SRI LANKA

TRADE SUMMARY

The U.S. goods trade deficit with Sri Lanka was $2.0 billion in 2012, up $251 million from 2011. U.S. goods exports in 2012 were $224 million, down 26.0 percent from the previous year. Corresponding U.S. imports from Sri Lanka were $2.3 billion, up 8.2 percent. Sri Lanka is currently the 130th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Sri Lanka was $156 million in 2011 (latest data available), up from $150 million in 2010.

Trade and Investment Framework Agreement

The United States and Sri Lanka held their annual trade discussions under the Trade and Investment Framework Agreement (TIFA) on March 27, 2012. The United States raised a wide range of trade and investment issues including market access, the U.S. Generalized System of Preferences (GSP) program, labor, trade promotion efforts, intellectual property rights (IPR), agriculture, promoting women entrepreneurs and sector-specific investment challenges. The United States and Sri Lanka agreed to establish a number of TIFA Committees to continue work throughout the year. The new TIFA Committees cover intellectual property, customs cooperation, and labor affairs.

IMPORT POLICIES

Despite efforts to open the economy to foreign trade and investment, the pace of reform in Sri Lanka has been uneven. In 2011, Sri Lanka faced a large current account and balance of payments (BOP) deficit due to increased imports, including rising petroleum imports. The government took several policy measures to stem import growth. For example, it depreciated the rupee and moved to a flexible exchange rate policy in early 2012. Sri Lanka also increased tariffs on motor vehicles in a bid to curb imports.

The Trade and Investment Policy Department of the Ministry of Finance and Planning is charged with the formulation and implementation of trade and investment policies. The Trade and Tariff subcommittee of the National Council of Economic Development (NCED) also examines trade and tariff issues and sends recommendations to the Ministry of Finance and Planning. Based on the Presidential Taxation Commission’s recommendations, the government simplified the tax structure in 2010, including eliminating some but not all supplementary charges on imports.

The government continues to stress the need to promote import substitution policies. The 2012 budget proposed investment incentives for selected sectors identified as “strategic import replacement enterprises.” The manufacture of cement, steel, pharmaceuticals, fabric, and milk powder are encouraged through new government incentives. The import duty regime for these items was largely unchanged. Sri Lanka’s 2013 budget stressed the importance of agriculture self- sufficiency. The government subsidizes fertilizer and seeds to support farmers. In addition, import charges on dairy products, meat, flowers, vegetables, fruits and confectionary were increased.

Import Charges

Sri Lanka's main trade policy instrument has been the import tariff. According to the WTO, Sri Lanka’s average applied agricultural tariff in 2010 was 25.4 percent, but its bound rates are significantly higher, averaging 50 percent. However, the compounded duty rates for imported agriculture products are routinely between 80 percent and100 percent of the cost, insurance, and freight (CIF) value. In 2010, Sri Lanka's average applied tariff for nonagricultural goods was 9.2 percent. However, less than 30 percent of Sri Lanka's nonagricultural tariffs are bound under WTO rules.

Sri Lanka's import tariff structure consists of "bands" in which all products covered by a particular band are subject to the same tariff rate. The import tariff structure was simplified in June 2010 by reducing the number of tariff bands from five to four. The current tariff bands are: 0 percent; 5 percent; 15 percent; and 30 percent. Textiles, pharmaceuticals and medical equipment, machinery, basic raw materials, computers, software, solar lights, sports footwear and selected consumer electronics enter Sri Lanka duty free. Tariffs on semi-processed raw material tariffs are 5 percent, while intermediate product tariffs are at 15 percent. Most tariffs on finished product are 30 percent. There continue to be a number of deviations from the four-band tariff policy. Some items are subject to an *ad valorem* or a specific tariff, whichever is higher, and there is intermittent use of exemptions and waivers. Footwear, ceramic products, and agricultural products carry specific tariffs.

In addition to the import tariff, there are a number of supplementary taxes and levies on imports. The government has introduced unit-based specific taxes on textiles and fruits, replacing the existing *ad valorem* taxes. The 2012 and 2013 budgets increased some supplementary taxes on selected goods. For example, the levy on biscuits increased from 35 percent or Rs 60 (approximately $0.51) to 35 percent or Rs 80 (approximately $0.62) per kg and cheese, butter and dairy spreads increased from 30 percent or Rs 100 (approximately $0.86) per kg to 30 percent or Rs 200 (approximately $1.56) per kilogram.

