

Agricultural Trade Policy in Sri Lanka: The Context and Instruments

Sri Lanka has been relying more on outward-looking strategies for its development since economic liberalisation in 1977. One of the major initiatives taken by the government during the initial phase of economic liberalisation was characterised by promotion of export-oriented industrial manufacturing which subsequently absorbed labour from the rural agricultural sector, which in turn retarded the growth of the latter. The agricultural sector of the country was gradually opened up since the mid 1990s, with direct influences on the prices of agricultural goods and indirect influences on the status of poverty and food security. This article presents the trade policies and instruments used in agricultural sub-sectors, namely, tea, coconut, other field crops, fruits and dairy sectors in Sri Lanka.

1. Trade Policy: The Historical Context

Sri Lanka has a long-documented history of international trade. For example, it has been reported that King Solomon had purchased gems, elephants and peacocks from Sri Lanka in the 10th century B.C. The Portuguese had traded products such as cinnamon, cloves and cardamom during the pre-independence era, whereas the Dutch had introduced two major cash crops, i.e., tobacco and coffee to Sri Lanka. This was in addition to their engagement in exporting cinnamon, betel, spices, coconut oil, coconut fibre, and some sea products. The British exported, mainly, tea, rubber and coconut.

The post-independence era is characterised by interventions on free flow of goods and services by successive governments so as to address the problems of shortage of foreign exchange, overdependence on tea exports, stagnant growth of output and employment and also the overdependence on the British market (Daniels and Radebaugh, 2001). The emphasis varied from import substitution to export promotion from time to time. Four distinct trade policy eras can be identified based on the types

of trade policies implemented over time: (i) 1948-1960, (ii) 1960-1977, (iii) 1977-1988, and (iv) 1988 onwards.

The government interventions on trade were minimal during the period of 1948 to 1960 (i.e., soon after the independence) as the country adopted a liberal trade regime. Agricultural exports dominated the export market where tea, rubber and coconut exports accounted for more than 90 percent of total exports. During this period, over 99 percent of Sri Lanka's exports were primary products, and around 45 percent of the total imports were food items, with rice alone contributing to about 15 percent of total imports (Sandaratne, 2000).

Food self-sufficiency had been the primary policy objective of the country during the period from 1960 to 1977. This era was characterised by imposition of import restrictions that were mainly aimed at encouraging local production, creating employment opportunities and saving foreign exchange. The agricultural policies during this period were mainly targeted at the rice market due to its importance for both consumers as well as producers. The country simultaneously relied on export earnings from its traditional commodities, tea, rubber and coconut.

The economy was progressively liberalised since 1977. This was despite the country's continued restrictions on the importation of certain locally-produced agricultural commodities such as rice, potato, chillies and onions, especially during the early phases of economic liberalisation (i.e., from 1977 to 1988).

The government also took initiatives to develop specific industries with export potentials (viz., processed tea, ready-made garments, and chemical derivatives of coconut oil, edible fats and rubber products) as well as to establish industrial development zones with the objective of getting private sector companies participated in export-oriented production.

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Since 1988, import restrictions were reduced and various incentives were offered by the government to encourage exports of commodities and trading of services. The country signed several trade agreements after 1998 with the intention of achieving economic gains of trade liberalisation.

Sri Lanka is a founding member of South Asia Preferential Trade Agreement (SAPTA) which was established in 1993 to promote and sustain mutual trade and economic co-operation among the member states. One of the most important decisions taken during this period was signing of the World Trade Organisation (WTO) agreement in 1994, with which Sri Lanka bound most of its agricultural tariff rates at 50%. Indo-Lanka Free Trade Agreement and Pakistan-Sri Lanka Free Trade Agreement came into force from 1998 and 2002 respectively.

In 2004, South Asian Free Trade Area (SAFTA) was signed with the intention of enhancing the objectives of SAPTA. In addition, the country signed the Asia Pacific Trade Agreement (APTA) in 2005 for promoting economic development among the developing member countries of Economic and Social Commission for Asia and the Pacific (ESCAP).

The present trade policy objectives of Sri Lanka are characterised by moving towards a more outward-oriented trade regime, strengthening and increasing the overseas market access for Sri Lankan products and further integrating Sri Lanka into the world economy.

