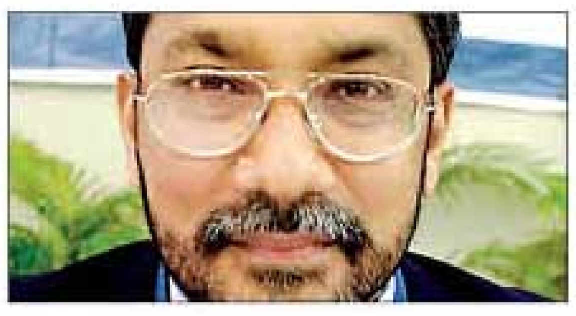
What does the latest WTO Review say on Sri Lanka's Trade Policy?



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BEFORE the World Trade Organization (WTO) was formed, a Trade Policy Review Mechanism (TPRM) of GATT member countries was introduced on a trial basis in 1989. It became a permanent feature once the WTO was established in 1995.

Under the TRPM, the trade policies of developing countries like Sri Lanka are generally reviewed every six years, although the time may vary according to the WTO schedules. The first review for Sri Lanka was completed in 1995 and the second in 2004, and the Report under review is the third one published in December 2010.

The objectives of the TPRM are to improve the adherence by all WTO Members to rules and commitments made under the Multilateral Trade Agreement, and where applicable in Plurilateral Trade Agreements, and thereby increase transparency in trade policies and practices of member countries for the smoother functioning of the international trading system.

It is not intended to serve as a basis for enforcement of obligations under the Agreements or to impose new policy commitments on members, but rather to highlight the progress and concerns of a member country's trading regime in the context of the smooth operation of the multilateral trading system.

The reviews are conducted using two documents, viz., a Policy Statement submitted by the Member Country (in the case of Sri Lanka, prepared by the Department of Commerce) and a comprehensive analysis of the member country trade regime prepared by the WTO experts.

On the basis of these two documents, a final Concluding Remarks is prepared by the Chairperson of the WTO Trade Policy Review Body, and these three submissions are included in the Report. After a brief introductory section, the Report has three key chapters, viz., Framework and Objective of the Trade Policy Regime, Trade Policies and Practices by Measure, and Trade Policies by Sector.

The Report first praises Sri Lanka for performing reasonably well despite major internal and external shocks after 2003. Examining the document, "Sri Lanka's Ten Year Horizon Development Framework 2006-2016" (TYHDF), the evaluation expresses satisfaction on mainstreaming trade policies with the overall economic development strategy of Sri Lanka.

That trade policy should dictate the development path of a country as advocated by ardent neo-liberal economists does not carry favour in the WTO review; this is indeed a positive feature. The Report then acknowledges that Sri Lanka's trade policy continues to be aimed at achieving greater integration into the global economy through multilateral (WTO), regional – SAFTA [South Asia Free Trade Agreement] and APTA [Asia Pacific Trade Agreement] – and bilateral – ISLFTA [India-Sri Lanka Bilateral Free Trade Agreement] and PSLFTA [Pakistan-Sri Lanka Bilateral Free Trade Agreement] – trading, through an incentive regime geared to encouraging exports and investments, and a number of development programmes to improve the infrastructure.

FT Quote

"The Report is very comprehensive and gives a broad brush scrutiny of the trading regime which is not normally found in economic reports produced on Sri Lanka. While welcoming the progress Sri Lanka has made in trade policy, the Report has highlighted the major shortcomings that needs the attention of policy makers, in particular, lack of notifications and going beyond bounded tariff levels and not renegotiating these levels under Article 28 of GATT. Given the diversity of issues that needs attention; it would be prudent for the Government to consider establishing an integrated approach for trade policy formulation in the near future"

The Report notes that Sri Lanka has been an active member in the WTO Doha Development Agenda (DDA) and has contributed to proposals/ debates on technical barriers to trade, geographical indicators, labelling of textile and clothing, footwear and travel goods, preference erosion, trade facilitation, among others. Since the last WTO review in 2004, Sri Lanka has not been involved in any disputes under the WTO rules.

