

SRI LANKA

TRADE SUMMARY

The U.S. goods trade deficit with Sri Lanka was \$1.8 billion in 2011, up \$211 million from 2010. U.S. goods exports in 2011 were \$307 million, up 71.7 percent from the previous year. Corresponding U.S. imports from Sri Lanka were \$2.1 billion, up 19.4 percent. Sri Lanka is currently the 114th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Sri Lanka was \$130 million in 2010 (latest data available), up from \$110 million in 2009.

BILATERAL TRADE TALKS

The United States and the government of Sri Lanka held their annual trade discussions under the Trade and Investment Framework Agreement on November 15, 2011. The United States raised the issues of government procurement, agricultural market access, tariff levels, the investment climate, intellectual property rights and individual trade disputes. The United States and Sri Lanka had productive talks, and agreed to continue working on these and other issues.

IMPORT POLICIES

Despite an economy that is attempting to open to foreign trade and investment, the pace of reform in Sri Lanka has been uneven. The Trade, Tariff, and Investment Policy Division of the Ministry of Finance and Planning is charged with the formulation and implementation of trade and investment policies. The Trade and Tariff cluster of the National Council of Economic Development also examines trade and tariff issues and sends recommendations to the Ministry of Finance and Planning. Based on the Presidential Taxation Commission's recommendations, the government simplified the tax structure in 2010, including eliminating some but not all supplementary charges on imports.

The government's 2012 budget stressed the need to promote import substitution industries and proposed investment incentives for selected sectors identified as "strategic import replacement enterprises." Manufacture of cement, steel, pharmaceuticals, fabric, and milk powder are encouraged through new government incentives. The import tax regime for these items would be largely unchanged, except for the introduction of an all inclusive charge of Rs 75 (\$0.68) per kilogram (kg) on fabric to replace existing taxes. Yarn would be made tax free to facilitate the fabric industry. The budget emphasized the need to have price controls on pharmaceuticals, which, if implemented, is likely to be detrimental to the pharmaceutical import trade.

Import Charges

Sri Lanka's main trade policy instrument has been the import tariff. According to the WTO, Sri Lanka's average applied agricultural tariff in 2010 was 25.4 percent, whereas its bound rates, *i.e.*, the rate that generally under WTO rules cannot be exceeded, are significantly higher, averaging 50 percent. However, the compounded taxes for imported agriculture products are routinely between 80 percent and 100 percent of the cost, insurance, and freight (CIF) value. In 2010, Sri Lanka's average applied tariff for industrial and consumer goods was 9.2 percent. However, less than 30 percent of Sri Lanka's tariffs on industrial and consumer goods are bound under WTO rules, meaning applied tariffs on those goods can be increased to any level.

The import tariff structure was simplified in June 2010 by reducing the number of tariff bands from five to four. As a result, the current tariff bands are: zero percent; 5 percent; 15 percent; and 30 percent. The highest duty band was increased from 28 percent to 30 percent. Textiles, pharmaceuticals, and medical equipment, machinery, basic raw materials, computers, software, solar lights, sports footwear and selected consumer electronics, have a zero tariff. Semi-processed raw material tariffs are at 5 percent, while intermediate product tariffs are at 15 percent. Most finished product tariffs are at 30 percent. There continue to be a number of deviations from the four-band tariff policy. Some items are subject to an *ad valorem* or a specific tariff, whichever is higher, and there is intermittent use of exemptions and waivers. Footwear, ceramic products, and agricultural products carry specific tariffs.

In addition to the import tariff, there are a number of supplementary taxes and levies on imports.

In 2010 the government eliminated the 5 percent to 10 percent Regional Infrastructure Fee for automobiles, the 1.5 percent Social Responsibility Levy, and the 15 percent general import surcharge. The Nation Building Tax on imports was reduced from three percent to two percent. Although the government eliminated or reduced several taxes, the existing levies on a variety of products continue to amount to between 60 percent and 100 percent of the CIF value of those products.

The 2012 budget introduced several changes to the import tax regime. There were changes to tax/levy rates on selected goods. Also, to avoid undervaluation of goods for customs purposes, the government introduced unit-based specific taxes on textiles and fruits, replacing the existing *ad valorem* tariffs.

In general, the frequent changes (mostly upward) of these rates have added unpredictability to foreign exporters' and local importers' cost calculations. Affected products from the United States include fruits, processed/packaged food, and personal care products. The United States continues to examine if these combined tariffs, levies, and taxes conflict with Sri Lanka's WTO commitments.

Other charges on imports include:

- An Export Development Board (EDB) levy, often referred to as a "cess," ranges from 10 percent to 35 percent *ad valorem* on a number of imports identified as "nonessential." Most of the items are subject to specific duties as well; for example, biscuits (35 percent or Rs 60 (\$0.54) per kg) and butter, cheese and dairy spreads (30 percent or Rs 100 (\$0.90) per kg). Whichever levy is higher, either *ad valorem* or specific rate, is applied. Also, when calculating the EDB levy, an imputed profit margin of 10 percent is added onto the import price. In some cases, such as on biscuits, chocolates, and soap, the tax is charged not on the import price but on 65 percent of the maximum retail price. In 2010, the EDB levy on a range of consumer electronics and motor vehicles was completely removed. Locally manufactured products are not subject to the EDB. In November 2011, the EDB levy on a range of items was changed. For example, the EDB levy on wheat flour was increased from 5 percent to 15 percent and shampoo was changed from 35 percent or Rs 350 (\$3.16) per kg to Rs 500 (\$4.52) per kg.
- A Ports and Airports Development Levy of five percent is applied on imports. Locally manufactured products are not subject to the Ports and Airports Development Levy.
- The Value Added Tax (VAT) rate of 20 percent was reduced to 12 percent on November 23, 2010. Also, from June 2010, a range of consumer electronics goods were exempted from the VAT. When calculating the VAT, an imputed profit margin of 10 percent is added on to the import price. Locally manufactured products are also subject to VAT, but not the imputed profit margin.

