National Trade Policy

Ministry of Development Strategies & International Trade

***Synopsis:** In recent years Sri Lanka's openness to international trade and investment has declined sharply. The increased protectionism and inward-orientation have slowed growth. Recognizing that no economy has grown sustainably in modern times without growing exports and opening to the world, the Government of Sri Lanka intends to adopt a national trade policy (NTP). The policy is designed to stimulate growth and job creation by improving the ability of firms to export and to compete for the domestic markets. The centerpiece of the NTP is a more liberal, simple, transparent and predictable trade regime promoting trade-led growth as envisioned in the Economic Statements of the government in 2015 and 2016. It aims to attract more export-oriented foreign direct investment, to improve trade logistics, to make customs procedures more transparent and quicker, and to implement other measures to boost firms' ability to compete in global markets. The policy will facilitate the adjustment of the most vulnerable segments of society to a more open trade regime. It will also ensure that the effect of tariff and para-tariff reductions on government revenue and on the trade balance are contained.*

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Abbreviations

APTA – Asia-Pacific Trade Agreement

BOI – Board of Investment

BOP – Balance of Payments

BPO – Business Process Outsourcing

CEPA - Comprehensive Economic Partnership Agreement

EDB – Export Development Board

EU – European Union

FDI – Foreign Direct Investment

FTAs – Free Trade Agreements

GATS - General Agreement on Trade in Services

GDP – Gross Domestic Products

GPN – Global Production Network

GPS – Global Production Sharing

GSLI – Global Service Location Index

IPRs - Intellectual Property Rights

ISLFTA - Indo-Sri Lanka Free Trade Agreement

ITES – Information Technology Enabled Services

KPO – Knowledge Process Outsourcing

MNEs – Multi National Enterprises

MRAs - Mutual Recognition Agreements

NTBs – Non-tariff Barriers

NTP – National Trade Policy

OECD - Organization for Economic Co-operation and Development

RCEP – Regional Comprehensive Economic Partnership

R&D – Research and Development

SMEs – Small and Medium Enterprises

SDT - Special and Differential Treatment

TBT - Technical Barriers to Trade

TFA – Trade Facilitation Agreement

TPP – Trans-Pacific Partnership

TRIPS - Trade Related Intellectual Property Rights

VAT – Value Added Tax

WTO – World Trade Organization

1. Introduction

01. Sri Lanka's trade has declined sharply as a share of GDP in recent years, while the growth of exports and the economy have failed to match those of the fastest growing Asian neighbors by a wide margin. Many factors account for Sri Lanka's disappointing growth performance in recent years. They include the turbulence in the global economy, cumbersome regulations, inadequate macroeconomic management, and the legacy of conflict. Moreover, the increased protectionism and separation from world markets were important contributing factors for the poor performance.

02. The past policies have made domestic real prices to be misaligned with Sri Lanka's comparative advantage. This was due to high nominal tariffs to increase revenue and high total tariffs with the use of para-tariffs also to raise revenues. The high level of protection has been the main factor that has contributed to Sri Lanka's a non-competitive economy, a corollary of which is that the country's productivity has averaged around 1.0 % over thirty years, remarkably low, compared to some of its neighbors and well below East Asian countries. It is time to reorder Sri Lanka's policies, approaches, and institutions.

03. Therefore, the government intends to adopt a National Trade Policy (NTP) to improve domestic productive capacity and trade performance, revitalize the nation's integration in global and regional markets, raise the living standards of the people and accelerate the nation's long-term economic growth rate. The NTP will address four key elements:

   a. **Competitiveness through domestic policy reforms**-entailing the rationalization of Sri Lanka's tariffs and para-tariffs, NTBs, and liberalization of the service sector while putting in place appropriate legal mechanisms, standards, regulations and safeguards

   b. **Market access and trade facilitation-** opening of foreign markets for Sri Lanka's exporters through multilateral, regional and bilateral trade agreements and comprehensive economic partnerships as well as faster customs procedures and improved logistics

   c. **Macroeconomic balance, policy and institutional coherence** – macroeconomic policy, trade and investment nexus, trade and development linkages, policies that contain the effect of trade liberalization on government revenues and on the trade balance, and streamlining and coordinating of institutions

   d. **Adjustment of firms and people** – taking measures designed to help Sri Lankan firms confront increased international competition in domestic and foreign markets, also taking measures that anticipate the effect on the most vulnerable people and cushion the impact, giving time for adjustment.

04. This paper develops a set of policies to guide Sri Lanka to use trade as a powerful driver of inclusive economic growth. The paper explains why the NTP is needed, outlines its main features and identifies some risks that must be managed**.** It is not intended to provide a detailed and comprehensive account of the measures envisaged for trade development at this stage. Instead, it

aims to outline the broad direction of the government's effort and will be followed by more specific blueprints and precise proposals in the future.

05. NTP is expected to deliver, *inter alia*, the following:

  a. Sri Lanka's trade regime to be an engine of growth contributing to creation of jobs and reduction of poverty
  b. Creation of a predictable, consistent and transparent liberal trade regime
  c. An enabling environment to attract foreign investment
  d. The expansion of trade and thereby offset a large part of the revenue loss from reduced trade taxes under the NTP. Fiscal consolidation and maintaining a competitive exchange rate will ensure sustainable trade balance.
  e. Enhanced capacity of domestic firms to compete for local and international markets
  f. Adequate time and relief for those most exposed to international competition, especially the most vulnerable to adjust, ensuring all benefit from trade.

2. The need for a national trade policy

2.1 Going backwards

06. Sri Lanka posted high growth rates on average since the start of the millennium. However, in recent years, growth slowed markedly, from 6.7% a year over 2001-2012 to 4.3% over 2013-2015. The growth deceleration coincided with a dramatic reduction of its integration with the rest of the world. This is measured by the share of trade (exports plus imports) to gross domestic product (GDP), which fell from 88 percent in 2000 to 49 percent in 2015; over this period. While most countries saw large increases in their trade/GDP ratio, Sri Lanka has exhibited the opposite trend.

07. Integration with the rest of the world can also be measured by the share of FDI in GDP, which has hovered around 1% since the start of the millennium and dipped below 1% recently, six years after the end of the armed conflict. These FDI flows, which are important sources of know-how as well as finance, are significantly lower than Asian peers, other middle-income countries, and perhaps even more surprising, than low-income countries, where the FDI/GDP is now over triple that of Sri Lanka. The country also languishes in 88th place on the World Bank's Logistics Performance Index, below Cambodia, Guatemala, and Malawi. The poor performance on trade logistics and FDI are also reflected in Sri Lanka's weak integration into global production networks (GPNs), which are a key driver of merchandise trade and an important pathway to industrialization. Participation in GPNs has been found to bring about a broad range of economic benefits, in terms of productivity, sophistication, and diversification of exports.

08. Despite these handicaps, Sri Lanka can boast of success stories in export sectors, such as apparel (a sector which has the largest number of women employees in manufacturing), transport services and tourism, where Sri Lankan firms have shown that they can face international competition when markets are open and the right configuration of incentives exists.

