*Note: Dark arrows, arrows with diamonds and arrows with dots represent the import of materials, export of final products and export of intermediate products, respectively.*

### **3.3. Domestic Value-Added Components**

The textiles and clothing industry in Sri Lanka has failed to create significant backward and forward linkages with the rest of the economy. Kelegama (2009) argued that the MFA quota system and other trade agreements between Sri Lanka and some important trade partners have not improved the competitiveness of the industry. Because of the lack of a fabric and accessory production base, the degree of vertical integration in the industry is also less compared with other competitive producer countries.

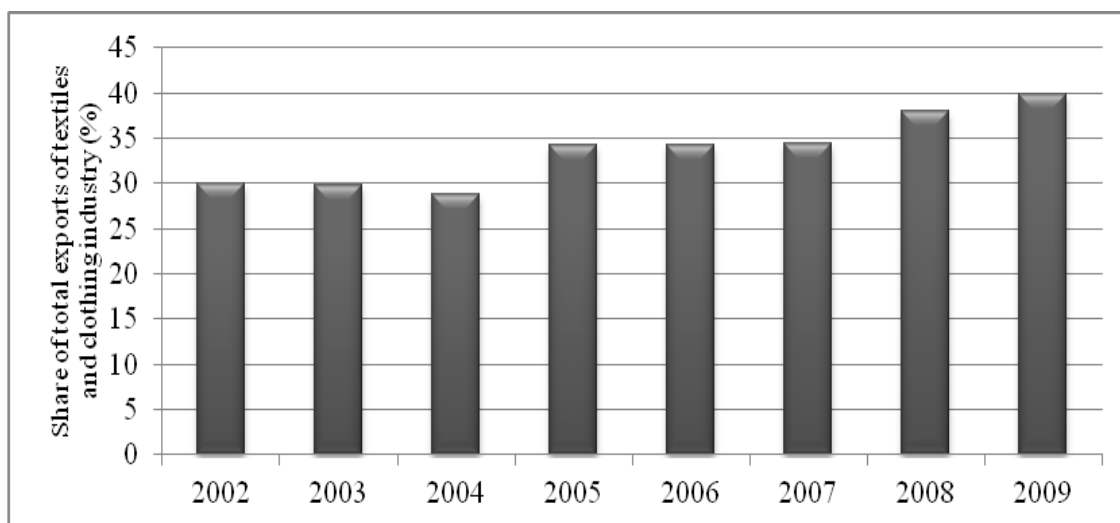
**Figure 9. Domestic Value Added in the Textiles and Clothing Industry, 2002-09**



*Source:* Authors' calculation based on Annual Report of the Central Bank of Sri Lanka, 2010.

Figure 9 shows that the domestic value-added content in the textiles and clothing industry increased gradually from 2002 to 2009. However, the increase for the manufacture of clothing was slightly faster than for the manufacture of textile materials. As shown in Figure 10, both the textile materials and clothing production together create domestic value added of about 40 percent of the industry's total export value in 2009, a 10 percentage point increase compared to the 2002 value. The local value-added component rose in recent years as the fabric and other material production expanded. In addition, the increased supply of embroidery, lace and other related materials by domestic small and medium enterprises (SMEs) also contributed to the increase in the domestic value-added component of the clothing industry exports. However, one manufacturer revealed that the local content of the material accounted for, on average, less than 20 percent of the market price of the final product. This 20 percent includes cutting and manufacturing costs, costs of fabric and other materials, packaging and local transport costs.

**Figure 10. Domestic Value Added in the Textiles and Clothing Industry, 2002-09**



Source: Central Bank of Sri Lanka, Annual Report 2010.

### **3.4. Fiscal Incentives Offered to the Textiles and Clothing Industry**

The government has offered various incentives for the BoI industries since the late 1970s when it moved towards a liberalized open economic policy. In general, if a company has a minimum of 50 million rupees of foreign investment, the company is liable to receive an exemption from profit and income tax for five years from the commencement of the business. Many textiles and clothing manufacturers which have started their operations since the late 1970s used this opportunity to receive income tax exemptions by incorporating their investment into large foreign investment projects. In addition, the textiles and clothing industry also benefited from a law which states that the profits and income of any company engaged in exporting commodities other than tea, rubber and coconut should be taxed at a rate not exceeding 15 percent.

Business entities approved by the Textiles Quota Board (TQB) of Sri Lanka for the manufacture of clothing or provision of services which add value to clothing products are taxed at a rate of 15 percent, on the relevant part of profits or income applicable to the service provided. In addition, fabric imported for the clothing industry is excluded from value added tax (VAT), subject to approval from TQB and BoI. Yarn, dye and other materials used for handloom manufacturing are exempted from VAT. The following are offered deferment of VAT: purchase of fabric produced by a BoI-approved entity for the manufacture of clothing for the purpose of export; any materials

imported by manufactures supplying non-traditional export-oriented companies including approved manufacturers registered with the TQB; and sales of materials by manufacturers supplying non-traditional export-oriented companies including clothing manufacturers registered with TQB and the Export Development Board. In addition, the government has reduced the Economic Service Charge for exports, supply to exporters and sales of BoI-approved trading houses to 0.1 percent from 1 percent which applies for all other exports. Recently, the government has removed the ports and airport levy on export and import items for processing and re-export products which benefits the textiles and clothing industry too.

