ADB

Deepening Economic Cooperation between India and Sri Lanka

edited by
Indra Nath Mukherji • Kavita Iyengar

Asian Development Bank

Deepening Economic Cooperation between India and Sri Lanka

edited by
Indra Nath Mukherji • Kavita Iyengar

Asian Development Bank

Printed in India.

ISBN 978-92-9254-169-9 (Print), 978-92-9254-170-5 (PDF)

Publication Stock No. BKK135771-2

Cataloging-In-Publication Data

Mukherji, Indra Nath and Kavita Iyengar.
Deepening economic cooperation between India and Sri Lanka
Mandaluyong City, Philippines: Asian Development Bank, 2013.

1. Trade. 2. Free trade agreement. 3. India. 4. Sri Lanka. I. Asian Development Bank.

Note: In this publication, "$" refers to US dollars.

6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
Tel +63 2 632 4444
Fax +63 2 636 2444
www.adb.org

For orders, please contact:
Department of External Relations
Fax +63 2 636 2648
adbpub@adb.org

Printed on recycled paper

Acknowledgements
Special thanks goes to discussants at the consultations Alokesh Barua, Amita Batram Paras Kharel, and Nisha Taneja and the peer reviewers Saman Kelegama, V.N. Attri, Vyuptkesh Sharan, B.B. Bhattacharya, and Mahendra Lama.

This work was undertaken under RETA 6472: Strategic Partnership for Policy Development and Action to Foster Regional Cooperation in South Asia

Preface

This study analyzes the India–Sri Lanka Free Trade Agreement (FTA) over the past decade. It is noted that bilateral trade between the countries has increased steadily and India became the most favored import source for the Sri Lankan importers immediately after the implementation of the FTA. The structure of bilateral trade has also undergone considerable diversification since the agreement came into force and trade in a number of new products has increased considerably. It is noted that due to provisions under the agreement, although India became an important source of imports initially, Sri Lanka subsequently benefited substantially from access to the vast Indian market.

The study suggests scope for expanded cooperation for goods, investments, and services by computing indices suggesting pruning the negatives lists, identifying potential investment on the basis of bilateral intra-industry trade in commodities at the disaggregate level, and suggesting policies for expanding cooperation in services. Consultation seminars were undertaken with policy-makers, academia, businesspersons, and other stakeholders in New Delhi and Colombo and the feedback was incorporated. The seminar in Sri Lanka was held in partnership with Pathfinders Foundation, Colombo.

Research and Information System for Developing Countries (RIS) has led the work on this study. I would like to specially thank Biswajit Dhar, Director-General, RIS for partnering with us in this very fruitful endeavor.

Hun Kim
Country Director
India Resident Mission

Contributors

Subrata K. Behera Drewry Maritime Services

Kavita Iyengar Asian Development Bank, India Resident Mission

Abhishek Kumar Marketing and Development Research Associates

Deshal de Mel Institute of Policy Studies, Colombo

Indra Nath Mukherji Research and Information System for Developing Countries

Biswajit Nag Indian Institute of Foreign Trade

Nawal K. Paswan Centre for South, Southeast and Central Asian Studies School of International Studies, Jawaharlal Nehru University

Nihal de Silva Lanka Market Research Bureau

Anushka Wijesinha Institute for Policy Studies, Colombo

Contents

Tables

Figures

Abbreviations

APTA	Asia Pacific Trade Agreement
ASEAN	Association of Southeast Asian Nations
ASIDE	Assistance to States for Development of Export Infrastructure and Allied Activities
ASYCUDA	Automated System for Customs Data
BIPA	Bilateral Investment Promotion and Protection Agreement
BIS	Bureau of Indian Standards
BITs	Bilateral Investment Treaties
BOI	Board of Investment
BV	Business visitors
CBEC	Central Board of Excise and Customs
CECA	Comprehensive Economic Cooperation Agreement
CEPA	Comprehensive Economic Partnership Agreement
CFTRI	Central Food Technological Research Institute
CHAs	Custom House Agents
CKITL	Ceat-Kelani International Tyres Pvt Ltd
COO	Certificate of Origin
CPC	Central Product Classification
CSS	Contractual service suppliers
CTB	Central Transport Board
CVA	Customs Valuation Agreement
CVD	Countervailing duties

DGAD	Directorate General of Anti-dumping and Allied Duties
DTTA/DTAA	Double Tax Avoidance Treaty Agreement/Double Taxation Avoidance Agreements
EDB	Export Development Board
EDI	Electronic data interchange
EIA	Export Inspection Agency
EPZ	Export processing zone
FDI	Foreign direct investment
FSSA	Food Safety and Standards Authority
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GEAC	Genetic Engineering Approval Committee
GFR	General Financial Rules
GL Index	Grubel-Lloyd Index
GOI	Government of India
HACCP	Hazard analysis and critical control points
IBSL	Insurance Board of Sri Lanka
ICRIER	Indian Council for Research and International Economic Relations
ICT	Intra-corporate transferee
IIFT	Indian Institute of Foreign Trade
IOC	Indian Oil Corporation
IPPC	International Plant Protection Convention
IRCON	Indian Railways Construction Company
ISFTA	Indo-Sri Lanka Free Trade Agreement
JP	Juridical person
JSG	Joint Study Group
JVP	Janatha Vimukthi Peramuna
LDC	Least developed country
LMRB	Lanka Market Research Bureau (Pvt.) Ltd.
M&A	Mergers and acquisitions
MAI	Market Access Initiative
MDA	Marketing Development Assistance
MDR	Medical Devices Regulatory
MDRA	Marketing and Development Research Associates
MFN	Most favored nation

MNEs	Multinational enterprises
MRA	Mutual recognition agreements
NAFED	National Agricultural Cooperative Marketing Federation of India Limited
NLDC	Non-least developed country
NTB	Non-tariff barrier
NTC	National Transport Commission
PAL	Ports and Airports Development Levy
R&D	Research and Development
RDA	Road Development Authority
RITES	Rail India Technical and Economic Services
RMS	Risk Management System
RPO	Revenue Protection Orders
RTA	Regional Trade Agreement
RTC	Regional Transport Companies
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Area
SAPTA	South Asian Preferential Trading Arrangement
SARSO	South Asian Regional Standards Organization
SDPA	Strategic Development Project Act
SEZ	Special economic zones
SLACCS	Sri Lanka Automated Cargo Clearance Systems
SLPA	Sri Lanka Ports Authority
SLSI	Sri Lanka Standards Institution
SME	Small and medium-sized enterprise
SPM	Sanitary and phytosanitary measures
SPS	Single Payment Scheme
STC	State Trading Corporation
STI	Scheme of Testing and Inspection
TBT	Technical Barriers to Trade
TEU	Twenty-foot equivalent units
TIEA	Tax Information Exchange Agreement
TIEP	Temporary importation for export processing scheme
TPR	Trade Policy Review
TRQ	Tariff-rate quotas

1 Introduction

Indra Nath Mukherji and Kavita Iyengar

1.1 STAGES OF REGIONAL INTEGRATION

Regional Trading Arrangements (RTAs) have become a prominent feature of the multilateral trading system and the surge in RTAs has seen prolific growth since the early 1990s. As of January 2012, 511 notifications of RTAs (counting goods and services separately) have been notified to the General Agreement on Tariffs and Trade (GATT)/ World Trade Organization (WTO). Of these, 351 RTAs were notified under Article XXIV of the GATT 1947 or GATT 1994; 31 under Enabling Clause; and 92 under Article V of the General Agreement on Trade in Services (GATS). On the same date, 283 agreements were in force. Counting goods and services together, 371 agreements were formed, of which 193 are currently in force.[1]

Market integration among various regional trading arrangements differs considerably in terms of scope and objectives. Preferential trading is one of the mildest forms of integrative arrangement. Under the arrangement, the contracting states offer a preferential margin with respect to trade barriers in relation to their most favored nation (MFN) rates. Contracting states with disparate levels of development as well as trade regimes, find this an acceptable

[1] http://www.wto.org/english/tratop_e/region_e/region_e.htm accessed on 1 November 2012.

instrument for initiating regional trade liberalization. Such an arrangement nevertheless provides the building blocks towards accelerated regional trade liberalization culminating in a free trade area within a defined time frame. Under a free trade area the contracting states eliminate all trade restrictions on their mutual trade, while maintaining restrictions in their trade with non-contracting states at a level they deem appropriate. When all contracting states decide on a common external tariff, then the arrangement translates itself in a more cohesive customs union. The more comprehensive integrative arrangement arises in the nature of a common market when all contracting states agree not only to allow free movement of goods and services, but all the factors of production including capital and labor. The highest stage of economic integration arises when, in addition to a common market, all contracting states agree to coordinate their monetary, fiscal and exchange rate policies to form an economic community.

The Indo-Sri Lanka Free Trade Agreement (ISFTA), which was signed in December 1998, and became operational in March 2000, thus symbolizes the second stage of regional economic integration. An India–Sri Lanka Study Group on Comprehensive Economic Partnership Agreement (CEPA), which submitted its report in 2003, has recommended further intensification of trade in goods and the promotion of an investment agreement that would promote freer flow of capital between the two countries, as also an agreement on cooperation in services. In addition, it has recommended economic cooperation in general, that would indirectly promote economic integration. However after several rounds of negotiation on CEPA, the study group has stalled discussions, due to some ambiguity surrounding the achievements thus far. The question of forming a customs union between the two countries has never been on the negotiating agenda of the two countries. Thus the ISFTA has been negotiating towards achieving some objectives of the fourth stage of economic integration, bypassing the third stage which is politically difficult to negotiate.

1.2 RATIONALE FOR BILATERAL FTAS

1.2.1 Extended Market Access and Early Mover Advantage

While trade liberalization at the multilateral level can yield the best positive outcome with widespread scale effects providing for economies of scale, the complexity of the negotiations among a large number of trading partners at disparate levels of development is well demonstrated by the stalled Doha Round negotiations among negotiating parties of the WTO. The proliferation of RTAs worldwide is a natural outcome as a second best solution. When RTAs also falter, due to similar reasons of lower intensity, bilateral agreements enter the fray, as a third best solution. The smaller countries in the region look towards India's huge and growing market, an entry into which could give them a first mover advantage. Access to the Indian market could help expand their scale of operations and thereby reap economies of scale, which otherwise would not have been possible given their small domestic markets.

1.2.2 Slow Progress of Regional Trading Arrangements

The move towards bilateralism has also been induced by the experience of South Asian countries in participating in alternative preferential trading arrangements at the plurilateral or regional levels. This can be well illustrated by the experience of three countries, viz., India, Pakistan and Sri Lanka participating in alternative RTAs.

Both India and Sri Lanka have been participating as original signatories to the (i) Asia Pacific Trade Agreement (APTA) earlier known as Bangkok Agreement, Asia's first multilateral preferential trading arrangement initiated under UN ESCAP in December 1975; and the (ii) South Asian Preferential Trading Arrangement (SAPTA), implemented since December 1995 and following its deepening to the (iii) South Asian Free Trade Area (SAFTA), implemented since July 2006, in which all the three countries have been original signatories.

The progress achieved in trade liberalization through APTA has been dismal as membership has not expanded beyond six and the scope of the agreement continues to remain confined to "goods only". Only three rounds of negotiations were held till 2006. At the end of the third round the countries had exchanged concessions on only 4270 products with average margin of preference of 27% for non-least developed countries (NLDCs) and 59% for least developed countries (LDCs). Figures for 2003 reveal that Sri Lanka imported Indian products worth $76 million (conceded preferences under its National List of Concessions) which comprised 17% of its world imports while India imported Sri Lankan products worth only $12 million which comprised less than 1% of its world imports the same year. In view of these trends, APTA does not hold much possibility of expanding bilateral trade between the two countries.[2]

The experience of SAPTA/SAFTA does not seem to hold much promise

[2] I.N. Mukherji. 2007. Asia-Pacific Trade Agreement: Implications of Exchange of Trade Preferences for Member and Prospective Member Countries. *Asia-Pacific Trade and Investment Review*. 3(1).pp. 87–144.

for the two countries either. Till the end of third round (August 1999) India had offered concessions on 2927 products of which only 477 were in favor of NLDCs. While India's margin of preference for LDCs was 50%–100%, those for NLDCs were no more than 20%–30%.[3] Thus Sri Lanka, being a NLDC, could not expect much in terms of concessions offered by India.

It will be evident that India has very modest preferential imports from Sri Lanka in a marked contrast with India's similar imports from other South Asian countries. Whereas in 2002–03, the value of preferential imports by India in conceded items from Bangladesh stood at 57%, from Maldives at 29% and from Pakistan accounted for as much as 65% of its total bilateral imports from each of these countries, the value share of such imports from Sri Lanka was no more than 2% (footnote 2).

India's value of preferential exports in conceded items offered by South Asian countries in the three rounds of negotiations as percentage of its bilateral exports declined from 14% of its total bilateral exports in 1996–97 to 6% in 2002–03. This indicates that preferences offered to India by Sri Lanka also failed to stimulate Indian exports to it (footnote 2).

1.2.3 Smaller Negative Lists

Under a bilateral trading arrangement it is possible to draw up a smaller negative list since the number of stakeholders to the negotiations is limited (negative list comprises the list of banned products). To illustrate, as on 4 March 2013, India's negative list for NLDCs was 614 items under SAFTA as compared to 429 under the ISFTA. Similarly Pakistan's negative list for NLDCs was 936 items under SAFTA, but only 697 items under the Pakistan–Sri Lanka Free Trade Agreement.

Lack of agreement between the two largest member states of SAARC stood in the way of positive and enduring cooperation among the contracting states. Till recently, Pakistan continued to offer concessions to India on the basis of its positive list, which in fact, turned out to be negative for the operational requirements and flexibility of the agreement.[4] Under SAFTA, an NLDC

[3] I.N. Mukherji. 2004.Towards a Free Trade Area in South Asia: Charting a Feasible Course for Trade Liberalization with Special Reference to India's Role. Research and Information System for Developing Countries. Discussion Paper # 86/2004. p. 6.

[4] However, this situation is fast transforming with Pakistan having agreed to offer India mfn status by end of 2012. On 22 March 2012, Pakistan scrapped its positive list of imports that allowed 1932 items to be imported from India and has since moved to a negative list (meaning

contracting state may, if it so chooses, grant non-reciprocal concessions to an LDC contracting state without having to extend the same to another NLDC contracting state. However when an NLDC grants a concession to another NLDC, it cannot but extend the same to all contracting states including any other NLDC. This implies that Pakistan must grant concessions to Sri Lanka from the list of products contained in India's positive list. But such products may not be of interest to Sri Lanka whose comparative advantage could lie in other products. Similarly India could have inhibitions granting concessions to Sri Lanka on products that could as well benefit Pakistan. In the absence of Pakistan not granting MFN status to India, this may be interpreted as Pakistan free-riding on its concessions to Sri Lanka.[5] To address this problem, it became necessary for Sri Lanka to have two separate free trade agreements, first with India, and then with Pakistan.[6]

Thus the need for a free trade agreement between India and Sri Lanka and between Pakistan and Sri Lanka was not merely based on a rationale for it in academic studies, but was in fact, also stimulated by the very limited impact on the bilateral trade between these countries under other regional preferential trading arrangements, as also by political constraints governing trade between India and Pakistan.