09. However, Sri Lanka's growth has been driven – not by exports- but predominantly by domestic demand, spurred by government spending, large and unsustainable government deficits, and inward remittances which partially financed a large trade deficit. In fact, Sri Lanka's share of world exports is about one quarter lower than it was 20 years ago, (it declined from about 0.08% to 0.06%). The end result is an economy driven by the volume of labor (rather than the quality embodied in its highly-literate and skilled workforce) and low-tech capital accumulation, resulting in low overall productivity growth. This factor-intensive growth model is not one that can sustain high growth for long.

10. There is no doubt that, given its strategic location, resource base, manageable size, and low starting point, Sri Lanka could do significantly better. By integrating more effectively into vast global markets, Sri Lanka could – in a favorable scenario - even match the productivity growth rate of the fastest growing Asian economies in its neighborhood. In fact, in the current complex and uncertain international environment, characterized by sluggish world trade and rising interest rates, Sri Lanka needs to "up its game" *even to maintain its recent sluggish growth performance*

2.2 A problematic trade regime

11. As mentioned above, several factors – such as turbulence in the global economy, inadequate macroeconomic management, the legacy of conflict, weak governance and cumbersome regulations are known to have handicapped Sri Lanka's development. While most countries have become more open to trade and attracted increased foreign investment, Sri Lanka's economy has become inward-oriented and markedly more protected. The major problems of the Sri Lankan trade regime are the promotion of production for domestic market through the high and complex import tariff regime, lack of attention to trade facilitation, low level of regional connectivity and ineffective trade agreements and lack of supply side capacity for exports.

2.2.1 Complex import tariff regime

12. The preferred tool of Sri Lanka's foreign trade policy was tariffs and para-tariffs that have increased the level of protection to the production and sale for the domestic market at the cost of the production for exports. In addition, there are some NTBs, in particular, relating to agricultural trade. It is estimated that in 2011 the average level of protection was 24%, extraordinarily high, of which para-tariff accounted for 12%. The rates of protection have doubled since 2004 with the number of tariff bands increased to 5 and tariff rates also revised upwards. These revisions have lacked a sense of direction, with the lowest and highest tariff rates being frequently revised upwards and downwards, increasing the complexity and unpredictability of the trading environment. Such policies create an incentive to produce and sell in the domestic market instead of exporting. Consumers pay more and given the large price wedge domestic producers are under less pressure to match international quality standards. Moreover, such high levels of protection divert factors of production from more efficient sectors that could be competitive in international markets, discouraging the development of new products and export diversification.

13. With the addition of para-tariffs, including import surcharges, the policy framework became even more distorted and ad hoc. To counter the negative impact of high protection rates on the capacity

of many firms to conduct business, various exemptions have been granted, making trade policy increasingly discretionary and adding to the pressure for rent-seeking.

14. Concentrating on exports alone neglects the role that efficient import substitution could play in raising the productivity growth and orienting those industries towards export markets with time-bound incentives and support for advances in technology and productive capacity. .

2.2.2 High dependency on trade taxes

15. In Sri Lanka, high and increasing tariffs and para-tariffs are motivated not only by a strong tendency to protect domestic producers and cater to special interests but also by the low "productivity" of the country's direct and indirect tax regime. It is not unusual for developing countries to struggle in efficient tax collection, but Sri Lanka's case is rather extreme since its tax revenue as a share of GDP (around 12%) is one of the lowest among comparable countries and even lower than those of many low-income countries.

16. To fund increasing government spending, Sri Lanka has relied increasingly on trade taxes at the border which is relatively easy to levy. Unfortunately, this tendency adds another turn to the vicious circle: as trade taxes increase, the incentives to produce (and to produce inefficiently) for domestic instead of export markets are augmented. Meanwhile, sluggish export growth contributes to a persistent trade deficit (the negative balance of trade in goods and services was over 7% of GDP in 2015, despite the windfall from lower oil prices), and, makes GDP growth, and the growth of government revenues, overly dependent on domestic demand and on inward remittances. However, there are natural limits to the size of the domestic market and to how much Sri Lanka's diaspora can remit.

2.2.3 High costs of trade transactions

17. Trade can be impeded directly by various cumbersome procedures, inefficient regulations, and poor logistics. Such measures can affect exports indirectly through their effects on imports as exports need imports of components and raw materials.

18. Sri Lanka's performance in World Bank's 'trading across borders' indicators shows time required to import and export has declined but it's still behind the South East Asian countries. Policy-induced barriers account for nearly 70 percent of the total time spent on exporting or importing goods. The preparation of documents is the most significant component, absorbing more than 50 percent of the time spent on import or export procedures. Border clearance procedures in Sri Lanka are cumbersome. In part, this reflects insufficient coordination between border agencies (customs, police, port authorities, public health agencies, etc.). And measures put in place at the time of the armed conflict, requiring checks on 100 percent of shipments remain in place, adding to delays and shipment costs.

19. In surveys, most traders consider that rules, regulations, and fees relating to trade transactions are not "easily accessible". Although all laws and regulations are published in the official gazette, they are not readily available to the trading community. The absence of a central repository of

information on laws and regulations for importing and exporting, cumbersome and discretionary application of the rules, and infrastructure weaknesses constrain the ability of enterprises, especially smaller ones, to trade.

2.2.4 Sub-optimal performance in trade agreements

20. In terms of regional connectivity, Sri Lanka has lagged in regional and bilateral agreements, especially compared with countries in South and Southeast Asia. Currently, Sri Lanka has only four such agreements in force (India, Pakistan, SAFTA and APTA). While these trade agreements have potential, preferences accorded are partial and limited and are anyway vastly underutilized by Sri Lankan exporters. Non-tariff barriers, logistical and infrastructure constraints, stringent rules of origin, lack of supply capacity of Sri Lankan exporters and lack of information about the concessions offered under these trade pacts among the business community have resulted in poor performance in FTAs. Moreover, progress on liberalization has been too slow, especially in the case of SAFTA and APTA. It is noteworthy that the proportion of trade undertaken within these agreements has been low.

2.2.5 Lack of supply capacity for exports

21. Supply-side capacity is critically important for any country to capture benefits of market access generated through trade deals at bilateral, regional and global levels. The under-utilization of the quotas offered under the ISLFTA (at least partially), the high dependence on unprocessed primary products, low volume of trade in services, and lack of product diversification of exports are some reflections of such capacity constraints to produce and export goods and services demanded in overseas markets. The supply capacity of exporters can be enhanced through various channels including the development of SMEs, provision of trade-related infrastructure and creation of new industries, products, and services. The trade-related infrastructure includes ICT facilities, export financing, and market and product information.

Box 1: Some Misperceptions about Trade Policy

Myth 1: **Import restrictions (tariffs and non-tariff measures) can correct an imbalance in the current account deficit in the Balance of Payments (BOP)**. The imposition of import controls does not reduce excess demand, the main cause of a current account deficit. In addition, import restrictions can contribute to widening the trade deficit by discouraging exports (generally speaking import restrictions are a tax on exports).

