



## Indo- Sri Lankan Economic cooperation and Trade related Issues

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### ABSTRACT

The Economic relations between India and Sri Lanka has started even before the pre-colonial times. But the relationship had its biggest boost when the two countries signed a bilateral agreement called India–Sri Lanka Free Trade Agreement (ISFTA) on March 2000. The agreement aims to promote economic links between India and Sri Lanka through enhancement of bilateral trade and investment. The agreement covers trade in goods and requires the two countries to offer market access for each other's exports on a duty-free basis and concessionary tariffs. This study focuses on the India–Sri Lanka Economic cooperation and trade related issues between the two countries. In the recent decades the bilateral trade between the two countries has increased steadily and India became the most favored import destination for the Sri Lankan importers immediately after the implementation of the free trade agreement.

**KEYWORDS :** Economic Cooperation, Free Trade Agreement, Bilateral Trade

### Introduction

India and Sri Lanka have worked together in a number projects with government cooperation which include substantial involvement of trade and investment. Indian government participated with a number of projects in Sri Lanka. It has assisted infrastructure development in Sri Lanka through lines of credit and grant assistance to the Government of Sri Lanka. The Government of India opened a line of credit for exports to Sri Lanka.

India is Sri Lanka's largest trading partner globally, while Sri Lanka is India's second largest trading partner in the SAARC. It is the number one source of supplies accounting for twenty percent of Sri Lanka's total imports and third largest export destination for Sri Lankan products absorbing six percent of total exports. India is among the top five foreign investors in Sri Lanka. After the Indo-Sri Lankan Free trade Agreement in March 2000, the trade between India and Sri Lanka has grown rapidly. The value of bilateral trade increased from 658 million USD in 2000 to 3.6 billion USD in 2013. Around 70% of Sri Lanka's exports to India is under ISFTA, while India's export to Sri Lanka under ISFTA is only 25%. Sri Lanka exporting more than 4000 product lines to Indian market on duty free basis. Under ISFTA, major exports from Sri Lanka includes, furniture, apparels, insulated wires and cables, poultry feed, ceramics products, electrical panel boards, machinery parts, rubber gloves, glass bottles, processed meat products, food preparations, spices etc.

### India–Sri Lanka Free Trade Agreement (ISFTA)

The Indo-Sri Lanka Free Trade Agreement (ISFTA) was signed on 28th December 1998 and came into force with effect from 1st March 2000. It provides duty free concessions to a wide range of products traded between India and Sri Lanka. Sri Lanka's tariff liberalization commitment under ISFTA came into existence since November 2008 and with this commitment, the ISFTA which came into effect from March 2000 and has been fully implemented. Due to this agreement, the Sri Lankan entrepreneurs can now export more than 4000 product lines to the Indian market on duty free basis.

### Review of Literature

Mukerji and Kelegama (2007) studied about the bilateral trade flows under different categories of products. Sector wise imports and exports figures are compared before and after the Free trade Agreement. Gould (1998) conducted a gravity model to find the impact of NAFTA on North American trade. He concluded that NAFTA may have stimulated the growth of US aggregate exports to Mexico, but not significant growth of US imports from Mexico. Soloaga and Winters (2001) find no distinguishable evidence of trade diversion on non-members of NAFTA. Krueger (1999, 2000), also adopted a gravity model approach and finds no evidence of trade diversion from the rest of the world after NAFTA. Fukao, Okubo and Stern (2003) focused on disaggregated level for selected goods, using a gravity model developed for the percentage of

imports from a country to US total imports of an industry. The most ambitious study of NAFTA on highly disaggregated is by Romalis (2005). This study is based on the estimation of effects of Free Trade Agreement on trade volumes and prices.

### Objective of the study

The study makes an analysis on Indo-Sri Lanka Trade Relations and Effect of India–Sri Lanka Free Trade Agreement: The structure of bilateral trade has also undergone considerable diversification since the agreement came into force. A significant number of new products has increased considerably. The study suggests scope for expanding cooperation for goods, investments, and provide suggestion for pruning the negatives lists and recommending policies for expanding cooperation in services.

### Data sources and Methodology

The major types of data used in the study are trade data and import tariff data of the two countries. Data includes bilateral as well as trade with rest of the world. Available data collected before the ISFTA and after the Agreement. Comparative analysis used for accessing the change. Looking at the time series data of both the countries, the complete data for India is available, but is not available fully in the case of Sri Lanka. Data for the years 1996-1998 and 2000 are missing.

### Comparative Analysis

Bilateral trade between India and Sri Lanka has undergone various structural changes over the years as a result of the FTA. An attempt was made to calculate the structural change in bilateral trade at a macro level. For this purpose, the section wise change was calculated and further extended into various broad categories.

**Mineral products.** Before FTA mineral products constituted only 1% of the total exports to Sri Lanka. But after FTA However, its share started to increase and rose to 4% and continues to increase through the years.

**a)Cement.** Sri Lanka put cement under the negative list, but the import of Indian cement grew substantially over the post-FTA period. In 1999, Sri Lankan import of Indian cement was \$1.3 million and then increased to \$21 million in 2000 and remained at the higher level thereafter.

