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Committee on Balance-of-Payments Restrictions

1995 CONSULTATION WITH SRI LANKA UNDER ARTICLE XVIII:12(B) OF THE GATT

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 12 of the Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994.

I. Sri Lanka's previous consultations

2. Sri Lanka first invoked Article XVIII:B in 1971 to justify its use of quantitative restrictions on imports. Since then Sri Lanka consulted under simplified procedures every two years, except in 1991 when consultation was delayed until 1992. During the last simplified consultation held on 26 and 27 July 1994, the Committee requested Sri Lanka to notify, by tariff line, import restrictions, if any, maintained for balance-of-payments purposes, or to disinvoke Article XVIII:B, no later than September 1994. The Committee also concluded that should any such import restrictions be identified, the Committee would hold a full Consultation with Sri Lanka (BOP/R/219). Subsequently, in a notification dated 19 October 1994, Sri Lanka informed the Committee that it would continue to invoke Article XVIII:B and submitted a list of eight agricultural items, which were at the time subject to import licensing measures for their indirect impact on the balance-of-payments situation (Table 1).

Table 1
Import-licensing measures notified by Sri Lanka as being retained for their indirect impact on the balance-of-payments situation, October 1994

H.S. Heading No.	Item	H.S. Code Number	Description
07.01	Potatoes, fresh or chilled	0701.90	Other
07.03	Onions, shallots, garlic, leeks and other alliaceous vegetables, fresh or chilled.	0703.10.01 0703.10.02	red onions big onions
09.04	Pepper of the genus 'Piper', dried or crushed or ground, fruits of the genus capsicum or of the genus pimenta	0904.20	fruits of the genus capsicum or of the genus pimenta dried or crushed or ground
10.01	Wheat and meslin	1001.10 1001.90	durum wheat other
11.01	Wheat or meslin flour	1101.00	Wheat or meslin flour
11.03	Cereal groats, meal and pellets	1103.11	of wheat

Note: Information contained in columns (1) and (2) above give merely a broad definition of the specific tariff lines under licences, which are indicated only in columns (3) and (4).

Source: GATT document L/7542 of 3 November 1994.

II. Sri Lanka's trade policy and recent changes

3. The following section gives a brief summary of trade policy and recent changes. A detailed examination can be found in the Report by the WTO Secretariat on Trade Policy Review of Sri Lanka (WT/TPR/S/6) of 13 October 1995.

(a) Licensing

4. In recent years, Sri Lanka has removed almost all import and export licensing requirements except those mentioned above and others maintained for security, health, moral and environmental reasons. Licences for the relevant items are issued by the Import and Export Control Department (Ministry of Trade, Commerce and Food). According to the authorities, imports of cereals have also been liberalized.

5. According to information provided by the Customs Department of the Ministry of Finance, a number of products, both agricultural and manufactured, are subject to import licensing (Table 2).

Table 2
Products subject to import licensing, mid-1995, other than those mentioned in Table 1.

Item	Competent authority
Motor vehicles	Department of Import and Export Control
Arms and ammunition	Ministry of Defence
Rice (including flour)	Department of Food Commissioner
Manufactured liquor	Department of Excise
Photocopying apparatus (colour)	Department of Import and Export
Goods restricted under the Montreal Protocol on Substances that Deplete the Ozone Layer and the Basel Convention on the Control of Trans-boundary Movements of Hazardous Waste and their Disposal	Central Environmental Authority

Source: WTO Secretariat based on information provided by the Customs Department (Ministry of Finance).

6. Import licences are originally valid for 180 days; they may be extended for up to one year if "acceptable reasons" are given. Block licences for one year may be issued for drugs and chemicals which may then be imported in instalments up to the ceilings mentioned. Licences are issued only to Sri Lankan nationals or companies majority owned by Sri Lankans.

7. As regards licences of imports of food items, only registered importers are permitted to import seasonal crops; the allocation of licences is generally based on their previous performance. (Any rents thus accrue to the established traders.) While licences are not officially transferable, the authorities are aware of informal transfers. Entry of seasonal agricultural products is particularly closely monitored by the Controller of Imports and Exports. The Controller of Imports and Exports can reject licence applications without giving reasons; the decision may be appealed to the Minister of Trade, Commerce and Food. Import quantities of seasonal food crops, such as potatoes and dried chillies, are decided at a weekly "food security meeting", involving the Department of Census and Statistics, the Food Commissioner, Ministry of Agriculture, and the Controller of Imports and Exports. The decisions are taken in view of the country's food supply situation and additional considerations such as the cost of living. The Import and Export Controller is accordingly authorized to issue licences during specified periods not coinciding with the domestic marketing season.