Myth 2: Exchange rate policy is not linked to the trade outcome. A good trade outcome cannot be expected from an out of line exchange rate. Sri Lanka had long periods of appreciated exchange rates that have created a bias against exports. The Central Bank of Sri Lanka attempted in the past to keep the nominal exchange rate low. It led to large balance of payments deficits, loss of reserves, and borrowing at commercial interest rates that increased external debt. Also, appreciated real exchange rates encourage more capital intensive production and discourages greater use of our labour abundant resources.

Myth 3: The trade measures can bring about domestic price stability. The use of trade measures leads to greater uncertainty with respect to trade measures (tariffs and non-tariff measures) which inhibit production planning and creates bias against exports.

Myth 4: **Only big countries benefit from FTAs**. Many small countries have FTAs with large countries – Australia-New Zealand FTA; India-Singapore CEPA, etc. That the big country will be the gainer is avoided by building in Special and Differential Treatment (SDT) in favour of the smaller country and working out a "win-win" situation for both countries. A "win-win' situation is the best deal for consumers as well as producers in both countries

3. Key Principles of National Trade Policy (NTP)

22. The Government recognizes the need to develop a comprehensive NTP as an integral part of the country's overall development program and strategy to support economic development and industrial transformation. In the context of an evolving global trading system, the NTP is designed to draw the maximum benefit from sectors in which Sri Lanka has a comparative advantage.

23. The aim of the NTP is the transformation of Sri Lanka into a high-income country, doubling its per capita income by 2024. To achieve that feat, Sri Lanka needs to transition from a 'factor-driven' economy, based on cheap labor and natural resources, to an 'efficiency and innovation-driven' economy that promotes productivity growth. Several examples from East Asia and other countries show that openness to trade enables this kind of transformation. In fact, no country has grown rapidly and on a sustained basis in recent times without successfully integrating into global markets.

24. The NTP is designed to expand exports, improve firms' ability to compete with imports, attract foreign investment, reduce prices for consumers, and create new and better jobs. The policy intends to ensure predictability, consistency, and transparency in both policies and regulatory structure. It would also enhance efficiency, competitiveness, institutional coherence and inclusiveness. The NTP is built on 4 major elements: enhancing competitiveness through domestic policy reforms, market access and trade facilitation, macroeconomic balance, policy and institutional coherence, and facilitating of adjustment of firms and people.

3.1 Enhancing competitiveness through domestic reforms

25. Competitiveness or the ability of a firm or an industry to produce goods and services at relatively lower costs than that of a competing firm could be constrained by failures in markets of goods, services and factors of production (i.e. inflexible labour markets), the absence of appropriate legal and regulatory structures, and unnecessary government interventions. Lack of competition in markets leads to misallocation of resources, inefficiency, lower productivity, and innovation.

26. Enhancing competitiveness through trade reforms is of utmost importance to a resource-scarce small country like Sri Lanka that depends primarily on trade and FDI. Export success of a company depends on being able to deliver goods and services to the world market at competitive prices. It is a generally accepted that opening of markets in goods and services as the best means of reducing the production and delivery costs, and eliminating anti-export bias associated with import protection. Tariffs and other measures that protect domestic industries create disincentives to export by directly raising the price of imported inputs: raw materials, and intermediate and capital goods. In addition, putting in place trade and investment related legal mechanisms, intellectual property rights, standards and regulations for the protection of human health, animals and plants are critically important for creating a competitive environment.

27. Duty-drawback schemes which compensate exporters for tariffs paid on imported inputs are cumbersome, often work badly, and are also distortionary. Yet tariffs and para-tariffs on many of these items, while they are lower than tariffs on final goods, remain high,

penalizing both domestic and foreign producers in Sri Lanka.The following measures will enhance domestic and international competitiveness of firms and industries;

3.1.1 Trade reforms

28. In an ideal world, the reduction of tariffs and para-tariffs would be achieved as part of multilateral trade negotiations under the WTO. Such a process would simultaneously open Sri Lanka's and all its foreign markets, achieving the maximum benefits from trade, raising living standards and stimulating growth across the world. However, multilateral negotiations take a long time and are currently stalled. An important alternative course, actively pursued by nearly all countries, is to engage in regional and bilateral trade agreements. Negotiated trade agreements have the advantage that they open the market of negotiating partners as well as Sri Lanka's. However, trade deals also could take many years to conclude, liberalize only the trade that is conducted by the parties to the deal, and provide the contracting parties with an artificial advantage that often means that sourcing is not from the cheapest suppliers.

29. An alternative is the unilateral trade liberalization which could make firms more efficient and nimble, enabling them to respond to domestic and international market opportunities as they arise. However, in a world where regional and bilateral trade agreements dominate trade policy making, such unilateral actions will have to be undertaken cautiously giving due consideration to their effects on the erosion of preferences under trade deals. The NTP envisages both unilateral reforms- through rationalization of the tariff regime and a stepped-up effort to negotiate bilateral trade agreements with Sri Lanka's main trading partners.

30. The centerpiece of the NTP is a more liberal, simple, transparent and predictable trade regime. This means that domestic prices become more aligned with international prices, and therefore provide more appropriate signals to domestic producers and consumers, improving efficiency. Such a simplified and more liberal trade regime would entail enacting two or three ad valorem tariff bands, replacing specific tariffs with ad valorem tariffs, and the elimination of para-tariffs. Taxes that apply to all domestic and imported products, such as VAT and excise taxes, will continue as before or be increased or reduced in function of revenue needs and other considerations. At the same time, effective measures are needed to reduce the costs of conducting trade.

31. In any trade reform, normally a greater attention is accorded to manufacturing. However, given the importance of agriculture in Sri Lanka, it is imperative for the government to formulate the long-term trade policy as an integral part of a comprehensive agricultural development strategy for the country. Such a policy should accord high priority to food security, livelihood and rural development, employment, and poverty reduction on one hand, and the improvement of productivity on the other. On the side of imports, in view of the serious implications that any change in import policy may have on incomes of farmers and prices of essential consumer goods, the government needs to be cautious in reforming tariffs and other levies at the border. On the side of exports, as an agrarian economy historically, Sri Lanka should diversify its export base to processed agro-products in which the country has a comparative advantage beyond tea, rubber and coconut and export to international markets learning from other countries, and import products which are

relatively expensive. Regional and bilateral trade agreements could be used as an effective tool in promoting agricultural exports.

3.1.2 Regulatory Reforms

32. Legal and regulatory structures should be introduced either parallel or in advance of trade reforms and import liberalization. Apart from general inefficiencies, the legal framework and regulatory structure related to trade and investment in Sri Lanka, suffer from fundamental gaps which need to be addressed urgently. In particular, Sri Lanka does not have basic laws which are essential for safeguarding open markets, such as anti-monopolies laws and trade remedial laws. These laws are a *sine qua non* for a market-oriented economy and need to be adopted to safeguard interests of both domestic producers and consumers. An effective regulatory structure would provide a level playing field to domestic producers and service providers.

