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Responding to Global Economic Challenges: Eight Priority Trade and Competitiveness Reforms for Sri Lanka

Global trade is entering a period of turmoil that is likely to be more acute and more challenging than during the Covid-19 pandemic five years ago. Smaller economies like Sri Lanka that depend on international markets and who have benefited from a relatively predictable international trading system, will be worst affected. Sri Lanka's trade and competitiveness reforms remain perpetually an 'unfinished agenda'.

This CSF Policy Note outlines eight (8) key trade and competitiveness reforms and strategic initiatives that Sri Lanka must now prioritize, to build resilience and success: 1) Doubling down on tariff and para-tariff liberalization; 2) Designing credible trade adjustment support; 3) Implementing a focused National Export Strategy; 4) Deepening and widening trade partnerships; 5) Enhancing trade negotiation capacity and private-public consultation; 6) Rethinking strategic international engagement; 7) Advancing commercial diplomacy; and 8) Accelerating trade facilitation.

Sri Lanka in an evolving global context

On the 2nd of April 2025, the President of the United States announced what is considered to be the single biggest trade shock in US history. Sri Lanka was featured high on the list at 44 percent, the highest in South Asia, and 6th overall, behind Vietnam. This announcement by the world's largest importer sent shockwaves across global markets.

The US is Sri Lanka's top export destination, accounting for 22 percent of total exports. It also accounts for 40 percent of Textile and Garment exports, which is Sri Lanka's main merchandise export and was the second highest source of gross foreign exchange income in 2024.

Therefore, reactions to the announced tariffs and trade reforms have taken centre stage in public discourse, with President Anura Kumara Dissanayake appointing an expert committee to strategize Sri Lanka's response, writing a letter to President Donald Trump on pathways to reduce the tariffs, and facilitating discussions with the US Trade Representative (USTR).

While the full extent of the Sri Lankan response and plan of action are yet to be made public by the government, many of the short- and medium-term strategies that are commonly discussed and recommended are not novel or unknown in the country's policy landscape. Their histories range from never moving beyond conceptualization, to partial implementation, and lack of consistent implementation.

So, the challenge that Sri Lanka faces now is not a purely technical one - in identifying and formulating the best possible strategies – but also a political one, in learning from and avoiding past failures to meaningfully follow through with identified reforms and strategies. Putting it simply, instead of reinventing the wheel, Sri Lanka must recognize the usefulness of previous reform efforts, understand what worked and what didn't, and double down on implementation.

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At the time of writing, the future of the proposed tariffs are uncertain, with President Trump having announced a "90 day pause" on the so-called 'reciprocal tariffs' (with the exception of China), imposing only the universal 10 percent tariff. However, as the trade war escalates with China's retaliatory response, and with countries scrambling to make bilateral deals with the US, Sri Lanka must navigate this new normal in international trade while mitigating impacts to its people and firms.

Many of the reforms and strategic initiatives discussed below are vital for refocusing and prioritizing today. In this Policy Note, we highlight that a) many of these are not new, were initiated in the past but remain an unfinished agenda, b) the present government must recognize the purpose and objectives with which they were crafted, identify their use today, and adapt them as necessary to suit the present context; and c) ensure focused and holistic implementation, with appropriate sequencing, and with meaningful and inclusive private-public consultation.

Priority Area 1: Doubling Down on Tariff and Para-tariff Liberalization

Policy intent to reduce and/or remove para-tariffs is not new, but consistent implementation of this reform agenda has been lacking. Since the early 2000s, Sri Lanka progressively garnered the reputation of having a high and complex regime of para-tariffs (Pitigala and Singh 2020; Pursell 2011). Simplifying the tariff structure and phasing out para-tariffs have been a stated policy goal regularly over the past two decades. The letters of intent presented by the government for the three most recent IMF Extended Fund Facilities (2003, 2016, and 2023) feature trade liberalization.

The most considerable effort was during the 2016-2018 period with duty rates of over 1200 tariff lines being removed in 2017 and a time-bound pathway established to remove para-tariffs such as CESS and PAL. However, this process was not completed amidst the multiple and overlapping crises that followed since the October 2018 constitutional crisis.

