

Seven Years Progress of the India-Sri Lanka Bilateral Free Trade Agreement: Problems & Prospects

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Trading in SAARC

- Sri Lanka saw that trading in SAARC eventually boils down to trading with India (accounts for more than 80% of SL's trade with SAARC)
- India was the largest source of imports to Sri Lanka even before the ILBFTA (8-9 per cent of overall imports of SL)
- Sri Lankan private sector was putting pressure on the government to do a deal with India (for more market access) given the slow progress of SAPTA.



Birth of ILBFTA

- 1998 ILBFTA signed (contemporary political factors influenced the signing)
- 1998-2000 period was allocated for conceptualization of the ILBFTA based on previous studies and recommendations (Panchamuki, et al, 1991; Lal Jayawardena, et al, 1993)
- SAARC + and SAPTA +



Conceptualization

- Product wise positive list approach to tariff preferences abandoned in favour of negative list approach
- Tariff phasing-out based on an 8 year time table
- NTBs to be removed with tariff preferences but not in the FTA – an understanding
- Asymmetry between the countries accommodated by S&D treatment (SDT)



SDT for Sri Lanka

- Larger negative list (Sri Lankan agriculture sector fully protected)
- Relaxed Rules of Origin – 35 per cent (and 25 per cent if Indian inputs used)
- Longer tariff phase out period (8 yrs for SL and 3 yrs for India)
- Negative list reduction based on SL's comfort level
- Revenue compensation excluded but SL insisted that high revenue import items will not be subject to tariff preferences (M duties = 2 % GDP revenue)



ILBFTA Product coverage and concessions granted

| Country | Number of Duty free items | Number of items for which duty is still to be phased out | Number of items in the Negative list | Margin of Preference MOP 25% | Tariff Rate Quotas TRQ |
|-----------|---------------------------|--|--------------------------------------|---|---|
| India | 4150 | Completed in March 2003 | 196 | Textiles Chapters 51-60 & 63 (few items in Chap 53,54,55 & 56 in the negative list) | Apparel - Chap 61 and 62 Quota – 8 Mn pieces Tea – 15 Mn kg |
| Sri Lanka | 3932 | Completed in March 2008 | 1180 | None | None |



NTBs and Para Tariffs

- Para-tariffs left for negotiation.
- NTB removal left out for negotiation (India's WTO commitments on NTB removal was 2004)
- Amicable settlement of disputes although safeguards included in the ILBFTA

INDIA'S EMERGENCE AS AN IMPORTANT TRADING PARTNER OF SRI LANKA

| Year | % of total exports | % of total imports |
|------|--------------------|--------------------|
| 1986 | 1.0 | 4.3 |
| 1990 | 1.0 | 4.4 |
| 1994 | 0.7 | 8.5 |
| 1998 | 0.8 | 9.2 |
| 1999 | 1.0 | 8.5 |
| 2000 | 1.0 | 8.2 |
| 2001 | 1.5 | 10.1 |
| 2002 | 3.6 | 14.0 |
| 2003 | 4.8 | 16.1 |
| 2004 | 6.8 | 18.0 |
| 2005 | 8.8 | 17.3 |

Source : Sri Lanka Customs
Note : 3rd largest buyer since 2003

SRI LANKA-INDIA TRADE – VALUE IN US\$. MN.

| Year | Trade Balance US\$. MN. | Import/ Export ratio |
|------|-------------------------|----------------------|
| 1998 | (501.7) | 14.3:1 |
| 1999 | (463.0) | 10.5:1 |
| 2000 | (544.4) | 10.8:1 |
| 2001 | (531.4) | 8.6:1 |
| 2002 | (665.9) | 5.0:1 |
| 2003 | (835.0) | 4.5:1 |
| 2004 | (972.5) | 3.5:1 |
| 2005 | (880.5) | 2.6:1 |

Source : Sri Lanka Customs

Outcome of 6 Years: 1999 cf 2005

- SL Xs to IND: 1 % -----→9%
- SL Ms from IND: 8.5% -----→ 17 %
- M/X ratio: 10.5: 1 -----→ 2.6:1
- No. of products from SL: 505 ---→ 1062
- IND – 3rd largest destination of SL Xs
- Investment followed trade – IND 4th largest investor in SL
- >50 % of IND investment in SAARC in SL

