Sri Lanka: Country Experience – Liberalization, RTAs and Bilateral FTAs

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Progress of Liberalization

- First Wave 1978/1979 -- trade, financial markets, commodity markets
- Second Wave 1990/1991 – FDI liberalization, privatization, stock market and capital markets
- Third Wave 2002/2003 – trade, labour market, foreign ownership of land, deregulation…
- Fourth wave 2015/2016 – deregulation, trade,…..
- In between – overheating of the economy in the mid-1980s, keeping the status quo in the mid-1990s, reversal of liberalization during 2006 to 2014

Progress of Liberalization

- Mid-1990s regional trade liberalization gathers momentum with SAPTA although slow regional liberalization did take place from late 1970s with the Bangkok Agreement
- Multilateral liberlization commenced with WTO -- 50% rate binding of agriculture tariffs, three services sectors (tourism, telecom and financial services) offered under GATS, NAMA tariff reductions, etc.
- Bilateral track commenced in 2000 with the ISLFTA and PSLFTA in 2005
- Next stage of ISLFTA which was CEPA abandoned in 2008 in line with reversal of liberalization policies

Experience with RTAs

SAFTA

- SAPTA had 4 rounds during 1995-2005 and the overall outcome was far from satisfactory
- SAFTA was signed in 2004 in Islamabad and extensive negotiations on modalities were conducted until July 2006
- Tariff liberalisation implemented on July 1st 2006
- Inter-regional trade in SAARC somewhere around 5-6%
- SAFTA aims at working towards the formation of a FTA by 2016, under which the customs duties on products from the region will be progressively reduced

Impediments to SAFTA: Technical, Political, and Institutional

- Several issues remain which threaten the success of the agreement: SL, ROO, Additional measures, Dispute Settlement, Slow integration of services under SATIS, TLP
- Regional politics which is impeding the progress of SAFTA, some of the key ones now getting addressed
- An ineffective institutional structure – a number of (overlapping) committees without proper coordination
- Lack of adequate resources in the SAARC Secretariat to monitor implementation of activities

SATIS

- SAARC Agreement on Trade in Services (SATIS) signed in 2010
- Based on ‘positive list’ approach and ‘GATS-plus’
- Studies show more complementarities in services than in goods in South Asia and the trade imbalance with India of other SA countries to be much lower than in goods
- A good start would be to bind whatever unilateral liberalization in services at the existing level under SATIS
- Current progress is not satisfactory

APTA

- APTA (SL, BGD, IND, KOR, LAO, CHIN): China became a member in 2000; largest PTA in the world in terms of coverage of population
- But APTA based on “positive list” approach, thus negations are slow
- Preferences diluted by NTBs, preferential tariffs not given to actively traded goods, preferential margins were small, etc.
- 4th Round –completed but meetings do not take place on a regular basis
- Some APTA tariff preferences remain unutilized

APTA

- Some regional exports receive MOPs of 50% and 20% but the reduction in duty for some products is from 5% to 4%, which is marginal
- APTA will provide ample opportunities for business expansion, sourcing & attracting FDI
- Most regional exporters are not aware of APTA concessions. Thus trade authorities need to raise awareness among exporters about the APTA agreement in order to increase its usage
- The 4th round of negotiations completed in September 2016, which aimed to widen the coverage of preferences to at least 50% of the number of tariff lines & provide a tariff concession of at least 50%
- The 4th round of negotiations is extended into areas beyond the traditional tariff concessions like trade facilitation, non – tariff measures and investments in order to deepen trade cooperation & integration

Experience with Bilateral FTAs – A Case Study of the ISLFTA

ILBFTA

- SL's trade with India changed dramatically following the implementation of the FTA in 2000
- In the period immediately preceding the Agreement (1995-2000), average annual exports from SL to India were US$ 39mn & annual average imports were US$ 509mn
- India was an important source of imports even prior to the Agreement – by 2000, India was already the second largest source of imports to SL after Japan
- But India was not a major export market prior to the ILFTA – it was the 14th rank in export destinations in 2000

ILBFTA: Special and Differential Treatment for Sri Lanka

- Larger negative list (SL agriculture sector fully protected)
- The immediate duty-free list (319 items) and 50% preferential duty list (889 items) were considerably smaller than those offered by India (1351 items and 2799 items respectively), while the Sri Lankan negative list (1180 items) was considerably lager than India’s (196 items)
- Relaxed Rules of Origin (ROO) – 35% (25% if Indian imports used)
- Longer tariff phase-out period (8 yrs for SL & 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% of GDP revenue)

