

TRADE, INNOVATION AND GROWTH: THE CASE OF SRI LANKAN TEXTILE AND CLOTHING INDUSTRY¹

1. Introduction

1. This paper is one of a number of case studies which is a part of a broader project to study how trade affects innovation, which is being conducted by the Trade and Agriculture Directorate of the OECD. The paper studies how trade has affected innovation in the textile and clothing sector in Sri Lanka. Trade can promote innovation² through a number of ways, including through technology transfer, increased competition and economies of scale (OECD, 2007). In this paper, we primarily look at how intensified competition in light of the Multi-Fibre Agreement (MFA)³ phase-out has led to a number of innovative measures being undertaken in the textile and clothing⁴ industry in Sri Lanka, in particular amongst some of the leading companies, to face the challenges of a quota free environment.

2. The abolition of the quota system which governed much of the international trade in apparel till 2005 has been the biggest challenge confronting the industry. Despite stiff competition from low cost producers from other countries, Sri Lanka has managed to survive due to a number of innovative initiatives undertaken by industry with support from the Sri Lankan government. Whilst the industry led by some of the large scale⁵ manufacturers have established themselves as credible suppliers to some of the big brand names in the apparel trade, they are striving to remain competitive through innovation.

3. The paper first briefly outlines the development of the garment industry in Sri Lanka in section 2, which is followed in section 3 by a description of some of the innovations (marketing, product, process, organisational) which have come about as a result of external competition in the market place. This is followed by a discussion on the role of technology transfer through FDI and imports in the garment industry in section 4, and section 5 concludes.

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² According to the OECD's Oslo Manual, an innovation is defined as 'the implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organisational method in business practices, workplace organisation or external relations.' Four types of innovations are identified: a) Product innovations; b) Process innovations – new or significantly improved methods for production or delivery; c) Organisational innovations – new or significantly improved methods in a firm's business practices, workplace organisation or external relations (organisational or managerial processes); d) Marketing innovations – new or significantly improved marketing methods.

³ The Multi Fibre Arrangement (MFA) governed world trade in textiles and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. The MFA was introduced in 1974 as a short-term measure intended to allow developed countries to adjust to imports from the developing world. The Agreement on Textiles and Clothing (ATC) agreed in the GATT Uruguay Round provided for the gradual phasing out of the quotas that existed under the MFA. This process was completed on 1 January 2005. However, large tariffs remain in place on many textile and garment products.

⁴ The key focus of the paper is on the clothing industry which is much larger. The words garment and clothing are used inter-changeably throughout the paper. The study also focuses on a handful of large companies that dominate the industry and as such the analysis may not necessarily reflect the typical garment factory in the country.

⁵ The size of the manufacturer is classified by the value of garments exported. According to this classification, small scale manufacturers export less than USD1million, medium scale manufacturers export between USD1.1-2.5 million while large scale manufacturers export USD.2.51 million and over (JAAF 2002).