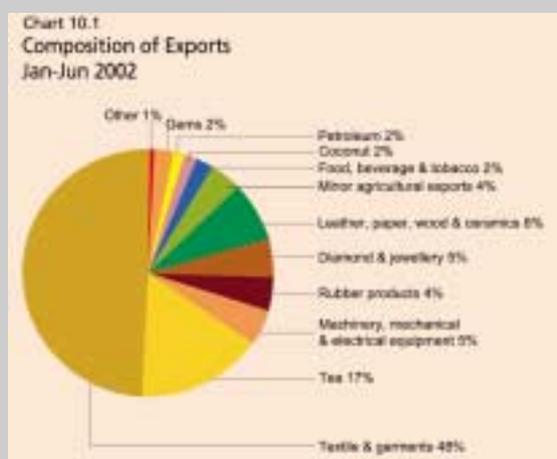


## 10. EXTERNAL TRADE AND TOURISM

Both exports and imports declined during the first half of 2002, but showed a recovery thereafter. The decline in exports was attributable to both lower prices and lower volumes of exports. The major contribution to the decline came from lower exports of textiles and garments which, in turn, was a result of low demand from industrialised countries. Imports declined in response to several factors—slower growth in exports that lowered demand for intermediate goods, lower prices of petroleum and other major commodities, and a decline in defence related imports. However, towards the second quarter of 2002, volumes of intermediate and investment categories of imports showed a gradual improvement, indicating signs of potential growth in future exports. The trade balance deteriorated significantly as the decline in exports was higher than in imports. In August, however, following a surge in exports, a trade surplus was recorded. With an expected improvement in the second half of 2002, annual export earnings are expected to decline by about 2 per cent in 2002; expenditure on imports is projected to increase by 2 per cent.



### Export Performance

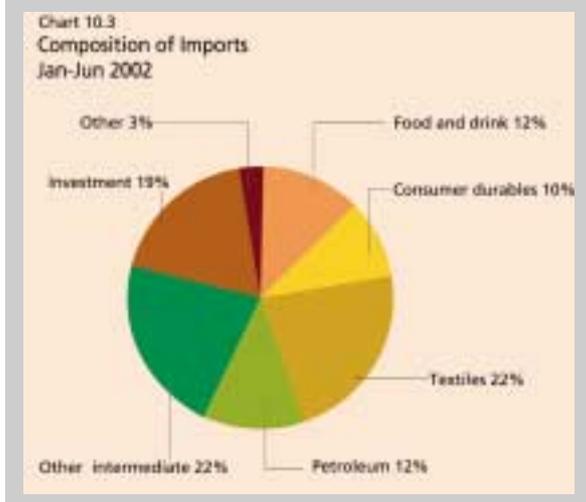
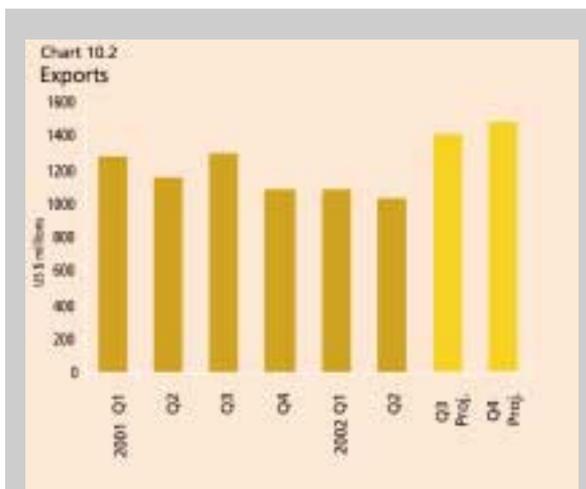
- ◆ Industrial exports, dominated by textiles and garments, accounted for 74 per cent of exports during the first half of 2002. Plantation crops, consisting of tea, coconut and rubber, accounted for 19 per cent of total exports, while non plantation agricultural products, dominated by cinnamon, un-manufactured tobacco, pepper, cloves, vegetable and fruits, contributed 4 per cent to total exports.
- ◆ During the first half of 2002, export earnings declined by 17.3 per cent to US dollars 2,012 million, compared with a decline of 1.5 per cent during the first half of 2001. This decline was attributable to both lower prices and lower volumes of exports. The export volume index declined by 8 per cent, while the unit value index declined by 10.1 per cent during the first half of 2002.
- ◆ Major contributors to the decline were textiles and garments, machinery and mechanical equipments, rubber tyres, footwear, plastics, fish products and gem exports. Earnings from textiles and garments, which account for 48 per cent of total export earnings, decreased by 21.9 per cent due to lower demand from the USA and European countries. The volume of textile and garment exports declined by 10.9 per cent, while the unit price declined by 12.3 per cent during the first half of 2002.
- ◆ All other industrial exports together declined by 16.2 per cent, reflecting lower exports of machinery, mechanical and electrical equipment, rubber tyres, crustaceans and molluscs and other