India-Sri Lanka Trade: 1995-2015

Year	Exports (US$ Mn)	Imports (US$ Mn)	Trade Balance (US$ Mn)	Import/Export Ratio
1995-1999 average	39	509	-470	13.1:1
2000	58.0	600.1	-542.1	10.3:1
2001	72.0	601.5	-529.5	8.4:1
2002	170.5	852.8	-682.3	5.0:1
2003	245.3	1073.2	-827.9	4.4:1
2004	391.5	1439.1	-1047.6	3.7:1
2005	566.4	1835.4	-1269.0	3.2:1
2006	489.5	2172.9	-1690.4	4.4:1
2007	515.3	2610.1	-2094.8	5.1:1
2008	418.3	3443.0	-3024.7	8.2:1
2009	322.3	1820.1	-1498.2	5.7:1
2010	474.1	2570.3	-2096.2	5.4:1
2011	519.2	4431.2	-3912.3	8.5:1
2012	567.0	3640.0	-3073.0	6.4:1
2013	544.0	3171.0	-2627.0	5.8:1
2014	624.7	3977.0	-3352.3	6.3:1
2015	644.8	4284.9	-3640.1	6.6:1

What the Data Reveal ?

- Clearly the Import-export ratio has improved after the FTA in favour of Sri Lanka although there are annual fluctuations
- Sri Lanka’s trade with India increased almost 11 folds since the ILFTA
- Sri Lankan exports to India has grown faster than Indian imports to Sri Lanka
- India has become the third largest destination for Sri Lanka exports after EU and US
- India is the largest source of imports to Sri Lanka
- Both these facts make India the most balanced trading partner of Sri Lanka

