



EUROPE INFORMATION

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THE EUROPEAN COMMUNITY AND SRI LANKA

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INTRODUCTION

The European Economic Community (EEC) and Sri Lanka have enjoyed a good working relationship with each other ever since 1971, when Colombo established diplomatic relations with the Community. A commercial cooperation agreement (CCA), concluded in 1974, has provided the institutional framework for this relationship, which covers both trade and aid.

The EEC represents a growing market for Sri Lanka's exports of both agricultural products and manufactures. The country's recently established garment industry has found a promising market in the Community, while its traditional trade in precious stones has been stimulated by the cutting and polishing of diamonds for the EEC market.

Sri Lanka is an important beneficiary of the Community's programme of development assistance to countries in Asia and Latin America. It has received a total of nearly ECU 150 mio. over the period 1976 to 1987. Most of the aid has been in the form of (1) food aid and (2) funds for rural development.

I. RECENT ECONOMIC DEVELOPMENTS IN SRI LANKA

Sri Lanka has a population somewhat larger than that of the Netherlands (15.8 million in mid-1985) and an area roughly comparable to that of Ireland (66,000 sq. km.). With a per capita Gross National Product (GNP) of \$ 380 (1985) it is much better off than most of the other 30 or so low income economies.

Sri Lanka had a favourable record of economic growth until the recent breakdown in ethnic relations. In 1985 GDP rose by 5%, which was very much in line with the average growth rate of 5.2% recorded over the period from 1978 to 1985. Sri Lanka in fact withstood better than many developing countries the unfavourable economic climate of the early 1980s. This was due in large measure to the wide-ranging programme of economic liberalization which the United National Party, led by J.R. Jayawardene, introduced in 1977, following its overwhelming victory in the Parliamentary elections.

The 1977 programme, which aimed at liberalizing trade and placing greater reliance on market forces in general, came after 15 years of protectionism. Its success was blunted by the 1979 oil price rise and a fall in demand for Sri Lanka's main exports. But the economy recovered in 1983 and 1984 with the sharp rise in the world price of tea, the country's major export commodity.

Industry's share in the distribution of the country's GDP rose to 26% in 1985, as against 21% in 1965. Over this same period the share of manufactures in Sri Lanka's total exports rose to 27%, as compared to a mere 1% in 1965. But garments have accounted for a substantial part of these new exports, largely because a highly protected home market has encouraged firms to produce for this market. However, in February 1987, the government approved a major industrial policy statement which favours less tariff protection for domestic manufacturers, as well as more attractive price incentives for exporters.

The continuing escalation in the ethnic conflict has inevitably put a heavy strain on Sri Lanka's economy. It has created a climate of uncertainty, while the rise in security-related spending has added to the pressure on the country's foreign exchange reserves. The debt service burden was expected to reach 30% of export earnings in the period from 1986 to 1988, despite the high percentage of concessional foreign aid.

Sri Lanka's social indicators, such as those relating to health and education, remain among the most positive in the developing world. Life expectancy at birth was 70 years in 1985. The average annual population growth was 1.4% between 1980 and 1985. The percentage of married women using contraception was a high 57% (in 1984). The numbers enrolled in school were also very high (as a percentage of the age group).

II. DEVELOPMENT OF EEC-SRI LANKA RELATIONS

Sri Lanka established diplomatic relations with the European Community in 1971. Britain's accession to the Community in 1973, and the declaration by the enlarged Community of its intention to develop trade relations with Asian members of the Commonwealth, led Sri Lanka to seek a more formal relationship. In 1974 it requested negotiations with a view to entering into a commercial cooperation agreement along the lines of the one the EEC had concluded with India the year before.

Negotiations opened in November 1974, and were successfully concluded the following month. The new agreement was signed on 22 July 1975 and came into force on 1 December 1975. A 5-year agreement, it provides for automatic renewal from year to year unless denounced by one of the parties. Neither side has given any indication of this so far.

- EEC-Sri Lanka Commercial Cooperation Agreement (CCA)

The CCA is a non-preferential agreement which seeks to develop trade between the EEC and Sri Lanka "to as high a level as possible" on the basis of comparative advantage and mutual benefit. The two sides undertake to "promote the development and diversification" of their trade with each other and to take "all appropriate steps" to this end.