SRI LANKA'S MAIN EXPORTS TO INDIA - 1999

| Products | Value SL Rs. Mn. | Percentage |
|--|------------------|------------|
| Pepper | 695 | 20.30 |
| Areca nut | 382 | 11.15 |
| Waste and scrap of alloy steel | 272 | 7.94 |
| Dried fruit | 214 | 6.25 |
| Cloves | 199 | 5.81 |
| Waste paper & paper board | 191 | 5.57 |
| Glycerol | 181 | 5.28 |
| Apparel & clothing accessories - plastic | 149 | 4.35 |
| Black tea in bulk | 146 | 4.26 |
| Nutmeg | 81 | 2.36 |

SRI LANKA'S MAIN EXPORTS TO INDIA – 2005

| Product | Value in SL RS.Mn. | % |
|------------------------------------|--------------------|-------|
| Copper and Copper products | 15,590 | 27.74 |
| Vegetable fats and oil - Vanspathy | 12,321 | 21.92 |
| Aluminium Products | 4,534 | 8.07 |
| Electrical Machinery and Parts | 2,304 | 4.10 |
| Antibiotics | 2,279 | 4.06 |
| Cloves | 1,659 | 2.95 |
| Iron & Steel Products | 1,511 | 2.69 |
| Pepper | 1,088 | 1.94 |
| Pulp | 1,077 | 1.92 |
| Fibre board of wood etc. | 1,034 | 1.84 |

Lop-Sided Export Growth: Why ?

- 64 % of SL exports (RMGs and Tea) are under TRQs and conditional entry;
- Some actively traded goods of SL still in the IND negative list.
- IND entrepreneurs in specific sectors making use of the ILBFTA to target the IND market
- NTBs in operation till 2005

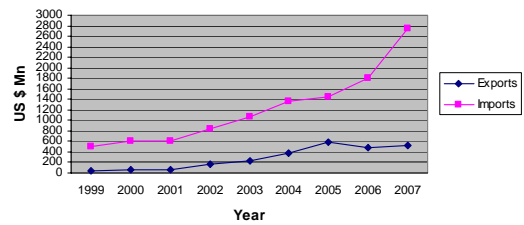
Some NTBs that were in operation in India

- Delays in custom clearance
- Port restrictions for some products
- Referring the COO to various places to double check the fulfillment of ROO
- Carrying out various tests despite possessing authorized certificates
- Food control systems in operation-excessive samples taken for quarantine testing

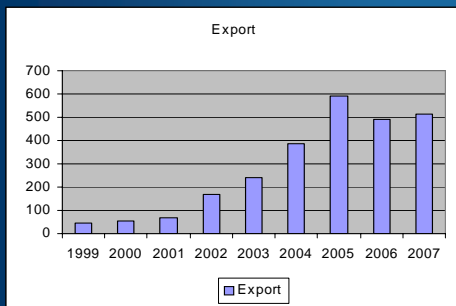
Sri Lanka-India Trade – Value in US \$ Mn

| Year | Exports | Imports | Trade Balance |
|------|---------|---------|---------------|
| 1999 | 47.1 | 510.2 | -463.1 |
| 2000 | 55.7 | 600.1 | -544.5 |
| 2001 | 70.1 | 601.5 | -531.4 |
| 2002 | 168.7 | 834.6 | -665.9 |
| 2003 | 241.1 | 1076.2 | -835.0 |
| 2004 | 385.5 | 1358.0 | -972.5 |
| 2005 | 589.1 | 1439.5 | -880.5 |
| 2006 | 489.5 | 1805.2 | -1315.7 |
| 2007 | 514.9 | 2744.3 | -2229.4 |

