SRI LANKA

TRADE SUMMARY

The U.S. goods trade deficit with Sri Lanka was $1.9 billion in 2006, roughly the same as in 2005. U.S. goods exports in 2006 were $237 million, up 19.7 percent from the previous year. Corresponding U.S. imports from Sri Lanka were $2.1 billion, up 3.0 percent. Sri Lanka is currently the 105th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Sri Lanka in 2005 was $40 million (latest data available), up from $37 million in 2004.

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 current government has backtracked on trade liberalization strategies followed by previous governments.

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

Import tariffs: Sri Lanka's main trade policy instrument – and greatest source of revenue – has been the import tariff. In 2005, Sri Lanka's average applied tariff for non-agricultural goods was 8.3 percent. However, the majority of Sri Lanka's non-agricultural tariffs are unbound under World Trade Organization (WTO) rules and can be increased at any time. Sri Lanka's average applied agricultural tariff in 2005 was 22.5 percent.

Currently in Sri Lanka, there are five tariff bands (reduced from six in November 2005) of zero percent, 2.5 percent, 6 percent, 15 percent and 28 percent. Textiles, pharmaceuticals and medical equipment are free of duty. 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. Tobacco and cigarette tariffs range from 75 percent to 250 percent. In addition, there are specific duties on certain items, including footwear, ceramic products and agricultural products. These specific duties are designed to protect domestic producers. Some items are subject to an *ad valorem* or a specific duty, whichever is higher, and there is intermittent use of exemptions and waivers.

Import taxes and other charges on imports: In November 2004, the Sri Lankan government introduced the Export Development Board (EDB) levy, an additional tax on a range of imports identified as "non-essential." Together with import tariffs and other charges on imports, the EDB levy effectively increases charges on most finished good imports to over 50 percent of the import value, with the highest charges on goods subject to specific duties. Despite an improvement in the foreign reserve position, the government has not revoked the tax.

Other charges on imports include:

- a 10 percent import duty surcharge on all dutiable imports;
- a 2.5 percent ports and airports development levy (PAL) on imports (increased from 1.5 percent from January 1, 2006);
- a Value Added Tax (VAT) of 0 percent, 5 percent, 15 percent and 20 percent (import prices are increased by 7 percent, adding an imputed profit margin, when calculating the VAT and excise duty);
- excise fees on some products such as aerated water, liquor, beer, motor vehicles (motor vehicle excise fees increased sharply in 2004) and cigarettes;
- a port handling charge that varies by container size; and
- a surcharge of 1 percent assessed on the import duty as a Social Responsibility Levy (to fund the National Action Plan for Children). This tax was increased from 0.25 percent from January 1, 2006.

As of October 2006, importers were required to keep a 50 percent deposit on letters of credit on non-essential imports. The requirement was introduced to discourage imports of over 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 Sri Lankan government 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 government officials noted their inability to reduce these duties immediately as Sri Lanka is dependent on border tariffs for a significant portion of government revenue.

Import Licensing

Sri Lanka requires import licenses for over 300 items at the 6-digit level of the Harmonized 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 Barriers

The government of Sri Lanka implemented the WTO Customs Valuation Agreement in January 2003 and follows the transaction value method to determine the cost, freight, insurance (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

At present, there are 102 items that come under the Sri Lanka Standards Institution (SLSI) mandatory import inspection scheme. The items 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 laboratorie, but retains the discretion to take samples and perform tests.

The Ministry of Health, in January 2007, implemented a regulation for mandatory labeling of genetically modified food. Some large U.S. food exporters have expressed concern about this regulation. They believe the regulation is not science-based and that the proposed labeling procedure is excessively burdensome. The regulation could hinder exports of U.S. food brands to Sri Lanka. During December 2006 discussions under the U.S.-Sri Lanka Trade and Investment Framework Agreement (TIFA), the United States raised concerns regarding Sri Lanka's imposition of the new labeling requirement in the absence of clear standards and the assertion that genetically modified products pose health risks. Sri Lanka assured the United States that the new regulations would not become a trade barrier.

Sri Lanka bans some food items completely. There is a ban on chicken in order to protect the domestic industry. Due to fears of Bovine Spongiform Encephalopathy (BSE), Sri Lanka bans imports of beef from the United States and Canada. Sri Lanka does not allow imports of seed potato from the United States due to unsubstantiated fears that the Colorado Beetle will be introduced into the country. The United States and Sri Lankan Departments of Agriculture currently are in technical discussions to resolve this issue.

