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TRADE SUMMARY

The U.S. trade deficit with Sri Lanka was $1.7 billion in 2003, an increase of $14 million from 2002. U.S. goods exports in 2003 were $155 million, down 10 percent from the previous year. Corresponding U.S. imports from Sri Lanka were $1.8 billion, down 0.2 percent. Sri Lanka is currently the 104th largest export market for U.S. goods.

The United States is Sri Lanka's largest export market and the destination for $1.8 billion (or 38 percent) of exports, predominantly garments. Sri Lanka's garment industry is heavily dependent on the United States, with 63 percent of all garment exports bound for the United States.

Sri Lanka's exports face many challenges. The largest export, garments, will face increased competition in a quota-free era when the WTO Agreement on Textiles and Clothing expires in 2005. Products from cheaper sources also threaten most other sectors. In order to meet these challenges, there are new efforts to diversify exports, expand tourism, improve competitiveness and increase foreign employment opportunities. The Government also hopes to take advantage of Sri Lanka's strategic location on shipping routes, make use of the Indo-Lanka free trade agreement, sign free trade agreements with other countries, and establish Sri Lanka as a regional hub for manufacturing, commerce and transport.

IMPORT POLICIES

Sri Lanka has one of the most liberal trade regimes in South Asia. Sri Lanka's main trade policy instrument is the import tariff. A few years ago Sri Lanka set out to have a simplified transparent two-band tariff system. The country has deviated from this policy recently and the tariff structure is now subject to an increasing number of changes. Currently, there are 6 tariff bands of 2.5percent, 5 percent,10 percent, 15 percent, 20 percent and 25 percent. Textiles, crude oil and wheat are free of duty. There are also a number of deviations from the 6-band tariff policy. Tobacco and cigarettes carry 75 percent and 100 percent duties, respectively. In addition, there are specific duties on 46 items, including about 12 agricultural products. These specific duties are aimed at protecting domestic producers. However, they remain below Sri Lanka's bound agricultural tariff rate of 50 percent in the WTO. There is no clear tariff policy on agriculture. Furthermore, 31 items carry an *ad-valorem* or a specific duty (whichever is higher). There is intermittent use of exemptions and waivers. "Regaining Sri Lanka", the Government's policy framework, proposes a strongly pro-trade package that includes moving towards a stable low uniform rate and reducing non-tariff barriers. The Government has established a Tariff Advisory Council to examine these issues. The finance minister recently announced that they would reduce the 6 tariff bands to 5.

There are other charges on imports:
1) a 10 percent import duty surcharge;
2) a 1 percent ports and airports development levy (PAL) on imports;
3) a Value Added Tax (VAT) of 15 percent;
4) an excise fee on some products such as aerated water, liquor, wines, beer, motor vehicles and cigarettes;
5) an Export Development Board fee on all imports where the customs duty is more than 45 percent; and
6) port handling charges.

VAT and excise duties are levied on imports and domestic producers.

Import Licensing

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A total of 353 items at the 6-digit level of the Harmonized Tariff Schedule (HST) code remain under license control, mostly for health and national security reasons. There is a 0.1 percent fee on import licenses.

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 c.i.f. value. The scheme has operated quite successfully. Major companies have not faced problems. Sri Lanka Customs complains of "fly by night" companies undervaluing goods brought in from Dubai and China. Customs is also in the process of installing an Electronic Data Interchange (EDI) system to support an automated cargo clearing facility. When implemented, this system should improve customs administration and facilitate trade.

Agriculture

Following is a list of agricultural trade barriers facing US exporters.

Poultry and meat: There is an unofficial ban on the import of chicken meat, ostensibly to protect the local industry. Importers have been discouraged from applying for licenses to import U.S. chicken. A Singaporean-owned poultry company in Sri Lanka dominates the domestic market with an approximately 80 percent market share. United States chicken could compete effectively if allowed into the market. Imports of duck and turkey from the United States are permitted only from states free of avian influenza. Imports of beef from the United States are banned due to fears of bovine spongiform encephalopathy.

Wheat: The Government is considering adopting phytosanitary regulations for wheat. Such a move could affect U.S. wheat exports to Sri Lanka. Urocystis agropyri syn Urocystis tritici' and Neovossia indica syn Telletia indica' are the organisms that are under review for possible prohibition.