The CCA also provides for economic cooperation, "when linked to trade" and "in the light of developments in their economic policies". This is a reference to the fact that the Community's jurisdiction does not extend as yet to all areas of economic activity. Cooperation, like the Community itself, must therefore follow an "evolutionary" pattern.

Cooperation is not confined to the activities within the Community and Sri Lanka: the agreement provides that the two sides will try to "increase their cooperation in commercial and related economic matters in third countries, so far as it is in their mutual interest".

The Community and Sri Lanka agree to grant each other most-favoured-nation (MFN) treatment in their trade. However, the Community undertook to bind tariff reductions and suspensions which it was already applying autonomously to six products: dessicated coconut, tea, whole pepper for industrial use, cinnamon, cardamon and East India kips (calfskin). This commitment was implemented, on an MFN basis, in the course of the Tokyo Round of multilateral trade negotiations in the GATT.

In a declaration on tariff adjustments, the Community stated its willingness to take Sri Lanka's export interests into account when making improvements to its generalized system of preferences (GSP), introduced in 1971, and to examine in the EEC-Sri Lanka Joint Commission the possibilities for further tariff adjustments. Sri Lanka has availed itself of this possibility on several occasions, seeking duty-free entry for a number of products of export interest to it.

The general supervision and implementation of the CCA has been entrusted to a Joint Commission (on which the Community is represented by the European Commission, assisted by representatives of its Member States). The Joint Commission is required to devise ways of overcoming trade barriers, encourage economic and commercial cooperation and facilitate exchanges of information and contacts on all relevant subjects.

III. OPERATION OF THE COMMERCIAL COOPERATION AGREEMENT

Implementation of the CCA did not begin in earnest until 1978, the year after the Sri Lankan government had embarked on its wide-ranging policy of economic liberalization, which included the liberalization of foreign trade and the encouragement of foreign private investments. When the Joint Commission met in 1978 the Government therefore sought the Community's help in building up its export industries and attracting European capital for joint ventures.

- Industrial cooperation remains an important area of activity. Although the prevailing climate of uncertainty is not conducive to fresh foreign investment, the fact is that Community enterprises account for around 30% of foreign investment in Sri Lanka. The Sri Lankan government was expected to ask the European Commission during the November 1987 meeting of the Joint Commission to provide the services of an investment consultant, who would help identify sectors which offer scope for further cooperation between Sri Lankan and Community enterprises. Such a project could eventually form the basis of a cooperation policy along the lines set out by the European Commission in its Memorandum of December 1986, on industrial cooperation with the Asian and Latin American countries.

Potential sectors cover a wide range. Those for which Sri Lanka is seeking European cooperation include soft toys and handicrafts as well as fisheries.

- Trade promotion has been an important feature of the technical and financial assistance provided under the CCA. Thus in 1979 the EEC helped financially with the publication of a Sri Lankan Export Directory. A new edition is now planned, for which the Community is likely to provide funds.

When Sri Lanka set up trade centres in Copenhagen and Dusseldorf in 1980, the EEC gave financial help. It has also provided the services of experts in such varied fields as jewellery and leather goods; in 1984 it met the costs of an advisor who was based at the Sri Lankan Mission to the EEC in Brussels.

The Community has also helped Sri Lankan experts obtain further training with Community organizations, such as the Irish Export Board, and paid for market surveys. Finally, the Community has subsidized Sri Lankan participation in numerous trade fairs throughout the Community.

This wide array of activities was conducted nevertheless on a largely ad hoc basis. As this situation was not unique to Sri Lanka, the EEC Council of Ministers decided on an integrated approach to trade promotion generally in April 1986. Under this new approach trade promotion is defined as the "development of trade in goods and services". It gives the European Community the possibility of providing technical and financial help from before the production stage - the processing of raw materials, for example - up to the final distribution. The Community is also prepared to help developing countries draw up an overall trade promotion programme policy which integrates the development of human skills, products and markets.

These guidelines were presented to Sri Lanka at the 1986 meeting of the Joint Commission, which expressed its agreement with them. The projects being implemented at present fit in very well with these guidelines, although they predate them. Under the most important projects the EEC is already providing technical assistance to the jewellery industry in production, design and marketing, both through the jewellery school in Colombo and through design scholarships for study in the EEC.

Two projects for which preparations are under way call for technical assistance to the leather industry and to exporters of packaged tea. European experts will provide advice on tanning and processing leather, help develop new design skills and recommend trade opportunities. Under the second project exporters will be given help with marketing packaged tea in the Middle East. The EEC has also undertaken to assist the Department of Commerce by providing technical assistance for the installation of a computerized system for export statistics and information retrieval.

