U.S. Department of State
FY 2001 Country Commercial Guide: Sri Lanka

The Country Commercial Guide for Sri Lanka was prepared by U.S. Embassy Colombo and released by the Bureau of Economic and Business in July 2000 for Fiscal Year 2001.

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Chapter I

EXECUTIVE SUMMARY

In 1999, Sri Lanka's economy slowed: the real GDP growth rate was 4.3 percent, compared to 4.7 percent in 1998 and 6.4 percent in 1997. Although the agricultural sector remained strong, the industrial and services sectors weakened, and export earnings slowed substantially. The economy was particularly hard hit by depressed world prices for tea, rubber and garments. The balance of payments recorded a deficit of $263 million. The government fiscal deficit rose in 1999 to 7.8 percent of GDP, compared to a projected figure of 6.0 percent. The armed conflict between Government forces and Liberation Tigers of Tamil Eelam (LTTE) insurgents continues and the renewed fighting in the North and assassinations and bombings in Colombo will likely deal another blow to investor confidence and tourism throughout 2000.

Real GDP growth in 2000 is expected to be about 4.0 percent. Exports have grown by 20 percent in the first five months. However, recent weakness in world prices for tea will depress export earnings, and garment exports, a mainstay of the Sri Lankan economy, are expected to experience slow growth during 2000. Imports have increased sharply by more than 40 percent through May, due to higher oil prices and defense imports. The privatization program is likely to slow, depriving the Government of an income around $300 million in 2000. Consequently, the balance of payments is likely to record a substantial deficit in 2000. Foreign exchange reserves are under pressure. The one bright spot remains to be strong flows of inward remittances, well over one billion dollars (or 6.7 percent of GDP), from Sri Lankan workers abroad. The Government fiscal deficit is set to increase considerably due to additional defense spending. Inflation is also set to rise to around 10 percent. Increased private sector participation in the telecommunications service industry has yielded strong growth and development in this sector, but there was some backsliding in 1999 and early 2000, as the Government attempted to protect Sri Lanka Telecom at the expense of other private operators. More thermal power generating capacity is slowly being added, but the country is still heavily dependent on hydropower, making the electric power supply vulnerable to vagaries of weather. Sri Lanka faced a power shortage in the summer of 2000 due to low rainfall.

Longer term prospects are unclear. Resolution of the continuing armed conflict is not expected in the near future. As demonstrated by the slow pace of infrastructure development and the myriad disputes over public tendering, Government decision-making and policy implementation are extremely slow. In the long run, the Government's inability to move quickly and decisively on major tendering and investment decisions and implementation could inhibit growth and keep Sri Lanka from reaching its potential.

Chapter II

ECONOMIC TRENDS AND OUTLOOK

Major Trends and Outlook

Sri Lanka began to shift away from a socialist orientation in 1977, but the pace of reform has been uneven over the past twenty-three years. Socialist sentiments remain strong among certain groups, particularly in the public sector workforce. In 1983, ethnic disputes slowed the process of liberalization and economic diversification. The disputes led to a serious armed conflict between the Liberation Tigers of Tamil Ealam (LTTE) and the Government armed forces in the northern and eastern parts of the country. The war still continues causing various economic and social problems in the country. In 1988-90, a violent uprising of the Maoist-communist JVP organization--led by educated but unemployed youth--threatened the Government of Sri Lanka (GSL) and caused extensive upheavals and economic uncertainty. Increased privatization, reform and an emphasis on export-oriented growth followed the successful quelling of the JVP revolt, taking GDP growth to 7 percent in 1993.

Growth has been uneven in the ensuing years as the economy faced a multitude of global and domestic economic and political challenges. Divisive elections in 1994 slowed growth moderately, with GDP expanding by 5.5 percent in both 1994 and 1995. In 1996, growth slowed further--to 3.8 percent--due mainly to a drought and resulting power cuts, along with major terrorist attacks in Colombo. Growth picked up in 1997 to 6.3 percent. The Asian financial crisis took less of a toll on the economy of Sri Lanka in 1997 than elsewhere in the region, due in part to exchange controls on the capital account and relatively low exposure to short-term foreign debt. But by the middle of 1998 growth in Sri Lanka started to slow markedly. The economy was hit by delayed effects of the Asian economic crisis, global recession, domestic and regional political problems, the Russian economic crisis resulting in sharply lower tea prices and terrorist bombings in civilian areas. Nuclear detonations by neighboring India and Pakistan in May 1998 had a chilling effect on foreign commercial and investor interest in Sri Lanka, especially on the Colombo stock market. Consequently, growth moderated in 1998 to 4.7 percent.

As the depressed conditions persisted into 1999 annual GDP growth rate slowed further to 4.3 percent, although still comparatively better than the developing country average growth of 3.3 percent in 1999. Sri Lanka’s exports declined by 4 percent, after 12 straight years of growth. The stock market remained depressed and the privatization process slowed.

For 2000, real GDP growth is expected to be around 4 percent. The economy is faced with a series of challenges. A new round of fighting began in the north in late 1999. Fighting intensified after mid-April 2000 causing heavy military losses. Consequently, the Government is spending around Rs 12 billion (approximately $160 million) more on defense in 2000. The Government has increased taxes and utility prices to meet the extra expenses. Nonetheless, the budget deficit is expected to rise from an estimated 7.6 percent of GDP to around 8.5 percent of GDP. Exports have recovered fairly strongly in the first five months. However, the balance of payments will record a significant deficit again this year due to a higher oil bill and defense-related imports. Foreign exchange reserves, which fell by 11 percent in 1999, have decreased further in the first half of 2000. To encourage exports and to stabilize the drain of foreign exchange, the Central Bank announced a 5 percent depreciation of the rupee in mid June. The outlook for tourism is also bleak. Privatization will slow once again in 2000, and private investment will also slow down. The Colombo Stock Exchange hit a 9-year low in May. As of June the country is facing a severe power shortage due to low rain fall and heavy dependence on hydropower. Inflationary pressures are rising. In the current scenario, economic prospects continue to be disappointing through at least early 2001.

In the longer term, prospects are uncertain. There are no imminent prospects for settling the ethnic conflict, and defense expenditures remain a significant drain on the economy. Implementation of major reforms in the civil service and education sectors and more disciplined spending and improved revenue collection would help generate stronger economic growth. If privatization continues and export orientation strengthens, weaknesses in government will be somewhat less critical to growth. We expect to see real growth continuing in the 4-6 percent range beyond 2001, still below Sri Lanka’s potential. Growth prospects would improve with stronger leadership and more vigorous implementation of economic policy commitments.

Principal Growth Sectors

All three principal growth sectors contributed to economic growth in 1999 growing by over 4 percent, although growth in services and manufacturing were less robust when compared with the previous two years. The services sector, which accounts for nearly 54 percent of GDP, increased by 4.0 percent. The manufacturing sector grew by 4.4. The manufacturing sector’s share of GDP was 16.4 percent. The agricultural sector increased by 4.5 percent and accounted for 20.7 percent of GDP. The construction sector grew by 4.8 percent.

The following table presents percentage changes in real sectoral output over the preceding year.

	Contribution to 1999 GDP(a) %	1998(b)	1999(b)
Services	(53.5)	5.2	4.0
Agriculture	(20.7)	2.5	4.5
Manufacturing	(16.4)	6.3	4.4
Construction	(7.6)	7.1	4.8
Mining	(1.8)	-5.4	4.1
Real GDP Growth		4.7	4.3

(a) At current prices.
(b) At constant prices

Agriculture: In recent decades, agriculture's contribution to the Sri Lankan economy has decreased. The agricultural sector's share of GDP has declined from 30.3 percent in 1978 to 26.3 percent in 1988 to 20.7 percent in 1999, as a result of the diversification of the economy and the consequent rise in manufacturing and services, lower prices for commodities such as coconut and rubber, and lower productivity. Despite its relatively small contribution to GDP, the agricultural sector still employs over 40 percent of the working population and remains a major force in society and politics. Low productivity, especially in subsistence agriculture, including paddy cultivation, is a major concern to policy makers. Efforts are underway to increase productivity in plantation agriculture--tea, rubber and coconuts--now under private sector management and ownership.

The agricultural sector performed reasonably well in 1999 due to favorable weather. Both tea, the main agricultural export, and rice, Sri Lanka's staple cereal, continued their upward momentum. Production of other main agricultural products, coconuts and rubber, also increased.

-- The 1999 rice crop yielded a bumper harvest, increasing by 7 percent to 2.9 million metric tons, the highest ever. Production grew due to both an increase in area under cultivation and improvements in yield. However, production was sufficient to meet only about 90 percent of demand. To offset supply shortfalls, Sri Lanka imported 214,000 metric tons of rice during the year. A 35 percent import duty on rice was removed temporarily to facilitate the imports.

-- Tea production increased, albeit marginally, for the sixth straight year in 1999 to a new record high. Total production was 284 million kgs. Prices at the Colombo tea auctions, which dropped sharply following the August 1998 Russian financial crisis, improved in the second half of 1999 due to increased buying by Russia and a drop in world supply. However, the annual average price in 1999 remained 14 percent below 1998. The small holders' share in the national output was 58 percent. Despite productivity improvements, the yield levels in the recently-privatized estate sector are about half the yield level in the small holder sector. Sri Lanka exported 268 million kgs of tea in 1999. Despite incentives provided to promote value added tea, such exports declined in 1999.

-- Rubber production, which has shown a declining trend since 1996, increased marginally by one percent in 1999. Dry weather in rubber growing areas helped to increase the tapping days. International natural rubber prices declined in the first half of 1999 before recovering slightly towards the end of the year. Sri Lanka withdrew from the beleaguered International Natural Rubber Organization (INRO) prior to its termination in 1999. In order to overcome the crisis in the rubber sector, Sri Lankan rubber producers are increasingly shifting to the production of crepe rubber and centrifuged latex. Increased local consumption has also helped to stabilize prices somewhat. Sri Lanka exports 44 percent of its rubber output. The balance is consumed locally by the industrial sector. Sri Lanka is world's largest industrial tire manufacturer.

-- Coconut production increased by 10 percent in 1999. Other agricultural exports such as spices (mainly cinnamon) and coffee also increased in 1999.

Major reform of the plantation sector (tea, rubber and coconut) began in 1992, when management (but not the land or assets) was privatized. In 1995 the GSL began privatizing the 23 regional holding companies. These holding companies obtained 50-year lease rights to the plantations. The GSL sold 20 plantation management companies in 1995-1997. Of these, 15 are listed on the Colombo Stock Exchange and account for about six percent of market capitalization. Plantation wages are based on a wage agreement, which contains a formula for profit sharing. It affords the plantation companies the flexibility to weather downturns in prices. The agreement came up for renewal in February 2000. After several months of negotiations and an eight-day long work slow down, plantation workers received substantial wage increases in June 2000.

The outlook for the agricultural sector in 2000 is not very encouraging. The paddy sector, which recorded strong growth rates in 1998 and 1999 is unlikely to grow further in 2000. Paddy production in the main "Maha" season has increased by about 2 percent. But the "Yala" crop is likely to be below last year's levels due to drought. As a result, Sri Lanka plans to import at least 150,000 metric tons of rice during the year. In the tea sector, production has increased by nearly 4 percent in the first four months of 2000. Prices also remained strong in the first quarter due to a shortfall in the world supply, but prices have weakened substantially since early May. The recent depreciation of the Sri Lankan rupee is expected to help boost tea prices in rupee terms. Tea accounts for more than 13 percent of Sri Lanka's export earnings. Therefore, any decreases in prices are of major concern to economists and the business community. Rubber production is up 2 percent in the first four months of 2000, but prices are still low. Coconut production has increased substantially by 17 percent during this period.

Industry: Manufacturing accounts for about 16.5 percent of GDP, about 44 percent of which is textiles, apparel and leather products. Growth in the manufacturing sector was 4.4 percent in 1999, compared with growth of 6.3 percent in 1998 and 9.1 percent in 1997. Growth slowed in 1999 due to increased competition faced by export-oriented industries. Performance in the domestic market oriented industries was mixed.

-- The textile, apparel and leather products sector is the largest industrial sector and accounted for 44 percent of industrial output. This sector grew by 7.3 percent in 1999 compared with 4.5 percent growth in 1998 and 18.7 percent growth in 1997. Garments, mainly exported to the U.S. and Western European markets, is the largest industrial sector. It accounts for about 85 percent of industry output, 32 percent of manufacturing employment and 48 percent of total exports. Currently, there are 891 garment factories in operation. In 1999, garment exports rose nine percent in volume terms, but unit prices recorded an eight percent drop. Consequently, export earnings from the garment industry dropped by one percent. Towards the end of 1999, robust economic growth in the U.S. and the European Union (EU) generated fairly strong orders for Sri Lanka's garment exports while exchange appreciation in East Asian countries enhanced Sri Lanka's competitiveness. The U.S. is the main export market for Sri Lanka's apparel exports, taking 60 percent of all apparel exports. The rapid growth in Sri Lanka's garment industry has been helped by the availability of quota allotments to the U.S. and to a lesser extent to the EU. About 76 percent of apparel exports to the U.S. are under quotas. Non quota exports to the U.S. increased by 9.4 percent in 1999. Data also indicate an increase in higher value added items to the U.S. During the year, Sri Lanka and the U.S. introduced the Electronic Visa Information System (ELVIS) for issuing export visas for Sri Lankan garment exports to the U.S. The new visa system has helped to streamline garment exports to the U.S. under the quota program. Sri Lanka’s textile and apparel industry faces increased competition from cheaper sources, preferential trading arrangements such as NAFTA, and phasing out of the Multi-Fibre Agreement in 2005. Thus it has become necessary to invest heavily in technology and skills to face increased competition when quotas are fully phased out in 2005. Although there is greater awareness, apart from a few key players in the Sri Lankan industry, most producers have not yet shown many signs of making necessary changes to confront the global competition.

-- Growth in the other two major industrial sectors was marginal. The second largest industrial sector, food, beverages and tobacco, contributed 24 percent of industrial output and grew by 2.4 percent, compared with 9.7 percent growth in 1998. The chemicals, petroleum and rubber products sector, which contributes 16 percent of industrial output, grew only 0.2 percent.

-- The nonmetallic mineral sector grew by 7.7 percent due to a strong recovery in the diamond processing industry.

-- The smaller fabricated metal products and basic metal products industries slowed markedly to 5.4 percent and 3.3 percent respectively compared to growth rates of over 10 percent in 1998.

The Government is encouraging production of selected goods for which the country is believed to have a comparative advantage. A range of special incentives is now given for investments in these selected "thrust" industries:

--electronics and components for electronic assembling
--ceramics and glassware
--rubber-based industries
--light and heavy engineering
--cutting and polishing gems, diamonds and manufacture of jewelry.

In addition, at the request of the Government of Sri Lanka, Japanese International Cooperation Agency (JICA) and United Nations Industrial Development Organization (UNIDO) have jointly prepared a master plan on industrialization and industrial promotion in Sri Lanka. The master plan has identified seven industrial sectors for development: (1) electrical/electronic; (2) information technology; (3) rubber and plastics; (4) machinery; (5) footwear; (6) textiles and apparel; and (7) agro-based industries. JICA will formulate policies and development plans for the first four sectors while UNIDO will formulate plans for the footwear and textile industry. USAID is assisting the government and the private sector to improve competitiveness of key industries in Sri Lanka such as tea, rubber, tourism, jewelry, information technology, ceramics, electronics and agribusiness.

The 2000 outlook for manufacturing is mixed. The manufacturing sector rose 10.6 percent in the first quarter of 2000 from 3 percent in 1999. Industrial exports have picked up strongly in the first four months of the year, but steep price hikes and inflation could restrain growth. The rupee has depreciated by nine percent so far in 2000 and will hopefully help maintain export competitiveness. Manufacturing industries are threatened by a power shortage due to low rainfall. Many large industrial establishments have procured standby generator power.

Services: Services, which account for 53 percent of GDP, grew by 4.0 percent in 1999 compared with 5.2 percent in 1998 and 7.1 in 1997. The general economic slowdown and decrease in external trade dampened services sector growth in 1999. The main contributors to growth in 1999 were communications and tourism. The communications sector continued to grow strongly by about 40 percent, boosted by increased private sector participation. The tourism sector also had a banner year as tourist arrivals increased 15 percent. Electricity generation grew by 9 percent. A new 40-megawatt thermal power plant was added to the national grid. Due to low rainfall in catchment areas storage in hydro power reservoirs decreased substantially towards the end of the year. Consequently, thermal generation increased. Growth in most other sectors was less impressive. The banking, insurance and real estate sector slowed considerably to 4.6 percent in 1999 from 6.4 percent in 1998 and 10.3 percent in 1997. The decline in external trade and general economic slowdown in the country constrained the growth of the banking sector and affected profitability. The insurance and leasing sectors expanded considerably. Trading was flat due to slowdown in external trade. Growth slumped to one percent in port services. The Colombo port faces increased competition from new regional ports including Port Raysut in Salalah, Oman. Two of the main shipping lines servicing Colombo, Sea Land and Maersk, have transferred the bulk of their transshipment traffic away from Colombo to Salalah. The losses have been partly offset by new shipping lines coming to Colombo.

Prospects for the services sector for 2000 are not very bright. The outlook for the tourism sector is bleak due to the escalation of the war in the North, terrorist bombings in civilian areas, and consequent negative international publicity. Growth in the electric power sector will be constrained. The country is facing an imminent electric power shortage and the Government has made a public plea to reduce power consumption. The expansion in external trade will benefit the banking sector, but at the same time banking could be constrained by a slowdown in general economic activity. The stock market fell to a nine-year low in May 2000 and there are no signs of a strong recovery. The economic, political and military ramifications of war, the forthcoming parliamentary elections, exchange depreciation and interest rate hikes will keep investors away from the stock market in the foreseeable future. The stock market downturn will continue to weaken financial sector profitability in 2000. The declining trend in port services has continued into 2000. The communication sector is expected to continue its growth momentum with planned expansions by Sri Lanka Telecom and other private operators.

Government Role in the Economy

Historically, the public sector employed one quarter of the work force, but this proportion is decreasing as reforms continue and the private sector's role in the economy expands. In 1999, employees in government and quasi-governmental agencies made up 18.5 percent of the workforce. The International Monetary Fund (IMF) and the Asian Development Bank (ADB) have been actively pressing for stronger Government action on public sector reforms.

Since 1977, the GSL has been deregulating, privatizing and opening the economy to international competition. It has eliminated most price controls and quotas, liberalized import licenses, terminated export taxes, and sold over 50 state-owned companies. Tariff levels have been reduced on many items, the latest in February 2000 when the highest rate band was lowered from 30 percent to 25 percent except for a few products including key agricultural products. The Government actively promotes inward foreign investment and has eliminated most foreign exchange controls. In March 1994, Sri Lanka obtained Article VIII status of the IMF after it removed all restrictions on current account transactions and allowed free convertibility of the rupee for such transactions.

The state continues to control the price of (basic) bread, petroleum, bus and rail fares, telecom rates, water and electricity. In addition, utilities and fertilizer are subsidized or have below-market prices. Aware of many of its shortcomings, the Government has been striving to eliminate subsidies and free-up prices, but finds it politically difficult sometimes. In 1998, the Government managed to fully phase out a subsidy on wheat flour, due to low world market prices for wheat. In the first half of 2000, the Government, no longer able to subsidize fuel in view of the rising oil prices and rising cost of war, announced a series of price increases on electricity, diesel, kerosene, fuel oil and transport. The Government regulators also approved price increases on telecommunication services and liquefied petroleum gas (LPG).

The Government is also moving to open the economy to more private sector participation and competition, albeit at a slower than desirable pace. In 1999, the Government liberalized the import and distribution of motion pictures. Also in late 1999, the Government allowed six foreign companies to enter the lubricant market. The GSL budget for 2000 announced plans to further liberalize several key economic sectors. It proposed to allow joint ventures and private sector investments in petroleum refining, ending the monopoly of the Government-owned Ceylon Petroleum Corporation. Foreign equity holding limit in local banks has been increased from 49 percent to 60 percent. The insurance sector was opened to foreign investors for the first time. Foreign equity up to 90 percent will be allowed in the insurance sector and a leading American insurance company has been the first to enter the market. In addition, 100 percent foreign ownership is now allowed in stockbroking companies.

Foreign shipping companies express concern that government-regulated fixed fee levels for a variety of port and related services are anti-competitive and make Sri Lanka's port less attractive in the long run.

