India-Sri Lanka

Comprehensive Economic Partnership Agreement

Joint Study Group Report

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on

India – Sri Lanka

Comprehensive

Economic Partnership Agreement

October 2003

Joint Statement of the Co-Chairmen

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1. India and Sri Lanka enjoy excellent bilateral relations, sustained by geographical proximity, historical and cultural affinities and frequent high level political interactions,

2. The India-Sri Lanka Free Trade Agreement (ISLFTA) was signed in December 1998 and became operational in March 2000. As a result, trade expanded significantly to touch US$ 1 billion in 2002.

3. During the visit of the Sri Lankan Prime Minister to India in June 2002, the Prime Ministers of India and Sri Lanka discussed the profound changes in the international economic and political arena that have been generated by the process of globalization, on the one hand, and emergence of closer regional economic associations, on the other. They agreed on the need to widen the ambit of the ISLFTA to go beyond trade in goods to include services and to facilitate greater investment flow between the two countries. Accordingly, a Joint Study Group (JSG) was set up to make recommendations on how to take the two economies beyond trade towards greater integration and to impart renewed impetus and synergy to the bilateral economic interaction, through the conclusion of a Comprehensive Economic Partnership Agreement (CEPA).

4. The JSG was appointed in April 2003 and held its first meeting in May 2003. Through its deliberations over five meetings, the JSG concluded that accomplishment of the CEPA would take the two countries to a qualitatively new level of engagement by intensifying and deepening bilateral economic interaction. It would also contribute to greater receptivity to bilateral, sub-regional and regional cooperation in the region by demonstrating visibly its benefits to South Asia as a whole.

5. There was complete agreement in the JSG on the need to forge closer economic linkages to build on the advantages of geographical proximity and close political relations. The CEPA would have four components.

6. First, the existing ISLFTA would be widened to include more goods, and deepened to improve market access through trade facilitation and removal of non-tariff barriers. The JSG recommendations, when implemented, would serve to enhance trade flows through adoption of additional flexibility regarding the Rules of Origin criteria, and through mutual agreement regarding procedures on issuance and acceptance of Certificates of Origin. The conclusion of Mutual Recognition Agreements (MRAs)

between product certifying agencies of both countries would help greatly in mutual acceptability of goods produced in either country.

7. Second, an agreement will be entered into on trade in services. Negotiations should cover all service sectors and modes of supply under the GATS framework and the resulting agreement should cover a wide spectrum of services. In this area, importantly, the JSG recommends that the two countries explore ways to lower barriers to movement of business people and professionals and facilitate Mutual Recognition Agreements (MRAs) on professional qualifications. The JSG recommendations accord special priority to market access for provision of transport and logistics services. Among other action, this will be facilitated by liberalization of the bilateral air services agreement to increase the number of flights and destinations available to each country's airlines, including private airlines.

8. Third, the CEPA will include measures for promotion of investment in each other's countries. The JSG recommends that administrative and regulatory constraints be removed to promote bilateral investment flows that would help to maximize mutual benefits of economic integration. Specifically, the Board of Investment of Sri Lanka should set up a special cell to encourage and facilitate Indian investment in Sri Lanka. In India, Sri Lankan investors seeking to make foreign direct investment or portfolio investment should be treated on par with other international investors. Significantly, in regard to Foreign Direct Investment (FDI), the JSG has recommended that consideration should be given to providing pre-establishment of national treatment in sectors where 100 percent FDI is permitted on the automatic route in both countries, but with appropriate safeguards built in. The existing Bilateral Investment Promotion and Protection Agreement and the Avoidance of Double Taxation and Prevention of Fiscal Evasion Agreement should be reviewed by the two Governments in order to enhance their scope and effectiveness.

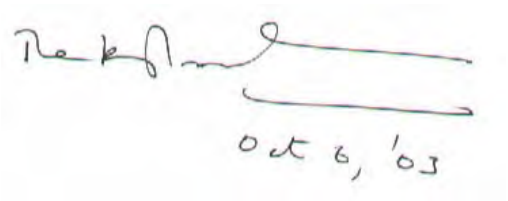
9. Fourth, the CEPA will include measures for enhanced economic cooperation in areas hitherto inadequately explored such as transportation, infrastructure, education, tourism, and information and communications technology. Specific actions for example could include financial and technical cooperation from India in modernizing the Sri Lanka railway system, and in establishing an educational institution in Sri Lanka on the lines of the Indian Institutes of Technology, to embody the spirit of friendship underlying the CEPA. To provide an impetus to some of its recommendations in this area, the JSG recommends the replenishment of the existing line of credit for commodities and services, as and when required, and to set up a new infrastructure line of credit of US$100 million, to begin with, for infrastructure projects. In addition, the JSG also recommends the establishment of an

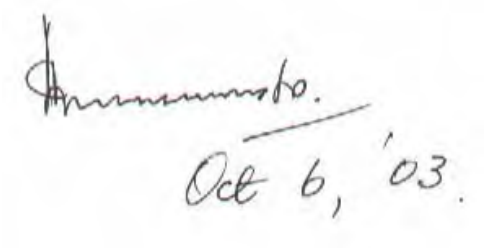
India Sri Lanka Economic Cooperation Fund for US$100 million, to begin with, to facilitate financial cooperation in such areas. The liberalization of visa regimes to include more categories of visitors for long term, multi entry visas and simplification of procedures for other visas will help in the movement of people related to all areas of trade, investment and economic cooperation.

10. Both countries are committed to an agreement consistent with WTO rules. The JSG assessed that the successful conclusion of the Comprehensive Economic Partnership Agreement between India and Sri Lanka would help both countries to experience the impact and potential of the process of integration on a bilateral basis in the first place. This would be beneficial to both countries in the context of the on-going global liberalization process that is continuing in the WTO framework. It would also give affected sectors in both countries time to adjust for the larger global changes anticipated.

11. We are of the strong view that negotiations for the India-Sri Lanka Comprehensive Economic Partnership Agreement should begin as soon as possible, with the aim to conclude negotiations within 4 to 6 months from the submission of this Report to the Prime Ministers. Such timely action will enable both countries to reap the early benefits of freer trade in goods and services, expansion of investment and enhanced economic cooperation.

12. As Co-Chairmen of the Joint Study Group we have great pleasure in submitting this Report to the Prime Ministers of India and Sri Lanka.





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06 October 2003

Acknowledgements

Acknowledgements by Dr. Rakesh Mohan, India Co-Chairman

I accepted this assignment to be the Co-Chairman of this Joint Study Group (JSG) with some optimism after having gained some experience in conducting a similar exercise with Singapore. It is gratifying to note that, as a consequence of that JSG Report, the negotiations for entering into a Comprehensive Economic Cooperation Agreement with Singapore are currently underway. At the outset, I am deeply grateful to the Prime Minister of India for having reposed his confidence in me a second time, to Co-Chair this important Group. We have been fortunate to have received clear-cut guidance from Shri Brajesh Mishra, Principal Secretary to the Prime Minister, which has enabled us to provide a blue print of a forward looking comprehensive economic partnership between India and Sri Lanka.

At the outset, I would like to thank all the members of the Group, Shri B.P. Misra, Shri S. Ramasundaram, Smt. Neelam Deo, Shri Firdose A. Vandrevala and Shri Rajiva Misra, for taking time from their busy schedules and actively participating and contributing effectively to the work of the Group within an exacting time schedule. We held five meetings in all within a short time span of about five months, which reflects the intensive nature of the work involved. Our High Commissioner in Sri Lanka, Shri Nirupam Sen, facilitated the meetings in Sri Lanka and spared the valuable time of his staff throughout the working of the JSG. I would like to place on record my tremendous appreciation to Shri V.Ashok, Counsellor (Economic and Commercial) at the our High Commission in Sri Lanka, Shri K.C. Rout, Director, Ministry of Commerce, India and Dr.A.Prasad, my Executive Assistant at the Reserve Bank of India for actively participating in all the meetings and contributing to the drafting process. Shri Ashok's knowledge of all ongoing economic cooperation activities between India and Sri Lanka was extremely helpful to the Group. Likewise, thanks are due to Shri P.R.Suresh, Officer on Special Duty at the Department of Economic Affairs for his able assistance in the completion of the Chapter on Investments. In addition, I would like to express my deep appreciation for the guidance provided by Shri Mohan Kumar, our Assistant Commissioner in Sri Lanka, particularly on technical aspects related to investments and services.

As would be evident from the coverage of issues in the Report, the Joint Study Group received tremendous support from a number of Ministries in the Government of India. Without implicating them in anyway with the conclusions of this Report, I would like to thank Shri Kanwal Sibal, Foreign Secretary, Shri Dipak Chatterjee,

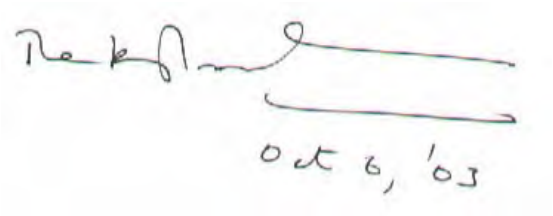
Commerce Secretary, Shri Rajeeva Ratan Shah, Secretary, Industrial Policy and Planning, Smt. Rathi Vinay Jha, Secretary, Department of Tourism, and Shri K.Roy Paul, Secretary, Ministry of Civil Aviation, for their wise counsel and active interest in this endeavour. Behind the scenes, assistance was rendered by Shri S.S.Kapur, Joint Secretary and Shri Augustine Peter, Director, Ministry of Commerce, Shri Anurag Goel, Joint Secretary, Ministry of Civil Aviation, Shri C.Balakrishnan, Joint Secretary, Education, Ministry of Human Resources Development and Shri Anwar Halim, Deputy Secretary, Ministry of Economic Affairs; their efforts are appreciated. Thanks are also due to Smt. Lalita Gupte of ICICI Bank and Shri B.Mahapatra and Smt. Grace Koshie, Chief General Managers, Reserve Bank of India for their suggestions on aspects related to the financial sector. A word of special appreciation goes to Shri Amitabh Kant, Joint Secretary of Tourism for his inputs on the subject.

A study on "India-Sri Lanka Investment Partnership: Some Analyses and Policy Recommendations" was commissioned through the Research and Information System for the Non-Aligned and Other Developing Countries (RIS). This study provided useful insights for the Chapter on Investments and identified valuable recommendations.

I would like to record my gratitude to Dr. Bimal Jalan, former Governor of the Reserve Bank of India, and Dr. Y.V. Reddy, the new Governor, for encouraging me and being extremely generous in allowing me the time required for completing such an exercise in five months, specially during this period of transition.

Last, but not the least, on behalf of all the Indian members of the JSG, I would like to record my deepest appreciation for the air of cordial and friendly atmosphere in which Mr. Ken Balendra, my Co-Chair and his colleagues functioned, which made a strenuous task seem easier to accomplish. Having spent his entire professional life as a leader in Sri Lanka's private sector, Mr. Balendra brought a whiff of fresh air to our discussions. His goal oriented, non-confrontational and informal approach was instrumental in both accomplishing this task within five months, but also in a manner that engendered great camaraderie among all the Members of the Joint Study Group. I have learned much from his leadership. This Report is truly a joint cooperative effort.

I do hope that our joint efforts will bear fruit in the early conclusion of the Comprehensive Economic Partnership Agreement between our two countries. Our deep historic relationship can flourish in the years to come for mutual economic benefit and become the precursor of similar warm economic relationships in the region as a whole.



Dr. Rakesh Mohan

Acknowledgements by Desamanya Ken Balendra, Sri Lanka Co-Chairman

When the Honourable Prime Minister appointed me to Co-Chair the Joint Study Group to complete this report in a relatively short space of time, I took it as a challenge and was confident of accomplishing the task because of the recognized stature and abilities of not only members of my team but also the Indian team.

I have always advocated closer economic co-operation with our large, friendly, neighbour, India; thus, the subject we were studying was of great interest to me, and meeting the challenge became the priority.

We used the India-Singapore Comprehensive Economic Co-operation Agreement (CECA) as the basic format upon which to build this Report. However, unlike in the case of India and Singapore, Sri Lanka and India already had experience in economic co-operation under the India-Sri Lanka Free Trade Agreement (ISLFTA). Thus, together with our Indian counterparts, we had to formulate a strategy to widen and deepen economic co-operation using the existing framework.

As I have stated earlier, I had an excellent team to support me and all the members handled their responsibilities with dedication and commitment. Despite their heavy official commitments, the members of the team attended numerous meetings in Sri Lanka and co-operated with one another in reading and commenting on the various chapters.

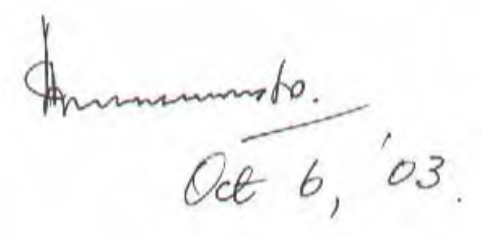
Those of us who had the privilege to meet with our counterparts from India on five occasions in New Delhi, Colombo, Mumbai (twice) and Kandy to formulate and complete this report will, no doubt, agree with me that we had the fullest co-operation from Dr. Rakesh Mohan, my Co-Chairman, and his team.

We found Dr. Rakesh Mohan and his high-powered team to be exceptionally supportive. The five joint meetings, without exception, were conducted in a very friendly and enjoyable atmosphere of camaraderie and good humour. There was no question of “we” and “you.” We worked together as one team. If ever I get round to writing my memoirs, I will certainly include a chapter on this particular assignment and narrate some of the most memorable moments, and Dr. Rakesh Mohan will certainly feature very prominently in it.

I would like to record my thanks to the support staff attached to members of our team, the Ministry of Commerce and Consumer Affairs, the Ministry of Foreign Affairs, the Central Bank of Sri Lanka, the Institute of Policy Studies of Sri Lanka, and the Board of Investment, Sri Lanka High Commission in New Delhi, and the Consulate General of Sri Lanka Office in Mumbai who went out of their way to make their resources available to us.

The secretarial support of the Institute of Policy Studies and Ms. Cheryl de Silva and Ms. Grace Boange, my secretaries, was of immense value as, without their input, it would not have been possible to meet the deadlines. The volume of electronic transmissions within our team as well as with our Indian counterparts was, by any standard, enormous.

In conclusion, I would like to record my appreciation of, and thanks for, the support extended to me by my team. A special word of thanks goes out to those who participated in the joint meetings and those who primarily wrote the chapters.



Desamanya Ken Balendra

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Overview

Chapter 1

OVERVIEW

Historical Overview

1.1 Trade between India and Sri Lanka has a history dating back to the pre- colonial era. However, during the colonial era, both economies were geared to producing goods for the colonial power. Even after independence, in the 1950s, the production structures of India and Sri Lanka did not undergo any significant changes. Thus there were no major transformations in the trade flow between India and Sri Lanka.

1.2 The state of affairs changed gradually with liberalization of the Sri Lankan economy. The first move towards an open economy came when the Sri Lankan Rupee was unified and subjected to a managed float in 1977 with the liberalization of external trade. The process of liberalization was expedited with the intensification of privatization and deregulation as well as progressive liberalization of various sectors over the ensuing years. Reforms in the Indian economy were also initiated in the 1980s and then intensified after 1991, which encompassed nearly all spheres of economic activity. Structural reforms in both countries have been dynamic and primarily aimed at fostering competitiveness, efficiency and growth by redirecting the economy towards openness and market orientation. India's trade-GDP ratio, an indicator of the degree of openness of an economy, increased from about 11.8 per cent during the 1980s to 17.4 per cent during the 1990s. Sri Lanka's trade-GDP ratio, following economic liberalization in 1977, increased substantially and stabilized at around 75 per cent in the 1990s.

1.3 The international trade and financial policies of India and Sri Lanka have also been greatly complementary.

1.4 While the regional initiatives moved slowly, the most significant outcome of this process for bilateral economic relations is the India-Sri Lanka Free Trade Agreement (ISLFTA), signed in 1998.

1.5 When the Prime Ministers of India and Sri Lanka met in New Delhi in June 2002, they took cognizance of the significant expansion of trade made possible by the ISLFTA. However, they also noted that there was much scope for expanding the areas of coverage of economic cooperation. Accordingly a Joint Study Group was set up to explore ways and means of deepening and widening economic cooperation through a Comprehensive Economic Partnership Agreement (CEPA).

1.6 The CEPA is intended to address issues such as reduction of items under the negative lists, harmonization of customs procedures, standardization and trade facilitation. Additional features of

this agreement would be the inclusion of trade in services, investment and economic cooperation. Such coverage would reinforce the bilateral framework established through the ISLFTA. Convergence of the two economies through globalization and the liberalization initiatives of the WTO will eventually erode the preferential margin between the two nations that is now provided by the ISLFTA. Therefore, it is vital to negotiate the CEPA promptly to enable both India and Sri Lanka to exploit the comparative advantages provided by expanded bilateral trade during this window of opportunity.

Consolidation of Institutional Mechanisms

1.7 Even before the ISLFTA came into effect in 2000, there were some mechanisms to facilitate and promote trade between India and Sri Lanka. In 1968, an Indo-Sri Lanka Joint Committee on Economic Cooperation was set up with the objective of increasing cooperation in trade, industry, agriculture and tourism. This committee was later transformed into the Indo-Sri Lanka Joint Commission for Economic, Trade and Technical Cooperation. An important aspect of the Joint Commission was that at subcommittee level, issues were taken up by senior officials, while at the Commission level issues were taken up by the Ministers of Foreign Affairs.

1.8 In 1992, the two governments set up a new Joint Commission with two sub committees: (1) Trade, Finance and Investment, and (2) Culture, Education, and Social Activities. A third sub committee on Science and Technology was added in 1993. The Joint Commission had its sixth and seventh Ministerial Meetings in April 1994 and January 1997, respectively. In recent years, the ISLFTA also has triggered regular meetings between trade officials of both countries. All such meetings have provided a forum to take up various trade and institutional issues. Thus, it is clear that substantial groundwork had been done by both countries to build an institutional framework to strengthen economic cooperation. It would be beneficial to review, consolidate and expand the functioning of such existing mechanisms and streamline their activities to meet the objectives of both nations under the proposed CEPA.

Developments following the India- Sri Lanka Free Trade Agreement

1.9 Since the establishment of ISLFTA between India and Sri Lanka in March, 2000, bilateral trade has increased considerably. Exports from India to Sri Lanka in 2002 amounted to US$ 835 million, while exports from Sri Lanka to India in the same year amounted to US$ 171 million. This is in sharp contrast to US$ 602 million of Indian exports and US$ 72 million Sri Lankan exports in 2001. Thus the ISLFTA has prompted a 48 per cent increase in bilateral trade between 2001 and 2002. At present, India is the largest source of imports into Sri Lanka, accounting for 14 per cent of Sri Lanka's global imports. India is the fifth largest export destination for Sri Lankan goods accounting for 3.6 per cent of Sri Lanka's global exports.

1.10 India is the third largest foreign investor in Sri Lanka with total investment over the last decade approximating US$ 400 million. Sri Lankan investment in India has also increased over the last decade. These investment trends clearly indicate strong potential for two-way investment flows between the two nations. Over half of Indian investments in SAARC are located in Sri Lanka, which has become the favoured destination for Indian investment in the region. India and Sri Lanka already have agreements on Avoidance of Double Taxation (1982) and Investment Promotion and Protection (1997).

1.11 Trade in services between the two countries has also seen a significant increase in recent years. There is considerable scope for further increasing trade in services between the two countries, especially in tourism, shipping, logistics, professional and airline services. Thus the present bilateral environment is conducive not only for expanding trade in goods, but also for increasing trade in services and in investment.

1.12 The ISLFTA between India and Sri Lanka is only a first step towards moving into higher stages of economic integration. If the deepening of economic cooperation is to take the traditional route, the ISLFTA will have to move towards a customs union. However, this is not feasible at present. Therefore, a non-traditional route of economic integration needs to be explored. A Comprehensive Economic Partnership Agreement (CEPA), that encompasses trade in goods and services, investment promotion and economic cooperation would serve to strengthen trade liberalization considerably. However, since the ISLFTA already exists, the CEPA could be implemented quickly to deepen economic cooperation between the two countries

Goals for the India-Sri Lanka CEPA

1.13 In order to measure the effectiveness and success of the CEPA, it will be beneficial to set up long term bilateral trade goals and define a time frame for their achievement. For example, presently India accounts for 3.6 per cent of Sri Lanka's total exports. It could be targeted to increase to 10 per cent by 2008. On the other hand, India's total exports to Sri Lanka are only 14 per cent of Sri Lanka's imports, which could be targeted to double by 2008. This is based on the assumption that the global exports of India and Sri Lanka would grow at a rate of 10-12 per cent and the trade between the two countries would grow at four times that rate. Similar targets can be established for bilateral investment between the two countries, since there is much potential for growth in a supportive environment. Goals could also be set in key service sector industries. For example, each nation could set targets aimed at increasing substantially the number of tourist arrivals from the other country by 2008.

