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Sri Lanka's Trade Policy: Reverting to Dirigisme?

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Abstract

This paper surveys recent development in Sri Lankan trade policy, with an emphasis on emerging protectionist tendencies, using Sri Lanka's Trade Policy Review (2010) by the World Trade Organization as a reference point. The Sri Lankan experience for over the three decades following the liberalization reforms started in 1977 has clearly demonstrated that an outward-oriented policy regime can yield a superior development outcome compared to a closed-economy regime, even under severe strains of a protracted ethnic conflict and macroeconomic instability. Viewed against this back drop, recent developments in the Sri Lankan policy scene do not seem to augur well for the future of the Sri Lankan economy.

Key words: Sri Lanka, trade policy, trade liberalization, World Trade Organization.

JEL Codes: F13, F14, O24, O53

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1. INTRODUCTION

Sri Lanka is one of the early liberalizers in the developing world. In 1977 it embarked on an extensive economic liberalization process in response to the dismal economic outcome of the protectionist import-substitution trade policies pursued over previous three decades. Notwithstanding political regime shifts and civil war, the reforms were sustained and broadened in the next two decades. By the mid-1990s Sri Lanka ranked amongst the few developing countries that had made a clear policy transition from inward orientation to global economic integration (Sachs and Warner 1995). The reforms changed Sri Lanka from a highly introverted economy to one that comes reasonably close to exploiting gains from specialization in labour intensive manufactures. There were considerable economic benefits in terms of the growth of GDP and increase in the demand for labour that would have reduced the number of persons in absolute poverty. These gains were substantial enough to make commitment to an open trade regime a bipartisan policy by the mid-1990s. However over the past decade the political climate has become increasingly sceptical of the merits of broad-based market-oriented liberalisation reforms. In particular, following ending of the civil war in June 2009, the government has become increasingly receptive to populist and protectionist policies. Consequently the overall restrictiveness and selectivity of trade and industry policy has begun to increase.

The purpose of this paper is to survey recent development in Sri Lankan trade policy, with an emphasis on emerging protectionist tendencies, using Sri Lanka's Trade Policy Review (2010) by the World Trade Organisation (WTO) (henceforth reference to as SLTPR-2010) as a vantage point.[1] The paper is mainly motivated by the need to systematically assess new developments in trade and industry policy in Sri Lanka and their likely implications for the sustainability of the achievements of past liberalisation reforms in order to inform the contemporary policy debate in the country. It also hopes to contribute to the on-going discussion on how to improve periodic assessment of trade policy regimes of member

[1]This is the third review of Sri Lankan trade policy conducted by the WTO under its Trade Policy review Mechanism. The two previous reviews were conducted in 1995 and 2004.

countries, with a view to strengthening the Trade Policy Review Mechanism (TPRM) of the WTO (Gosh 2011).

The paper is structured as follows. Section 2 briefly chronicles trade policy shifts in Sri Lanka since independence to provide the context for the ensuing analysis. Section 3 reviews recent developments in the Sri Lankan economy with a focus on international dimensions of macroeconomic performance. The next four sections discuss the principle issues highlighted in the report under the following headings: measures directly affecting imports, export taxes and incentives, foreign direct investment, and some selected issues relating to the overall economic policy environment which impact on trade and investment. In each section, we summarise the report, update some of its analysis, and point to policy issues that were overlooked in the report. The final section makes some concluding remarks against the tasks assigned to individual-country trade policy reviews under the TPRM.

2. POLICY CONTEXT

During the first decade after independence in 1948, Sri Lanka (commonly called Ceylon until 1972) continued as an open trading nation with only relatively minor trade and exchange rate restrictions. From the late 1950s, a combination of the influence of the state of development thinking at the time, change in political leadership and balance of payments difficulties led to the adoption of a state-led import substitution development strategy. By the mid-1970s the Sri Lankan economy was one of the most inward-oriented and regulated outside the communist bloc, characterized by stringent trade and exchange controls and pervasive state interventions in all areas of economic activity.[2]

At the time of independence Sri Lanka was regarded by many as one of Asia's most promising new nations. It was favoured with many early advantages which were not shared by most other Asian countries: a vibrant export sector, relatively high level of education, good physical infrastructure, and a broad-based and efficient administrative apparatus. However, this early promise was not sustained. Until about the late 1960s Sri Lanka's per

[2] Sri Lanka's post-independence policy history has been well documented: Rajapatirana (1989), Athukorala and Jayasuriya (1994), More (1997), Dunham and Kelegama (1997), Snodgrass (1998) and Athukorala and Rajapatirana (2000). For a review of the Sri Lankan experience with trade policy reforms from a comparative South Asian perspective, see Panagariya (2002).

capita income (purchasing power adjusted) was much higher than those of Thailand and South Korea, and only marginally lower than that of Malaysia (Athukorala and Rajapatirana 2000, Table 1). From then on Sri Lanka slipped below these and many other countries, rapidly converging to the levels of her two South Asian neighbours and becoming a member of the 'low-income' country category according to the country classification adopted by the World Bank.

As a reaction to the dismal economic outcome of the inward-looking policy, the right-wing United Nation Party (UNP) which came to power in 1977 embarked on an extensive economic liberalization process. Sri Lanka was the first country in South Asia to undergo such policy transition (Panagariya 2002). The first round of reforms carried out during 1977-79 included a significant trade reform: supplanting quantitative restrictions on imports with tariffs and revising the tariff structure to achieve greater uniformity; lifting of price controls on domestic trade; opening up the economy to foreign direct investment (FDI), with new incentives for export-oriented foreign investment under an attractive Free Trade Zone (FTZ) scheme; the unification of the exchange rate followed by a sharp devaluation; financial reform: adjusting interest rates to levels above the rate of inflation, opening the banking sector to foreign banks and freeing credit markets to determine interest rates; and the abolition of state enterprise monopolies over the imports of a number of key commodities and the introduction of limits on public sector participation in the economy.

The reform process lost momentum in the early 1980s, first because of an unfortunate shift in policy priorities towards politically appealing glamour investment projects, and subsequently owing to the onset of the ethnic conflict in 1983 between Sinhalese-dominated Government of Sri Lanka and the Tamil militants.[3] There was, however, no retreat to the old control regime. In a decisive move to infuse momentum to the unfinished reform process, a significant 'second wave' liberalization package was implemented in 1990. This included an ambitious privatization program, further tariff cuts and simplification of the tariff structure, removing exchange controls on current account transactions and several important changes to the foreign investment policy framework in line with the increased outward orientation of the economy, and a more flexible exchange rate regime. By the mid-1990s Sri Lanka had become one of the most open economies in the developing world.

[3]For discussions on the ethnic conflict in Sri Lanka see Rotberg (1998) and Richardson (2005). Abeyratne (2004) provides a penetrating analysis of how lack-lustre economic performance during the era of economic dirigisme contributed to the onset of the conflict.

After 17 years in government, the United National Party (UNP) lost power at the 1994 general elections to the Peoples' Alliance (PA), a centre-left coalition led by the Sri Lanka Freedom Party (SLFP) which had governed the country during most of the era of economic dirigisme. However, there was no significant change in the broad direction of economic policies; the gains from export-oriented industrialization had been impressive enough to set the stage for 'leading the left to the right' (More 1997, p. 1009). In fact, the liberalization process, particularly in the privatization area, accelerated under the new regime. Further tariff reform, in particular progressively harmonizing the tariff structure towards a single band over the medium term was a key element of PA government's policy reform package. An important dimension of this positive aspect was the shaping of expectations by foreshadowing changes and then delivering the changes. All in all, by the mid-1990s Sri Lanka appeared to be 'at the point of moving into an important policy phase marked by shifting the agenda away from protection and towards achieving a stable and predictable economic policy environment' (Cuthbertson 1997, P. 47).