In June 2024, the Cabinet approved a 'National Tariff Policy' which was to be implemented in three phases from January 2025. Under this, Sri Lanka's tariff regime would be progressively simplified to four bands - 0%, 10%, 20%, and 30%. This reform was a 'Prior Action' required under the second phase of Resilience, Stability, and Economic Turnaround (RESET) Development Policy Operation (DPO) by the World Bank. It was formulated by officials at the Ministry of Finance's Trade and Investment Policy Department, supported by consultations with technical experts and the private sector.

Although the progress of this was unclear amidst the change in government (and the 1st January 2025 implementation date was missed), in the aftermath of the Trump tariff announcement we see Ministers in the present government also referring to it. This builds on the 2025 Budget Speech making reference to the National Tariff Policy and more recently, the Cabinet approval of the formulation of a National Tariff Policy Committee headed by a Deputy Secretary of the Treasury to oversee the implementation of the National Tariff Policy.

Even though industrial policy may have been the more dominant consideration for the imposition of para-tariffs in the early years of their use, fiscal (revenue) implications have become a key factor

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in the continued existence of such tariffs. It is interesting that even in the newly formed Tariff Policy Committee, the Ministry of Finance is taking a lead role, as revenue considerations would necessarily need to be accounted for when formulating tariff liberalization policies.

Priority Area 2: Designing Credible Trade Adjustment Support

As unilateral tariff liberalization occurs there would be impacts on domestic industries. Therefore, trade adjustment support is a critical consideration. This was a key consideration in the past as well. In the previous 2016-2018 push for trade liberalization, an accompanying Trade Adjustment Programme (TAP) was designed considering the potential impact to firms and workers. There are two salient points of that programme which are relevant today to designing credible trade adjustment support in the short- to medium- term.

Firstly, trade adjustment support must be underpinned by a rational and evidence-based approach. The TAP benefited from international technical expertise in developing a model to review the situation for each product sector and to assess the likely impacts of liberalization.

For instance, the model assessed the level of protection enjoyed, alongside production dynamics, employment trends, and firm growth. Analysis of how product sectors have performed during the period under which they enjoyed para-tariff protection, the number of establishments that exist, the number of workers, and the level of production (and even exports) over that time, could be observed. It also facilitated assessing impacts along dimensions such as gender and geographical distribution.

Using tools such as this, it was expected that the government would engage in credible and evidence-based discussions at the sector level, rather than simply reacting to individual firm or sector lobbying, and raising unfounded fears among politicians.

Secondly, the Cabinet approved the formulation of a Trade and Productivity Commission and an accompanying Secretariat staffed with trade, industry and statistical experts, to deliver on the TAP. This commission, consisting of economic experts and industry professionals, was to review industry requests regarding the timing of the tariff reductions and related concerns from trade liberalization, alongside the analysis from the analytical tool. This platform for public private dialogue facilitated the gathering of qualitative insights and ancillary considerations from the industry that may not be apparent from a purely data-driven exercise.

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The commission was empowered to then make informed recommendations to the Ministry of Finance on whether to adjust (e.g., a longer phase out) or retain the planned para-tariff liberalization on a particular sector. The committee would also be empowered to identify regulatory and other barriers hindering an affected sector and make recommendations to the Government for their urgent resolution.

As Sri Lanka rushes to formulate its

response and its short and medium-term trade strategy, legitimate industry concerns will arise due to shifts in tariff policies. Unlike economies such as South Korea, Sri Lanka does not have the fiscal space to provide broad-ranging financial support to at-risk sectors such as Textile and Garments. Therefore, leveraging evidence-based and objective criteria, accompanied by a systematic approach to industry consultation, will help to design and implement more meaningful and fiscally-responsible trade adjustment support.

Priority Area 3: Implementing a Focused National Export Strategy

The impacts from the US tariff increases are acute particularly due to Sri Lanka's high reliance on a select few export sectors concentrated on a few export markets. This two-stage concentration is symptomatic of a chronic aversion to export diversification, with the composition of key exports virtually unchanged since mid-1990s. In stark contrast, regional peers such as Viet Nam and Thailand have diversified exports significantly by tapping into global production networks. Successful export diversification not only requires stringent policies, but also evidence-based strategies.

