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Japan International Cooperation Agency

The Democratic Socialist Republic of Sri Lanka
Ministry of Plan Implementation, Ethnic Affairs and National Integration

**The Master Plan Study
For
Southern Area Development
In
The Democratic Socialist Republic of Sri Lanka**

Final Report

**Sector Report 2
Industry, Tourism and Services**

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February 1997

**Nippon Koei Co., Ltd.
International Development Center of Japan
System Science Consultants Inc.**

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List of Reports

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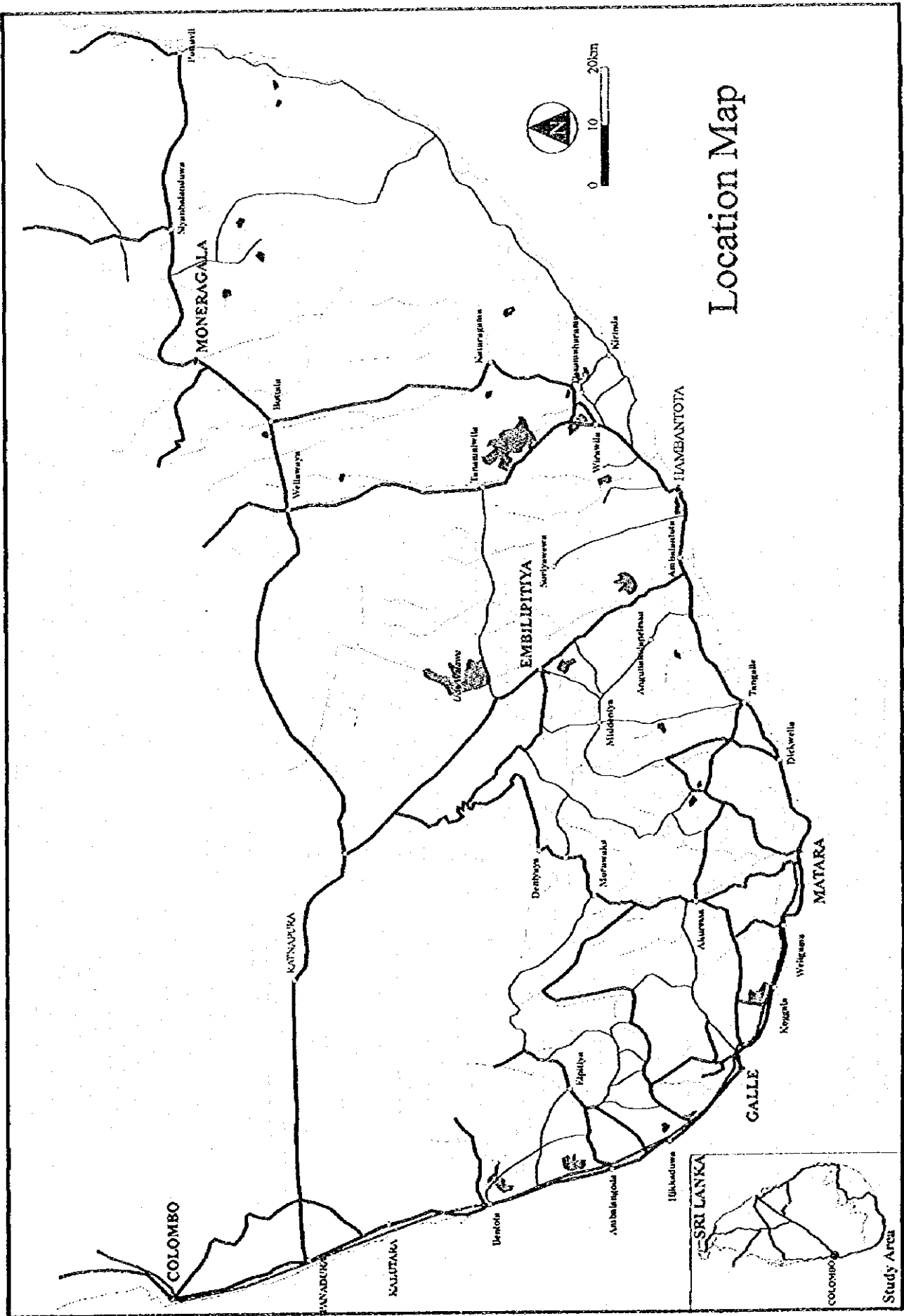
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Location Map



SECTOR REPORT 2 INDUSTRY, TOURISM AND SERVICES

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ABBREVIATIONS

PART 1 INDUSTRY

ADB	Asian Development Bank
BOI	Board of Investment
CISIR	Ceylon Institute for Scientific and Industrial Research
CITI	Clothing Industry Training Institute
DSI	Department of Small Industries
EPZ	Export Processing Zone
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IDB	Industrial Development Bank
JICA	Japan International Cooperation Agency
NCC	National Crafts Council
NDB	National Development Bank
NERD	National Engineering Research Development Center
RRDB	Regional Rural Development Bank
RSBR	Public Sector Borrowing Requirements
SLBDC	Sri Lanka Business Development Center
SMI	Small- and Medium-size Industry
TCCS	Thrift and Credit Cooperatives Society
UDA	Urban Development Authority

PART 2 TOURISM

BOI	Board of Investment
CTB	Ceylon Tourist Board
JICA	Japan International Cooperation Agency
NGO	Non Governmental Organization
UNDP	United Nations Development Program
UNESCO	United Nations Educational, Scientific, and Cultural Organization

PART 3 SERVICES

BOI	Board of Investment
CFC	Cooperative Finance Corporation
CWE	Cooperative Wholesale Establishment

DFCC **Development Finance Corporation of Ceylon**
MPCS **Multi-Purpose Cooperative Society**
NGO **Non Governmental Organization**

Abbreviation of Measures

Length

mm	=	millimeter
m	=	meter
km	=	kilometer

Area

ha	=	hectare
km ²	=	square kilometer

Volume

l	=	lit = liter
m ³	=	cubic meter
MCM	=	Mm ³ = million cubic meter

Weight

mg	=	milligram
g	=	gram
kg	=	kilogram
t	=	ton = MT = metric ton

Energy

kcal	=	kilocalorie
TOE	=	tons of oil equivalent
kW	=	kilowatt
MW	=	megawatt
kWh	=	kilowatt-hour
Gwh	=	gigawatt-hour
MVA	=	megawolt-ampere
MMBFOE	=	million barrels of fuel oil equivalent

Others

%	=	percent
°C	=	degree Celsius
cap	=	capita
mil.	=	million
no.	=	number

Industry

SECTOR REPORT 2 INDUSTRY, TOURISM AND SERVICES

PART 1 INDUSTRY

CHAPTER 1 EXISTING CONDITIONS

1.1 Background

Successive Governments in Sri Lanka pursued an extreme policy of import substitution until 1977. These policies provided complete protection to local manufacturing industries. Imports were prohibited in most cases. In others, the level of protection provided to domestic industries exceeded 200% through a combination of tariffs and other import restrictions.

Many small industries developed beyond these protective measures and supplied the local market. Prominent among these were textiles, manufacture of soap, salt, coil wire, soft drinks and metal based products. Within this import substitution strategy, the Governments emphasized two characteristics: to create employment and benefit the small/micro enterprises to the maximum extent possible. These two major preoccupations still dominate government approach to industrialization.

Limited import liberalization measures were instituted in 1977. These and associated changes had a drastic impact on the domestic manufacturers, particularly the handloom industry: the number of handlooms that stood at 110,000 in 1977 (close to 20% of manufacturing employment at the time) declined to an estimated 15,000 looms by 1980.

Partial import liberalization was accompanied by a boom in exports. This was largely in response to market access provided under the textile quota system primarily to the USA. Handicrafts and other local industries, however, had little to do with the surge in exports. Firms with foreign direct investment contributed two-thirds of manufactured export growth. The contribution of these firms to garment exports was near total.

The pattern of industrialization since then has thus come to be characterized by a contraction in small industries and handicrafts, and an expansion in export oriented industries, particularly garments, gems, toys, and plastic and rubber products. At the same time, the government policy priorities largely ignored these industries. A variety of support measures were instituted to support cottage/micro enterprises. This was partly in response

to pressing needs to create employment. It also reflected the biases of Western donors who had found a receptive client in Sri Lanka to experiment with a strategy based on cottage industries.

The new policy initiated in 1994 recognizes the need to create jobs in efficient industries that are internationally competitive and are capable of paying reasonable wages. The relative emphasis has also shifted from production for the small domestic market to exports. Another factor leading to this shift in emphasis is the scaling down of support provided by the foreign donors who have been disappointed with the decade-long experiment. The past policies cannot be sustained without the subsidies provided by the donors.

In line with global trends and recent changes in policy, the Government will also refrain from public investment in directly productive sectors. The Government's role will be confined to providing support to private industries. A key factor will be the stability and continuity of domestic development policy. The Country will reap a large peace dividend if the problems in the North could be settled.

There are direct support measures that can be undertaken even within this new role. These include streamlining of regulations, development of industrial sites, provision of infrastructure, credit, and technical training. Details of these are discussed in the following sections.

1.2 Regional Resource Base

Southern Area has limited natural resources to support a major industrialization drive. The main potential is the availability of a large pool of educated workers that can be employed by large, export oriented companies. Agricultural and mineral resources provide limited opportunities for further processing. The size and purchasing power of the regional market also can support limited manufacturing production.

1.2.1 Mineral resources

A comprehensive survey of the mineral resources of Southern Area was completed by the Geological and Survey Bureau in July 1996. The study identified 12 mineral resources. Of these, rocks for road building and construction were noted to be abundant. Sufficient quantities of kaolin were also noted to be available for the continued production of the existing ceramic industry in Galle district.

Some of the vein quartz/feldspar pegmatites could be utilized in ceramic and walltile industries. Clays suitable for brick, tile and pottery are noted to be available in moderate quantities. There are limited mica deposits in Kolonna and these are exported in raw form.

Severe limits have been placed on quarrying of construction stones for environmental reasons. Explosives are also not available due to recent security concerns. As a result, the non-metallic mineral based industries in Sri Lanka remain highly undeveloped. This poor performance is also affected by the state of cement industry; it is very expensive and not always available.

Gem mining is a traditional industry in the north central parts of Southern Area. This has led to a gem cutting industry and gem trade around Ratnapura. The Government discourages introduction of large-scale gem mining to protect the existing labor intensive practices. There is also cosmetic jewelry production in the Area for exports primarily to Germany.

1.2.2 Agricultural resources

The agricultural resource base in the Area is reasonably diverse. Productivity in agriculture and development of agriculture-based industries is severely constrained by structural factors. All of the output is consumed fresh and there is little surplus available for processing.

Agriculture mainly consists of paddy and plantation crops. The latter consists of tea, coconut and rubber. Coconut is grown on the coastal areas and support downstream industries in oil production, a variety of copra products and coir production. The major impact of this crop is through processing of coconut fiber. Spinning of coco fiber and production of products based on this fiber is one of the major sources of manufacturing employment. The coconut itself is all consumed fresh. Coco oil and other products are not developed. The volume of primary production is not large enough to support processing industries in oil extraction, desiccated coconuts and other products.

Tea is grown on the hilly areas in inland divisions. Tea processing is the largest source of employment after coir products. Processed tea is packed in barrels for sale in the Colombo auction. Blending and packaging occur after that. Consequently, packaging has not developed in the region.

Rubber is grown in the same agro-ecological zones as tea. It is not processed in the region. The exception is a few relatively large firms re-treading tires in Matara. Most of the domestic market demand is for this type of tires which cost less than half of the new ones. This, however, is likely to change as the incomes increase.

Paddy is grown in both hilly inland areas and along the coastal plains. The pattern of rice milling reflects this location. There is little production of other agricultural commodities and therefore no processing. Vegetable and fruit processing is rare, though cinnamon and chilies provide some prospects for processing. A small part of the cinnamon output (substandard grades) is processed into bark oil. The leaves are all used for oil extraction and there are hundreds of small scale producers of this oil. Other potential raw materials for this type of oil include lemongrass and citronella. Cardamon is another local crop with good prospects for processing into spice, condiment and medicine.

Limited processing occurs for the small dairy sector: buffalo milk into curd production and cow milk to produce yogurt and drinking yogurt. All fish caught seem to be marketed fresh. Very small quantities are dried when they cannot be sold fresh.

1.3 Industry in Southern Area

1.3.1 Location of industry

Despite its limited resource base the region is not particularly underdeveloped as far as industry is concerned. Excluding industry in Colombo, the region's share of industry in Sri Lanka would be similar to its share of national population. Southern Area's relative underdevelopment is thus a reflection of industrial concentration in Colombo. Rather, Southern Area has achieved some modest level of industrialization. The relative proximity of the region to Colombo, one export processing zone out of the national total of four located in the region and the government program of locating 200 garment factories in the provinces have all played a role in this industrialization of the Area.

Industry is also distributed fairly evenly among districts in the region. Galle and Matara districts have similar levels of industrial activity while Hambantota district is less developed (Tables 1.1 and 1.2). The location of garment factories is one reason for this pattern. The Government determined the actual location of 165 factories established under the "200 Garment Factories Program." Of these, 23 were located in the region whose distribution is fairly even: 11 in Galle, six in Matara and six in Hambantota.

Table 1.1 Value Added by Industry in Study Area in 1990

	(Rs. million)			
	Galle	Matara	Hambantota	Total
Mining	20.9	5.3	31.2	57.4
Food, Beverages and Tobacco	511.2	521.7	31.2	1,064.1
Textile, Apparel, Leather	313.0	25.2	7.1	345.3
Wood and Wood Products	11.0	24.9	0.5	36.4
Paper, Printing and Publishing	2.6	1.6	-	4.2
Chemicals, Petroleum, Rubber	101.3	13.5	-	114.8
Non-Metallic Mineral Products	23.7	10.9	44.6	79.2
Metal Products, Machinery and Equip.	2.1	5.6	1.1	8.8
Other Manufacturing	1.2	6.7	2.2	10.1
Total	987.2	615.5	118.1	1,720.8

Notes: 1) Data collected in 1991, but covered the situation as of 1990.

2) Includes enterprises with five workers or more only.

Source: Ministry of Finance and Planning, Census and Statistics Department (unpublished census data).

Table 1.2 Size Distribution of Manufacturing Enterprises in Southern Area

Number of Workers	Galle	Matara	Hambantota	Moneragala	Total
1	6,363	3,498	1,546	229	11,636
2-3	4,530	4,189	1,620	398	10,737
4-5	598	1,507	674	139	2,918
6-9	339	282	202	90	913
10-14	126	138	82	26	372
15-24	82	87	36	7	212
25-200	109	109	22	3	243
Over 200	17	19	8	3	47
Total	12,164	9,829	4,190	895	27,078

Source: Industrial Employment Survey of Southern Area, conducted for the JICA Study Team by the Southern Province Planning Secretariat, Oct. 1995.

Another cause of the even distribution of manufacturing in the region is small-scale industries. Until the reforms initiated in 1977, most handicraft industries were directly controlled by the Government. The Government provided trainers, buildings and production inputs for the traditional handicrafts. These included textiles (handlooms), carpentry and metal products (mostly brass). In an effort to promote employment in the poor areas, the Government assigned priority to the less developed areas in locating these small enterprises. The program led to concentration of different handicrafts in specialized villages. This brought about specialized producing villages for metal works, textiles, ceramics, coir manufacturing, and jewelry.

1.3.2 Industrial composition

The present pattern of industrialization in the Area reflects its resource base. Textiles, apparel and food processing provide most of manufacturing value added and employment. According to a 1990 survey of enterprises with more than five workers, 82% of manufacturing value added was provided by these subsectors (Table 1.1). There is a similar dominance of food processing and textiles/apparel in manufacturing employment: 71% in 1995 (Table 1.3). Furniture, clay and cement products, metal industries and light engineering provide most of the rest.

Within the food processing subsector of the region, tea processing is dominant employing over 16,000 workers or 14.6% of total manufacturing employment (Table 1.4). Rice milling is not as significant with only 2,700 employment, though all of local paddy production is processed in the region. Within the textiles/apparel subsector, large export oriented companies dominate the value added while most of the employment is in cottage industries, mostly in coir manufacture. In 1995 there were nearly 6,300 coir processing businesses employing over 17,000 workers, or 15.1% of manufacturing employment in the region (Table 1.4).

Table 1.3 Employment by Skill Level in Southern Area in 1995

Type of Industry	Unit	Employment			
		Skilled	Unskilled	Semi Skilled	Total
Mining	332	1,190	1,420	194	2,804
Food, Beverage and Tobacco	5,757	25,726	7,246	2,361	35,333
Textile, Wearing Apparel and Leather	12,209	37,060	6,164	2,101	45,325
Wood, Wood Products and Furniture	1,768	3,899	1,643	732	6,274
Paper Products, Printing and Publishing	171	629	342	117	1,088
Chemicals, Petroleum, Rubber, Plastic	1,115	4,735	1,238	439	6,412
Non-metallic Mineral Products	4,673	6,685	5,097	733	12,515
Metal Products, Machinery and Equipment	724	1,222	478	175	1,875
Other Manufacturing Industries	221	764	323	88	1,175
Total	26,970	81,910	23,951	6,940	112,801

Source: Industrial Employment Survey of Southern Area, conducted for the JICA Study Team by the Southern Province Planning Secretariat, October 1995.

Table 1.4 Number of Firms and Employment in Selected Manufactured Products in Southern Area in 1995

	Unit	Employment
1. Paddy Mills	1,184	2,689
2. Bricks, Ceramics and Other Clay Products (except Pottery)	1,824	6,920
3. Pottery	477	1,122
4. Coir and Coir-Based Products	6,263	17,048
5. Handloom Weaving	306	1,404
6. Tea Factories	173	16,467
7. Beedi and Tobacco Products	393	890
Total	10,620	46,540

Source: Industrial Employment Survey of Southern Area, conducted for the JICA Study Team by the Southern Province Planning Secretariat, October 1995.

1.3.3 Industrial enterprises by size and type

Southern Area has a mix of industries of different sizes and types: cottage (handicraft) industries, small- and medium-sized industries, and large factories. In terms of the number of work places and workers employed, cottage and small industries dominate (Table 1.2). In terms of output value, however, they are equally important.

(1) Cottage industries (handicrafts)

Cottage or micro industry dominates the workplaces that could be identified: 11,600 work places had only one worker, presumably the owner. Together with those employing two to three people, these small manufacturers accounted for 83 % of the workplaces (Table 1.2). Employment in cottage-type industries is heavily concentrated in a few products. These are textiles, coir and coir products, clay products (bricks and roof tiles), and food products (Table 1.4).

Textile

All textile production in the region is in handlooms. Not only is the output low, the quality is also very poor. Even the traditional markets (for bed sheets, pillow cases, loin cloth, etc.) are being rapidly lost to better quality products imported from India and Southeast Asia.

If the availability of raw materials is ensured, this sector has capacity to produce good quality fabric such as grey base cloth for the garment sector and uniform materials for school children.

Coir

Coir is primarily used to produce place mats and floor covers. The main market is local with limited exports. Output per worker is so low that a worker could never earn as much as the minimum legal wage: at present the highest income for skilled coir worker spending ten hours on heavy manual labor is less than Rs. 1,000 a month.

Known processes cannot increase productivity to levels which would make these products a viable source of income. The number of workers in these sectors would be reduced proportionately even if modest increases in productivity are to be achieved. This is because the demand for most products is highly inelastic with regard to both prices and incomes. Increasing the supply of these products, therefore, would reduce its price (and therefore producer incomes) even more. Improvements in marketing (getting rid of the middleman)

will have little impact: the producer incomes will not be affected significantly even if all trade/transport margins were eliminated and producer prices were set at the retail price levels. This has happened in some cases with the Government bearing all marketing costs.

(2) Small- and medium-sized industries

Only 1,700 of the 26,000 enterprises in the region were in the size class employing six to 250 workers (Table 1.2). This lack of intermediate-sized enterprises is partly due to the sectoral composition of output and partly policy induced. Conspicuously absent from the region are light engineering (particularly products of casting and forging), non-metallic mineral products, and wood and paper industries. It is in these subsectors that the share of medium-sized industries is typically large in other countries.

Government policy has also effectively prevented the development of medium-sized industries. Availability of cement has always been a problem and local cement-based industries have not developed at all in the region. Mining and quarrying for clay and granite is heavily regulated by the Government. It has effectively banned the emergence of private enterprises in these areas.