1.3 AN OVERVIEW OF STUDIES

1.3.1 Indo-Sri Lanka Free Trade Agreement: An Analysis of Merchandise Trade

In Chapter 2, following a literature survey of studies on India–Sri Lanka Free Trade Agreement, Behera and Mukherji analyze trends in India–Sri Lanka merchandise trade prior to and following the liberalization of trade between the two countries. The study observes buoyant flow of bilateral trade between March 2000 (when the agreement came into force) and 2008, after which the global recession kicked in and depressed bilateral trade in 2009.

banned products) of just 1209 items, allowing remaining 5599 products to be imported on MFN basis. However, due to procedural delays, as of March 2013, the implementation of MFN status to India is still awaited.

[5] A case in point is tea in respect of which Pakistan would like to extend concessions to Sri Lanka but not to India.

[6] Pakistan–Sri Lanka Free Trade Agreement was signed on 1 August 2002 and implemented from 12 June 2005.

While India's exports to Sri Lanka witnessed a continuous upward trend till 2008, India's imports from that country increased briskly up to 2005 and a declining trend set in thereafter, much ahead of the global recession.

While the study acknowledges the dominance of copper and *vanaspati* (refined hydrogenated oil) in Sri Lankan exports to India, it simultaneously takes note of substantial diversification in the export basket with manufacturing products such as refrigerating and freezing display counters and parts thereof, wooden office furniture, sausages and bakery products, cruise ships and boats from Sri Lanka having found their way into the Indian market.

The study presents a detailed analysis of trade flows under different categories of concessions offered by the two countries. An interesting finding is that while a large value of India's exports to Sri Lanka took place under the Sri Lankan negative list, a large value of Sri Lanka's exports to India took the concession-offered route. This reflects the position that while concessions offered by India to Sri Lanka did enhance access to the Indian market, the converse did not hold for India's exports to Sri Lanka. It is noteworthy that over the period 2001–09 preferential import of products under different concession categories increased faster than similar imports from the rest of the world, reflecting an increasing share of bilateral trade in the world trade of signatory countries under different concession product categories. The study proceeds to examine how the negative lists of both the countries could be pruned in keeping with the objectives of CEPA. The study recommends the removal of six products from Sri Lanka's negative list and 25 from India's. The number of eligible products can be increased by relaxing some of the filters.

The study highlights the role of declining preferential margins and the stagnation of Sri Lanka's exports to India since 2005. While copper and vanaspati were the major products affected by this, a number of other products too suffered loss of Indian market access on account of this factor. The loss of preferential margins arose as India undertook tariff reforms, partly as a matter of accepted policy and partly with a view to absorbing the adverse impact of spike in commodity prices on consumers in 2008.

The bringing down of tariffs on essential commodities, particularly on crude / refined palm oil and copper also narrowed the external tariff differential on these products in the two countries. It no longer remained profitable for Indian investors operating in Sri Lanka to import these low duty products, convert them to finished ones in the form of vanaspati or copper ingots and export them duty free to the Indian market. Nominal profitability merely on account of external tariff arbitrage was clearly lost and many such investors had to wind up their operations in Sri Lanka.

In order to prevent the recurrence of similar trade deflection on other commodities, the study identifies products with marked external tariff differentials that could enter the market duty free. It urges trade/regulatory authorities in both the countries to pre-empt such occurrence, either by enforcing rules of origin, or if feasible to harmonize external tariffs on such identified products.

The JSG on CEPA had also recommended that the existing ISFTA needs to be widened to include more goods, and deepened to improve market access through trade facilitation and removal of non-tariff barriers. Chapter 3 addresses these issues.

1.3.2 Issues Related to Trade Facilitation and Non-tariff Barriers in India and Sri Lanka: A Synthesis of Secondary Literature

In Chapter 3, using secondary literature, Biswajit Nag presents trade facilitation issues both in India and Sri Lanka and brings out notable advances made in both the countries towards automation, in particular in respect of electronic data interchange (EDI).

In case of the ISFTA, it has been identified that Certificate of Origin plays a very crucial role, particularly the one issued by Sri Lanka. It has been observed that Sri Lanka issues such certificate once the goods are delivered at Indian ports resulting in clearance delays. Similarly, additional certificate requirements increase the hassles of the traders who export and import through the ISFTA route. Many a times the officials are not aware of the documentation requirements of the ISFTA. Further, there no nodal body which can tackle trader's grievances. Also, lack of testing laboratories at ports renders export/import rather time consuming with adverse repercussions for trade in perishable items.

Nag deals with issues relating to non-tariff barriers in the second part of his paper. The study identifies a number of barriers beyond the traditional sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBT). In Sri Lanka, regulations regarding packaging are stringent in some cases. Besides, there are complexities associated with marketing of foreign products through domestic companies as also norms and procedures to be followed in case a domestic company enters into a joint venture with an Indian company.

Barriers on imports of "non-essential" goods require clarification. The inordinate delays by the Sri Lankan authorities in providing technical certification even to companies which already have internationally accepted certificates also act as a barrier to trade. High bank margins on imported goods also acts as a dampener to imports. In India quota restrictions on selected products, port restrictions (presently largely addressed), and high variability in state-level taxes impose restrictions on imports from Sri Lanka.

1.3.3 Indo-Sri Lanka Trade Relations and Effect of India–Sri Lanka Free Trade Agreement: A Survey of Indian and Sri Lankan Stakeholders

Chapter 4 is devoted to field surveys on Indian and Sri Lankan traders.

The Indian survey was undertaken by Marketing and Development Research Associates (MDRA), New Delhi (coordinated by Abhishek Agrawal). A sample of 103 respondents was selected, of which 22 were surveyed through in-depth interviews; 44 exporters and 37 importers who had availed of the FTA facility were probed through structured interviews. Lanka Market Research Bureau (LMRB) conducted a survey of Sri Lankan stakeholders consisting of a sample of 66 of which 20 were exporters, 40 importers, and 6 business associations (coordinated by Nihal de Silva).

The MDRA survey indicated that importers and exporters had different reasons for trading with Sri Lanka. For the exporting community, the benefits provided by the ISFTA weighed in to bolster the existing advantages of geographical proximity of India with Sri Lanka, good export prices and ease of payment. Importers, however, were strongly persuaded by the good quality of Sri Lankan products available at competitive prices. Benefits under the ISFTA ranked third among factors that favored trading with Sri Lanka.

The study also found that many imports are mandated by the final buyers. Apparel manufacturers are often compelled to import the accessories from Sri Lanka because their customers are very particular in this regard.

Under the LMRB survey exporters mentioned tariff concessions under the ISFTA as a key determinant of exports to India. Other important reasons given were close proximity and good market demand.

Low price was the main incentive for importers, followed by benefits obtained under the FTA and the close proximity of the two countries.

Under the MRDA survey maximum number of respondents both in case of exporters as well as importers opted for the FTA route due to the tariff concessions that it provides. The exporters cite the easy process and the drawback benefits as the other two important reasons for using the FTA.[7] The importers on the other hand cite better service, ease in operating through this channel and the benefit of the duty free re-export as the other important reasons for using the FTA route.

Under the LMRB Survey duty concessions under the ISFTA were by far, the most important reason for both exporters and importers to trade with India.

The JSG on CEPA recommended the removal of administrative and regulatory constraints to provide bilateral investment flows that would maximize mutual benefits of economic integration. In regard to foreign direct investment (FDI), the JSG recommended that national treatment in pre-establishment be provided in sectors where 100% FDI is permitted via the automatic route in both countries, but with appropriate safeguards built in. It further stated that the existing Bilateral Investment Promotion and Protection Agreement and the Avoidance of Double Taxation and Prevention of Fiscal Evasion should be reviewed by both the governments to enhance scope and effectiveness. These issues are discussed in Chapter 5.

1.3.4 Investment Linkages between India and Sri Lanka

In Chapter 5, Nawal K. Paswan examines and addresses some of the issues raised by JSG on investment promotion between India and Sri Lanka.

The overall assessment that emerges from this study is that both India and Sri Lanka have created a business environment conducive to enhanced bilateral investment flows through the liberalization of the regulatory framework for FDI. The progressive liberalization investment regimes (in both India and Sri Lanka) have already transformed the nature of economic links between them, and this process looks set to continue even further.

Prior to the launch of the ISFTA, in 1999, Indian investment in Sri Lanka was limited to food, beverages and tobacco, chemical, petroleum, rubber, and plastic products but in 2006, it was diversified to include services, fabricated metal products, machinery and transport equipment, manufactured products, and non-metallic mineral products.

In contrast to wide ranging direct investment in Sri Lanka by India, Sri Lankan investments in India are very few reflecting the low volume of outbound FDI from Sri Lanka in general. However, since 1990s, investment

[7] Duty drawback seeks to rebate duty charged on any duty or tax chargeable on any imported/excisable materials and input services used in the manufacture of export goods.

from Sri Lanka to India has risen though the flows are small in terms of value. Some successful ventures include outbound FDI in confectionary, apparel and furniture. In services, the most significant have been in banking and leisure sectors. But the last few years have also witnessed an increasing trend of Sri Lankan investments into India. Main Sri Lankan investments in India include Ceylon Biscuits (Munchee brand), Carsons Cumberbatch (Carlsberg), Brandix (to set up a garment city in Vizag), MAS holdings, John Keels, Hayleys, and Aitken Spence (Hotels). Investments have also flowed into the freight servicing and logistics. Sri Lankan investments in India that have increased include areas such as garments, confectionaries, hotels and furniture, with participation from some of Sri Lanka's top blue chip companies.

These two countries are also moving towards further industrialization. The possibilities of intra-industry trade emerge with more product differentiation which certainly requires different value chains of the same products. The estimated horizontal intra-industry trade suggests that instead of exporting and importing the same product, India may decide to set up a joint venture in Sri Lanka (with more favorable investment climate and cost advantage) to buy back the same in the home country (or vice versa). This study highlights some possibilities of Indo-Sri Lankan joint ventures in both markets to not just meet the needs of the partners but even beyond to tap international markets.

India and Sri Lanka have not yet transformed to high trade complementarities due to the lack of vertical specialization through a production-sharing arrangement. Hence, vertical specialization will certainly allow them to reap economies of scale by concentrating on a specific production process in the value addition chain. There is a need to evolve production agreements between both countries in specific sectors (i.e. textiles and clothing, leather, rubber and electronics) which could qualify for production integration schemes.

Safe and congenial climate for investment is an essential prerequisite for enabling the flow of investments between two sovereign countries. The study has highlighted some of the measures to enhance the effectiveness of Bilateral Investment Promotion and Protection Agreements (BIPAs) and Double Taxation Avoidance Treaty Agreements (DTTAs) between India and Sri Lanka (based on the template of India–Nepal BIPA and DTTA) for making similar modifications to India Sri Lanka BIPA and DTTA as suggested by the India–Sri Lanka Study Group on CEPA.

The JSG further recommended that the two countries enter into an agreement on trade in services. Negotiations should cover all service sectors and modes of supply under the GATS framework. Significantly, the JSG recommended that the two countries explore ways to lower the barriers to movement of business people and professionals and facilitate Mutual Recognition Agreements (MRAs) on professional qualifications. The JSG accorded special priority to market access for provision of transport and logistic services, and also liberalization of bilateral air services. Chapter 7 addresses some of these issues.

1.3.5 Trade in Services between India and Sri Lanka

In Chapter 6, Deshal de Mel and Anushka Wijesinha examine some of the issues highlighted by the JSG. The study highlights the increasing share of services in both the countries' gross national product. The study examines the revealed comparative advantage (RCA) of both India and Sri Lanka in different sectors and brings out the complementarities between them. In the transport sector, Sri Lanka has higher RCA than India. The same can be said in communications and insurance. India's RCA however is convincingly much higher in computer and related services as also in other business services (business process servicing and IT and IT–enabled services).

The study proceeds to examine some policy issues in service liberalization covering business services, financial services, education, health services, transport services (maritime, road, and air).

The study affirms that Sri Lanka has much to gain from liberalizing the mobility of people engaged in professional services. In order to achieve this, Sri Lankan professional qualifications must be recognized by international professional bodies and institutions. One could start this process in the areas of IT, accountancy, architecture, engineering, urban planning and health.

While Sri Lanka does not maintain restrictions regarding the establishment of foreign financial service providers, approval, registration and licensing related to banks and other financial institutions are subject to an economic needs test.

Sri Lanka retains very few restrictions with respect to market access for foreign providers of financial services. However, supply of financial services remains restricted in accordance with provisions governing the Exchange Control Law.

Sri Lanka allows the establishment of health care facilities under the BOI with no restriction on foreign equity participation.

Sri Lanka does not impose restrictions on foreign investment in transport infrastructure though FDI in freight forwarding is subject to certain restrictions.

Neither country has been very proactive in the WTO framework, at least in terms of existing actual liberalization as opposed to proposed new commitments.

The CEPA negotiations on services agreement followed many of the GATS principles. It was based on the four accepted modes of trade in services and adopts a positive list, request-offer approach. Accordingly, both sides exchanged request lists specifying the sectors and sub-sectors where each wishes to receive market access and national treatment commitments from the other party. The other party can then choose to make liberalization commitments within its comfort zones and developmental interests and liberalization will occur in the sectors and sub-sectors to the extent specified in the schedules. The positive list approach provides both countries with a great deal of flexibility in making commitments.

Furthermore, like the existing FTA in goods, CEPA fully recognized the asymmetries between the two countries and hence less than full reciprocity was expected of Sri Lanka.

At the end of the initial set of technical negotiations, both countries presented draft offers in June 2008. Since then negotiations have resumed to further develop these offers.

Under the proposals made, in almost all of these sectors Sri Lanka would get full market access to modes 1, 2 and 3 (except in accounting which is limited to mode 1 and 2, architecture where mode 3 access requires a joint venture and research and development (R&D) in agriculture which is limited to mode 1). In terms of mode 4, business visitors and intra-corporate transferees get access to almost all sectors while contractual service suppliers and independent professionals get access to the sectors specified.

Compared to India, Sri Lanka's draft offers are somewhat limited. Sri Lanka's offers build upon what is on the table at the current Doha round of WTO GATS and include a few additional sectors based Sri Lanka's service import needs. Offers in mode 4 (movement of professionals) are almost nil and other offers are all either at or below the current level of liberalization that is autonomously accorded through Sri Lanka's investment and exchange laws.

In this paper it has emerged that there are substantial benefits that could be reaped through greater cooperation between India and Sri Lanka in the services sector. This has been recognized by both governments and efforts were made to formalize and institutionalize cooperation in the form of CEPA, the negotiations for which began in 2005.

However actual progress on the ground is currently stalled awaiting buy-in from all stakeholders, particularly in Sri Lanka.

Better communication with the government is important in order to put stakeholder concerns at rest and convince them that their issues would be addressed through the various flexibilities made available in the framework of the services agreement of the CEPA in particular. A bilateral services agreement would be very useful, particularly in the context of slow progress of the Doha Round of the WTO and the delays anticipated in implementing the new commitments in the GATS.