33. In Sri Lanka, there are significant gaps in the existing laws and procedures for testing, inspection, and monitoring of standards and regulations, relating to both exports and imports. The ineffectiveness of enforcement of such laws and regulations has serious implications on food safety, quality of imported goods and consumer protection. Hence, there is an urgent need to review the current system of standards and regulations and introduce appropriate measures for both addressing the gaps and the issues related to the enforcement.

34. On the side of exports, Sri Lankan exporters face numerous non-tariff barriers (NTBs) in foreign countries and therefore, Sri Lanka has not been able to benefit fully from FTAs. In this regard, the Mutual Recognition Agreements (MRAs) are considered as a powerful instrument to address standards and regulations related compliance issues faced by Sri Lankan exporters in foreign markets such as lengthy inspection and testing procedures, delays in releasing goods, warehouse shortages, etc.

35. Moreover, measuring, standardizing, assessing and certifying of products and services are carried out in a fragmented manner by different institutions coming under the purview of different ministries. The current system not only leads to the duplication of work with more than one institution responsible for the same task but also results in higher costs of production because of multiple inspections and tests where at the end of the day the consumer has to suffer. Coordination of all the work related to Sanitary and Phytosanitary (SPS) and Technical Barriers to Trade (TBT) by one national level institution is even more important in facilitating exports.

36. Until such an institution is established in the country, an existing public agency should be authorized to act as the national coordinating body as an interim measure as a matter of priority. The most NTBs that Sri Lanka is facing in foreign markets are found to be largely due to the absence of an effective inter-country coordination mechanism.

37. Given the importance of IPRs for trade and investment and taking into account the WTO agreement on Trade Related Intellectual Property Rights (TRIPS), the following measures will be implemented:
    a. strengthening enforcement of existing laws,
    b. introducing more product specific IPR laws,

c. encouraging the business sector and inventors of new technologies to patent such inventions in time,
d. the accession to the Madrid Protocol of registering international trade marks to reduce time and cost taken to register trade marks in foreign markets and to move Sri Lankan exports from selling generic products, or manufacturing for foreign brands to developing its own brands,
e. use the IPR laws and their effective enforcement as a powerful factor to attract more FDI and to further develop the domestic business sector, and
f. a comprehensive training and capacity building programme to educate both government officials and the business sector of the importance of IPRs for economic development, in particular, investment, innovation and new technologies.

3.2 Market access and trade facilitation

38. The success of the newly adopted trade-led growth largely depends on the ability of the Sri Lankan companies to penetrate foreign markets. While domestic policy reforms help companies to enhance their competiveness as explained above, the government could use export promotion, trade agreements, production sharing networks, the export-seeking FDI, trade facilitation and supporting the private sector to create greater market access**.**

3.2.1 Boosting exports

39. The tariff and para-tariff reductions and simplification alone will significantly improve the incentives to invest in the export sector. There will also be a decline in the cost of domestic inputs, including the cost of labor and the many domestic services that are needed to support exports. This is because the displacement of the least efficient import-competing sectors will cause labor and new investment to be freed and shifted to the most competitive export sectors. A large part of the Sri Lanka's labor force that is engaged in a few low-productivity agricultural sectors, so a gradual process of trade liberalization in agriculture can speed up the structural transformation of the economy that is inevitable if incomes are to rise-Not only will the export sector expand, but jobs in service activities which support the export sector, can also be expected to grow. In lower-middle income countries, export sectors tend to be labor intensive and to employ many women.

40. Exports can also be facilitated through a pro-active export promotion program articulated through an export strategy consisting of policy tools, specific projects, sector-specific time-bound targets, expected results and a monitoring mechanism. Linkages between exports and free trade agreements, FDI, trade in services, and global value chain will be built into the export strategy. The major policies required for promoting exports are outlined below:

41. **First, the creation of a sound macroeconomic climate and complementary policies** conducive to **export expansion** is required to make exports from Sri Lanka competitive in international markets. To achieve this objective emphasis should be given to measures including,
    a. a flexible and realistic exchange rate policy that attaches the highest priority to supporting export competitiveness,
    b. removing anti-export bias by rationalizing the structure of tariffs and para-tariffs

c. maintaining an attractive business environment enabling foreign investors to enter the Sri Lankan market and to ensure that there is a level playing field between BOI and non-BOI companies, and
d. strengthening the financial sector to ease the access to credit and insurance by exporters.

42. Second, market development is a key to penetrate new overseas markets and expand the existing markets. The government institutions led by EDB could assist the business sector, in particular, the SMEs through various measures including providing the latest information to local exporters about potential markets, trade policies, standards, regulations and tariff and non-tariff barriers in overseas markets.

43. Third, Sri Lanka needs to diversify its export basket as well as export destinations .Sri Lanka 's export basket is concentrated on a few products and a few markets .While some countries are rapidly growing their respective export bases, even during a global economic downturn, Sri Lanka's lack of export innovation and limited markets have stymied growth .Since industrialization is one of the key locomotion of Sri Lanka's economic development and growth, export promotion should be an essential element of industrial growth strategy.

44. Fourth, the government will have to recognize the role of the private sector in export development including by respecting the sanctity of international trading contracts made lawfully in the ordinary course of business and ensuring that no impediments are placed in the execution of such contracts, continuing to maintain a dialogue with the exporter community and seeking its concurrence and views on matters relating to export development and rewarding the efforts by private enterprises in export development.

45. Fifth, in terms of supply capacity development it is necessary to develop new or strategic industries which normally are promoted when a country faces a crisis or sharp slowdown as those countries cannot depend only on traditional industries. A concerted and focused effort on the part of the government is required to encourage and promote some specific industries or sectors, both existing and new, with a potential for exports through an array of policy tools and other incentives including support for R&D. Such assistance is time-bound and conditional upon achieving set targets.

46. Giving due consideration to the potential of transforming efficient import competing industries into export-orientation, the NTP emphasizes that the strategic industries be selected transparently using a clear pre-set criteria based on an in-depth study of the export sector.

47. The pre-set criteria for selecting export-oriented strategic industries could include global presence, past growth rates, high spillovers, innovativeness, productivity and potential for large-scale production .The government could make such industries champions by assisting them to upgrade technology, skills, and productivity.

3.2.2 Entering into Trade and Comprehensive Partnerships Agreements

48. Sri Lanka will take a more strategic approach in future trade and partnership agreements, drawing on the lessons of experience, while simultaneously addressing shortcomings in existing ones. Namely, negotiators will identify non-tariff barriers at the onset and address them along with tariff

reductions, specify the mutually recognized or agreed standards, clarify and negotiate rules of origin that best serve its industry requirements, and aim to make market access more predictable for Sri Lankan exporters. Awareness campaigns are required so that companies, especially SMEs, are made aware of the provisions of the agreement.