#### **4. Trade Policy, Trade Agreements and the Textiles and Clothing Industry**

Trade restrictions on the textiles and clothing industry have a long history tracing back to the 1930s, when the US and the UK took action to limit textile imports from Japan. The emergence of East Asian countries as producers of textiles and clothing led Western developed countries to negotiate voluntary export restraints. The introduction of the MFA quota system by developed countries provided protection for their domestic textiles and clothing industries. The MFA also provided opportunities for small exporting countries to access large markets and enable them to increase their export earnings. As discussed in section 1, the URA on textiles and clothing envisaged the elimination of the MFA quota over a 10-year period and provided for an average reduction of 22 percent of tariff rates on textiles and clothing. However, the progress of removing quotas in the US and EU markets has been slow. At present many of the quotas offered by the EU markets have been removed and trade in textiles and clothing has been facilitated under various bilateral and regional trade agreements.

Researchers state that trade reforms towards preferential trade agreements were rather slow in Sri Lanka as the country mainly focused on unilateral tariff reforms (see de Mel et al., 2011). However, at present the country has the following trading arrangements with its trading partners: Generalized System of Preferences with the US

and the EU; South Asian Free Trade Area; Indo-Sri Lanka Free Trade Agreement; Pakistan--Sri Lanka Free Trade Agreement and Asia--Pacific Trade Agreement. Each of these agreements is discussed below.

#### **4.1. Generalized System of Preferences**

The Generalized System of Preferences (GSP) is a trading agreement through which the EU countries and the US provide preferential access for developing countries into their markets in the form of reduced tariffs. Under the EU GSP scheme Sri Lanka enjoys normal provisions given in the GSP scheme and some additional tariff rate reduction under the GSP+ scheme, a special incentive arrangement for sustainable development and good governance. The textiles and clothing industry enjoys a reduction of duty by 20 percent under the normal GSP scheme. For a product to qualify for GSP provisions, the following requirements should be satisfied: the product must originate in beneficiary countries and proof of originating status; direct shipment from the beneficiary country to the EU; and regional accumulation criteria which would encourage regional cooperation should be satisfied. The following documents are required: certificate of origin, invoice declaration, certificate of movement when goods are exported to beneficiary countries from the EU in the context of bilateral relations, and ex-works (ex-factory) price information. The ex-work price information should include the following details: customs value of imported inputs, local raw materials, labor, others direct costs and overheads costs.

The market establishment under the GSP and GSP+ schemes has greatly benefited Sri Lanka's textiles and clothing industry. In particular, the protection provided under the GSP+ scheme helped domestic clothing producers penetrating the European market, although the facility was withdrawn recently. The utilization of the EU GSP scheme by Sri Lankan exporters has increased since 2004 with the introduction of the GSP+ facility. Wijayasiri and Dissanayake (2008) found that the utilization rate of the EU GSP scheme was at around 40 percent. However, the study found that the utilization rate of the US GSP scheme was higher at 89 percent, due mainly to relatively fewer Rule of Origin (ROO) restrictions.

#### **4.2. Indo-Sri Lanka Free Trade Agreement**

The Indo-Sri Lanka Free Trade Agreement (ISFTA) was signed on 28 December 1998 and came into effect from 1 March 2000. ISFTA aims to promote economic linkages between India and Sri Lanka through enhancement of bilateral trade and investment. The agreement only covers trade in goods and requires the two countries to offer market access for each other's exports on a duty-free basis and with concessionary tariffs.

India included clothing products in the negative list of the agreement. The negative list of trade agreements includes commodities that are not opened for negotiations under preferential trade arrangement. However, India has made special provisions under the agreement since 2000 to allow Sri Lanka to export into India 8 million pieces of clothing falling under HS61 and HS62 categories in any one calendar year. It was also agreed that for the manufacture of 6 million pieces out of the 8 million pieces of clothing products, the sourcing of fabrics would be done from India. It was further agreed that not more than 1.5 million pieces would be of any one product category.

Manufacturers are authorized to export to India under the following conditions: a certificate of origin is required; the import of clothing from Sri Lanka to India is allowed through the designated ports of Chennai and Mumbai; a tariff rate quota certificate (TRQC) issued by TQB of Sri Lanka is required. Carry-forward or carry-over of quota from a given year to another year is not allowed and off-shore sales of textiles and clothing products are prohibited under the agreement.

#### **4.3. Pakistan Sri Lanka Free Trade Agreement**

The Pakistan Sri Lanka Free Trade Agreement (PSFTA) was signed on 1 August 2002. Following the signing of the framework agreement, the two countries, having conducted several rounds of bilateral negotiations, finalized the annexes to the agreement in December 2004. In addition, the two sides signed a protocol, which aims to expand the scope of the current FTA and move towards a Comprehensive Economic Partnership Agreement, covering trade in services and investment cooperation. The objectives of this agreement are: to promote the development of economic relations between Pakistan and Sri Lanka through the expansion of trade in goods and services; to provide fair conditions of competition for trade in goods and services between Pakistan



and Sri Lanka; and to contribute, by the removal of barriers to trade in goods and services, to the expansion of bilateral as well as multilateral trade. Pakistan has agreed to offer Tariff Rate Quota (TRQ) of 3 million pieces of clothing products per financial year for 21 product categories of HS61 and HS62 classification with a preferential duty margin of 35 percent. The quantity exported under any specific product category is restricted to 200,000 pieces per annum.