2

Indo-Sri Lanka Free Trade Agreement

An Analysis of Merchandise Trade

Subrata K. Behera and Indra Nath Mukherji

2.1 INTRODUCTION AND OBJECTIVES OF THE STUDY

The year 2010 marked the completion of a decade of India–Sri Lanka Free Trade Agreement (ISFTA). Although trade relations between India and Sri Lanka can be traced back to the pre-colonial times, the inward-looking policies of both the countries did not allow bilateral trade to touch new heights. While Sri Lanka was the first South Asian country to liberalize unilaterally in 1976, it was only after India liberalized its economy in early 1990s, that the bilateral trade witnessed a considerable improvement. Perceived trade complementarities between the two nations along with slow progress of SAARC Preferential Trading Arrangement (SAPTA) acted as rationale for some form of trading arrangement between the two neighboring countries.[1] Initiative from leadership of India and Sri Lanka resulted in the signing of the ISFTA on 28 December 1998. The agreement came into effect from 1 March 2000. It is a well-known fact that the trade dynamics between the contracting states completely changed after the implementation of the agreement. The present study aims to examine the functioning of the agreement through the years. The study investigates, over the decade between 1998–99 and 2008–09:

[1] SAARC: South Asian Association for Regional Cooperation

1. the overall trend in bilateral trade between India and Sri Lanka;
2. the changing structure of bilateral trade;
3. the emergence of new products and decline of old ones in the composition of trade
4. the trade potential between the two countries given the supply–demand balances and existing trade;
5. ways to work out the revealed comparative advantage of the identified potential products and further, to assess their competitiveness in respective markets.

Based on such analysis, the study suggests modalities for pruning products in the respective negative lists of the contracting states and assesses the role of decline in preferential margins in the operation of ISFTA.

2.2 REVIEW OF LITERATURE

The possibility of a free trade agreement between India and Sri Lanka was brought out several years prior to the signing of ISFTA. Two in-depth studies were carried out under the auspices of United Nations University World Institute for Development Economic Research (UN-WIDER) that sought to bring out the rationale and justification of a bilateral free trade agreement between India and Sri Lanka.

In a preface to the first report Lal Jayawardena, the then Director of the Institute, stated: [2]

> While modalities of regional cooperation have broadly been agreed upon, a meaningful operational programme of cooperation among the nations of the SAARC region is yet to be put in place. WIDER took the initiative, in consultation with the Governments of India and Sri Lanka, to support studies that would bring out clearly defined package of proposals facilitating economic cooperation between India and Sri Lanka. The Research and Information System for Non-Aligned and Other Developing Countries (RIS) was designated to carry out the study.

[2] V.R. Panchamukhi et al. 1993. Indo-Sri Lanka Economic Cooperation: An Operational Programme. United Nations University. World Institute of Development Economics Research (WIDER) Study Group Series. No. 8. www.unu.edu/publications/search/en_GB/publication-search.

The report highlighted the potential areas of Indo-Sri Lanka cooperation in the field of trade, manufactures and services. To increase the volume of bilateral trade between the two countries, it suggested the establishment of an institutional mechanism to negotiate the reduction of tariff and non tariff barriers on trade on products of mutual interest. The study emphasized the importance of joint ventures and technological transfers as vehicles of economic cooperation. It highlighted that transfer of resources and technology through developing country joint ventures was more appropriate and better adapted to the resource endowments in developing host countries.[3] It suggested that the Government of India could consider setting up a revolving fund on which Indian joint ventures abroad could draw upon for their financing needs.[4]

A follow-up 9th Study Group Report by WIDER on the same theme of India–Sri Lanka economic cooperation stated that there was growing recognition that the countries of the region cannot rely exclusively on their traditional markets in OECD countries for fast export growth.[5] The economic and trade environment which in the 1960s and 1970s provided a strong magnet for imports into OECD countries from developing countries (particularly from newly industrializing economies), had deteriorated, whereas competition to supply to these markets had increased. Hence for a substantial increase in trade growth, South Asian countries needed to diversify their export markets particularly to East Asia and within South Asia.[6]

Further elaborating on the rationale for enhanced bilateral trade cooperation between India and Sri Lanka, the report highlights the deceleration of economic growth in OECD countries concomitant with increasing protectionism among them and stagnating demand in the 1990s. This has been accompanied by increasing competition among developing countries to supply these markets. The emergence of trading blocs (e.g. single EEC market and proposed North American Free Trade Agreement) centered on major world economic powers poses another challenge.[7]

The report complements and carries forward work of its earlier study in

[3] Footnote 1, p.11.

[4] Footnote 1, p. 65.

[5] Abel G Aganbegyan et al. 1993. Indo-Sri Lanka Economic Cooperation: Facilitating Trade Expansion Through a Reciprocal Preference Scheme. *Study Group Series* No. 9. www.unu.edu/publications/search/en_GB/publication-search (accessed 18 May 2010).

[6] Footnote 2, p.vii.

[7] Footnote 2, p. 4.

respect of one of its key recommendations, namely, the need to evolve an institutional mechanism involving trade preferences to facilitate bilateral trade between the two countries. The report states:[8]

> Basic to the design is the shift from a traditional focus on individual commodities for which each country might grant preferences to the other, to a focus on granting across-the-board, to all commodities, except for a small limited exclusion list of sensitive items. ……The objective is the creation of a "fast track" for enhancing mutual trade between the two countries within the overall process now underway under SAARC. The underlying premise is that at the political level there is no impediment whatsoever to enhance cooperation between the two countries for mutual benefit. In particular, reciprocal trade preferences would make a major contribution to the political and economic stability of Sri Lanka regarding which India has a major stake; they would at the same time, support India's economic reform process by providing an export platform in Sri Lanka for joint ventures involving foreign investment (including Indian investors), serving both the joint Indo-Sri Lankan market and the outside world.

After ISFTA became a reality, there have been a number of studies on its operation. Deshal de Mel examines the structure of the bilateral agreement, analyzing the negative lists, tariff liberalization programme, tariff rate quotas in selected items, and rules of origin.[9] While analyzing the economic impact, the paper notes how the two major exports of Sri Lanka to India, viz. copper and vanaspati (refined hydrogenated oil) lost their competitive advantage as India started enforcing its rules of origin criteria and also reduced its own external most favored nation tariff on the principal raw materials, copper ingots and palm oil (crude and refined). Nevertheless according to the study, the scope and depth of coverage of benefits far outpaces those available under SAFTA.[10]

Dushni Weerakoon and Jayanthi Thennakoon maintain that although efforts to foster economic linkages through SAARC process got underway from the late 1990s, with the implementation of SAPTA, the implementation process remained less effective and slow due to lack of commitment

[8] Footnote 2, p. viii.

[9] Deshal de Mel. 2010. Bilateral free Trade Agreements in SAARC and Implications for SAFTA. In Sadiq Ahmed et.al, *Promoting Economic Cooperation in South Asia*. Sage Publications: New Delhi.

[10] Footnote 9, p.106.

among member countries.[11] India and Sri Lanka therefore, embarked on an alternative course to strengthen bilateral economic ties, facilitated by a significant improvement in the political relations between the two countries from the late 1990s.

Sri Lanka, on the other hand, viewed an FTA with India as a means of broadening its industrial base by taking advantage of the "first mover" access to the large and growing Indian market. Post-ISFTA trade flows have expanded rapidly. However it is also clear that the bulk of Sri Lanka's exports to India have originated in vegetable oils and copper wherein their principal raw material was imported from third countries at low external tariffs. Nevertheless the bilateral agreement has been found to be less restrictive in terms of market access as compared to SAPTA/SAFTA. The latter can play a more positive role by reducing the negative list and hastening the pace of trade liberalization.[12]

A study by Law and Society Trust, Sri Lanka has however been very critical of the outcome of ISFTA.[13] While accepting the paucity of information and confusion regarding the available data, the study questions the strength of claims made by the protagonists of the ISFTA and CEPA that appears to be founded on ideological supposition rather than scientific evidence. The findings of study indicate that the basis on which decisions are made on the relevance and value of this agreement are unclear and unsound. The study questions trade as an end in itself without looking at dimensions of equity and employment. The problems relating to the overwhelming importance of copper and vanaspati exports, using Indian investment and labor, has also been highlighted. According to the study, Sri Lanka had undergone significant trade liberalization prior to the launching of ISFTA. Besides, Sri Lanka has undertaken commitments under Agreement on Agriculture and under Non-Agricultural Market Access (NAMA) of World Trade Organization (WTO).

[11] Dushni Weerakoon and Jayanthi Thennakoon. 2006. *India Sri Lanka FTA: Lessons for SAFTA*. CUTS International. Jaipur. http://www.thecommonwealth.org/files/178424/FileName/India-Sri%2520Lanka%2520FTA--Lessons%2520for%2520SAFTA--Final.pdf (accessed 15 November 2010)

[12] Footnote 11, pp: 37–39.

[13] Law & Society Trust. 2010. An Act of Faith? Ten Years of the India-Sri Lanka Free Trade Agreement (ISLFTA). Law and Society Trust. New Delhi. http://www.lawandsocietytrust.org/PDF/An%20Act%20of%20Faith%20India%20Sri%20Lanka%20Free%20Trade%20Agreement%20Ten%20Years%20On%20March%202010-1.pdf (accessed 12 November 2010).

Hence it would be more meaningful, when investigating the impacts of trade liberalization factoring the negative list, to look at the entire trade liberalization process, including multilateral and other bilateral commitments, rather than to study the ISFTA in isolation.[14]

2.3 DATA SOURCES AND METHODOLOGY

The two major types of data used extensively in the present study are a) trade data (bilateral as well as trade with rest of the world) and b) import tariff data (preferential as well as MFN rates).

UN COMTRADE database is used for analysis. HS 1996 classification is considered as we can get information regarding the trade pattern before the signing of the agreement. At the time of preparing this report, India's trade data (India as reporter country) is available till the calendar year 2009. On the other hand, Sri Lanka's trade data (Sri Lanka as reporter country) is available till the calendar year 2008. Looking at the time series data of both the countries, it was found that data for India is available for the complete time series (1996-2009). But as UN COMTRADE database is concerned, Sri Lanka's data is not available for the complete time period. Data for the years 1996-1998 and 2000 are missing (Table 2.1).

Table 2.1: Availability of UN COMTRADE Data

Country	*Time series data required for*	*Trade data available for the years*
India	1996–2009	1996–2009
Sri Lanka	1996–2009	1999, 2001–2008

It may be noted that, in the present study, unless otherwise mentioned, India's export values are expressed in *fob* (free on board) terms and import values are expressed in *cif* (cost, insurance, freight) terms. As India's reported data is considered, Sri Lanka's export values are expressed in *cif* terms and import values are expressed in *fob* terms.

TRAINS database was used extensively to assess the changing pattern of the tariff barrier in India and Sri Lanka. Both the most favored nation (MFN) and preferential tariff (under the ISFTA) have been used from this data source (Table 2.2).

[14] Footnote 12, p. 15.

Table 2.2: Availability of TRAINS Data

Country	*Time series data required*	*MFN tariff data available*	*Preferential tariff data available*
India	1996–2009	1997, 1999, 2001, 2004–2005, 2007-2009	2001, 2004–2005, 2008–2009
Sri Lanka	1996–2009	1997, 2000–2001, 2004–2007, 2009	2004–2007, 2009

In the present study only MFN rates are taken from the TRAINS database as the margin of preference (MOP) is clearly mentioned in the text of the agreement. Except the negative list products, tariff for the rest of the products has become zero over the years (by third year of the implementation of the agreement in India and by eighth year in Sri Lanka).

The methodology used for pruning the negative lists is presented in the Section 2.7.

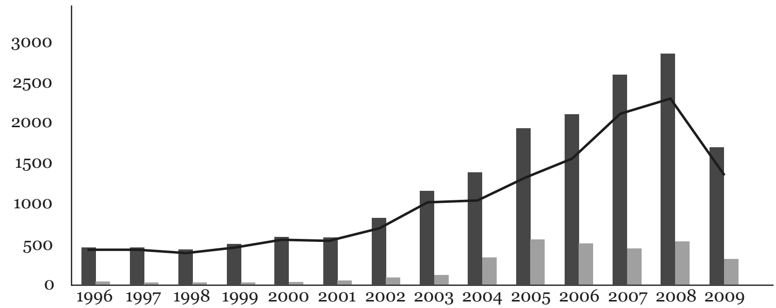
2.4 OVERVIEW OF BILATERAL TRADE

As per the trade data available with us, we can see the generic growth in India's exports to Sri Lanka through 1996 to 2000 with a slight decline in 1998. Although an insignificant decline (0.5%) in India's exports to Sri Lanka was seen in 2001 (ISFTA implemented from March 2000), it gathered momentum from 2002 to 2008. In 2002, the y-o-y growth rate for the same was 40% and 42% in the following year. The only year which registered a 40% y-o-y decline in India's exports to Sri Lanka was 2009 owed to the global economic downturn (Figure 2.1).

Although India's imports from Sri Lanka increased by 38% in 2001 y-o-y and continued to increase, it declined in year 2006 and 2007 mainly due to decrease in imports of two products—primary copper (HS. 7403) and vanaspati (refined hydrogenated oil-HS. 151620).These products performed well not due to comparative advantage that Sri Lanka had, but because Indian manufacturers invested heavily in Sri Lanka to take advantage of the low external tariffs on their principal inputs and preferential entry into Indian market. Imports from Sri Lanka gathered pace in the initial months of 2008 but when the recession hit the global economy in later part of 2008 and 2009, India–Sri Lanka trade felt the impact.

The impact of the FTA can be observed in the variation in the number of products traded pre- and post-1999. As far as India's exports are concerned,

Figure 2.1: India's Trade with Sri Lanka ($ million)

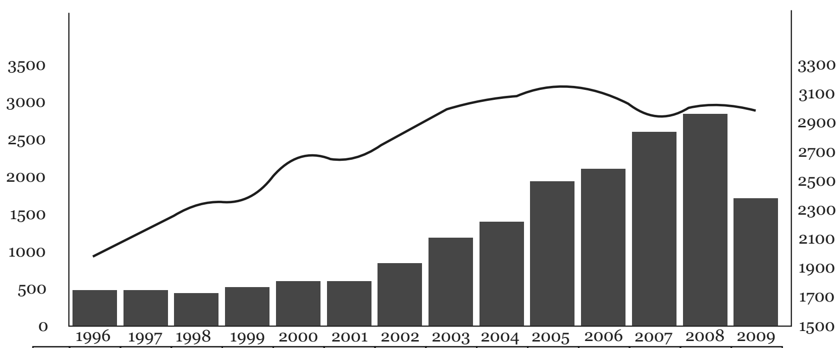


	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Exports	459	464	434	500	590	587	823	1166	1384	1927	2097	2584	2827	1692
Imports	41	30	37	44	40	55	92	120	333	568	505	441	541	327
Trade balance	417	434	397	456	550	533	731	1045	1052	1359	1592	2143	2285	1365

Source: Computed from UN-COMTRADE database, December 2010

the number of products exported to Sri Lanka has gone up from 1988 (at HS- 6 digit level) in the year 1996 to 2648 in 2001 and further to 3018 in 2008. However, due to global economic downturn, the number of items declined marginally from 3018 in 2008 to 2988 in 2009. As the commodity prices were affected adversely in the same period, a sharp decline in the export value was witnessed (Figure 2.2).