Sri Lanka has not been serious about export diversification, even when it had world-leading technical expertise at their disposal. The National Export Strategy 2018-2022 (NES) was developed with assistance by the International Trade Centre. While initially budgetary allocations were provided for implementation, the NES was not fully implemented amidst the intervening political circumstances and bureaucratic delays. However, this strategy consists of many lessons and approaches that can inform a renewed effort to implement an export strategy.

The strategy included targeted sector-specific interventions for high-potential export sectors.

Firstly, in addition to international expertise, the strategy was formulated through the participation of a range of local stakeholders across sectors and geographical regions in the country. So, the strategy reflected industry desires and was rooted in private sector and international market realities. Secondly, the strategy included targeted sector-specific interventions for high-potential export sectors. For example, the strategy for the IT-BPM sector consisted of a two-pronged approach: initially to create a business enabling environment and subsequently launching a unique public-private collaboration to provide next generation IT companies with targeted financial market access and promotional assistance. Thirdly, there was a key focus on general exporter innovation and upgrading through targeted financing such as the Export Market Access Support Program which focused on existing small exporters and new entrants.

The 2025 budget speech announced the development of a National Export Development Plan for 2025-2029. While the details of this plan are still not public, the government does not have to 'reinvent the wheel' - the NES can inform the contours of a new strategy. A crucial lesson to be learnt through the experience of the NES is to delink the implementation of such comprehensive strategies from the political cycle by garnering bi-partisan support.

It is encouraging to hear that a multi-party discussion on the implications of and response to the US tariff increase was convened. Such efforts must be sustained well beyond the immediate crisis period to ensure that implementation is followed through.

Priority Area 4: Deepening and Widening Trade Partnerships

Though Sri Lanka is unique in being the only country to have bilateral free trade agreements (FTAs) with both India and Pakistan (entered into in 2000 and 2005, respectively), it has since been slow at pursuing bilateral and multilateral trade integration.

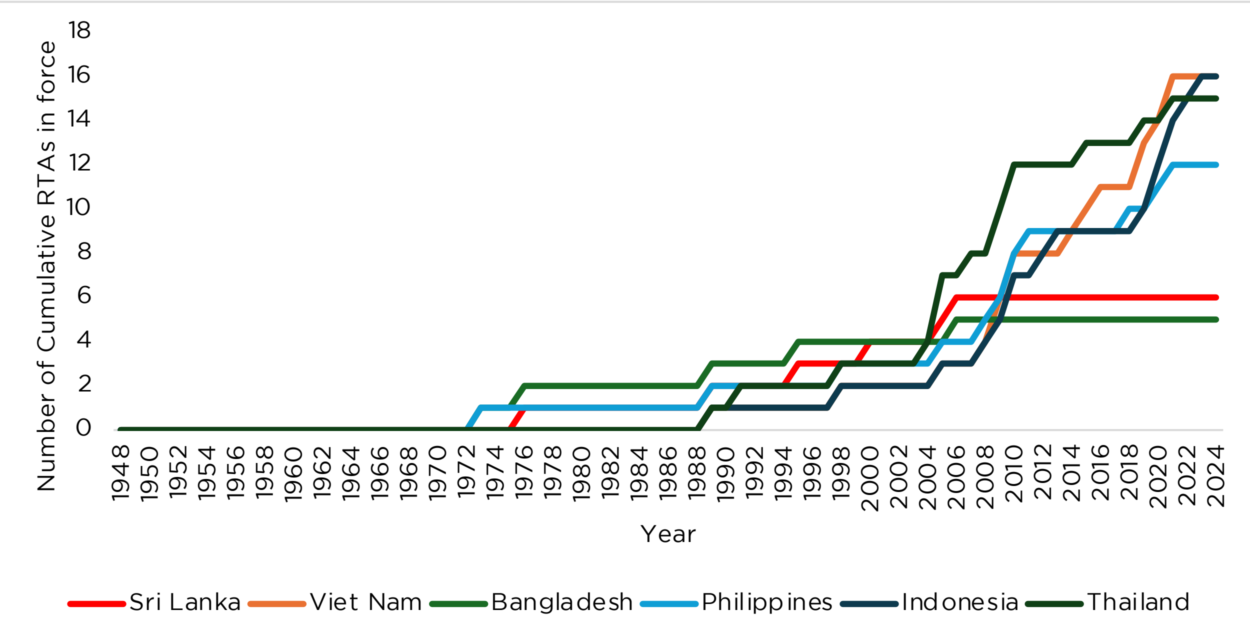
Only in recent years have two new agreements, with Singapore and Thailand, been signed. Even then, there appears to be a regression – while the Singapore and Thailand FTAs were comprehensive ones (going beyond goods, to investment and services), more recent attempts seem to be to forge simple goods agreements (for instance, the Indonesia-Sri Lanka Preferential Trade Agreement).