fish products, travel goods, plastics, tableware, footwear and chemical products. However, improvements were shown in export categories such as rubber gloves, canned or bottled fruits, diamonds and animal fodder.

- ◆ Earnings from agricultural products declined by 3.5 per cent, marked by decreases in the exports of tea, rubber, coconuts, un-manufactured tobacco, vegetable and fruit exports. Exports of cloves, cinnamon, pepper, and nutmeg and mace improved during the first half of 2002.
- ◆ Earnings from tea declined by 7.5 per cent to US dollars 332 million during the first half of 2002. The volume of tea exports declined by 3.6 million

kg (-2.5 per cent), while the average price of tea declined by US dollars 0.13 cents per kg (-5.2 per cent). Export prices were low due to depressed demand and an over supply in the world market due to large carry over stocks from last year.

- ◆ Earnings from mineral exports decreased by 4.6 per cent as a result of a 4.6 per cent decline in earnings from gem exports, which accounted for 96 per cent of total mineral exports.
- ◆ Export earnings showed signs of recovery from July 2002. A significant improvement was seen in August 2002, where an increase of 33 per cent over August 2001 was recorded. This was the first such positive growth recorded since February 2002.
- ◆ With this development export earnings are expected to show a faster recovery during the latter half of the year. This recovery is expected mostly from textiles and garments, rubber based products, chemicals, diamonds and agricultural products such as tea, cinnamon, cloves and pepper. Accordingly, annual export earnings are expected to decline by 2 per cent in 2002 as against the 12.8 per cent drop in 2001.

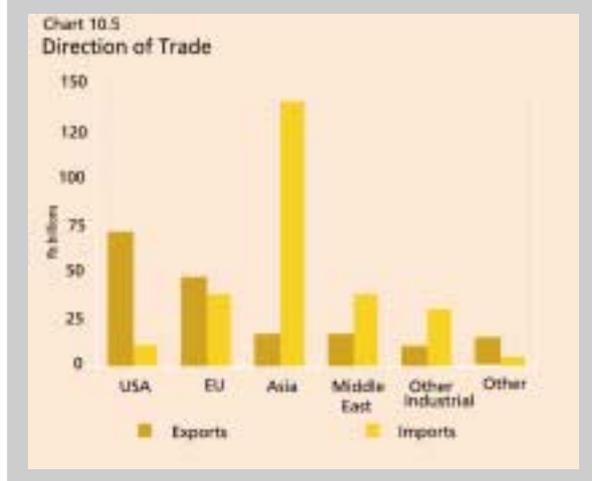
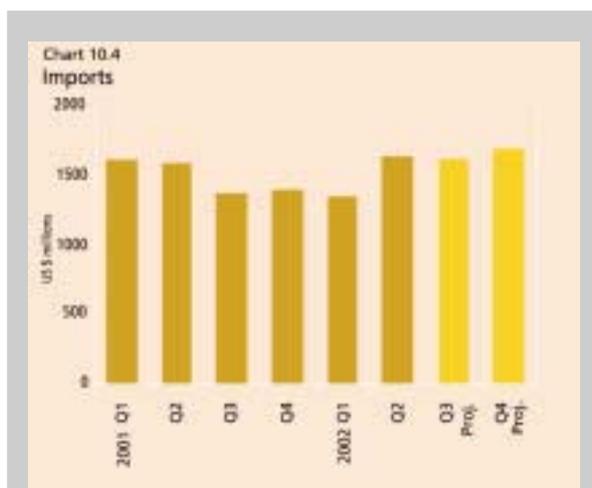


