

Chapter 19

The Way Forward on Tariffs, Non-tariff Barriers, SAFTA, Bilateral Free Trade Agreements: The Case Study of Sri Lanka

Indra Nath Mukherji

19.1 Introduction

The forces of globalisation have led to the freer movement of goods, services and capital (if not labour) across borders. Even though South Asia continues to be the least integrated region in the global economy, considerable liberalisation in trade in goods, services and investment flows has nevertheless taken place. Among the South Asian countries, Sri Lanka stands out as an early liberaliser, since it initiated economic reforms in 1977. Much of this liberalisation today is not only taking place multilaterally under the World Trade Organization (WTO), but regionally and bilaterally. It is also apparent that, in parallel with lowering of tariff barriers, more opaque non-tariff barriers (NTBs)/measures have emerged as the main 'behind the border' instrument restricting the free flow of goods and services.

Technical regulations and industrial standards are important, but they vary from country to country. Having too many different standards makes life difficult for producers and exporters. If the standards are set arbitrarily, they could be used as an excuse for protectionism. Standards can become obstacles to trade.

The WTO Agreement on Technical Barriers to Trade states that the procedures used to decide whether a product conforms to national standards have to be fair and equitable. It discourages any methods that would give domestically produced goods an unfair advantage. The agreement also encourages countries to recognise each other's testing procedures. That way, a product can be assessed to see if it meets the importing country's standards through testing in the country where it is made.

The objective of this chapter is to examine with respect to Sri Lanka the nature of tariff barriers, the incidence of other import charges or para-tariffs on imports, the nature and incidence of NTBs, initiatives taken under regional and bilateral agreements and the reform process initiated, and to suggest the way ahead.

19.2 Import tariff

The Trade, Tariff and Investment Policy Division of the Ministry of Finance and Planning is responsible for formulation and implementation of Sri Lanka's import policy. In addition, the Trade and Tariff cluster of the National Council of Economic Development (NCED) also examines trade and tariff issues and sends

recommendations to the Ministry of Finance and Planning. NCED consists of 22 clusters, representing both private and public sector officials, which examine various sectors of the economy (USTR 2009).

Import tariffs are the main instrument of Sri Lanka's trade policy. In 2006, Sri Lanka's applied tariff rate for non-agricultural goods was 9.2 per cent. Its average bound tariff rate for these goods was 19.6 per cent. However, approximately 70 per cent of Sri Lanka's non-agricultural tariffs are unbound and can be increased any time. Sri Lanka's average applied agricultural tariff was 23.8 per cent (USTR 2009). According to Central Bank of Sri Lanka, the average import duty rate based on total imports and customs duties increased from 4.6 per cent in 2008 to 7.8 per cent in 2009 (Central Bank of Sri Lanka 2009).

The average import duty collection rate for products under different categories is presented in Table 19.1.

If we examine Sri Lanka's changes in average basic import duty collection rates for different categories of imports between 2005 and 2009, it is observed the country's duties on consumer goods almost doubled from 10.4 per cent in 2005 to 19.4 per cent in 2009. The rate was higher for food and beverages, for which average duties increased by about 2.8 times from 9.6 to 26.8 per cent over the same period. However, the basic custom duties of non-food consumer goods declined by almost half from 11.1 to 6.7 per cent over the reference period. The duties on intermediate and investment goods were substantially lower. But while customs duties on intermediate goods increased from 2.1 to 5.0 per cent, those on investment goods declined from 5.8 to 4.4 per cent during the same period.

Until the end of May 2010, Sri Lanka maintained a five-band tariff structure of zero duty for import of essential goods, 2.5 per cent for basic raw materials, 6 per cent for semi-processed goods, 15 per cent for intermediate products and 28 per cent for other finished goods (Central Bank of Sri Lanka 2009). In a major step towards simplifying and broad-basing the tax structure, a press release issued by the government stated that the multiplicity of the customs duty structure has

Table 19.1 Average import duty collection rate, 2005–09^a

	2005	2006	2007	2008 ^b	2009 ^c
1. Consumer goods	10.4	11.2	12.4	12.6	19.4
1.1 Food and beverages	9.6	10.7	13.5	14.8	26.8
1.2. Non-food consumer goods	11.1	11.7	11.2	8.4	6.7
2. Intermediate goods	2.1	1.5	1.5	2.2	5.0
3. Investment goods	5.8	5.2	4.8	5.3	4.4
Average import duty collection rate	4.6	4.3	4.1	4.6	7.8

Notes: ^aAverage import duty collection rate (including special commodity levy whenever applicable) as per cent of total imports (CIF value).

^bRevised.

^cProvisional.