Figure 2.2: India's Exports to Sri Lanka



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Trade value (million $)	459	464	434	500	590	587	823	1166	1384	1927	2097	2584	2827	1692
No. of items at HS6 level (right axis)	1988	2143	2342	2385	2661	2648	2819	3003	3072	3138	3101	2943	3018	2988

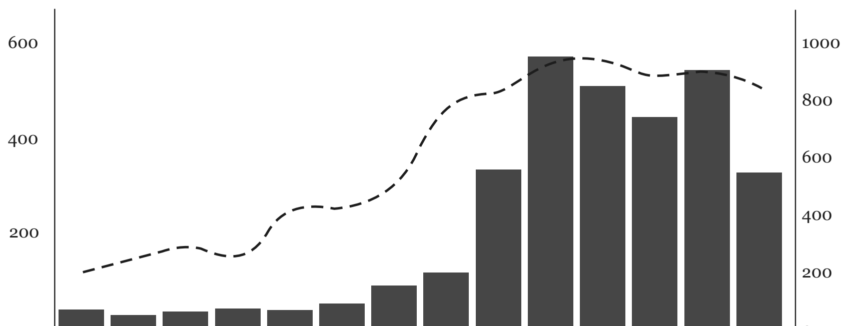
Trade value (million $) — No. of items at HS6 level (right axis)

Source: Computed from UN-COMTRADE database, December 2010

On the other hand, the number of products imported by India from Sri Lanka has gone up dramatically. India imported 262 products (HS-6 digit level) from Sri Lanka in the year 1999.After the implementation of the FTA, 415 Sri Lankan products entered the Indian market in 2000 and 428 in 2001 (as a result of greater market access by eliminating/lowering the tariff). The list of products went up to 899 in 2008 and declined marginally to 843 in 2009.

When we compare the growth in trade in terms of number of products traded India's exports to and imports from Sri Lanka present very different pictures. The number of products entering Indian market from Sri Lanka increased by more than three times during the first decade of the FTA. However, the number of products entering the Sri Lankan market from India has grown only by 1.25 times during the same period. In other words, previously uncompetitive products of Sri Lankan origin gained competitiveness as a result of the FTA and found its market in India (Figure 2.3).

Figure 2.3: India's Imports from Sri Lanka



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
■	41	30	37	44	40	55	92	120	333	568	505	441	541	327
—	199	241	296	262	415	428	513	770	833	918	940	885	899	843

■ Trade value (million $) — No. of items at HS6 level (right axis)

Source: Computed from UN-COMTRADE database, December 2010

After looking at the growth in number of products as a result of the FTA, an attempt was made to analyze the importance of the contracting states in each others market. The importance of Sri Lanka as India's trade partner improved during the first half of the FTA period. For example, Sri Lanka's rank as an import source for India improved after the implementation of the agreement from 60th in 2000 to 31st in 2005.

Faster decline of India's MFN rates from 2005 onwards is understood to have impacted adversely, Sri Lankan exports to India. Similarly, rank of Sri Lanka as an export destination of India's products improved from 18th in 2000 to 13th in 2005.

On the other hand, India became the most favored import source for the Sri Lankan importers immediately after the implementation of the FTA surpassing Japan. India remained the top import source for Sri Lanka thereafter. However, although India raised its rank in the favored export destination of the Sri Lankan products, it could not become the most favored one. Rank of India was 16th in 1999 as far as Sri Lankan exports are concerned. It secured the 10th position in 2001 and 5th in the following year. By 2003, India ranked 3rd in the Sri Lankan export destinations (first two being the USA and the UK). Thereafter, India maintained it position (3rd) till 2007 and in 2008, it lost its 3rd rank to Italy.

2.5 CHANGING STRUCTURE OF BILATERAL TRADE

Bilateral trade has undergone various structural changes over the years as a result of the FTA. An attempt was made to calculate the change in structure in bilateral trade at a macro level. For this purpose, the section-wise change was calculated and further aggregated into various broad categories. The details of the product classification can be seen in the Annex 2.1 attached to this study.

2.5.1 Changing Structure of India's Exports to Sri Lanka

Mineral products. During the pre-FTA period, mineral products constituted only 1% of the total exports to Sri Lanka. However, its share started to increase immediately after the implementation of the FTA. In the year 2000, its share rose to 4% and continues to increase through the years. By the year 2007 share of the mineral products reached 38% of the total exports to Sri Lanka (Figure 2.4).[15] Within this broad category of products, few products are worth mentioning here.

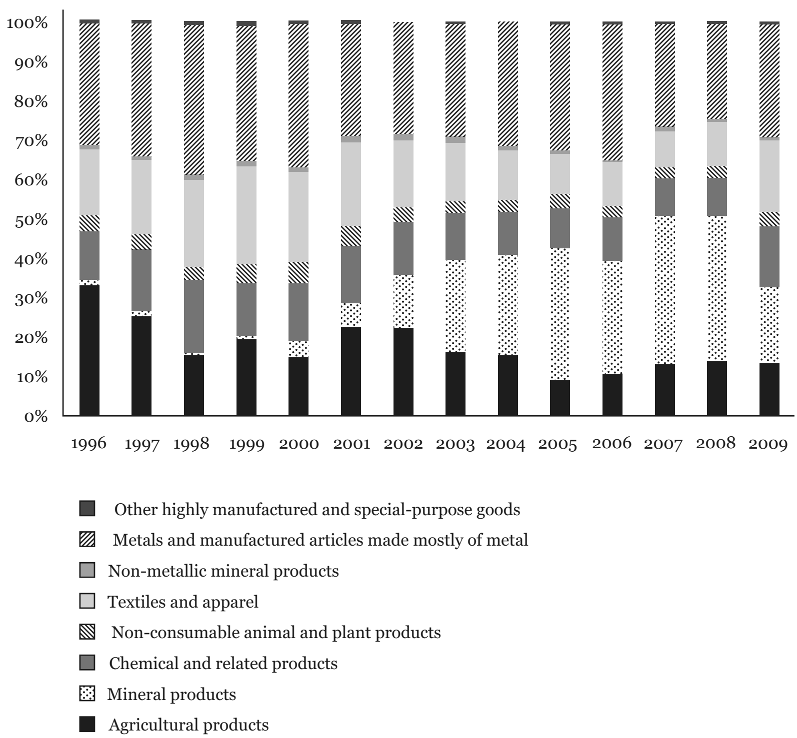
1. **Cement**. Although Sri Lanka put cement (HS 252321 and HS 252329) under the negative list, the import of Indian cement grew substantially over the post-FTA period. In 1999, Sri Lankan import of Indian cement was $1.3 million which increased to $21 million in 2000 and remained at the higher level thereafter.

[15] Although few products under the residual list like cement clinkers (HS 252310) and Felspar (HS 252910) also registered growth in the post-FTA period, products under the negative list within the broad category of mineral products grew faster.

2. **Petroleum products**. Many of the petroleum products remained under the negative list. However remarkable increase in imports by Sri Lanka was witnessed.

Agricultural products. In order 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 only 9% in 2005.

Figure 2.4: Structure of India's Exports to Sri Lanka



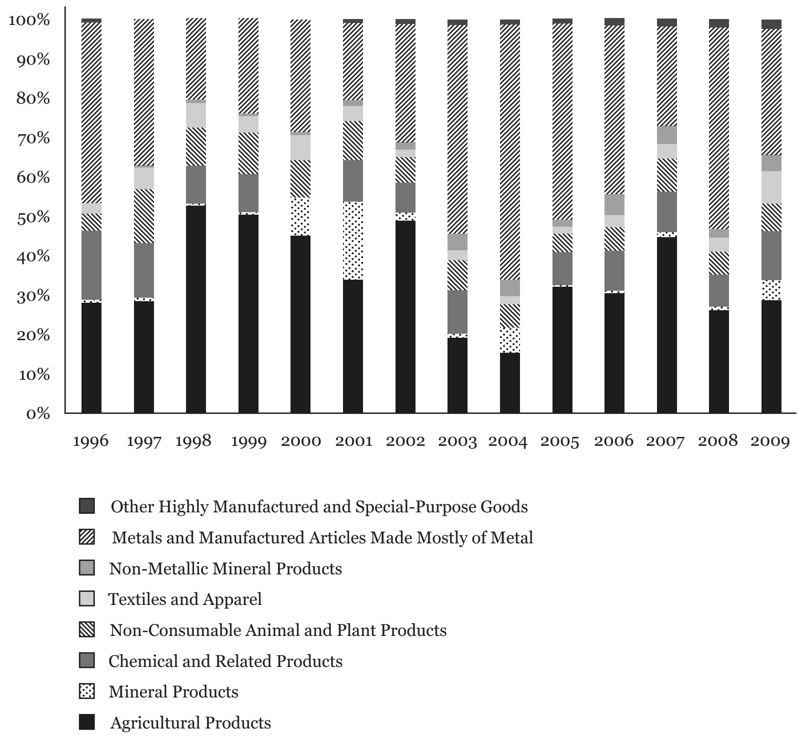
Source: Computed from UN-COMTRADE database, December 2010.

2.5.2 Changing Structure of India's Imports from Sri Lanka

Like exports, India's import structure from Sri Lanka or in other words Sri Lanka's export structure to India has also undergone changes (Figure 2.5).

Agricultural products. Agricultural products constituted about the half of the Sri Lanka's total exports to India in the pre-FTA period. However, it has declined

Figure 2.5: Structure of Sri Lanka's Exports to India



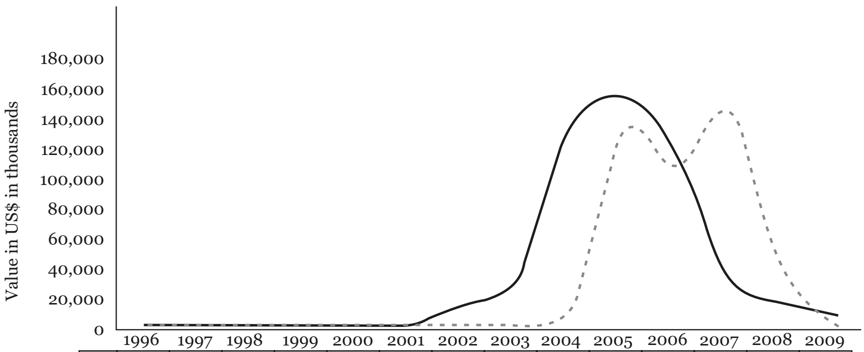
Source: Computed from UN-COMTRADE database, December 2010.

over the years after the implementation of the FTA. In 2009, its share was reduced to only 29%. Among the products whose import considerably declined over the years is crude glycerol (HS 152000). The value of imports of glycerol was reduced from $2.3 million in 2000 to only $0.5 million in 2007 and further to $51,000 in 2009. In spite being in India's residual list, it performed badly.

Metals and metal manufactured articles. Before the implementation of the agreement, metal products constituted 24% (1999) of the total Sri Lankan exports to India. Through the years its share has been rising. Within metal products, while 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.

Copper and vegetable oil imports from Sri Lanka have been a contentious

Figure 2.6: India's Imports of Copper and Vegetable Oil from Sri Lanka



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Vegetable oil	58	-	-	3	-	3	276	2161	12066	12962	10711	14159	37329	69
Copper	1533	1102	635	319	1133	2459	15505	32319	13461	15328	11364	30918	16174	7971

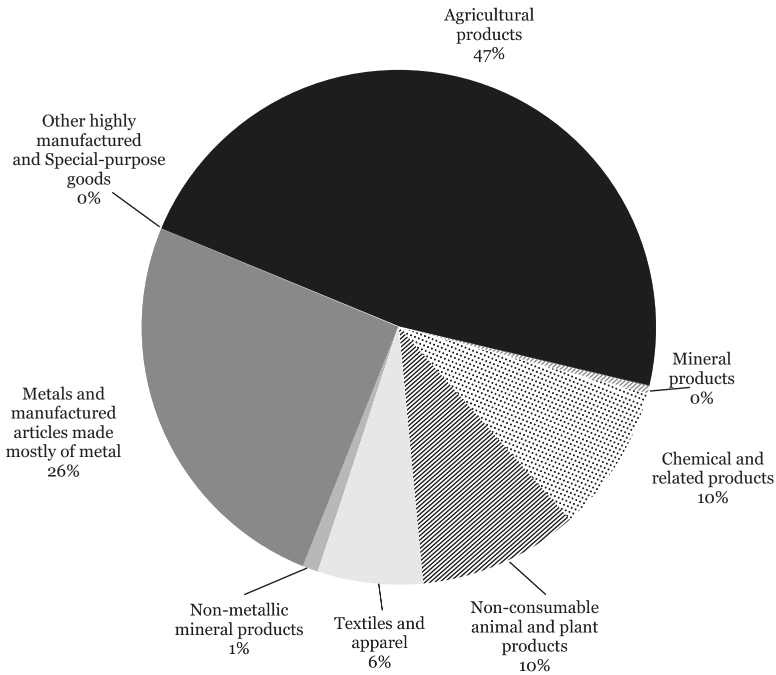
Source: Computed from UN-COMTRADE database, December 2010.

issue between the contracting states. Figure 2.6 shows the import pattern of these items by India. Although import of copper and vegetable oil existed before the FTA, it grew much faster after the FTA. Both the products were put under the residual list by India, rendered zero duty products after three years of implementation of FTA. Hence the difference between the MFN rate and preferential tariff widened, resulting in surge in imports.

An attempt was made to estimate the structure of India's imports by netting the effect of copper and vegetable oil imports. In 2000, prior to the implementation of FTA, agricultural products accounted for nearly half (47%) of India's imports from Sri Lanka. Metal and manufactured articles made mostly of metals accounted for another quarter (26%).

In 2008, the share of metals and manufactured articles mostly of metals increased even further to 53% while the share of chemical and related product remained at one-tenth and agricultural products at around one-fifth. Thus the increasing shares of metals and manufactured articles made mostly of metal and declining share of agricultural products demonstrates the increasing diversification of Sri Lankan exports to the Indian market (although copper and vegetable oil continued to dominate its total exports to the Indian market). Comparison of Figures 2.7 and 2.8 reveals the change in import structure between 2000 and 2008.

Figure 2.7: Structure of India's Imports from Sri Lanka, 2000



Source: Computed from UN-COMTRADE database, December 2010.

What were the new products that brought about this change (Table 2.3)? Our micro analysis reflects that a number of manufactured products such refrigerating and freezing display counters and parts thereof, winding wires of copper, wooden office furniture, carton box cases, pneumatic tires, surgical gloves and food products such as sausages and bakery products made significant entry into the Indian market—most remarkable being Sri Lankan cruise ships and boats. From a modest value of $6,291 in 2000 it increased to $140 million in 2008.

In response to Sri Lanka's offer, a number of Indian products also made significant entry into the Sri Lankan market. Some of these include refined copper, internal combustion piston engine, and printed plain weaves (Table 2.4).