Trade Policy regime: Framework and objectives

After highlighting the positive developments in the trade policy regime the Report expresses concerns on a number of areas. The exports have grown over the years but the performance is comparatively less impressive vis-à-vis competitors. For instance, in 1990 exports from both Vietnam and Sri Lanka amounted close to US$ 2 m, but by 2008, exports of Vietnam amounted to US$ 61 m. while Sri Lankan exports amounted to approximately US$ 8 m.

Moreover, Sri Lankan exports were less diversified, products and markets-wise. The Report while identifying these features of the Sri Lankan export sector, closely observes that the non-US and non-European markets, in particular in Asia, are increasingly becoming important destinations for Sri Lankan exports (while these markets have been large sources of imports to Sri Lanka for many years). The Report cogently argues for consolidating Sri Lanka's links with Asian markets, in particular the growing markets of India and China.

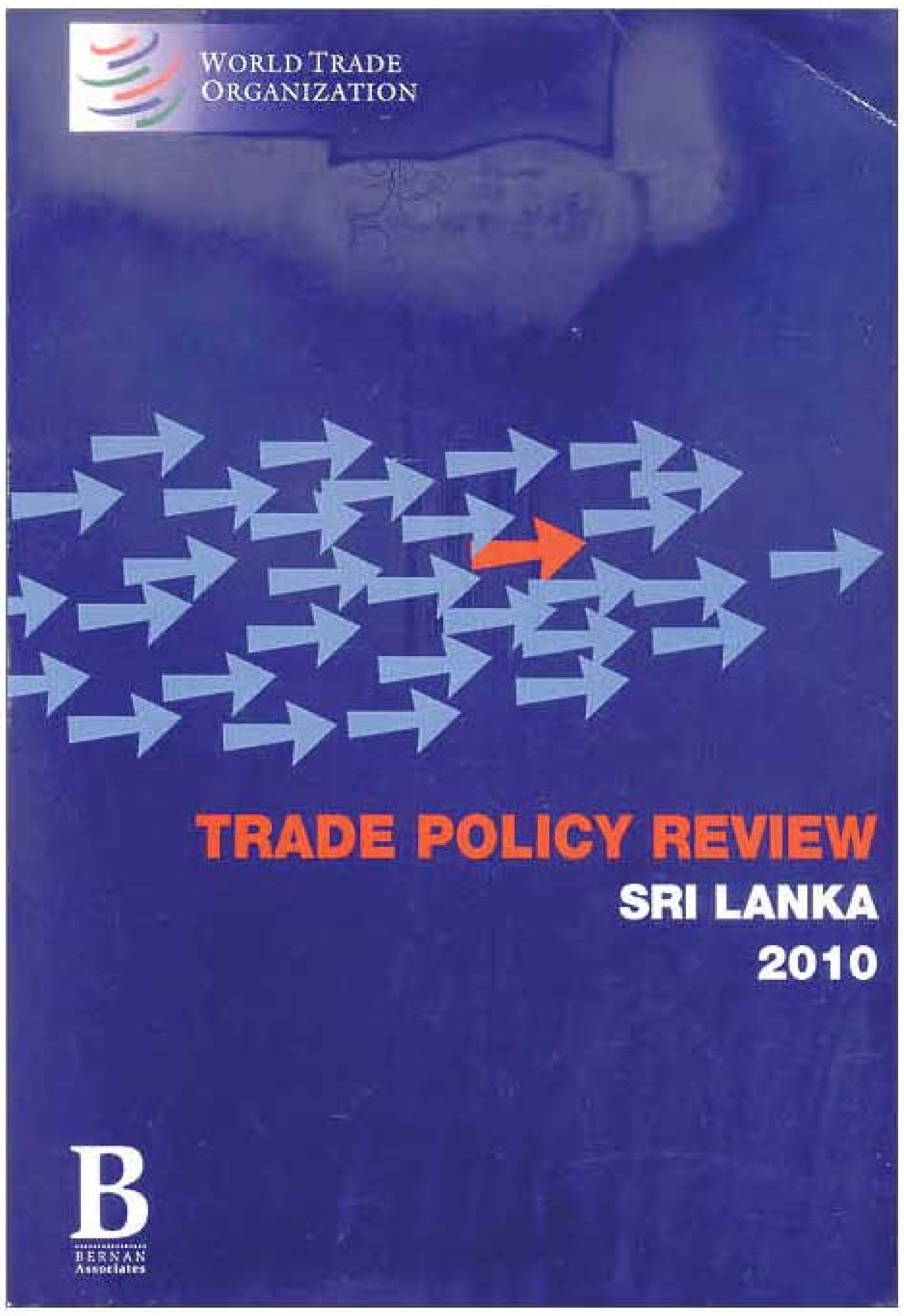
The Report states that the trade reforms since the last review shows a mixed picture with new border charges which on average has increased trade protection, for instance, the average MFN (Most Favoured Nation) tariffs was 11.5% in 2010 compared to 9.8% in 2003. The Report then goes on to say that trade policy has been guided to a large extent by revenue consideration.