Source: Abridged from Central Bank of Sri Lanka: Annual Report–2009

been simplified with a four-band duty structure of zero duty, 5, 15 and 30 per cent with effect from 1 June 2010. Besides, a 15 per cent surcharge (increased from 10 per cent as of 8 November 2007) was waived. In order to provide a boost to the rapidly recovering post-conflict economy, the 2.5 per cent import duty on most raw materials, plant and machinery has also been removed with effect from 1 June 2010 (GoSR 2010).

The press release further states:

In support of expanding tourist activity and rising levels of tourist arrivals, the government has slashed duties on motor vehicles by 50 per cent. To promote Sri Lanka as an active shopping centre for internationally branded products, phones, wrist watches, cameras and electronics have also been brought down below 10 per cent of overall taxes. These items will be liable for only Port Levy and Nation Building Tax and exempted from VAT and Cess. A distortionary Cess has also been scaled down to boost domestic activities. Cess will be maintained only for selected import affecting domestic activities which require safeguard from unfair import competition. In order to further support for local value-added activities for making raw materials, plant and machinery imports available at zero duty, the Government is also working towards providing anti-dumping legislation, prescription of quality standards etc. to improve the enabling environment for home-based industries.

As the Government is moving towards a simple tax structure, all essential commodities will be liable at the point of imports for only special commodity levy. This will minimise the cumbersome administrative procedures, particularly for small traders who are generally engaged in such import business.

(GoSR 2010)

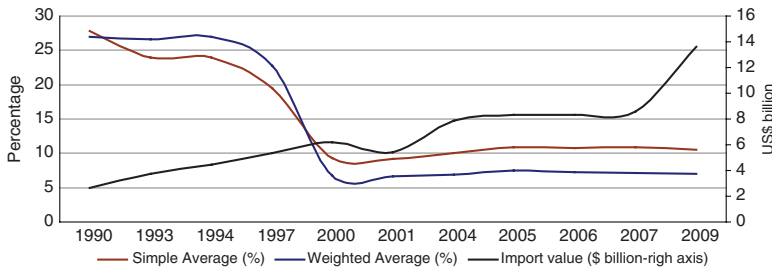
The WTO has also listed Sri Lanka's tariff and duty-free imports as may be seen in Table 19.2.

Table 19.2 Tariff and duty-free imports of Sri Lanka: October 2010

Sectors	Final bound rates	Applied rates (2009)
1. Most favoured nation (MFN) tariffs (all goods (simple average))	30.2	11.2
1.1 Agricultural goods	50.1	24.8
1.2 Non-agricultural goods	19.6	9.2
1.3 Non- <i>ad valorem</i> duties (% of total tariff lines, 2008)	0.5	2.5
1.4 MFN duty-free imports: Agricultural goods (% of total tariff lines: 2008)		0.3
1.5 Non-agricultural goods		42.1
1.6 Tariff binding coverage (%)	38.1	

Source: World Trade Organization: Country Profiles, available at: www.wto.org.in, 9 accessed 28 December 2010

Figure 19.1 Sri Lanka's simple and weighted average tariffs (per cent) and imports (US\$ billion)



Source: UN Comtrade database, accessed 28 December 2010

It sets Sri Lanka's final bound tariffs for all goods at 30.2 per cent and the applied rate for the same at 11.2 per cent. On agricultural goods the final bound rate is 50.1 per cent, the applied rate being 24.8 per cent. For non-agricultural goods the final bound rate is 19.6 per cent and the applied rate is 9.2 per cent. One half a per cent of Sri Lanka's final bound rates are *ad valorem*, while the same is true for applied rates at 2.5 per cent. Sri Lanka's duty-free imports, in respect of applied rates, cover 0.3 per cent of total tariff lines while the same for non-agricultural goods cover 42.1 per cent. Sri Lanka's tariff binding coverage for all products under final bound rates is 38.1 per cent.

The structure of import duties imposed by Sri Lanka on imported goods reflects both its revenue and development objectives. Since consumer goods constituted a large share of Sri Lanka's total imports, and many consumer goods items were considered as non-essential, the duties imposed on their imports were kept relatively high. Since the country wanted to promote industrialisation, it kept its duties on imports of intermediate and investment goods substantially lower.

UN Comtrade data reveals Sri Lanka's simple and weighted average tariffs during the period 1990 to 2008 (Table 19.1). It will be seen that both these rates started falling sharply from 1997 until 2000. Thereafter these rates have stabilised and a mildly increasing trend is visible. Over the period the simple average rate declined from 27.8 per cent in 1990 to 10.54 per cent in 2008, while the weighted average rate declined from 26.96 to 7.05 per cent. Until 1997 the weighted average rate was slightly higher than the simple average rate, but since then the simple average rate has been lower than the weighted average.

