Executive Summary

The end of the war in 2009 has allowed Sri Lanka to focus on rebuilding the country's economy and infrastructure. The government has set ambitious goals for economic development – aspiring to GDP growth rates over 8 percent and developing five economic hubs in ports, aviation, commerce, knowledge, and energy. Tourism is also growing rapidly. With a relatively open investment climate and financial system, moderately stable monetary policy, improving infrastructure, and world-class local companies, Sri Lanka has many of the ingredients to progress economically. For some U.S. and foreign investors, Sri Lanka's frontier market has been fertile ground for both direct and capital investments.

The current president, Mahinda Rajapaksa, was reelected to a second six-year term in January 2010. The Rajapaksa government follows a statist economic policy and the space for the private sector has contracted. The government supports import substitution. Private investment both foreign and local has been sluggish. Certain other policies are impeding the investment climate such as a prohibition on land sales to foreigners and the November 2011 "Underutilized Assets" Act, which resulted in the seizure of 37 companies and assets. Although most of these companies were defunct enterprises, several were viable businesses. Political violence aimed at businesses has also increased. The business community claims that corruption has the greatest impact on investors in large projects and on those pursuing government procurement contracts. Some claim that the level of corruption makes it difficult to compete with bidders not subject to the U.S. Foreign Corrupt Practices Act. Improvements to governance, regulatory environment, financial landscape, human resources, and government administration would be pre-requisites to achieve government's economic targets. Growth could also be hampered by the lack of export diversification and the lack of private investment.

The United States remains concerned with the human rights situation in Sri Lanka. A United Nations Human Rights Commission (UNHRC) resolution passed in March 2014 requests the office of the UN Human Rights Commissioner to lead an investigation into alleged violations and abuses of human rights during the conflict and to monitor the human rights situation.

Despite the 1983-2009 civil war, GDP growth averaged around 5 percent from 2000-2008. Economic activity rebounded at the end of the war resulting in an average growth of 7.5 percent in the last four years. GDP reached $67 billion in 2013. The Central Bank of Sri Lanka (CBSL) predicts the economy will grow by 7.8 percent in 2014 and over 8percent thereafter, and the per capita GDP of $3,280 will increase to $4,000 by 2016. The CBSL is keen to maintain lower interest rates and lower inflation than in the past to spur growth, but the private sector is yet to respond. Losses of state-owned enterprises (SOE) and a bloated civil service are major concerns. Sri Lanka suffers from a large current account deficit. Sri Lanka's annual exports are about $10 billion, mostly tea and garments. The United States is the most important market for Sri Lankan exports. Imports are about $18 billion. Remittances from migrant workers, around $6.4 billion per year, are Sri Lanka's largest source of foreign exchange and help to partially offset the external deficits.

With the conclusion of the war, the GSL is investing heavily in infrastructure. The government has also undertaken a significant urban renewal program – cleaning up and beautifying cities. In its drive to improve infrastructure, Sri Lanka's non-concessional foreign debt has increased significantly to about 50 percent of total foreign debt. China has emerged as the largest project lender. Many observers believe Sri Lanka will have difficulty repaying loans taken to improve infrastructure, although government officials are confident that growth will bring in the necessary revenue.

1. Openness To, and Restrictions Upon, Foreign Investment

Attitude Toward FDI

Sri Lanka is a constitutional, multiparty republic. In 1978, it shifted away from a socialist orientation and opened up to foreign investment, although changes in government have often been accompanied by reversals in economic policy. The current president, Mahinda Rajapaksa, was reelected to a second six-year term in January 2010.

The Rajapaksa government follows a statist economic policy, with key goals including the development of Sri Lanka as a regional hub for air and sea transportation, trading, energy, and knowledge-based services. The government aims to use the current Indo-Lanka FTA and the proposed Sri Lanka –China FTA to make Sri Lanka a gateway to massive Indian and Chinese markets. The government also aims to reduce poverty by steering investment to disadvantaged areas; developing small and medium enterprises (SMEs); promoting agriculture; and expanding the civil service. The government has halted privatization – reversing several previous privatizations – and advocates state control of what it deems "strategic" enterprises such as state-owned banks, airports, and electrical utilities. The government has increased its control of the banking sector and utilized government-controlled pension funds and companies to take majority control of leading private banks. The Sri Lankan military has expanded into activities traditionally reserved for the private sector, including air services, agriculture, construction and tourism. The government supports import substitution and import duties remain very high on vehicles, food, consumer items and most finished products. The government has removed taxes on certain intermediate imports, however, to make the country a trading hub.

While the state is a major player in many economic sectors, the private sector plays a key role across the economy, including in finance, exports, tea, apparel, IT, and tourism. However, both local and multinational companies complain that an increasing government role in business is impacting the investment climate. Though many multinational companies and local small and medium enterprises often perform better than large local companies, some feel that government procurement and project approval decisions favor large local operators.

Sri Lanka requires high levels of FDI to meet the desired growth levels. Most of the current economic potential is in the tourism sector, with Sri Lanka designated as Lonely Planet's top destination in 2013, and major international chains opening hotels over the next few years. Tourist arrivals reached 1,275,000 in 2013. Investors are capitalizing on Sri Lanka's environment, culture, religious history, and wildlife to attract high-end tourists, especially from the growing markets in India and China. The ports are another important driver of growth, with the Colombo Port being one of the most active in the region, and the country situated at the crossroads of global shipping lines.

Ample scope exists as well for an expansion in the information technology/business processing operations (IT/BPO) sector. With a growing and aspirational middle class, investors see opportunities in franchising, retail, and services, as well as light manufacturing. Investments with an export dimension have the most potential. Reconstruction in the North and East, and infrastructure development throughout the country, including new ports and roads, are also fuelling growth. Sri Lanka's free trade agreements with India and Pakistan offer preferential access to those markets, and Sri Lanka maintains friendly relations with all its neighbors in the region. The capital city of Colombo offers expatriate managers a good quality of life relative to the region.

Areas of Concern

Sri Lanka can still be a challenging place to do business, with high transaction costs related to an unpredictable economic policy environment. While many government departments and ministries boast competent staff, the government's overall provision of services is impeded by inefficiency, and economic growth is stymied by opaque government procurement practices. Certain recent policies have also sent mixed signals to investors. The 2013 budget prohibited all land sales to foreigners and imposed a tax on lease transfers to foreigners, but the government then issued circulars exempting diplomatic missions, condominiums over the fourth floor, and foreign majority-owned companies in business for ten consecutive years. The Cabinet can also approve a land purchase for an investment "in the national interest," provided there is a substantial foreign remittance for the purchase of the land. A land transfer tax of 100 percent may still apply.

Other recent policies include the November 2011 "Underutilized Assets" Act, which resulted in the seizure of 37 companies and assets. Although most of these companies were defunct enterprises, several were viable businesses. The government stated that these companies had violated the terms of their land leases with the government. The government has promised that this was a "one-time" measure, but subsequently announced plans to seize 10,000 hectares of allegedly unused tea plantation land leased to private companies. The expropriation law – and its passage after one day of debate in Parliament – created an atmosphere of uncertainty and unpredictability in the business environment.

The Securities and Exchange Commission (SEC) was rocked by scandals in 2013. Media reports accused SEC chief of accepting a bribe of $3 million from an Indian property investor and passing the payments to government VIPs. There have been no investigations and all concerned parties have denied any wrongdoing. Previously, four senior SEC officials resigned over regulatory issues, citing pressures from high net-worth local investors. In December 2012, a special parliamentary committee impeached the Chief Justice over corruption charges in what many called a politically-motivated process. Local investors cite the risks of contract repudiation, cronyism, damage to reputation, and de facto or de jure expropriation as concerns.