These points are debatable because the post-2004 economic policies are based on a mixed economy model where import substitution and SMI promotion have received equal priority as export promotion, thus enhancement of the MFN tariffs are as per the TYHDF, although may not be consistent with the spirit of WTO.

Moreover, it was not only revenue but a concerted effort for additional protection that has driven tariffs upwards. The most widely used tariff rate of 25% was increased to 28% in August 2007 and again increased to 30% in June 2010 after abolition of some nuisance taxes that were imposed on the border.

It is well known that binding tariff levels under the WTO gives more predictability to the trade regime. In Sri Lanka, only 36.4% of tariff lines are bounded at rates ranging from 0 to 75%. In general, applied rates are lower than bounded rates with average bound tariff of 32.7%. The Report notes that 103 HS applied rates exceeded the bounded rate. This is an area that needs policy attention.

On the positive side, the following are noted. The number of tariff bands has fallen from 11 in 2003 to nine in 2009 and to five in late 2010. At present, the highest bands 100% and 250% are applied for a handful of products (mostly cigarettes and tobacco) and this is followed by the 30% band (mostly agricultural and food products, consumer goods, chemicals, and other intermediate goods manufactured locally), 15% band (intermediate products), 5% band (semi-processed raw material), and 0% band. Some 44.4% of tariff lines are on the zero band, 23.1% are on the 15% band, and 21.3% are on the 30% band. Zero duty items have increased due to the elimination of the 2.5% tariff rate and replacing it with zero duty.



The WTO: Trade Policy Review Report

The Report also refers to various add-on taxes at the border – Commodity Export Subsidy Scheme (CESS), Social Responsibility Levy (SRL), Ports and Airport Development Levy (PAL), Nation Building Tax (NBT), etc., which have been highlighted in the past. For instance, in 2007, the overall customs revenue increased close to 8% of GDP compared to import tariff revenue amounting to 2 % of GDP due to these add-on taxes (see The Island, Business, 30 August 2010).

Some of them such as the SRL were removed in the November 2010 budget but more needs to be done to have a transparent and predictable border trade regime and the Report goes on to say that frequent resort to ad hoc import tax imposition and removal, adds discretion and creates confusion among importers. Despite the complex import tax regime, the Report commends efforts made by the authorities to make available all import charges online.

Trade policies and practices by measures

Sri Lanka has benefitted somewhat from donor partners on Aid for Trade initiative to implement trade-related measures. Most Aid for Trade has been focused on trade facilitation, improving competitiveness and investment climate, and amounted to US$ 1.77 bn. between 2004 and 2008. Sri Lanka has now implemented the WTO Customs Valuation Agreement (CVA), however the Report expresses concern on domestic legislation permitting use of minimum values which is a departure from CVA rules, citing the example of reconditioned motor vehicles.

Non-automatic import licensing is required for 500 tariff lines although Sri Lanka's use of non-tariff barriers is relatively limited. All 103 trade-related technical regulations of Sri Lanka have been notified, including 18 SPS (Sanitary and Phytosanitary Measures), to the WTO. The Report notes that the Anti-Dumping Bill that was debated in Parliament in 2005 is yet to be ratified. Whether to implement Anti-Dumping legislation or not could be debated (see Chapter 15, IPS SOE – 2004) but it was opposed in Parliament strangely by a political party representing the interest of the national economy, arguing on the misguided belief that anti-dumping legislation is pro-WTO and against the national interest! Ever since this opposition, the Bill has been kept in cold storage.