49. While recognizing the importance of reviving the existing FTAs, the government of Sri Lanka believes that it should integrate with the global economy further with a two-tier strategy – one for Asia and the other for the West. In this regard, Sri Lanka will follow the emerging global practice which goes beyond the FTAs based on trade in goods to trade in services and cooperation in other areas including investment and technology.

50. In Asia, Sri Lanka's strategic location provides great opportunities to enter into free trade and partnership agreements with several of Asia's trade powerhouses, such as China, India, and Singapore and regional blocs such as RCEP. Asian partners deserve close attention on grounds of geographic and cultural proximity, low cost connectivity, complementarity, and the need to diversify markets.

51. Under a "Looking West" strategy, Sri Lanka will also seek preferential agreements with its main markets, beginning with the European Union (EU), the UK, and the USA. Even if – as expected – Sri Lanka regains GSP Plus concessions from the EU, it is expected to graduate from the program when it reaches upper-middle income country status. Comprehensive trade agreements with the EU and US will help Sri Lanka remain competitive in these major markets, offset preferences granted to others, and also tap into global value chains. The engagement in high-quality trade agreements also helps "lock-in" reforms and can provide the necessary political impetus. The future of mega-regional trading arrangements such as the Trans-Pacific Partnership (TPP) is uncertain at present, but should Sri Lanka one day wish to be associated with them, the demands on domestic institutions will be even greater. More generally, Sri Lanka will pursue a policy of open regionalism, consisting of free trade agreements with all major trading partners, and insisting on liberal rules of origin enabling relatively seamless trade even when the imported component of exports is high.

3.2.3 Benefitting from Trade in Services

52. In relation to trade agreements, services deserve a special attention. Sri Lanka made a concerted decision to expose its services sector for more international trading in 2002. For this purpose, the option that was selected was GATS Article V, where countries could engage in services liberalization under a GATS-Plus framework in bilateral or regional trading agreements. This decision was taken due to three reasons: (a) Services were the largest sector in Sri Lanka's GDP amounting to 58% but its trading capacity was relatively low compared to its size; (b) Sri Lanka's strategic location that gave it a comparative advantage of being a services hub for some areas of services remaining not fully utilized; and (c) WTO Trade in Services liberalization agenda under GATS coming to a standstill and most countries engaging in services liberalization bilaterally or regionally, and Sri Lanka lagging behind.

53. As trade in goods is closely linked to services and investment and 'servecification' of manufacturing exports has increased over the years, there is a need to have a fresh look at the trade in services, not only for exports of services but also for the improvement of competitiveness of

manufactured products. The service liberalization either unilaterally or as part of trade agreements will (a) increase efficiency of the domestic service sector leading to greater competitiveness of agricultural and manufacturing sectors in both domestic market and international markets (b) enhance trade in services in which Sri Lanka has comparative advantage, (c) increase competition among providers of services leading to higher quality and lower domestic prices for consumers, (d) encourage more FDI as an efficient service sector is a major attraction for MNEs to locate their investments, and (e) benefit better from global production sharing or value chain.

54. Back-office services such as call centers and IT-driven business processing functions which are clear areas of comparative advantage of Sri Lanka. The rapid proliferation of these services has transformed the way businesses are run and transactions are carried out, paving the way for the rapid expansion of e-commerce and digital payments, as well as other e-services that support virtually all industries. Software and Information Technology Enabled Services (ITES) such as Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO) have emerged as export sectors with high growth potential in Sri Lanka, generating significant growth in inflows. As a result, Sri Lanka now ranks at the fourteenth position on the 2016 A.T Kerney Global Services Location Index (GSLI), moving up two notches from the position in 2015.

55. However, Sri Lanka is yet to latch on to the boom in the e-commerce space. The e-commerce sales worldwide were projected to reach $1.5 trillion by 2018. Sri Lanka's internet penetration is on the rise with an increasing number of Sri Lankans using and relying on the internet for online information when it comes to most day-to-day decision making. Digital payment companies are starting to win over customers. However, underdeveloped e-platforms, insufficient band-with, and lack of compliance/security are slowing its progress.

56. The FTAs that the government is negotiating currently can be used as a vehicle to promote trade in services .In this regard, two important guidelines would be:

I. While keeping the movement of independent persons of the Mode 4 of the GATS unbound until such time the country is equipped with necessary regulatory mechanisms to protect domestic interests, Sri Lanka should consider liberalizing the remaining three Modes if they are beneficial to the country.

II. There is no reason for Sri Lanka to have the same commitments in trade in services for FTAs with all FTA partners. The scope of liberalization of services (i.e .which Modes to be liberalized) depends on:

   a. potential opportunities in trade in services for Sri Lanka in the partner country,

   b. the relative ability of the Sri Lanka service sectors (i.e .the degree of competitiveness to compete with the concerned trading partner in the domestic market), and

   c. the availability of regulatory mechanisms .

Though there are some general principles and criteria for liberalization of services applying to all FTAs, Sri Lanka should strategically treat each FTA as a "differentiated product. Moving away from these guidelines requires proper consultation with the relevant public and private institutions including the professional organizations .

3.2.4 Linking with Global Production Sharing Networks or Global value chains

57. Global Production Sharing (GPS), the breakup of the production process into separate stages, with each country specializing in a particular stage of the production cycle, has been an increasingly important facet of economic globalization over the past four decades. GPS is heavily concentrated within industries that are commonly classified as high-tech and capital intensive, such as electronics, electrical goods, and transport equipment. With a modest start in electronic industries in the late 1960s, international production networks have gradually evolved encompassing many developing countries and spreading to many industries such as automobiles, television and radio receivers, sewing machines, office equipment, electrical machinery, machine tools, cameras, watches, solar panels and surgical and medical devices.

58. In Sri Lanka, a number of medium – size joint venture firms have set up businesses for assembling parts and components mostly for automobile, textiles, electronics & electrical goods industries. It is encouraging to observe some Sri Lankan firms have been able to penetrate successfully into global high-tech industries by producing components such as sensor switches for automobile seat belts and air bags. Exports of such parts and components increased from $35 million in 1990 to $472 million in 2014 with a share of 6% of total manufactured exports from Sri Lanka.

59. Some measures that can be adopted to expand GPS or production sharing networks include identifying sectors with high potential for GPS in terms of Sri Lanka's comparative advantage **(**e.g**.** apparel, fashion products, rubber products**)** include**:**
    a. working with the private sector to make them champions,
    b. liberalization of imports, in particular, inputs used in the production of intermediate goods,
    c. trade facilitation including through improving logistics, infrastructure, and regulatory mechanisms, harmonization of domestic rules, regulations, standards with international norms,
    d. enhancing **"**servicification**"** through liberalization of services,
    e. education and training,
    f. increasing technology transfer through creating an enabling environment for FDI, and
    g. regional and bilateral cooperation partnerships and joint ventures**.**

3.2.5 Attracting export-oriented Foreign Direct Investment

60. Trade and foreign investment are closely interconnected. More foreign investment often means more exports. Foreign investment augments domestic capital for all uses, including for exports and trade infrastructure, transfers management know-how and technology, introduces new products for exports, increases productivity, and enhances capacity to penetrate markets abroad. Foreign investment also tends to galvanize domestic investment in upstream and downstream activities.