From an investor viewpoint, the power and petroleum sectors are particularly challenging, as decision-making authority is highly fragmented, and the capital investments required are substantial. Trade union opposition at both the Ceylon Petroleum Corporation and the Ceylon Electricity Board (CEB) make reform of these loss-generating SOEs very difficult.

Sri Lankan financial institutions (FI) may have trouble complying with the U.S. Foreign Accounts Tax Compliance Act (FATCA). The government has directed banks to directly register with the Internal Revenue Service (IRS).

Start-up Costs, Scalability, Retention, and the Need for a Local Partner

Investors report that starting a business in Sri Lanka is relatively simple and rapid – especially when compared to other frontier markets – and 20 percent cheaper than in neighboring countries. But scalability is a problem. Lack of skilled labor and a smaller talent pool means that companies can take years to double in size. Investors claim retention is good in Sri Lanka, but numerous public holidays, worker reluctance to work at night (which is especially problematic in the IT/BPO sector), lack of labor mobility, and a difficulty in recruiting women can reduce efficiency and increase start-up times. The garment industry has had more difficulty with employee retention, especially in the North and East because of poor quality of life issues in these regions. Many service sector companies rely on Sri Lankan engineers, researchers, technicians, and analysts to deliver high-quality, high-precision products. Foreign and local companies report a strong worker commitment to excellence in Sri Lanka, with rapid adaptation to quality standards.

Increasing Ties to China

Chinese companies are building much of Sri Lanka's new infrastructure using Chinese loan financing. Most of these companies bypass the government tender process, and Sri Lanka's corporate sector or non-Chinese foreign investors play little to no role in the projects. The projects, valued between $3 billion to $6 billion or more, range from construction of major ports, international airports, and power stations to expressways and reclaimed cities, highways, railways, and telecommunication towers.

Laws/Regulations of FDI

The Board of Investment (BOI) (www.investsrilanka.com), an autonomous statutory agency, is the primary government authority responsible for investment, with a focus on foreign investment. BOI promotes the following sectors as priority sectors for FDI: tourism and leisure; infrastructure; knowledge services; utilities; apparel; export manufacturing; export services; agriculture; and education. Specialized divisions representing these sectors are tasked with providing services to foreign investors through the entire investment process.

The BOI manages a number of export processing zones that feature business-friendly regulations and improved infrastructure for foreign investors. The BOI is intended to provide "one-stop" service for foreign investors, with duties including approving projects, granting incentives, and arranging utility services. It also assists in obtaining resident visas for expatriate personnel, and facilitates import and export clearances.

BOI incentives are attractive and real, but the BOI is not yet a "one-stop shop." Although the BOI is relatively effective in assisting investors who want to establish operations within its export processing zones, it is less effective in facilitating and servicing large investments outside these zones. Sri Lanka's bureaucracy often works at cross-purposes with BOI authorities. For example, registration of foreign company branch offices in Sri Lanka can be expensive.

The Treasury and a special Cabinet Review Committee outside of the BOI handle large investment projects, both local and foreign, identified as strategic development projects. These projects require approval from the full Cabinet, as well as Parliamentary approval.

The principal law governing foreign investment is Law No. 4, created in 1978 (known as the BOI Act), as amended in 1980, 1983, and 1992, along with 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 recommend concessions to companies satisfying certain eligibility criteria on minimum investment. Such companies are eligible for generous investment concessions. Investment approval under Section 16 of the BOI Act permits companies to operate under the "normal" laws of the country and applies to investments that do not satisfy eligibility criteria for BOI incentives. The Strategic Development Project Act of 2008 (SDPA) provides generous tax incentives for large projects that the Cabinet identifies as Strategic Development Projects. Other laws affecting foreign investment are the Securities and Exchange Commission Act of 1987 as amended in 1991 and 2003, the Takeovers and Mergers Code of 1995 (revised in 2003), and the Companies Act of 2007. Various labor laws and regulations also affect investors.

Foreign investments, particularly if not keyed toward export, are often more successful when guided by a local partner who can navigate the cultural and political landscape. Some sectors, however, such as IT/BPO, report relatively little need to rely on local agents or the government to start operations. Most investors agree that any export-based investment faces fewer problems, especially if the company is registered with the BOI. The greatest challenges lie in infrastructure contracts or competing for any government tender offer, where foreign investors find it difficult to navigate the opaque procurement process.

Industrial Promotion

The Government of Sri Lanka aspires to develop economic hubs in ports, aviation, commerce, knowledge, and **energy**. **Travel and tourism** also have great potential. The government invites companies to set up manufacturing plants, warehouses, and service companies near a newly built port and airport in the Southern city of Hambantota. Government hopes a proposed FTA with China and the current Indo-Lanka FTA would help Sri Lanka to be a gateway to massive markets in China and India.

Limits on Foreign Control

The government allows 100% foreign investment in any commercial, trading, or industrial activity other than a few specified sectors, which are regulated and subject to approval by various government agencies or the BOI: air transportation; coastal shipping; large scale mechanized mining of gems; lotteries; and manufacture of military hardware, military vehicles, and aircraft; dangerous drugs; alcohol; toxic, hazardous, or carcinogenic materials; currency; and security documents.

Foreign investments in the areas listed below are limited to 40% of foreign equity. Foreign ownership in excess of 40% must be approved on a case-by-case basis by the BOI: the production for export of goods subject to international quotas; growing and primary processing of tea, rubber, coconut; timber-based industries using local timber; deep-sea fishing; mass communications; education; freight forwarding; travel agency; and shipping agency business. The government is considering opening higher education to foreign investment. Foreign investment is not permitted in the following businesses: non-bank money lending; pawn-brokering; retail trade with a capital investment of less than $1 million; and coastal fishing.

Privatization Program

The government has halted privatizations, preferring to maintain state-owned enterprises, and has even reversed several privatizations. Labor unions in state-owned enterprises often oppose privatization and restructuring and seem particularly averse to foreign ownership. In the past, this made the privatization of government entities problematic for new foreign owners.

Investment Trends

Sri Lanka has failed to attract major foreign investments. From 2006-2010, foreign direct investment (FDI) flows to Sri Lanka averaged only about $500 million per year. The Central Bank claims annual FDI flows increased to about $1 billion in 2011-2012 and $1.4 billion in 2013, mainly for telecommunications, ports and property development, but fell short of the $2 billion annual government target. However, a 2012 UNCTAD report estimates FDI in Sri Lanka at only $300 million.
(See http://unctad.org/sections/dite_dir/docs/wir12_fs_lk_en.pdf). According to the BOI, the top sources of foreign direct investment in Sri Lanka (total flows from 2005-2012) are Malaysia, India, Hong Kong, United Kingdom, UAE, Mauritius, Netherlands, Singapore, China, Luxembourg, USA, Sweden, Japan, Italy, and Belgium.

Total cumulative U.S. investment in Sri Lanka is estimated to be in the range of $150 million. Major U.S. investors include Energizer Battery, Mast Industries, Smart Shirts (a subsidiary of Kellwood Industries), Chevron, Citibank, 3M, Coca-Cola, Pepsi Co, Fitch Ratings, AES Corporation, AIG/Chartis Insurance, American Liquid Packaging Systems USA, Virtusa, Avery Denison, Motorola Solutions, Amsafe Bridport, RR Donnelly, and Revlon (through its Indian subsidiary). Several Sri Lankan-Americans have started IT and BPO companies in Sri Lanka serving the U.S. market. In addition, IBM, AT&T, Procter & Gamble, Microsoft, Google, Intel, Oracle, DuPont, Bates Strategic Alliance, McCann-Erickson, Pricewaterhouse Coopers, Ernst and Young, and KPMG all have branches, affiliated offices, or local distributors/

representatives. Kentucky Fried Chicken, Pizza Hut, Federal Express, UPS, McDonald's, TGIF are represented in Sri Lanka through franchises. Numerous other American brands and products are represented by local agents.