Privatization: The state retains control over a great deal of infrastructure (ports, roads, rail and electricity). It owns the two largest commercial banks, two insurance companies, a national shipping line, and many other companies. The Government has taken steps to privatize some of the utilities and infrastructure sectors. In early 1998, the Government completed the sale of 40 percent of Air Lanka (now Sri Lankan Airlines), the national airline, to Emirates of Dubai, UAE. Although the Government retains majority ownership, it ceded managerial control to the new owners. In August 1997, the Government sold 35 percent of Sri Lanka Telecom (SLT), the state-owned telecommunications entity, to Nippon Telephone and Telegraph (NTT) of Japan. The privatization deal kept majority ownership for the Government but gave management control of SLT to NTT. In 1996, well ahead of SLT privatization, the Government effectively ended the state monopoly on telephone landlines when it approved the provision of 200,000 new lines, based on wireless local loop technology, by two private companies. In the power sector, the first medium scale BOO-BOT power project of 51 MW (megawatts) started operations in June 1998. During 1999-2000, the Government signed contracts for a 160 MW combined cycle power plant with Virginia-based AES Corporation. It also signed a contract with a Japanese company for the delivery of a smaller 60 MW barge mounted power plant. In the ports sector, after several years of negotiations, the GSL handed over the Queen Elizabeth Quay of the Colombo Port to a private sector consortium including P&O Netherlands and local conglomerate John Keells Holdings Ltd. for development and operation. These private power and port projects were marked by protracted negotiations.

Following a competitive tender process, Caltex bought control of Lanka Lubricants in 1994, the Colombo Gas (bottled) Company was sold to Shell Oil in late 1995, and the Colombo Steel Corporation was bought by the Korean company Hanjung in December 1996. The Caltex-Lanka Lubricants venture has been extremely successful. However, both the gas and the steel companies were troubled by labor unrest in 1996 and 1997, but seem to have put those problems to rest since then. Government-owned plantations have been privatized under long-term lease arrangements, and some shares have been offered to the public. Many other ventures are also slated for privatization, though the GSL agency responsible for privatization, the Public Enterprise Reform Commission (PERC) is now proceeding carefully and slowly, avoiding the most controversial entities. Further, given the depressed conditions of capital markets in Sri Lanka, the privatization process slowed considerably after mid-1998. As a result, there have been no major privatization sales during the past twenty-four months.

The Government has plans to sell a further 30 percent stake of SLT in 2000 through an international placement. The Government has appointed a lead manager to manage the sale. Other sectors identified for privatization in 2000 are graphite mines, hotels, farms and an insurance company owned by the Government. But some of these sales, including SLT, will almost certainly be delayed due to the war, depressed capital market conditions, and serious commercial disputes involving SLT. The Government also has plans to restructure several important Government departments and corporations such as the postal department and the railways department. The Asian Development Bank has designed a detailed public sector reform program based on a study carried out by Arthur Andersen. The program, yet to be approved by the Government, proposes to restructure several key state corporations such as the Ceylon Electricity Board (CEB), ports, aviation department and the Ceylon Petroleum Corporation. In addition, the program includes financial and labor market reforms. Under the proposal, the Ceylon Electricity Board (CEB) will be unbundled so power generation, transmission and distribution will be handled by separate entities. Privatization of the state banks is not considered feasible in the short term due to political constraints. The IMF and the World Bank are pressing for broad restructuring of the two state commercial banks.

Government procurement: While Government of Sri Lanka representatives at the highest levels have emphasized the importance of reform and transparency in policy announcements and publications on government procurement, unfortunately procedures for bidding on major government projects and supply contracts in practice are still not transparent or predictable, and lengthy unexplained delays (of years, rather than months) are common. Competitive bids are normally reviewed by a Technical Evaluation Committee, which makes recommendations to a Cabinet-Appointed Tender Board (CATB). The CATB then makes its recommendation to the relevant line ministry, which forwards a final recommendation to the Cabinet for approval. The deliberations and decisions of these different bodies are made "in secret," although information often leaks out.

The Cabinet has been known to reject recommendations and choose less competitive bidders on obscure or unsubstantiated grounds. Procuring agencies sometimes fail to follow up in making the contracted procurement. In addition, the Government has abruptly canceled tenders (or reneged on signed or implicit contracts that resulted from tender decisions) with no adequate explanation or compensation, causing significant financial hardship and inconvenience to the winning bidders. Military procurements are often made completely outside of normal tendering procedures, resulting in no transparency or accountability.

The Ministry of Finance and Planning in September 1996 issued "Guidelines on Government Tender Procedure" and reissued an expanded version of these guidelines in August 1997. The stated intent of the guidelines is to "reduce the time taken for the tendering process to six months, while keeping the whole process transparent and ensuring a level playing field to all tenderers." As of mid-2000, this intent has not been realized. Although the guidelines stipulate that appeals can be directed to a Tender Appeal Board, no such entity has been established. As a result, there is no functioning appeal mechanism in place.

With a view to streamlining and expediting Government procurement, a Procurement Support Bureau (PSB) was established in 1999 at the Department of Public Finance of the General Treasury, with ADB technical assistance. The PSB has prepared new procurement guidelines, revising previous guidelines issued in 1995 and 1997, and expects to implement them in the second half of 2000. PSB is also engaged in training officers who attend CATB meetings. In addition it will monitor tendering. PSB was initially intended to handle tenders for JBIC, ADB, and the World Bank projects. Its scope is to be expanded to cover tenders of other donor agencies as well.

Budgetary performance: The budget deficit in 1999 (excluding grants and privatization proceeds) was 7.8 percent of the GDP, up from 6 percent as originally planned due to revenue shortfalls and expenditure overruns. Revenue from the Goods and Services Tax (GST) was extremely weak, falling 30 percent below target. Revenue from import duties also fell below targets due to a fall in imports. Privatization proceeds were very low in 1999, only about Rs 130 million compared with a targeted Rs 8 billion. Consequently the Government had to resort to increased domestic financing to bridge the budget deficit. There were expenditure overruns due to increased debt service and higher defense, transport and public administration expenses. The effects of increased expenditure were mitigated by cuts in infrastructure development. Current expenditure was 74 percent of total expenditure. Interest on public debt along with expenditure on public sector salaries (including for defense personnel) and pensions to retired public servants account for nearly 70 percent of total current expenditure. Therefore, the creation of a more balanced expenditure structure that effectively promotes long-term economic growth is a major challenge to the Government.

Despite being an election year, the budget for 2000 did not contain any giveaways. It aimed at the consolidation of recent fiscal achievements to improve macro-economic stability. Nonetheless, the recent escalation of war has made budgetary control extremely difficult. The Government has already revised the deficit targets and currently expects a deficit of around 8.3 percent of GDP, higher than the original target of 7.6 percent of GDP. The Government has increased the defense budget for 2000 from Rs 52.4 billion to around Rs 65 billion to fund the war. It is spending $150-$200 million to purchase new military equipment including aircraft. The increased expenditure is to be funded by tax increases, cuts in non-essential capital expenditure and by domestic borrowing. In addition, privatization proceeds in the region of Rs 30 billion are expected to finance the budget deficit in 2000 and any shortfall will sharply increase domestic financing. The Government has also made a downward revision to its revenue forecasts. In June 2000, the Government announced a series of price hikes on Government-controlled utilities and petroleum products to offset budgetary impacts of recent world oil price hikes.

The following table presents Government fiscal operations as a percentage of GDP. 1999 figures are provisional and 2000 figures are Central Bank projections:

Government Accounts
(percent of GDP)

	1998	1999	2000
Revenue	17.2	17.6	18.4
Expenditure and net lending	26.3	25.1	26.7
Defense	5.6	4.6	5.2
Budget deficit before grants	9.2	7.8	8.3
Domestic finance	7.0	5.3	4.4
Privatization proceeds	0.4	0	2.4
Foreign grants and loans (net)	1.7	0.7	1.5
Current account deficit	2.2	2.4	1.1

Total government debt rose to Rs 1,050 billion ($14.6 billion) in 1999, or about 95 percent of GDP. Domestic debt was Rs 543 billion and foreign debt was Rs 507 billion ($7 billion). Despite the difficult fiscal environment, the Government continued its policy towards developing a more market-oriented, medium and long-term debt market for government securities. Accordingly, about 70 percent of total net domestic borrowing was through treasury bonds.

Prices and Money: Inflation, as measured by the Colombo Consumer Price Index, dropped significantly to 4.7 percent in 1999, from 9.4 percent in 1998. Inflation remained around 4.5 percent in the first five months of 2000. Since then, a series of price hikes and tax increases as well as the depreciation of the rupee have boosted inflationary pressures. Inflation could rise to well over 10 percent by the end of the year.

Money supply (M2) growth was 13.4 percent in 1999. Domestic credit expanded by 17.1 percent largely due to a 46 percent increase in government borrowing. Private sector credit grew moderately by 9.9 percent due to sluggish economic growth and a slowdown in external trade. Despite the increase in government sector credit, the slow growth in private sector credit and a significant reduction in foreign inflows helped contain monetary expansion and inflation in 1999.

Monetary policy management faced several challenges in 1999 including a reduction in inflation, a significant deficit in the BOP and increased government borrowings. In this scenario, monetary policy focus in 1999 was on maintaining stability in the financial market. The Central Bank used its repurchase rate to signal the direction of interest rates. The repurchase rate was reduced by 200 basis points in several steps during the year. The statutory reserve requirement for commercial banks were also reduced in 1999 to 11 percent from 12 percent. This measure resulted in a release of Rs 2.5 billion to the economy, and helped to mitigate crowding out effects due to increased government borrowing. As a result, despite increases in the government fiscal deficit, interest rates were generally stable in 1999. Weighted average prime lending rate rose to 15.69 percent in 1999 from 14.9 in 1998, and applied to prime customers of commercial banks. Throughout 1999, the Central Bank floated several long-term credit instruments including treasury bonds of varying maturity. Due to increased government borrowing, interest rates are set to increase fairly sharply in 2000.

Balance of Payments

Sri Lanka's balance of payments situation deteriorated sharply in 1999. Exports slowed markedly, and both the trade and the current account deficits deteriorated. Together with a slowdown in capital inflows to the Government and a reduction in foreign liabilities of commercial banks, the balance of payments recorded a deficit of $263 million in 1999 compared with a surplus of $37 million in 1998. Consequently, Sri Lanka's external reserves contracted from $2,907 million in 1998 to $ 2,582 million in 1999, or 4.6 months of imports of goods and services.

Sri Lanka's exports declined by 4.1 percent in 1999, after 12 straight years of growth. Exports suffered due to depressed global demand and declining commodity prices. Imports, including three aircraft for Sri Lankan Airlines, increased by 1.6 percent. Consequently, Sri Lanka's merchandise trade deficit expanded to $1,299 million in 1999, from $1,092 million in 1998. The services account surplus improved slightly by one percent to $147 million in 1999. Tourism was buoyant but port services declined. Remittances from Sri Lankan workers abroad continued to make an important contribution to the balance of payments as private transfers were up 5.7 percent to over $1 billion. Official transfers (grant aid) decreased by 25 percent to $96 million. The deficit in the current account expanded to $495 million in 1999 (or 3.1 percent of GDP) from $226 million in 1998.

Private long-term capital inflows (loans and foreign direct investment (FDI)) increased significantly in 1999 due to a sharp increase in borrowings by Sri Lankan Airlines. Net long term loan capital to private sector was $189 million, compared with $2 million in 1998 and $47 million in 1997. Sri Lankan Airlines, jointly owned by the Government and Emirates Airlines of UAE, borrowed $290 million to purchase aircraft under a refleeting program. FDI inflows increased to $177 million in 1999, from around $130 million in both 1998 and 1997. The largest share of FDI inflows was to telecommunications, power, industries, garments, and ports. There were no inflows on account of privatization in 1999, compared with $56 million in 1998 and $300 million in 1997. Further, portfolio investment through the Colombo Stock Exchange resulted in a net outflow of $13 million in 1999.

In 1999, Sri Lanka received $447 million from the donor community in grant aid and concessional loan assistance. The major donors were Japan ($186 million), the Asian Development Bank, and the International Development Association. U.S. assistance amounted to $11 million, $4 million of which constituted development assistance and $7 million of wheat donation.

International Trade: External trade was sluggish in 1999. Exports recorded a drop of 4.1 percent to $4.6 billion, due to lower export prices, which offset higher export volumes. Sri Lanka's two main exports, garments and tea, were extremely sluggish in the first half of 1999. Earnings from textile and garments, which account for 53 percent of total export receipts, dropped by 1.4 percent to $ 2.4 billion. Earnings from tea exports declined sharply by 20 percent to $621 million, due to a drop in demand following the Russian currency crisis in August 1998. A few other important exports such as rubber and rubber products, footwear & leather products, and food & beverages also faltered in 1999. Jewelry and processed diamond exports recovered after a two year slump due to the East Asian crisis and global recession. Performance of other manufactured exports was mixed. Ceramic products and chemicals declined. Toys and copper products increased.

Import growth was held to 0.2 percent in 1999, despite the import of three aircraft. The decline in imports was due to a drop in import prices and a drop in volumes. Lower international food prices for major food imports helped to lower the food import bill by 10 percent to $655 million in 1999. Imports of durable consumer goods rose 9 percent. Import of motor cars and motorcycles increased substantially as did the import of television sets and sound recorders. Sri Lanka imported textiles to the value of $1.3 billion in 1999, mainly for the export garment industry. In the investment goods category, machinery and building material imports declined. Expenditure on transport equipment increased substantially due to the import of aircraft.

The United States is Sri Lanka's largest export market and the destination for $1,740 million (or 38 percent) of exports, predominantly garments. Sri Lanka's garment industry is heavily dependent on the U.S., with 60 percent of all garment exports bound for U.S. Japan is Sri Lanka's largest supplier with exports of $563 million in 1999, followed by India ($514 million). Other leading suppliers were Hong Kong, Singapore, Taiwan and South Korea. The United States remained the eighth largest supplier to Sri Lanka with a 3.6 percent market share. According to statistics compiled by the Central Bank of Sri Lanka, imports from the U.S. amounted to $217 million in 1999. U.S. data indicate a lower import figure. U.S.-origin goods enter Sri Lanka from regional entreports (e.g. Singapore, Dubai and Bangkok) and are not captured as U.S. exports in trade data.

According to U.S. Customs' statistics, U.S. exports to Sri Lanka were $167 million in 1999 compared to $190 million in 1998 and $155 million in 1997. Wheat accounted for 30 percent of U.S. exports. For many years, U.S. exports to Sri Lanka were dominated by wheat. However, with the general decline in concessionary funding programs, as well as increased trade in other areas, the U.S. export mix continues to evolve. Telecommunications equipment, data processing equipment, cathode valves, textile fabric, paper, aircraft parts, non-electrical machinery, synthetic rubber, insecticides, fruits and electrical machinery parts constituted the bulk of these exports. Sri Lanka's trade surplus with the U.S. in 1999 was $1.57 billion, the same as in 1998.

Exchange rate: The rupee depreciated by 6 percent against the dollar in 1999. It depreciated 3.5 percent against the SDR. The real effective exchange rate depreciated by 7 percent. The rupee depreciated by 4 percent against the dollar in the first five months of 2000. In the second quarter of 2000, the rupee came under severe pressure due to a worsening BOP situation caused by increased defense-related imports and increased oil prices. On June 20, the Central Bank allowed the rupee to be depreciated by a further 5 percent for a total depreciation of over 9 percent. The Central Bank monitors the rupee's float closely against a basket of major currencies and intervenes to reduce excessive volatility of rates.

Debt service: Debt service as a percentage of exports and services increased from 13.3 percent in 1998 to 15.2 percent in 1999. Sri Lanka's external debt (both private and public) stood at $9 billion at end of 1999. Total external debt was equivalent to 57 percent of GDP. Government or government-guaranteed debt accounted for 95 percent of total external debt.

The balance of payments outlook for 2000 is not encouraging. External assets have decreased by $250 million in the first five months. Both exports and imports have picked up strongly, but the trade deficit is set to widen considerably over the next six months. Exports have increased by 21 percent in the first four months of 1999. Exports will be further boosted by a nine percent depreciation of the rupee in the first half. However, recent declines in tea prices and increases in inflation could dampen export growth. Import expenditure has recorded a massive 36 percent growth in the first four months of 2000. Imports will continue to rise further due to increased defense-related expenditure, import of aircraft and sustained high oil prices. The service balance is likely to weaken in 2000. The outlook for tourism is bleak, and revenues from port services are also under pressure due to a drop in transshipment traffic. Private investment will be sluggish. Increased FDI is expected into two major private infrastructure projects in ports and power and to the expanding telecommunications sector. Other private foreign direct investment inflows will be weak in view of the unsettled security situation. Portfolio investment flows will be negative as foreign investors continue to exit from the Colombo Stock Market. Foreign exchange flows to the Government is also likely to be weak. The sale of a 30 percent stake of Sri Lanka Telecom, expected to possibly bring in $300 million, could be delayed due to the war and unfavorable market conditions brought on by SLT's commercial disputes. A $200 million sovereign debt issue by the Government in international financial markets will probably also be delayed. The only bright spot continues to be remittances from Sri Lankan workers abroad, which have remained strong this year, rising by about 25 percent in the first quarter.

The Government expects to receive $93 million in foreign grant aid and about $435 million in concessional and commercial loans in 2000 which could partly offset some gaps in FDI.

Infrastructure Situation

Sri Lanka’s infrastructure and its management are inadequate. Investment in transport (airports, ports, roads) and power has been marginal in the recent past, while demand continues to grow. As a result, there is considerable pressure on these facilities, especially on power and roads causing power shortages during drought periods and chronic road congestion in city areas. International air connections to Colombo from the West are still limited. Telecommunications infrastructure, while not completely adequate, is the one bright spot in infrastructure development, thanks to liberalized policies which have rapidly allowed significant private sector participation and considerable growth in the sector. Given budgetary constraints and the incapacity to absorb aid fully, the Government of Sri Lanka is promoting private infrastructure, particularly through build-own-operate (BOO) and build-own-transfer (BOT) schemes. The Bureau of Infrastructure Investment (BII) within the Board of Investment (BOI) is the primary authority for promoting and developing such projects. However, the BII has few successes to show for its efforts to date. BII does not have adequate technical and financial expertise to evaluate project proposals or tenders speedily. As a result, even after initial award of tenders, project sponsors could face inordinate delays before finalizing agreements. The lack of long term domestic financing is another bottleneck to private sector infrastructure development. The ADB and the IFC have recently come forward to assist private sector infrastructure projects.

Sri Lanka is served by a fairly modern (by regional standards) international airport and three commercial ports, the largest being the port of Colombo. The Government has extensive plans for the development of the Colombo Port. Colombo has an annual capacity of 1.7 million twenty-foot equivalent units (TEU). Major expansion work of the existing Queen Elizabeth Quay (QEQ) got underway in late 1999 (after five years of negotiations) on a BOT basis with private sector financing. QEQ is being developed by South Asia Gateway Terminals (SAGT), a joint venture between P&O Netherlands, P&O Nedlloyd and local conglomerate John Keells Holdings Ltd. Under the first phase of the project, the capacity of the QEQ will be increased by 750,000 TEU's at a cost of $240 million. There are plans to develop the north pier of the Colombo port with Japanese financing. The Government has been trying to develop the southern port of Galle since 1994. In 1999, the Government started to develop a small area of the Galle port. The project will increase break bulk and container capacity of the port. A feasibility study by JICA is underway to draw a master plan for the comprehensive development of the Galle port as a regional port.

There are several development projects underway to expand the Bandaranaike International Airport (BIA) at Katunayake on the outskirts of Colombo. The capacity of the airport is currently limited to 3 million passengers and 110,000 metric tons (MT) of cargo. The parking apron has a capacity to accommodate a mix of 17 wide/narrow body aircraft. Phase I of the expansion project is now underway. It involves limited improvements to the airport facilities such as a new duty free shopping complex, additional aircraft parking facilities, a new cargo terminal with a capacity of 50,000 MT and upgrading of radar management systems. After prolonged delays, the Government has recently launched a USD 100 million Phase II expansion project with JBIC financing. The project will involve increasing the passenger handling capacity by 1 million and the cargo handling capacity by 100,000 MT, expansion of the aircraft parking apron and improvements to air navigation systems.

Inland transportation is dominated by road, but the system has hardly changed since independence, 50 years ago. The Government has plans to develop four new highways: Colombo-Katunayake, Colombo-Matara, Colombo-Kandy and a Colombo outer circular road. Proposals to widen large sections of the existing trunk roads leading to key cities are slowly being implemented. These trunk roads presently are not wide enough for standard two-way traffic. A total of 345 kilometers (207 miles) of main roads and 47 bridges will be upgraded within a five-year period with the assistance of the Asian Development Bank and the JBIC. In addition, several other inner and outer circular roads in Colombo are being upgraded.

Sri Lanka is heavily reliant on hydropower for its electricity, making it vulnerable to fluctuations in rainfall. Sri Lanka's installed electrical capacity of 1680MW consists of 1137 MW of hydropower and 543MW of thermal power. As of June 2000, the country was on a brink of a severe power shortage due to low rainfall. Although thermal power capacity has been doubled since 1996 by the addition of 247MW of thermal energy, it has not been enough to meet the demand during periods of low rainfall. The Government has procured several generators on short-term basis to meet the crisis. In addition, many large industrial and commercial organizations have standby generators, which are being used under a CEB subsidy program. The Government has requested the public to consume power sparingly and has imposed a 25 percent surcharge on those who are unable to reduce consumption by 20 percent. A 60MW barge mounted power plant is to be connected to the national grid in July relieving pressure on the power supply.