#### **4.4. South Asia Free Trade Agreement**

The South Asia Free Trade Agreement (SAFTA) was finalized and signed by the Council of Ministers of the member states of the South Asian Association for Regional Cooperation (SAARC) on 6 January 2004. SAFTA aims to enhance the program of regional economic integration through the promotion of preferential trade, which commenced with the establishment of the South Asian Preferential Trading Arrangement (SAPTA) in 1995. This agreement offers different margins of preference for different product categories across countries. The following are the rules of origin: products should wholly be produced/obtained in the territory of the contracting exporting party; products should have a different HS code number from the imported items; the regional aggregate content should not be less than 50 percent of the freight on board (FOB) value; and the domestic value-added content should not be less than 20 percent of the FOB value. Direct shipment from the beneficiary country is required.

#### **4.5. Asia--Pacific Trade Agreement**

The Asia--Pacific Trade Agreement (APTA), formerly known as the Bangkok Agreement, was signed on 2 November 2005 and came into effect from 1 September 2006. The APTA member countries of Bangladesh, China, India, Laos, South Korea and Sri Lanka have a total population of about 2.5 billion, a large market with significant trade potential. The third round of negotiations of APTA has offered a maximum of 50 percent margin of preference on existing tariffs among the member countries for a wider coverage of products. With the conclusion of the third round of negotiations, the member countries had exchanged concessions on 4,270 products plus 587 products offered exclusively to less developed countries (LDCs), a marked increase from the 1,721 products plus 112 products for LDCs before the third round.

Sri Lanka's major export items to the APTA member countries were: natural rubber, desiccated coconut, coconut fibre, copra, coconut oil, tea, cloves and crude glycerin. In addition, Sri Lanka was able to secure tariff concessions from APTA member countries for products of spices (such as pepper, nutmeg, mace), cashew nuts, natural graphite, activate carbon, rubber products (tyres, gloves, mats, rings), floor tiles, ceramic, tableware/kitchenware, glassware, semi-precious stones, gems and jewelry, stuffed toys, brooms and brushes, cut flowers, footwear, biscuits, chocolates, clothing, fresh fruits and juices, wooden furniture, mattresses, electric lamps, ornamental fish, fresh/frozen fish and fishery products. However, Sri Lanka does not export a significant part of its clothing products to APTA member countries.

#### **4.6. Ongoing Trade Negotiations with Asian Countries**

Sri Lanka is a member of the proposed Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMST-EC) which includes Bangladesh, India, Thailand and Myanmar. The main objective of this new sub-regional grouping is to foster socio-economic progress in the member countries by promoting cooperation in eight priority sectors: trade, investment, industry, technology, infrastructure and transportation, tourism, energy, agriculture and human resource development. Sri Lanka is assigned the role of leading the textiles and clothing industry and coordinating the activities among the group. Further, Sri Lanka is involved in ongoing negotiations with China, Singapore, South Korea and Japan to establish free trade agreements. If the country is able to enter into trade agreements with these countries, it would greatly benefit the textiles and clothing industry because access to these Asian markets through FTAs will provide large market opportunities and reduce the uncertainty of the industry due to the high dependency on Western markets and attract more foreign investment into the industry from the region.

#### **4.7. Preferential Duty Rates Under FTAs**

The export of textiles and clothing products is subject to zero duty in Sri Lanka. Therefore, FTAs would have no significant impact on the export trade of textiles and clothing. Table A2 (see Appendix) gives the details of the duty rates applied for textiles and clothing imports into Sri Lanka. Almost all textile materials imports are subject to

zero duty. Exceptions are: woven fabric obtained from strip; binder and baler twine; twine; cordage and ropes; articles of yarn and strip tullors and net fabrics; woven textile wicks; and coconut fibre, which are all subject to 15-30 percent duty. Special duty rates for the above products are offered under ISFTA, PSFTA, SAFTA and APTA bilateral and multilateral trade agreements. For example, for most of these products, a preferential rate of zero percent is offered under ISFTA and PSFTA, 10.83 percent duty rate is offered for SAFTA member countries and rates of 13 percent or less are offered for APTA member countries. Thus, for some textile-related products, countries with trade agreements received zero percent or concessional duty rates compared to other countries. However, one may argue that as the duty rate is zero for most textile-related products, trade agreements would not generate significant preferential benefits for the textiles and clothing industry in Sri Lanka.

Imports of clothing products of HS61, HS62 and HS63 categories into Sri Lanka are generally subject to a 15 percent duty. As noted earlier, together with all other domestic taxes and surcharges the price of imported finished clothing products would be at least 65 percent higher than the prices of domestic clothing products. However, the import of clothing under ISFTA and PSFTA is subject to zero duty. A concessional rate of 10.83 percent is applied to clothing imports from other SAFTA countries and a concessional rate of 13.5 percent for some clothing products is applied to APTA member countries (see Table A2).

## **5. Case Studies**

Factories and establishments that are engaged in the textiles and clothing industry in Sri Lanka can be divided into three categories. The first consists of large-scale factories that manufacture clothing for the purpose of exporting, operating in all stages of production and export sales. The following Cases (i) and (ii) are examples for this category. The second category includes large-scale factories that produce clothing for orders of export agencies. Export agencies obtain orders from foreign trade partners, probably multinational textiles and clothing firms, and subcontract to these local

clothing manufacturers. Export agencies supply all materials for the production and product design, and also assess the quality of products before export. The following Case (iii) provides an example for the second category. The third category of clothing producers includes SMEs which produce clothing accessories, other materials and sometimes the final product for large-scale clothing manufactures. Case (iv) provides an example for the third category. Case (v) is an export agency which subcontracts clothing manufacturers and engages in international trade in clothing.