(b) Tariffs and other charges on imports

8. The 1995 Budget introduced a three-band import tariff structure intended to reduce effective rates of protection. Most import tariffs are grouped into rates of 10, 20 and 35 per cent. A two-pronged import tariff of 10 and 20 per cent and a single 15 per cent tariff are under consideration.

9. Other charges on imports include:

- a computer maintenance fee of SL Rs 200 (approximately US$4) per transaction;
- a customs examination charge of SL Rs 300 (approximately US$6) per transaction;
- a 2 per cent stamp duty is levied on compulsory letters of credit on import consignments with a c.i.f. value exceeding US$7,500;
- motor vehicles, alcoholic beverages, tobacco and tobacco products are subject to a surcharge (cess) of 10 per cent on the duty value; and
- a turnover tax (up to 20 per cent), defence levy (4.5 per cent) and excise duty (up to 200 per cent) apply to both imports and domestic production but the value of imports on which they are levied includes import duties and is subject to a markup. Domestically manufactured cigarettes carry a lower excise tax (SL Rs 525 per 1000) than imports (SL Rs 925 -1,500 per 1000).

10. Tariff concessions are available for firms producing for exports, approved by the Board of Investment. Board of Investment approved firms producing for export are also exempt from all other import charges. The Import Tariff Guide published by the Customs Department (1994) provides for full tariff exemptions on 34 products as well as partial exemptions on 19 items. The number of products with full exemption has been narrowed down to 23 items in the February 95 Budget. Granting of duty waivers have now been discontinued. Items on which duty waivers were earlier granted concerning machinery, equipment and parts, etc. have now been included in the customs tariff with appropriate duties.

11. Preferential tariffs are granted under the Bangkok Agreement, the Agreement on the Global System of Trade Preferences (GSTP) and, from December 1995, the South Asian Preferential Trade Area Arrangement (SAPTA). The preferential margins vary widely among the products covered, but are the same for all participants. There are no full tariff exemptions. The relevant rules of origin hinge on a value-added criterion.

(c) Foreign exchange and capital controls policy

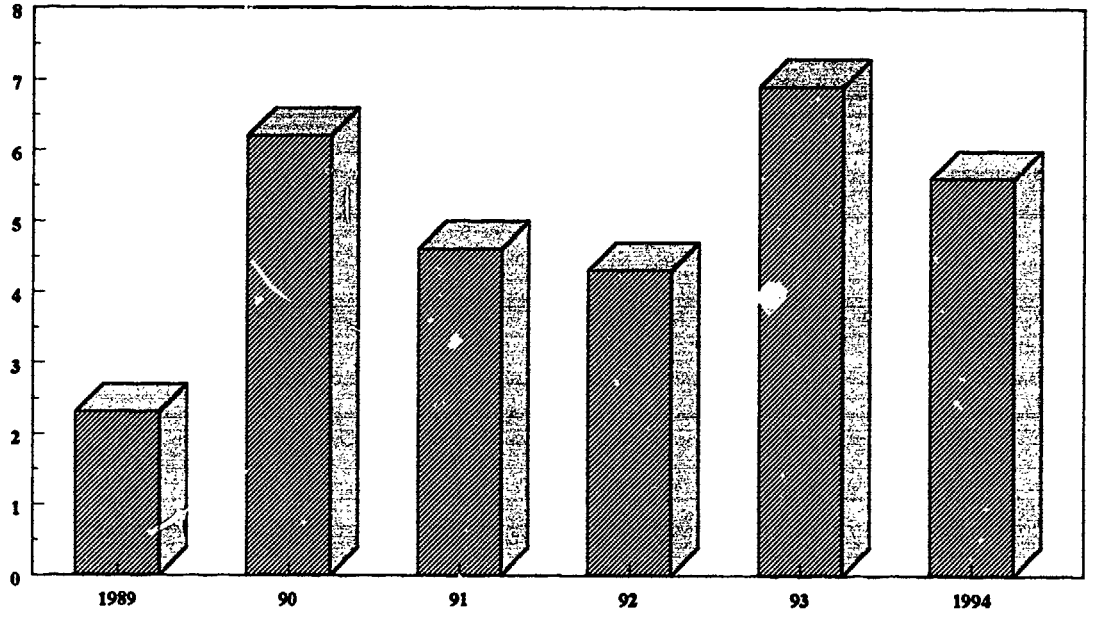
12. Sri Lanka has removed all restrictions on current transactions and formally accepted the obligations of Article VIII, Sections 2, 3 and 4 of the International Monetary Fund (IMF) Agreement as of 15 March 1994. The authorities are considering the liberalization of the capital-account transactions in the medium term.