IV. THE GENERALIZED SYSTEM OF PREFERENCES (GSP)

Sri Lanka has been a beneficiary of the Community's GSP scheme since its inception in 1971. In the early years exporters took advantage of GSP benefits mainly for their processed agricultural products, such as coconut oil, dessicated coconut, spices, etc. Once Sri Lanka began to develop its exports of manufactures it made greater use of the GSP benefits available to it.

Even so, Sri Lanka is far from exploiting GSP benefits to the full. In 1986 exports of manufactured products enjoying GSP benefits rose by 7% - but there was a fall of 40% in the case of agricultural products, especially processed coconuts, vegetable oils and packaged tea.

Sri Lanka did much better as regards textile products. There was a 14% increase in its GSP exports of coir and other products in 1986. The EEC reintroduced tariffs on three products covered by the Multifibre Arrangement, the GSP limits for 1986 having been exceeded, in one case (socks) by nearly 3,600%. The projected changes in the Community's GSP scheme for textiles and clothing should favour Sri Lanka.

Sri Lanka has been seeking duty-free entry under the Community's GSP scheme for a number of agricultural products, such as flowers, plants, vegetable oils as well as canned tuna.

V. EEC-SRI LANKA TRADE

The EEC is a major trading partner for Sri Lanka, as the following Table shows:

Sri Lanka's main trading partners (in %)

	<u>EXPORTS</u>			<u>IMPORTS</u>		
	<u>1973</u>	<u>1984</u>	<u>1985</u>	<u>1973</u>	<u>1984</u>	<u>1985</u>
EEC-10	15.6	16.4	19.4	19.0	14.0	15.5
United States	6.9	19.5	22.3	9.0	8.9	7.1
Japan	4.7	4.2	5.1	8.8	16.7	15.4
Indian Sub-continent	8.7	4.7	4.3	6.9	7.4	6.7
ASEAN	11.9	1.5	4.8	11.9	9.3	7.3
Oil exporting countries	-	16.2	12.3	-	21.8	21.7

Source : IMF-
Direction of Trade

The following Table shows the evolution of EEC-Sri Lanka trade in 1973 and in recent years:

EEC-Sri Lanka Trade, 1973 and 1983-86
(million ECU ⁽¹⁾)

	<u>EEC exports</u>	<u>EEC imports</u>	<u>Balance</u>
1973	78	87	- 9
1983	375	283	92
1984	385	375	10
1985	376	373	3
1986	310	341	- 31

(¹) The ECU is the European unit of account. It is a "basket" unit, based on a certain quantity of each Community currency. In 1986, 1 ECU was equivalent to US\$ 0.98.

Source: Statistical Office of the European Communities.

The changes in the range of goods exported by Sri Lanka are evident from the following table:

Sri Lanka's Major Exports to the EEC, 1973 and 1984-86
(million ECU)

	<u>1973</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
TOTAL EXPORTS	87	375	373	341
A. Agriculture and food products	59	191	168	129
of which, Tea	44	123	87	61
Coconuts	8	36	39	23
B. Primary & Energy Products	22	49	53	56
of which, Natural rubber	11	29	25	24
C. Manufactured goods	6	127	149	162
of which, Diamonds, cut	-	13	20	32
Clothing	0.1	83	86	9

- Sri Lanka's Textile and Clothing Exports

The rapid growth of Sri Lanka's textile industry is one of the country's major success stories. Sri Lanka's exports to the EEC are governed by a bilateral agreement concluded under the Gatt Multifibre Arrangement. The agreement was renegotiated in 1986, following the renewal of the MFA itself.

The new agreement is for four years (1987-1990) but could be extended by a year. It reflects Sri Lanka's position as a low-income developing country, by providing its exporters additional export opportunities. Annual growth rates have been increased substantially, in relation to the earlier agreement, and the number of items subject to quantitative restrictions (annual quotas) has been reduced from 6 to 4. The new agreement has special provisions to encourage EEC firms to sub-contract garment manufacture to Sri Lankan firms.

