SRI LANKA

TRADE SUMMARY

The U.S. goods trade deficit with Sri Lanka was $1.8 billion in 2007, a decrease of $70 million from $1.9 billion in 2006**.** U.S. goods exports in 2007 were $227 million, down 4.0 percent from the previous year. Corresponding U.S. imports from Sri Lanka were $2.1 billion, down 3.7 percent. Sri Lanka is currently the 112th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Sri Lanka was $54 million in 2006 (latest data available), up from $40 million in 2005.

IMPORT POLICIES

Despite an economy open to foreign investment, the pace of reform in Sri Lanka has been uneven. President Rajapaksa's broad economic strategy focuses on poverty alleviation and steering investment to disadvantaged areas, developing the small and medium enterprise sector, promotion of agriculture, and expanding the already large civil service.

The Trade, Tariff, and Investment Policy Division of the Ministry of Finance and Planning is charged with the formulation and implementation of policies in these areas. In addition, the Trade and Tariff cluster of the National Council of Economic Development (NCED) also examines trade and tariff issues and sends recommendations to the Ministry of Finance and Planning. The NCED consists of 22 clusters representing both private and public sector officials, which examine various sectors of the economy.

Import Charges

Sri Lanka's main trade policy instrument has been the import tariff. According to the World Trade Organization (WTO), in 2006, Sri Lanka's average applied tariff for nonagricultural goods was 9.2 percent. Its average bound (ceiling) tariff for these goods was 19.6 percent. However, approximately 70 percent of Sri Lanka's nonagricultural tariffs are unbound under WTO rules and can be increased at any time. Sri Lanka's average applied agricultural tariff in 2006 was 23.8 percent.

Currently in Sri Lanka, there are five tariff bands: 0 percent; 2.5 percent; 6 percent; 15 percent; and 28 percent. Textiles, pharmaceuticals, and medical equipment are duty free. Basic raw materials are generally assessed a 2.5 percent duty. Semi-processed raw material tariffs are 6 percent, while intermediate product tariffs are 15 percent. Most finished product tariffs are 28 percent. There are also a number of deviations from the five band tariff policy. Some items are subject to an *ad valorem* or a specific duty, whichever is higher, and there is intermittent use of exemptions and waivers. In addition, there are specific charges on certain imported items, including footwear, ceramic products, and agricultural products. For example, in 2007 the government raised taxes on imported textiles and apparel by imposing an Export Development Board Levy (often referred to as a cess) of 50 Rupees (approximately $0.5) per kilogram on imported textiles not intended for use by the apparel export industry. Apparel imports are subject to a 15 percent import duty, a 30 percent cess, a 15 percent VAT, a 3 percent Ports and Airports Levy, and a 1.5 percent Social Responsibility Levy.

In addition to tariffs, a variety of taxes introduced in the past several years have effectively increased Sri Lanka's tax rates on a range of imported items to between 60 percent and 90 percent of the cost, insurance, and freight (CIF) value of the product. The government has imposed these charges on imports primarily to raise revenue or to defray the costs of specific government services. Most of these charges were revised upwards effective November 8, 2007. The frequent changes (mostly upward) in these rates have added unpredictability to foreign exporters' and local importers' cost calculations. Affected products include fruits, processed/packaged food, personal care products, and consumer electronics.

Other charges on imports include:

- An Export Development Board (EDB) levy, ranging from 10 percent to 35 percent *ad valorem* on a range of imports identified as "nonessential." Some items are subject to specific duties; for example, shampoo (35 percent or Rs 100 ($0.9) per kg), apparel (30 percent or Rs 60 ($0.6) per unit), and oranges (30 percent or Rs 40 ($.37) per kg). Whichever levy is higher – percentage versus a flat rate – is applied. Also, when calculating the EDB levy, an imputed profit margin of 10 percent is added onto the import price.

- An import duty surcharge of 15 percent on all dutiable imports (increased from 10 percent as of November 8, 2007).

- A Ports and Airports Development Levy (PAL) of 3.0 percent on imports (increased from 2.5 percent in January 2007).