2. Agricultural Trade over Time

The trade pattern of Sri Lanka can largely be explained using the trade policy framework adopted by the country. Since the liberalisation of the economy in 1977, it is evident that incentives were given to manufacturers, and in most of the instances, these became disincentives for the agricultural sector. Consequently, the contribution of food and agriculture to the total trade has been declining over time (Figure 1). For example, during pre-trade liberalisation era, the food and agriculture exports were around 60 percent of the total trade while it had declined to around 40-30 percent during the post liberalisation period. The current contribution is around 20 percent in 2005. The food and agriculture imports were around 45 percent during the pre-trade liberalisation era and the contribution declined to around 30 percent with the liberalisation. During 2005, it was around 15 percent of the total trade (UN Comtrade, 2008).

Table 1 and 2 show the values of major agricultural imports and exports of Sri Lanka during 1978 to 2008. According to the Tables, the total food and agriculture trade has been increasing over time though the contribution of food and agriculture to the total trade has been declining.

Table 1 depicts that value of export of tea, coconut and other agricultural products have been steadily rising despite their declining share in relative terms. A significant increase in value of imports is recorded for wheat and milk. About 95% of the total value of milk imports is spent on import of powdered milk.

Table 1: The value of agricultural exports changed over time

Product	1978	1988	1998	2008
Tea	409	384	780	1271.5
Rubber	129	116	44	125.1
Coconut products	81	48	94	171.0
Other agricultural products	46	80	170	287.3

Value of Exports in US Dollars million

Source: Central Bank Annual Reports (various years).

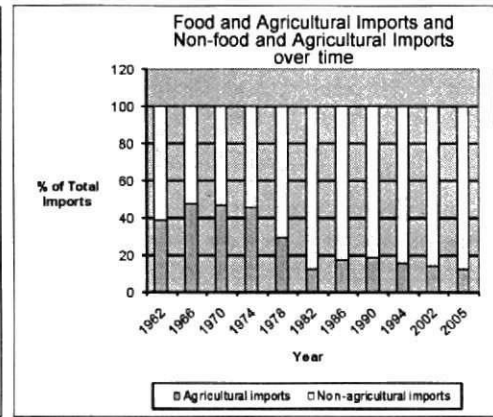
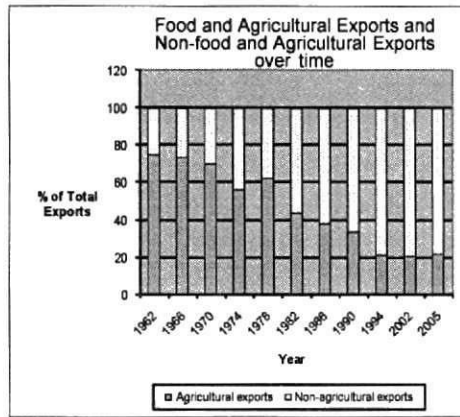


Figure 1: Trade pattern in Sri Lanka over the years

Source: UN comtrade (Food and Agricultural and non-food and agricultural commodities are defined in SITC revision 1)

The values of rice imports do not display a significant change over the years as the increase in local requirement was largely met by the local production. However, wheat as well as milk imports show a significant increment due to the increasing demand (Table 2).

3. Trade Policy Instruments

The most commonly-used trade policy instruments during the recent past comprises of import tariffs, import quotas, export subsidies, cesses and non-tariff barriers such as import licenses, tariff rate quotas, etc. (Box 1). Of them, import tariff is the preferred instrument as it is easy to administer and is widely used.

Import quotas, import licences, tariff rate quotas are implemented occasionally, whereas a renewed interest on imposing cesses on food and agricultural products is visible in the recent past.

The following section focuses on sectoral trade policies of six major agricultural sub-sectors, i.e., paddy, tea, coconut, other field crops, fruits, and dairy.

Paddy sector

Rice being the staple food and cultivation of paddy being the livelihood of the majority of rural agricultural households, the successive governments have enthusiastically intervened in the paddy sector, mainly because of its greater political sensitivity. Interesting parallels could be drawn between the country's food and trade policy initiatives.