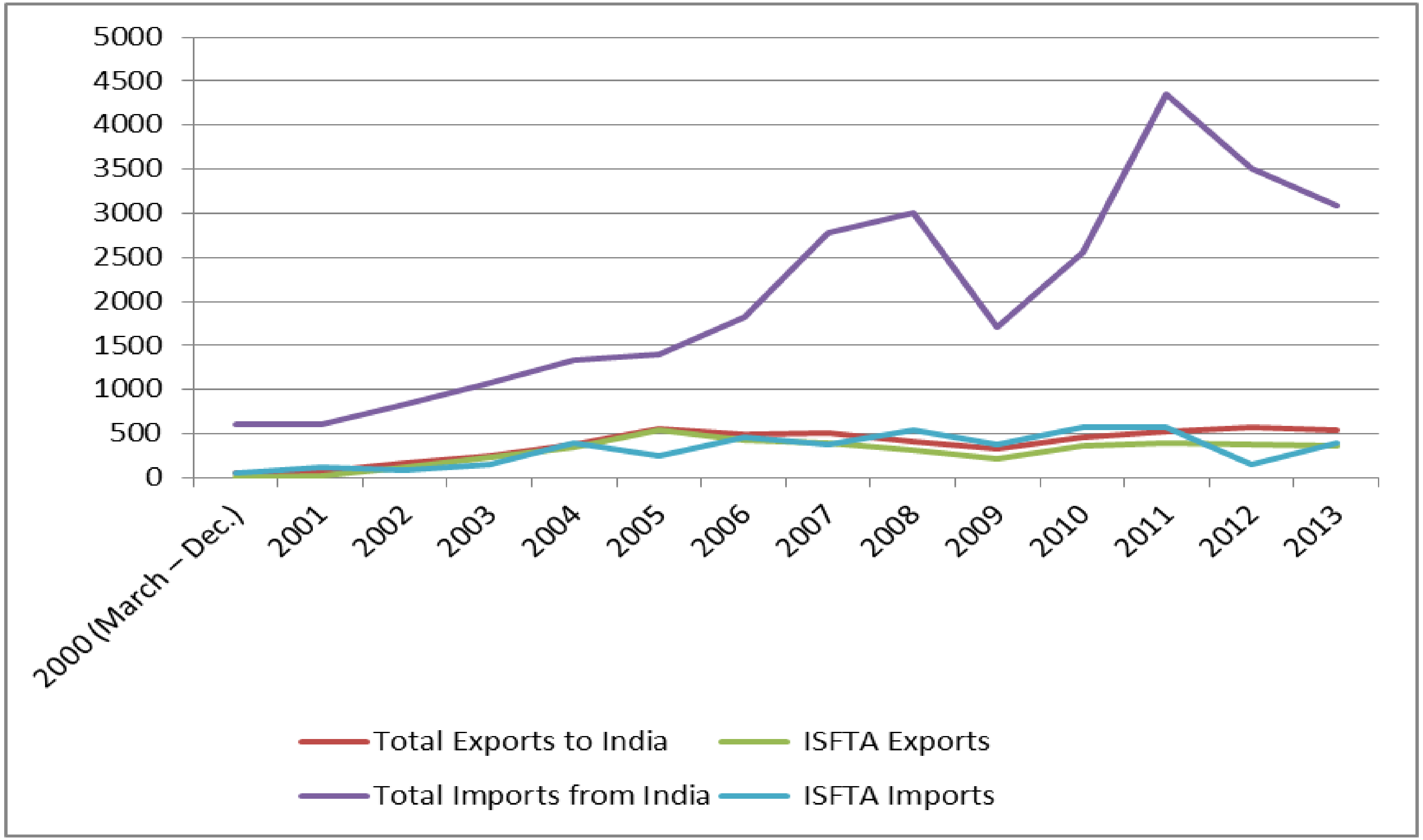
Usage of Free Trade Channel

	Exports (US $ Mn.)			Imports (US $ Mn.)		
Year	Total Exports to India	ISFTA Exports	% under the ISFTA	Total Imports from India	ISFTA Imports	% under the ISFTA
2000 (March – Dec.)	55.65	8.6	16	600	53.9	9
2001	70.12	15.9	23	601	113.1	19
2002	168.81	114.2	68	834	81.7	10
2003	241.14	238.8	99	1076	150.4	14
2004	385.49	339.9	88	1342	394.7	29
2005	559.21	543.0	97	1399.43	246.2	18
2006	494.06	431.1	87	1822.07	459.3	25
2007	516.4	398.2	77	2785.04	385.3	14
2008	418.08	309.3	74	3006.93	541.4	18
2009	324.87	218.5	67	1709.93	371.7	22
2010	466.6	358.4	77	2546.23	573.7	23
2011	521.59	391.5	75	4349.43	579.6	13
2012	566.37	379.5	67	3517.23	156.4	4
2013	543.37	354.8	65	3092.67	393.4	13
2014	624.8	375.8	60	3977.8	540.1	14
2015 (Jan-Nov)	598.6	406.3	68	3972.1	240.3	6

What the Data Reveal ?

- Sri Lanka has used the FTA more than India – average 80% compared to India’s 20%
- When the actual trade flowing under the FTA is considered, there is hardly a deficit between the two countries (next slide)
- One can thus argue that had the FTA not being in operation the deficit would have been larger

Trade with India, 2000-2013, USD Mn.



Product Composition and Number of Products

- Increasingly higher value added products are penetrating the Indian market – boat building, animal feed, pepper, apparel, cloves, insulated wires and cables, paper boards, glass & glassware, woven fabrics, etc.
- Arecanuts export increase in 2014 is an aberration
- The number of Sri Lankan products exported to India increased from 505 in 1999 to 1062 in 2008 to 2100 in 2012