Sri Lanka's ability to reap benefits from this remarkable policy transition was seriously hampered by the escalation of the civil strife. During 1983-2009 the economy continued to be burdened by the massive military expenditure (which increased from 1% to 9% of GDP between 1984 and 2008)[4] and its consequences for macroeconomic instability. The Northern Province and large parts of the eastern province (which together account for one-third of Sri Lanka's total land area and almost 12% of the population) remained mostly cut off from the national economy. Even in the rest of the country, prospects for attracting foreign investment, particularly in long-term ventures, was seriously hampered by the lingering fear of sporadic attacks by the rebels. The government's preoccupation with the civil war also hampered capturing the full benefits of economic opening through delays and inconsistencies in the implementation of the reform processes.

Despite these unsettled conditions, the reforms dramatically transformed the economic landscape of Sri Lanka. The share of manufacturing in GDP rose from around 10% in the mid-1970s to over 20% (about two percentage points higher than the share of agriculture) by the dawn of the New Millennium. The export structure of the economy underwent a remarkable transformation from land-intensive, plantation exports to labour-intensive manufacturing. The share of manufacturing in total merchandise trade increased

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[4] Unless otherwise stated, the data reported in the paper are from, Central Bank of Sri Lanka, *Annual Report* (various issues).

from 5% in the mid-1970s to over 70% in the same period, ending the historic dependence on three primary commodities (tea, rubber and coconut products). This successful diversification of the export structure effectively ended the prolonged (1955–1975) deterioration of the terms of trade. Export-oriented manufacturing sector emerged as the major generator of employment opportunities in the economy, accounting for over a half of total employment growth during the 1980s and 1990s. With the gradual erosion of the dominant role of state-owned enterprises (SOE) the private sector was largely responsible for economic dynamism of the country. In a summing up of the Sri Lankan experience under market-oriented policy reforms, World Bank's *Sri Lanka Development Policy Review* of 2004 noted that 'It would be hard to find a more convincing case of trade and industrial transformation of a small island economy through market-friendly policy reforms' (World Bank 2004).

Notwithstanding these achievements, there has been a back-sliding from liberalisation reforms since the beginning of this decade. Initially, trade liberalisation process suffered a setback because of the pressure for raising additional revenue from import tariffs to finance the ballooning war budget. The planned reduction of tariffs into a single band had been abandoned by the late 1990s and from then on tariffs were changed frequently in an ad hoc manner. The protectionist tendencies soon received added impetus from the growing discontent amongst the electorate, propelled by the crisis economic conditions as the civil war accelerated. The anti-liberalisation lobby (dominated by senior academic economists) begun to portray failure of the gains from reforms to meet initial expectations as an intrinsic flaw of 'neo-liberal' reforms, while downplaying (or overlooking) the importance of taking into account incomplete and staggered nature of the reform process in assessing the actual outcome (Rajapatirana 2004). The anti-liberalisation lobby also received added impetus from the backlash against economic globalisation and 'Washington Consensus' in international policy circles.

These developments set the stage for Mahinda Rajapakse, who had long been one of the most active, campaigning member of SLFP, to win the presidential election of November 2005,[5]by promising a 'new vision' for achieving 'balanced growth' (Department of National Planning 2006). The proposed development strategy emphasised the role of the state in

[5] With the support of the Janatha Vimukthi Peramuna (People's Liberation Front), a Sinhala Nationalist Left-wing party and the Jathika Hela Urumaya (National Heritage Party), a party led by Buddhist monks, in addition to the support of the erstwhile left-wing allies of the PA.

'guiding the markets' in redressing untoward effects of economic globalisation and effectively ruled out privatisation of the key remaining state enterprises, while conspicuously avoiding any reference to further trade liberalisation.

The country returned to a state of normalcy at the end of the 30-decade old civil war in May 2009. On the back of the military victory, President Rajapakse consolidated power by calling fresh presidential and parliamentary elections in 2010 and winning both decisively. Immediately after the elections, the constitution was amended removing the two-term limit on the tenure of the president. One of the main arguments advanced in defense of this legislation was that the country needed a strong executive to facilitate the development of the economy under the new state-led approach (Uyangoada 2010).

3. ECONOMIC ENVIRONMENT

Chapters II to IV of the TSLTPR-2010 provide a comprehensive overview of Sri Lanka's economic performance since the previous WTO review a background to the analysis of trade and investment policy. Table 1 summarizes the relevant data presented in these chapters, while updating the statistics to 2010 and filling some gaps.

During the review period (2004-2010) performance of the Sri Lankan economy was adversely affected by the Indian Ocean Tsunami in December 2004, and surge in world oil and food prices during 2007-2008 and the global financial crisis that followed. Despite these external shocks, and the intensification of the civil war at its final stage, the Sri Lankan economy expanded by an annual average rate of 6.5% during this period. Per capita income almost doubled between 2004 and 2009, from US$1,062 to US$2,053. The rate of inflation came down from 22.5% in 2008 to 5% in 2010. The unemployment rate fell from 8.3% in 2004 to 4.4% in 2010. Foreign reserve position of the country improved substantially and external debt continued to remain at a manageable level, around 80% of GDP. Based on these generally positive indicators, SLTPR-2010 concludes that 'the performance of Sri Lanka's economy during the period under study was strong,' and predicts that 'The end of the internal conflict [will] offer new growth opportunities, particularly in the short- to medium-term' (p. viii). However, when we go beneath these indicators and analyze the growth process in the context of the overall performance of the economy during the reform era, there are a several qualifications to this rosy picture.

First, relating to the overall performance of the economy, growth has come predominantly from non-tradable sectors ─ construction, transport, utilities, trade and other services ─ propelled largely by public sector investment. These sectors accounted for over two-thirds of the total increment in real GDP between 2004 and 2009. Manufacturing grew only at a modest rate, resulting in a decline in its share in GDP from 18.5% during 2000-04 to 17.5% during 2005-2009. Within manufacturing, the largest contributor to growth has been the food, beverages and tobacco product sector where the production is predominantly domestic market oriented; Sectors such as textile and garment, rubber and plastic products, and non-metallic mineral products where export production is concentrated, have recorded much slower growth. Thus the inference that 'the sectoral composition of Sri Lanka's economy has not changed significantly since its last Review' (p. 5) is not consistent with the actual data.

Second, the doubling of per capita income in current US$ terms during this period partly reflects domestic inflation and artificial stability of the exchange rate of the Sri Lankan rupee against the dollar (see below). When the data are expressed in real (2000) prices in order to allow for these factors, the increase is per capital income in 2009 (US$ 1240) was only 30% higher than that in 2004 (US$ 959) (Figure 1).

Third, the decline in the unemployment rate was largely due to increase in public sector recruitments, in a context where total recorded employment in the formal private sector remained virtually stagnant. In a dramatic reversal of the contraction in the size of the public sector workforce maintained over the previous decade, total employment in the public sector increased from around 900,000 in to over 1.2 million in 2010 (Government of Sri Lanka 2011). Another contributory factor was the increase in the number of people leaving the country in search of overseas employment (mostly on short-term employment contracts) which contributed to the decline in the domestic unemployment rate. By 2010 an estimated 1.2 million Sri Lankan's were employed overseas as contract migrant workers (IPS 2011).