The Report shows that the export taxes almost abolished in 1992, now apply only to some mining/mineral items exported in raw form while an export CESS applies to a number of products in order to develop R&D for those sectors. Since these CESS funds go to the Consolidated Fund, it is difficult to say how much of these funds actually go for the development of those sectors.

With regard to the Consumer Affairs Authority (CAA), the Report highlights a major anomaly that has been highlighted in previous writings on the subject, i.e., the CAA Act does not empower it to conduct investigations on the existence of monopolies or to examine mergers and acquisitions that have already taken place (Chapter 11, IPS SOE 2004 and others).

Utilities that fall under the Public Utilities Commission and listed companies under the Securities and Exchange Commission will only be subject to investigation for mergers and acquisition but all other companies outside this domain will not be investigated. It is high time that legislation in this area is enacted for promoting a more competitive and consumer friendly environment.

The Report makes a number of references to the trade-investment nexus in Sri Lanka (investment follows trade and more trade follows from investment). In regard to the Board of Investment (BOI), the Report argues the case for streamlining all BOI incentives under the Inland Revenue Department – a recommendation which makes resonance with the Presidential Taxation Commission and various Reports of the IMF. The Report emphasises that since the war is over and the economy is showing high growth rates, the case for extra incentives for FDI is not appropriate.

WTO: Trade Policy Review – Sri Lanka 2010, Co-Published by the WTO and Bernan, 2010, pp. 178.

In order to comply with the TRIPS Agreement, Sri Lanka enacted new intellectual property rights (IPR) legislation in 2003. This Act covers copyright and related rights, industrial designs, patents, marks and trade names, layout designs of integrated circuits, geographical indications, etc. The terms of copyright protection has been extended to life plus 70 years (from 50 years earlier). Despite this legislation, the Report says that counterfeiting and piracy is a problem due to weak enforcement. The Report recommends training officers, building public awareness, and stricter enforcement as the way forward.

Important concerns face Sri Lanka in formulating IPR policies in agriculture. The major issues include: the implications of IPRs on the price of seeds; the rise of bio-piracy; access of farmers to seeds; and the impact of property rights on biodiversity. Various countries in the South Asian region are currently attempting to evolve a twin strategy of granting both plant breeders' rights (a form of IPR for plant varieties) with farmers' rights (rights of farmers to engage in and benefit from their agricultural practices).

The Report does not make any reference to the Protection of New Plant Varieties (Breeders' Rights) Bill of 2001. This Bill has been discussed in a number of seminars but there does not seem to be any urgency in regard to debating the Bill and speedy enactment. India has already enacted legislation in this area.

The Report makes strong reservations on procurement procedures. It notes that the Government procurement, despite the abolition of the National Procurement Agency in 2008, continues to be used to promote domestic suppliers and products, which is contrary to WTO rules. Moreover, notification is yet to be done to the WTO with respect to State-Trading Enterprises under Article XVII of GATT 1994.

In regard to the former, Sri Lanka has not violated any WTO rules as Sri Lanka has still not made any notification in the WTO Plurilateral Agreement on Government Procurement, and is not planning to do so in the future. In order to strengthen domestic entrepreneurship, the Government grants price preferences for locally manufactured goods to promote value added to local raw materials and domestic bidders. The latter point is of course valid.

Trade policies by sector

The final section of the Report highlights the following in regard to agriculture, industry, and services sectors. The Report shows that a consistent trade policy is absent for the agriculture sector. Tariff changes to encourage domestic agriculture production and at the same time to give a reasonable price to the consumer have been a difficult exercise, thus giving an ad hoc structure to agricultural tariffs.

While more protection to the farmer has been the preferred Government policy, when supply responses are inadequate due to internal shocks and infrastructure inadequacies, the Government has resorted to tariff reduction to keep food prices low. The Report argues that a more consistent trade policy could be put in place with developing the agricultural infrastructure/ institutions such as marketing chains, storage facilities, transportation, etc.