### **5.1. Case (i): Large-Scale Textiles and Clothing Manufacturer and Exporter**

We gathered information from one of the leading clothing manufacturers with a production capacity of 6 million pieces of clothing per month. The company has 12 factories in Sri Lanka and two factories overseas – one in Vietnam and one in Bangladesh. It imports yarn and fabric from suppliers in China, Taiwan, Hong Kong, India, Indonesia and some EU countries. It also produces fabrics in its own fabric plant, which is a joint venture with one of the largest fabric manufacturers in the world. The company has its own product design and development centre, printing and embroidery centre, washing plant and a packaging plant. It produces clothing for international brands such as Marks & Spencer, Lucky, Levi's, Ralph Lauren and Tommy Hilfiger for the markets in the EU and the US.

The export of final products of the company is handled by its own export centre. It also purchases clothing products from other small-scale suppliers for exporting. The company stated that provisions in the EU and the US GSP schemes have benefited the industry in securing markets for its production. According to the company, it has utilized the GSP schemes as the regional accumulation and domestic value-added content has been satisfied in their products. The requirement of domestic value-added content led the company to start its own fabric plant with foreign collaboration. However, the existing bilateral free trade agreements of Sri Lanka with Asian countries will not contribute greatly to the betterment of the industry as their main export market is in the Western countries and duty rates for textile material imports are mostly zero.

## **5.2. Case (ii): Large-Scale Producer and Supplier to an Export Agency**

We interviewed the manager of one of the factories of a large group of companies engaged in the manufacture of clothing in Sri Lanka. The company has production plants in many parts of the country and overseas. In this study, we observed the production process of one of its branch factories which produces ladies' blouses, dresses and jackets with a production capacity of 12,000-15,000 units per day. The factory mainly supplies to Marks & Spencer in the UK through an export agency. The export agency obtains orders from the foreign buyer and subcontracts the producer. All production materials are supplied by the export agency along with production orders. The foreign buyer and the export agency provide design of the garment. Most of the time, the foreign buyer directly feeds the design to the automated cutting machine of the manufacturer. The manufacturer supplies the final product to the export agency and receives the cutting and manufacturing payment from the export agency if the product passes the accepted quality level test. The manufacturing firm has no idea about the impact of free trade agreements on the industry. The manufacturing firm however has concerns and interests relating to the domestic tax policies and incentive schemes.

## **5.3. Case (iii): Clothing Producer-cum-Exporter Operating Under BoI Law**

A clothing manufacturer with foreign investment operating under the BoI law, this company stated that it operates in Katunayake EPZ where various incentives and infrastructural facilities are provided as a means of encouraging foreign investment. The company started operations in the 1980s and, at present, it produces ladies' and children's wares and mainly exports to US and EU markets. It purchases materials from some EU countries, the US and Asian countries. Since the import of raw materials for the clothing industry is duty free in Sri Lanka, the company does not consider FTAs to be important in the import of textile materials. However, the firm has extensively used the provisions in the EU GSP and US GSP schemes to penetrate those two markets for its finished clothing. The company informed us that the utilization rate of the US GSP scheme is higher than the utilization rate of the EU GSP scheme due to less stringent ROO requirements in the former. However, the documentation requirement in terms of domestic value-added content and regional accumulation is a hindrance to the use of these trade facilities. Responding to the question as to whether FTAs facilitate trade,

the company stated that GSP and GSP+ schemes provided opportunities to enter into many European country markets which were highly restrictive otherwise.

The company identifies the ISFTA and PSFTA as having large potential for Sri Lanka's textiles and clothing industry. However, the company reports that non-tariff barriers imposed by India and Pakistan for Sri Lanka's clothing exports play a major role in discouraging the utilization of the ISFTA and PSFTA. In these FTAs, both India and Pakistan included textiles and clothing products in the negative list initially and offered a preferential duty rate for a limited amount of exports later. India allows only 8 million pieces of clothing products to be imported from Sri Lanka for which sourcing of materials should be from India. Further, these products should reach India only through the designated ports in Chennai and Mumbai to qualify for preferential duty under the ISFTA. The PSFTA allows Sri Lanka to export only 3 million pieces of clothing products to Pakistan in a given year. Quantitative restrictions, requirements on sourcing of materials and other non-tariff barriers are obstacles to the utilization of FTAs with Asian countries. In addition, the company states that it would prefer to export to Western countries than to Asian countries with FTAs since the prices in Asian countries are significantly lower than prices in Western countries though there is no significant quality difference in the product.

The company believes that trade agreements with Asian countries such as Japan, China, South Korea, Singapore, Taiwan and Hong Kong, in terms of the textiles and clothing industry, would create a huge market for Sri Lanka's clothing products. Markets in these rich Asian nations would be highly important as their own textiles and clothing industries have moved to other countries. The opening up of the Asian markets through trade agreements would lessen the high dependency of the country's textiles and clothing industry on the Western markets. The company, however, is unaware of the APTA in which Sri Lanka has trade agreements with China and some other Asian countries.

#### **5.4. Case (iv): Subcontracting Small-Scale Clothing Producer**

The authors interviewed an owner-cum-manager of a small-scale clothing producer in Sri Lanka. This category includes many SMEs in the production of clothing accessories and final clothing products. Large firms outsource various clothing

accessories from these small firms and subcontract small firms occasionally to produce the final products in order to complete orders on time. The contracting manufacturing firm provides all the materials and cut fabrics to the subcontracting small firm for production and supervises the production process to maintain the accepted quality level imposed by export agencies/foreign buyers. These small firms were unaware of foreign markets, market prices, trade agreements, trade barriers and tariffs, etc. As the trade-related matters were handled by large manufacturing/contracting firms or exporting agencies. In the absence of subcontracts from large manufacturers for the purpose of export, these small-scale firms produce clothing for the local market.

