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Analysing Consumer vs Producer Interests in Trade Liberalization under SAFTA

***Further Liberalization could Save US $ 2 billion for South Asia says a Study**

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Dr. Saman Kelegama

Consumer Unity and Trust Society (CUTS) has recently come out with a novel publication titled "Cost of Economic Non-Cooperation in South Asia" which highlights the costs to the SAARC consumers as a result of existing trade restrictions. The study estimates that trade restriction due to the SAFTA Sensitive List is costing the SAARC consumers close to US$ 2 billion per annum. In other words, SAARC consumers are paying more to obtain imports from the rest of the world rather than purchasing them from SAARC countries due to the Sensitive List. The study has been done using a static framework and it is argued that the gains to the consumer will be much more in a dynamic setting.The Island Financial Review spoke to Trade Economist, Dr. Saman Kelegama, Executive Director, Institute of Policy Studies of Sri Lanka (IPS) on these findings and related issues.

Q: Are you in agreement that consumers' gains have been undermined by SAFTA due to the large Sensitive List and why has CUTS brought out such a study?

A:Trade liberalization, whether done unilaterally, multilaterally, regionally, or bilaterally brings welfare gains to a country. These gains can be disaggregated among producers, consumers and the government. Although an overall gain is reaped from trade liberalization, at disaggregated level the government may lose revenue, producers may lose, and consumers will gain or both producers and consumers will gain and the government may lose, or consumers and the government may gain and producers will lose. Economic modelling can identify such gains and losses but the point to note is that in all three scenarios, the consumer is a gainer.

When trade negotiations take place, however, always producer interests and government revenue are given priority over consumer interests. That is why member countries of a regional trading arrangement, first, bargain for a large Sensitive List where goods in that List will not be subject to liberalization and second, member countries that are heavily dependent on import taxes for revenue bargain for a Revenue Compensation Mechanism in the short run. Incidentally in SAFTA, the latter was agreed upon but never became a reality. However, nothing is negotiated with the interests of consumers in mind as it is taken for granted that the consumer is a "winner" in trade liberalization. But what is overlooked is that the gains to a consumer can be enhanced if the consumer interests are also taken into account in trade negotiations.

That may be the reason why CUTS that represents the interest of consumers decided to bring out this study highlighting the consumer welfare gains from reducing the Sensitive List of SAFTA. The findings of the CUTS study may further strengthen the case for the Addu City Declaration of the 17th SAARC Summit in 2011, which clearly stated that the SAFTA Sensitive List will be reduced "to fully and effectively implement SAFTA".

Q:The CUTS study claims high gains to the consumer. What are the concerns you have in regard to reaping these gains?

A: Although consumer gains appear huge when liberalizing the items included in the Sensitive List in South Asia, there are some factors other than producer interests and government revenue that prevent achieving these goals.

The liberalization of non-competing goods can bring noteworthy gains to the consumer. A small South Asian country like Sri Lanka does not produce items such as motor vehicles, sophisticated machinery, high-end pharmaceuticals, etc. Importing them from India under normal tariff or preferential tariff gives significant gains to the consumer due to the lower price of India compared to the rest of the world. However, the quality matters at a lower price level and it is here that preference for regional products faces the challenge. China from outside the region has emerged as a serious competitor for certain items such as machinery. Japanese re-conditioned vehicles can effectively compete with new vehicle imports from India: thus, even in the non-competing domestic market, the quality of regional import matters if they are to make a significant impact on the market. A study that estimates Consumer Welfare to the region with further liberalization of trade will find it difficult for incorporation of quality factors and thus may overestimate the consumer welfare gains.

Q:For the regional competing goods, will the consumer welfare gains come at the cost of the producer?

A: Trade liberalization widens the choice of a particular product to the consumer. It will provide competition and exert pressure on the prices to come down in favour of the consumer. However, the local producers may not like prices coming down and cutting into their margins and also local producers will lose part of their market share with the arrival of competitive imports, which they will not like.

It must therefore be kept in mind that when trade liberalization is undertaken, both consumer and producer interests should be considered. No country will be ready to take only the interest of the consumer and convert the country into a trading nation. The production base has to be maintained with competitive pressures and the tariffs have to be adjusted accordingly. This is what we see in the agriculture sector – always the tariff policy is a compromise between producer and consumer interests. If this compromise is prudently worked out, consumer welfare gains will not come at the cost of the producer – it will be a "win-win" outcome.

Q:Don’t you see misperceptions in countries like Sri Lanka, Bangladesh and other smaller South Asian countries on cheaper goods coming from the South Asian region?

A: Yes, there are misperceptions like for instance, that imported items from a South Asian country are inferior to the same goods coming from a Western Country. This may have been the case three decades ago, but not now. Pharmaceuticals coming to Sri Lanka from India and Bangladesh are not inferior to equivalent Western products, textiles from India, Pakistan and Bangladesh that reach the Sri Lankan market are both quality-wise and price-wise, competitive of the same coming from the rest of the world.

