Trade Connectivity as a Strategic Tool: Challenges and Opportunities for the EU and Sri Lanka

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Conference on "The EU Indo-Pacific Strategy through Sri Lanka's Lens: Opportunities for Cooperation and Partnership"

LKI and the EU delegation

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Introduction

- The EU-Sri Lanka trade
  - Long history
  - Colonial ties: reduced trade cost
  - Non-reciprocal trade concessions for Sri Lanka
  - For the EU: an opportunity to transfer low-tech manufacturing to Sri Lanka
  - The EU firms can invest in sectors with high preferential margin
- Bilateral trade based on utilising factor cost advantages and comparative advantage

The EU as an export destination

- Before the pandemic (2019) 3.57 USD billion exports to the EU (30%)
- Low-tech manufacturing products dominate (2020)
  - HS 621210 (Brassieres of all types of textile materials)
  - HS 611610 (Gloves, mittens)
  - HS 401290 (Tyres)
  - HS 610711 (Men's & boy's underpants)
  - HS 610910 (T-shirts)
- The EU is the major market for Sri Lanka's Seafood
- Most of Sri Lanka's exports are covered by GSP+

EU exports to Sri Lanka: Forward linkages

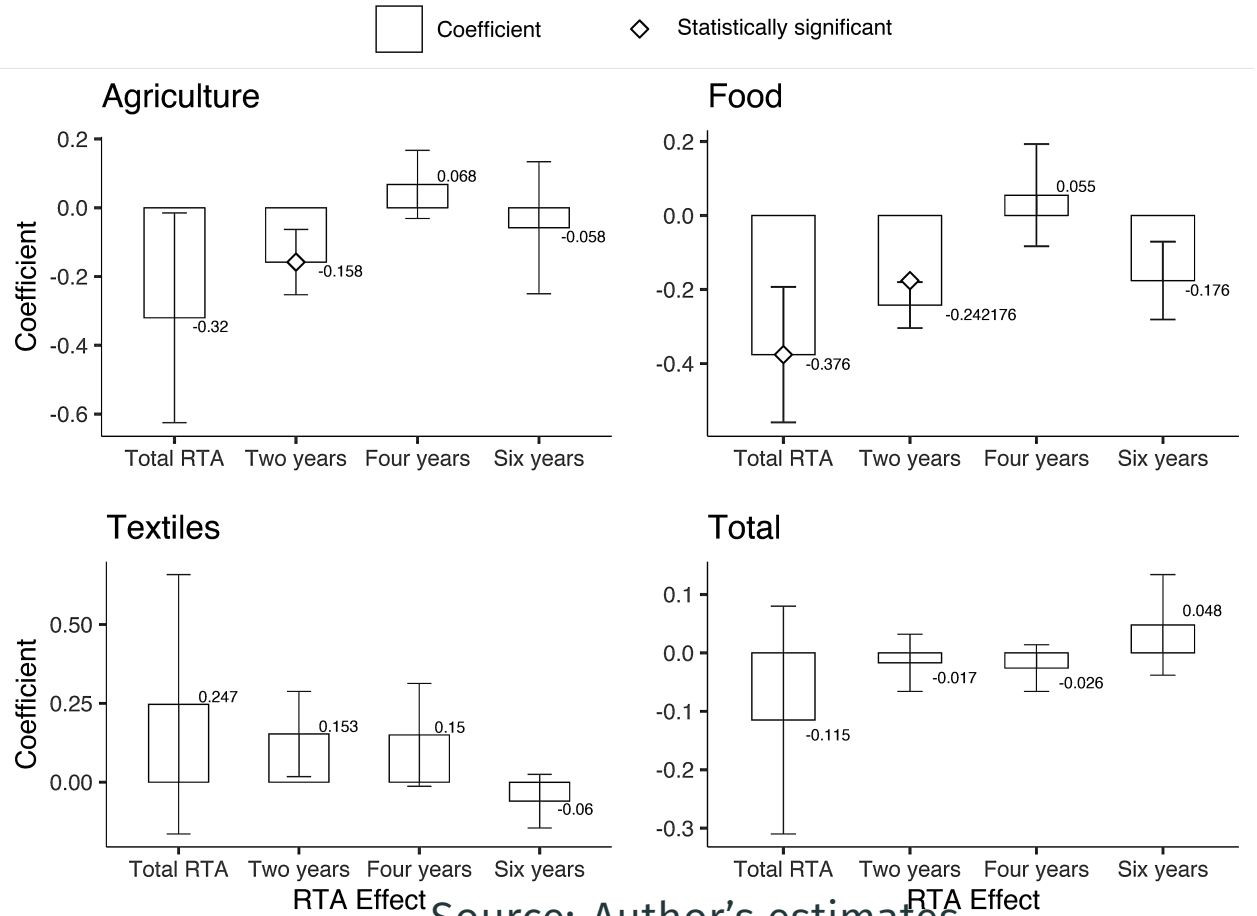
- Reduced trade cost due to GSP+ induces forward and backward linkages
- Supplier of raw materials
- Key products:
  - HS 600410 (Knitted and crotcheted fabrics)
  - HS 853190 (Parts of electric sound/visual signalling apparatus)
  - Hs (300490 Medicament)
  - HS 580620 (Narrow woven fabrics)