1.14 If such targets are to be achieved, it is important to have a mechanism to monitor the progress of the CEPA and conduct periodic reviews. This task should be fulfilled by designated nodal points in the two countries.

1.15 A time table should be established by India and Sri Lanka, so that negotiations for the CEPA could take place in a timely and efficient manner. A suitable time-frame for India and Sri Lanka to achieve the CEPA would be roughly 4 to 6 months. This time-frame is important as the ongoing multi-lateral trade liberalization results in the rapid erosion of preferential duty margins under ISLFTA.

1.16 The CEPA will cover a broad range of liberalization actions and binding commitments regarding goods, services, and investment, as well as economic cooperation complementary to trade liberalization. In other words, the CEPA will widen and deepen the ISLFTA and supersede it in the near future. In this light, the JSG is of the view that CEPA should be notified under Article XXIV of GATT and Article V of GATS in the WTO. Such notification will indicate that both countries are committed to further liberalization and are committed to meet the standards stipulated by the WTO.

Best Practices for the CEPA

1.17 A primary objective of the CEPA should be to maximize trade creation and minimize trade diversion. Among others, the following best practices adopted by other nations and regional blocs may prove to be beneficial for Indo – Sri Lanka bilateral trade.

- Non-Tariff barriers

1.18 Trading across international borders entail many administrative costs and barriers that result from uncoordinated customs procedures, divergences in standards and requirements. This is presently one of the main anomalies that negate the scope of the India – Sri Lanka FTA. This situation could be effectively tackled through standardization and harmonization and mutual recognition at a bilateral level. The European Union has already implemented procedures to cut these costs and overcome these impediments through regional standardization and the introduction of “paperless” trade. The possibilities of adopting such a stance at a bilateral level by India and Sri Lanka are examined in detail in the following chapters.

- Private sector cooperation

1.19 The facilitation of private sector cooperation between the two nations is also an important element that should be considered in the CEPA. Through this, the concerned Ministries provide the opportunities for stakeholders from the private sector to actively participate in negotiations through periodic consultative sessions. Furthermore, the private sector is also given an opportunity to partake in the review of bilateral agreements and interact with counterparts through conferences and seminars. Sri Lanka and India will greatly benefit from the adoption of such a practice. These

measures could be strengthened via the Business Chambers of the two countries and possible nodal points.

Conclusion

1.20 Moving forward with a Comprehensive Economic Partnership Agreement (CEPA) to include broader areas of services and investment, in addition to trade in goods, represents a logical approach to achieving deeper economic integration. The economic gains from CEPA will result in both countries enhancing their productivity and competitiveness in order to face the challenges of multilateral liberalization under the WTO.

1.21 It is also important to establish clear objectives, a realistic time-frame and an effective monitoring mechanism to keep the partnership on track. Furthermore, the adoption of practices that maximize trade creation through the CEPA will greatly strengthen and deepen economic integration between India and Sri Lanka.

1.22 To sum up, this JSG report attempts to provide a blueprint for the deepening of economic integration, which has been initiated through the ISLFTA. The following chapters highlight the avenue for such a paradigm shift in line with the shared vision of the leadership of the two countries and the international obligations of India and Sri Lanka. In this context, the objective of the JSG is to:

- Develop an enhanced policy framework for trade in goods building upon the experience of the ISLFTA.

- Develop a policy framework for strengthening bilateral linkages, encompassing trade in goods and services, investment and other areas of economic cooperation, to maximize the benefits of geographical proximity and close relations between India and Sri Lanka.

- Suggest parameters and modalities for the incorporation of trade in services in the ambit of CEPA.

- Identify measures to facilitate greater investment flows by addressing possible regulatory and operational constraints.
- Identify opportunities for enhancing economic cooperation in areas of mutual interest.

Summary of Recommendations

The JSG recommends that the two countries:

- Enter into a Comprehensive Economic Partnership Agreement.
- Build upon the ISLFTA by deepening and widening the coverage and binding of trade in goods.
    - Notify the resultant agreement to the WTO under GATT Art. XXIV.
- Enter into broad negotiations covering all service sectors and modes of supply under the GATS framework.
    - Notify the resultant agreement under GATS Art. V.
- Facilitate greater investment flows by addressing identified regulatory and operational constraints.
- Implement measures to enhance economic cooperation to complement trade and investment liberalization.
- Complete negotiations on the CEPA within 4-6 months.
- Establish institutional mechanisms to monitor the progress of the CEPA so that the objectives are realized.
- Facilitate interaction between, and participation of, the private sectors of the two countries in the negotiation of the CEPA and its implementation.

Trade in Goods

Chapter 2

TRADE IN GOODS

2.1 Regional groupings are increasingly becoming an integral part of the present global trading system. More than 50 per cent of world trade is transacted within various forms of regional trade agreements (RTAs). RTAs have come to be accepted as 'second best' options to free trade or multilateralism, and the India Sri Lanka Free Trade Agreement (ISLFTA) should be viewed in this context.

Tariffs

2.2 Tariffs have the least trade distorting effects compared to other forms of restrictions on trade. Very high tariffs maintained for long periods would however render the domestic industry uncompetitive and inefficient. While multilateral tariff reduction is the first best solution, bilateral/regional preferential or free trade arrangements have their own merit and could also contribute to the strengthening of the multilateral trading system. The Free Trade Agreement between India and Sri Lanka signed in December 1998 has demonstrated capabilities for trade creation leading to mutual benefit for both India and Sri Lanka. Trade creation can occur within a bilateral free trade area if production efficiency improves when a member of the free trade area imports more from the lower cost partner leading to a fall in less efficient domestic production. Consumption efficiency improves when consumers in one member of such an area can import at a price that is lower than the price of the domestic product. At the same time, in the case of most developing countries, import tariffs constitute an important part of government revenue. They also serve the purpose of providing the necessary protection to the domestic industry.

2.3 Under the Uruguay Round (UR), India committed to bind tariffs for 62 per cent of its industrial products. In the pre-UR era, the binding was applicable for only 3 per cent of tariff lines. The UR commitments were expected to reduce India's trade-weighted average tariff from 71.4 per cent to 32.4 per cent. Further, at the UR, India committed to bind rates on mineral and basic products at 25 per cent and manufactures at 40 per cent, while consumer goods were not bound. Since the UR, modifications to the UR commitments have been effected owing to:

a) The Information Technology Agreement (262 items);
b) Re-negotiations with principal trading partners under Article XXVII of GATT in respect of 15 items; and
c) Binding rates in the textile sector.

2.4 Under the Uruguay Round (UR), Sri Lanka committed to bind 97 per cent of agricultural products at 50 percent. In the pre-UR era, the binding of agricultural products was applicable for only 3 per cent of tariff lines at 6 digit level. Sri Lanka's binding coverage of non-agricultural products as of today, including the tariff commitments undertaken under UR is 28.3 per cent. In the pre-UR era, the binding of non-agricultural products was applicable only for 5 per cent of tariff

lines at 6 digit level. Pursuant to the Doha mandate to liberalize tariffs of non-agricultural products, Sri Lanka is in the process of consulting the relevant stakeholders to decide on further commitments, which would eventually increase the sector's binding coverage.

2.5 The UR commitments in the agriculture area were expected to reduce Sri Lanka's trade-weight average tariff from 66 per cent to 50 percent. Further, at the UR, Sri Lanka committed to bind rates of certain non-agricultural products, such as fish and fisheries products, leather and leather products, wood products, products of iron and steel and products of other base metals at 50 per cent.

2.6 Since the UR, Sri Lanka has made modifications to its UR commitments in the non-agricultural area, particularly in the textile sector, with a view to increasing the binding coverage. WTO bound rates of both countries with their present applied MFN rates are given in Annex 1 and Annex 2.

2.7 The JSG took note of the substantial differences in the present levels of tariff bindings of India and Sri Lanka.

Assessment of trade under ISLFTA

2.8 A bilateral Free Trade Agreement was signed between India and Sri Lanka in December 1998 which became operational from March 2000. India has undertaken the following commitments:

a) Fixed duty concession of 50 per cent is granted on 233 tariff lines covered under ready made garments and 05 tariff lines covered under tea.
b) Fixed duty concession of 25 per cent is granted on 528 items in HS chapters 51 to 56, 58 to 60 and 63.
c) Duty concession of 100 per cent is granted on 1,351 items upon entry into force of the Agreement.
d) Margin of preference of 50 per cent on the remaining items of 2,799 shall be increased to 100 per cent in two stages within three years of coming into force of the Agreement.

(Note: the level of 100 per cent duty concession came into force with effect from 18th March 2003).

Tariff concessions are not granted for a total number of 429 items listed in the Negative List of India.

2.9 Sri Lanka has undertaken the following commitments:

a) Duty concession of 100 per cent is granted on 319 items upon entry into force of the Agreement.

b) Margin of preference of 50 per cent on 839 items shall be deepened to 70 per cent, 90 per cent and 100 per cent respectively, at the end of the first, second and third years of entry into force of the Agreement.

(Note: All items in this list are enjoying zero duty concession with effect from March 5, 2003).

c) For the remaining items of 2,724, the tariff shall be brought down by not less than 25 per cent before the expiry of three years and 70 per cent before the expiry of the sixth year and 100 per cent before the expiry of eight years, from the date of entry into force of the Agreement.

Tariff concessions are not granted for a total number of 1180 items listed in the Negative List of Sri Lanka.

2.10 Total bilateral trade has touched US$ 1 billion in 2002. Exports from India to Sri Lanka grew from US$ 602 million in 2001 to US$ 835 million in 2002 (by 39 per cent) making India the largest supplier to the Sri Lankan market. Meanwhile, the value of exports from Sri Lanka grew from US$ 72 million to US$ 171 million during the same period recording a 138 per cent growth. Sri Lanka's import/export ratio improved from 8.6:1 to 4.9:1 while the import coverage ratio, which measures the extent to which export proceeds can cover disbursements on imports, improved from 11.6 per cent in 2001 to 20.23 per cent in 2002.

2.11 India, which stood as the 22nd buyer of Sri Lankan goods during the 1990s emerged as the fifth largest buyer in 2002 accounting for 3.6 per cent of the value of total exports (US$ 171 million). The growth momentum of Sri Lanka's preferential exports was propelled by copper related products which have collectively accounted for 63 per cent of the value of total preferential exports in 2002 (Rs.10,930 million or US$ 114.3 million) as against 10 per cent in the year 2001. Other preferential products also recorded a remarkable growth rate of 192 per cent in the year 2002 as compared with the growth rate of 43 per cent in 2001. These include, inter alia, waste paper, dual inline memory modules (DIMMs), furniture, pneumatic tyres, multi wall paper sacks, marble slabs, ceramic ware, jewellery and ice cream machines.

2.12 The portion of Sri Lanka's exports absorbed by India in 2002 (US$ 171 million) is equivalent to 9.6 per cent of the value of Sri Lanka's exports to the USA (US$ 1762 million), Sri Lanka's leading export market during the same period.

2.13 In the assessment of the FTA the key issues which have arisen are:

a) Sri Lanka's utilization of quotas for tea (15 million kg.) and readymade garments (8 million pieces) remained below 5 per cent of quotas available. Limitation of entry points granted to preferential exports of these items have inhibited their trade. Accordingly the number of entry ports has recently been increased from 4 to 7.
b) During the period March 2002 to end 2002 Sri Lanka effected 4600 shipments to India under the FTA of which less than 50 consignments were subject to unanticipated delays. Doubts expressed by Indian Customs regarding the authenticity of Certificates of Origin contributed to

delays in the case of certain shipments. Direct contact between authorities of both countries and the placement of FTA conversant nodal officials at the entry points have been identified as measures to resolve these problems.

c) The surge in Sri Lankan copper exports created a `critical circumstances' situation which was resolved through discussion under the consultative mechanisms in place under the ISLFTA.

d) Rigidities of the present Rules of Origin criteria, particularly the requirement of 4 digit HS conversion were seen as inhibiting potential exports from Sri Lanka despite high value addition involved.

e) Discriminatory sales taxes levied by certain Indian states adversely affect some preferential exports from Sri Lanka. Tariff escalations through special additional duties too similarly affect the competitiveness of such preferential exports.

f) A factor which causes the trade balance to be heavily in favour of India is the asymmetry of economies between the two countries in terms of export base, excess capacity, raw material supply base, degree of industrialization, lower freight charges and availability of skilled technical manpower. A realistic appreciation of Sri Lanka's capacities in the relevant sectors may render possible further deepening of certain preferences granted to them by India, e.g. enhancing the present concessionary rate for textile exports (25 per cent of the general rate).

g) Around one third of India's total exports to Sri Lanka are items that come under Sri Lanka's negative list. In 17 of these tariff lines, exports to Sri Lanka exceed Ind. Rs.100 million. Some of these items are onions, vegetables, masoor dhal, fruits, wheat, rice, sugar, Portland cement, paper products, motor vehicles and auto parts. Sri Lanka's exports on India's negative lists are approximately 6 per cent of its total exports at present. Items of significance are rubber, plastics, printed labels, and polyester and nylon yarn. Removal of further items of export interest to either country from the other's negative list is under consideration through the consultative mechanism provided under the FTA.

2.14 The JSG observed that possibilities of further enhancement of benefits for both countries utilizing hitherto untapped market opportunities available under the ISLFTA, show vast potential. However, several impediments which deter utilization of preferential access that is currently granted can also be observed. Additional flexibility in granting originating status, the need to phase out negative lists as far as possible as well as the need to ensure "National Treatment" as per WTO commitments, Mutual Recognition Agreements and conformity assessment procedures are areas that need to be addressed. In this regard, the JSG noted that further expansion of quotas granted in tea and readymade garments, which are of key export interest to Sri Lanka, will be favourably considered by India once the present quotas are nearing full utilisation.

2.15 With further reduction of basic customs duty as a result of regional arrangements and multilateral liberalization under the WTO, the margins of preference that are currently enjoyed are likely to get gradually eroded rendering all preferences granted under FTAs and PTAs redundant. Therefore, it is of paramount importance to undertake fast track liberalization between the two countries under the framework of a CEPA.

2.16 Further liberalization of the goods trade under the CEPA, keeping in view the asymmetries of both economies, would lead to an overall increase in bilateral trade flows. Both countries would benefit from tariff reductions as this would reduce the cost of business, increase the competitiveness of domestic industries and enhance both countries' effectiveness as investment destinations.

2.17 A central objective in developing the CEPA is to broaden and deepen the existing ISLFTA in order to elevate trade between the two countries to their next level in the economic relationship. Both countries are committed to a CEPA that meets the conditions for trade in goods stipulated under GATT Article XXIV, including coverage of substantially all trade with no sector wholly excluded and with implementation to be completed in a timely manner. This process should progress towards phase out of the existing negative lists under the ISLFTA to their lowest conceivable levels, while ensuring that no new barriers that would impede further expansion of bilateral trade would be introduced. The asymmetries of the economies of India and Sri Lanka should be recognized in the reduction of the negative lists.

2.18 The agricultural sector accounts for 23 per cent of India's GDP, which is comparable to 20 per cent for Sri Lanka. But in terms of magnitude, the agricultural Sector GDP of Sri Lanka is 2.5 per cent of the Indian agricultural GDP and consequently is smaller than that of most of the Indian states.

2.19 Most countries, the developed as well as the developing, offer a measure of protection to their agricultural sectors. The WTO Doha Declaration has addressed the need to liberalize multi lateral trade in agriculture, with commitments to substantial improvements in market access, reduction/phase out of export subsidies and substantial reductions in domestic support. It is hoped that, despite the failure of the WTO Cancun talks, progress in this direction will continue to be made. The importance of according Special and Differential Treatment to the Developing countries within these parameters to accommodate their adjustment needs has also been recognized by the WTO.

2.20 With trade liberalization, most of the quantitative restrictions have been abolished in both countries and formal instruments such as tariffs and other taxes have been kept low to moderate, including those protecting domestic primary and food processing industries. However, since rural labour absorption and food security needs are important factors for both countries at present, there are important exemptions. Restrictions in the form of WTO-legal non tariff measures such as State Trading Enterprises (STEs), Tariff Rate Quotas (TRQs), specific tariff values for duty calculations, Sanitary and Phyto-Sanitary measures (SPS) continue to provide protection to specific sub sectors in both countries. For example, while import policies are restrictive with regard to rice, wheat and coarse grains, dairy products, edible oils and sugar in India at present, rice, pulses, onions, potatoes and chillies are subject to restrictive import policies in Sri Lanka.

2.21 It is also significant that world prices in these product groups are highly cyclical. Several of these products have been in the low phase of such cycles in recent years. While noting the

sensitivities and complexities involved in the management of policies for the agricultural sectors of both countries, the JSG recommends that long in-grained anti-import tendencies that offer redundant protection to products with low production costs or with low stakeholder interest would need to be rectified in both economies. Empirical investigations may reveal that several such products will not require much adjustment of policies, if competing imports are allowed. The JSG recommends that CEPA negotiations should facilitate further liberalization of agricultural trade and cooperation in the agricultural sector between India and Sri Lanka in the above context.

Rules of Origin

Rules of Origin and Principles as applied in ISLFTA

2.22 Rules of Origin (ROO) are criteria to determine the nationality of goods (where they are made, produced etc.). They are crucial in any bilateral or regional performance or free trade arrangement in order to prevent trade deflection (i.e. to ensure that such arrangements are not used to route third country products to the participating countries). The rigour of the preferential ROO would depend on the differential between the MFN and preferential rates of duty and the perceived risk of trade deflection. In the ISLFTA, the total value of the material, parts, or produce originating from countries other than the Contracting Parties or of undetermined origin used should not exceed 65 per cent of the FOB value of the products produced or obtained and the final process of manufacture is performed within the territory of the exporting Contracting Party. Further, in respect of a product exported by either Contracting Party and which has used material, parts or produce from the other Contracting Party the value addition in the territory of the exporting Contracting Party shall not be less than 25 per cent of the FOB value of the product under export subject to the condition that the aggregate value addition in the territories of the Contracting Parties is not less than 35 per cent of the FOB value of the product under export. However, as can be seen in section 7 of Annex 4, conversion of HS heading at the 4 digit level, remains the main determinant of preference availability under the ISLFTA.

2.23 Most FTA/PTAs have adopted conversion of HS heading at the 4 digit level as denoting sufficient transformation in a manufacturing process of ROO purposes. However across the board application of this rule imposes certain rigidities by which some products with value addition even higher than 40 per cent-50 per cent are denied originating status. MERCOSUR and NAFTA agreements have therefore built-in flexibility to overcome these rigidities and to stimulate the desired trade flows.

2.24 The JSG recommends that the CEPA negotiations should consider the following measures, while maintaining the effectiveness of ROO criteria to ensure that only products with genuine value addition are granted originating status.

a) Abolition of the requirements of conversion at 4 digit level where Domestic Value Addition (DVA) exceeds 40 per cent of the FOB of the finished products.
b) Dispense with the HS conversion requirement where the CIF value of non- domestic input is less than 7 per cent of FOB value of finished product.
c) In order to encourage Indian and Sri Lankan exporters to source inputs from each other, imported inputs from either party should be considered as domestic inputs of the finished product and the requirement of HS conversion may be dispensed with.
d) Depending on the level of value addition and the importance of products concerned in stimulating two way trade, the CEPA, should consider adoption of 6 digit HS conversion for identified groups of tariff lines.

Customs Procedures

Risk Management

2.25 India: Since 1998, a Fast Track Clearance Scheme has been in place in India under which certain categories of importers have been allowed to pay duty and clear the imported goods on the basis of self-assessment of duty. Under the Indian EDI (Electronic Data Interchange) system, there is a 'green channel' facility under which identified importers, on the basis of past performance, are allowed waiver of examination of the imported cargo. For certain categories of cargo (gold, silver, books, defence cargo, imports by universities and other public funded research institutions), the assessment is done through the "Systems Appraisal". In these cases, the import document, after submission, is assessed for duty and the duty amount is calculated in the EDI system without intervention by customs officers. Large scale simplifications have been carried out in the export procedures as well. The JSG took note of the statement by the Indian Finance Minister, in his budget speech on 28 February 2003, of his intention to bring India's customs procedures on par with best international practices. He proposed to introduce a self-assessment scheme this year.