Second, for agricultural items, there is an argument saying that cheaper agriculture items are produced in some South Asian countries using government subsidies. On these grounds, such cheap agricultural imports are restricted. But heavily subsidized sugar produced in EU is tolerated as an import! There the argument is that it is the European tax payers who are subsidizing the sugar, so we can accept the cheap sugar from EU. We fail to think in a similar way for regional agriculture imports. I am not arguing for blanket liberalization but rather an attitudinal change for regional imports especially when there is a need for importation of agricultural items.

Q:Will perceptions about importation of goods from the region change with time?

A: Yes, there are already indications of this happening in South Asia. Take, for instance, the India-Sri Lanka trade in services. There are a number of Indian services operating in Sri Lanka that have not received major adverse reactions from the Sri Lankan public in regard to the quality of services, whether it is Taj Hotels, Apollo Hospital, Bharati Air Tel, ICIC Bank or Lanka IOC. Similarly, a number of Sri Lankan services operate in the Indian market like Aitken Spence Hotels or Damro retailers, with no major consumer issues. The change in perception in regard to regional goods will come with time when the public begins to appreciate what they get from the region in the form of imports as reflected in some services already operating from the region.

Q:Why are consumers not influential on changing government policy on importation?

A: Trade dialogue in South Asia has been so far heavily tilted in favour of the producers. Producers are well organized and they have their respective chambers to lobby with the government to protect their interests. In contrast, the consumers are scattered and not well organized and neither do they have powerful associations to lobby with the government to safeguard their interests. If producers feel that their interests are threatened by liberalization of trade, they organize themselves whereas consumers who gain do not bother to organize and assert their right.

All chambers represent the interest of producers whether they are SMIs, import substitution industrialists, exporters, and so on. There is no major organization representing the consumer – even though Federation of Consumer Associations exist in some countries – they are not powerful bodies that could influence government policy.

Q:Even if there is preferential or duty free market access to the South Asian regional market, there may not be adequate supply in some South Asian countries to make full use of such access and provide benefits to the consumer. What can be done about this?

A: Supply constraints is an issue for small South Asian countries to make use of preferential market access in a larger South Asian country. Take for instance, cloves exported under the India - Sri Lanka FTA from Sri Lanka to the Indian market. Sometimes, a supplier in Sri Lanka may not be able to export the full amount requested by an Indian buyer. In some such cases, the buyer may switch to a bulk supplier from another country like Indonesia or Vietnam to fulfill the order even though there will not be a price advantage like in purchasing from Sri Lanka that would have given a gain to the Indian consumer.

Problems of this type in small South Asian countries could be addressed by promoting joint ventures for the product concerned with the purchasing country. New technology and additional investments can always increase the supply capacity as happened in Kelani-CEAT joint venture which is now fulfilling many industrial orders for rubber tyres from India.

Q:There is also the view that further liberalization and reducing the Sensitive List under SAFTA will benefit the larger countries like India and Pakistan than smaller countries like Bangladesh and Nepal. As a result, there is resistance for further liberalization. What is your view on this ?

A: This perception exists and it is also an impediment for further liberalization under the regional framework of SAFTA. But if we look at the issue carefully, the perception that larger countries gain more is not necessarily correct. Prima facie the larger supply potential and advancements in technology indicate that the larger countries will be the beneficiary but the real beneficiaries will be the small countries that will be able to reap economies of scale and improve their production and exports.

Fears of this nature existed before the signing of the India-Sri Lanka Bilateral FTA and they were overcome by providing Special and Differential Treatment (SDT) for Sri Lanka – longer Sensitive List, phased trade liberalization programme with more time for tariff reduction, favourable rules of origin, high government revenue earners like motor vehicle imports not subjecting to preferential tariffs, and so on. Within the first 6 years of the Agreement, Sri Lanka’s exports to India increased from 1% in 1999 to 8% in 2005, and the trade deficit improved in favour of Sri Lanka.

SAFTA also has SDT for LDCs and recently, India reduced the Sensitive List for LDCs to 25 items in a non-reciprocal basis. These steps should allay any fears of large countries gaining at the cost of smaller countries. If the larger country is the main gainer it would have been the case for Indonesia in ASEAN, Brazil in MERCSOUR, USA in NAFTA, and Germany in EU and there is no evidence to say that this has been the case.

Q:So what is a possible way forward to stimulate further trade in the region and give the best deal to the consumer?

A: At present, the negotiations for trade in services liberalization is taking place under SATIS (South Asian Trade in Services). This process has to be expedited in order to stimulate trade in services in the region. What the consumers of South Asia require is better quality services at an affordable price and SATIS can fulfill this objective.

Second, South Asia needs to liberalize investment flows in the region. It is more investment flows that would stimulate the trade-investment nexus and stimulate further trade flows in the region. It is investment flows that will encourage vertical and horizontal integration of regional industries and stimulate intra-industry trade, which in turn will increase intra-regional trade, giving more benefits to the consumers in the region.