In general, the frequent changes—mostly upward—of these taxes and other levies have added unpredictability to foreign exporters' and local importers' cost calculations. Affected products from the United States include fruits, processed/packaged food, and personal care products.

Other charges on imports include:

An Export Development Board (EDB) levy, often referred to as a "cess", ranging from 10 percent to 35 percent *ad valorem* on a range of imports identified as "nonessential." Most of the items are subject to specific duties as well. Also, when calculating the EDB levy, an imputed profit margin of 10 percent is added onto the import price. In some cases, such as on biscuits, chocolates and soap, the levy is charged not on the import price but on 65 percent of the maximum retail price. Locally manufactured products are not subject to the EDB levy. The government keeps increasing the EDB levy, most recently in November 2012, when the EDB was increased on a range of items including dairy products, meat, fruits, vegetables and confectionary.

A Ports and Airports Development Levy of 5 percent is applied on most imports. Locally manufactured products are not subject to the Ports and Airports Development Levy.

When calculating the Value Added Tax (VAT), an imputed profit margin of 10 percent is added on to the import price. Locally manufactured products are also subject to VAT, but not the imputed profit margin.

Excise fees are charged on some products such as aerated water, liquor, beer, motor vehicles, and cigarettes. When calculating the excise fee, an imputed profit margin of 15 percent is added on to the import price. The excise fee is applied on the price inclusive of other duties. Locally manufactured products are also subject to excise fees.

A Special Commodity Levy (SCL) is charged on some food items including oranges, grapes and apples from November 21, 2011. The items subject to the SCL are exempted from all other taxes. The SCL on oranges is Rs 60 per kg, on grapes Rs 130 per kg, and on apples Rs 45 per kg. The SCL on grapes was increased in 2012.

In November 2011, the government introduced an all-inclusive tax of Rs 75 per kg (approximately $0.65) on imported textiles not intended for use by the apparel export industry, replacing an Export Development Board Levy of Rs 50 (approximately $0.45) per kg, a Ports and Airports Tax of 5 percent, and a VAT of 12 percent. This all-inclusive tax was increased to Rs 125 per Kg (approximately $0.97) in November 2012.

Currently, apparel imports are subject to a 15 percent import duty, Rs 75 (approximately $0.65) per unit EDB Levy, a 12 percent VAT, and a 5 percent Ports and Airports Levy.

Import Licenses

Sri Lanka requires import licenses for over 400 items at the 6-digit level of the Harmonized Tariff System, mostly for health, environment, and national security reasons. Importers must pay a fee equal to 0.222 percent of the import price with a minimum fee of Rs 1,000 (approximately $9) to receive an import license.

GOVERNMENT PROCUREMENT

Government procurement of most goods and services is primarily undertaken through a public tender process. Some tenders are open only to registered suppliers. Procurement may also be undertaken outside the normal competitive tender process. The government publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards are common. In 2006, Sri Lanka published guidelines and a procurement manual to improve the public procurement process. However, in early 2008 the government disbanded the National Procurement Agency, which it had established in 2004, and shifted its functions to a unit in the Ministry of Finance. A special Cabinet-appointed review committee reviews unsolicited development proposals, and this committee has considered the most important infrastructure projects and investment proposals, which occur outside the tender process. These moves have raised concerns about the government's commitment to improve the transparency of procurements.

Sri Lanka is not a signatory to the WTO Agreement on Government Procurement and has indicated it has no plans to join despite its status as an observer to the WTO Committee on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

Although intellectual property rights (IPR) enforcement has improved in Sri Lanka, piracy levels continue to remain very high for sound recordings and software. According to an industry-commissioned study, the rate of software piracy in Sri Lanka was 84 percent in 2011 compared to 86 percent in 2010, 89 percent in 2009 and 90 percent in 2008. However, the commercial value of pirated software rose to $86 million in 2011 from $83 million in 2010 due to increased personal computer sales. There has been an improvement in the use of legal software in the corporate sector. The government of Sri Lanka published a policy in 2010 requiring all government ministries and departments to use only licensed software. Licenses can be for either proprietary software or for open source software. This has enabled government organizations to legalize the software they use.

