PN-ABA-400

THE INVESTMENT CLIMATE

IN

SRI LANKA

Prepared for
USAID
by
Business International

December 1982

Business International Corporation International Business Strategies Group

INVESTMENT, LICENSING, AND TRADING CONDITIONS IN SRI LANKA

Currency: Sri Lanka Rupee, which floats against a trade-weighted basket of currencies. Exchange rate US$1:Rs22 in November 1982.

In the Past Twelve Months

* The President, J.R. Jayawardene, was reelected in Sri Lanka's early presidential elections. This gives him another six years in office (1.01).

* Real GDP grew by about 5.8% in 1981, about the same as in 1980, but down from the three years before that. Inflation eased considerably to about 18-20% in 1981 (1.03).

* The rupee depreciated against the dollar, but far less -- or not at all -- against European and other currencies (1.04).

* A stock exchange was set up, replacing the Colombo Brokers' Association in this function (11.04).

In the Next Twelve Months

* The United National Party (UNP) sponsored referendum, to extend the term of the present parliament with its 5/6 UNP majority, will probably be passed. This will give Sri Lanka another six years of probusiness government (1.01).

* Nevertheless, the government, while remaining favorable to foreign investment, will be more selective about incentives given to investors (10.01). Increased protectionism is also possible (1.03).

* Changes are expected in legislation affecting severance pay, maternity leave (12.05), and taxes on share transfers (3.07).

1. INTRODUCTION

1.01 Political Forecast

Sri Lanka is a presidential democracy and the President is both head of State and head of government. The ruling party is the United National Party (UNP), led by President Junius R. Jayawardene. The party returned to power in 1977, after seven years of rule by the primary opposition party, the Sri Lanka Freedom Party (SLFP). The UNP has followed strongly pro-business policies, in contrast to the socialist SLFP.

The political situation has been Sri Lanka's greatest advantage, but also investors' greatest concern; they have feared the policy consequences of an opposition return to power. President Jayawardene preponed the presidential election from 1984 to 1982 to take advantage of oppostion disunity and provide a stable political climate for investment. Having won this election, he has now decided to try to extend the term of the present parliament for another six years by referendum (December 22, 1982) instead of holding the parliamentary elections due in 1983. If, as expected, the move passes -- which requires only a simple majority constituting at least a third of the electorate -- the UNP will retain its 5/6 majority in parliament. In an election, this would almost certainly be diluted to 50-60%.

Moreover, if a seat is vacated by any member of parliament, the party is free to nominate a replacement rather than hold a by-election. This will give Jayawardene the ability to hand-pick 5/6 of his parliament.

In the unlikely event that the referendum returns a negative result, parliamentary elections are due in 1983. Most probably, the UNP would get a majority, but not an overwhelming one as it has at present.

Since independence, Sri Lankan politics have been marked by

sharp swings between the socialist policies of the SLFP, and the more free-enterprise attitudes of the UNP. Recently, the electoral system has been altered from the British "First past the post" to a system of proportional representation. While this would already have strenghthened the ruling party -- which has traditionally polled more votes than its chief opponent, the Sri Lanka Freedom Party, but often lost because of the voting patterns -- the recent manouevres have practically wiped out the opposition.

The UNP, on winning power in 1977, changed the electoral system. Based on proportional representation, the present system is thought to favor stability (see box for how system works). The president is directly elected for a term of six years and is eligible to stand for reelection. He has wide executive powers -- including that of dissolving parliament or taking on any portfolio himself. Since the parliamentary and presidential elections are not directly linked, it is possible for the president to preside over an unfriendly parliament.

Changes to the constitution require a two-thirds majority in parliament; while the new system was intended to ensure that no party would obtain such a majority unless voting patterns change considerably, the referendum method has provided the ruling UNP with a loophole.

Though Sri Lanka has a number of opposition parties (see box on p. 18) the only one of any significance is the SLFP. The Tamil United Liberation Front, which is, by a quirk of fate, the major opposition in parliament today, has only limited regional appeal. There is now speculation as to whether the opposition will resort to unparliamentary procedures, or if it will join with the ruling party to form a "National Government".

On the whole, six more years of the UNP will improve the business climate. Jayawardene's election win has been regarded as an endorsement for free enterprise, and certainly business and industry are more confident now of stability in industrial policy. However,

firms should not be surprised to find some hardening of the government's line. In the first five years, they had the difficult job of convincing firms to invest in what had traditionally been a difficult environment; now they can afford to be more discriminating in the type of investment they favor and the terms allowed.

BOX 1.01A

How The Proportional Representation System Works

1. The country is divided into 22 voting districts. Candidates run for a seat within a single district.

2. Parties that poll less than 12.5% of the votes in any district are completely eliminated from the running.

3. The seats in the district (varying between four and 21) are then divided up among the remaining parties, in proportion to their percentage polled.

For example: Party A wins 5% of the vote, party B wins 12%, Party C wins 13%, Party D wins 25%, and Party E wins 45%. Parties A and B will be eliminated completely. Parties C, D, and E will apportion the seats among them, on a base of 83% (the vote without A and B) -- and will therefore receive 16%, 30%, and 54% of the seats respectively. The system thus tends to be weighted heavily against smaller parties.

The parliamentary election is held separately from the presidential election; the next parliamentary election is due in 1983. The presidential election has been preponed from 1984 to October 1982.

BOX 1.01B

How the Referendum Works

1. The president drafts a constitutional amendment that will extend the term of the present parliament for another six years.

2. If the amendment is approved by a majority of the voters, constituting at least one third of all registered voters, it is passed.

3. This means that the present parliament -- in which 5/6 of the seats are filled by MPs from the UNP -- has its term extended another six years.

4. In an election, on the other hand, a simple majority of the votes would give only 50-60% of the seats. This was predicted as the likely outcome, were the UNP to have gone to the polls rather than held a referendum.

BOX 1.010

The Opposition in Sri Lanka

PARTY	% votes 1970 (Seats won)	% votes 1977 (Seats won)	Description
Sri Lanka Freedom Party (SLFP)	36.9% (91)	29.7% (8)	Led by Sirimavo Bandaranaike, the party has moderate socialist policies. The SLF was the leader in the United Front coalition that governed Sri Lanka in 1970-77. Bandaranaike cannot run for office until 1986.
Tamil United Liberation Front (TULF)	7.2%* (16)	6.4% (18)	A moderate Tamil separatist party. Its head -- M. Sivasithamparam is the leader of the opposition since it received more seats in the last election (with substantially fewer votes) than the SLFP.
Janatha Vimukthi Peramuna (JVP)	--	--	(Translates as the Peoples' Liberation Front.) Led by Rohana Wijeweera, its policies are extreme left. It played a major role in the 1971 insurrection.
Lanka Sama Samaja Party (LSSP)	8.7% (19)	3.6% (-)	Leftist, Trotskyite party. Translates as "Lanka Equal Society Party"
Communist Party	3.4% (6)	2.0% (-)	Moscow-oriented, leftist
Ceylon Workers' Congress	--	1% (1)	An Indian Tamil, trade union-based party with strong support in the plantations. Led by S. Thondanam, who serves in the UNP cabinet.

Note: Figures in brackets refer to number of seats won.

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The legal system consists of the Supreme Court, the Courts of Appeal, the High Court, and District Courts. Thirty Courts of Requests have original civil jurisdiction in all actions in which the value of the amount at dispute does not exceed a stipulated amount.

A special presidential commission tries offenses connected with government misuse of power -- it recommended that Bandaranaike be stripped of her civic rights and is currently hearing the case of a member of parliament who is alleged to have accepted bribes. It has no punitive powers but makes recommendations to parliament. The opposition has accused the commission of being used for political ends.

Sri Lanka's constitution and law have tended to hold up. It is possible that a government would go outside the law -- for instance, to change the electoral system. Nevertheless, the judicial system is well established and adequate for business purposes.

Bureaucracy and red tape are better than in most South Asian countries, but companies have raced problems from the lack of organization and the relaxed attitude of many bureaucrats. The Sri Lanka government is still heavily influenced by colonial British styles. The upper levels are efficient and reasonably flexible, but the lower levels are still slow. Compared with Western countries, red tape remains a problem. The export processing zones have a better reputation for efficiency. The GCEC is the only authority companies need to deal with, and it does try to be helpful.

Sri Lanka maintains peaceful and friendly relations with most countries. India is its largest and closest neighbor, and the relationship has always been friendly. A bilateral Sri Lanka-China trade agreement (principally a rice for rubber barter deal) has been in force for many years, and Sri Lanka imports Chinese textiles and other consumer goods. (Recently, China has also agreed to supply oil.) Sri Lanka has recognised the PLO. The government has made overtures to the ASEAN countries and may eventually succeed in developing a special tie with the association.

One issue which was outstanding between India and Sri Lanka is treatment of the Indian Tamil population in Sri Lanka. The repatriation of fairly large numbers of Tamils to India has reduced friction; however, during periods of communal agitation the relationship tends to become somewhat uneasy.

1.02 Attitude toward Free Enterprise

The present government under the UNP is extremely pro-business and strongly favors free enterprise. This would not be true under an SLFP government, which, however, is unlikely to gain power in the medium term.

While the private sector will continue to increase its role, denationalization of existing state corporations is unlikely. The Business Acquisition Act, brought in by Bandaranaike, allows the government to take over private companies relatively easily. It has not been repealed under Jayawardene. In the unlikely event of the SLFP returning to power, a more socialist pattern would be adopted, and a spate of nationalizations is not impossible.

Trade Unions, mostly affiliated to political parties, are quite powerful. Industry associations and Chambers of Commerce can be influential in representing trade views to the government, and to some extent, in regulating their members. Chambers of Commerce have successfully made representations to the government for reductions in certain tariffs.

1.03 Market Forecast

Sri Lanka can expect a real GDP growth of 4-6% over the next 18 months.

Sri Lanka's GDP, which averaged only 2.9% per year real growth from 1970 to 1977, increased by an average of 6.8% per year from 1977 through 1980. In 1980 the rate declined to an estimated 5.8%, because of drought, the poor performance of the public corporations, sluggish growth in the manufacturing sector as it was hit by the impact of lower tariffs, and construction growth slowed as the industry encountered bottlenecks in the supply of labor, materials, and equipment.

In 1981, GDP again grew 5.8%. Agriculture this time was not at fault; it showed reasonably strong growth at 6.9%. But construction actually declined from the peak levels of earlier years, and the industrial sector was hurt by power shortages. Credit restraint, aimed at curbing inflation, slowed growth in trade, services and other sectors.

Inflation in fact, has been one of the most serious problems the economy has had to face in recent years -- in part, because the country had become accustomed to a slow-growth, low inflation life-style. It rose sharply as a result of the UNP's economic policies, but is now gradually being brought under control, inevitably at the expense of rapid economic growth. Some of it was artificial; the removal of price controls allowed prices to trend upward. However, massive investments in projects with long-gestation periods also fueled inflation. Production responded to increased prices, but not rapidly enough. Inflation has gone down from the 35-40% level of 1980; but it was still estimated at about 18% in 1981, and 13% in the first half of 1982. And these figures may be understated; other estimates show rates of about 24% for 1981.

Constrained by power shortages, and inefficient after years of protectionism, domestic industry is not well developed and has not

expanded greatly since 1977. The domestic market, small as it is, seems to prefer imported goods, and demand for domestically produced goods has grown only slowly. The government is becoming increasingly aware of the problem, and some infant industry protection is not unlikely in future.

