SRI LANKA

TRADE SUMMARY

The U.S. goods trade deficit with Sri Lanka was $1.7 billion in 2008, a decrease of $160 million from $1.8 billion in 2007. U.S. goods exports in 2008 were $283 million, up 24.7 percent from the previous year. Corresponding U.S. imports from Sri Lanka were $2 billion, down 5.0 percent. Sri Lanka is currently the 116th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Sri Lanka was $80 million in 2007 (latest data available), up from $69 million in 2006.

IMPORT POLICIES

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

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

Import Charges

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

Currently in Sri Lanka, there are five tariff bands: 0 percent; 2.5 percent; 6 percent; 15 percent; and 28 percent. Textiles, pharmaceuticals, and medical equipment are duty free. Basic raw materials are generally assessed a 2.5 percent duty. Semi-processed raw material tariffs are 6 percent, while intermediate product tariffs are 15 percent. Most finished product tariffs are 28 percent. There are also a number of deviations from the five band tariff policy. Some items are subject to an *ad valorem* or a specific duty, whichever is higher, and there is intermittent use of exemptions and waivers. In addition, there are specific charges on certain imported items, including footwear, ceramic products, and agricultural products. In 2007 the government raised taxes on imported textiles by imposing an Export Development Board Levy (often referred to as a cess) of 50 Rupees (approximately $0.50) per kilogram on imported textiles not intended for use by the apparel export industry. Currently, apparel imports are subject to a 15 percent import duty, a 30 percent or Rs 75 per unit cess, a 15 percent Value Added Tax (VAT), a 3 percent Ports and Airports Levy, and a 1.5 percent Social Responsibility Levy. Beginning January 1, 2009, the VAT on apparel imports will be reduced to 12 percent and the Ports and Airports Levy will increase to 5 percent. A new Nation Building Levy of 1 percent will also come into force on all imports, including apparel and textiles.

In addition to tariffs, a variety of taxes introduced (see below) in the past several years have effectively increased Sri Lanka's tax rates on a range of imported items to between 60 percent and 100 percent of the cost, insurance, and freight (CIF) value of the product. The government has imposed these charges on imports primarily to raise revenue, to defray the costs of specific government services, or to promote local producers. Most of these charges were revised upwards effective November 2007, and again in November 2008. In addition, the government imposed a new Nation Building Tax of 1 percent on imports that came into effect on January 1, 2009; it will be in effect for two years. The frequent changes (mostly upward) in 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.

Other charges on imports include:

- An Export Development Board (EDB) levy, ranging from 10 percent to 35 percent *ad valorem* on a range of imports identified as "nonessential." Most of the items are subject to specific duties as well; for example, shampoo (35 percent or Rs 150 per kg), apparel (30 percent or Rs 75 per unit), biscuits (35 percent or Rs 60 per kg) and oranges (20 percent or Rs 15 per kg). Whichever levy is higher – percentage versus a flat rate – is applied. Also, when calculating the EDB levy, an imputed profit margin of 10 percent is added onto the import price. 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. The EDB levy on most imports was increased by increasing the specific duties (unit rate) in November 2008.

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

- A Ports and Airports Development Levy of 3 percent on imports (increased from 2.5 percent in January 2007; this tax will be increased from 3 percent to 5 percent from January 1, 2009).

- A VAT of 0 percent, 5 percent, 15 percent, or 20 percent. When calculating the VAT, an imputed profit margin of 10 percent (increased from 7 percent on January 1, 2007) is added on to the import price. Locally manufactured products are also subject to VAT but not the imputed profit margin. (The VAT rates of 5 percent and 15 percent are to be replaced with a VAT band of 12 percent with effect from January 1, 2009.)

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

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

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

A regional infrastructure fee of 5 percent, 7.5 percent or 10 percent (based on engine capacity) is imposed on automobiles. This tax, first introduced in January 2007 at a flat rate of 2.5 percent, was increased in 2008 to 5 percent.

In October and November 2008, the Central Bank introduced limits on forward contracts for the sale and purchase of foreign exchange, prevented prepayments on import bills, and imposed a 100 percent deposit requirement on Letters of Credit for the import of non-essential items. The list includes confectionary, chocolates, personal care products, electrical items, tableware, apparel, footwear, lighting products and watches. In the case of motor vehicle imports, the deposit requirement is 200 percent of the import value.