The CEB has recently signed a few contracts to procure additional generation capacity including two combined cycle power plants of 160MW each and a 70MW hydro power plant. The CEB also has tentative plans to build a 300 MW coal-fired power project. There is considerable anguish in power circles in the country as tendering for this 300 MW coal power plant, required under the long term generation plan, has been delayed due to environmental concerns. CEB sources say if this plant is not procured soon, the country could face a severe power shortage in 2004. According to the CEB, Sri Lanka will need to add 1,500 MW of new generating capacity between 2000-2010; during the same period, the CEB hopes to achieve a hydro:thermal balance of 1:2. Environmental groups and nearby residents often object to and actively demonstrate against both hydro projects and thermal projects.

The telecommunications infrastructure has been expanded and modernized recently, due to increased private sector participation. There is one fixed line operator, Sri Lanka Telecom (SLT), and two wireless local loop operators. As of January 1, 2000 there were 580,200 subscribers and another 236,250 on the waiting list of the partly state-owned SLT. Each wireless loop service provider is expected to add 100,000 new lines by the end of 2000. As of January 1, 2000, 91,700 subscribers were connected to these services. In addition, four private companies provide 256,665 mobile phone connections. Private operators also provide radio paging, data communication, Internet service and satellite link-ups. Private operators continue to expand and upgrade their services.

The August 1997 sale of a 35 percent stake in SLT to NTT of Japan created a "strategic partnership." Since then, SLT has been vigorously pursuing an expansion plan with some of the projects being funded by the JBIC. SLT also raised a $60 million syndicated loan facility locally in December 1998 to meet expansion costs. The privatization agreement included a provision to extend SLT's monopoly control over all the main international switches until 2002. This represents a backtracking by the Government on an earlier WTO commitment to eliminate the monopoly by 2000 and affects the competitiveness of other operators in the sector.

The expansion in the telecommunications sector has provided impetus for the growth of information technology and for the development of Internet, email and e-commerce. In addition, computerized integrated banking services are provided in major towns and being expanded even to some rural areas.

Regional economic integration: Sri Lanka is a member of the South Asia Association for Regional Cooperation (SAARC); Bangkok Agreement; Bangladesh, India, Myanmar, Sri Lanka, Thailand- Economic Cooperation (BIMST-EC) and Indian Ocean Rim Association for Regional Cooperation (IOR-ARC).

In March 2000, India and Sri Lanka finalized a free trade agreement, which provides for duty free entry as well as duty preferences for goods manufactured in the two countries. The agreement is now in operation. India has provided duty free access to over 1,300 Sri Lankan products. In turn, Sri Lanka has granted duty free access to about 300 items from India. India has agreed to phase out its tariffs on a large number of other items within a period of three years. Sri Lanka will also phase out tariffs for Indian imports within a period of eight years.

Chapter III

POLITICAL ENVIRONMENT

Nature of the Bilateral Relationship with the United States

The United States and Sri Lanka enjoy good relations. The two countries celebrated 50 years of diplomatic relations in April 1998, following Sri Lanka's marking of 50 years of independence in February 1998. The Government of Sri Lanka is currently fighting Liberation Tigers of Tamil Eelam (LTTE) insurgents, who seek to create a separate state in the North and East. The U.S. Government supports the territorial integrity of Sri Lanka and has called for a peaceful resolution of the conflict which protects the interests and dignity of all communities. The conflict is likely to drag on until the LTTE abandons its demand for a fully independent state, which it thus far shows no sign of doing.

In October 1997, the State Department formally designated the LTTE as a foreign terrorist organization (FTO), along with 29 other terrorist organizations around the world. This move was welcomed by the Government of Sri Lanka. The LTTE was re-designated an FTO in October 1999.

The U.S. Government maintains low-level military exchange, exercise and education programs with Sri Lanka similar to programs conducted in 40 other countries in the region. The U.S. military is not operationally involved in the ongoing conflict, and any training with U.S. forces takes place well away from operational areas.

The U.S. Government has increasingly become involved in commercial disputes on behalf of U.S. companies experiencing difficulties with Sri Lankan Government tenders and projects, and these have placed some strain on the bilateral relationship.

USAID partners with government, business and civil society to work towards broad-based participation in sustainable development. USAID's current program will sharpen business competitiveness in global markets and extend its program affecting trade and investment. USAID also supports protection of human rights and the ability of the judiciary to resolve complaints effectively and efficiently. In addition, its programs provide humanitarian assistance to children and families most affected by the conflict and related violence, to help them return to a normal life.

Major Political Issues Affecting the Business Climate

The most serious political issue affecting the investment climate is the ongoing armed conflict. From late 1999 though mid 2000, fighting in the North, particularly around Jaffna, intensified. This conflict has its roots in long-standing ethnic tensions between the majority Sinhalese (70-plus percent of the population) and minority Tamil (approximately 18 percent) communities (in addition, the Muslim community comprises more than seven percent of the population). It has brought direct military confrontation and sometimes heavy fighting to the island's Northern and Eastern provinces and has led to terrorist attacks elsewhere. The January 1996 destruction of the Central Bank and surrounding buildings in Colombo's financial district, the October 1997 bombing of the World Trade Center and adjacent five-star hotels in the same vicinity and the January 1998 attack on the country's pre-eminent Buddhist shrine in Kandy, the Temple of the Tooth Relic, were particularly hard blows to investor (and tourist) confidence. In June 2000, the LTTE assassinated through suicide bombing the Industrial Development Minister and more than 20 others in a southern suburb of Colombo. So far, foreigners have not been targeted in any LTTE attacks, but several have been seriously injured. For expat business persons working in Colombo and elsewhere, the primary security concern is being in the wrong place at the wrong time.

Outside the armed conflict, business people remain concerned about lethargy and indecisiveness in the bureaucracy, the politicization of major government projects and deals, inadequate maintenance and upgrading of infrastructure, corruption, inflexible labor laws on downsizing, and militant trade unions.

Private investment, which was slowly improving in 1997, is suffering again due to the Asian financial crisis and the Indo-Pak nuclear detonations of May 1998. The Colombo Stock Exchange also continues to face declines due to slumps in foreign investor confidence. Although the Government is committed to greater private sector role in the economy, there is still some resistance -- mainly from socialist and communist-oriented politicians, including some who are part of the governing coalition -- which must be addressed with stronger leadership and management. Long-term growth and stability will require effective public administration and implementation of reforms and policy commitments.

Political System, Schedule for Elections and Orientation of Major Political Parties

Sri Lanka has been a functioning democracy since gaining independence in 1948. It has an executive presidency and a unicameral parliament. Legislative drafting is generally handled by the executive. Constitutional reform packages under active consideration could replace the executive presidency with a ceremonial position and return the country to a British-Westminster cabinet system of government, and lead to broader powers for parliament and the prime minister. Power in almost all spheres of public life rests with the center, but additional proposals to devolve power to smaller units of regional or local government are also under review.

Elections for all provincial councils, except in the Northern and Eastern conflict areas, were held in the first half of 1999. The governing People's Alliance (PA) coalition won the most votes in each province. A presidential election was held in December 1999 and President Kumaratunga of the PA won re-election with 51% of the votes. Parliamentary elections are due to be held in the autumn of 2000.

The Sri Lanka Freedom Party (SLFP) is the dominant partner in the PA coalition which came to power in late 1994. Traditionally expousing a leftist political and economic philosophy, the SLFP currently endorses free-market policies. As previously noted, implementation of the policy is uneven. Sri Lanka pursues a non-aligned foreign policy, while maintaining strong trade relations with the West.

The United National Party (UNP) is the leading opposition party. During its seventeen years in office (1977-1994), the UNP was a strong advocate of an open economy and was instrumental in building closer economic relations with the West. Like the SLFP, the UNP supports a non-aligned Sri Lanka.

Chapter IV

MARKETING U.S. PRODUCTS AND SERVICES

Distribution and Sales Channels

International trade is centered in Colombo, with more than 90 percent of all imports and exports passing through the port of Colombo. While there are many medium to small importers, 20 to 30 relatively large firms handle the bulk of international traffic. Only a few importers control distribution networks elsewhere in the country; most simply wholesale directly to regional distributors or to retailers. The Government's role in trade and distribution is minimal, except in the case of the food sector, which is controlled for national security reasons. Inland transport is dominated by independent truckers.

Use of Agents/Distributors; Finding a Partner

Most foreign firms select local agents on the basis of financial stability and technical capability. As the largest trading houses represent many (sometimes competing) foreign principals, medium and smaller firms are becoming more attractive. If products require stocking or servicing, however, large firms are often better. Sales commissions paid to agents range from 5 percent to 20 percent, depending on sales volume and the product price. Agency relationships can be terminated for inefficiency, misappropriation or inability to fulfill contractual obligations.

Franchising

Franchising is not as common as agent/distributorships. The few U.S. franchises include Coca Cola, Pepsi, Pizza Hut, UPS, Federal Express, Kentucky Fried Chicken (KFC) and McDonald's.

Direct Marketing

Direct marketing usually takes place when a product is sold on a one-time or irregular basis. Companies with regional branches or representatives have successfully entered the market directly, but an agent is often necessary to penetrate the market.

Joint Ventures/Licensing

Joint ventures have become popular in recent years, particularly in export-oriented projects. Joint ventures are eligible for the same preferences and tax benefits as domestic companies. There are no restrictions on foreign ownership, except for certain specified sectors (see Chapter VII). Only a few foreign companies have licensed products or services to local companies. Two prominent licensing agreements involve Cable News Network of the U.S. (broadcasting services) and Clipsal of Australia (electric switch manufacturing).

Steps to Establishing an Office

A foreign company must apply to register with the Registrar of Companies in order to establish an industry or a branch office in Sri Lanka. The application for registration should be accompanied by a certified copy of the charter, statute or memorandum and articles of association of the company; a certified copy of the incorporation of the company; a list of directors; names and addresses of company directors resident in Sri Lanka; a statement containing the full address of the registered or principal office of the company and principal place of business within Sri Lanka; and, a valid power of attorney authenticated using the seal of the company authorizing the person or persons resident in Sri Lanka to act on behalf of the company. The registration fee is on average about $100; the fee varies according to the amount of issued share capital.

A foreign company may also establish a liaison office in Sri Lanka. In addition to the above certificates, the application for registration should include a written undertaking that the company will not engage in any export, import, trade or investment in Sri Lanka. A liaison office can engage in market promotion activities, extend technical support, and source raw materials and manufactured products.

A branch office must file the statutory company documents (annual accounts, returns to be filed) as well as copies of accounting statements compiled under the company's country of origin. There is also legal provision for a company to be registered as an off shore company, in order to carry on business outside Sri Lanka. For more information contact the Registrar of Companies, "Samagam Medura," 400 D.R. Wijewardane Mawatha, Colombo 10, Phone: 94-1-689212; Fax: 94-1-689211.

Selling Factors and Techniques

Price is generally the most crucial factor in selling. Most Government purchases are made on the basis of cost. Increasingly, however, the quality of the product and after-sales service are becoming important selling factors in the Sri Lankan market. U.S. products are regarded as highquality products here. Advertising and participation in sales promotions and other trade events are often helpful for raising consumer awareness and gaining market share, but effectiveness will vary according to product. Appointing an agent/distributor is recommended to aid in marketing and sales.

Advertising and Trade Promotion

Advertising is becoming increasingly important as new private television and radio stations open and expand operations and programming. There are five radio stations (operating 22 channels) and six TV stations (operating ten channels) as of June 2000; some are run by the state, and others by the private sector. Newspapers, radio and television all accept commercial advertising. There are several English language newspapers, as well as dailies in Sinhala and Tamil (see below).

Trade exhibitions and fairs are limited. The Government sponsors a regular trade event called "Sri Lanka Expo"; The American Chamber of Commerce in Sri Lanka sponsors an American Trade Fair every one and a half years; the most recent fair was held in February 1999. The Embassy Commercial section sponsors catalog exhibitions to promote U.S. products and services.

Major Web Sites

Internet web sites featuring news and business reports on Sri Lanka:
Lanka Academic Network: www.lacnet.org/the_academic/this
Lanka Page: www.lankapage.com
Sri Lanka official webpage: www.lk
The Embassy's own webpage is http://usembassy.state.gov/srilanka

Major English-Language Newspapers

Daily News and Sunday Observer
Associated Newspapers of Ceylon Ltd.- Lake House
Phone: 94-1-421181 Fax 94-1-449069
Internet edition: http://www.lanka.net/lakehouse

The Island and Sunday Island
Upali Newspapers Ltd.
Phone: 94-1-324001 Fax 94-1-448103
E-mail: gaminw@lankacom.net
Internet edition: http://www.upali.lk/island

Daily Mirror and Sunday Times
Wijeya Newspapers Ltd.
Phone: 94-1-441070 Fax 94-1-449504
E-mail: editor@suntimes.is.lk
Internet edition: http://www.is.lk/times/index.html
http://www.ccom.lk/midweekmirror

The Sunday Leader
Leader Publications (Pvt) Ltd.
Phone: 94-74-719968 Fax 94-1-699968
E-mail: leader@lanka.net
Internet edition: http://www.lanka.net/sundayleader

Send queries to the attention of the Advertising Manager.

Major vernacular newspapers include Dinamina, Silumina, Divayina, and Lankadeepa, all in Sinhala; and Thinakaran and Virakesari, in Tamil.

Business Journals

Business Today
TW Network (Private) Limited

Phone: 94-1-503-109 Fax: 94-1-597-990
E-mail: btoday@sri.lanka.net
Internet edition: http://www.b-today.com

Lanka Monthly Digest
Media Services Private Ltd
Phone: 94-1-672-017 Fax: 94-1-672-019 E-mail: lmdmail@sri.lanka.net
Internet edition: http://www.lanka.net/LMD

Advertising Agencies

J Walter Thompson (Pvt) Ltd
Phone: 94-1-580-827 Fax: 94-1-500-710

Grant McCann Erickson
Phone: 94-1-580-971 Fax: 94-1-580-978

Bates Strategic Alliance
Phone: 94-1-588-120 Fax: 94-1-500-175

E-Commerce Related Websites

www.eceycom.com

Pricing Products

Price, which is the most crucial buying factor, should be on par with the prevailing market price. A local agent or distributor can provide helpful suggestions and market intelligence to enable companies to make informed pricing decisions. Some firms have successfully offered special, low introductory prices on consumer products to gain a foothold in the market and develop customer awareness and loyalty.

Sales Service/Customer Support

After-sales service and customer support are becoming increasingly important factors in selling in this market. Local companies with comprehensive support services have proved successful over the years. U.S. firms should consider this factor when appointing an agent.

Selling to the Government

Most Government purchases are made by public tenders, which are usually advertised in the local media. Tender procedures are not fully transparent, and delays are common (see

Chapters II and VII). Well-informed local agents can be the key to winning these tenders. However, local agents often represent more than one foreign supplier, so that when they encounter difficulties, including charges of possible corruption, they are reluctant to voice concerns, fearing it will jeopardize other business interests.

Protecting Your Product from IPR Infringement

All trademarks, designs and patents must be registered with the Registry of Patents and Trademarks. Sri Lanka is a member of the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). Sri Lanka has signed a bilateral agreement with the U.S. to protect intellectual property rights and is a signatory to the Paris and Berne Conventions, but enforcement remains a problem. Registered trademarks are valid for 10 years, patents for 15 years, and industrial designs for 5 years. A comprehensive amendment to the intellectual property rights law in keeping with WTO TRIPS requirements is in the process of being drafted. The section relating to information technology has already been legislated. For more detailed information, see Chapter VII.

Need for a Local Attorney

It is always useful to put agreements made with local partners and agents into writing. In the event any disputes or problems arise, it is helpful to have written records for the purpose of supporting a legal case, if necessary.

The Embassy's Consular section maintains a list of attorneys in Sri Lanka, a copy of which may be obtained on request.

Chapter V

LEADING SECTORS FOR U.S. EXPORTS AND INVESTMENT

Best Prospects for Agricultural Products

(a) Wheat
Rank of sector: 1
Name of sector: Wheat

	1998	1999	2000
		(in $ millions)	
Total Market Size	126	121	124
Local Production	0	0	0
Total Exports	0	0	0
Total Imports	126	121	124
Imports from the U.S.	71	63	70

Note: The above statistics are unofficial estimates.

The Sri Lankan wheat market has remained consistent over the past few years. Flour consumption has remained at a fairly high level, although the flour subsidy has been gradually eliminated. This has been attributed to the convenience of preparation of flour-based products compared to rice which is more time consuming. A Singapore company, Prima Ltd, has been the exclusive millers for the Sri Lankan Government since 1977. Prima has a milling capacity of 3,000 MT per day and is the largest flour mill in the world located in a single factory. The mill produces one type of all-purpose flour from a mixture of 50/50 hard and soft wheat. Due to Prima operating at almost full capacity, negotiations are underway for a joint venture project for a 1000 MT per day flour mill to meet future flour requirements. The U.S. Government donated 50,000 MT of wheat under the U.S. Department of Agriculture's (USDA) 416(B) wheat aid program in 1999. Proceeds from the monetization of this consignment have been allocated for humanitarian projects in Sri Lanka. The Sri Lankan market for wheat is close to $120 million annually. Over the last couple of years the US has been a major player capturing over 50 percent of the market. Competitive pricing together with good harvests enabled US suppliers to dominate wheat exports to Sri Lanka in 1999. The US exported nearly $63 million of wheat to Sri Lanka in 1999. Two consignments of wheat, one with excess dockage above the stipulated levels and the other with protein deficiency were the only two negative aspects of an otherwise fruitful year for US suppliers. The Australian Wheat Board, a major competitor, offered two parcels of US wheat in 1999. This was the first time the Australians tendered for US wheat in Sri Lanka. This year the U.S. Government has indicated that two parcels of wheat totalling 85,000 MT will be made available to Sri Lanka under 416(B) and PL-480 USDA concessionary wheat sales program. Australia and Canada were the other two major suppliers in 1999. Argentina continues to have special conditions imposed for supply of wheat to Sri Lanka due to a record of quality issues and delivery problems. The forecast for the 2nd half of 2000 is promising for US suppliers and US wheat is expected to dominate the market for the rest of the year.

Wheat flour imports were liberalized in February 2000. The import duty on wheat flour is fixed at 10 percent.

(b) Cotton
Rank of sector: 2
Name of sector: Raw Cotton

	1998	1999	2000
		(in $ millions)	
Total Market Size	24	35	30
Local Production	0	0	0
Total Exports	0	0	0
Total Imports	24	0	0
Imports from the U.S.	2	1.4	2

Note: The above statistics are unofficial estimates.

Total cotton imports to Sri Lanka were $35 million in 1999. US cotton exports to Sri Lanka declined to $1.4 million. The local textile fabric industry continues to face problems for many reasons. The removal of tariffs on textile imports has been proffered as the main reason for the decline in the industry. This decision to lift tariffs was to boost the export garment industry, which will face stiff competition when the MFA quota system is phased out in 2005. Low productivity, lack of up-to-date technology and labor problems are some of the other contributing factors for the dismal performance in the textile industry. There are very few local textile producers who have survived in the past few years. The USDA-sponsored GSM 102 program for cotton exports are available to Sri Lankan companies. However, local banks have not passed down the full benefits of the concessionary credit under this program thus not making the program attractive to cotton buyers in Sri Lanka. Pakistan, South Africa and Hong Kong continue to be the major competitor for US cotton exports to Sri Lanka.

(c) Fresh Fruits
Rank of sector: 3
Name of sector: Fruit & Nuts

	1998	1999	2000
		(in $ millions)	
Total Market Size	na	na	na
Local Production	na	na	na
Total Exports	na	na	na
Total Imports	25	10	14
Imports from the U.S.	1.8	2	3.5

Note: The above statistics are unofficial estimates.

The Sri Lankan market for fruit and nuts continues to grow, with consumers being educated on the health benefits of fruit consumption. Although most of the fruits consumed in Sri Lanka are domestically produced, there is an increasing variety of imported fruits being sought by certain segments of the population. Apples and oranges enjoy a wide acceptance from most consumer segments while grapes, cherries and dried fruits are consumed by more up market and sophisticated consumer groups. The US market share increased slightly from $1.8 million in 1998 to $2 million in 1999. US suppliers are expected to consolidate market share in 2000. Export sales of fruits and nuts in excess of $2.5 million is forecasted for 2000. Although initially the market for imported fruits was limited to the big cities, gradually it has been extending to towns in rural areas. Australia, Pakistan and India are the other major suppliers of fruits to the local market. Sri Lanka exported $6 million of fresh fruit in 1999. Pineapples were the major export item while mangoes, papaya and avocado were exported in relatively small quantities to the Middle East, Europe and the Maldives.

Best Prospects for Non-Agricultural Products

(a) Telecommunications Equipment

Rank of sector: 1
Name of sector: Telecommunications equipment

	1998	1999	2000
		(in $ millions)	
Total Market Size	118	100	115
Local Production	0	0	0
Total Exports	0	0	0
Total Imports	118	100	115
Imports from the U.S.	13	9	12

Note: The above statistics are unofficial estimates.