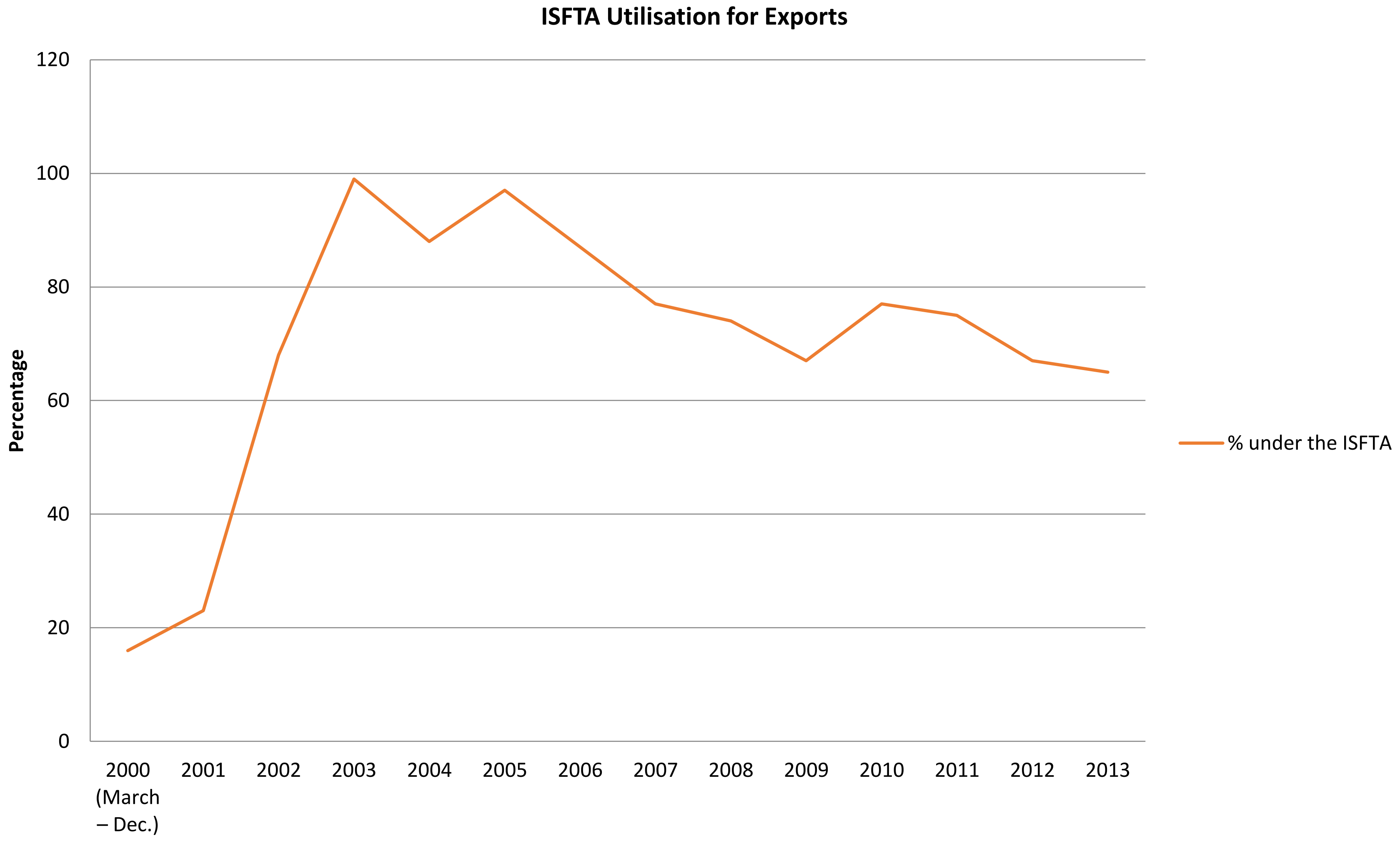
Why convert an FTA

into

an Economic Partnership Agreement (EPA), Comprehensive Economic Partnership Agreement (CEPA), or an Economic and Technology Cooperation Agreement (ETCA) ?

Underutilization of ISFTA

- Despite the success, ISFTA utilization rates have been falling



Source: Department of Commerce (2014)

To better utilize the FTA it needs updating

- FTAs have a life time and after some time they show diminishing returns
- This could be due to lack of supply capacity, exports of interest being in the negative list in the partner country, meeting rules of origin (ROO) obligations, and NTBs/POs
- Therefore, FTAs should be modified to face the contemporary realities

The Method of updating FTAs is via EPA, CEPA, CECA, ETCA, etc

- Economic Partnership Agreements (EPA) basically broaden and widen FTAs
- Broadening is done by including services and investment liberalization in the FTAs
- Widening is done by gradually reducing the negative list on products that are not available locally and domestic products that are ready to compete

Why Liberalize Trade in Services?

- Services account for nearly 60% of GDP but its capacity to earn foreign exchange is weak
- Services liberalization increases trade in services; it also increases the competitiveness of the manufacturing products
- Recent research has shown that 29% of value addition in manufactured exports of developing countries comes from services (WTO Annual Report 2014)
- This is also known as “servicification” of the manufacturing sector
- Services liberalization will bring down the cost of this component and thus improve the overall competitiveness of the manufacturing product as an export or as an import substitute

Modern Production Flows Stage Process Identity

1 Basic Research	Service
2 Applied Research	Service
3 Incubation and Testing	Service
4 Commercial Development	Service
5 Planning and Financing	Service
6 Manufacturing	Industry
7 Warehousing, Transporting and Marketing	Service
8 Financing	Service
9 After-sale services and maintenance	Service
10 Continued Research and Development for Next Generation Products	Service

Why Liberalize Investments Flows in EPAs/ETCAs ?

- Investment-Trade nexus is important in pushing trade
- Investment increases the supply capacity of existing firms and introduces new supply lines
- FDI is a key component in stimulating trade and it is FDI that links small countries to Global Value Chains and Global Production Networks
- To attract more FDI there needs an Investment Treaty with double taxation agreements, investment protection agreements, IPR laws, etc – all these are part of an investment liberalization package