During the times when the government implemented universal rice rationing scheme in 1942, the country had to depend largely on imports to meet the domestic requirement. The country imported around 70% of its requirement, and it accounted for 15 percent of the total imports (Sandaratne, 2000). During 1950-70, the government entered into bilateral trade agreements with China and Burma to secure country's rice requirement in reliable quantities.

Along with the introduction of open economic policies in 1977, the rice rationing scheme was replaced by a food stamp program, which was targeted at the poorest households with the objectives of alleviating poverty,

Table 2: The value of agricultural imports changed over time

Product	1978	1988	1998	2008
Rice	44	56	42	43.8
Wheat and Meslin	9	94	127	375.5
Milk and Milk products	25	60	116	296

Value of Imports in US Dollars million

Source: Central Bank Annual Reports (various years)

Box 1
Definitions of Trade Policy
Instruments Implemented in Sri Lanka
at Present

Import tariff

A tariff is a tax imposed on a good imported into a country. A tariff may be specific, when it is levied as a fixed sum per unit of the imported good, or ad valorem, when it is applied at a percentage rate with reference to the value of the import.

Import quota

Import quotas are restrictions on the quantity and or value of imports of specific commodities for some given time period, which are administered globally, selectively or bilaterally.

Import licensing

The administrative procedures requiring the submission of an application or other documentation (other than those required for customs purposes) to the relevant administrative body as a prior condition for importation of goods.

Tariff rate quotas

This import system established a quota and a two-tier tariff regime for affected commodities. Imports within the quota enter at a lower (in-quota) tariff rate while a higher (out-of-quota) tariff rate is used for imports above the concessionary access level

Other Non-tariff barriers

Non-tariff barriers refer to all barriers to trade that are not tariffs. Examples of these include countervailing and anti-dumping duties; "voluntary" export restraints, subsidies which sustain in operation loss making enterprises, technical barriers to trade, and obstacles to the establishment and provision of services.

Export subsidies

Export subsidies consist of all subsidies on goods and services that become payable to resident producers when the goods leave the economic territory or when the services are delivered to non-resident units; they include direct subsidies on exports, losses of government trading enterprises in respect of trade with non-residents, and subsidies resulting from multiple exchange rates.

Cess

A local levy on a commodity / product for a special purpose.

increasing the nutritional status, increasing domestic savings and protecting those from removal of food and non-food price subsidies. The households with a monthly income of less than Rs.300 per month were eligible for food stamps, and 75% of the food stamp purchases constitute rice. In 1978, private traders were officially allowed to buy and sell rice, and the Colombo wholesale market was started.

Along with the food ration program, the government encouraged local production and maintained strict import restrictions on rice. The sole authority of rice importation was with the Food Commissioners Department (FCD) under the Ministry of Agriculture. Importation was done after forecasting the domestic production for the year. Imported rice was distributed through Co-operative Wholesale Establishment (CWE), Multi Purpose Co-Operative Societies (MPCS) and private wholesalers.

The import restrictions on rice were lessened since 1988. The private sector companies were allowed to import rice, based on a licensing and a strict quota system through bondsmen. The level of quota was decided according to the deficit of the domestic requirement. Initially, rice importation was allowed only for three companies which had stored rice in the FCD warehouses once imported. By 1995, there were 10 companies under this system. Import license on rice were abolished in 1996, and since then, the trade policy levels imposed can best be considered as ad-hoc. Table 3 and 4 reveal that the trade policy instruments used for rice imports are of short term in nature.

Tea sector

Sri Lanka is the world's third biggest tea producer. The country produces nine percent of the world production and contributes 19 percent to the total global exports (Sri Lanka Tea Board (SLTB), 2008). The tea industry is one of the main sources of foreign exchange which accounts for more than two-thirds of the total agricultural exports in Sri Lanka (Central Bank of Sri Lanka (CBSL), 2008). Moreover, it is a significant source of income for the

estate labourers who are among the poorest workforce in the country.

In 1934, the government imposed a law to prohibit the export of poor-quality tea in order to secure a better price in the world market for Ceylon tea. An ad-Valorem Tax on exports was first introduced for tea in 1959 (SLTB, 2008).