### Import Expenditure

- ◆ Expenditure on imports during the first half of 2002 consisted of intermediate goods ( 56 per cent), investment goods (19 per cent), consumer goods (22 per cent ) and other imports ( 3 per cent) including defence related imports.
- ◆ Expenditure on imports during the first half of 2002 was US dollars 2,875 million, a 10.5 per cent

drop over the corresponding period of 2001. This decline was attributable to lower prices, which negated the impact of volume growth. The unit value index declined by 15.4 per cent, while there was a 5.8 per cent increase in the export volume index.

- ◆ Expenditure on imports showed marginal recovery in volume terms during the second quarter of 2002. During the second quarter of 2002, a much faster recovery was seen in the intermediate and investment categories.
- ◆ Consumer goods imports decreased by 8.8 per cent during the first half of 2002. Within this



category, food imports declined by 4.4 per cent due to lower import costs of products such as milk products, lentils, green gram, black gram, potatoes, dried fish, canned fish, chillies and chocolates. The reduction in imports of chillies, canned fish and dried fish could be attributed to the higher import duty applied on these products since March 2002. Owing to lower expenditure on several items such as medical and pharmaceutical products, rubber tyres and tubes, radio receivers, and television sets, import payments for non-food consumer items decreased by 13.9 per cent.

- ◆ Expenditure on intermediate goods imports decreased by 6.6 per cent largely due to lower prices of petroleum products, textiles, fertiliser and other intermediate goods. However, the volume of intermediate goods imports increased by 2.6 per cent. Expenditure on intermediate goods, excluding petroleum product imports, decreased by 5.2 per cent during the first half of 2002.
- ◆ Investment goods decreased by 13.5 per cent during the first half of 2002 reflecting the impact of lower prices. Investment goods in volume terms increased by 12.8 per cent as a result of higher imports of machinery and equipment such as generators, parts and accessories and building material.
- ◆ With an expected recovery in export industry and domestic economic activities, imports are likely to continue to increase during the second half

of 2002. The expected decline in expenditure on defence imports will partly offset the increase in the import expenditure. Accordingly, expenditure on imports is expected to increase by about 16 per cent during the second half of 2002 bringing annual imports for 2002 to US dollars 6,070 million, 2 per cent higher than 2001.

#### Direction of Trade

- ◆ USA continued to be the single largest destination for Sri Lanka's exports (39 per cent) during January – June 2002. Sri Lanka's exports to USA are mostly garments (77 per cent). The European Union (EU), dominated by the United Kingdom, was the second largest destination (26 per cent), while Middle Eastern (9 per cent) and Asian countries (10 per cent), led by India, were the third and fourth group of countries.
- ◆ India became the largest single exporter to Sri Lanka (13 per cent) followed by Hong Kong (8 per cent), Singapore (7 per cent) and South Korea (5 per cent). Accordingly, Asian countries, as a group, continued to be the main origin of Sri

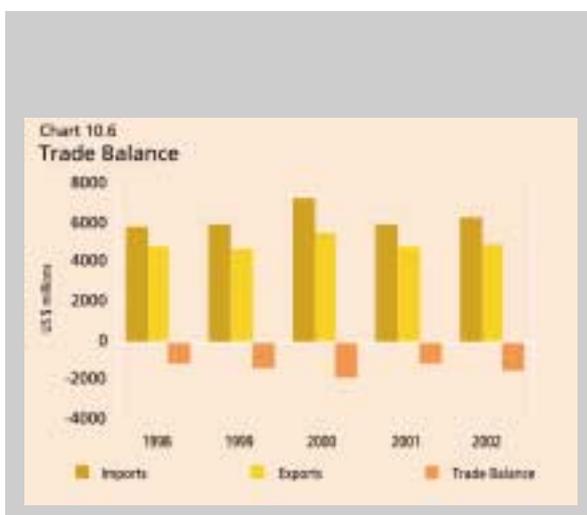
Lanka's imports, accounting for 53 per cent of total imports. Japan, UK, United Arab Emirates (5 per cent each) and USA (4 per cent) were other major suppliers to Sri Lanka during the first half of 2002.