In sharp contrast, Viet Nam and Thailand have accelerated forward with their trade integration – both bilaterally, as well as through mega-regional agreements like RCEP and CPTPP (See Figure 1). Sri Lanka's trade partnerships lack both width (number of partners), and depth (level of integration). For comparison, Viet Nam's 16 trade agreements cover more than 60 countries accounting for almost 90 percent of global GDP.

Contemporary trade agreements are deeper and more complex than Sri Lanka's existing bilateral agreements with India, Pakistan, Singapore and Thailand. The focus now should be on agreements like RCEP and CPTPP that pin Sri Lanka down to undertaking deeper and more modern trade and investment reforms.

Meanwhile, a priority must surely be the conclusion of negotiations on the Economic and Technology Cooperation Agreement (ETCA) with India – the 14th round of which has been pending for nearly a year now. Sri Lanka would need to insist on asymmetric treatment as a fundamental principle of the agreement and seek an 'early harvest' programme that includes the increase of the

Figure 1: The evolution of RTA adoption among selected peer countries (1948-2023)



Source: WTO RTA Database

garments quota from the current 8 million pieces. If the ETCA will not include an investment chapter (according to India's new policy approach), then we must swiftly update our Bilateral Investment Treaty.

Priority Area 5: Enhancing Trade Negotiation Capacity and Private-public Consultation

For the ambitious trade integration agenda set out above, Sri Lanka desperately needs to increase its capacity for handling complex and comprehensive trade negotiations. It wouldn't be an exaggeration to say that Sri Lanka's trade negotiation capacities are currently in dire straits. There is no longer a fully-fledged negotiation team in place, and no chief negotiator. In fact, Sri Lanka has never had a firmly established, institutionalized mechanism for trade negotiation teams.

The teams are usually brought together from different institutions to work together for the duration of a specific trade agreement, and then are disbanded. Some of them are brought together again for the next one, but some are not. So, there is little institutional memory that is built up and preserved over time.

Efforts to establish an Agency for International Trade (in 2017-18) fell through. More recent efforts to establish the Office for International Trade (first under its own Act, but later subsumed under the omnibus 'Economic Transformation Act') are uncertain. Due to the latter, the Department of Commerce was also placed in a state of unease and uncertainty. Having a permanent entity with a clear and specific mandate of pursuing trade agreements, with robust institutional mechanisms, is essential. Cobbling together officials and independent experts on an ad hoc basis can no longer be the norm.

In contrast to Sri Lanka's situation, the country we most recently concluded an FTA with – Thailand – has a fully-fledged 'Department of Trade Negotiations'.

What this also helps with is more robust and transparent private-public consultation. We see many instances where industry input into trade negotiations can be ad hoc, unpredictable, and poorly managed. This creates uneven influence for some parts of the private sector over others, it creates risks around elite capture, it fosters distrust around the consultative process and hurts negotiators' ability to seek actionable and credible insights (on both offensive and defensive interests).

Overall, a more permanent and robust entity to handle trade negotiations, coupled with an institutionalized process for private-public consultation, is critical for Sri Lanka to advance its trade relationships in the short- and medium-term. It can help minimize Sri Lanka's chronic adhockery in trade policy formulation, facilitate grounded identification of defensive and offensive interests, and build enthusiasm and confidence around trade integration among domestic stakeholders.

Priority Area 6: Rethinking Strategic International Engagement

The US tariff increase and subsequent responses by other countries and regions are disrupting the established world trade order. Countries are leveraging various regional and intergovernmental platforms when formulating their responses, and finding alignment and unity. For instance, the ASEAN members issued a joint statement on the US tariff increase, calling for the WTO to anchor dialogue on how to navigate the shocks. Sri Lanka risks being isolated, as we do not have an active bloc of influence to rely on during crises like this. Sri Lanka's efforts have focused on forums such as SAARC, IORA and BIMSTEC, but these are ill-equipped to support countries amidst the current threats. SAARC - the only regional cooperation bloc Sri Lanka is part of - is unable to provide the platform leadership that smaller economies like ours desperately need.