61. The linkages between foreign investment and trade have become more important in recent years as Global Production Sharing (GPS), the division across countries of 'tasks' within the same production cycle, has spread. High-tech and capital intensive industries rely heavily on GPS networks. MNEs often move investments to low-cost locations to export back to their own

countries and to third countries. Among developing countries, especially in Asia, industries as diverse as automobiles, television and radio receivers, sewing machines, office equipment, electrical machinery, machine tools, cameras, watches, solar panels and surgical and medical devices have become established as part of GPS networks animated by MNEs. These were among the fastest growing segments of global trade in recent years.

62. Foreign direct investment can also play a crucial role in boosting the efficiency of the domestic services sector, which, in turn, helps exporters .An efficient services sector requires adequate (not overly intrusive) government regulation as well as a high degree of competition among domestic suppliers .But, in the export arena, this is usually not enough .To spur competition, access expertise, and boost exports of manufactures as well as services, foreign direct investment in services is often needed .Classic examples include express delivery services and international legal advice, but these are just the tip of the iceberg .

63. As is commonly seen around the world, foreign investment and exports also tend to generate new, higher-paying jobs. Yet, in 2013, Sri Lanka ranked at 100th place in terms of FDI flows and 125th in terms of FDI stock. The most Asian late comers in their industrialization process, have managed to attract larger volumes of FDI compared to Sri Lanka. Unfortunately, no major MNE has set up operations in Sri Lanka's manufacturing sector over the last decade.

64. Sri Lanka's attractiveness to foreign investors depends on certain factors that cannot be changed such as natural resources. Attractiveness to foreign investors also depends on many general policy-driven factors, such as macroeconomic stability, the business climate, and the realism of the exchange rate. But trade- and investment-related constraints also play a role. For example, to be internationally competitive, both domestic firms and Multi National Enterprises (MNEs) operating in Sri Lanka require easy and predictable access to state-of-the-art machines and intermediate inputs, as well as raw materials.

65. Several measures will be undertaken to attract more FDI, especially FDI capable of generating exports. These include: a liberal and transparent import regime for imported inputs and components, a 'one stop" process for approval of investments, targeted promotion of Sri Lanka as an investment destination, the establishment of special export-processing/investment zones, inclusion of investment chapters in the negotiation of bilateral agreements, and negotiation of deeper and more comprehensive bilateral investment treaties designed to assure foreign investors of national treatment and of the freedom to invest across a wide array of sectors. Any incentives offered to investors should be performance-based and neutral between sectors.

3.2.6 Trade facilitation

66. Empirical research shows that reducing direct export costs in Asia to OECD levels – a 14% reduction on average – could increase Asian exports by at least 10%, or about US$ 340 billion. This, in turn, could be expected to increase regional GDP by up to 2.5%. Reducing trade costs begins at home. Several of the most successful economies in the region have been actively engaged in streamlining their trade procedures, removing unnecessary ones, improving coordination between control agencies, and consulting with the trading community on how to make further

improvements. Most of these can be achieved, in Sri Lanka, through fairly simple and low-cost interventions which include the following.

67. First, harmonization and simplification of procedures related to international trade make trade transactions efficient and low cost. In Sri Lanka, more than fifteen border regulatory agencies are responsible for the issuance of regulations and administration of procedures for border management and protection of human, animal, and plants. All these agencies should take appropriate steps to harmonize and simplify the regulations and procedures related to international trade.

68. Second, in order to ensure the transparency, predictability, and accessibility, all applicable laws, regulations, procedures, and documents should be published and updated in a timely manner on a single platform or interlinked platform. One or more inquiry points should be established by every border regulatory agency to provide answers within a reasonable time to the inquiries, possibly free of charge.

69. Third, with a view to promoting a business friendly environment for trade, it is important to create a culture of stakeholders' consultation and review in a timely manner. This process enables the incorporation of suggestions and concerns of exporters and importers into the trade facilitation process.

70. Fourth, a national single window platform is required for facilitating importers and exporters to submit regulatory documents and data requirements for importation, exportation or transit of goods through a single entry point to the participating agencies and also to receive the results on the submission through the same single window platform in a time bound manner.

71. Fifth, Sanitary and phytosanitary measures, as well as technical barriers to trade, are required to ensure consumer safety, environmental protection and protection of fauna and flora (Protection of Human, Animal, and Plants) within a well-established national regulatory framework in line with international standards and best practices.

72. Sixth, Customs Administration should take steps for a speedy release and clearance of goods through the pre-arrival processing facility, electronic payment system and post-clearance audit system within the scope of risk management principle.

73. In early 2016, Sri Lanka became a signatory of the landmark WTO Trade Facilitation Agreement (TFA), and the speedy implementation of the TFA is a cornerstone of the NTP. Sri Lanka already notified trade facilitation measures that would be implemented under Category A, B and C. The key measures that will be adopted include transparency and advance publication of all procedures, rules, laws and regulations including tariffs, fees and charges, speedy release of goods through customs according to established benchmarks and subject to risk management principles, and establishment of regularly updated trade facilitation indicators. Sri Lanka has also established a National Trade Facilitation Committee as required by the TFA.

3.2.7 Supporting private sector

74. The economic and financial crisis, some 8 years ago, clearly showed once again that markets are not perfect and the government needs to intervene to correct such market failures and safeguard producers and consumers by enacting regulatory mechanisms. In this regard, it is of utmost importance to identify the respective roles of the government and the private sector. One thing is very clear. It is companies, not the government, that engage in trade and investment. The government should create an enabling environment for the private sector to invest, innovate, produce and trade. Ease of Doing Business needs to be enhanced by introducing sound economic policies, building basic infrastructure, simplifying business processes and facilitating trade and investment.

75. The government formulates, implements and monitors public policies and regulatory mechanisms to set a conducive environment for business to prosper. It prepares contingency plans for any external shocks and supports the business sector when they are in trouble. The government also promotes public-private partnerships and facilitates business development through building capacities and creating opportunities for more business by setting up trading partnerships including through regional and bilateral agreements.

76. Reforms that encourage innovation are especially important in Sri Lanka given the need for industrial upgrading, domestic productive capacity and export diversification**.** As elaborated in a recent World Bank report, innovation in Sri Lanka remains rudimentary, stymied by past import substitution policies**.** However, the garments sector in this country has become a world leader in innovation**.** And, there are innovations taking place in the digital and electronic activities**.** While no means widespread, these cases show that innovation can take place**.** To extend the present scope for innovation, a more streamlined and less costly business startup framework, together with support programs to support entrepreneurship, are required to promote new business entry and innovation**.** Special attention needs to be given to SMEs **(**including though the spread of e-commerce**).** Rationalizing and upgrading the R&D sector in Sri Lanka, and providing it with increased public funding for would support an expansion of innovation**.**

77. The private sector, in turn, has a crucial role and responsibility in taking the process of development forward by improving productivity and competitiveness, adapting new technologies, connecting with foreign markets, and using resources efficiently. Further, companies should act as socially responsible corporate citizens by supporting and implementing social development projects and activities.