"Physical inspection of imported goods will be done by using risk assessment and management techniques on a computer-based system and not on the orders of customs examining staff. Further, the existing system of concurrent audit of import documents will be replaced by post-clearance audit, as prevalent in developed countries".

2.26 Sri Lanka: In 1992 Sri Lanka customs introduced an Automated Cargo Clearance System with the assistance of UNCTAD. This project was called ACCESS (Automated Customs Cargo Entry system for Sri Lanka) and the software used for this project was called ASYCUDA.

With the use of ASYCUDA version 2.6, Sri Lanka Customs began automating the process of Customs Declaration (Cusdec) in the areas of Import, Export and Bonding. Certain modules like Manifest, Selectivity were not introduced due to practical problems and the project was fully completed in 1995.

The present version of ASYCUDA called ASYCUDA++ which runs on a Unix platform supported by an Oracle Data Base was introduced in 1998. In addition, the Sri Lanka Customs has developed two other independent software programmes to monitor the Container Clearance and Bank Guarantees in Bonding Procedures.

Under the ASYCUDA system there are number of selected DTI (Direct Trader Input) operators working with Sri Lanka Customs who lodge their Cusdecs from their offices to the Customs Data Base. The Customs works on expansion of this facility under a selectivity criteria process.

Further, Sri Lanka Customs with the cooperation of the Ministry of Commerce and Consumer Affairs is presently working on EDI (Electronic Data Interchange) project. The basic steps such as procedures, message testing and office locations were completed and it is expected to introduce this system (EDI) in the near future.

With the implementation of the EDI, it is envisaged to introduce an Automated Selective Module in ASYCUDA++. Under this, the processing of Customs Declaration and the Clearance of Cargo will be subjected to the following four channels;

Green	-	No document check and no cargo check
Blue	-	No document check, no cargo check but subject to post audit.
Yellow	-	Subject to document check but no cargo check
Red	-	Subject to document check and cargo check

With the Automated Selecting, it is expected to minimize the delays in the clearance process and enhance the uniformity in selection of consignments for examination.

2.27 The JSG recommends;

a) The adoption of a risk management system by India for customs clearance procedures. The JSG noted that India has already moved significantly in this direction. However, the time frame for its introduction, specific elements of risk management, and exceptions for goods coverage would need to be negotiated. Priority for implementation of trade facilitation measures, including risk management, should focus on ports that account for substantial bilateral trade, including Nhava Sheva, Chennai, Mumbai and Colombo. The list of ports could be augmented as modernization takes place.
b) Both Customs Administrations should, as far as possible, administer their customs procedures based on risk management principles to focus on compliance efforts on high-risk goods and to clear low-risk goods from both India and Sri Lanka expeditiously through designated “Green Channels” with minimal physical examinations.
c) Both Customs Administrations could also exchange information on best practices relating to risk management techniques for customs clearance.

Origin Verification Procedures

2.28 Both countries recognize that unless the integrity of the CEPA is maintained and all of its provisions, notably the Rules of Origin, are scrupulously observed, few economic benefits will accrue. While the Certificate of Origin procedures, established under the ISLFTA are included in Annex 4, additional verification procedures will be put in place.

2.29 The JSG noted India's concerns regarding under-valuation of preferential trade. More direct means of communications between officials and departments of both countries should be established to address these concerns. In recognition of the critical importance of this issue, the Sri Lankan Government has indicated that it would have no objection to Indian Customs and/or Trade officials being based in Colombo to ensure effective implementation of the CEPA. The JSG recommends that a Working Group consisting of appropriate officials of both Governments be set up to examine and approve a verification procedure that would refine the issuance of Certificates of Origin as well as validate their content. Once such a Joint Working Group (JWG) sets up a verification procedure that is acceptable to both sides, the validity of such certificates of origin should not be questioned. The Working Group should draw on models that are operational elsewhere and proven successful, keeping in mind that the objective of free flow of trade should not be hampered in any way.

2.30 There will still be need to have mechanisms for settlement of disputes that may arise due to the implementation of the CEPA. Currently the respective officials in both countries undertake this process periodically. The JSG recommends that the existing mechanisms for addressing issues and disputes that arise could be further strengthened. It also recommends that greater involvement of the private sector would facilitate resolution of many of the problems that arise.

Trade Facilitation

Paperless Trade Documentation

2.31 "Paperless Trading" refers to the electronic filing and transfer of trade-related information and documents in relation to business applications between each country and its trading community.

2.32 The Indian Customs authorities have an advanced automation programme for customs clearance of imported goods. The basic objective of this programme is to allow trade, transport and other regulatory agencies to interchange live electronic messages pertaining to customs clearance by an EDI. The Customs EDI system is geared to support various popular electronic communication methods (such as internet) and various technical standards related to communication and messaging so that EDI trading partners have choice and flexibility while not compromising on security. The status of implementation is as follows:

a) Electronic exchange of information and data is taking place between customs and agencies like the Directorate General of Foreign Trade (DGFT) and the Directorate General of Commercial Intelligence and Statistics (DGCI&S).
b) At Customs locations in Delhi, airlines are filing the export general manifest (EGM), and the Apparel Export Promotion Council (AEPC) is transmitting quota details on a trial basis through the EC/EDI Gateway.
c) The Message Exchange between Customs, banks and custodians (like ports and airports) is taking place through Message Exchange Servers between the respective LANs.
d) The facility for the importer, exporter and Custom House Agents to use the E-Commerce Gateway for filing their document is due to be launched in April 2003.
e) Customs stations in Nhava Sheva, Chennai and Mumbai ports are automated. In fact, as all major ports, airports and inland container deports (ICDs) have been placed on automation, the scope for paperless trading system can be increased to more ports in a phased manner.

2.33 The JSG recognized that the adoption of "paperless trading" would enhance the efficiency of trade information flow and documentation exchange. However, such electronic transfer should not compromise the confidentiality or integrity of information.

2.34 The JSG recommends that trade regulatory bodies of the respective parties work towards accepting electronic versions of current paper-based trade administrative documents submitted by private entities as supporting documents. The JSG further recommends that:

a) The private sector of both countries be encouraged to adopt paperless trading; and
b) Priority be given for implementation of paperless trading in ports that account for substantial bilateral trade, including Nhava Sheva, Chennai and Mumbai.

Sri Lanka is also moving towards electronic paperless transactions.

Transparency

2.35 To improve transparency of customs laws and procedures, it would be desirable to have a provision for publication of all laws, regulations, judicial decisions and administrative rulings of general application related to requirements for imported or exported goods in both paper as well as in electronic medium.

2.36 In India, such laws and regulations that are duly published as gazette notifications or public notices, are commercially available as Customs Law Manual, and are also largely available on the Central Board of Excise and Customs (CBEC) website (www.cbec.gov.in). This website contains all relevant Acts, tariff, rules, regulations, forms, notifications and circulars relating to customs, central excise and service tax. Decisions of the Supreme Court of India and some of the High Courts are available on their respective web-sites. In addition, a number of private publications and websites provide access to judicial decisions. It would be difficult for the Government of India to place all judicial decisions on the website or in paper format as the number of legal disputes in

customs/excise related matters is very large and judgements are available from a wide number of judicial authorities like a large number of Commissioners (Appeal) and different Benches of Central Excise and Gold Appellate Tribunal (CEGAT), in addition to the Courts. It would also be an onerous burden because it would require very frequent updating/publication given the large number of judicial pronouncements that are made frequently.

2.37 In line with the general international obligations of the two countries relating to transparency under GATT Article X, the JSG recommends that India and Sri Lanka make available all laws, regulations, judicial decisions and administrative rulings of general application relating to requirements for imported or exported goods, wherever possible.

Mutual Recognition

2.38 In India, four organizations, the Bureau of Indian Standards (BIS), the Directorate General of Foreign Trade (DGFT), the Ministry of Health and Family Welfare (MoHFW) and the Ministry of Agriculture (MoA) – are responsible for laying down import control requirements, while the Export Inspection Council (EIC) is responsible for export inspection and certification of commodities. Details are in Annexes 3 and 4 of this chapter.

2.39 The Sri Lanka Standards Institution (SLSI) is responsible for the implementation of product standards, in respect of most imports and some compulsory export inspection schemes. The Ministry of Health, Nutrition & Welfare and the Ministry of Agriculture and Livestock cover health and hygienic standards related to food stuffs, animal and plant material imports, respectively. Details are given in Annex 3 of this Chapter.

2.40 To facilitate exports from India and simplify inspection procedures, a MOU was concluded between SLSI and EIC of India. Sri Lanka desires similar MOUs between the relevant bodies/organizations in India in respect of Sri Lankan exports to India. The JSG recommend that SLSI and any other relevant bodies in Sri Lanka should be enabled to conclude MOUs with the relevant bodies/organizations in India.

2.41 The JSG recommends that such MOUs should form the basis for commencing negotiations on MRAs at the earliest. To this end, the product standard certifying agencies of both countries should meet the earliest with a view to setting out a concrete roadmap defining the scope and parameters of mutual recognition of standards in a time bound manner. The relevant ministries of both Governments should monitor the progress on a periodic basis to ensure that the negotiations are completed and MRAs concluded as per the agreed schedule.

Non-Tariff measures

2.42 The JSG recommends that the CEPA negotiations should identify non-tariff measures (NTMs) in each other's regimes that might unduly affect bilateral trade and explore the possibility of eliminating them, or introducing disciplines to ensure that these NTMs do not act as unnecessary obstacles to trade. This is already being done as part of the consultation mechanism under the present ISLFTA.

Anti Dumping/Countervailing Duty/Safeguards

2.43 The JSG underscored the shared philosophy of India and Sri Lanka against protectionist and arbitrary use of such unilateral remedies in the international trading system and the need to contribute towards the WTO's objective of promoting freer trade, and affirmed the rights and obligations of the two countries under the WTO agreements on Anti-dumping, Subsidies and Safeguards. The JSG recommends that this would be a subject for further negotiations in the CEPA.

Summary of Recommendations

The JSG recommends:

- Trade Liberalization:
  - Reduction in the size of the "negative list", taking into consideration the socio-economic sensitivities of both countries and the asymmetry between the two economies.
  - Encouragement to the Sri Lankan tea and garment exporters to make use of existing quotas, given India's commitment to enhance them if they approach full utilisation.

- Rules of Origin
  Additional flexibility regarding the Rules of Origin criteria, by considering the following:
  - Abolition of the requirement for HS conversion at 4 Digit level where Domestic Value Addition (DVA) exceeds 40 per cent of the FOB of the finished products.
  - Dispensing with the conversion requirement where CIF value of non-domestic input is less than 7 per cent of the FOB value of the finished product.
  - Encouragement to Sri Lankan and Indian exporters to source inputs from each other by considering imported inputs from either country as domestic inputs.
  - Adoption of 6 digit HS conversion for certain identified groups of tariff lines.

- Origin Verification Procedures
  - A verification procedure be designed by the two countries that would refine the issuance of the Certificates of Origin in order to facilitate enhanced trade flows.
  - The dispute settlement mechanism be strengthened, including greater participation of the private sector.

- Customs Procedures
  - Both Customs administrations adopt risk management procedures on compliance efforts on high risk goods and clear low risk goods expeditiously through the "green channels", and exchange information on best practices.

PTO

- Both countries adopt paperless trading and give priority to the implementation of paperless trading at the major ports of Mumbai, Chennai, Nhava Sheva and Colombo.

- Transparency
  - Both countries make available all laws, regulations, judicial decisions, and administrative rulings relating to requirements for imported and exported goods on the electronic media and paper.

- Mutual Recognition
  - MOUs between the relevant agencies of the two countries should form the basis for commencing negotiations on MRAs at the earliest.
  - The product standard certifying agencies of both countries should meet at the earliest to set out a roadmap defining the scope and parameters of mutual recognition of standards and conclude MRAs expeditiously.

- Non-Tariff Barriers
  - Identify non-tariff barriers and work towards their elimination.

Annex 1

India's WTO Bound Rate as of January 2001 by Average* of Broad Commodity Groups (Different HS Sections) along with the Basic Rate of Custom Duties

HS Sections	Chapters	Average Bound Rate (per cent)	Average Basic Duty (per cent)	Range of Duties (per cent)
Agriculture Tariff Lines				
Section 1: Live Animals	1-5	103	32	30-100
Section 2: Vegetable Products	6-14	109	30	0-105
Section 3: Animals or vegetable fats and oils and their cleavage products; prepared edible fats; animals or vegetables	15	224	50	15-100
Section 4: Prepared Food Stuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes	16-24	119	35	30-182
Non-Agriculture Tariff Lines				
Section 5: Mineral Products	25-27	37	22	5 – 30
Section 6: Products of the Chemical or Allied Industries	28-38	44	30	0 – 160
Section 7: Plastics and Articles thereof; Rubber and articles thereof	39-40	39	30	25 – 70
Section 8: Raw hides and skins, leather, fur skins and articles thereof; saddlery and harness; travel goods, handbags and similar container; articles of animal gut (other than silk worm gut)	41-43	38	24	0 - 30
Section 9: Wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of Esparto or of other Plaiting materials; basketwork and wickerwork	44-46	38	26	5 – 30
Section 10: Pulp of wood or of other fibrous cellulosic material; recovered (waste and scrap), Paper or paperboard and articles thereof	47-49	36	28	5 – 30

Section 11: Textiles and Textiles articles	50-63	34	25	10 – 30
Section 12:	64-67	34	30	30
Section 13: Articles of stone, plasters, cement, asbestos, mica or similar materials ceramic products; glass and glassware	68-70	39	29	25 – 30
Section 14: Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof; imitation jewellery, coin	71	40	30	30
Section 15: Base Metals and Articles of base metal	72-83	40	32	15 - 40
Section 16: Machinery and Mechanical appliances; electrical equipment; part thereof; sound recorders and reproducers, television image and sound recorders and reproducers and parts and accessories of such articles	84-85	28	25	10 – 30
Section 17: Vehicles, aircraft, vessel and associated transport equipment	86-89	37	30	3 – 105
Section 18: Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instrument and apparatus; clocks and watches; musical instruments; part and accessories thereof	90-92	33	25	10 – 30
Section 20: Miscellaneous manufactured articles	94-96	39	28	25 - 30

Note:

* Does not include tariff lines (3223 at 6 digit level) which are unbound

** Does not include specific tariff rates (77 at six digits level)

Annex 2

Sri Lanka's WTO Bound Rate as of January 2001 by Average* of Broad Commodity Groups (Different HS Sections) along with the Basic Rate of Custom Duties

HS Sections	Chapters	Bound Rate (per cent)			**Applied Rate (per cent)		
		*Average	Min	Max	Average	Min	Max
Agricultural Tariff Lines Section 1: Live Animals	1-5	50	50	50	16.1	02	25
Section 2: Vegetable Products	6-14	50	50	50	19.3	02	25
Section 3: Animals or Vegetable Fats And Oils and their Cleavage Products; Prepared Edible Fats; Animals or Vegetables	15	50	50	50	17.4	10	25
Section 4: Prepared Food Stuffs; Beverage, Spirits and Vinegar; Tobacco and Manufactured Tobacco Substitutes Non-Agricultural Tariff Lines	16-24	50	50	50	21.5	02	100
Section 5: Mineral Products	25-27	38.6	05	60	5.3	02	25
Section 6: Products of the Chemical or Allied Industries	28-38	21.0	0	60	3.8	02	25
Section 7: Plastics and Articles thereof; rubber and articles thereof	39-40	Unbound	-	-	11.2	02	25
Non-Agricultural Tariff Lines Section 8: Raw Hides and Skins, leather, fur skins and article thereof; Saddlery and harness; travel goods, handbags and similar container; articles of animal gut (other than silk-worm Gut)	41-43	50	50	50	16.7	10	25
Section 9: Wood and articles of wood; wood charcoal, cork, and articles of cork, manufactures of straw, of Esparto or of other Plaiting materials; basketwork and wickerwork	44-46	49.3	05	60	9.4	02	25
Section 10: pulp of wood or	47-49	7.8	0	35	11.1	02	25

of other fibrous cellulosic material; recovered (waste and scrap) paper or paperboard and articles thereof							
Section 11: Textiles and textiles articles	50-63	13.0	0	50	4.2	0	25
Section 12: Footwear, Headgear, Umbrellas, Sun Umbrellas, Walking -Sticks, Seat- Sticks, Whips, Riding-Crops and parts thereof: prepared feathers and Articles made therewith; Artificial flowers, Articles of Human Hair	64-67	50	50	50	19.8	02	25
Section 13: Articles of Stone, plasters, cement, asbestos, mica or similar materials ceramic products; glass and glassware	68-70	52.5	50	60	16.9	02	25
Section 14: Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery' coin	71	54.6	50	75	5.6	0	25
Section 15: Base metals and articles of base metal	72-83	52.1	25	75	8.0	02	25
Section 16: Machinery and mechanical appliances; electrical equipment; parts thereof ; sound recorders and reproducers, television image and sound recorders and reproducers and parts and accessories of such articles	84-85	12.3	05	60	7.0	02	25
Section 17: Vehicles, aircraft, vessel and associated transport equipment	86-89	22.9	05	50	7.7	02	25
Section 18: Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instrument and apparatus; clocks and	90-92	7.9	05	25	6.2	02	25

watches; musical instruments; parts and accessories thereof							
Section 19: Arms and Ammunition; parts and Accessories thereof	93	Unbound	-	-	6.2	02	10
Section 20: Miscellaneous manufactured articles	94-96	48.9	05	100	15.5	02	25

Note:

* Does not include tariff lines (3223 at 6 digit level) which are unbound.

** Does not include specific tariff rates (77 at six digits level).

Annex 3

India's Product Regulations

1. In India there are four organizations, viz the Bureau of Indian Standards (BIS), the Directorage General of Foreign Trade (DGFT), the Ministry of Health and Family Welfare (MoHFW) and the Ministry of Agriculture (MoA) which are responsible for laying down import control requirements, while the Export Inspection Council (EIC) is responsible for export inspection and certification of commodities.

2. The BIS is empowered through the Bureau of Indian Standards Act, 1986, to operate a product certification scheme under which licences are granted to enable manufacturers to use the standard mark (popularly known as the ISI Mark). The BIS product certification scheme is essentially voluntary in nature. However, in consideration of public health and safety, mandatory certification of 135 products have been specified. A sizeable number of Indian Standards have also been harmonized with ISO/IEC Standards to facilitate acceptance of Indian products in international markets.

3. The BIS Product Certification Scheme is open to all domestic manufacturers. The broad product categories now under certification are textiles; chemicals and pesticides; rubber and plastic products; cement and concrete products; basic meals and fabricated metal products; machinery and equipment; electrical, electronics and optical equipment; automotive components; agriculture, food, beverages and tobacco; leather products; wood products; paper and pulp products; testing instruments; building materials; pumping, irrigation, drainage and sewage equipment.

4. Besides the normal product certification scheme, the BIS also grants licences to environmentally friendly products under a special scheme and awards the ECOMARK to such products.

5. The BIS is also a National Certifying Body (issuing and recognizing) under the IEC System for Conformity testing and certification of Electrical products (IECEE). The product categories for which BIS has IECEE acceptance are cables and cords; capacitors and components; low voltage high power switching equipment; installation protective equipment; and electronics equipment. The BIS is also the National Authorised Institution and the National Standards Organization under the IEC System of Quality Assessment of Electronics component (IECQ).

6. The BIS operates a product certification scheme for foreign manufacturers and Indian importers. In this scheme, a licence can be granted for any product against an Indian Standard specifying product characteristics, which is amenable to certification. The scheme operates on a self-certification basis, whereby the manufacturer is permitted to apply the Standard Mark on the product after ascertaining its conformity to the Indian Standard licensed for. Through its surveillance operations, the Bureau maintains a close vigil on the quality of goods certified.

7. The import control in India for the food sector is operated under the Prevention of Food Adulteration Act by the MoHFW for health and safety aspects and the MoA for quarantine aspects. All products which are under compulsory certification by the BIS for the domestic market should conform to BIS standards when imported as well.

8. The JSG also noted that the Export Inspection Council (EIC) is the only agency in India responsible for export inspection and certification of a range of commodities in areas like food, chemicals, leather, engineering and footwear as commodities notified under the Export (Quality Control & Inspection) Act, 1963. To date, nearly 1000 commodities have been notified by the Central Government under the Act. Besides, wherever required, EIC operates export inspection and certification on voluntary basis also by developing suitable inspection/certification schemes. EIC is offering one such service in the tea sector, although it is not a notified commodity.