#### Trade Balance

- ◆ The trade deficit during the first half of 2002 widened to US dollars 863 million compared to US dollars 779 million in January-June 2001. With the expected increase in imports, the annual trade deficit is expected to expand to US dollars 1,345 million in 2002.

#### Terms of Trade

- ◆ Terms of trade improved in favour of Sri Lanka during the first half of 2002, reflecting a larger drop in the import unit value index relative to the decline in the export unit value index. During the first half of 2002, the import unit value index declined by 15 per cent over that of the first half of 2001, while the export unit value index declined by 10 per cent. As a result, the terms of trade improved by 6 per cent during the first half of 2002. However, this trend may not continue in the second half mainly due to rising oil prices in the international market.



#### Trade Policy

- ◆ The external trade and tariff policy directed to achieve a more liberal regime through a lower and simplified tariff structure was disturbed by the introduction of specific duties on selected agricultural products during the first half of 2002.

Specific duties were introduced on rice in January 2002 and on red onions, big onions and chillies on 22 March 2002 to replace existing ad valorem taxes. With these revisions, the number of items under specific duties were raised to thirty five.

- ◆ Distortions to the tariff regime by way of duty waivers, exemptions and introduction of surcharges were maintained at a minimum level. As positive initiatives, the licensing requirement on the import of rice was removed with effect from 21 January 2002, while the surcharge of 40 per cent on import duty under the Section 10(A) of the Customs Ordinance, was reduced to 20 per cent with effect from 15 April 2002. Furthermore, the specific surcharge of Rs. 20 per kg on soya bean oil, palm oil, sunflower oil, coconut (copra) oil, palm kernel or babassu oil and other vegetable oils was reduced to Rs. 5 per kg for the period 1 April 2002 to 31 December 2002.
- ◆ The two band tariff system with 10 and 25 per cent rates, which has been in effect since February 2000, continued during the first half of 2002. However, a few tariff lines still remain outside the two tariff bands. Some selected machinery and equipment were kept under the 5 per cent rate of tariff, while a few agricultural products were maintained at 35 per cent. A few items such as liquor and tobacco are still under the higher rates of 75 and 100 per cent.
- ◆ In place of stamp duty, which was abolished on 30 April 2002, a Port and Airport Development Levy of 1 per cent of cif value of imports was

introduced with effect from 1 May 2002, with a very few exemptions. Furthermore, a fee of 0.1 per cent on the import licences, subject to a minimum charge of Rs. 100, and a levy of Rs. 100 on Export Control licences were introduced on 22 March 2002.

### **International Trade Relations**

- ◆ Commitments under the Indo-Sri Lanka Free Trade Agreement at the end of the second year of entry into the Agreement were honoured by granting further concessions on selected items from 22 March 2002. The Indian government reduced tariff rates on 2,799 tariff lines in the residual list of Sri Lanka's imports by 90 per cent in its Budget 2002/2003 effective from 1 March 2002. These items received a 50 per cent tariff reduction under the first phase of the FTA.
- ◆ Under Article XII of the FTA, a Joint Committee established at the Ministerial level has to meet at least once a year to review progress in the implementation of the FTA. The first meeting of the Joint Ministerial Committee (JMC) was held on 6-7 June 2002 in New Delhi, India. Pursuant to the JMC, a meeting of Senior Officials was held on 4-5 July 2002 in Colombo, Sri Lanka.
- ◆ India agreed to include Calcutta and Mumbai as additional entry ports for garments to India, while agreeing to raise the limit of 1.5 million pieces per category per annum on garment exports to 2 million pieces. India also agreed to consider flexibility in the restriction of using Indian fabrics in 6 million pieces of the garment quota.