A case for trade between the EU and Sri Lanka: Economics

- Importance of a trade-led growth strategy for Sri Lanka
  - Small country
  - Less resource endowments
  - Small consumer base
- The EU is a large market for raw materials and final products
- Non-reciprocal trade concessions (GSP+)

Importance of the EU market for Sri Lanka

- Poor performance of regional-trade agreements in the South Asian region

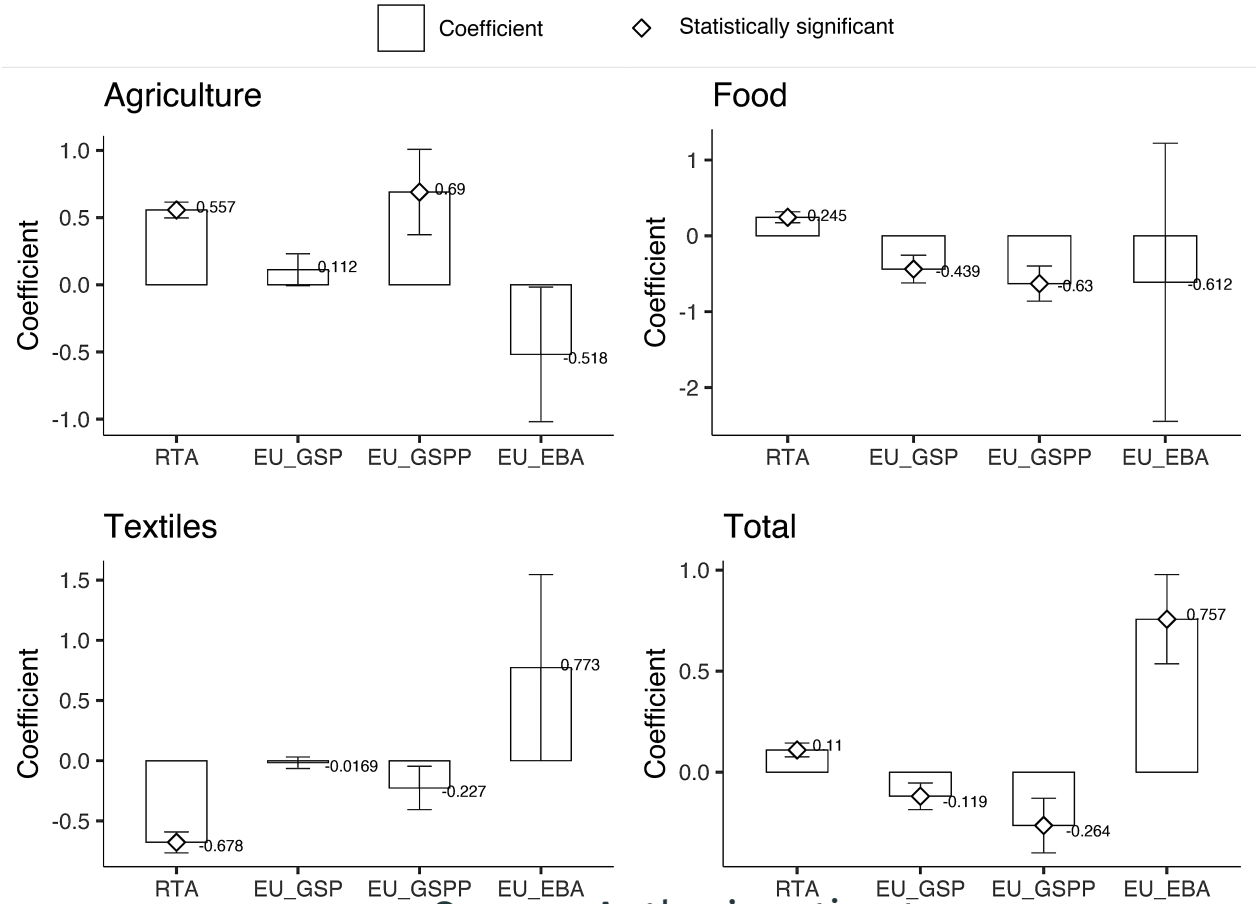


Source: Author's estimates

FIGURE 1: RTA effect on Gross trade: South Asia

Importance of the EU market for Sri Lanka

- Positive effect of GSP program on certain sectors

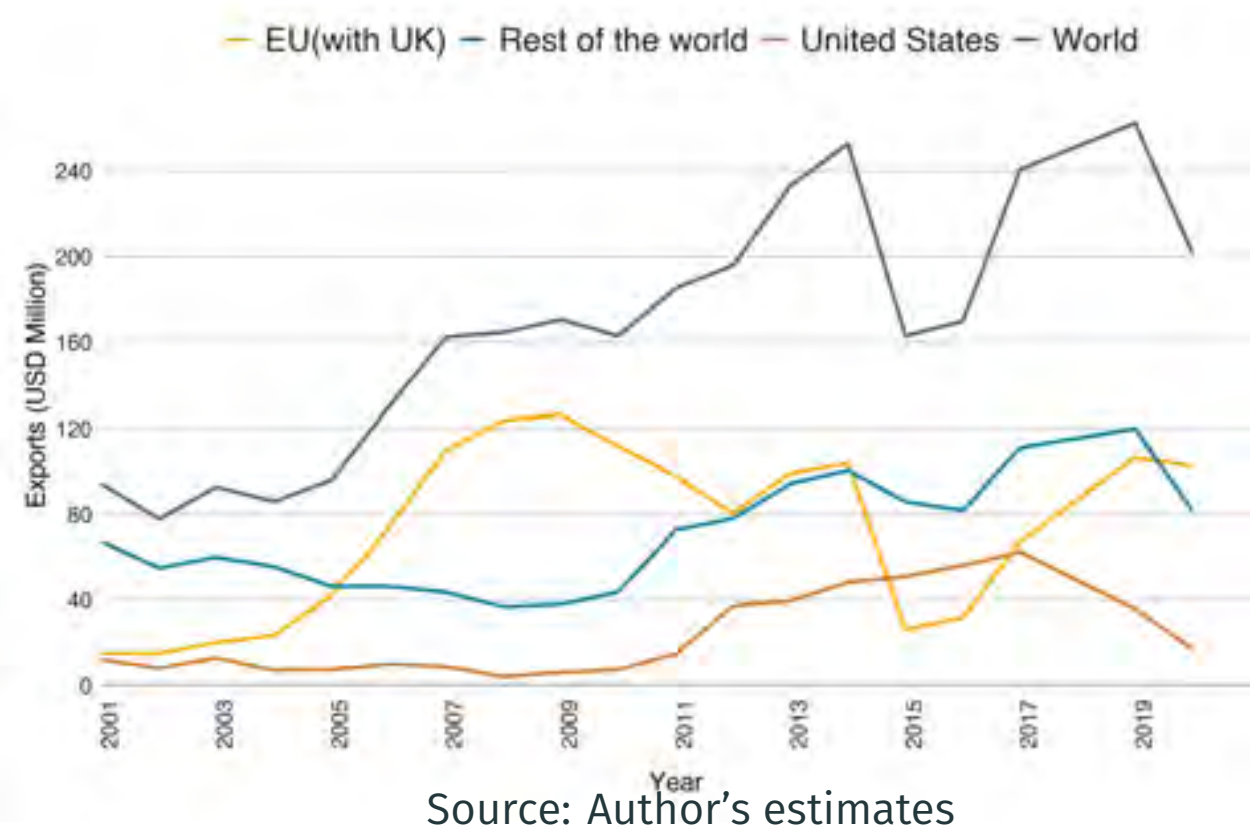


Source: Author's estimates

FIGURE 2: GSP program effect on Gross trade: Asia

Importance of the EU market for Sri Lanka

- Seafood exports

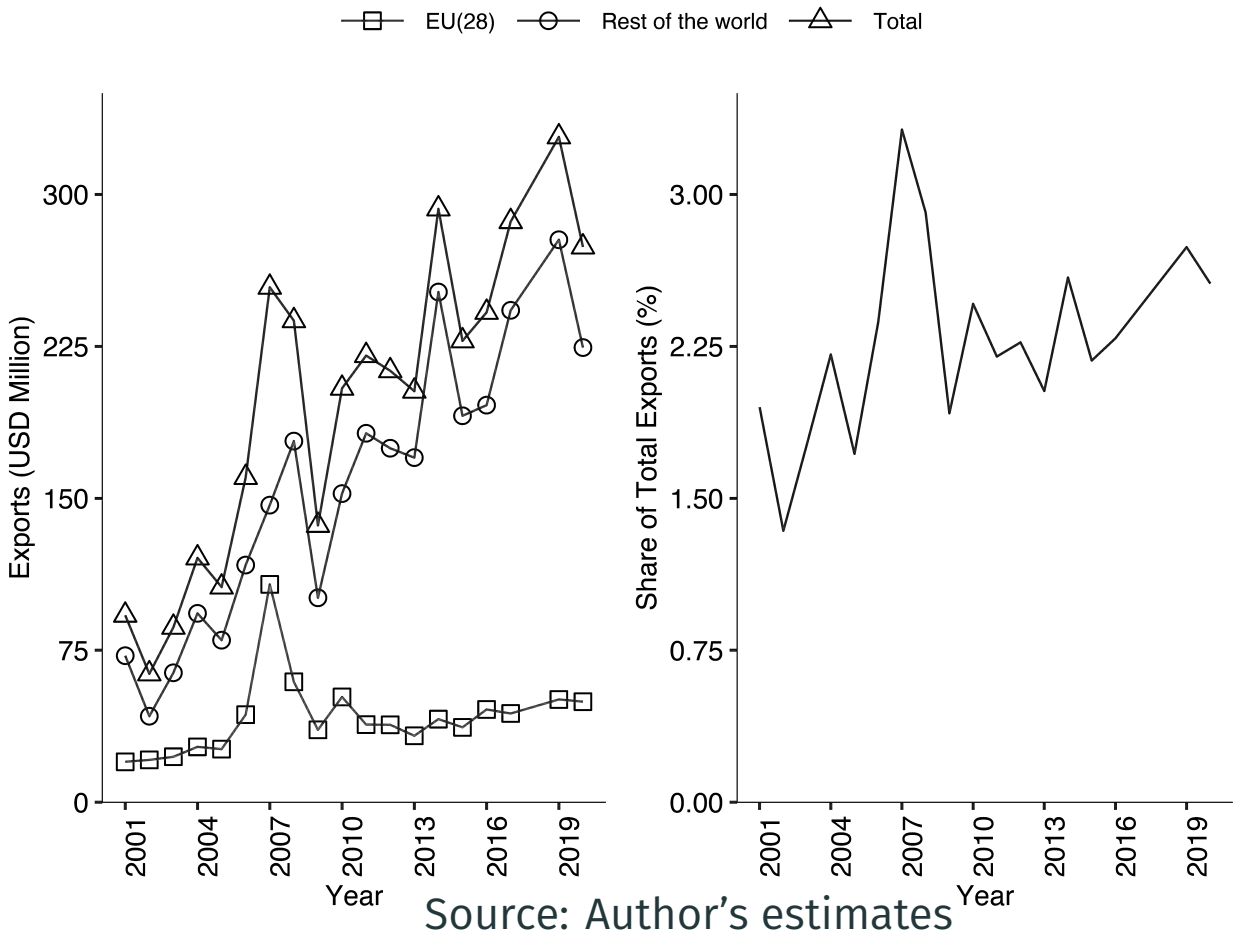