Major non-U.S. investors include Unilever, Nestle, British American Tobacco Company, Mitsui, Fonterra, Pacific Dunlop/Ansell, Prima, FDK, Telekom Malaysia Bhd, S.P. Tao, HSBC, AIA Group, the Indian Oil Corporation, Bharathi Airtel and Cairn India. In 2011, Shangri La Hotels signed agreements to build hotels in Sri Lanka. Leading U.S. and foreign investors that have acquired significant stakes in privatized companies include Chevron, Mitsubishi Corporation, and the Indian Oil Corporation.

The Colombo Stock Exchange remains below its 2010 peak when it was ranked as one of world's best performing stock markets, and some foreign investors, including U.S. funds exited the Colombo market in the first quarter of 2014.

TABLE 1: The following chart summarizes several well-regarded indices and rankings.

Measure	**Year**	**Rank or value**	**Website Address**
TI Corruption Perceptions index	2013	91 of 177	http://cpi.transparency.org/cpi2013/results/
Heritage Foundation's Economic Freedom index	2013	90 of 177	http://www.heritage.org/index/ranking
World Bank's Doing Business "Ease of Doing Business"	2013	85 of 189	http//doingbusiness.org/rankings
Global Innovation Index	2013	98 of 142	http://www.globalinnovationindex.org/content.aspx?page=gii-full-report-2013#pdfopener
World Bank GNI per capita	2012	USD 2,920	http://data.worldbank.org/indicator/NY.GNP.PCAP.CD

TABLE 1B - Scorecards: The Millennium Challenge Corporation, a U.S. Government entity charged with delivering development grants to countries that have demonstrated a commitment to reform, produced scorecards for countries with a 2012 per capita gross national income (GNI) or $4,085 or less. A list of countries/economies with MCC scorecards and links to those scorecards is available here: http://www.mcc.gov/pages/selection/scorecards. Details on each of the MCC's indicators and a guide to reading the scorecards, are available here: http://www.mcc.gov/documents/reports/reference-2013001142401-fy14-guide-to-the-indicators.pdf

2. Conversion and Transfer Policies

Sri Lanka generally has investor-friendly conversion and transfer policies. Companies note they can repatriate funds relatively easily. In accordance with its Article VIII obligations as a member of the IMF (http://www.imf.org/external/pubs/ft/aa/aa08.htm), Sri Lanka liberalized exchange controls on current account transactions in 1994, and in 2010-2012, the government relaxed exchange controls on several categories of capital account transactions. When the government experiences balance of payments difficulties , the government tends to impose controls on foreign exchange transactions but has showed restraint in recent years.

Local business contacts claim there is also a legal parallel mechanism for conversion, i.e., small traders carrying up to $10,000 on travel in personal luggage. Exporters must repatriate export proceeds within 120 days to settle export credit facilities. Other export proceeds can be retained abroad in a local bank's correspondent bank. No barriers exist, legal or otherwise, to the expeditious remittance of corporate profits and dividends for foreign enterprises doing business in Sri Lanka. The average delay period for remitting investment returns, interest, and principal on private foreign debt, lease payments, royalties, and management fees through normal legal channels is one to four weeks. All stock market investments can be remitted without prior approval of the Central Bank through a special bank account. Investment returns can be remitted in any convertible currency at the legal market rate. Policies are becoming more restrictive for real estate investment, however; no gains can leave the country, and investors can only take out what they brought in. Gains from real estate cannot be transferred unless the investment is in a BOI-approved project. The informal money transfer/exchange system (hawala) is active, although with higher rates.

Foreigners are now permitted to invest in Sri Lankan debt instruments, both government and corporate debt. The Central Bank's rupee-denominated T-bill and T-bond issues in the local market are also open to foreign investors. Both foreign and local companies are permitted to borrow from foreign sources.

In June 2013, the Financial Action Task Force (FATF) removed Sri Lanka from the list of countries that are subject to FATF's monitoring process. A Financial Intelligence Unit (FIU) was created in 2006 and operates under the Central Bank.

3. Expropriation and Compensation

Until recently and since economic liberalization policies began in 1978, the government had not expropriated a foreign investment. The last expropriation dispute was resolved in 1998. However, on November 9, 2011, the government approved a new law entitled the Revival of Underperforming Enterprises and Underutilized Assets Act that allowed expropriation of assets belonging to 37 companies the government considered as underperforming. These companies had leased land from the government, but the government claimed the companies were not meeting the lease conditions. Although many of the 37 companies were defunct, several were viable businesses. The Central Bank stated that the Act was a "one-off" measure, but the government subsequently announced plans in the 2012 and 2013 budgets to retake 10,000 hectares of tea plantation land leased to private companies that the government said was not being fully utilized. The law increases investor uncertainty regarding property rights in Sri Lanka and is often cited as having a chilling effect on foreign direct investment.

Apart from the Underutilized Assets Act, the land acquisition law empowers the government to take over private land for public purposes. Compensation is paid per government valuation, which some local investors consider relatively fair. There are cases, however, of the military taking over businesses in the North and East on claims they are on government land, with little to no compensation. Many land records were lost or destroyed during the war, which complicates land tenure issues and delays resolution. There are recent reports of government taking over private lands throughout the country for purportedly public purposes.

4. Dispute Settlement

Legal System, Specialized Courts, Judicial Independence, Judgments of Foreign Courts

Sri Lanka's legal system reflects diverse cultural influences. Criminal law is fundamentally British. Basic civil law is Roman-Dutch. Laws pertaining to marriage, divorce, and inheritance are ethnic. Sri Lankan commercial law is almost entirely statutory. The law reflects colonial British law, but amendments have largely kept pace with subsequent legal changes in the United Kingdom. Several important legislative enactments regulate commercial matters: the Board of Investment Law; the Intellectual Property Act; the Companies Act; the Securities and Exchange Commission Act; the Banking Act; the Industrial Promotion Act; and the Consumer Affairs Authority Act.

Sri Lanka's court system consists of the Supreme Court, the Court of Appeal, Provincial High Courts and the Courts of First Instance, i.e., district courts (with general civil jurisdiction) and magistrate courts (with criminal jurisdiction). The provincial high courts have original, appellate, and reversionary criminal jurisdiction. The Court of Appeal is the intermediate appellate court with a limited right of appeal to the Supreme Court. The Supreme Court exercises final appellate jurisdiction for all criminal and civil cases. Citizens may apply directly to the Supreme Court for protection if they believe any government or administrative action has violated their fundamental human rights.

All commercial matters exceeding the value of Rs 3 million (approximately $23,000) fall within the jurisdiction of the Commercial High Court of Colombo. A number of tribunals also exercise judicial functions, such as the Labor Tribunals that hear cases brought by workers against their employers. Litigation can be slow and unproductive. Monetary judgments are usually made in local currency, but procedures exist for enforcing foreign judgments. Overall, Sri Lanka’s record in handling investment disputes is problematic. Disputes have become politicized, and the stability of contracts in general could be improved.

Bankruptcy

The Companies Act and the Insolvency Ordinance provide for dissolution of insolvent companies, but there is no mechanism to facilitate the reorganization of financially-troubled companies. Other laws make it difficult to keep a struggling company solvent. The Termination of Employment of Workmen Act (TEA), for example, makes it difficult to fire or lay off workers who have been employed for more than six months for any reason other than serious, well-documented disciplinary problems.