(3) Large factories

Despite the policy emphasis on cottage industry, a significant share of manufacturing employment in the region is in factory-type employment. Garments, textiles and tea processing play an important role in factory-type employment. There are 11 plants operating in the Koggala EPZ producing garments, toys and plastic products for export. These plants employed 5,600 workers in 1995. There are an additional 23 garment factories in the region. These 34 plants together provide around 20,000 jobs. The employment in these large plants would thus be around 17% of total manufacturing employment.

(4) Export-oriented industries

Garments dominate manufactured exports. There are, however, other industries with a strong export orientation. Most of these industries have a significant presence in the region. These include gems and jewelry, electronics, ceramics, wooden products and handicrafts, leather footwear, spices and essential oils, and processing of traditional export crops:

coconut, tea and rubber. There have been efforts to look at individual commodities within these groups to identify new processing opportunities and promote export of these products.

The most formal of such efforts are various Boards created under the Government. These Boards deal with their respective products at all levels: primary production, processing and exports. Their main shortcoming is being state-owned/managed. One suggestion that the Government has considered in recent years is to develop private trading houses along the Japanese and Korean models. There have also been efforts to contract out the management of these Boards to private companies.

The Government has also supported programs to look at individual products. Technical assistance from the potential markets (Japan, Western Europe and North America) was received at primary production and processing levels. Export promotion measures were undertaken for these products. These efforts range from export subsidies given through the Sri Lanka Export Development Board to expatriate technical assistance provided to individual producers and traders.

(5) Problems with cottage industry

The problem of cottage/micro enterprises is not only the inferior technology and extremely poor product quality. They also produce products for low income segments of the market where the market is shrinking rapidly due to a number of factors discussed below. Most of these changes are natural outcomes of development and should not be reversed. Yet, successive Governments have made huge efforts to maintain and promote these traditional activities.

The dominance of cottage industries is partly a result of government policies which targeted textiles, metal industries and ceramics for promotion. The Government support programs included an elaborate system of training, input provision and marketing. These were devised to allow individual producers to undertake manufacture of textiles and other products. Many processes that could and should have been mechanized to improve efficiency and quality remained unchanged in an effort to create employment.

At the national level, training and technology transfer services were first provided. Initially, these programs aimed to help independent producers. Overtime, a growing part of the production was taken over by the Government with the independent producers becoming government employees. This process has accelerated with the devolution: local

governments manage these programs while costs are born by the central Government. This is a clear recipe for inefficiency and waste. One way for the local governments to avoid closing down any of these programs is to rename them "training" rather than production centers. As such they become eligible for legitimate subsidies provided to training programs. The skilled producers are placed on government payroll as trainers. In some cases these training programs have no trainees. Another mechanism used for maintaining the existing structure is to transfer part of production costs to central government budget. Financing of stocks and marketing costs are typical examples. This transfer of costs maintains a semblance of project profitability while actually making large losses.

Eventually, these training services were supplemented with central services for raw material procurement and marketing. The central services addressed diverse constraints. In some cases, particularly brass handicraft, machinery was provided to undertake specialized, machine-intensive components of production: mould, lathing or turning machines or special electroplating equipment. These machines were provided to producers either for free or at highly subsidized rates with donor support.

Additional steps were taken when these measures proved insufficient. These included provision of raw materials and marketing services. This was to reduce production costs and increase producer prices by eliminating the middleman. These were supported either by specialized credit programs or undertaken directly by government agencies. Eventually the Government ended up with a large number of agencies, skilled producers on the public payroll, marketing outlets and national procurement agencies. All of these had little impact on producer incomes.

Efforts were also made to structurally transform these industries by developing new products. Prominent among these are the services provided by the Ministry of Livestock and Rural Industries. The three institutions that operate under this ministry provide the following services: National Crafts Council provides skills training, finance, raw materials and production tools; Sri Lanka National Design Center develops product design and provides advanced training; and, finally, Sri Lanka Handicrafts Board is responsible for marketing through its 23 marketing branches nationwide. Each branch has large marketing outlets in prime locations. The Board also provides training through 208 units.

These efforts have had little impact. The demand for traditional products is limited; local production is very inefficient; and local handicraft products cannot compete with imports.

Scarce public resources should be shifted to support new products and those small- and medium-sized industries producing them.

1.4 Input Costs and Availability

1.4.1 Credit

Two major sources of industrial credit for small industry in Sri Lanka are the credit lines under the World Bank/ADB supported small- and medium-size industry (SMI) schemes and credits extended by the Regional Rural Development Banks. The total external funding provided under the four SMI schemes is US\$ 100 million (Table 1.5). To date, the scheme is estimated to have created 70,000 jobs in the Country at a cost of US\$ 3,000 per job.

Under the SMI schemes, the Central Bank lends to the National Development Bank (NDB) at the average prime lending rate (APLR). In turn, the NDB lends to the commercial banks at 6% below this rate with this negative spread subsidized. The commercial banks are free to set the rate at which they lend, but generally charge a margin of 6-7%. The Bank of Ceylon and the People's Bank are the largest intermediary lending institutions for SMIs.

Support to the small industries is also provided by the Regional Rural Development Banks (RRDB) which were established in 1985. They promote self-employment for the rural poor. In Southern Area, there are ten branches in Galle district, eight in Matara district and seven in Hambantota district. As of end June 1990, the RRDBs made 255,000 loans nationally with an average loan size of Rs. 5,573. Loans to industry were 13.7% of all loans made by the three institutions.

The largest number of loans made to industry are under the self-employment scheme with a maximum loan size of Rs. 50,000. These are financed through the refinance facility of the Central Bank which charges 9%. The RRDBs charge a margin of around 7% and lend at 16%. The average repayment rate under these loans (60%) has been lower than that of SMIs (an average of 80%).

Thrift and Credit Co-operative Societies (TCCS) support small enterprises. These are independent member organizations established since the 1970s. Their only source of funds is members' contributions and retained earnings. In Galle district, there are 414 societies with 49,414 members. In Hambantota, there are 116 societies. These societies make three types of loans: 1) short-term loans of up to Rs. 5,000 repayable within 12 months, at

12% interest; 2) medium-term loans of up to Rs. 20,000 repayable within 12 months, at 16% interest; and 3) long-term loans of up to Rs. 50,000 repayable within 24 months, at 18% interest. Each loan application is signed by two members for security. The repayment is generally good.

A similar type of support is provided by the Janassaviya Program. The Janassaviya Trust boosted the availability of small loan funds to micro-enterprises and small rural producers.

Table 1.5 Sectoral Distribution of Credits under the SMI Project

Main Sector	Third SMI Project			Fourth SMI Project		
	No. of Projects	Amount (Rs.1,000)	Share (%)	No. of Projects	Amount (Rs.1,000)	Share (%)
Food Processing, Beverage and Tobacco	475	233,547	13.9	523	269,664	23.8
Textile	67	73,071	4.3	62	41,768	3.7
Garments	131	80,754	4.8	238	153,430	13.5
Metal Products	169	116,378	6.9	227	79,087	7.0
Construction Materials (Mineral Based)	99	51,412	3.1	256	88,897	7.8
Rubber Products	33	38,091	2.3	64	55,969	4.9
Wood and Wood Products	132	71,164	4.2	181	57,181	5.0
Leather and Allied Products	34	18,229	1.1	34	10,214	0.9
Plastic Products	49	74,563	4.4	35	27,221	2.4
Printing and Paper Product	101	108,844	6.5	93	56,324	5.0
Chemical and Chemical Products	31	33,138	2.0	34	19,072	1.7
Agro-industries	43	23,922	1.4	78	24,097	2.1
Fisheries	161	177,330	10.5	27	13,731	1.2
Animal Husbandry/ Horticulture/Aquarium	168	58,259	3.5	147	42,277	3.7
Construction Contracting	18	16,082	1.0	19	10,177	0.9
Services	289	249,603	14.8	114	46,978	4.1
Miscellaneous	72	59,468	3.5	129	67,271	5.9
Transport/Storage and Communication	373	198,247	11.8	187	71,882	6.3
Total	2,445	1,682,102	100.0	2,448	1,134,900	100.0

Source: The World Bank Office in Colombo.

Despite the variety of existing credit channels, both the cost and availability of loan finance is a major constraint to the development of industry. The low level of savings (15% of GDP over the last ten years) and government fiscal deficits have crowded out all private investment in Sri Lanka. The real cost of loan financing is considerably higher in Sri Lanka (around 8 to 10%) than any other country in Southeast Asia. There has been little investment in new machinery by the existing companies as a result of these low rates of saving and investment.

In rice milling, for example, there has been little new investment. The existing mills are small: an average of 2.27 workers per mill in 1995. The mills use steel rather than rubber rollers. One consequence of this is to mix rice bran with paddy husk, losing a very valuable feed. A program of new investments in rice mills should be instituted to upgrade technology.

1.4.2 Infrastructure

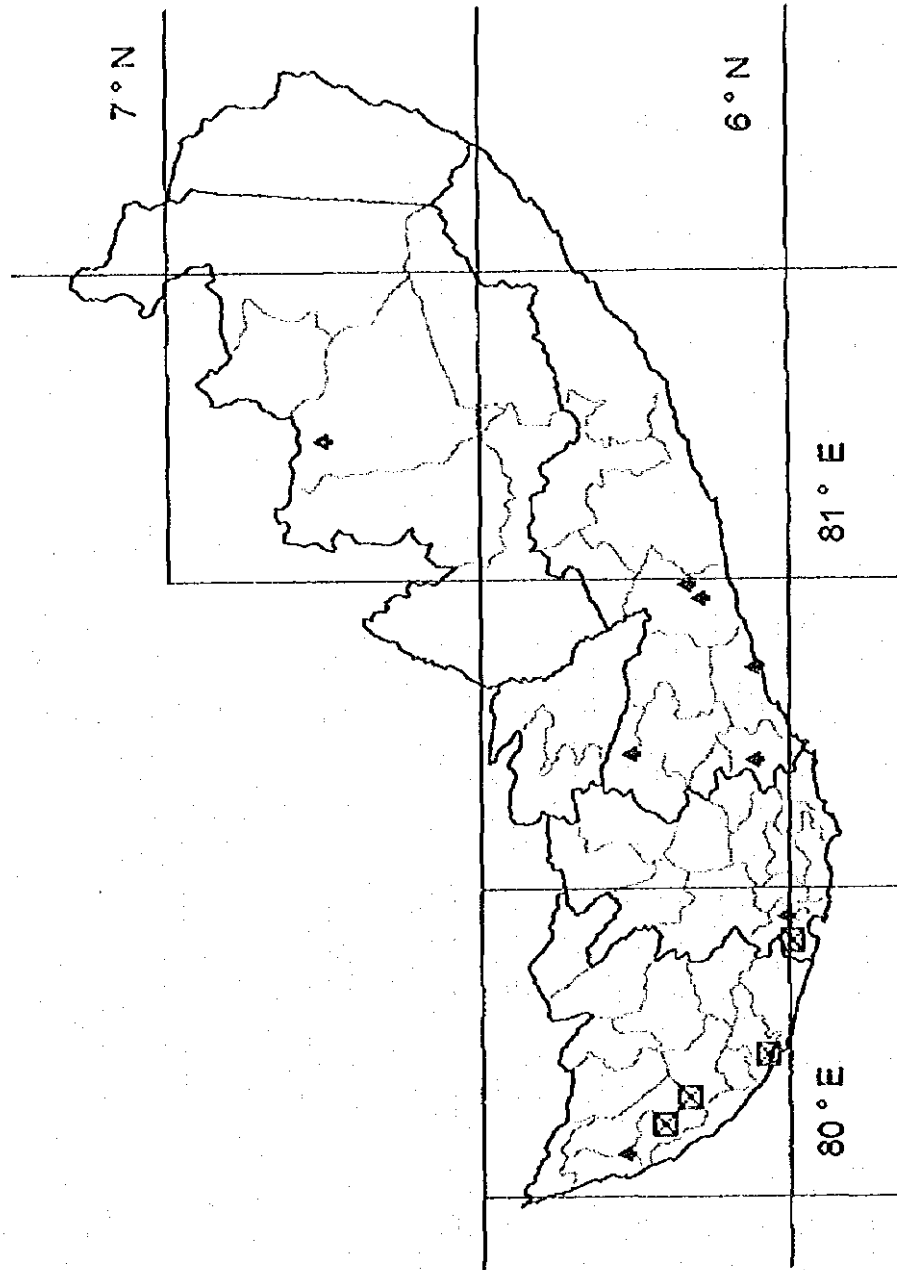
Availability of reliable electricity, telecommunication, transport, water and sewerage is a constraint to industry in all Sri Lanka. The problems are more serious in areas outside Greater Colombo. Inefficiencies of respective government monopolies, inappropriate pricing policies, limited investment funds, and overregulation all play a role. Sector-specific problems are discussed in respective Sector Reports of this Plan.

(1) Industrial estates/districts

One important tool for addressing site-specific infrastructure problems faced by industry is industrial estates and districts. In this report the former term is used to refer to areas developed for large industries. The latter term is used for small tracks of land developed for small- and medium-sized industries. The total land area of such districts tend to be a few hectares or less. Typically, the plot size is less than one decare (1,000 sq. meters). These districts also tend to locate around settlements as the workers generally walk or cycle to work.

There are many programs to develop industrial land in the region. Eight industrial districts and one estate are at different stages of development in Southern Area: four are in Matara district, three in Galle district and one in Hambantota district (Figure 1.1).

Figure 1.1 Existing and Proposed Industrial Estate Locations



- Industry
- Existing
 - Proposed
 - Lat-Long grid
 - District boundary
 - Divisions

Å

0 8 16 Kilometers

Source : JICA Study

The Master Plan Study for Southern Area Development of Democratic Socialist Republic of Sri Lanka
Japan International Cooperation Agency

Four separate government agencies develop industrial estates/districts. Of these, the most dominant is the Ministry of Industry. It has initiated five of the eight districts in the region. The Industrial Development Board, a specialized agency of the same ministry, has a separate program. It has developed a district which is fully occupied (Uragaha in Karadeniya, Galle district) and a partially filled up one in Baddegama, Galle district. It is planning to develop a specialized estate in Devwimana-watta, Hambantota district.

The third agency in charge of industrial land development is the Board of Investment (BOI). All industrial estates in Sri Lanka (including the Koggala EPZ) are owned and operated by the Government through BOI. The Koggala EPZ is a free zone with 116 acres (a total of 225 acres including central facilities and green spaces) of industrial plots which are fully developed. Of these, 29.4 acres are occupied by eleven enterprises. All but three are garment factories. Of the three, one produces hats, one toys and one plastic kitchen ware. All of the factories located within two years when the estate was opened in 1991. At the time, companies had to locate outside Colombo to be eligible for investment incentives. In 1992, these privileges were extended island-wide and no new company has located in the Koggala EPZ since then. The Zone administration reports that two new projects are seriously considering location in the estate.

The last agency with the mandate to develop industrial land is the Urban Development Authority (UDA). This agency has not implemented industrial projects in the region yet, but it is actively considering several locations.

The Industrial Promotion Act of 1990, discussed in Section 1.5 below, provides a different avenue for developing industrial land, though this has not been used in the region so far. Under this Act, the Regional Industry Service Committees may develop industrial land. The master plan proposes that these committees which have strong local representation should be actively involved in developing new tracks of land.

Although legally possible, private development of industrial estates has not happened. Three causes of this government monopoly are: 1) land ownership; 2) free provision of infrastructure to the estates developed by the Government; and 3) government pricing practices for the leases at the rates set by the Government, developing industrial land for leasing is not financially viable.

There has been limited interest from the private manufacturers to acquire a plot in these estates/districts even though the Government provides the land for free and infrastructure

costs are highly subsidized. The main cause of this seems to be the insecurity regarding ownership. Plots in some of the industrial districts in the Area were developed years ago and yet titles are still not given. Individuals who built workshops on these plots carry unnecessary risks. The probability that the Government will reclaim these plots is very small, but the present situation creates enormous anxiety among the owners of small businesses in industrial districts.

This also prevents the use of assets on these plots as collateral for bank loans. The lease right can be transferred between individuals only with the consent of the government agency concerned. This takes time and the outcome can be very uncertain. The asset value of the workshop is considerably reduced as a result.

There is a similar set of policy-induced constraints faced by industrial estates and export processing zones. For these, the key factor is the change in advantages of locating outside Colombo. At present the same incentives are available to investors everywhere in Sri Lanka and there is no particular incentive for locating in Southern Area.

The estates and districts developed or planned in the region are all on the Government-owned land plots. This presumably reduces the cost and eases financing problems. The resulting pattern of location, however, is not always the most appropriate. Major problems of the existing locations are the distance to residential areas and lack of flexibility for expansion. The Koggala EPZ, for example, is not located near residential areas from which workers would be drawn. Most workers therefore are housed in temporary accommodations nearby, sometimes three to five workers in a single room. This situation helps them view their employment as temporary. They will leave when alternative employment becomes available. The estate is also unable to expand because no more open land can be acquired in its adjacent areas.

(2) Transportation and telecommunications

In Southern Area, the state of other important infrastructure, transportation and telecommunications, is far from satisfactory, imposing serious constraints on industrial development. Since Colombo is both the largest market in the Country and the primary gateway to and from the foreign markets, access to the capital city is the foremost consideration for industrialists and entrepreneurs in the region. As to land transportation, the main artery road connecting the region to Colombo, route A2, is getting increasingly congested and numerous bottlenecks have appeared along the entire route. Railways, on

the other hand, play practically no role in freight transport because of their antiquated facilities and unreliable services. In the absence of the Galle port capable of handling a reasonable volume of cargo around the year, these constraints on land transportation between the region and the capital can prove quite detrimental to regional industrial development.

The scope and quality of available telecommunications services are also very limited in the region. A huge backlog of telephone subscribers exists particularly in major urban centers. Because line capacity is not sufficient for interregional connections to Colombo, international communications, which must go through Colombo, are not always readily available as well. Private mobile phone services are extending rather rapidly in the Country, but their coverage is still confined to a few major urban areas. In this era of economic globalization, it is highly unlikely that any region of any country which lacks ready and reliable means of intra- and international communications can succeed in achieving a rapid economic development.

1.4.3 Labor

The large number of unemployed youth is a distinct feature of Southern Area. Some of these could find jobs in the existing industries if supplied with the requisite skills. This is well recognized and many skill training programs are available in the Area. In manufacturing skills alone, close to 5,000 youths are trained per annum. This is a higher number than the total new manufacturing employment in the Area. Either most trainees migrate outside the region or they remain unemployed after receiving training.

It is likely that only a fraction of these trainees are employed by industries in the region. Most find employment in Colombo or abroad. This in itself is not undesirable. To the extent that those migrating outside the region are farmers, it will also improve the resource balance for those staying behind.

Skills training programs are provided by seven government agencies and a number of private organizations. In Matara district alone, the existing institutions have the capacity to train 2,730 trainees per annum. The duration of these courses varies from three months (e.g., electrician and typist) to 24 months (textiles and accounting technicians).

The most popular training program is on use of industrial sewing machines (Juki). Courses ranging from two to four months are provided for this subject by half a dozen training programs and vocational schools in the region. Many centers also provide training

in traditional skills (weavers, carpenter, mason and plumber). The available supply of labor in these fields appears to exceed the local demand. On the other hand, there is an unmet labor demand for engine and electrical gadget repair, radio/TV repairmen and machinery operators. Courses have been initiated in these fields in recent years. Even for this latter group, however, there seem to be a sufficient number of trainees. The real problem is the relevance of training that is provided.

Compared with the multiplicity of training programs, on-the-job training has been completely neglected. The present emphasis is exclusively on training to get a job. Conceptually, the skill acquisition could occur as easily on the job. In this case, in fact, training will be more relevant as it is totally demand driven. The present institutional setup and legislation prevent this. The law allows employers to hire workers for an initial period as trainees. This period, however, is limited to six months. In case of training beyond this period, the employee acquires permanent status and would have to be retained by the training company. Furthermore, the payments to the trainee are fully taxed during the training period. The employer thus has no incentive to provide on-the-job training.

Despite these programs, availability of skilled labor is not always insured. Many of the programs are not properly targeted to emerging employment opportunities. Migration abroad and to other regions of Sri Lanka also contributes to scarcity of skilled labor in the region. The major constraint is the relevance of both formal education and the existing training programs to the requirements of employees in the region.

The present labor regulations, particularly the Termination of Employment Act, are considered to be very restrictive for the development of efficient labor markets. Firms are not allowed to shed labor, even in the face of repeated absenteeism. The likely impact of the present regulation on job creation is recognized and the President has appointed a bi-partisan task force to formulate recommendations.

