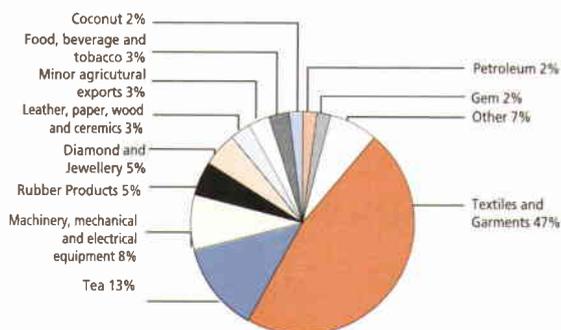


11. EXTERNAL TRADE AND TOURISM

The external trade in the country increased in the first half of 2004 reflecting higher growth in both exports and imports. The continuous recovery in the international market generated the demand for Sri Lankan exports, particularly apparel, rubber based products, diamonds, machinery, tea, rubber, coconut and gem and jewellery. In response to the domestic economic recovery, imports of investment and intermediate goods increased by 19 per cent and 50 per cent, respectively, in the first half of 2004. Imports of other goods such as petroleum, wheat, sugar and milk products also increased in the first half of 2004, mainly due to higher prices of these items. However, higher imports led to a widening of the trade deficit during the first half of 2004. With the continuing recovery in the international markets, annual export earning is expected to grow by 8 per cent in 2004. Meanwhile, import expenditure is expected to grow by 17 per cent in 2004 partly due to the higher oil prices in the international market.

Composition of Exports January - June 2004

Chart 11.1



Export Performance

- The total export earnings of the country increased by 9.6 per cent to US dollars 2,606 million in the first half of 2004 from US dollars 2,378 million in 2003. Industrial exports, which accounted for 78 per cent of total exports, continued to be the main contributor to Sri Lanka's exports, followed by agricultural exports. Agricultural exports accounted for 19 per cent of total exports while mineral exports contributed by 2 per cent. Industrial exports increased by 10 per cent from US dollars 1,833 million in the first half of 2003 to US dollars 2,020 million in the first half of 2004, mainly due to higher exports of machinery, mechanical and electrical equipments, diamonds and garments. The textiles and garments sector accounted for 47 per cent of the total exports while the three plantation crops contributed to 16 per cent of the total exports. The share of minor agriculture in the total exports was 3 per cent.
- Textiles and garments exports increased by 5 per cent in the first half of 2004 and accounted for 26 per

cent of overall export growth. The growth of the apparel exports is attributed to the recovery in the major export markets. The exporters received higher export orders mainly due to continuous shift to up market non-quota products, measures taken by the exporters to consolidate existing markets and moving into new niche markets. Other industrial categories that recorded higher growth in the first half of 2004 were rubber tyres (32 per cent), vulcanised rubber products (30 per cent), diamonds (19 per cent) and petroleum products (27 per cent).

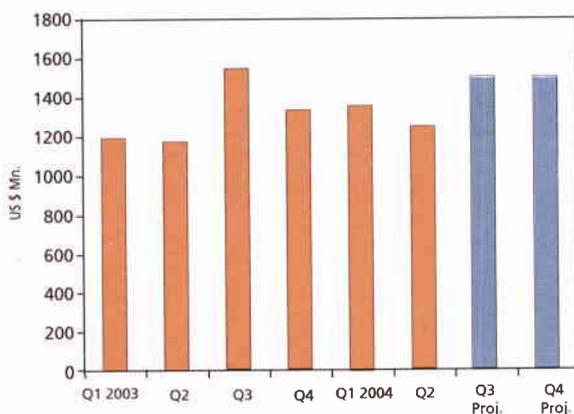
- The agricultural exports grew by 14 per cent, from US dollars 442 million in the first half of 2003 to US dollars 503 million in the first half of 2004 due to higher performance by all plantation crops.
- Tea exports, dominated by bulk tea increased by 9 per cent in the first half of 2004 compared to the negative growth of 4 per cent during the same period of the previous year. In volume terms, tea exports increased by 3 per cent in the first half of 2004. Global tea prices witnessed an upward trend during the first half of 2004. The average price during this period increased by 5 per cent to US dollars 2.38 per kg from US dollars 2.26 per kg in the previous year. The average export price of tea in all producing countries in the world remained high during this period, attributed to high demand from Russia and Middle East countries. The demand from these countries may continue to grow with high oil prices generating higher income in these countries.

