SRI LANKA

TRADE SUMMARY

The U.S. trade deficit with Sri Lanka was $1.8 billion in 2004, an increase of $148 million from $1.7 billion in 2003. U.S. goods exports in 2004 were $164 million, up 6.0 percent from the previous year. Corresponding U.S. imports from Sri Lanka were $2.0 billion, up 8.2 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 2003 was $47 million, up from $31 million in 2002.

IMPORT POLICIES

Sri Lanka witnessed a change of government in April 2004, following parliamentary elections. The current government has espoused a shift to a mixed economy from the largely free market policies of the previous government. The government’s Economic Policy Framework has backtracked on the previous government’s trade liberalization strategy. It specifically calls for protection of small and medium enterprises and agriculture.

The government has created the National Council of Economic Development (NCED). NCED consists of approximately 18 clusters representing both private and public sector officials which examine various sectors of the economy. The Trade and Tariff cluster is charged with designing trade policy.

Sri Lanka's main trade policy instrument has been the import tariff. The tariff structure is subject to frequent changes. The budget for 2005 reduced the number of tariff bands from six to five. Departing from the previous liberalization path, the Government recently imposed a new import tax on selected items by way of a levy (referred to as a “cess” in Sri Lanka) in light of a decline in foreign reserves. The government also hopes this new tax will protect domestic agriculture and industry.

Import tariffs and other import charges: Currently, there are 5 tariff bands of 0 percent, 2.5 percent, 6 percent, 15 percent, and 28 percent. The highest tariff band was increased from 25 percent in 2002 to 27.5 percent in January 2004, and to 28 percent in November 2004. 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 products are at 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. Imports for export industries enter duty-free.

Export Development Board (EDB) Levy: In November 2004, the government introduced a new additional tax on a range of imports identified as "non-essential." The EDB levy is applied on C.I.F value, and ranges from 10 percent to 20 percent. Together with import tariffs, the EDB levy will effectively raise charges on most finished good imports to over 48 percent of the import value, with the highest charges on goods subject to specific duties.

There are other charges on imports:

1) a 10 percent import duty surcharge;
2) a 1.5 percent ports and airports development levy (PAL) on imports;
3) Value Added Tax (VAT) of 0 percent, 5 percent, 15 percent and 18 percent;
4) excise fees on some products such as aerated water, liquor, beer, motor vehicles and cigarettes. Excise fees on motor vehicles were increased sharply in 2004;
5) an Export Development Board surcharge on all imports where the customs duty is more than 45 percent;
6) a port handling charges; and
7) a surcharge of 0.25 percent assessed on the import duty (to fund the National Action Plan for Children, to be finalized and implemented in 2005).

Import prices are increased by 5 percent (by adding an imputed profit margin) when calculating the VAT and excise duty.

According to U.S. trade data, the total value of imports affected by the EDB cess will be about $5 million out of a total of about $143 million annual U.S. exports to Sri Lanka. The total effect on U.S. exports could be much higher, because U.S.-sourced products sent via other trading hubs are not captured in the export data used to compile this analysis. The Embassy has received complaints from affected U.S. exporters regarding the new "prohibitive" tariff regime.

Import Licensing

Sri Lanka requires import licenses for over 300 items at the 6-digit level of the Harmonized System (HS) code require import licenses, mostly for health, environment, and national security reasons. Importers must pay a fee equal to 0.1 percent fee 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 C.I.F. 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 (EDI) 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 85 items that come under the Sri Lanka Standards Institution (SLSI) mandatory import inspection scheme. These 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.

There is discussion within some sections of the health and environment sectors to introduce a labeling requirement for imports of biotechnology food, but no requirements are in place currently. The Sri Lankan Government considered previously implementing such a requirement in 2000 – 2001.

A new labeling and advertising regulation was published in January 2004. This 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. The regulation came into effect on January 19, 2005. Implementation, however, could be delayed further.

Poultry and meat: The ban on imports of U.S. poultry has been lifted subsequent to the USDA notification to the World Animal Health Organization (OIE) that the United States is free of Highly Pathogenic Avian Influenza (HPAI). An unofficial ban on the import of chicken to protect the local industry was revoked in November 2004 following a Government decision to allow poultry imports into the country. The primary beneficiary of the foreign chicken ban was a Singaporean-owned poultry company in Sri Lanka, which dominates the domestic market with an approximately 80 percent market share. Imports of beef from the United States are banned due to fears of bovine spongiform encephalopathy (BSE).