Fourth, improvement in the external reserve position occurred only after the signing of a Stand-By Agreement (SBA) in mid-2009 for a total of US$2.9 billion (IMF 2012). By late 2008, the country was on the brink of a balance of payments crisis: foreign reserves were approaching alarming levels, external debt was rising and the Central Bank was struggling to meet debt servicing commitments. The government had no alternative but to go the IMF and negotiate a SBA. The SBA helped Sri Lanka to avoid a balance-of-payments crisis, build foreign exchange reserves and improve investor confidence.[6] The current account deficit, which is obviously a more important indicator of the soundness of the external payment position of a country,

[6]Following the signing of the SBA, Standard and Poor's and Moody upgraded Sri Lanka's foreign currency rating, while Fitch upgraded sovereign rating (EIU 2011).

continued to remain stubbornly high throughout this period. This was an outcome of lackluster export performance. Exports as a share of GDP declined from 30% in 2004 to 17% in 2010, while imports continued around 35% of GDP in spite of the decline in world commodity prices during 2008-09.

Fifth, the widening current account deficit was underpinned by a persistent appreciation of the real exchange rate. The stated objective of government's macroeconomic policy was to achieve a 'stable exchange rate regime' through appropriate coordination of exchange rate policy, and fiscal and monetary policies (Department of National Planning 2010). But, in reality, while the Central Bank managed to maintain a stable nominal exchange rate based on the balance of payments support provided under the SBA, and foreign borrowing based on the market-confidence provided by the SBA,[7] fiscal and monetary policy excesses continued to fuel domestic inflation. In the face of widening current account deficit and rapid deflation of foreign exchange reserves, in February 2012 the Central Bank was forced to abandon foreign exchange market intervention to back up the exchange rate. By mid-2102, the rupee had depreciated by 25% against the US dollar. Whether this nominal exchange rate adjustment would bring about necessary current account adjustment through real exchange depreciation or will the country sink into a debt trap and eventual financial crisis depends very much on the government's readiness to engineer necessary adjustment on the domestic fiscal front.

Finally, on the fiscal front, the budget deficit as a percentage of GDP increased from 7.7% in 2008 to 9.9% in 2010, far above the 7% target for the year under the SBA. Achieving the SBA target necessitated cutting public spending, but the government failed to resist strong domestic pressure to increase expenditure on civil service and armed forces, which constituted important voter bases. Loss-making public enterprises also continued to remain a huge drain on the fiscal position. Notwithstanding the ballooning budget deficit, the central government's debt as a percentage of GDP remained within apparently manageable level (around 86%), but this was a rather deceptive indicator of fiscal health of the country: a shift in government borrowing from relatively high-cost domestic to foreign sources combined with the 'stable rupee policy'

[7]There was also some foreign fund flows to the treasury bill market following the opening of that market to foreign investors (with an aggregate ceiling of 10% of the outstanding treasury bill issues) (CBSL 2010).

resulted in reduction of the external debt stock in rupee terms.[8] Funds generated through the sovereign bond issues were used to retire part of high-cost domestic debt

4. POLICY MEASURES DIRECTLY AFFECTING IMPORTS

SLTPR-2012 observes that 'Sri Lanka has a fairly open and transparent trade regime, characterized by reliance on price-based measures and scant-use of non-tariff measures and, in general, relatively low tariffs' (P vii) and 'Sri Lanka's main trade-policy thrust continues to be aimed at achieving greater integration into the world economy' (P viii). However, this inference is not consistent with what one would learn by a careful reading of the material presented in the text of the report. There are a number of new developments which have a direct bearing on the degree of protection and predictability of the trade regime.

First, the scope and level of tariff bindings have remained unchanged since 2004. Bound tariff line (at HS 6 digit level) accounts for only 36.4% of the total tariff lines and the bound rates range from 0 to 75%. Bound rates greatly exceed their applied rates: the average bound rate is 32.7%, compared with an average MNF rate of 11.5%. By mid-2010 some 103 HS applied tariff lines exceeded their bound rate, affecting mostly tobacco products, textiles, carpets, ploughs and switches.

Second, even though the bulk of tariff lines are still ad valorem, tariff lines subject to specific duties (which are naturally less transparent) has increased from 1.3% to 3.9% between 2004 and 2009. The new specific duties are heavily concentrated in agricultural products such as rice, onions and potato.

Third, it is true that by the standards of the average developing country 'Sri Lanka's use of non-tariff barriers is relatively limited' (P x), but there has been a notable increase in NTBs since 2000, particularly relating to agricultural products. Politically 'sensitive products' such as rice, potatoes have been subjected to special import licensing under which the volume of imports permitted is subject to frequent changes.

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[8] The Central Bank raised US$2000 million through sovereign bond issues during 2007-2010 at an interest rates of 6.25-6.5% (with is almost half of the rate applicable to domestic borrowing) (CBSL 2010). In addition there was massive borrowing from China, mostly at concessional rates, to fund infrastructure projects.

Fourth, the degree of escalation of tariffs (or the cascading nature of tariffs) seems to have increased in recent years, with the maximum rate applied to products (mainly final consumer goods) that the government wishes to protect, and lower taxes on semi-processed goods, raw materials for which there is no competing domestic production. The proportion of duty-free tariff lines increased from 10% to 44.4% and those with 30% or more rates increased from 5% to 20% between 2004 and 2009. Fifth, and more importantly, the remarkable stability of the simple average tariff rate (which remained virtually at the same level in 2010 as in 2004 (9.85) notwithstanding an erratic jump to 12% in 2009), is very deceptive because it excluded numerous other import taxes introduced during this periods to raise revenue, to defray the costs of specific government services, or to promote local producer (SLTPR-2010, pp. 44-51, Table 111.8)

By 2009 the Sri Lankan tariff schedule included nine import taxes in addition to the standard customs duty. Of these nine taxes, five were ‘para-tariffs’: taxes which are only applied to imports and there is no domestic equivalent, and hence add to whatever protection is provided to domestic production by customs duties. These are the ports and airport development levy (5% of the CIF value of imports), the customs (import duty) surcharge (charged as 15% of import duty), the Export Development Board cess (ranging from 10% to 35%; levied on the CIF value plus a 10% imputed profit margin), the regional infrastructure development levy (applied on automobile imports as 5%, 7.5% or 10% of FOB value, based on engine capacity). The four remaining import taxes have domestic equivalent or approximately equivalent taxes, and thus can be treated roughly as neutral in terms of protection. These are the value added tax (12% to 20%), the Social Responsibility Levy (1.5% of import duty, other import surcharges and excise duties), the nation building tax (3%, payable on a self-assessment basis by importers, manufacturers and service providers with a quarterly turnover exceeding Rs 650,000) and excise duty (7% until 2007 and 10% since October 2007). In addition to these, there is a ‘special commodity levy on imports of a small number of ‘essential’ commodities. These are specific duties which replace all other import taxes. Sri Lanka is perhaps the only country in the world to have such a complex tariff system. As the calculations reported in Table 111.8 in SLTPR-2010 show, when both the standard Customs duties and all these export taxes were taken together the un-weighted average total protection rate turned out to be as high as 31% (compared to the standard customs duty rate of 12%)

Pursell and Ahsan (2011)[9] have undertaken a systematic comparison of Sri Lanka's tariff structure as at November 2002, January 2004, 2009 and January 2011 by taking into account both normal import duties and the five para-tariffs.[10] Their estimates are summarized in Table 3. According to these estimates the total (Customs duty + para-tariff) protection rate, went up slightly between late 2002 and early 2004, but then more than doubled between 2004 and 2009. The average protection rate for agriculture increased from 28.1% to 49.6%, for industrial products from 10.7% to 24.1%, and for all imports lines from 13.4% to 27.9%. These protection rates are very high by world standards and suggest that Sri Lanka's previously long term declining trend in average tariffs which started in about 1982 and continued until the turn of the 20th century have clearly reversed. Nearly all of the dramatic increase in the average protectiveness of the import tax system is attributable to extra protection provided by para-tariffs.