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. The government of Sri Lanka publicly subscribes to principles of international competitive bidding but charges of corruption and unfair awards continue. Some tenders are open only to registered providers. 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. During December 2006 TIFA talks, NPA officials stated that in March 2006 Sri Lanka published new guidelines to improve the procurement process. A new manual was also published in August 2006. Changes include a requirement to have generic specifications and the opportunity for bidders to protest if the specifications are biased.

Recent examples of procurement outside the normal tender process include an agreement in 2006 with the government of China to build a coal power plant, negotiations with India to build an additional coal power plant, a memorandum of understanding in 2006 with a Chinese consortium for detailed design works for a port in Hambantota without calling for competitive bidding and the decision to grant oil exploration rights off the western coast of Sri Lanka to India and China without a competitive tender process.

U.S. pharmaceutical exports to Sri Lanka are approximately $20 million annually. The Sri Lankan government is committed to providing free health care to its people. The Sri Lankan Ministry of Health buys pharmaceuticals largely from known suppliers and determines the quality and quantity of its pharmaceutical purchases; importers registered with the Ministry can supply pharmaceuticals to the government. Unfortunately, certain clauses of the National Drug Policy (NDP) – on "need" and "cost effectiveness" – could negatively impact U.S. exports of pharmaceuticals to the Sri Lankan government. The "need" clause aims to limit the number of medicines available for a given indication, disregarding approval by leading drug authorities such as the U.S. Food and Drug Administration based on quality, safety and efficacy. The "cost effectiveness" clause may actually mean low cost and as such all research based manufacturers' products will be excluded as they will not be able to compete in price with generic manufacturers who have no burden to recover the cost of research and development that leads to finished marketable products. The U.S. Government raised this issue during the December 2006 TIFA discussions and will work with Sri Lanka to ensure that the NDP does not impede U.S. suppliers in participating in government procurement of pharmaceuticals.

EXPORT SUBSIDIES

Exporting companies approved by the Board of Investment (BOI) are generally entitled to corporate tax holidays and concessions. Exporters receive institutional support from the Export Development Board in marketing. Imports for exporting industries and BOI-approved projects usually are exempted from the payment of VAT. For others, the VAT is refunded. The airports and ports' levy on imports for export processing is 0.25 percent of the CIF value.

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). Sri Lanka and the United States signed a Bilateral Agreement for the Protection of Intellectual Property Rights in 1991 and Sri Lanka is a member of the World Trade Organization. Sri Lanka is not a signatory to the WIPO Performances and Phonograms Treaty and the WIPO Copyright Treaty.

In November 2003, a new intellectual property law – governing copyrights, patents, trademarks and industrial design – came into force that was intended to implement both the U.S.-Sri Lanka bilateral IPR agreement and WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) obligations. Infringement of IPR is a punishable offense under the new law and IPR violations are subject to both criminal and civil jurisdiction.

Copyrights

The Sri Lankan police have conducted some raids of stores selling pirated DVDs and music CDs as well counterfeit apparel. Several offenders have been charged or convicted by courts.

Nevertheless, counterfeit goods continue to be readily available. Local agents of the U.S. and other international companies representing recording, software, movie, and consumer product industries continue to complain that the lack of IPR protection is damaging their business. Piracy levels are very high for sound recordings and software, making it difficult for the legitimate industries to protect their market and realize their potential in Sri Lanka. Software companies complain of the lack of IPR enforcement within government institutions.

Enforcement

Unfortunately, enforcement against piracy and counterfeiting is inadequate, as is public awareness of IPR protection. Aggrieved parties must seek redress of any IPR violation through the courts, a frustrating and time-consuming process. As a sign of limited progress, during 2004-2006, Sri Lanka began enforcing the provisions of its new IPR law.

The government's Director of Intellectual Property and international experts have begun IPR legal and enforcement training for customs and police officials. An IPR working group of adversely affected industries led by the U.S. Embassy and American Chamber of Commerce of Sri Lanka is also working closely with the Sri Lankan government to pursue more aggressive enforcement and enhance public awareness.

These issues were discussed during the December 2006 TIFA meeting. The Sri Lankan government reported that in 2007 it will develop a national IPR strategy to increase enforcement and public awareness as well as use intellectual property for economic development. The U.S. Government will monitor implementation of this initiative.