13. Overseas borrowing or borrowing in foreign currencies is not allowed, except for export-oriented firms approved by the Board of Investment (BOI). Foreign currency loans to other export-oriented firms are permitted on a case-by-case basis by the Department of Exchange Control of the Central Bank. Since 1990, there have been no restrictions on foreign investment in securities registered at the Sri Lanka Stock Exchange, except government securities; funds may be withdrawn at any time.

III. Main Macroeconomic Developments

14. Real GDP growth averaged over 5 per cent over the 1990-94 period, with particular robust growth being recorded in 1993 (6.9 per cent). Manufacturing and, recently, construction were the leading sectors developing rapidly. The manufacturing sector grew on average over 8 per cent annually during 1990-94 and 10.5 per cent during 1993. By comparison, agriculture grew by less than 4 per cent annually during the same period, partly as the result of a decline during 1992 owing to weather conditions.

Chart 1
Sri Lanka - Real GDP growth, 1989-94
Annual percentage change



Source: IMF.

15. Inflation averaged about 10 per cent during 1986-89 but jumped to over 20 per cent in 1990, declining to around 12 per cent during 1991-93. However, the recent decline owes much to cuts in government administered prices, in particular of the bread price. The underlying rate in 1994 was well above the recorded 8.6 per cent.

16. The Central Bank of Sri Lanka's main instruments to conduct monetary policy are open-market operations and changes in reserve requirements for commercial banks. While, until 1993, open market operations were conducted mainly in treasury bills, the bank has since issued its own securities. In addition, high minimum reserve requirements, 15 per cent on deposits in SL rupees in 1994, have been used to reduce the money multiplier and, thus, inflation.

17. The Central Bank intervenes to prevent wide fluctuations in the exchange rate. It announces daily spot buying and selling rates of the U.S. dollar, with a margin of 2 per cent, and buys and sells the rupee at these rates. Forward exchange rates are market determined.

18. The unemployment rate was estimated to be 13.0 per cent in 1994, down from 16.6 per cent in 1992.

IV. Public Finance

19. The budget deficit excluding grants has remained above 7 per cent of GDP for each single year during 1990-94, reaching 11.6 per cent in 1991, declining to 7.3 per cent in 1992, going up since, reaching 10.0 per cent in 1994. The increase in 1994 was caused mainly by election related rise in current expenditure. However, it might prove difficult to constrain such expenditure as well as increases in military expenditure in view of the resurgence in civil war activities.

20. Government revenue has declined as a share of GDP from 21.1 per cent in 1990 to 19.0 per cent in 1994. Tax exemptions and waivers contributed to this declining share of government revenue in GDP. The use of tax exemptions and waivers has been reduced since. Some consumption taxes, such as the broad-based defence levy, have been increased in mid-1995 to cover additional expenditure related to the civil war. Furthermore, the government has announced that it intends to introduce a value-added tax to enhance the elasticity of the revenue system by broadening the tax base. Private-sector involvement in infrastructure projects is also expected to ease their budgetary impact.

V. Composition and Direction of Merchandise Trade

21. The gradual refocusing of Sri Lanka's industrial policy from import substitution to export promotion, and the emergence of an export-oriented clothing industry, have brought about significant changes in the country's export basket. The share of clothing in total exports increased from 10.5 per cent (US$110 million) in 1980 to close to 48 per cent (US$1,350 million) in 1993,[1] although domestic value added is very low.[2] Not surprisingly, the world's two major clothing importers, the United States and the European Union, have taken increasing shares of Sri Lanka's total exports. The United States alone accounted for 35 per cent of the country's total shipments in 1993, up from 11 per cent in 1980 (Chart 2).

22. While Sri Lanka's share in the world tea market remained stable, the share of tea in total exports declined as shipments of manufactures expanded rapidly (Chart 2). Middle-Eastern countries have remained the most important export market for tea.