The telecommunications sector has seen rapid expansion and has provided a sophisticated level of service in recent years. The expansion of the sector gained momentum after the privatization of Sri Lanka Telecom Ltd. (SLT) in 1997. The growth and development of the telecommunications sector has provided an impetus for economic activity with the availability of Internet, e-mail, e-finance, e-commerce and other sophisticated products which play an important role in global commercial activity. SLT fixed lines and wireless telephones recorded almost a 100 percent increase from 1997-1999. Cellular phones also doubled within the same period. SLT invested $200 million in 1999, an increase of 30 percent from the previous year. SLT is presently implementing a number of major telecommunications infrastructure development projects. The private sector involvement in telecommunication services also recorded an increase in growth. The supply of cellular telephone services, payphones, paging services, data communication services and wireless local loop telephone services are dominated by the private sector. The number of private operators providing different telecommunication services increased from 26 in 1998 to 32 in 1999. Private telecommunication services increased by 40 percent in 1999. The total investment in the private telecommunications sector was $123 million.

(b) Power and Energy
Rank of sector: 2
Name of sector: Electrical Power Systems and Energy Conservation Technology

Sri Lanka by its own estimates needs to add an additional 1500 MW of generating capacity between 2000-2010. Since the country's hydro power potential is nearly exhausted and is highly vulnerable to poor rainfall, the Government has no option but to develop thermal power plants. There is also potential for wind and solar energy given the desire to cut fuel imports. Both these sectors are open to foreign participation. Opportunities exist for U.S. firms to supply combined-cycle, conventional oil, and possibly coal fired plants (see below: major projects). Given excess demand and rising energy prices, there are also opportunities for the sale of conservation technology.

(c) Electrical Machinery
Rank of sector: 3
Name of sector: Electronics and Electrical Machinery

	1998	1999	2000
		(in $ millions)	
Total Market Size	390	270	300
Local Production	0	0	0
Total Exports	0	0	0
Total Imports	390	270	300
Imports from the U.S.	45	25	30

Note: The above statistics are unofficial estimates.

In 1999, total electrical machinery and equipment imported to Sri Lanka was $270 million. The U.S. exported $25 million worth of electrical equipment to Sri Lanka. Recently, Sri Lanka has been flooded with many foreign brands of electrical equipment. Many Asian products as well as European brands are being represented in the local market. The increasing reliance on all types of consumer electrical products by the local consumer has seen a surge in demand for electronic equipment. The electrical home appliance market has also developed rapidly over the last few years and most urban households possess basic home appliances. Japanese and other Asian products dominate the market in the home appliance market. Static converters, inductors and parts also continue to offer good potential within this sector for US exporters, who in 1999 remained one of the major suppliers. The construction sector has also grown in spite of the slowdown in the economy with many condominium projects being developed in Colombo. There is potential to supply electronic equipment for these projects. Imports of boards, panels, consoles and related equipment for the industrial manufacturing sector have continued to grow steadily and offer good prospects to US exporters. The future expansion of this sector will require technological sophistication, which presents technically-advanced US suppliers with good opportunities in the medium/long term. The major suppliers in the electrical machinery and equipment market in Sri Lanka are Japan, UK, South Korea, Singapore and Taiwan.

(d) Machinery/Mechanical Appliances
Rank of sector: 4
Name of sector: Machinery/Mechanical Appliances

	1998	1999	2000
		(in $ millions)	
Total Market Size	490	430	440
Local Production	0	0	0
Total Exports	0	0	0
Total Imports	490	430	440
Imports from the U.S.	17	21	23

Note: The above statistics are unofficial estimates.

Total machinery and equipment imports to Sri Lanka were $680 million. US exports of machinery and mechanical appliances to Sri Lanka from $17 million in 1998 to $21 million in 1999. An incentive scheme offered by the Government in 1996 to encourage the use of sophisticated technology to increase productivity was extended. Under this scheme new enterprises investing over $50,000 and existing industries investing over $15,000 are entitled for duty free imports of machinery and equipment. Machinery worth $128 million was imported by over 300 projects under this scheme. Furthermore, a new master plan for industrialization and investment promotion has identified seven sectors for development. These sectors include agro-based industry, apparel industry, leather and footwear, rubber and plastic processing, machinery industry, electric/electronic industry and information technology industry. They offer good scope to develop market potential for US technology and equipment. Special incentives have also been offered to sectors identified as 'thrust' industries in order to diversify and expand industrial and export bases. These industries include electronics and electronic components, ceramics and glassware, rubber and rubber-based industries, light and heavy engineering, cutting and polishing of gems, diamonds and manufacture of jewelry. Industries in these sectors are eligible to import machinery and equipment duty free. The main suppliers for machinery and mechanical appliances are India, Taiwan, Japan and the European Union.

(e) Textile Fabrics
Rank of sector: 5
Name of sector: Textile Fabrics

	1998	1999	2000
		(in $ millions)	
Total Market Size	1400	1300	1300
Local Production	17	15	16
Total Exports	Na	Na	Na
Total Imports	1400	1300	130
Imports from the U.S.	18	15	17

Note: The above statistics are unofficial estimates.

The garment and textile exports accounted for over 50 percent of total exports in 1999 and continued to be the most productive export earner. The U.S. remained the major buyer of Sri Lankan apparel exports, the total value of which increased by 6 percent in 1999. The country relies heavily on fabric imports to meet the demand of garment manufacturers. Sri Lanka imports over $1 billion worth of fabric annually. US suppliers accounted for approximately $15 million of textile exports to Sri Lanka in 1999. Sri Lankan garment manufacturers often depend on foreign buyers for designs, which result in the buyers' specifying the type of fabric to be used in manufacturing. As a result, buyers often nominate the type and country of origin of the fabric. The removal of tariffs on textile imports has opened up the Sri Lankan market for high quality fabric with South East Asian and European companies vying for a share of the textile market. Good quality US fabric has immense potential for the garment manufacturing sector, provided adequate planning is done to forecast proper lead times for shipping. Hong Kong, South Korea, Taiwan, and India are the other major exporters of textile fabric to Sri Lanka.

(f) Medical Equipment
Rank of sector: 5
Name of sector: Medical equipment

	1998	1999	2000
		(in $ millions)	
Total Market Size	28	24	26
Local Production	0	0	0
Total Exports	0	0	0
Total Imports	28	24	26
Imports from the U.S.	7	5	6

Note: The above statistics are unofficial estimates.

The medical equipment market is dominated by imports and both the Government and private sector hospitals are dependent on imports to meet their requirements. Total government expenditure in the health sector was Rs.15,671 million in 1999, an increase of 9 percent over the previous year. Capital investment (buildings and equipment) in the health sector was Rs. 4,456 million. Government hospitals provide free medical services. Most rural areas of the country are mainly served by Government hospitals. Private sector investment in the health sector has increased due to attractive incentives offered by the Government. There are 17 new private hospitals approved by the Board of Investment of Sri Lanka by end of 1999. One hospital has already commenced operations while construction work of two others are in progress. The demand for private sector health care has increased rapidly despite availability of free medical care, with almost 50 percent of curative health care needs being met by the private sector in 1999. The Ministry of health does the purchases for Government hospitals. Government purchasing decisions for recurring expenditure is normally price sensitive. However purchasing of sophisticated medical equipment is carefully reviewed before purchasing decisions are made. Japan continues to be the major supplier to the market. Diagnostic equipment, operating theater equipment, intensive care equipment, clinical analyzers and hematology equipment continue to offer the best sales prospects for US firms.

(g) Paper and Paper Products
Rank of sector: 6
Name of sector: Paper products

	1998	1999	2000
		(in $ millions)	
Total Market Size	244	238	250
Local Production	79	78	100
Total Exports	0	0	0
Total Imports	165	160	170

Imports from the U.S.	5.5	4.3	5

Note: The above statistics are unofficial estimates.

The paper and paper product industry declined marginally in 1999 due to a drop in the manufacture of corrugated cartons and printing materials. The paper product market catering to the domestic market increased by 5 percent with increased demand for newspapers, magazines, children's books and maps, computer paper, diaries, posters and calendars. The National Paper Company experienced difficulties in 1999 due to greater competition from imports, high cost of production and relatively poor quality final product arising from outdated production processes. Local production of paper and pulp is limited. Almost the entire requirement of paper and pulp is imported with around 15 percent domestically produced. The US share of this market is about 5 percent, with regional countries dominating exports to Sri Lanka.

(h) Textile Machinery
Rank of sector: 7
Name of sector: Textile Machinery

	1998	1999	2000
		(in $ millions)	
Total Market Size	31	28	30
Local Production	0	0	0
Total Exports	0	0	0
Total Imports	31	28	30
Imports from the U.S.	1.2	1	1.2

Note: The above statistics are unofficial estimates.

The Sri Lankan apparel industry is the largest industrial sector in the country and registered an 8 percent increase in volume growth. The garment industry contributed 63 percent to industrial sector growth in 1999. Sri Lanka will continue to face increased competition due to opening up of economies in Eastern Europe, more exports from new entrants to the market, phasing out of the Multi Fibre Agreement and growing preferential trade in the world. Stiff competition for the US market can be expected particularly from countries such as Mexico due to geographical proximity, lower labor costs and duty advantages under NAFTA. The lower end of the market is also being heavily saturated with new entrants posing serious threat in this segment. Since it will be necessary for Sri Lanka to move away from the traditional quota items and capture niche markets in the U.S., the industry will have to acquire new technology, modern garment manufacturing equipment and improve information technology to stay competitive in the world market. This presents US suppliers and service providers a good opportunity to explore market potential in this sector.

(i) Environment Services & Equipment
Rank of sector: 8

Name of Sector: Pollution Control Technology
Statistics/estimates not available

The importance of the environmental preservation while promoting sustainable economic growth in agricultural and industrial sectors is recognized in Sri Lanka. Solid waste disposal and air pollution are the two major environmental problems in urban areas. The Central Environmental Authority (CEA) and the industry associations are working together to introduce and implement better environmental management systems. All new industries are required to obtain a CEA license prior to commencing operations and to conduct Environmental Impact Assessment (EIA) if needed. There are proposals to relocate existing high polluting industries in industrial parks, where effluents and emission could be treated in a systematic manner. Increasing public pressures, signs of environmental deterioration of natural resources, and export market demand for products manufactured under strict environmental standards require authorities to improve environmental practices.

Many Sri Lankan companies in the environment technology business are interested in US products and services. US environmental products have a good reputation in Sri Lanka. There will be opportunities for US companies to participate in Government projects in waste management, air quality and water purification. In areas where Government funding is limited, US companies are encouraged to propose technological solutions combined with financial terms such as BOO/BOT. The USAID-funded United States-Asia Environmental Partnership (US-AEP) program office in Colombo is actively promoting US environmental products and services in Sri Lanka. The contact is usaep@sri.lanka.net and the fax number is 94-1-472850.

Solid Waste Management: Greater Colombo area municipalities are generating about 1000 MT/day municipal solid waste. They are looking for technological and financial solutions. Business opportunities exist for US companies to introduce presorting and high rate composting technologies to process organically rich municipal solid waste. There are small municipalities generating between 10-100 MT/day solid waste also looking for solutions. Often times medical waste is being disposed along with municipal solid waste and cities are looking for better ways of disinfecting and disposing. Hazardous waste disposal is a new area in Sri Lanka.

Environmental Monitoring and pollution control systems: The demand for pollution control equipment such as wastewater treatment systems, sewage treatment mechanisms, industrial stack emission controls and energy efficient systems is also expected to increase. Potential exist for monitoring equipment for industrial effluents, surface and ground water quality and industrial and mobile air emissions.

Upcoming Major Projects

Ports: Sri Lanka is an island nation in the Indian Ocean on the major sea routes between East and West. It has three commercial ports, the largest being the port of Colombo. The Port currently operates at its maximum capacity of 1.7 million twenty-foot equivalent container units (TEU's). It is heavily dependent on transshipment cargo. As a result, it currently faces tough competition from new regional ports. However, major expansion work of the existing Queen Elizabeth Quay (QEQ) is underway on a BOT basis with private sector financing. QEQ is being developed by South Asia Gateways (SAGT), a joint venture between P&O Netherlands and local conglomerate John Keells Holdings Ltd. In addition, the Ministry of Ports proposes to develop the north pier area of the Colombo Port, which is currently serving as an oil jetty, into a multipurpose terminal with facilities to handle break-bulk, bulk and containerized cargo. A feasibility study is underway for the development of the north pier. The Government has also been trying to develop the southern port of Galle since 1994. In the past few years, the Government commissioned several studies, but did not proceed with any of them. In 1999, the Government started to develop a small area of the Galle port. The project will increase break bulk and container capacity of the port. In February 2000, the Government commissioned a feasibility study to draw a master plan for the comprehensive development of the Galle Port as a regional port.

Power: Sri Lanka's installed electrical capacity of 1,680MW consists of 1,137 MW of hydropower and 543MW of thermal power. Sri Lanka's energy policy has come under sharp criticism in recent years, as droughts underscored Sri Lanka's heavy reliance on hydropower. As of June 2000, the country is on a brink of a severe power shortage due to low rainfall and slow addition of thermal power. The Government has recently finalized agreements to procure several plants to boost generation capacity through 2002. The plants include a 60MW barge-mounted power plant (to be commissioned in July 2000); two 160 MW combined cycle plants (2001-2002); and two small 20 MW thermal plants (2001). Some of the thermal plants are being built by the private sector on BOO or BOOT basis, including by the U.S.-based AES Corporation. In addition a 70 MW hydro power plant is being built with Japanese funding.

Sri Lanka's electricity demand has been growing at around 8 percent the last few years. According to the Ceylon Electricity Board, Sri Lanka will need to add about 1500MW of new generating capacity between 2000-2010. Sri Lankan authorities plan to shift the country's electric power system from a predominantly hydro base to a thermal base during this period. Government policy has traditionally favored CEB ownership and control of hydropower generation. Due to resource constraints, the Government has recently begun to solicit foreign investment to develop thermal generation capacity. The CEB's long term generation plan (LTGP) includes the addition of a combined cycle power plant of 150MW (in 2003) and a coal-fired power plant with an initial capacity of 300 MW (in 2004). The second and third stages of the coal power project will add 300 MW each for a total capacity of 900MW within a ten-year period. JBIC has expressed willingness to fund the first stage of the coal project while the combined-cycle project is likely to offered to the private sector. The CEB also has plans to develop a 150 MW hydropower project (Kotmale power project), perhaps the last medium/large hydropower plant that could be built in Sri Lanka. According to the LTGP, the hydro power plant is scheduled to come on stream in 2006/2007. However, the coal power project and the Kotmale hydropower project have been delayed for years due to opposition from environmentalists and religious groups. The delays may force the CEB to procure barge-mounted power plants in the future as well.

(A cautionary note: The GSL regrettably lacks a comprehensive, cooperative framework for project evaluation, approval and implementation by the different agencies involved--as a result, power policy tends to be ad hoc, heavily politicized, and subject to sudden reversals.)

Airports: There are several development projects underway to expand the Bandaranaike International airport, Sri Lanka's only international airport, located at Katunayake in the outskirts of Colombo. The capacity of the airport is currently limited to 3 million passengers and 110,000 MT of cargo. The parking apron has a capacity to accommodate a mix of 17 wide/narrow body aircraft. Phase I of an expansion project is now underway. It involves limited improvements to the airport facilities such as a new duty free shopping complex, additional aircraft parking facility, a new cargo terminal with a capacity of 50,000 MT and upgrading of radar management systems. After prolonged delays, the Government has recently launched a $100 million Phase II expansion project with JBIC financing. The project will involve increasing the passenger handling capacity by one million passengers and the cargo handling capacity by 100,000 MT, expansion of the aircraft parking apron and improvements to air navigation systems. JBIC is presently carrying out detailed designs, which are to be completed by the end of 2000. Construction will begin towards the end of 2001. The project will be open for international competitive bidding. Pre-qualification of contractors is scheduled to begin in the fourth quarter of 2000.

Roads: Inland transportation is dominated by road, but the system has hardly changed since independence, 50 years ago. The Government has plans to develop five new highways: (a) new 130 kilometer highway from Colombo to the southern city of Matara, funded by the JBIC and the ADB. Detailed design studies are currently underway. Pre-qualification of contractors for the ADB-funded section began in the summer of 2000; (b) A four-lane expressway linking Colombo to the international airport in Katunayake. The expressway will be approximately 25 kilometers in length, with four interchanges, several over-passes and underpasses and user fee levying facilities. The GSL has recently selected civil construction contractors for the project; (c) A new Colombo-Kandy road; (d) A Colombo outer circular road; and (e) A Katunayake-Padeniya-Anuradhapura Road. There will be opportunities for construction contracts, supply of raw material and machinery required for construction.

Dam Safety Project: Sri Lanka's largest irrigation/hydro power network is located along the Mahaweli River in the central highlands of Sri Lanka. This region has recently experienced several earth tremors, which raised serious concerns about the ability of the dams to withstand such tremors. The Mahaweli Authority of Sri Lanka (MASL), recently initiated a "Dam Safety and Conservation Project" to safeguard the structural integrity of these dams and related structures to mitigate adverse consequences in an unforeseen natural disaster. The proposed project aims to upgrade the present operation, maintenance and monitoring systems of the dam network. The World Bank has already made funds available for a technical study. After the completion of the feasibility study, the project is scheduled to begin in 2001. The MASL anticipates the implementation of this project to require following equipment and technical assistance: modern seismography equipment; dam monitoring equipment; electromechanical equipment; and flood warning, public address, alarm, high tech communication and security systems. The project is likely to be funded by the World Bank.

Chapter VI

TRADE REGULATIONS AND STANDARDS

Tariff and Non-Tariff Barriers

Sri Lanka has a largely two-band import tariff schedule based on the Harmonized System of Classification. The two bands are 10 and 25 percent. Most agricultural and food products, consumer goods, chemicals and other intermediate goods manufactured locally are subject to a 25-percent tariff. Parts and components used in local industry and raw materials are subject to a 10-percent tariff. Ready-made garments are also subjected to a 10-percent tariff. There are a few exceptions to the two band tariff structure: Some raw materials and machinery and equipment are subject to a 5-percent tariff. A few selected agricultural products such as rice, chilies, onions and potatoes are at 35 percent. All imports of textile materials, yarn, and all related intermediate and capital goods required for the garment export industry are free of import duty. In addition, imports of gold, gems, computers and related equipment, software, telecommunications equipment, sports equipment, medical and dental equipment, agricultural seeds and a range of machinery and equipment needed for agriculture and fisheries industry are also duty-free.

Motor cars are subject to a 25 percent import tariff. There is an additional excise duty which is currently set at 15 percent for petrol cars and 65 percent for diesel cars. Vehicle imports for most export-oriented industries either qualify for duty-free entry or are entitled to duty rebates at the start of the venture. Tobacco, cigarettes and liquor do not come under the two-band rate structure. Sri Lanka has bound most agricultural tariffs and a few other non-agricultural tariffs at 50 percent under the World Trade Organization (WTO). Although most items are already subject to duties below the bound rates, the GSL has not honored its WTO commitments on liquor and cigarettes, which remain subject to excessively high duties. As a result, the cigarette market remains effectively closed to significant import competition.

Other taxes include a 6.5 percent national security levy (0.5 percent for machinery and equipment), a 12.5 percent Goods and Services Tax (GST) which is a value-added tax and an excise tax on cigarettes, liquor, petrol and motor vehicles. All taxes are also charged on locally manufactured goods.

Goods and Services Tax

A value-added tax called the "Goods and Services Tax" (GST) with an input tax credit mechanism was implemented in Sri Lanka on April 1, 1998. The GST is applicable on most goods and services imported, produced or sold locally. The GST has two rates: a standard 12.5% for most goods and services and a zero rate for a limited number of goods and services. A range of essential goods such as certain food items and petroleum products, public transport services and health care are completely exempt from GST. Goods and services supplied to diplomatic missions have been granted GST exemptions only on a case-by-case, negotiated basis. Importers and distributors, manufacturers and service centers are liable for GST. All exports from Sri Lanka, and passenger and cargo airline services and shipping services are zero-rated. No GST is payable on zero-rated goods and services but suppliers of zero-rated products may be able to recover GST paid on inputs used. Suppliers of GST-exempted goods cannot recover any of the GST applied on their own expenses. Suppliers of standard rate goods and services have to charge GST on sales to customers, who in turn will be able to deduct the amount of tax from the amount they collect and owe to the Government, if such supplies are used in their businesses. Customers who consume goods and services for non-business purposes cannot claim the deduction. GST is not due on raw material imports to businesses located within free trade zones.

When goods are imported to Sri Lanka, GST is payable at the same rate as on a supply of those goods in Sri Lanka. GST must be paid at the point of import. Exporters (who were exempted from turnover tax on imports and exports) are required to pay GST on inputs (both imported and locally obtained) but are eligible to receive a refund. In the case of imported inputs, GST must be paid within 30 days of import. GST refunds are granted only after exporters submit proof that the goods made from the inputs were exported, and processing time is at least one month. Exporters have complained that this system creates cash flow problems and is cumbersome and time consuming.

The GST is the biggest revenue earner for the government. However, the current 12.5 percent GST rate is well below the revenue neutral tax rate of around 17 percent, which is a major cause for concern. GST collections fell below targets in 1998 and 1999.

