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n.a.	Not applicable
..	Not available
-	Zero
.	Insignificant

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*a*bstract

Over the past three decades Sri Lanka has made significant progress in undoing a legacy of import-substitution policy pursued vigorously during the first three decades following political independence in 1948. Indeed, in terms of both continued commitment to market-oriented reforms and the significant economic gains achieved from this commitment, the Sri Lankan experience is remarkable in the developing world. These developments notwithstanding, both high tariffs and quantitative restrictions remain important deterrents to import trade in agricultural goods.

The net direct impact of implementation of the market access provisions of the Uruguay Round by other countries on Sri Lanka's agricultural trade is likely to be negligible. The direct impact on existing trade patterns is, however, only one aspect of an assessment of the overall impact of the Round on a given member country. What is more important is the potential benefit emanating from significant achievements of the Round in improving the rules for world agricultural trade and ensuring the transparency of such rules. These achievements imply setting the stage for a positive shift in the production possibilities faced by individual agricultural producing countries through opening up new market opportunities. A small open economy like Sri Lanka certainly has a strong and direct interest in the world economy and its trading rules.

*a*gricultural trade liberalisation in the Uruguay Round: implications for Sri Lanka

Uruguay Round—a turning point

The Uruguay Round Agreement on Agriculture (URAA) marks a turning point in the regulation of international trade in agricultural goods. More than four decades after the GATT was inaugurated, the agricultural sector is now included in the mainstream GATT/WTO rules. Even though the degree of liberalisation finally achieved under URAA tariff bindings has fallen well short of original expectations, the Round has clearly succeeded in establishing a rule-based trading system for agriculture. Through the establishment of a multilateral framework for the discipline of agricultural trade and the achievement of transparency in trade restrictions through the tariffication process, a firm foundation has now been laid for further liberalisation (Cline 1995; Rayner et al. 1993; Martin and Winters 1995). In order to build on this promising start, it is vital to broaden our understanding of the trade policy-making process in developing countries and the constraints, both perceived and real, faced by these countries in their attempts to comply with new URAA rules. This paper aims to contribute to this end through a case study of Sri Lanka.

The paper begins with a description of the agricultural sector in the Sri Lankan economy. The following section provides an account of current agricultural production and trade policies while paying attention to their roots in Sri Lanka's economic policy history and the related socio-political considerations. The fourth section is the core of the paper and examines Sri Lanka's URAA commitments to date and the constraints to further compliance with URAA provisions, and assesses of the impact of the URAA on world agricultural trade from the perspective of global trading opportunities for Sri Lanka. The final section draws out the implications of the URAA for Sri Lanka.

Agriculture in the Sri Lankan economy

Despite significant structural transformation over the past three decades, the agricultural sector still constitutes a fifth of GDP in Sri Lanka (Table 1). It provides employment to about 40 per cent of the labour force, surpassing the contribution of any other major sector. About 65 per cent of the country's population is largely dependent on agriculture for their livelihood. Within the agricultural sector, the output share of plantation agriculture (tea, rubber, coconut and related processing activities), the mainstay of the classical export economy of Sri Lanka, has declined sharply. In terms of the relative contribution to GDP, non-plantation agriculture is over four times of that of the plantation agriculture.

Table 1 **Sectoral composition of domestic product of Sri Lanka** (per cent)

	1970–71[a]	1980–81[a]	1993–94[a]
Agriculture, forestry and fishing	35.06	33.66	26.06
Agriculture	32.49	28.94	21.23
Plantation agriculture	15.80	13.95	5.77
Tea	3.21	2.63	1.40
Rubber	1.77	1.40	0.55
Coconut	4.05	3.80	1.93
Processing of tea, rubber and coconut	6.77	6.12	1.89
Non-plantation agriculture	16.69	14.99	15.46
Paddy	7.21	6.09	4.39
Other	9.48	8.90	11.07
Forestry	1.36	1.97	2.13
Fishing	1.21	2.75	2.69
Industries	16.98	23.55	24.03
Manufacturing[b]	9.88	11.62	13.42
Services	47.96	42.79	49.91
Total	100	100	100

[a] two-year average.
[b] Excluding processing of plantation products (tea, rubber and coconut).
Source: Compiled from Central Bank, *Annual Report* (various issues).

The land area under cultivation of tea, the main agricultural export, is about 222,000 hectares. Over 55 per cent of this land is covered by state-owned plantations, while the remainder is held by smallholders with less than 20 hectares. Coconut and rubber, which cover 416,000 and 191,000 hectares respectively, are predominantly smallholder crops. More than 90 per cent of Sri Lanka's tea production, 65 per cent of rubber production and 17 per cent of coconut production is exported.

Paddy (rice), the main staple crop, accounts for about a third of the share of non-plantation agriculture in GDP. The area under paddy cultivation is 930,000 hectares or 45 per cent of the total area under agriculture. The majority of farmers in the paddy sector are small-scale producers—more than 70 per cent of paddy holdings are less than one hectare and only about 5 per cent have a holding size greater than two hectares. The rice sector employs about half of the total agricultural labour force which is about 20 per cent of the total labour force. Rice accounts for approximately 25 per cent of the consumer goods basket, about three-quarters of total grain consumption and 45 per cent of calorie intake in the country. Nearly 90 per cent of the total domestic rice requirement is now met from local production. The other non-plantation crops include subsidiary food crops such as maize, pulses, chillies, onions and potatoes, and a range of tree-crops such as cinnamon, cardamon, coffee, cloves, pepper and arecanut (betel-

Table 2 **Main agricultural crops, 1994**

	Area under culltivation[a] ('000 ha)		Government ownership[b] (%)	Export–output ratio (%)	Import penetration ratio (%)[c]
Tea	222	(10.8)	55	94.8	.
Rubber	192	(9.3)	15	65.8.	.
Coconut	416	(20.2)	4	16.7	.
Minor export crops	75	(3.7)	.	55.0	.
Paddy	930	(45.2)	0	.	12
Sugar	13	(0.6)	20	.	83
Minor food crops	21	(10.2)	0	1.5	15

[a] Share in total cultivated land is given in brackets.

[b] Ownership is measured in terms of output share for sugar and share of cultivated land in all other cases.

[c] Imports as a ratio of total domestic absorption (in value terms).

[d] Cinnamon, coffee, cocoa, cloves, pepper, cardamom and arecanut.

Sources: Compiled from Central Bank of Sri Lanka, *Annual Report 1994;* Department of Census and Statistics, *Statistical Abstract 1994;* and Ministry of Finance, Planning, Ethnic Affairs and National Integration, *Public Investment: 1995–1999.*

nut) which are based mostly on home-garden activities. The non-plantation tree-crops are mostly export oriented, and they jointly contribute some 3 per cent to total export earnings. In terms of organisational characteristics, the sugar industry differs significantly from other agricultural activities. It is based on a nucleus estate/outgrower system under which three companies (one state owned and two foreign owned and managed) undertake end production while a major portion of sugar cane cultivation is done by individual farmers. At present, about 20 per cent of domestic demand is met by domestic production (MFPEANI 1995).