- A Value Added Tax (VAT) of 0 percent, 5 percent, 15 percent, or 20 percent. When calculating the VAT, an imputed profit margin of 10 percent (increased from 7 percent on January 1, 2007) is added on to the import price. Locally manufactured products are also subject to VAT but not the imputed profit margin.

- Excise fees on some products such as aerated water, liquor, beer, motor vehicles, and cigarettes. The list of products subject to these fees was expanded in 2007 to include certain household electrical items. When calculating the excise fee, an imputed profit margin of 15 percent (increased from 10 percent on October 11, 2007 and from 7 percent on January 1, 2007) is added on to the import price. Locally manufactured products are also subject to excise fees.

- A port handling charge, which varies by container size.

- A Social Responsibility Levy, a surcharge of 1.5 percent assessed on the import duty to fund the National Action Plan for Children. This tax was increased from 1 percent as of November 8, 2007.

- A regional infrastructure fee of 2.5 percent on automobiles introduced in January 2007 was scheduled to be increased to 5 percent on January 1, 2008. The fee is levied on both imports and domestically assembled vehicles.

In March 2007, the government lifted a requirement to keep a 50 percent deposit on letters of credit on nonessential imports. The requirement had been introduced in October 2006 to discourage imports in more than 40 categories of consumer items including confectionary, liquor, personal care products, footwear, and tableware.

The U.S. Government engaged in bilateral Trade and Investment Framework Agreement (TIFA) talks with the government of Sri Lanka in December 2006. The United States underscored that Sri Lanka's import regime, characterized by high finished goods tariffs, continues to impede significantly U.S. export opportunities to Sri Lanka. Sri Lankan officials noted their inability to reduce these duties immediately as

Sri Lanka is dependent on border tariffs for a significant portion of government revenue. In 2007, the U.S. Ambassador also discussed with senior Sri Lankan ministers the adverse impact that Sri Lanka's high charges on imports have on trade.

Import Licensing

Sri Lanka requires import licenses for over 400 items at the 6-digit level of the Harmonized Tariff System code, mostly for health, environment, and national security reasons. Importers must pay a fee equal to 0.1 percent of the import price to receive an import license.

Customs Administration

The government of Sri Lanka implemented the WTO Customs Valuation Agreement in January 2003 and follows the transaction value method to determine the CIF value. The scheme has operated quite successfully and major companies have not faced problems. Customs is also in the process of installing an Electronic Data Interchange system to support an automated cargo clearing facility. When implemented, this system should improve customs administration and facilitate trade.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Standards

At present, 102 items are subject to the Sri Lanka Standards Institution (SLSI) mandatory import inspection scheme. These include food, steel, electrical cables, switches, water heaters, and cement. Importers of these items must obtain a clearance certificate from the SLSI to sell their goods. SLSI accepts letters of conformity from foreign laboratories but retains the discretion to take samples and perform tests.

Laws Governing Genetically-Engineered (GE) Food

In January 2007, the Ministry of Health established a regulation for the control of import, mandatory labeling, and sale of GE food. The regulation is in place but is not being fully implemented by the government of Sri Lanka. Some U.S. food exporters have expressed concern about this regulation and have restricted their product portfolio to limit products with GE content. The regulation is not science-based and that the proposed labeling procedure is excessively burdensome. During December 2006 discussions under the United States-Sri Lanka TIFA, the United States raised concerns regarding Sri Lanka's imposition of the new labeling requirement as it lacks scientific rationale and creates undue fears in the minds of consumers.

The United States Department of Agriculture (USDA) also expressed concern in 2007 that the labeling component of the regulation could be burdensome and costly and hinder U.S. food exports to Sri Lanka. Any regulatory system by a member of the WTO should be consistent with international obligations and be administered in a manner that is least trade restrictive.

Planting material and corn require nongenetically modified organism certification. This regulation is burdensome and trade restrictive despite a national biosafety framework that is in place, which outlines procedures for the import of biotechnology products and the domestic use of biotechnology.