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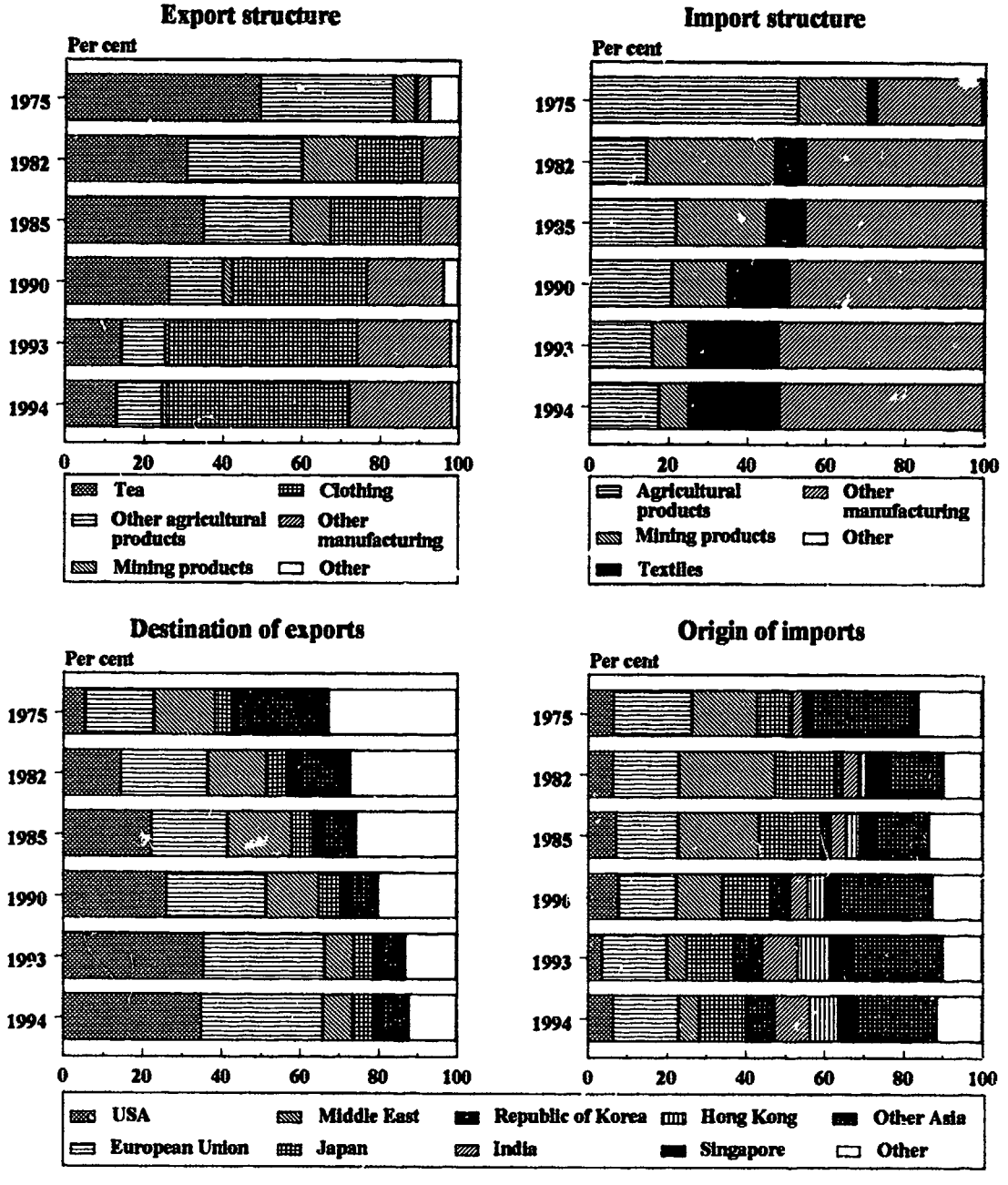
[1]Trade Policy Review - Sri Lanka 1995, (WT/TPR/S/6), Table AI.2.

[2]Trade Policy Review - Sri Lanka 1995, (WT/TPR/S/6), Chapter V(4)(ii).

Chart 2
Composition and direction of merchandise trade, 1975-94



Total merchandise imports, 1994, c.i.f.:	US$3,528 million
Total merchandise exports, 1994, f.o.b.:	US$2,786 million

Source: UNSTAT, Comtrade database.