Imports of tea are subjected to quality controls. Orthodox tea may be imported under a permit, to be blended with domestic tea for re-export. Speciality tea (e.g., green tea, Assam, Oolong, Darjeeling) for which there is no domestic substitute can be imported without being subject to quality control (WTO, 2004).

Under Indo-Lanka bilateral agreement, Sri Lankan exporters are able to utilise a tariff rate quota of 12.5 million kg per annum at a fixed tariff preference of 50% (Mukherji *et al.*, 2002). With the Pakistan-Sri Lanka free trade agreement, Pakistan has granted tariff rate quota for 10, 000 tonnes of tea per annum at zero rate of duty (CBSL, 2007).

The Government levies various types of cesses on tea exports such as the Tea Board cess (Rs. 2.50 per kg), and Tea Medical cess (Rs 0.0035 per kg). In 2006, the cess rate was raised from Rs.2.50 per kg to Rs.4.00 per kg (Exports Development Board (EDB), 2007).

Coconut sector

The coconut industry has been contributing significantly to the country's revenue for a long period of time. The commercial potential of the coconut trading in Sri Lanka was first exploited by Dutch in the 1960's who exported fresh nuts and other coconut products such as coir and arrack. The British started systematic cultivation of coconut as a major export crop in the country. The major products exported at present include copra, coconut oil, desiccated coconut and fresh nuts.

Under the Bulk Purchased Scheme signed in 1942, Sri Lanka agreed to exports its entire amount of copra to the United Kingdom at an agreed price. The experts consider that this scheme was not as beneficial as intended since world market prices were increased in the later years.

Sources: Organisation for Economic Co-operation and Development (2003), Export Development Board (2007).

Table 3: Statutory duty and effective import duties for rice, 1996-2004

Rice	Statutory Duty	Duty Waiver	Effective Import Duty	Total tax incidence
Pre-April 1996	35	0	35	7.6
April 15, 1996 -Jan 30, 1997	35	35	0	44.6
Jan 31, 1997-Nov 20, 1997	35	0	35	44.6
Nov 21, 1997-Jan 31, 1998	35	35	0	7.6
Feb 01, 1998-Oct 23, 1999	35	0	35	44.6
Oct 24, 1999 - Dec 31, 1999	35	25	10	19.6
Jan 1, 2000-May 10, 2000	35	0	35	46.3
May 11, 2000-July 16, 2000	35	0	35	48.0
July 17, 2000-Jan 2002	35	0	35	na
Jan 2002 - Nov 2002	Rs.7 per kg			
Nov 2002 - Mar 2003	Rs.5 per kg			
Mar 2003 - Aug 2003	Rs.7 per kg			
Aug 2003 - Sep 2004	Rs.9 per kg			

Source: World Bank (2003), WTO Trade Policy Review (2004)

Since 1963, export taxes had been imposed based on a sliding scale on various coconut products. Higher export duties are charged from copra products than those from value added products so as to discourage exports of raw products in order to trigger the development of local industries.

During the 1970's, specific duties on coconut products were imposed at a rate of 40-60 percent of the value of exports. This duty structure helped stabilising the domestic prices of coconut products. From 1978 to 1982, fixed duties were applied by the government. Lakshman and Tisdell (2000) state that, due to reduced supply of nuts in the country, exports of kernel products were controlled in 1981 in order to satisfy the needs of domestic consumers. Meanwhile, the government introduced a sliding scale of duties in order to minimise the shortcomings existed in the previous

duty scale and to ensure a greater share of profits from export to the producers. This policy was considered as a more producer oriented. In 1982, export duties were brought to zero, and an export incentive scheme was introduced due to decreasing prices.

Coconut products such as fresh nuts, coconut shells, coconut kernels, young king coconut, coconut rafters, etc., were exempted from obtaining export licensing in 1985. In 1986, the export duties on desiccated coconut and copra were halved while the cesses on desiccated coconut, copra, fresh nuts and coconut oil were suspended. Moreover, in 1987, the export licensing of copra, desiccated coconut, coconut oil and coir fibre were abolished to minimise export documentation work and restrictive regulations.

The liberalisation of edible oil imports in the early 1980s had a significant influence on the demand for coconut oil (Samarajeewa *et al.*, 2002). The edible oil import duty was reduced from 35 percent to five percent for three months in 1996. The cess for desiccated coconut was increased from Rs.1.00 to Rs.2.00 for three years since 1996.