The share of agricultural products in total exports declined from 40 per cent in 1987 to 21 per cent in 1994 (Table 3). The underlying factors included the decline in production in public sector plantations, the rapid growth in the absorption of rubber by domestic industry, and the expansion of manufacturing exports (especially garments). This decline, measured in terms of gross export earnings, hides the continued importance of tea and other agricultural products in the balance of payments. As many of the manufacturing exports are based on the domestic processing of

Table 3 **Composition of Sri Lanka's exports** (per cent)

	1970–71[a]	1980–81[a]	1993–94[a]
Agricultural exports	94.6	61.6	22.4
Tea	55.5	35.1	13.8
Rubber	22.0	14.7	2.3
Coconut	14.5	7.0	2.2
Minor agricultural products[b]	3.1	4.8	4.1
Cinnamon	1.5	1.3	1.4
Cloves	0.4	1.1	.
Cocoa	0.2	0.3	.
Tobacco	.	0.2	1.3
Cashew nuts	.	0.2	0.1
Essential oils	.	0.2	0.1
Manufactured exports	1.7	31.2	73.2
Textiles and garments	0.4	10.3	48.8
Petroleum products	0.9	17.7	2.6
Mineral exports	0.8	4.5	2.7
Unclassified (including re-exports)	3.9	2.7	1.7

[a] two-year average. - less than 0.1 per cent.
[b] The other products in this category include coffee, pepper, nutmeg, cardamom, betel leaves, essential oils, cashew nuts, arecanuts, papain, vegetables and fruits.
Source: Compiled from data reported in Central Bank, *Annual Report* (various issues).

Table 4 **Composition of Sri Lanka's imports** (per cent)

	1976–77	1980–81	1993–94
Agricultural imports	34.2	18.9	12.8
Rice	14.2	2.6	0.8
Flour	15.1	5.4	0.2
Wheat and meslin	2.8	1.7	2.6
Sugar	2.4	6.0	3.3
Milk and milk products	1.7	1.6	1.9
Other imports	65.8	81.1	87.2
Total imports	100.0	100.0	100.0
SDR millions	554	1,596	3,099

Source: Compiled from data reported in Central Bank, *Annual Report* (various issues).

imported inputs (garments and diamonds, in particular), in terms of net foreign exchange earnings, agriculture is much more important than indicated by the data on the value of exports (Athukorala and Bandara 1990). Sri Lanka is the leading tea exporting country in the world, accounting for over 20 per cent of world tea trade. In other agricultural product markets, Sri Lanka is a minor player.

Agricultural imports (proxied here by food and drinks plus wheat) accounted for 13 per cent of total commodity imports in 1993–94 (Table 4). The main import items were sugar (3.3 per cent), flour (0.2 per cent) wheat (2.6 per cent) and rice (0.8 per cent).

Agricultural policy

Key policy trends

During the first three decades or so after independence in 1948, Sri Lanka's agricultural policy was characterised by a striking dualistic approach: policy discrimination against plantation agriculture and an emphasis on the promotion of domestic food production agriculture, in particular rice. The plantation sector suffered from a high level of taxation imposed on exports and from a continuing fear of nationalisation, and from mismanagement following the nationalisations that did occur in 1973 and 1975 (Bhalla 1991; Cuthbertson and Athukorala 1991). On the other hand, the paddy sector and subsidiary food crops (since the early 1970s), have benefited from government investment in irrigation schemes, subsidised inputs, cheap bank credits, guaranteed purchase prices and stringent import controls aimed at maintaining domestic market prices above competitive world prices. In fact, the policy emphasis of Sri Lankan political leaders on reviving domestic food crop agriculture in the sparsely populated dry zone (through large-scale public investment in irrigation-cum-land development projects) has a history dating well back to the 1930s (Athukorala and Jayasuriya 1994:9).

Since 1977, Sri Lanka has made significant progress in undoing a legacy of import substitution policies and removing distortions in the price system. The initial focus was on trade policy reforms, largely in manufacturing (ADB 1995). The liberalisation attempts have, however, become broad-based over the years with the objective of redressing distortions economy-wide and harmonising competitive conditions across sectors. The removal of export duties on all plantation products took effect from December 1992, thus correcting a long-standing anomaly in the taxation of traditional exports vis-à-vis non-traditional exports. In the same year, steps were taken to turn the management of plantation companies over to private sector companies. The other noteworthy reform measures implemented since the mid-1980s have included the abolition of government monopoly in the procurement of paddy output (operated through the Paddy Marketing Board), the rationalisation of rural credit schemes, the gradual removal of monopoly import rights enjoyed by the Cooperative Wholesale Establishment in food imports, and the relaxation of restrictions on foreign capital participation in agriculture.

The change of government in 1994 has not resulted in a policy reversal. The inaugural policy statement of the new government assured that economic policy will in general be market friendly and the private sector will be considered the principal engine of growth (Sri Lanka 1995a). According to this policy statement, the key objectives of the agricultural policy are

- removing hidden discrimination against agriculture resulting from macroeconomic and trade policies, bureaucracy, over regulation and other discriminatory measures which have reduced agricultural productivity and constrained investment
- limiting state intervention and eliminating monopolies so as to foster greater competition in agricultural markets
- granting freehold titles to settlers and removing restrictions on leasing land in agricultural settlement schemes in order to create a land market and give farmers the freedom to make the best use of their land
- ensuring a greater role for the private sector in agricultural development through privatisation of plantations, investment in agro-based industries to create rural employment, the transfer of the commercial activities of the

Mahaweli Authority to private enterprises, a greater voice in agricultural research and the encouragement of collective agreements between the plantation companies and trade unions.

The new government is committed to progressively reducing and harmonising tariffs towards a single rate over the medium term (Sri Lanka 1995b). A two-pronged import tariff of 10 and 20 per cent (1996) and a single (uniform) 15 per cent tariff (1997 or 1998) are under consideration.

The 1995 Budget contained a proposal for restructuring the management of state-owned plantations under long-term (50 year lease) management contracts assuring a financial stake for the private sector management companies. This initiative recognises that privatisation in some form is the best way of revitalising tree-crop plantations. Under the management contract system introduced by the previous government in 1992, there has been some improvement in agronomic practices and management in the plantation sector, however, due to the short time period involved the management contracts failed to provide appropriate incentives for private companies to invest their own resources in rehabilitating the estates. The new scheme aims to redress this limitation.