This Act discriminates against relatively large firms. It applies only to enterprises with 15 workers or more. This is reported to be a strong barrier for intermediate-sized firms which may otherwise graduate into a larger size class.

1.4.4 Technology

Technical services available to local industry include extension, assistance to prepare feasibility studies, management and skill training, as well as help with selection and design of technology and process choice.

The major institution providing these services is the Industrial Development Board (IDB). IDB has a regional office in Matara and district offices in Galle and Hambantota. Two other departments of the Ministry of Livestock Development and Rural Industries operate in Southern Area. These are the Department of Small Industries (DSI) and the National Crafts Council (NCC). These agencies operate over 100 training facilities in the region. The activities include textiles and handloom, ceramics, coir spinning/weaving and light engineering. Until recently, most of these were under DSI, but many have now been transferred to the Provincial Ministry of Industries. Other institutions involved in technology upgrading include the National Engineering Research Development Center (NERD) and Ceylon Institute for Scientific and Industrial Research (CISIR). The Sri Lanka Business Development Center (SLBDC) was established recently.

While the support provided by these agencies may be useful, the ultimate solution to technology upgrading is through the purchase of foreign machinery (and thus the technology embodied in them) and encouraging direct foreign investment which will also introduce new technology. Sri Lanka appears to have placed excessive emphasis on support for local technology at the cost of neglecting the larger issues of technology import and adaptation.

Although levels of protection are declining, there still are barriers to importation of investment goods and production inputs. These barriers are not only administrative. Import taxes are close to 40% of CIF landed value for capital goods even after the recent import liberalization measures.

One facility available to industry is the incentive system under BOI. This is utilized only by the largest of the manufacturing companies in cases where investments exceed Rs. 500 million. This agency does not have the capacity to deal with thousands of applications from all investors if the size criteria for eligibility were eliminated.

A new program was introduced for the intermediate-sized companies and was publicly announced in October 1995. Under this program new companies with investment of over Rs. 10 million and expansion projects over Rs. 2.5 million can undertake duty free imports

under the "Advanced Technology Program" of the Ministry of Industry. Four months after the announcement, only 35 companies applied to benefit from the program. Both the size and procedural problems have discouraged the potential applicants from utilizing this facility. The program was introduced as a one time measure and will run out in 1996. There is no comparable program for the small industry. It would be desirable to expand the coverage of this program to include small industries as well and apply it continuously.

1.5 Investment Promotion and Regulations

1.5.1 Land use regulations

Regulations to guide location of industries are not explicit. Case-by-case decisions are made without explicit criteria. Each new enterprise thus has to go through the complete procedures for licensing on its own. Each step in this process is arbitrary with no clear rules.

This has now been combined with a very high level of environmental standards. While the concern with environmental protection is obviously very important, it can lead to arbitrary decisions when the standards and enforcement mechanisms are not very clear. The licensing requirements are reported to have been used in many cases as an instrument to eliminate competition.

1.5.2 Legal and administrative issues

Industrial promotion measures are contained in the Industrial Promotion Act, most provisions of which came into effect in 1992. The Act establishes an Industrialization Commission with representatives from all related agencies. This commission is responsible for advising the Government on all issues related to industrialization. This includes finance as well as trade restrictions. Under the enacting legislation, the commission is required to meet at least once a month.

The commission, and additional members representing the private sector, constitute the Advisory Council for Industry. The Council is expected to be the major forum for formulating national strategies. The same Act also establishes Regional Industry Service Committees. These committees are established in the provinces by the Minister of Industry in consultation with the Chief Minister of each province. This committee has the authority to establish Regional Service Centers in that province.

The Minister of Industry, in consultation with the Chief Minister of a province, may declare, by an order published in the Gazette, any area in the province as an "industrial area." The Regional Industry Service Committee is required to submit to the commission plans and schemes for the provision of infrastructure for industries in such industrial areas. These committees can develop industrial estates/districts and can operate the full range of industrial support services.

This existing legislative and administrative framework appears sound for formulating national strategies and programs. The necessary instruments for coordination at the provincial level are also provided. The emphasis would need to be on practical measures to facilitate implementation rather than changing the existing system.

1.5.3 Investment incentives

(1) Incentive schemes and their effects

The Government provides a variety of incentives to promote both domestic and foreign investments. They include duty free imports of capital goods and production inputs, tax privileges and, in some cases, outright grants. As in other countries, a one-center facility is provided to help investors and exporters. Initially, this service was provided by the Greater Colombo Economic Commission. This agency was re-constituted as the Board of Investment (BOI) in 1992.

Almost all new investments in Sri Lanka appear to have occurred under the BOI incentives and a parallel program for garment factories. This is indicated both by the macro investment data and the number of jobs reportedly created under these schemes. The BOI projects alone are estimated to have created 125,000 jobs between 1992-1995 (Table 1.6). Close to 100,000 jobs seem to have been created under the "200 Garment Factory Program." Employment in these two would seem to be more than one-third of the total manufacturing employment in Sri Lanka in 1994, estimated at around 750,000.

If true, this size of new manufacturing jobs generated in large-scale industries is very impressive. Together with cottage-type employment and the SMIs, the sector would have created sufficient jobs to absorb all new entrants and would have reduced the existing stock of un- and under-employed.

In Southern Area, 5,600 jobs were created in 11 companies that located in the Koggala EPZ under the BOI incentives. Additional employment of around 15,000 was created under the "200 Garment Factories Program." The incentive system appears to have played a critical role in generating new investment and employment. This is likely to continue in the future.

Table 1.6 Projects in Commercial Operations under the Incentive System in Sri Lanka in 1995

	No. of Projects	Investment (Rs. million)	No. of Workers
1. Food, Beverages and Tobacco	32	1,346	6,563
2. Chemicals and Rubber	29	2,336	6,656
3. Wood Products	14	214	2,877
4. Textiles, Coir	34	5,607	11,864
5. Wearing Apparel and Footwear	82	3,978	54,780
6. Jewelry and Lapidary	27	1,159	4,831
7. Electronics and Electrical Goods	20	2,110	5,990
8. Fabricated Metal Products	11	636	1,177
9. Transport Equipment	5	300	931
10. Leather Products	7	235	3,445
11. PVC Products	25	1,006	10,297
12. Fishing Gear and Accessories	6	112	1,089
13. Other Manufactured Products	37	1,579	7,949
Total Manufacturing	344	21,347	125,696

Source: BOI Investment News, Jan/April 1995.

(2) Sectoral selectivity in investment incentives

There is no sectoral selectivity in the incentive system, though the Government keeps identifying priority areas of investment. Initially, six areas were identified as being eligible for investment incentives. These were: 1) infrastructure, 2) exports, 3) tourism, 4) services, 5) agriculture, and 6) dairy and livestock products. These sectors still remain eligible for incentives. However, the emphasis in 1995 shifted to a narrower range of investment areas. Four priority areas were emphasized by the Government in 1995: 1) high technology industries, including science parks and production of scientific and measurement instruments, 2) electronics, 3) light engineering, and 4) infrastructure.

The exclusion of major export items (textiles, garments and precious metals) from this list is conspicuous. The policy on this issue could prove very problematic. Garments provided three-quarters of total manufacturing exports in 1995. Their share of incremental manufacturing exports since 1990 is even larger. A slowdown in textile/garment exports will have a drastic effect on value added and output of industry (Table 1.7). Their exclusion from the list of industries to be promoted is thus noteworthy.

Table 1.7 Value Added by Manufacturing Sector in Sri Lanka

	(% in current prices)		
	1985	1990	1994
1. Food, Beverages and Tobacco	46.13	38.94	34.83
2. Textile, Apparel and Leather Products	19.41	23.13	29.52
3. Wood and Wood Products	3.14	1.56	1.54
4. Paper and Paper Products	4.21	3.29	3.29
5. Chemicals and Plastic Products	10.48	7.84	8.23
6. Non-Metallic Mineral Products	8.15	15.30	13.25
7. Basic Metal Products	-	0.63	0.53
8. Fabricated Metal Products	7.89	8.86	6.21
9. Others	0.44	0.44	2.64
Total	100.00	100.00	100.00

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

In the case of garments, the Government has decided on the present policy because it believes that there is sufficient capacity to serve the existing quota markets. Quite on the contrary, the garment industry is not using the full quota on all export items. It is true that in the case of so-called fast moving items (jackets, shorts and pants), the current quotas are fully utilized. Under the existing bilateral and GATT agreements, however, the quotas on these items will still increase by 6% per annum for the next ten years. In the case of other items, as much as 35% of the existing quotas may be unused. These include lady's shirts, synthetic pants and lady's cotton jackets and blouses. Thus there is still considerable room for expansion for Sri Lanka to use its quotas on all items. The present policy of discouraging further garment investments is thus totally misguided.

In Sri Lanka, all quotas are distributed on the basis of producers' past performance. Instead the Government may utilize the access to quota markets to encourage exports to non-quota markets or auction the quotas to generate revenue. Producers will be allowed to sell only part of their output to quota markets and will have to develop new, non-quota markets. This requires creation of production capacities beyond the requirements of quota markets. In contrast, the Government seems to be trying to curtail capacity creation at existing levels which are inadequate even to serve the existing quotas.

Furthermore, textiles would be targeted for development if Sri Lanka wanted to supply the garment export industry with locally manufactured textiles. The development of a domestic textile industry in Sri Lanka will increase the share of domestic value added in garment exports. This will also considerably reduce the lead time that the exporters must have for delivering on export orders. This industry, however, must be developed at an internationally competitive level. Otherwise, it will rather adversely affect the garment industry. In any case, garment manufacturers must retain their total freedom of access to international fabric markets. The local textiles manufacturers will supply the garment exporters only in cases where they meet the price and quality standards.

The Government will be well advised not to deprive the Country of the benefits of further growth in textiles and garments, despite whatever pressure the local industry may exert to limit further competition.

(3) Geographic selectivity of investment incentives

There was a strong element of geographic selectivity in the investment incentives until 1992. Three levels of incentives were available to companies depending on their location. The most generous set of incentives was accorded to industries which were located in one of the four Export Processing Zones (EPZ) operated by BOI. In 1992-93, however, there was no space available in the three industrial estates other than the Koggala EPZ. Companies had no choice but to locate in Koggala if they wanted to benefit from the BOI privileges granted to industrialists in EPZs. Subsequently since 1993, BOI has made two major changes in its policy. One change was to provide new space in EPZs in the Colombo area. The other was extension of BOI privileges to all companies regardless of location: the whole island is considered an EPZ since 1994. With these changes, all new investments have taken place in Western and Central provinces. The Koggala EPZ has thus seen no new tenant coming to add to the initial 11 companies.

(4) Other incentive schemes

A parallel set of incentives were available under the "200 Garment Factories Program." This program was initiated in 1991 to distribute garment factories to peripheral provinces. Every province was to receive a share of these factories. Factories were built in 163 of the 175 locations identified (23 factories in Southern province). At the time of establishment, each factory was required to employ at least 500 workers. On the average, they have maintained this level of employment and now provide as much employment per plant (425 workers in 1995) as factories located in EPZs. The program appears to have been very successful.

The major instrument under this program was access to export quotas. This privilege was given not only to the factories located in the provinces but to the companies' main factories elsewhere as well. In the case of Southern province, the primary motivation for locating these factories there was this privilege extended to the main factory. This explains why almost all of the garment factories are subsidiaries of Colombo-based large operations.

A separate set of incentives is available to industries that fall outside the two categories discussed above. These are special credit facilities created for provincial industries, technical support services and other privileges. These are provided to specific export or development oriented businesses under the Inland Revenue Act, Turnover Tax Act and other specific legislation.

CHAPTER 2 CONSTRAINTS TO REGIONAL INDUSTRIAL DEVELOPMENT

Some of the constraints discussed below are policy-induced and can be removed with appropriate policies. Others derive from the nature of the resource base and the existing level of industrialization. These cannot be changed by conscious policies but simply have to be taken into account in devising a regional industrialization strategy.

Further development of industry in Southern Area is constrained by a number of factors. These include the limited resource base, small size of local markets, low level of skills and technology, and lack of investment funds. The physical infrastructure is also poor compared with what is available in the developed parts of the Country. Its large pool of workers, on the other hand, seems to be the major locational advantage of the Area. Some of these have the basic education and can be easily trained in many of the existing centers. However, government input pricing policies and labor laws blunt this potential advantage of the Area. Some of these constraints are discussed below.

2.1 Limited Resource Base and Small Regional Market

Southern Area has a weak agricultural and mineral resource base. This is compounded by low growth in key sectors and limited value added in major sectors such as garments.

Mining in the South is very undeveloped. There is a shortage of river sand and aggregates for construction. Government monopoly on cement has stifled all downstream industries. There was some exports of silica quarts from the region up to 1995. Such exports were banned in 1995 on the assumption that the Country could export processed products instead. This has not happened and the Country has lost the revenue from export of raw quarts.

The existing manufacturing base is largely of micro/cottage type with a large concentration in handlooms and coir products. These, together with food processing, provide most of regional employment and value added. There has been little growth in these sub-sectors due to the weaknesses in the raw material base and adverse effects of government regulations.

Garments provide close to half of employment in textiles and are totally export dependent. Value added is largely confined to labor costs while almost all production inputs are

imported. Imports of production inputs must continue in the short term to maintain the export competitiveness of garments.

Two other significant components of textiles are coir-based products and handlooms. Production techniques are labor intensive, using no machines and there are no apparent prospects for mechanization. Under these conditions, these products provide an income well below subsistence. It is likely that this subsector will provide a form of disguised unemployment.

The number of looms has fallen to a third of that in 1980 despite the government support. This was a result of partial liberalization which opened up the captive domestic market to some international competition. With the poor quality of weaving and dying and the extremely low productivity, hand-operated looms could not compete with imports. Production is increasingly narrowed down to local specialized niche markets. Even these are threatened by competition from abroad. The Government has implemented an array of fairly comprehensive support measures but these have been in vain.

2.2 Weak Industrial Integration

Linkage industries develop in relation to the existing regional industrial base. The size of manufacturing activity in the region is very small. This and the agrarian structure limits the demand for manufactured inputs, parts and components, and replacement needs of existing plants. Similarly, subcontracting to supply Colombo-based industries with parts and components has not developed.

The small but growing textile sector is the raw material base for garments. In the case of garments, value added will be increased by developing a local textile industry. Its growth, however, has been slowed down by the misguided national policy. BOI is considering excluding garment factories from the list of industries eligible for incentives. In the region, the management of the Koggala EPZ discourages new garment factories from locating in the estate. This stems from the conclusion that the Country has sufficient capacity, though Sri Lanka still does not fully utilize its quotas in most categories. One typical case of industrial linkage is thus strongly hampered from development.

Opportunities to foster industrial integration are limited in most other products. The policymakers must resist inappropriate advice to move to the highly specialized end products in an effort to create industrial linkage and maximize value added: producing some

essential oils, for instance, does not give Sri Lanka a competitive edge in producing cosmetics.

2.3 Cost and Availability of Production Inputs

If materials-oriented industries have little prospect and market-oriented ones are barred, Southern Area's only hope lies with the so-called foot-loose industries. The region, however, has limited comparative advantage for foot-loose industries. Availability of skilled workers is considered an advantage but the labor costs do not change by location due to government regulations. The current levels of infrastructure services do not prove an advantage to the region, either. Credit availability and cost, scarcity of industrial land equipped with the required infrastructure, and access to new technology were all noted to be major constraints. This, however, can be changed by conscious policies. For instance, telecommunication services are in short supply throughout the island and giving priority to the region would be effective to attract such industries. Another potentially important tool would be provision of free land equipped with the necessary infrastructure. This is made easier by the government ownership of large tracts of land; by some estimates the Government owns 82% of all land in the Country.

In reality, however, such changes are hard to come by. For example, in the Koggala EPZ, where two-thirds of the land area is still unused five years after completion of costly infrastructure, the Government is now trying to capture the costs of its own inefficiency through high rates and fees. This puts the EPZ land beyond the reach of local industries and increases the cost of common utilities. The model presently tried in Charli Mount is even more problematic: a private company is developing the estate at government cost. Because in this case the developer will simply receive a fee on top of costs, there is no incentive for them to limit the overall costs or not to come up with some exceptionally costly solutions. The demand for these lots will disappear if the Government tries to pass on these excessive costs to the users.

Restrictions on land ownership is a major constraint to private investment. It is claimed that the occupants of land in both EPZs and industrial districts can use it for mortgages with the creditor banks. The banks are supposed to accept this land and property as collateral. There are so many restrictions on the transfer of land that it is practically impossible for the banks to resell the property after foreclosing. This must diminish the value of this property, if it has any value at all, to a fraction of the possible market price. This is one reason why there is little demand for the small industry districts advertised by IDB, RISC and Provincial

Councils. It is hard to understand why the Government wishes to keep owning land on which the small entrepreneurs have built a workshop and undertaken other investments.

2.4 Inflexibility due to Regulations

The regulatory environment in Sri Lanka discourages both firms and labor to move to locations with the lowest production costs. Minimum wage is not regionally differentiated. This prevents wage adjustments to draw industries to areas with excess labor and lower labor costs. Employers are not allowed to adjust the size of their work force in response to changes in market conditions. The same applies in cases of labor discipline as well. This discourages firms from hiring new workers.

Excessive social welfare systems have a similar impact on labor adjustment. With a social safety net that contains an excessive proportion of the population and provide generous levels of support, the workers have no incentive to migrate to regions with higher employment prospects.

Many sectors of industry in Sri Lanka are owned by the Government or are monopolies/oligopolies. Firms do not respond to market signals and make inefficient locational choices under these conditions. The extent of this and the implications for location in the region are difficult to assess, however.

Another hindrance to regional industrial development is the complicated regulations concerning private investment. It is affected by the present complications in licensing and a myriad of interventions, particularly in price determination.

2.5 Lack of Spatially Differentiated Incentives

Despite the emphasis on the development of provinces, there are no incentives for firms to locate outside Colombo. The firm enjoys the same level of incentives regardless of whether it locates in or outside the Colombo area. Firms will continue to locate in Colombo if additional incentives are not provided to those that locate in outlying areas.

CHAPTER 3 DEVELOPMENT OBJECTIVES AND STRATEGY

3.1 National Policy Priorities

The cornerstone of government policy is to maintain macro-stability. The emphasis is on reducing the public sector borrowing requirements (PSBR). It is believed that this will contain inflation and reduce crowding out private investment. The PSBR in recent years has been around 10% of GDP, about the same level as the national savings. The Government has thus borrowed from the domestic market most of available funds leaving no investable surpluses. All new investment has thus been financed by external borrowing or through direct foreign investment.

The principal mechanism identified for reducing the PSBR is a reduction in public expenditures. The present levels of taxation and revenue are high by international standards. The Government will curtail its expenditure to legitimate areas of public concern. These include education, health, vocational training, environmental protection and rural infrastructure. This new policy direction contrasts with past policies where the Government invested in the plantation sector in agriculture and in the manufacturing enterprises. The role of the public sector will be further reduced by speeding up privatization.

The Government has established ambitious development targets in its current Five Year Public Investment Program. The realization of these targets is dependent on private sector investment increasing to 25% of GDP with the public investment maintained at the present levels. At least 20% of all private investment is projected to be private foreign investment. This translates into annual private capital inflows of around \$500 million. This is a modest amount in comparison with the volume of foreign private investment coming into South Asia, but it is more than double the actual levels in Sri Lanka since 1989. This level of foreign investment can be drawn in only with a major departure from past policies.

The Government has published an industrial development policy document which addresses some of these concerns. Industrialization policy is based on a more open trade regime and flexible exchange rates. This should help create a dynamic, internationally competitive, export oriented and diversified industry. Direct foreign investment will play a critical role in that process.

The Government will provide an open and transparent legal framework and a market friendly investment climate for private sector. One mechanism for achieving this will be the creation of a National Development Council which will include representatives from all interested segments of the society. The Council will provide the private sector with an avenue for informing the relevant agencies about constraints facing the industry. It will also advise the Government on appropriate actions to be taken.

There will be changes in the investment incentive system to introduce transparency and predictability. Tax holidays will be replaced with a uniform 15% tax on export profits, while the firms serving the domestic market will be taxed at a uniform rate of 35%. Export orientation will be insured with a reduced and uniform tariff on imports. This will check the prices and profitability in the domestic market while exports remain profitable.