Customs Valuations

Most import duty rates are ad valorem, calculated on the CIF value. GST on imports is also calculated on the CIF value plus import duty. The national security levy on imports is determined after the CIF value, plus import duties, have been marked up by an additional 25 percent to reflect the approximate market price. Given the high effective level of taxation on many imported goods, smuggling is, not surprisingly, a serious problem for products such as cigarettes.

If an item is sent abroad for repair, at the time it is "exported" the shipper should submit a reimportation form to the Customs Department to enable the repaired item to be reimported free of duty. However, if the cost of repair exceeds 50 percent of the item’s value, an import duty will be charged.

Import Licenses and Import Controls

Over the years the Government has liberalized most license controls. Import licensing on potatoes, onions and chilies was removed in July 1996. Imports of wheat, a major food commodity import, are controlled by the state-owned Cooperative Wholesale Establishment (CWE). Only a few other items remain under license control, mostly for health and national security reasons. The import of drugs is subject to the approval of the Drugs and Cosmetic Devices Committee of the Ministry of Health. Similarly, the import of firearms and ammunition for use by the armed forces and police, as well as for civil security, is controlled by the Ministry of Defense. There are additional restrictions on the import of toxic and hazardous chemicals and pesticides. In 1996, used and reconditioned air conditioners and refrigerators came under license control for environmental protection. Remote-controlled toys are under license control for public security reasons.

As of June 2000, the Ministry of Health was in the planning stages to introduce a ban on the import of Genetically Modified (GM) food products. The proposed list of banned items would include, among others, GM soya bean products except for soya bean oil, corn and corn products, tomato and tomato products, cheese, potatoes, yeast, and micro-biological starter cultures. If the ban comes into effect, all imports of items in the banned list would be required to be accompanied by a certificate to state they do not contain GM organisms. This possible ban is still very much in the planning stages.

Export Controls

There are no export controls other than on the following four categories of exports: coral chunk and shells; wood and articles of wood; ivory; and antiques over 50 years old including antique motor vehicles. These exports are controlled for reasons of environmental protection and preservation of antiquities.

Import/Export Documentation

International trade can be conducted on letters of credit (LC), Documents against Payment (DP) or Documents against Acceptance (DA) terms or Advance Payment terms. Goods can also be imported to Sri Lanka on a consignment account basis, where the goods imported are books and periodicals or ornamental fish imported for re-export. LCs are valid for up to 180 days. Under DA terms, the supplier is expected to give credit for a maximum of ninety days. Trade on Advance Payment terms is allowed where the total value of the goods does not exceed $7,500. Payments for imports made on Advance Payment basis can be made through either bank draft, mail transfer or telegraphic transfer.

Import/export documentation required by commercial banks for imports includes an invoice, insurance certificate and bill of lading/airway bill. Depending on the product and the mode of payment, certificates such as certificates of origin, inspection certificates and packing lists may also be required. Shipments by air cargo require the same documentation as those arriving by sea. All shipping documents in relation to imports made on LC, DP or DA terms should be forwarded by supplier's bank or by the supplier to a commercial bank in Sri Lanka for release to the importer of goods. In the event the original documents are not received on time, the importer, at the discretion of the bank, may submit copies of those documents for certification by the bank for clearance of the goods and the importer should arrange the original shipping documents to be received by the bank concerned within 30 days from the date of certification of the copies.

To clear goods from customs, the importer should submit relevant shipping documents certified by a commercial bank and customs declaration forms to the Sri Lanka Department of Customs. In the case of an import made on AP basis, goods will be released on submission of satisfactory proof of payment such as bank memos. Goods for which advance payment has been made should be received by the importer within 30 days of effecting the remittance. In the case of an import made on consignment account basis, goods will be released by customs on the submission of clearance documents and the importer should make arrangements for remittances to be made within 60 days of clearing goods.

Temporary Entry

Temporary entry for exhibition material is allowed under the Carnet system of the International Chamber of Commerce. The exporter should ensure that required documents under the Carnet system are certified in the country of origin of the material. These documents should be presented at the time the goods are clearing Customs. Goods brought into the country under the Carnet system must be re-exported within six months. For additional information, contact the approving authority: Director of Customs, Times Building, Colombo 1, telephone 94-1-421141~9, fax 94-1-446364. Any products subject to import controls (as described above) also require approval from the relevant Government authority.

Labeling and Marking Requirements

All labeling of packages should be in large bold lettering in indelible ink or paint. For container cargo, the weight, center of gravity, and sling or grab points may be marked to encourage careful handling. Goods shipped to Sri Lanka should be well-packed in order to withstand heat, humidity, rough handling and pilferage. Shipping marks should show consignee order number and port of entry.

Prohibited Imports

Imports of illegal drugs are prohibited.

Standards

The Sri Lanka Standards Institute (SLSI) sets product standards. There are over 1200 standards relating to manufactured products, agricultural commodities, industrial raw materials, and production processes; however, only about 70 of them (mainly on building materials, household electrical items, food and consumer products) are mandatory. Sri Lanka has already adopted ISO 9000 series standards (ISO 9000 to ISO 9004) on quality management and assurance and ISO 10011 standards on quality management audits. SLSI has certified 80 companies so far, and foreign standard institutions, including the British Standard Institution, have certified approximately 70 other companies. The SLSI has recently introduced the ISO 14000 series on environmental management systems.

Free Trade Zones/Warehouses

Sri Lanka has six free trade zones, also called export processing zones, which are administered by the BOI. The oldest of them, the Katunayake and Biyagama Zones, located north of Colombo near the Bandaranaike International Airport, are fully occupied; in fact, labor shortages have been reported by some companies located in these zones. The third zone is located at Koggala on the southern coast. Three new mini Export Processing Zones were opened in 1997-1999. They are located North-East of Colombo in Mirigama, Malwatte and Wathupitiwala. There are nearly 200 foreign export processing enterprises operating in the six export processing zones. In addition there are three industrial parks which have both export-oriented and non export-oriented factories. They are located in Pallekelle, near Kandy in Central Sri Lanka, in Seethawaka in Avissawela about 60 kilometers from Colombo and in Hambantota in the deep south. In addition, several other export processing zones and industrial estates are being developed. The BOI now actively encourages the setting up of export-oriented factories in the newly developed industrial zones. BOI finds it easier to provide infrastructure facilities and security, as well as monitor enterprises, when they are located in the zones.

The Sri Lanka Ports Authority (SLPA) operates a bonded warehouse at the port of Colombo for transit shipments. Importers can either use SLPA's bonded warehouse or establish their own bonded warehouse outside the port. SLPA's warehouse can be used for a maximum period of six months. For further information about the SLPA's warehouse facility contact the Commercial Manager of SLPA at: Commissariat Street, Colombo 1, telephone and fax 94-1-431648. The licensing authority for establishing a company-owned warehouse is the Director of Customs, Times Building, Colombo 1, telephone: 94-1-421141~49, Fax: 94-1-446364.

Membership in Free Trade Arrangements

In March 2000, India and Sri Lanka finalized a free trade agreement (Indo-Sri Lanka Free Trade Agreement), which provides for duty-free entry as well as duty preferences for goods manufactured in the two countries. India has provided duty free access to over 1,300 Sri Lankan products. In turn, Sri Lanka has granted duty free access to about 300 items from India. India has agreed to phase out its tariffs on a large number of other items within a period of three years. Sri Lanka will also phase out tariffs for Indian imports within a period of eight years. Foreign investors in Sri Lanka can enjoy preferential access to the Indian market, under the Indo-Lanka Free Trade Agreement. Domestic value addition of 35 percent is required to qualify for concessions granted under the agreement. See http://www.boisrilanka.org

Sri Lanka is a member of the South Asian Preferential Trading Arrangement (SAPTA), a trading arrangement of seven South Asian nations belonging to the South Asian Association for Regional Cooperation (SAARC). The objective of the organization is to expand into a free trade area. However, work even on the exchange of preferential tariff rates among the member countries is progressing at an extremely slow pace.

Customs Contact Information

Sri Lanka Customs Department
Lakshman Perera, Director General
Custom House, Times Building
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Chapter VII

Investment Climate Statement

Openness to Foreign Investment

Sri Lanka actively welcomes foreign investment, which has become an important element of the country's economic growth. Sri Lanka opened its economy to foreign investment in 1978 long before its South Asian neighbors but results have been mixed. Over the past twenty-two years, several hundred foreign investors have invested in the country but foreign investment flows have been weak in the past few years due to economic and political problems. Although many investors have done well, some have had problems with government practices and regulations.

The Board of Investment (BOI), an autonomous statutory agency operating directly under the president, is the primary government authority responsible for foreign investment. The BOI acts as a facilitator for investment and is structured to provide "one-stop" service for foreign investors, including approval of projects, granting licenses, establishing tax incentives, and assisting in procurement. Information about the BOI is found on the worldwide web at http://www.boisrilanka.org

The principal law affecting foreign investment is Law No. 4 of 1978 (known as the BOI Act), amendments made in 1980, 1983 and 1992, and implementing regulations established under the act. The BOI Act provides for two types of investment approvals. Under section 17 of the act, the BOI is empowered to grant concessions (see details below) to companies satisfying certain eligibility criteria; a qualifying investor enters into an agreement with the BOI which modifies, exempts and waives applicable laws, including inland revenue, customs, exchange control and import control statutes. Investment approval under section 16 of the act permits entry for foreign investment to operate under the "normal" laws of the country and is applicable to investments which do not satisfy eligibility criteria for BOI incentives.

Other laws affecting foreign investment are the Securities and Exchange Commission Act of 1987 and the Takeovers and Mergers Code of 1995. In addition, various labor laws and regulations affect investors. See sections below.

The Bureau for Infrastructure Investment (BII), a division of BOI, coordinates all private infrastructure projects. Projects are usually structured on the basis of build own operate (BOO), build operate and transfer (BOT) or build own operate and transfer (BOOT).

The BOI gives priority to the following sectors: infrastructure; electronics and new technologies; light engineering; tourism; agriculture, dairy and livestock projects; mining and processing of non-renewable resources; computer software; rubber products; gems and jewelry; textiles, garments and accessories; and, services such as healthcare and shipping-related activities.

Foreign equity participation of up to 100 percent is allowed in many sectors of the economy, and the BOI gives automatic approval for most foreign investments. Investment in certain restricted sectors is subject to screening and approval on a case-by-case basis where foreign equity exceeds 40 percent. The restricted sectors include: shipping and travel agencies; freight forwarding; professional services; mass transportation; telecommunications; supply of water; fishing; timber-based industries; growing and primary processing of tea, rubber, coconut, rice, cocoa, sugar and spices; and, finally, the production for export of goods subject to international quota.

In addition, the activities of several industries, particularly services, are regulated and subject to approval by other government agencies. In some cases, limits on foreign equity participation apply. The regulated activities include banking, investment banking, stockbroking and finance; insurance; air transportation; coastal shipping; energy and power; lotteries; large-scale mechanized gem mining; "sensitive" industries such as military hardware, dangerous drugs and currency; and, the establishment of local branches of foreign companies. The screening mechanism is non-discriminatory and for the most part routine.

Foreign investment is not permitted in the following businesses: non-bank money lending; pawnbroking; retail trade with a capital investment of less than $1 million (with one notable exception: the BOI permits retail and wholesale trading by reputed international brand names and franchises with an initial investment of not less than US$ 150,000); personal services other than for the export or tourism sectors; coastal fishing; education of Sri Lankan citizens not over 14 years; and award of local university degrees.

In general, the treatment given to foreign investors is non-discriminatory. In fact, some local companies have complained that they are discriminated against, while qualifying foreign investors can benefit from a wide range of advantages. However, even with incentives and BOI facilitation, foreign investors from time to time face certain difficulties in operating here. Problems range from the mundane but critical matter of clearing equipment and supplies through customs speedily to getting land for factories, as well as transport of finished export products from out-station factories (internal flights are prohibited by security constraints and road transport is slow, extremely bumpy, and often hazardous). The BOI now encourages investors to locate their factories in industrial processing zones managed by the BOI to overcome land allocation problems. Investors locating in industrial zones also get access to relatively better infrastructure facilities such as reliable power supplies, telecommunication and water supplies.

Government treatment of foreign investors with respect to privatization has been non-discriminatory. However, labor unions are often opposed to privatization and seem particularly averse to foreign owners, which has made the purchase of certain entities problematic for new foreign owners.

Conversion and Transfer Policies

Sri Lanka has no exchange controls on current account transactions (Article VIII of the IMF). There are no barriers, legal or otherwise, to the expeditious remitting of corporate profits and dividends for foreign enterprises doing business in Sri Lanka. Remittances of business fees (management fees, royalties and licensing fees) are also freely permitted as well as funds for debt service and capital gains. There are also no surrender requirements on export receipts and as such export receipts can be held abroad indefinitely but cannot be used for the purchase of capital assets. In addition, all stock market investments can be remitted without prior approval of the Central Bank. Investment returns can be remitted in any convertible currency at the legal market rate. Controls on capital account (investment) transactions prohibit foreigners from investing in debt and fixed income securities.

Expropriation and Compensation

Since economic liberalization policies began in 1978, the Sri Lankan Government has never been legally found to have expropriated a foreign investment. Under the terms of the U.S./Sri Lanka Bilateral Investment Treaty (BIT), investors have the right to arbitration under the International Center for the Settlement of Investment Disputes (ICSID). A longstanding dispute involving an alleged expropriation of a U.S. company's investment was satisfactorily resolved during 1998 after lengthy negotiations involving the company, the Sri Lankan Foreign Ministry, the Sri Lankan Attorney General, and the U.S. Embassy.

Dispute Settlement

There have been several troublesome investment and investment-related commercial disputes involving U.S. companies in recent years. One such dispute, involving an alleged expropriation, was resolved in 1998 after 17 years of on-and-off negotiations between the company, the Government of Sri Lanka and the U.S. Embassy.

A partially U.S.-owned internet service provider became involved in a major dispute in 1999 when its new "enhanced voice" service competed successfully with the national telecom service provider, Sri Lanka Telecom (SLT). Even though the company had a valid license to provide enhanced voice service, SLT and the Government of Sri Lanka attempted to have its service blocked. Even more troubling, the Sri Lankan police raided the company's premises, arrested some personnel, and held one employee under the Prevention of Terrorism Act, which allows unlimited detention without bail. Active intervention by the U.S. Embassy helped secure the eventual release of this employee, but apparently unsubstantiated terrorism charges remain in place against the company. Equally troubling has been the reluctance of senior Government officials to engage constructively with the company or U.S. Embassy officials to try to resolve the problem. As of mid-2000 the company was attempting to obtain relief via the Sri Lankan court system, but this effort was subject to repeated delay. The U.S. partners in the company filed a claim with the ICSID in June 2000.

In another troubling development, the Sri Lankan Supreme Court in May 2000 effectively blocked an existing investment agreement between the Government of Sri Lanka and a US mining company. Although the investment agreement was already signed and approved by the Sri Lankan cabinet, work on the project had not yet begun. A group of citizens filed a fundamental rights case, which under Sri Lankan law goes directly to the Supreme Court. The plaintiffs alleged in this case that their rights would be violated by implementation of the mining project, and the court upheld their complaint. Without any technical argument, the Court ruled that the project could not proceed before completion of a new series of detailed and highly comprehensive technical studies, some of which appear to be technically infeasible. Because this is a Supreme Court decision, options for reversing the decision appear extremely limited, and the company is contemplating withdrawing from the project.

Foreign investments are in principle guaranteed protection by the constitution of Sri Lanka. The Government has entered into 24 investment protection agreements with foreign governments (including the United States) and is a founding member of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank. Sri Lanka is also a founding member of the World Trade Organization. The Government has ratified the provisions of the convention on settlement of investment disputes, which provides the mechanism and facilities for international arbitration through the ICSID of the World Bank.

A center for arbitration known as the Institute for the Development of Commercial Law and Practice (ICLP) has been established in Colombo, for the expeditious, economical and private settlement of commercial disputes. The center is affiliated with the arbitration institute of the Stockholm Chamber of Commerce and follows the institute's standards. Although it has successfully arbitrated some disputes between private parties, it has never undertaken arbitration in any dispute involving a public sector entity. The Arbitration Act of 1995 gives recognition to the New York convention on recognition and enforcement of foreign arbitral awards. Arbitral awards made abroad are now enforceable in Sri Lanka. Similarly awards made in Sri Lanka are enforceable abroad.

The U.S.-Sri Lanka BIT was ratified by both governments in early 1993. A bilateral treaty on avoidance of double taxation is currently under consideration and review.

Although there are legal alternatives for dispute settlement, settlement through the Sri Lankan court system is subject to extremely protracted and inexplicable delay. Aggrieved investors (especially those dealing with the Government of Sri Lanka on projects) have frequently pursued out-of-court settlements, which offer the possibility -- not frequently realized -- of speedier resolution of disputes. Although the ICLP may develop into an effective arbitration center, its experience thus far is limited, and it appears unlikely to become involved in disputes involving the Sri Lankan Government, the source of most disputes involving US companies in recent years.

The Labor Department has the infrastructure for settling industrial disputes with labor, and compulsory arbitration is available when attempts to conciliate industrial disputes fail. The Labor Commissioner typically becomes involved in labor-management mediation. The Labor Minister and even the president have intervened in particularly difficult cases.

Sri Lankan commercial law is almost entirely statutory. The law was codified before independence in 1948 and reflects the letter and spirit of British law of that era. It has, by and large, been amended to keep pace with subsequent legal changes in the U.K. The court system is largely free from government interference. Procedures exist for enforcing foreign judgments. Several important legislative enactments regulate commercial matters: the Board of Investment Law; the Code of Intellectual Property Law; the Companies Act; the Securities Council Act; the Banking Act; and the Industrial Promotion Act. The Companies Act and the Insolvency Ordinance provide for the winding up of insolvent companies. Litigation can be very time consuming.

Performance Requirements/Incentives

Foreign investment is encouraged in enterprises which involve extensive use of foreign capital or sophisticated technology, in export-oriented manufacturing, and in large-scale infrastructure projects. Foreign investors are generally not expected to reduce their equity over time or to transfer technology within a specified period of time, except for build-own-transfer or other projects in which such terms are clearly specified.

The Board of Investment specifies certain minimum investment amounts for both local and foreign investors to qualify for incentives, which vary according to sector. Incentives for some projects are offered on a sliding scale, depending on the amount of investment. Firms enjoying preferential incentives in the manufacturing sector in most cases are required to export 90 percent of production, while those in the service sector must export at least 70 percent of production. Investors also are expected to perform according to a mutually agreed-upon program.

Maintaining a certain level of employment is a condition in some BOI-approved enterprises. In addition, privatization agreements as a rule prohibit new owners from laying off workers, although the owners are free to offer voluntary retirement packages to reduce their workforce. Some foreign investors have received political pressure to hire workers from a particular constituency or a given list, but have successfully resisted such pressure with no apparent adverse effects.

Foreign investors who make an equity investment of $50,000 can qualify for a resident visa. Employment of foreign personnel is permitted when there is a demonstrated shortage of qualified local labor. Technical and managerial personnel are in short supply, and this shortage is likely to continue in the near future. Foreign employees attached to BOI-approved companies usually receive preferential tax treatment and do not experience any significant problems in obtaining work or residence permits.

The Board of Investment is empowered to offer special incentives as follows:

-- a tax holiday of ten to twenty years for investments in "thrust" industries (i.e. electronics, light engineering, ceramics and glassware, rubber products, and any industry or service of pioneering nature as defined by the BOI). A preferential tax of 15 percent for a period of five to ten years follows the tax holiday. (Minimum investment is Rs 50 million or approximately $667,000.)

-- a tax holiday of five years for textile and ancillary products required for the garment export industry with a minimum investment of Rs 5 million or approximately $67,000. A preferential tax of 15 percent follows the tax holiday. To qualify, a minimum of 50 percent of output should be exported or supplied to garment export industry.

-- a tax holiday of eight years for software exporting industry. A preferential tax of 15 percent for a period of twelve years follows the tax holiday. At least 70 percent of production should be exported.

-- a tax holiday of five years for software companies catering to the domestic market.

-- a tax holiday of ten years for export-oriented agriculture, dairy and livestock development. A preferential tax of 15 percent for a period of ten years follows the tax holiday. (Minimum investment is Rs 10 million, or approximately $133,500, excluding land.)

-- a tax holiday of five years for companies utilizing advanced (new) technology, with a minimum investment of Rs 4 million (approximately $53,500).

-- a preferential tax of 15 percent per annum for a period of 20 years for direct and indirect export of non-traditional manufactured goods (minimum investment is Rs 12.5 million, or approximately $167,000) and direct and indirect export of services (no minimum). Tax holidays ranging from five to ten years are available depending on size, type and location of investment.

-- a preferential tax of 15 percent for a period of fifteen years for the construction and operation of hotels and recreation facilities. (Minimum investment is Rs 10 million, approximately $133,500.)

-- a tax holiday of seven years for low cost housing projects with a minimum of 100 units. (Minimum investment is Rs 50 million, approximately $667,000.)

