GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

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Limited Distribution

Committee on Balance-of-Payments Restrictions

1989 CONSULTATION WITH SRI LANKA (SIMPLIFIED PROCEDURES)

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205) to assist the Committee on Balance-of-Payments Restrictions in taking the decision referred to in paragraph 8 of the Declaration.

I. Sri Lanka's previous consultations

2. The last full consultation with Sri Lanka took place on 22 June 1971. At that consultation the Committee recognized that the then balance-of-payments difficulties of Sri Lanka warranted the use of quantitative restrictions on imports. The Committee urged Sri Lanka to consider additional measures to increase foreign exchange earnings, particularly through promotion and diversification of exports, and expressed the hope that the recent improvement in the balance of trade would continue so as to enable some easing of the stringent restrictions placed on imports essential for the further development of the economy (BOP/R/58, paragraph 27).

3. The last full consultation was followed by consultations under simplified procedures in 1973, 1975, 1977, 1979, 1981, 1983, 1985 and 1987 (BOP/R/169).

II. Sri Lanka's trade policy and recent changes

4. The economic downturn and domestic political unrest of recent years, have had serious consequences for Sri Lanka's balance of payments. Export earnings have stagnated, income from tourism has declined, and net transfers from Sri Lankans working abroad have also fallen. The share of the current account deficit (including overseas grants) in GDP increased from 5.1 per cent in 1987 to 5.8 per cent in 1988. Despite this, Sri Lanka has continued its policies of reducing administrative controls, easing trade and payments restrictions and continuing tariff reforms. Sri Lanka is also continuing its serious efforts to diversify its export structure away from the traditional plantation sectors of tea, rubber and coconuts into such areas as clothing, shellfish, wood manufactures and products incorporating precious stones.

5. Most imports have now been freed from import licensing. The Sri Lankan statement for these consultations shows the items which have been liberalized during 1988. The liberalized list includes some textiles items, principally yarn and netting for use in the tea industry; precious

stones and metals for use in jewellery; machinery for the plastics and automatic filling and packaging industries; and regenerated cellulose. Maize, truck and bus bodies, and some chemicals were placed under licensing early in 1988: maize and truck and bus bodies were subsequently liberalized again. Items of certain capital goods in CCCN categories 84.37 (looms and knitting machines), when over 700,000 Sri Lankan rupees, 84.42 (machinery for working leather) and 84.59 (certain other machinery, except machines used in the rubber industry) have been freed from the requirement of approval by the Foreign Investment Committee.

6. Export licensing requirements for coconut, coconut products and rubber, and floor prices for exports of spices and allied products were abolished in January 1988. Export taxes on tea, after an increase in early 1988, were later reduced in order to encourage exports.

7. Annex A of the Sri Lankan statement also shows that State organizations maintain whole or partial monopolies of trade in salt, gems, caustic soda, infant milk food, dried chillies, wheat, rice, items for use in explosives, jute hessian cloth, tarpaulins, exposed film, petroleum products, and certain items for use in ayurvedic medicine. The share of State monopoly products in total imports is estimated at 7.9 per cent in 1988.

8. Over time, Sri Lanka has considerably liberalized its trade policies in an attempt to diversify and regenerate its economy. However, the country's economic management possibilities are strongly constrained by such factors as the course of world prices for traditional exports such as tea, rubber and coconut products; the evolution of trade policies and measures in partner countries, particularly as regards restraints on trade in clothing; the development of remittances of income from Sri Lanka residents overseas; the perceived need to maintain a high degree of self sufficiency in rice and other basic supplies; and the evolution of foreign aid and investment, the latter being itself considerably dependent on domestic political stability.

9. In early 1988, minimum tariffs on capital goods were increased to 10 per cent. A number of specific duties were introduced to combat dumping. Temporary credit restrictions were reportedly introduced in June 1989 under which letters of credit for "luxury consumer goods" must be covered by a bank deposit of 100 per cent of the value of the goods. Items covered include electrical, gas or mechanical domestic appliances, refrigerators and air-conditioners, sanitary ware, alcoholic drinks, tobacco, computers and peripherals, furniture and household equipment, glassware, electric lamps, detergents, motor vehicles, perfumes and cosmetics, photographic equipment, radios and televisions, video cassettes, watches and clocks, and carpets and other floor coverup. These restrictions are to be in force until 15 November 1989. In June 1988 a licensing requirement was also introduced on the establishment of letters of credit for import of cloves; exports of cloves quadrupled during 1988.