Current policies

Export duties. After the abolition of export duties on all plantation crops in December 1992, the taxation of exports has been limited to various surcharges and cesses which are applied at moderate rates. The proceeds from these surcharges and cesses are ploughed back into the export sector in the form of selective incentives, replanting subsidies and start-up subsidies for new exporters.[1] The share of export taxes (duties + cesses + other surcharges), was as high as 25.2 per cent in the early 1980s, but declined to 0.05 per cent in 1993 (PCTT 1994:27). There are no quantitative restrictions on exports, apart from licensing requirements on a limited number of minor items on the grounds of cultural value and health implications.

Export subsidies. The Sri Lanka Export Development Board assists new exporters in non-traditional agricultural activities with grants of up to 3 per cent of the fob value during the first year of operation. These new exporters are also eligible in principle for the use of refinancing facilities operated by the Central Bank, the provision of seed capital for new ventures by the Board, and income tax exemptions and customs duty waivers on intermediate goods imported with Board of Investment approval. However, this assistance has hardly been utilised by agricultural producers, with the exception of a few large companies involved in the seafood industry and horticulture. All subsidies on non-plantation export crops amount to less than 1 per cent of export earnings from the designated products.[2]

A variety of subsidies are given by the Tea Board to promote the marketing of processed tea. These include a 50 per cent interest rate subsidy on loans obtained for the purchase of tea bagging machinery; exemption from import duty and other levies on capital goods used for the export processing of tea; and a cash grant to exporters who increased the volume and export price of processed tea over the previous year. In 1992, the total value of these subsidies (26 million rupees) amounted to less than 0.5 per cent of the total value of processed tea exports. Similar subsidies, but on a smaller scale, are given by the Sri Lanka Export Development Board to exporters of fresh fruit and vegetables for their imported packing materials. There are no export subsidies on coconut products, spices and tobacco.

Production subsidies. There are subsidies to encourage the production of both major and minor export crops. Subsidies to the tea sector provided by the Tea Smallholdings Development Authority and the Tea Board in 1994 under new planting, replanting, factory development and factory modernisation schemes amounted to 250 million rupees, or 1.6 per cent of the value of total tea production in that year. The rubber and coconut production subsidies respectively amounted to about 0.6 per cent and 0.4 per cent of the value of production (Central Bank 1994).[3]

Minor export crops—cinnamon, cloves, coffee, cocoa, pepper, nutmeg, cardamon and citronella oil—are provided with incentives in the form of a direct subsidy to producers, a fertiliser subsidy, and the supply of planting material at subsidised prices by the Department of Export Agriculture. A price support scheme and a concessionary credit scheme is also operated by the Department with the assistance of the Asian Development Bank. In 1993, credit and fertiliser subsidies amounted to 9.6 million rupees, while the subsidy under the price support scheme was 16.8 million rupees. The combined figure (26.4 million rupees) amounted to less than 0.2 per cent of the total value of minor agricultural exports in 1993.

The government's policy of promoting rice production has historically involved three key elements: a guaranteed price scheme operated by the Paddy Marketing Board, a fertiliser subsidy, and concessionary bank credits. The impact of the guaranteed price scheme has been significantly eroded since the abolition of the Paddy Marketing Board monopoly in the procurement of paddy in the mid-1980s. In the competitive market for paddy, the Board now only purchases about 2 per cent of total paddy output. As a result of financial market reform in 1979, concessionary credit for paddy farmers is now responsible for only a very small share (7.5 per cent) of non-plantation crop agriculture input financing. In a context where the saving deposit rate is well below the concessionary loan rate, farmers rely mostly on self-financing for cultivation purposes. The fertiliser subsidy was abolished in 1990 as part of a wide-ranging structural adjustment policy package, but it was reintroduced in 1994 by the new government. The current subsidy rates are: 40 per cent for urea, 15 per cent for ammonium sulphate, 9 per cent for nitrate of potash, and 22 per cent for triple super phosphate.

Apart from direct production and price supports, the paddy sector has continued to be the beneficiary of state-sponsored research and extension services and, more importantly, free irrigation of rice fields by state built and maintained irrigation schemes. According to a recent World Bank study, the annual equivalent of the subsidy to new major irrigation schemes in the form of operation and maintenance expenditures amounts to about 1,350 rupees per hectare or 3.5 per cent of value added (World Bank 1995a:10).[4]

There are no direct subsidies to encourage the production of subsidiary crops although in some areas farmers benefit from free irrigation. There are, however, agricultural extension services to educate farmers on improved methods of production. There are also guaranteed price schemes operated by both the Paddy Marketing Board and the Cooperative Wholesale Establishment for eight subsidiary food crops: maize, *kurakkan*, groundnuts, soybean, ginger, cowpea, green gram and black gram. As in the case of paddy, annual purchases under these schemes are small (about 3 per cent of annual output) and hence the effect on market prices is insignificant.

Import duties and quantitative import restrictions. Trade liberalisation initiatives since 1977 have reinforced the role of the tariff as the central instrument regulating Sri Lanka's merchandise trade. The tariff regime has also become less distortionary during subsequent rounds of reforms. It currently relies on a three-pronged structure with rates of 10, 20, and 35 per cent. In 1994, the unweighted average (across 6,050 tariff items) was on the order of 20 per cent and the ratio of actual duty revenue to imports was even lower (about 11 per cent)[5] (WTO 1995a:35). These developments notwithstanding, both high tariffs and quantitative restrictions continue to be important deterrents to import trade in a number of key agricultural commodities (Table 5).

The importation of rice to Sri Lanka is subject to licensing and an *ad valorem* tariff of 35 per cent. Licences are issued by the Food Commissioner's department guided by the twin objectives of protecting domestic rice producers and maintaining a reasonable price for consumers. The Presidential Commission on Tariffs and Trade has spelled out the government policy stance as follows.

> Fluctuation in international market price could be detrimental to the interests of Sri Lankan farmers. [However] if this item is liberalised and placed at some higher rate of duty to protect the local farmers, the consumers will be adversely affected. The only practical method by which both objectives of protection to the local farmer and providing rice to consumers at a reasonable price would be to permit import during a shortfall of domestic production under an appropriate tariff (PCTT 1994:71).

Table 5 **Tariff and trade restriction on agricultural imports, January 1996**

	Tariff (per cent)		Quantitative restrictions (QRs)
	1986-88	1996 Jan.[a]	
Rice	25	35	License to bondsmen
Wheat	25	20	License to CWE
Wheat flour	35	35	License to CWE
Potatoes	100	35	License to private traders
Chillies	5	35	License to private traders
Onions (big)	5	35	License to private traders
Onions (red)	5	35	Licence to private traders
Pulses (lentils)	5	35	No QRs
Pulses (others)	5	35	No QRs
Maize	5[b]	35	No QRs
Ginger	60	35	No QRs
Turmeric	60	35	No QRs
Saffron	60	35	No QRs
Aniseed	5	35	No QRs
Coriander	5	10	No QRs
Cumin Seed	5	10	No QRs
Fennel Seed	5	10	No QRs
Sugar	60	35	No QRs
Milk (full cream)	60	20	No QRs
Milk (powder)	60	20	No QRs

[a] For all licensed imports, licensing is non-automatic.
[b] 75% for non-animal feed.
Note: CWE = Cooperation Wholesale Establishment.
Source: Sri Lanka Customs Notifications (various).