While export-oriented large scale industry remains the main vehicle of development, the Government will assist efficient medium- and small-scale industries. This will contribute to a broad-based industrialization and will generate new jobs. One mechanism to achieve this is an expanded program supported by a loan guarantee scheme. Under this scheme, the Government will provide guarantees for loans extended to SMIs. The objective is to establish 20,000 such companies employing 200,000 workers over a five-year period. This is a very ambitious target in the light of the present size of total manufacturing employment in Sri Lanka.

Another area where government support will concentrate is labor training. The present supply-driven skill training and education system will be replaced with one driven by demand. This will apply to general education as well as industrial research and development institutes. The programs for skill training and research will be determined by the private industry. Private industry will also play an active role in implementing these programs.

Local resource-based and small-scale industries will be encouraged in rural areas to promote regional development. Infrastructure development will assist this local material-based industry. Further processing of agricultural products will be emphasized. The growth in these industries will thus considerably exceed that of regional incomes.

The large-scale, export-oriented industries tend to locate in industrial estates where a high level of infrastructure is provided. The location of indigenous resource-based industries

will reflect that of agriculture and mining. They have a more diverse locational pattern with limited concentration within the region.

At the same time, privatization will be accelerated to reduce the size of public sector in manufacturing. All restrictions on foreign private investment will be removed with the exception of few areas of activity (e.g., coastal fishing, money lending, local services) which will remain restricted to nationals.

While export-oriented large-scale industry remains the main vehicle of development, the Government will assist efficient medium- and small-scale industries. This will contribute to a broad-based industrialization and will generate new jobs. Further growth of manufacturing will rely on the private investment. The Government will play a facilitating role. It will emphasize the provision of infrastructure in advance of industrial location.

The industrial development program formulated for the region is based on these national choices. The national strategy, the regional resource base, and development priorities specified for the region determine the level and type of industry that is likely to develop in the region. The Master Plan tries to facilitate these developments and promote an efficient locational pattern within the region.

3.2 Policy Instruments

To materialize the national strategy described above, several policy instruments would be effective. Their descriptions will follow.

3.2.1 Investment incentives

The Government has targeted some sectors for manufacturing growth, though the incentive system's locational and sectoral selectivity has now been largely discontinued. This is a positive development and the system's selectivity should be confined to a small list where the Government does not encourage investments (negative list). All others should receive the same support automatically as a matter of right. This will limit the Government's and planners' ability to affect the pattern and location of industry, but it will also reduce inefficiency and waste. The new emphasis will be on maintaining a conducive policy milieu and indirect support to promote and guide private sector investments.

3.2.2 Differentiated input prices

The Government has never resorted to this particular set of policy instruments to encourage development of the provinces, though many countries use it. It would include reduced taxes on payroll in the provinces and lower rates for the regulated utilities (power, telephone, water, etc.) for the regional industries. Costs of credit to provincial industries can also be substantially reduced. Two main mechanisms for this would be varying the reserve requirements and providing credit guarantees at government cost for credits directed to provincial industries. The latter is emphasized in the public investment program. Another possibility is to apply discriminating tariffs for utilities such as power and water.

3.2.3 Fiscal incentives

These are not available outside the BOI system, but they can be instituted independently. They would involve lower rates of corporate taxation for provincial industries. In Sri Lanka, the turnover tax is the major instrument of taxation and the Government may consider applying lower rates outside Colombo.

3.3 Projection of Industrial Development in Southern Area

3.3.1 Manufacturing employment

The level of industrialization envisioned for the region derives from the growth and structural characteristics envisioned for the region. Based on the projected population and employment structure, manufacturing employment in the region is projected to almost double by the year 2015 as shown in Table 3.1. The projected growth in manufacturing jobs (2.9% per annum over the planning period) is quite modest and is largely a result of reliance on relatively efficient industries being promoted.

Table 3.1 Projections of Employment

Employment	1995	2015
Total	794,111	1,214,000
Industry	161,000	304,000
Manufacturing	121,600	213,000

All of the incremental expansion in manufacturing employment will occur in formal sector enterprises. Some of these will be large enterprises producing for the national and international markets. Some will be small firms employing less than ten workers.

The estimated distribution of the new enterprises by size class is somehow arbitrary and is determined by comparison with the experiences of other countries whose performance Sri Lanka may emulate. The bulk of expansion is projected for the intermediate-sized enterprises employing between 10 to 100 workers. It is estimated that over half of the incremental employment will be in this type of firms. The growth projected for the micro/cottage industry group is insignificant. The target composition is given in Table 3.2.

Table 3.2 Projected Employment by Size

	1995	2015	Change
Large Factory Type	20,000	50,000	30,000
Other Formal Sector	80,000	138,000	58,000
Micro/Cottage Industry	21,600	25,000	3,400
Total Manufacturing	121,600	213,000	91,400

The projected growth in large factory type employment is modest compared with the past performance. The Koggala EPZ and the "200 Garment Factories Program" created close to 20,000 jobs over a five-year period in the region. The projected employment of this type is 30,000 jobs over a 20 year period.

These targets are also modest in comparison with the national targets as well. The Government development target for the Country is to create 200,000 new manufacturing jobs in 1994-2000 through a loan guarantee scheme alone. The projected expansion in manufacturing employment in the South, on an annual basis, is 14% of the national target. This is similar to the present share of the population of the region and its share of industry in the Country.

3.3.2 Type of industry

The sources of regional comparative advantage, and the existing composition of the industry is indicative of likely industries that will expand in the region. Product lines where rapid

expansion is expected for the regional market are non-metallic mineral products and fabricated metal products. Export- and national market-oriented industries where large expansions are expected are gems and jewelry, leather products, textiles and, above all, garments. These will grow at higher rates than the regional market-oriented industries.

The Master Plan objective for industry is to reduce the present reliance on food processing and textiles/garments. This diversification will be pursued by promoting selected subsectors. The share of fabricated metal products should be increased from 5% in 1995 to 15% in 2015. A similar increase is possible in the non-metallic mineral products from around 3% in 1995 to 10% of the manufacturing value added.

Fabricated metal products cover a very wide range of products. Studies in Sri Lanka indicate that two areas that are particularly promising within that group are foundry products and metal plating. In non-metallic mineral products, there are serious prospects for the development of particularly labor intensive products. The availability of suitable clay and kaolin is less important. At present, over half of the raw materials are imported for the manufacture of export quality porcelain and china. Export-oriented firms in these product lines are doing well and have plans for expansion.

There are three sources of growth in garment industry. First, exports will continue to grow because the Sri Lankan export quotas will be increased by 6% per annum under the GATT rules over the next ten years. Second, the Country has not fully utilized its available quotas. Finally, continued growth in value added is possible with the same physical level of quotas: Sri Lanka has been able to increase the export value index by 6% per annum. This makes growth rates of over 12% possible for the garments if the regional industries grow at the same rate as the national average.

Regional industrialization strategy calls for specialization in some new regional industries. Already, the region is planning to have the only industrial district in the Country for leather tanning. This will be the base of an export-oriented leather industry. The region can become the center of production for integrated circuits and consumer electronics if special training and promotional measures are undertaken in the region as suggested by the Master Plan and private foreign investment is drawn into the Country. Other industries in which the region may be specialized include essential oils, condiments and salt-based industry.

Another foot-loose industry that can be developed on the basis of trained labor is gem cutting. There already is a substantial industry in the region concentrating around Ratnapura. It can

be further developed if a specialized institute is established and other support is provided to the industry. The ability to import, duty free, gold and silver is of paramount importance for the export-oriented jewelry manufacturers.

The region should develop male-oriented industries in the light of the present dominance of garments which employ young females. This is because most female workers leave when they get married. It would be highly desirable to create jobs that employ men on a permanent basis. Heavy machine and metal industries, ship building and ship wrecking are such industries. The last, in particular, has development possibilities despite projects to develop this industry in Bangladesh.

As a planning target, it would be sufficient if one third of these new manufacturing jobs were created in large industries serving the national and international markets. The rest will come from linkage industries and industries serving the regional market. Some of these linkage industries themselves would be large-scale and would use modern technology. Good examples of such industries are textiles, garment accessories, and packaging materials.

3.3.3 Size of industry

At present, one quarter of the large factory type employment is located in the Koggala EPZ. The rest have located on free standing industrial plots. This trend is projected to continue. The projected growth in factory type employment over the planning period of 20 years is 30,000 new jobs. Based on past performance, 10,000 of these would locate in industrial estates. All of these could be accommodated in Koggala alone: the EPZ there has vacant developed land for new factories employing 15,000 additional workers.

Not all of the large factory type employment will and should locate in Koggala. BOI has planned a new EPZ in Hambantota which has already been approved by the Cabinet. This estate has a planned area of 250 acres and is slightly larger than the one in Koggala. The two can meet all of the expected growth in demand for industrial estate land over the next 20 years.

The emphasis should be placed on developing industrial areas for the middle-size industries. The expansion in these type of jobs is estimated to be close to 60,000. Separate industrial land will be needed only for a part of this kind of industrial expansion. Eight such centers have already been planned (Figure 1.1) in the region. At full development, these industrial

districts would accommodate enterprises providing jobs for approximately 20,000 workers. This is sufficient to absorb the incremental employment in manufacturing over the next five to seven years. Because of locational requirements, however, it is suggested that three additional districts should be initiated immediately. It is proposed that they should be developed in a tight cluster around Matara city.

3.3.4 Industrial land requirements

For the first group (large factories), estimates of industrial land requirements are based on the actual average of the Koggala estate which are similar to the national averages. The average number of workers per acre of industrial plots for the 11 enterprises in Koggala was 190. This is similar to the national average of 200 workers/acre used for industrial estate planning in Sri Lanka.

The density is higher in industrial areas around Colombo. Additional information on factories inside Colombo show that labor intensity per acre is almost twice in the factories located within the metropolitan area. For the region, the relevant parameter is that of Koggala and other industrial estates.

Land requirements of industry in the small industry districts are five to six times higher than those of large industries. The land requirements in these districts are much larger because of both higher land requirement per worker and the larger size of employment projected for these types of industries.

These estimates are based on the actual figures for two districts already in operation in the region. The Karadeniya industrial district had 11 workshops operating in January 1996 and they employed 47 workers. The one in Baddegama had nine operating workshops with a total of 27 workers. The area occupied by the industries in Karadeniya was 1.15 acres and 0.89 acres in Baddegama. Employment per acre was 41 in Karadeniya and 30 in Baddegama.

The total land requirements will be 1,650 acres over the planning period given the expected expansion (58,000 workers) and 35 workers/acre. Only part of the demand will be for industrial district land. The planned estates contain 731 acres, or 44% of total projected requirements. It is unlikely that the proportion of SMIs locating in these districts will exceed that. Additional districts should be built only in areas with high potential demand

while development of some of the planned districts should be postponed to later stages of Master Plan implementation.

Two types of locations are envisioned for the intermediate-sized firms. The relatively large ones that may create noise, fumes and other environmental problems will be located in specialized industry districts. These districts would be similar to the ones in Karandeniya and Baddegama. These districts should be developed to accommodate half of the projected growth of 58,000 workers in that group.

Others that have no adverse environmental impacts (bakeries, confectionery and other sugar products, small garment and leather manufacturers and similar firms) will locate in the residential areas. Sometimes these may be in the form of mixed uses together with commerce and housing. Separate industrial areas will not be needed for these, but their space requirements should be taken into account in planning for the built-up areas.

For the small/cottage type industries separate industrial areas need not be planned. Provisions, however, should be made in local development plans to accommodate the requirements of these industries. Similarly, the issues of acquiring land, the development of infrastructure, and credit requirements of these small producers need to be further analyzed to develop new programs and identify the support that can be provided by the public sector and foreign donors.

The required new industrial land is not unmanageable in comparison with the existing plans of government institutions. The Regional Industries Service Committee of Southern province alone has forwarded plans to the Presidential Task Force for Southern Area that call for developing 358 acres in six proposed locations. Three additional sites are to be developed by the Industrial Development Board and the Provincial Council. The Ministry of Industry has plans to develop up to eight districts.

The proposed program of small industry districts is, however, very demanding in comparison with the actual achievements of the government institutions. So far, the government agencies have been able to develop a total of only two acres in the region. The private sector has not been involved.

3.3.5 Location within Southern Area

Galle is projected to be the major center for export-oriented activities. Linkage-based industries and those exhibiting scale economies are also to be developed in Galle. Agro-processing is targeted for Hambantota district. Two product groups with large potential are livestock products and fruit/vegetable processing. The center of livestock production in the region is Hambantota and livestock product processing activities will locate there. For fruit and vegetable processing, the major centers will be in Matara district and Embilipitiya.

A large range of other industries can also be developed in Matara district. Most of these would be skill based. In addition, regional and national market-oriented industries will also locate there. Fabricated metals and consumer goods production will also concentrate in Matara district.

Both Matara and Hambantota districts can develop products of handlooms, wood carving and clay dolls. In Moneragala district, agro-industries based on sugarcane and byproducts of sugar will be developed.

3.4 Development Strategy

3.4.1 Overall strategy

There are three critical components of industrial development strategy for Southern Area: 1) the region will capitalize on its proximity to Colombo to attract national and international market-oriented industries; 2) industries utilizing local labor and raw material resources will be promoted; and 3) the growth will rely on the private initiative with the Government playing a supportive role. Possible sources of industrial growth are introduction of new high-growth industries, increasing value added on existing products, and deepening the extent of industrial processing in traditional activities.

The area's attractiveness for industrial location could be increased if the Government differentiated investment incentives regionally. In the absence of this, improvements in infrastructure, skill training and access to a variety of government services will be the major instruments to promote industries in the region. Large export- and national market-oriented industries and those processing local raw materials will be targeted for support. New programs for the cottage/micro enterprises are not proposed. These enterprises will

continue to be significant in providing employment in the short to medium term. They will be the buffer against unemployment while meaningful jobs in efficient industries are created.

Large, export-oriented industries require a level of technical sophistication, finance and marketing capability that is generally provided only by direct foreign private capital investments. These investments are extremely sensitive to policy stability. The availability of disciplined, and trained labor is an important attraction for these industries. They also require a high level of physical infrastructure and will locate in the largest urban centers.

These export-oriented industries tend to have very high import/output ratios. They may even be of an "enclave" nature, importing all their inputs and exporting all output. This import dependence emphasizes the physical access to international ports and trade related facilities. It also underlines the importance of unhindered access to inputs in the world markets.

By contrast, the local raw material industries have a different set of requirements. The market for these industries tends to be local, at most regional. Only in exceptional cases such industries are able to develop supply arrangements with the large, national market-oriented industries. Availability and cost of inputs, skill training and infrastructure is equally important for these industries. For industries producing intermediate products (parts and components), development of material and product standards is critical. Government policy could speed this process by providing incentives to domestic procurement as opposed to imports. Domestic procurement should not be encouraged by denying manufacturers access to world markets, but by providing additional incentives.

Mining and agriculture are the two main raw material bases. Both present limited opportunities. There are selective possibilities to further process some agricultural commodities. Infrastructure investments that enlarge the market area will help these producers as will the increases in loan financing and skill training. Gradually, the mining technology should be upgraded to increase supply of construction materials and reduce their costs. One possibility is to allow large quarrying sites opened for large development projects to continue operating and supply the local market. Government policy discourages large projects in gem mining for social reasons and this sector will remain under similar practices in the medium term.

3.4.2 Specific strategy

Industrial deepening and faster growth in local industries will occur as the regional industrial base diversifies and the size exceed critical thresholds. This calls for a sustained government effort during the early phases of industrialization. For most of this, what is needed is not new government programs but to minimize government interventions. Thus, for instance, this effort can be undertaken without undue fiscal burden by making available government-owned land to industry and by introducing efficient new mechanisms for infrastructure provision, by improving the local planning and construction capability, and promoting new schemes to allow private sector participation in infrastructure provision.

In the short run, three key instruments for supporting the regional industrialization are infrastructure, credit and a streamlined administrative support system. The last includes promotional measures aimed at foreign investment and investor support services provided through a single service center located in two or three growth centers in the region. For the medium term, training and education programs will become important.

Infrastructure provision should be substantially speeded up in three to five regional growth centers with large potential for industrial growth. Candidate centers are Galle, Matara, Hambantota and Embilipitiya. It is recommended that not only industrial but total urban infrastructure development be targeted in these centers. An important component of infrastructure is links with Colombo. The present road and rail system does not provide fast access between the region and Colombo, but serves as a minor artery designed to serve the local communities on the routes. Alternative, efficient ways of transport are strongly recommended.

Concurrently, industrial finance must be made available at reasonable interest rates. Directed credit should be established and be made available to all firms including those that agree to relocate part of their operations from Colombo or undertake their expansion in Southern Area. All financing requirements of such firms, including the part continuing production in Colombo, should be provided by the new facility. These programs can be discontinued when Sri Lanka attains macroeconomic balances that will reduce interest rates down to the levels observed in other countries in Southeast Asia.

One-stop service centers should be established in the selected urban centers to provide all functions presently performed by BOI, Customs Department, and relevant ministries. These centers will also liaise with other related government agencies to secure permits and

acquire support services. These will be the core of the regional offices of the Southern Development Authority in the region. It is recommended that they operate in close cooperation with the Regional Industry Service Committees.

For the medium term, these functions should be supported by establishing technology and training institutes specialized in one of the few products where the region has a dominant share of the national production. It is likely that these will include consumer electronics, leather, fabricated metal products, and gems and jewelry.

The bulk of new investment will come from large Colombo-based companies and firms from abroad. For both of these, access to Colombo and social amenities will be important. It is, therefore, highly desirable to guide these new industries into a few selected locations in the region. Galle is an ideal location from this perspective. The Galle port industrial area development project formulated by the Presidential Task Force will fit well with this strategy.

The Cabinet has made a decision to establish an industrial estate in Hambantota similar to the Koggala EPZ. The site has already been selected and preparatory works are underway. The development of this Hambantota estate should aim not only for export-oriented firms but include local resource-based industries as well. Agro-processing, livestock and production of agricultural machinery for the regional and national market should be promoted in Hambantota. These companies should be encouraged to locate in the planned estate side by side with export-oriented firms.

The question of land ownership must be settled as a priority issue. Land titles should be given both to industries who locate in the EPZs and those that locate in small industry districts. The development of industrial estates and districts must be undertaken by private firms or the association of manufacturers with government support.

In the immediate future, the industrialization strategy calls for speeding up infrastructure provision. This carries the risk that such infrastructure will remain idle if the planned growth does not materialize. This risk is considered to be small. It can be further reduced by encouraging the private sector to undertake these schemes with sufficient inducements by the Government. It is likely that there will be strong foreign private investment interest if the Government provides the appropriate regulatory environment and provides insurance against possible policy-related risks.

CHAPTER 4 MEASURES

4.1 Support Programs

The Master Plan recommends implementation of four specific programs to support industrial development in Southern Area. These are designed to support private sector investments. The main thrust of these is summarized below.

4.1.1 Industrial finance

The real cost of bank loans in Sri Lanka is higher than that of any other country in South and Southeast Asia. The prime cause of this is the large fiscal deficit and the resulting borrowing requirements of the Government. The medium-term objective is to eliminate this pressure, which crowds out private investment in all sectors of economy, by reducing public expenditures.

As an interim measure, the Government should implement a directed credit program in the region. This would be an expansion of the ongoing program financed by ADB and the World Bank. A major new feature of the proposed program is that the real interest rates must be reduced to a few percentage points compared with almost 10% under the existing programs.

4.1.2 Infrastructure development

Private investment will be facilitated by provision of infrastructure in the region. It is proposed that this be extended to cover provision of plots supplied with all infrastructure on which small industrialists will build their workshops. This is similar to the concept of sites and services for housing.

4.1.3 Technology upgrading

The existing technology support services are geared to small and micro enterprises. Furthermore, they are based on the assumption that the civil servants hired by the Government, sometimes with support from international donor agencies, can provide meaningful advice to the private entrepreneurs on available technologies. Such a government service is not needed and is inappropriate under market conditions. Firms themselves will seek, locate and choose the appropriate technology. Similarly, technology

upgrading is done by the firms themselves. The emphasis must shift to fiscal and other incentives that encourage firms to upgrade their technology. This includes promotion of expenditures for R&D and investments in new technology.

The Advanced Technology Program for duty-free imports under the Ministry of Industry should be continued indefinitely. The minimum size requirements of this program should be removed and access should be made automatic for all industries as a matter of right.

4.1.4 Legal and administrative measures

A comprehensive framework is provided for planning and administration of regional industrialization by the Industrial Promotion Act No. 46 of 1990. The immediate priority is to implement the provisions of this Act. In the medium term, it would be useful to revise the Act to eliminate some of its restrictive covenants concerning approval procedures for setting up new businesses and to clarify the authority for implementation.