Source: Author's estimates

FIGURE 3: Seafood exports: Sri Lanka

Importance of the EU market for Sri Lanka

- Diversification into complex products:



Source: Author's estimates

FIGURE 4: HS chapter 85 exports: Sri Lanka

EU-Sri Lanka trade: Mutual Benefits

- The EU concessions are economically and strategically important
  - The key sectors benefited are the ones that employ workers from economically marginalised sectors (agriculture, and seafood)
  - Agriculture sector is 1/4 of the labor force in Sri Lanka
- For the EU: Sri Lanka is a destination for investments and trade through forward and backward linkages

The EU Indo-Pacific Strategy and Sri Lanka

”The EU is committed to further engagement on open, sustainable and rules-based trade with partners in the Indo-Pacific region, including on building support for the modernization of the WTO” -The strategy for cooperation in the Indo-Pacific-

- Approach is to support a rule-based trade based on multilateral institutes
- Implementing and enforcing comprehensive trade agreements with Japan, the Republic of Korea, Singapore, and Vietnam
- Economic Partnership agreements with Pacific States
- Conclude trade agreements with Australia and New Zealand

Opportunities and Challenges for Sri Lanka

- Open trade will allow Sri Lanka to:
  - Trade based on comparative advantage (increased economic efficiency)
  - Preferential access (GSP+): Profit and efficiency seeking investments
  - Diversification into high-tech manufacturing
  - The EU-US trade relationship under the supply chain realignment of US (for semiconductors, EV batteries etc.)
- Trade with the EU $\Rightarrow$ poverty alleviation, increasing income and efficiency
- Tangible economic benefits will bolster strategic alliances

Opportunities and Challenges for Sri Lanka

- Challenges coming from current trade regimes:
  - Sri Lanka's import controls (The EU's thrust for rule based open trade)
  - The link between human rights and GSP+
  - The EU's leverage through GSP+ and political sentiments
  - Rules of origin: need for expanding the cumulation
  - Impact of the EU's NTMs
- Trade agreements of the EU with other Indo-Pacific nations
- Trade diversion to Sri Lanka's competitors

The Way Forward

- Solving political disputes on GSP+ compliance
- Expanding the cumulation $\Rightarrow$ increase GSP+ utilization ratio
- NTMs and compliance to sanitary and phytosanitary measures
- A trade policy in compliance to WTO framework

Thank you!