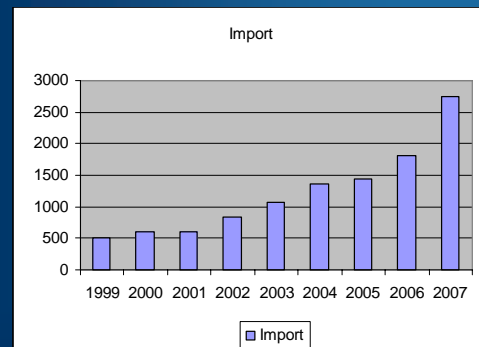
Sri Lanka-India Trade: 1999-2007



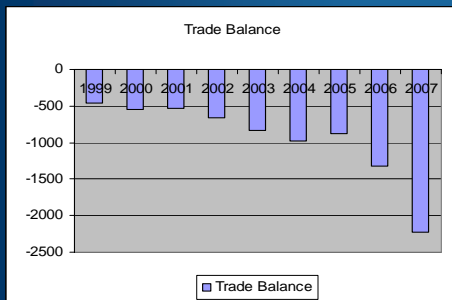
Exports



Imports



Trade Balance



SRI LANKA'S EXPORTS TO INDIA: 2005 – 2007

| PRODUCT | 2005 | | 2006 | | 2007 | |
|---|---------------|----------------------|---------------|----------------------|---------------|----------------------|
| | Value US\$ Mn | % share of the total | Value US\$ Mn | % share of the total | Value US\$ Mn | % share of the total |
| Vanaspathi | 122.6 | 21.92 | 79.0 | 16.14 | 144.8 | 28.1 |
| Electrical machinery, equipment & parts | 42.0 | 7.51 | 59.6 | 12.18 | 49.5 | 9.6 |
| Copper and copper based products | 155.1 | 27.73 | 103.0 | 21.04 | 27.9 | 5.4 |
| Bakery shortening | 12.9 | 2.30 | 23.0 | 4.7 | 25.0 | 4.9 |
| Pepper | 10.8 | 1.93 | 13.2 | 2.7 | 19.9 | 3.9 |
| Natural Rubber | 2.3 | 0.41 | 8.3 | 1.7 | 18.5 | 3.6 |
| Woven fabric | 7.2 | 1.29 | 14.4 | 2.94 | 15.9 | 3.1 |
| Marble products | 6.8 | 1.22 | 22.4 | 4.58 | 15.7 | 3.0 |
| Waste & scrap paper (unsorted and recovered) | 10.7 | 1.91 | 12.6 | 2.57 | 15.3 | 3.0 |
| Fibre board of wood or other ligneous materials | 10.3 | 1.84 | 9.2 | 1.88 | 13.8 | 2.7 |
| Chemical products | 34.9 | 6.24 | 23.6 | 4.82 | 12.3 | 2.4 |



SRI LANKA'S EXPORTS TO INDIA: 2005 – 2007 Cont'd

| PRODUCT | 2005 | | 2006 | | 2007 | |
|-------------------------------------|---------------|----------------------|---------------|----------------------|---------------|----------------------|
| | Value US\$ Mn | % share of the total | Value US\$ Mn | % share of the total | Value US\$ Mn | % share of the total |
| Poultry feed | - | - | 4.1 | 0.84 | 10.3 | 2.0 |
| Rubber Tyres (for buses or lorries) | 3.8 | 0.68 | 5.9 | 1.21 | 8.8 | 1.7 |
| Cloves | 16.5 | 2.95 | 11.7 | 2.39 | 8.4 | 1.6 |
| Lead & lead based products | 2.2 | 0.39 | 3.5 | 0.72 | 7.2 | 1.4 |
| Rubber gloves-other | 1.3 | 0.23 | 2.7 | 0.55 | 4.7 | 0.9 |
| Diamonds | 1.8 | 0.32 | 0.8 | 0.16 | 4.2 | 0.8 |
| Garments | 0.5 | 0.09 | 2.4 | 0.49 | 4.2 | 0.8 |
| Wooden furniture (bed room) | 1.2 | 0.21 | 2.7 | 0.55 | 4.2 | 0.8 |
| Nutmeg & mace | 3.7 | 0.66 | 2.8 | 0.57 | 3.1 | 0.6 |
| Tea | 1.1 | 0.20 | 1.4 | 0.29 | 2.8 | 0.5 |
| Other products | 141.4 | 24.00 | 83.2 | 17.00 | 98.4 | 19.1 |
| Total | 589.1 | 100.00 | 489.5 | 100.00 | 514.9 | 100.0 |



Achievements till 2005 based on Two Factors

- Indian tariff structure for inputs for specific manufacturing that led to Indian investment in those sectors to migrate to Sri Lanka and establish manufacturing units to produce for the Indian market (trade deflection)
- India not imposing TRQs for growing exports under the ILBFTA (vanaspathy, bakery shortening, pepper, desiccated coconut etc.)