9. The export inspection and certification activity of the EIC is based on standards recognized under the notification, which invariably are international standards or standards of importing countries or national standards prescribed in the notification or even contractual specifications. Therefore, EIC has statutory authority to certify against the standards and technical regulations of the importing countries. EIC has obtained recognition from the European Communities (EC) and USFDA, and recently from the Australian Quarantine and Inspection Service (AQIS) for fish & fishery products and the Sri Lanka Standards Institution for 84 products under their import regulations. This is individual recognition by the respective agencies and represents products of export interest to India, which are under regulatory import control in the respective countries.

Annex 4

India's Regulations in the Food Processing Sector

1. The food control system in India has federal, as well as a state level structure. The various regulations that govern the food processing industry can broadly be classified into compulsory legislation and voluntary standards.

Compulsory Legislation: Essential Commodities Act, 1954

2. A number of control Orders have been formulated under the provision of this Act. The main objectives of the Act are to regulate production, distribution, storage and marketing of essential commodities including food. These Orders include the Fruit Products Order, 1955; Meat Food Products Order, 1973; Milk and Mild Products Order, 1992; and Solvent Extracted Oil, De-oiled Meat and Edible flour (Control) order, 1967.

3. The Fruit Order, 1955 regulates sanitary and hygienic conditions in the manufacturing of fruit and vegetable products. This is administered by the Ministry of Food Processing Industries through the Directorate of Fruit and Vegetable Preservation at New Delhi. The Order is mandatory in nature and all fruit and vegetable processing units are required to obtain FPO licenses under this Order. The license is issued only after the licensing officers satisfied about the quality of the product sanitation, personnel, machinery and equipment and work area standards.

4. Meat Food Product Order, 1973 is implemented by Directorate of Marketing and Inspection (DMI)). This Order controls production quality of solvent extracted Vegetable oil products. This is also mandatory in nature.

5. The Solvent Extracted Oil De-oiled Meal and Edible Flour (Control) Order, 1967 is implemented by Directorate of Vanaspati, Ministry of Civil Supplies. This Order regulates production, distribution and quality of solvent extracted vegetables oil products. This is also mandatory.

6. The Milk and Milk Products Order (MMPO) is administered and implemented by the Department of Animal Husbandry and Dairying, MoA. This Order regulates production, supply, distribution of milk and milk products throughout the country.

7. The Prevention of Food Adulteration Act, 1954 is intended to protect the common consumer against the supply of adulterated food. This specifies different standards for various food articles including agricultural commodities such as spices, pulses, cereals, fruits and vegetable products etc. The standards are in terms of minimum quality levels intended for ensuring safety in the consumption of these food items and safeguarding against harmful impurities and adulteration. This Act is administered by Directorate General of Health Services, MoHFW and implemented through state governments.

8. The Export (Quality Control and Inspection) Act, 1963 is administered by the EIC under the Ministry of Commerce and Industry. Under this Act, a number of exportable agricultural commodities including processed food have been notified for compulsory pre-shipment inspection.

Voluntary Standards

9. The Agricultural Product (Grading and Marketing) Act is one of the voluntary Acts promulgated by the Government of India. This is better known as AGMARK and is specifically meant for grading and making of common agricultural produce such as food grains, tobacco, ghee, edible oils and spices. The Department of Marketing and Inspection (DMI) under the MoA administers this Act.

10. The BIS (Certification Marks) Act 1952 provides third party assurance/guarantee to consumers. Manufacturers complying with these standards can obtain "ISI" mark that can be exhibited on product packages. BIS certification is compulsory for certain food items like food colours, additives, mineral water, packaged drinking water etc. This is under the administrative control of the Department of Consumer Affairs, Ministry of Food, Consumer Affairs and Public Distribution.

Annex 5

Product Regulations of Sri Lanka

1. The organizations which are responsible for the implementation of product regulations in Sri Lanka are as follows;

Department of Import and Export Control	-	Import/Export licensing
Sri Lanka Standards Institution (SLSI) and certification across virtually all product areas	-	standardization, testing
Ministry of Health	-	Pharmaceuticals, food products
Department of Agriculture (Registrar of Pesticides)	-	Import of pesticides and plant and seed materials
Department of Animal Production and Animal Health	-	import of live animals and animal food
Sri Lanka Tea Board	-	Import of tea for blending purposes

2. Sri Lanka has removed almost all the import and export licensing requirements except those maintained for security, sanitary, phyto-sanitary, moral and environmental reasons. Licenses for the import of relevant items are issued by the Department of Import and Export Control (under the powers vested in it under the Imports and Exports Act of 1969) which comes under the purview of the Ministry of Commerce and Consumer Affairs. An application in the prescribed form along with the supplier's invoice and the letter of approval from the relevant authority are the requirements for obtaining an import license.
The export of following items are subjected to Export Control Licensing requirements.

   a) Ivory and ivory products
   b) Timber
   c) Motor vehicles of first registration of which in Sri Lanka is prior to 01.01.1945
   d) Non Ferrous iron scrap

3. The Sri Lanka Standards Institution (SLSI) which functions under the powers vested in it under the SLSI Act No. 06 of 1984, implements the compulsory import inspection scheme in respect of 85 import items. The importer shall submit to the SLSI, a duly filled notification form in duplicate together with the following documents for this purpose;

a) Quality certificate/s, if any, if the consignment consists of several batches, quality certificate shall be provided for each batch.
b) Invoice
c) Customs goods declaration form
d) Packing list
e) Bill of lading
f) When the consignment contains a product bearing the product certification mark of the exporting country, a copy of the certificate issued for the product certification shall also be submitted. This copy shall have been certified by the national standards body.

The certification process will involve sampling and testing of the same to determine whether the sample taken conforms to the standard. If an importer is not satisfied with the decision, there is provision for making an appeal to the Director General, SLSI within 3 working days of receipt of such decision, and in such instances further investigations will be carried out by the SLSI.

In addition, the SLSI implements the compulsory pre-export quality certification of cashew kernels. The export of raw cashew kernels of consignment size greater than 100 Kg is required to undergo the compulsory quality certification scheme. The consignment will be inspected/sampled and tested in accordance with the standards set by the SLSI for cashew kernels.

The SLSI is also operating a scheme for registration/inspection of establishments processing fishery products for export purposes. This scheme is operated under the provisions of the Fish Processing Establishments Regulations, 1998 and the Fish Products (export) Regulations 1998, framed under the Fisheries and Aquatic Resources Act No. 2 of 1996.

4. Cosmetics Devices and Drugs Authority of the Ministry of Health (established under the Cosmetics, Devices and Drugs Act No.27 of 1990) regulates the import of pharmaceuticals. Only the companies registered under this authority can import approved drugs and pharmaceuticals.

   Health and food safety related regulatory work is handled by the Food Advisory Committee of the Ministry of Health (Food Act No.26 of 1980). National regulations are generally based on international standards and general principles approved by the Codex Alimentarious Commission (CODEX) and WHO. Regulations are enforced through inspection by Food and Drugs Inspectors, Medical Officers of Health and Public Health Inspectors.

5. The import of “restricted” plants and planting material (including seeds) is permitted subject to a pest risk analysis and plant quarantine requirements carried out by the Department of Agriculture under the provisions of the Plant Protection Act No.35 of 1999.

   The Director General of Agriculture who is also designated as the Registrar of Pesticides is responsible for regulating the import of pesticides and related agro chemicals under the provisions of the Control of Pesticides Act No.33 of 1980.

6. Any registered exporter of tea who wishes to import tea for blending and export thereafter should be registered as an importer with the Sri Lanka Tea Board. The issue of permits for import of tea under this scheme would be limited only for the importation of CTC teas and speciality type teas.

This scheme is implemented through the Sri Lanka Tea Board under the provisions of the Tea Control Act No.56 of 1957 and subsequent amendments.

7. Import and export of precious stones are regulated by the National Gems and Jewellery Authority established under the National Gems and Jewellery Authority Act No.50 of 1993.

8. Parliament has recently approved a new Act on Intellectual Property Rights compatible with the WTO Agreement on Trade Related Intellectual Property Rights (TRIPS) viz. The Intellectual Property Act, to replace the existing Code of Intellectual Property Act No. 52 of 1979.

9. Fishing in the Sri Lankan waters is regulated by the Fisheries Ordinance No.29 of 1940 and subsequent amendments thereto.

10. The Board of Investment of Sri Lanka Law, No.4 of 1978 under which the Board of Investment of Sri Lanka has been established, is empowered to undertake promotion, facilitation and regulation of foreign investments in Sri Lanka.

Annex 6

Rules of Origin as contained in ISLFTA

1. Short title/commencement:-
   These rules may be called the rules of Determination of Origin of Goods under the Free Trade Agreement between the Democratic Socialistic Republic of Sri Lanka and the Republic of India.

2. Application:-
   These rules shall apply to products consigned from the territory of either of the Contracting Parties.

3. Determination of Origin:-
   No product shall be deemed to be the produce or manufacture of either country unless the conditions specified in these rules are complied with in relation to such products, to the satisfaction of the appropriate Authority.

4. Claim at the time of importation:-
   The importer of the product shall, at the time of importation:

   (a) make a claim that the products are the produce or manufacture of the country from which they are imported and such products are eligible for preferential treatment under the Agreement, and
   (b) produce the evidence specified in these rules.

5. Originating products:-
   Products covered by the Agreement imported into the territory of a Contracting Party from another Contracting Party which are consigned directly within the meaning of rule 9 hereof, shall be eligible for preferential treatment if they conform to the origin requirement under any of the following conditions :

   (a) Products wholly produced or obtained in the territory of the exporting Contracting Party as defined in rule 6; or
   (b) Products not wholly produced or obtained in the territory of the exporting Contracting Party, provided that the said products are eligible under rule 7 or rule 8.

6. Wholly produced or obtained:-
   Within the meaning of rule 5(a), the following shall be considered as wholly produced or obtained in the territory of the exporting Contracting Party

   (a) raw or mineral products extracted from its soil; its water or its sea bed;
   (b) vegetable products harvested there;

(c) animals born and raised there;
(d) products obtained by hunting or fishing conducted there,
(e) products obtained by hunting or fishing conducted there,
(f) products of sea fishing and other marine products from the high seas by its vessels;
(g) products processed and/or made on board its factory ships exclusively from products referred to in clause (f) above;
(h) used articles collected there, fit only for the recovery of raw materials;
(i) waste and scrap resulting from manufacturing operations conducted there;
(j) products extracted from the seabed or below seabed which is situated outside its territorial waters, provided that it has exclusive exploitation rights;
(k) goods produced there exclusively from the products referred to in clauses (a) to (j) above.

7. Not wholly produced or obtained:-

(a) Within the meaning of rule 5(b), products worked on or processed as a result of which the total value of the materials, parts or produce originating from countries other than the Contracting Parties or of undermined origin used does not exceed 65 per cent of the f.o.b. value of the products produced or obtained and the final process of manufacture is performed within the territory of the exporting Contracting Party shall be eligible for preferential treatment, subject to the provisions of clauses (b), (c), (d) and (e) of rule 7 and rule 8.
(b) Non-originating materials shall be considered to be sufficiently worked or processed when the product obtained is classified in a heading, at the four digit level, of the Harmonized Commodity Description and Coding System different from those in which all the non-originating materials used in its manufacture are classified.
(c) In order to determine whether a product originates in the territory of a Contracting Party, it shall not be necessary to establish whether the power and fuel, plant and equipment, and machines and tools used to obtain such products originate in third countries or not;
(d) The following shall in any event be considered as insufficient working or processing to confer the status of originating products, whether or not there is a change of heading :
    1) Operations to ensure the preservation of products in good condition during transport and storage (ventilation, spreading out, drying, chilling, placing in salt, sulphur dioxide or other aqueous solutions, removal of damaged parts, and like operations).
    2) Simple operations consisting of removal of dust, sifting or screening, sorting, classifying, matching (including the making-up of sets of articles), washing, painting, cutting up.
    3) (i) Changes of packing and breaking up and assembly of consignments, (ii) Simple slicing, cutting and repacking or placing in bottles, flasks, bags, boxes, fixing on cards or boards, etc. and all other simple packing operations.
    4) the affixing of marks, labels or other like distinguished signs on products or their packaging;
    5) simple mixing of products, whether or not of different kinds, where one or more components of the mixture do not meet the conditions laid down in these Rules to enable them to be considered as originating products;
    6) simple assembly of parts of products to constitute a complete product;

7) a combination of two or more operations specified in (a) to (f);
8) slaughter of animals.

(e) The value of the non-originating materials, parts or produce shall be:
   (i) The CIF value at the time of importation of the materials, parts or produce where this can be proven; or
   (ii) The earliest ascertainable price paid for the materials, parts or produce of undermined origin in the territory of the Contracting Parties where the working or processing takes place.

8. Cumulative rules of origin:-

In respect of a product, which complies with the origin requirements provided in rule 5(b) and is exported by any Contracting Party and which has used material, parts or products originating in the territory of the other Contracting Party, the value addition in the territory of the exporting Contracting Party, the value addition in the territory of the exporting Contracting Party shall be not less than 25 per cent of the FOB value of the product under export subject to the condition that the aggregate value addition in the territories of the Contracting Parties is not less than 35 per cent of the FOB value of the product under export.

9. Direct consignment:-

The following shall be considered to be directly consigned from the exporting country to the importing country.

(a) if the products are transported without passing through the territory of any country other than the countries of the Contracting Parties,
(b) the products whose transport involves transit through one or more intermediate countries with or without transhipment or temporary storage in such countries; provided that:
   (i) the transit entry is justified for geographical reason or by considerations related exclusively to transport requirements;
   (ii) the products have not undergone any operation there other than unloading and reloading or any operation required to keep them in good conditions.

10 Treatment of packing:-

When determining the origin of products, packing should be considered as forming a whole with the product it contains. However, packing may be treated separately if the national legislation so requires.

11. Certificate of origin:-

Products eligible for a Certificate of origin in the form annexed shall support preferential treatment issued by an authority designated by the Government of the exporting country and notified to the other country in accordance with the certification procedures to be devised and approved by both the Contracting Parties.

12. Prohibitions:-

Either country may prohibit importation of products containing any inputs originating from States with which it does not have economic and commercial relations;

13. Cooperation between contracting parties:-

(a) The Contracting Parties will do their best to co-operate in order to specify origin of inputs in the Certificate of origin.

(b) The Contracting Parties will take measures necessary to address, to investigate and, where appropriate, to take legal and/or administrative action to prevent circumvention of this Agreement through false declaration concerning country of origin or falsification of original documents.

(c) Both the Contracting Parties will cooperate fully, consistent with their domestic laws and procedures, in instances of circumvention or alleged circumvention of the Agreement to address problems arising from circumvention including facilitation of joint plant visits and contacts by representatives of both Contracting Parties upon request and a case-by-case basis.

(d) If either Party believes that the rules of origin are being circumvented, it may request consultation to address the matter or matters concerned with a view to seeking a mutually satisfactory solution. Each party will hold such consultations promptly.

14. Review:-

These rules may be reviewed as and when necessary upon request of either Contracting Party and may be open to such modifications as may be agreed upon.

Notes

1. includes mineral fuels, lubricants and related materials as well as mineral or metal ores.
2. includes agricultural and forestry products.
3. "Vessels" shall refer to fishing vessels engaged in commercial fishing, registered in the country of the Contracting Party and operated by a citizen or citizens of the Contracting Party or partnership, corporation or association, duly registered in such country, at least 60 per cent of equity of which is owned by a citizen or citizens and/or Government of such Contracting Party or 75 per cent by citizens and/or Governments of the Contracting Parties. However, the products taken from vessels, engaged in commercial fishing under Bilateral Agreements which provide for chartering/leasing of such vessels and/or sharing of catch between Contracting Party will also be eligible for preferential treatment.
4. In respect of vessels or factory ships operated by Government agencies, the requirements of flying the flag of the Contracting Party do not apply.
5. For the purpose of this Agreement, the term "factory ship" means any vessel, as defined, used for processing and/or making on board products exclusively from those products referred to in clause (f) of Rule 6.
6. Cumulation as implied by Rule 8 means that only products which have acquired originating status in the territory of one Contracting Party may be taken into account when used as inputs for a finished product eligible for preferential treatment in the territory of the other Contracting Party.

CERTIFICATE OF ORIGIN

1. Goods consigned from (Exporters' Business Name, Address, Country)			Reference No. INDO-SRI LANKA FREE TRADE AGREEMENT (ISFTA) (Combined declaration and certificate) Issued in ……. (country) (see notes overleaf)		
2. Goods consigned to (Consignee's Name, Address, Country)			4. For Official Use		
3. Means of transport and Route (as far as known)					
5. Tariff item number	6. Marks and number of packages	7. Number and kind of packages : description of goods	8. Origin criterion (see notes overleaf)	9. Gross weight or other quantity	10. Number and date of invoice
11. Declaration by the Exporter The undersigned hereby declares that the above details and statements are correct. That all the goods were produced in ……. (Country) and that they comply with the origin requirements specified for those goods in ISFTA for goods exported to …….. (importing country) …….. Place and date, signature of the authorized signatory.			12. Certificate It is hereby certified on the basis of control carried out that the declaration by the exporter is correct. ……..……. Place and date, signature and stamp of certifying authority.		

To qualify for preference, the product must:

(a) fall within a description of products eligible for concessions in the country of destination under this agreement,

(b) comply with ISFTA Rules of Origin. Each Article in a consignment must qualify separately in its own right; and

(c) comply with the consignment conditions specified by the ISFTA Rules of Origin. In general products must be consigned directly within the meaning of Rule 9 hereof from the country of exportation to the country of destination.

II Entries to be made in Box 8

Preference products must be wholly produced or obtained in the exporting Contracting Party in accordance with Rule 6 of the ISFTA Rule of Origin, or where not wholly produced or obtained in the exporting Contracting Party must be eligible under Rule 7 or Rule 8.

(a) Products wholly produced or obtained enter the letter 'A' in box 8.

(b) Products not wholly produced or obtained; the entry in Box 8 should be as follows :-

i) Enter letter 'B' in box 8 for products, which meet the origin criterion according to Rule 7. Entry of letter would be followed by the sum of the value of materials, parts or produce originating from non-contracting parties or undermined origin used, expressed as a percentage of the FOB value of the products; (example 'B' ( ) per cent.

ii) Enter letter 'C' in box 8 for products, which meet the origin criteria according to Rule 8. Entry of letter 'C' would be followed by the sum of the aggregate content originating in the territory of the exporting Contracting Party expressed as a percentage of the FOB value of the exported product : (example 'C' ( ) per cent.

Trade in Services

Chapter 3

TRADE IN SERVICES

Importance of Services

3.1 Service activities are playing an increasingly important role in global economic growth. The share of agriculture and mining tends to decline and the share of manufacturing, and subsequently that of services, grow in importance as economies develop. Growth and efficiency of the manufacturing sector and its international competitiveness depend, to a large extent, on the performance of the services sector. Infrastructure – both physical and support – including transport, telecommunications, power and financial services, are pre-requisites for rapid economic growth. Increasingly, technology is improving the tradability of services, leading to increases in productivity in service sectors. Improved productivity in services contributes to the overall improvement of productivity and efficiency in the economy.

3.2 The JSG noted that the economic potentials of India and Sri Lanka remain under-exploited because of the many inadequacies in basic infrastructure. Improvements in health, education and other service activities are crucial to the development of human capital. In most developed countries, the share of services in the Gross Domestic Product (GDP) is above 60 per cent.

3.3 In the past two decades, the services sectors of India and Sri Lanka have experienced remarkable growth, replacing agriculture as the dominant sectors in both countries. In India the share of services in its GDP grew from 38 per cent in 1980-81 to 55 per cent in 2002. A large part of this growth is accounted for by growth in knowledge-based services rather than in traditional services, such as tourism. India's trade in services has also increased. In 1995, India ranked 34th and 28th among the WTO member countries in services exports and imports. This ranking improved significantly to 19th and 18th respectively in 2001. Sri Lanka's share of services in its GDP has grown from 48 per cent in 1980-81 to an estimated 54 per cent in 2002.