It appears per capita income may even have declined in recent years, further decreasing demand. Inflation has boosted costs, eroding price differentials. In 1981, manufacturing accounted for only 17.4% of the GDP at current factor cost (GDP can be stated at either market prices or at factor cost; GDP at factor cost, plus indirect taxes, less subsidies, equals GDP at market prices), down from 23% in 1977. (At 1970 prices, these were 13.7% and 13.6% respectively -- indicating that in real terms, manufacturing has grown no faster than GDP as a whole.)

The fourth rolling five year plan, 1982-86, calls for an expenditure of Rs98 billion in current terms. The lead projects (see below) will account for 36% of the expenditure (as against 44% in the 1981-85 plan). Resources have been shifted to power from other sources. water supply schemes, education, and health. Expenditure on short-gestation projects -- other irrigation, plantation agriculture, field and minor export crops, animal husbandry, forestry and lands, fishreies and industry -- have also been increased.

The government's main investment plans over the next five years center on three schemes which will account for 33% of planned government investment between 1982 and 1986. The lead projects are:

Ibe_Mahaweli_project: The project consists of a series of dams, power generating stations, and irrigation channels off the Mahaweli river. Five giant multipurpose reservoirs will irrigate 391,000 acres of land and provide 500 megawatts (Mw) of hydroelectric power. They will provide 500,000 permanent jobs in agriculture and service industries, and over 400,000 construction jobs. Cost escalation, insufficient aid, and technical problems have led to a scaling down of the project.

The Integrated Development Programme of the Mahaweli Authority promotes the development of agri-industries, integration of crop and animal husbandry. Foreign investors could take advantage of these investment opportunities.

Housing and urban development: The government plans to construct 100,000 new houses and upgrade 84,000 more. The Greater Colombo Urban Renewal Program is intended to completely reorganize Colombo.

Colombo Investment Promotion Zone: Sri Lanka's export processing zone, located near Colombo's airport, opened in 1978. Its objective is to provide jobs and increase exports by attracting foreign investors. The zone is not a major investment for the government.

Investment must be largely financed from abroad, since domestic savings are low and could decline further. High inflation makes fixed interest rates unattractive, and potential savings lie locked up in consumer durables. The savings of the public sector have tended to be negative. A large part of this is because of the losses of the Central Transport Board.

1.04 Currency Outlook

The rupee floats against a basket of currencies, which is heavily weighted toward the US dollar. It has steadily depreciated since the UNP took charge, before which a system of dual exchange rates existed. (In recent months, however, though it has declined against the US dollar, the strength of that currency has meant that the rupee remained stable or appreciated against most others.)

Critics have argued that the country's exports, mainly commodities, tend to be supply inelastic- while imports, designated in dollars, are also fairly inelastic. According to this argument, depreciation imports inflation, without substantially improving the trade balance. However, the falling rupee has curbed imports to some extent.

With balance of payments problems, high import levels, and a soft export market, downward pressure on the rupee is inevitable. A gradual decline is expected over the next few years, after which some strengthening is possible.

Sri Lanka has the highest foreign aid per capita of any country in the world. Foreign aid has been used liberally to finance the new planned investments. If the country does not succeed in bringing its trade deficit under control, it may have to resort increasingly to commercial borrowings to finance the deficit.

1.05 Attitudes toward Foreign Investment

The Jayawardene government actively encourages foreign investment in most areas of the economy (except trading). With plans to transform the economy on the Singapore pattern, the government has opened areas to foreign companies and given concessions that would have been unthinkable a few years ago.

While Sri Lanka welcomes foreign investment as part of its new strategy, an underlying nationalist sentiment does exist. If it were economically feasible, Sri Lanka might again close its doors. Should the SLFP return to power at any stage, it may follow more nationalistic policies. To reassure investors, Sri Lanka has entered into several investment protection agreements that will be honored regardless of the party in power.

The export processing zones are gaining widespread acceptance as a tool for economic progress -- it provides the possibility of drawing advantages from foreign investment while also insulating the economy from potentially harmful effects. (See section 13.05).

If the present government is removed (which is improbable), a change in policy is likely. Changes that could be expected under an SLFP government include a crackdown on consumer goods imports and an erosion of concessions to foreign investors.

Sri Lanka has tried to ensure protection of investments made by foreign companies. Sri Lanka has concluded several double taxation agreements that are especially tailored to allow for the tax breaks Sri Lanka provides. In 1981, it reached an investment protection agreement with Japan, which will remain effective for 10 years. It also has entered into investment protection agreements with the US, West Germany, the UK, Singapore, and France. The Japanese pact is expected to make a difference in the level of Japanese investment, which has been quite modest. Japanese investors attach considerable importance to the protection guaranteed by the agreement. When Japan

signed such a treaty with Egypt, Japanese investment in Egypt increased sharply.

Over the next 18 months, the government will remain basically favorable to foreign investment but fine tuning of incentives is probable, with some hardening of requirements. Generally Sri Lanka favors the setting up of industries that are basically export oriented, labor intensive and where possible resource - based.

According to the FIAC, it actively encourages investment in several resource based projects:

- Rubber-based industries.
- Graphite based industries.
- Coconut palm products.
- Clay, dolomite, feldspar and silica based products.
- Other agro-based industries using sugar cane, soya bean, spices and essential oils.

The GCEC and the FIAC periodically send out investment promotion missions. One to Hong Kong is intended to attract investors nervous of the colony's instability.

1.06 Amount of Foreign Investment

The government's new economic policies have had a very positive influence on the level of overall investment. From 1979 to mid-1981, total investment was Rs1,530 million, in 450 projects. By comparison, total investment was only Rs130 million in the eight years immediately before. This includes investment both under the auspices of the Foreign Investment Advisory Committee (FIAC) and the Greater Colombo Economic Commission (GCEC). (All foreign investment must fall into one of these two categories.)

Foreign investment outside the export processing zone must be approved by the Foreign Investment Advisory Committee. Not all of the projects approved by the FIAC are implemented; out of a total of 512 projects approved between 1977 and mid-1982, about half were under way as of mid-1982. The rest were under negotiation (121 projects) or had been abandoned (128 projects). Seven others had been implemented, but not under the FIAC. The leading sector was fabricated metal/machinery/transport equipment, but significant investments have also taken place in other sectors (see Box 1.06A). In the first three quarters of 1982, the FIAC approved 84 projects, with a total of Rs1.7 billion in foreign investment, to be matched by local investment of Rs2.5 billion.

Top investors in Sri Lanka (in FIAC approved projects) from 1977- mid 1982 were the United Kingdom with 79 enterprises, Hong Kong with 55, West Germany and Singapore with 54 each, Japan with 36 and the United States of America with 33.

In the GCEC, 74 industrial investment projects were contracted in the Investment Promotion Zone coming under the authority of the Greater Colombo Economic Commission in 1978-1981 (see box 1.06B). The capital investment of these enterprises amounted to Rs 2,269 million. Gross earnings from GCEC exports during 1981 was Rs 882 million. The largest number of GCEC projects have been in the field of garments, but manufacturing is starting to catch up.

BOX 1.06A

Industrial Investments Contracted - FIAC
1978-1981

Category	Number of Units				Foreign Investments (Rs million)				Local Investments (Rs million)			
	1978	1979	1980	1981a	1978	1979	1980	1981a	1978	1979	1980	1981a
Food beverage and tobacco	-	6	8	13	-	37	527	178	-	77	589	229
Textiles, wearing apparel and leather products	7	29	12	8	20	261	16	30	31	688	43	55
Wood and wood products (including furniture)	-	-	2	-	-	-	1	-	-	-	6	-
Paper and paper products	-	3	3	3	-	3	6	3	-	12	24	20
Chemicals, petroleum, coal, rubber and plastic products	11	7	12	15	24	36	193	100	36	75	385	210
Non-metallic mineral products (except petroleum and coal)	1	1	-	6	9	4	-	89	21	12	-	235
Fabricated metal products and transport equipment	2	9	10	13	21	41	226	232	33	97	361	362
Manufactured products	-	6	19	6	-	5	90	9	-	10	177	50
TOTAL:	21	61	66	63	74	387	1049	642	121	971	1585	1161

BOX 1.06B

Industrial Investments Contracted - GCEC
1978-1981

Category	Number of Units				Foreign Investments (Rs million)			
	1978	1979	1980	1981a	1978	1979	1980	1981a
Food beverage and tobacco	1	-	2	-	2	-	25	-
Textiles, wearing apparel and leather products	20	9	5	2	73	126	755	111
Wood and wood products (including furniture)	-	-	1	-	-	-	1	-
Paper and paper products	-	-	-	-	-	-	-	-
Chemicals, petroleum, coal, rubber and plastic products	3	-	2	3	22	-	44	43
Non-metallic mineral products (except petroleum and coal)	-	2	-	1	-	388	-	18
Fabricated metal products and transport equipment	1	1	3	1	9	8	377	33b
Manufactured products	4	-	10	3	16	-	98	120
Services	-	-	-	-	-	-	-	-
TOTAL:	29	12	23	10	122	522	1300	325

a: provisional
b: includes expansion of earlier projects.

1.07 Examples of Foreign Investment

A number of foreign investments have been made over the last few years. In hotels -- the Taj Hotel in Colombo (owned by Indian Hotels group); a resort hotel being erected at Bentota by the Robinson group of Germany; a Sheraton hotel in Colombo; and a 500-room hotel in Colombo owned by the Galadhari Brothers of Dubai. In the manufacturing sector, Gilbey's of the UK has gone for a local public subscription to obtain local equity for a distillery project; Mitsui and Shigyo, of Japan, have set up the Tokyo Cement Co (Colombo) Ltd. to make 200,000 metric tons of cement per annum.

For many Western firms, Sri Lanka's small domestic market means that an investment by the foreign firm is not cost-effective in terms of travel expenses and executive time. Some of these have found it worthwhile to invest in Sri Lanka through subsidiaries based in India or Pakistan. Expatriates can also be brought in from those countries. For example, International Cosmetics Ltd was set up in 1981 to produce a wide range of cosmetic products for the domestic market. The company is 40% owned by Maharajah Organisation Ltd, a Sri Lankan company. The remaining 60% is owned by Ponds (India) Ltd, which itself is 40% held by Chesebrough Ponds Inc of the US. The Sri Lanka company is managed by executives delegated from Ponds (India).

The government will accept innovatively structured deals, if they are beneficial to both parties. For instance, Prima of Singapore, with three associates, has set up a complete wheat flour milling facility (milling 2,200 tons per day) on land leased by the government. The government will supply whole wheat for milling, free. Prima will return 76% of the flour to the government free of charge, retaining the bran etc. and the remaining 24% as their share. After about 20 years, the mill will be returned to the government. In the interim, a lumpsum payment has been made in lieu of all taxes.

The government has also entered into some joint venture

projects with foreign partners in areas usually reserved for the State sector (see section 2.02).

In general, many examples of successful foreign investments in Sri Lanka are available. A few of these:

o The Nestle group of companies have three different operations in Sri Lanka with different foreign equity shares. Food Specialities Ceylon Ltd has an 80% foreign equity share. They have set up a factory on a 50-acre area in the Kurunegala district on the banks of the Maha Oya. The Rs 430 million investment project will develop and utilise all principal local raw materials and resources. It is reckoned that 300 persons will receive direct employment, while amost 2,000 others will be involved in ancillary activities. Milk powder, infant formulae, milk cereals and malted milk will be manufactued and production is estimated to begin in 1983.

International Dairy Products Limited, another Nestle company has a sweetened condensed milk factory in Polonnaruwa. The foreign equity share is 60%.