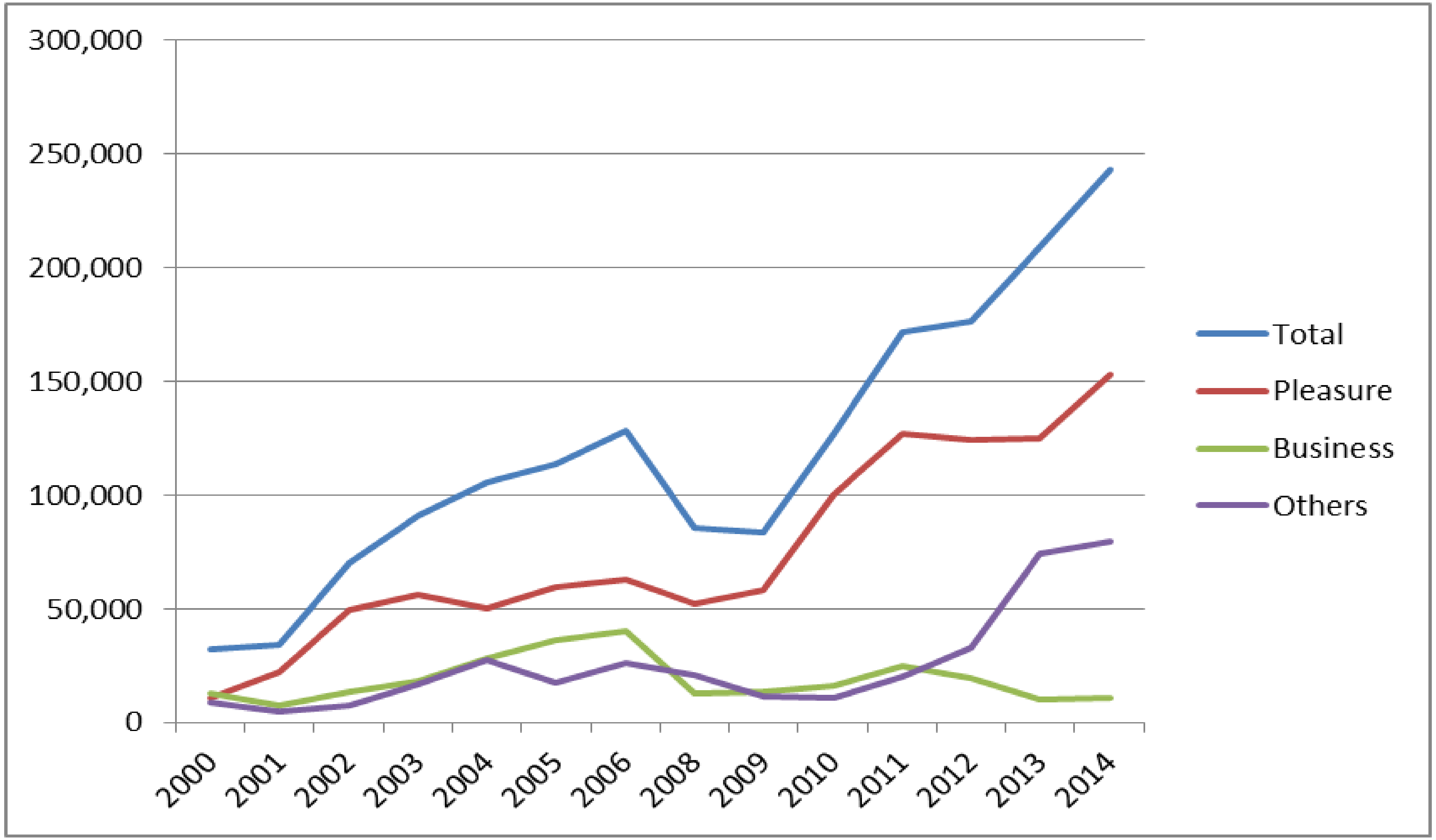
EPAs/CEPAs/CECAs

- In EPAs/CEPAs/CECAs/ETCAs, services and investment liberalization are combined with liberalization in trade in goods to get the best possible results
- We see that out of the 419 odd RTAs/FTAs operating at present, 133 have been already converted to CEPAs, CECAs or EPAs – all of them have services liberalization component under GATS-Plus and investment liberalization (www.wto.org)
- Sri Lanka, although a late comer is now seriously looking at this option

Services Trade Highlights – Current Sri Lanka gains from Servicing India

- 70 to 80% of transshipment cargo handled in Colombo Port are from India
- More than 40% of revenue of Sri Lanka Airlines comes from flights to India
- Largest Tourist inflows are from India
- Bulk of the Indian FDI in Sri Lanka are in services (Taj Hotels, Bharati Airtel, ICIC Bank, Apollo Hospitals, Lanka IOC, etc.)