- Exports of rubber and coconut registered healthy growth rates of 59 per cent and 54 per cent respectively in the first half of 2004. The price of rubber, which increased by 50 per cent in 2003, grew further by 21 per cent in the first half of 2004.

industry benefited from the increased export orders received from South Asian and Middle Eastern countries.

Exports

Chart 11.2



- Minor agriculture, dominated by vegetables, cloves and cinnamon, recorded a modest growth of 3 per cent in the first half of 2004. The export growth of minor agricultural crops were driven by vegetables, fruits, arecanuts, cinnamon, cloves, betel leaves and sesame seeds. The exports of unmanufactured tobacco, pepper and nutmegs decreased by 14 per cent, 18 per cent and 32 per cent, respectively, in the first half of 2004.

- According to the industry sources, rubber prices are expected to remain high in the near to medium term due to the formation of the International Tripartite Rubber Company (ITRC) in October 2003. The ITRC, which represents the world's largest producers, Thailand, Indonesia and Malaysia, intends to purchase, manage and sell natural rubber in the open market. The rubber exports of Sri Lanka also benefited from the supply shortage in the world market following the unrest in southern Thailand in May 2004, increased demand from China and existing low stocks.
- The growth of coconut exports was mostly driven by desiccated coconut, which increased by more than twofold during the first half of 2004 compared to the same period in 2003. The desiccated coconut

- Total export is estimated to grow by 7 per cent in the second half of 2004 realising an annual growth of 8 per cent in 2004. This growth is mainly expected from higher export performance in garments, machinery equipments and the three plantation crops. In spite of high oil prices and intensified competition in the international markets, industrial exports are expected to benefit from strong global demand. Despite the lower margins, in the wake of dismantling of quota in 2005, the early preparation for the quota free market, reduced reliance on quota based exports compared with regional competitors and higher labour standards maintained by the industry will help to withstand increased competition. Tea export is expected to benefit from the anticipated bad weather in Kenya and India in the second half of 2004. Coconut export is expected to decline in the second half of 2004 due to the lag effects of the drought during the first half of 2004.

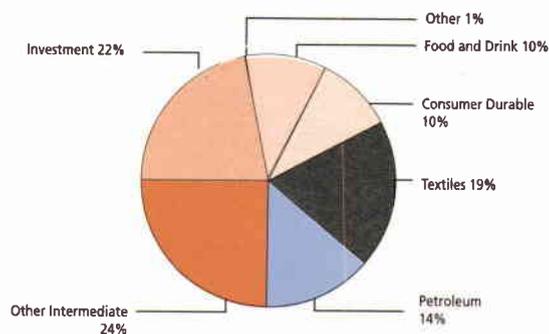
Import Performance

- Expenditure on imports increased by 21 per cent from US dollars 3,078 million in the first half of 2003 to US dollars 3,732 million in the first half of 2004. The expenditure on imports consisted of intermediate goods (57 per cent), investment goods (22 per cent) and consumer goods (20 per cent) in the first half of 2004. Intermediate goods and investment goods imports accounted for 53 per cent and 41 per cent respectively to the overall growth of imports in the first half of 2004. The growth in the import expenditure in the first half of 2004 is the combined outcome of an increase in import volumes and prices. The import volume index and the price index increased by 21.3 per cent and 8.0 per cent respectively in the first half of 2004.
- Expenditure on consumer goods import increased by 8 per cent during the first half of 2004 mainly due to the increase in motorcar and motorcycle imports. The imports of food and beverages increased by 5 per cent in 2004 as compared with the 0.2 per cent growth registered in 2003 mainly due to the higher increase in wheat prices. Owing to the decline in quantities, rice and sugar imports decreased by 43 per cent and 5 per cent respectively in the first half of 2004. The expenditure on imports of milk products remained unchanged during the first half 2004 while expenditure on non-food items increased by 10 per cent.
- The imports of intermediate goods increased by 19 per cent during the first half of 2004 compared to

10 per cent in 2003. The petroleum import bill increased by 42 per cent in the first half of 2004 as compared with the 7 per cent increase in 2003, due to the soaring oil prices. Apart from petroleum, expenditure on textiles, diamonds, paper and chemical products have increased in the first half of 2004. Textile imports, which is the single largest item, accounting for 34 per cent of total intermediate expenditure, increased by 8 per cent to US dollars 718 million from US dollars 663 million in 2003. The total import bill of fertilizer decreased by 12 per cent to US dollars 42 million.