Disaggregated data reported in Pursell and Ahsan (2011) suggest that after allowing for para-tariffs the protective structure has become even more complex, with 75 different total protection rates ranging from zero to more than 90%. A large number (42%) of industrial tariff lines have low TPRs of below 10%, while a third (32.2%) of tariff lines have TPRs of 35% or higher, with many clustering in the range of 35% to 60%.. Almost 40% of agricultural TRPs are within a range of 70% to 80%, while only a few (6.7%) are below 10%. The TRPs on almost half (46.1%) of agricultural tariff lines exceed 50%, clearly breaching Sri Lanka's Uruguay Round commitment which bound nearly all agricultural tariffs at 50%.

SLTPR-2010 observes that 'fiscal revenue considerations have played a role in the determination of trade policy during the review period' (P. 18). However, it has stopped short of examining the validity of this reason for justifying protection. Interestingly, despite the general increase in tariffs, the average annual duty collection rate (import duty collection as a percentage of recorded imports) declined from 5.5% during 2000-04 to 5.1% during 2005-2009. There are three possible reasons which deserve further scrutiny as to why tariff revenue fell substantially in the face of tariff increases.

First it could be that very high tariff levels are prohibitive and kill imports, so that bringing them down into the range where imports materialize gain is a sure-fire way to increase

[9] See also Pursell (2011a) and (2011b) for syntheses of key findings of this study.

[10] In estimating total protection rate Pursell and Ahsan (2011) and only para-tariffs to custom duties, excluding the other export taxes which have an equal domestic counterpart and hence are probably con-protective.

revenues. Second, some of the products subject to high tariff rates are subject to duty-free entry under various incentive schemes for supporting domestic manufacturers. Third, and perhaps more importantly, importers evade high import duties. Duty evasion could take place in the form of outright smuggling and bribing customs officials to accept faked invoices or to classify imports under lower duty slabs. Also, under a cascading tariff structure in which tariffs on parts and components (inputs) are much lower compared those on final (assembled) products importers can reduce duty payments by importing some final product in separate components. Such practice is facilitated by the ongoing process of global production sharing (international production fragmentation) — the break-up of the production process into geographically separated tasks, particularly in electrical goods and electronics (Athukorala 2004). There is, indeed, evidence from other countries that tariff reduction can in fact lead to increased government revenue by both increasing total import duty collection and broadening the domestic tax base (Pritchet and Seth 1994, Greenaway and Milner 1991).

5. EXPORT DUTIES AND INCENTIVES

Prior to the liberalization reforms initiated in 1977, taxation of traditional exports was a major source of government revenue in Sri Lanka. Export duties on the principal agricultural commodities were reduced in successive stages and virtually removed in 1993. Export duties as a share of government revenue fell from 20% in 1980 to virtually zero by 1995. Currently, export duties are levied only on value-added vein quarts (HS 2506.10.90) and raw vein quarts (HS 2506.10.10) (zero if the price exceeds US$300 per ton, 14% of the FOB value if the price is below that threshold).

Exporters of non-traditional goods exporting at least 80% of their production also enjoy a number of tax concessions, including preferential income tax rates on export profits, and a full tax holiday between three and seven years for new investment. These concessions are also extended to service providers that export at least 70% of turnover. Export Development Board is authorised provide subsidised loan grants to direct, indirect and potential exporters for up to Rs 1 million (US$8900) per project. There are also a Duty drawback scheme, a temporary importation for export processing scheme (TEP), and a manufacturing-in-bond scheme operated by the Customs. Under the duty rebate scheme, only custom duties and import surcharges are refundable; the cess, excise duties, the PAL, and other duties levied on imports are not included. Locating an enterprise in an EPZ entitles a company to tax holidays, duty free imports, and concessionary land prices.

The only new item added to the existing export incentives during the review period was an economic stimulus package of Rs 16 billion (some US$140 million) introduced in January 2009 with the aim of cushioning exporters against adverse impact of currency appreciation and difficult world demand conditions in the aftermaths of the onset of the global financial crisis. The package included an Export Development Reward Scheme under which a 5% rebate is provided to industrial exporters that maintain export earnings, employment and output (value added) at least at a level equivalent to that of 2008 (exporters may either apply for cash or set off the rebate against their taxes). It also provided for the removal of a 15% surcharge of electricity for apparel, rubber, and tourism industries. There is little evidence to suggest that these selective incentives have been successful in boosting exports. Institution of a battery of incentives may not do much to promote exports, simply because they are in the nature of antidotes to distortions present elsewhere in the economy. Introducing a new distortion in the form of export promotion scheme in order to correct existing distortions can cause more harm than good for the promotion of exports.

The government budget of 2011 introduced new export taxes on tea and rubber exported in raw and semi processed form (Government of Sri Lanka 2010). The stated rationale behind such a policy stance was domestic value addition from these products through resource-based industrialisation. There is however no presumption that the expected reduction in domestic market price of these products per se would promote resource-based industrialisation. The dominant costs in most resource-based industries are capital charges rather that raw material inputs (Roemer 1979). It is important to note that during the closed-economy era, almost the entire domestic production of tea and rubber (and other primary exports) were exported in raw form in spite of the fact that the rate of export tax was much higher than the newly proposed rates. By contrast, the 1980s and 1990s have seen the emergence of a number of successful export-oriented resource-based manufacturing firms resulting in a notable reduction in the share of tea and rubber exported in raw form (Athukorala and Rajapatirana 2000).

6. FOREIGN DIRECT INVESTMENT

The promotion of foreign investment, particularly in export-oriented manufacturing was a pivotal element of Sri Lanka's market-oriented policy reforms initiated in 1997. The most important aspect of the new foreign investment policy was the setting up of the Greater Colombo Economic Commission (GCEC) in 1978 with wide-ranging powers to establish and operate Export Processing Zones (EPZs). As part of the second-wave liberalization, a new *Investment Policy Statement* announced in 1990 introduced several important changes to the foreign investment policy framework in line with the increased outward orientation of the economy. These included abolition of various restrictions on the ownership structures of joint-venture projects outside EPZs and providing free-trade-zone status to export-oriented foreign ventures in all parts of the country (in addition to the area demarcated by the original GCEC Act). As an important part of the FDI policy, steps were also taken to enter into Investment Protection Agreements and Double Taxation Relief Agreements with the major investing countries. A guarantee against nationalisation of foreign assets without compensation was provided under the Article 157 of the new Constitution of Sri Lanka adopted in 1978.