As countries intensify efforts to form new blocs of shared interest (for instance, China's attempts to woo Australia, and the potential trilateral agreement between China, Korea, and Japan) Sri Lanka too must strategically leverage any opportunities instead of ad hoc partnerships. The Ministry of Foreign Affairs must spear head such an effort with a medium- and long-term vision. This strategizing also includes the decisions on whether to use or not use WTO mechanisms, as seen recently by the different approaches other countries have taken.

Priority Area 7: Advancing Commercial Diplomacy

The foreign service and commercial officers are Sri Lanka's front line when facilitating entry into frontier export markets and responding to international shocks such as the US tariff increases. Therefore, commercial diplomacy plays a crucial role in the trade policy machinery of Sri Lanka. A study conducted by CSF in June 2024 for the Sectoral Oversight Committee on International Relations of the 9th Parliament highlighted that Sri Lanka's commercial diplomacy apparatus suffers from issues ranging from a lack of clear vision and long-term strategy, low funding and resources, unclear monitoring and evaluation, and a highly fragmented institutional environment with competing and overlapping mandates.

Key stakeholders highlighted that due to resource constraints, commercial officer postings are often held vacant when officers retire or shift postings. This leads to either foreign service officials lacking necessary skills and expertise engaging in commercial diplomacy, or staff assigned for commercial affairs experiencing mission creep due to increasing consular work. Due to limited and strict budget constraints and procedures, often officers find it unable to participate in strategic opportunities. In a space where professional network building pays considerable dividends, Sri Lanka's commercial officers lack the conducive environment to be entrepreneurial. Literature suggests that the existence of diplomatic presence can have a significant impact on trade flows and if conditions are right, increase exports.

As per the Ministry of Foreign Affairs Website as of April 2024, Sri Lanka had 60 missions, and 110 honorary consuls situated in 101 countries globally. Each of these posts had a mandate to advance commercial diplomacy. In addition, 28 such countries were allocated a commercial officer, though some posts were vacant.

While commercial officer postings broadly cover the current major trade partners of Sri Lanka, such postings have not extended to countries with high potential. For instance, a preliminary analysis of Sri Lankan export data from 2014-2023 indicate that Mexico is a country with no diplomatic presence that Sri Lanka has increasingly exported to. In contrast, Kenya and Iraq are two countries with significant growth in exports which have Sri Lankan diplomatic presence but not commercial officers. Jordan is a country in which Sri Lankan exports rapidly bounced back post Covid. It has a Sri Lankan mission but no commercial officer.

As Sri Lanka is pushed to explore alternative markets and forge new partnerships, commercial diplomacy must be utilised as a proactive mechanism. While fiscal constraints persist, policies can focus instead on establishing long-term commercial diplomacy strategies for high-potential economies and bridging the gap between the private sector and the commercial diplomatic apparatus.

It is encouraging to note the recent dialogue which took place between Sri Lankan overseas missions and exporters. Formalising such platforms and fostering consistent engagement is key to align diplomacy efforts with strategic economic needs.

Priority Area 8: Accelerating Trade Facilitation

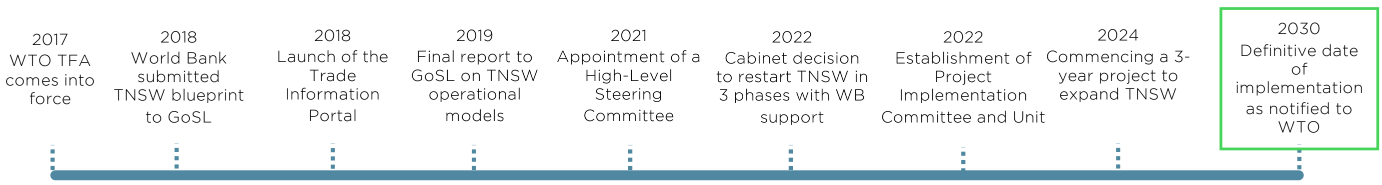
Following the ratification of the WTO Trade Facilitation Agreement (TFA) in 2017, trade facilitation has consistently featured in Sri Lanka's trade policy agenda. However, Sri Lanka's progress in trade facilitation has been slow both in absolute and relative terms. Sri Lanka's notification of TFA commitments as has been far below not only its regional peers such as Bangladesh, Vietnam and Pakistan, but also least developed countries on average. The issue is not just lacklustre implementation (recording only a 2.5 percent increase in implementations in the first 6 years), but also a lack of ambition - Sri Lanka recorded commitments as Category C (requiring both time and external assistance to implement) 1.7 times more than the average Least Developed Country.