Ceylon Nutritional Foods Ltd, a long-established company and the third of the Nestle operations is a distribution company and will distribute the products of Food Specialities Ceylon Ltd and International Dairy Products Ltd. It has a foreign equity share of 49%.

o Nestle's also look over the assets of the National Milk Board, formerly a state-owned organisation. The National Milk Board had been a loss-making concern.

o Lever Brothers Ceylon Limited, 100% owned by UniLever, has set up two projects through fully-owned subsidiary companies. Lever Agro Enterprises Ltd was started in 1981 to manufacture rice bran; it is expected to go into production by the end of 1982. The objective of this project is to reduce the use of coconut oil in soap and animal feed by using a satisfactory substitute. Lever Aqua Products Ltd, a

prawn farming venture, has been set up on Government owned land. It is primarily an export oriented project and is expected to be commercially viable by 1983.

o The Somerville Group of Companies have invested an estimated Rs 33 million in a hotel resort to be opened on the South coast shortly. Somervilles will contribute 51%, the Beaufort International hotel 20% and the balance will be offered to the public. As the foreign partner, Beaufort International Hotels will manage the resort on the payment of a 10% management fee.

o Haleys Limited (a large local manufacturing and trade organization) set up a seed station at Olugantota in the Welimada area with Zaadunie B V a Dutch Collaborator. Approved by the FIAC, the seed station provided many local women with jobs.

o Tootals of the UK has set up a joint venture for the manufacture of sewing thread, the Colombo Thread Company. They received approval in 1979, started construction in 1980, and production in March 1981. The foreign equity share is 60% from Tootals. The authorised capital is Rs 25 million. However, this includes a sum of Rs 5 million for which there is no matching local equity; the company has found it difficult to raise local capital.

1.08 Profitability of Foreign Investment

No figures are available from most companies, since only public companies have to publish profitability figures. However, firms consider profitability in Sri Lanka average to above-average.

1.09 Official Sources of Business Information

For any firm interested in investing in the Export Processing Zones, the Greater Colombo Economic Commission maintains various data that may be useful. The address is:
The Investment Promotion Division,
Greater Colombo Economic Commission,
P.O. Box 1765, Colombo, Sri Lanka

GCEC also has an information centre in New York:
Mr. Arjuna Kadirgamar
Greater Colombo Economic Commission
UNIDO Investment Promotion Service
821, U N Plaza, 6th Floor
New York, NY 10017, USA
Phone: (212) 935-0369

Proposals for foreign investment in Sri Lanka outside the Investment Promotion Zones of the GCEC, are examined by the Foreign Investment Advisory Committee, Secretariat Building, Galle Face, Colombo 1, Sri Lanka.

The FIAC is serviced by the International Economic Co-operation Division of the Ministry of Finance and Planning which provides advice to prospective investors on suitable areas for investment outside the GCEC area of authority. It also provides assistance to investors (local and foreign) in finding suitable collaborators in joint venture projects, and in overcoming various difficulties encountered in setting up an industry. Project proposals should be forwarded to the Director, International Economic Co-operation Division, Ministry of Finance and Planning, Secretariat Building, Galle Face, Colombo, Sri Lanka.

Among other activities undertaken, the Ceylon Chamber of Commerce helps visiting businessmen make contacts in Sri Lanka, organizes trade exhibitions and operates an information service.

The Ceylon Chamber of Commerce is located at 127 Lower Chatham Street, PO Box 274, Colombo 1, Sri Lanka.

The Sri Lanka Export Development Board helps in the development of supplies of export products, and will carry out export potential surveys related to Sri Lanka products. It is located at 310, Galle Road, Colombo 3, Sri Lanka.

Feasibility studies for industry are undertaken by: Industrial Development Board (IDB), 615 Galle Road, Katobedde, Moratowa, Sri Lanka.

The Integrated Development Programme of the Mahaweli Authority promotes the development of agri-industries, integration of crops and animal husbandry. Foreign investors could take advantage of these investment opportunities. The Mahaweli Authority of Sri Lanka has set up an Economic Unit at 500, T B Jayah Mawatha, Colombo 1, Sri Lanka which will assist investors with information and procedural matters.

The Ministry of Agricultural Development and Research could also provide useful information and assistance. The Ministry is situated at 73/1, Galle Road, Colombo 3, Sri Lanka.

The following overseas offices will provide information pertaining to investment in Sri Lanka:

Los Angeles Pacific Basin Marketing Corporation
9100, Sebulveda Eastway
Los Angeles, California 90045, USA
Phone: (213) 641-1373
(800) 421-5643

Sri Lanka Investment and Trade Centres
International House
Bella Centre
Centre Boulevard DK 2300
Copenhagen, Denmark
Phone: (01) 520211

Sri Lanka Trade and Investment Centre
App 1519
Enauel Leitze Str 1a
4000 Dusseldorf, West Germany
Phone: (0211) 593053/54

2.00 STATE ROLE IN INDUSTRY

2.01 General

Partly as a legacy of its socialist past, large sections of Sri Lankan industry are government owned and managed. Power generation, the railways, public transport, plantations, most newspapers are in the government's charge, as are many industrial ventures (see 2.02). However, the UNP has no intention of expanding this role further -- quite the opposite, in fact. The government believes that expertise available in private companies can help turn around some inefficient performers in the state sector.

The leftist policies of the previous government -- and, some say, political vendettas -- resulted in the nationalization of large sectors of the economy. Most important were the plantations, which were the heart of Sri Lanka's economy. Nationalization usually has led to inefficient production units, with overstaffing and lower productivity.

While the private sector will continue to increase its role, wide-scale denationalization of existing state corporations is unlikely. The Business Acquisition Act, brought in by Bandaranaike, allows the government to take over private companies relatively easily. It has not been repealed under Jayawardene, and, in fact, in an earlier term the UNP used it to take over the Independent Television Network, and Times of Ceylon, a newspaper in the hands of Anura Bandaranaike. Were the SLFP to come to power, a more socialist pattern would be adopted, and a spate of nationalizations, while unlikely, is not impossible.

The role of the State at present is to promote industrial growth in desired directions. The highest priorities are to provide jobs, promote exports, and utilise effectively the country's natural resources. For instance, the government has been trying to promote agri-based industry, where considerable potential for expansion of

field crops and minor agricultural export crops exists, especially on unused lands and on lands being diversified out of other crops such as tea. The government leases land to companies to promote agri-based industries where local workers could be employed.

For example, Lankem Ceylon Ltd (a Shell Company) which had been engaged in the distribution of lemon grass oil for some years apllied to lease 2,000 acres of land in the Mahiyangana area from the government; it was approved.

In some cases, it is less successful. Despite the stress on exports, growth has not been encouraging. In some cases, the protection provided in the local market tends to offset the benefits of exporting -- despite the incentives provided by the government -- and many companies have opted for the former. Import substitution is generally more profitable than export. But this is largely true only on the average: there are many instances of import substitutes which receive little or no protection. Conversely there are some very highly subsidized export subsectors.

The EDB (Export Development Board) has recognised the problem, and are making efforts to rectify the situation. Funds constraints will prevent any very major changes in the short term.

2.02 State-owned Industry

Besides the usual areas -- such as utilities -- the public sector operates in industries such as fertilizer, petroleum, cement, steel hardware, transport, plantation agriculture, banking, shipping, caustic soda and chlorine, paper, textiles, ceramics, oils and fats, plywood, leather goods, sugar, minerals and sand, slats, tyres and tubes, trade, etc.

By policy, state monopolies are petroleum and minerals, railways, and mining. (General mining is an exception in the Mahaweli reservoir areas, in order that rapid exploration could take place before inundation. The State Gem Corporation had invited an Australian Mining company to engage in strip mining for gems in the Mahaweli area; but the company has discontinued the project since it is not satisfied with its finds so far.) Further expansion is reserved for the public sector (except in the Greater Colombo Economic Commission Area). However, the present government is flexible about this; for example, they have invited investment in a hydrocracker.

It has been a Treasury policy on the whole to encourage collaborations between state industry and well-known international companies, subject to the demand that the necessary capital contributions are raised by the Corporations themselves out of their own resources. Generally, it should be possible to obtain a tax holiday, and often, the pioneering industry concession would also be given (see Section 10.04). In the event of a strike, there is a cost-recovery and production-sharing agreement.

Several state-owned corporations and other statutory bodies are currently seeking government authority to enter joint venture agreements with international companies. The Cabinet has recently authorised a venture between the State Development and Construction Corporation and Showa of Japan in the ready-mixed concrete production industry. It has also authorized a tobacco export venture between the Sri Lanka Tobacco Industries Corporation and Interbex of Belgium. The

Sri Lanka Sugar Corporation and KCP Ltd of India are to set up a sugar factory, planned to produce 27,000 metric tons annually from 1985.

Pending government approval are two more projects. They are a tyre manufacturing venture between the Sri Lanka Tyre Corporation and the Swiss subsidiary of the Chicago-based Bear Cat Company, and the Lanka Leyland collaboration with Ashok Leyland of India for the assembly and progressive manufacture of buses. They expect to get both the tax holiday and the pioneering industry concession.

During 1980, most major state corporations made profits. The more profitable corporations which earned returns on sales of over 20% were the tyre, Plywoods, Tobacco, Salt and Chemical Corporations. The State Hardware, Paper and Steel Corporations performed poorly with returns of less than 6% on sales (see box 2.02A for profitability of state corporation from 1976 onwards.) However, the Ceylon Transport Board has also been losing money heavily. So also have the railways (a government department).

BOX 2.02A

Performance of major state industrial corporations 1976-1981

Corporation	Net profit (Rs million)						1980 net profits as % of	
	1976	1977	1978	1979	1980	1981a	Capital investment[b]	Sales
Ceylon Petroleum	-77.0	-178.9	-374.1	192.0	108.8	na	13	1
National Textile	-11.9	-8.1	-24.7	-87.3	na	na	-23	-29
State Flour Milling	30.4	-15.3	45.5	10.4	1.0	-11.7	2	e
Ceylon Cement	-4.8	-24.1	15.6	10.4	134.9	na	34	18
Ceylon Steel	13.3	1.5	25.5	40.8	28.3	27.9	8	6
Sri Lanka Tyre	6.5	2.4	42.9	-28.4	58.3	na	34	24
National Paper	17.7	12.3	14.0	-0.9	18.3	2.3	2	6
Ceylon Ceramics	12.1	2.6	13.8	18.1	44.5	34.1	17	23
Ceylon Plywoods	-2.1	-12.0	-3.1	0.4	35.8	na	22	32
Sri Lanka Tobacco	12.3	11.0	30.6	33.3	10.2	12.2	31	24
National Salt	8.2	5.6	6.7	8.3	14.2	19.2	39	40
State Hardware	-11.9	-9.2	-1.3	0.8	1.0	na	2	2
Ceylon Leather products	1.1	0.7	3.6	6.8	4.2	1.9	10	14
Paranthan Chemicals	7.8	3.4	3.9	6.0	7.6	4.5	16	28
TOTAL/AVERAGE	1.5	-208.1	-201.1	267.5	467.1[c]	d	13	4
Excluding Petroleum	78.5	29.2	173.0	75.5	358.3[c]	d	13	13

a - Provisional
b - Capital investment is defined as capital reserves and long term liabilities-accuulated losses
c - Excludes National Textile Corporation for which data is not available
d - Not provided as information for five or more Corporation is not available
e - Less than 1%
Sources: Central Bank of Ceylon and Ministry of Industries and Scientific Affairs

2.03 Nationalization Policy

No nationalizations will take place as long as the current government remains in place. In fact, the government believes that expertise available in private companies can help turn around some inefficient performers in the state sector. Some other examples:

- Five large state-run textile mills were handed over to the management of three Indian firms and a joint UK-Indian venture. They have shown sharp increases in production and improved labor discipline.

- The state-owned bus services are to be streamlined and already face competition from private operators. The state-owned transport board, set up in 1958 when the bus services were nationalized, lost US$67 million in 1981. It runs 6,000 buses and employs 60,000 people -- of whom as many as 20,000 may be redundant, employed because of political pressure. In 1979, private firms were allowed to run parallel services, and 4,000 private vehicles were believed to be in operation by 1980.