3.3 Macroeconomic balance, policy, and institutional coherence

3.3.1 Policy coherence

78. The horizontal policy coherence is crucial for trade and investment to play their expected roles in economic growth. Especially, export expansion could deliver expected results only if macroeconomic policies, in particular, the foreign exchange rate is kept realistic. For example, an overvalued exchange rate could create a bias against exports as it makes exports more expensive to foreigners leading to lower demand for Sri Lankan goods and services.

79. In addition to macroeconomic policies, trade has linkages with sectoral policies such as agriculture, health, labour, environment, and competition. For example, flexible labour policies enabling the business sector including foreign companies, to hire workers at competitive wages is required for attracting FDI. Similarly, trade and environment are interconnected. While environmental standards could be misused as protective barriers on trade flows, increased trade resulting from trade liberalization could lead to the production of environmentally sensitive goods, leading to increased pollution in the absence of appropriate environmental protection policies. The reconciliation of trade and environment policies could enhance sustainable development and create enormous business opportunities. In this regard, development of supply-side capacity is critically important to the production of eco-friendly goods and services that are demanded by other countries, in particular, advanced developed countries. Capacity development can include assistance (i.e. credit facilities) to export-oriented SMEs to produce environmentally friendly goods and services, provision of trade information, entrepreneurship development, human resource training and capacity building. On the side of imports, tariff structure, para-tariffs, and other trade measures at both border and behind the border need to be designed in such a way as to reduce the costs of imported material that are being used in the production of such goods. Regional and bilateral trade agreements can also be used to promote trade of both eco-friendly goods and services.

3.3.2 Effect on government revenue

80. While policy coherence is critical for trade expansion, as a trade-tax dependent country, Sri Lanka should accord due consideration to the effects of trade reforms on its revenue. The rationalization of tariff regime is likely to have some implications on government revenue in Sri Lanka as it runs a large budget deficit and relies heavily on taxes levied at the border. Sri Lanka's Public debt stands at 76% of GDP, high for a Lower-Middle-Income country, and this is without including the debt of state-owned-Enterprises, which stands at 11.4% of the GDP. Since Sri Lanka runs a large budget deficit and relies heavily on taxes levied at the border, there is, understandably, a concern that the NTP will create a big hole in the government's finances. Indeed, while high-income countries no longer rely on import taxes for significant revenue, there is evidence that middle-income countries like Sri Lanka often struggle to replace lost tariff revenues and – in episodes of rapid trade liberalization – tend to do so only partially.

81. However, there is a reason to think that these concerns are less applicable to Sri Lanka. To start with, important taxes levied at the border – such as VAT and excise taxes – and which are often included under the catch-all "trade taxes" will not be affected by the NTP since they apply across the board, i.e. not only to imports but also to domestic production. Thus, while total taxes levied at the border amount to about 40% of government revenue, approximately half of these tax proceeds will be unaffected by the NTP. Furthermore, the current tariff and para-tariff regime provide for many exemptions which could be eliminated to simplify the tariff structure and make it more uniform. The regime also presents many loopholes (including outright evasion) which could be closed as part of a broad-based rationalization of the system and by making it more transparent and uniform. Moreover, important sources of tariff and para-tariff revenue are derived from products that are essentially unavailable in Sri Lanka, such as those on petroleum and on automobiles. These tariffs and para-tariffs are like excise taxes and are less distortive of the economy. They can remain, or be pared more moderately and over a longer period. Perhaps most important, Sri Lanka's border taxes are so high on many products that their net effect is to minimize imports and so to reduce

rather than increase revenue. Over time, the boost to exports and to aggregate economic growth expected to emanate from the NTP will also help offset the revenue loss.

82. To give time for these effects to work, the liberalization can be paced accordingly. Historically, Sri Lanka has struggled to broaden its tax net and to increase its total tax take from all sources from very low levels, 12% of GDP. But there is no doubt that – with political will and improved administration - far less distortive sources of government revenue such as increased VAT and direct taxes on income and property, can be found. Sri Lanka's "tax productivity" – defined as taxes raised as a share of GDP/ tax rate – is among the lowest in a sample of Asian countries, according to the IMF. And this is true for all three main sources of non-trade tax revenue: the tax on corporate profits, on personal income, and on value added (VAT). These taxes can also be designed to be more progressive than tariffs and para-tariffs which raise prices for all consumers indiscriminately. This is another way that the NTP will help all, and not just a privileged few.

3.3.3 Effect on balance of payments

83. An additional challenge posed by the reduction of tariff and para-tariffs is the effect of increased imports on Sri Lanka's current account deficit, which is projected to be near 2% of GDP in 2016. Although this is not a large deficit by international standards, concerns about it are justified because it is persistent despite the large windfall from lower oil prices and Sri Lanka's foreign currency reserves are barely adequate, standing currently at 3.8 months of imports. Concerns about external balance underscore the importance of measures that strengthen Sri Lanka's competitiveness. The confidence of both domestic and foreign investors and their willingness to invest in the export sector depends critically on a sound and sustainable macroeconomic framework. An important part of such framework is a competitive exchange rate. It will also help facilitate the shift of labor and investment towards exports and to help firms in Sri Lanka withstand the increased pressure of foreign competition in domestic markets. Fiscal consolidation, will also help moderate domestic demand and contain the possible deterioration in the balance of payments.

3.3.4 Institutional coherence

84. Countries with more congruent institutions in terms of pursuing a common goal are known to perform better than others as such institutions can enhance synergies in their respective areas of work and achieve expected results from various public policies, programmes, and projects. On the other hand, inconsistency in the implementation of public policies by institutions in related fields could result in unsuccessful outcomes and costly failures. In a wider context, institutional coherence extends beyond public institutions and includes private sector and civil society so that all public and private institutions work towards some common development goals such as increased growth in exports. Currently, in Sri Lanka, trade policy making and implementation are with a wide range of public institutions causing significant delays, bottlenecks, confusion and inefficiencies in trade related activities including trade negotiations. In order to expedite the decision making and implementation trade-related programs and measures, there is an urgent need to streamline both processes and the institutions. One obvious gap in the mechanisms for trade policy and implementation is an inter-ministerial coordination body consisting of all relevant ministries. In addition, the consultation with the business sector should be made an integral part of the institutional mechanism that is responsible for trade policy making.

3.4 Facilitating Adjustment of Firms and People

85. Several measures are contemplated which will accompany the NTP and which are designed to prepare the most affected firms, in particular, SMEs, from import liberalization to face increased international competition and to ensure all benefit from trade.