**b)Petroleum products.** Many of the petroleum products remained under the negative list, but remarkable increase in imports by Sri Lanka was witnessed.

**Agricultural products.** To protect its farmers, Sri Lanka put most of the agricultural products under the negative list. As a result the share of agricultural products declined from 20% in 1999 to 9% in 2005.

**Metals and metal manufactured articles.** Before the execution of the agreement, metal products constituted 24% (1999) of the total Sri Lankan exports to India and through the years its share has been rising .In metal products, the share of base metals and related products is declining from 2005 onward, share of machinery and mechanical appliances has been increasing from 2000 onwards.

**Macro Analysis of FTA**

As per the agreement, various degrees of tariff concession were exchanged between India and Sri Lanka. Under the agreement the discount in tariffs are categorized under three major headings:

**Zero duty.** Products under this category enjoy no import tariff in the partner's market.

**Negative list.** Products under negative list are exempt from tariff negotiations. These products continue attract MFN tariff in partner's market till both the parties agree to revise the list.

**Residual list.** These are the products on which the import tariff is reduced in a manner such that they attract zero duty after a stipulated period.

**Pruning of Negative List**

After FTA, an attempt was made to analyze the negative list, specifically for pruning items in it. The objective was to expand the coverage of goods trade as recommended under Joint Study Group report on CEPA. To achieve this objective, mainly two approaches were adopted. In first approach, negative lists of India and Sri Lanka under the South Asian Free Trade Area (SAFTA) were compared. It was assumed that tariff cuts are deeper in bilateral arrangements compared to multilateral trading. The comparison found that there were a number of items that are not listed under the SAFTA negative list ,found under the negative list of ISFTA. There are around 97 products in the negative list of India which don't figure in the negative list of India under the SAFTA.

**Table-I Trade between India and Sri Lanka: 2010-2013(values in USD Millions)**

| Year | Exports | Imports  | Total Trade | Balance of Trade |
|------|---------|----------|-------------|------------------|
| 2010 | 466.60  | 2,546.23 | 3,012.83    | -2,079.63        |
| 2011 | 521.65  | 4,338.04 | 4,859.69    | -3,816.39        |
| 2012 | 566.37  | 3,517.23 | 4,083.60    | -3,517.23        |
| 2013 | 543.37  | 3,092.67 | 3,636.04    | -2,549.30        |

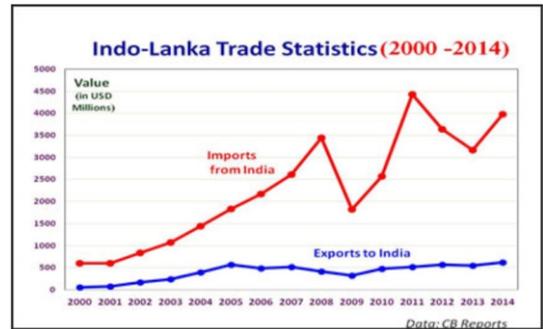
Source: Sri Lanka Customs

The qualitative phase of the study analyzed the general perception of the respondents about the role of the ISFTA. Most of the respondents agreed that ISFTA had a role in increasing the bilateral trade but insisted that it was not always positive. Some respondents (these too were mostly related to government linked organizations like India-ASEAN-Sri Lanka Chambers of Commerce and Industry) were of the opinion that it has acted as a major stimulant to trade. Senior personnel of Tea Board said that it has had a positive effect and has made the Indian tea industry more competitive and forced the Indian tea brands to learn the good practices of marketing and packaging from their Sri Lankan counterparts.

**Problems Faced by Importers and Exporters**

International trading is a field of challenges and are more costly, time consuming, and complex than domestic trade. An international border imposes additional costs in terms of tariffs, time delays, and costs associated with procedures, differences in legal system and culture. The respondent exporters and importers using the FTA route were asked to address the problems that they faced in the bilateral trade.

**Table-II Indo- Sri Lankan trade Statistics after FTA**



Some problems may be common to both countries. But the problems at the Export Inspection Agency (EIA) are specific to India and those related to non-tariff barriers (NTBs) and dishonoring of the Certificate of Origin (COO) are specific to Sri Lanka.

In a general opinion ISFTA might have pushed trade, it also suffered from its share of problems and a more holistic approach was required for drastic improvement in bilateral trade

**Conclusion**

After the implementation of the FTA India became the most favored source for the Sri Lankan importers. On the other hand, Sri Lanka as an export destination of India's products improved but remained low. Also the structure of trade changed over the FTA periods. Some new products emerged and trade in others declined. Sri Lanka's exports to India diversified even after netting two products, copper and vegetable oil. To make the FTA more effective, trade in services and cooperation in investment is needed along with trade in goods. This can be done by moving on to the next platform or by restructuring the existing agreement. After analyzing the implementation of the ISFTA, the study strongly recommends a deeper cooperative arrangement incorporating the lessons learned from the present agreement.

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