SERVICES BARRIERS

Sri Lanka has opened its services sector to foreign investment. Foreign ownership of 100 percent equity is allowed in a range of service sectors such as banking, insurance, telecommunications, tourism, stock brokerage, the construction of residential buildings and roads, mass transportation, distribution of energy, and professional services. The establishment of liaison offices is permitted as are direct branches of foreign companies in some sectors. These services are regulated and subject to approval by various government agencies. The screening mechanism is non-discriminatory and, for the most part, routine. The regulatory agencies review investment proposals for their financial and technical viability, examine the suitability of sites (for tourism) and conduct Environmental Impact Assessments.

Banking

Foreign commercial banks are allowed to open branch offices in Sri Lanka, subject to an economic needs test and approval by the Central Bank. Foreign investors are allowed to hold 100 percent equity in local banks, subject to limits on individual share ownership. Currently, there are twelve foreign commercial banks operating in Sri Lanka, including one U.S. bank. Listed below are the main constraints faced in the commercial banking sector:

- government ministries and departments must use only state-owned banks for their banking business;
- restriction on speculative foreign exchange trading by commercial banks (banks are allowed to buy or sell foreign exchange for commercial transactions only);
- restriction on total lending by foreign banks to a single name limited to 30 percent of capital funds in Sri Lanka. (The option of a guarantee from the head office in lieu of capital was withdrawn by the Central Bank in 2006.);
- a VAT on profits before tax and salaries; and
- a mandatory lending requirement to the agricultural sector (applicable to both local and foreign banks). The Central Bank requires banks to increase lending to the agricultural sector to 10 percent of total advances by December 2009.

Insurance

One hundred percent foreign ownership is allowed in insurance. Foreign insurance companies are required, however, to incorporate in Sri Lanka to conduct insurance business. The government has recently privatized the state-owned insurance companies. Resident Sri Lankans are prohibited from obtaining foreign insurance policies except for health and travel. Sri Lanka’s insurance regulatory body retains the discretion to introduce minimum and maximum premiums for various insurance products.

Telecommunications

The telecommunications sector is the most dynamic service industry in Sri Lanka. The government of Sri Lanka maintains a majority share in Sri Lanka Telecom (SLT). Due to SLT’s past monopoly status under government control, 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. In early 2003, the government liberalized international telecommunications and issued 33 non-facilities-based gateway licenses, ending the SLT monopoly over international telephony. Since then, international outgoing call rates have dropped sharply. All other operators are privately owned.

A key problem facing the telecommunications sector is the restriction imposed on interconnection. The regulatory authority has failed to enforce regulations provided under the Telecommunications Act to establish an efficient and transparent interconnection regime. As a result, SLT, the wireless operators and the mobile operators have effectively restricted interconnection for other operators. This has adversely affected the operations of most of the other operators and new international gateway licensees who are unable to make use of their licenses due to lack of interconnection by the local exchange operators. This situation has resulted in illegal bypassing by some operators. Spectrum management is also weak and frequencies are not properly allocated, thereby negatively affecting telecommunication operators.

Tax on foreign television programs and commercials

New barriers to trade exist in the media sector. For example, following a proposal contained in the 2006 government budget, the government imposed taxes on foreign movies and television programs as follows:

- Imported English language movies shown on television are taxed at Rs25,000 (approximately $250). Movies in other languages are taxed at Rs200,000 (approximately $2,000).
- English language television programs are taxed at Rs10,000 (approximately $100) per half hour episode. Programs in other languages are taxed at Rs75,000 (approximately $750) per half hour episode.
- Any foreign film or program dubbed in the local language Sinhala is taxed at Rs90,000 (approximately $900) per half hour.
- Documentaries of educational interest are exempted. Imported Tamil language programs are also exempted.
- Foreign television commercials are taxed at Rs500,000 (approximately $5,000) per year.
- Government approval is required for all foreign films and programs shown on television.

Sri Lankan television stations import English, Tamil and Hindi movies and programs in addition to locally made Sinhala and Tamil ones. President Rajapaksa, who is also the Finance Minister, proposing the tax on television programs, said the revenue will be used to assist the local film and teledrama industry. So far, however, no revenues have been allocated for this stated purpose.

Copies of movies and programs need to be submitted to the Ministry of Media and Information for prior approval. However, the Ministry does not ask for copies of each and every episode of long running television serials. Approval is usually given within 24 hours.