Until 1990, the Cooperative Wholesale Establishment had a monopoly in rice imports. In August 1990, a 'bondsmen' scheme was introduced. Under this scheme private traders (bondsmen) are allowed to import and operate buffer-stocks subject to paying import duties only when the stocks are released to the domestic market. The gazetted tariff rate on rice imports was 20 per cent until 1992; it was revised upward to 35 per cent in 1993. Though the present gazetted duty rate is 35 per cent, the government in effect is levying a duty varying from 12 per cent to 20 per cent in order to keep the price of imported rice slightly above the price of rice milled out of the paddy purchased under the generalisaed system of preferences.[6]

Chillies, onions and potatoes are subject to stringent import licensing. The import quantities of these seasonal food crops are decided at a weekly 'Food Security Meeting' (involving the Department of Census and Statistics, the Food Commissioner, the

Ministry of Agriculture and the Controller of Imports and Exports). The Food Commissioner issues import licences free of charge to private traders with Sri Lankan citizenship and who are registered with the Registrar of Companies. The stated operational rule has been to 'decide import quantities by taking into account the country's food supply situation and additional considerations such as the cost of living' (PCTT 1995). In practice, however, the objective of protecting farmers seems to receive priority. In particular, imports of potatoes have been virtually banned for many years, but imports of seed potatoes are allowed under a licence scheme. Given the exorbitantly high market price for potatoes (as high as US$2 per kg. during off-harvest seasons), importers are believed to reap handsome quota rents by selling seed potatoes illegally for consumption. Given stringent restrictions on the total volume of imports in each case, import licences for all three commodities (chillies, onions and potatoes) carry an attractive scarcity premium. There is circumstantial evidence that a large number of licensees sell their licences to Indian traders in the Colombo wholesale market at a commission of 10 to 15 per cent of the wholesale market value of imports.[7] At present the government is contemplating introducing a licence fee with a view to avoiding the misuse of licences.

According to a number of recent studies, Sri Lanka is a high-cost producer by international standards of rice and subsidiary food crops. Thus both continuation at the current level and any increase in production, unless brought about by productivity improvements, will come at a very high cost to the economy. Moreover, the opportunity costs of investments in irrigation will increase over time as all long-term rice projections suggest declines in real international prices. At the same time, the existing control regime does not seem to have achieved its declared objective of cushioning domestic consumers and producers from excessive fluctuations in world market prices. On the contrary, there is convincing empirical evidence that seasonal price fluctuations in international markets for these products are far less than in the Sri Lanka domestic market. All in all, the economic arguments for removing existing non-tariff barriers with a view to diverting resources to alternative uses appear to be very strong (Bhalla 1991; Edirisinghe et al. 1991; World Bank 1995a).

Sri Lanka's flour and wheat requirements are entirely met through imports. These are the only agricultural commodities in which the Cooperation Wholesale Establishment currently has an import monopoly. The major obstacle to the privatisation of trade in these commodities is a long-term agreement (entered into in 1980 and due to expire in 2004) between the government and Prima Ceylon Ltd, a fully foreign-owned (Singapore) company which is the only flour mill in the country. Under the agreement the government supplies an agreed amount (450,000 metric tonnes) of wheat every year under the condition that Prima provides the Cooperation Wholesale Establishment with 74 metric tonnes of flour for every 100 metric tonnes of wheat supplied for distribution through the Cooperation Wholesale Establishment trading network. Prima is allowed to retain and use wheat bran (free of charge) to produce animal feed. After purchasing Ceylon Oils and Fats Corporation in 1992 (under the government's privatisation program), Prima now enjoys a virtual monopoly in the animal feed market.[8] Prima also exports a significant portion of animal feed production.

The government fixes the domestic price of wheat flour through the Cooperation Warehouse Establishment. Imports of wheat and wheat flour are therefore determined in such a way that the demand requirements are satisfied at the fixed price. Until 1994, flour prices were set to cover the full cost and the Cooperation Warehouse Establishment made a profit from flour sales. On 29 August 1994, the administered price for flour sales by Cooperation Warehouse Establishment was reduced from 11.00 to 6.55 rupees per kilogram, accompanied by a reduction in the price of a loaf of bread from Rs. 5.00 to 3.50 to fulfil an election promise.[9] With the rise in the world market price of wheat, the subsidy on wheat flour has become a big burden to the government. Although the price of wheat flour was raised twice, it is still below cost and the government subsidy is estimated at 5,000 million rupees a year at prevailing prices. The wheat subsidy, by reducing the price of flour relative to rice, has increased the consumption of wheat in Sri Lanka on one hand and acts as a disincentive to rice cultivation on the other.

The importation, distribution and maintenance of buffer stocks of sugar is now mainly in the hands of the private sector; the Cooperation Warehouse Establishment plays only a supplementary role. While there are no licensing or other non-tariff restrictions, the import tariff is set by the government according to a special agreement with the Pelwatte Sugar Company (a subsidiary company of the sugar giant, Booker International) aimed at guaranteeing a certain rate of return to the company.[10] The current tariff (35 per cent) aims to maintain a minimum efficiency ex-factory price of not less than US$500 per tonne based on 'the average cost of production of efficient producers elsewhere in the world and ensure reasonable remuneration to the cane producer and the miller' (MFPEANI 1995). However, according to a recent Asian Development Bank study 'this is a price in line with prices in the highly protected US domestic market and about twice the import price' (ADB 1995:112). The government usually justifies its controversial sugar pricing (tariff) policy by pointing to the 'strategic importance' of increasing local production to meet a considerable part of the domestic demand.

The current import duty on milk powder and full-cream milk is 20 per cent. The apparent intention of tariff protection here is to increase protection 'to ensure adequate returns to domestic producers/processors and to increase domestic fluid milk consumption and reduce dependence on imported milk powder' (MFPEANI 1995). Nestle Lanka, a subsidiary company of Nestle, is the sole milk powder producer in the country. The company was formed (in the early 1980s) under an assurance given at the highest political level of providing reasonable returns to local production through tariff policy. Nestle Lanka has argued in its various submissions to the Presidential Commission on Tariff and Trade that the import duty is crucial for maintaining the profitability of high-cost local production in the face of stiff competition from other brands of imported milk powder (both imported in packeted form, and imported in bulk and packeted locally) (Ratnayaka 1993).