23. On the import side, the share of rice and other food supplies declined from about half in 1975 to 14 per cent in 1993, reflecting both reductions in quantities supplied and increasing imports of non-food items. Imports of textiles developed particularly dynamically, destined mostly as inputs for the booming clothing industry. They originated mainly from traditional textiles producers, underpinning the rôle of the Republic of Korea, India and some other Asian countries as suppliers to Sri Lanka (Chart 2).

VI. Balance of Payments

(a) Current account

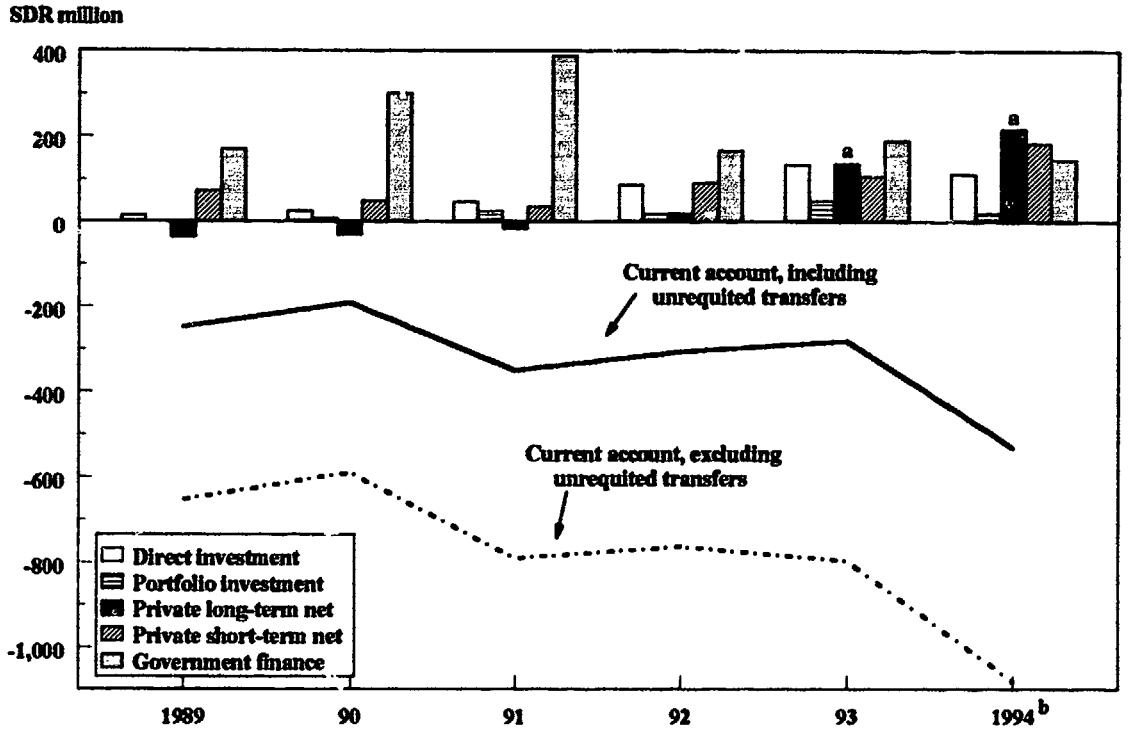
24. In spite of rapid export growth the trade deficit increased from 8.8 per cent of GDP in 1990 to 13.4 per cent of GDP in 1994. In 1994, total merchandise exports amounted to SDR 2.2 billion, while merchandise imports were SDR 3.3 billion. However, foreign grants and, increasingly, private remittances are a major source of foreign exchange earnings (Annex A). The current account deficit (excluding official transfers) was therefore contained in the range of 5-8 per cent of GDP during 1990-94, rising from 5.3 per cent of GDP in 1993 to 7.9 per cent in 1994 (Chart 3).