### **5.5. Case (v): Textiles and Clothing Export Agency**

We interviewed one of the textiles and clothing export agencies. This particular export agency is the one referred to in Case (ii) above. The export agency receives orders for clothing from foreign buyers and completes orders by contracting large-scale textiles and clothing producers. The export agency provides all the materials and product design to the producer. Materials are purchased from EU countries, Asian countries and domestic suppliers. The sourcing of materials from various countries has enhanced the production network of the industry and helps to meet the regional accumulation criterion. While having their own quality control mechanisms, the export agency works closely with foreign buyers to identify market needs and new designs. Therefore, the export agency is well aware of the changes in foreign market conditions including prices.

The export agency states that it uses the provisions in given trade agreements, in particularly, the EU GSP scheme. The quota given in the EU GSP and GSP+ schemes greatly benefited the exporting agency in supplying to markets in the UK and other European countries. The exporting agency ranks the EU GSP scheme as 'highly beneficial' for its trading activities. In particular, the EU GSP and GSP+ schemes opened up markets of many EU countries for Sri Lanka's textiles and clothing products. The exporting agency was able to fulfill the ROO requirements and regional accumulation criteria in the EU GSP scheme as a significant part of the material imports are from EU countries, and from South and East Asian countries. However, as the export agency mainly supplies to a foreign buyer in the UK, it does not pay much

interest to the bilateral and regional trade agreements of Sri Lanka with Asian countries such as ISFTA, PSFTA and SAPTA. The exporting agency was unaware of the APTA regional trade agreement. It admitted that there are greater delays at custom clearance due to security concerns and confirmation of regional accumulation and domestic value-added criteria. It did not respond to the question of how FTAs change the regulatory issues that affect the textiles and clothing industry in Sri Lanka.

## **6. Conclusion and Policy Implications**

This chapter has examined the supply chain network of the textiles and clothing industry in Sri Lanka and the impact of FTAs on changing the supply chain pattern of the industry. We find that Sri Lanka's textiles and clothing industry has important backward linkages with South Asia, East Asia, ASEAN and ASEAN+1 countries. Sri Lanka outsources a large part of textile materials from these countries. At the same time, Sri Lanka exports a significant amount of its textile material production to the region. However, the market for the final clothing products of Sri Lanka is dominated by the US and the EU. The supply chain map of the country's textiles and clothing industry clearly illustrates that Sri Lanka's textiles and clothing industry is highly integrated with Asian countries in terms of import and export of textile materials, while its markets for final clothing products depends on Western countries. About 95 percent of total textiles and clothing exports are final products which are exported to the EU and the US.

The MFA quota system was highly beneficial for the textiles and clothing industry of the country. However, the gradual removal of the MFA quota system forced Sri Lankan textiles and clothing producers to be more efficient in order to be competitive in the world market. In the absence of secured markets through the quota system, the government of Sri Lanka tends to reach international markets through preferential trade agreements. The country is currently involved in a few bilateral and multilateral trade agreements such as ISFTA, PSFTA, EU and US GSP schemes, SAFTA and APTA. The country is currently in negotiation with some important Asian countries such as



Japan, China, South Korea and some of ASEAN countries to reach trade agreements.

The EU and US GSP schemes have contributed greatly to the progress of the textiles and clothing industry of Sri Lanka. About 95 percent of total clothing production is exported to the EU and the US mainly under the GSP provisions. Textiles and clothing manufacturers recognize GSP schemes as highly beneficial for the country's textiles and clothing industry. Less stringent ROO and regional accumulation criteria make manufacturers/exporters comfortable in exporting to the EU and the US.

FTAs that the country has with South Asian and some East Asian countries have less contribution to the progress of the textiles and clothing industry. This is for three reasons: first, almost all textile material imports are subject to zero duty in Sri Lanka and exports of clothing products are also subject to zero duty under the existing FTAs. Thus, existing trade agreements do not create a preferential treatment/environment to make a significant impact on the industry. Second, since Sri Lanka's clothing products are mainly exported to the US and the EU countries, FTAs with Asian and ASEAN countries do not generate significant benefits for the country's textiles and clothing industry. Third, although Sri Lanka has free trade agreements with India, Pakistan and other South Asian countries and some East Asian countries, trading of textiles and clothing products is highly restrictive in those agreements.

The experience of some of the manufacturers and exporters in the industry revealed that the utilization rate of the EU and US GSP schemes was high while the utilization rate of FTAs with Asian countries was low/less extensive. Textiles and clothing manufacturers believe that it would be beneficial for Sri Lanka to sign FTAs with ASEAN and ASEAN+1 countries as these countries provide alternative markets for the final clothing products. Also, FTAs with ASEAN and ASEAN+1 countries would make outsourcing of textile materials for the clothing industry of Sri Lanka more efficient and promote investment in the industry. It would also force Sri Lanka to concentrate on the most efficient production points in the global value chain of the textiles and clothing industry.