To meet the shortage of copra in the domestic market in 2001, 1000 tonnes of copra was imported under temporary importation for export promotion. The specific surcharge on edible oil was withdrawn in 2002. In 2004, again the tariff band on edible oil was changed from 15 percent to 20 percent.

The export cess for desiccated coconut was again increased from Rs.1000 to Rs.2000 per tonne for three years. The cess is charged by the Coconut Development Authority, and different rates are charged for different products. For example, one thousand fresh nuts, one metric ton of desiccated coconut, one metric ton of coconut oil and copra are subjected to Rs.750, Rs.2000, Rs.400 and Rs.900 cesses respectively.

Besides, the government has imposed Rs.6 per kg cess on imported edible oils in order to raise funds for the development of the coconut industry.

However, increased levies have adversely affected the desiccated coconut industry due to shortage of nuts. On the other hand, the government imposes a 35% import tariff on coconut products.

Other Field Crops

Other field crops have been subjected to various trade policies with the aim of relieving the burden on consumers and safeguarding the semi-subsistence farmers, depending upon the pressure exerted by different groups.

Chilies, onions and potatoes have been highly subjected to trade restrictions. During 1973-1977, when the country adopted an import substitution policy, the imports of chillies, onions and potatoes were highly controlled (Lakshman and Tisdell, 2000). Until 1996, they remained as highly protected crops in the country. Import licenses were eliminated in 1996, and potato chili and onion imports were subject to a variety of policy levels since then (Table 5).

Red onions, big onions, shallots, garlic, leeks and other fresh or chilled alliaceous vegetables were subjected to Rs.10 per kg cess under the Sri Lanka Export Development Act no. 40 of 1979 in 2006.

Table 4: Average Import Duty Collection Rate*

Food and Beverages	2005	2006	2007	2008
Rice	10.6	23.4	3.1	4.2
Flour	3.8	33.7	31.9	24.3
Sugar	1.5	1.9	23.9	2.5
Wheat and Meslin	1.1	5.6	6.3	6.3
Milk and milk products	10.2	9.6	7.7	1.4
Dried fish	5.9	5.0	2.9	2.9
Other fish products	9.8	7.8	4.9	1.4
Other	22.0	24.2	20.8	14.0

* Actual custom duty collection as a percentage of total import value (c.i.f.).

Source: Central Bank Annual Report (2008)

Maize is another food crop that became politically sensitive in recent years (Maize is used in the food industry as well as in the animal feed industry). There is no regular pattern in the importation of maize to Sri Lanka. Twenty five percent (25%) cess was imposed on imported maize in 2008 with the objective of encouraging the local maize farmers (CBSL, 2008).

However, the experts are of the view that desired benefits were not passed on to the maize farmers since animal feed manufacturers imported other complementary raw materials instead of importing maize.

Fruits

Unlike other field crops, imports and exports of fruits and vegetables have not been subjected to high trade taxes with few exceptions. However, a program was implemented in 1997 to subsidise the cost of international transport and freight for fresh fruits. According to the Central Bank of Sri Lanka (2008), in line with the government's plan to increase the current level of fruit production to one million tonnes by 2010 so as to meet domestic requirements and export demand, the existing cess rates on selected categories of imported fruits

were increased substantially, i.e., from Rs. 40 to 60 per kg (CBSL, 2008). In addition, regulations specify that importers of fresh fruits for human consumption must obtain a certificate from the plant protection authority of the country of origin, stating that the fruits have been in cold storage for more than two weeks. However, no certificates are accepted from countries where there are fruit flies, unless they are approved by the Director of Agriculture, Sri Lanka. Regulations require that consignments should be inspected by the respective officer for protection upon reaching Sri Lanka (*United Nations Conference on Trade and Development* (UNCTAD)- Trains, 2004).