GOVERNMENT PROCUREMENT

Sri Lanka is not a member of the WTO Agreement on Government Procurement. 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. There are no professional evaluation experts in Sri Lanka. The Government recently created a National Procurement Agency (NPA) to introduce an improved system of procurement.

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. Imports for exporting industries and BOI approved projects usually are exempted from 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

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. 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 was intended to meet both the U.S.-Sri Lanka Bilateral IPR Agreement and TRIPS obligations to a great extent. The law governs 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 a 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 a second offense. Enforcement, however, against piracy and counterfeiting is a serious problem, as is public awareness of IP protection. Aggrieved parties must seek redress of any IPR violation through the courts, a frustrating and time-consuming process.

The Sri Lankan police uncovered a Malaysian-owned CD/VCD production facility in a Colombo suburb in October 2004. It is alleged to have produced pirated copies of music, movie and software violating rights of several US companies. The police investigation continues. The police have also conducted a few other raids of stores selling pirated movie and music CDs.

The Director of Intellectual Property and international experts have begun IPR legal and enforcement training for customs and police officials. In September 2004, a group of five lawyers and a judge attended an IPR program in the United States under the International Visitor program of the U.S. State Department. An active US Embassy-led IPR working group comprising adversely affected industries is also working closely with the Sri Lankan 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 its services sector to foreign investment. Foreign ownership of 100 percent of equity is allowed in a range of service sectors such as banking, insurance, telecommunications, tourism, stock brokerage, the construction of residential buildings and roads, the supply of water, mass transportation, 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.

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. Currently, there are twelve foreign commercial banks operating in Sri Lanka, including one US bank.

Listed below are the main constraints faced in 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;
5) the absence of laws to protect and facilitate electronic commerce; and
6) absence of anti-money laundering legislation. Draft legislation is being developed.

Insurance

One hundred percent foreign ownership is allowed in insurance. Foreign insurance companies are required 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. 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 premiums for various insurance products.

Telecommunications

The telecommunications sector is the most dynamic service industry in Sri Lanka. There is one fixed wire 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 (including main switches) and the only two international cable landing stations, controls access to the international fiber optic cables 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 33 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 terrestrial facilities, they are forced to use the infrastructure of existing domestic operator networks (including SLT and Lanka Internet) to terminate or originate international calls.

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, the wireless operators and some of the mobile operators have formed an unofficial cartel to control local gateways and restrict 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 bypass by some operators. Spectrum management is also weak and frequencies are not properly allocated which affect telecommunication operators. The Regulatory Agency, under a new management, has plans to improve the regulatory regime.

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. The quota does not effectively restrict access as annual imports are well below the limit. There are controls on the screening of films: except for the 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 from screenings. Part of the fee on tickets for local films is paid by the NFC to local film producers. 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 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. 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 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 (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.

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 a non-government organization, 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.

Engineers and architectural services

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

INVESTMENT BARRIERS

Sri Lanka welcomes 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 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. 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 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, 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, 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, telecommunication and water supplies.

Government treatment of foreign investors in the privatization process has been largely nondiscriminatory with foreigners buying a controlling interest 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. A major U.S. supplier that had earlier acquired a government-owned lubricant plant has complained that the government had reneged on the terms of an exclusivity agreement extending up to mid-2004.

Access to local credit markets by foreign-owned companies incorporated in Sri Lanka was liberalized in 2003 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 and 2004, which were opened to foreign investors. The government has proposed allowing foreign investment in corporate debentures and government bonds. 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.

OTHER BARRIERS

Delays in litigation are a 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, and the company has suffered financial losses as a result. The government has established a commercial court to hear business litigation, but delays are common.

In order to support the domestic software industry, private sector companies using locally produced software will be allowed to depreciate 100 percent of the cost in the first year, according to 2005 budget proposals. The depreciation allowance on foreign software is only 25 percent. The public sector is required to give preference to locally produced software and ensure at least 50 percent local value addition when using foreign software.

The government has recently re-introduced a 100 percent transfer tax on property purchased by foreign nationals and companies. For this purpose, a "foreign company" is defined as an entity with at least 25 percent foreign equity. Apartments above the third floor of condominium buildings, land for the development of large housing schemes, hospitals, and large infrastructure projects are exempted from the tax. Foreigners maintaining $ 150,000 in a bank account in Sri Lanka will be given concessionary treatment. In addition to the tax, the government has plans to prohibit certain geographical areas for purchase by non-citizens. Property transfers to foreigners were exempted from tax in 2002