Breakdown of India Tourist Arrivals to Sri Lanka by Purpose of Visit, 2000-2014



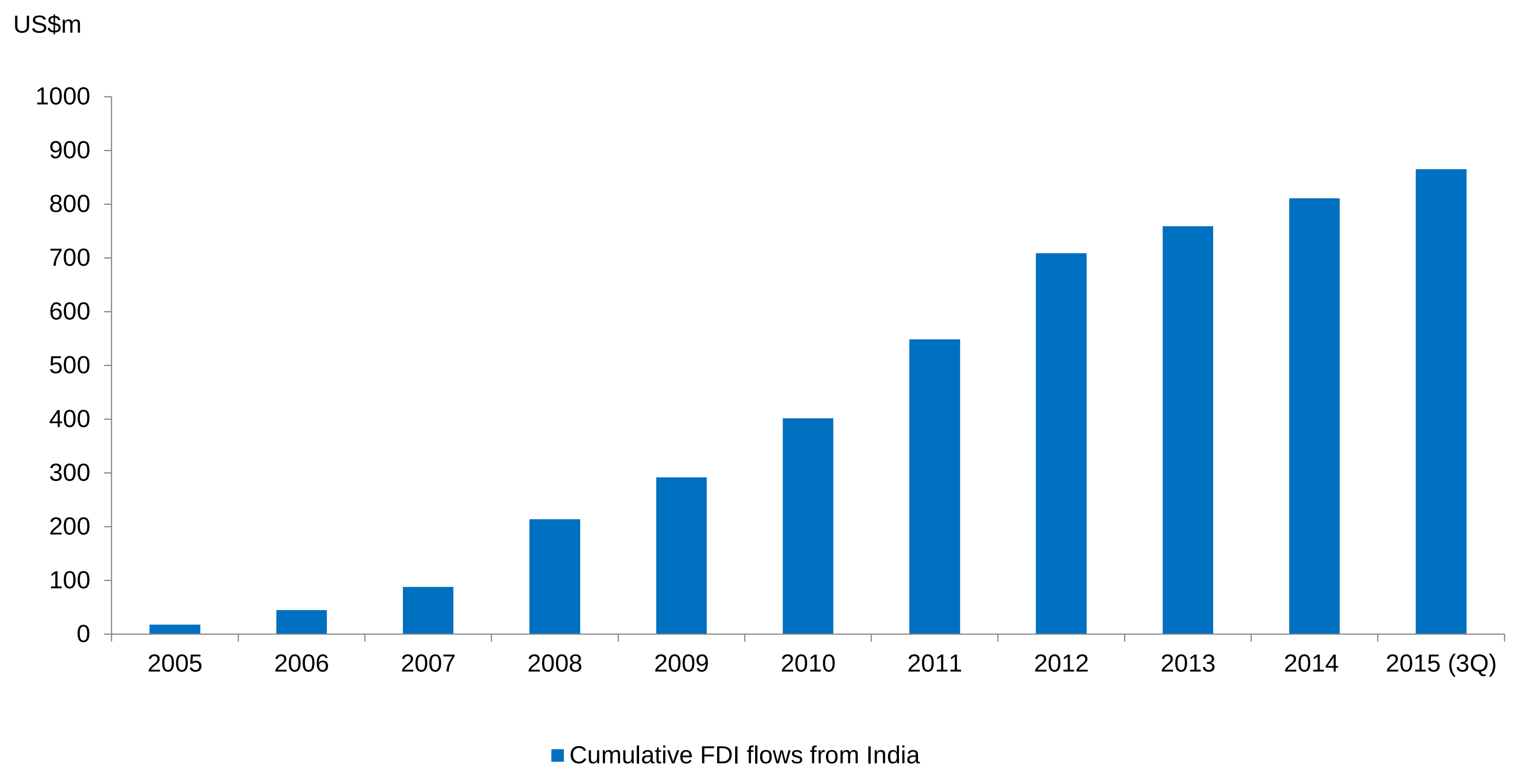
Why Liberalize Services in the ETCA ?

- Services liberalization will assist Sri Lanka to gain further from the FTA
- Many economist are now of the view that Sri Lanka's comparative advantage is more in services
- Even 'Mahinda Chintana' spoke about promoting 5 Hubs based on this thinking
- But hubs cannot be developed by restricting trade in services
- For example, to make best use of Hambantota Port and Mattala airport services liberalization will assist

Why Liberalize Investment under ETCA ?

- Sri Lanka’s supply capacity to India and to the world can be improved; for example, Kelani Tyres was basically an import substitution product catering to the domestic market; but with the entry of CEAT from India (as a joint venture) to produce Kelani-CEAT tyres, it has made this industry reaping economies of scale by exporting tyres to many parts of the world
- Indian cumulative investment in Sri Lanka is close to US$ 1 bn while Sri Lankan investment in India is close to US$ 300 mn

Cumulative FDI inflows from India into Sri Lanka, 2005-15



Investments now Happening Both Ways

bharti Airtel

Ashok Leyland

State Bank of India
With you - all the way

IOC
Lanka IOC

ICICI Bank

CEAT
born tough

Aitken Spence

brandix
inspired solutions

DAMRO

FAQ on ETCA ?

Difference between ETCA and CEPA ?

- CEPA was a comprehensive partnership agreement where many MRAs (Mutual Recognition Agreements) would be under one agreement and had the power of removing all NTBs in both sides
- ETCA is not a comprehensive partnership but has a limited number of MRAs
- ETCA does not have a separate Chapter of "Movement of Natural Labour" and Mode 4 will be 'unbound' under services liberlization
- In other words, stand-alone Mode 4 will not take place under ETCA
- Existing quotas and procedural delays on the Indian side will be under an "Early Harvest for Sri Lanka" under ETCA
- ETCA takes into account the asymmetry between the two countries like in the FTA and Special and Differential Treatment will be built in favour of Sri Lanka (was also included in CEPA)

Impediments to Market Access in India ?

- The Indian NTBs were identified after extensive consultation with the private sector, Chambers, and others by the Department of Commerce over the last year
- The list was submitted to India for early rectification and an Early Harvest was worked out with ETCA coming into full operation – it will be based on a comprehensive Mutual Recognition Agreement (MRA)