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## Appendix

**Table A1. Duty Rates and Other Taxes and Surcharges**

HS Code	Product description	UoM	Duty %	VAT %	Cess tax (value)	Cess tax (uom) Rs	PAL %	NBT %	Total w/o Cess (uom) %
5001 5002 5003 5004 5005 5006	Silk-worm cocoons, raw silk, silk waste, silk yarn, yarn spun from silk waste	kg	0	0			5	3	8
5007	Woven fabric of silk and silk waste	kg	0	12			5	3	20
5101 5102 5103 5104	Wool not carded or combed, fine or coarse animal hair (not put up for retail sale), waste of wool or fine and coarse animal hair, garneted stock of wool/fine or coarse animal hair	kg	0	12			5	3	20
5201, 5203, 5205,5206	Cotton not carded or combed, cotton carded or combed, cotton yarn	kg	0	0			5	3	8
5202, 5204, 5207	Cotton waste, cotton sewing thread, cotton yarn retail packed	kg	0	12			5	3	20
5208111	Plain woven fabrics of cotton (cotton 85% or more, not more than 100g/m <sup>2</sup> ; unbleached)	kg	0	12			5	3	20
5208, 5209, 5210, 5211, 5212	Woven cotton fabrics wt over 200g/m <sup>2</sup> , woven cotton fabrics under 85% of cotton over/not over 200g/m <sup>2</sup> , woven cotton fabrics nest.	kg	0	12		50	5	3	20
5301,5302, 5303	Flax; true hemp; jute and other textile based fibres, raw and not spun, flax tow and waste	kg	0	12			5	3	20
5305	Coconut, abaca, ramie fibres raw and not spun	kg	30	12			5	3	50
530521, 530529, 530591, 530599	Textile fibres of abaca, ramie , raw, tow and waste	kg	0	12			5	3	20
5306, 5307, 5308, 5309, 5310, 5311,	Flax yarn, yarn of jute and other textile based fibres, yarn of vegetable textile based fibres nest. and paper yarn, fabrics of flax, fabrics of jute and other fibres, fabrics of vegetable based fibres	kg	0	12			5	3	20

HS Code	Product description	UoM	Duty %	VAT %	Cess tax (value)	Cess tax (uom) Rs	PAL %	NBT %	Total w/o Cess (uom) %
5401, 5404, 5405, 5406	Sewing thread of man-made filaments; synthetic monofilaments; artificial monofilaments, man-made filament yarn	kg	0	12			5	3	20
5402, 5403	Synthetic filament yarn	kg	0	0			5	3	8
5407	Woven fabrics of synthetic filament yarn	kg	0	12		50	5	3	20
540720	Woven fabrics obtained from strip	kg	15	12		50	5	3	35
5408	Woven fabrics of artificial filament yarn	kg	0	12		50	5	3	20
5501, 5502, 5504, 5505, 5506, 5507, 5508, 5511, 5512, 5513, 5514, 5515, 5516	Synthetic filament tow, artificial filament tow, artificial staple fibres not carded/combed, waste of man-made fibres, synthetic staple fibres carded/combed, artificial staple fibres carded/combed, sewing thread of man-made staple fibres, yarn of synthetic and man-made fibres, woven fabrics of synthetic, artificial and other man-made fibres	kg	0	12		50	5	3	20
5509, 5510	Yarn of synthetic staple fibres; yarn of artificial staple fibres, not retail	kg	0	0		50	5	3	8
5601, 5602, 5603, 5604, 5605, 5606	Textile wadding and articles, textile fibres nest; felt, impregnated or coated; non woven; rubberized thread and cord; textile covering; rubberized textile yarn	kg	0	12			5	3	20
56011, 560721, 560741, 560749, 560790, 5608	Sanitary towels, tampons, napkins and napkin liners of wadding, binder of bale twine of sisal, binder or bale twine of polythene or polypropylene; other twine, knotted net twine	kg	30	12			5	3	50
560729, 560750, 5609	Cordage, ropes and cables of sisal fibres; twine cordage and cables of other synthetic fibres; articles of yarn like heads of 5404/5408	kg	15	12			5	3	35
5701	Carpets and other textile floor coverings, knotted	mt	15	12	25	50	5	3	60
5702, 5703, 5704, 5705	Carpets and other textile floor coverings, woven not tufted, carpets and floor coverings not tufted; carpets and floor covering tufted; carpets and floor covering felt not tufted, nest	mt	15	12			5	3	35
570220	Floor coverings of coconut fibres (coir), woven	mt	0	12	25	100	5	3	45

HS Code	Product description	UoM	Duty %	VAT %	Cess tax (value)	Cess tax (uom) Rs	PAL %	NBT %	Total w/o Cess (uom) %
5801, 5802, 5804, 5807, 5808, 5809,5810, 5811	Woven pile and chenille fabrics, woven terry fabrics, tulles and other net fabrics, labels, badges and other textile material, braids and ornamental trimmings, embroidery, quilt textile products	kg	0	12		50	5	3	20
5803	Gauze fabrics	kg	15	12		50	5	3	35
580410	Tulles and other net fabrics, not including woven, knitted or crocheted	kg	15	12		50	5	3	35
5901, 5902, 5903, 5904, 5905, 5906, 5907, 5909, 5910, 5911	Textile book cover fabrics, tracing cloth, paint, canvas; tire code fabric of high tenacity yarn; plastic textile fabric coat; linoleum, floor cover with coats on a textile base; textile wall coverings; rubberized textile fabrics; textile hose piping and tubing; transmission/conveyor belts; textile products for special use.	kg, mt	0	12			5	3	20
590310, 5908	Textile fabrics impregnated, coated, covered with polyvinyl and chloride; textile wicks for lamps and gas mantle, etc.	kg	15	12			5	3	35
5907	Coated textile fabrics, theatrical	kg	0	12		50	5	3	20
6001, 6002, 6003, 6004, 6005, 6006	Pile fabrics, fabrics of a width not exceeding 30cm, wrap knit fabrics and other	kg	0	12		50	5	3	20
6101, 6102, 6103, 6104, 6105, 6106	Men's or boys' overcoats, car coats, cloaks, anoraks, wind-cheaters, wind jackets and similar products ; Women's and girls' overcoats, car coats, cloaks, anoraks, wind-cheaters, wind jackets and similar products ; Men's or boys' suits, ensembles, jackets, blazers, overalls, breeches and shorts ; women's or girls' suits, ensembles, jackets, blazers, overalls, breeches and shorts ; men's or boys' shirts (knitted or crocheted); women's or girls blouses, shirts, shirt-blouses (knitted or crocheted)	unit	15	12	30	75	5	3	65
6107, 6108, 6111, 611211, 611212,	Men's or boys' underpants, briefs, nightshirts, pajamas, bath robes, dressing gowns and similar ; women's or girls' slips and petticoats, briefs and panties (knitted or crocheted) ; track suits, ski suits and swimwear;	unit	15	12	25	60	5	3	60
6114, 6116, 6117	Other garments, gloves, mittens and mitts ; other made-up clothing accessories	kg	15	12	25	60	5	3	60