3.4 The services sector contributes significantly to Sri Lanka's GDP and exports. With improvements to its infrastructure and the removal of legal and regulatory impediments, Sri Lanka can become a services hub for South Asia. As both the Indian and Sri Lankan economies shift to above-average growth trajectories, there is significant scope for both economies to invest in each other's service sectors. The two economies would benefit from two-way trade in IT and knowledge-based services, in which India has already established a presence in the global market, but where Sri Lankan firms are beginning to establish positions in niches. Further benefit could be accrued in areas such as education, health care, infrastructure services, transport, railways, aviation, ferry links, and power generation. A significant volume of India's transhipment trade goes through the Colombo port, perhaps as a result of the efficiency of the service industries constituting the logistics cluster. The logistics cluster includes air and maritime transportation and transhipment by sea and air, as well as the coordination of suppliers of services in and beyond the port/airport areas, including provisioning of ships and aircraft, storage, forwarding and

tracking of goods, services and related information, electronic documentation, streamlined customs procedures, express delivery/courier, etc. In addition, both countries could benefit from each other's specialized expertise in the tourism industry.

3.5 It is in the interest of the two countries to leverage their complementarities in services trade through the CEPA:

a) India's Tenth Five-Year Plan document has projected GDP growth of 8 per cent over the next 10-15 years. This would require an annual FDI inflow of US$ 8-10 billion over the same period. To achieve the 8-10 per cent growth rates envisaged in the "Regaining Sri Lanka" Initiative, Sri Lanka will have to mobilize at least US$ 1 billion in FDI annually.
b) Sri Lanka is committed to the reform of vital infrastructure sectors under the "Regaining Sri Lanka" initiative. Indian companies have shown interest in investing in Sri Lanka. Already more than half of Indian investment in SAARC is in Sri Lanka. Sri Lanka can emerge as a regional and international services hub in the light of comparative advantages in logistics, and access to the Sri Lanka market will widen the global marketing network of Indian companies.

3.6 Both countries stand to benefit significantly from a services agreement under the CEPA. In particular, India can benefit from the efficient logistics services offered by Sri Lanka. Sri Lanka would benefit from the removal of any investment-related barriers in the services sector. By bilaterally liberalizing trade in services, both countries would stand to gain through improved efficiency and productivity. The relatively modest pressures caused by bilateral liberalization will help both countries prepare for the challenges of multilateral liberalization. For certain service sectors such as IT and tourism, both countries have different competences and could enhance their skills and shares in international trade through the CEPA. In infrastructure services, there is significant scope for Indian investment in Sri Lanka.

Recommended Negotiating Parameters

3.7 In light of the potential benefits to both countries of liberalization and cooperation in service sectors between India and Sri Lanka, the JSG agrees that:

a) Negotiations shall cover all services sectors and all modes of supply using GATS as the negotiating framework;
b) Commitments by both countries shall cover a wide spectrum of service sectors to ensure consistency with the substantial sectoral coverage requirement in GATS Article V.1(a); and
c) Commitments of each country under the CEPA should be GATS-plus bearing in mind the need to be consistent with GATS Article V. The negotiated commitments should be implemented either immediately upon entry into force of the CEPA or within a reasonable period.

3.8 Priority for negotiations could be given to sectors that are critical to the infrastructure of either country or are growth areas of the future. Each government can work out the prioritization of sectors for inclusion in the negotiations and its negotiating position using internal procedures.

The identification of sectors and the outlining of certain modalities below are provided for illustrative purposes only.

Information and Communications Technology (ICT) Services

3.9 Given the increasingly important role of ICT sectors in both countries directly as sources of economic growth and indirectly as sources of productivity improvements in other sectors, the JSG recommends that the CEPA cover liberalization and market access for computer and related services (CPC 841-44 and others)[1] and telecommunication services (CPC 7521, 7522, 7523, 7529 and 843 and others). This would also cover improvement of international and domestic bandwidth, the liberalization of international private leased circuit (IPLC) services and the aggregation of Internet traffic to enable better terms of interconnection to the US backbone. Investments in the upgrading of telecom services in both countries would be encouraged. Participation of Sri Lankan as well as Indian firms would be possible in the least-cost subsidy auctions being prepared for the building of networks in the North and East and the Deep South of Sri Lanka.

3.10 Both countries have already undertaken substantial liberalization in the telecommunications sector. The JSG recommends the GATS Protocol Four Regulatory Reference Paper as an approach to liberalization of trade in telecom services. The JSG also recommends e-commerce commitments to ensure non-discriminatory treatment of software (whether delivered physically or electronically).

Tourism Services

3.11 Tourism (including business travel) involves a comprehensive cluster of services, including transportation (CPC 7211, 731, etc.), hotel and restaurant services (CPC 641-43), travel agency and tour operator services, tour guide services (CPC 7472, etc.), recreation and entertainment services (CPC 9619) as well as services such as telecommunications, financial services, etc. The regulations pertaining to release of foreign exchange for travel in both countries have already been liberalized. Furthermore, residents of both countries can freely use their international credit cards for payments abroad without limits. In addition, account holders of one country can access ATM's in the other country. Thus, the JSG noted that considerable freedom now exists for individuals to enter into financial transactions in India and Sri Lanka for travel and tourism purposes. Given the different comparative advantages of the two countries in tourism, there is great potential for increased tourism services trade. Each is currently a significant source of tourist flows to the other (Mode 2 trade). Liberalization of visa regulations can further encourage Mode 2 trade in this area. Great potential exists for development of specialized forms of tourism such as meetings, incentives, conventions and exhibitions (MICE) travel, and religious-themed

[1] The service sectors are identified by CPC numbers, according to the Services Sectoral Classification List (MTN.GNS/W/120) of the WTO.

tourist services (including pilgrimages). If the current constraints limiting travel between the two countries are removed or reduced, it is likely that greater tourist traffic from third countries will be attracted to both countries in addition to enabling increased tourist trade between the two countries. Existing Indian investments in the Sri Lankan tourism industry can be complemented by opening up Mode 3 opportunities for Sri Lankan tourism services suppliers in India.

Transport and Logistics Services

3.12 The JSG recommends that market access for the provision of transport and logistics services (CPC 7211-14, 7221-24, 8868, 731-34, 746, 7111-13, 7121-23, 7131, 7139, 741-42, 748) should be an area for special consideration.

3.13 The JSG noted that maritime transport and logistics services are a critical element of the development of Sri Lanka as a services hub for South Asia. The improvement of these services in both countries is crucial to effective participation in the global economy. There is potential for Indian investment in Sri Lanka's plans to develop the South Colombo port and other ports.

3.14 The JSG noted that air services are of vital importance and an urgent requirement for the expansion of trade, tourism and people-to-people contacts between the two countries. Sri Lanka is already a hub for international air traffic. Between 2000 and 2003 the number of Indian destinations to which Sri Lankan Airlines flies has gone up from 5 to 8, the number of flights from 29 to 44 and the number of seats from around 8,000 to nearly 9,500, all of which represent significant increases in capacity. A further increase of flights through reduction of the current constraints to travel between the two countries is likely to stimulate direct tourism services trade through greater tourist and business traffic between Sri Lanka and India as well as from third countries to India via Sri Lanka.

3.15 The JSG believes that participation by India in the management and development of the rail infrastructure in Sri Lanka may have mutual benefits, given the synergies, similarities of track gauge and climatic and operating conditions. Similarly, Indian companies may consider participation in road and bridge projects in Sri Lanka, including BOT expressways.

3.16 Noting the progress towards commencement of ferry services between India and Sri Lanka, the JSG recommends that services to multiple points be encouraged. Consideration should be given to extension of such services to include carriage of unaccompanied cargo and freight. Further, the JSG noted the potential of high-end tourist-oriented services such as cruises.

Educational Services

3.17 Given the importance of human capital in knowledge based economies, the JSG recommends that educational services, in particular higher educational services (CPC 923) and adult education

(CPC 924), as well as other educational services (CPC 929) be considered for inclusion and binding.

Health Services

3.18 The Apollo Hospital set up in Colombo with Indian investment and Indian medical personnel is an example of Mode 3 and Mode 4 services trade preceding the formalization of a regime. It is expected that there may be more activities on these lines, including non-Western health services (CPC 9311 and 9319; plus additional services that may be defined). The JSG recommends that Mutual Recognition Agreements (MRAs) be formulated and implemented for health service workers to facilitate existing Mode 4 services trade.

Infrastructure Services

3.19 Sri Lanka seeks investments and participation in infrastructure projects (i.e., Mode 3 trade) from India in sectors such as roads, rail, power, ports, etc. If the land bridge or an undersea power cable between India and Sri Lanka is constructed, there may be possibilities of energy trade between the two countries (Mode 1).

Construction and Related Engineering Services

3.20 The Indian construction industry has considerable strengths. The Sri Lankan construction industry has obtained contracts in SAARC countries other than India and includes firms with specialized skills and abilities. The construction associated with the rebuilding of infrastructure in the North and East of Sri Lanka will require significant involvement of foreign construction firms. The JSG notes that there is significant value in establishing a rule-governed arrangement for trade in construction and related engineering services (CPC 514, 516, 517) between the two countries. Greater experience within the region will allow firms from both countries to position themselves to venture a field under future liberalized multilateral regimes.

Financial Services

3.21 The JSG noted with satisfaction the existing relationship between the two countries in the banking sector. The JSG also acknowledged the ongoing negotiations between the two countries under the GATS framework. At present, three Indian banks are operating in Sri Lanka and one Sri Lankan bank in India. The JSG recognized the need for the financial sector to respond favourably to the other changes that will come about consequent to the CEPA. The JSG strongly recommends further cooperation between the respective regulators of the financial sector of the two countries, going well beyond the multilateral framework. The regulators of the two countries

are encouraged to identify areas of further liberalization and expansion in the financial sector while keeping in view international best practices. In addition, illustratively, the two countries can benefit considerably from sharing of experiences in areas such as offshore banking, derivatives markets and business processes outsourcing.

Movement of Natural Persons

3.22 Recognizing that the mobility of people and liberalization of professional services will significantly enhance economic links between both countries, the JSG recommends that both countries:

a) Explore ways to lower barriers to the movement of people between both countries. Emphasis could be on business people and professionals. A possible mechanism is outlined in Annex 1.
b) Encourage and facilitate negotiations between relevant professional bodies and institutions on the recognition of professional qualifications between both countries. IT, accountancy, architecture and urban planning, engineering, and health (medical, dental, nursing, physiotherapists and paramedics) are potential areas. A possible mechanism is outlined in Annex 2.

3.23 The process of facilitating Mode 4 services trade that involves movement of natural persons is envisaged to involve sequence on the following lines:
a) Each country decides on priority service sectors for inclusion in the CEPA and the modes.
b) If Mode 4 is included within the scope of a bound sector and involves credentialed professionals, the procedure for reaching MRAs (on the lines of Annex 2) is activated.

3.24 Parallel to the above sector-specific liberalization process, the overall movement of natural persons to facilitate bilateral trade in goods and services needs to be liberalized. Normally, this liberalization applies only to professionals crossing the border to engage in bona fide trade-related activities and may take the form of a special visa category. This procedure will facilitate Mode 4 trade in particular sectors enabled by actions taken under paragraph 3.23 above.

Summary of Recommendations

The JSG recommends that the two countries:

- Enter into negotiations that cover all service sectors and modes of supply under the GATS framework and conclude an agreement that will cover a wide spectrum of services.
- Bind market opening in telecommunications, computer and related services and e-commerce.
- Facilitate increased tourism trade through liberalization of the cluster of related services and visa formalities.
- Accord special priority to market access for provision of transport and logistics services.
- Increase passenger transport by liberalizing the air services agreement and commencing ferry services.
- Further Mode 3 trade and facilitate Mode 4 trade in health services through Mutual Recognition Agreements (MRAs).
- Encourage Mode 3 and other trade in infrastructure services and enable energy trade by linking utility grids.
- Establish rule-based arrangements for trade in construction and related engineering services.
- Increase cooperation between financial regulators, beyond the multilateral framework to respond to CEPA-driven changes.
- Explore ways to lower barriers to movement of business people and professionals and facilitate MRAs on professional qualifications.

Annex 1

Possible mechanism for facilitating trade-related movement of natural persons

1. Both countries to take full commitment within CEPA on independent professionals delinked from commercial presence.

2. To put in place a visa system to ensure the fulfilment of Horizontal and Sectoral Commitments undertaken.

3. Undertake to put in place a Visa system ensuring grant of multiple entry visas to professionals.

4. Allow inter-firm mobility to professionals.

Annex 2

Possible mechanism for arriving at mutual recognition arrangements (MRAs) to facilitate Mode 4 services trade

With regard to certain professional services, buyers require a degree of confidence regarding the qualifications, knowledge and skills of the suppliers of services. Partly for this reason, credentialed personnel have traditionally provided these services. Credentialing across borders can be done on the basis of Mutual Recognition Arrangements (MRAs). MRAs require specialized knowledge and can be best developed by specialized working groups from the countries party to the MRA. Because protectionist interests may cause delays in the reaching of agreements on MRAs, there would be merit in establishing a procedure that will create incentives for cooperative engagement by the professional organizations. This would be on the lines of:

(i) Announcement of a default list of educational establishments in the two (or more) countries that would be considered to grant acceptable credentials;

(ii) Constitution of a committee chaired by an outsider, with equal representation from the relevant professional bodies, and where possible, representation from the consumers of that service;

(iii) A target of, say 10 months, shall be set, with intermediate mileposts for reporting.

If there is an impasse at 18 months the issue will be submitted to binding arbitration by a designated entity, payment for which shall be made in proportion by the professional bodies that failed to reach agreement.

Investment

Chapter 4

INVESTMENT

Importance of Investment

4.1 Investment is another important element of the CEPA. Foreign investment plays a vital role in economic development in both countries, as domestic savings may not be adequate to meet the desirable levels of investments that would move the two countries on to a higher growth path. Sri Lanka requires high foreign direct investment (FDI) inflows to fill the projected national savings-investment gap of around 4 per cent of GDP, i.e., about US$ 1 billion, to achieve an average annual economic growth of 8-10 per cent in the longer term. It has also been estimated that to achieve an 8 per cent annual growth, India needs to attract an annual inflow of about US$ 10 billion of FDI, given the projected domestic savings-investment gap of 2.2 per cent of GDP.

4.2 With economic liberalization, the economic activity between the two countries has been expanding, covering wide-ranging areas of tourism, trade and investment. Although trade relations have preceded investment relations, the latter is fast emerging as an important channel of bilateral economic cooperation between India and Sri Lanka. In turn, increasing investment flows would also improve trade in goods and services between the two countries. Thus, bilateral trade and investment expansion are dynamically interrelated. Historically, investment relations have remained mainly as one-way flows of FDI from India to Sri Lanka, but in the 1990s there has been a rise in direct investment, albeit small in quantum, from Sri Lanka to India. Not only have the bilateral flows of direct investment been increasing, but the sectoral composition has also been diversifying. The JSG felt that, therefore, further liberalization, removal of administrative and regulatory constraints, and promotion of bilateral investment flows between the two countries would help maximize mutual benefits of economic integration.

Assessment of Bilateral Investment Flows

4.3 Despite close proximity and growing bilateral trade, investment flows between the two countries remained low, although they have been growing faster with the implementation of the ISLFTA. The share of total Indian investment in Sri Lanka was only about US$ 105 million, i.e., about 4 per cent of total FDI approved by the BOI, at end 2000. Total Sri Lankan FDI investment in India was less than US$ 10 million or 0.01 per cent of total FDI inflows to India in the 1990s.

4.4 India's investment activities in Sri Lanka have strengthened in the last decade and more so in the recent years in absolute terms. In relation to the other South Asian countries, Sri Lanka has occupied a place of primacy for Indian investors. However, within the overall ambit of Indian outward FDI in developing countries as a whole, the relative share of Sri Lanka is still low, about 6 per cent (Table 1). Therefore, the JSG recommends the creation of a cell in the Board of Investment (BOI) of Sri Lanka to encourage and facilitate Indian investment in Sri Lanka, particularly for infrastructure projects.

4.5 However, it is encouraging that large Indian investors have shown an increasing interest in investing in various sectors in the Sri Lankan economy, responding positively to opportunities created by the ISLFTA and continuation of economic liberalization. It would be pertinent to highlight that possibly the real significance of Indian FDI in the Sri Lankan economy lies not only in

its contribution to capital formation, but also in its impact on technological transfer and trade creation.

4.6 FDI outflows from Sri Lanka to India, even though relatively small, have increased since the implementation of the ISLFTA. Total Sri Lankan investments in India have been about US$ 4 million since 1997, which is 11 per cent of total outward investments during the period. The most interesting recent development is that the FDI flows between the two countries changed from a mere one-way flow to an increasingly two-way relationship.

4.7 The JSG is of the view that these bilateral investment flows could be further encouraged by removing or minimizing existing constraints in both countries and expanding facilities.

Foreign Direct Investment Policies in India

4.8 Perceptible changes in the foreign investment policy of India started with the announcement of the Industrial Policy Statement of July 1991, which introduced far reaching liberalization measures with regard to the Industrial Licensing Policy and also the foreign technology and foreign investment policies. Two routes of FDI were specified in the Industrial Policy Statement, namely, the government/Foreign Investment Promotion Board (FIPB) route and the automatic route through the Reserve Bank of India (RBI). To begin with, foreign direct investment up to 51 per cent was permitted in 35 high priority industries. The sectors open to FDI, as also the extent of FDI equity, has progressively been liberalized and categories of sectors were notified for FDI up to 50 per cent, 51 per cent, 74 per cent and 100 per cent.

4.9 In 2000, all items/activities, except for a small list of items, were placed under the automatic route for FDI. Sectoral caps were reviewed and relaxed for e-commerce, power generation, petroleum refinery, Internet Service Providers (ISPs) without gateways, e-mail and voice mail during that year. The automatic route was also extended for payment of trade mark and royalty up to 2 per cent and 1 per cent respectively. Technology transfer agreements involving lump sum payments up to US$ 2 million were also included under the automatic route.

4.10 In 2001, FDI up to 100 per cent was allowed under the automatic route for manufacture of drugs and pharmaceuticals, (provided the activity does not attract compulsory licensing or involve use of recombinant DNA technology), the hotel and tourism sector, and mass rapid transport system. The new sectors that were opened up for FDI in 2001 under the government approval route included airports (requiring government approval for FDI beyond 74 per cent); defence industry sector (26 per cent); development of integrated townships (100 per cent); courier services (100 per cent). Other liberalization measures during this year included revision of sectoral caps in the banking sector, ISPs (with gateways), radio paging and end-to-end bandwidth. Non-Resident Indian (NRI) investments in foreign exchange was made fully repatriable. During 2002, the tea plantation sector was opened to allow FDI of up to 100 per cent under the Government approval route subject to certain conditions. The sectoral cap for the advertising sector was increased to 100 per cent through the automatic route, and entry-level conditions for FDI up to 100 per cent in the film sector were dispensed with. The Government of India Budget 2003 announced the raising of the sectoral cap in respect of FDI in private sector banks from 49 per cent to 74 per cent.

Sector specific Guidelines for FDI is at Annex 1. List of Sectors with equity cap on FDI is at Annex 2.

4.11 India's liberalized outward investment policy provides for the following routes:

a. Automatic Route: Under this scheme, Indian companies can freely invest up to US$ 100 million (US$ 150 million in SAARC countries, excluding Pakistan and Myanmar) and up to Rs.7 billion by way of rupee investments in Nepal and Bhutan in a year without prior approval of RBI or the Government of India, provided the overseas investment is not real estate oriented. Certain additional conditions would, however, apply for investment in the financial sector. Funding of the above investments can be out of the balance held in the Exchange Earners Foreign Currency Account (EEFC) of the Indian company, or 100 per cent of ADR/GDR proceeds or withdrawal of foreign exchange from an authorised dealer in India, not exceeding the net worth of the Indian company. Under the automatic route, the company only needs to make a post facto report to the RBI in the prescribed format. Special Economic Zone (SEZ) units in the country are eligible to make overseas investments up to any amount under the automatic routes within an overall ceiling of US$ 500 million to be funded out of foreign currency balances of the unit.
b. American Depository Receipts (ADR)/Global Depository Reports (GDR) Automatic Route: In terms of this scheme, Indian companies can freely utilise up to 100 per cent of ADR/GDR proceeds for overseas investments without any limit under the automatic route, subject to post facto report to the RBI.
c. ADR/GDR Automatic Stock Swap Route: Under this route, Indian companies can automatically swap their fresh issue of ADRs/GDRs for overseas acquisitions in the same core activity up to US$ 100 million or 10 times their export earnings in the last year, subject to reporting to the RBI.
d. Investment by Partnership Firms: A partnership firm registered under the Indian Partnership Act of 1932, which is engaged in providing specified professional services, may, without prior approval of RBI (post facto report only) invest up to US$ 1 million or its equivalent in one financial year in a foreign concern engaged in a similar activity, by way of remittance from India and/or capitalization of fees/other entitlements due to it from foreign concerns, provided the investing firm is a member of the relevant All Indian Professional Organization/Body.
e. Normal Route: Proposals not covered under the above automatic routes are considered by the Special Committee on Overseas investments headed by the Deputy Governor, RBI, with member representatives from the Ministries of Finance, Commerce, External Affairs and the Reserve Bank. The RBI is the secretariat for this Committee. The application for direct investment in a joint venture/wholly owned subsidiary outside India or by way of exchange of shares of a foreign company, shall be made in Form ODI or in Form ODB respectively, to the RBI, Exchange Control Department, Central Office, Mumbai – 400 001.
f. Block Allocation by RBI: An Indian party, which has exhausted the limit of US$ 100 million a year, may apply to the RBI for a block allocation of foreign exchange subject to such terms and conditions as may be considered necessary.