Table 2.3: Emergence of New Products as a Result of ISFTA: India's Imports from Sri Lanka ($ thousand)

HS code	*Product description*	*1996*	*2001*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
090610	Cinnamon and cinnamon-tree flowers neither crushed nor ground	7	4	581	921	1022	1153	1541	1380
160100	Sausages and similar products of meat, meat offal or blood; food preparations based on these products		1	78	274	393	800	1000	2160
401120	New pneumatic tires, of rubber, of a kind used on buses or trucks			1039	2817	4981	5833	8183	5517
401519	Gloves, except surgical gloves, of vulcanized rubber, nesoi		11	788	868	1966	2994	2631	4330
481930	Sacks and bags, having a base 40 cm (15.75 in.) wide or more, of paper, paperboard, cellulose wadding or webs of cellulose fiber	2	182	474	287	830	595	851	813
481940	Sacks and bags, nesoi, including cones of paper, paperboard, cellulose wadding or webs of cellulose fiber	13	139	288	570	487	465	1009	616
491199	Printed matter, nesoi		1	11	1	8	1896	2741	2699
680221	Monumental or building stone and articles thereof nesoi, simply cut or sawn with a flat or even surface, of marble, travertine and alabaster		469	11933	8385	20496	15567	6294	3520
691110	Ceramic tableware and kitchenware, of porcelain or china	5	231	369	805	1430	1194	865	648

HS code	*Product description*	*1996*	*2001*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
780110	Refined lead, unwrought		23	1048	924	1114	916	1216	158
841850	Refrigerating or freezing chests, display counters, cabinets, showcases and similar equipment, nesoi		59			1	3120	12821	24642
841899	Parts of refrigeration or freezing equipment and heat pumps, nesoi			82	951	584	663	2912	2394
854411	Insulated winding wire of copper		8	4133	5491	12383	8527	6871	2420
890110	Cruise ships, excursion boats and similar vessels principally designed for the transport of persons; ferry boats of all kinds				261			139679	
940330	Wooden furniture (except seats) of a kind used in offices		99	1008	1751	2594	3862	5193	2510

Note: nesoi stands for not elsewhere specified or included

Source: COMTRADE database

Table 2.4: Emergence of New Products as a Result of ISFTA: India's Exports to Sri Lanka
($ thousand)

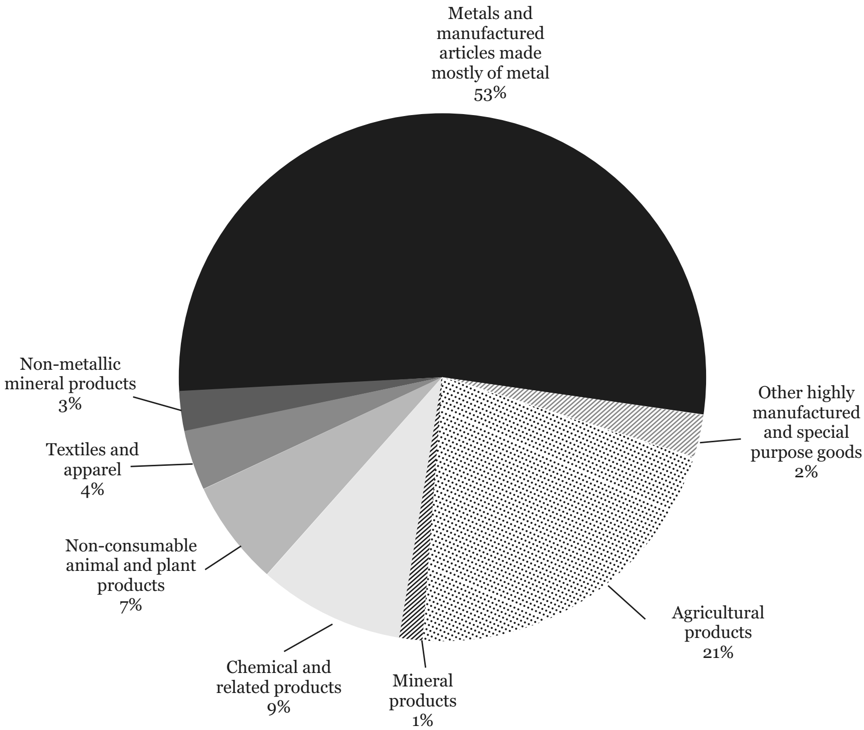
HS code	*Product description*	*1996*	*2001*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
300320	Medicaments containing antibiotics, nesoi, not put up in measured doses or retail packings	26	107	723	116	2297	2730	4016	2623
340211	Anionic organic surface-active agents, whether or not put up for retail sale	19	14	43	327	1193	310	3841	3968
380210	Activated carbon	20	155	7	53	516	1059	2500	3417
400300	Reclaimed rubber in primary forms or in plates, sheets or strip	287	76	463	1063	1371	1419	3139	1943
440200	Wood charcoal (incl shell or nut charcoal)		92	119	352	1364	1208	3223	3703
520852	Woven fabrics of cotton, 85% or more cotton by weight, printed, plain weave, weighing over 100 g/m^2 but not over 200 g/m^2	137	2	521	711	622	6835	11973	6130
540262	Synthetic filament yarn except sewing thread, not for retail sale, yarn nesoi, multiple or cabled, of polyesters		57	67	591	1003	2463	2986	2613
580620	Narrow woven fabrics nesoi not over 30 cm in width, containing 5% (wt.) or more of elastomeric yarn or rubber thread		15	88	1053	1731	1511	2728	2062
720230	Ferrosilicon manganese		114	424	311	671	962	2010	1004

HS code	*Product description*	*1996*	*2001*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
721391	Bars and rods, hot-rolled, in irregularly wound coils, of iron or non-alloy steel, of circular cross-section measuring less than 14mm in diameter, nesoi	23	4034	1544	2065	11105	4008	6095	9039
740811	Wire of refined copper, with a maximum cross sectional dimension over 6 mm (.23 in.)	213	4	17404	20342	45236	35209	53704	29899
780110	Refined lead, unwrought	121		802	1311	1325	854	2103	1441
850211	Generating sets with compression-ignition internal combustion piston (diesel or semi-diesel) engines of an output not exceeding 75 kva	593	25	159	882	850	386	2266	715
871110	Motorcycles and cycles with an auxiliary motor, with reciprocating internal combustion piston engine, cylinder capacity not over 50 cc	164	20	284	1792	3272	13483	10111	3998

Note: nesoi stands for not elsewhere specified or included

Source: COMTRADE database

Figure 2.8: Structure of India's Imports from Sri Lanka, 2008



Note: Data excludes copper and vegetable oil.
Source: Computed from UN-COMTRADE database, December 2010.

2.6 MACRO ANALYSIS OF THE FTA

As per the text of the agreement, various degrees of tariff concession were exchanged between the contracting states. Under the agreement the discount in tariffs is categorized under three major headings:

1. **Zero duty**. Products put under this category enjoy no import tariff in the partner's market.
2. **Negative list**. Products put under negative list are exempt from tariff negotiations. In other words, these products continue attract MFN tariff in partner's market till both the parties agree to revise the list.
3. **Residual list**. These are the products on which the import tariff is reduced in a phased manner such that they attract zero duty after a stipulated period.

2.6.1 Tariff Concession by India

- Zero duty on items upon entering into force of the Agreement (E): 1351 products; concessions on textile items restricted to 25% on Chapters 51–56, 58–60, and 63
- Four chapters under the textile sector retained in the negative list (Chapters 50, 57, 61 and 62) (TEX): 528 products
- GAM: 223 products. In the present study these products have been included in the negative list.
    - o Garments (GAM) covering Chapters 61 and 62 while remaining in the negative list, will be given 50% tariff concessions on a fixed basis, subject to an annual restriction of 8 million pieces, of which 6 million shall be extended the concession only if made of Indian fabric
    - o On utilization of the unrestricted quota, an additional quota of 2 million pieces out of 8 million pieces is permitted. The quota level per category is increased from 1.5 million to 2 million pieces per category per year.
    - o India has removed restriction on entry ports and sourcing of fabrics for 3 million pieces of apparel products from Sri Lanka to India at zero duty, out of the available Tariff Rate Quota (TRQ) of 8 million pieces of apparel products. Under the ISFTA, India had initially allowed import of 8 million pieces of apparel products from Sri Lanka, manufactured using Indian made fabrics with restriction on entry ports.[16]
    - o The Government of India has issued a Custom Notification No. 52/2008 dated 22 April 2008 giving immediate effect to this arrangement.
    - o With the above customs notification, India has also removed port restrictions on the balance 5 million pieces of apparel products. These 5 million pieces of garments will be allowed to enter India at zero duty or MOP of 75% depending on the product category provided that they are manufactured using Indian fabrics.
- TEA: 5 products. Tariff preference of 50% on five tea items, subject to a quota of 15 million kg per year.

[16] See Department of Commerce, http://www.doc.gov.lk/web/news7.php (accessed on 25 April 2008).

- IR: 2799 products. MOP 50% upon coming into force of this agreement on all items, except for those on the negative list. To be phased out to zero duty in three years.
- DI: 429 products. A negative list of items to be retained.

2.6.2 Tariff Concession by Sri Lanka

- FI: 319 products. Zero duty on about 319 items upon entering into force of the agreement.
- FII: 889 products. Phasing out of tariffs on items with 50% MOP on 889 products upon coming into force of the agreement, with up to 70% at the end of the first year, up to 90% at the end of the second year and 100% at the end of third year.
- SLR: 2724 products. For the remaining items, (except for those on the negative list), which is the residual list, preference would be not less than 35% before the expiry of 3 years, 70% before the expiry of 6 years and 100% before the expiry of 8th year.
- DII: 1180 products. Negative list.

Table 2.5 presents the main features of the concessions exchanged between India and Sri Lanka.

Table 2.5: Broad Agreement on Tariff Concessions under ISFTA

Granting country	*Degree of tariff cut*	*Description of items receiving tariff cut*
India	0% removal of tariff	For items in Annexure D of the agreement (negative list)
	25% removal of tariff	For items in Chapters 51–56, 58–60, 63
	100% removal of tariff	For items in Annexure E of the agreement
	50%, 75%, 100% removal of tariff	Up to 15 million kg of tea (fixed at 7.5 %). India has removed restriction on entry ports and sourcing of fabrics for 3 million pieces of apparel products from Sri Lanka to India at zero duty, out of the available TRQ of 8 million pieces of apparel products. The balance 5 million pieces of garments will be allowed to enter India at zero duty or MOP of 75% depending on the product category provided that they are manufactured using Indian made fabrics.

Granting country	*Degree of tariff cut*	*Description of items receiving tariff cut*
	50% removal of tariff followed by phased removal of tariff	For remaining items (margin will be increased up to 100% in two stages within 3 years)
Sri Lanka	0% removal of tariff	For items in Annexure D of the agreement
	100% removal of tariff	For items in Annexure F-I of the agreement
	50% removal of tariff followed by phased out removal of tariff	For items in Annexure F-II of the agreement (the margin will be deepened to 70%, 90% and 100% respectively at the end of first, second and third year of the entry into force of the agreement)
	Residual list	For remaining items by not less than 35% before the expiry of three years. 70% before the expiry of sixth year and 100% before the expiry of eighth year

Notes:

1. **India.** Negative list: D(I): 429; Garments: 233; Zero Duty: 1351; Tea: 5; Textiles: 528; Phased Residual List: IR: 2799 (zero duty in three years).
2. **Sri Lanka.** Negative list: D(II): 1180; Zero Duty: (F1): 319; Phased Immediate: F (II) (three years): 889; Phased Residual (SLR between 3rd and 8th year): 2724.

Trade patterns of the products under different categories as defined by the FTA were studied and the results summarized in sections 2.6.3 and 2.6.4.

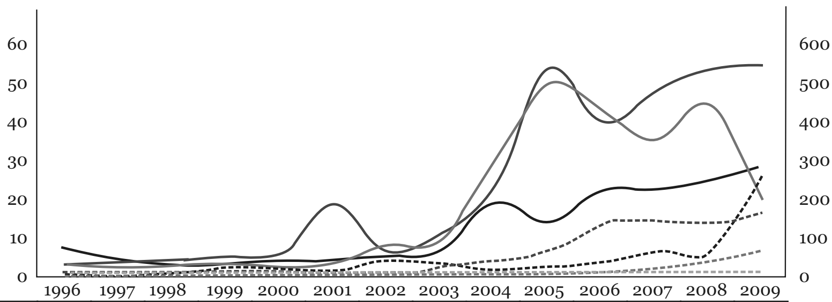
2.6.3 India's Offer

As discussed above, India offered different concessions on tariff for different products. The present section makes an attempt to analyze the impact of the offer on the trade pattern, specifically India's imports from Sri Lanka or in other words Sri Lanka's exports to India (Figure 2.9).

There is no doubt that import of all categories of products has grown after the implementation of the FTA. However, the growth differs widely across product categories. The notable feature is that the import of items under the negative list has also witnessed considerable growth. The total value of imports under the negative list was just above \$4.32 million in 2000 and it reached \$13.77 million in 2005 and further crossed 28 million by the year 2009.

Products (exported by Sri Lanka) which gained the status of zero import duty in Indian market from the date of implementation of the agreement rose from $4.85 million in 2000 to $54.39 in 2009, an increase by more than 11 times in 9 years. The products falling under the residual list of India's offer that gradually became the zero duty products from 1 March 2003 also witnessed considerable growth. The value of such imports increased from $27 million in 2002 to approximately $96 million in 2003 and $284 million in 2004 i.e. a three–fold increase in one year. It further increased to $439.7 million in 2008 constituting more than 80% of India's total imports from Sri Lanka till it declined considerably in 2009 with the slump.

Figure 2.9: India's Imports from Sri Lanka under Different Product Categories ($ million)



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
---	0	0	0	0	0	0	0	0	0	0	0	0	0	0
—	7	5	3	4	4	3	5	7	19	14	22	22	25	28
---	0	0	0	0	0	0	0	0	0	0	1	2	4	6
---	1	0	1	1	1	1	1	3	5	7	14	14	13	17
—	3	4	4	5	5	19	6	11	23	53	39	47	53	54
---	0	1	1	2	2	1	4	4	2	2	3	6	6	26
—	31	20	28	32	27	29	75	96	284	491	425	349	440	196

--- Garments
— Negative list
--- Negative list-Garments
--- Textiles
— Zero-duty product
--- Others
— Residual list (right axis)

Source: Computed from UN-COMTRADE database, December 2010.

Products (exported by Sri Lanka) which gained the status of zero import duty in Indian market from the date of implementation of the agreement rose from $4.85 million in 2000 to $54.39 in 2009, an increase by more than 11 times in 9 years. The products falling under the residual list of India's offer that gradually became the zero duty products from 1 March 2003 also witnessed considerable growth. The value of such imports increased from $27 million in 2002 to approximately $96 million in 2003 and $284 million in 2004 i.e. a three–fold increase in one year. It further increased to \$439.7 million in 2008 constituting more than 80% of India's total imports from Sri Lanka till it declined considerably in 2009 with the slump.

Among the rest of the products, a considerable improvement was witnessed in the textile items (Chapters 51–56, 58–60, and 63). Although the tariff concessions on these products were restricted to 25%, the exports from Sri Lanka to India continue to rise over the post-FTA period. India's import of these textile items from Sri Lanka which was only \$1.13 million in 2000 rose to \$16.57 million in 2009. In other words, these textile items constituted more than 5% of the India's imports from Sri Lanka in 2009 compared to 3% in 2000.

2.6.4 Sri Lanka's Offer

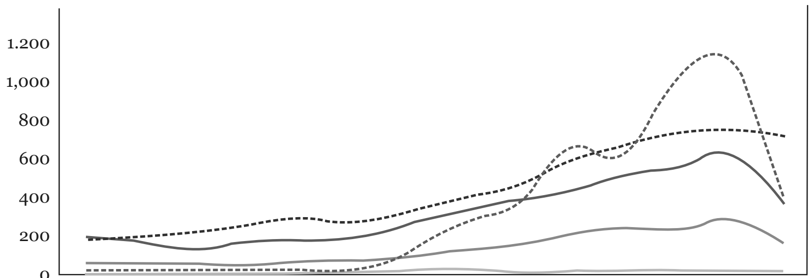
The nature of concession offered by Sri Lanka in the FTA is different from the India's offer. India offered zero-duty on items in the residual list upon completion of the third year. On the other hand, Sri Lanka committed to give 100% MOP on the products in its residuary list after the expiry of 8 years. The total imports of Sri Lanka from India increased to \$1,692 million in 2009 from just \$590 million in 2000 (Figure 2.10).