Quantifying policy intervention

After discussing various agricultural policies, the next logical step is to identify the cumulative impact of these policies on the incentive structure faced by domestic producers. There are two recent studies which provide such estimates, Edwards (1993) and World Bank (1995b). A major limitation of Edwards' estimates is that they are based on duty-adjusted border prices, not on a direct comparison of world-market and domestic-market prices. Thus the reliability of these estimates for food crops under stringent licence control is questionable (PCTT 1994:69).[11] To redress this limitation, the World Bank (1195b) has made its estimates through a direct comparison of world and domestic-market prices. Moreover, the latter study provides estimates of the effective subsidy coefficients, in addition to nominal protection coefficients and effective protection coefficients. For theses reasons, the discussion in this section is based on World Bank estimates (see Table 6).

The nominal protection coefficient for import-competing agricultural crops is 1.33. This suggests that the prices paid by the Sri Lankan consumers for these goods are, on average, 33 per cent higher than what they would pay in the absence of trade protection. The estimates for individual items vary from 1.3 (rice) to 2.4 (big onions). For rice, despite the existence of non-automatic licensing, the nominal protection coefficients is slightly lower than the average gazetted duty rate (35 per cent). This reflects both the variable tariff policy and the relatively flexible import licensing procedure adopted by the government to stabilise the domestic market price of rice (the staple food of the country) in the event of a domestic production shortfall. For chillies, onions and potatoes, the nominal protection coefficients estimates are 1.5, 2.4 and 1.6, respectively. Given the price raising impact of stringent licensing, the existing gazetted tariff rates are largely irrelevant for these commodities.

The effective protection coefficient for import-competing agriculture is 1.53, with rice and other subsidiary food crops showing coefficients of 1.36 and 1.70, respectively. The fact that the magnitude of effective protection coefficients for these products does not differ much from respective nominal protection coefficients suggests that trade

Table 6 **Structure of incentives for agriculture, 1993**

	Gazetted import duty (per cent)	NPC	EPC	ESC
Inport-competing agriculture	..	1.33	1.53	1.68
Rice	35	1.30	1.36	1.56
Others (average)	..	..	1.70	1.79
Chillies	10	1.50	..	..
Onions (big)	10	2.40	..	..
Potatoes	5	1.60	..	..
Lentils (1990–93)	10	1.20	..	..
Export-oriented agriculture	..	..	1.02	1.06
Non-plantation crops	..	..	1.35	1.45
Plantation crops	..	..	1.00	1.03
Tea	15	..	..	1.04
Rubber	36	..	..	1.04
Coconut	10	..	..	1.02
Agriculture (average)	..	..	1.24	1.32
Manufacturing	..	..	1.30	..
Import-competing[a]	..	..	1.70	..
Export-oriented	..	..	1.00	..

[a] This estimate is from Edwards (1993).

Notes: NPC = Nominal protection coefficient = the ratio of domestic price over border-equivalent (world) price. EPC = Effective protection coefficient = the ratio of value added under existing trade policy intervention to value added at border price. ESC = Effective subsidy coefficient = EPC adjusted for net subsidies on non-traded inputs.

Sources: World Bank, 1995b. 'Sri Lanka: non-plantation crop sector policy alternatives', Working Papers 1-7, Agriculture and Natural Resource Division, South Asia Region, World Bank, Washington DC (mimeo); Edwards, Chris, 1993. *A Report on Protectionism and Trade Policy in Manufacturing and Agriculture: Sri Lanka*, Institute of Policy Studies, Colombo.

restrictions play a more important role than various supports on traded inputs, such as credit and fertiliser subsidies, in providing incentives to the farmers. The degree of protection enjoyed by export agriculture is well below the levels observed for import-competing agriculture. Following the abolition of export duties in 1992, plantation agriculture now operates under virtually free trade conditions.

The effective subsidy coefficient for import-competing agricultural crops is 1.68 compared to an effective protection coefficient of 1.53. The difference is largely a reflection of the irrigation subsidy (free irrigation facilities) for the rice sector. As there is no user charge for irrigation, the effective subsidy per hectare for rice under major irrigation schemes is fairly high (giving rise to an effective subsidy coefficient of 2.30), while it is less for minor irrigation scheme rice and absent in rain-fed cultivation. Thus the average effective subsidy coefficient for the rice sector is around 1.56 compared to an effective protection coefficient of 1.36.

The degree of protection of import-competing manufacturing is much higher (effective protection coefficient = 1.70) than that of both total (1.24) and import-competing (1.53) agriculture. However, this comparison seems to give a misleading picture of the anti-agricultural bias embodied in the overall incentive structure of the economy. As a result of the industrial adjustment process brought about by liberalisation since 1977, the share of export-oriented production in the manufacturing sector has increased significantly, reaching a level of over 60 per cent by the mid-1990s. Apart from some subsidies given to firms located in export processing zones, export-oriented production receives little direct government assistance (trade protection). On these grounds, the World Bank (1995b) estimates a weighted-average effective protection coefficient of 1.30 for total manufacturing, assuming an effective protection coefficient of 1.00 and a 60 per cent output share for export-oriented production. According to this estimate, the manufacturing sector is largely at a par with agriculture in terms of the degree of protection enjoyed. Even this estimate may overstate the current level of manufacturing protection for two reasons. First, in the presence of various tariff exemptions and loopholes in tariff administration, the gazetted rates (on which Edwards' estimates are based) are normally much higher than the actual rates.[12] Second, Edwards' (1993) estimates predate the significant cuts in tariffs on manufactured goods introduced by the 1995 Budget.

Sri Lanka and the Uruguay Round

Sri Lanka has been a contracting party to the General Agreement on Tariffs and Trade (GATT) since 1948. It ratified the Marrakesh Agreement establishing the World Trade Organisation (WTO) on 1 June 1994 to become a founding member of the WTO on 1 January 1995. Sri Lanka thus assumed the commitments of the Multilateral Agreement of Traded Goods, the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of International Property Rights. Following the signing of the WTO agreement, the Sri Lankan government set up a Committee on Agriculture to monitor the implementation of the commitments undertaken under the Uruguay Round, and to review notifications of new or revised support measures and other matters of concern. This committee will work in conjunction with the Secretariat of the WTO.

The trade reform provisions of the Uruguay Round Agreement on Agriculture (URAA) fall under three main categories: market access, domestic support, and export subsidies. Of these three categories, export subsidy provisions are applicable to industrial countries only. The URAA requires developing countries to reduce trade-distorting domestic subsidies by 13.3 per cent of the 1986–88 level over 10 years, starting 1 January 1995. Subsidies for the following purposes are, however, not considered trade-distorting and are therefore exempted from the reduction requirement

- direct or indirect government assistance to encourage agricultural and rural development that is an integral part of the development program
- investment subsidies generally available to agriculture
- agricultural input subsidies generally available to low-income or resource-poor producers
- subsidies to producers to encourage diversification from growing illicit narcotic crops
- product-specific domestic subsidies which do not exceed 10 per cent of the value of production of the product
- non-product specific domestic subsidies which do not exceed 10 per cent of the value of total agricultural production
- subsidies which have a minimal effect on production or 'green box policies' such as research, pest or disease control, training services, extension services, marketing and promotion services, infrastructural services, stockholding for food security, food aid, crop insurance, environment conservation, assistance to producers in disadvantaged regions, and direct income support not related to production or price.