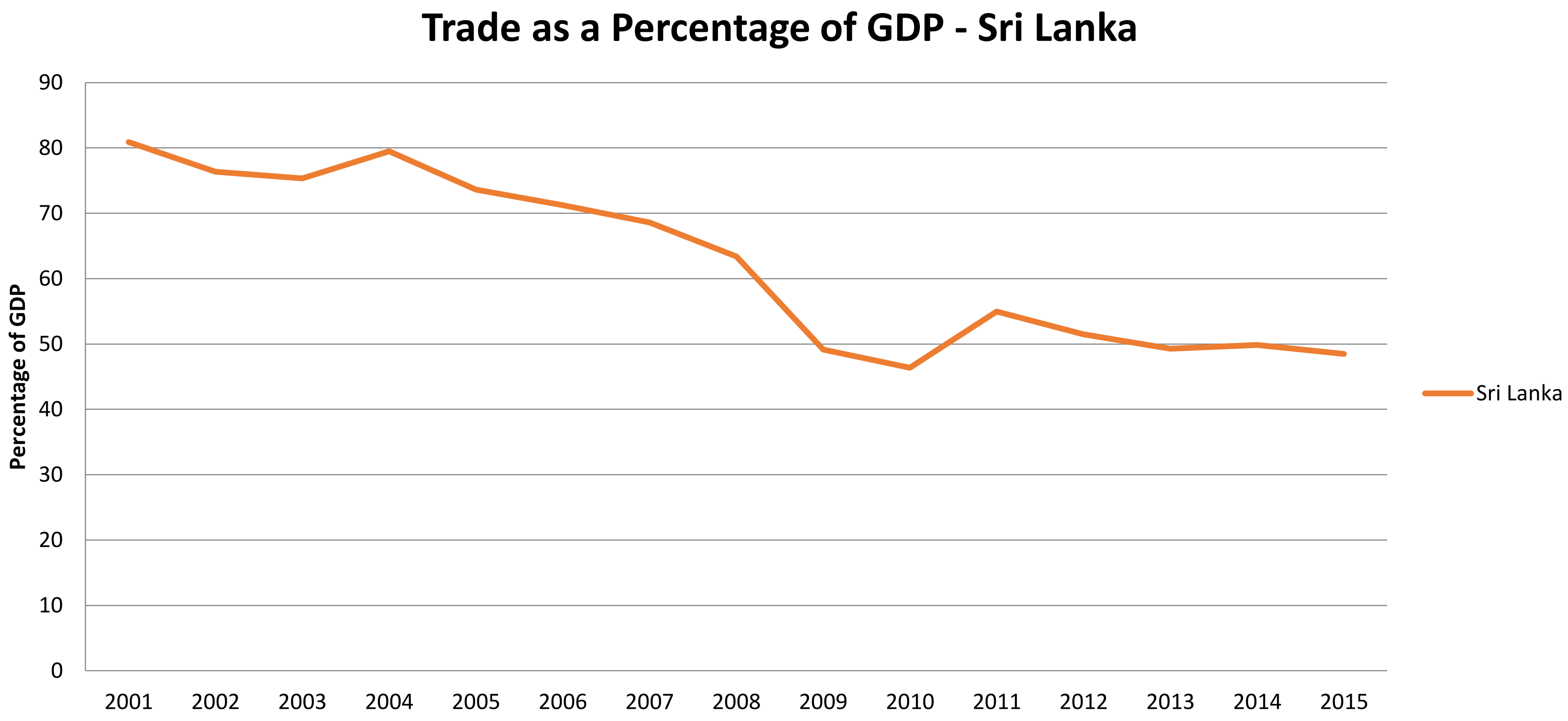
Rectify the Anomalies of the FTA and then move to ETCA ?

- The tasks must move forward in parallel
- No one said first rectify the anomalies in SAFTA and address the NTBs before signing SATIS
- After signing an agreement there is time to agree on which products to liberalize and prepare the schedules in services
- The rest of the world is not going to wait for us until we get our act together

Comparing Sri Lanka’s Trade Regime with the Changes Taking Place in Global Trading –Can we be Satisfied ?

Impact on Overall Trade

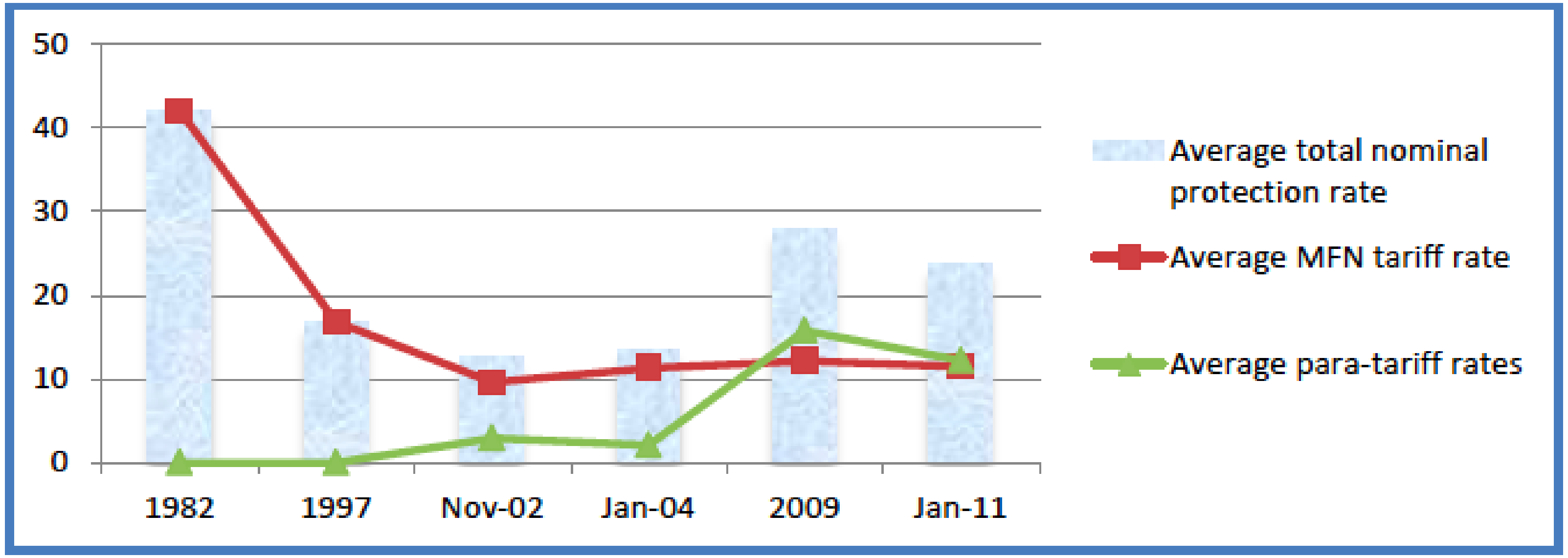
- Restrictive trade policies have hindered Sri Lanka's trade potential