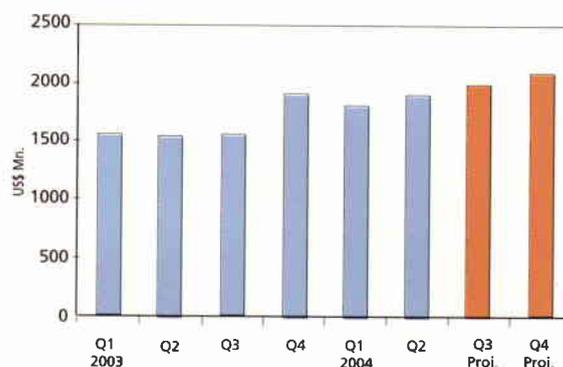
Composition of Imports Jan-Jun 2004

Chart 11.3



Imports

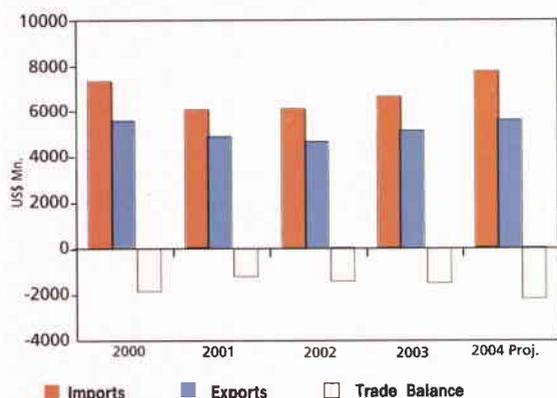
Chart 11.4



- Investment good imports registered a substantial growth. Expenditure on investment good imports increased by 50 per cent to US dollars 813 million in the first half of 2004 as compared with the 2 per cent growth registered during the same period in 2003. Increases were recorded in all sub sectors of building material, transport equipment and machinery and equipment. The Import of machinery and equipment consists of electrical apparatus, transmission apparatus, motor spare parts, automatic data processing machines and other types of machines and related accessories.
- The total expenditure on imports is expected to grow by 12 per cent in the second half of 2004, registering a 17 per cent annual growth in 2004. The demand for imports is expected to increase during the second half of 2004 mainly due to the higher monetary growth and credit expansion in the economy. The expected higher growth in apparel exports in the second half of 2004 will be associated with higher imports of fabrics.

Trade Balance

Chart 11.5

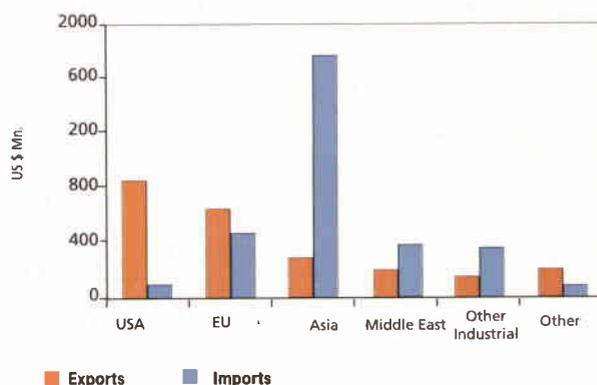


Direction of Trade

- During the first half of 2004, the USA continued to be the largest single destination for Sri Lankan exports with a share of 31.2 per cent, followed by the United Kingdom (UK) (13.6 per cent), India (6.1 per cent), Germany (5.5 per cent) and Japan (3.1 per cent). The major export item to the USA were textiles and garments and these items accounted for 81.5 per cent of total exports to the USA. In region wise, export market share of the European Union was 31.1 per cent, while Asia and the Middle East accounted for 7.9 per cent and 6.8 per cent, respectively, in total exports. In the first half of 2004, Russia remained the largest buyer of tea in value terms followed by the U.A.E (United Arab Emirates) and Turkey.