STANDARDS TESTING, LABELING AND CERTIFICATION

At present there are 84 items that come under the Sri Lanka Standards Institution (SLSI) mandatory import inspection scheme. Importers have to 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. The list of items under the SLSI inspection scheme is to be expanded by another 25 items in 2004.

There is discussion within some sections of health and environment sectors to introduce a labeling requirement for imports of bioengineered food, but no requirements are in place currently. A new labeling regulation has come into effect which relates to the information that should appear on a label of any prepackaged food product offered for sale, transported or advertised for sale in Sri Lanka, including imported food.

GOVERNMENT PROCUREMENT

Sri Lanka is not a member of the WTO Government Procurement Agreement. Government procurement of goods and services is mostly done through a public tender process. Some tenders are open only to registered providers. The Government publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards continue. All tenders presented for Cabinet approval now need to be routed through a cabinet subcommittee chaired by the Minister of Finance. There are no professional evaluation experts in Sri Lanka. Tender board members are routinely pulled from other jobs B applying limited evaluative capacity and lengthening the tender process.

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EXPORT SUBSIDIES

Exporting companies approved by the BOI, are generally entitled to corporate tax holidays and concessions. Exporters receive institutional support from the Export Development Board in marketing. Sri Lanka Export Credit Insurance Corporation (SLECIC) issues insurance policies and guarantees to exporters.

Imports for exporting industries and BOI approved projects usually are exempted from VAT. For some others, the VAT is refunded. There are no major complaints regarding VAT refunds. The airports and ports levy on imports for export processing is 0.5 percent.

INTELLECTUAL PROPERTY (IPR) PROTECTION

Local agents of U.S. and other international companies representing recording, software, movie, and consumer product industries continue to complain that 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 establish themselves in Sri Lanka.

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 Madrid Agreement for the elimination of false or deceptive indication of source on goods, the Nairobi Treaty, the Patent Co-operation Treaty, the Universal Copyright Convention and the Convention establishing the World Intellectual Property Organization (WIPO). Sri Lanka's intellectual property law is based on the WIPO model law for developing countries. Sri Lanka and the United States signed a Bilateral Agreement for the Protection of Intellectual Property Rights in 1991, and Sri Lanka is a party to the WTO Trade-Related Intellectual Property Rights (TRIPS) Agreement.

In November 2003, a new intellectual property law came into force. This law meets both U.S.-Sri Lanka Bilateral IPR Agreement and TRIPS obligations to a great extent. The law will now govern copyrights and related rights, industrial designs, patents for inventions, trademarks and service marks, trade names, layout designs of integrated circuits, geographical indications, unfair competition and undisclosed information. All trademarks, designs, industrial designs and patents must be registered with the Director General of Intellectual Property.

Infringement of IPR is a punishable offense under the new law, and IPR violations are subject to both criminal and civil jurisdiction. Relief available to owners under the new law includes injunctive relief, seizure and destruction of infringing goods and plates or implements used for the making of infringing copies, and prohibition of imports and exports. Penalties for the first offense include a prison sentence of 6 months or a fine of up to $5,000.The penalties could double for the second offense. Enforcement, however, is a serious problem, as is public awareness of IPR. The domestic implementing legislation under the old law was very weak and the Government did not act as an enforcer of IPR laws. Aggrieved parties had to seek redress of any IPR violation through the courts, a frustrating and time-consuming process. The Director of Intellectual Property and international experts have begun IPR legal and enforcement training for customs and police officials. An active US Embassy-led IPR working group comprising affected industries is also working closely with the Sri Lanka Government to pursue more aggressive enforcement and enhance public awareness.

It will take time before new procedures and court precedents are established under the new law. In addition, Sri Lanka needs to ratify and conform to the WIPO Performances and Phonograms Treaty

(WPPT) and the WIPO Copyright Treaty (WCT). Sri Lanka is completing its accession to the WTO Information Technology Agreement.

SERVICES BARRIERS

Sri Lanka has opened the services sector to foreign investment. Foreign investment of 100 percent is allowed in a range of service sectors such as banking, insurance, telecommunications, tourism, stock brokerage, construction of residential buildings and roads, supply of water, mass transportation, telecommunications, production and distribution of energy, professional services and the establishment of liaison offices or local branches of foreign companies. These services are regulated and subject to approval by various government agencies. The screening mechanism is non-discriminatory and, for the most part, routine. Some other services have restrictions on foreign investment.