In the absence of proper bankruptcy laws, extra-judicial powers granted by law to financial institutions protect the rights of creditors. When a company cannot meet creditor demands for a sum exceeding Rs 50,000 (approximately $385), the creditor may petition the court to dissolve the company. Lenders are also empowered to foreclose on loan collateral without court intervention. However, loans below Rs 5 million ($38,000) are exempt, and lenders cannot foreclose on collateral provided by guarantors to a loan. Financial institutions also face other legal challenges as defaulters obtain restraining orders on frivolous grounds due to technical defects in the recovery laws.

The Companies Act of 2007 introduced a "solvency test" to determine the financial health of a company. The solvency test is intended to prevent companies without sufficient assets from obtaining loans and to protect rights of creditors. The law sets forth the responsibilities of a company's directors in cases of serious loss of capital. While the Companies Act does not provide for the revival of struggling companies, the courts generally take a liberal attitude towards any restructuring plans that would benefit a company.

Investment Disputes

Sri Lanka's courts have a mixed record with regard to upholding the sanctity of contracts. The courts are not practical for resolving disputes or obtaining remediation, because their procedures allow one party to prolong cases indefinitely. Aggrieved investors (especially those dealing with the government on projects) have frequently pursued out-of-court settlements in hopes of speedier resolution. In late 2008, the Supreme Court, in an interim order, halted payments to five international and local banks involved in oil hedge contracts with the government. One of the involved banks was American. The banks filed for international arbitration. The record on international arbitration is mixed, as two banks won their cases and the government won the third case against the American bank.

Some U.S. companies have experienced problems with payment of valid contracts, implementation of agreements with the government, and failure to secure contracts, despite demonstrated superior performance, high value, and competitive bids. In practice, it may be advisable to seek to include provisions for international arbitration.

A U.S. power company producing electricity in Colombo has experienced several difficulties since 2010, including late payments and failure to provide required letters-of-credit by the state-owned power purchaser, and a retroactive law that requires partial government ownership. Overdue payments have reached alarming levels – creating a serious cash flow problem for the company. The USG has raised the issue in bilateral meetings, but the issue has not been resolved.

International Arbitration

Most investors prefer to choose arbitration over litigation due to court delays. Investors are advised to go to a neutral country for arbitration purposes. 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.

An independent center for arbitration known as the Institute for the Development of Commercial Law and Practice (ICLP) (www.iclparbitrationcentre.com) has been established in Colombo for the expeditious, economical, and private settlement of commercial disputes. However, the ICLP appears unlikely to become involved in disputes involving the Sri Lankan government, which is often a party to disputes involving foreign investors.

The Labor Department has a process involving labor tribunals for settling industrial disputes with workers or unions, and arbitration is required when attempts to reconcile industrial disputes fail. The Labor Commissioner typically becomes involved in labor-management mediation. Other senior officials, including the Labor Minister and the President, have intervened in particularly difficult cases.

Investment Protection

The government has entered into 27 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. Under Article 157 of the Sri Lankan Constitution, investment protection agreements enjoy the force of law, and no legislative, executive, or administrative action can contravene them. The government has ratified the Convention on Settlement of Investment Disputes, which provides the mechanism and facilities for international arbitration through the World Bank's International Center for the Settlement of Investment Disputes.

The U.S. Sri Lanka Bilateral Investment Treaty (BIT) can be found at (www.state.gov/documents/organization/43588.pdf). The United States and Sri Lanka hold annual bilateral Trade and Investment Framework Agreement (TIFA) talks, which is a forum to seek to resolve trade disputes.

5. Performance Requirements and Investment Incentives

WTO/TRIMS

To qualify for investments, the Board of Investment specifies certain minimum investment amounts for both local and foreign investors. In most cases, firms enjoying preferential incentives in the manufacturing sector must export 80% of production, while those in the service sector must earn at least 70% of their income in foreign exchange. Foreign investors are generally not expected to reduce their equity over time, nor are they expected to transfer technology within a specified period of time, except for build-own-transfer or other such projects in which the terms are specified within pertinent contracts. A member of the World Trade Organization (WTO), Sri Lanka complies with the WTO Trade Related Investment Measures obligations.

Foreign investors who remit at least $250,000 can qualify for a one-year resident visa, which can be renewed. 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 in the commercial sector do not experience significant problems in obtaining work or residence permits. Sri Lanka has ceased issuing dual citizenship status to Sri Lankans who have obtained foreign citizenship. Tourist and business visas are granted for one month, with possible extensions. The international donor community has increasingly experienced delays and difficulty in obtaining business visas for their implementing partners.

Investment Incentives

For strategic development projects, the Strategic Development Project Act of 2008 provides tax incentives for large projects that the Cabinet identifies as Strategic Development Projects (SDP). SDPs are defined as investments that are in the national interest, likely to bring economic and social benefits to the country and change the landscape of the country through the provision of goods and services, substantial inflow of foreign currency, generation of employment and income, and transfer of technology. Information regarding projects selected as SDPs is published in the official gazette and needs to be approved by the Cabinet and Parliament. Projects are exempted from taxes for up to 25 years. The exempted taxes include corporate income tax, Value Added Tax, Economic Service Charge, Debit Tax, Customs Import and Export taxes, Port and Airport Tax, and the Nation Building Tax.

For other projects, the BOI provides the following incentive regime:

- *Small-Scale Enterprises:* A 4 to 5-year tax holiday for small-scale enterprises in agriculture, animal husbandry, fisheries, and creative work, including art work and information technology. Minimum investment of Rs 25 million ($219,000).

- *Medium-Scale Enterprises:* A 4 to 6-year tax holiday for medium-scale enterprises in manufacturing, agriculture, agro processing, animal husbandry, fisheries, fish processing, IT/BPO, health care, education, beauty care, cold rooms/storages, tourism, sports and fitness centers and creative work. Minimum investment of Rs 25 million to Rs 200 million ($192,000 to $1.5 million).

- *Large-Scale Enterprises:* A 6 to 12-year tax holiday for large-scale enterprises in agriculture, dairy or forestry; manufacturing or processing of non-traditional goods for exports; services provided to a person or partnership outside Sri Lanka; tourism; infrastructure projects, renewable energy, industrial estates, knowledge cities, urban housing, town centers, waste management systems, water services, hospitals, health care services; maintenance of maritime vessels/ aircrafts; sporting services; software development; light or heavy engineering industry; education services. Minimum investment of Rs 300 million to over Rs 2.5 billion ($2.3 million to over $19.2 million).

- *Import Replacement Industries:* A 5-year tax holiday followed by a concessionary tax rate of 12 percent for strategic import replacement industries (i.e., cement, steel, pharmaceuticals, fabric, and milk powder). Minimum investment levels apply.

For further information on investment incentives and other investment-related issues, potential investors should contact the Board of Investment directly (www.investsrilanka.com or info@boi.lk.) The BOI has introduced an investor matchmaking service via the BOI website. Information regarding this service can be found at www.investsrilanka.com/online_resources/partnership.

Trade Agreements

The Indo-Lanka Free Trade Agreement (ILFTA) (www.doc.gov.lk) between Sri Lanka and India has been in effect since 2000. Under this agreement, most products manufactured in Sri Lanka with at least 35% domestic value addition (if raw materials are imported from India, domestic value addition required is only 25%) qualify for duty-free entry to the Indian market. Because production constitutes a portion of value addition, the ILFTA enables foreign firms operating in Sri Lanka to gain preferential entry into the Indian market. Current exporters to India claim to face a variety of non-tariff barriers that have reduced the FTA's effectiveness. Discussions on liberalization of the services sector under a proposed Comprehensive Economic Partnership Agreement (CEPA), with a possible incorporation of investment and economic cooperation has stalled, however. The 2005 Sri Lanka-Pakistan Free Trade Agreement (SLPKFTA) (www.doc.gov.lk) provides duty-free entry into Pakistan for almost all Sri Lankan exports except for 541 items on Pakistan's negative list.