The WTO's third Trade Policy Review for Sri Lanka (2010) states that Sri Lanka introduced major changes to its tariff structure in 2007 and 2010. The simple average applied tariff was 11.5 per cent in 2010, up from the 9.8 per cent reported in Sri Lanka's Review for 2003, but lower than the 12 per cent posted in 2009. Tariff rates for most products range from 0 to 30 per cent, with few peaks, mainly for tobacco products. Despite the increase in the average rate, the proportion of duty-free lines rose from 10 per cent of the total in 2003 to 44.4 per cent in 2010, mainly through the elimination of the 2.5 per cent tariff rate and its replacement with duty-free access (WTO 2010). However, as most of the increase in tariff rates since 2007 were in the range of 25–30 per cent, the average tariff rate increased.

Table 19.3 Classification of taxes and levies on imports

Sl. No.	Description	Applicable statutes/ authority	Revenue accounts officer
1.	Import/export duties	Customs Ordinance No. 17 of 1869	Director General of Customs
2.	Import/export licences	Imports and Exports Control Act No. 01 of 1969	Controller of imports and Exports
3.	Ports and airports development levy	Finance Act No. 11 of 2006	Director General of Customs
4.	Import cess levy	Sri Lanka Export Development Act No. 40 of 1979	Director General of Customs
5.	Regional infrastructure development levy	Regional Infrastructure Development Levy Act No.51 of 2006	Director General of Customs
6.	Special commodity levy	Special Commodity Levy Act No. 48 of 2007.	Director General of Customs
7.	Value-added tax	Value Added Tax Act No. 14 of 2002.	Commissioner General of Inland Revenue
8.	Excise (ordinance) duty (liquor)	Excise Ordinance No. 8 of 1912	Commissioner General of Excise
9.	Excise (special provisions duty) cigarettes, liquor, petroleum products, others)	Excise (Special Provisions) Act No.13 of 1989 Act No.13 of 1989	Director General of Excise (Special Provisions)
10.	Social responsibility levy	Finance Act No.05 of 2005.	Director General of Fiscal Policy
11	Nation building tax	NBT Tax Act No.9	Inland Revenue Department

Source: Ministry of Finance and Planning and Treasury of Sri Lanka, available at: www.treasury.gov.lk, 9 accessed 25 May 2010

19.2.1 Para-tariffs on imports

Para-tariffs are a number of charges that an importer has to pay on imports other than customs duties. These para-tariffs are in the nature of levies designed to promote a number of developmental objectives for the country. Generally these are imposed at rates that are similar whether levied on the importer or the domestic manufacturer to create a level playing field for the latter. A list of import charges on top of tariffs is presented under Table 19.3. It will be seen that there are at least ten taxes/levies on top of customs duties relating to the development of infrastructure, protection of agriculture, value-added tax, excise and social sector levy.

Ports and airports development levy

In order to develop ports in Sri Lanka, a Ports and Airports Development Levy imposed in January 2007 was increased to 5 per cent of cost, insurance and freight (CIF) value of import items (other than specifically exempted items) from 1 January 2009.

Export development board (EDB) levy or import cess levy

In 2007, an EDB levy or cess ranging from 1 to 35 per cent was imposed on a range of consumer goods identified as 'non-essential.' Both *ad valorem* and unit rates are specified, and whichever rate is higher, is applicable.¹ The objectives of the levy are (i) to discourage imports of non-essential items; (ii) accord protection to local farmers/manufacturers; and (iii) to mobilise funds for the implementation of the country's Export Development Programme (*ibid.*).²

Cess on edible oils includes soya oil, ground nut, olive oil, sunflower oil, palm oil, etc. and their fractions. The objective in this case is to generate funds for launching programmes for a sustainable development of the coconut sector. The rate applicable is LKR 6/kg. on imported edible oil.³

EDB levy (cess) is charged on imports under some 3,500 tariff sub-headings covering a relatively large range of products, including fruits, vegetables, processed and unprocessed food, shoes, bags, rubber and plastic products, textile products, toiletry and perfumes. The cess is applied on the customs value calculated in rupees, adding a 10 per cent margin, and ranges from 1 to 35 per cent, with most goods at rates at or above 20 per cent (WTO 2010).

Regional infrastructure development levy

With effect from 1 January 2008, regional infrastructure development levy (Act No. 51 of 2006) charged at the time of import of any motor vehicles other than auto rickshaw is liable to the payment of excise duty as per schedule indicated in Table 19.4. It will be seen that that the rate of tax varies from 5 to 10 per cent depending on the cylinder and seating capacity of the vehicles.

Special commodity levy

As the government is moving towards a simple tax structure, and also to keep retail prices of essential food items under check, such commodities will be liable for tax at the point of imports only for special commodity levy. No para-tariffs are applicable on such products. In November 2009, customs duty, port levy, nation building tax, social responsibility levy and value-added tax were replaced by a lower special commodity levy. This levy was reduced further on rice and sugar in December 2009.