The existing production subsidies in Sri Lanka are consistent with WTO domestic support provisions, without requiring any further policy adjustment. Sri Lanka's commitment to the URAA, therefore, relates only to the market access provisions. In addition, there are three other WTO agreements with provisions affecting trade in agricultural goods, namely the Agreement on Trade-Related Intellectual Property Rights; the Agreement on Sanitary and Phytosanitory Measures; and the Agreement on Safeguard, Anti-Dumping, and Subsidies and Countervailing Measures.

Market access

The URAA requires that participant countries convert virtually all non-tariff measures affecting agricultural imports into *ad valorem* or specific tariffs as soon as the agreement enters into force. Specific mention is made of quantitative import restrictions, variable import levies, minimum import prices, distortionary import licensing, and non-tariff measures maintained through State trading enterprises, and voluntary export restraints. The resultant tariffs are to be 'bound' [13] and reduced over a period of six years (the period is extended to ten years for developing countries and the least-developed countries). Industrial countries will reduce tariffs by 36 per cent over six years and developing countries will do so by 24 per cent over ten years. The conversion of non-tariff measures into tariffs (tariffication) is based on the actual difference between internal and external prices during the years 1986–88. For those developing countries whose tariffs had not been previously bound under the GATT, there is no limit on the level of these bindings and no obligation to reduce them during the 10-year phase-in period. In other words, these countries are permitted to tariffy the existing non-tariff measures and set bound rates at their own choice (regardless of the degree of protection embodied in the tariff regime during 1986–88).

Tariffied products are subject to minimum access requirements, which are to be guaranteed where necessary through tariff quotas. Minimum access opportunities are to be provided when imports of a product subject to tariffication are less than 6 per cent of domestic consumption in the base period (1986–88). The minimum access opportunity is equal to 3 per cent of base period consumption in the first year, rising to 5 per cent in six years. In the case where imports of tariffied products exceeded 5 per cent of consumption in the base period, countries must maintain the access opportunity that existed in the base period.

A narrowly defined exception has been made to the general elimination of non-tariff measures. Under this exemption, countries may designate certain agricultural products for 'special treatment', thereby exempting them from the tariffication requirement. There are three eligibility criteria. First the imports of designated products should have accounted for less than three per cent of corresponding domestic consumption in the base period (1986–88). Second the designated product should not have benefited from any export subsidies since the beginning of the base period. Third, measures restricting growth in domestic production should be applied to the relevant primary agricultural product.

In compliance with its commitments under the URAA, Sri Lanka has bound all tariffs on agricultural goods at a uniform rate of 50 per cent. Sri Lanka informed the WTO Secretariat on 1st January 1995 that it had 'implemented 99 per cent of its agricultural trade bindings' (WTO 1995a:21).[14] The list of tariff lines contained about 700 agricultural items including meat, fish, milk, milk powder, fruits, vegetables, nuts, spice, coffee, seeds, sugar, maize, starches, oils and fats, cocoa, pastries, fruit juices and fruit preparations. Since Sri Lanka had not previously bound its agricultural tariffs under the GATT, there is no obligation to reduce tariffs from the bound level (50 per cent) during the 10-year phase-in period. At present, Sri Lanka's gazetted tariff rates on all agricultural products are much lower than the bound rate (Table 5). The bound rate is, therefore, important only as an upper bound on possible future tariff adjustment.

The bound tariff rate (50 per cent) chosen by Sri Lanka is the lowest among the four South Asian WTO member countries.[15] Bangladesh announced a uniform bound rate of 200 per cent, while Pakistan set bound rates in the range of 100 to 150 per cent. India had submitted very high bindings of 100, 150 and 300 per cent for most products, coupled with zero or low (between 10 and 40 per cent) rates for a few products which are imported solely by State trading enterprises. In all three countries bound rates are much higher than those that previously applied. The fixing of high bound rates by these countries appears to have been motivated by the desire to leave themselves plenty of room for future manoeuvres and bargaining in the tariff negotiation process. By contrast, the Sri Lankan policy-makers, intentionally or by default, have made use of the window of opportunity provided by the URAA commitments to lock in the ongoing trade reform process in the country at low duty levels.

Like other South Asian WTO member countries, Sri Lanka has bound import tariff without abolishing the existing non-tariff measures. For the non-tariff measures-restricted imports (in particular potatoes, onions and chillies), the actual nominal rates of protection are well above the bound rate of 50 per cent (see Table 6 and the related discussion). Therefore, as long as the non-tariff measures remain in force, the effect of tariff binding on domestic market prices for these commodities will be limited only to the upper limit set on the use of surcharges during harvest seasons.

Sri Lanka cannot achieve full compliance with the URAA provisions without removing the existing non-tariff measures. During its November 1994 consultations with the WTO on the URAA, Sri Lanka requested temporary cover for the non-tariff measure-restricted items under the Balance of Payments Clause (Article XVIII(B)) of the GATT/WTO.[16] The Sri Lankan officials, however, made it clear that the actual motive behind the request was to provide protection to domestic farmers until such time as they become competitive through the adoption of improved farming techniques and crop diversification. They further mentioned that taking appropriate policy initiatives towards this end had been hampered by the ongoing civil war in the country. In response, the WTO has informed the Sri Lankan government that while there was no basis for retaining import restrictions on a few selected products on balance of payments grounds, Sri Lanka would be able to obtain appropriate alternative legal cover for these restrictions under the Security Exceptions Clause of GATT (Article XX1) (WTO 1996:10).

At present, Sri Lanka's future position relating to the tariffication of existing non-tariff measures remains unclear. The legal cover provided under Article XX1 is essentially temporary and there would be no justification for retention of non-tariff measures once the security situation improves. The government's stated policy is in favour of complete tariffication once the security situation in the country improves. For instance, in the 1996 Budget Speech (presented on 8 February 1995), the Finance Minister stated that

> ...all remaining trade licences, *ad hoc* surcharges and other indirect controls will be eliminated except those essential for security, health and environmental reasons. In order to ensure transparency in our protection structure, the government will

also do away with specific duties and introduce *ad valorem* tariffs. However, with a view to providing reasonable protection to agricultural commodities, the government will impose temporary and time-bound surcharges, particularly during harvesting seasons. Similarly, when international prices of essential consumer items such as sugar, lentils, milk powder, etc., rise to exceptionally high levels, the government will grant temporary duty waivers to protect consumers (Government of Sri Lanka, 1995b:21).

The Central Bank of Sri Lanka has spelt out its position on the issue as follows.