As the preferential tariff on products listed under the residual list declined, the imports from India started picking up. Under this list the value of imports increased to \$768 million in 2008 and declined slightly in 2009. As far as import under the zero-duty products is concerned, it rose considerably (four-fold between 2000 and 2008) and declined in 2009 due to global economic downturn.

The import of Indian cement declined drastically from \$21 million in 2000 to only \$6 million in 2009. The imports of other products under the negative list continued to increase during the post-FTA period. The value of import increased 3.5 times during the period 2000–2008 to \$378.57 million.

After studying the trade pattern of different product categories, an attempt was made to compare the pattern with the rest of the world. The real test of the FTA can best be analyzed in comparison to similar imports from the rest of the world. The following is the summary table describing the compound annual growth rate (CAGR) of imports by India and Sri Lanka under respective product categories. It will be observed that over the period 2001-09 the preferential imports in different concession categories of both the countries increased at a pace faster than that from the world, thereby

Figure 2.10: Sri Lanka's Imports from India under Different Product Categories ($ million)



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
—	3	3	1	1	21	25	22	23	13	15	23	7	4	6
—	190	171	133	171	182	187	264	339	392	437	520	565	638	379
---	183	228	256	292	278	332	404	464	0	597	679	743	768	729
—	60	54	51	72	73	92	130	152	5	215	247	233	287	167
---	22	19	21	23	24	114	270	364	23	664	629	1036	1129	411

— Cement
— Negative list
--- Residual list
— Zero-duty products
--- Rest of the products

Source: Computed from UN-COMTRADE database, December 2010.

reflecting and increasing share of bilateral trade in the respective countries' world trade. The only exception was cement in which Sri Lankan imports from India declined.

Table 2.6: Compound Annual Growth Rate of Imports of the Two Contracting States under Different Product Categories, 2001–09

India's imports	*Sri Lanka*	*RoW*	*Sri Lanka's imports*	*India*	*RoW*
Negative list	23.1%	18.0%	Negative list	9.2%	8.1%
Residual list	24.5%	20.6%	Residual list	12.8%	3.2%
Textiles (Chapters 51–56, 58–60, and 63)	34.7%	11.0%	Zero-duty	10.8%	5.3%
Zero-duty	30.8%	19.4%	Cement	–15.8%	30.1%
Total	26.4%	19.6%	Total	14.1%	6.1%

Source: Computed from UN-COMTRADE database, December 2010

2.7 PRUNING OF THE NEGATIVE LIST

After studying the changing trade pattern between India and Sri Lanka in the post-FTA period, 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 and also as stipulated under WTO objective under Article XXIV to cover "substantially all trade." To achieve this objective, two approaches were adopted. In the 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 revealed that there were a number of items that are not listed under the SAFTA negative list but found under the negative list of ISFTA. There are 97 products in the negative list of India which don't figure in the negative list of India under the SAFTA (Table 2.7).

Table 2.7: Illustrative List of Products in India's Negative List in the ISFTA but not under SAFTA

S. no.	*HS code*	*Product description*
1.	220720	Ethyl alcohol and other spirits, denatured, of any strength
2.	392043	Plate, foil, strip of polymers of vinyl chloride (PVC), non-cellular and not reinforced, etc., with >6% plasticisers by weight
3.	392049	Other plate, foil, strip of polymers of vinyl chloride (PVC), non-cellular and not reinforced, etc
4.	401211	Retreaded tires of rubber, of a kind used on motor cars (including station wagons and racing cars)
5.	401212	Retreaded tires of rubber, of a kind used on buses or trucks
6.	401213	Retreaded tires of rubber, of a kind used on aircraft
7.	401219	Retreaded tires of rubber, nesoi
8.	401691	Floor coverings and mats, of vulcanized rubber other than hard rubber
9.	401694	Boat or dock fenders, whether or not inflatable, of vulcanized rubber other than hard rubber
10.	481141	Self-adhesive paper and paperboard

Note:

1. nesoi stands for not elsewhere specified or included
2. Details of the remaining 87 products may be obtained from the authors.

This study recommends removal these products from the negative list of ISFTA. These lists include 49 products in the readymade garments category (Chapter 61 and 62) on which India allowed duty free import up to a limit of 3 million pieces in the bilateral negative list in 2008.

Similarly, there are 201 products in the negative list of Sri Lanka which don't figure in the negative list of Sri Lanka under the SAFTA. Table 2.8 provides an illustrative list of such products. The present study recommends removal these products from the negative list.

Table 2.8: Illustrative List of Products in Sri Lanka's Negative List in the ISFTA but not under SAFTA

S. no.	*HS code*	*Product description*
1.	010110	Pure bred breeding animals: live horses, asses, mules and hinnies
2.	010190	Live horses, asses, mules and hinnies – other
3.	010290	Live bovine animals, other than pure-bred breeding animals
4.	010391	Live swine weighing less than 50kg
5.	030211	Fresh or chilled trout (salmotrutta, oncorhynchus mykiss, clarki, aguabonita, gilae, apache and chrysogaster)
6.	030212	Fresh or chilled pacific salmon (Oncorhynchus nerka, gorbuscha, keta, tschawytscha, kisutch, masou and rhodurus), Atlantic salmon (Salmo salar) and danube salmon (Hucho hucho)
7.	030219	Fresh or chilled salmonidae (excl. 0302.11 and 0302.12)
8.	030221	Fresh or chilled halibut
9.	030222	Fresh or chilled plaice
10.	030223	Fresh or chilled sole

Note: Details of the remaining 191 products may be obtained from the authors.

The second approach to pruning the negative list is to undertake a quantitative analysis of the trade pattern of partner country's trade with each other as well as with the rest of the world for products contained in the negative lists. In order to recommend removal of some items from the negative list, the study attempted to calculate a number of trade indices/measures that point to the export potential of one of the contracting states in the market of the other for products contained in the latter's negative list and vice versa. These indices/measures are discussed in the following paragraphs. The products selected are those more likely to lead to trade creation rather than trade diversion.

It may be noted that data for the year 2008 has been used for calculation as data for 2009 reveals irregularity due to downturn in the global economy affecting the trade pattern of both the contracting states.

In this analysis the supplying country's export potential for products contained in the negative list of the partner country is assessed in terms of the products' potential trade, export specialization index, and trade intensity index. The concepts are defined below:

1. Potential trade

The concept of potential trade (PT) is used to assess country i's potential in country k's market with regard to product j. In this calculation demand and supply constraints are considered.

$PTi = |\min(Xij, Mkj) – xikj|$

where,

PT: Potential trade of country i

Xij: country i's total world exports of product j (supply)

Mkj: total world import of product j in market k (demand)

xikj: country i's exports to market k of product j

By matching the import demand with export supply, it gives the possibility of trade expansion under most favorable competitive conditions after netting the existing trade.

2. Revealed comparative advantage index

Measures of revealed comparative advantage (RCA) have been used to help assess a country's export potential. The RCA indicates whether a country is in the process of extending the products in which it has a trade potential, as opposed to a situation in which the number of products that can be competitively exported is static. It can also provide useful information about potential trade prospects with new partners. Countries with similar RCA profiles are unlikely to have high bilateral trade intensities unless intra-industry trade is involved. RCA measures, if estimated at high levels of product disaggregation, can focus attention on other non-traditional products that might be successfully exported. The RCA index of country i for product j is often measured by the product's share in the country's exports in relation to its share in world trade.

$RCAij = (xij/Xit) / (xwj/Xwt)$

Where xij and xwj are the values of country i's exports of product j and world exports of product j and where Xit and Xwt refer to the country's total exports and world total exports. A value of less than unity implies that the country has no comparative advantage in the product. Similarly, if the index exceeds unity, the country is said to have a revealed comparative advantage in the product.

3. Export specialization index

The export specialization index (ESI) is a slightly modified RCA index, in which the denominator is usually measured by specific markets or partners. It provides product information on revealed specialization in the export sector of a country and is calculated as the ratio of the share of a product in a country's total exports to the share of this product in imports to specific markets or partners rather than its share in world exports:

$$ES = (xij/Xit) / (mkj/Mkt)$$

Where xij and Xit are export values of country i in product j, respectively, and where mkj and Mkt are the import values of product j in market k and total imports in market k. The ESI is similar to the RCA in that the value of the index less than unity indicates no comparative advantage and a value above unity represents specialization in this market.

4. Trade intensity index

The trade intensity index (TII) is used to determine whether the value of trade between two countries is greater or smaller than would be expected on the basis of their importance in world trade. It is defined as the share of one country's exports going to a partner divided by the share of world exports going to the partner. It is calculated as:

$$Tij = (xij/Xit)/(xwj/Xwt)$$

Where xij and xwj are the values of country i's exports and of world exports to country j and where Xit and Xwt are country i's total exports and total world exports respectively. An index of more (less) than unity indicates a bilateral trade flow that is larger (smaller) than expected, given the partner country's importance in world trade.

After calculating the above indices, unit cost of the products were calculated to check the price competitiveness of the products in the negative list. As the issue of negative list is very important to both the government as well as the domestic industry, the study needs a firm ground to recommend the removal of products from the negative lists. For this purpose, the threshold value was kept at reasonably high for filtering results of other trade indices. The threshold values for different trade indices used in this analysis are mentioned in Table 2.9.

Table 2.9: Criteria for Selection of Products in the Negative List

Indices	*Threshold value*
Potential trade	>\$1602,000 for Indian exports >605,000 for Sri Lankan exports
Exports specialization index (ESI)	>1
RCA	>1
Trade intensity index	>1
Unit value	import value from the FTA partner < import value from the world

Notes:

1. Average value of the potential trade of India in the Sri Lankan market is calculated as $\frac{\Sigma_{j=0}^{n} \text{PT (Ind} - \text{SL)}}{n}$
2. Average value of the potential trade of India's exports to Sri Lanka is calculated as $\frac{\Sigma_{j=0}^{n} \text{PT (SL} - \text{Ind)}}{n}$

After considering all of the above parameters, and filtering the data accordingly, a handful of products were identified. The present study suggests removing these products from the respective negative lists after negotiations. The study suggests removing six items from the Sri Lanka's negative list under the bilateral FTA. It was found that these six products have high export potential in the Sri Lankan market. The products are listed in Table 2.10.

Table 2.10: India's Potential in Sri Lanka's Negative List

S. no.	*HS code*	*Product description*
1	040229	Milk and cream, concentrated, sweetened, in powder, granules or other solid forms, of a fat content, by weight, exceeding 1.5%
2	090240	Black tea (fermented) and other partly fermented tea, nesoi
3	100630	Rice, semi-milled or wholly milled, whether or not polished or glazed
4	691090	Ceramic sanitary fixtures (sinks, washbasins, baths, water closet bowls and tanks, etc.), of other than porcelain or china, nesoi
5	730820	Towers and lattice masts of iron or steel
6	871499	Parts and accessories nesoi, for bicycles and other cycles nesoi

Similar exercise was undertaken for India's negative list. However, in this case more products were identified, that met the filtering criteria. A total of 22 such products were identified—mainly readymade garments (Chapter 61 and 62) and rubber products (Table 2.11).

Table 2.11: Sri Lanka's Potential in India's Negative List

S. no.	*HS code*	*Product description*
1	400121	Natural rubber in smoked sheets
2	400821	Plates, sheets and strip of vulcanized rubber, except hard rubber, of non cellular rubber
3	401699	Articles of vulcanized rubber other than hard rubber, nesoi
4	482110	Paper and paperboard labels of all kinds, printed
5	610510	Men's or boys' shirts of cotton, knitted or crocheted
6	610610	Women's or girls' blouses and shirts of cotton, knitted or crocheted
7	610910	T-shirts, singlets, tank tops and similar garments of cotton, knitted or crocheted
8	610990	T-shirts, singlets, tank tops and similar garments, of textile materials nesoi, knitted or crocheted
9	611519	Panty hose and tights, of other textile materials, knitted
10	620332	Men's or boys' suit-type jackets and blazers of cotton, not knitted or crocheted
11	620333	Men's or boys' suit-type jackets and blazers of synthetic fibers, not knitted or crocheted
12	620342	Men's or boys' trousers, bib and brace overalls, breeches and shorts of cotton, not knitted or crocheted
13	620349	Men's or boys' trousers, bib and brace overalls, breeches and shorts of textile materials nesoi, not knitted or crocheted
14	620442	Women's or girls' dresses of cotton, not knitted or crocheted
15	620462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton, not knitted or crocheted
16	620469	Women's or girls' trousers, bib and brace overalls, breeches and shorts of textile materials nesoi, not knitted or crocheted
17	620520	Men's or boys' shirts of cotton, not knitted or crocheted
18	620590	Men's or boys' shirts of textile materials nesoi, not knitted or crocheted

S. no.	*HS code*	*Product description*
19	620630	Women's or girls' blouses, shirts and shirt-blouses of cotton, not knitted or crocheted
20	620640	Women's or girls' blouses, shirts and shirt-blouses of manmade fibers, not knitted or crocheted
21	620920	Babies' garments and clothing accessories of cotton, not knitted or crocheted
22	621210	Brassieres, whether or not knitted or crocheted

Note: Nesoi stands for *not elsewhere specified or included.*

2.8 ROLE OF DECLINE IN PREFERENTIAL MARGINS

So far in this study we have seen that the implementation of the India-Sri Lanka FTA has resulted in substantial growth in two-way trade, although the degree of growth has been different in different product categories for both the countries. However, of late it was observed by the stakeholders in the FTA that although the preferential tariff cuts have deepened through the years, the concerned products have actually lost their competitiveness in each other's market, particularly for Sri Lankan products in the Indian market. Massive cuts in the MFN tariff rates as part of their liberalization process are considered as the dampening factors for the producers and the traders utilizing the FTA route to export in each other's market. In other words, effective differential between the MFN and the preferential rates have reduced considerably over the years (Table 2.12).

Table 2.12: India and Sri Lanka's Tariff Barriers, 2001-2009

Year	*India's tariff barrier*				*Sri Lanka's tariff barrier*			
	Simple average (%)		*Weighted average (%)*		*Simple average (%)*		*Weighted average (%)*	
	MFN	*Preferential*	*MFN*	*Preferential*	*MFN*	*Preferential*	*MFN*	*Preferential*
2001	32.32	17.74	26.5	9.69	9.25	n/a	6.68	n/a
2005	18.3	2.08	13.42	0.29	10.94	5.16	7.54	6.27
2009	12.37	1.26	7.7	1.33	10.54	0.77	7.05	2.99

Source: TRAINS Database, 2010.

Figures 2.11, 2.12, 2.13 and 2.14 illustrate how the effective difference between the MFN rates and the preferential tariff rates has declined over the years.