Direction of Trade Jan-June 2004

Chart 11.6



- India became the largest single exporter to Sri Lanka (20 per cent) followed by Singapore (10 per cent), Hong Kong (9 per cent), Japan (6.3 per cent), China (6 per cent), United Kingdom, Iran and Malaysia (5 per cent each), USA (4 per cent) and U.A.E. (3 per cent).

cent). As a group, Asian countries continued to be the major source of Sri Lanka's imports, with a share of 58 per cent of total imports. In the Asian market, SAARC countries accounted for 33 per cent of total imports. Meanwhile, the European Union and the Middle East represented 16 per cent and 10 per cent of total imports of Sri Lanka.

Trade and Tariff Policy

- ❑ The main objectives of the trade and tariff policy of the government are to encourage export led economic growth, utilization of domestic raw materials in the manufacturing sector and encourage mutually beneficial bilateral and investment treaties.
- ❑ The Economic Policy Statement issued by the government on 1 July 2004 emphasised that the government will maintain moderate tariffs for manufactured goods with local value addition and low tariffs for machinery, equipment and raw material imports to provide incentives for export oriented industries. All imports used for manufacturing of exports for indirect exports or used by direct exports will be made duty free.
- ❑ The tariff on agricultural products will be at the high range of 25-35 per cent or at appropriate specific rates to protect the domestic agricultural sector and improve food security of the country.
- ❑ The government intends to discourage the export of local minerals in its raw form and encourage

establishment of processing and conversion plants to upgrade the industry towards a value added finished goods export base. Incentives also will be provided to adopt modern manufacturing technology and management practices, introduce best packing, brand names etc. to improve competitiveness of export oriented industries.

- ❑ Special assistance will be extended to meet needs of garment exporters such as product designing, brand name promotions, trade lobbying and business development and complying with relevant standards in respect of labour, environment, corporate governance and environment and ecological sustainability.
- ❑ Mutually beneficial bilateral trade and investment treaties will be used for promoting trade and investment. In this regard, bi-lateral relations with India, the EU, the USA and several other countries will be strengthened.

International Trade Relations

- ❑ The World Trade Organization (WTO) with 147 member countries had the Ruling General Council Meeting in Geneva on July 31, 2004. At this meeting, member states formally agreed on a framework of setting parameters for completing the Doha Round of Negotiations.
- ❑ Under the latest accord, wealthier nations agreed to eliminate government export subsidies for agriculture

products, other forms of farm subsidies and to reduce barriers on global trade. In return, developing nations agreed to support guidelines that would reduce tariffs and other barriers for manufactured products and services such as telecommunication and financial services.

- Details of implementation were left for further negotiations. However, the accord has now become a part of the "framework" for continued dialogue on global free trade talks that are set to be resumed in the near future.

- The BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka and Thailand Economic Cooperation) summit of leaders of member countries was held on 30-31 July 2004, in Bangkok, Thailand. Leaders of the member countries exchanged their views on BIMST-EC cooperation and its future direction on transitional crimes and terrorism, combating and controlling diseases, poverty alleviation, promotion of tourism, energy, fishery sector cooperation and the use of traditional medicine and knowledge. The leaders agreed and adopted the new name for BIMST-EC, as "Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation."

- As a follow-up action, five working committees were appointed and Sri Lanka will lead the committee on Experts/ Working Group Meeting on the Protection of Bio-Diversity & Traditional Knowledge and its Intellectual Property Dimension.

- Under the South Asian Free Trade Agreement (SAFTA), three Committee of Experts meetings were held in Kathmandu, Islamabad and Colombo. Negotiations were taken place with a view to reducing tariff and for the removal of non-tariff barriers that will increase the intra regional trade and investments. The SAFTA is scheduled to come into force on 1st January 2006. Trade negotiations on outstanding issues under the SAFTA need to be completed before the deadline.

- The third commerce secretary level talks between Sri Lanka and India under the Indo – Sri Lanka Free Trade Agreement (ISFTA) and the Comprehensive Economic Partnership Agreement (CEPA) were held on 16th and 17th August 2004, in Colombo. The talks centred around operational issues and other matters relating to ISFTA. The first round of discussion on CEPA at the commerce secretary level were also held in Colombo on 18th August 2004. Both countries highlighted the importance of deepening and broadening the scope of ISFTA in moving towards CEPA.