- The government may draw on private sector expertise to manage (but not own) tea, rubber, and coconut plantations, most of which are state owned.

- Private agencies are allowed to handle some mail and telecommunication services, including subagencies for the sale of postal items, local telegrams, and foreign telexes.

- Private companies may even be allowed to generate electricity and distribute it through the national grid.

However, the government has not repealed the Act under which previous governments have made most of their nationalisations. The

Business Undertakings (Acquisition) Act of 1971 is similar to British law whereby it is possible for the government to take over businesses with the public interest in mind. The act empowers the government to appoint a 'competent authority' to manage the affairs of the undertaking. All the rights and liabilities under any contract at the time of takeover vest with the government. Appeals may be made against the takeover to the Minister of Finance within fifteen days of the vesting order. The government may direct a bank in which the proprietors of the undertaking has an account to prevent the operation of the account. Several companies were taken over during the SLFP regime under this act.

There is no stated intention to nationalise any companies in the future. The following companies were absorbed as government owned business undertakings under the Business Undertakings Acquisitions Act, during the SLFP and are now managed by a government appointed Competent Authority:

- Acland Finance and Investment Ltd
- Colombo Commercial Company (Engineers) Ltd
- Colombo Commercial Company (Fertilizer) Ltd
- Contact Ltd
- Essential Oils Ceylon Ltd
- Heavyquip Ltd
- Hunnas Falls Ltd

- The Wellawatte Spinning and Weaving Mills Ltd
- United Motors and Automobile Assemblers and Manufacturers Ltd
- Ceylon Silks Ltd
- British Ceylon Corporation
- Ceylon Oxygen Ltd
- Orient Company Ceylon Ltd
- Colombo Gas and Water Company Ltd

All employees of the above companies receive tax-free salaries and wages comparable to other government employees. A tribunal was set up to appeal against the take over and also to decide

on the quantum of compensation offered. Compensation for the Commercial Group (comprising the first seven companies listed) has recently been approved at Rs 78 million.

Court actions can be successful in foiling an acquisition. For instance, Jafferjees was ordered to be taken over under the SLFP government. After it came to power, the UNP continued the action; but Jafferjees won the case on the basis that the original vesting order was incorrectly served and therefore invalid.

The Act has also been used punitively against companies that broke the law. In fact, there has been a strong lobby to limit it to such use, but such legislation is unlikely. The takeover of the Colombo Commercial Company group was a punitive action. In one instance, however, a company itself sought to be taken over. This was permitted, and the company was nationalised.

The government (under the SLFP) has also, in the past, taken over the Lakehouse Group of newspapers by a special act of parliament -- rather than under the Act.

The Land Acquisition Act is also similar to British law that permits the government to take over land and buildings with the public interest in mind. The premises of Shaw Wallace and Hedges Ltd were acquired by the SLFP-dominated United Front government to house the Ministry of Plantations. When the stores of Shaw Wallace and Hedges Ltd were acquired, the company was compensated. In 1981, Mackinnon Mackenzie and Company's buildings were taken over the Airports Authority, but the buildings were later returned to the Company.

Compensation payments may be delayed by upto five years. This may be a major disadvantage as compensation is based on market value at the time of takeover.

In order to reassure investors, and provide a stable framework within Sri Lanka's volatile democracy, the present government has sought to protect foreign investors through the

Constitution. It gives special status to international treaties and agreements to promote and protect foreign investments in Sri Lanka. Where Parliament, by two thirds majority, approves any agreement between the government of Sri Lanka and a foreign government for the promotion and protection of investments in Sri Lanka, as being essential for economic development, the agreement is to have the force of law in Sri Lanka. No written law -- or executive or adminstrative action -- can then be made (except for national security reasons) which contravenes the agreement.

The government has investment protection agreements with the US, West Germany, the UK, Singapore, Korea, and France. In 1981, it reached an agreement with Japan, which will remain effective for 10 years. The Japanese pact is expected to make a difference in the level of Japanese investment, which has been quite modest. The government are negotiating similar agreements with other countries.

The Greater Colombo Economic Commission provides special protection in addition. Neither the assets nor income of a business that comes under the GCEC may be liable to acquisition, expropriation or nationalization. The capital investment of non-resident shareholders, the profits, and any liquidation proceeds will be freely transferable, and not subject to exchange controls.

For companies that come under the GCEC, disputes relating to their agreements with the GCEC will generally be referred to the International Centre for Settlement of Investment Disputes (ICSID) (see Section 3.01).

3. ORGANISING

3.01 General

Companies that mean to do business in Sri Lanka must be incorporated in that country; no company may carry on any undertaking in Sri Lanka, nor have an interest in any property in Sri Lanka, unless it is incorporated in Sri Lanka (see section 3.10) or is exempted by the Minister of Trade and Shipping. However, this does not apply to banks.

Sri Lanka's policy on foreign investment and incentives is determined by the Cabinet. The Ministers (and the departments under them) for each portfolio assist in formulating the overall policy. The general policy is determined by the Ministry of Planning and Economic Affairs and the Ministry of Finance. For taxes, the Ministry of Finance is assisted by the Department of Inland Revenue. The Department of Exchange Control of the Central Bank assists the Ministry of Finance for policy concerning foreign exchange transactions. The Ministry of Industries and Scientific Affairs is in charge of the industrial sector. Fishing and tourism come under the Ministry of Fisheries and the Ministry of Shipping and Tourism respectively.

All foreign investments come either under the Foreign Investments Advisory Committee (FIAC) or the Greater Colombo Economic Commission (GCEC). In the private sector, in general, only 49% foreign equity is permitted, and the domestic shareholders must retain effective control. However, the government is flexible about this if the projects are particularly attractive; they may allow majority foreign ownership. In the state sector, foreign investment may be negotiated.

The Greater Colombo Economic Commission Law provides for two types of enterprises which are eligible for special treatment, namely "Area enterprises" and "Licensed enterprises". In both cases, they must be companies with which the GCEC has an agreement. The

difference between the two is that an "Area enterprise" operates within Greater Colombo Economic Commission Area, while a "Licensed enterprise" operates outside the area. The law is sufficiently flexilble to extend the special treatment which is given to companies in the GCEC Area to other enterprises as well.

For hotel projects, FIAC recently revised its project approval terms. Foreign investors can now hold up to 70% of the equity in hotels of the five star category, with at least 200 rooms, situated in the Colombo area. In Ceylon Tourist Board approved sites outside Colombo, hotels with a minimum of 50 rooms will be permitted upto 49% equity. This is not rigid, and can be further modified on a case by case basis.

Proposals for projects that will operate under the GCEC aegis must be authorized by the GCEC. These are mainly investments in the Investment Processing Zones (see 13.05) but may include GCEC Licensed Enterprises also. For investments in the GCEC Area, there are no equity restrictions; even 100% foreign ownership will be allowed. The GCEC is directly under the control of the President; it has one Director-General and four directors. Wide powers are conferred on the Commission (see 13.05).

Under GCEC Law, any disputes about the agreements between the foreign investor and the GCEC will, unless otherwise agreed, be referred to the International Centre for Settlement of Investment Disputes (ICSID). The District Court of Colombo may enforce the awards of ICSID. Even if the company, by incorporating in Sri Lanka, becomes Sri Lankan, it is regarded as a foreign national for this purpose.

3.02 Basic Approval Procedure for New Investments and Expansions

Under the Companies (Special Provisions) Law, No. 19 of 1974, no company may have an interest in any property in Sri Lanka, or do business in Sri Lanka, unless it is incorporated in Sri Lanka (see section 3.10). This does not apply to banks. The government may exempt companies from this provision.

Besides banks, the following businesses are exempt:

- any proprietorship or partnership companies, owned by Sri Lankans
- foreign airline, shipping, and insurance companies.
- buying agents of foreign governments or state corporations who do not engage directly in trade, but only supervise the trade with Sri Lanka;
- any foreign company which owns proprietory rights in industrial or intellectual property (patents, trademarks, industrial designs or copyright);
- any foreign company which has agreements with the government or with local businesses for specific works, services or the supply of imported goods;
- any foreign company that has stopped doing business in Sri Lanka;
- any foreign plantation company;
- certain other businesses specified by name.

Enterprises in the Greater Colombo Economic Commission area (Investment Promotion Zones), must also be incorporated in Sri Lanka.

Proposals for investment in the GCEC Zone must be authorized by the GCEC. In addition to investments in the Commission Area, the GCEC may grant licences to investments outside the Commission Area (see 13.05). Enterprises enter into agreements with the Commission. The terms are subject to negotiation, and the GCEC takes a case by case approach.

The GCEC Law has not provided guidelines for evaluating projects for the Commision Area. However, GCEC will consider the following when granting incentives:

- o creation of employment;
- o degree of export orientation;
- o capital investment;
- o development of technology;
- o use of local raw materials and components, etc.

The government is more conservative regarding foreign investment proposals outside the authority of the GCEC, but they will be considered if they conform to government policies, and if prove out on a social cost-benefit analysis. Important considerations would be:

- o use of indigenous raw materials;
- o production primarily for export, particularly those products which diversify Sri Lanka's export trade and have a net foreign exchange earning. (Projects could include further processing of Sri Lanka's traditional products);
- o locating the project in one of the less industrialized or less developed parts of the country, provided that the costs of locating there are not excessive;
- o adopting intermediate or labor intensive techniques of producton;
- o whether the project will tend to foster local technology growth.

Projects that conform to these specifications may be able to negotiate a higher equity share than the prescribed 49% (e.g. see Nestles, section 1.07).

In addition, foreign investment proposals in the private sector will be evaluated for the following:

- o the technical skill necessary for the industry must not be available locally;
- o if the cost of imported machinery is high, the foreign investor should contribute enough capital to cover its cost in foreign exchange.

- the greater part of the product must be exported.

For foreign participation with the public sector, the conditions will be dealt with on a case by case basis.

An example of an instance in which the government has been reticent about allowing increased foreign investment is the footwear industry -- in which, incidentally, it is represented through a major state Corporation. Bata Shoe Company, which already has a factory in Sri Lanka, wishes to expand by setting up a second factory. The government has so far withheld permission to expand, as no provision has been made for local equity participation. The matter is still pending.

During the period 1978-1981 there were increases in approvals granted by the FIAC in projects relating to (i) food, beverage and tobacco, (ii) Chemicals, petroleum, coal, rubber, and plastic products, (iii) non-metallic mineral products (except petroleum and coal) (iv) fabricated metal products, machinery and transport equipment. On the other hand there was a considerable drop in investment in textiles, wearing apparel, leather products, paper and paper products and manufactured products. In 1981 investment in wood and wood products including furniture was nil.

Already established joint ventures do not usually require FIAC approval for expanding company operations if the scope of the expansion was defined in the original application to the FIAC. If a change of equity structure is envisaged, then FIAC approval is necessary.

FIAC approvals would take from four to eight weeks to process. In the case of Tootals Ltd UK, the application for a joint venture with 60% foreign ownerships and an authorized capital of Rs 23 million, took eight weeks to process.

No special laws or procedures are applicable to oil and

mining, which are state monopolies. Foreign investment in these areas will usually be permitted only in conjunction with state participation. The Ceylon Petroleum Corporation determines the extent of foreign participation in ventures pertaining to petroleum and petroleum products.

Graphite (in which Sri Lanka has considerable reserves) mining is another area which is restricted to the foreign investor, but a case by case consideration of the proposed project by the State Graphite Corporation is possible.

Sri Lanka has signed the IBRD Convention in the Settlement of Investment Disputes.