III. Economic trends and foreign trade

10. Sri Lanka has been engaged since 1977 in major domestic policy reforms towards a more open, market-oriented economy. However, these efforts have been adversely affected by domestic political problems, as well as by external disturbances such as the second oil price shock, a severe recession in developed countries in the early 1980s and depressed commodity prices.

11. Economic performance in 1988, the first year of the current three-year stabilization program, fell short of expectations. Although there was a modest recovery from the 1987 setback, the economy was beset by acceleration in inflation, high unemployment, large budget and current account deficits, and a mounting debt servicing problem. This year real gross domestic product is expected to grow by less than 3 per cent, no higher than last year's growth rate, while the balance-of-payments position is expected to deteriorate.

12. The continued balance-of-payments difficulties since the second oil shock (with an exception of 1984) is a reflection of the structural weaknesses of the Sri Lankan economy. First, the economy has been facing a sizeable resource gap between domestic investment and national saving, which must be financed by external borrowing (and foreign aid). While gross domestic investment declined from an average level of 30 per cent of GDP in 1981-82 to 23½ per cent in 1986-87, gross national saving (including grants) averaged 17½ per cent (except 1984) during the period 1981-87. This left a current account deficit of about 6 per cent of GDP.

13. Behind the low level of domestic saving in Sri Lanka lies a high level of borrowing by the public sector. In 1987, the overall budget deficit (including grants) amounted to 8½ per cent of GDP, of which about 5½ per cent was financed by domestic borrowing from the private sector. The recent deterioration in the government's fiscal position has been caused in a large part by increased expenditure on defence and internal security.

14. Second, structural weaknesses of Sri Lankan economy are also found in its export structure. More than half of total merchandise exports are tea and clothing, followed by rubber and gems (together 15 per cent). In addition, nearly half of total merchandise exports last year were purchased by two trading entities, namely, the United States and the EEC (particularly the Federal Republic of Germany and the United Kingdom). Such heavy dependence of export earnings on a few products and markets makes the economy very vulnerable to external shocks.

15. Led by a strong rise in tea exports, export volume increased by 3½ per cent in 1988, up from a 1 per cent increase in 1987. Although the continued strength of commodity prices for such products as tea and rubber was a favourable factor, this was not enough to offset the weak demand for clothing, particularly in the United States and the Federal Republic of

Germany. Thus, the dollar value of merchandise exports rose only 6 per cent last year, down from a 14½ per cent gain the year before.[1]

16. In volume terms, the growth of merchandise imports was a modest 2½ per cent for in each of the last two years. On a customs basis, the dollar value of merchandise imports expanded by 10 per cent in 1988, marginally down from 11 per cent in 1987, but considerably faster than last year's growth of merchandise exports. Against the background of a rapid expansion of the domestic money supply (M2 was up 14 per cent last year), any further contraction in merchandise imports would add to inflationary pressures.

17. Third, debt servicing has become another 'structural' problem for Sri Lanka. It reached nearly 29 per cent of exports of goods and services last year. Due to increased interest payments, together with a decline in tourism income, the invisibles account deficit increased by 9½ per cent to US$164 million.

18. Finally, the net inflow of foreign capital has tended to decline since 1983. Last year it dropped by about 9 per cent to US$249 million, as a 10 per cent rise in net capital inflow to the government was not enough to offset a large fall in net capital inflow to the private sector.

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[1] In national currency, the value of merchandise exports grew by 20½ per cent in 1987 and by 14 per cent in 1988.