Table 19.4 Regional infrastructure development levy

HS Code	Cylinder capacity/ seating capacity/weight of motor vehicle	Rate(%)
87.03	Cylinder capacity not exceeding 1600	5
87.03	Cylinder capacity exceeding 1600 but not exceeding 2000	7.50
87.03	Cylinder capacity exceeding 2000	10
87.02	Seating capacity of less than 13 persons	10
87.02	Seating capacity of 13 or more persons but less than 17 persons	5
87.02	Seating capacity of 17 persons or more	7.50
87.04	Possessing the specified weight	5

Source: <http://taxsrilanka.com/infocentre/index.php/tax-types/35-debit-tax/98-tax-type>

Table 19.5 Special commodity levy-rates applicable on select commodities, per kg (January–May)

Tax Base	2009	2010
Dhal		
-whole	15	1
-splits	20	2
Potatoes	25	10
B' onions	25	10
Sugar	15	1
Chillies		
-crushed	50	25
-not crushed	40	20
Canned fish	85	85
Sprats	30	30
Green gram	15	15
Chick peas	25	15

Source: Fiscal Management Report, 29 June 2010, available at: www.treasury.gov.lk, 9 (accessed 29 December 2010)

This is expected to minimise cumbersome administrative procedures, particularly for small traders who are generally engaged in such import business. Amendments made with effect from 10 May 2010 listed 22 items (classified as HS six-digit) as essential. Such products include sprats, potatoes, onions, garlic, chick peas, peas, green gram, lentils, chillies, salmon, herrings, tunas, mackerel, etc. This list is reviewed every three months. Table 19.5 presents rates of special commodity levy applicable on select commodities in 2009 and 2010 (January–May). Considering the need to soften the cost of living on essential commodities, and their domestic availability, these levies have been brought down. The levy has resulted in lower import duties for the products concerned.

Value-added tax (VAT)

A VAT based on based on four slabs: zero duty, 5, 15, or 20 per cent is being levied on imports in Sri Lanka. While calculating the VAT, an imputed profit margin of 10 per cent (increased from 7 per cent on 1 January 2007), is added to the import price. Locally manufactured products are also subject to VAT, but the imputed margin is not added to the base. The VAT rates of 5 and 15 per cent have been replaced with the VAT band of 12 per cent with effect from 1 January 2009 (USTR 2009). Further exemptions on new items with effect from 1 June 2010 have been announced on import or supply of imported items under the HS Codes given by the Department of Inland Revenue. Electronic calculators, LP gas conversion kit for auto-trishaws, food grinders, shavers, hair dryers, cellular mobiles, digital cameras, electric call bells, wrist watches and video games are certain items exempted from VAT (DPR 2011). The exemption covers 54 products, mainly at six-digit HS classification. The distribution of these products at the level of Chapters is presented in Table 19.6. It will be observed that the largest number of products (27) fall in the category of electrical machinery and equipment (HS 85), followed by optical, photographic,

Table 19.6 Proposed VAT exemption (with effect from 1 June 2010)

HS Chapter	Description	No. of products
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	2
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers and parts	27
90	Optical, photographic, cinematographic, measuring, checking precision, medical or surgical instrument and appliances and parts and accessories thereof	13
91	Clocks and watches and parts thereof	10
95	Toys, games and sports requisites, parts and accessories thereof	2
	Total	54

Source: Sri Lanka Customs: Abridged, available at: www.customs.gov.lk/news/vat.pdf, (accessed 2 June 2010)

cinematographic products (13), falling under HS Chapter 90. Ten products fall under HS Chapter 91 containing items such as clocks and watches. Such a step has been in conformity to promote Sri Lanka as an attractive shopping centre for internationally branded products of phones, wrist watches, cameras and electronics, which have also been brought down below 10 per cent of overall taxes. These items will be liable only for port levy and nation building tax and have been exempted from VAT and cess.

Excise duty

In support of the expanding tourist activity and rising level of tourist arrivals, the Government of Sri Lanka slashed import excise duty on vehicles by 50 per cent while a reduction of duty on vehicle imports varies according to the engine capacity of each vehicle. However, general customs duty on such items has been increased from 28 to 30 per cent. With effect from 1 June 2010, excise duty is exempted from paints and varnish, air conditioners, vacuum cleaners, hair dryers, rice cookers, telephone sets, video recording, digital and television cameras, monitors and projectors, motor vehicles for transport of ten or more persons including driver and auto trishaws (DPR 2010).

As per gazette notification No. 1656/25 dated 2 June 2010, 50 per cent value addition recommended for exemption on locally manufactured articles has been reduced to 30 per cent of value addition, classified under HS Chapters 84 and 85.