BOX 3.028

Investment Approvals by FIAC

Applications are made in the prescribed form to the International Economic Co-operation Division of the Ministry of Finance and Planning. Specimen application forms may be obtained from:

Director, International Economic Co-operation Division,
Ministry of Finance and Planning, 1st Floor, Galle Face Secretariat
Colombo 1

Twelve copies of the forms should be submitted to the FIAC. They must contain the following details:

Part I

1. a) Name and address of proposed business
   b) Form of business organization

2. Summary description of the proposed venture.

3. Proposed site of project/base of operations and estimated area of land required.

4. a) Name and address of local investor/promoter
   b) Name and address of foreign collaborator
Documentary evidence of foreign collaborator's willingness to invest, and an appropriate bank reference.

5. Why foreign collaboration is necessary:
a) Contribution envisaged from foreign collaborator
b) Experience and know-how available to foreign collaborator for the production of commodities/services proposed
c) Information regarding investments undertaken by the proposed foreign collaborator outside his home country.

6. If the local or foreign investor/promoter has any interests in any existing local industrial concern, details and the precise nature of the interest must be given.

Part II

7. Cost of project:
a) Fixed assets - (Separate schedule giving details of each item)
b) Current assets

8. Proposed financing:
A statement showing duration of loans, source quantum under each duration, repayment schedules and rate of interest. A specific explanation must be made if shares are being issued to foreign parties for consideration other than cash.

9. Use of raw materials for 5 years. (A separate schedule must be

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attached, detailing quantities and values of different products.)

10. Sales over 5 years. (Separate schedule detailing quantities and value of different products.)

11. Requirements of power and fuel.

12. Water use, effluents.

13. High intensity noise/vibration generating equipment, potentially dangerous or injurious substances/processes, fire risk.

14. Marketing of products.

15. Estimate of operating results, funds flow statement, manpower requirements, time schedule.

Part_III

16. If machinery is to be imported, it must be stated whether it will be new or re-conditioned. If re-conditioned, reasons must be given as to why that particular machinery is to be imported. Investor must state if investigations to ascertain whether any or part of the production equipment could be locally fabricated were made. Also, if investigations were made to ascertain whether prices to be paid for machinery are competitive in relations to similar machinery in world markets. Details of capacities to be installed. The productive life of the main items of equipment and what replacements will be needed during this period.

17. Royalty payments: amount, basis and period of payment, whether payment of royalties is linked to export performance.

18. Details of technical collaboration, technical service fees.

19. Foreign personnel to be employed, job description, period of contract and terms of payment.

20. Dividends on foreign capital.

21. Foreign loans and suppliers' credits - terms of repayment, rates of interest, period of payment.

22. Any other remittable recurrent liabilities.

23. Basis of projected export programme and rate of foreign collaborator in marketing the products.

Each project proposal should be supported by a letter from the foreign collaborator stating his willingness to join the project. Projects are evaluated in terms of the technology transfer involved, access to foreign markets, gains in foreign exchange, spread of skills as well as the contribution to output and employment.

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BOX 3.02B

Investment Approvals by the GCEC

The GCEC provides one-stop shop processing for foreign investments that come under its purview.

The application for investment approval (in triplicate) must include:

- o a description of the project
- o the cost of the project (foreign and local currency);
- o capital structure (issued and paid up share capital);
- o details of long term loans (including repayment and interest rates);
- o projected amount and value of foreign and local raw materials and components for each of the next five years;
- o production programme for each of the next five years;
- o markets for the products;
- o projected cash flow statement for the next five years;
- o the infrastructure requirements;
- o manpower;
- o time schedule for start-up;
- o proposals for training local personnel, if any.

If any part of an existing business is to be transferred to the new enterprise, full details should be given of the exports, the items of manufacture; the number of employees; the machinery, equipment, etc. to be transferred. Particulars of any splitting up, reconstruction or amalgamation of an existing business with the new enterprise should also be furnished.

The terms of approval will be included in the investment agreements with the Greater Colombo Economic Commission.

The Commission has prepared a draft agreement, which provides that the enterprise must commence business within a period of nine months, but this can be extended.

The draft also provides that the enterprise must

- o maintain an accounting system which will clearly show its revenue and expenditure, and must make available to the Commission, whenever necessary, the quantum of the revenue and expenditure in foreign currency as distinct from such revenue and expenditure in Sri Lanka currency
- o within four months of the end of a company's financial year, it must give the GCEC a statements of accounts, audited by a member of the Institute of Chartered Accountants.

For machinery and equipment to be imported, a certificate from an internationally reputed firm of surveyors is required. The certificate should indicate

- o whether the machinery is new and modern (if not new the age of the machinery)
- o that the price is fair, reasonable and competitive.

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3.03 Activities not Open to Foreign Capital

Generally, foreign investment in trading will not be permitted. Recently, the government has also decided to slow further investment in garment manufacturing. Garments had been a major area of interest among foreign investors and numerous Asian investors had started manufacture in Sri Lanka to avoid quota restrictions on exports from their own countries. The government does not want to become overdependent on this kind of investment, and, in the future, only certain specialized garment manufacturers will be allowed to invest.

In the case of sectors in which state enterprises are engaged or which are reserved to them, foreign participation must be with such enterprises.

Certain other areas may be limited to foreign companies in special circumstances. For instance, Guthrie, a Malaysian controlled UK firm gained approval for a palm oil plantation in the Mahaweli area, but was not able to go ahead with the scheme. Resistance came from the local scientific community for ecological and social reasons. The USAID, which is assisting the Mahaweli project also opposed it as a misallocation of resources.

3.04 Limitations on Foreign Equity

Outside the export promotion zones -- where even 100% foreign shares are permitted -- foreign equity is theoretically limited to 49%, and the domestic shareholder must retain effective control. As a matter of practice, the government permits a majority foreign held company even outside the zones if it feels the project is worthwhile.

Transfer of business interests to foreigners requires Central Bank permission. According to the Exchange Control Act, Central Bank permission (either special or general) is required for any resident to do anything that will cause a business which is controlled by Sri Lanka residents to cease to be so controlled. Further, the Central Bank must approve any transfers of a business in Sri Lanka by a non-resident to a resident, but this does not apply to shares in a company.

In the case of 5 star luxury hotels of over 200 rooms the equity share of the foreign investor could be as much as 70%. However this percentage would refer to the hotels which are under construction, not to the hotels that are already in existence. In the case of construction projects undertaken for the Mahaweli Development Programme, the foreign equity share could go upto 60%. In contrast, in those instances, in cases where there is no significant transfer of technology -- as in the garment industry, for example -- the equity share holding of the foreign investor is limited to 25%.

Tootal's sewing thread venture is Colombo Thread Company Ltd is an exception; of its authorised capital of Rs 23 million, 60% is foreign. In the case of Gilbeys (Lanka) Ltd, a joint venture in the liquor industry, shares were offered to the local public. These were not fully subscribed. The unsubscribed amount was then offered to the foreign partner which now has a majority shareholding.

In all other cases, as a rule, the minimum share holding for the local investor is 51% and the maximum for the foreign share holder is 49%.

3.05 Buildings and Related Permits

In the GCEC, sites for investment are allotted on a 99-year lease basis on the payment of an initial premium of Rs300,000 per acre and an annual ground rent of Rs8,000 per acre. Companies can use these only for buildings for projects approved by the GCEC, subject to any conditions prescribed by the GCEC. At present, no alternations or additions in the structure can be made without the written permission of the GCEC. The company cannot sub-lease or part with leased property without the GCEC's consent. However, right and interests in the lease can be mortgaged to any Bank or credit institution approved by the GCEC.

All applications to construct any type of building must be made to the relevant local authority - i.e. Municipal Council, Urban Council, Town Council, or Village Council. The application must state the purpose of the proposed building, the materials and chemicals to be used, and the site. This application will then be forwarded to the Urban Development Authority (UDA) which comes under the Ministry of Local Government, Housing and Construction.

Zoning approvals are granted by the UDA. In a primarily residential area, industry of any sort will not be permitted. In a mixed residential area, cottage industries are permitted, but not large scale industry.

The UDA would need to know the extent of pollution and what measures could be taken to safeguard the environment, and would require proof that the public sewage system will not be utilised for waste matter. In certain cases concessions are granted to industries as long as they are not detrimental to the environment.

No new industries may be set up within city limits.

A foreign investor needs investment approval from the Foreign Investment Advisory Committee (FIAC) before permits for construction

are granted. Occasionally a foreign investment project approved by the FIAC could need further approval from local governmental authority. Prima Ltd, a Singapore based company obtained FIAC approval for a flour milling plant in Trincomalee on the North-east coast of the country. Although the company's project had been approved, the Municipal Council (i.e. local authority) decided to impose a tax on the plant.

If all necessary information is supplied in the application form to the UDA, approvals would normally take a month or two to process. There are no regional differences in UDA regulations.

The President heads a Cabinet Sub-committe for urban development mainly to take up a specific position with regard to policy, when a difference of opinion arises between the investor, and the UDA.

At present there is some discussion about moving company offices out of residential premises in Colombo. However, in view of the fact that even State Corporations are housed in such premises, this will take some time to come about.

Besides the area which comes under the authority of the Greater Colombo Economic Commission and has been demarcated as the investment promotion zone, the UDA has been instrumental in setting up industrial estates. Such estates have been set up on the outskirts of Colombo. The Ministry of Industries has also opened up small scale industrial estates.

Companies will have to approach the Post and Telegraphs Deparetment for telephone and telex connections; the waiting time in Colombo can be upto six months. Obtaining telegraph addresses takes about one month, and post box addresses, around one year. However these times may vary substantially.

3.06 Acquisition of Real Estate

There is no legal restriction on the ownership of land and buildings by foreigners. A transfer of land or a building to a non-citizen is subject to a tax of 100% of its value. However, the tax does not apply to transfers to a company incorporated in Sri Lanka (even if controlled by foreigners).

(For land in the GCEC area, see see 3.05).

Under the Land Reform Act of 1972 the ceiling on ownership of land is 50 acres. This is applicable to individuals as well as companies. Exceptions may be made in special cases. For example, the government allowed several agribusiness ventures land in excess of the ceiling.

3.07 Acquisitions and Takeovers

It is impossible for a foreign firm to take over a Sri Lankan one without Central Bank and FIAC permission; the Exchange Control Act prohibits it.

If foreign companies wish to have 100% ownership of a local company, the matter will also have to be taken up by the FIAC. Usually 100% foreign ownership is not granted. In the event of purchasing shares in a local company a foreign investor is subject to a tax of 100% on the shares; this tax, however, is soon to be abolished.

3.08 Local Content Requirements

The government encourages maximising local content, but does not specify any fixed percentage. In the Investment Promotion Zone, at least 25% domestic value added is desired; this includes the value of local labor.

Companies are allowed to import certain items under license for which specific quotas are allowed. For renewal of the licence a letter is required from relevant local suppliers to say that the specifications of the item cannot be met locally.

Companies may start by importing their raw material requirements, and shift to local suppliers when possible. For example, Lever Brothers initially sourced the plastic sachets for Sunsilk shampoo from abroad, but have now developed a local supplier.

3.09 Mandatory Memberships

Membership in any business or industry association is entirely voluntary.

3.10 Establishing a Local Company

The basic forms of doing business are proprietorships, partnerships, companies, and co-operative societies. Companies are further subdivided into private and public companies. A private company is limited by its Memorandum or Articles of Association to not more than 50 shareholders, with limited rights to transfer shares; public offers are prohibited.

Companies may be limited by shares, limited by guarantee, or unlimited. The company is the most popular form of doing business, though many firms are not public.

The procedures for incorporation are quite simple (see box).