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

The U.S. Government engaged in bilateral Trade and Investment Framework Agreement (TIFA) talks with the government of Sri Lanka in May 2008. The United States stressed the importance of reducing Sri Lanka's high tariffs on agricultural products; opening the Sri Lankan market for U.S. agricultural biotechnology products; providing more certainty and transparency in Sri Lanka's government procurement, and integrating U.S. technical assistance into the government of Sri Lanka's overall intellectual property rights enforcement plan.

Import Licensing

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

Customs Administration

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

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Standards

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

Laws Governing Genetically-Engineered (GE) Food

In January 2007, the Ministry of Health established a regulation for the import, sale and mandatory labeling of GE food products. This regulation is moving towards full implementation. Sri Lankan importers have raised several concerns about the regulation, including that conformity with a 1 percent GE content labeling threshold would be costly. Additionally, importers fear bureaucratic procedures and delays in granting approvals may obstruct and limit future imports of GE products. They also fear that mandatory labeling could needlessly raise consumer concerns with biotechnology. As a result, some businesses have stopped importing GE products altogether. During May 2008 discussions under the United States-Sri Lanka TIFA, the United States raised its concerns regarding Sri Lanka's mandatory labeling requirement, noting a lack of scientific justification and that it would act as a nontariff barrier. In November 2008, a United Nations World Food Program shipment of donated U.S. rice was rejected by Sri Lankan authorities citing unsubstantiated risks from consuming GE products.

Sri Lanka also requires regulatory approval of foods with 1 percent or more GE content. No approvals have been issued. Soybean and corn food imports must therefore be certified as non-GE products. The government has not provided any scientific justification for the certification requirement. The U.S. Government has requested that the non-GE labeling regulation be suspended pending full implementation of a science-based risk assessment system to appropriately evaluate the health and safety of products produced using biotechnology. In addition, the non-GE certification requirement is inconsistent with the National Biosafety Framework of Sri Lanka, and the United States has noted this discrepancy.

Sanitary and Phytosanitary (SPS) Measures

Sri Lanka has banned the importation of U.S. chicken meat, which is not mechanically deboned, for other than food safety reasons. Additionally, Sri Lanka had imposed avian influenza bans on all U.S. poultry and poultry products from the following states: Nebraska, Montana, Delaware, West Virginia, Maryland, Illinois, Michigan, New Jersey, Pennsylvania, Virginia and Arkansas. These bans are believed to have been imposed due to detections of low pathogenicity avian influenza (LPAI) in wild or domestic birds in the United States; but Sri Lanka did not provide notification or justification for the bans. The United States provided information regarding the current status of avian influenza in the United States as well as information supporting its assertion that the World Organization for Animal Health (OIE) does not recommend trade bans based on detections of avian influenza in wild birds, or on poultry meat based on detections of LPAI in any birds.

In July 2008, Sri Lanka withdrew its avian influenza ban on imports from several U.S. states (Nebraska, Montana, Delaware, West Virginia, Maryland, Illinois, Michigan, New Jersey, and Pennsylvania). Until recently, avian influenza bans remained on poultry from Virginia and Arkansas. In February 2009, the Sri Lankan Department of Animal Production and Health lifted the avian influenza bans on poultry imports from Virginia and Arkansas. However, the avian influenza ban remains on poultry from Idaho as a result of April 2008 LPAI detection.

In addition to the avian influenza bans, a ban on imports of beef from the United States is maintained, due to the detection of bovine spongiform encephalopathy in the United States in 2003. As noted above, many of the prohibitions imposed by local health authorities differ from the guidelines and recommendations of the OIE's guidelines for meat and poultry.

Sri Lanka lifted a ban on imports of seed potato from the United States in March 2007, initially instituted due to fears that the Colorado Potato Beetle (CPB) could have been introduced into Sri Lanka by these imports. However, Sri Lanka now requires a certificate from a plant entomologist stating that the CPB does not exist in the potato tuber to accompany the seed potato imports. The United States has pressed for the removal of this certificate requirement on the grounds that it was not scientifically justified. In July 2008, Sri Lankan officials visited the U.S. potato industry to further review the issue. It is hoped that as a result of this visit, the issue will be resolved and a visual inspection at the time of shipment will be considered sufficient to address any concerns. Although this issue may be addressed, recent 2008 import permits have included overly restrictive virus tolerances and requirements on generations of seed potatoes. There is concern that the generation requirements are not being applied to seed potatoes imported from other markets such as Europe. The CPB area freedom certificate, virus tolerances, and restrictive generation requirements all need to be addressed before the Sri Lankan market can grow into a strong commercial export market for U.S. seed potatoes.