4.2 Development Programs

An integrated package of industrial development programs is proposed to increase the rate and level of regional industrialization. They are:

- 1) Industrial Districts for Small- and Medium-Sized Industries,
- 2) Industrial Finance,
- 3) Integrated Urban Industrial Development Project,
- 4) Improved Availability of Manufacturing Inputs, and
- 5) Training and Technology Institute (Center).

These proposals are realistic within the policy and resource environment of the Country. Given the reliance on the private sector with no direct government investment, the proposed programs are designed to eliminate constraints facing the private sector and to improve the infrastructure conditions. These programs call for provision of infrastructure and credit, and coordination among activities of various government agencies and local authorities.

These programs are designed to support the regional industries. The level of industrialization in the region will also be heavily affected by national level policies. The ability of the Country to draw private foreign investment is a key factor. This in turn

depends both on maintaining policy stability and continuation of the outward oriented development strategy instead of import substitution policies pursued in the past.

4.2.1 Industrial Districts for Small- and Medium-Sized Industries

This program is to provide industrial sites with infrastructure for small- and medium-sized industries. The management of these projects will also undertake all administrative work involved in setting up a small business, including getting construction and operating permits. The project will lead to a clustering of many industries in adjacent locations. This will make it possible to provide common service and support facilities. It may induce the development of related cottage industries.

Availability of a site provided with the necessary infrastructure can reduce the cost of investment for the small industries by up to 50%. The choice of appropriate location can also significantly reduce operating costs for the enterprises. Locating small industries in a planned fashion minimizes adverse environmental effects and contributes to the quality of urban life by reducing travel time and costs. Locating these industries in a single site provides agglomeration economies associated with size. Such a common site becomes a powerful magnet for the potential buyers of the output of enterprises. It also provides economies of scale for services used by small industries. The costs of starting a business can be reduced under this scheme as well.

The implementing agency of the central Government will acquire the land. In many cases this land will be owned by the government and its acquisition will not have any costs. The primary criteria for the choice of location, however, should be the suitability of the site rather than its ownership. The choice of site and provision of infrastructure will be undertaken in cooperation with local agencies. The office of the Chief Minister will play a lead role.

The development of these districts should not be undertaken by the Government but by the expected beneficiaries whenever possible. One possibility is to form an association of the beneficiaries in advance of actual development. All development works on the districts can be supervised by these associations.

4.2.2 Industrial Finance

The nominal cost of loan financing for the manufacturing companies varied from 18 to 22% during the last five years. Given inflation rates of around 10%, this has meant real interest

rates of around 10%. For the interim period, this project will provide credit to manufacturing enterprises at more reasonable interest rates. Unlike the ongoing SMI credit scheme supported by the World Bank and ADB, the real rate of interest under the proposed scheme will be more or less 3%.

All existing companies in Sri Lanka will be eligible for the credit scheme if they locate a significant part of their operations in the region. Thus, not only existing and new companies in the region but all manufacturing enterprises will be eligible. This will introduce some locational selectivity into the investment incentive scheme which now has completely lost this characteristic since 1993.

4.2.3 Integrated Urban Industrial Development Project

This project aims at providing the necessary infrastructure and coordinating development activities in selected growth centers. This will allow the public agencies to lead growth of urban areas. It will produce desirable living conditions in the critical urban centers targeted for rapid growth. Infrastructure facilities to be provided may include small industrial plots as well as housing. Orderly urban development and integration of these activities with planned industrial development requires a level of resource commitment and administrative capability that cannot be provided throughout the region.

The integration of the activities of all agencies in a given location is also expected to create synergy and increase the development multipliers. The size and diversity that the program will generate will lead to rapid growth of linkage industries and will encourage these industries to locate in the region. The program will generate experience, based on the pilot schemes, which may result in an expanded program for the whole region at a later phase.

4.2.4 Improved Availability of Manufacturing Inputs

This program is to provide the same facilities for access to imported inputs in the three districts (Galle, Matara and Hambantota) as are presently available in Colombo. This will include all new facilities (for licensing, finance and other support measures), as well as fully authorized offices of the Customs Department.

One factor that encourages import-dependent and export-oriented companies to locate in Colombo is access to the government offices that administer foreign trade-related activities. Regional industries are at a disadvantage if they have to maintain offices in Colombo for

these procedural requirements. These procedures are also time consuming and they increase delivery times for production inputs and for shipping out finished products.

Government agencies will be able to maintain fully staffed offices in the provinces by relocating some of the existing staff to the districts. This is compatible with the new policy of devolution of powers to the provinces. Locating these functions in the districts will reduce the dependence of provincial industries on central government functions in Colombo. This will support the decentralization of industry to provinces.

The project will establish branch offices of selected central government ministries in the provinces. As a first step, an office will be set up in Galle. This office will have the power to provide all services presently provided by BOI as well as the customs department. The office will also have the authority to act on behalf of other related agencies that may be required to monitor the performance of manufacturing enterprises for fulfillment of export and incentive-related commitments.

4.2.5 Training and Technology Institute (Center)

The project will establish a specialized institute in each commodity group where a major expansion is expected in the region to serve other regions as well. The concept is similar to that of existing Clothing Industry Training Institute (CITI). A major function will be training of workers. It is expected that the trainees will be those with around eight years of schooling. Short-term specialized training may also be provided for the unemployed educated youth. Labor intensive skills in which Sri Lanka is believed to have comparative advantage include gem cutting and jewelry, electronics, leather goods, and automotive parts and components. The project will provide trained labor in one of these fields initially. The second center will be established in a different location for a different product line after an evaluation of the results of the first.

The proposed Institute will be fully equipped to undertake testing and quality control for the product. It may also provide specialized central services to the industry on commercial basis.

Operating costs of the Institute will be financed by the Government with some private sector participation. For electronics, the Government can use the existing Technology Transfer Fund operated by BOI. This government support, however, must be restricted to a fixed period. Furthermore, it would be conditional on a parallel private sector commitment.

The first specialized Institute will be established only after a few large firms, internationally well known in the respective field of production, have made a firm commitment to start production in the region. The Institute will be initiated concurrently with the investment schedules of these companies. These companies will provide assistance on the type of training to be provided and equipment requirements. They may also provide trainers whose costs could be born by the Institute.

Tourism

SECTOR REPORT 2 INDUSTRY, TOURISM AND SERVICES

PART 2 TOURISM

CHAPTER 1 EXISTING CONDITIONS OF TOURISM

1.1 Existing Tourism Policies and Institutions

1.1.1 Tourism sector policies

The Sri Lankan Government regards tourism not only as a potentially high growth sector and job creator but also as a sector which creates a positive and distinctive image of the Country. It recognized at the same time that tourism development in Sri Lanka would have to depend substantially on foreign investments. Measures to encourage foreign investments apply equally to tourism related investments.

The Tourism Master Plan prepared for the period 1992-2001 has established the strategy for tourism development in Sri Lanka. The strategy aims to diversify the market mix, increase tourist spending by developing and upgrading tourist facilities, increase the emphasis on cultural, natural and other tourist attractions, and create a positive image of Sri Lanka. Under the strategy Sri Lanka's tourism is expected to contribute to increasing investment, job creation, and foreign exchange earnings, while minimizing negative effects--environmental degradation and social problems.

1.1.2 Government institutions for tourism

The Ministry of Media, Tourism and Aviation, established in 1994 by reorganizing the former Ministry of Tourism and Rural Industrial Development, is the principal government agency responsible for the promotion and development of both domestic and international tourism in Sri Lanka. It has eight divisions including Tourism Division I and II, which are directly involved in tourism development, as well as the Planning, Development, Research and Training Division and the Aviation Division.

Tourism Division I is in charge of supervising the Hotels Corporation, managing and conducting development activities in the Cultural Triangle and Southern Area, liquor licenses and parliamentary matters. Tourism Division II is responsible for national zoos, the Ceylon Tourist and Training Board, a restaurant and a hotel.

The Ceylon Tourist Board (CTB) is the implementing arm of the Ministry, administering tourism affairs and implementing tourism related projects. The Board conducts marketing and promotion, operates the Ceylon Hotel School and plans and develops various tourism activities.

1.2 Present Conditions of Tourism in Sri Lanka

1.2.1 Tourism resources

Sri Lanka is favored with tourism resources distributed throughout the Country. National parks, natural reserves, and sanctuaries are dispersed in 22 places, with innumerable attractive sites containing historical remains found in many places. The following clusters are where these tourism resources particularly abound.

Cluster A: The cultural triangle connecting Anuradhapura, Polonnaruwa and Kandy (the central northern area) with historical remains showing the rise and decline of the Sinhara Dynasty as the center.

Cluster B: Highlands more than 2,000 meters above sea level in Kandy and Nuwara Eliya areas featuring a magnificent view with waterfalls, cool temperatures and tea plantations.

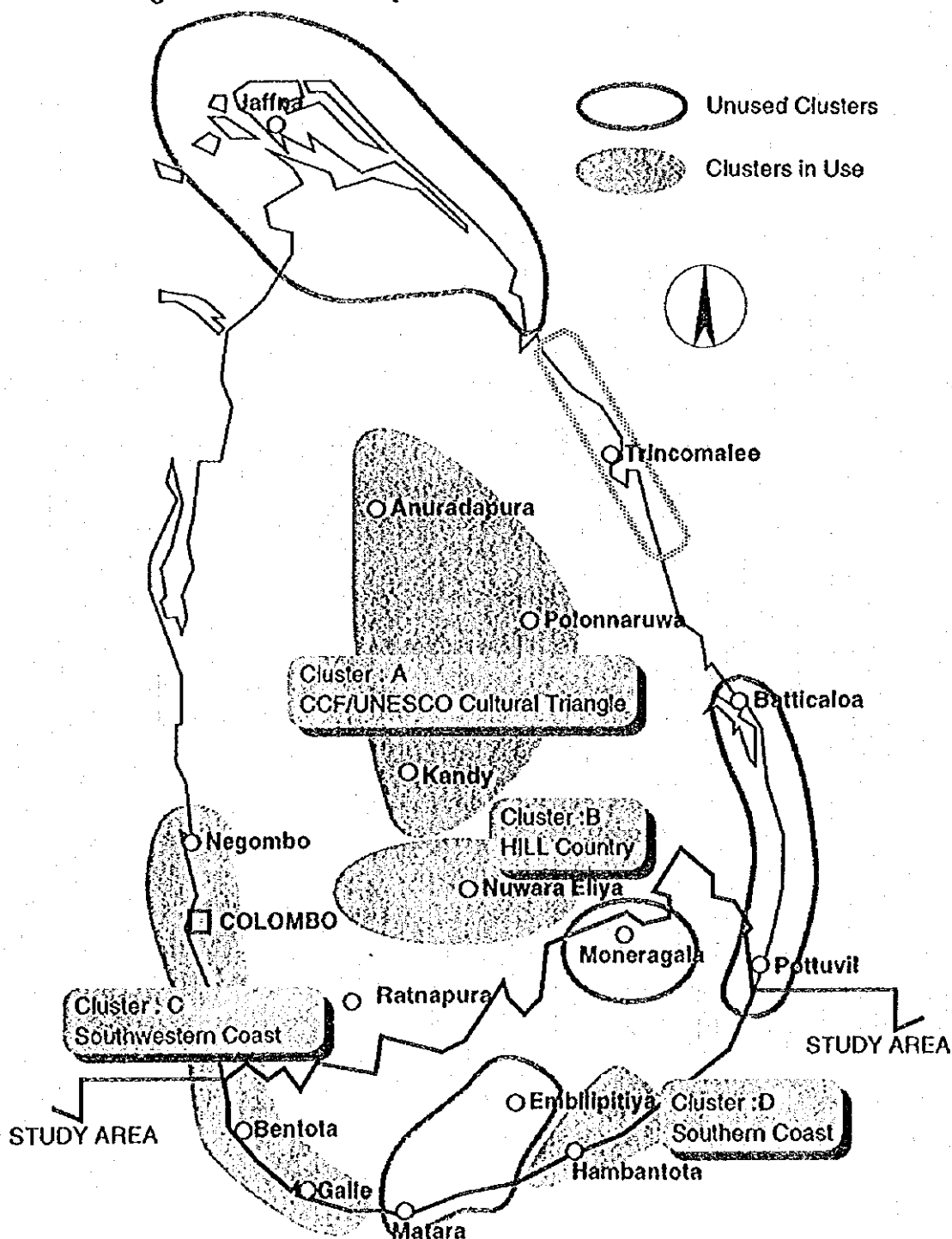
Cluster C: Beach resort places from Negombo through Colombo and Mt. Lavinia to Galle as centers.

Cluster D: Historical remains of the Ruhuna Dynasty and the Yala National Park, linked closely with other remains.

These districts are currently visited by tourists and local resources are used for tourism purposes; they do not include the eastern and northern parts of Sri Lanka. There are still many tourism resources located along the coast of Sri Lanka. CCD Internal Reports No. 9 and No. 10 of 1986 report that along the coast of Sri Lanka, there are a total of 183 locations with tourism resources, including 94 sites of archeological, historical, or cultural interest, and 89 locations noted for their scenery or suitable for resort development. Approximately 80 of these are in the east and north. That is, in addition to the tourism resource concentrations A to D listed above, there are believed to be two or three more

clusters in the eastern and northern parts of the Country which will be utilized in the future (Figure 1.1).

Figure 1.1 Locatin Map of Tourism Resource Clusters



Source : JICA Study Team

1.2.2 Changes in tourist visits

A study of long-term changes in the number of foreign tourists visiting Sri Lanka indicates that the number increased by an average of about 15,900 per year from a total of 39,654 in 1971 to 103,204 in 1975, and beginning in 1976, this figure began to climb at a more rapid average rate of 48,000 per year to stand at 407,230 in 1982. Beginning in 1983, however, unfortunate events in Sri Lanka resulted in a sharp drop in foreign tourist arrivals, with only 180,000 to 190,000 visiting the Country each year between 1987 and 1989. With the subsequent restoration of public safety and the pacification of southwestern Sri Lanka, the number began to climb again at an annual rate of approximately 70,000 persons. By 1992, foreign tourist arrival had recovered to 393,669 and, although this growth slowed after 1992, it stood at 407,511 in 1994, almost the same as during the peak year of 1982. This rapid recovery was possible because hotels built in earlier boom years were available to accommodate the growth.

These long-term fluctuations in the number of foreign tourists have been reflected in tourism income and the number of people employed by the industry, and have directly affected the amount of foreign currency earned by the Country (Table 1.1). The gradual decline extending from 1984 to 1991 was reflected in a conspicuous slump in investment in the Country's tourism industry.

In 1995, the number of foreign tourists continued to rise with a total of 281,304 having visited the Country by August, an increase of 5.3% over the same period of the previous year. However, the total for 1995 was 403,101 persons, a decrease of 1.1% from the preceding year. This may be ascribed to the fact that safety, an absolute prerequisite for tourism, was not sufficiently secured. A good example is that, owing to incidents which occurred in the latter half of 1995, the number of visitors from abroad dropped by 14.8% in November and by 25.1% in December respectively from the numbers in the same months of the previous year, or a decrease of 10,737 visitors. This declining trend continued in 1996; between January and May, the number of overseas visitors each month was down by 30% to 40% from the same month in the previous year.

Table 1.1 Tourism Growth Trends—1987 to 1995

Year	Tourist Arrivals	Official Tourist Receipts (US\$ mn)	Accommodation Capacity (Graded Rooms)	Employment	
				Direct	Indirect
(1982)	407,230	146.6	7,539	26,776	37,486
1987	182,620	82.0	9,921	20,338	28,473
1989	184,732	76.6	9,459	21,958	30,741
1990	297,888	97.5	9,556	24,964	34,950
1991	317,703	114.6	9,679	26,878	37,629
1992	393,669	201.4	10,214	28,790	40,306
1993	392,250	208.0	10,365	30,710	42,992
1994	407,511	230.2	10,748	35,064	49,090
1995	403,101	—	—	—	—

Source: C.T.B. Annual Statistical Report

1.2.3 Tourism market

(1) Foreign tourists by region and by country

A regional breakdown of foreign visitors to Sri Lanka in 1994 reveals that those from Western Europe, a total of 253,899, accounted for 63.2% of the total 407,511 visitors, while Asia was next with 116,352 or 28.6%. These two regions combined provided a total of 90.9% of all foreign tourists. The remainder came from North America (3.8%), Australasia (2.7%), Eastern Europe (1.1%), and the Middle East (1.0%). Tourists also came from Africa and Latin America. The country providing the largest number of tourists was Germany with 93,528 or 23.0% of all foreign tourists, and 36.8% of those from Western Europe. Germany was followed by the U.K., India, France, Japan, Italy, Switzerland, Holland, the U.S., and Pakistan.

Reflecting internal situations of Sri Lanka, visitors from India fell from 93,112 in 1982 to 12,412 by 1987. Although it had risen gradually since then the number of Indian visitors had recovered only to 44,142 by 1994, or a little less than half as many as in 1982. The number of visitors from Pakistan continued to rise despite the unpleasant events occurring

in Sri Lanka. The numbers of tourists from other countries have been influenced to varying degrees by the level of security within Sri Lanka (Table 1.2).

Table 1.2 Tourist Arrivals by Region—1987 to 1994

	1982	1987	1990	1992	1994
North America	15,528	7,166	8,084	12,615	15,612
Western Europe	232,290	121,112	169,294	246,393	253,899
Eastern Europe	4,160	3,160	7,562	3,642	4,386
Asia	135,088	43,462	100,004	114,162	116,352
(India)	93,112	12,412	13,056	25,944	44,142
(Pakistan)	4,860	4,320	7,600	11,481	10,188
Australasia*	12,834	4,448	8,914	12,363	12,033
Others	7,330	3,272	4,030	4,494	5,229
Total	407,230	182,620	297,888	393,669	407,511

Note: Australasia denotes Australia, New Zealand and neighboring countries.

Source: C.T.B.

(2) Number of tourists by age and sex

A study of the sex of tourists visiting Sri Lanka in the *CTB Annual Statistical Report* in 1994 indicates that 59.5% are men while only 40.5% are women. The same breakdown of tourists from Western Europe reveals that 55.1% are men with women accounting for 44.9%, a narrower gap than the overall figures indicate. In the case of Asian tourists, however, the gap is wider, with 68.5% men and only 31.5% women.

Statistics on the number of visitors by age group show that 62.1% of those from Western Europe, 66.2% of travelers from Asia, and 62.9% overall were between the ages of 20 and 39. These breakdown by sex and age (20-39) for leading countries is shown in Table 1.3.

Table 1.3 Breakdown by Sex and Age (20-39)

	Male	Female	Age (20-39) (%)
Germany	56.0	44.0	63.3
U.K.	55.9	44.1	59.3
France	51.4	48.6	56.4
Japan	58.2	41.8	60.0
Italy	53.9	46.1	72.0

Source: C.T.B.

(3) Air routes and average length of stay

All visitors to Sri Lanka came by air in 1994. Of these, 373,122 or 91.6% flew on regularly scheduled flights, while 34,389 others traveled on charter flights. A total of 34,083 charter flight travelers, representing almost all charter flight passengers, were from Western Europe. Germany was the home of 8,826 (25.7%) charter flight passengers. An additional 20,442 (59.4%)—between 3,000 and 4,000 from Austria, Finland, Italy, Sweden, Switzerland, and the U.K.—also came by charter flight. Altogether, seven European countries including the leader Germany accounted for 85.1% of all visitors coming to Sri Lanka on charter flights. The airlines operating the charter flights include Fin Air, Scandinavian Air, Sobel Air, Condor, AF/Emirates, Bal Air, Lauda Air, and Air Europe. No passengers traveled from the Middle East and Asia on charter flights.

The average length of stay for travelers from leading demand nations was 13.6 days for Germany, 9.9 days for the U.K., 9.2 days for France, 6.6 days for Japan, and 8.1 days for Italy. The longest average lengths of stay were recorded for Australia at 14.4 days, Sweden at 13.8 days, Germany at 13.6 days, Denmark at 13.2 days, Austria at 12.2 days, and Holland and Canada whose visitors stayed an average of 12.0 days.

A comparison of non-charter and charter visitors indicates that the average length of stay by charter visitors is about 2 days longer than the average length of stay of non-charter visitors (Table 1.4). This trend has continued unchanged since 1989.