No minimum capital is stipulated. Capital may be in the form of cash or in the form of immovable property. A company that is limited by shares must state its authorised capital at the time of registration, but this can be increased by an ordinary resolution, and the Registrar of Companies notified within 15 days. Reduction of authorised capital is more difficult, requiring authorisation under the Articles of Association, a special resolution, and confirmation of the resolution in Court.

If shares are allotted for consideration other than cash it will be necessary to value such property for the purpose of paying stamp duty. Shares may be alloted against knowhow, but the government does not favor such arrangements, in part because of valuation difficulties.

The government stipulates that a foreign investor importing machinery should obtain a certificate of quality and prices from a Surveyor of international repute. (e.g. Lloyds International, Bureau Veritas) These valuations will be useful in determining the value of machinery for stamp duty when shares are issued.

A minimum of two shareholders is required for a private

company, and of seven for a public company. Non-residents or their nominees need Central Bank permission to subscribe to shares -- including the qualifying shares. The company may have founders' shares.

Public companies must have at least two directors. No nationality or age requirement is imposed; a corporate director is not prohibited. Directors retire from the Board at the age of seventy-three save with the approval of the shareholders. There is no statutory requirement of share qualification. Disclosure of interests in contracts with the company is necessary. The company cannot pay a director remuneration free of income tax, and loans cannot be granted to directors except under certain circumstances. A company should have a qualified secretary if its turnover is more than Rs one million (Rs 1,000,000) or if it has a paid up capital of Rs five hundred thousand (Rs 500,000) or more. Every company must maintain a register of directors or managers at its registered offices.

A company may appoint non-nationals or non-residents as managers; however the necessity of foreign personnel and the grant of visa will be determined by the FIAC.

There is no requirement for labor to be represented on the Board.

A company may hold shares, but a partnership cannot hold shares in its own name; the partners will be joint holders.

Every company must maintain proper books of accounts of money received and expended, all sales and purchases and all assets and liabilities of the company. The books must be open to inspection by the Directors, the Registrar of Companies or the Company's Auditors.

For example, under the disclosure provisions of the Companies Act No. 17 of 1982, firms must reveal emoluments of Directors (as a lump sum, not individually); and also contracts of the company in which its Directors have interest. For e.g. Walker Tours Ltd, a local

travel firm in Colombo, was required to report that four of its directors are also directors and shareholders of John Keels Ltd and John Keels Holdings Ltd, with which companies they (Walker Tours) had contracts for payment. Contracts for payment have been stated to be the rent to John Keels Ltd for the premises occupied by Walker Tours Ltd and a fee of 1% on turnover or Rs 150,000 per month, whichever is higher for the provision of higher managerial services.

Within eighteen months of incorporation and at least once in every calendar year, at intervals of not more than fifteen months, the directors must submit to the company at its annual general meeting a profit and loss account, a balance sheet and directors' report with respect to the state of the company's affairs.

On authorised capital the maximum fee payable on incorporation is Rs 5,000. However, if company pays Rupees Three thousand (Rs 3,000) on incorporation for a company have authorized capital of Rs 1,000,000 and later increases the authorised capital to Rs 10,000,000 the balance sum of Rs 2,000 is payable at the time of the increase. Stamp duty and other charges amount to Rs 300. The approximate stamp duty payable on issue of share certificate is Rs 0.50 per Rs 100 share registration fee, while notification of charges of the directorate and other particulars amount to Rs 100.

Shares may be ordinary or prefered. Non-voting shares are permitted. If authorised by the Articles of Association, redeemable preference shares may be issued, but may be redeemed only if fully paid up, and out of either profits or proceeds of a new share issue. Share warrants may be issued by public companies subject to certain conditions, with permission of the Central Bank if non-residents are involved.

Shares of a public company may be converted into stock. The common practice is for shares in public companies to be quoted in the share market. Non-residents' share cannot be sold or transferred without the permission of the Central Bank. Bonus shares may be

issued against revalued assets.

Shares may be issued at a discount if authorized by an ordinary resolution and sanctioned by the court. There are no restrictions exist about the issue of shares at a premium. Commissions for subscriptions may be paid if authorised by the Articles; they cannot exceed 10% of the issue price -- or the amount authorized by the Articles, if less. A company cannot purchase its own shares. It also cannot provide financial assistance for the purchase of its shares except for employees.

Dividends may be paid only from profits and not from capital. They may be paid from capital gains.

Control of a company depends on the control of the vote at the Directors' meeting and shareholders meetings. The usual practice is for a director to have one vote on a show of hands and one vote per share on a poll at a shareholders meeting. A resolution passed at the directors' meeting is by majority resolution, while that passed at a shoareholders' meeting may be ordinary, extra ordinary or special. An ordinary resolution is a resolution passed by a majority of persons on voting. An extra ordinary resolution is a resolution passed by a majority of not less than 3/4 or those present with not less than 10 days notice in the case of a private company and 14 days notice in the case of public company been given. A special resoultion is on which is passed by a majority of not less than 3/4 of such members of which not less than 14 days notice in the case of private company and 21 days notice in the case of a public comlpany has been given. The Companies Act No. 17 of 1982 provides all information with regard to amending the Memorandum and Articles of Association passed by a special resolution.

Every public limited company must hold a statutory meeting of the members of the company not more than three months (and not less than one) after the date on which it is entitled to commence business. A statutory report must be sent to every member at least

seven days before the meeting, and a copy filed with Register of Companies.

An annual general meeting must be held by every company in every calendar year, not more 15 months after the last annual general meeting. Extraordinary general meetings may be called either by the directors themselves (if the articles provide for it), or on the request of members holding at least 10% of the paid up share capital. If the articles do not provide otherwise, two or more members holding not less than 10% of the issued share capital may call a meeting.

BOX 3.10A

How to Form A Company

o Draw up Memorandum and Articles of Association.
o Print the Memorandum and Articles of Association and obtain the signature of at least two subscribers on the Memorandum and Articlesd of Association.

It is necessary that a Notary Public should attest the signing, if a non-resident wishes to sign the Memorandum and Articles of Association prior to the approval of the Central Bank.

File with the Registrar of Companies within 28 days of incorporation:

o Two copies of the Memorandum and Articles of Association, duly signed.
o A statutory declaration of compliance with the requirements of the Ordinance, which must come from an attorney-at-law of the Supreme Court, or a Director or a Secretary of the Company;
o A statement of authorised capital;
o A list of persons who have consented to be Directors of the company, if it is to be a public company.
o Non-resident directors or their nominees need Central Bank permission to subscribe to shares.
o If it is to be a public company, undertakings by the directors to take and pay for their qualification shares, if they have not signed the Memorandum of Association as subscribers for such shares;

Declaration of Compliance with the requirements of the Companies Act to be signed by an Attorney-at-law engaged in the formation of a person named in the Articles of Association as Director or Secretary of the Company.

o Pay the requisite registraiton fee (a maximum of Rs 5,000) and stamp duty.
o The name of a company may not be similar to a company already existing.

If the company is a private limited liability company the words 'PRIVATE LIMITED' should be printed.

o A Private Company can commence business immediately after the Certificate of Incorporation is received from the Registrar of Companies. In the case of a Public Company it is necessary to obtain a further certificate to commence business.

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BOX 3.10B

Off-shore Companies

A company incorporated in Sri Lanka or outside can apply for registration as an off-shore company. An off-shore company is not entitled to carry on any business in Sri Lanka and its requirements are restricted to only carry on any business outside the shores of Sri Lanka.

The documents required for registration are:

i) A banker's statement that the company has a minimum amount of US$25,000 in the account.

ii) A registration fee of Rs 10,000.

3.11 Establishing a Branch

Generally speaking, companies cannot do business in Sri Lanka through branches, except for banks, airlines, and a very few service organisations. Branches require special Ministerial permission. Companies which establish a place of business in Sri Lanka must, except with this permission, form a company in Sri Lanka. This does not apply to banks and some other firms (see section 3.02).

If Ministerial permission is granted, the company must, within one month from establishing a place of business, deliver to the Registrar of Companies certain documents specified in the Companies Act. ("Business" includes a share transfer or share registration office.) These are similar, but not identical, to those required of a company.

Under the Companies Act number 17 of 1982, new companies which are set up in Sri Lanka cannot be established as branches. They need to be incorporated as companies. The Travel Corporation of India sought approval to establish a branch in Sri Lanka, but was turned down.

Incorporation does not require approval, but it is registered with the Registrar of Companies. Exchange Control regulations are operative for remittance - i.e. a permit is required for outward remittance. The Central Bank of Ceylon approves all inward remittances. Taxes on branches are 5% higher than on companies.

Thomas Cook, and Reuters are two exceptions to the general rule; they have been given permission to retain their branches. However, this puts them at a tax disadvantage; branches pay 5% more. (They are allowed some expense deductions for headquarters expenses, but these are usually minor.) A company that decides to incorporate its branch in Sri Lanka may retain 100% equity.

4.00 RULES OF COMPETITION

4.01 General

There is no specific anti-trust or monopolies and restrictive trade practices legislation in Sri Lanka.

Several cases exist in which brands of products (e.g. soap, talcum powder, biscuits) constitute 50% of market sales of that respective product. There is no antitrust or competition law which restricts the marketing of these items.

The Consumer Protection Act No. 1 of 1979 ensures fair practice among traders. The Act deems that an act of competition contrary to honest practices in industrial or commercial matters will constitute an act of unfair competition. All the following acts would constitute unfair competition: confusion with goods, services, or the establishment or with industrial or commercial activities of a competitor; false allegations; any indication of source, or appellation of origin which is liable to mislead the public as to the nature of the goods; any false or deceptive indication of the source of goods; and imitation of an article. The Business Undertakings (Acquisition) Act No. 35 of 1971 (see section 2.03) empowers the government to take over any enterprise that engage in unfair practices.

4.02 Monopolies and Market Dominance

There is no legislation regarding monopolies. Monopolies in the private sector are not unknown, and include the Ceylon Tobacco Co, the sole supplier of locally manufactured cigarettes. The government has a monopoly in the railway, petroleum and mining sectors.

4.03 Mergers

Under the Companies Act Number 17 of 1982, the proposed compromise or arrangement between two companies, must be with the purpose of reconstruction of any company or companies, or the amalgamation of two or more companies.

4.04 Freedom to Sell

Under the Consumer Protection Act No. 1 of 1979, refusal to sell is an offence. Only with the written approval of the National Prices Commission, can a trader engage in the practice of exclusive dealing; this too will be granted only in the national interest. It is not permitted to discriminate between purchasers of goods, in relation to the prices charged for the goods, discounts, allowance, rebates or credit given in relation to the supply of goods, the provision of services or facilities in respect of the goods or the making of payments for services or facilities provided in respect of the goods.

However, no recent prosecutions under this Act have occurred.

4.05 Resale Price Maintenance

A manufacturer cannot enforce a minimum resale price and dealers are free to undercut margins as long as consumer price is maintained. A trader cannot sell any article at a price above the minimum retail or wholesale price and all price lists must be conspicuously displayed.

Prices are either controlled or supervised by the National Prices Commission (See Section 5.0). While making an application for a price revision the entire price structure should be given to the authorities. The price structure would include all costs involved in the production of any article. The cost of raw materials, manufacturing costs like labor and packaging, and marketing costs covering delivery and discounts to trade, would constitute the price structure.

District Court where an injunction may be served on the infringing party, rather than in the Magistrate's Court where it is treated as a criminal offence. A permanent injunction prevents the coutinuance of the abuse by the infringing party. Until the case is over, a temporary or interim injunction is served.