These policy initiatives combined with significant trade liberalisation played a pivotal role in rapid expansion of export-oriented manufacturing in Sri Lanka (Athukorala and Rajapatirana 2000). Export-oriented FDI attracted to Sri Lanka during this period was heavily concentrated in standard light consumer goods industries such as garments, footwear, sport goods, and cutting and polishing imported diamonds. There is, however, evidence to suggest that foreign firms could have played a much more important role in export expansion, with involvement in a wider range of export products, if it were not for the increase in political risk following the eruption of the ethnic conflict in 1983. Foreign firms involved in vertically integrated assembly activities in high-tech industries (such as electronics and electrical goods), unlike those involved in light consumer goods industries, view investment risks from a long-term perspective because output disruption in a given location can disturb production plans for the entire production chain. In fact, in the early 1980s two electronics multinationals, Motorola and Harris Corporation, signed agreements with the Board of Investment and incorporated subsidiary companies to set up assembly plants in Sri Lanka. However, they soon left the country as the political climate begun to deteriorate. There is evidence that there is something of a herd mentality in the site selection process of electronics multi-national firms, particularly if the first-comer is a major player in the industry. If the two projects of Motorola and Harris Corporations had been successful, other multinationals would probably have followed suit (Athukorala and Rajapatirana, 2000; Snodgrass, 1998).

With the ending of the civil conflict, Sri Lanka is in a much better position to harness the gains from the role of FDI, building on its achievements over the past three decades. However, paradoxically recent developments in the Sri Lankan policy scene have begun to send mixed signals to foreign investors. although the new government has 'officially' committed moving towards 'a more outward-oriented' trade regime, strengthening and increasing overseas market access for Sri Lankan products, attracting foreign direct investment, and further integrating Sri Lanka into the world economy' (Government of Sri Lanka, 2010, p.18). Surprisingly, TPR 2010 has overlooked these developments; it simply observes that 'Sri Lankan foreign investment regime has not undergone any significant change since 2004, except as regards the new regulations on incentives introduced in 2006' (p 24).

Up until 2006, the minimum level of investment required for a company to qualify for a five-year tax holiday under the BOI scheme was US$ 500,000. Since then this has been increased to US$ 3 Million for projects in all sectors. This minimum threshold seems highly excessive when compared to that in other countries in the region: Malaysia 65,000; Thailand 65,000; South Korea 50,000; India 2,100 (Word Bank 2010).

In 2008 the parliament passed the Strategic Development Projects (SDP) Act, empowering the minister in charge of the Board of Investment (BOI) to grant exemption to 'strategic development project' from all taxes for a period of up to 25 years. In the Act a strategic development project means 'a project which is in the national interest and which is likely to bring economic and social benefits to the country and which is also likely to change the landscape of the country, primarily through provision of goods and services which will be of benefit to the public, substantial inflow of foreign exchange, substantial employment, and technology transfer' (Government of Sri Lanka 2008, p. 3). This definition naturally leaves ample room for discretion in the investment approval process. Projects identified under the SDP Act are largely confined to investments in relation to information technology and business process outsourcing, tourism and infrastructure (Ekanayake 2011).

An expropriation law, entitled 'Revival of Underperforming Enterprises and Underutilized Assets Act', was passed in November 2011 empowering the government to acquire and manage 37 'underperforming' or 'underutilized' private enterprises. These enterprises (some of which are said to be profit making, according to media commentaries), include 7 enterprises with foreign capital participation (including Colombo Hilton). Thus, the Act obviously violates the existing constitutional guarantee against expropriation of foreign owned assets. Both the Fitch Group and Moody Corporation, two major credit rating agencies, have warned that the bill would erode investor confidence and potentially affect Sri Lanka's investment rating (Goodhand 2012).

A major policy issue in the current Sri Lankan policy debate relating to FDI promotion relates to the role of provision of generous fiscal incentives in attracting foreign investors. The majority view that has underpinned recent changes to the incentive structure is that tax incentives have little impact on foreign investors' location decision and they are an unnecessary drain on the government budget. The SLPR-2010 seems to concur with this view. However, when a clear distinction is drawn between "market-seeking" (tariff jumping) and "efficiency-seeking" (export oriented) investments, a number of studies found that tax incentives do matter for attracting FDI of the latter variety, provided other determinants such as political stability, geographical location and infrastructure are favourable (Morisset and Pirnia 2001, Weigand 1983, Wells and Allen 2001).

Another key concern governing the approval of new manufacturing projects (both foreign and local) by the board of investment is 'domestic value added' (or 'domestic content').[11]The authorities consider that Sri Lanka has the potential to expand its industrial base by focusing on industries with high domestic value added. The SLTPR 2010 simply comments on this in an approving tone and notes that this policy emphasis 'require investment in new technologies and in human capital' (p. vii). However, attempts to increase domestic content through direct policy intervention in the context of a labour abundant economy whose initial comparative advantage essentially lies in standard light manufactured good, could stifle the evolution of the export structure in line with changing patterns of internationalization of production and frustrate employment generation (Little 1981; Athukorala 1998).

First, in achieving economic growth through export expansion what is more relevant is the market potential of the given export products (which determines the total net addition to national income), not net foreign exchange earnings per unit of exports. Labour intensive manufactured goods that are made to local specifications using local raw material account for only a small and shrinking share of manufactured exports from developing countries.

[11]Both these terms are used interchangeably in the relevant official documents and policy debate in Sri Lanka, to imply the latter (domestic content = the sum of domestically procured inputs, wages and returns to domestic capital as a percentage of the ex-factory value of the given products)

Success in increasing the volume of net foreign exchange earnings therefore depends crucially on the country's ability to enter the fast-growing markets for made-to-order manufactured goods, and component production and assembly within vertically integrated production systems, which are typically more import intensive. In the former area, producing what is sought in competitive international markets, in contrast to producing import substituting products for a shortage-ridden supplier's market, calls for a vector of imported inputs meeting exacting quality requirements and specifications. Substitution of inferior locally produced inputs for higher quality imported inputs may lead to significant market losses, and the cost involved in correcting the defects at a further stage may be prohibitive. Hence it is unrealistic to expect export producers to source many inputs from local suppliers at the formative stage of export-oriented industrialisation. In the area of component production and final assembly in electronics and electrical goods, the input structure is determined as part of the overall process of international production - the ability of policy makers to influence procurement practices of firms involved is intrinsically limited. In these products, the per-unit domestic value added is normally low, but the total addition to the national income of the country can be much higher - because of the larger sales volume (compared to the conventional resource-based products).

Second, based on resource allocation considerations derived from the principle of comparative advantage, one can make a strong case for the expansion of low value added (footloose or loosely linked) export industries in a labour-abundant economy. In an open economy, the factor intensity of production depends not only upon the technology in the final and intermediate stages of domestic production, but also upon the technology which underlies the structure of foreign trade. This is because participation in international trade provides the economy with the opportunity to specialise in products in which it has comparative advantage (i.e. labour-intensive products in the case of a surplus labour economy), while relying on world trade for the procurement of intermediate inputs. Intermediate goods industries are typically more capital intensive than are final goods industries. The importation of intermediate inputs for export production, therefore, involves an implicit substitution of labour for relatively capital intensive intermediate products in the production process. For instance, when an economy imports capital intensive inputs such as machinery, synthetic fibre, and industrial chemicals with foreign exchange earned by exporting labour intensive products such as garments, footwear and toys, it is implicitly substituting the latter labour intensive goods for the former capital-intensive goods in the production process. This would enhance the employment potential of the overall production process. Indeed, the emerging employment pattern of Sri Lankan manufacturing appears to be consistent with this view.