Sri Lanka and six other South Asian nations belonging to the South Asian Association for Regional Cooperation (SAARC) agreed in 2004 to establish a South Asian Free Trade Area (SAFTA) (http://www.saarc-sec.org/main.php), which began operation on July 1, 2006. SAFTA offers regionalized tariff reductions for imports from member countries. Sri Lanka also hopes to sign a Free Trade Agreement with China.

Together, the above agreements could help make Sri Lanka a gateway to South Asia for foreign investors. To date, however, inter-regional trade remains quite low, and investors and relevant officials are not optimistic for a near-term increase.

Generalized System of Preferences (GSP)

Sri Lanka lost duty-free privileges for exports to the European Union (EU) enjoyed under the "EU GSP-Plus" incentive agreement in 2010 because the EU found that Sri Lanka had not fully complied with three human rights conventions (the International Covenant on Civil and Political Rights, the Convention against Torture, and the Convention on the Rights of the Child), and that the government is not committed to resolving human rights complaints. Currently, Sri Lanka enjoys preferential import duty rates in EU markets under the "EU GSP" incentive program.

Many Sri Lankan exports to United States enter duty-free under the U.S. GSP program, although garments – Sri Lanka's biggest single export sector – are excluded. In June 2012, the United States Trade Representative closed the review of a petition filed by the AFL-CIO alleging that Sri Lanka was not meeting internationally recognized labor standards, without any change to Sri Lanka's GSP trade benefits. The closure of the review was based on the Sri Lankan government's efforts over the past few years to address the worker rights issues outlined in the petition. The United States and Sri Lanka have established a TIFA subcommittee to improve labor practices in Sri Lanka.

6. 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 to access to markets, credit, or licenses. Foreign ownership is allowed in most sectors, although the new land ownership law prohibits foreigners from owning land, with some exceptions. (See "*Areas of Concern,"* above) Most investors say acquiring land is often the biggest challenge for any new business in Sri Lanka. Private land ownership is limited to fifty acres per person. The government owns approximately 80% of the land in Sri Lanka, including the land housing most tea, rubber, and coconut plantations, leased to the private sector on 50-year terms. Although state land for industrial use is usually allotted on a 50-year lease, the government may approve 99-year leases on a case-by-case basis, depending on the nature of the project. As noted above, many land title records were lost during the war, and significant disputes remain over property ownership in the North and East.

7. Protection of Property Rights

Real Property

Secured interests in property in Sri Lanka are generally recognized and enforced, but many investors claim protection can be flimsy. A fairly reliable registration system exists for recording private property including land, buildings, and mortgages, although problems exist due to fraud and forged documents. In the World Bank's Doing Business Index, Sri Lanka ranked 145 out of 188 countries in the ease of "registering a property" index involving 8 procedures and 52 days.

Intellectual Property Rights Protection (IPR)

IPR enforcement has improved in Sri Lanka, although counterfeit goods continue to be widely available, making it difficult for the legitimate industries to protect their markets. Local agents of well-known U.S. and other international companies representing recording, software, movie, clothing, and consumer product industries continue to complain that lack of IPR protection is damaging their businesses. Sri Lanka has a comprehensive IPR law and several offenders have been charged or convicted. Overall, progress on IPR protection is improving in the country. For instance, the government's new Information Technology (IT) policy requires government agencies to use licensed or open source software. Software companies have also reported an improvement in the IPR regimes of large companies.

Sri Lanka is a party to major intellectual property agreements. Sri Lanka adopted an intellectual property law in 2003 that was intended to meet both U.S.-Sri Lanka bilateral IPR agreement and TRIPS obligations to a great extent. The law governs copyrights and related rights, industrial designs, patents, trademarks and service marks, trade names, layout designs of integrated circuits, geographical indications, unfair competition, databases, computer programs, and undisclosed information. All trademarks, designs, industrial designs, and patents must be registered with the Director General of Intellectual Property.

Infringement of intellectual property rights is a punishable offense under the IP law with criminal and civil penalties. Recourse available to owners includes injunctive relief, seizure and destruction of infringing goods and plates or implements used for the making of infringing copies, and prohibition of imports and exports. Penalties for the first offense include a prison sentence of six months or a fine of up to Rs 500,000 ($4,425), but smaller penalties are the norm. Aggrieved parties can seek redress for any IPR violations through the courts, though this can be a frustrating and time-consuming process.

The government has established a special antipiracy and counterfeit unit in the Criminal Investigation Division (CID) of the police to specifically address IPR concerns. There is also an IPR unit in the Social Protection Unit of Sri Lankan Customs, and a trademark database to advance IPR protection.

The U.S. Embassy, the United States Patent and Trademarks Office (USPTO), and the American Chamber of Commerce of Sri Lanka are working to pursue more aggressive enforcement and enhance public awareness.

Patents, Copyrights, and Trademarks

Patents are valid for 20 years from the date of application but must be renewed annually. The law permits compulsory licensing and parallel imports of pharmaceutical products. Copyrights are not registered. A work is protected automatically by operation of law. Original literary, artistic, and scientific works including computer programs and databases are protected under the law. Enforcement limitations 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 and renewable. The law also recognizes both certification marks and collective marks.

For additional information about treaty obligations and points of contact at local IP offices, please see WIPO's country profiles at http://www.wipo.int/directory/en/.

- *Resources for Right HoldersContact at Mission:*

Christopher Corkey, Economic Officer
94-11-2498500
commercialcolombo@state.gov

Local lawyers list: http://srilanka.usembassy.gov/service/legal-resources-in-sri-lanka.html

Country/Economy Resources: American Chamber of Commerce in Sri Lanka www.amcham.lk
National Intellectual Property Office of Sri Lanka www.nipo.gov.lk

8. Transparency of the Regulatory System

The Board of Investment strives to inform potential investors about laws and regulations that may affect operations in Sri Lanka, but some of the measures are difficult to find. Proposed laws and regulations are generally made available for public comment, but are occasionally published without public discussion. Foreign and domestic investors often complain that the regulatory system is unpredictable due to outdated regulations, rigid administrative procedures, and excessive 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. Lack of sufficient technical capacity within the government to review financial proposals for private infrastructure projects also creates problems during tendering. The Sri Lankan Cabinet must approve strategic projects by private investors to receive incentives.

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. Some claim that the level of corruption makes it difficult to compete with bidders not subject to the U.S. Foreign Corrupt Practices Act. Some multinational firms have experienced extensive unexplained delays in trying to reach agreement on investment projects. Others have had contracts arbitrarily canceled without compensation, even though the Cabinet had already approved the contracts.

9. Efficient Capital Markets and Portfolio Investment

Retained profits finance about 70 percent of private investment in Sri Lanka, with short-term borrowing financing a further 20percent. Local companies are allowed to borrow from foreign sources. Foreign direct investment finances about 6 percent of overall investment. Foreign investors are allowed to access credit on the local market and are free to raise foreign currency loans.

The state consumes over 50 percent of the country's domestic financial resources and has a virtual monopoly on the management and use of long-term savings in the country. This inhibits the free flow of financial resources to product and factor markets. In the past high budget deficits have caused interest rates to rise and resulted in higher inflation.

The Securities and Exchange Commission (SEC) covers the Colombo Stock Exchange, unit trusts, stock brokers, listed public companies, margin traders, underwriters, investment managers, credit rating agencies, and securities depositories. Portfolio investment is encouraged. Foreign investors can 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 may obtain SEC approval to invest in Sri Lanka's stock market. These funds make transactions through share investment external rupee accounts maintained in commercial banks. During 2012-2013, the SEC started to investigate insider trading, market manipulation, and fraud, but came under pressure from powerful market players who argued that these regulations were depressing stock values. Four senior SEC officials resigned over regulatory issues during this period, citing pressures from high net-worth local investors.