Chemical Industries Ceylon Ltd (which is affiliated to Imperial Chemical Industries), challenged the Swedish company, Dyrup, which marketed a paint bearing a similar name to their own. Ceylon Cold Stores Ltd, the established manufacturer of Elephant Brand soft drinks, often have infringement problems; Elephant brand labels are used to sell other drinks. Pfizer has also found tablets for sale, bearing brand names similar to those they manufacture. In all these cases injunctions have been served on the infringing party.

Lever Brothers Ceylon Ltd have had frequently encountered brand piracy, with spurious brands and imitations of Lever products being manufactured. The company's sales representatives, and nominated Lever wholesalers, are always vigilant for such products; when they are found, Levers tries to reach a written agreement without police intervention. If this is not possible, action is filed in the District Court. Identifying distributors of these fake products is relatively easy -- and the firm can cut off supplies, at least temporarily, by making the arrangement with the distributor -- but it is sometimes difficult to trace manufacturers of spurious products.

Legal proceedings would cost from Rs 10,000 to Rs 15,000.

No changes are anticipated in this area in the next eighteen months.

BOX 6.028

Patents: Basic Laws

Conventions - The Patent Co-operation Treaty of 1978. Sri Lanka became party to this on February 26, 1982.

Basic Laws - The world Intellectual Property Ordinance (WIPO) Act number 52 of 1979.

Duration - The period of protection is 15 years from the date of the grant of a patent. A patentee who intends to keep a patent in force must pay an annual fee. (This can be paid in advance.) There is no provision for renewal of the patent after the expiry of 15 years.

Novelty - An invention is patentable if it is new, involves an inventive step and is industrially applicable.

Unpatentable

* discoveries, scientific theories, and mathematical methods.
* plant or animal varieties, or essentially biological processes for production of plants or animals, other than micro-biological processes and the products of such processes.
* schemes, rules, or methods for doing business, performing purely mental acts or playing games.
* methods for the treatment of the human or animal body by surgery or therapy, and diagnostic method practised on the human or animal body.

Application procedure

An application for the grant of patent must be made to the Register of Patents and Trademarks, Union Place, Colombo 2. It should be made in the prescribed form and contain:
* a request for the grant of the patent
* a description
* a claim or claims
* a drawing or drawings where required for the understanding of an invention
* an abstract.

Where the applicant's ordinary residence or principal place of business is outside Sri Lanka, he should be represented by an agent resident in Sri Lanka, whose name and address must be supplied in the application. The application should be accompanied by a power of attorney granted to such an agent, by the applicant. Where the applicant is not the inventor, the request for the patent must be accompanied by a statement justifying the applicant's right to the patent.

Provided that legalization or certification is not necessary, the application must be accompanied by a declaration signed by the inventor, giving his name and address and requesting that he is named as such in the patent.

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The request should contain:

* a petition that that patent be granted
* title of the invention
* name, address, description and any other prescribed information concerning the applicant, the inventor and the agent if any.

An application for the grant of a payment will not be entertained unless the prescribed fee has been paid to the Registrar.

Examination Procedure

Every applicant must submit a report of an international type search as may be prescribed, to the Registrar in English, (or a translation in English).

In lieu of the international type search an applicant may request the Registrar to refer the application to a local examiner, who will examine the applicaton on the basis of the claims with regard to descriptions and drawings (if any), and furnish a reporet to the Registrar.

Grant of a patent

This will not be refused and a patent will not be invalidated on the ground that the performance of any act in respect of the claimed invention is prohibited by any law or regulation, except where the performance of that act would be contrary to public order.

On granting the patent, the Registrar will:
* issue a certificate of the grant of the patent and a copy of the patent together with a copy of the search report to the applicant.
* record the patent in the register.
* publish in the Gazette a reference to this grant.
* make available to the public copies of the patent together with the search report.

The court may declare the patent null and void on grounds that the subject matter is not an invention, is not patentable, the description unsatisfactory, non-furnishing of drawings or that the right to the patent does not belong to the patentee or has not been assigned to him.

The patentee may exploit the patent invention assign or transmit the patent or conclude licence contracts.

Fees

Where a patentee intends at the expiration of second year from the date of grant of the patent to keep the same in force, he must pay the prescribed annual fee, twelve months before the date of expiration.

Compulsory licensing

There is no legislation to this effect in Sri Lanka. Foreign companies may extend brand names/marks to be used by local firms but

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these are not subject to licensing conditions. However, all agreements with principals must be recorded with the Registrar of Patents and Trade Marks.

Right of priority is given for applicants from any State which is party to the Paris Convention for the Protection of Industrial Property.

Trademarks: Basic Laws

Duration: Registration of a mark (trademarks and service marks) may be valid for a period of 10 years, as of the date of receipt by the Registrar.

Renewal: Registration of a mark may be renewed for consecutive periods of 10 years each on payment of the prescribed fee. This must be done within the 12 months preceding the date of expiry of the period of registration. The renewal is not subject to further examination by the Registrar or any opposition.

Legal effect: The Code of Intellectual Property Act deems that the registered owner of a mark shall have the following exclusive rights in relation to the mark: to use the mark; to assign or transmit the registration of the mark; to conclude licence contracts.

Without the consent of the registered owner of the mark, third parties are precluded from using the mark in any such way as to mislead the public, or in a manner that would be prejudicial to the registered owner of the mark.

The registration of the mark does not confer on its registered owner the right to preclude third parties

* from using, bona fide, their names, addresses, pseudonyms, a geographical name or exact indications concerning the kind, quality, quantity, production or of supply of their goods and services in so far as such use is confined to the purpose of mere identification or information and cannot mislead the public as to the source of the goods or services;
* goods lawfully manufactured, imported, offered, for sale, sold, used or stocked in Sri Lanka under that mark, provided that such goods have not undergone any change.

Qualifying for registration

Arbitrary or fanciful designations, names, pseudonyms, geographical names, slogans, devices, reliefs, letters, numbers, labels, envelopes, emblems, prints, stamps, seats, vignettes, selvedges, borders and edgings, combinations or arrangements of colours and shapes of goods or containers.

Marks which cannot be registered

That which consists of shapes or forms imposed by the inherent nature of the goods or services, or by the industrial function, cannot be registered. Service marks and collective marks may be registered.

5.00 PRICE CONTROLS

Under Section 61 C of the Consumer Protection Act, the Commissioner of Internal Trade has the power to declare price controls and price supervision on items that are deemed 'essential to the life of the community'. Items like bread, flour, sugar, pasteurised and sterilized milk, petroleum products (diesel oil, kerosene oil) are price controlled. Many items are "price-supervised", among them rice, soap, toothpaste, talcum powder, and aerated water.

Permission for revision of prices may be made by the manufacturer or importer to the National Prices Commission, setting out the price structure (see Section 4.05) according to which the revised prices (ex-factory, wholesale and retail) are to be fixed. The Commission's view is referred to the Ministry concerned for consideration.

In the case of price supervised items (items which are not price controlled) the manufacturer is free to disregard the view of the National Prices Commission and act as he pleases. However it is considered unwise to do so, particularly in view of the fact that the National Prices Commission can advertise in the media that its recommendation went unheeded. This has never been actually done by the Commission.

The National Prices Commission has no specific legislation regarding price controls, but keeps a vigilant eye on market prices, hoarding and black marketing. It is with the approval of this body that prices are fixed. Under the Consumer Protection Act No. 1 of 1979 the Commissioner of Internal Trade may issue directions to manufacturers or traders in respect of the price marking, labelling and packeting of articles.

The Commissioner has the power to specify the maximum quantity of any article to be sold on any day, and the time during which and the places at which such an article may be sold.

It is an offence to sell, or offer to sell any article at a price above the maximum retail or wholesale price as the case may be.

All the traders are required to display prices on a board in a conspicuous place.

Imports are not subject to administered prices, save those that are imported by government Ministries, State Corporations, Boards and other State institutions.

6.00 LICENSING

6.01 General

Proposals for technical collaboration without equity investment are welcome in both public and private sectors. Some companies have used licensing agreements as a way to enter Sri Lanka without an equity commitment. Well-known brand names may be licensed to Sri Lankan companies (e.g. Tek toothbrushes).

The government reserves the right to invalidate a contract if it is found to be "detrimental to the economic development" of Sri Lanka, but this provision is unlikely to be used under the present government, except in exceptional cases.

Though licensing is not very popular in Sri Lanka, some companies have found this an inexpensive way to access Sri Lanka's tiny domestic market. British Paints, for instance, licenses the use of its brand name, Permaglaze. Metal Box also has a licensing agreement with Metcan Ceylon Ltd.

Several foreign companies in Sri Lanka use the brand name of the foreign parent company, (and its subsidiary companies); for instance, Eveready (Union Carbide) or Waterbury's Compound (Warners). Lever Brothers Ceylon Ltd uses brand names of the parent company Unilever (London) Ltd, as well as those of the Unilever subsidiaries, A & F Pears Ltd, and B & W Gibbs Ltd. Lever Brothers Ceylon entered into agreements with these companies before the Code of Intellectual Property Act No. 52 of 1979 became legislation. (The Act ordains that all agreements must be registered with the Registrar of Patents and Trademarks.)

Companies seldom seek patent protection in Sri Lanka; the patent office reports very few applications. Recently, Ceylon Tobacco company won patents on two inventions relating to the manufacture of coir dust briquettes, and Jose R. Concepcion of the Philippines was granted a patent on an alcohol-powered car.

6.02 Patent and Trademark Protection

In 1979, the patent laws were changed from the old prewar UK system to incorporate the WIPO (World Intellectual Properties Orangization) code. The Code of Intellectual Property Act, No. 52 of 1979 protects most products. Patents have a maximum life of 15 years; trademarks of 10 years. However, trademarks can be renewed.

Companies are not forced to disclose the contents of patent registrations.

Copyright protection is given to original literary, artistic, and scientific works, and the derivative works. Copyright is protected during the life of the last surviving author and for 50 years after his death. Copyright in cinematographic, radiophonic or audio-visual work is protected until 50 years after the making of the work or, if the work is made available to the public during that time with the consent of the author, 50 years from the date of its being made public. In the case of photographic work or a work of applied art, the period of protection is 25 years from the making of the work. On sound recordings, the maker has the exclusive right to reproduction of the sound recording for 50 years from its first publication.

Trade names are protected even prior to, or without registration, against any unlawful act committed by a third party.

It is possible to obtain a patent from the Registrar of Patrents and Tademarks within a year. However, obtaining a trademark would take longer -- anything from three to four years. An acute shortage of staff in the office of the Registrar of Patents and Trademark has been the reason for this delay.

The Registrar does not protect the rights of patentees or owners of trademarks, but in the case of infringment, the victimised party may take legal action either in the country's District Court or Magistrate's Court. Companies usually opt to take up the case in the

Application procedures

Applications should be made to the Registrar of Patents and Trademarks, Union Place, Colombo 2, in the prescribed form and should contain:

* request for the registration of the mark.
* name, address and description of the applicant and if resident outside Sri Lanka, a postal address for service in Sri Lanka.
* four copies of a representation of the mark.
* a clear and complete list of the particular goods or services in respect of which registration of the mark is requested with an indication of the corresponding class or classes in the international classification.

If filed through an agent, the application should be accompanied by a power of attorney.

The application is then subject to an examination by the Registrar.

Fees

The Gazette Extraordinary of 31-10-1979 carried all official fees relating to filing, registration, and annual renewal, fees.

Industrial Designs and Models: Basic Laws

Duration: The period of protection is five years, with renewal for two consecutive periods of five years each, on payment of renewal fees. Protection of industrial designs applies only to new designs. 'Industrial designs' means any composition of lines, or colors, or any three dimensional form (whether or not associated with lines or colors), that gives a special appearance to a product of industry or handicraft, and is capable of serving as a pattern for a product of industry or handicraft.