Table 1 - Sri Lanka : Selected Economic Indicators

	1986	1987	1988[P]
		(Percentage Changes)	
Real GDP [1,2]	4.3	1.5	2.6
- Agricultural Production[1]	2.6	-5.8	...
- Industrial Production[1]	8.0	8.4	...
Money Supply (M2)[2]	4.2	16.3	14.0
Consumer Prices[2]	8.0	7.7	14.0
Volume of[2]:			
- Exports[2]	7.0	0.9	3.7
- Imports[2]	13.8	2.4	2.4
The rupee vis-à-vis U.S. dollar (appreciation +; depreciation -)	-3.0	-4.8	-7.4
Percentage shares in GDP of:		(Percentage Shares)	
- Current account balance[1]	-6.5	-5.1	-6.2
- Gross domestic investment[2]	23.5	23.3	...
- Gross national saving[a]	17.0	18.2	...
Debt service as percentage of exports of goods and services[1.b]	26.4	27.7	28.8
		(US$ billion)	
Exports (f.o.b.)[2]	1.215	1.393	1.476
Imports (c.i.f.)[2]	1.857	2.058	2.262
Trade balance (f.o.b. - c.i.f.)[2]	-0.642	-0.665	-0.786
Current account balance[1,2]	-0.417	-0.344	-0.435
Total external debt[1,3]	4.1	4.7	4.9

a - Defined as gross domestic investment plus current account balance
b - Including interest payments on short-term debt, progress payments and Fund changes and repurchases
P - Provisional
... not available

Sources: [1]Central Bank of Sri Lanka.
[2]IMF, International Financial Statistics August 1989.
[3]World Bank, World Debt Tables, 1988 - 1989 edition.

Table 2 - Sri Lanka: Trade by Major Trading Partner 1988

A. Exports		Share 1988	Percentage change in value (US$) 1988/87
	Destination		
1	United States	25.1	3.5
2	European Communities	23.5	16.3
	(Germany F.R.	7.1	3.8)
	(United Kingdom	5.4	8.7)
3	Japan	5.7	26.4
4	Egypt	4.0	-11.2
5	Pakistan	3.6	68.2
6	Belgium - Luxembourg	3.6	92.8
7	Iraq	3.5	8.1
8	Netherlands	3.2	23.9
9	Singapore	2.7	27.1
	Total of above	63.9	
	Total merchandise exports		6.0

B. Imports		Share 1988	Percentage change in value (US$) 1988/87
	Origin		
1	European Communities	17.3	9.4
	(United Kingdom	5.7	-9.9)
	(Germany F.R.	4.6	14.1)
2	Japan	13.8	0.3
3	United States	6.9	29.5
4	Hong Kong	5.3	-10.2
5	China	4.7	64.6
6	Iran I.R.	4.6	-2.2
7	Singapore	4.2	-7.2
8	India	4.1	8.9
9	Korea R.	4.0	13.5
	Total of above	57.9	
	Total merchandise imports		9.9

Sources: IMF, Direction of Trade Statistics July 1989.

Table 3 - Sri Lanka: Trade by Principal Product - 1987

A.	Exports	Share 1987
1	Coffee, tea, mate and spices	29.3[a]
2	Articles of apparel and clothing accessories	26.1
3	Rubber and rubber products	8.6
4	Pearls, precious and semi-precious stones	6.0
5	Knitted and crocheted goods	5.4
6	Miscellaneous goods	4.6
7	Edible fruit and nuts	3.6
8	Fish, crustaceans and molluscs	1.5
9	Mineral fuels and oil products	1.4
10	Other vegetable textile materials	1.3
	Total of above	87.8

B.	Imports	Share 1987
1	Mineral fuels and oil products	15.2
2	Boilers, machinery and mechanical appliances	9.4
3	Vehicles, other than railway and parts thereof	6.4
4	Cotton	6.1
5	Electrical machinery and equipment	4.7
6	Iron and steel	4.7
7	Man-made fibres, discontinuous	4.5
8	Sugar and sugar confectionery	3.7
9	Cereals	3.4
10	Knitted and crocheted goods	2.9
	Total of above	61.0

[a] 27.0 per cent for tea only.

Source: Sri Lanka Customs Department, External Trade Statistics 1987.