3.4.1 Trade cost adjustment

86. Trade reforms have long term benefits including higher economic growth through the efficient allocation of resources and increased competiveness. They also have short term disadvantages in terms of loss of outputs and employment in import competing sectors and loss of government revenue. These costs are expected to be minimized or eliminated in the long run when the displaced labour are shifted to export-oriented sectors and the tax revenue is increased from higher imports. However, it is important to develop a trade-cost adjustment programme to address any short-term potential negative impacts of liberalization**.** These include government-sponsored training and capacity building activities and trade cost adjustment compensatory (i.e. financial) programmes for local firms, in particular, SMEs.

3.4.2 Making trade work for all-Inclusive Trade

87. Trade can create opportunities for all including the poor. Such opportunities could be enhanced, for example, through trade agreements by promoting sectors-both goods and services-in which the vulnerable people are engaged such as agriculture by the inclusion of such products in the Sri Lanka's "request lists" for market access in its trading partners. Trade reforms can also benefit women, who represent a vast and relatively untapped part of the labor force despite their becoming increasingly educated. Greater gender equality in a country that already has higher gender equality in the South Asian context, can raise economy-wide productivity and raise the growth rate. Experience elsewhere indicates that trade reforms and FDI reduce gender inequality in developing countries, improving labor rights and reducing discrimination. In fact, women tend to be disproportionately employed in export sectors such as agriculture (e.g. tea), garments, tourism and IT-based remote provision of back-office services and call centers. The jobs in the export sector not only provide income for women but also tend to contribute to their greater autonomy and empowerment as well as to family and social stability.

88. On the other hand, the adverse effect of trade liberalization on the most vulnerable people needs to be identified and rectified. The share of national consumption of the bottom 20% of Sri Lanka's population is just 7%. Many of Sri-Lanka's poor are small-holder farmers or farm laborers, and some are among the lowest-paid workers in the services and import competing sectors. Many of the poor can benefit greatly from trade liberalization insofar as it reduces the cost of staples, or creates new export opportunities but some can also be hurt by the lower prices of that which they produce. Trade reforms in the most sensitive sectors will be carried out cautiously with these considerations in mind and, where possible, mechanisms will be put in place to facilitate the migration of workers out of those sectors. Policies and programs supporting workforce development that address wage gaps, and those intended to encourage entrepreneurship among them, are likely to pay high dividends.

3.4.3 Strengthening the Capacity to Compete in Domestic Markets

89. The NTP will create new opportunities for Sri Lanka's exporters, but it will also open Sri Lanka's markets to foreign firms, exposing firms in the economy to increased international competition which entails confronting some of the world's most efficient suppliers. However, just as the NTP will help exporters become more competitive, it will also enhance the competitiveness of Sri Lankan firms, in particular, SMEs, in domestic markets by reducing barriers on imported inputs and getting rid of monopoly control of domestic inputs, maintaining competitive exchange rate, reducing the cost of regulation, and spurring service providers as well as producers of goods throughout the domestic production networks to become more efficient. In addition, a programme of tariif phasing-out will be built into the proposed trade reforms so that import substitution sector will have adequate time to adjust and enhance their competitiivness.

3.4.4 Helping the consumer

90. As shown above, the NTP will benefit firms in many ways. However, another important effect of the NTP and one that should not be overlooked is to benefit consumers directly. Since tariffs and para-tariffs fall disproportionately on final products and especially on consumer items, there is significant scope for a decline in the domestic price of imported products, potentially raising the living standards of all. It should also be noted that many consumer markets in Sri Lanka are dominated by a small number of domestic suppliers. By lowering barriers and allowing increased competition, the NTP will result in greater pressures on domestic suppliers to improve productivity, raise quality to world standards, and match lower international prices. Of course, the desire is always to see those domestic suppliers succeed and grow, but they must do so by improving their offering to consumers. The benefits to consumers from the NTP will be large, especially in those sectors where the market is dominated by a few suppliers. The NTP will also seek to increase competition and lower prices especially in those products that the poorest and most vulnerable people in Sri Lanka consume.

4. Summary and conclusions

91. The main measures envisaged under the NTP rest on 4 elements: competitiveness through domestic policy reforms, market access and trade facilitation, macroeconomic balance, policy and institutional coherence, and the adjustment of firms and people.

92. The NTP will be an integral part of a national development strategy of the country. A list of major measures contemplated under the NTP, whose detailed blueprint will be elaborated in due course is given below.
    - **a.** Rationalize the trade regime, by eliminating para-tariffs and NTBs, eliminating specific tariffs, and consolidating tariff lines into two or three bands.
    - **b.** Conduct a comprehensive review of trade and investment related legal and regulatory structure and undertake necessary reforms in parallel to the envisaged expansion of trade agreements to safeguard domestic industries and protect consumer interests

- **c.** Review current standards and regulations on both exports and imports and introduce appropriate amendments and strengthen or develop a new institutional mechanism
- **d.** Negotiate deep and comprehensive trade agreements with all major trading partners, beginning with India, China, Singapore, the United States and the European Union.
- **e.** Establish a more liberal regime of trade in services, aiming to attract foreign direct investment, especially through domestic establishment (Mode III).
- **f.** Develop a national export strategy with a special focus on some selected strategic export sectors including export-oriented import substitution industries
- **g.** Liberalize the foreign investment regime and undertake a systematic effort to attract FDI, especially that of the export-seeking variety and that which establishes Sri Lanka as part of Global Production Networks.
- **h.** Develop a National Single Window for facilitation of trade, remove impediments to conduct of trade and improve trade logistics
- **i.** Implement the WTO Agreement on Trade Facilitation.
- **j.** Promote industries capable of integrating into global production networks.
- **k.** Improve supply capacity of SMEs for export of goods and services
- **l.** Widen and deepen the tax net to reduce the budget deficit and compensate for the loss of revenue from trade taxes and from the tariff and para-tariff reduction, if any.
- **m.** Allow increased exchange rate flexibility to reduce bias against exports.
- **n.** Ensure policy and institutional coherence by streamlining all trade and investment related public agencies with duties and responsibilities of each institution
- **o.** Develop a Trade-cost Adjustment programmes to mitigate the adverse effects of trade liberalization on firms and people and to give time for adjustment.

93. Sri Lanka's new Trade Policy represents a major departure from the recent history of increased protection and growing isolation from world markets. These policies have hurt the living standards of the Sri Lankan population at large, and have depressed the country's growth rate below what it could have been. Only a small part of the population are net gainers in the status quo, as they enjoy rents from selling into highly protected and oligopolistic domestic markets, which allows for high prices and inadequate quality. Many more could benefit from Sri Lankan exporters accessing world markets, and drawing from them, far more comprehensively than at present. Sri Lanka needs trade reforms now because any delays imply a cost to the economy. Failure to use the opportunities arising from globalization and integration through reforms will penalize Sri Lanka with low growth, continuing imbalance in the fiscal and payments areas and a less competitive economy. The shift in policy need not be effected overnight and could be paced to ease the adjustment. The direction to be taken is clear. The destination is a familiar one: a return to Sri Lanka to its historical place at the cross-roads of world trade.