The Colombo Stock Exchange (CSE) was the world's second best performing stock market in 2009-2010, based on post-war economic optimism. The CSE went through a sharp correction in 2011 and 2012. The market remains below its peak. Some foreign investors exited the Colombo market in the first quarter of 2014. Analysts point to several factors driving the market downturn, including excessive speculative investment during bull runs, regulatory issues, market manipulation, insider trading, negative investor sentiments on emerging markets as well as concerns about UN resolutions regarding a lack of Sri Lankan government action on postwar reconciliation and accountability. Corporate profits of Sri Lankan companies are still strong, however, and do not seem to be a factor in driving away determined investors. Market participation needs to be deepened – both in terms of investor base and number of businesses listed on the Colombo Stock exchange – a concern local investors echo.

Credit Instruments

Commercial banks are the principal source of bank finance. Bank loans are the most widely used credit instrument for the private sector. Financial institutions also raise syndicated bank loans to fund large-scale investment projects undertaken by the private sector.

The domestic debt market in Sri Lanka is still at a nascent stage. Credit ratings are now mandatory for all deposit-taking institutions and for all varieties of debt instruments.

Sri Lanka received its first sovereign credit ratings in December 2005. Current ratings stand at "BB-Minus" with a stable outlook (Fitch), "B-Plus" with a stable outlook (S&P) and "B1" with a stable outlook (Moody's).

U.S. investors have shown a strong appetite for Sri Lanka's capital market, holding a little over 60 percent ($3.8 billion) of Sri Lanka's sovereign bonds, as well as 80 percent ($3 billion) of the 12.5 percent of rupee-denominated debt set aside for foreign investors.

Banking System

Sri Lanka has a fairly well-diversified banking system. There are 24 commercial banks – 12 local and 12 foreign. In addition, there are nine local specialized banks. Citibank NA is the only U.S. bank operating in Sri Lanka. Several domestic private commercial banks now have substantial government equity acquired through investment agencies controlled by the government. Access to credit remains a significant problem for the SME sector nationwide. The Central Bank is actively promoting consolidation in the banking and financial sector.

The Central Bank is responsible for supervision of all banking institutions and has driven improvements in banking regulations, provisioning, and public disclosure of banking sector performance. Credit ratings are mandatory for all banks operating in Sri Lanka. The Central Bank has accepted the Basel II standardized approach framework, and has introduced accounting standards corresponding to International Financial Reporting Standards for banks from January 1, 2012.

Total assets of commercial banks stood at Rs 5,942 billion ($45.7 billion) as of December 31, 2013. The two fully state-owned commercial banks – Bank of Ceylon and People's Bank –are still important players, accounting for over 35 percent of all banking assets. The two state banks have a large portfolio of non-performing loans. Both these banks have significant exposure to the state and state-owned companies, which are treated as performing loans. However, as these banks are implicitly guaranteed by the state, their problems have not harmed the credibility of the rest of the banking system.

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. Foreign banks tend to make provisions in line with international best practices, as most foreign bank branches are subject to supervision in their own country in addition to that of the Sri Lankan Central Bank. Partly due to a fall in gold prices, and default of loans given on gold pawning, non-performing loans of the banking sector, increased from 3.7 percent in 2012 to 5.2 percent in 2013.

10. Competition from State-Owned Enterprises (SOE)

The government has halted SOE privatization, and SOEs are active in transport (bus and railways, ports and airport management, airline operations); utilities such as electricity; petroleum imports and refining, and water supply; retail; banking; telecommunications; TV and radio broadcasting; newspaper publishing; and insurance. Since the end of the war, Sri Lankan armed forces have begun operating air services, tourist resorts, and farms for civilian purposes, crowding out some private investment. Directors of SOEs are appointed by the Cabinet or a line ministry. The government allocates board seats to both senior government officials and politically-affiliated individuals. There is concern that the public banks are required to take on increasing debt from inefficient SOEs, forcing them to carry a greater share of non-performing loans. In addition, there are several important large private banks in which multiple government entities own interest, so on aggregate these companies are majority government owned. By the virtue of the shareholding the government exerts control over the appointment of boards of directors and management of these banks. SOEs structure of governance is questionable. SOE senior managers usually report to politically affiliated boards of directors. SOEs are often charged with working to political agendas.

Government Control of Private Sector Pension Funds

Sri Lanka does not have a sovereign wealth fund (SWF). Currently, the government manages and controls large pension funds of private sector employees, using these funds for budgetary purposes and stock market investments. The government and the Central Bank are accused of misusing the Employees Provident Fund (EPF), a large retirement fund of private sector workers managed by the Central Bank, for unwise stock market investments and to help governing party supporters. Contacts argue the fund must be segregated from politics and professionalized. SOEs, and government-managed pension funds must meet Sri Lanka accounting standards.

11. Corporate Social Responsibility

Leading companies in Sri Lanka are actively promoting CSR and some SME companies have also started to promote CSR. The Ceylon Chamber of Commerce, the largest business chamber in Sri Lanka, has a CSR section promoting CSR among its membership. In addition, a professional accounting body has a program to promote sustainability reporting. Internationally, some of Sri Lanka's leading companies have joined the UN Global Compact initiative. The apparel industry, Sri Lanka’s largest export industry, has a specially designated CSR program for the industry under the title "Garments without Guilt" (www.garmentswithoutguilt.com). The ethical sourcing and sustainable development practices under the program aim to empower women and their communities through poverty alleviation and opportunities for education and personal growth. In addition, the program endeavors to promote sustainable eco-friendly manufacturing practices in the apparel industry. Accounting standards are applicable for all banks, stock exchange listed companies, and all other large and medium-sized companies in Sri Lanka. Accounting standards are constantly updated to reflect current standards adopted by the International Accounting Standards Board (IASB). Sri Lanka adopted IASB’s Financial Reporting Standards (IFRS) from January 1, 2012. However, these standards don’t govern executive compensation.

12. Political Violence

The Sri Lankan government's military campaign against the Liberation Tigers of Tamil Eelam (LTTE) ended in May 2009 with the defeat of the LTTE. During the war, the LTTE had a history of attacks against civilians, and the U.S. government designated the LTTE as a terrorist organization, although none of the attacks were directed against U.S. citizens. There have been no terrorist attacks since the end of the conflict, although the Sri Lankan government claims a nascent terrorist cell attacked a police officer in March 2014. The government has authority throughout the island. Demonstrations take place in Sri Lanka from time to time in response to world events or local developments. Demonstrations near Western embassies are not uncommon. Protests aimed at Western embassies have been well-contained, with support from the Sri Lankan police and military.

Business-related Violence

Business related violence has increased recently. In August 2013, a large rubber glove manufacturing factory was forced to move to a new location due to protests. Residents near the factory protested alleging it to have polluted water in the area. An army crackdown on protesters resulted in three deaths. In March 2014, residents near another rubber factory protested against water pollution. In mid-2013, a leading international food company temporarily suspended operations in Sri Lanka, citing precautionary measures to ensure the safety of its employees after it faced product bans, court cases and angry demonstrators over the sale of contaminated milk powder. In 2013, a group of local politicians were charged with killing a Sri Lankan tea estate manager. In 2011, a British tourist vacationing in Sri Lanka was murdered at a tourist hotel by a group that included local politicians.