Excise duties are levied on tobacco products, oil products, aerated water, liquor, beer, motor vehicles and certain household electrical items. Although locally manufactured products are also subject to excise fees, when calculating the excise fee on imports, an imputed profit margin of 15 per cent is added to the import price including most other import duties. Applied excise duty rates vary considerably; they may be *ad valorem* or specific and, in some cases, alternate. The highest rates are applied on automobiles and some machinery (WTO 2010).

Social responsibility levy

The social responsibility levy is imposed under the Finance Act and a levy of 1.5 per cent on taxes and levies is chargeable (Table 19.7).

Nation building tax

The nation building tax (NBT) came into operation from 1 February 2009, under NBT Tax Act No.9. It is payable by every person who imports any article (other than personal baggage) in to Sri Lanka. With the approval of the parliament, the tax rate increased from 3 to 5 per cent with effect from 1 May 2009. This tax was to be in effect for only two years as the government hoped to deploy the revenues for the development process in the North and the East (Newslanka 2009). The NBT will be applicable to every business that earns a daily income of LKR 1,000 or more.

The cascading effect of a plethora of taxes and levies paid on top of customs duties implies that the final price paid by the consumer will be more than double (in some cases such as vehicles, multiple) of what is reflected under basic customs duties.

The cascading effect of tax levies on Sri Lankan imports is best illustrated in a hypothetical import value of LKR 100. It will be apparent that in the case of products where all levies are applicable, the landed import cost would be more than double of the country's CIF import value.

The Sri Lankan Customs website has provided for accessing information on both tariff and para-tariffs in a transparent way. The Tariff Guide in Excel format with the provision of a tariff calculator enables the trader to find out the total incidence of the import levies online. However, the WTO in its Trade Policy Review of Sri Lanka (2010) states:

However, although orders modifying tariff and other import tax rates are published and available online, the frequent resort to this kind of practice adds discretion and creates confusion among importers; limiting the number of changes and converting specific duties into ad valorem charges would help to further foster transparency.

Bank margin requirements

Vide circular No. 35/01/005/0010/1 of 5 December 2008, commercial banks in Sri Lanka were informed that the margin requirements against the letters of credit for the importation of vehicles under Schedule A imposed by the circular No. 35/01/005/0010/01 of 2004 were to be increased from 100 to 200 per cent with immediate effect. Schedule A lists 80 categories under HS eight-digit classification of vehicles under six broad groups.⁴

Under Schedule A1, the products listed are mainly consumer goods requiring 100 per cent margin deposit under letters of credit. This list contains around 41 groups of products.⁵

Under the circular all licensed commercial banks were requested to adhere to a number of requirements on the importation of motor vehicles or related items given

Table 19.7 Tax levies on imports in Sri Lanka

Tax levies	Duty rate	Value – LKR
Cost, insurance and freight		100
Customs duty	0.10%	10
Surcharge	0%	0
Ports and airports development levy	1%	1
Cess levy	30%	33
Value-added tax	10%	18
Excise duty	15%	27
Regional infrastructure development levy	7.5%	14
Social responsibility levy	1.5%	1
Nation building tax	1%	2
Total tax value		106

Note: Modified to remove customs duty surcharge, which has been waived. This can only be used for *ad valorem* rate (percentage) only. Convert the specific rate into a percentage of value where specific rate is applicable. Input the rate of levy into the relevant cages in green. (Input 0 per cent when the rate is free or exempt.)

Source: www.customs.gov.lk/adp/Tariff%20Calculator.xls, (accessed 28 December 2010)

in the Schedule A on documents against acceptance (DA) terms with immediate effect. One requirement is that a 200 per cent margin deposit on the invoiced value which is imported under DA terms should be placed by the importer at the time of release of documents and acceptance of bills by the importer. This margin will apply to the total value of the invoice, even if the same invoice includes items which are not subject to margin requirement. The banks are not to grant any advance to enable importers to place the margin deposit.

19.3 Non-tariff measures/barriers

Non-tariff measures (NTMs)/barriers (NTBs) are all measures other than normal tariffs, namely trade-related procedures, regulations, standards, licensing systems and even trade defence measures such as anti-dumping duties, etc., which have the effect of restricting trade between nations. Some of these measures could be justified under the various provisions or exceptions provided under the various multilateral agreements governing international trade. On the other hand, certain NTMs that cannot be justified under any of these legal provisions are termed as NTBs (GoI 2008). Sometimes even when an action is justified under certain provisions or exceptions, the conditions required to be met by the importer may be too costly or cumbersome to comply with, which in effect becomes a constraint to trade. Thus, the dividing line between NTBs and NTMs may at times be quite thin and often blurred to draw a distinct classification. In this chapter we take a broad view on the subject so that all trade restricting measures, whether or not justified, are taken into account.