Table 1.4 Average Duration of Stay and Tourist Nights by Country of Nationality 1994

Country of Nationality	Non Charter			Charter			Total		
	Arrivals	Average Duration of Stay	Tourist Nights	Arrivals	Average Duration of Stay	Tourist Nights	Arrivals	Average Duration of Stay	Tourist Nights
NORTH AMERICA	15,675	9.9	155,664	147	14.8	2,177	15,822	10.6	157,841
Canada	4,863	12.0	58,356	87	17.3	1,505	4,950	12.1	59,861
U.S.A.	10,812	9.0	97,308	60	11.2	672	10,872	9.0	97,980
LATIN AMERICA & THE CARIBBEAN	522	8.4	4,385	18	14.9	268	540	8.6	4,653
WESTERN EUROPE	222,444	11.4	2,544,102	34,083	12.9	440,477	256,527	11.6	2,984,580
Austria	5,382	12.2	65,660	3,354	13.5	45,279	8,736	12.7	110,939
Belgium	9,024	11.7	105,581	1,128	12.1	13,649	10,152	11.7	119,230
Denmark	1,995	13.2	26,314	1,131	13.4	15,155	3,126	13.3	41,489
Finland	927	9.2	8,528	3,219	12.6	40,559	4,146	11.8	49,088
France	28,575	9.2	262,890	1,935	10.5	20,318	30,510	9.3	283,208
Germany	84,930	13.6	1,155,048	8,826	14.8	130,625	93,756	13.7	1,285,673
Italy	14,871	8.1	120,455	3,195	9.6	30,672	18,066	8.4	151,127
Netherlands	12,135	12.0	145,620	87	14.3	1,244	12,222	12.0	146,864
Norway	864	10.7	9,245	390	10.5	4,095	1,254	10.6	13,340
Spain	2,787	8.0	22,296	24	10.0	240	2,811	8.0	22,536
Sweden	2,673	13.8	36,887	3,720	12.9	47,988	6,393	13.3	84,875
Switzerland	8,961	11.4	102,155	3,528	12.6	44,453	12,489	11.7	146,608
U.K.	46,887	9.9	464,181	3,426	13.1	44,881	50,313	10.1	509,062
Others	2,433	7.9	19,221	120	11.0	1,320	2,553	8.0	20,541
EASTERN EUROPE	4,296	9.7	41,479	63	11.0	733	4,359	9.7	42,212
Russia	2,547	10.0	25,526	12	10.5	126	2,559	10.0	25,652
Others	1,749	9.1	15,953	51	11.9	607	1,800	9.2	16,560
MIDDLE EAST	3,912	8.8	34,426	0	0.0	0	3,912	8.8	34,426
AFRICA	585	7.5	4,388	12	0.0	0	597	7.3	4,388
ASIA	114,417	7.6	864,401	0	0.0	0	114,417	7.6	864,401
China(P.R.)	1,380	8.4	11,592	0	0.0	0	1,380	8.4	11,592
Hong Kong	2,640	4.8	12,672	0	0.0	0	2,640	4.8	12,672
India	44,100	8.3	366,030	0	0.0	0	44,100	8.3	366,030
Indonesia	1,290	4.4	5,676	0	0.0	0	1,290	4.4	5,676
Japan	19,506	6.6	128,740	0	0.0	0	19,506	6.6	128,740
Korea(South)	2,817	8.3	23,381	0	0.0	0	2,817	8.3	23,381
Malaysia	5,199	5.7	29,634	0	0.0	0	5,199	5.7	29,634
Maldives	7,191	8.9	64,000	0	0.0	0	7,191	8.9	64,000
Pakistan	10,194	7.5	76,455	0	0.0	0	10,194	7.5	76,455
Philippines	1,338	6.5	8,697	0	0.0	0	1,338	6.5	8,697
Singapore	7,383	5.6	41,345	0	0.0	0	7,383	5.6	41,345
Taiwan	3,069	6.3	19,335	0	0.0	0	3,069	6.3	19,335
Thailand	6,396	9.8	62,681	0	0.0	0	6,396	9.8	62,681
Others	1,914	7.4	14,164	0	0.0	0	1,914	7.4	14,164
AUSTRALASIA	11,271	14.0	158,254	66	6.3	413	11,337	14.0	158,666
Australia	9,894	14.4	142,474	42	7.0	294	9,936	14.4	142,768
New Zealand	1,293	11.6	14,999	6	6.0	36	1,299	11.6	15,035
Others	84	9.3	781	18	4.6	83	102	8.5	864
TOTAL	373,122	10.2	3,807,098	34,389	12.9	444,068	407,511	10.4	4,251,166

Source C.T.B.

(4) Tourist movements

The results of interviews conducted by CTB to determine tourist movements are summarized below.

Europe, North America, and Australia: A stay in the western and southwestern resort area and a three- or four-day optional tour (a safari, the cultural triangle, central highlands).

Asia (excluding India and Pakistan): The cultural triangle and the central highlands.

India: Visits to family and relatives and business trips; concentrated in some particular regions.

Pakistan: Business, concentrated in Colombo, but partially scattered.

Sri Lanka (domestic): The cultural triangle, central highlands, and the southern resort area.

An exit survey at the airport is needed to determine tourists' movements more accurately.

(5) Seasonal fluctuations in tourism

According to the record for 1994, seasonal fluctuations in the number of tourists coming to Sri Lanka are governed largely by seasonal fluctuations in arrivals from Germany and other countries in Western Europe, the countries providing a stable supply of foreign tourists to Sri Lanka. Statistics for 1994 indicate that tourists from the Western Europe group peaked in January at 30,648, dropped to below one third of this peak level in May and June at 10,710 and 10,020 respectively, then increased again to 26,487 in December.

Asian arrivals peaked at 10,827 in December and recorded the lowest total in May when only 8,700 Asian visitors arrived. This lowest figure, which is only 2,127 fewer than in December and 80% of the peak value, indicates little seasonal fluctuation in visitors from Asia. Tourists from other areas also peaked in December, but little fluctuation appears in the monthly figures for visitors from these other regions.

Overall, the tourist peak was in January, when 45,402 visitors arrived and the lowest month was June when only 21,399 (almost as many as the 21,777 coming in May), or only 47% of the January peak, visited Sri Lanka. This pattern of fluctuation has remained almost the same for the past five years (Table 1.5).

Table 1.5 Tourist Arrivals by Region and Month 1994

Month	North America	Latin America	Western Europe	Eastern Europe	Middle East and Africa	Asia	Australasia
January	1,278	84	30,648	723	570	10,794	1,305
February	1,173	36	27,921	438	381	10,359	759
March	2,058	39	27,417	438	402	10,188	735
April	951	51	16,752	291	333	8,878	804
May	1,119	42	10,710	204	354	8,700	648
June	1,101	30	10,020	141	294	8,934	879
July	1,785	45	21,399	231	489	10,107	1,314
August	1,002	42	21,642	321	342	8,796	672
September	981	63	19,266	165	396	9,309	882
October	1,047	24	20,676	234	408	10,068	759
November	1,212	39	20,961	459	306	9,372	957
December	1,905	45	26,487	741	414	10,827	2,319
Total	15,612	540	253,899	4,386	4,689	116,352	12,033

Note: Australasia denotes Australia, New Zealand and neighboring countries.

Source: C.T.B.

1.2.4 Hotel investment

Investment in tourist facilities in Sri Lanka has been stimulated by the rapid increase in the number of foreign visitors between 1990 and 1992 and by steady growth since 1993, with the result that in 1995, a total of 2,227 rooms are under construction and final approval has been given to the construction of an additional 1,357 rooms. Assuming that these will all be completed, a total of 17,598 rooms will be available in five or six years (Table 1.6). A total of 11,133 rooms are in operation at present, and including some hotel expansion after 1995, a total of 11,555 rooms will be available in 1996. This is an increase of 422 rooms, and assuming that the hotel operating rate is 60%, the shared-room rate is 40 to 60%, and the average length of stay is 10 days, this hotel capacity will be able to accommodate approximately 13,000 to 15,000 guests. Table 1.7 presents a forecast of the increase in room requirements up to 1999 prepared by CTB.

Table 1.6 Hotel Room Capacity as at the End of August 1995

Region	In Operation	Under Construction	Given Final Approval	Total	Room Requirement	
					1996	2001
Colombo City	2,880	0	0	2,880	2,615	3,766
Colombo Resort Region	1,826	249	240	2,315	-	-
South Coast Region	4,007	1,232	722	5,961	5,472	6,715
Kandy	865	367	114	1,346	1,412	2,207
Hill Country	344	156	170	670	416	624
East Coast Region	108	0	26	134	323	2,215
Ancient Cities	1,103	173	0	1,276	1,025	1,580
Other Areas	0	50	85	135	292	491
Total	11,133	2,227	1,357	14,717	11,555	17,598

Source: C.T.B.

Table 1.7 Total Hotel Room Requirement 1995/1999

Region	1995	1996	1997	1998	1999
Beach: West and South	5,266	5,472	5,830	6,188	6,546
Beach: East	252	323	750	1,177	1,604
Colombo	2,615	2,615	2,718	2,821	2,924
Kandy	1,290	1,412	1,653	1,894	2,135
Other Ancient Cities	959	1,025	1,157	1,289	1,421
Hill Country	416	416	416	416	416
Others	292	292	329	354	385
Total	11,090	11,555	12,847	14,139	15,431

Source: C.T.B.

1.2.5 Tourism opinion survey

The current state of tourism in regions and countries accepting tourists is supported by awareness of tourism among residents of the regions. The promotion and development of tourism are also influenced to a great extent by the awareness of those attempting to conduct such promotion and development and of those in the region who benefit from their efforts. A survey was conducted to clarify opinions of both knowledgeable people and of people living in regions and countries where development is in progress to measure the gap in perception of the two groups. Where the gap is large, development will likely cause social problems.

A total of 26 knowledgeable persons (school teachers, university professors, lawyers, directors of government bureaus, consultants, managers, etc.), mostly from the city of Colombo, were randomly selected and an attempt was made to grasp their perception of tourism. As a whole, knowledgeable people in Sri Lanka typically hold the following views about tourism's roles.

- Tourism is an important or a very important industry for the Country.
- The average citizens of Sri Lanka think that tourism benefits the Country.
- The average citizens of Sri Lanka think that tourism affects their lives.
- The average citizens of Sri Lanka think that tourism benefits them individually.
- The people of Sri Lanka are, to varying degrees, positive about tourists visiting their Country.

Concerning the quality of services provided in Sri Lanka, their overall views are as follows.

- | | |
|----------------|--|
| - Hotels | Generally, most respondents rate them as good. (A few rate them as very good.) |
| - Restaurants | Generally, most rate them as good. (A few answered "rather dissatisfied.") |
| - Shopping | Generally, most rate it as good. (A few answered "rather dissatisfied.") |
| - Taxi service | Almost half responded "rather dissatisfied" with the rest divided between good and poor. |

- Bus service More than half responded "rather dissatisfied," with the rest declaring the service to be poor.
- Airports Most consider them good, with a few responding "rather dissatisfied."

They believe that tourism affects their jobs. Serious social problems affecting tourism in Sri Lanka conceived are as follows.

- Unkind C.I.Q. controllers: Most believe the problem is a little serious, and if those who think it is a serious problem are included, almost all consider it a problem.
- Unclear taxi charges: Almost all consider it to be a problem, but not a serious problem.
- Insufficient services in hotels and restaurants: A few consider it a serious problem, with the majority divided between a little serious and not serious at all.
- Panhandlers and pushy merchants: Almost all consider it either a serious or a minor problem.
- Pollution caused by trash and personal waste: Almost all consider this problem either a serious or a little serious.
- Crimes involving tourists: It is considered a slightly serious problem but not a serious problem.
- Tourists' ignorance of Sri Lankan customs and social mores: It is considered a slightly serious problem, but it is tolerable.
- Tourists' intolerance of Sri Lankan customs and social mores: It is considered a slightly serious problem but it is tolerable.

Almost all agreed that social problems affecting tourism include unkind C.I.Q. controllers and taxi charges, and many believe that panhandlers and pushy merchants and unsanitary conditions caused by trash and personal waste are serious problems. The respondents were divided on the question of whether other issues are problems or not (see Annex 1). A survey of perception of tourism among residents of the Area (primarily Southern province) is described later in Section 3.4.

CHAPTER 2 TOURISM POTENTIALS AND DEMAND

2.1 Tourist Images of Sri Lanka

Tourism in Sri Lanka has been supported by images of the Country formed by those who have already visited it, and further promotion of tourism will be influenced by such images. The more positive and the less negative images of Sri Lanka formed by travelers, the larger the number of foreigners who will return for a second time, the greater the number of foreign travelers who will decide they wish to come here in response to reports by travelers who have already visited the Country, and the greater the effectiveness of tourism promotion activities by Sri Lanka.

Sri Lanka is an ideal resort region with comparatively comfortable climate thanks to the wind despite its high humidity. The land is affected by powerful winds during the southwest monsoon (May to September) and the northeast monsoon (December to February). When the wind direction is changing, the Country is subject to short intensive rain storms to the surprise of foreign visitors. For more than 2,000 years since the age of the Sinhala Dynasty, the people's firmly established rice-centered life style has persisted through a long process of historical development, and both the changing and unchanging aspects of Sri Lanka have contributed to the creation of the historical legacy, stories, and natural setting of the Country as well as to the people themselves. It is these products of its long history that have formed Sri Lanka's dominant image as a tourist destination. Specific images, both positive and negative, may be represented by the following.

2.1.1 Positive images

A tourism asset of Sri Lanka may be represented by clusters of houses hidden along edges of luxuriant forests composed of giant trees and underbrush standing under powerful sunlight, casting dark shadows, and buffeted by powerful winds and torrential rainfalls. Near these homes, flowering plants and trees are cultivated by the people. Surrounded by brilliant red, yellow, and white blooms, the people live with their cattle, dogs, and many other animals and poultry as they conform to the powerful forces of their natural surroundings to live lives marked by acceptance of their lot in life. The lives of the people, animals, birds, and flowers are characterized by gentleness and consideration for others. Even those people along the seacoast live in the shadow of the large rock with their animals protected from high waves, blazing sunshine, and powerful winds.

The Country's culture has been nurtured through the long history of coexistence of people and animals under the great force of nature. When historical tales passed down in Sigiriya, Kirinda and elsewhere are retold, not only young boys and girls, but even adults who hear these stories feel that their dreams may come true in this culture.

- Sri Lanka, a land of gentle people.
- Sri Lanka, a land of flowers, animals, and birds.
- Sri Lanka, a land where you can meet elephants.
- Sri Lanka, a land of stories.
- Sri Lanka, a land of fantasy.

2.1.2 Negative Images

In contrast to the image of gentleness described above, life under harsh natural conditions has nurtured strong characteristics to endure hardships which appears as an overbearing attitude in the behavior and actions of the people. This has contributed to the feeling that tourists are received poorly. The people of Sri Lanka seem to emphasize a self-centered or severely self-disciplined approach to life, perhaps as a result of their Hinayana Buddhist faith or historical domination by other nations.

These characteristics seem to make tourists feel slightly uncomfortable. This problem, however, will be resolved by enhancing the people's consciousness of tourism and by training those working in the tourism industry.

The continued use of run-down houses on old streets constructed in the colonial era also leave visitors with an impression of disorder. This prevents visitors from enjoying window shopping and considering the history of the area. Even though they do not wish to be reminded of it, the history of these streets is still alive, and the houses still constitute a splendid tourist resource. Steps must, therefore, be taken to preserve these streets by repairing the houses in order to attract tourists.

A study of the tourist potential of streets and neighborhoods in Sri Lanka has revealed that a clock tower stands in the center of almost every town or city and all are quite similar. As one studies these communities more carefully, however, the special features of each and lives of its people are revealed. These are extremely attractive elements in the eyes of tourists. When future town and city plans are prepared, planners should look for ways

to provide each one with unique features distinguishing it from other Sri Lankan cities and towns.

Transportation is a basic requirement for tourists, but within cities tourists often find that the fare for a ride in a Bajaj (three-wheeled peddled conveyances) is almost identical to that of a taxi, and because the fare is not clear, the travelers are often upset by the experience of riding one. Hopefully, the Government will do something to help resolve this problem.

Essentially, tourism is enjoyable because it is a free, unconstrained activity. When tourists to Sri Lanka enter a city, however, they are confronted by police and army check points along principal roadways. Although tourists are allowed considerable freedom of movement, these security precautions have left them feeling a lack of freedom, a form of constraint on their actions. The return of more peaceful times is strongly called for.

2.2 Tourism Demand for Sri Lanka

A regression analysis shows that the number of visitors to Sri Lanka should stand at about 957,000 in 2001, based on the number of visitors from abroad in 1982: 407,230 (the highest in the past save for 407,511 in 1994). It should reach 506,000, if the analysis is based on the 1992 figure of 393,669.

According to the master plan drafted by the Ceylon Tourist Board (CTB) and UNDP, forecast tourist demand for the year 2001 is 874,000, based on 317,703 foreign visitors in 1991. The figure lies between the minimum and maximum figures estimated above. It reflects expectations of an average annual growth rate of 25.6%: the growth rate recorded from the latter half of 1970 to 1982 (Table 2.1).

Table 2.1 Estimate of Tourism Demand in 2001

	Base Year	Number of Foreign Tourists	Annual Growth Rate (%)
Team Estimate A	1982	957,000	3.0
Team Estimate B	1992	506,000	3.5
CTB/UNDP	1991	874,000	8.0

As a long-term estimate of the number of foreign tourists, another regression analysis, based on the 1994 figure of 407,511, shows that the number should rise to 588,000 in 2005 and 786,000 in 2015 at an average increase of 3% per annum. CTB has provided an estimate for the years until 2014, based on the master plan, and the figure should reach 1,081,000 in 2005, for an average annual growth of 6%, and 1,510,000 in 2014, representing a mean annual increase of 4% from 2005. This may be extended to the year 2015 to obtain 1,560,000 (Table 2.2).

Table 2.2 Long-term Tourism Estimate

	2001	Average Annual Growth Rate	2005	Average Annual Growth Rate	2015	Average Annual Growth Rate
Lower Estimate	506,000	3.5%	588,000	3.3%	768,000	2.7%
CTB Estimate	874,000	8.0%	1,081,000	7.5%	1,562,000	4.4%

The total number of tourists throughout the world stood at 315.5 million in 1984 and 528.5 million in 1994, representing an average increase of 5.5% per year. For 1990-1994, the average annual increase was 5.0%. The CTB estimate implies the average annual growth rate of 7.5% until 2005, slightly higher than the world average, but nevertheless plausible up to the year 2015.

A target of 1,560,000 may be attained by the strengthening and expansion of CTB promotional activities in major market countries, and by strengthening and enlarging public relations (PR) offices in Asian countries, including Japan which serves as promotional bases. Also, taking advantage of Sri Lanka's favorable climate, diversified travel should be promoted in order to efficiently link beaches and other natural resources, national parks and safaris, as well as historical, and cultural resources, all of which will serve to enhance the nation's tourist attractions. Drastic changes which have taken place since the end of 1995 are not reflected in the estimate.

When classified by points of foreign tourist origin, according to the CTB estimate, the goal should be as shown in Table 2.3.

Table 2.3 Classification of Originating Regions

Region	2005 (persons)	2015 (persons)	Share (%)
Major Market Countries (Europe)	610,000	880,000	56
North America and Australia	70,000	100,000	6
Asian Countries	280,000	400,000	26
Other Countries	120,000	180,000	12
Total	1,080,000	1,560,000	100

The average number of nights foreign visitors stay in Sri Lanka, based on the CTB estimate, is shown in Table 2.4.

Table 2.4 Average Nights per Stay by Region of Origin

Region	1981	1992	1994	2005	2015
Western Europe	11	12	12	13	14
Eastern Europe	5	9	10	13	14
North America	8	11	11	12	13
Australia	13	14	14	15	16
Asia	9	7	8	9	10

CHAPTER 3 PRESENT TOURISM CONDITIONS IN SOUTHERN AREA

3.1 Tourism Resources

Of the four tourism resource clusters (Clusters A, B, C, and D), Cluster C, the resort zone centered in the southwest and Cluster D, a cluster centered on the Ruhuna Dynasty historical sites and a National Park are particularly relevant to Southern Area. Each district is described below.

Galle district (Cluster C): This district's tourism resources includes resort areas concentrated along the coastline from Bentota to Hikkaduwa and Koggala with marine sports, diving, and river cruising facilities, the Sinharaja Forest Reserve that extends into Ratnapura district and the fortress constructed when Galle was an outpost of the Dutch Empire.