The following table shows Sri Lanka's textile and clothing exports to the Community in recent years:

Sri Lanka: Textile and clothing exports to the EEC, 1979 and 1984-86
(tonnes)

	<u>1979</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
All MFA products	2,238	5,014	5,706	7,022
Textiles	309	617	1,094	1,107
Clothing	1,929	4,397	4,612	5,915

The European Community's exports to Sri Lanka consist largely of machinery of all kinds, together with their spare parts; transport equipment; chemical and steel products. But the Community also exports unworked diamonds, which are re-imported after cutting and polishing.

VI. DEVELOPMENT ASSISTANCE

Sri Lanka has received development aid from the inception of the Community's programme of technical and financial aid to developing countries in Asia and Latin America. In the first year it received a total of ECU 4.2 million; this had risen to ECU 36 million in 1987. Between 1976 and 1987 Sri Lanka will have received a total of ECU 148 million, under a variety of Community aid programmes. To this must be added ECU 650,000 representing aid to displaced persons in 1985 and 1987.

Roughly half the total amount (ECU 70 million) has been devoted to rural development projects, especially in the context of the Mahaweli scheme. Food aid has accounted for much of the remainder (ECU 69 million). Other forms of development aid provided by the Community include trade promotion (ECU 3.3 million), energy cooperation (ECU 3 million) and help to European voluntary organizations active in Sri Lanka (ECU 2.3 million).

- Rural Development

Since 1977 the EEC has been contributing to the realization of the ambitious Mahaweli scheme, which involves the construction of dams, electricity generation and the development of irrigation. It made a contribution of ECU 15.4 million in 1980 and one of ECU 20 million in 1983 to help co-finance rural development schemes on the left bank of the Mahaweli Ganga river.

In 1987 the Community joined the World Bank and Canada in co-financing an ECU 62 million development project on the river's right bank. It is providing ECU 25 million in foreign exchange and making available to the Mahaweli authorities another ECU 25 million in counterpart funds generated by its food aid to Sri Lanka.

The right bank project involves the construction of 75 km. of irrigation canals and the resettlement of 14,000 families, mainly of Tamil origin. Projects undertaken so far in the framework of the Mahaweli scheme include the construction of low-cost housing, development centres and training programmes.

- Food Aid

The EEC has provided substantial quantities of cereals to Sri Lanka under its food aid programme. The allocation for 1987 was provisionally fixed at 55,000 tonnes, and included 10,000 tonnes for distribution to drought victims. In keeping with its decision to use food aid for development purposes, the Community has expressed its willingness to provide skimmed milk powder (SMP) for a dairy development project, similar to India's "Operation Milk Flood."

In 1986 the Community provided 300 tonnes of SMP for refugees of both Tamil and Sinhalese origin. This aid was in addition to the Community's regular food aid programme.

Food Aid Shipments, 1982-87
(tonnes)

	Cereals	Skimmed Milk Powder	Butteroil
1982	37,000	-	-
1983	40,950	-	-
1984	30,400	400	-
1985	40,000	-	-
1986	40,000	300	-
1987(1)	55,000	1,200	100

(1) Provisional

- Energy

The Community made available to the Sri Lankan government the services of a senior energy advisor in 1981. His main task was to indicate ways of reducing the country's dependence on imported oil. As a follow-up to this the EEC sponsored a South Asian Regional Seminar on Energy in 1985.

The Community has also provided technical help for the development of renewable sources of energy. An early successful project involved using solar energy to dry tea. Other projects have included the development of small-scale hydro-electric schemes and windpower.

VII. SOUTH ASIAN ASSOCIATION FOR REGIONAL COOPERATION (SAARC)

As a regional grouping, the European Community encourages regional cooperation among developing countries. It has supported the efforts of Sri Lanka and its six South Asian neighbours to form a regional grouping of their own.

The first South Asian Regional Conference, held in New Delhi in 1983, was attended by Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka. It led to the formation of the South Asian Association for Regional Cooperation (SAARC), with its own Secretariat, located in the Nepalese capital, Katmandu. In 1986 the SAARC heads of state or government undertook "to promote the welfare of the peoples of South Asia, to improve the quality of life, to accelerate economic growth, social progress and cultural development."

The Community has provided SAARC financial aid for developing regional projects in the fields of energy and transport. It has also given the Nepalese Government logistical support in organizing the third meeting of SAARC heads of state or government in 1987.

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The head of the European Commission's Delegation to South Asia also deals with EEC-Sri Lanka relations. The Delegation's offices are located in New Delhi, India. Consideration is being given to the possibility of opening an office in Colombo.

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