> The continuation of the import licensing of certain agricultural products (potatoes, big onions and chillies) undermined the transparency of the trade policy regime. These import licensing requirements are a form of quantitative import controls and acted as a deterrent to efficient functioning of markets, with heavy cost to the consumers...Instead of licensing, a variable tariff system would be more appropriate to provide the required protection to farmers as the discretionary element [of the existing licensing regime] would then be avoided. In addition, a transparent and consistent policy in this area would encourage private sector participation in the storage and distribution network for these agricultural products (Central Bank 1995:16).

There is, however, a strong political lobby, encompassing some key cabinet ministers and members of parliament (both in the opposition and the ruling People's Alliance), against the removal of non-tariff measures and tariff cuts. The old case for protection based on the self-sufficiency motive has largely lost its rigour in Sri Lanka in the context of the ongoing process of trade liberalisation and successful economic adjustment since 1977. The key emphasis of the protectionist lobby at present is on the potential employment and income losses in cultivating areas. In order to support their case against liberalisation on these grounds, the lobbyists often point to the regional concentration in production of these crops (Table 7).[17] This is particularly so for chillies, potatoes and onions—the three most heavily protected agricultural crops. Whether

Table 7 Regional concentration production of subsidiary food crops, 1984–90

	1st district	2nd district	3rd district	Total of top 3 districts
Big onion	Matale (42%)	Mahaweli (16%)	Jaffna (11%)	70%
Chillies	Mahaweli (25%)	An'pura (12%)	Matale (11%)	48%
Potatoes	Badulla (60%)	N'Eliya (38%)	.	98%
Red onions	Jaffna (44%)	Batticaloa (12%)	.	56%

Source: Dunham, David, 1992. *Increased Productivity and Commercialisation of the Non-estate Agriculture,* Agricultural Policy Series No. 2, Institute of Policy Studies, Colombo.

the pro-liberalisation policymakers would be able to make use of the window of opportunity opened up by international commitments under the URAA to effectively counter the protectionist lobby is yet to be seen.

For wheat flour and sugar, impediments to import liberalisation are firmly rooted in the past foreign investment approval policy of the country. In both cases, trade related conditionality has been written into the investment agreements signed with the respective foreign companies without giving due consideration to future developments in related commodity markets and the inevitable implications for the overall trade policy of the country in a rush to entice foreign investment. This criticism seems to have some validity for milk food imports as well.

Despite the escalation of defence expenditure, revenue considerations do not appear to be a significant impediment to trade policy reform. The contribution of trade taxes on agricultural products is at present less than 3 per cent of total government revenue. Moreover, a new goods and services tax, scheduled for introduction in mid-1996, is expected to broaden the government's revenue base, resulting in a further reduction in the government's dependence on trade taxes for revenue purposes.

Other Uruguay Round commitments

No notification has yet been made by the Sri Lankan government regarding its commitments under the Agreement on Trade-Related Intellectual Property Rights and the Agreement on Sanitary and Phytosanitory Measures. As a developing country, Sri Lanka may postpone the implementation of these WTO Agreements (WTO 1995a). Draft laws are in preparation to incorporate the provisions of the WTO Agreement on Safeguard, Anti-Dumping, and Subsidies and Countervailing Measures in domestic legislation, since international treaties and laws cannot be cited directly in Sri Lankan courts without ratification by the Sri Lankan government.

Many trade policy analysts fear that the remarkable success of the Uruguay Round in outlawing important non-tariff barriers may intensify the pressure on other routes to protection such as increased recourse to the use of anti-dumping legislation and sanitary (human and animal health) and phytosanitory (plant health) safeguard mechanisms (see for instance, Martin and Winters 1995; Cline 1995). The WTO Agreements on Safeguard, Anti-Dumping, and Subsidies and Countervailing Measures; and Sanitary and Phytosanitory Measures have been designed to guard against this potential threat. It is important for national policy-makers to clearly understand this legislation and set up appropriate institutional procedures for their implementation.

The implications for Sri Lanka of market access provisions at the global level

The actual tariff-lowering effects under tariff bindings finally agreed upon for many commodities are much smaller than originally envisaged. This lacklustre outcome can be ascribed to three main factors: the choice of the period 1986–88, when the world prices for many agricultural commodities were the lowest in the decade, as the base period for tariffication; 'dirty' tariffication practices; and ample room being provided for the developing countries to escape the discipline at their own choice (Hathaway and Ingco 1995).

Sri Lanka's exports generally will benefit only marginally from market access provided by liberalisation in other countries. Compared with some other agricultural commodities, trade in tea—Sri Lanka's major agricultural exports—had been relatively free of intervention even prior to the URAA. Some major developed country importers, in particular, the UK, USA and European Union, had no import duties or other restrictions on bulk or packaged tea. Most of the developing country importers had significant tariff and non-tariff restrictions on tea imports, but most of these countries are not signatories to the URAA. In this context, a Food and Agriculture Organisation (FAO) projection for the world tea trade suggests that the tariff bindings agreed under the URAA would stimulate only a 1.4 per cent increase in world consumption (FAO 1995:6). The FAO study concludes that 'the impact of the Uruguay Round Agreement on the world tea economy is apparently small and despite some increase in demand, world market prices are expected to continue to be mainly influenced by the existence of large export availabilities' (FAO 1995:6).

Natural rubber, the second largest agricultural export from Sri Lanka does not come under the commodity coverage of the URAA. As for coconut products, there are no direct estimates available, but judging from estimates by Hathaway and Ingco (1995) for the broader commodity category of oil seeds, significant price reductions (more than 1 per cent) are expected only in Japan and Australia. These are not important markets for coconut product exports from Sri Lanka. The main market for desiccated coconut exports from Sri Lanka—the European Union—already has a zero tariff and no restrictions. Egypt has also reduced its tariff from 30 per cent to 20 per cent. Latin American countries provide a small market. The main market for coconut oil and copra is Bangladesh, which being a Least Developed Country has no obligation to reduce tariffs. For fresh coconuts, the European Union has a zero tariff, while Middle Eastern countries, account for 60 per cent of exports, are not members of GATT.

For minor agricultural exports, Sri Lanka's main market is the European Union (EU) where Sri Lanka benefits from a generalised system of preference (GSP) tariff of 7 per cent. The reduction of the most favoured nation (MFN) rate by the EU from 35 to 23 per cent may have an adverse impact on imports from Sri Lanka because of the reduction in the preference margin. The other minor agricultural exports are exported either to industrial country markets where the pre-URAA tariffs were either zero or to developing countries which are not signatories to the agreement.

On the import side, the effect of the URAA on the world market prices of rice, sugar, milk powder and other milk products has been estimated to be virtually zero (Sharma et al. 1995). The most significant price increase that has been estimated for a Sri Lanka's import products relates to wheat. The reductions in production and price supports in major producing countries are predicted to increase world wheat prices by 3.8 per cent between now and 2005 (Hathaway and Ingco 1995). However, this is a very small increase relative to the magnitude of price variability historically experienced by the commodity. Sri Lanka's imports of chillies, potatoes, onions and other subsidiary food products predominantly come from India and Pakistan. As discussed, it is unlikely that trade policy changes in these countries under the URAA will have any significant effect on the import prices of these products.