The data on aggregate FDI reported in this report (pp. 12-14) point to a notable slowing down in FDI inflows to Sri Lanka during 2004-09 (Table 1). Moreover, when the data are disaggregated by sector/industry, it is revealed that this increase has come largely from projects in the construction and services sectors (SLTPR-2010, Table 1.4). According to a recent analysis of the profile of BOI-approved manufacturing firms based on a comparison of the firms in operation as at end of 2002 and 2009, 465 which were in operation in 2002 had disappeared from the BOI list in 2009 (Ekanayake 2011, Table 11). Of these enterprises, the majority are firms with foreign capital participations (joint venture or fully foreign owned). The number of firms set up between 2002 and 2009 have virtually matched the numbers disappeared from records, leaving the total number of firms unchanged between the two years. However, the majority newly established firms (over 80%) are fully locally owned. Investors from India now dominate the list of firms operating in Sri Lankan EPZs; many firms from Korea, Hong Kong and a number of developed countries have left the country (Ekanayake 2011, Table 12). No major MNE has setup operation in Sri Lankan manufacturing over the last decade. The data on export performance of BOI firms are patchy.

7. OTHER POLICIES AFFECTING TRADE AND INVESTMENT

In addition to tariffs and foreign investment policy, the report discusses institutional and legal framework for trade policy formulation and implementation, and other aspects of government policy that affect trade such as government procurement, intellectual property rights protection, sanitary and phyto-sanitary measures, business environment and taxation, competition policy and price regulations. The subject coverage of this discussion, which is based on the standard trade policy review template, is comprehensive. However, we find that it has overlooked at least three important developments which are bound to have significant implications for further directions of trade and industry policy in Sri Lanka.

State-Owned enterprises

At the time of market oriented policy reforms in 1977, SOEs accounted for 20% of GDP and 60 % of manufacturing output and 50% of total manufacturing employment. Loss-making SOEs was a huge drain on the government budget. The provision of key utilities and economic services by state-owned enterprises (SOEs) has resulted in low quality of service delivery, politicized pricing and management, and employment decisions. This has adversely affected the competitiveness of the entire economy. Over the next three decades the position of SOEs in domestic manufacturing significantly eroded because of privatisation and rapid output growth in private manufacturing ventures. By the turn of the century SOEs accounted for less than 5% of total manufacturing output. However, SOEs in petroleum refining and distribution, public transport, electricity and ports pose a heavy burden on the budget, further shrinking the fiscal space for investment in physical and social infrastructure.

The privatization program was abandoned following the regime shift in 2005. Initially policy of the new government was not to privatize, but to restructure and improve performance of the existing venture, if required with private sector involvement but retaining government ownership of at least 51%. However, following consolidation of power after the war, the government has embarked on further expansion of the role of SOEs in the economy by re-nationalizing of some previously privatized ventures, revitalizing closed-down SOEs, fresh nationalization, and setting up of new ventures. As already noted, in November 2011 the government passed an expropriate bill to bring under government ownership 37 private enterprises, including a number of foreign-invested enterprises.

Automobile industry

The present cascading tariff structure in Sri Lanka, which is characterized by very high import tariff on completely-built automobiles (300%) coupled with low tariffs on car parts and components (5% to 10%), has made local assembly of certain models of automobiles highly profitable. Since 2006 four assembly plants have been set up under the approval of the Ministry of Industry and Trade: Micro Car Company (2006), Union Enterprise (2008), Universal Auto Assembly (2008), and Frontier Automobile (2010). All these plants are fully locally owned, but operate under licensing arrangements with car makers in China (Union Enterprise and Frontier), Korea (Micro Car) and India (Frontier).

In January 2010 the government introduced an excise duty rebate exception scheme as a further incentive for these companies. Currently excise duty is charged on all vehicles produced, assembled or imported into Sri Lanka at 25%, 48% and 65%, depending on the engine capacity. Under this rebate scheme, automobile assembled in Sri Lanka are eligible for complete exemption from these duties provided the domestic content is not less than 30% of the exactor price and the value of locally manufactured components accounts for at least half of the domestic content. There is also anecdotal evidence that the government procurement practices generally favor local automobile assemblers. Frontier Automobile which assembles Land Rover Defender started operations with a sales agreement signed with the Sri Lankan Army.

All four automobile plants are engaged in simple assembly of imported completely-knocked-down (CKD) units of outdated models which have already been scrapped from their production schedule by the parent companies. It is therefore doubtful whether the expected gains (in the forms of technology transfer, backward linkages to local spare part manufactures, foreign exchange saving, and supply of vehicles to the local market at affordable prices)[12] would be sufficient to counterbalance the government revenue losses involved. Indeed the excise duty rebate appears to be an anomaly given that the cascading tariff structure already provides local automobile assemblers with massive effective protection.

Free Trade Agreements

Recent years have seen a greater emphasis in Sri Lankan policy circles on regional/bilateral free trade agreements (FTAs). The sluggish economic recovery of developed countries following the global financial crisis, the termination of GSP plus preferential market accesses by the European Union in 2009, and the remarkable resilience of China, and other emerging economies in the region, to the global economic slowdown are often cited as the rationale for this policy emphasis.

Sri Lanka is currently a member of two regional agreements: the South Asia Free Trade Area (SAFTA) Agreement and the Asia-Pacific Trade Agreement (APTA) (covering Bangladesh, China, India, South Korea, Sri Lanka, Lao), and two bilateral agreement: Indo Sri Lanka Free Trade Agreement (ISFTA) and Pakistan-Sri Lanka Free Trade Agreement. Negotiations are also underway for entering into FTAs with Egypt, Bangladesh and a number of other countries. TPR has a comprehensive coverage of the FTAs in operation and those under negotiation. But it has stopped short of discussing the actual trade impact and how these agreements comply with the WTO norms.

Under Indo-Lanka FTA (ISFTA) Sri Lanka's trade with India has expanded notably, but predominantly on the import side. During 2005-2009 Sri Lanka's annual average exports to India amounted to a mere US$500 million compared to imports of $2335 from India (IPS 2011,

[12] As listed in the government gazette announcing the excise duty rebate scheme.

p. 50). So far, the impact of all other FTAs on Sri Lanka's trade has been negligible. Only about 6% of all tariff lines (at the HS six digit level) of Sri Lanka's foreign trade has come under regional tariff concessions under the these agreements. The share of intra-regional trade covered by these concessions in the country's total trade was even lower (less than 3%and 1% of imports and exports, respectively).

Indeed, there are good reasons to re-assess the apparent enthusiasm for proliferating FTAs and regional trade agreements. The FTAs approach to trade liberalization is becoming a major distraction to the process of unilateral liberalization which has served Sri Lanka so well in the past three decades. Proliferation of FTAs generates a serious problem of multiple "rules of origin", which entail significant costs for both government and private economic agents. They complicate customs of administration and weaken efficiency improvements in the custom system. With multiple FTA, the tariff structure becomes highly differentiated, depending on the country of origin, thus compromising the goal of uniformity in tariffs and giving rise to new inefficiencies in resource allocation and specialization.