-- a tax holiday of ten years to twenty years for investments of Rs 500 million (approximately $6.7 million) or more in a new enterprise undertaking export-oriented large-scale projects. A preferential tax of 15 percent for a period of five years to ten years for export-oriented industries follows the tax holiday.

-- a preferential tax of 15 percent for a period of ten years for investments of Rs 500 million (approximately $6.7 million) or more in non export-oriented large scale projects.

-- a tax holiday of ten to twenty years for investments over Rs 3,500 million (approximately $46.7 million) in large scale projects.

-- a tax holiday of twenty years for manufacturing or trading of gems, diamonds and jewelry with a minimum investment of Rs 5 million (approximately $67,000). Minimum export requirement is 70 percent.

-- a tax holiday of five to eight years for companies expanding, relocating or setting up new enterprises in designated zones.

-- a tax holiday of five years for regional operating headquarters.

-- a tax holiday of ten years for hospitals. Minimum investment for hospitals located in Colombo is Rs 75 million (approximately $1 million) and outside Colombo is Rs 25 million (approximately $333,000).

-- a preferential tax of 15 percent for ten years for training institutes.

-- a preferential tax of 15 percent for seven to ten years for small scale infrastructure projects. (Minimum investment is Rs 50 million, or approximately $667,000 for power projects; Rs 125 million, or approximately $1.7 million for others.)

Other incentives for the above projects include:

-- duty-free imports (generally, during the life of the project for export-oriented projects, and during the project implementation period for others). Duty concessions will not be available for certain items manufactured locally, which are included in negative product list submitted by Sri Lanka under the Indo-Lanka Free Trade Agreement.

-- 15 percent income tax on emoluments of expatriate employees during the first five years; in case of large scale projects where the investment is greater than Rs 2,500 million the preferential tax rate will be applicable for the duration of the tax holiday period.

-- no restriction on repatriation of dividends or profits.

-- free transferability of shares.

For further information on investment incentives and other investment-related issues, potential investors are encouraged to contact the Board of Investment directly. The BOI can be found on the internet at http://www.boisrilanka.org, or reached via e-mail at info@boisrilanka.org.

Right to Private Ownership and Establishment

Private entities are free to establish, acquire and dispose of interests in business enterprises. Private enterprises enjoy benefits similar to those granted to public enterprises, and there are no known limitations in access to markets, credit or licenses. Foreign ownership is allowed in most sectors. However, private land ownership is limited to twenty hectares per person. About 80 percent of the land in Sri Lanka is owned by the Government, including most tea, rubber and coconut plantations. In the past three and a half years, the Government divested most of these plantations to the private sector on 50-year lease terms as part of ongoing privatization efforts. Although state land for industrial use is usually allotted on a 50-year lease, 99-year leases may also be approved on a case-by-case basis depending on the nature of the project.

Foreign investors can purchase land from private sellers, but non-nationals of Sri Lanka may be liable for a 100 percent tax payment on land purchases. If the foreign purchaser has incorporated a company in Sri Lanka under the Companies Act and buys the land in the name of the company, the tax payment is not required.

Protection of Property Rights

Secured interests in property are recognized and enforced. A fairly reliable registration system exists for recording property such as land, buildings and mortgages. The legal system is nondiscriminatory and protects and facilitates acquisition and disposition of property rights by foreigners.

Intellectual property is protected through the Intellectual Property Act of 1979 which governs copyrights, industrial designs, patents, trademarks, trade names and unfair competition. All trademarks, designs, and patents must be registered with the Government’s registry of patents and trademarks.

Infringement of Intellectual Property Rights (IPR) is a punishable offense under the law. Intellectual Property Rights come under both criminal and civil jurisdiction. Relief available to owners includes injunctive relief, seizure and destruction of infringing goods, and prohibition of importation. However, enforcement is a crucial problem, as is public awareness of IPR. Domestic implementing legislation is very weak and the prevailing attitude of the Government is that it cannot act as an enforcer of IPR laws. At present, aggrieved parties must on their own seek redress of any IPR violation through the courts, which can be a frustrating and time-consuming process. Although the legal system is well-established and non-discriminatory, it is fraught with long delays. Necessary amendments to Sri Lankan IPR law have been formulated and were being introduced in parliament as of June 2000. It will likely take years before new procedures and court precedents are established.

Sri Lanka is a party to major Intellectual Property Agreements including the Berne Convention for the protection of literary and artistic works, the Paris Convention for the protection of industrial property, the Madrid Agreement for the repression of false or deceptive indication of source on goods, the Nairobi Treaty, the Patent Co-operation Treaty, the Universal Copyright Convention and the Convention establishing the World Intellectual Property Organization (WIPO). Sri Lanka's intellectual property law is based on the WIPO model law for developing countries. Sri Lanka and the U.S. in 1991 signed a Bilateral Agreement for the Protection of Intellectual Property Rights, and Sri Lanka is also a party to the Trade Related Intellectual Property Rights (TRIPS) Agreement in the World Trade Organization. The Government of Sri Lanka took the view that as a developing country it had until 2000 to change its laws to comply with WTO requirements. Legislation satisfying both bilateral and WTO requirements has been drafted, and passage by the Sri Lankan Parliament is expected in 2000.

Patents are granted for inventions, with the following exceptions: discoveries, scientific theories and mathematical methods, plant or animal varieties or essentially biological processes for the production of plants and animals, other than microbiological processes and the products of such processes, business rules and methods, methods of treatment by surgery or therapy, and diagnostic methods practiced on the human or animal body. A patent is valid for 15 years from the date of grant, but must be renewed annually.

Copyrights are not registered. A work is protected automatically by operation of law. Original literary, artistic, and scientific works are protected. Computer software is not specifically listed as a protected item under the amended Sri Lankan IPR Law, and already received de facto protection under international conventions which extend the definition of literary works to cover software as well. The enforcement limitations described above apply to copyrights, including software.

Sri Lanka recognizes both trademarks and service marks. The exclusive right to a mark is acquired by registration. A mark may consist of words, slogans, designs, etc. Protection also is available to well known marks not registered in Sri Lanka. Registered trademarks are valid for ten years.

Trade secrets are not protected under the current law, but the Government of Sri Lanka has included trade secret protection in its new IPR amendments.

Transparency of the Regulatory System

The BOI strives to inform potential investors about laws and regulations, which may affect operations in Sri Lanka. Laws pertaining to tax, labor and labor standards, exchange controls, customs, environmental norms, building and construction standards are in place. However, some of the laws and regulations are not freely available and are difficult to access. Foreign and domestic investors often complain that the regulatory system allows far too much leeway for bureaucratic discretion. Effective enforcement mechanisms are sometimes lacking and coordination problems between the BOI and relevant line agencies frequently emerge. Lethargy and indifference on the part of mid- and lower-level public servants compound transparency problems.

Although many foreign investors, including U.S. firms, have had positive experiences in Sri Lanka, some have encountered significant problems with government practices and regulations. For example, one foreign company that had obtained a waiver of a particular requirement in order to obtain a license was later told it must meet the requirement to continue to be qualified for the license, with no advance warning and little justification. Other multinational firms have experienced extensive unexplained delays in trying to reach agreement on investment projects. Others have had contracts inexplicably canceled without compensation, even after contracts were approved by the Sri Lankan Cabinet.

A partially U.S.-owned internet service provider encountered major difficulties in 1999 when its "enhanced voice" service competed successfully with Sri Lanka Telecom (SLT). The company had a valid license to offer enhanced voice service, but Sri Lanka Telecom claimed otherwise. Although technical questions regarding the interpretation of licenses should in theory be resolved by the industry regulatory authority, this option was less attractive to the company because the Director General of the Regulatory Authority was in this case a former CEO of SLT.

Efficient Capital Markets and Portfolio Investment

Retained profits are the principal source of funding private investment in Sri Lanka. According to Colombo Stock Exchange estimates, retained profits financed 67 percent of private investment in 1998. Commercial banks and two development finance institutions, the National Development Bank (NDB) and the Development Finance Corporation of Ceylon Bank (DFCC), are the principal source of bank finance. Bank loans are the most widely used credit instrument for the private sector. Financial institutions such as the DFCC and some commercial banks also raise syndicated bank loans to fund large-scale investment projects undertaken by the private sector. In recent years, a few companies have turned to the share market to raise capital. However, due to depressed stock market conditions, capital raised in the primary market has been extremely low in 1997-1999. The International Finance Corporation (IFC), the arm of the World Bank group which invests in the private sector, also provides equity and debt financing for private sector ventures in Sri Lanka such as infrastructure, financial markets, IT, healthcare and education as well as general manufacturing and services.

The domestic debt market in Sri Lanka is still at a very nascent stage. A few leading companies and financial institutions have recently started to raise capital through credit instruments such as debentures, corporate bonds and commercial paper. Efforts are underway to develop a listed market for corporate debt of both publicly listed companies and companies not listed on the stock exchange. At present there are 27 debt listings of thirteen companies on the Colombo Stock Exchange (CSE). Until recently, only publicly listed companies were permitted to issue quoted debt securities, and not many have made use of this facility. In September 1999, the CSE amended its listing rules to enable listing of debt securities of companies not listed (equity) on the exchange. Furthermore, in October 1999, Duff and Phelps Credit Rating Company opened the first credit rating agency in Sri Lanka. The local branch company, DCR Lanka Ltd, is a joint venture between Duff and Phelps, IFC, the Central Bank of Sri Lanka and several local financial institutions. DCR Lanka rates debt instruments of corporations, banks and other financial institutions in accordance with international banking standards.

There is an active and relatively competent accounting profession, based on the British model. The source of accounting standards is the Institute of Chartered Accountants of Sri Lanka (ICASL) and standards are constantly updated to reflect current international accounting and audit standards. Due to the lack of an adequate enforcement mechanism, however, problems with the quality and reliability of financial statements exist. Until early 1999, accounting standards were not mandated by law, other than for publicly quoted companies, financial institutions and insurance companies. For other companies, the Companies Act Law No. 17 of 1982 described the accounting requirements. To overcome these shortcomings, Sri Lanka carried out a major revision of accounting and auditing standards in September 1997. The revised accounting/auditing standards ensure compliance in all material respects with the international standards adopted by the International Federation of Accountants. The standards also provide for an Accounting Standards and Monitoring Board (ASMB) which is responsible for monitoring compliance. The standards became applicable for all banks and companies listed on the stock exchange from 1998. Other large- and medium-sized companies in Sri Lanka are required to follow the revised standards with effect from January 1, 1999. Accounts of such business enterprises are required to be audited by professionally qualified auditors holding ICASL membership. The ASMB has just begun monitoring compliance.

The Securities and Exchange Commission (SEC) regulates the securities market in Sri Lanka. Foreign investors can freely purchase up to 100 percent of equity in Sri Lankan companies in numerous permitted sectors. In order to facilitate portfolio investments, country funds and regional funds are also allowed to invest in Sri Lanka's stock market; such funds must first receive Ministry of Finance approval to operate in Sri Lanka. These funds make transactions through share investment external rupee accounts maintained in commercial banks.

The Colombo Stock Exchange, while small by "big emerging market" standards, is one of the most efficient in the region. The CSE is fully automated, with automated trading and clearing and settlement systems. The CSE has a rolling settlement period of five days for buyers and six days for sellers. Fifteen local and foreign joint venture brokers currently operate at the CSE. In February 2000, the Government announced it would amend foreign investment regulations to permit foreigners to hold 100 percent in stock broking firms operating at the CSE. In order to improve confidence in the settlement of market transactions, the SEC inaugurated a settlement guarantee fund with an initial capital of Rs 100 million in May 1998. The primary purpose of the fund will be to guarantee the settlement of trades between clearing members of the exchange. The Chartered Financial Analysts (CFA) program was introduced to Sri Lanka in 1993 with the assistance of the USAID.

The Colombo stock market has been on a downward trend since mid 1998, when foreign investors pulled out from the region after the nuclear tests in India and Pakistan and the East Asian financial crisis. Although most stock exchanges in South and South East Asia have recovered over the past year, the Colombo Stock Exchange remained depressed throughout most of 1999 and early 2000, finally falling to a nine-year low in May 2000. Aggressive selling by foreign investors, due to escalation of the war in the North and negative political and economic sentiment, has been largely responsible for the recent decline. Foreign activity resulted in a net outflow of $20 million during the first four months of 2000. The stock market is likely to remain depressed until after the parliamentary elections due in the autumn of 2000. The single overriding constraint for the sustainable development of the stock market is the conflict in the North and East and its effect on investor confidence and the economy as a whole. Other broader issues include lack of liquidity and limited market size. Improvements are also needed in corporate governance and accountability and public disclosure in companies. The new accounting and auditing standards and ASMB are expected to address some of these issues. In addition, the Ceylon Chamber of Commerce, the SEC, the Colombo Stock Exchange and professional accounting bodies are taking initiatives in these areas.

Sri Lanka has a fairly well diversified banking system. There are 26 commercial banks, consisting of ten local banks and sixteen foreign banks. In addition, there are ten specialized banks. The Central Bank is responsible for supervision of all banking institutions. Steady improvements are being made in banking supervision and regulation and in public disclosure of banking sector performance. In 1997, the Central Bank issued for the first time directives with respect to loan classification, suspension of interest, provisioning, investments in equity, and the acquisition of immovable property, and it tightened its directives with respect to capital adequacy and single borrowers. Subsequently, the Central Bank has expanded its reporting system to monitor compliance. It has also increased on-site and off-site supervision of banks. Standards for the public disclosure of banking sector data were raised considerably in 1999. All banks including foreign bank branches must now publish their half-yearly and annual financial accounts in the newspapers. With the exception of classification and provisioning, all Central Bank requirements are up to international standards. A USAID consultant has completed a feasibility study for setting up of a mandatory deposit insurance scheme for all commercial banks. The Central Bank expects to implement such a scheme during 2001.

Total assets of the commercial banks stood at Rs 570.8 billion ($7.6 billion) as of December 31, 1999. Despite a gradual loss in market share, the two state-owned commercial banks, Bank of Ceylon and People's Bank (with assets amounting to Rs 179 billion and Rs 135 billion respectively), still dominate banking, making up a little over half of all assets and liabilities. The state banks are considerably weaker than the banking system on average. Much of that is due to past government interference. The Government has tried but largely failed to improve the health and efficiency of these two banks by re-capitalizing them. However, since most of the bad debt of the two banks is implicitly guaranteed by the state, these problems do not affect the credibility of the banking system in Sri Lanka. The World Bank and IMF have identified the dominance of these inefficient state banks as a main constraint for development of the financial sector. In a bid to overcome the problems at the state-owned banks, the Government signed two performance agreements with the Bank of Ceylon and People's Bank in July 1998. These agreements aim at commercializing and consolidating operations, increasing productivity, reducing costs, rationalizing staff levels and branch network, conserving assets, increasing loan recoveries and improving risk management. The Central Bank monitors compliance with the agreements on behalf of the Government. The performance agreements have been somewhat successful in restructuring the Bank of Ceylon in 1998-1999, but have scored little success thus far with respect to People's Bank. A new chairman of People's Bank was named in May 2000 with the mandate to move aggressively to restructure the bank. The Government continues to consider its options as to how best to improve the financial conditions and operating efficiency of the state banks. Although the ultimate solution lies in privatization of the state banks, this solution is not feasible in the short term due to current political constraints. There is a likelihood of a management contract for the state banks in the future. The International Development Association (IDA) has offered assistance to the Government if the Government is prepared to initiate a private management contract for the two state banks.

Private commercial banks and foreign banks operating in Sri Lanka generally follow more prudent credit policies and as a group are in better financial shape. However, a sharp drop in provisions relative to non-performing loans in private domestic commercial banks in 1998 suggests increasing fragility. Banks have been adversely affected by the economic slowdown, decline in trading and increased competition in 1998-1999. The banks are required to comply with central bank guidelines on loan loss provisioning. In 1998, the average rate of non-performing loans to total advances was 20 percent for the two state commercial banks, 13.1 percent for private domestic banks and 11.9 percent for foreign banks operating in Sri Lanka. Non-performing loans to total assets in all banks was 8.8 percent in 1999Q1. The Central Bank is proposing to impose stricter loan loss provisioning from 2001. Sri Lanka adopted capital adequacy standards set by the Basel Committee on banking regulations and supervisory practices in 1993. The Central Bank has issued a directive to increase the minimum capital adequacy ratio for all banks from 8 percent to 10 percent of risk adjusted assets from the year 2001.

Acquisition of companies through mergers and takeovers is governed by the Takeovers and Mergers Code of 1995 made under the Securities and Exchange Commission of Sri Lanka Act. This law applies only to companies listed on the Colombo Stock Exchange. Acquisition of more than a 30% stake of a listed company requires the buyer to make a mandatory offer to all other shareholders. Draft legislation is being prepared to give discretionary powers to the SEC to waive this obligation. There are 239 companies listed on the stock exchange, some 40 of which place restrictions on foreign equity ownership. The articles of association of a few listed companies restrict foreign equity to certain levels. Foreign shareholding in local banks and insurance companies is restricted to 60% and 90% respectively.

Political Violence

Sri Lanka has been plagued by ethnic conflict for several decades, and especially since 1983, when fighting between separatist guerillas and Government forces escalated dramatically. The fighting is in northern and eastern Sri Lanka, but other parts of the country have been the scene of sporadic terrorist attacks. Tourists and foreign business representatives have not been terrorist targets but have suffered collateral injury during attacks on other targets.

The Liberation Tigers of Tamil Eelam (LTTE) detonated large bombs in Colombo’s financial district in January 1996 and again in October 1997, causing extensive damage. The 1996 attack killed almost 100 people and injured close to one thousand, while the other attack killed 18 people and injured several dozen people. In June 2000, the LTTE assassinated the Industrial Development Minister by suicide bombing. More than 20 other people were also killed and more than 50 others were injured although no foreigners were killed in these and other bombings in the greater Colombo area, some who were in the vicinity suffered minor injury. The key concern for expatriates doing business in Sri Lanka is being in the wrong place at the wrong time.

In 1998, the U.S. Peace Corps decided to suspend operations in Sri Lanka after LTTE bombings occurred outside the Colombo area, including places such as Galle in the south and Kandy in the central highlands -- locations where volunteers had been posted-based on the low probability of terrorist attacks. As a result, all Peace Corps volunteers completed their assignments by July 31, 1998.

The U.S. Embassy’s Security Officer has joined with the American Chamber of Commerce in Sri Lanka to establish an Overseas Security Advisory Council (OSAC) to enhance the exchange of security related information.

Corruption

The country has fairly adequate laws and regulations to combat corruption, but they are very unevenly enforced. U.S. firms identify corruption as a restraint to foreign investment, but, by and large, it is not a major threat to operating in Sri Lanka. Corruption is a persistent problem in customs clearance and enables wide-scale smuggling of certain consumer items, to the detriment of legitimate manufacturers and importers. Corruption appears to be most troubling in large projects as well as government procurement and tendering, especially in military and defense purchases. The law provides that giving or accepting a bribe is a criminal offense and carries a maximum sentence of seven years imprisonment and a fine at the discretion of the courts. However, few have been found guilty of corruption in recent years. Highly publicized efforts to investigate bribery and corruption in recent years have failed miserably, damaging public confidence in such processes.

A Special Presidential Commission (SPC) of inquiry was established when the People’s Alliance (PA) Government came to power in 1994, to investigate alleged corruption, bribery and other malpractices during the previous regime. In 1997, the SPC issued an interim report, which found four former government ministers and officials guilty of misuse of power in a number of deals. SPC findings were later squashed by the Supreme Court on technical grounds (for the failure of one of the Commissioners to sign the report). The warrant of the Commission expired in 1999.

A separate, three-member commission to investigate allegations of bribery or corruption was also appointed in 1994 for a five-year term to replace a single bribery commissioner. The function of the Bribery Commission (as it is better known), under Act No 19 of 1994, is to investigate allegations brought to its attention and as necessary, institute proceedings against responsible individuals in the appropriate court. The commission was assisted by a Director General for the Prevention of Bribery and Corruption. In 1998, this commission received severe criticism from opposition politicians as well as the current government for mismanagement, ineffectiveness (few cases were investigated), and other problems. The term of the Commission expired in December 1999.

In February 2000, a new bribery commission consisting of two retired judges and a retired senior police officer was appointed. A high-ranking official from the Attorney General's department has been appointed as Director General and works on part-time basis. The commission is also assisted by several police officers. The new Bribery Commission is in the process of studying complaints.

A separate hotline (Fax: 94-1-473-838) was established in August 1999, for communicating corruption complaints directly to the President.

Transparency International, an international "watchdog" organization promoting anti-corruption strategies, opened a national chapter in Sri Lanka in September 1999. The local chapter, with the assistance of the USAID, is planning to start off its activities in the second half of 2000 with an awareness program followed by a survey of public perceptions of corruption.