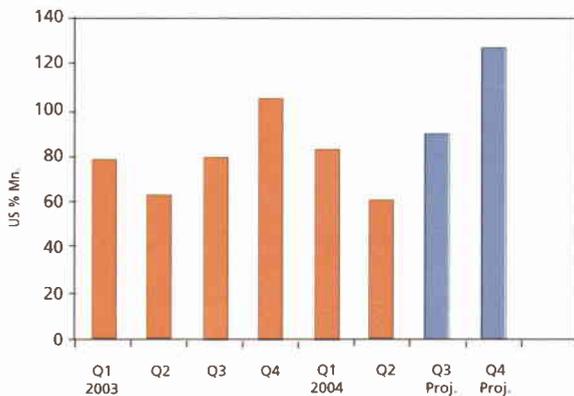
Tourism

- Tourist arrivals increased by 4.1 per cent during the first half of 2004 compared with 24.4 per cent in 2003. In 2003 the tourist arrivals recorded a highest number of arrivals in the history of Sri Lanka.
- The tourist arrivals registered substantially higher growth of 17 percent during January - February 2004. Subsequently, reversing these trend arrivals declined by 5.9 per cent and 9.0 per cent in March and April, respectively, due to election related uncertainties

prevailed in the country. However, tourist arrivals increased marginally in May and June, but increased substantially by 15.5 per cent and 15.6 per cent in July and August 2004.

Tourist Earnings

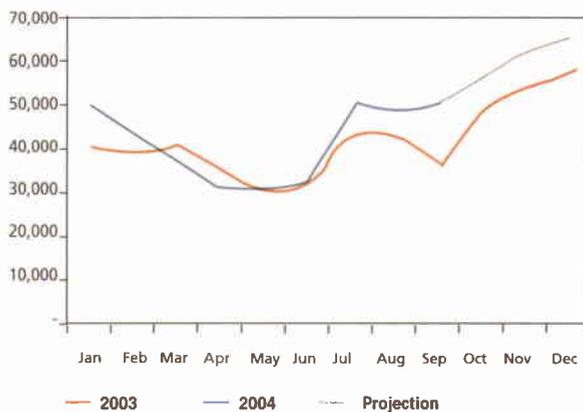
Chart 11.7



- In line with the increasing trend in arrivals, the gross earnings of the tourism industry increased by 4 per cent to US dollars 140 million during the first half of 2004, as compared with the same period of the previous year. Foreign exchange earnings from tourism continued to be the fifth largest foreign exchange earner in Sri Lanka.

Tourist Arrivals - Monthly

Chart 11.8



- Western Europe continued to be the largest source of tourist arrivals with a share of 52.4 per cent. In the first half of 2004, the UK stood as the largest source of tourists from a single country. Tourist arrivals from the UK increased by 20 per cent to 43,410 in the first half of 2004.

- South Asia remained the second largest tourist-generating region to Sri Lanka with India being the major source. However, tourist arrivals from India decreased by 10.6 per cent to 38,312 visitors during the first half of 2004, from 42,831 in 2003.

- In order to promote tourism, Sri Lanka Tourist Board (SLTB) participated in 35 trade fairs in the first half of 2004. Meanwhile, the government arranged several meetings with relevant authorities in India, China and Thailand to attract more tourists from those countries to Sri Lanka.

- The SLTB is expected to be restructured under the new Tourism Act and introduced a special levy on all tourist related activities to fund tourist promotion activities. The SLTB officials participated in a number of trade fairs in Europe, Eastern Europe, Asia and the Middle East, and are scheduled to participate several fairs in different markets during rest of this year to promote tourism.

- Sri Lankan Airlines operated flights to 41 destinations in 23 countries in the first half of 2004. The number of scheduled passenger airlines increased from 23 to 26 including new five airlines namely, SAHARA Airline and JET Airways from India, Pakistan Air Line and another two airlines from the United Arab Emirates namely, ETIHAD and Air Arabia. Aeroflot and Cyprus Airways suspended their operations in 2004.