Effect on food aid

There is a widespread fear in developing countries that the roll back of agricultural subsidies in industrial countries will reduce the quantity of food aid (UNCTAD 1990). This fear seems largely unfounded for the following reasons. First, the actual price-raising effect of the URAA on the related food products, in particular wheat and other cereals, is likely to be much lower (and perhaps even smaller in magnitude than usual price fluctuations) than was originally envisaged. Second, once direct production subsidies are outlawed, food aid will become perhaps the only legitimate method open to industrial countries for moving excess surpluses into the world market. Thus despite the potential depressing effect of price increases on the volume of food aid, the URAA may encourage the use of more rather than less food aid (Hathaway and Ingco 1995:23). Moreover, the adverse implications of reduction in food aid (or any other form of resource inflow) on a given aid-recipient country depends significantly on the nature of that country's economic policy regime. It is possible that trade liberalisation and rationalisation of the trade policy regime achieved as part of URAA commitments would negate the welfare-reducing consequences of food aid cuts (Ahammad and Warr 1995).

Future concerns

Over the past three decades Sri Lanka has made significant progress in undoing a legacy of import-substitution policy pursued vigorously during the first three decades following political independence in 1948. Indeed, in terms of both continued commitment to market-oriented reforms and the significant economic gains achieved from this commitment, the Sri Lankan experience is remarkable in the developing world. Sri Lanka's tariff regime has become increasingly less distortionary during subsequent rounds of reforms. It currently relies on a three-pronged structure with rates of 10, 20, and 35 per cent—an unweighted average tariff of 20 per cent. Export taxes have been eliminated and State trading monopolies have been largely dismantled. These developments notwithstanding, both high tariffs and quantitative restrictions remain important deterrents to import trade in agricultural goods.

Many trade policy analysts fear that the remarkable success of the Uruguay Round in outlawing non-tariff barriers may intensify the pressure on other routes to protection such as increased recourse to the use of anti-dumping legislation and sanitary (human and animal health) and phytosanitory (plant health) safeguard mechanisms. It is important for trade policy-makers in Sri Lanka to closely study the WTO Agreements on Safeguard, Anti-Dumping, and Subsidies and Countervailing Measures; and Sanitary and Phytosanitory Measures and to set up appropriate institutional procedures for their implementation as a guard against this potential projectionist threat.

The net direct impact of implementation of the market access provisions of the Uruguay Round by other countries on Sri Lanka's agricultural trade is likely to be negligible. The direct impact on existing trade patterns is, however, only one aspect of an assessment of the overall impact of the Round on a given member country. What is more important is the potential benefit emanating from significant achievements of the Round in improving the rules for world agricultural trade and ensuring the transparency of such rules. These achievements imply setting the stage for a positive shift in the production possibilities faced by individual agricultural producing countries through opening up new market opportunities. A small open economy like Sri Lanka certainly has a strong and direct interest in the world economy and its trading rules.

Endnotes

[1] For a detailed listing of these charges see WTO 1995a: Table IV 7, p. 47.

[2] This estimate is based on data provided by the Sri Lanka Export Development Board.

[3] Estimates reported in this paragraph are based on data reported in Central Bank, *Annual Report 1994.*

[4] The study has also come up with an annual irrigation subsidy estimate (incorporating both annual capital cost repayments and financial charges on capital investment in irrigation projects, and the operation and maintenance cost) of 12.65 billion rupees (3 per cent of GDP) for 1993. This estimate gives an exaggerated picture of production incentives because of the erroneous inclusion of the cost capital investment (sunk cost) as a part of the subsidy.

[5] The difference between the gazetted rate and the actual rate may be due to the operation of tariff exemptions and waivers and the deterrent effects of high tariffs on trade in the relevant items.

[6] In April 1996, the government issued licences to import 400,000 tonnes of rice free of duty in the face of a shortfall in domestic rice production caused by a drought in the main cultivation areas.

[7] According to records maintained by the Food Commissioner's Department, out of a total of 382 traders who were issued licences in 1995, only 200 made use of these licenses for direct importation.

[8] This situation may, however, change dramatically in years to come with the entry of Cargil (a large US animal feed producing firm which has an aggressive marketing record) into the Sri Lankan animal feed market.

[9] As predicted, a significant share of the subsidy is captured by higher income groups. Based on an analysis of the household expenditure survey, the World Bank has estimated that only about 8 per cent of the 5 billion rupee subsidy projected for 1995 would be captured by the poorest 20 per cent of households (ADB 1995:114). There have also been reports of a shortage of 450 gram bread at the controlled price as bakers shifted to different sized loaves or products to avoid price control ('Bakers make "Mockery" of controlled price of bread', *Daily News*, 1 June 1995:4).

[10] The original investment agreement (signed in 1982) between the company and the Foreign Investment Advisory Committee of Sri Lanka provided for maintaining a fixed domestic price (which was most of the time two to three times higher than the world market price) for sugar. The agreement was renegotiated in 1992 to provide for maintaining a minimum efficiency ex-factory price through tariff adjustment.

[11] In the presence of binding quantitative restrictions the actual domestic market price normally tends to be higher than the duty-adjusted world market price.

[12] In 1994, the actual import duty rate (total import duty revenue as a percentage of dutiable imports) was only 20 per cent compared to an average gazetted rate of over 40 per cent.

[13] A tariff binding is the legally set maximum rate at which a tariff may be set. The actual tariff can be below the bound rate, but cannot go above it unless the rate is renegotiated with trading partners.

[14] By that date, Sri Lanka's tariff binding on industrial exports, also at 50 per cent, covered only about 11 per cent of the relevant product lines.

[15] It is also one of the lowest among all developing country WTO members (WTO 1995b; Martin and Winters 1995).

[16] Article XVIII(B) of the GATT permitted the use of quantitative restrictions on imports by developing countries whenever a threat of balance of payments difficulties was perceived. Because of this article developing countries could simultaneously be members of GATT and employ restrictive trade practices. Under the WTO, there is still a balance of payments exception to the requirement that quantitative restrictions be eliminated, but the conditions under which it may be invoked are far more stringent than they have been heretofore, and those countries using it will be subject to more frequent and critical surveillance (see Krueger 1995, Chapter 2 for details.)

[17] It is important to note that the concentration of production of a particular crop in a given district does not necessarily imply that the crop accounts for a large proportion of the district's total employment in arable agriculture. Higher output concentration may simply reflect high yield (as in the case of red onions in Baticaloa). However, potential income losses *per se* are a powerful factor in lobby-group behaviour, particularly because of the political power of the rich farmers in these regions.

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