Application: The application must be made by the owner to the Registrar of Patents and Trade Marks. The application must contain:
* The name, address and description of applicant; if the applicant resides away from Sri Lanka a postal address for service in Sri Lanka must be included.
* a specimen of the article embodying the industrial design, or copies of a photographic or graphic representation of the industrial design, in color where it is in color, or drawings and tracings of the design.
* an indication of the kind of products for which the industrial design is to be used.
* a declaration that the design is new to the best of the applicant's knowledge.

Where the application is filed through an agent it must be accompanied by a power of attorney. Right of priority is given to an applicant from a State which is party to the Paris Convention on Industrial Property.

Novelty: A new industrial design shall mean an industrial design which has not been made available to the public anywhere or anytime.

Rights of registered owner of industrial design

The registered owner of an industrial design has the following exclusive rights in relation to the industrial design:
* to reproduce and embody such industrial design in making a product.
* to import, offer for sale, sell, or use, a product embodying such industrial design.
* to stock for the purpose of offering for sale, selling, or using, a product embodying such industrial design.
* to assign or transmit the registration of the industrial design.
* to conclude licence contracts.
* No person shall do any of the acts earlier referred to without the consent of the registered owner of the industrial design.
* If done by any unauthorised person, these acts shall not be lawful solely by reason of the fact that the reproduction of the registered industrial design differs from the registered industrial design in minor respects, or that the reproduction of the registered industrial design is embodied in a type of product different from a product embodying the registered industrial design.

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6.03 Legal and Administrative Limitations on Licensing

The law does not state that government approval is necessary for licensing agreements, although any agreements between principals and companies must be registered with the Registrar of Patents and Trade Marks. If national interest is involved, then the Registrar has the authority to refer the matter to the Central Bank of Ceylon.

There is no priority basis for the granting of approval. The Colombo Thread Company made an application for the registration of 'Astra' thread in 1979 to the Registrar of Patents. It took two years before it was approved.

All patent licences and technical assistance agreements must be first recorded with the Registrar of National Patents and Trade Marks. All royalties must be paid, to have any legal effect. It is possible for a licensee to sue in his own name against infringement of the licensor's patent.

The Controller of Imports and Exports restricts the import territory of a licensee.

A licence agreement cannot outlast the patent right for which it was granted. Before the licence contract expires, should the patent application be withdrawn, or patent application be rejected, or patent surrendered or declared null and void, or if registration of licence contract is invalidated, then the licensee shall no longer be required to make any payment to the licensor under the licence contract. The licensee will be entitled to repayment of the payments already made.

6.04 Royalty and Fee Patterns

Reasonable royalties and technical assistance fees will be permitted. The amount of royalties payable are fixed when the investment proposal is approved. The Foreign Investment Advisory Committee (FIAC) will attempt to strike a fair balance between the actual services received (and the benefit to the country) and royalties payable. The GCEC has not issued any guidelines.

Though no guidelines are actually specified, the FIAC will usually approve fees of 1-3%, (rarely 5%) on turnover. The maximum period is usually 5 years. However, FIAC is flexible on the matter. Lumpsum payments are allowed.

Usually, only firms in a manufacturing industry can obtain the permission for technical service fees. The J. Walter Thompson Company, USA, and Hindustan Thompson Associates Ltd, India, set up a joint venture advertising agency in Sri Lanka with local collaboration. Their request to the FIAC for a 3% technical service fee was turned down.

Capitalisation of technology (e.g. equity for knowhow) is permitted, but not favored -- in part because of valuation problems. However, it is sometimes granted. In one case, even pre-operating expenses -- mainly travel costs -- were allowed to be capitalised.

The government does not generally favor requests to pay royalty for marketing foreign brand bames or trade marks in Sri Lanka, but has approved them on occasion.

There are usually no difficulties with respect to remittance of technical service fees. The Exchange Control authorities approval is required, along with an auditors' certificate.

Though there is no legal restriction on payment of interest, FIAC usually fixes the rate of interest which may be paid.

Some examples of fees and royalties in Sri Lanka:

o The Colombo Thread Company Ltd has been allowed to remit 2% of net sales value (less the cif value of imported raw materials) to the parent company as a fee for unspecified technical services. This figure is below the company's international norm.

o Sri Lanka Tyre Corp, which has a technical collaboration -- including use of the trademark -- with Goodrich Tyre Co (US) was permitted to pay 2-1/2% on turnover as royalties/technical service fees.

o Two textile mills in the private sector are paying 10%, and 22% of net profits, respectively, to two Indian firms under management contracts.

o When five government mills were brought under foreign management contracts, the terms given were:
* Tootals of UK: 2-1/2% on inputs (costs)
* Bombay Dyeing: 2% on turnover, or 35% of net profit to be reduced gradually
* Others: 30-35% of net profits. The periods were for upto 7 years.

7.00 REMITTABILITY OF FUNDS

7.01 Exchange controls

Exchange controls are imposed outside the export processing zone, but these are formalities and approved foreign projects should anticipate little trouble with exchange controls under the present government.

When the UNP government came to power, the former dual exchange rate system was abolished. A unified rate of exchange was introduced and the rupee permitted to float. In consequence, the Foreign Exchange Entitlement Certificate (FEEC) Scheme was abolished. Exchange rates are announced daily by the Central Bank. However, in November 1982, the Central Bank decided to deal with commercial banks only in US dollars (rather than a range of foreign currencies) and allow the commercial banks a crack at the foreign exchange market.

Foreign banks may open and operate non-resident accounts without prior approval of the Exchange Control Department. Domestic Banks can operate accounts for certain categories of non-nationals. Foreign companies need approval from the Exchange Control Department for local borrowing.

The Department of Exchange Control of the Central Bank is the administrative agency. The GCEC Law stipulates that investments that fall within its scope (that is, under agreement with the GCEC) may be exempted from the Exchange Control Act; for these projects, the GCEC is the Administrative Agency.

Capital may be imported for investments in government-approved projects. Investments can also be made from blocked accounts in Sri Lanka in investments approved by the Controller of Exchange. (Blocked accounts are accounts which hold funds of non-residents, repatriates and emigrants which are not permitted to be transferred abroad.)

Foreign currency investments may also be made from special accounts maintained by Sri Lankans working abroad. If these are made in projects approved by the Controller of Exchange, they are exempt from income and wealth tax.

Issue or transfer of securities registered in Sri Lanka to a non-resident requires Central Bank permission. ("Securities" mean shares, stock, bonds, notes other than promissory notes, debentures, debenture stock, units under a unit trust scheme and shares in an oil royalty.) No permission of the Central Bank is required to transfer shares in a company from a non-resident to a non-resident.

Similarly, the permission of the Central Bank is required to issue any bearer certificate of coupon in Sri Lanka, or to transfer it to a non-resident outside Sri Lanka. Only Sri Lankan residents need this permission for transfers to or from Sri Lankan residents.

Permission of the Central Bank is also needed for a resident in Sri Lanka to get payment of capital payable on a security registered in Sri Lanka outside Sri Lanka. Further, where the certificate of title to a security is in Sri Lanka, similar permission is required for a resident in Sri Lanka to secure the payment outside Sri Lanka without production of the certificate to the person making the payment.

The GCEC has indicated that shares in companies falling under its authority may be transferred within or outside Sri Lanka to residents or non-residents, and the country of payment for such shares may be decided between the buyers and sellers.

Loan agreements with enterprises which are not under the GCEC require the approval of FIAC. GCEC has not yet indicated its position relating to loan agreements. Land leased out by the GCEC cannot be mortgaged to a third party.

Controls exist on certain other forms of remittances.

* Commissions to agents abroad for export orders secured may be remitted, with a ceiling of 5% of the c.i.f. value of the export orders.

* Remittances by foreign individuals working in Sri Lanka are also controlled. Remittances of up to two thirds of gross income for family maintenance are permitted; but value limits, which may have the effect of reducing the remittable amounts, apply in some cases. Rules for Indian and Pakistani nationals are more stringent; the upper limit on remittances for these persons is Rs200,000. The individual however, may remit the balance at the time of departure.

* Sri Lanka nationals are not entitled to any exchange for family remittance other than for education in specified catagories.

7.02 Transfer of Profits and Dividends

Companies do not need special permission to remit profits or dividends after income tax clearance, through authorised dealers, though a procedure has been specified. Interim profits or dividends may also be remitted; firms do not have to wait for the final annual report to be made available.

The application for final dividend remittance must contain the following documents:

* audited copy of the company's profit and lose account and the balance sheet for the year to which the remittance relates;
* a certificate from the company's auditors confirming that the amount sought to be remitted represents dividends earned during the period to which it relates and does not include undistributed dividends of previous years or any transfers from the comlpany's reserve or on account of the sale of any of the company's fixed assets;
* a certificate from the secretary/accountant/officer of the company authorized to sign documents on its behalf confirming that the beneficiary is, according to information available to him, resident outside Sri Lanka;
* a schedule certified by the secretary/accountant/officer of the company authorized to sign documents on its behalf indicating the name/names of the beneficiaries and the net amount due to each of them.

If these conditions are not fulfilled, the Controller of Exchange may direct that the amount be placed in a blocked account.

All profits and dividends from investment promotion Zone companies can be transferred without being subject to a remittance tax or income tax.

Profits and dividends declared out of the year's profits could be remitted freely through the commercial banks. Reinvested earnings may count as original investment for purpose of the base of calculating the percentage dividend. No tie up exists between the firm's export earnings and its ability to remit profits.

7.03 Transfer of Interest

Interest, royalties and technical service fees paid by enterprises in the GCEC Area may be repatriated freely in accordance with the agreements entered into with the GCEC. The interest rates payable have to be approved by the Exchange Control Authorities and should be in line with prevailing rates. One foreign joint venture company has been permited to pay 3/4% over LIBOR on a loan from its parent company.

Hotel Services (Ceylon) Ltd -- part-owner of Hotel Ceylon Intercontinental -- is allowed to remit loan repayment instalments, and interest at 6%, to the Export-Import Bank of the United States on account of the Intercontinental Hotels Corporation, New York. Accrued funds have been invested in short term deposits. The current loan agreement with the Export-Import Bank requires that if any cash dividend in excess of 6% is paid to shareholders, a dollar equivalent of the excess must be paid to the bank against the final instalment of the loan due to be liquidated in 1985.

7.04 Transfer of Fees and Royalties

(see 7.03)

Firms will have no problems in remitting fees and royalties, once approved. All royalties and interests are taxed at source. Relief is provided if there is a double taxation agreement.

7.05 Repatriation of Capital

For investments in the GCEC area, the GCEC guarantees repatriation of capital -- including liquidation proceeds -- without exchange control restrictions. The shares in a GCEC company may be freely transferred to residents or nonresidents in or out of Sri Lanka.

The transfer of shares in companies that fall outside the GCEC authority is also freely permitted, provided that the transfer would not affect the prevailing ratio of non-resident shareholding permitted by the FIAC.

For FIAC investments, exchange control permission is required for the repatriation of capital (including liquidation proceeds). Companies should have no problems with foreign investments in approved projects (other than investments made from blocked accounts). Capital may include the proceeds of capital appreciation. The Exchange Control Department will allow a foreign investor to repatriate his capital contribution towards the equity of a company on the sale or liquidation of the investment, after settlement of local liabilities like taxes.

The liquidation and sales proceeds of foreign investments not approved by the government may not be transferred abroad, but may be reinvested in approved projects or transferred to blocked accounts.

Reinvested profits can be transferred once taxes have been paid.

There is no tie-up between a firm's export earnings and its ability to repatriate capital.

7.07 Guarantees against Inconvertability

Under current exchange control conditions, the government does not provide guarantees against inconvertibility.