Matara district: Attractions in this district include the Kustaraj statues, a race track, and stilt fishing in Weligama; a fortress in Matara; Wehelehena Temple, a Hindu temple in Dondra; a lighthouse at a cape, the Wewurukannala Vihala Temple, a blow well, and other attractions in Dikwella. Aside from the blow well, however, these attractions are not very impressive. Other attractions are the Sinharaja Forest Reserve and the region's tea fields. The coast appears well suited for resort development, but it will be difficult to obtain the needed land there because local fishermen have lived there for a long time.

Hambantota district (Cluster D): It is the site of the Yala National Park, the Bundala National Park and the Gal Oya National Park. Historical sites and others related to Buddhism are located along the National Highway A4 at Buduruwagala, Maligawila, etc. There are two scenic sites, with waterfalls as the main attraction. Further east along the National Highway A4, there is a small cluster including the Lahugala Kitulana National Park, Yala National Park East (Kumana) and historical sites at Pottuvil in Ampara district. Additional attractions include the Great Besses and the Little Besses in the Indian Ocean with light houses and the Kumana Bird Sanctuary.

Tourism potentials of the Galle-Matara area with its historical and natural resources may even exceed those of Bentota-Galle, which are now used as a beach resort. Therefore, in view of the future increase of foreign tourists, Cluster C of Bentota-Galle can be extended to Galle-Matara. On the other hand, Hambantota and part of Moneragala district in Cluster D are more versatile than Galle-Matara, with their historical remains and safari

potential. It is possible for Galle-Matara or Buttala to serve as a base for safaris and other activities, with the Gal Oya National Park in the north and the Yala National Park North in the background. The area's potential will be further heightened after the Arugam Bay resort near Pottuvil proposed by CTB and UNDP is developed as an inducement for foreign tourists to come south from the Hill Country. However, as it lacks a seacoast, it is better to regard it as Cluster D-2. Hambantota can be considered as Cluster D-1 with various places suitable for resorts and safaris plus its refined cultural and social elements. If, in this Cluster D-1, road improvements are performed, the cluster will incorporate some divisions of Ratnapura, increasing its attractiveness to tourists by, for example, offering safaris in the Uda Walawe National Park. It will become possible to integrate Clusters C and D, increasing their tourism appeal even more (Table 3.1 and Figure 3.1).

3.2 Tourist Visits and Stays

3.2.1 Tourist visits and length of stays

Statistics concerning tourists in the southern part of the Country reveal that about 70% of them are foreigners, particularly people from Western Europe, etc. (including North America and Australasia). As outlined in Section 1.2, they stayed an average of 12 days in resorts extending from Colombo and Kalutara to resorts on the southern sea coast, and that for about four days, they took optional tours such as safaris in the Yala National Park or visits to the Hill Country, where the main attraction is its scenery, or to the cultural triangle around Kandy. Visitors from Asia spend an average of seven days in the cultural triangle or the Hill Country, and like the Middle Eastern visitors, few ventured to the south. Many Asian visitors visit Ratnapura, a place famous as a gem center, but they almost never stay there overnight.

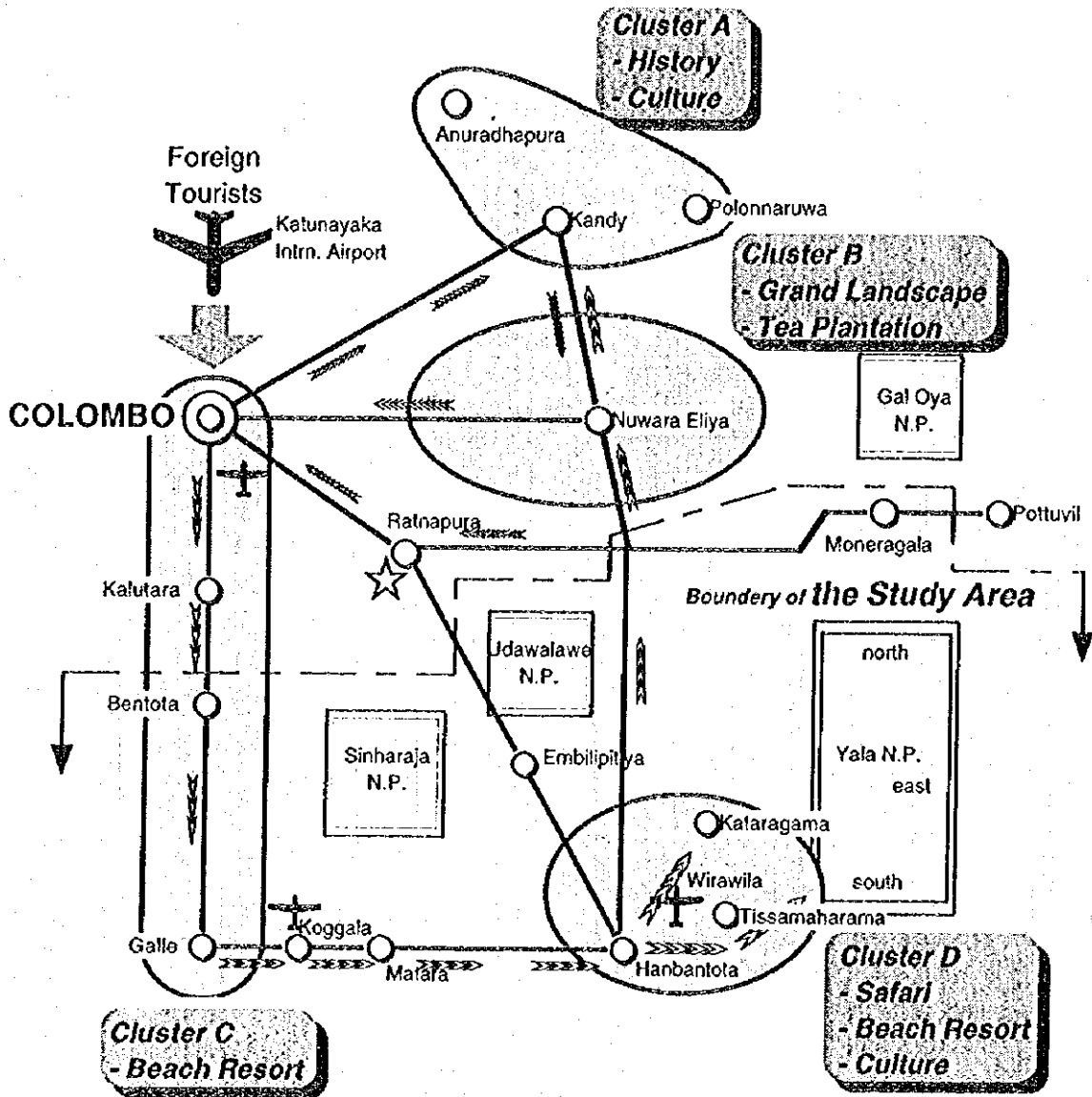
Turning to the situation in Moneragala district, which lies in the interior of the southern part of Sri Lanka, Western Europeans, etc. staying in coastal resorts in the south participate in a Yala safari, then travel north towards Nuwara Eliya and Kandy through Hambantota, or travel in a reverse direction, but rarely stay overnight in this district. The number of tourists visiting the south is subject to large seasonal variations under the direct effect of the tourism pattern of visitors from Western Europe, etc. In sum, during the off season, their numbers drop to about one third of the number visiting in the busiest season.

Table 3.1 Evaluation of Tourism Resources

Evaluation Item	Seashore Beach		National Park & National Reserve etc.		Historical Resources			Community Culture			Industrial Resources	Other Resources	Access	Accommodation	Remark				
	Landscape	Beach (Color)	Wave (High, Calm)	Landscape	Flora	Fauna	Others	Religious & Historical Site	Other Historical Site	Archaeological ruin						Street (Building etc.)	Tradition	Crafts	Life Custom
City & Town																			
Bentota	3	3	3	4	4	3								5	River Crossing, Galapata Vihara				
Balapitiya	4	4	3											5	Ahugalla "Old City and Beach Resort"				
Ambalangoda	4	3	3								4	4		4	Mask Museum				
Hikkaduwa	4	4	4	4	4	3					3	3	3	4	Black Coral, Diving, Glass Bottom Boat				
Galle	4	3	3	4	3	3	3	5			4	3	2	3	Unawatuna Beach, Fort Wallis, Exotic Street, Light House View				
Habaraduwa	4	3	3								3			4	Koggala Industrial Estate				
Neligama	4	3	3	4	3	3	2	3			3	3	3	3	Stilt Fishing, Lace, Kusta Raja, Iceage				
Katara	4	3	3	3	3	3	4	2			3	3	3	3	Dondra Head (with Light House), Maha Vishnu Devala, Lubuna Univ., Peheraihena Temple				
Deniyaya & Neluwa				5	5						3			1	Sinharaja Forest Reserve, Tea Estate				
Dikwella	4	4	3								3			3	Blow Well, Largest Buddha Statue (Newurukannala Vihara)				
Tangalla	4	3	3				5				3	3		3	Mulairigara Cave Temple				
Ambalantota, Embilipitiya	3	3	3	4	3	3	3				3				Uda Walawe N. P.				
Hambantota	5	4	4	5	4	5	3	3	4	3	3	3	4	3	Malaya town, Bundala N. P.				
Tissamaharama	4	4	3	4	5	5	4	3	4	3	2	3	3	3	Situlpahwa Yala N. P. Camping Site, Kirinda Fishing Port				
Kataragama				4			5	4			3	4	3	2	Hindu Temple				
Yellawaya							4	3			2	2		3	Budurawagala Buddhism Historical Site				
Buttala				4	4	4	4				2	2		2	Maligawila Buddha Statue, North Yala N. P.				
Konragala				3	4	3	4	3			2	2	2	2	Galebedda Historical Site				
Siyabalanduwa											2	2		2					
Lahugala															Pottuvil UNDP Project Site (Resort Planning)				
OTHERS : Kandy				4			5	4	4	4	4	3		4	Buddhism Temple, Kandian Dance, Street				
Nuwala Eliya				5	5		4		4	4	5	5		3	Grand Landscape, Tea Estate				
Ratunapura										3	4	5		4	Jewel				
Others																			

Evaluation degree : Excellent = 5. Good = 4. Average = 3. Poor Attractive = 2. Very Poor = 1

Figure 3.1 Tourist Circuit and Resources Cluster at Present



LEGEND

- | | | | |
|--|----------------------------------|--|---|
| | Major Road & Urban Centre | | Place of Gem Mining |
| | Local Airport | | Major Flow of Oriental Tourists |
| | Tourism Resources Cluster in Use | | Major Flow of Euro/American Tourists |
| | | | Optional Flow of Euro/American Tourists |

Source : JICA Study Team

3.2.2 Changes in tourist visits

The number of visitors entering Southern Area can only be estimated. A trial calculation was done based on the number of guest nights "up to Galle" and "beyond Galle," indicated in the *Annual Report 94* of CTB. The number of visitors to Bentota to Galle was calculated. The results are shown in Table 3.2.

According to this estimate, a total of 103,994 foreign visitors visited Southern Area in 1994, and about 36% of those were from Western Europe. The number increased rapidly from 28,574 in 1989 to 92,329 in 1992, but this was followed by a slower increase to 103,994 in 1994. The number of domestic tourists had fluctuated but generally been increasing from 24,150 in 1989 to 30,722 in 1994.

The number of tourists "up to Galle (from Bentota)" does not show an increasing trend with 65% increase in 1992 from the previous year, 3% decrease in 1993 and 3% increase in 1994. In the "beyond Galle" category, on the other hand, growth continued after 1992, rising to 116% in 1993, and climbing to 132% of the 1993 figure in 1994. These figures indicate that the lodging facilities in the "up to Galle" resort area were nearly filled up to their capacity, forcing visitors to travel further south.

3.3 Tourism Investment

Tourism investment in Sri Lanka has been outlined in subsection 1.2.4. Data by CTB about its breakdown by region and by location of investment reveal that hotel investment in the south is now concentrated in Galle district, where 34 units are in operation providing 2,371 rooms. Seven units, which will provide 492 rooms, are now under construction, mainly in Galle and Hambantota districts. Developers of 18 units, which will provide 1,661 rooms have either received final approval for their construction, or are waiting for this approval. About half of these will be constructed in Galle, with the rest divided between Hambantota and Matara districts. Preliminary clearance has been given for 31 units containing 1,717 rooms, which has increased the relative importance of Hambantota district. During the next ten years, the number of rooms in hotels centered on the southern coast is expected to rise to 7,162 (Table 3.3).

Table 3.2 Estimation of Number of Visitors to Southern Area

Year	Up to Galle			Bentota- Galle			Beyond Galle			Total number of visitors (C+D)	
	Guest night	Length of stay	Number of visitors in graded rooms (A)	Number of visitors in graded rooms (B=A x 49.5%)	Non-graded deflator α	Number of visitors in graded/non-graded rooms (C=B x α)	Guest night	Length of stay	Number of visitors in graded rooms (D)		
1981	FG	489,127	6.83	71,614	32,871	1.14	37,473	166,382	6.83	24,360	61,883
	LG	5,111	2.00	2,555	1,173	"	1,377	4,656	2.00	2,328	3,705
1989	FG	358,358	7.30	49,090	22,532	1.09	24,559	28,223	7.30	4,015	28,574
	LG	40,563	2.00	20,282	9,309	"	10,146	23,007	2.00	14,004	24,150
1990	FG	769,787	7.64	100,757	46,247	1.11	51,334	59,268	7.64	7,758	59,092
	LG	50,281	2.00	25,141	11,540	"	12,809	16,507	2.00	8,254	21,063
1991	FG	826,757	8.77	94,271	43,270	1.12	48,462	84,960	8.77	9,688	58,150
	LG	58,202	2.00	29,101	13,357	"	14,959	22,501	2.00	11,251	26,210
1992	FG	1,030,661	7.43	138,716	63,670	1.16	73,857	137,245	7.43	18,472	92,329
	LG	47,605	2.00	23,803	10,925	"	12,673	25,655	2.00	12,828	25,501
1993	FG	1,075,502	8.03	133,935	61,476	1.15	70,697	171,602	8.03	21,370	92,067
	LG	44,673	2.00	22,337	10,252	"	11,789	31,650	2.00	15,825	27,614
1994	FG	1,052,946	7.61	138,363	63,508	1.19	75,574	216,273	7.61	28,420	103,994
	LG	57,518	2.00	28,759	13,200	"	15,708	30,027	2.00	15,014	30,722

Source: CTB

Notes: 1) FG stands for foreign guest; LG for local guest.

2) Guest nights are counted only for graded accommodations.

3) Length of stay is obtained by subtracting 4 days (for optional tours) from the average length of stay of visitors from Europe, America and Australia.

4) Visitors to Bentota-Galle (in graded accommodations) are calculated as 49.5% of total visitors to Up to Galle; the remaining 50.5% are assumed to stay in Kalutara.

5) α denotes the deflator to calculate the total visitors (in graded and non-graded accommodations) from the visitors in graded accommodations.

6) For Beyond Galle, visitors in non-graded accommodations are negligible because of their limited availability.

Table 3.3 Number of Rooms in the Future

(Region)	(Location)	In Operation Accommodation - 1985 -				Hotel Accommodation in the Future - up to 2001 -						Grand Total								
		Hotels		Guest Houses		Sub Total		Under Construction (1999)		Final Approved (2000)			Pending Final Approved (2001)		Preliminary Clearance		Pending Preliminary Clearance (2005)		Sub Total	
		Units	No. of Rooms	Units	No. of Rooms	No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units		No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units
Colombo City Colombo Resort Kandy Hill Country Ancient Cities East Coast Resorts Others		19	2,880	31	378	3,258	-	-	-	-	1	50	1	26	-	-	-	-	76	3,334
		28	1,826	33	389	2,195	5	249	3	240	1	60	2	651	2	230	-	-	1,430	3,625
		14	1,865	24	228	1,993	5	387	2	114	8	900	12	531	8	48	-	-	1,942	3,935
		7	344	21	189	533	3	156	6	220	5	246	15	900	2	246	-	-	1,570	2,103
		15	1,103	29	222	1,325	3	173	1	25	2	116	9	641	-	-	-	-	930	2,255
		2	108	9	50	158	1	50	1	25	-	-	-	-	-	-	-	-	26	184
Total		85	7,126	152	1,467	8,593	12	995	12	600	19	1,502	48	2,819	4	278	-	-	6,194	14,787

(Division)	(Location)	Hotels		Guest Houses		Sub Total		Under Construction (1999)		Final Approved (2000)		Pending Final Approved (2001)		Preliminary Clearance		Pending Preliminary Clearance (2005)		Sub Total	
		Units	No. of Rooms	Units	No. of Rooms	No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units	No. of Rooms	Units
KALUTARA	Bentota	6	517	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	272
	Induruwa	2	108	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	24
	Kosgoda	1	54	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	130
	Abungalla	1	60	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	45
	Barapitiya	1	25	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	60
	Abalangoda	10	761	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	71
	Hikkaduwa	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	75
	Galle	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	172
	Unawatuna	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	150
	Talpe	4	440	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50
Koggalla	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50
* Total	25	1,965	49	558	2,523	4	372	5	434	6	392	10	525	0	0	0	0	1,723	4,246
KALUTARA	Veligama	1	57	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	543
	Matara	1	20	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	50
	Dickveilla	2	60	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	80
	* Total	4	137	7	49	186	1	10	1	70	2	360	4	225	0	0	0	0	675
KALUTARA	Tangalle	2	52	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	315
	Abalangoda	1	111	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	70
	Hambantota	1	56	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	180
	Tissamaharana	1	56	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	120
	Keerawila	1	50	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	250
	Kirinda	1	50	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	200
	Yala	1	50	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	52
* Total	5	269	15	159	428	2	110	2	250	1	100	12	712	1	15	15	15	1,187	
KALUTARA	Ebbilipitiya	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	140
	Pinnawela	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	140
KALUTARA	Kataragama	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	135
	Moneragala	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	25
* STUDY AREA (Except KALUTARA)	34	2,371	86	906	3,277	7	492	8	784	10	877	31	1,717	1	15	15	15	3,885	7,162
NATIONAL	138	11,193	250	2,630	13,823	26	2,287	21	1,484	29	2,530	85	4,695	6	383	383	383	11,379	25,202

1) KALUTARA is not defined as the study area.

A total of 15 hotels containing 1,276 rooms are now under construction or have received final approval. This represents 34% of the 3,771 rooms in the same category nationwide. It indicates active tourism investment in the southern part of the Country. Figure 3.2 indicates this situation.

Guest houses, which are not included in hotel accommodation statistics, provide about 2,600 rooms nationwide, a figure corresponding to 23% of the number of available hotel rooms. Their share is even higher in the south, where they provide 906 rooms corresponding to 38% of the number of available hotel rooms.

3.4 Survey on Public Awareness of Tourism

The present state of tourism in the southern part of Sri Lanka is supported by local residents. Tourists' image of the region as a tourist destination can be improved by enhancing the local residents' consciousness of tourism. Such consciousness raising is an important part of tourism promotion activity which costs little. To stimulate investment, expand employment and obtain tourist revenue, it is essential to get to know the extent of public awareness, feeling and intentions toward tourism, and enlighten them so that the occurrence of social problems would be avoided in the course of tourism development.