Sanitary and Phytosanitary (SPS) Measures

Sri Lanka bans imports of some food items completely, including raw and frozen chicken imports because of outbreaks of avian influenza in the United States, which have since been resolved. A ban on imports of beef from the United States is maintained, due to the detection of bovine spongiform encephalopathy (BSE) in the United States. These bans, however, are inconsistent with and more constraining than the World Organization for Animal Health's guidelines as they are not scientifically based.

Sri Lanka lifted a ban on imports of seed potato from the United States in March 2007. The prohibition had been established due to unsubstantiated fears that the Colorado Potato Beetle could have been introduced into Sri Lanka by these imports. The United States pressed for the removal of this barrier on the grounds that it was not scientifically justified. Although the government allowed a shipment of U.S. seed potato recently, an additional declaration certifying field freedom was provided by the U.S. state level Department of Agriculture. A declaration certifying field freedom was not included as an import permit condition in the measure allowing U.S. potato seed import into Sri Lanka. The government of Sri Lanka has decided to review each shipment on a case-by-case basis to accept shipment freedom certification of Colorado Potato Beetle.

GOVERNMENT PROCUREMENT

Sri Lanka is not a signatory to the WTO Agreement on Government Procurement. Government procurement of goods and services is primarily undertaken through a public tender process. Some tenders are open only to registered suppliers. Procurement is also undertaken outside the normal competitive tender process. Examples of such procurement include agreements in 2006 with the government of China to build a coal power plant and for two Chinese companies to build a new bulk cargo port in Hambantota; an agreement with India to build a coal power plant; and the granting of oil exploration rights off the western coast of Sri Lanka to India and China.

The government publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards are common. In 2004, the government created a National Procurement Agency (NPA) to introduce a more transparent procurement system. However, political influence continues to hamper the new system's effectiveness. In 2006, Sri Lanka published new guidelines to improve the public procurement process as well as a new procurement manual. Changes included a requirement to have generic specifications and the opportunity for bidders to protest if the specifications are biased.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Sri Lanka is a party to major intellectual property agreements, including the Berne Convention for the Protection of Literary and Artistic Works, the Paris Convention for the Protection of Industrial Property, the Patent Cooperation Treaty, the Trademark Law Treaty, and the convention establishing the World Intellectual Property Organization (WIPO).

In 2003, a new intellectual property law – governing copyrights, patents, trademarks, and industrial design – came into force. Infringement of IPR is a punishable offense under the new law and IPR violations are subject to both criminal and civil jurisdiction. Notwithstanding the new law, IPR enforcement is still a problem. Piracy levels are very high for sound recordings and software. Government use of unauthorized software also appears to be a problem. According to a study commissioned by the Business Software Alliance, 90 percent of new computers sold in Sri Lanka in 2006 used pirated software. The study estimated retail revenue losses of $86 million in 2006 due to software piracy.

Further, redress through the courts is often a frustrating and time-consuming process. Police can legally take action without complaints by rights holders, but rarely do so. The government's Director of Intellectual Property and international experts have begun IPR legal and enforcement training for customs, judicial and police officials. The government of Sri Lanka is also expected to develop a plan specifically to improve IPR enforcement. The U.S. Embassy, the American Chamber of Commerce of Sri Lanka, and the European Chamber of Commerce are also working with the government of Sri Lanka to improve enforcement, provide enforcement training, and enhance public awareness.

The U.S. government raised these issues during the December 2006 TIFA meeting. The government of Sri Lanka reported that in 2007 it would develop a national IPR strategy to increase enforcement and public awareness as well as use intellectual property for economic development. The government has since decided not to issue a national IPR strategy, but instead to develop a plan specifically to enhance IPR enforcement.

SERVICES

Insurance

Sri Lanka allows 100 percent foreign ownership in insurance. Foreign insurance companies are required, however, to incorporate in Sri Lanka to conduct insurance business. In 2003, the government privatized state-owned insurance companies. Resident Sri Lankans are prohibited from obtaining foreign insurance policies, except for health and travel, from foreign companies not incorporated in Sri Lanka. Sri Lanka's insurance regulatory body retains the discretion to establish minimum and maximum premiums for various insurance products. In practice, premiums are not regulated, though. In early 2008, the government implemented a new regulation requiring all insurance companies to reinsure 20 percent of their insurance business with a state-run insurance fund.