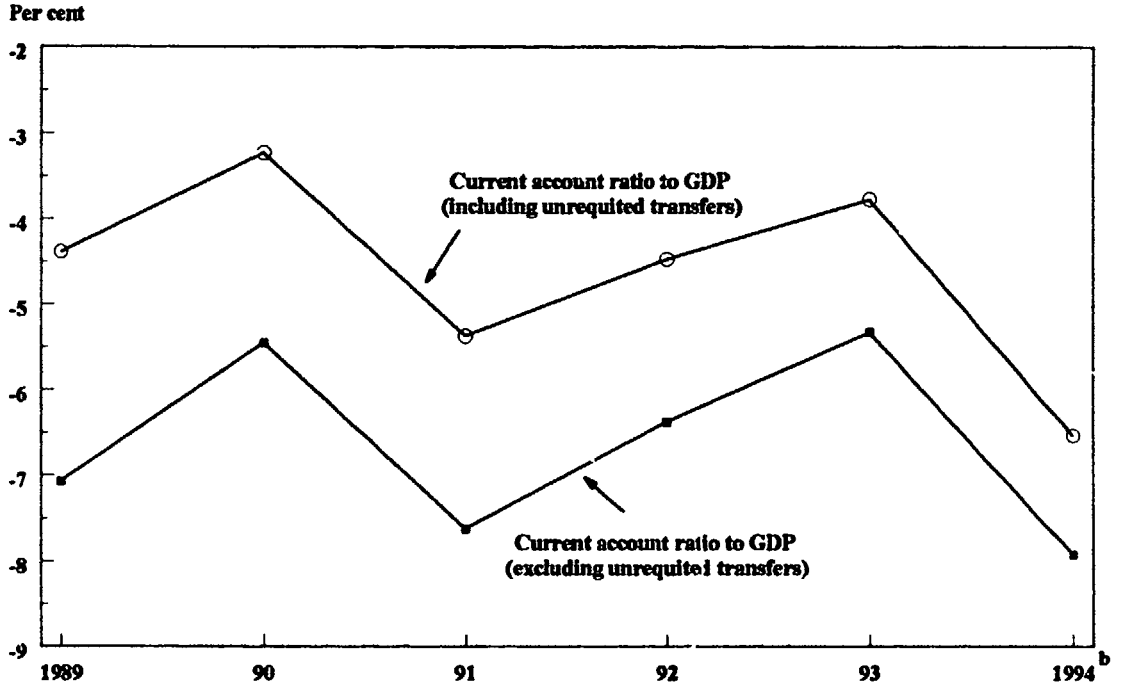
(b) Capital account

25. During 1990 and 1991, net overseas long-term government borrowing to finance public investment projects exceeded the current account deficit (including official transfers), thus contributing to the accumulation of foreign reserves.[3] Private capital inflows rose rapidly during 1993 and 1994, lead by private foreign borrowing of both a short- and a long-term nature while government borrowing declined below the 1990-91 levels. Foreign investment increased gradually; portfolio investment made a minor contribution during 1991-94 (Chart 3).

[3]Public capital inflows continued to exceed the current account deficit until 1993, but as public capital outflows increased slightly and inflows declined substantially after 1991, net public inflows did not exceed the current account deficit since 1991.

Chart 3
Balance of payments, 1989-94





a Includes adjustment to capital inflows on account of import of four aircrafts for which advance payments had been made in previous years.

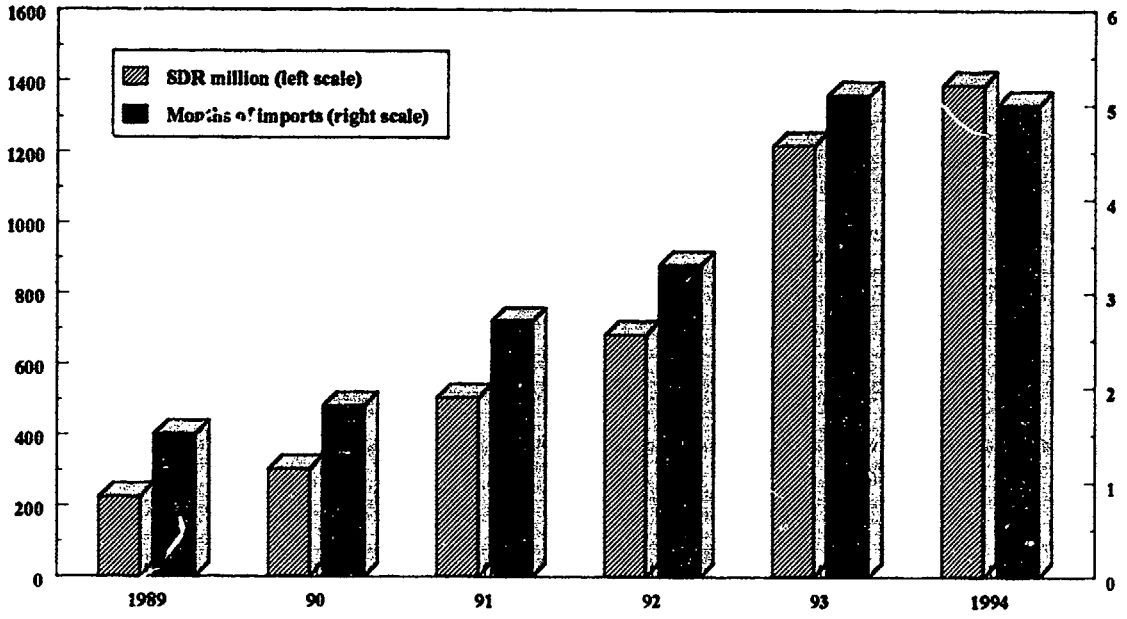
b Provisional.