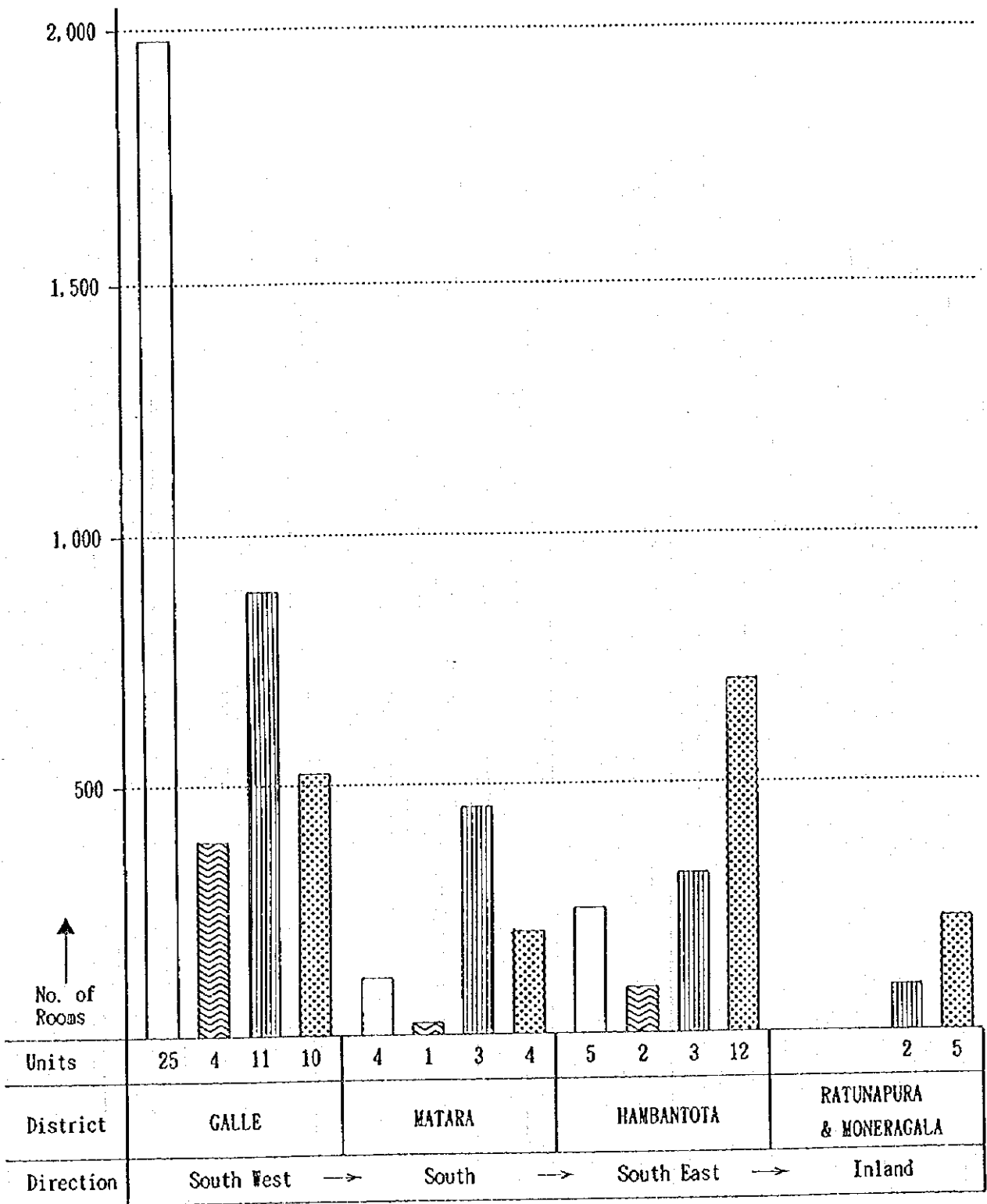
A questionnaire survey was conducted to ask twelve questions to 1,002 persons living in 47 districts, including Southern province and a part of Uva province. Respondents to the questionnaire included 629 men and 373 women, with average age of 35 to 35.7 years respectively (Table 3.4, Annexes 2 and 3). The results of survey are summarized below.

Question 1: 88% of the respondents thought that tourism is important for Sri Lanka; this will provide a good base for making education on tourism effective.

Questions 2 and 3: approximately 60% thought that agriculture is a vital industry in Sri Lanka and employs most of its people; manufacturing comes next at about 20%; tourism ranked low with only 3 to 5%.

Question 4: active engagement in different sectors indicates 45% of respondents in agriculture, 15% in sales and 5% in tourism; this implies a poor social status of the tourism industry in Sri Lanka, including the hotel trade; the tourism industry and the Government together should conduct mass education to attract the kind of good quality labor necessary for tourism development.

Figure 3.2 Present Conditions of Investment for Hotel Accommodation 1995



LEGEND :
 In operation
 Under Construction
 Final Approval Given and Pending
 Preliminary Clearance Given

Table 3.4 Results of Public Awareness Survey (1/3)

Province District	South			Uva			Grand Total
	Galle		Matara	Hambantota		Maneragala	
	Answer	Ratio %	Answer	Answer	Ratio %	Answer	
No. of Division	16		14	11		6	47
Total No. of Answer	327		280	275		120	1,002
Male	199	60.9	165	176	64.0	89	629
Female	128	39.1	115	99	36.0	31	373
Average Age	35.55		35.74	34.99		35.69	141.97
Ratio %							
Very important	100	30.6	53	35	12.7	23	211
Important	183	56.0	201	204	74.2	81	669
Not so important	44	13.5	26	36	13.1	16	122
Ratio %							
Agriculture	180	55.0	144	207	75.3	92	623
Marine Products	17	5.2	6	28	10.2	3	54
Transportation	2	0.6	4	0	0.0	1	7
Tourism	35	10.7	12	4	1.5	2	53
Construction	8	2.4	7	3	1.1	0	18
Manufacturing	54	16.5	86	18	6.5	11	169
Commerce	25	7.6	15	8	2.9	10	58
Others	6	1.8	6	7	2.5	1	20
Ratio %							
Agriculture	160	48.9	85	226	82.2	111	582
Marine Products	19	5.8	9	23	8.4	1	52
Transportation	4	1.2	3	1	0.4	1	9
Tourism	24	7.3	9	1	0.4	0	34
Construction	7	2.1	10	0	0.0	0	17
Manufacturing	76	23.2	152	8	2.9	5	241
Commerce	33	10.1	9	13	4.7	2	57
Others	4	1.2	3	3	1.1	0	10
Ratio %							

1. Do you think that tourism is important industry in Sri Lanka?

2. Which do you think is the most important industry?

3. Which do you think employs the most people?

Table 3.4 Results of Public Awareness Survey (2/3)

	Province District	South			Uva Maneragala	Grand Total						
		Hambantota										
		Galle	Matara									
4. What kinds of jobs do you think are important?	Agriculture	149	45.6	105	37.5	128	46.5	73	60.8	455	45.4	
	Construction	35	10.7	30	10.7	7	2.5	3	2.5	75	7.5	
	Bank	54	16.5	47	16.8	26	9.5	17	14.2	144	14.4	
	Tourism	35	10.7	8	2.9	1	0.4	5	4.2	49	4.9	
	Sale	33	10.1	67	23.9	42	15.3	12	10.0	154	15.4	
	Others	21	6.4	23	8.2	71	25.8	10	8.3	125	12.5	
	5. Which factor is the most important to foreigners who visit Sri Lanka?	Historic ruins (exp. Buddhist)	136	41.6	87	31.1	91	33.1	48	40.0	362	36.1
		Scenery	68	20.8	109	38.9	124	45.1	53	44.2	354	35.3
		Hospitality	20	6.1	29	10.4	2	0.7	5	4.2	56	5.6
		Beach	56	17.1	25	8.9	14	5.1	6	5.0	101	10.1
National park		29	8.9	5	1.8	26	9.5	2	1.7	62	6.2	
Shopping		13	4.0	14	5.0	2	0.7	4	3.3	33	3.3	
Others		5	1.5	10	3.6	16	5.8	4	0.0	31	3.1	
6. Which industry causes the most environmental pollution in Sri Lanka?		Agriculture	62	19.0	9	3.2	22	8.0	8	6.7	101	10.1
		Manufacturing	193	59.0	172	61.4	114	41.5	86	71.7	565	56.4
		Transport	38	11.6	72	25.7	83	30.2	22	18.3	215	21.5
	Tourism	25	7.6	23	8.2	5	1.8	0	0.0	53	5.3	
	Others	9	2.8	4	1.4	51	18.5	4	3.3	68	6.8	
7. What image do you have of tourists who visit Sri Lanka?	Rich	110	33.6	108	38.6	51	18.5	57	47.5	326	32.5	
	Friendly	109	33.3	121	43.2	54	19.6	30	25.0	314	31.3	
	I do feel they are tourists	108	33.0	51	18.2	170	61.8	33	27.5	362	36.1	

Table 3.4 Results of Public Awareness Survey (3/3)

Province District	South		Uva		Grand Total
	Galle	Matara	Hambantota	Maneragala	
8. How do you feel about foreign tourist's visiting?					
Positive	80	66	78	35	259
Somewhat Positive	181	177	141	70	569
Somewhat negative	48	23	27	10	108
Negative	18	14	29	5	66
9. Who do you think gets benefits in the tourism industry?					
Government	61	47	33	23	164
Hotels	110	92	165	55	422
Private companies	65	47	45	17	174
Merchant	7	7	6	5	25
Everybody	77	83	24	18	202
No one	7	4	2	3	16
10. Do you receive benefits from the tourism industry?					
Yes	92	60	73	20	245
No	193	165	135	89	582
Doubtful	33	47	63	11	154
Others	9	8	4	0	21
11. Do you want to be engaged in the tourism industry ?					
Yes	133	70	159	36	398
No	194	210	116	84	604
12. Do you want the tourism industry, for example hotels, to develop this area?					
Yes	140	108	195	66	509
No	187	172	79	54	492

Source : JICA Susy Team

Question 5: more than 70% thought that foreign tourists visit Sri Lanka to see historic ruins or cultural and historical assets and scenery, 10% thought they come to enjoy beaches or national parks; actually, the respondents were quite wrong in their guessing, because Europeans visit Sri Lanka mainly for its beaches and national parks; education can remove such misunderstanding and, at the same time, the importance of environmental preservation should be stressed as natural surroundings greatly influenced major destinations.

Question 6: more than 78% presumed that manufacturing and transportation are causing most of the pollution; this reflects the lack of perception that waste materials discarded from people's homes also affect the environment.

Question 7: the public image of foreign tourists is classified almost equally into three categories: "rich," "friendly," and "they are just tourists (indifference)"; it should be noted, however, that tourists are not necessarily rich and many have saved money for quite some time to make a trip; also, the fact that sizable number of persons are indifferent to tourists may suggest that they are less concerned about well-being of "rich" tourists.

Question 8: concerning personal feelings toward tourists, 82% replied they felt positive or rather so in welcoming them.

Question 9: most respondents thought that benefits from tourism go to specific enterprises; about 20% replied that everybody receives benefits from the tourism industry.

Question 10: 74% answered that they do not receive benefits personally; this means that they consider tourism benefits as cash incomes rather than other effects on Sri Lanka's economy.

Question 11: about 40% expressed wishes to be engaged in the tourism industry; this seems strange for Southern province where unemployment is high; this may reflect a generally low regard for the tourism industry and lack of sufficient understanding of tourism among the people in Sri Lanka.

Question 12: positive and negative replies were divided almost equally for and against tourism development in respondents' communities; this may imply that members of the community are rather conservative and lack correct understanding of tourism.

CHAPTER 4 TOURISM DEVELOPMENT POTENTIALS IN SOUTHERN AREA

4.1 Basic Conditions of Tourism Development and Regional Development

For any nation or region, to attract foreign travelers to stimulate its tourism industry, it must either satisfy the following conditions or make efforts to satisfy these conditions to a prescribed level.

- 1) The country is stable, its society is safe, and its people hospitable;
- 2) People working in the tourism industry are capable of providing suitable services;
- 3) Means of traveling to tourist destinations are provided;
- 4) Lodging facilities and other suitable space for accommodation are provided; and
- 5) Tourism resources such as attractive tourist destinations exist.

Tourist travel is difficult if any one of the above conditions is absent. The five conditions must be balanced so that tourists feel satisfied with their experiences at the cost they spent. Areas that do not provide travelers with this feeling of satisfaction cannot attract repeat tourists, and will not benefit from the effects of word-of-mouth publicity, a powerful medium of communication. Therefore, the following condition is very important:

- 6) Travel costs are appropriate.

Also, because travelers are motivated to take trips by some form of information, it is necessary for governments or the private sector (tourism industry) to provide suitable tourism information. Thus, the following is indispensable:

- 7) Tourism information can be provided.

A trip to a destination without any basic information about the place cannot be described as tourist travel. When a hotel provides information about its surroundings, it attracts tourists to the region. The benefits of this information are shared by the hotel and the regions surrounding it.

Including tourism in a comprehensive regional development program can, by increasing the number of tourists in the region, be counted on to produce the following economic effects:

- At the national level, bringing in foreign currencies,
- At the regional level, redistribution of the national income by attracting domestic tourists to tourism regions,
- Increase in employment opportunities by expanding tourist facilities, and
- Expansion of facilities and employment opportunities as an economic multiplier effect in the region.

The anticipated economic benefits are particularly closely tied to necessary conditions for tourism 3), 4) and 5) described above. They may contribute to the following:

- Improvement of the public infrastructure,
- Improvement of the investment environment (particularly by guaranteeing land for appropriate sites) and encouragement of private investment, and
- Preservation and protection of the environment in National Parks, etc.

4.2 Tourism Development in Southern Area: Problems and Strategy

The following facts have been revealed by an analysis of problems and strategy for tourism in Southern Area.

4.2.1 Issues

Issues on tourism development in Southern Area include the following.

- 1) The distance from gateways to final destinations and the time required to complete these trips are both too long;
- 2) Streets are littered, and garbage containers can be seen scattered around at tourist locations;
- 3) Access from hotels to nearby attractions is poor;
- 4) Traffic is congested;
- 5) Facilities at attractive sites are not satisfactory;
- 6) There is a shortage of sports (on the surface and under the water) equipment at and near hotels;

- 7) Hotels are short of information about nearby attractive sites;
- 8) Community culture (dance, festivals, etc.) is underdeveloped, and places to introduce it to tourists cannot be found;
- 9) There is a shortage of training in reception skills at hotels, etc.;
- 10) There are too few tourist guides (German and Japanese speaking ones in particular); and
- 11) Forceful demands for donations at historical sites, etc. and panhandling at tourist sites disturb tourists.

4.2.2 Strategy

To attract future tourists to Southern Area, it is important to put priority on the implementation of the following improvements in tourism infrastructure and administration, as the region already has sufficient tourism resources.

- 1) Improvement and construction of roads from the gateway to Galle (for travelers bound for seacoast resort areas);
- 2) Roads from Kandy to Hambantota by way of Nuwara Eliya (for travelers who want to see historical ruins, ancient cities, scenery, and take part in a safari, etc.: a product with future promise);
- 3) A direct road link from Colombo to Hambantota (for travelers who want to take part in a safari, stay in resorts, and buy gems);
- 4) Expansion of air routes from Colombo to Hambantota (private lines) and direct connections for charter flights bound for Hambantota: improvement of the Wirawila Airport (for travelers who want to go on a safari or stay in a resort);
- 5) Construction of a resort hotel (300 to 500 rooms) in Hambantota: the ideal location is the tip of the peninsula (for charter passengers flying in directly from Colombo, to temporarily accommodate travelers coming from Kandy, and for travelers whose final destination is Hambantota);

- 6) Construction of a look-out and lodge on high ground near the road in the Sinharaja Forest Reserve (to increase its attractiveness to visitors to the southern resort area);
- 7) Road improvements to Moneragala from a point midway between Colombo and Hambantota, and a future extension of road improvement work to Pottuvil (for the benefit of travelers visiting the historical sites at Moneragala or staying at lodges and joining safaris in the Yala National Park and for tourists who will be attracted by new resort development at Pottuvil, and to develop the inland areas of Southern Area);
- 8) Tourism development in the central south coastal region as the number of visitors to Matara rises as a result of a shift in tourists from both directions: from the existing resorts in the southwest corner and from Hambantota to the east; and the linking of Hambantota with Moneragala will increase the attractiveness of safaris in the Gal Oya and the Yala National Parks, and tourist resources expanded by the addition of the historical sites at Buduruwagala, Maligawila, and Galebadda will be used to increase the number of tourists visiting inland areas in the south and east, and in the future, will stimulate tourism enterprises such as hotels; and
- 9) Administrative guidance by the Ministry of Media, Tourism and Aviation, CTB, other concerned bureaus and implementation bodies, and regional governments to solve other problems; at the same time, private companies and NGOs have to plan and carry out other concrete measures as they fully harmonize views of all concerned.

4.3 Tourism Demand for Southern Area

4.3.1 Conditions for demand estimate

European visitors (those from Western and Eastern Europe, North America and Australasia) numbered 285,930 in 1994, of which 103,994 (36.4%) entered Southern Area as mentioned in Section 3.2. Many of the remaining 63.6%, or 181,851, stayed at Colombo resorts and Kalutara.

In view of the CTB forecast of future tourism supply and demand (target) and the investment situation at present, as well as the fact that young travelers from other parts of Asia will not necessarily be attracted to cultural and historical sites, the number of foreign tourists visiting the region is estimated at 600,000 in 2015 (Table 4.1). The number of domestic tourists should reach 85,000. These estimates take the following elements into account.

- 1) In Colombo resort areas, it is growing more and more difficult to secure places suitable for resorts.
- 2) Investment in tourist facilities along the coast north of Colombo resorts can hardly be expected.
- 3) Colombo resort areas consist of small facilities that hinder an increase and/or upgrading of guest rooms by redevelopment or other means.
- 4) The "up to Galle" area, including Kalutara, has many places suitable for resorts with new investments under way, and can provide an ample number of guest rooms and facilities of good quality. The area is just as accessible as Colombo North timewise and distancewise.
- 5) The "beyond Galle" area offers many places suitable for resorts, affording opportunities for new investment and an increase of guest rooms. On the other hand, it is expected that places suitable for resorts in "up to Galle" will gradually reach their limit from 2001 onward.
- 6) Many natural resources and historical and cultural assets are scattered throughout the Country, all of which provide enhanced tourism charm.
- 7) At present, CTB is building a hotel school in Weligama, which can furnish the human resources necessary for tourist investment. Through such measures the investment environment is being improved.
- 8) Enriching such tourism attractions as safari and bird watching in Hambantota and Yala should enable diverting some of Asian tourists staying at the cultural triangle and the Hill Country to these areas.

Taking into account the above elements, it is assumed that 36.4% of the European visitors will stay in the region. They will gradually diminish in Kalutara and Bentota and expand their vacationing spheres to Galle and Matara, and further to Hambantota and Buttala.

Guest rooms in the Colombo and Kalutara resorts will count about half of all hotel rooms in Southern Area after 2001. Since it is difficult to foresee any development of tourism sites in the eastern and the northern parts of the Country, it is highly likely that the ratio between visitors to the Colombo-Kalutara/Bentota-Galle resorts and to "beyond Galle" areas will stand at 40% for the former and 60% for the latter.

Table 4.1 Estimate of Foreign Tourists to Southern Area

	1994	2001	2005	2015
European visitors to Sri Lanka	285,930	526,000	680,000	980,000
European visitors to the region	103,994	192,000	340,000	590,000
Asian visitors to the region	0	0	5,000	10,000
Total foreign visitors to the region	104,000	192,000	345,000	600,000
(Number of guest rooms required)	(3,000)	(5,500)	(9,900)	(17,000)

Notes:

- 1) The numerical ratio of Europeans visiting Southern Area as against that of all incoming Europeans was 36.4% in 1994, and should reach 36.4% in 2001, and 50% in 2005, and 60% in 2015.
- 2) The number of rooms required was calculated based on CTB materials. Assumptions are: "up to Galle" will need 60.2% more rooms (89.9% more in the peak month and 39.3% more in the slowest month); the Colombo Resort-Greater Colombo district will need 60.1% more rooms (85.1% in the peak month and 35.5% in the slowest month), assuming that the annual average room operation ratio is 60% and the mean length of stay for European guests will be 10 nights (an average 14 nights in Sri Lanka less four nights spent for optional tours) with a room sharing ratio of 60%, and that 35,000 persons will use 1,000 rooms per year. Also, the figure (number of rooms) agrees with the number of rooms operated in 1994 and those assumed to be in operation by 2001 (see Table 4.5 below).

4.3.2 Demand estimate by regression

(1) Bentota-Galle

Recently, the number of visitors has not been growing. Consequently, by excluding annual data which indicated a rapid increase from 1989 to 1992, future demand was calculated from data for the past three years. The following equation was used.

$$Y_t = Y_{t-1} \times 1.04$$

where Y_t denotes the number of visitors in year t .

(2) Beyond Galle

The demand is estimated in accordance with data from 1989 to 1992 and based on the following equation:

$$Y_t = a \times Y_{t-1} + b$$

where the value for a and b is found using the method of least squares. The results are:

$$Y_t = 1.09273 \times Y_{t-1} + 3,744$$

The forecast of future demand was found using the above two equations (Table 4.2).

Table 4.2 Calculated Number of Visitors to Southern Area

Area	1994	2001	2005	2015
Bentota-Galle	75,574	99,450	116,342	172,215
Beyond Galle	28,420	87,607	142,099	402,552
Total	103,994	187,057	258,441	574,767

4.3.3 Estimate of domestic tourists

There has been an average yearly increase of 2,000 domestic tourists in Southern Area from 1990 to 1994. Assuming that the annual increase will remain at the same level up to 2001, accelerate to 2,500 persons a year up to 2005 and further to 3,000 up to 2015, the number of domestic tourists will reach 85,000 in 2015 (Table 4.3).