Foreign Direct Investment Policies in Sri Lanka

4.12 The major objective of the foreign investment policy of Sri Lanka is to attract capital through FDI and thereby to generate high economic growth, create more employment, promote transfer of

technology, develop management skills and expand market access. As the possibilities of raising capital within Sri Lanka are rather limited, FDI constitutes an important part of its plan for future economic development.

4.13 Since the economic liberalization policies began in 1977, Sri Lanka has been pursuing a liberal FDI policy by opening up all sectors to foreign investment (except a few restricted areas e.g., defence), providing attractive investment incentives, granting national treatment to foreign investment and, establishing the Board of Investment as a single clearance authority and Export Processing Zones (EPZs) with flexible labour laws and better infrastructure facilities. The BOI Act, which was first formulated in 1978 and had been revised subsequently in 1980, 1983, 1992 and 2002, governs foreign investment in Sri Lanka. The Board of Investment that was established under the BOI Act is an autonomous statutory agency, responsible for promoting, approving and assisting foreign investment in Sri Lanka. Section 17 of the BOI Act entrusted the Board with the power to grant a wide range of incentives and concessions to foreign investors satisfying specified eligibility criteria in terms of exports (percentage of output) and employment. The Board of Investment acts as a 'one-stop-shop' central facilitator for qualifying foreign investment. Foreign investment that does not qualify for the BOI route on account of not meeting the required eligibility criteria falls under Section 16 of the BOI Act that permits such investment to operate under the normal laws of the country.

4.14 A new BOI Act was also passed by Parliament in December 2002 to set up Regional Economic Development Commissions with a view to speeding up the process of countrywide development. The new BOI Act also has the same powers in relation to an enterprise making foreign direct investments, except granting tax incentives. The authority to grant tax exemptions will be vested in the Department of Inland Revenue once the Inland Revenue (Amendment) Bill of 2003 becomes law. The relevant sections of laws from which the new BOI Act can grant exemptions are given in Annexure 3.

4.15 Investment Approvals: The existing Sri Lankan FDI policy allows automatic approval up to 100 per cent foreign investment in all sectors of the economy under the BOI route, except for a small list of restricted areas (Annex 4). However, the 'thrust areas' into which FDI is specially encouraged by the BOI include infrastructure, information technology, electronics, light engineering, textiles, garments & fashion accessories, rubber products, agriculture, mining & processing, gems & jewellery, tourism, recreation & leisure services.

4.16 Investment Incentives: To encourage foreign investment flows into these thrust areas, the BOI provides several investment incentives to new enterprises and existing enterprises going for expansion. The incentives offered to investors operating under the BOI Law are available to both foreign and local investors, provided the investment is undertaken through a company incorporated in Sri Lanka. The quantum of incentives offered depends upon the value of investment, the number of employment opportunities, and the level of export orientation. The package of incentives includes tax holidays, preferential taxation, and duty-free import of capital goods and raw materials (Annex 5).

4.17 Regulations have been framed under the BOI Act to grant specific incentives to new and existing enterprises satisfying specific eligibility criteria. These incentives generally involve a combination of exemptions relating to income tax, customs duty and foreign exchange controls, which are conferred on an eligible company that enters into an agreement with the BOI.

4.18 The types of investments that qualify for incentives under Section 17 of the BOI Act are indicated below. More details are given in Annex 5.

- Manufacture of non-traditional goods for exports
- Export oriented services
- Manufacture of industrial tools and/or machinery
- Small scale infrastructure projects
- Information Technology (IT) and/or IT enabled services
- IT related training institutes
- Regional Operating Head Quarters
- Any large scale industrial, agricultural, construction or service or any other business activity
- Research and development
- Agriculture and/or agro processing other than processing of black tea
- Existing enterprises undertaking an expansion
- Rehabilitation of non-performing or under-performing enterprises
- Export Trading Houses
- Large-scale (new/existing) projects
- Large-scale infrastructure projects

4.19 Protection is provided to mutual investments through the following institutional mechanisms:

a. Constitutional Guarantee.
b. Bilateral Investment Promotion and Protection Agreement (BIPPA).
c. Sri Lanka is a founder member of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank, which provides guarantees against non-commercial risks, such as those arising out of political changes or political instability and insecurity.
d. Avoidance of Double Taxation and Prevention of Fiscal Evasion Agreement.

The JSG recommends that reviews be carried out by the two governments to enhance the scope and effectiveness of the Bilateral Investment Promotion and Protection Agreement and the Avoidance of Double Taxation and Prevention of Fiscal Evation Agreement.

Potential Areas for Investment Promotion in Sri Lanka

4.20 Despite fairly open foreign direct investment policies maintained by both countries, bilateral investment flows have not grown to desirable levels that could produce mutual benefits, partly due to the lack of awareness of investment opportunities and existing administrative and regulatory controls mentioned above. Therefore, the following illustrative but not exhaustive list highlights some areas in Sri Lanka where Indian investors could exploit their comparative advantages.

- Port development
- Rail transportation
- Power generation and transmission
- Infrastructure in the tourism industry
- Land bridge connecting India and Sri Lanka
- ICT projects
- Petroleum exploration
- Film industry
- R&D (biotechnology and agricultural research)
- Health and education

Furthermore, there exists a vast range of joint investment opportunities in both countries. These investments will enhance economic activities in both countries and improve competitiveness of their exports.

Outward Investment Policy Measures in Sri Lanka

4.21 Outward investments by Sri Lankan residents are currently governed by the Exchange Control Act under which all applications for investment abroad should be approved by the Minister of Finance following a recommendation from the Controller of Exchange. The Minister has delegated his power to approve outward investments to the Controller of Exchange and the Secretary to the Treasury up to certain limits, subject to guidelines approved by the Minister. However, establishments approved by the BOI are not required to obtain permission under the Exchange Control Act to make investments abroad, to the extent that the investment is in respect of the business activities agreed upon with the BOI.

4.22 In granting permission to make investments abroad, the Controller of Exchange follows some guidelines approved by the Minister. The guidelines are mainly aimed at permitting foreign investments by resident establishments which have earned substantial amounts of foreign exchange in their existing business in Sri Lanka to enable them to extend their business for further promotion of export of goods and services from Sri Lanka. They would also ensure that the ventures have a reasonable chance of success.

4.23 New Foreign Exchange Management Act: The proposed Foreign Exchange Management Act (FEMA), which will replace the Exchange Control Act, relaxes some of the existing restrictions on outward foreign direct investment and has provisions to further liberalize investment abroad. The new Act makes provisions for the orderly management and regulation of foreign exchange with the objective of further liberalizing dealings in foreign exchange. Section 7 of the Act authorizes the Minister of Finance, in consultation with the Monetary Board of the Central Bank, to issue orders effecting further liberalization of the capital account without amending the FEMA.

Outward Investment Policy Measures in India

4.24 Overseas Investments in Joint Ventures: Overseas Investments in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognized as important avenues for promoting global business in terms of foreign exchange earnings like dividends, royalties, technical know-how fees and other entitlements on such investments. They are also a major source of increased exports of plant and machinery and goods. Joint Ventures have also been perceived as a medium of economic cooperation between India and other countries. Transfer of technology and skills, sharing of results of R&D, access to wider global markets, promotion of brand image, generation of employment and utilization of raw materials available in India and the host country are other significant benefits arising out of such overseas investments.

4.25 Any Indian party has, therefore, been permitted to make investments under the automatic route in an overseas joint venture/wholly owned subsidiary up to US $ 150 million or its equivalent in any one financial year in Sri Lanka. Partnership firms engaged in professional services like chartered accountancy, legal practice, IT, entertainment, software related services and medical and health care services are also permitted to invest abroad without prior approval up to US $ 1 million or its

equivalent in one financial year. The Exim Bank of India has been financing various companies in setting up Joint Ventures in Sri Lanka and has supported bids submitted by Indian companies in Sri Lanka.

Recommendations

4.26 The JSG recommends that Sri Lankan investors, both individuals and Sri Lankan companies seeking to make Foreign Direct Investments (FDI) in India be treated on par with other international investors. The investments accordingly would access the automatic route of Reserve Bank of India in sectors where FDI is on the automatic route. Where Government of India approval is required (i.e., where it is not on the automatic route) they would need to obtain the necessary Government of India approval as is applicable to all other international investors.

4.27 In regard to FDI, consideration should be given to providing pre-establishment national treatment in sectors where 100 per cent FDI is permitted on the automatic route in both countries. Appropriate conditions would need to be framed such as restricting this facility to nationals and juridical persons of the two countries and excluding categories such as permanent residents and branches of non-incorporated companies.

4.28 The JSG also noted that for making portfolio investments in the Indian capital markets (both equity and debt markets), the smaller investors from Sri Lanka, like investors of all other countries, could come through the Foreign Institutional Investor (FII) route. For this, they would need to come through SEBI-registered Sri Lankan institutional investors. It is possible for Sri Lankan Institutional Investors like financial institutions, banks, mutual funds to have India dedicated funds pooled from Sri Lankan nationals and invest in the capital markets after obtaining SEBI registration. Close coordination between eligible Sri Lankan Institutional Investors and SEBI could ensure their successful participation in the Indian capital markets.

Cross Listing of Stocks between Sri Lankan and Indian Stock Exchanges

4.29 Listing of Indian Companies on the Colombo Stock Exchange and Sri Lankan Companies on Indian Stock Exchanges could be considered as a further step towards greater economic cooperation between the two countries. This would expand the resource base for firms in either country, increase liquidity and facilitate portfolio and risk diversification. The JSG, therefore, recommends that the cross listings of stocks between Sri Lankan and Indian Stock Exchanges be permitted. Going by the international practice, securities of companies in Sri Lanka should be allowed to be listed on the Indian stock exchanges in the form of Indian Depository Receipts (IDR) and vice-versa. To illustrate, in India, the mechanism of IDR would involve Sri Lankan companies issuing depository receipts designated in Indian rupees, which would be subscribed by Indian investors. The JSG further recommends that such DR proceeds should be allowed to be repatriated fully. To alleviate any concerns regarding outflows of foreign currency, the concerned authorities could, if deemed necessary, impose initially an annual limit for issue of such DRs. The JSG requests the relevant authorities in the two countries to work out acceptable modalities.

4.30 The JSG recommends that top rated Sri Lankan financial institutions be permitted to raise resources in India for on-lending to Sri Lankan companies. The limits and other modalities could be subsequently worked out.

4.31 The JSG noted that India has established a strong institutional framework in the capital market such as screen-based trading systems and clearing corporations, which are on par with international best practices. There are benefits in the sharing of this experience with Sri Lanka through Technical Assistance programmes.

4.32 The JSG further recommends that the investment promotion authority (BOI) in Sri Lanka and the Exim Bank in India play a more pro-active role in identifying areas of cooperation including opening of additional LOCs with banks/financial institutions in Sri Lanka to fully exploit the trade potential between the two countries.

4.33 Focus on Investment Promotion in Services: As discussed above, a special thrust on the services sector is required to bring about a structural change in the sectoral composition of Indian investment in Sri Lanka. In so doing, the scope for investment complementarities would widen with significant positive implications for trade, employment and technological profiles of the two countries.

4.34 Bridging the Gap between FDI Approvals and Actual Project Implementation: As it has been noticed, there is a significant gap between FDI approvals and actual investment inflows in Sri Lanka. Under the proposed investment area agreement, this aspect could be given a place of primacy so that both countries are able to reap the actual benefits of investment flows.

4.35 Cooperation in the Area of Technical Manpower and other Skills: Special investment promotion measures need to be set in place so as to achieve skills development and technological capability building in both countries through mutual cooperation. The process may first get initiated with the help of investment measures, but later, a large pool of technical and skilled manpower itself could determine the quantity and quality of bilateral FDI flows.

4.36 Information Flows for Generating Investment Flows: Policy and business initiatives are required for providing timely and accurate information on investment opportunities available in Sri Lanka so as to enhance Indian FDI. This calls for building databases on business queries from Sri Lankan firms, government regulations and incentives, up-to-date business activities and managerial and consultancy experts, as well as economists.

4.37 Provision of Supporting Services: The JSG is of the view that an institutional mechanism needs to be worked out and included as part of the proposed investment area for initiating special programmes on financial/credit support services for Indian investment firms in Sri Lanka, as well as providing advisory and management training services to assist them.

4.38 While making the above recommendations the JSG is conscious of the fact that the ultimate objective is to accord national treatment to Sri Lankan Investors in India and vice versa.

Table 1
Indian Joint Venture Approvals in Sri Lanka, 1975-2001

Period	Indian Joint Ventures in Sri Lanka		Memorandum: Total Indian Joint Ventures Abroad in			
			Developing Countries		South Asia	
	No.	Equity (US$ million)	No.	Equity (US$ million)	No.	Equity (US$ million)
1975-80	4	6.6	57 (7.02)	68 (9.71)	8 (50.0)	11.72 (56.3)
1981-90	12	3.4	108 (11.11)	123.52 (2.75)	22 (54.5)	9.19 (37.0)
1991-2001*	87	96.8	1176 (7.40)	1719.82 (5.63)	197 (44.2)	157.39 (61.5)
1991-95	29	41.8	453 (6.40)	442.42 (9.45)	65 (44.6)	59.11 (70.7)
1996-2001 *	58	55.0	723 (8.02)	1277.4 (4.31)	132 (43.9)	98.28 (56.0)

Notes: (I)* Up to March 2001; (ii) Figure in parenthesis is percentage share of Sri Lanka in Indian outward FDI in developing and South Asian region.

Source: RIS-DSIR database (2002).

Table 2
Sectoral composition of Indian FDI in Sri Lanka, 1975-2001

Sector	1975-90		1991-2001	
	No.	Equity (US $ million)	No.	Equity (US $ million)
Exploration & refining of oil			1	0.203
Total Extractive			1	0.203
Oilseeds, food products & processing	1	0.09	1	2.735
Textiles and garments	2	1.86	5	7.536
Chemicals, petro-chemicals & paints	2	0.22	5	0.291
Drugs & pharmaceuticals			4	4.303
Rubber, plastic & tyres	1	0.59	5	2.728
Cement, glass & building material			16	53.984
Iron and steel	1	0.07	2	0
Electrical & electronic equipments			1	1.342
Transport equipment	1	0.31	1	0.198
Beverages & tobacco			4	3.005
Engineering goods & metallurgical items	2	0.144	6	2.837
Fertilizers, pesticides & seeds	1	0.58		
Miscellaneous	1	0.054	9	3.881
Total Manufacturing	12	3.918	59	82.84
IT, communication & software			5	3.28
Hotels, restaurants, tourism	3	6.024	1	0.007
Civil Contracting & engineering services			1	0.56
Consultancy			2	0.023
Media broadcasting & publishing			5	0.989
Financial services & leasing	1	0.004	7	1.725
Transport services			1	0.833
Other professional services			5	6.351
Total Services	4	6.028	27	13.768
All Sectors	16	9.946	87	96.811

Source: RIS-DSIR database (2002).

Table 3
Importance of Indian FDI in Sri Lanka

Period	Cumulative FDI Inflows in Sri Lanka (US $ million)		Indian FDI as a share of Total FDI in Sri Lanka (%)	Indian FDI as a share of Gross Fixed Capital Formation in Sri Lanka (%)
	Indian FDI	Total FDI		
1975-80	6.6	91.0	7.23	0.153
1981-90	3.4	407.4	0.82	0.022
1991-2000	94.8	1766.5	5.37	0.286

Summary of Recommendations

The JSG recommends that:

- Board of Investment of Sri Lanka to have a special cell to encourage and facilitate Indian investment in Sri Lanka, particularly for infrastructure projects.
- Sri Lankan investors, both individuals and companies seeking to make Foreign Direct Investments (FDI) and portfolio investment in India be treated on par with other international investors.
- In regard to FDI, consideration should be given to providing pre-establishment national treatment in sectors where 100 per cent FDI is permitted on the automatic route in both countries. Appropriate conditions would need to be framed such as restricting this facility to nationals and juridical persons of the two countries and excluding categories such as permanent residents and branches of non-incorporated companies.
- Cross listing of Indian Companies on the Colombo Stock Exchange and Sri Lankan Companies on Indian Stock Exchanges be considered through the Depository Receipts mechanism.
- Top rated Sri Lankan financial institutions be permitted to raise resources in India.
- The investment promotion authority (BOI) in Sri Lanka and the Exim Bank in India play a more pro-active role for identifying areas of cooperation including opening of additional LOCs with banks/financial institutions in Sri Lanka.
- Reviews be carried out by the two Governments to enhance the scope and effectiveness of Bilateral Investment Promotion and Protection Agreement and Avoidance of Double Taxation and Prevention of Fiscal Evasion Agreement.
- Focus be given to investment promotion, and cooperation in the area of technical manpower.
- Work out an appropriate institutional mechanism for provision of information and support services to enhance the quantity and quality of investment flows between two countries.