Figure 2.11: India's MFN Vs. Preferential Tariff on Zero-duty Products (%)

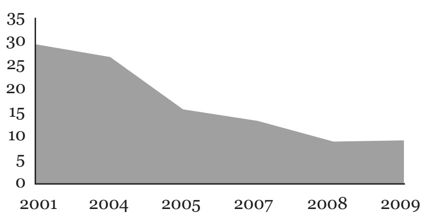


Figure 2.12: India's MFN Vs. Preferential Tariff on Residual List Products (%)

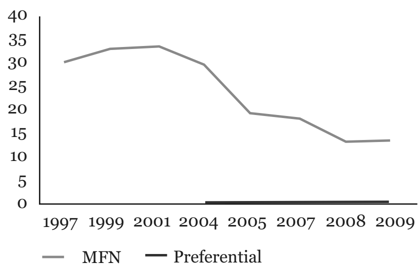


Figure 2.13: Sri Lanka's MFN Vs. Preferential Tariff on Zero-duty Products (%)

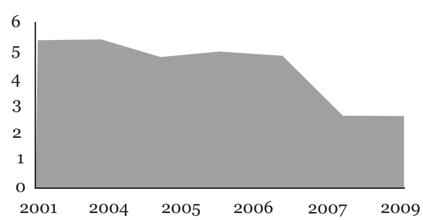
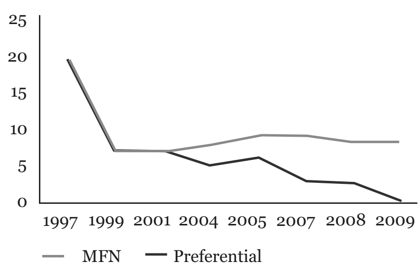


Figure 2.14: Sri Lanka's MFN Vs. Preferential Tariff on Residual Products (%)



Source: TRAINS Database, 2010.

The study on the decline of margin was undertaken by the Department of Commerce, Government of Sri Lanka. As per the department, Sri Lanka lost competitiveness in the Indian market as India reduced its MFN rates. The major products losing competitiveness in the Indian market are listed in the Table 2.13.

Table 2.13: Major Sri Lankan Products Losing Competitiveness in the Indian Market Due to Fall in India's MFN rates

Product	*Description*
7403	Refined copper and copper alloys, products
7605	Aluminium wire
72 to 73	Iron or steel and its articles
7601	Aluminium products
68	Marble
282490	Lead oxide
740811	Copper wire
740400	Copper waste and scrap

Source: http://www.doc.gov.lk/web/indusrilanka_freetrade_introduction.php as on 12 Dec 2010.

As noted above, one of the contentious issues in ISFTA has been the trade deflection arising from significant external tariff differential between the two countries. Such trade deflection does very little to the welfare of the consumers in both the countries. Employment generation in the concession receiving country is also minimal. In order to pre-empt any further trade deflection on other products, it is necessary to identify the current differential that still exists. Products in which the external tariff differentials exist between India and Sri Lanka are presented in Table 2.14.

Table 2.14: Differential between India's MFN (≥50%) and Preferential Tariff (duty-free) vis-à-vis Sri Lanka's MFN Tariff, 2009

Product	*Product description*	*India*	*Sri Lanka*
210690	Food preparations nesoi	150	16.14
020713	Chicken cuts and edible offal (including livers) fresh or chilled	100	28
020714	Chicken cuts and edible offal (including livers) frozen	100	28
070320	Garlic, fresh or chilled	100	15
080620	Grapes, dried (including raisins)	100	28
090111	Coffee, not roasted, not decaffeinated	100	28
090112	Coffee, not roasted, decaffeinated	100	28
090121	Coffee, roasted, not decaffeinated	100	28

Product	*Product description*	*India*	*Sri Lanka*
090122	Coffee, roasted, decaffeinated	100	28
090190	Coffee substitutes containing coffee; coffee husks and skins	100	28
151110	Palm oil and its fractions, crude, not chemically modified	100	28
160100	Sausages and similar products, of meat, meat offal or blood; food preparations based on these products	100	28
160232	Prepared or preserved chicken meat, meat offal or blood	100	28
870310	Passenger motor vehicles specially designed for traveling on snow; golf carts and similar vehicles	100	30
870321	Passenger motor vehicles with spark-ignition internal combustion reciprocating piston engine, cylinder capacity not over 1,000 cc	100	30
870322	Passenger motor vehicles with spark-ignition internal combustion reciprocating piston engine, cylinder capacity over 1,000 cc but not over 1,500 cc	100	30
870323	Passenger motor vehicles with spark-ignition internal combustion reciprocating piston engine, cylinder capacity over 1,500 cc but not over 3,000 cc	100	30
870324	Passenger motor vehicles with spark-ignition internal combustion reciprocating piston engine, cylinder capacity over 3,000 cc	100	30
870331	Passenger motor vehicles with compression-ignition internal combustion piston engine (diesel), cylinder capacity not over 1,500 cc	100	30
870332	Passenger motor vehicles with compression-ignition internal combustion piston engine (diesel), cylinder capacity over 1,500 cc but not over 2,500 cc	100	30
870333	Passenger motor vehicles with compression-ignition internal combustion piston engine (diesel), cylinder capacity over 2,500 cc	100	30
870390	Passenger motor vehicles, nesoi	100	30
871110	Motorcycles and cycles with an auxiliary motor, with reciprocating internal combustion piston engine, cylinder capacity not over 50 cc	100	5

Product	*Product description*	*India*	*Sri Lanka*
871120	Motorcycles and cycles with an auxiliary motor, with reciprocating internal combustion piston engine, cylinder capacity over 50 cc but not over 250 cc	100	5
871130	Motorcycles and cycles with an auxiliary motor, with reciprocating internal combustion pistol engine, cylinder capacity over 250 cc not over 500 cc	100	5
871140	Motorcycles and cycles with an auxiliary motor, with reciprocating internal combustion piston engine, cylinder capacity over 500 cc not over 800 cc	100	5
871150	Motorcycles and cycles with an auxiliary motor with reciprocating internal combustion piston engine, cylinder capacity over 800 cc	100	5
871190	Motorcycles and cycles fitted with an auxiliary motors, nesoi; side-cars	100	5
100610	Rice in the husk (paddy or rough)	80	0
100620	Rice, husked (brown)	80	0
100640	Rice, broken	80	0
170111	Cane sugar, raw, in solid form, not containing added flavoring or coloring matter	60	10
170112	Beet sugar, raw, in solid form, not containing added flavoring or coloring matter	60	10
170191	Cane or beet sugar and chemically pure sucrose, refined, in solid form, containing added flavoring or coloring matter	60	10
170199	Cane or beet sugar and chemically pure sucrose, refined, in solid form, not containing added flavoring or coloring matter	60	10
240210	Cigars, cheroots and cigarillos, containing tobacco	60	10

Note: nesoi stands for not elsewhere specified or included
Source: TRAINS database and ISFTA text

It may be observed that a high differential still exists in products such as specialized food preparation (soft drink concentrates, *pan masala*, etc), garlic, dried grapes, coffee, etc. Therefore, it is important that the rules of origin for these products be administered strictly. Further, an attempt could be made to harmonize the external tariff of these products as far as possible.

2.9 MAJOR FINDINGS

Overall trade. Trade between the two contracting states increased over the years. Although trade relations between the two neighbors did exist in the pre-FTA period, it gained a much needed boost from the date of implementation of the trade agreement (from $544 in 1999 to $3,368 in 2008). Further number of products traded between the contracting states increased considerably over the years. The notable feature of the FTA is that trade in a number of products increased considerably in spite their being on the negative list. The share of bilateral trade in world trade improved.

Importance in partner's market. India became the most favored source for the Sri Lankan importers immediately after the implementation of the FTA. On the other hand, rank of Sri Lanka as an export destination of India's products improved but remained below 10 (from 18th in 2000 to 13th in 2005).

Structure of trade. 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, namely, copper and vegetable oil.

Revision of the negative list. Despite being in the negative list, number of products (at HS-6 digit level) performed well during the post-FTA period. Therefore, the study attempted to analyze the performance of the products in the negative list. After analyzing through various trade indices, the study identified products in the negative list that could be removed.

Decline in margin of preference. Due to unilateral liberalization of the economy in general and the import duty in particular (in both the contracting states), the products listed out in the zero-duty category for duty-free/concessional imports from Sri Lanka lost their competitiveness.

2.10 POLICY IMPLICATIONS

At the time of signing of the ISFTA, this was first bilateral free trading arrangement for Sri Lanka and the third one for India after Nepal and Bhutan. Therefore, people from both the countries had a lot of expectations from (also apprehensions about) the FTA. Slow progress at the regional level (SAPTA/SAFTA) is also understood to be the factor that encouraged its emergence.

After a decade of implementation of the FTA, many positive as well as some negative outcomes were observed.

Bilateral trade under ISFTA got a boost in the initial five years—Sri Lanka was able to make deeper penetration into the Indian market. Special and differential treatment provisions under the agreement were considered to have been instrumental in moderating the adverse trade balance in India's favor during this period.

The buoyancy in Sri Lankan exports to India post-2005 led to considerable rethinking on the positive gains achieved till then. A scrutiny of the data revealed that nearly half of the increase in Sri Lanka's exports to India was on account of only two products, namely, copper and vanaspati.

In order to protect domestic industries the contracting states presented negative lists as part of the agreement. A detailed analysis of the bilateral trade flow indicated that a number of products from the negative list registered considerable growth. The present study also analyzed their competitiveness in each other's markets using various quantitative trade measures. The study lists such products and recommends removal of these from the negative lists. In other words, the contracting states should revise their respective negative lists after due consultation with the concerned industry.

Vastly differentiated external tariffs (particularly on copper and refined vegetable oil) have caused considerable trade deflection on these products, the benefits flowing from which have been suspect. The countries need to trade on products in which they have real comparative and competitive advantage. This study highlights the need to prevent the further recurrence of such trade distortion by identifying a number of products on which arbitrage in differential tariffs could still occur. Harmonization of external tariffs, to the extent feasible, as also stricter adherence to norms of rules of origin has been suggested, particularly keeping vigil on the identified products.

In recent years the MoP for many of the products has declined due to unilateral import tariff rationalization in a globalized world. Therefore, there is an urgent need for change in approach. To keep 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 (like CEPA) or by revamping the existing agreement. After analyzing the implementation of the ISFTA, the study strongly recommends a deeper cooperative arrangement incorporating the lessons learned from the working of the FTA.

Annex 2.1: Broad Product Categories used to Analyze the Structure of Bilateral Trade

Category	*Sections*	*Chapters*
	Agricultural products	
I	Animals and animal products	01–05
II	Vegetable products	06–14
III	Animal or vegetable fats	15
IV	Prepared foodstuffs	16–24
	Mineral products	
V	Mineral products	25–27
	Chemical and related products	
VI	Chemical products	28–38
VII	Plastics and rubber	39–40
	Non-consumable animal and plant products	
VIII	Hides and skins	41–43
IX	Wood and wood products	44–46
X	Wood pulp products	47–49
	Textiles and apparel	
XI	Textiles and textile articles	50–63
XII	Footwear, headgear	64–67
	Non-metallic mineral products	
XIII	Articles of stone, plaster, cement, asbestos	68–70
	Metals and manufactured articles made mostly of metal	
XIV	Pearls, precious or semi-precious stones, metals	71
XV	Base metals and articles thereof	72–83
XVI	Machinery and mechanical appliances	84–85
XVII	Transportation equipment	86–89
XVIII	Instruments – measuring, musical	90–92
XIX	Arms and ammunition	93
	Other highly manufactured and special-purpose goods	
XX	Miscellaneous	94–96
XI	Works of art	97

Source: http://www.globaltariff.com/SectionsandChapters.cfm

3

Issues Related to Trade Facilitation and Non-tariff Barriers in India and Sri Lanka

A Synthesis of Secondary Literature

BISWAJIT NAG

3.1. BACKGROUND

3.1.1. Introduction

To achieve the best possible outcome from a free trade regime, we require a trading environment which is free from barriers at the borders. World Trade Organization is making attempts to address specific concerns like regulation of imports for sanitary and phyto sanitary purposes, technical regulations, procedures for issuing import licenses, etc. However, presently there is hardly any discipline regarding documentation, legal appeal systems, and transit procedures maintained by WTO members at their borders. These procedures are generated by the need for governments and trade operators to monitor and control the movement of goods, transfer of services, and related financial flows thereby generating tariff revenues. These procedures also try to control the cross-border movement of illegal drugs, arms, protected species, hazardous waste, and other controlled products and to collect relevant information for operational and statistical purposes. However, tedious and complex procedures and documentation can sometimes be major impediments to trade. The average customs transaction involves 29–30 different parties, 40 documents, 200 data elements (30 of which are repeated at least 30 times), and the rekeying of 60%–70% of all data at least once.[1] The varying customs procedures and requirements result in very high administrative costs that are currently estimated to represent 7%–10% of the value of global trade.[2]

The main objective of trade facilitation is to minimize transaction costs and the complexity of international trade for businesses, while maintaining efficient and effective government control. Trade facilitation does not merely benefit traders. Ongoing research shows that welfare gains from streamlining trade procedures could exceed gains from trade liberalization (i.e., tariff reduction). Average gains from trade facilitation in the Asia-Pacific region account for at least 0.26% of the real GDP, while the gains from trade liberalization account for only 0.14% of the real GDP.[3]

Discussions on trade facilitation started in the WTO during the Singapore Ministerial Conference in 1996, when members directed the Council for Trade in Goods "to undertake exploratory and analytical work … on the simplification of trade procedures in order to assess the scope for WTO rules in this area".[4] Though discussions started in 1996, the negotiation on trade facilitation commenced during the Doha Ministerial Declaration in 2001. Trade facilitation formally came to be accepted as a subject of rule-making in the WTO in 2004, i.e. 8 years after it was first agreed in the WTO to start a work program on the subject. The broad contours of the negotiation are governed by the modality of negotiation on trade facilitation as agreed under Annex D of the July Framework Agreement of 2004. The WTO negotiations on trade facilitation are covered under three existing articles of General Agreement on Tariffs and Trade (GATT): Article V (Freedom of Transit); Article VIII (Fees and Formalities connected with Importation and Exportation); and Article X (Publication and Administration of Trade Regulations). As per these articles, the objectives of the negotiation are to: (a) clarify and improve clauses of Articles V, VIII, and X of GATT 1994 with a view to further expediting the movement, release, and clearance of goods including those in transit; (b) enhance technical

[1] J. Roy. 1998.*Trade Facilitation –The World Bank Experience.* Geneva: WTO Trade Facilitation Symposium.

[2] Economic and Social Commission for Asia and the Pacific (ESCAP) 2001.*Training Manual on Increasing Capacities in Trade and Investment Promotion* (ST/ESCAP/2184). Bangkok, Thailand.

[3] Asia-Pacific Economic Cooperation (APEC) 1998.*The Impact of Trade Liberalization in APEC*, APEC Secretariat. Singapore.

[4] Singapore Ministerial Declaration (para 21). For details visit WTO website http://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.htm

assistance and support for strengthening systems in trade facilitation; and (c) aim at effective cooperation on trade facilitation and custom compliance issues.

As WTO is yet to resolve the issues related to trade facilitation, most of the countries have started taking a unilateral approach to improving the system. Regional groups through Regional Trade Agreements (RTAs) have also addressed the issues. In this context, this chapter examines the status of trade facilitation in India and Sri Lanka and scope for improvement in bilateral trade.