Rationalising domestic support (such as the fertiliser subsidy), improving agriculture infrastructure, implementing some reforms in the land market, and implementing a more consistent trade policy will increase agriculture productivity, says the Report. This is the correct way forward but Sri Lanka did a mistake in the mid-1990s by binding agricultural tariffs at a relatively low 50% (compared to other South Asian countries) which triggered many ad hoc tariff changes and lowered the productivity of the agriculture sector.

In regard to the manufacturing sector, the Report highlights the following. Tariffs for manufactured products range from 0% to 30%. Processed goods receive higher protection than semi-processed goods, and raw material are duty free. Average MFN tariff for manufactured products (WTO-NAMA [Non-Agricultural Market Access] products) increased from 8% in 2003 to 9.2% in mid-2010 resulting from an increase of rates applied on all main industrial categories.

The tariff structure basically reflected the Government strategy of promoting value added in manufacturing and the domestic industry's high dependence on imports of raw materials and intermediate goods although adjustments of tariffs in June 2010 adversely affected some import substitution industries. Only 26% of manufacturing tariff lines is bound at an average bounded rate of 21.3%. Applied rates on 143 HS tariff headings exceeded the bound rates, and this matter needs addressing.

Incentives are the preferred policy instrument to promote manufacturing when exchange rate policy is restricted by debt management, cost escalation, and other issues. However, fiscal space for granting incentives are limited and the BOI incentives, as stated earlier, need streamlining and in this context maintaining flexibility and stability of the exchange rate becomes a vital policy issue for the growth and sustenance of the manufacturing sector.

In regard to services, the Report notes that it is the largest sector in Sri Lanka's GDP, however its exposure for international trading has so far been limited. Sri Lanka has made commitments in three service subsectors, viz., tourism, telecommunication, and financial services. In its schedule of commitments in these sectors, horizontal limitation and conditions relating to commercial presence is described. Commercial presence with foreign equity in excess of about 40% is subject to case-by-case approval under the discretion of the BOI. Sri Lanka considers services liberalisation as an important tool to attract FDI.

The Report notes that Sri Lanka's actual market access conditions are more liberal than those stipulated in its GATS schedule of specific commitments. It also notes that under the DDA, Sri Lanka has considered the possibility of making further commitments in sectors such as tertiary education, retail trade, and professional services where the initial offer has already been submitted.

There is a detailed description of these three sectors with special reference to the regulatory structure governing them. In tourism and financial services, the regulatory structures have made rapid progress to withstand further liberalisation of the sector. But in financial services, the large presence of the two state banks is seen as an impediment for private sector expansion, although this assertion is disputed by the Government claiming that the lending to the private sector by both these banks have increased significantly. The regulatory framework vis-à-vis the telecom has some way to go to encourage more private sector participation, according to the Report.

The Telecom Regulatory Commission Proposed Ten Year Development Plan (2006 – 16) identifies some of the problems in the sector as the lack of a seamless interconnection regime, the reluctance to share infrastructure facilities among operators, the lack of an effective surveillance mechanism to monitor compliance, and insufficient enforcement powers in current legislation.

Since the Government has identified IT-enabled services (13% of service exports amounting to $ 250 m in 2009,) in particular, Business Process Outsourcing (BPO) as an area offering significant potential, it is all the more imperative to address the shortcomings in the telecom regulatory framework as early as possible.

In sum, the section on services highlight some of Sri Lanka's strengths and the need to expose the services sector for international trading to gain the maximum opportunities from economies of scale.

Concluding remarks

Despite the slow progress of the DDA, the WTO creates a framework within which local decision making can unleash important opportunities flowing from a rules-based international system. Strong signals to the market can be given by 'locking-in' the trade policy regime (while giving due policy space) under these rules by trade policy makers. This will also enhance the credibility of the country in multilateral forums.

The Report is very comprehensive and gives a broad brush scrutiny of the trading regime which is not normally found in economic reports produced on Sri Lanka. While welcoming the progress Sri Lanka has made in trade policy, the Report has highlighted the major shortcomings that needs the attention of policy makers, in particular, lack of notifications and going beyond bounded tariff levels and not renegotiating these levels under Article 28 of GATT.

Given the diversity of issues that needs attention; it would be prudent for the Government to consider establishing an integrated approach for trade policy formulation in the near future.

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