Source: Central Bank of Sri Lanka.

(c) Reserves

26. As the combined public and private capital inflows exceeded the current account deficit (and capital outflows were negligible) they contributed to the accumulation of foreign reserves during the 1990s. However, imports also increased sharply during this period and the number of months of imports covered by reserves increased less dramatically during 1989-93 and stabilized during 1993 and 1994 (Chart 4). At the end of 1994, gross official reserves amounted to SDR 1,389 million, equivalent to 5 months of imports (Annex B).

Chart 4
Sri Lanka - Gross official reserves at year end, 1989-94
SDR million; and months of imports

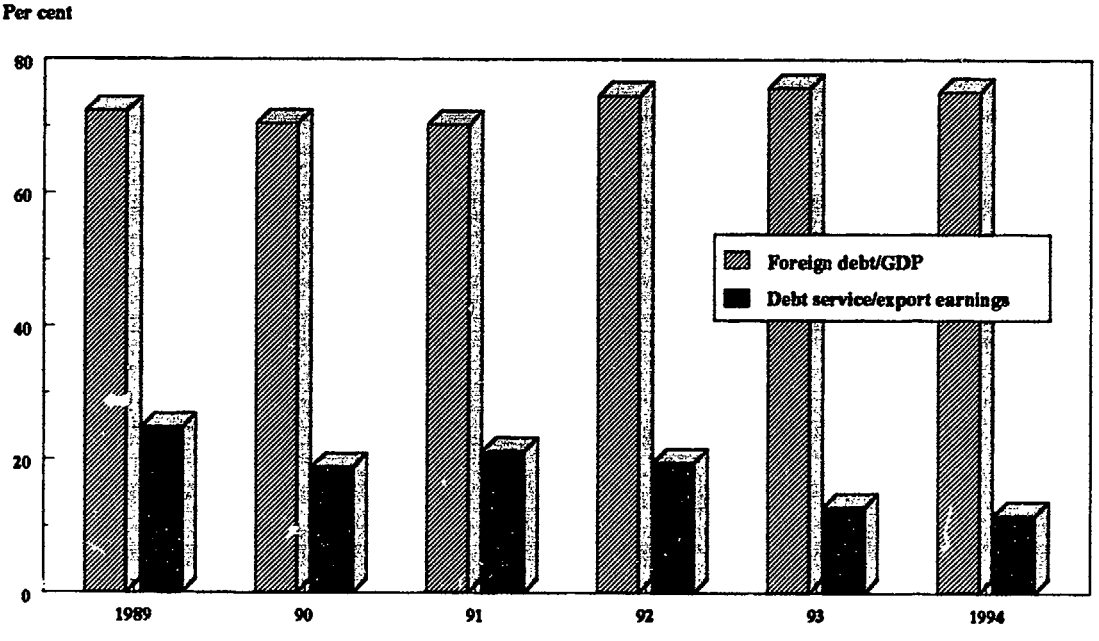


Source: IMF.

(d) External Debt

27. Following an increase during the late 1980s, foreign debt has remained fairly constant as a percentage of GDP. The debt-service ratio declined during recent years owing to a rapid growth in exports and favourable terms in the context of foreign aid backed loans (Chart 5). In 1994, total debt amounted to 75.2 per cent of GDP, while debt service was 11.6 per cent of total exports of goods and non-factor services (Annex B)

Chart 5
Sri Lanka - External debt as a percentage of GDP and debt service as a percentage of exports of goods and services, 1989-94



Source: IMF.