Bilateral Investment Agreements

The Government of Sri Lanka has signed Investment Protection Agreements with the United States (which came into force in May 1993) and the following countries:

1. Belgium
2. People's Republic of China
3. Denmark
4. Egypt
5. Finland
6. France
7. Germany
8. Indonesia
9. India
10. Iran
11. Italy
12. Japan
13. Korea
14. Luxembourg
15. Malaysia
16. Netherlands
17. Norway
18. Romania
19. Singapore
20. Sweden
21. Switzerland
22. Thailand
23. United Kingdom

OPIC and Other Investment Insurance Programs

The U.S. and Sri Lanka concluded in 1966 (and renewed in 1993) an agreement that allows the Overseas Private Investment Corporation (OPIC) to provide investment insurance guarantees for U.S. investors. OPIC currently provides coverage to banking sector investments in Sri Lanka. Sri Lanka's membership in the Multilateral Investment Guarantee Agency (MIGA) offers an opportunity for insurance against non-commercial risks.

Approximately $9.3 million is spent annually by the U.S. Embassy and other U.S. Government institutions in Sri Lanka. This amount can potentially be utilized by OPIC to honor an inconvertibility claim; however, no such claims have been made to date in Sri Lanka. The Embassy purchases local currency at the financial rate. The currency has depreciated about 9 percent since January 1, 2000. The currency is not expected to fluctuate by more than 10 percent relative to the U.S. dollar over the next year.

Labor

Sri Lanka's labor force is literate and trainable, although weak in certain technical skills. Although more computer skills training programs are becoming available, the demand still outpaces supply, as many qualified workers seek employment overseas. The average worker has eight years of schooling. Two-thirds of the labor force is male and one-third is female. The unemployment rate (employment is defined as one who worked for pay, profit or unpaid family gain for one or more hours during the survey week) in the third quarter of 1999 was 9.1 percent, with an estimated 613,000 of a total labor force of 6.7 million out of work. (Labor force data excludes the North and East; armed forces personnel deployed away from home and Sri Lankan migrant workers abroad.) Including unpaid family workers, the unemployment rate is 10.3 percent. Youth unemployment remains a critical problem. Nearly 80 percent of unemployed persons are in the 15-29 year age range. Almost 50 percent of unemployed youth are educated at the O-Level (10th grade) or higher. Not surprisingly, a significant proportion of unemployed seek "white collar" jobs, and most sectors facing labor shortages offer manual or semi-skilled jobs or require technical or professional skills such as management, marketing, information technology, accountancy and finance, and English language. The Government has recognized the challenge of reformulating the educational system to meet the needs of the private sector better, but it will likely take some time before the mismatch of skills to requirements is rectified.

There are an estimated 790,000 Sri Lankan workers abroad. The majority of Sri Lankan workers abroad are unskilled (housemaids and laborers) and are primarily in the Middle East. Sri Lanka is also losing many of its technically and professionally qualified workers to more lucrative jobs abroad.

Labor is available at a relatively low cost, though it is priced higher than in other South Asian countries. Child labor is prohibited and is virtually nonexistent in the organized sector. Child labor is prevalent in informal sectors. The minimum legal age for employment in domestic service is set at 14. Most permanent full-time workers are covered by laws pertaining to minimum hours of work, minimum wage, leave, the right of association, and safety and health standards. In addition, a Termination of Employment Act makes it almost impossible to fire or lay off workers who have been employed more than six months for any reason other than serious, well-documented disciplinary problems. Disputes over dismissals can be brought to a labor tribunal administered by the Ministry of Justice. However, the labor tribunals have large and growing backlogs of unresolved cases. Certain labor disputes founded upon fundamental rights (allegations of termination/transfers based upon discrimination, etc.) can be brought directly to the Supreme Court. There is widespread belief that the labor laws and a plethora of holidays are dampening productivity. The full moon day of each month, if it falls on a week day is a paid holiday. There are also eight other public holidays. The public sector and banks enjoy additional holidays. The statutory holidays are in addition to 21 days annual/casual leave and approximately 21 days sick leave (number of days for sick leave is at the discretion of the management). In addition, female employees are entitled to 84 days fully paid maternity leave for the first two confinements.

Collective bargaining is not yet very popular. However, over 400 companies (including a number of foreign-owned firms) belonging to the Employers' Federation of Ceylon (EFC) rely on it to conduct negotiations on their behalf as and when required.

Sri Lanka is a member of the International Labor Organization (ILO) and has ratified 37 international labor conventions. The labor laws of Sri Lanka are laid out in almost 50 different statutes. With ILO assistance, the Government is attempting to carry out a codification of these laws. In 1994, the Government announced a new workers' charter, but the implementing legislation met with stiff opposition from the private sector and was never approved. A task force on employment subsequently appointed by the President made recommendations to a cabinet subcommittee.

In December 1999, the Parliament approved an amendment to the Industrial Disputes Act prohibiting unfair labor practices by employers. The amendment was introduced bypassing moves made by the task force for a more flexible approach towards the labor market (i.e., freeing up the provisions on termination) and making labor unions more accountable for the sometimes violent and destructive conduct of their members, in exchange for strengthened recognition of unions. The law now requires the employers to recognize trade unions and the right to collective bargaining, in line with ILO Convention 98 on the right to organize and bargain collectively. The amendment now compels employers to enter into negotiations to settle disputes with a trade union where the membership is more than 40 percent of the total workforce. It prohibits antiunion discrimination. Previously, the law did not require management to recognize or bargain with unions. The private sector has expressed dissatisfaction regarding the enactment of the new law without reciprocal guarantees from trade unions for responsible conduct. However, since the enactment of the new law in December 1999, there has been no trade union action that could be directly attributed to the law.

Only about 15 percent of labor in the industry and service sector is unionized. Labor in free trade zone enterprises tends to be represented by non-union worker councils (labor advocates criticize BOI rules and management regulations which make access to the zones virtually impossible for union representatives and labor organizers). In the plantation sector, union participation rates are as high as 75 percent, though unionization levels are reportedly on the decline. Many public sector entities also have large and vocal unions, which often stage protests and "industrial actions," sometimes to protest anticipated moves towards privatization. Most of the major trade unions are affiliated to political parties, creating a highly politicized labor environment.

Labor management relations in Sri Lanka in the past have been by and large antagonistic due to a failure to recognize the need for a social partnership. The attitude of employers towards workers has changed considerably in the last few years. Employers are becoming conscious of the need to look after their human resources, and more effort is being taken to ensure that workers feel motivated and cared for. Labor-management relations vary from organization to organization; managers who emphasize communication with workers and offer training opportunities generally experience fewer difficulties. US investors in Sri Lanka (including US garment buyers) generally promote better labor management relations and labor conditions that usually exceed local standards.

Sri Lanka has ratified five of the seven conventions included in 1998 ILO Declaration on Fundamental Principals and Rights at Work (ILO Core Labor Standards) and will soon ratify a sixth convention, the ILO Convention 138 on minimum age for admission to employment. The ILO, EFC and the AFL-CIO-sponsored American Center for Labor Solidarity are trying to improve awareness about core labor standards.

In general, labor unions are quite activist, and strikes are not uncommon. All workers, other than civil servants and workers in "essential services", have the right to strike. Before September 1994, the Government controlled strikes by declaring some industries to be essential under Emergency Regulations. Subsequently this practice largely ceased. There were at least two major strikes in 1998 by plantation workers (notably, the settlement included acceptance of a profit-sharing mechanism) and by postal workers, which caused disruption to mail delivery for many weeks. In June 1999 Government doctors struck work for several days protesting efforts to give provincial governments control over health services, crippling medical services throughout the country.

In May 2000, in view of the escalation of war in the North, the Government invoked the Public Security Act to prohibit all activities that could be interpreted to encourage terrorism and disrupt the normal activities of the people, including strikes in both private sector and public sector work places.

Foreign Trade Zones

Sri Lanka has six free trade zones, also called export processing zones, which are administered by the BOI. The oldest of them, the Katunayake and Biyagama Zones, located north of Colombo near the Bandaranaike International Airport, are fully occupied. The third zone is located at Koggala on the southern coast. Three new mini export processing zones were opened in 1997-1999. They are located north-east of Colombo, in Mirigama, Malwatte and Wathupitiwala. There are nearly 200 foreign export processing enterprises operating in these six export processing zones. In addition there are three industrial parks which have both export-oriented and non-export oriented factories. They are located in Pallekelle, near Kandy in central Sri Lanka, in Seethawaka in Avissawela about 60 kilometers from Colombo, and in Hambantota in the deep south. In addition, several other export processing zones and industrial estates are being developed.

In the past, industrialists preferred to locate their factories in close proximity to Colombo harbor or airport to reduce transport cost and save time. However, excessive concentration of industries around Colombo has created problems such as scarcity of labor and poor infrastructure, environmental pollution, escalation of real estate prices and congestion in the city. Therefore, the BOI now actively encourages the setting up of export-oriented factories in the newly developed industrial zones. BOI also finds it easy to provide infrastructure facilities and security, as well as monitor enterprises when they are located in the zones.

Foreign Direct Investment

Major U.S. companies with investments in Sri Lanka include: Energizer Battery, Mast Industries, Smart Shirts (a subsidiary of Kellwood Industries), CPC International/Bestfoods, Caltex, Sportif, Citibank, American Express Bank, 3M, Cargill, Tandon Associates, North Pole, and Intellical. Two major US companies, AES Corporation and American International Group (AIG), set up joint ventures in Sri Lanka recently with plans for substantial investments in power generation and insurance respectively. Also in 1999, Duff and Phelps Credit Rating Company opened the first credit rating agency in Sri Lanka. In addition, IBM, NCR, Lanier, GTE, AT&T, Sea-Land, Motorola, Procter & Gamble, Liz Claiborne, May Department Stores, Federated Department Stores, London Fog, Tommy Hilfiger, J.C. Penney, the Gap, Sun Microsystems, Microsoft, Bankers Trust, Coca Cola, Bates Strategic Alliance, McCann-Erickson, J. Walter Thompson, Pricewaterhouse Coopers, Ernst & Young and KPMG all have branches, affiliated offices or local distributors/representatives. Kentucky Fried Chicken, Pizza Hut, Federal Express, UPS and McDonald’s are represented in Sri Lanka through franchises. Numerous other American brands and products are represented by local agents.

Major non-U.S. investors include: Unilevers, Nestle’s, British American Tobacco Company, Mitsui, Pacific Dunlop/Ansell, Prima, FDK and S.P. Tao. Leading U.S. and foreign investors which have acquired significant stakes in privatized companies include Caltex; Norsk Hydro of Norway; Kabool Spinning and Textile, Tongyang Nylon, and Hanjung Steel, all of Korea; Nippon Telephone and Telegraph, Mitsubishi Corporation and C. Itoh (A.K.A. Itochu) of Japan; Emirates Airlines of United Arab Emirates; and Shell Oil of the UK. A Sri Lankan conglomerate with P&O Netherlands and P&O Nedlloyd embarked on a major expansion project of the Port of Colombo in 1999.

Reliable statistics on foreign investment by country are not available. Leading sources of foreign investments are South Korea, Japan, U.S., Australia, Hong Kong, Singapore, and the U.K. U.S. investments are estimated to be in the region of $150 to $200 million.

Investment Statistics

Estimated total foreign investment by sector
(in $ millions)

--	Total	Inflow	Total
--	end 1998	1999	end 1999
Food & beverage	80	-	80
Text/apparel,leather	260	-	260
Chemicals, rubber, plastic	110	2	112
Non-met. mineral products	47	13	60
Fabricated metal, machinery	44	23	67
Other manufactured	104	-16	88
Services	903	97	1000

Total	1,550	117	1,667

Source: Board of Investment of Sri Lanka

Note: Investment figures reported here consist of direct investment plus loan financing. The data provided by the BOI are incomplete. They do not include foreign investment that came through non-BOI sources prior to 1994. Foreign investment in the banking and insurance sectors are also not included. Figures reported by the BOI have been converted at average exchange rates prevailing in 1998 and 1999.

Chapter VIII

TRADE AND PROJECT FINANCING

Banking System

Sri Lanka has a fairly well diversified banking system which includes the Central Bank of Sri Lanka, two large state-owned commercial banks, nine private domestic commercial banks, sixteen foreign banks, a national savings bank, six regional development banks, two large development finance institutions--the Development Finance Corporation of Ceylon (DFCC) and the National Development Bank (NDB)--a mortgage bank, and ten merchant banks. There are two American banks (Citibank N.A. and American Express) among the foreign commercial banks operating in Sri Lanka. In addition, Bankers Trust has correspondent banking operations here. The domestic commercial banks operate a wide network of branches throughout the island. All commercial banks operate foreign currency banking units (FCBU), and conduct off-shore business and finance projects approved by BOI. All Sri Lankan commercial banks have correspondent relationships with U.S. banks. The Central Bank of Sri Lanka is responsible for regulation and supervision of Sri Lanka's banking system. The legal framework consists of the Monetary Law Act and the Banking Act. The Central Bank is empowered to issue detailed directives to the commercial banks. In 1993, Sri Lanka adopted the Basel Accord capital guidelines of 8 percent of risk-adjusted assets as the minimum capital requirement for commercial banks. Commercial banks are also required to comply with Sri Lanka Auditing and Accounting Standards and Central Bank guidelines on loan loss provisioning.

Foreign Exchange Controls Affecting Trading

There are no foreign exchange controls affecting active trading. Sri Lanka removed all exchange control restrictions on current account transactions effective March 15, 1994. Controls do exist on capital account transactions, but these are generally avoided on projects receiving Board of Investment (BOI) approval.

General Financing Availability

Commercial banks provide term loans and working capital loans for importers. High interest costs (averaging 20 percent; about 15 percent for prime customers) are a fact of life faced by the local business community, but foreign investors, BOI-approved local firms and exporters can access dollar-denominated loans with dollar interest rates. Two local development banks provide development financing and equity. The commercial banks are allowed to borrow abroad up to 15 percent of their capital funds.

Foreign-owned companies' access to local credit markets was liberalized recently. Foreign majority joint ventures, other than companies approved under section 17 of the BOI Act, are allowed automatic access to local credit markets with effect from February 14, 1999. Earlier such firms had to obtain approval from the Central Bank on a case-by-case basis to borrow rupee funds. Foreign-owned firms approved under section 17 of the BOI also have been allowed access to local credit markets very recently. Previously, such ventures were required to have foreign sources of financing for fixed and working capital requirements. Local lending institutions can now lend to these foreign-owned firms subject to limits imposed by the Central Bank. There are no such limits on lending by foreign commercial banks operating in Sri Lanka.

Export Financing and Insurance

U.S. exports to Sri Lanka can be supported by the U.S. Export-Import (ExIm) Bank, which can provide loan and loan guarantee programs to U.S. exporters interested in exporting to Sri Lanka. Further information on EXIM bank programs is available at http://www.exim.gov.

The U.S. Department of Agriculture's PL-480 and GSM credit guarantee programs are currently in operation to finance U.S. wheat and cotton exports to Sri Lanka.

The Overseas Private Investment Corporation (OPIC) provides investment insurance guarantees for U.S. investors. OPIC currently provides coverage to banking sector investments in Sri Lanka.

Project Financing

Funds provided through multilateral agencies have been the major source of term lending for government projects. The Asian Development Bank and the World Bank are the major sources of project financing. Long-term subordinated debt for private infrastructure is available through the Private Sector Infrastructure Development Company (PSIDC), a state-owned company. PSIDC, established in 1995, supplements the usual commercial sources of finance for infrastructure projects with funding obtained from the World Bank and the KfW of Germany. It concentrates on four areas, namely power, telecommunications, transport and solid waste management. The International Finance Corporation (IFC) also supports private sector projects in Sri Lanka in the form of equity and long-term debt financing. IFC has been active in Sri Lanka for several years and focuses mainly on infrastructure (power, telecommunications, water), financial markets, information technology, healthcare, education and industrial/service sector projects with a development character. In addition, bilateral donors like Japan and Germany also fund major projects by providing long term concessional loans.

The U.S. Trade and Development Agency (TDA) funds feasibility studies, orientation visits, specialized training grants, business workshops and various forms of technical assistance to help American businesses compete for infrastructure and industrial projects. Further information on TDA programs is available at www.tda.gov

Existing World Bank IDA loans:
- $39 million for Colombo environment improvement
- $77 million for private infrastructure development
- $64 million for teacher education
- $70 million for general education
- $15 million for environmental action
- $24 million for energy services delivery
- $18 million for health services
- $57 million for Mahaweli restructuring
- $18 million for legal reform

Proposed IDA loans:
- $25 million for Kelanitissa power partial-risk guarantee
- $37 million for postal service reform
- $40 million for power sector restructuring
- $40 million for poverty alleviation/rural development
- $40 million for port efficiency improvement
- $60 million for urban settlement improvement
- $60 million for community water

Existing ADB loans:
- $75 million for water supply and sanitation
- $30 million for southern road development
- $20 million for perennial crops development
- $16 million for watershed improvement
- $20 million for science and technology personnel
- $20 million for north central province rural development
- $75 million for power systems expansion
- $60 million for plantation reforms
- $80 million for road network development
- $74 million for urban development and housing
- $37 million for tea development
- $30 million for coastal resource management
- $80 million for southern transport development
- $20 million for skills development

Proposed ADB loans (2000-2001):
- $20 million for forestry resource management
- $40 million for secondary education modernization

- $12 million for protected area management and wildlife conservation
- $85 million for private sector development (public sector restructuring)
- $20 million for water resources management

Office of the Multilateral Development Bank Operations (MDBO) of the U.S. Department of Commerce assists U.S. suppliers and consultants seeking information and assistance on business opportunities available through the multilateral development banks including the World Bank and the Asian Development Bank. U.S. companies interested in receiving early warnings on multilateral development bank projects can subscribe to services provided by the MDBO. Interested Parties should contact Multilateral Development Bank Operations Office, International Trade Administration, U.S. Department of Commerce, Ronald Reagan Building, Washington D.C. 20230; phone: (202) 482-3399; fax: (202) 482-3914; email: MDBO.Banks@mail.doc.gov;
website: www.ita.doc.gov.mdbo.

Selling to the Asian Development Bank: A Commercial Liaison Office which reports directly to the Office of Multilateral Development Banks at the Commerce Department in Washington, assists U.S. suppliers and consultants in winning contracts on ADB-funded projects and activities. The office includes a Senior Commercial Officer and two Commercial Specialists. One of the specialists represents the United States-Asia Environmental Partnership (US-AEP) at the bank. The liaison works closely with the U.S. Executive Director who represents the United States on the Bank's Board of Directors. Interested parties should contact the Mr. Denny Barnes, Senior Commercial Officer and U.S. Commercial Liaison to the Asian Development Bank, c/o U.S. Embassy Manila, PSC 500 Box 33; phone: (632) 804-0460; fax: (632) 804-0357;
email: Denny.Barnes@mail.doc.gov;

The U.S. Department of Commerce has also assigned commercial liaison officers to the World Bank. These officers work closely with the U.S. Executive Director to support efforts of U.S. companies pursuing World Bank contracts. Interested parties should contact Mr. Eric Weaver, Director, Office of the U.S. Executive Director, 1818H Street N.W., Washington D.C. 20433. phone: (202) 477-2967; fax: (202) 458-0120;
email: Eric.Weaver@mail.doc.gov

A list of useful financial sector contacts including U.S. and foreign banks operating in Sri Lanka, major local commercial banks with correspondent U.S. banking arrangements, U.S. based financing agencies such as EXIM and TDA and multilateral development bank offices in Sri Lanka is provided in Chapter XI.

Chapter IX

BUSINESS TRAVEL

Business Customs

The business language is English. Business cards are a necessity. Courtesy is highly valued in Sri Lanka, and personal graciousness plays a major role in clinching deals. While punctuality is not as highly prized as in the United States, most appointments and other commitments are scrupulously observed.

Travel Advisory and Visas

Excerpts from the latest Embassy Consular Information Sheet dated April 21, 2000, and updated since follow:

> Areas of Instability: The 17-year old armed conflict between the government of Sri Lanka and a Tamil separatist group, the Liberation Tigers of Tamil Eelam (LTTE) continues. Combat operations in the North-Central and Eastern parts of the country have been intermittent and often intense. Sri Lankan defense regulations restrict travel in much of the island's northern area, including Wilpattu and Gal-Oya national parks. Yala National Park was closed following several terrorist incidents in July 1996 , but block one of the Park has since re-opened. Travelers are advised not to travel to the north, east and far southeast of the country. The U.S. Government maintains tight security procedures regarding travel of U.S. Government employees, officials, and dependents to those areas.
>
> Terrorist Activity: In October 1997, the State Department formally designated the LTTE as a foreign terrorist organization; that designation was renewed in October 1999. Terrorist activities in the capital city of Colombo and other areas remain a serious threat. In 1997 the LTTE attacked several commercial ships flying flags in the waters off the north and east of the country. While no terrorist attacks against international or domestic aviation in Sri Lanka have been recorded since 1987, threats were directed at domestic air carriers flying between Colombo and Jaffna in 1998. A domestic civilian aircraft flying from Colombo to Jaffna crashed in September 1998 killing everyone on board. The cause of the accident is still unknown.
>
> Bomb attacks remain the greatest terrorist hazard. Political assassinations or attempted assassinations are routinely carried out by the LTTE. In February 1998 an LTTE suicide bomber killed herself and eight others when she detonated her concealed bomb after being detected at a security checkpoint in Colombo. A suicide bomber killed four people in an attempted assassination in a suburb of Colombo in March 1999. In July 1999, a suicide bomber killed a prominent moderate Tamil Member of Parliament, as well as his escort, in the midst of a traffic jam in a residential section of Colombo. In December 1999, during the Presidential election campaign, a suicide bomber's attack on the Sri Lankan President killed 14 and wounded hundreds of others, including the President. Also in December 1999, a bomb attack at an opposition-party political rally killed 10 and injured 43. In January 2000, a suicide bomber killed ten and injured

several passers-by when she detonated her bomb outside the Prime Minister's Officer after being detected by security personnel. In early March, terrorists detonated bombs on a main Colombo highway leading to the parliament killing several civilians and security personnel. In June 2000, the Minister for Industrial Development, his wife and 23 others were killed and over 60 others were injured when a suicide bomber detonated himself at a procession held to commemorate war heroes. Again in mid-June another suicide bomber detonated a bomb in morning rush hour in a major highway leading to Colombo, killing three people.