Table 19.8 Import licensing requirements in Sri Lanka

Sl. No.	Categories	Items	Licence fee (CIF value)
1.	Drugs	<i>Ayurvedic</i> , western, veterinary, homoeopathy, surgical sutures, Chinese herbal	0.2%
2	Vehicle and vehicle parts	11 categories are listed	Varying from 0.2% 50% and LKR 25,000 to 250.000 per license
3	Chemicals	Chemicals, pesticides, cereals, alcohol, radioactive materials, animal products, live animals, cashew in the shell, etc. and petroleum products (petrol and diesel)	0.2%, for petroleum products LKR 5,000 per licence issued to Ceylon Petroleum Corporation and Indian Oil Company; for other companies 0.2%
4	Telecommunication equipment and miscellaneous	Telecom equipment, cellular phones, sports goods, coins and discs and operated games, refrigerator gas Used refrigerators, deep freezers, and air conditioners Used furniture Coins and metals, dolls and other toys electricity generated, explosives, arms and ammunitions, other miscellaneous Sludge oil	0.2% 5% (Personal) 10% (Commercial) 50% 0.2% LKR 5,000 (per consignment)
5	Exports	Ivory and ivory products, scrap waste materials, repair and return items, timber, gift, re-export, samples, films, ebony handicrafts, old motor vehicles, others	LKR 1,000 (per licence)

Note: Minimum licence fee: Import licence: LKR 1,000 per licence, Amendments: LKR 750 per amendment, Licence abstract: LKR 500 per abstract.

Source: Abridged from Export and Import Control Department; Commodity list under Extraordinary Gazette No. 1574-12, www.imexport.gov.lk, (accessed 4 June, 2010)

19.3.1 Import licensing

Sri Lanka requires import licences for over 400 items at the HS six-digit level, mostly for health, environment and national security reasons (USTR 2009).

Import control licences are issued under following categories and schemes: (i) importation of vehicles; (ii) importation of drugs; (iii) importation of chemicals and bases, and (iv) miscellaneous items. In Table 19.8 a summary of import licensing requirements on various items/categories with applicable licence fees has been presented.

It will be observed that for drugs an import licence fee of 0.2 per cent of the CIF value is imposed. For vehicle and vehicle parts, 11 categories of products are listed, the license fee in respect of which ranges from 0.2 to 50 per cent of CIF value of imports and the licence value per licence ranges from LKR 5,000 to LKR 250,000.

For chemicals the rate is 0.2 per cent of CIF value and LKR 5,000 per licence issued to government oil companies and 0.2 per cent of CIF value for other companies. For telecommunication equipment the fee is 0.2 per cent of CIF value. The same is charged for cigarette papers, dolls, explosives, arms and ammunition, and a few miscellaneous items. For used refrigerators, deep freezers and air conditioning the fee is 5 per cent for personal use and 10 per cent for commercial use. The fee for sludge oil is LKR 5,000 per consignment.

The Sri Lankan government also applies licence fees on export items. For items such as ivory, scrap waste metals, timber, gift, samples, films, re-export items, ebony handicrafts, old motor vehicles and a few other items, the rate is LKR 1,000 per licence.

Generally, licensing requirements (including imposition of quotas and prohibitions) are designed to meet specific objectives such as protection of human and animal

Table 19.9 Spread of NTBs across tariff lines (2004)

Sl. No.	Categories of NTBs	No. of tariff lines
1	Authorisation for protection of human, plant, animal health and to ensure national security	78
2	Finance measures	1
3	Labelling requirements to protect human health	13
4	Licence requirements	102
5	Marking requirements to protect human health	4
6	Production characteristics requirements to protect human and animal health	52
7	Product characteristics required to protect human, plant and animal health	110
8	Prohibitions to control drug abuse, ensure human safety, national security, protect humans, plants and wildlife	48
9	Requirements to use specific points of entry	5
10	State trading administration	19
11	Testing, inspection and quarantine for human and plant health and to ensure safety.	84
	Total	516

Sources: Compiled from the World Bank WITS database and extracted from Ram Upendra Das (2009), 'Regional Economic Integration in South Asia: Prospects and Challenges', RIS Discussion Paper No. 157, available at: www.ris.org.in.

health, protection of the environment, protection of cultural heritage, morals, etc. Table 19.9 presents the spread of tariff lines to meet such objectives as in 2004. As many as 516 tariff lines could be identified as having some form of non-tariff measures. It will be seen that the highest number of tariff lines (110) relate to product characteristics to protect human, animal and plant health; licensing requirements in general covered 102 tariff lines; testing, inspection, and quarantine for human and plant health accounted for another 84.