- Excise fees are charged on some products such as aerated water, liquor, beer, motor vehicles, and cigarettes. When calculating the excise fee, an imputed profit margin of 15 percent is added on to the import price. The excise fee is applied on the price inclusive of other duties. Locally manufactured products are also subject to excise fees.
- The Nation Building Tax (NBT) was reduced to 2 percent from 3 percent on January 1, 2011. The NBT is applied on the price inclusive of other duties. Local manufacturers also pay NBT.
- Beginning on November 21, 2011, new Special Commodity Levy (SCL) is charged on some food items including oranges, mandarins, grapes, and apples. The items subject to the SCL are exempted from all other taxes. The SCL on oranges is Rs 60 (\$0.54) per kg; on mandarins Rs 35 (\$0.32) per kg; on grapes Rs 120 (\$1.09) per kg; and on apples Rs 45 (\$0.41) per kg.
- Textiles and Apparel: In November 2011, the government introduced an all inclusive tax of Rs 75 per kg (\$0.68) on imported textiles not intended for use by the apparel export industry. This tax replaces an Export Development Board Levy of Rs 50 (\$0.45) per kg, a Ports and Airports Tax of 5 percent and a VAT of 12 percent.
- Currently, apparel imports are subject to a 15 percent import duty, a Rs 75 (\$0.68) per unit Export Development Board Levy, a 12 percent VAT and a 5 percent Ports and Airports Levy.

Import Licensing

Sri Lanka requires import licenses for over 400 items at the 6-digit level of the Harmonized Tariff System, reportedly for health, environment, and national security reasons. Importers must pay an increased fee equal to 0.222 percent of the import price with a minimum fee of Rs 1,000 (\$9.05) to receive an import license.

GOVERNMENT PROCUREMENT

Government procurement of most goods and services is primarily undertaken through a public tender process. Some tenders are open only to registered suppliers. Procurement is also undertaken outside the normal competitive tender process. The government publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards are common. A special Cabinet-appointed review committee reviews unsolicited development proposals; it also has conducted procurements for the most important infrastructure projects outside of the regular government procurement process. These actions have raised concerns about the government's commitment to improve the transparency of procurement.

Sri Lanka is not a signatory to the WTO Agreement on Government Procurement, but it is as an observer to the WTO Committee on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

Weak intellectual property rights (IPR) enforcement remains a problem in Sri Lanka. Piracy levels remain very high for sound recordings and software. According to an industry-commissioned study, as much as 86 percent of personal computers in Sri Lanka used pirated software in 2010 (down slightly from 89 percent in 2009). However, the commercial value of pirated software rose to \$83 million in 2010 from \$77 million in 2009 due to increased personal computer sales. Despite this problem, industry reports that

there has been an improvement in the use of legal software by large companies in Sri Lanka. Further, while government use of unauthorized software remains a problem, the government of Sri Lanka has published an information and communications technology policy requiring all government ministries and departments to use only licensed software.

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

The Sri Lankan government's Director of Intellectual Property, along with international experts, continues to conduct IPR legal and enforcement training for customs, judicial, and police officials. The U.S. Embassy Colombo, the U.S. Patent and Trademarks Office, and the American Chamber of Commerce of Sri Lanka are also working with the government of Sri Lanka and the private sector to improve enforcement, provide enforcement training, and enhance public awareness. Sri Lankan Customs has created a computer based Customs Trade Mark recordation system, although it is not yet fully operational. A new IP unit has been established within the Criminal Investigative Division of the Sri Lankan police. The United States will monitor the effectiveness of these new programs.

SERVICES BARRIERS

Insurance

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

Broadcasting

The government imposes taxes on foreign movies, programs, and commercials to be shown on television, ranging from Rs 25,000 (\$226) for an imported English-language movie to Rs 90,000 (\$814) per half hour of a foreign language program dubbed in the local language, Sinhala. Foreign television commercials are taxed at Rs 500,000 (\$4,523) per year. Rates for non-English foreign programming are higher. Government approval is required for all foreign films and programs shown on television.

INVESTMENT BARRIERS

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

On November 9, 2011, the government of Sri Lanka approved a new law entitled the "Revival of Underperforming Enterprises and Underutilized Assets Act" that allows expropriation of assets belonging

to 37 companies the government considers as underperforming. These companies had leased land from the government, and the government states that the companies were not meeting conditions of their leases. Although many of the 37 companies were defunct, several were operating businesses, including one owned by a prominent member of the opposition. The Bill was passed under a mechanism that limited Parliamentary debate to one day. The Central Bank stated that the Bill was a “one off” measure, but the government has subsequently announced plans to retake 37,000 hectares of tea plantation land, which the government said was not being fully utilized. The law increases investor uncertainty regarding property rights in Sri Lanka and could become a significant barrier to foreign investment.