In May 2011, workers at the Katunayake Export Processing Zone (EPZ), the country’s largest EPZ, held a large protest demanding the withdrawal of a proposed new pension plan covering all private sector employees. The protest led to a violent clash between the workers and the police. The clashes resulted in the death of one EPZ worker, injuries to a number of protestors and police officers, and damage to several factories. The government closed the EPZ for two days as a precautionary measure. Following the clash, the government withdrew the pension bill.

Human Rights Concerns

The United States remains concerned over the human rights situation in Sri Lanka, which includes allegations of extrajudicial killings, disappearances, intimidation, and harassment during the war. Due to the lack of a credible reconciliation and accountability effort after the 2009 end of the conflict, the United States sponsored resolutions on the situation in Sri Lanka in the UN Human Rights Council (UNHRC) in March 2012, March 2013 and again in March 2014. All three resolutions passed. The 2014 resolution requests the office of the UN Human Rights Commissioner to lead an investigation into alleged violations of human rights during the conflict and to monitor the human rights situation.

13. Corruption

While the country has generally adequate laws and regulations to combat corruption, enforcement is considered weak and inconsistent. U.S. firms identify corruption as a constraint on foreign investment, but, by and large, it is not a major threat to operating in Sri Lanka – at least once a contract has been won. The business community claims that corruption has the greatest effect on investors in large projects and on those pursuing government procurement contracts. Some claim that the level of corruption makes it difficult to compete with bidders not subject to the U.S. Foreign Corrupt Practices Act. Projects geared toward exports face fewer problems. Local investors say internal controls do exist, although they are weak. Sri Lanka ratified the UN Anti-Corruption Convention in 2004. Sri Lanka has signed but not ratified the UN Convention against Transnational Organized Crime. Sri Lanka is a signatory to the OECD-ADB Anti-Corruption Regional Plan. Attempts to introduce a Freedom of Information Act to increase transparency have been unsuccessful.

Bribery Commission

The Bribery Commission is the main body responsible for investigating allegations brought to its attention and instituting proceedings against responsible individuals in the appropriate court. The law states that a public official's offer or acceptance of a bribe constitutes a criminal offense and carries a maximum sentence of seven years imprisonment and a fine at the discretion of the courts. A bribe by a local company to a foreign official is not covered by the Bribery Act.

Resources to Report Corruption

Contact at Government Agency responsible for combatting corruption:

Jagath de S. Balapatabendi, Chairman
Commission to Investigate Allegations of Bribery or Corruption
No 36, Malalasekara Mawatha, Colombo 7
Phone: 94-11- 2595039 Email: ciaboc@eureka.lk

Contact at watch dog organization:

S Rannuge, Executive Director
Transparency International, Sri Lanka
183/5 High Level Road, Colombo 6
Phone: 94-11-11 436978 Email: ed@tisrilanka.org

14. 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 with the following other countries: Australia, Belgium-Luxembourg, China, Denmark, Egypt, Finland, France, Germany, Indonesia, India, Iran, Italy, Japan, Korea, Kuwait, Malaysia, the Netherlands, Norway, Pakistan, Romania, Singapore, Sweden, Switzerland, Thailand, the United Kingdom, and Vietnam.

Taxation

Sri Lanka’s tax rates are mid-range for the region; the highest corporate tax rate is 28 percent. Private sector contacts generally laud the government for maintaining a fairly consistent corporate tax policy over the last several years; for some, consistent taxes are more important than lower taxes. One notable exception was the 2013 extension of the 12.5 percent Value Added Tax (VAT) to supermarkets and large trading houses.

Foreign investors not qualifying for Board of Investment incentives such as tax and exchange control exemptions or concessions are liable to pay taxes on corporate profits, dividends, and remittances of profits. They are also liable to pay a VAT on goods and services. An Economic Service Charge (ESC) at 0.25 percent of income applies to BOI-approved companies enjoying tax holidays.

A bilateral treaty between Sri Lanka and the United States to avoid double taxation was ratified and entered into force on June 12, 2004. The Embassy encourages prospective U.S. investors to contact an international auditing firm operating in Sri Lanka to assess their tax liability.

15. OPIC and Other Investment Insurance Programs

The United States 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 and power sector investments in Sri Lanka. Sri Lanka's membership in the Multilateral Investment Guarantee Agency (MIGA) offers the opportunity for insurance against non-commercial risks. The U.S. Embassy and other U.S. Government institutions spend tens of millions annually 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.

16. Labor

Labor Market

Sri Lanka’s labor market is small, with a limited pool of skilled workers. Engineering, accounting, legal, and architectural professions follow high standards, although local design talent is still underdeveloped. Labor is available at relatively low cost, though it is priced higher than in some other South Asian countries. Many of Sri Lanka’s top graduates seek employment outside the country. For those who remain, Sri Lanka's labor laws afford many employee protections. Many investors consider this legal framework somewhat rigid, however, making it difficult for companies to reduce their workforce even when market conditions warrant doing so. The cost of dismissing an employee in Sri Lanka is, percentage-wise, one of the highest in the world. Sri Lanka's labor force is literate (particularly in local languages) and trainable, although weak in certain technical skills and the English language. The average worker has eight years of schooling, and two-thirds of the labor force is male. Retention is fairly good in the IT/BPO sector, but the garment industry reports up to a 40 percent staff turnover rate. Lack of labor mobility in the North and East is also a problem, with workers reluctant to leave their families and villages for employment elsewhere.

In 2013, 8.4 million Sri Lankans were employed, with 44 percent in services, 26 percent in industry, and 30 percent in agriculture jobs. Overall, 41 percent of the workforce is in the private sector and 15 percent in the government. Self-employed workers constitute 32 percent of all employed, while another 9 percent were unpaid family workers. About 61 percent of the employed are in the informal sector.

The unemployment rate has declined in recent years to around 4 percent, although low unemployment rates are due in part to a large outflow of Sri Lankan migrant labor. Unemployment among women and high school/college graduates has been proportionally higher than the rate for less-educated workers. Youth and entry-level unemployment and underemployment remain a problem. A significant proportion of unemployed people seek "white collar" employment, often preferring low-paying but stable government jobs. However, most sectors seeking employees offer manual or semi-skilled jobs or require technical or professional skills such as management, marketing, information technology, accountancy and finance, and English language proficiency. The construction, plantation, and apparel industries also report a shortage of workers. Some investors have faced problems in finding sufficient employees with the requisite skills, a situation the tourism industry is likely to face as more hotels open in the near future.

The government has initiated educational reforms it hopes will lead to better preparation of students and better matches between graduates and jobs. More computer, accounting and business skills training programs and English language programs are becoming available. But the demand for these skills still outpaces supply.

Migrant Workers Abroad

There are an estimated 1.8 million Sri Lankan workers abroad. Remittances from migrant workers, at $6.4 billion, are Sri Lanka’s largest source of foreign exchange. The majority of this labor force is unskilled (housemaids and factory laborers) and located primarily in the Middle East. Sri Lanka is also losing many of its skilled workers to more lucrative jobs abroad.

Trade Unions

About 20 percent of the workforce is unionized, but union membership is declining. There are more than 1,900 registered trade unions (many of which have 50 or fewer members), and 19 federations. About 15 percent of labor in the industry and service sector is unionized. Most of the major trade unions are affiliated with political parties, creating a highly politicized labor environment. In many cases, several unions, affiliated with different political parties, work together at state-owned enterprises. This is not the case for private companies, which only have one union or perhaps a workers' council to represent the employees.

All workers, other than police, armed forces, prison service, and those in essential services, have the right to strike. By law, workers may lodge complaints to protect their rights with the commissioner of labor, a labor tribunal, or the Supreme Court. The President retains the power to designate any industry as an essential service.