Banking

Foreign commercial banks are allowed to open branch offices in Sri Lanka, subject to an economic needs test. Foreigners are allowed to hold 100 percent equity in banks. Bank ownership is subject to limits on individual ownership. Individual/company share ownership of a bank is limited to 15 percent of equity; group of companies 20 percent and promoters 25 percent. Currently, there are twelve foreign commercial banks operating in Sri Lanka.

Listed below are the main constraints faced by the commercial banking sector:

1) restriction of banking business by government ministries and departments to state-owned banks;
2) restriction on speculative foreign exchange trading by commercial banks; Banks are allowed to buy or sell foreign exchange for commercial transactions only;
3) a VAT on profit before tax and salaries;
4) inadmissibility of electronic documents in courts; and
5) the absence of laws to protect and facilitate electronic commerce. Several laws are being drafted to permit electronic transactions; They include an electronics transactions law, a computer crimes law, a data protection law, and a code for administration of ATMs and Credit Card Operations.

Insurance

One hundred percent foreign investment is allowed in insurance. Foreign insurance companies are required to incorporate in Sri Lanka to undertake insurance business. The Government has recently privatized the state-owned insurance companies. Sri Lankans with access to foreign currency can obtain foreign insurance policies. Resident Sri Lankans are otherwise prohibited from obtaining foreign insurance

policies except for health and travel. A major insurance company has reported difficulty in penetrating government business due to corruption. Sri Lanka's insurance regulatory body retains powers to introduce minimum and maximum tariffs for various insurance products.

Telecommunications

The telecommunications sector is the most dynamic service industry in Sri Lanka. There is one fixed line operator, Sri Lanka Telecom (SLT), two wireless local loop operators and four mobile phone operators. Several private operators also provide radio paging, data communication, internet service and satellite link-ups. The Government of Sri Lanka sold a 35 percent stake in SLT to NTT of Japan in 1997. The Government sold a further 12.5 percent stake of SLT in 2003 to the public. SLT has recently acquired a mobile phone operator. Due to the past monopoly status under Government control, SLT continues to own most of the national telephone infrastructure (switches) and the main international switches, and continues to dominate the sector affecting the competitiveness of other operators. All other operators are privately owned.

In early 2003, the Government liberalized international telecommunications and issued 29 (non- facilities based) gateway licenses, ending the SLT monopoly over international telephony. Since then, international outgoing call rates have dropped sharply. However, since new licensees are not allowed to establish facilities based operations, they are forced to use the international switches of the four facilities based licensees (including SLT and Lanka Internet, which has U.S. equity). This restricts access to cheaper bandwidth by other operators.

A key problem facing the telecommunications sector is restricted interconnection. The Regulatory Authority has failed to enforce regulations provided under the Telecommunications Act to establish an efficient and transparent interconnection regime.

SLT and the two wireless operators have formed an unofficial cartel to control local gateways and restrict interconnection to other operators. This has adversely affected the operations of other telecom and Internet operators and new international gateway licensees who are unable to make use of their licenses due to lack of interconnection by the three local exchange operators. Spectrum management is also weak and frequencies are not properly allocated which affect telecommunication operators.

Quotas on foreign films

The state-owned National Film Corporation’s (NFC) approval is required to import films. There is a quota restriction on imports of English language films, which is currently set at 100 per year. There are controls on screening of films: except for 6 top cinemas, all other theaters in Sri Lanka are required to screen at least 60 percent local films. The theaters exempted from the rule are free to screen foreign films without any restrictions. The NFC also charges a tax of $0.31 per ticket for foreign films. The charge on tickets for local films is only $0.04. NFC, which is instituted by an Act of Parliament, has wide powers that can be used to effectively restrict foreign film imports.

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 attached to 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. The Department also grants visas for expatriates 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 scheme 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 (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.

Education

Movement of people for education is not restricted. Foreign students are allowed to study in private schools in Sri Lanka, or follow other professional study courses. Foreign teachers also work in private schools in Sri Lanka.