Telecommunications

Telecommunications, especially mobile services, is increasingly competitive and may be the most dynamic service industry in Sri Lanka. The government of Sri Lanka maintains a majority share in the fixed line carrier Sri Lanka Telecom (SLT). All other operators are privately owned.

Due to SLT's past monopoly status, it continues to own most of the national telephone infrastructure (including the main switches and the only two international cable landing stations) and continues to dominate the sector, affecting the competitiveness of other operators. The government liberalized international telecommunications in 2003 and issued 33 nonfacilities based gateway licenses, ending the SLT monopoly over international telephony.

Broadcasting

The government imposes taxes on foreign movies, programs, and commercials to be shown on television in the following ways:

- Imported English language movies shown on television are taxed at Rs 25,000 (approximately $250).

- English language television programs are taxed at Rs 10,000 (approximately $100) per half hour episode.

- Any foreign film or program dubbed in the local language Sinhala is taxed at Rs 90,000 (approximately $900) per half hour.

- Foreign television commercials are taxed at Rs 500,000 (approximately $5,000) per year.

Rates for non-English foreign programming are higher. Government approval is required for all foreign films and programs shown on television.

Professional Services

There is no formal national policy on professional services. In practice, many foreign doctors, nurses, engineers, architects, and accountants work in Sri Lanka. Most of them are employed by foreign companies. Sri Lanka has not made any WTO commitments on the presence of natural persons and national treatment is not accorded to foreign nationals working in Sri Lanka. Most foreign nationals do not have statutory recognition in Sri Lanka and cannot sign documents presented to government institutions or regulatory bodies.

The Immigration Department grants resident visas for expatriates and professionals whose services are required for projects or by companies approved by the Board of Investment (BOI). Non-BOI companies, such as banks, can also employ expatriate staff; however, in practice the Immigration Department has limited the number of expatriates to levels below those desired by the banks. The Immigration Department also grants visas for foreign professionals required for projects approved by the government. Sri Lanka also operates a resident guest visa program for foreign investors and professionals who are recommended by the relevant ministry.

Legal Services

A person can provide legal consultancy services without being licensed to practice law in Sri Lanka. Foreigners are not allowed to practice law (*i.e.*, appear in courts) and do not have statutory recognition in Sri Lanka. Sri Lankan citizens with foreign qualifications need to sit for exams conducted by the Sri Lanka Law College in order to practice and register in the Supreme Court.

INVESTMENT

Sri Lanka welcomes foreign investment but has restrictions in specific sectors. Foreign investment is not permitted in the following areas:

- nonbank money lending;

- pawn brokering;

- retail trade with a capital investment of less than $1 million (with one notable exception: the BOI permits retail and wholesale trading by reputable international brand names and franchises with an initial investment of not less than $150,000);

- coastal fishing;

- education of students under 14 years of age for local examinations; and
- local degree-awarding university education (institutions awarding overseas degrees are permitted).

Investment in the following sectors is restricted and subject to screening and approval on a case-by-case basis when foreign equity exceeds 40 percent:

- shipping and travel agencies;
- freight forwarding;
- higher education;
- mass communications;
- deep sea fishing;
- timber-based industries using local timber;
- mining and primary processing of nonrenewable national resources; and
- growing and primary processing of tea, rubber, coconut, rice, cocoa, sugar, and spices.

Foreign investment equity restrictions and government regulations also apply to air transportation, coastal shipping, lotteries, large-scale mechanized gem mining, and “sensitive” industries such as military hardware, illegal narcotics, and currency.

The BOI offers a range of incentives to both local and foreign investors. To qualify for BOI incentives, investors need to meet minimum investment and minimum export requirements. In general, the treatment given to foreign investors is nondiscriminatory. Even with incentives and BOI facilitation, however, foreign investors can face difficulties operating in Sri Lanka. Problems range from difficulties in clearing equipment and supplies through customs to obtaining land for factories. The BOI encourages investors to locate their factories in BOI-managed industrial processing zones to avoid land allocation problems. Investors locating in industrial zones also get access to relatively better infrastructure facilities such as improved power reliability, telecommunications, and water supply.