8. CONCLUSON

The TPRM represents the most institutionalized forum for monitoring trade policies of WTO member states. In developed countries private agents have the capacity to monitor what their governments are doing, spot protectionist tendencies and urge their governments to defend their trading interests. Institutional monitoring is expected to offer greater marginal benefits to poor countries where such natural mechanism of scrutiny is lacking. These countries do not have access to the required information, the capacity to analyse such information, or political power to apply peer pressure on an individual basis against their trading partners. Trade policy reviews undertaken by the WTO is expected to fill this vacuum: they are expected to strengthen the hands of trade policy reformers against policy backsliding on the part of policy makers under pressure from the protectionist lobby (Gosh 2010).

SLTPR-2010 is a valuable compendium of information on Sri Lankan trade policy and overall economic policy and performance that impact on trade policy. However, relating to a number of critical aspects on trade policy and the related policy context it has fallen short of meeting the TRPM transparency requirements. After reading together the report by WTO secretariat (part 1 of SLTPR-2010) and the statement by the government of Sri Lanka (Part 2), one would wonder whether the former was negotiated paragraph by paragraph so as to avoid offending the client.

The market-oriented policy reforms initiated in 1977 have led to far-reaching changes in the structure and performance of the Sri Lankan economy. It is important to note that what has been achieved in Sri Lanka under liberalisation reforms occurred while civil war has persisted for much of the period. Quite apart from its direct debilitating effect of political risk on investor perception, the civil war constrained capturing the full benefits of economic opening through delays and inconsistencies in the implementation of reform process and macroeconomic instability emanating from massive war financing. In this context, the Sri Lankan experience can be explained as the outcome of trade liberalisation that increased the potential returns to investments which capitalize on the country's comparative advantage. Despite political risk and policy uncertainty, rapid export growth was consistent with this policy configuration as it ensured a handsome profit in labour intensive export production, which is usually characterised by a short payback period in a labour abundant economy. Interestingly, the Sri Lankan experience over the past three decades has clearly demonstrated that an outward-oriented policy regime can yield a superior development outcome compared to a closed-economy regime, even under severe strains of political and macroeconomic instability. Viewed against this back drop, recent developments in the Sri Lankan policy scene do not augur well for the future of the Sri Lankan economy. Unfortunately, SLTPR-2010 has failed to deliver this important message.

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Table 1: Sri Lanka: Selected Macroeconomic Indicators, 2004-2010

	2004	2005	2006	2007	2008	2009	2010
GDP per capital at current US$	1062	1241	1421	1617	2014	2057	2399
Real GDP (2002 price) growth (%)	5.4	6.2	7.7	6.8	6.0	3.5	8.0
Domestic demand (% of GDP)							
Consumption	83.6	82.1	83.0	82.4	86.1	82.1	81.3
Private	70.9	69.0	67.7	67.2	70.0	64.4	65.8
Government	12.6	13.1	15.4	15.3	16.2	17.6	15.6
Gross fixed capital formation	22.6	23.4	24.9	24.7	25.3	23.8	27.1
Exports of goods and non-factor services	35.3	32.3	30.1	23.6	19.9	16.8	16.7
Imports of goods and non-factor service	44.2	41.3	41.1	39.5	38.5	24.3	27.2
Gross national saving(% of GDP)	22.0	23.8	22.3	23.3	17.8	23.9	24.7
Gross domestic investment(% of GDP)	25.3	26.8	28	28	27.6	24.4	27.8
Unemployment rate %	8.3	7.7	6.5	6.0	5.4	5.8	4.9
Inflation (CPI) rate %	7.6	11.6	10.0	15.8	22.6	3.4	5.9
Exchange rate							
Nominal effective exchange rate (2004 = 100)[1]	100.0	99.8	95.9	85.5	86.5	86.3	86.4
Real effective exchange rate (2004 = 100)[2]	100.0	107.8	110.4	110.6	130.5	133.4	136.5
Government finance (% of current GDP)							
Central government balance (including grants)	-7.5	-7	-7	-6.9	-7	-9.9	-7.9
Central government total debt	102.3	90.6	87.9	85	81.4	86.2	81.9
Domestic debt	54.7	51.6	50.3	47.9	48.5	49.8	45.8
Import duties:							
As % of imports	5.1	5.1	4.9	4.5	4.2	6.8	6.9
As % of government revenue	13.4	12.3	11.0	10.1	10.1	11.0	11.3
External sector (% of current GDP, unless otherwise indicated))							
Current account balance	-3.1	-2.7	-5.3	-4.3	-9.5	-0.5	-2.9
Total external debt (end of year)	54.9	46.5	42.4	43.2	37.1	44.4	43.3
Debt service ratio[3](%)	11.6	7.9	12.7	13.1	15.1	19.1	15.2
Foreign exchange reserves (US$ million)	2196	2735	2837	3508	2402	5357	7197
In months of imports	5.2	5.7	4.7	5.3	3.1	8.3	7.7
Terms of trade (2004 = 100)	100.0	95.8	92.6	90.0	79.5	98.8	93.4
Direct foreign investment (US$ million)							
Direct foreign investment in Sri Lanka	227	234	451	548	690	404	478
Sri Lanka's direct investment abroad	6	38	29	55	62	20	43

Note:

1. The NEER is the trade-weighted average of nominal exchange rates (expressed as foreign currency price of the rupee) of the 24 trading partner countries.
2. NEER adjusted for inflation differentials with the trading partner countries (based on consumer price indices).
3. External debt repayment and interest payments as a percentage.

Source: TPR 2010, Table 1.1, 1.2 and 1.3; Central Bank of Sri Lanka Annual Report (various years).

Table 2: Sri Lanka: Tariff Structure, 2003, 2009 and 2010

	MFN applied rates			Final bound[2]
	2003	2009	2010[1]	
Bound tariff lines (% of all tariff lines)		35.8	36.4	36.4
Simple average tariff rates				
Agricultural products (HS01-24)	9.8	12	11.5	32.7
Industrial products (HS25-97)	7.9	9.9	9.1	19.8
First stage processing	12.5	14.9	15.7	45.9
Semi-processing	4.4	5.4	4.1	16.9
Final processing	12.1	14.9	14.5	32.5
Duty free tariff lines (% of all tariff lines)	10	11.7	44.4	0.4
Non-ad valorem tariffs (% of all tariff lines)	1.3	3.9	3.9	1.8
Tariff quotas	0	0	0	0
Domestic tariff peaks (% of all tariff lines)[3]	0.3	0.3	0.3	0.1
International tariff peaks (% of all tariff lines)[4]	21.9	23.8	23.9	69.3
Coefficient of variation of tariff rates (%)	1.3	1.1	1.3	0.6
Nuisance applied rates (% of all tariff rates)[5]	27.1	0	0	0

Notes:

1. As at June
2. Including partial bound rates
3. Domestic tariff peaks are defined as those exceeding three times the overall simple average tariff rate
4. International tariff peaks as those exceeding 15%.
5. Nuisance rates are those greater than zero, but less than or equal to 2%

Source: SLTPR 2010, Table 111.2

Table 3: Sri Lanka: Unweighted Average Protection Rates[1], 2002, 2004, 2009 and 2011