HS Code	Product description	UoM	Duty %	VAT %	Cess tax (value)	Cess tax (uom) Rs	PAL %	NBT %	Total w/o Cess (uom) %
6109, 6110, 6112, 6113	T-shirts, singlet and other vests of cotton; jerseys, pullovers, cardigans, waistcoats and similar products of cotton, man-made fibres and other materials ; track suits, ski suits and swim wear; garments made up of knitted or crocheted fabrics of heading 5903, 5906 and 5907	unit	15	12	30	75	5	3	65
6115	Panty hose, tights, stockings, socks, and other hosiery	kg	15	12	25	625	5	3	60
61178	Other made up clothing accessories, knitted or crocheted	kg	0	12	25	60	5	3	45
61179	Parts of garments or of clothing accessories , knitted or crocheted	kg	0	12			5	2	19
6201, 6202, 6203, 6204, 6205, 6206, 6207	Men's or boys' overcoats, car coats, cloaks, anoraks; women's and girls' overcoats, car coats, cloaks, anoraks, wind-cheaters, wind jackets and similar products ; men's or boys' suits, ensembles, jackets, blazers, overalls, breeches and shorts ; women's or girls' suits, ensembles, jackets, blazers, overalls, breeches and shorts; men's or boys' shirts (not knitted or crocheted); women's or girls blouses, shirts, shirt-blouses (not knitted or crocheted); men's or boys' underpants, briefs, nightshirts, pajamas, bath robes, dressing gowns and similar	unit	15	12	30	75	5	3	65
6208	Women's or girls' slips and petticoats, briefs and panties (not knitted or crocheted)	kg	15	12	25	60	5	3	60
6209, 6210, 6211, 6212, 6213, 6214, 6215, 6216	T-shirts, singlet and other vests; jerseys, pullovers, cardigans, waistcoats and similar products; babies' garments and clothing accessories ; track suits, ski suits and swim wear; garments made up of knitted or crocheted fabrics of heading 5903, 5906 and 5907; other garments; panty hose, tights, stockings, socks, and other hosiery; gloves, mittens and mitts	kg	15	12	30	75	5	3	65
6217	Other made-up clothing accessories (knitted or crocheted)	kg	0	12			5	3	20
6301, 6302, 6304	Blankets and travelling rugs; bed linen, fabric linen, toilet linen, and kitchen linen; furnishing articles	kg	15	12	30	75	5	3	65
630392, 630411	Curtains and interior blinds, bed valances	kg	15	12			5	3	35

HS Code	Product description	UoM	Duty %	VAT %	Cess tax (value)	Cess tax (uom) Rs	PAL %	NBT %	Total w/o Cess (uom) %
6305	Sacks and bags of kind used for the packing of goods	kg	15	12	25		5	3	60
6306	Tarpaulins, awnings and sun blinds, tents, sails for boats, sailboards of land crafts, camping goods	kg	15	12	30		5	3	65
6307, 6309, 6310	Made-up articles of textile materials nest; worn clothing and other worn textile articles ; used or new rags, scrap twine, etc	kg	15	12	30		5	3	65
6308	Needlecraft sets of woven fabrics and yarn	kg	15	12	30	50	5	3	65

Source: Department of Customs, Sri Lanka 2011

Note: UoM is unit of measurement. PAL is Port and Airport Levy and NBT is Nation Building Tax, Cess tax is a specific tax on the commodity.

**Table A2. Preferential Duty Rates Offered by Sri Lanka in Bilateral and Multilateral Trade Agreements**

HS code	Product description	UOM	General %	Preferential duty rates offered in FTAs %			
				ISFTA	PSFTA	SAFTA	APTA
50	Silk including yarn and woven fabrics	kg					
5001, 5002, 5003, 5004, 5005, 5006, 5007	Silk-worm cocoons, raw silk, silk waste, silk yarn, yarn spun from silk waste, fabric of noil silk	kg	0				
51	Wool and fine or coarse animal hair including yarn and woven fabrics thereof	kg					
5101, 5102, 5105	Shom wool, other wool, carbonized wool, fine or coarse animal hair (not carded or combed)	kg	0				
5111, 5112, 5113,	Woven fabric of wool, woven fabric of combed wool, woven fabric of animal hair	kg	0				
52	Cotton , cotton yarn and woven fabrics	kg	0				