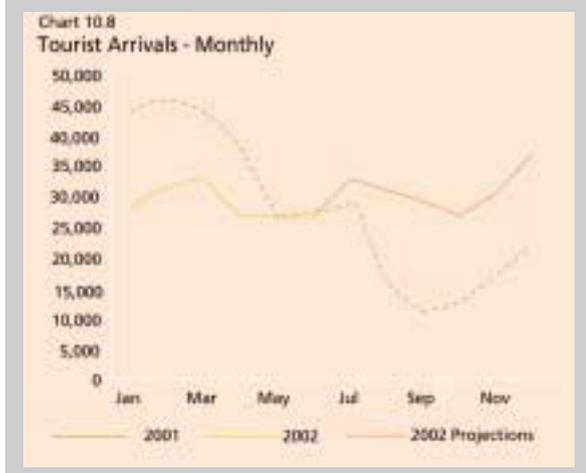
- ◆ India agreed to designate Mumbai and Vizag as the additional entry ports for tea, while Sri Lanka agreed to consider export of Indian tea to the Sri Lankan market, subject to prevailing duty and some quality parameters. Both countries will take administrative action necessary in terms of constitutional requirements and implement these decisions on or before 7 September 2002.
- ◆ Other major issues discussed at the JMC were revision of Rules of Origin criteria, a joint marketing strategy for tea, a feasibility study on future market for tea in Colombo and a draft

Memorandum of Understanding between the Export Inspection Council of India and the Sri Lanka Standards Institute.

- ◆ The Framework Agreement for a Sri Lanka – Pakistan Free Trade Agreement was signed on 1 August 2002 in Colombo with the objective of establishing a free trade area for movement of goods and services. Annexes containing offers of both countries and Rules of Origin criteria were to be finalised within a period of 90 days of the signing of this agreement.

#### Tourism

- ◆ During the first half of 2002, tourists arrivals, at 173,136 persons, had declined by 23.8 per cent over January-June 2001. However, this figure was an increase of 58 per cent over the second half of 2001, reflecting a recovery in the tourism industry. Gross earnings from tourism, amounting to US dollars 109 million during the first half of 2002, was a decline from the US dollars 143 million earned during the first half of 2001, but was much higher than the US dollars 69 million earned in the second half of 2001.
- ◆ Progress under the ongoing peace process, which enables building up confidence among both foreigners and domestic service suppliers, will improve the market for the tourist industry during the latter half of the year.
- ◆ During the first half of 2002, Western Europe continued to be the major source of tourists to the country, accounting for 48 per cent of the



arrivals, although in absolute numbers arrivals dropped by 42 per cent. However, arrivals from Asia increased by 25 per cent with a high turnover from India. Accordingly, the market share of the Asian region increased from 24 per cent in the first half of 2001 to 40 per cent in the first half of 2002.

- ◆ The larger arrivals from the Asian region was partly due to the extension of a package of incentives 'Buy One Get One Free' which was enjoyed by tourist from all regions during the period 1 November -20 December 2001 to Asian countries till July 2002 and an introduction of a flight between Colombo and Bangalore.
- ◆ The expected increase in tourist arrivals due to the Esala Perahera in Kandy in July, the South Asian Games in August and Mini World Cup cricket tournament in September will help attract more tourists. An improvement in travel facilities is expected due to agreement with Malaysian Airlines to operate to Colombo and an additional aircraft to be added to the fleet of SriLankan Airlines during the third quarter of the year. Oman Air will also resume four weekly flights between Muscat and Colombo.
- ◆ With these developments, tourist arrivals are expected to increase by 90.8 per cent during the second half of 2002 when compared with the corresponding period in 2001. Annual tourist

arrivals for 2002 are projected to increase by 13.5 per cent to 382,000.

#### **External Trade and Tourism - 2003**

- ◆ Export growth is expected to be around 18 per cent in 2003 as the global economy is projected to grow at a higher rate of about 2.8 per cent in 2003. The major impetus for the high growth in exports is expected to come from industrial exports, including apparel exports.
- ◆ Imports are also estimated to grow at a higher rate of about 19 per cent, particularly if major reconstruction work commences in 2003 with further progress in the peace process. The growth in imports is expected to be led by investment and intermediate goods imports.
- ◆ As a result, the trade deficit is expected to widen to 9.3 per cent of GDP from 8.2 per cent of GDP in 2002.
- ◆ The tourism industry, which showed a significant improvement towards the second half of 2002, is expected to grow further in 2003 as progress under the ongoing peace process will build up confidence among both foreigners and domestic service suppliers, and improve the market for the tourist industry.
- ◆ Tourist arrivals are projected to grow by 18 per cent to 450,000 in 2003.