Doctors

The Sri Lanka Medical Council allows qualified foreign doctors and medical specialists to work in Sri Lanka. They have to be sponsored by a medical institution or an non-government organizations, and are required to obtain temporary registration from the Sri Lanka Medical Council (SLMC). Many Indian doctors have been issued resident work visas recently to work in an Indian-owned hospital in Sri Lanka.

Accountants

All big four international accounting firms are represented, together with most of the second tier international firms. The Institute of Chartered Accountants of Sri Lanka (ICASL) membership is required to conduct audits and discharge other statutory duties in Sri Lanka.

Engineers and architectural services

Over the years, most foreign funded projects have used foreign consultants and contractors.

INVESTMENT BARRIERS

Sri Lanka actively pursues foreign investment. One hundred percent foreign investment is allowed in most manufacturing and services sectors.

Foreign investment is not permitted in the following businesses: non-bank 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 reputed international brand names and franchises with an initial investment of not less than $150,000); providing personal services other than for the export and tourism sectors; coastal fishing; education of students under 14 years for local examinations; and the awarding of local university degrees.

Investment in additional 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; fishing; timber-based industries using local timber; mining and primary processing of non-renewable national resources; growing and primary processing of tea, rubber, coconut, rice, cocoa, sugar and spices; and, finally, the production for export of goods subject to international quota.

Foreign investment restrictions and government regulations also apply to air transportation, coastal shipping, lotteries, large-scale mechanized gem mining, and "sensitive" industries such as military hardware, dangerous drugs 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, foreign investors can face difficulties operating here. Problems range from difficulties in clearing equipment and supplies through customs speedily to getting 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, telecommunication and water supplies.

Government treatment of foreign investors in the privatization process has been largely non-discriminatory. Recently, however, the government sold part of the retail operations of state-owned Ceylon Petroleum Corporation (CPC) to a foreign entity without a formal tender process. A major U.S. supplier that had earlier acquired a government-owned lubricant plant, and obtained exclusivity in the sale of lubricants in CPC outlets until mid-2004, has complained that the government had reneged on the terms of the exclusivity agreement.

Foreign-owned companies' access to local credit markets was liberalized recently and such firms can now borrow rupee funds without the approval of the Central Bank. Foreign-owned companies, BOI approved firms and exporters can access dollar denominated loans. Applications for dollar denominated loans from local firms are considered on a case-by-case basis and not encouraged.

Capital Repatriation

Sri Lanka has accepted Article VIII status of the IMF and has liberalized exchange controls on current account transactions. 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.

There are also no barriers, legal or otherwise, to the expeditious remitting of corporate profits and dividends for foreign enterprises doing business in Sri Lanka. Remittance of business fees (management fees, royalties and licensing fees) is also freely permitted. Funds for debt service and capital gains of BOI-approved companies exempted from exchange control regulations are freely permitted. Other foreign companies remitting funds for debt service and capital gains require Central Bank approval. Prior to Central Bank approval they also need a tax clearance certificate.

All stock market investments can be remitted without prior approval of the Central Bank. Investment returns can be remitted in any convertible currency at the legal market rate. Controls on capital account (investment) transactions usually prohibit foreigners from investing in debt and fixed income securities. One exception has been the Central Bank’s local market dollar denominated bond issues in 2001-2002, which were opened to foreign investors. Allowing foreign investment in corporate debentures and government bonds has been proposed by the GSL.

Local companies require Central Bank approval to invest abroad. The process of granting approval for such investments was streamlined in 2002, resulting in an increase in approvals.

ELECTRONIC COMMERCE

See above section under Services Barriers on Banking.

OTHER BARRIERS

Delays in litigation are a problem. For example, a US 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 going on with the company suffering financial losses as a result. In many disputes, defendants resort to obtaining injunctions, stay orders or postponements to drag cases on for years. The Government has established a commercial court to hear business litigation, but delays are still common.

List of other significant barriers:

1) IPR: Lack of IPR protection.
2) Banking: Restriction of government banking business to state owned banks.
3) Telecommunications: Dominance of telecommunications infrastructure by partly state-owned Sri Lanka Telecom (SLT) and lack of interconnection to other telecom and internet operators.
4) Government Procurement: Lack of transparency and corruption.
5) Agriculture: Import ban on chicken meat and beef from the United States.