Some of the key initiatives undertaken to increase trade facilitation such as the Trade National Single Window (TNSW) and the National Trade Facilitation Committee (NTFC) have been visited and revisited multiple times in the past with little credible progress (Figure 2).

Roadblocks to such initiatives have ranged from lack of consistent funding, to lack of meaningful participation by the relevant stakeholders. In September 2024, the previous government approved a Roadmap and an Action Plan for Trade Facilitation for 2025-2028. The current status of this under the new government is unclear, but an announcement of a three-year project expanding the TNSW was made in February 2025. Encouragingly, Sri Lanka's performance in TFA commitment implementation has improved from 34.9 percent in May 2024 to 58 percent by April 2025.

A critical piece that remains delayed is the introduction of a new customs law, to replace the existing Customs Ordinance. The 2025 Budget speech mentioned that this would be pursued, but it was not the first such announcement. Customs law reform

Figure 2: Long road to 2030 - Progress on the TNSW implementation



Source: Authors' Compilation

has been pending since initial efforts since at least 2016, if not earlier. The focus of the new government in advancing digitalization can give a new impetus to these reforms, as much of the changes needed rely on a holistic approach to digitalization of border control and trade facilitating agencies.

Yet, these latest efforts must appreciate that all changes are not technological in nature - the reforming of people, processes, and incentives structures in these agencies are equally - if not more - important to ensure meaningful and lasting changes are achieved.

The key challenge that the government must tackle is reversing past trends of inconsistent implementation, creeping in of vested interests, and lack of high-level oversight. Maintaining momentum is key, for all stakeholders to recognize that there is commitment to making, and sustaining, change.

Considerations in Implementation

The government must draw on the best possible sources of expertise in the country and ensure an inclusive and transparent process for dialogue and consultation. Advisory committees must better represent the ecosystem of firms in the economy, including ensuring better representation of the spectrum of exporters – not just the large and most obvious firms and their owners.

Public officials who were involved in strategic trade and investment efforts in previous years must be brought in from across the civil service, as they possess institutional memory, technical expertise, and practical insights.

This Policy Note summarizes eight (8) priority areas of reforms and strategic initiatives for Sri Lanka. It is published on the back of the Trump tariffs and their unpredictable roll-out, intensifying trade war between US and China, and turmoil in international trade. While the list may not be exhaustive, it is meant to inform and inspire the renewed efforts by the government to pursue long-delayed reforms. It is also meant to support private sector associations and trade chambers in their high-level policy advocacy. The support of multilateral institutions and development partners are useful to help anchor, and advance, many of these reforms. But they must review previous efforts by successive governments and the lessons from technical assistance programmes provided over the years, to inform a better design of support this time, and improve chances of success.

1. **Doubling Down on Tariff and Para-tariff Liberalization**
2. **Designing Credible Trade Adjustment Support**
3. **Implementing a Focused National Export Strategy**
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5. **Enhancing Trade Negotiation Capacity and Private-public Consultation**
6. **Rethinking Strategic International Engagement**
7. **Advancing Commercial Diplomacy**
8. **Accelerating Trade Facilitation**

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This is a publication under CSF's thematic pillar on: International Trade & Competitiveness

Under this pillar, we conduct research and policy engagement on key issues relating to trade, investment, SMEs and economic competitiveness, with pragmatic recommendations for action by private and public sectors. Past and ongoing work includes research on the nexus between international environmental, regulations and trade, advisory work on policy reforms in FDI, productivity, and SME development, and research for the Parliament's Sectoral Oversight Committee on International Relations.

This Policy Note was authored by Anushka Wijesinha (Director) and Senith Abeyanayake (Research Associate)

@CSFasia
@centreforasmartfuture
@csfasia
@centreforasmartfuture

www.csf-asia.org