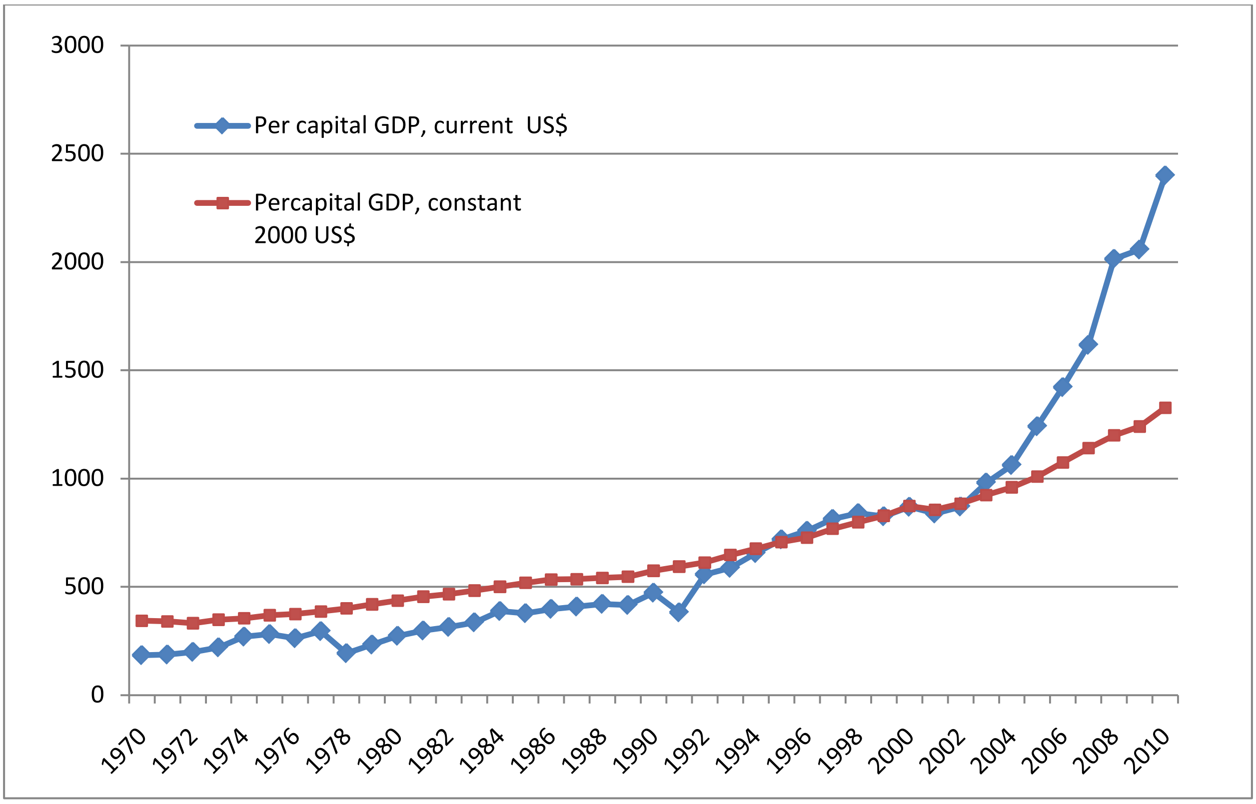
	Customs duties	Para-tariffs	Total protection rate
November 2002			
Agriculture (HS 01-24)	21.1	5.2	26.3
Industry (HS 25-87)[2]	7.6	2.5	10.1
All tariff lines	9.6	2.9	12.5
January 2004			
Agriculture (HS 01-24)	24.6	3.5	28.1
Industry (HS 25-87)[2]	8.8	1.9	10.7
All tariff lines	11.3	2.1	13.4
December 2009			
Agriculture (HS 01-24)	24.6	25.0	49.6
Industry (HS 25-87)[2]	10.3	13.7	24.0
All tariff lines	12.4	15.5	27.9
January 2011			
Agriculture (HS 01-24)	25.4	21.4	46.8
Industry (HS 25-87)[2]	9.1	10.6	19.7
All tariff lines	11.5	12.2	23.7

Notes:

1. All protection rates are percentages of cif import value.
2. This predominantly reflects manufacturing protection. Mining (less than 3%) accounts for a tiny share of industrial output.

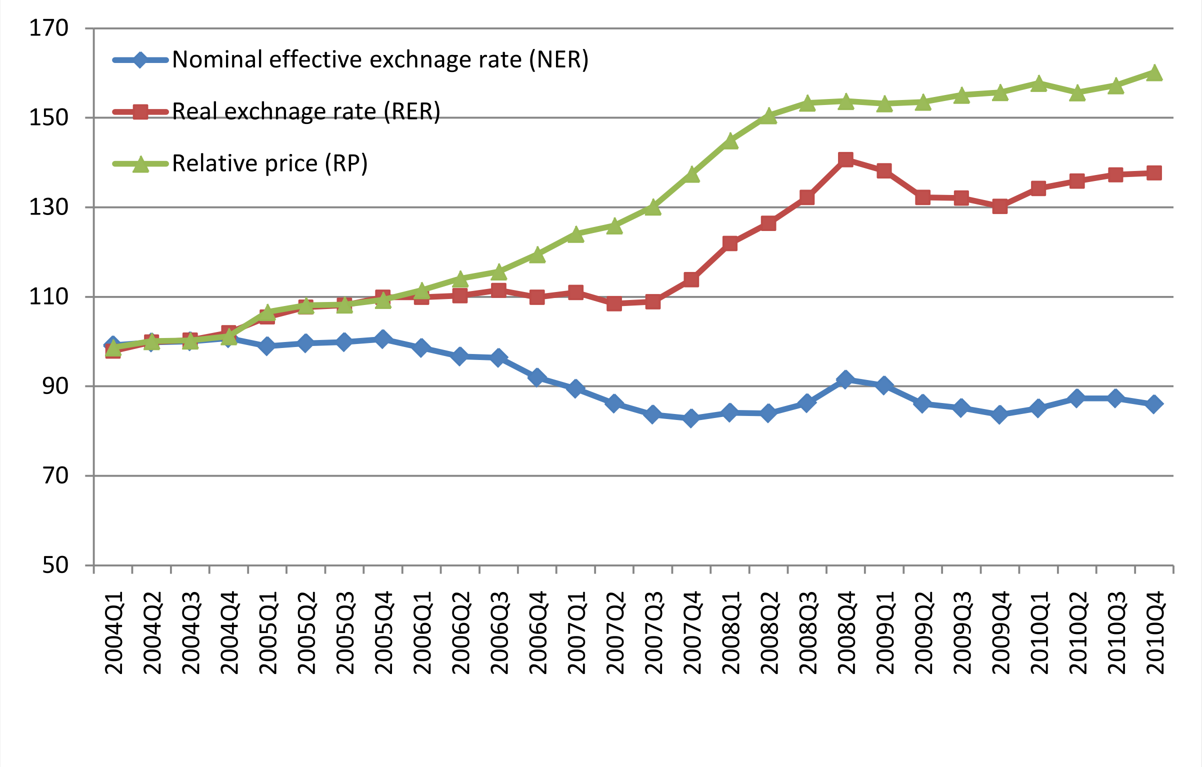
Source: Pursell and Ahsan (2011)

Figure 1: Sri Lanka, per capital GDP in current and constant (2000) price (US$)



Source: Based on data compiled from Central Bank of Sri Lanka, Annual Report (various issues).

Figure 2: Sri Lanka: Real exchange rate and its components, 2004Q1 – 2004Q2



Notes:

NER: trade weighted nominal exchange rates relating to 24 top trading-partner countries (measured as foreign currency units per rupee)

RP: trade weights relative price (measured by the consumer price index) between Sri Lanka and its 24 top trading partners

RER = NER*RP; an increase indicates appreciation.

Source: Compiled from Central bank of Sri Lanka, *Annual Report* (various issues).

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