Annex 1

Sector Specific Guidelines for Foreign Direct Investment in India

Sl.No.	Sector	Guidelines
1.	Private Sector Banking	49% from all sources on the automatic route subject to guidelines issued from RBI from time to time. Consolidated guidelines are given at Appendix-A
	Non Banking Financial Companies (NBFC)	**(a) FDI/NRI/OCB investments allowed in the following 19 NBFC activities shall be as per levels indicated below :** i) Merchant banking ii) Underwriting iii) Portfolio Management Services iv) Investment Advisory Services v) Financial Consultancy vi) Stock Broking vii) Asset Management viii) Venture Capital ix) Custodial Services x) Factoring xi) Credit Reference Agencies xii) Credit Rating Agencies xiii) Leasing & Finance xiv) Housing Finance xv) Forex Broking xvi) Credit card business xvii) Money changing Business xviii) Micro Credit xix) Rural Credit (b) Minimum Capitalization Norms for fund based NBFCs: i) For FDI up lo 51% - US$ 0.5 million to be brought upfront ii) For FDI above 51% and up to 75% - US $ 5 million to be brought upfront iii) For FDI above 75% and up to 100% - US $ 50 million out of which US $ 7.5 million to be brought upfront and the balance in 24 months (c) Minimum capitalization norms for non-fund based activities Minimum capitalization norm of US $ 5 million is applicable in respect of all permitted non-fund based NDFCs with foreign investment (d) Foreign investors can set up 100% Derating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian entities, subject to bringing in US$ 50 million as al (b) (iii) above (without any restriction on number of operating subsidiaries without bringing in additional capital) (e) Joint Venture operating NBFC's that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capital inflow i.e. (b)(i) and (b)(ii) above

		(f) FDI in the NBFC sector is put on automatic route subject to compliance with guidelines of the Reserve Bank of India. RBI would issue appropriate guidelines in this regard Insurance FDI up to 26% in life Insurance sector is allowed on the automatic route subject to obtaining licence from Insurance Regulatory & Development Authority (IRDA)
2.	Domestic Airlines	(Detailed guidelines have been issued by Ministry of Civil Aviation) In the domestic Airlines up to 40% permitted subject to no direct or indirect equity participation by foreign airlines 100% investment by NRIs/OCBs The automatic route is not available Up to 100% with FDI, beyond 74% requiring Government approvals
3.	Telecommunication	i) In basic, cellular, value added services and global mobile personal communications by satellite, FDI is limited to 49% subject to licensing and security requirements and adherence by the companies (who are investing and the companies in which the investment is being made) to the licence conditions for foreign equity cap and lock- in period for transfer and addition of equity and other licence provisions ii) In ISPs with gateways, radio-paging and end-to-end bandwidth, FDI is permitted up to 74% with FDI, beyond 49% requiring Government approval. These services would be subject to licensing and security requirements iii) No equity cap is applicable to manufacturing activities iv) FDI up to 1 00% is allowed for the following activities in the telecom sector : a. ISPs not providing gateways (both for satellite and submarine cables) b. Infrastructure Providers providing dark fibre (IP Category 1) c. Electronic Mail; and d. Voice Mail The above would be subject to the following conditions: (a) FDI up to 100% is allowed subject to the condition that such companies would divest 26% of their equity in favour of Indian public in 5 years, if these companies are listed in other parts of the world (b) The above services would be subject to licensing and security requirements, wherever required (c) Proposals for FDI beyond 49% shall be considered by FIPB on case to case basis

4.	Petroleum (other than Refining)	a. Under the exploration policy, FDI up to 100% is allowed for small fields through competitive bidding; up to 60% for unincorporated JV; and up to 51% for incorporated JV with a No Objection Certificate for medium size fields b. For petroleum products and pipeline sector, FDI is permitted up to 51% c. FDI is permitted up to 74% in infrastructure related to marketing and marketing of petroleum products d. 100% wholly owned subsidiary(WOS) is permitted for the purpose of market study and formulation e. 100% wholly owned subsidiary (W0S) is permitted for investment/Financing f. For actual trading and marketing, minimum 26% Indian equity is required over 5 years The automatic route is not available a. FDI is permitted up to 26% in case of public sector units (PSUs). PSUs will hold 26% and balance 48% by public. Automatic route is not available b. In case of private Indian companies, FDI is permitted up to 100% under automatic route
5.	Housing & Real Estate	No foreign investment is permitted in this sector except for development of integrated townships and settlements where FDI up to 100% is permitted with prior Government approval. NRIs/OCBs are allowed to invest in the following activities a. Development of serviced plots and construction of built up residential premises b. Investment in real state covering construction of residential and commercial premises including business centres and offices c. Development of townships d. City and regional level urban infrastructure facilities, including both roads and bridges e. Investment in manufacture of building materials, which is also open to FDI f. Investment in participatory ventures in (a) to (e) above g. Investment in housing finance institutions, which is also open to FDI as an NBFC
6.	Coal and Lignite	(i) Private Indian companies setting up or operating power projects as well as coal or lignite mines for captive consumption are allowed FDI up to 100% (ii) 100% FDI is allowed for setting up coal processing plants subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing (iii) FDI up to 74% is allowed for exploration or mining of coal or lignite for captive consumption (iv) In all the above cases, FDI is allowed up to 50% under the automatic route subject to the condition that such investment shall not exceed 49% of the equity of a PSU.
7.	Venture Capital Fund(VCF) and Venture Capital Company(VCC)	Offshore Venture Capital Funds/Companies are allowed to invest in domestic venture capital under taking as well as other companies through the automatic route-subject only to SEF3I regulations and sector specific caps on FDI

8.	Trading	Trading is permitted under automatic route with FDI up to 51% provided it is primarily export activities, and the undertaking is an export house/trading house/super trading house/star trading house. However, under the FIPB route:- i. 100% FDI is permitted in case of trading companies for the following activities: • exports • bulk imports with ex-port/ex-bonded warehouse sales • casli and carry wholesale trading • other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group and not for third party use or onward transfer/distribution/sales ii. The following kinds of trading are also permitted, subject to provisions of EXIM Policy: a. Companies for providing after sales services (that is not trading per se) b. Domestic trading of products of JVs is permitted at the wholesale level for such trading companies who wish to market manufactured products on behalf of their joint ventures in which they have equity participation in India c. Trading' of hi-tech items/items requiring specialized after sales service d. Trading of items for social sector e. Trading of hi-tech, medical and diagnostic items f. Trading of items sourced from the small scale sector under which, based on technology provided and laid down quality specifications, a company can market that item under its brand name g. Domestic sourcing of products for exports h. Test marketing of such items for which a company has approval for manufacture provided such test marketing facility will be for a period of two years, and investment in setting up manufacturing facilities commences simultaneously with test marketing i. FDI up to 100% permitted fore-commerce activities subject to the condition that such companies would divest 26% of their equity in favour of the Indian public in five years, if these companies are listed in other parts of the world. Such companies would engage only in business to business (B2B) e-commerce and not in retail trading
9.	Investing companies in infrastructure/ service sector	In respect of the companies in infrastructure/service sector, where there is a prescribed cap for foreign investment, only the direct investment will be considered for the prescribed cap and foreign investment in an investing company will not be set off against this cap provided the foreign direct investment in such investing company does not exceed 49% and the management of the investing company is with the Indian owners. The automatic route is not available
10.	Atomic Minerals	The following three activities are permitted to receive FDI/NRI/OCB investments through FIPB (as per detailed guidelines issued by Department of Atomic Energy vide Resolution No.8/1(1)/97-PSU/ 1422 dated 6. 10. 98): a. Mining and mineral separation b. Value addition per sc to the products of (a) above c. Integrated activities (comprising of both (a) and (b) above.) The following FDI participation is permitted: (i) Up to 74% in both pure value addition and integrated projects (ii.) For pure value addition projects as well as integrated projects with value addition up to any intermediate stage, FDI is permitted up to 74% through joint venture companies with Central/ State PSUs in which equity holding of at least one PSU is not less than 26% (iii) In exceptional cases, FDI beyond 74% will be permitted subject to clearance of the Atomic Energy Commission before FIPB approval

11.	Defence and strategic industries	Foreign Direct Investment, including NRI/OCB investment, is permitted up to 26% with prior Government approval subject to licensing and security requirements. Detailed guidelines for participation of private sector and foreign investors in this sector are given in Appendix-B
12.	Agriculture (including plantation)	No FDI/NRI/OCB investment is permitted other than Tea sector, where FDI permitted up to 100% in Tea sector, including tea plantations, with prior Government approval and subject to following conditions:
13.	Print media	The following FDI participation in Indian entities publishing News Papers and periodicals is permitted: (a) FDI up to 74% in publishing scientific/technical and speciality magazines/periodicals/journals FDI up to 26% in publishing News Papers and Periodicals dealing in News and Current Affairs subject to verification of antecedents of foreign investor, keeping editorial and management control in the hands of resident Indians and ensuring against dispersal of Indian equity. The detailed guidelines had been issued by Ministry of Information and Broadcasting.
14.	Broadcasting	Broadcasting a) TV Software Production 100% foreign investment allowed subject to: (i) all future laws on broadcasting and no claim of any privilege or protection by virtue of approval accorded, and (ii) not undertaking any broadcasting from Indian soil without Government approval b) Setting up hardware facilities, such as up-linking, HUB, etc. Private companies incorporated in India with permissible FII/NRI/OCB/PIO equity within the limits (as in the case of telecom sector FDI limit up to 49% inclusive of both FDI and portfolio investment) lo set up up-linking hub (teleports) for leasing or hiring out their facilities to broadcasters Foot note: As regards satellite broadcasting, all TV channels irrespective of management control to uplink from India provided they undertake to comply with the broadcast (programme & advertising) code c) Cable Network Foreign investment allowed up to 49% (inclusive of both FDI and portfolio investment) of paid up share capital. Companies with minimum 51% of paid up share capital held by Indian citizens are eligible under the Cable Television Network Rules (1994) to provide cable TV services d) Direct-to-Home Company with a maximum of foreign equity including FDI/NRI/OCB/FI1 of 49% would be eligible to obtain DTH License. Within the foreign equity, the FDI component not to exceed 20% e) Terrestrial Broadcasting FM The licensee shall be a company registered in India under the Companies Act. All share holding should be held by Indians except for Hie limited portfolio investment by FII/NRI/PIO/OCB subject to such ceiling as may be decided from time to time. Company shall have no direct investment by foreign entities, NRIs and OCBs. As of now, the foreign investment is permissible to the extent of 20% portfolio investment No private operator is allowed in terrestrial TV transmission
15.	Power	Up to 100% FDI allowed in respect of projects relating to electricity generation, transmission and distribution, other than atomic reactor power plants. There is no limit on the project cost and quantum of foreign direct investment

16.	Drugs & Pharmaceuticals	FDI up to 100% is permitted on the automatic route for manufacture of drugs and pharmaceutical, provided the activity does not attract compulsory licensing or involve use of rpfombinaril DNA technology, and specific cell / tissue targeted formulations FDI proposals for the manufacture of licensable drugs and Pharmaceuticals and bulk drugs produced by recombinant DNA technology, and specific cell / tissue targeted formulations will require prior Government approval
17.	Roads & Highways, Ports and Harbours	FDI up to 100% under automatic route is permitted in projects for construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular tunnels, ports and harbours.
18.	Hotels & Tourism	100% FDI is permissible in the sector on the automatic route The term hotels include restaurants, beach resorts, and other tourist complexes providing accommodation and/or catering and food facilities to tourists. Tourism related industry include travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment, amusement, sports, and health units for tourists and Convention/Seminar units and organizations For foreign technology agreements, automatic approval is granted if / up to 3% of the capital cost of the project is proposed to be paid for technical and consultancy services including fees for architects, design, supervision, etc. ii. up to 3% of net turnover is payable for franchising and marketing/publicity support fee, and iii. up to 10% of gross operating profit is payable for management fee, including incentive fee
19.	Mining.	i. For exploration and mining of diamonds and precious stones FDI is allowed up to 74% under automatic route ii. For exploration and mining of gold and silver and minerals other than diamonds and precious stones, metallurgy and processing FDI is allowed up to 100% under automatic route iii. Press Note No. 18 (1998 series) dated 14. 12.. 98 would not be applicable for setting up 100% owned subsidiaries in so far as the mining sector is concerned, subject to a declaration from the applicant that he has no existing joint venture for the same area and /or the particular mineral
20.	Postal services	FDI up to 100% is permitted in courier services with prior Government approval excluding distribution of letters, which is reserved exclusively for the state
21.	Pollution Control and management	FDI up to 100% in both manufacture of pollution control equipment and consultancy for integration of pollution control systems is permitted on the automatic route
22.	Advertising and films	(a) Advertising sector FDI up to 100% allowed on the automatic route (c) Film sector (film production, exhibition and distribution including related services/products) FDI up to 100% allowed on the automatic route with no entry-level condition
23.	Mass Rapid Metro Transit System	FDI up to 100% is permitted on the automatic route in mass rapid transport system in all metros including associated real estate development

24.	Township Development	FDI up to 100% is permitted for development of integrated townships including houses, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit system; and manufacture of building materials. Development of land and providing allied infrastructure will form an integral part of township's development. FDI in this sector would be permissible with prior Government approval. Detailed guidelines regarding investment in this sector are given at Appendix-C
25.	Establishment and Operation of satellite	FDI up to 74% is permitted with prior Government approval
26.	Lottery business, gambling & betting	Government has reiterated prohibition of foreign direct investment (FDI) / Foreign technical collaboration (FTC) in any form in lottery business, gambling and betting sector.

Annex 2

India: List of Sectors with Equity Cap on Foreign Direct Investment (FDI)

Sr.No.	Sector	FDI equity cap	Entry route	Entry condition
1.	Financial Services			
(a)	Private Banking	49%	Automatic	Subject to RBI regulations
(b)	Insurance	26%	Automatic	Subject to licence from IRDA
2.	Civil Aviation			
(a)	Domestic Airlines	40%	FIPB	(a) No direct or indirect equity participation by foreign airlines. (b) Guidelines by Ministry of Civil Aviation to be compiled with.
3.	Telecommunication			
(a)	Basic, Cellular, Value Added Services, Global Mobile Communication System by Satellite.	49%	FIPB	(a) Subject to Licensing and Security requirements, adherence to licensing conditions for foreign equity cap and lock-in period for transfer and addition of equity and other licence provisions.
(b)	ISPs with gateways, radio paging and end-to-end bandwidth	74%	FIPB approval for equity beyond 49%	Licensing and security requirements.
4.	Petroleum & Natural Gas			
(a)	Petroleum exploration – unincorporated IV	60%	FIPB	
(b)	Petroleum Exploration-incorporated IV	51%	FIPB	No objection certificate for medium size fields.
(c)	Petroleum Products and Pipeline	51%	FIPB	
(d)	Petroleum (refining) PSUs	26%	FIPB	PSUs 26% - balance 48% by public.
5.	Defence			
(a)	Defence	26%	FIPB	Subject to licensing and security requirements.
6.	Print Media & Broadcasting			
(a)	Scientific and technical magazines/periodicals speciality journals	74%	FIPB	
(b)	Newspapers and periodicals dealing with News and current Affairs	26%	FIPB	(a) verification of the antecedents of investor, (b) keeping editorial and management control in the hands of resident Indians.
(c)	Setting up of hardware facilities, up linking, HUB, etc.	49%	FIPB	Inclusive of both FDI and Portfolio; Satellite broadcasting all TV Channels irrespective of management control to uplink from India and compliance with the broadcast code.
(d)	Cable Network	49%	FIPB	Inclusive of both FDI and portfolio
(e)	DTH	20%		FDI/NRI/OCB/FII equity not to exceed 49%.
(f)	Establishment % Operation of Satellites	74%	FIPB	
7.	Mining			
(a)	Mining of Diamonds and precious stones	74%	Automatic	
8.	Coal & Lignite			
(a)	Exploration and mining of Coal or Lignite for captive consumption	74%	FIPB	Up to 50% under Automatic Provided such investment shall not exceed 49% of the equity of PSU.

Annex 3

Relevant Sections of the Laws from which the New BOI Act Can Grant Exemptions - Sri Lanka

Applicable Laws		Relevant Sections
1.	Customs Ordinance (Chapter 235)	Sections 10 and 23
2.	Exchange Control Act (chapter 423)	Parts I. IA, II, III, IV, V, VA and VI
3.	The Companies Act, No. 17 of 1982	Section 255 (e) and (f)
4.	National Film Corporation Act, No. 47 of 1971	Sections 5(d), (e) and (g) of Part I and Sections 57 and 61 of Part Vi
5.	Municipal Councils Ordinance (Chapter 252)	Sections 127, 230, 239, 247A, 247B and 247C
6.	Urban Councils Ordinance (Chapter 253)	Sections 160, 164, 165A and 165C
7.	Pradeshiya Sabhas Act, No. 15 of 1987	Sections 134, 149, 150, 151 and 152
8.	Forest Ordinance (Chapter 451)	Sections 24 and 25
9.	Fauna and Flora Protection Ordinance (Chapter 496)	Section 56
10.	Coast Conservation Act, No. 57 of 1981	Sections 14, 15, 16 and 17
11.	Urban Development Authority Law, No. 41 of 1978	Part II
12.	Sri Lanka Land Reclamation and Development Corporation Act. No. 15 of 1968	Sections 2 and 8
13.	Crown Lands Ordinance (Chapter 454)	Sections 296 (8) and 96 (9)
14.	Land Acquisition Act (Chapter 460)	Section 49A
15.	Plant Protection Act, No. 35 of 1999	Sections 2 and 3 of Part I

Source: Board of Investment of Sri Lanka.

Annex 4

Regulated Areas for Foreign Investment in Sri Lanka

A. Areas Regulated by Government Agencies

- International air transportation
- Sensitive industries such as military hardware, dangerous drugs and currency
- Lotteries
- Large scale mechanized mining of gems
- Coastal shipping

B. Areas where BOI can provide limited direct approval for foreign ownership above the stipulated limit of 40 per cent.

- Export production of goods subject to international quotas
- Growing and primary processing of tea, rubber, coconut, rice, cocoa, sugar and spices
- Mining and primary processing of non renewable resources
- Timber based industries using local timber
- Fishing
- Mass communications
- Education
- Freight forwarding
- Travel agencies
- Shipping agency services

C. *Areas Reserved for Local Enterprises*

- Money lending
- Pawn broking
- Retail trade with capital investment of less than US$ 1 million and retail trade in franchise/branded goods below an investment of US$ 150,000
- Coastal fishing
- Education of students who are citizens of Sri Lanka and not over 14 years of age
- Award of local educational degrees

Source: Board of Investment of Sri Lanka

Annex 5

Sri Lanka: Industry-wise Incentives at a Glance (as at May 2003)

Category	Qualifying Criteria		Incentives						
	Minimum Investment (USD)	Minimum Export Requirement (% of output)	Full Tax Holiday	Concessionary Tax			Import Duty Exemption on		Exemption from Exchange Control
				10%	15%	20%	Capital goods	Raw materials	
1. Manufacture of non-traditional goods[1] for export including deemed exports	150,000	80%	5 years[a]	2 years	Thereafter	N/A	Yes	Yes[2]	Yes
2. Export-oriented services	150,000	70%	5 years[a]	2 years	Thereafter	N/A	Yes	Yes[2]	Yes
3. Manufacture of Industrial Tools and /or Machinery	150,000	N/A	5 years[a]	2 years	N/A	Thereafter	Yes[3]	No	No
4. Small scale Infrastructure Projects: Power generation, Tourism and/or recreation, Warehousing and/or Cold storage, Garbage collection and/or disposal, Construction of houses not less than 25 housing units in not more than 4 locations, Construction of hospitals	500,000	N/A	5 years[a]	2 years	N/A	Thereafter	Yes[3]	No	
5.1 Information Technology (IT) and/or IT enabled services[4] (15 technically qualified persons for IT enabled services)	N/A	N/A	3 years[a]	2 years	If export oriented	If not	Yes[5]	No	Yes, if exports > 70%
5.2 IT related Training Institutes (Min. 300 students p.a. in IT related Training Institutes)	N/A	N/A	3 years[a]	2 years	If export oriented	If not	Yes[3]	No	No
6. Regional Operating Head Quarters[6]	N/A	70%	3 years[a]	2 years	If export oriented	If not	Yes	No	Yes
7. Any Industrial, Agriculture, Construction or Service or any other business activity approved by the Board subject to the concurrence of the Minister	5,000,000	N/A	3 years[a]	2 years	If export oriented	If not	Yes[3]	No	Determined by the BOI
8. Research and Development[7]	50,000	N/A	5 years[a]	N/A	Thereafter	N/A	Yes[3]	No	No
9. Agriculture and/or Agro-processing other than processing of Black tea[8]	10,000	N/A	5 years[a]	N/A	Thereafter	N/A	Yes (lifetime)	No	Yes, if exports >70%
10. Existing enterprises[9] undertaking an expansion of its industry in the same location or another location	500,000	N/A	2 years[b]	N/A	Thereafter	N/A	Yes	Yes	Yes
11. Non-performing or under performing enterprise[10]	10,000	Apply accordingly	3 years[a]	N/A	Apply accordingly	Apply accordingly	Apply accordingly		Determined by the BOI
12. Export Trading House exporting entirety of locally procured manufactured products or re-exporting the entirety of imported products and location should be within the EPZ	Annual value of turnover (USD) 5-10 mn			5 years[a]					
	10–25mn		5% tax up to 5 years[a]		Thereafter	N/A	Yes	Yes	Yes
	Over 25 mn		0% tax for 5 years[a]						

Category	Qualifying Criteria		Incentives						
	Minimum Investment (USD)	Minimum Export Requirement (% of output)	Full Tax Holiday	Concessionary Tax 10%	Concessionary Tax 15%	Concessionary Tax 20%	Import Duty Exemption on: Capital goods	Import Duty Exemption on: Raw materials	Exemption from Exchange Control
13. Large-scale (new /existing) Projects A company formed by the acquisition of assets of any existing enterprise to engage in the business relating to Petroleum, Power generation, transmission and Development of highways, Sea ports, Air ports, Railway, Water services, Public Transport, Agriculture and/or Agro processing services other than processing of black tea in bulk or any other Infrastructure project approved by the Board with concurrence of the Minister	12,500,000	Apply accordingly	5 years[√a]	N/A	Thereafter	N/A	Yes[√3]	No	Determined by the BOI
	25,000,000	Apply accordingly	8 years[√a]						
	over 50,000,000	Apply accordingly	10 years[√a]						
14. Large-scale Infrastructure Projects: • Power generation, transmission & distribution • Development of Highways, Sea Ports, Air Ports, Public transport, Water services • Establishment of Industrial Estates • Any other Infrastructure projects approved by the Board	10,000,000	N/A	6 years[√a]	N/A	Thereafter	N/A	Yes[√3]	No	Determined by the BOI
	25,000,000	N/A	8 years[√a]						
	50,000,000	N/A	10 years[√a]						
	75,000,000	N/A	12 years[√a]						

[√a] The tax holiday period will be reckoned from the year of assessment in which the enterprise begins to make profits or any year of assessment not later than 2 years reckoned from the date of commencement of commercial operation or production whichever year is earlier.

[√b] The tax holiday period (2 years) will be reckoned from the date of expiry of the tax holiday of the existing company or from the date of commencement of commercial operation of the expansion.