Source: World Development Indicators, 2016

• One of the most complex tariff systems in the world (MFN tariffs and multiple Para-tariffs)

Nominal Protection in 1982, 1997, 2002, 2009, and 2011 (in percent)



Source: Kaminski and Ng, 2013

Current Export and FDI Scenario

- Sri Lankan exports have declined from 27% of GDP in 2000 to 16% of GDP by 2014
- Sri Lankan exports have lagged behind Vietnam and Bangladesh (both referred to as LDCs)
- In 1990, both Vietnam and Sri Lanka's annual exports amounted to US$ 2bn; by 2014 Vietnam's annual exports were US$ 158 bn whereas Sri Lankan exports were US$ 12 bn
- In 2000, both Sri Lanka's and Bangladesh annual exports were US$ 5.5 bn; by 2014 Bangladesh exports amounted to US$ 33.1 bn compared to Sri Lanka's US$ 12 bn
- FDI inflows in Sri Lanka still remains around 1.3% of GDP compared to Vietnam amounting to between 4.5 – 5.5% of GDP

Vietnam/Bangladesh/Sri Lanka

Comparing Sri Lanka's Export Performance with Vietnam and Bangladesh (amounts in US$ Billions)

Country	1990	2000	2005	2010	2014
Vietnam	2.0	14.5	32.4	72.2	157.8
Bangladesh	1.7	5.5	9.3	19.2	33.1
Sri Lanka	2.0	5.5	6.4	8.9	11.9

Source: Export Development Board of Sri Lanka

Table 1: Share of GPS Products in Manufacturing Exports, 2012-13 (%)

	Parts and Components	Final Assembly	Total
Sri Lanka	6.2	----	6.2
India	11.6	11.3	22.9
Indonesia	20.1	13.2	33.3
Malaysia	63.5	9.8	73.2
Thailand	46.9	22.8	69.7
Viet Nam	20.1	10.3	30.5
South Asia	11.2	11.2	22.5
Developing Countries	34.1	28.0	62.0
World	29.2	17.9	47.1

Source: UN Comtrade (2016)

Link between GVCs and International Trade

- Global trade now increasingly moves now via GVCs
- Links to GVCs cannot be developed by excessive protection
- Liberal trade and investment through a more open economy are essential for linking to GVCs
- Since the multilateral trade liberalization process as determined by the WTO is at a standstill, most countries opt for Regional Trade Agreements (RTAs) and Bilateral Free Trade Agreements (FTAs) to pursue more liberal trade
- Today, nearly 50% of global trade takes place via regional trade agreements (RTAs),Free Trade Agreements (FTAs), etc.

Need to move forward with FTAs to strengthen the new development strategy

Change in Development Strategy

- Sri Lanka is witnessing a change of development strategy: from debt-financed development strategy to exports and FDI-led development strategy
- Export-led strategy: while consolidating market share in existing markets (especially EU and US), exploring new markets in the growing regions of the world
- FDI strategy: while having a focused strategy to attract FDI, exploiting the investment-trade nexus via Free Trade Agreements and Regional Trade Arrangements to attract FDI

Exploit Emerging Opportunities

- Sri Lanka's major exports markets both US and EU are in recession or recovering very slowly
- Therefore Sri Lanka needs to depend on growing markets of Asia– China, India, Singapore, etc., for her export growth
- It is Asian giants like India, China, and Singapore that can bring more FDI to Sri Lanka
- We have to see the proposed ETCA, China-Sri Lanka FTA, and Singapore-Sri Lanka FTA as widening opportunities and not as a threat

- Thank you