19.3.2 Standards, testing, labelling and certification

Sri Lanka Standards Institution (SLSI) is operating a compulsory Import Inspection Scheme covering 102 products as per regulations. Conformity to the designated products to the relevant Sri Lankan standards is monitored.

Five categories of consignments have been classified. Categories 1–4 relate to quality certifications accompanying the consignments by (i) an international accreditation agency with which SLSI has a memorandum of understanding (MoU); or (ii) by a national standards body of exporting country; or (iii) a certification by a manufacturer/exporter registered with SLSI or (iv) carrying the certification mark of the national standards body of the exporting country.

In all the above-mentioned categories, samples will be drawn from the consignments and subjected to testing either for a random check and released for sale or if there is reasonable doubt regarding the product quality, SLSI may refuse release of such consignments. In case of consignments not accompanied by any certification, the consignment will be sampled at the port, and the consignment will not be released from the port until test report is available (SLSI nd).

The WTO considers Sri Lanka as a fairly open and transparent trade regime, characterised by reliance on price-based measures and scant use of NTMs and in general, relatively low tariffs (WTO 2010).

19.4 Trade liberalisation under preferential/free trade agreements

Apart from multilateral trade liberalisation, Sri Lanka has been liberalising its economy through regional and bilateral FTAs. Under the SAARC Preferential Trading Arrangement (SAPTA), Sri Lanka offered tariff concessions on 302 products of which 167 were offered for least developed countries (LDCs). While the preferential tariff was a modest 10 per cent for non-LDCs, the preferential margin for LDCs varied from 10, 20, and 35 per cent. In only three products, 100 per cent margin of preference was given. As Sri Lanka's most favoured nation (MFN) rates varied from 2.5, 6, 15, and 28 per cent, the offer of preferential margins by Sri Lanka can be considered to be very modest.

Sri Lanka's offer of concessions under South Asian Free Trade Area (SAFTA) and bilateral trade agreements with India and Pakistan is summarised in Table 19.10. It can be seen that under SAFTA Sri Lanka restricted trade liberalisation on 1,065

Table 19.10 Duty concessions offered by Sri Lanka in regional and bilateral trade agreements

Categories of concessions	SAFTA	India–Sri Lanka FTA	Pakistan–Sri Lanka FTA
Negative list ^a (% of import value)	1,065 HS six-digit tariff lines. (26.99% of total import value from region)	1,180 HS six-digit tariff lines (50.5% of import value from India, 2006)	697 HS six-digit tariff lines
Zero duty phased items		342 tariff lines w.e.f. 1 March 2000 880 tariff lines w.e.f. 1 March 2003 Items listed under residual are entitled for duty concession of 70% from 1 March 2006 and it will be 100% w.e.f. 31 March 2008	102 HS six-digit tariff lines For remaining items tariff will be phased out
Products subject to tariff rate quota (TRQ)			Sri Lanka has granted Pakistan TRQ for 6,000 m/t of basmati rice and 1,000 m/t of potatoes per each calendar year on duty-free basis. However, import of potatoes is permitted only during Sri Lanka's off-season. (two-thirds to be imported during June–July and one-third during October–November each year)
Trade Liberalization Programme	Tariff to be reduced to 20% over 2 years; and 0–5% over next 6 years		

Notes: ^aNo concessions are permitted: Imports based on MFN duties. Two items relating to cement (HS Codes 2523.21 and 2523.29) will remain on Sri Lanka's negative list. The tariff on these items would nevertheless be reduced progressively in such a manner, so that at the end of eight years, the items shall attract no duty and shall be phased out from the negative list w.e.f. with effect from.

products in its negative list. This accounted for 27 per cent of its imports from the SAARC region. Under the Indo–Sri Lanka Free Trade Agreement (ILFTA) Sri Lanka's negative list contained as many as 1,180 products. This covered more than half of its imports from India. The list of products in Sri Lanka's negative list under the Pakistan–Sri Lanka Free Trade Agreement (PSFTA) contained 697 products. While no estimate is available as to what extent its imports from Pakistan were precluded from liberalisation, it is expected to be substantial. With respect to ILFTA Sri Lanka is providing India duty-free imports on 342 items with effect from 1 March 2000 and on another 880 products with effect from 1 March 2003. On the residual list of items Sri Lanka has brought down its tariffs to zero with effect from 31 March 2008. Thus barring the negative list, Sri Lanka has opened up its market for duty-free imports from India.

Under PSFTA Sri Lanka has opened up its market for duty-free imports of 102 items. For the remaining items tariffs will be phased out. Sri Lanka has applied tariff rate quotas on imports of basmati rice and potatoes from Pakistan.