Closure of satellite television stations

Courts imposed a clampdown in June 2006 on two of the biggest companies offering pay television services in Sri Lanka. The initial reason cited for the closure of the first operator was an alleged connection to the Liberation Tigers of Tamil Eelam (LTTE), a U.S.-designated foreign terrorist organization (on the basis that they used the same commercial satellite to receive data). Later it was announced that these operators did not have proper licenses. In July 2006, the President ordered the regulators, the Ministry of Mass Media and Information and the Telecommunications Regulatory Commission of Sri Lanka, to license the operators and regulate the industry. However, the regulators failed to take action to restart the operations until October 2006. The four month closure of the two pay television services has curtailed satellite broadcasts of foreign programs, including some U.S. programs. The two affected companies were allowed to resume operations in November and December 2006, respectively.

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). The Department also grants visas for foreign professionals required for projects approved by the government. Non-BOI companies, such as banks, can also recruit expatriate staff. 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 BARRIERS

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

- non-bank money lending;
- pawn brokering;
- retail trade with a capital investment of less than $1 million (with one notable exception: the Board of Investment (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
- the awarding of local university degrees (note that this does not limit the awarding of degrees from overseas institutions).

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 non-renewable national resources; and
- the 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 non-discriminatory. 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 supplies.

Government treatment of foreign investors in the privatization process has been largely non-discriminatory, with foreigners buying controlling interests in some companies. The privatization process has not always been transparent, however. For instance, in 2003, the government sold part of the retail operations of state-owned Ceylon Petroleum Corporation (CPC) to a foreign entity without a formal tender process.

Government failure to pay, and delays in paying, agreed subsidy payments and other charges owed to foreign companies are acting as a clear barrier to foreign investment in Sri Lanka. For example, a major U.S. company has faced problems due to government failure to honor an agreement to pay for services rendered under an agreement signed between the U.S. company and a government-owned company. As a result, the state-owned entity initially owed $3 million to the U.S. company. The U.S. company has now reduced its claim substantially, although even this amount remains outstanding. In another case, a foreign majority-owned (not U.S.) retailer has suffered heavy losses due to the government failure to honor agreements with regard to the payment of subsidies to the company resulting from price controls on the company's product. The government has recently withdrawn this price control and allows the foreign company to set its own prices. The company complains, however, that it is finding it difficult to compete with its competitor, a state-owned enterprise which continues to sell at below cost. Finally, in another case, a U.S. subsidiary of a foreign firm has faced serious difficulties in obtaining access to raw materials, in contravention of a BOI agreement. The company was prepared to make a sizeable investment based upon access to local raw materials, but was blocked when the Supreme Court – contrary to the government's assurances – issued a ruling barring the company from accessing local raw materials, resulting in increased costs to the company.

In response to repeated complaints from foreign investors that BOI pledges and assurances have not been kept, the Sri Lankan president created a special committee within his office in January 2006 to take up legitimate investment complaints. The committee started functioning in March 2006. However, this committee has not adequately addressed or resolved investor complaints.

Capital Repatriation

Sri Lanka has accepted Article VIII status of the IMF and has liberalized exchange controls on current account transactions. However, in October 2006, the Central Bank introduced restrictions on import financing. Banks are required to obtain a deposit of 50 percent of the invoice value at the time of opening letters of credit for imports of non-essential consumer items. There are no surrender requirements on export receipts but exporters need to repatriate export proceeds within 120 days to settle export credit facilities. Other export proceeds can be retained abroad. Currently, contracts for forward bookings of foreign exchange are permitted for a maximum period of 360 days for the purposes of payments in trade and 720 days for the repayment of loans.

Controls on capital account (investment) transactions usually prohibit foreigners from investing in debt and fixed income securities. Since October 2006, foreign investors are allowed to invest up to 5 percent in government rupee bond issues. The Central Bank's local market dollar-denominated bond issues were opened to foreign investors in 2001, 2002, 2004 and 2006.

OTHER BARRIERS

Litigation delay is a serious problem. For example, a U.S. investor with a substantial investment in an export manufacturing company has faced lengthy delays in a court case over a large insurance claim. The company instituted legal action in June 1999 and court proceedings are still on-going, resulting in additional financial losses for the company. The government has established a commercial court to hear business litigation, but delays are common.