HS code	Product description	UOM	General %	Preferential duty rates offered in FTAs %			
				ISFTA	PSFTA	SAFTA	APTA
53	All other vegetable textile fibre, paper yarn, and woven fabric of paper yarn	kg					
5301	Raw flax	kg	0				
5305	Raw bristle fibre of coconut	kg	30				
53050082, 53050089, 53050099	Tow, noils and waste, other coconut fibre	kg	30		0		
5306, 5307, 5308, 5309, 5310, 5311	Flax yarn, yarn of Jute and other based fibres, yarn of other textile fibres and paper yarn, woven fabric of flax, woven fabric of jute and other based fibres, woven fabrics of other vegetable textile fibres	kg	0				
5401, 5402, 5403, 5404, 5405, 5406, 54071, 54073	Sewing thread of man-made filaments, synthetic filament yarn, artificial filament yarn, synthetic monofilaments, artificial monofilaments, man-made filament yarn, woven fabrics obtained from high tenacity yarn of nylon/polyamides/polyesters, other fabrics	kg	0				
54072	Woven fabric obtained from strip or the like	kg	15	0	0	10.83	
55	Man-made staple fibres	kg	0				
560110	Sanitary towels and tampons, napkin liners for babies of wadding	kg	30				
560121	Sanitary towels and tampons, napkin liners for babies of cotton, man-made fibres, other textile dust	kg	0				
5602, 5603, 5604,	Needle loom and other felt, stitch bonded fibre fabrics, other felt of wool, other textile material, rubber thread and cord, textile covered/with rubber plastic	kg	0				
560721, 560741	Binder or baler twine	kg	30				
560729	Twine, cordage, ropes, and cables etc of other material	kg	15				

HS code	Product description	UOM	General %	Preferential duty rates offered in FTAs %			
				ISFTA	PSFTA	SAFTA	APTA
5607491	Twine, cordage, ropes, etc imported for manufacture of fishing nets	kg	15		0		
5607499	Twine, cordage, ropes, etc imported for other purposes	kg	30		0		
5607509	Synthetic fibre imported for manufacture of fishing nets	kg	15				
56079010	Other material imported for manufacture of fishing nets	kg	15		0		
56079020 - 56079090	Coir twine, coir ropes, other twine of jute or other textile fibres	kg	30		0		
56081-56089	Made up fishing nets and other	kg	30				
5609	Articles of yarn, strip or the like	kg	15				
57	Carpets and other textile floor covering						
57011	Carpets and textile floor covering,	m2	15	0	0	10.83	13.5
5701901, 5701902,	Coir carpets and rugs, jute carpets and other	m2	15	0	0	10.83	7.50
57021, 57022	Hand-woven rugs, floor covering of coconut fibre, wool, animal hair,	m2	15	0	0	10.83	
5702391-5702399	Floor coverings of jute and other vegetable fibres	m2	15	0	0	10.83	7.50
570310	Tufted carpets and other textile floor coverings of wool, nylon or other polyamides, other man-made textile fibres	m2	15	0	0	10.83	13.50
5703901-5703909	Tufted carpets and other textile floor coverings of jute	m2	15	0	0	10.83	12.75
58	Special woven fabrics, tufted textile, lace and other material						
580110	Woven pile fabrics and chenille fabrics of wool, cotton and other man-made fibres	kg	0				
5802-5803	Terry towelling and similar woven fabric of cotton and other fibres	kg	0				

HS code	Product description	UOM	General %	Preferential duty rates offered in FTAs %			
				ISFTA	PSFTA	SAFTA	APTA
5804101	Tullors and net fabrics (knotted netting)	kg	15 or 350/kg	0	0	10.83 or Rs 253/kg	
580421-580430	Mechanically or man-made lace	kg	0				
5805	Woven pile fabrics	kg	0				
5807	Labels, badges and similar articles of textile material	kg	0				
5808	Braids in the piece, ornamental trimmings	kg	0				
5809	Woven fabrics of metal thread and metalized yarn	kg	0				
5810	Embroidery in the piece in strips or in motifs	kg	0				
59	Impregnated, coated, covered or laminated textile fabrics, textile articles of a kind of suitable for industrial use						
5901	Fabrics coated with gum/amylaceous substances	kg	0				
5902	Tyre cord fabric of high tenacity yarn of nylon or other polyamides, polyesters or viscose rayon	kg	0				
59032-59033	Textile fabrics impregnated coated covered laminated with other substance	kg	0				
5904, 5905	Linoleum, textile wall coverings	m2	0				
5906, 5907	Rubberized textile fabrics, textile fabrics otherwise impregnated coated covered painted and canvas	kg	0				
5908	Woven textile wicks	kg	15	0	0	10.83	
5909, 5910, 5911	Textile hose piping and similar textile tubing, transmission or conveyer belts or belting of textile materials	kg	0				

HS code	Product description	UOM	General %	Preferential duty rates offered in FTAs %			
				ISFTA	PSFTA	SAFTA	APTA
60	Knitted crocheted fabrics						
6001, 6002-6003, 6004, 6005, 6006	Pile fabrics, fabrics of a width not exceeding 30cm, wrap knit fabrics and other	kg	0				
61	Articles of apparel and clothing accessories (knitted or crocheted)	unit	15	0	0	10.83	15-13.5
62	Articles of apparel and clothing accessories (not knitted or crocheted)	unit	15	0	0	10.83	15-13.5
63	Other made up articles of textile and garment accessories	unit	15				

Sources: ISFTA, PSFTA, SAFTA and AFTA agreements and Department of Customs, Sri Lanka.