It has been observed that almost 90 per cent of Sri Lanka's imports have taken place outside the bilateral framework of concessions offered and the top ten items imported by Sri Lanka have been from its negative list with India. Thus the offer of preferences by Sri Lanka to India has not been very effective in increasing India's market access to the Sri Lankan market.

19.4.1 The way ahead

Sri Lanka is on the verge of a new era of growth and developmental challenges as it moves from a war economy to a peace economy. To capitalise on its new opportunities, the country requires urgent policy reforms to rebuild and reconstruct its economy. Sri Lanka is faced with mounting public expenditure and declining revenues. Its tax–GDP ratio has fallen from 24.9 per cent in 1995 to 14.9 per cent in 2008. This has been so in spite of a steep increase in the country's real GDP per capita since the tax base did not sufficiently broaden. Tax evasion, poor tax administration, a plethora of exemptions, and discretionary and ad hoc tax policy changes have contributed to this while making the existing tax structure too complex.

Sri Lanka was the first country in South Asia to initiate reforms in 1977. Over the years, however, many of the reforms were put in reverse as both tariff rates and the incidence of para-tariff measures increased over time.

Sri Lanka needs to widen its tax base in order to reduce its overall tax rate. Unfortunately in Sri Lanka key income groups such as professionals and public employees remain largely outside the direct tax net. This chapter has noted that even though the country's basic customs duties appear modest, there are at least ten other taxes on top of customs duties in Sri Lanka which make the incidence of taxation on imports a multiple of what is reflected under customs. Further, the calculation of the tax itself, using the same base, can be quite complex.

Kelegama using different sources of information, has maintained that high import duties on certain goods have fuelled a growing illegal importation trade (Kelegama

2009). According to an estimate of the Central Bank of Sri Lanka, revenue losses at import entry points due to illegal importation and undervaluation of imports are in the region of LKR 300 million. The Board of Investment has estimated that in the mobile phone market alone, illegal imports, spurred by high duty rates, have cost revenue losses in the magnitude of LKR 600 million. It is possible that a lower flat-rate duty may bring some of this illegal importation into legal channels and earn more revenue. There are proposals to position Sri Lanka, similar to Dubai, as an *entreport* trade hub for portable consumer items, such as mobile phones and other electronic items by imposing a lower tariff rate on such items (Kelegama 2009).

A case in point is the high duty rates on vehicles imports. Demand for imported vehicles has contracted sharply recently, mainly because of high duties and compounded by the global economic crisis. Currently vehicles imported into Sri Lanka cost 200–300 per cent of the CIF price. Now that the Sri Lankan economy is fast moving towards recovery and tourist traffic is on the upswing following the end of hostilities, a lowering of duties on vehicles could see a volume-led rise in revenue.

A slew of measures announced by the Sri Lankan government on 1 June 2010 is designed to address some of the problematic issues in fiscal reform in Sri Lanka. Such measures have perhaps brought down the effective incidence of taxation in Sri Lanka, but do not significantly address the country's 'new protectionism'. Post-conflict Sri Lanka urgently needs to capitalise on its peace dividend. It is hoped that the Presidential Commission on Taxation set up by the government to address the issue of fiscal reform will further deepen the reform process.

Notes

- 1 To illustrate, shampoo 35% or LKR 150/kg.; apparel 30% or LKR 75/unit, biscuits 35% or LKR 60/kg.; oranges 20% or LKR 15/kg. (USTR 2009).
- 2 Not applicable for the purpose processing and re-export, for manufacturing goods for export; to drugs registered under the Cosmetic Devices and Drugs Act; to ayurvedic imani, and siddha preparations.
- 3 Sri Lanka also applies EDB cesses on exports of cashew nuts with shells; raw hides and skins; ferrous metal and non-metal scrap; and natural rubber. Cesses on raw hides and skins to ensure sufficient local supplies for manufacture of leather products. Cess on export of metal scrap to enable continuous supply raw materials required by the local foundry industry at competitive prices; on export/import of rubber to generate funds for developing rubber cultivation in Sri Lanka and to encourage the export of value-added rubber production.
- 4 These are motor vehicles for transport of ten or more, motor cars and other motor vehicles, motor vehicles for the transport of goods, chassis fitted with engines, for the motor vehicles, part or accessories of motor vehicles, and trailers/semi-trailers.
- 5 Some of the products listed are oil and other fractions, chocolates, bakery products, wine, spirits, perfumes, beauty preparations, shaving lotions, soap, tableware, kitchenware, articles of leather, articles of apparel knitted/crocheted, footwear, artificial flowers, wall tiles, ceramic articles, imitation jewellery, locks, refrigerators, dish and household washing machines, electro mechanical domestic appliances, shavers, storage water heaters, electric irons, microwave and other ovens, coffee/tea, toasters, cellular mobile phones, video recorders, televisions, etc.

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