GOVERNMENT PROCUREMENT

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

The government publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards are common. In 2006, Sri Lanka published new guidelines, as well as a new procurement manual, to improve the public procurement process. However, in early 2008 the government disbanded the National Procurement Agency, which it had established in 2004, and shifted its functions to a unit in the Ministry of Finance. This move has raised concerns about the government's commitment to improve the transparency of procurements.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

In 2003, Sri Lanka's new intellectual property law – governing copyrights, patents, trademarks, and industrial design – came into force. Under the new law, IPR infringement is a criminal offense and IPR infringement is subject to both criminal and civil jurisdiction. Sri Lanka also passed a new Computer Crimes Act in 2007 strengthening Sri Lanka's IPR regime pertaining to software.

Notwithstanding the new laws, weak IPR enforcement remains a problem. Piracy levels are very high for sound recordings and software. According to a study commissioned in 2006 by the Business Software Alliance, 90 percent of personal computers in Sri Lanka used pirated software. The study estimated retail revenue losses of $86 million in 2006 (latest data available) due to software piracy. Further, government use of unauthorized software continues to be a problem.

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 2008, the Business Software Alliance successfully worked with government authorities to increase prosecutions for IPR infringement in the software sector. In the apparel sector, right holders have scored some legal successes in combating trademark counterfeiting.

The Sri Lankan Government's Director of Intellectual Property along with international experts has begun IPR legal and enforcement training for customs, judicial and police officials. The U.S. Embassy, the American Chamber of Commerce of Sri Lanka, and the European Chamber of Commerce are also working with the government of Sri Lanka to improve enforcement, provide enforcement training, and enhance public awareness.

SERVICES

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. Sri Lanka allows 100 percent foreign ownership for locally incorporated insurance firms, but branching is not allowed. Although Sri Lanka's insurance regulatory body has the authority to establish minimum and maximum premiums for motor, fire and employers liability policies, in practice these premiums are not regulated. In early 2008, the Sri Lankan government implemented a new regulation requiring all insurance companies to reinsure 20 percent of their insurance business with a state-run insurance fund.

Telecommunications

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

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

Broadcasting

The government imposes taxes on foreign movies, programs, and commercials to be shown on television, ranging from Rs 25,000 (approximately $250) for an imported English-language movie to Rs 90,000 (approximately $900) per half hour of a foreign-language program dubbed in the local language Sinhala. Foreign television commercials are taxed at Rs 500,000 (approximately $5,000) per year. Rates for non-English foreign programming are higher. Government approval is required for all foreign films and programs shown on television.

Professional Services

There is no formal national policy on liberalization of professional services. In practice, many foreign doctors, nurses, engineers, architects, and accountants work in Sri Lanka. Most of them are employed by foreign companies. Unless the government has recognized a foreign national's professional qualifications, such professional cannot sign documents presented to government institutions or regulatory bodies.

The Immigration Department grants resident visas for foreign professionals whose services are required for projects approved by the government or by companies approved by the Board of Investment (BOI). Non-BOI companies, such as banks, can also employ foreign staff; however, in practice the Immigration Department has limited the number of resident visas to levels below those desired by companies.

Legal Services

Any person, including foreigners, can provide legal consultancy services without being licensed to practice law in Sri Lanka. Only Sri Lankan citizens can register in the Supreme Court and practice law (*i.e.*, appear in courts) in Sri Lanka.

INVESTMENT BARRIERS

While Sri Lanka welcomes foreign investment, there are restrictions in a wide range of sectors. Foreign investment is not permitted in the following areas:

- nonbank money lending;
- pawn brokering;
- retail trade with a capital investment of less than $1 million (with one notable exception: the BOI permits retail and wholesale trading by reputable international brand names and franchises with an initial investment of not less than $150,000);
- coastal fishing;
- education of students under 14 years of age for local examinations; and
- local degree-awarding university education (institutions awarding overseas degrees are permitted).

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

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

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

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