Redress through the courts for IPR infringement is often a frustrating and time-consuming process. While police can initiate action against counterfeiting and piracy without complaints by rights holders, they rarely do so. In the apparel, software, tobacco and electronics sectors, however, rights holders have had some successes in combating trademark counterfeiting through the courts.

There has been more focus on, and awareness of, IPR in Sri Lanka over the past few years. The Sri Lankan government's Director General of Intellectual Property, along with international experts, continues to conduct IPR legal and enforcement training for customs, judicial and police officials. Moreover, Sri Lankan Customs has created a computer based Customs Trade Mark recordation system, although it is not yet fully operational. Additionally, a new IP unit has been established within the Criminal Investigative Division of the Sri Lankan police and it has successfully carried out several raids against IPR violators. The United States will monitor the effectiveness of these new programs.

SERVICES BARRIERS

Insurance

Sri Lanka does not allow the cross-border supply of insurance, with the exception of health and travel insurance. In order to provide all other insurance services to resident Sri Lankans, insurance companies must be incorporated in Sri Lanka. Branch offices are not permitted. The Sri Lankan government requires all insurance companies to reinsure 20 percent of their insurance business with a state-run insurance fund.

Broadcasting

The government imposes taxes on foreign movies, programs, and commercials to be shown on television, ranging from Rs 25,000 (approximately $200) for an imported English-language movie to Rs 90,000 (approximately $700) per half hour of a foreign-language program dubbed in the local language, Sinhala. Foreign television commercials are taxed at Rs 500,000 (approximately $3,900) per year. Rates for non-English foreign programming are higher. Government approval is required for all foreign films and programs shown on television.

INVESTMENT BARRIERS

While Sri Lanka welcomes foreign investment, there are restrictions in a wide range of sectors. For example, foreign investment is not permitted in certain types of money lending activities, in the coastal fishing sector, and in retail trade for investments of less than $2 million (approximately $150,000 in the case of international brands and franchises). In other sectors, foreign investment is subject to case-by-case screening and approval when foreign equity exceeds 40 percent. These sectors include shipping and travel agencies, freight forwarding, mass communications, deep sea fishing, local timber industries, mining and primary processing of natural resources, and the cultivation and primary processing of certain agriculture commodities. Foreign equity restrictions also apply in the air transportation, coastal shipping, lotteries, and gem mining sectors, as well as in "sensitive" industries such as military hardware.

Sri Lanka prohibits the sale of public and private lands to foreigners despite the fact that there is no basis in law for this prohibition. The government has instructed land registries to enforce this policy with immediate effect in advance of amendments to existing law. Any investment with over 25 percent foreign equity will be treated as a foreign investment for the purpose of these measures. The measures will not apply to the purchase of condominium properties above the fourth floor. The government has also proposed to impose a tax in the amount of 100 percent of the lease value when state land is leased to foreign investors. The tax for the entire lease periods would be due at the time the lease is signed, unless the investors pay the entire lease in a foreign currency.

On November 9, 2011 the government approved a new law, the Revival of Underperforming Enterprises and Underutilized Assets Act, which allows for the nationalization of assets belonging to 37 companies deemed by the government to be underperforming and not meeting lease conditions. Although many of the companies were defunct, several were operating businesses, including one that was owned by a prominent member of the opposition. The measure was passed under procedures that limited Parliamentary debate to one day. While the Central Bank noted that the enactment of the law was a "one-off" measure, the government subsequently announced plans to retake 25,000 hectares of tea plantation leased land that was not being fully utilized according to the government. The law significantly increases investor uncertainty regarding property rights in Sri Lanka.

OTHER BARRIERS

The private sector, including prospective investors, report that public sector corruption, including bribery of public officials, remains a significant challenge for U.S. firms operating in Sri Lanka. While the country has generally adequate laws and regulations to combat corruption, enforcement is weak and inconsistent. U.S. firms identify corruption as a constraint on foreign investment. In particular, U.S. industry has expressed concern about corruption in large projects and in respect to government procurement.