Annex A - Sri Lanka Balance of Payments, 1989-94
(In millions of SDRs)

	1989	1990	1991	1992	1993	1994[1]
Trade balance	- 520.0	-517.8	-725.7	-721.4	-825.2	-1,095.0
Exports	1,217.0	1,456.1	1,490.6	1,747.6	2,046.3	2,235.5
Of which: Traditional	(426.0)	(472.0)	(408.6)	(348.9)	(382.3)	(399.5)
Nontraditional	(742.0)	(916.0)	(1,082.1)	(1,397.7)	(1,664.0)	(1,836.0)
Imports	-1,737.0	-1,973.9	-2,216.3	-2,469.0	-2,871.5	-3,330.5
Of which: Petroleum	(182.2)	(264.0)	(277.7)	(225.6)	(221.3)	(207.0)
Services, net	-127.3	-72.1	-67.6	-23.0	31.3	12.6
Receipts	303.9	365.8	440.9	489.3	535.0	627.4
Of which: Travel	(59.3)	(94.0)	(115.6)	(138.5)	(146.2)	(161.6)
Payments	-431.2	-437.9	-508.5	-512.3	-503.7	-614.8
Of which: Interest	(150.5)	(146.6)	(159.0)	(151.4)	(141.3)	(161.1)
Private transfers, net	257.9	268.4	293.3	328.2	401.6	437.6
Current account (excl. official transfers)	-389.4	-321.5	-500.0	-416.2	-392.3	-644.8
Official transfers, net	146.7	129.8	148.6	130.2	115.0	114.8
Current account	-242.7	-191.7	-351.4	-286.0	-277.3	-530.0
Capital account	226.1	320.6	474.9	352.0	611.1	676.8
Medium - & long-term net	153.1	272.9	417.1	307.2	506.0	495.1
Disbursements	316.5	396.2	525.8	424.9	550.8	513.8
Government	301.6	372.3	463.4	311.4	366.7	328.0
Private[2]	14.9	23.9	62.4	113.5	184.2	185.8
Amortization	177.3	154.0	178.3	220.6	227.0	149.2
Government	127.9	97.2	98.3	124.7	143.8	146.9
Private [2,3]	49.4	56.8	80.0	95.9	83.2	2.3
Direct investment, net[4]	14.0	30.7	69.6	103.0	182.1	130.7
Government short-term, net	--	--	22.7	-22.0	--	--
Private short-term, net[5]	73.0	47.7	35.1	66.8	105.1	181.7
Errors and omissions	50.1	10.8	29.5	68.0	40.8	26.1
Overall balance	-66.7	139.7	152.3	133.0	374.5	172.9
Monetary movements						
Gross official reserves	-17.0	-82.0	-197.1	-178.6	-535.8	-171.8
Use of Fund credit	20.9	12.9	-7.6	57.6	37.9	47.1
Central Bank borrowing, net	45.1	-14.3	1.5	-16.7	87.4	3.9
Commercial banks, net	17.7	-56.3	50.9	4.7	36.0	-52.1

Annex B

Memorandum items:						
Gross official reserves at year end	223.6	305.6	502.7	681.3	1,217.1	1.388.9
In months of current year imports	1.5	1.8	2.7	3.3	5.1	5.0
			In per cent of GDP			
Current account balance (excluding official transfers)	-7.1	-5.4	-7.6	-6.1	-5.3	-7.9
Current account balance (including official transfers)	-4.5	-3.2	-5.3	-4.2	-3.7	-6.5
Capital account	4.1	5.4	7.2	5.1	8.3	8.3
Overall balance	-1.2	2.4	2.3	2.0	5.1	2.1
Debt service ratio [6]	24.8	18.8	21.2	19.5	12.9	11.6
Total debt [6]	72.3	70.4	70.2	74.6	75.8	75.2

1 Preliminary estimates.
2 Consists of public corporations and private companies.
3 Includes progress payments for Air Lanka of SDR 40.7 million in 1991 and SDR 42.9 million in 1992. For 1993, progress payments of SDR 43 million are netted against the unfinanced value of 2 commercial airliners imported by Air Lanka.
4 Includes portfolio investment and privatization proceeds.
5 Consists of trade credits, short-term borrowings of public corporations and private companies, and liabilities to FCBUs.
6 Total debt, including use of Fund credit, private sector debt, and short-term debt. Debt service ratio is expressed as a percent of exports of goods and nonfactor services.

Source: IMF , based on data provided by the Sri Lanka authorities.