IND reducing tariffs on inputs for local industries

- India reduced tariffs for inputs to manufacture Copper, Aluminum, Chemicals, etc. This saw a dramatic reduction of these exports from SL to IND
- Many IND manufacturers operating in SL went back to IND and commenced production



TRQ on Vanaspathy

- TRQ of 250,000 MT per annum (could easily be fulfilled in 6 months by the operating firms)
- US \$ 25 per MT of crude palm oil (main input for vanaspathy production) was imposed by SL
- Reduce the number of firms operating in SL to 10 (stop approvals by the BOI)
- By June 2006, NAFED (National Agricultural Marketing Federation) was empowered to import Vanaspathy from SL (canalization)
- June-December 2006: No vanaspathy exports from SL to IND



TRQ Vanaspathy

- IND position: ROO violated by Vanaspathy manufacturers in SL, 120 out of 260 vanaspathy firms IND closed down, etc.
- SL position: safeguards imposed contrary to the spirit of the FTA, BOI of SL credibility undermined.
- January 2007 Vanaspathy exports from SL resumed under TRQ and NAFED was removed from importation.

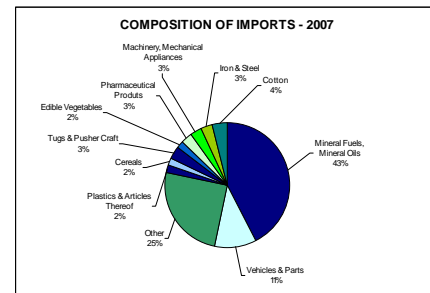
TRQ on Pepper

- SL exported 6,167 MT of pepper in 2003. This became a major concern for IND because IND felt that third country pepper is entering IND via SL.
- Since ROO monitoring is difficult, IND imposed a TRQ of 2500 MT per annum
- SL argued that the 2001-2004 average exports from SL amounted to 5% of total Pepper production in IND but this was not considered as it was going to one State (Kerala) in IND

Problems

- TRQs and NTBs have diluted the SDT offered by IND to SL
- SL industrialists are also to be blamed – have not put an extra effort to study the IND market
- SL has adhered to the spirit of the ILBFTA and have not imposed any TRQs despite pressure from certain SMIs

Did many SMIs close down due to consumer goods imports from India under the ILBFTA?



Looking Beyond the FTA

- In any FTA there are the positives and the negatives.
- SL feels that it would be better to rectify the shortcomings and build on the achievements from the FTA.
- Institutions already in place: FICCI/CCC focal points; WG on Customs, Indo-Lanka Joint Commission. No need for a fresh start.
- Deep economic integration with a fast moving economy like IND could contribute to stimulating the growth rates in SL

Beyond FTA

- June 2002: ILCEPA agreed upon/ April 2003: JSG appointed/Oct 2003 JSG Report out/ February 2005 TLNs start/ July 2008 – 13 rounds of TLNs completed
- ILCEPA by August 2008 – under Enabling Clause, but will be considered for listing under GATT Article 24 as suggested in the ILCEPA JSG report in a future date

ILCEPA

- Trade preferences deepening, reducing the negative list and relaxing the ROO (derogations)
- Liberalization of Services (GATS-plus)
- Liberalization of Investment
- Economic Cooperation to provide an impetus for Services and Investment liberalization
Indian Line of Credit to play a crucial role

Lessons from 7 Years

- NTB removal should be mandatory with tariff liberalization. All NTBs should be clearly defined in the FTA
- Para-tariffs could be Indian State policy (eg. Tamil Nadu) and the Central govt. may not have a say over their removal. These have to be carefully studied
- When exporting to India it is not the 300 million odd middle class market that matters, rather the State of entry and State lobbies (e.g. tea in Bengal, pepper in Kerala, etc.). It is better to negotiate for a number of entry points to India without confining to one port

Lessons (contd.)

- If there is a herd behaviour of Indian investors after the FTA in a particular sector (copper, vanaspathy, etc.) should be cautious in approving many of them. If not it can trigger safeguard measures in IND and do harm to the industry

Positive Lessons from ILBFTA and Moving Forward

- India becoming the 3rd largest export destination and Sri Lankan exports to India increasing by 8 times are by no means achievements. The fact that Indian imports wiping out Sri Lankan SMI is also not correct.
- Can make it work if there is political will to go ahead by both governments
- A 'win-win' situation can be worked out in a FTA between a small and a large country by building in SDT in favour of the small country

Positive Lessons & Moving Forward

- In such a FTA, dormant complementarities can be invigorated – one country cannot have comparative advantage in everything
- Unilateral liberalization initiatives have triggered steps for deeper integration by the FTA – clearly visible in tourism, air travel, etc
- India seen as an opportunity not as a threat. Economic benefits can transform political relations – bitter IND-SL relations of the late 1980s – history

- For more detailed study of the ILBFTA:

See: http://www.ris.org.in/4p119_nap.pdf

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