In addition to individual suicide bombers, vehicle-mounted bombs have been used by the LTTE. Major hotels have been directly affected by terrorist activities and could be again because of their proximity to likely economic, government and military targets. An October 1997 truck bomb in downtown Colombo killed 18, injured over 100, and badly damaged nearby office buildings and adjacent five-star hotels. In January 1998, the Temple of the Tooth, an important religious and tourist site in Kandy, was subjected to a truck bomb; eight people were killed and the temple, nearby businesses, and an historic hotel were damaged. In March 1998, a large bomb concealed in a bus was detonated near a busy intersection in Colombo, killing 32 and wounding 250.

Small bombs have frequently been placed against infrastructure targets such as telephone switchgear or electrical power transformers. Since the September 1999 detonation of three bombs placed in buses in separate incidents in Negombo and Badulla, attacks on buses have increased. In one week in February 2000, there were seven separate explosions of bombs left on public buses in Colombo and other cities. Bombs have also been found on trains and on train roadbeds.

Except for minor injuries in the October 1997 truck bombing, no U.S. citizens were killed or wounded in these incidents. Although U.S. citizens have not been specifically targeted, LTTE operations have been planned and executed with the knowledge that Americans and other foreigners might be killed or injured. Tourists or business representatives traveling in Sri Lanka who are in the wrong place at the wrong time may be inadvertently caught up in random acts of violence. Additional attacks, especially on infrastructure facilities, could result in future tightening of security, causing hardship to travelers.

Americans are urged to exercise extreme caution in Colombo because of possible terrorist activities there. In addition, Americans are advised to avoid political rallies and other mass gatherings, limit exposure to government and military installations and avoid public transportation if at all possible. Street and highway checkpoints staffed by security personnel are common; travelers should closely follow any instructions given. Non Sri-Lankan citizens of Tamil heritage have occasionally been detained during security operations. All U.S. citizens, of any ethnic heritage, are encouraged to keep their passports with them at all times. In the event of a terrorist attack, Americans should monitor local radio and television, seek cover away from windows and return to their homes or hotels when it is safe to do so.

U.S. citizens are strongly encouraged to register with the Embassy upon arrival in Sri Lanka.

Crime Information: Petty street crime such as purse snatching and pickpocketing is common, especially on crowded local transportation. The Embassy has received an increase in reports of incidents involving violence in the coastal towns of Negombo and Hikkaduwa. Exercise caution in these towns, especially at night. The loss or theft of a U.S. passport should be reported immediately to local police and the U.S. Embassy. U.S. citizens may refer to the Department of State's pamphlets "A Safe Trip Abroad" and "Tips for Travelers to South Asia" for ways to promote a more trouble-free journey. The pamphlets are available from the Superintendent of Documents, U.S. Government Printing Office, Washington D.C. 20402, via the internet at http:// www.access.gpo.gov/su_docs, or via the Bureau of Consular Affairs home page at http://travel.state.gov

Drug Penalties: While in a foreign country, a U.S. citizen is subject to that country's law and regulations. Penalties for possession, use and trafficking in illegal drugs are strictly enforced, and convicted offenders can expect jail sentences and heavy fines.

Entry and Registration Requirements: A passport, onward/return ticket and proof of sufficient funds (US$15 per day) are required. A tourist visa can be granted at the time of entry into Sri Lanka and may be valid for a maximum of 90 days. Visitors to Sri Lanka intending to engage in business transactions must have Sri Lankan visas prior to entry into the country. Landing visas for business visitors can be arranged by their local sponsors/representatives through Sri Lanka Immigration Department. Yellow fever and cholera immunizations are needed if arriving from an infected area. Further information can be obtained by contacting the Embassy of the Democratic Socialist Republic of Sri Lanka, 2148 Wyoming Avenue, NW, Washington, DC 20008, telephone (202) 483-4025 through 28, email: slembasy@clark.net, homepage http://www.slembassy.org; or the Sri Lankan Consulate in New York, telephone (212) 986-7040. There are also honorary Sri Lankan consuls in Los Angeles, telephone: (323) 634-0479; Honolulu, telephone (808) 735-1622; and New Orleans. telephone (504) 455-7600. Sri Lankan law requires all persons including foreigners, who are guests in private households to register in person at the nearest local police station. Individuals who stay in a private household without registering may be temporarily detained for questioning. This requirement does not apply to individuals staying in hotels or guesthouses.

Travel and consular information is available via the Department of State's Internet web site at http://www.travel.state.gov/

Holidays

Sri Lanka holidays are connected with the country's four religions: Buddhism, Hinduism, Islam and Christianity. Dates change from year to year. Holidays with fixed dates include Independence Day (February 4), Labor Day (May 1) and Christmas (December 25). Each full moon is marked by a Poya Day holiday.

The following is a list of holidays for 2001.

January	09	Duruthu Poya
January	14	Thai Pongal
February	04	National Day
February	07	Navam Poya
February	21	Mahasivarathri Day
March	06	Id-Ul-Allah (Hajji Festival)
March	09	Medin Poya
April	07	Bak Poya
April	13	Good Friday
April	13	Day Prior to Sinhala/Tamil New Year
April	14	Sinhala and Tamil New Year
May	01	May (Labor) Day
May	07	Vesak Poya
May	08	Day Following Vesak Poya
June	05	Poson Poya
June	05	Holy Prophet's Birthday
July	05	Esala Poya
August	03	Nikini Poya
September	02	Binara Poya
October	02	Adhi Vap Poya
October	31	Vap Poya
November	14	Deepavali Festival
November	30	Il Poya
December	17	Ramazan Festival
December	25	Christmas
December	30	Unduvap Poya

Business Infrastructure

Colombo is served by a fairly modern international airport. Long-distance international flights often arrive and depart at somewhat inconvenient times (i.e., in the middle of the night). At present, no U.S. carriers provide service to Sri Lanka, though several U.S. airlines have sales agents in the country.

With over 25,000 kilometers of paved road, all parts of the island--aside from the war zones in the North and East--are easily accessible. However, virtually all roads are only one lane in each direction, and the average speed of travel is only about 20 miles per hour (30 kmh). Traffic in Colombo is congested. Vehicle traffic moves on the left (British style). Narrow highways, dangerously driven intercity buses, overloaded trucks and a variety of vehicles ranging from ox carts to new four-wheel drive jeeps on the road make driving a challenge, not to mention dangerous. Many visitors hire cars and drivers, or use local taxi services. Radio-operated metered taxi cabs and motorized trishaws are freely available in the Colombo area. Taxi cabs are generally prearranged by phone, while the trishaws can be hailed on the street (rates must be negotiated in advance).

International direct dialing is available and cellular telephones have become increasingly popular. International mail and courier services (including FedEx, UPS and DHL) are also available. A number of local providers offer Internet and e-mail services; because the phone line quality varies, connections are sometimes unstable.

Several five-star hotels provide accommodations and a wide range of amenities and services for business travelers in Colombo. There are also dozens of fine beach resorts two to three hours away. Housing facilities for expatriates are satisfactory, and options have improved. Stand-alone homes with yards are available, but often require extensive effort and resources to renovate and maintain. Some expats choose to negotiate long-term living arrangements with five-star hotels for suites or rooms with kitchenettes. Several luxury apartment buildings, offering furnished units and numerous amenities (e.g., pool, health club, shopping, restaurants) and catering primarily to expatriates, have recently opened in Colombo.

Medical facilities are limited but generally adequate. Doctors and hospitals often require immediate cash payment for health services. A serious illness or injury might require evacuation to the nearest country where more comprehensive medical facilities are available, usually Singapore or Thailand. Because U.S. medical insurance is not always valid outside the United States, supplemental insurance with specific overseas coverage, including medical evacuation coverage, may prove useful.

Several well-stocked supermarkets are located in Colombo. The Overseas School of Colombo offers programs for pre-school through twelfth grade and is the only international school offering an International Baccalaureate diploma, which is the equivalent of a diploma from an American high school. Comprehensive practical information for Americans living in Colombo can be found in the "Colombo Handbook" published by the North American Women’s Association of Sri Lanka and available in bookstores in Colombo.

The American Chamber of Commerce in Sri Lanka (AmCham) has over 250 members, including firms with majority U.S. ownership, local agents representing U.S. goods and services, as well as local companies that have commercial relations with U.S. entities. The AmCham sponsors monthly luncheon meetings with a featured speaker, intermittent breakfast meetings with visiting U.S. officials and other guests, and occasional cocktail get-togethers. Since 1997, the AmCham has hosted an annual American Ambassador’s Dinner. In addition, the AmCham has with other local and U.S. government-sponsored organizations co-sponsored quality and productivity seminars and a trade mission. The AmCham also organizes and sponsors the American Trade Fair, held once every 18 to 24 months, with Embassy support. The AmCham published a comprehensive membership directory in 1998, which is available to non-members for purchase. See appendix E for contact information.

"Key Officers of Foreign Service Posts: Guide for Business Representatives" is available for sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402; tel. (202) 512-1800; fax (202) 512-2250. Business travelers to Sri Lanka seeking appointments with U.S. Embassy Colombo officials should contact the Economic-Commercial Section in advance. The Economic-Commercial Section can be reached by telephone at 94-1-448-007, by fax at 94-1-437-345, or by email at coml@eureka.lk or ecpo@eureka.lk. Economic and commercial information prepared by the Embassy can also be found on the Embassy's website at http://usembassy.state.gov/srilanka

Temporary Entry of Goods

Temporary entry for exhibition material is allowed under the Carnet system of the International Chamber of Commerce. The exporter should ensure that required documents under the Carnet system are certified in the country of origin of the material. These documents should be presented at the time the goods are clearing Customs. Goods brought into the country under the Carnet system must be re-exported within six months. For additional information, contact the approving authority: Director of Customs, Times Building, Colombo 1, telephone 94-1-421141~9, fax 94-1-446364.

Visitors carrying laptop computers and software for use during their stay should declare the items to Customs upon entry and pay a refundable deposit, which is equivalent to a 12.5% GST and a 0.5% National Security Levy. The deposit is refunded at the time of departure at the Customs counter at the airport. In practice, the rule is not strictly enforced in the case of small quantities of software brought in for temporary personal use.

Business travelers can enter a portable computer, with or without encrypted software, as personal baggage. No duties or taxes are charged. Customs does not check for software.

Chapter X

ECONOMIC AND TRADE STATISTICS

APPENDIX A – The Domestic Economy

- Population: 19,043,000 (1999)
- Population growth rate (percent): 1.4 (1999)
- Religions: Buddhism, Hinduism, Islam, Christianity
- Government system: Executive President and Parliament
- Languages: Sinhala, Tamil and English
- Work week: Monday to Friday

	1998	1999	2000 Proj
GDP (in Rs billions) (a)	1,018	1,111	1,245
GDP growth rate, (%) (b)	4.7	4.3	4.0
GDP (in $ millions) (a)	15,760	15,783	15,800
GDP per capita ($)	839	829	820
Government spending (% of GDP)	26	25	27
Inflation (%)	9.4	4.7	9
Unemployment (%) (c)	10.9	9.9	9
Foreign exchange reserves (in $ millions)	2,900	2,580	2,200
Average Exchange Rate (Rs. Per $)	64.59	70.39	79
Foreign debt (in $ millions)	8,750	9,050	9,450
Debt service ratio (%) (d)	11.0	12.5	12.5
U.S. economic assistance (in $ millions)(e)	11.7	11.0	14.0

Notes: (a) at current market prices; (b) real growth; (c) unemployed numbers include unpaid family workers; (d) as a percentage of receipts from merchandise exports, services, income and private transfers; (e) includes USAID, PL480 and PL416 in assistance.
Sources: Central Bank and Embassy estimates

APPENDIX B – Trade Statistics
(in $ millions, except where noted)

	1998	1999	2000 Proj
Total exports	4,798	4,600	5,000
Total imports	5,890	5,900	6,600
U.S. imports from Sri Lanka	1,767	1,742	1,790
U.S. exports to Sri Lanka	190	167	180

Sources: Central Bank of Sri Lanka and Embassy estimates

Chapter XI

U.S. AND COUNTRY CONTACTS

Trade Associations/Chambers of Commerce/Other Organizations

American Chamber of Commerce of Sri Lanka
Kavan Ratnayake, President
Maria Ondaatjie, Executive Director
Colombo Hilton Hotel, Lotus Road, Colombo 1
Phone: 94-1-544644
Fax: 94-1-544657
E-Mail: amcham@itmin.com

Ceylon Chamber of Commerce
C. Jayasuriya, Secretary General
50 Nawam Mawatha, Colombo 2
Phone: 94-1-421745/46/47
Fax: 94-1-449352
E-Mail: chamber2@sri.lanka.net

National Chamber of Commerce
Neil Seneviratne, General Secretary
450 D.R. Wijewardene Mawatha, Colombo 10
Phone: 94-1-689600
Fax: 94-1-689596
E-Mail: nccsl@slt.lk

Federation of Chambers of Commerce & Industry of Sri Lanka
Lal de Mel, President
29 Gregory's Road, Colombo 7.
Phone: 94-1-698225
Fax: 94-1-699530
E-Mail: sgneral@fccisl.org

The Ceylon National Chamber of Industries
Asoka Tennakoon, Secretary General
Flat 20, 1st Floor Galle Face Court #2, Colombo 3.
Phone: 94-1-331444
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Sri Lanka Chamber of Small Industry
Aloy Jayawardena, President
9, 3rd Floor, Galle Face Court 1, Colombo 3
Phone: 94-1-438715
Fax: 94-1-336466

Colombo Stock Exchange
A.D. Gunawardene, Chairman
#4-01 West Block, World Trade Center
Echelon Square, Colombo 1
Phone: 94-1-446581
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E-Mail: cse@sri.lanka.net

Employer's Federation of Sri Lanka
Franklyn Amarasinghe, Secretary General
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Ministry of Foreign Affairs
Lionel Fernando, Secretary
Republic Building, Colombo 1
Phone: 94-1-325371
Fax: 94-1-333450

Ministry of Industrial Development
Sumanasiri Hulugalle, Secretary
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Ministry of Internal & International, Commerce and Food
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E-Mail: trade@tradenetsl.lk

Ministry of Irrigation, Power and Energy
Jaliya Medagama, Secretary
Phone: 94-1-687370/43
Fax: 94-1-694968
K. Warnakulasooriya, Additional Secretary (power)
Phone: 94-1-687377
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E-Mail: jaliyam@eureka.lk

Ministry of Post, Telecommunication & Media
S.M.J. Senaratne, Secretary

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Central Bank of Sri Lanka
A.S. Jayawardena, Governor
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http://www.centralbanklanka.org

Public Enterprise and Reform Commission (PERC)
P.B. Jayasundera, Chairman
Mano Tittawela, Director General
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http://www.boisrilanka.org

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Department of Commerce
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Department of Inland Revenue
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Sir Chittampalam A. Gardiner Mawatha, Colombo 2
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Fax: 94-1-430816

Sri Lanka Customs Department
Lakshman Perera, Director General
Custom House, Times Building
Bristol Street, Colombo 1
Phone: 94-1-421141/445147
Fax: 94-1-446364

Department of Labor
R.P. Wimalasena, Labor Commissioner
Labor Secretariat, Narahenpita, Colombo 5
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Fax: 94-1-581145

Ceylon Electricity Board
Arjun Deraniyagala, Chairman
Ananda Seneviratna, General Manager
D.K.B.S. Thilakasena, Deputy General Manager, Private Power Projects
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Telecommunications Regulatory Commission of Sri Lanka
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Sri Lanka Standards Institute
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Ceylon Petroleum Corporation
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National Intellectual Property Office of Sri Lanka
Dr. D.M. Karunaratne, Director
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D.K. Hettiarachchi, Registrar
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Department of Civil Aviation
Lal Liyanaarachchi, Director
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Private Sector Infrastructure Development Co. Ltd.
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Drugs Regulatory Authority of Sri Lanka

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Org-Marg Smart
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Resource Organization and Management Intl. Ltd.
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Teams (Pvt) Ltd.
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Lanka Market Research Bureau Ltd.
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Transparency International
Sri Lanka National Chapter
Aritha Wickramanayake, Director
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Internationally Affiliated Accounting/Consulting Firms

Pricewaterhouse Coopers
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Fax: 94-1-445871/446058

Ernst & Young
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Fax: 94-1-697369

Someswaran Jayawickrema & Co.
(Arthur Anderson Representative)
T. Someswaran, Senior Partner
222 Galle Road, Colombo 4
Phone: 94-1-580409
Fax: 582452

Major Commercial Banks and Development Banks

U.S. Banks

American Express Bank Ltd.

Akbar Khan, Senior Country Executive
104 Dharmapala Mawatha, Colombo 3
Phone: 94-1-682795
Fax: 94-1-682786

Citibank N.A.
Kapila Jayawardena, Chief Executive Officer
67 Dharmapala Mawatha, Colombo 7
Phone: 94-1-449061
Fax: 94-1-445487

Other Foreign Banks

ABN AMRO NV
103A Dharmapala Mawatha, Colombo 3
Phone: 94-1-448448
Fax: 94-1-446986

ANZ Grindlays Bank Ltd.
37 York Street, Colombo 1
Phone: 94-1-446150~57, 432286/87/88
Fax: 94-1-446158

Hongkong & Shanghai Banking Corporation Ltd.
24 Sir Baron Jayatilaka Mawatha, Colombo 1
Phone: 94-1-325435~38/446591~99
Fax: 94-1-438585

Standard Chartered Bank
17 Janadhipathi Mawatha, Colombo 1
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Fax: 94-1-432522

Local Banks

Hatton National Bank
10 R.A. de Mel Mawatha, Colombo 3
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Fax: 94-1-446312
E-Mail: hnblanka.com

Peoples Bank
75 Sir Chittampalam A. Gardiner Mawatha, Colombo 2
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Fax: 94-1-447671

Sampath Bank

55 D.R. Wijewardana Mawatha, Colombo 10
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Seylan Bank Ltd.
33 Sir Baron Jayatilleke Mawatha, Colombo 1
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Bank of Ceylon
4 Bank of Ceylon Mawatha, Colombo 1
Phone: 94-1-446790/544333
Fax: 94-1-445798

Commercial Bank
21 Bristol Street, Colombo 1
Phone: 94-1-447516/430420
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Development Finance Corporation of Ceylon (DFCC)
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73/5 Galle Road, Colombo 3
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National Development Bank (NDB)
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Hayleys Limited
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John Keells Holdings Limited
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Ceylinco Limited
Lalith Kotelawala, Chairman
55 R.A. de Mel Mawatha, Colombo 1
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Carson Cumberbatch and Company Limited
Mano Selvanathan, Director
61 Janadhipathi Mawatha, Colombo 1
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E-Mail: info@slt.lk

Sri Lankan Airlines
Peter Hill, Chief Executive Officer
37 York Street, Colombo 1
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George Stuarts and Company Limited
S. Skandakumar, Chairman
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Maharaja Organization
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Nawaloka Group of Companies
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Peliyagoda
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Multilateral Development Bank/IMF Offices in Sri Lanka
World Bank
Mariano Todorovo, Resident Representative
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International Finance Corporation
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World Bank Office
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International Monetary Fund
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Asian Development Bank
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USG-funded Programs dealing with Economic/Trade Issues in Sri Lanka:

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United States-Asia Environment Partnership
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American Center for International Labor Solidarity
William Conklin, Field Representative
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U.S.-based Contacts

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Vacant
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Bureau of Diplomatic Security
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Department of Commerce

Art Stern, Office of South Asia
Dept. of Commerce, Room 2308
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Trade Information Center (TIC) in Washington
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Agency for International Development
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U.S. Department of Agriculture
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Chapter XII

TRADE EVENT SCHEDULE

Hotel Asia 2000 Exhibition, November 4 – 6, 2000 in Male, Maldives. The exhibition will provide an opportunity to international suppliers related to the hospitality industry to display their products and services. Around 500 buyers from Sri Lanka, India, Maldives, Pakistan and Bangladesh are expected to attend the exhibition. The commercial section of the Embassy will be sponsoring a booth at this exhibition to display U.S. products and services.