Table 5
Statutory duty and effective import duties for potato, onion and chillie

Potato	Statutory Duty	Duty Waiver	Effective Import Duty	Total tax incidence
Pre-July 1996	35	0	35	54.7
July 1996 -Dec 03, 1996	35	0	35	44.6
Dec 04,1996 - Jan 31,1997	35	15	20	28.8
Feb 01,1997-Nov27,1997	35	0	35	44.6
Nov 28,1998 -Jan 31,1998	35	15	20	27.8
Feb 1,1998-Nov 5, 1998	35	0	35	44.6
Nov 6,2000 - May 10,2000	35	0	35	46.3
May 11,2000 -Aug 29,2000	35	0	35	48.0
Aug 30,2000 - Dec 7,2000	35	0	35	60.2b/
Dec 8,2000 - January 2002	35	0	35	na
Jan 2002	Rs. 20 per kg			

Onion	Statutory Duty	Duty Waiver	Effective Import Duty	Total tax incidence
Pre-July 1996	35	0	35	54.7
July 1996 -Dec 03, 1996	35	0	35	44.6
Dec 04,1996 - Jan 31,1997	35	15	20	28.8
Feb 01,1997-Nov27,1997	35	0	35	44.6
Nov 28,1997 -Jan 31,1998	35	15	20	27.8
Feb 1,1998-Nov 5 1998	35	0	35	44.6
Nov 6,1998 - May 10,2000	35	0	35	46.3
May 11,2000 -Dec 31,2000	35	0	35	48.0
Jan 1,2001-January2002	35	0	35	60.2b/
Jan 2002	Rs. 6 per kg			na
Sep 2003	Rs. 8 per kg			

Chilies	Statutory Duty	Duty Waiver	Effective Import Duty	Total tax incidence
Pre-July 1996	35	0	35	78.3
July 1996 -Dec 03, 1996	35	0	35	44.6
Dec 04,1996-Nov 5, 1998	35	0	35	44.6
Nov6,1998-May 10,2000	35	0	35	46.3
May 11,2000 - Dec 31, 2000	35	0	35	48.0
Jan,2001 -Jan 2002	35	0	35	na
Jan 2002	Rs 6 per kg			na

Source: World Bank (2003).

Dairy sector

The main items which come under the milk and milk food include fresh milk, powdered milk, cheese, butter yoghurt, etc. Despite the fact that milk being an essential food item and the demand for dairy product is steadily increasing still the daily intake of dairy product (i.e., 36Kg/year/person) is far below the recommended level (65Kg/year/person) (Household Income and Expenditure Survey, 2006). Most of the food and agricultural products, prior to 1977, were subjected to a 60 percent tariff though milk powder was imported to the country only with five percent tariff. A significant feature that can be observed in the dairy sector is gradual increment of the import volume of milk and milk products. During 1960-1980, only 20 percent of the total milk requirement was imported. By 2005, around 85 percent of the milk and milk product requirements were met by the imports (Abeyratne, 2007).

Import tariff is being used to restrict importation of dairy products. The tariff rates applicable to the Most Favoured Nations (MFN) for dairy products during 1998, 2001, 2003 and 2007 were 24.8, 19.0, 20.7, and 19.6 per cent, respectively (WTO, 2004; International Trade Centre, 2008). However, the applied tariff rate for dry milk powder (15%), which is consumed in large quantities, is lower than that for other dairy products (28%). The government lowered import tariff for dry milk powders in order to minimise the adverse effects on the consumers

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due to the price hikes in the international market during 2007-2008.

4. Summary and Conclusions

Liberalisation of agricultural trade was commenced in the early 1990s with the removal of export taxes on plantation crops, import licenses on rice, chili, onion and potato, and allowing of private traders to import rice. At present, most of the agricultural items are subjected to import tariffs and sanitary and phyto-sanitary regulations. Sri Lanka bound import tariffs at a rate of 50% for most of the agricultural items due to commitments with the World Trade Organisation. SAPTA, Indo-Lanka Free Trade Agreement and Sri Lanka-Pakistan Free Trade Agreement also provided opportunities to enhance agricultural trade within the South Asian region.

Though a gradual reduction in tariff levels can be observed over the years, during the recent past, the restrictions imposed on agricultural trade can best be described as ad-hoc. The tariff levels announced in the beginning of the year have been frequently modified by various exemptions, surcharges and levies the external environment rather uncertain. More recently, a number of cesses have been introduced on agricultural items, at the times of export and import, so as to increase

investments in the respective agricultural sectors.

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