[√1] **Non-traditional Goods include all goods other than** Black tea in bulk, Crepe rubber, Sheet rubber, Scrap rubber, Coconut oil, desiccated coconut (other than Desiccated coconut manufactured using continuous scale automated process technology and marketed with a quality guarantee), Copra, Fresh coconuts, coconut fibre or such other commodity as may be determined by the Board

[√2] For export quantities

[√3] During the project establishment/implementation period

[√4] IT enabled services includes call centres or contact centres, transcription (data entry), data centres, hosting centres, e-governance related projects and any other related activity determined by the Board subject concurrence of the Minister.

[√5] If exports less than 70%, only during the project implementation period

[√6] Incentives to Regional operating head quarters are available provided 2 or more of the following services are provided to related businesses established outside Sri Lanka: Administration, business & co-ordination, Sourcing of raw materials & components, R & D services, Technical support services, Financial & treasury management, Marketing & sales promotion

[√7] Any systematic or intensive study carried out in the filed of science or technology with the object of using the result of the study for the production or improvements of materials, devices, products, produce or process but not include: Quality control of products or routine testing materials, devices, products or produce; Research in the social sciences or humanities; Routine data collection; Efficiency surveys or management studies; Market research or sales promotion

[√8] Agriculture include cultivation of plants, animal husbandry and rearing and/or processing of fish but excluding processing of black tea & prawn culture.

[√9] An Existing enterprise which is engage in the manufacture for non-traditional goods for export including deemed or export of services as approved by the Board & investment should be made before 31 March 2004.

[√10] A new or existing enterprise which takes over , merges or acquires a non-performing or under performing industry/factory for rehabilitation with the provision to meet statutory liabilities of these industries & investment should be made before 31 March 2004. If a non-BOI company takes over non performing or under performing company, a new company should be incorporated. ("**Non-performing**" – not in operation at least for 6 months prior to the submission of the application; "**under performing**" – not made profits for consecutive 2 years)

Source: Board of Investment of Sri Lanka.

Economic Cooperation to Compliment Trade Liberalization and Investment Promotion

Chapter 5

ECONOMIC COOPERATION TO COMPLEMENT TRADE LIBERALIZATION AND INVESTMENT PROMOTION

The Scope of Economic Cooperation

5.1 The warm and friendly relations between India and Sri Lanka make possible economic cooperation above and beyond rule-based trade liberalization. The identification of opportunities for such cooperation is important for the success of the CEPA. Some forms of economic cooperation in areas such as transportation, communications and the movement of people between the two countries will have a direct bearing on the success of the CEPA, in that they enable and create opportunities for greater trade and investment. In a second cluster of economic cooperation areas such as tourism, the positions of both countries will be strengthened vis a vis third countries. A third cluster of cooperative actions such as in education and agricultural research fall primarily within the scope of friendly cooperation between neighbouring countries. Of course, proposed actions in one cluster will have collateral beneficial effects: Actions that will facilitate trade will also build understanding and trust. Actions that are intended to enhance the positions of both countries vis a vis third countries will also facilitate bilateral trade and investment.

5.2 Within the overall perspective of economic cooperation, the JSG sees the role of the Governments of India and Sri Lanka as being supportive of the private sectors of both countries identifying and capitalizing on opportunities that lead to the continuing expansion of economic activities. The JSG is of the view that it is unwise for governments to be overly prescriptive and that business decisions are best made by private individuals and companies on the basis of long-term sustainability and profitability.

5.3 The JSG notes that differences in economic strength, resource endowment and capability offer scope for India and Sri Lanka to complement each other. The following is an indicative list of areas in which the public and private sectors of the two countries can cooperate.

Trade Facilitating Cooperation

Transport and Travel

5.4 The CEPA will result in increased trade in goods and services and greater investment between the two countries. Increased trade will create demand for greater travel between the two countries. Transportation links must therefore not only be capable of handling increased volumes of traffic but must also be able to do so expeditiously, cost-effectively and in ways that satisfy the varying requirements of traders and travellers. This can only be achieved by qualitative improvements to the historical and existing air, sea and land links between the two countries. For example, both legend and space imagery suggest that Sri Lanka and India were linked by a land bridge in ancient times. As recently as three decades ago, one could purchase a railway ticket to

any point in India from a railway station in Sri Lanka and complete the journey by train and ferry. Unfortunately, today travellers are limited to the option of air travel. Goods can move only by ship and by air. The success of the CEPA demands that early and urgent attention be paid to increasing the capacity, variety and cost-effectiveness of all modes of travel and transport between the two countries with the participation of multiple providers.

Air Services

5.5 The JSG noted that air travel, which is currently the sole mode of travel between the two countries, is of vital importance and an urgent requirement for the expansion of trade, tourism and people-to-people contacts. Between 2000 and 2003 the number of Indian destinations to which Sri Lankan Airlines flies increased from five to eight, the number of flights from 29 to 44 per week and the number of seats from around 8000 to nearly 9500, representing significant increases in capacity. Sri Lanka has an open door policy for inbound flights and currently receives 10 flights per week from Indian Airlines. Reduction of the current constraints will not only stimulate direct tourist trade between Sri Lanka and India but is a pre-condition for the success of joint marketing campaigns to attract third-country nationals to visit both countries. Tourists will be discouraged by congested flights that are subject to over-booking and offloading of passengers and which do not offer them choices in terms of levels of comfort, customer-friendly schedules and direct service to desirable destinations. In this light, the JSG recommends:

a. Liberalization of the Bilateral Air Services Agreement to increase air traffic rights between India and Sri Lanka.
b. Open skies for charter flights at the outset, with the possibility of broader coverage in the future. This should apply, in the first instance, to the many attractive secondary destinations in India such as Jaipur, Khajuraho, Aurangabad, Goa, Varanasi and Bhubaneshwar. After Sri Lanka upgrades its domestic airports in the regions, such flights may be feasible for Sri Lanka's secondary destinations. Consideration may be given to seaplane connections between certain tourist destinations as well;
c. Other private airlines from Sri Lanka and India be permitted to operate between the two countries to facilitate the much felt need for an expansion of seat capacity.
d. Regular meetings be held between the civil aviation authorities of the two countries to evaluate the adequacy of traffic arrangements and to continue the liberalization process.

Ferry Services

5.6 The JSG recommends that the authorities conclude an agreement to restore ferry services between the two countries and facilitate the operation of such services between mutually agreed terminal points. The JSG notes the potential of this cost-effective service to contribute to the fulfilment of the anticipated demand for travel between the two nations. Luxury ferry services can

meet a niche demand among tourists, for example, those combining visits to Kerala backwaters with Sri Lankan beaches, thereby contributing to the success of joint marketing of tourism.

Railways

5.7 India has a railway system second in size only to the USA, with some 11,000 trains running each day carrying around four million passengers across 63,000 km of track. Supporting ancillary services have also been developed, and in some cases exported to other countries. The Government of Sri Lanka has decided to improve the management of, and investment in, the Sri Lankan railway system through a Public-Private Partnership (PPP). Recognizing the extensive progress that has already been achieved through consultancy assistance in the planning of organizational reform of the railways as well as similarities of gauge, climate and other factors, the JSG notes the potential for continuing involvement by Indian entities in the modernization of the Sri Lankan railway system.

5.8 The JSG recommends that (i) the railway authorities of the two countries form a joint working group to intensify the existing relationship (ii) consideration be given to utilization of trade credits and the India Sri Lanka Economic Cooperation Fund to help finance the modernization of the Sri Lankan railway system.

5.9 The JSG noted the Sri Lankan proposal suggesting the potential of a land bridge between India and Sri Lanka in terms of connecting the land transportation systems and the possibility of linking the utility grids of the two countries. The JSG recommends that if the project presents economic benefits to both sides, feasibility and other studies for such a project be taken up at a future date to be mutually agreed upon. The possibility of reconciling the land bridge with the dredging of a ship channel to enable maritime traffic through the Sethu Samudram between India and Sri Lanka would be examined at the same time.

5.10 The JSG noted the potential of a regional power pool for Southern India and Sri Lanka, enabled by interconnecting the respective electricity grids. The JSG notes that the interest of Indian companies to participate in future bids for coal-fired plants in Sri Lanka may be accentuated by the existence of a regional power pool. A regional power pool would also enable better management of peak-load demands on both sides, as well as enable faster recovery from disasters.

Visa Issues

5.11 In light of the expected increase in travel resulting from the CEPA, the JSG recommends the further liberalization of the visa regimes of the two countries to include more categories of visitors for long term multiple entry visas and simplification of procedures for other visas. This is essential in order to facilitate trade and investment cooperation and mutual understanding. Both countries should explore the feasibility of allowing bona fide third-country tourists to obtain short-term visas

in each other's countries as part of the overall effort to encourage cross-destination travel. Ease and convenience of border crossing is critical to attracting and holding high-spending tourists in the region.

Information and Communication Technology

5.12 Many observers agree that South Asia is poised for explosive growth in the ICT sector. India's Information Technology (IT) and IT Enabled Services (ITES) industries have established themselves in the world market, to the extent that India is almost a brand name in relation to IT. The telecommunications sector is among the leading growth sectors in Sri Lanka. India is home to many innovative e-government and rural outreach projects. Sri Lanka recently launched an ambitious e-Sri Lanka Initiative intended to enable all of its citizens to participate in the global information economy and society. Without question, ICT is critical to the near term economic and social progress of both countries. The JSG recognizes as imperative cooperation in the ICT sector.

5.13 The JSG notes with appreciation the further integration of the two telecommunication networks including restoration of the earlier microwave link between the two countries. The JSG recommends cooperation between the two countries in undersea cable consortia and in removing hindrances to private sector initiatives to lay undersea cables connecting the two countries. The entry of Sri Lankan telecom operators to the Indian Internet Service Provider market as well as the entry of a major international operator from India into the External Gateway Operator business in Sri Lanka improves the prospect of establishing a regional peering point for Internet traffic that will result in lowering the costs of connecting to the Internet backbone from the entire region. The JSG recommends actions to facilitate the establishment of a regional Internet peering point by the regulatory authorities in both countries.

5.14 The JSG recognises the potential for strong links between India and Sri Lanka in the Information Technology (IT) and IT Enabled Services (ITES) sectors in the context of the Memorandum of Understanding between the two countries, signed by the two countries on March 1, 2003. The JSG recommends that Sri Lanka should send a technical team to India to finalize the scope of technical assistance and both countries are urged to establish the working group envisaged in the MOU. The existing cooperation among private sector ICT industry associations should be deepened as part of the implementation of the MOU.

5.15 India has innovative and cost-effective software development and Business Process Outsourcing (BPO) industries. The JSG recommends the establishment of redundancy and back up facilities for these time-critical facilities in each other's countries.

5.16 Inspired by the transparency and efficiency benefits yielded by e-governance systems introduced in some Indian states, the e-Sri Lanka Initiative includes a major programme on e-government. Ensuring compatibility of the various e-systems, especially those associated with CEPA transactions such as the customs departments of both countries, is a goal that should be pursued

under the MOU. This would include the harmonization of Public Key Infrastructures, e-signature legislation and data protection laws.

Coordination and Joint Promotions

Tourism, Sports Events and Cultural Production

5.17 The JSG recommends that high priority be assigned to the realization of the untapped potential of joint promotion of tourism. Sri Lanka's geographical proximity to South India's tourist destinations and complementarities of attractions must be exploited to the benefit of both countries. Eco and adventure tourism, Meetings, Incentives, Conventions and Exhibitions (MICE) tourism, and religious and cultural themed holiday packages are some of the possible foci of joint promotions. For example, the tourist authorities of the two countries could launch a concerted marketing effort in third countries for Buddhist themed pilgrimage and tourism. Success in such joint marketing efforts can then be used as a foundation for collaboration in the organization of Travel and Tourism fairs, food, shopping and cultural festivals in key markets. The JSG notes the successful joint tourist promotions of Singapore and Malaysia and recommends that such examples be used as models for cooperative activities between tourist authorities of India and Sri Lanka. Sri Lanka, Maldives and Kerala in India offer enormous potential for multi-destination nature tourism. Their geographical proximity offers easy connectivity by air and sea. These three locations can be promoted jointly under an "Emerald Triangle" package.

5.18 The JSG emphasizes the importance of reducing constraints in air travel between tourist destinations for the success of joint promotions. Any existing regulatory barriers to the introduction of attractive airfares to encourage multiple stopovers in the South India and Sri Lanka region should be removed. Creating the facilities for charter flights, seaplane flights, luxury ferries and stopovers by cruise ships are also recommended.

5.19 The JSG recommends that sporting authorities in India and Sri Lanka make preparations for joint bids to host International sporting events. Noting that such co-ordination has already taken place in chess, the JSG recommends its extension to other games.

5.20 The JSG notes the important role played by popular culture in the fostering of friendly attitudes and understanding among peoples. Action should thus be taken by tourism and related authorities to promote films and TV programmes with Sri Lankan themes and content in India and vice versa. Film and TV program makers in one country should be encouraged to use locations in the other country. Sri Lanka offers Indian filmmakers low costs, isolation from media and fans, and a high degree of diversity and flexibility. Sri Lankan filmmakers may find attractive the use of India's advanced production facilities. The JSG also recommends that the relevant public and private sector bodies in the two countries explore the feasibility of bilateral agreements to obtain regional exhibition rights for films and other cultural products.

Ocean Resources Exploration

5.21 The geographical boundary between the two countries runs through the middle of the shallow and unnavigable Palk Strait. Indian vessels routinely circumnavigate Sri Lanka en route from one Indian port to another. The ocean that separates and binds the two countries together is obviously a prime area for cooperation. Noting the importance of the management of the boundary for friendly relations, the JSG recommends that government organizations dealing with various aspects such as oil exploration and fishing establish procedures for regular meetings and consultations and that appropriate provisions be included in the relevant legislation by both governments to recognize each other's interests.

5.22 The JSG notes the fast approaching deadlines for demarcating boundaries and registering claims under the UN Law of the Sea Convention and encourages the relevant authorities in both countries to initiate time-bound programmes to coordinate their activities in this regard.

5.23 The JSG recommends joint exploration and exploitation of mineral and biological resources of the seabed and subsoil as well as oil and gas resources. The advantages of pooling geo-physical data in the Palk Strait and the Gulf of Mannar in close proximity to the Cauvery Basin should be exploited. The possibility of cooperation in Ocean Thermal Energy Conversion (OTEC) also exists.

5.25 The JSG notes the frictions caused by fishermen from one country straying into the territorial waters and Exclusive Economic Zones of the other and recommends that both countries develop and implement procedures for the humane treatment of the transgressing persons. The relevant Ministries and other government organizations from both countries should convene periodic meetings to monitor the procedures and develop mechanisms to reduce the incidences of illegal fishing, including some forms of licensing.

5.26 The JSG recognises the importance of joint studies for identification of economically viable fishing grounds through the sharing of research data and the utilization of advanced equipment. In particular, the JSG notes the opportunities for co-ordination in the use of spatial data for identifying and monitoring marine resources. The JSG recommends that India consider extending technical and financial assistance in software development, spatial data acquisition, storage and analysis in the area of maritime resources Geographical Information Systems.

Cooperation and Assistance

Education

5.26 Education has always been a critical ingredient of long-term relationships between countries. The opportunities for mutual understanding afforded by living in another country and interacting with its

citizens in the context of learning are uniquely valuable. In this light, the JSG encourages the relevant authorities in the two countries to exert optimal efforts to foster educational exchanges between their young people.

5.27 Noting the Sri Lankan government's increasing interest in expanding and upgrading tertiary education, the JSG recommends greater Indian participation in Sri Lanka's education sector, especially in the fields of science and technology. In particular, the JSG noted the desire of the Government of Sri Lanka to establish a centre of excellence in science and technology on the lines of the Indian Institutes of Technology (IIT). The JSG recommends that the two governments form a joint working group on the feasibility of financial and technical cooperation in setting up such an institute. It is suggested that a consortium of IITs can be formed to facilitate this effort. The possibilities include Sri Lanka contributing the physical facilities and some organizational structure and India contributing to the adoption of cutting-edge pedagogical content, equipment and processes. There is considerable merit in creating conditions for attracting the best students in both countries to the proposed institute. The JSG recommends that the proposed institute be fast-tracked to serve as a tangible embodiment of the spirit of friendship that gave rise to CEPA.

5.28 Noting the comparative advantages of certain components of the Indian higher education system, the JSG recommends the promotion of postgraduate studies in select Indian institutions to Sri Lankan students through greater financial support.

5.29 Noting the growing interest of Sri Lankan students in obtaining undergraduate degrees in India, the JSG recommends greater dissemination of information about Indian higher education in Sri Lanka. The mutual recognition agreements that are to be negotiated under the Trade in Services Agreement may provide a good platform for the acceptance of each other's high-quality academic credentials.

5.30 Sri Lanka has expressed a desire to recruit English teachers from India on a temporary basis to serve in Sri Lankan schools. It is noted that manpower corporations in the various Indian states can play a useful role in supplying such personnel.

Health

5.31 The JSG noted the increasing number of private sector partnerships over the past few years that have resulted in the transfer of Indian health care expertise to Sri Lanka and recognized the potential for greater cooperation in the health care sector.

5.32 The JSG recommends that the respective organizations facilitate the supply of affordable generics to substitute for high-priced patented drugs.

5.33 The JSG recommends enhanced cooperation in Ayurvedic research and development, including academic links such as those currently existing between the Institute of Indigenous Medicine in Sri Lanka and the Benares Hindu University in India.

Agriculture

5.34 The JSG notes that there is considerable cooperation between the two countries in agriculture, including several MOUs. It recommends the expeditious implementation of the MOUs.

5.35 Noting the ongoing successful crop varietal improvement programmes through the partnership of the Indian Council for Agricultural Research (ICAR) and Sri Lankan Council for Agriculture Research and Policy (SL–CARP), the JSG recommends further collaboration in areas such as post-harvest technology, seeds, tissue culture, especially with regards to rice and coconuts.

5.36 The JSG noted that dairy, poultry and animal husbandry are additional sectors where Sri Lanka could benefit from Indian expertise, especially with regard to fresh milk production and distribution.

Facilitation of Activities under CEPA

5.37 The JSG noted the successful operation of the existing Lines of Credit amounting to US$ 131 million for various commodities and services. The JSG recommends continuation and replenishment of these Lines of Credit, as and when required, with the anticipated expansion of Trade and Investment. The JSG further recommends creation of an additional Indian infrastructure Line of Credit for infrastructure development projects in Sri Lanka, of US$ 100 million, to begin with, available to Indian companies engaged in turnkey or joint venture projects in Sri Lanka.

5.38 The JSG recommends that the Government of India set up an India-Sri Lanka Economic Cooperation Fund of US$ 100 million, to begin with. This Fund should then be used to facilitate and finance various economic cooperation activities recommended where economic assistance from India is necessary.

Summary of Recommendations

The JSG recommends that the two countries:

- Engage in economic cooperation beyond rule-based liberalization, in order to facilitate trade and investment, engage in joint activities with mutual benefits, and build understanding and trust.

Actions to Facilitate Trade and Investment

- Liberalize the Bilateral Air Services Agreement to increase air transportation capacity to serve current and anticipated demand.
- Conclude an agreement on, and facilitate early operation of, ferry services.
- Build on Indian cooperation in modernizing the Sri Lankan railway system.
- Liberalize visa regimes to include more categories of visitors for long-term, multi-entry visas and simplify procedures for other visas.
- Increase cooperation on undersea cables and encourage a regional peering point for Internet traffic.
- Implement expeditiously the existing MOU on cooperation in IT and IT enabled services.
- Encourage redundancy and backup facilities for software and business process outsourcing industries in each other's countries and ensure compatibility of e-government and authentication systems.

Coordination and Joint Promotions

- Engage in joint promotion of tourism and facilitate short-term visas for bona fide third-country tourists.
- Make joint bids for international sporting events.
- Promote film and TV programmes with themes and locations from each other's countries and obtain regional exhibition rights to cultural products.
- Undertake joint efforts to explore mineral and biological resources.
- Study fisheries resources.
- Cooperate to minimize frictions caused by transgressing fishermen.

Cooperation and Assistance

- Encourage financial and technical cooperation in establishing an educational institution in Sri Lanka on the lines of the Indian Institutes of Technology, to embody the spirit of friendship underlying the CEPA.
- Facilitate supply of affordable generic drugs.
- Improve cooperation in Ayurvedic research and development.
- Implement expeditiously the existing MOUs on agricultural research cooperation.

PTO

The JSG recommends that India

- Replenish existing lines of credit as required and create a new line of credit for US$ 100 million, to begin with, for infrastructure projects.
- Establish an India-Sri Lanka Economic Cooperation Fund, for say US$ 100 million to begin with, to facilitate economic cooperation.