Unions represented workers in many large private firms, but workers in small-scale agriculture and small businesses usually did not belong to unions. The tea industry, however, is highly unionized, and public sector employees are unionized at very high rates. Labor in export processing zone enterprises tends to be represented by non-union worker councils, although unions also exist in the EPZs. Worker councils have functioned well in some companies in providing for worker welfare. The BOI has requested that companies recognize trade unions, allow union access to export processing zones, and accept the right to collective bargaining. The BOI has issued guidelines for employee councils, giving powers to employee councils to negotiate binding collective agreements. According to the BOI, where both a recognized trade union with bargaining power and a non-union worker council exist in an enterprise, the trade union will represent the employees in collective bargaining. The International Labor Organization's (ILO) Freedom of Association Committee has observed that Sri Lankan trade unions and worker councils can co-exist, but advises that there should not be any discrimination against those employees choosing to join a union. The right of worker councils to engage in collective bargaining has been held as valid by the ILO.

Unions have complained that the BOI and some employers, especially in the export processing zones, prohibit union access and do not register unions on a timely basis. Employers allege that the JVP, a Marxist political party opposed to private enterprise, could provoke labor to strike under the pretense of trade union activity. Due to the JVP's violent past, employers are generally not in favor of it or its trade union arm, the Inter-Company Trade Union. There are also a number of independent unions.

In June 2012, the United States Trade Representative closed the review of a petition submitted by the American Federation of Labor and Congress of Industrial Organizations complaining of alleged labor rights violations in EPZs without any change to Sri Lanka’s trade benefits. The closure of the review was based on the Sri Lankan government’s efforts over the past few years to address the worker rights issues outlined in the petition. Further, the BOI established “facilitation centers” for unions to meet members and other workers in the three largest

EPZs. The United States and Sri Lanka have established a subcommittee under the Trade and Investment Framework Agreement to discuss labor issues in Sri Lanka.

Collective Bargaining

Collective bargaining exists but is not universal. The Employers' Federation of Ceylon, the apex employers' association in Sri Lanka, assists its member companies to negotiate with unions and sign collective bargaining agreements. While about a quarter of the 548 members of the Employers' Federation of Ceylon are unionized, 121 of these companies (including a number of foreign-owned firms) are bound by collective agreements. A further 24 have signed Memorandums of Understanding with trade unions. As of December 2012, there were only five collective bargaining agreements signed in companies located in EPZs.

Labor Rights

The law prohibits all forms of forced and compulsory labor. While there was no national minimum wage, 43 wage boards established by the Ministry of Labor set minimum wages and working conditions by sector and industry in consultation with unions and employers. Minimum wage laws did not cover workers in sectors not covered by wage boards, including informal sector workers. The law does not require equal pay for equal work. The law prohibits most full-time workers from regularly working more than 45 hours per week. In addition, the law stipulates a rest period of one hour per day. Regulations limit the maximum overtime hours to 15 per week. The law provides for paid annual holidays, sick leave and maternity leave. Occupational health and safety regulations did not fully meet international standards.

Child Labor

Child labor is prohibited and is virtually nonexistent in the organized sector, although child labor occurs in informal sectors. The minimum legal age for employment is set at 14. The minimum age for employment in hazardous work is 18 years. The Hazardous Occupations Regulation contains a list of 51 occupations considered to be hazardous forms of child labor in Sri Lanka.

Labor-Management Relations

Formerly confrontational labor-management relations have improved in the last few years as employers have worked harder to motivate and care for employees. Work stoppages and strikes in the private sector increased in 2013 compared to 2012. While labor-management relations vary from organization to organization, managers who emphasize communication with workers and offer training opportunities generally experience fewer difficulties. U.S. investors in Sri Lanka (including U.S. garment buyers) generally promote good labor management relations and labor conditions that exceed local standards.

ILO Conventions

Sri Lanka is a member of the International Labor Organization (ILO) and has ratified 31 international labor conventions. The labor laws of Sri Lanka are laid out in almost 50 different statutes, and the Ministry of Labor has consolidated these in a Labor Code. Sri Lanka has ratified all eight of the ILO's core labor conventions. The ILO and the Employers' Federation of Ceylon are working to improve awareness of core labor standards, and the ILO also promotes its Decent Work Agenda program in Sri Lanka.

17. Foreign Trade Zones/Free Ports

Sri Lanka has 12 free trade zones, also called export processing zones, administered by the BOI. In addition, a large private apparel company opened Sri Lanka's first privately-run fabric park in 2007. The company invites local and foreign companies to set up fabric and apparel factories in this eco-friendly park.

In the past, firms preferred to locate their factories near Colombo harbor or airport to reduce transport time and cost. However, excessive concentration of industries around Colombo has caused heavy traffic, higher real estate prices, environmental pollution, and scarcity of labor. The BOI and the government now encourage export-oriented factories to set up in industrial zones farther from Colombo, although Sri Lanka's poor roads make these outlying zones more challenging.

18. Foreign Direct Investment and Foreign Portfolio Investment Statistics

TABLE 2: Key Macroeconomic data, U.S. FDI in host country/economy

	Central Bank of Sri Lanka*		USG or international statistical source		USG or international Source of data
Economic Data	Year	Amount	Year	Amount	
Gross Domestic Product (GDP) (*Millions U.S. Dollars)*	2013	67,200	2012 2013	59,400 65,833	http://www.worldbank.org/en/country http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/weoselgr.aspx
GDP Growth Rate	2013	7.3%	2013	7.3%	http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/weoselgr.aspx
Population *(Million)*	2013	20.4	2013	20.8	http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/weoselgr.aspx
Per Capita GDP *(U.S. Dollars)*	2013	3,280	2013	3,161	http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/weoselgr.aspx
Inflation	2013	4.7%	2013	4.7%	http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/weoselgr.aspx

Budget Deficit	2013	5.9%	2013 *(Proj)*	5.8%	http://www.imf.org/external/np/sec/pr/2013/pr13481.htm
Exports *(Millions of U.S. Dollars)*	2013	10,394	2013 *(Proj)*	9,826	http://www.imf.org/external/np/sec/pr/2013/pr13481.htm
Imports *(Millions of U.S. Dollars)*	2013	18,003	2013 *(Proj)*	19,406	http://www.imf.org/external/np/sec/pr/2013/pr13481.htm
Remittances Inflow *(Millions of U.S. Dollars)*	2013	6,400			
Total Public Debt *(pct of GDP)*	2013	78.3%	2013 *(Proj)*	76.6%	http://www.imf.org/external/np/sec/pr/2013/pr13481.htm
Total Foreign Debt *(Millions of U.S. Dollars)*	2013	39,740	2013 *(Proj)*	35,500	http://www.imf.org/external/np/sec/pr/2013/pr13481.htm
Public Foreign Commercial Debt *(Millions of U.S. Dollars)*	2013	11,285	2013		http://www.imf.org/external/np/sec/pr/2013/pr13481.htm
Foreign Reserves	2013	8,574	2013 *(Proj)*	6,661	
Foreign Direct Investment	Sri Lanka Statistical source*		USG statistical source		USG Source of data
U.S. FDI in Sri Lanka (*Millions U.S. Dollars, stock positions)*	NA	NA	2012	102	Bureau of Economic Analysis(BEA)

Sri Lanka's FDI in the United States (*Millions U.S. Dollars, stock positions)*	NA	NA	2012	18	Bureau of Economic Analysis (BEA)
Total inbound stock of FDI as % GDP	2013	2%			

* Central Bank of Sri Lanka http://www.cbsl.gov.lk

19. Contact Point at Post for Public Inquiries

Economic Counselor
U.S. Embassy, 210 Galle Road, Colombo 3
Phone: 94-11-2498500
Email: commercialcolombo@state.gov