South Asian nations are trying to address the issue of trade facilitation in regional and bilateral forums also. In the South Asian Association for Regional Cooperation (SAARC) trade facilitation was addressed under both the SAARC Preferential Trading Arrangement (SAPTA) and the South Asian Free Trade Agreement (SAFTA). Under Article 6 (Additional Measures) of SAPTA the members agreed to consider trade facilitation measures to support and complement reduction in tariffs, para-tariffs, and liberalization of trade. According to SAFTA the states agreed to consider the trade facilitation measures outlined under Article 8. Although trade facilitation is not addressed in a binding form, the intention of the countries to harmonize and simplify standards, customs procedures, business visa procedures, etc. is highlighted.

Table 3.1 provides an overview of some selected indicators on trade facilitation issues in India and Sri Lanka. The values are compared with some other South Asian countries and Singapore (as one of the benchmarks). India and Sri Lanka are relatively well-placed as compared to other countries in the South Asian region. In terms of competitiveness, India ranks at 51 and Sri Lanka at 62 among 139 countries. In terms of the selected indicators, Indian scores are lower than the world average in all categories except in "transparency of government policy making". While Sri Lanka scores just above the world average in "infrastructure" as a result of the focus on infrastructure development in the country, its scores are at par with the world average in terms of burden of customs procedures and burden of government regulation. However, Sri Lanka falls below the mean value in terms of transparency of government policy making, which is essential in terms of business, confidence building, and predictability. Being a geographically large country, catering to a population of over 1 billion people, India ranks 86th in the category of overall infrastructure quality. While comparing India and Sri Lanka, it is clear that Sri Lanka has better infrastructure and India has greater transparency in policy making. In other categories, both the countries are very close to each other and generally below the world average, implying that they need to improve on several counts.

Table 3.1: Selected Indicators of Trade Facilitation in the South Asian Region, 2010–2011

	Mean	*Singapore*	*Bangladesh*	*India*	*Pakistan*	*Sri Lanka*	*Nepal*
Prevalence of trade barriers (1)	4.6	6.2	4.1	4.2	4.1	4.2	4.0
Burden of customs procedure (2)	4.2	6.3	3.4	4.0	3.6	4.2	3.4
Infrastructure (3)	4.3	6.6	2.7	3.6	3.5	4.4	2.4
Transparency of government in policymaking (4)	4.4	6.3	3.8	4.7	3.7	3.8	4.0
Irregular payments and bribes (5)	4.3	6.6	2.5	3.7	3.0	4.1	2.7
Burden of government regulation (6)	3.3	5.5	2.9	3.0	3.2	3.3	2.7
Global Competitiveness Index (Rank)	–	3	107	51	123	62	130

Notes: Significance of range of scores in each indicator.

(1) 1= strongly limits the ability of imported goods to compete in the domestic market; 7= do not limit the ability of imported goods to compete in the domestic market.

(2) 1= extremely inefficient; 7= extremely efficient.

(3) 1= extremely underdeveloped; 7= extensive and efficient by international standards

(4) 1= extremely underdeveloped; 7=extremely easy.

(5) 1= very common; 7= never occurs.

(6) 1= extremely burdensome; 7= not burdensome.

Source: World Economic Forum. 2010–2011. *Global Competitiveness Report*. World Economic Forum: Geneva, Switzerland.

Table 3.2 analyzes the cost of doing business in terms of delay, number of documents/administrative processes, etc. in India and Sri Lanka. In India the cost of export and import per container is much higher than Sri Lanka. When Tables 3.1 and 3.2 are seen together it becomes clear that one of the reasons for the higher cost of export and import in India is the lack of modern and efficient infrastructure. Both the countries, however, compare well with the South Asian average.

Table 3.2: Trading Across Borders, India, Sri Lanka, and South Asia, 2010

	India	*Sri Lanka*	*South Asia*
Documents to export (number)	8	8	8.5
Time to export (days)	17	21	32.4
Cost to export ($ per container)	945	715	1364.1
Documents to import (number)	9	6	9.0
Time to import (days)	20	20	32.2
Cost to import ($ per container)	960	745	1509.1

Source: World Bank. 2010. Doing Business Report 2010: Reforming Through Difficult Times (South Asia). World Bank and IFC.

3.1.2 Trade Facilitation Issues in India

In India the Information Technology Act, 2000 which is related to introduction and support of e-governance was a major step towards trade facilitation. This led to the acceptance of electronic signatures and helped in accelerating growth in trade. The Central Board of Excise and Customs (CBEC) had the task of issuing digital signature certificates that give legal validity to electronic declarations. In 2007, through the introduction of an Electronic Data Interchange (EDI) system, customs declarations were digitized and transferred through the internet. This system also allowed the operation of a Risk Management System (RMS), an e-manifest system, and an e-payment system which facilitated a reduction in import time by 7 days. By 2008, it allowed exporters to submit documents to customs online. The EDI system also enabled customs to automatically assess export documents, making customs clearance more efficient. The new system reduced the time needed to export by 1 day. During the survey conducted by Marketing and Development Research Associates (MDRA) it was noticed that almost 68% exporters and 75% importers felt strongly that the extent of paperwork had come down in the last few years.[5] They also mentioned that the electronic system and the simplification of the documentation process were

[5] MDRA has been involved in the primary field survey of Indian stakeholders who are part of the Indo-Sri Lanka Free Trade Agreement (ISFTA) as a separate study. The terms of reference for this study stipulated that it be linked up with the primary survey.

responsible for this. It is important to observe traders' views on reduction in paperwork as an enabler of faster clearances rather than reduction in corruption or increase in transparency.

3.1.3 Issues Related to Transaction Cost of Trade in India

The Government of India in January 2011 has brought out a report on transaction cost in trade which goes beyond the traditional trade facilitation issues and takes into account a large number of processes that primarily affect India's export growth. The report encompasses a number of issues dealt with by various ministries and suggests possible ways of handling them.[6] On the basis of secondary data analysis, expert opinion, and various indicators like manpower cost, the cost of money locked as a result of bank guarantees, drawback amount, and other direct costs were factored in to arrive at indicative monetization of the transaction cost of relevant issues. The Task Force identified 44 issues across 7 line ministries for action. Of these 44 issues, actions have been taken for 23 issues and the rest are under consideration. It was estimated by the task force that implementation of 23 issues is likely to mitigate transaction cost of Rs. 21,000 million and in the long run it will have a lasting impact on India's competitiveness. The major ministries involved in the process are those in charge of commerce and industries, agriculture, civil aviation, finance (revenue and banking), etc. Issues that are already taken up for this purpose range from plant quarantine and single payment scheme (SPS) to taxation, custom procedure, and efficiency in logistics.

3.1.4 Trade Facilitation Issues in Sri Lanka

Sri Lanka was a forerunner in implementing trade facilitation in Asia. It appointed a National Trade Facilitation Committee in 1980. Through this committee, Sri Lanka introduced trade and transport facilitation documents aligned with the United Nations layout key for trade documents. It was mandated to take action to simplify external trade procedures/documents. Among its main achievements were: eliminating unnecessary documents and replacing a number of other documents, the introduction of the EDI concept, further simplification of the import/export procedure, and strengthening

[6] Ministry of Commerce and Industry. 2011. *Task Force on Transaction Cost in Exports: A Report*. Government of India: New Delhi.

relevant institutions. The committee however discontinued in the 1990s.[7] Following WTO recommendations the Department of Commerce of Sri Lanka appointed a Steering Committee in 2006 on trade facilitation but it is not functional anymore. Now, some public and private organizations advocate trade facilitation measures.

The Trade Policy Review (TPR) of the WTO for Sri Lanka identifies three main policy reforms undertaken in the country towards trade facilitation: (a) adoption of the Sri Lanka Automated Cargo Clearance Systems (SLACCS); (b) implementation of the WTO/GATT Valuation Agreement; and (c) simplification and harmonization of customs procedures.[8] In terms of technological developments for trade facilitation, the system of EDI was established in Sri Lanka in 2004 under SLACCS. The Automated System for Customs Data (ASYCUDA) for lodging entries with customs and assessing them has been in operation since 1994, while ASYCUDA++ has been in use since 1998. Information and Technology has been used in Sri Lanka for automation at the Customs (introduction of ASYCUDA), automation of the Colombo port (EDI and a new automated terminal management system called NAVIS), and introduction of electronic submission of Certificate of Origin (COO) by the Ceylon Chamber of Commerce.[9] WTO indicates that the ASYCUDA system has been implemented centrally in Sri Lanka.[10] The system processes data, including information on transit and customs warehouses, and manages the allocation of preferential quotas under Free Trade Agreements (FTA). On an average the processing time required for completing all these is 16 hours.

The focus of the customs is on the need to strike a balance between revenue collection and trade facilitation, more so in Sri Lanka as the customs collect 50% of the government revenue. Since revenue from customs is an important source of income for the government, it gives specific revenue targets to be met by the Department of Customs. In such a scenario a collaborative effort between customs and traders is needed for effective trade facilitation where the government improves the facilities and the trading community ensures its

[7] J. Wijayasiri and S. Jayaratne. 2009. *The Impact of Information Technology in Trade Facilitation on SME in Sri Lanka*. Bangkok, Thailand: ARTNeT UNESCAP.

[8] World Trade Organization. 2004. *Trade Policy Review: Sri Lanka: Report by the Government*. Trade Policy Review Body.WT/TPR/G/128.Last accessed on 10 December 2010.

[9] Footnote 7.

[10] World Trade Organization. 2010. *Trade Policy Review: Sri Lanka: Report by the Secretariat*. WT/TPR/S/237/Rev.1.Last accessed on 10 December 2010.

compliance. Custom valuation is an important issue that has to be mentioned here. Between 2004 and 2010 (WTO has made two TPRs), an important policy development has been the implementation of the WTO Customs Valuation Agreement (CVA). However, Sri Lankan legislation grants the authorities the flexibility to depart from CVA rules if necessary, in the interest of the national economy or for any other reason, allowing the use of minimum values. While Schedule "E" of Customs (Amendment) Act No. 2 of 2003 implements the WTO CVA, Article 10 of the schedule grants the Minister (of Finance), with the approval of the cabinet of ministers, the authority to apply minimum values for any good for the period specified in the order implementing the measure. WTO reports that minimum import prices were applied on imports of used cars during that time.[11]

Sri Lanka has also introduced port reforms keeping in mind trade facilitation of 2002. As the Colombo port reached its maximum capacity in recent years, the South Port increased the annual container handling capacity from 4 million Twenty-foot Equivalent Units (TEUs) to 12 million TEUs. The Colombo port handles majority of Sri Lanka's trade and most of it is trans-shipment trade.

Sri Lanka uses both printed and electronic media to publish regulatory and administrative changes related to trade. Dissemination of information regarding tariffs and regulations are done through gazette notifications. In addition, changes in tariffs are instantaneously made public through Revenue Protection Orders (RPOs). Sri Lankan customs is responsible for advance rulings on classification and a standard format is used for this purpose.[12] In the survey of traders and other stakeholders, nearly 70% of the respondents stated that collection of information related to trade was very time-consuming, whereas 45% said it was costly.[13] Moreover, a majority of the respondents found it difficult to access laws and administrative rulings even though there are designated official enquiry points for traders to obtain information. Also from the survey it was evident that government procedures take time in publishing information through gazette notifications. Even though several government agencies launched websites, they have not been regularly updated. The World Bank also indicates (refer to Table 3.2) that Sri Lanka

[11] Footnote 10.

[12] D. Weerakoon, J. Thennakoon, and B. Weeraratne. 2005. *Multilateral Agreement on Trade Facilitation: Important but Complex Agenda for South Asia*, South Asian Positions in the WTO Doha Round: In Search of a True Development Agenda.

[13] Footnote 12.

has fallen behind with regard to transparency of government regulation.[14] Weerakoon et al. also highlighted that according to the stakeholders, the most time-consuming aspect of trade procedures in Sri Lanka was obtaining various refunds like duty drawbacks, obtaining different licenses, export/import codes, and clearance through customs, getting remittance through banks, and final dispatch of export consignments (due to the time taken for the process).[15] In case of EDI implementation, respondents identified that traders were not able to take full benefits as they were not fully aware of the systems. The clearing agents and freight forwarders also made an attempt to resist the implementation of EDI. Even after the introduction of the system there was lack of coordination between different government agencies. By 2009, there were over 30 government and non-government agencies that were part of the import/export process. Out of these institutes the only regulatory agency which was linked to the EDI system was the Tea Board. The partial implementation of the EDI system which required a major component of the trading process to be carried out manually, the lack of connectivity with the stakeholders, and the additional cost of using EDI discouraged many traders from using it.[16] The study has also identified that an appeal process is quite cumbersome and receiving a reply to any enquiry takes a long time. Table 3.3 provides some detailed information about the documents and time required (on an average) to clear an export or import consignment in Sri Lanka. Among all the heads, custom clearance is costliest followed by documents preparation and port handling. In terms of time, maximum time is required to prepare the documents but for other clearances, time required is less when compared to India.

Table 3.3: Export and Import Procedures, Duration, and Cost in Sri Lanka

Nature of export procedures	*Duration (days)*	*Cost in $*
Customs clearance and technical control	3	285
Ports and terminal handling	3	155
Inland transportation and handling	3	115
Total	**21**	**715**

[14] World Bank. 2010. *Doing Business in South Asia*. (See the details given above).

[15] Footnote 12.

[16] Footnote 7.

Nature of import procedures	*Duration (days)*	*Cost in $*
Documents preparation	12	190
Customs clearance and technical control	3	285
Ports and terminal handling	3	155
Inland transportation and handling	2	115
Total	**20**	**745**

Source: World Bank. 2010.*Doing Business in South Asia.*

3.1.5 Prime Issues of Trade Facilitation with the Indo-Sri Lanka Free Trade Agreement

Weerakoon and others in a study have identified issues related to trade facilitation in South Asia.[17]

1. Laws, regulations, formalities, and procedures
2. Use of EDI
3. Dwell time
4. Fees, charges, penalties, and appeals
5. Corruption-related costs
6. Personnel at government agencies

All these require urgent attention for developing a smooth system for transaction of goods across the border. In case of Indo-Sri Lanka Free Trade Agreement (ISFTA), issues related to documentation have been a major challenge. It has been identified that COO plays a very crucial role, particularly the one issued by Sri Lanka. It has been observed that Sri Lanka issues this certificate once the goods are delivered at Indian ports resulting in delays in clearance.[18] Similarly additional certificate requirements increase the hassles of the traders who export and import through the ISFTA route. Many a times the officials are not aware of the documentary requirements of the ISFTA thereby creating problems for the traders. Sometimes, customs demand detailed cost sheet for re-calculation of value addition.[19] This also presents an opportunity for

[17] Footnote 12.

[18] De Mel D. et al.1 October 2010. Concept Note. Conference on Trade Facilitation Issues Related to the India-Sri Lanka FTA.Colombo. Institute of Policy Studies, Sri Lanka and UNDP Asia-Pacific Regional Centre, Bangkok.

[19] Somi Hazari. 2010. Ground Level Problems Encountered in Importing Sri Lankan Goods to India under the FTA published in *The Island (online): Business*, 24 February 2010. Available at

corruption. Further there is a lack of a nodal body that can tackle the traders' grievances. Due to poor information flow small and medium-sized (SME) players are deprived of concessions provided within the ISFTA framework. Lack of testing laboratories at ports is another impediment that makes export/ import quite time-consuming. This particularly affects the perishable items. The unavailability of technologically sophisticated equipment at major ports implies that quality check remains a physical process which is time consuming. Import of products such as tea, spices, vanaspati, copper, fabrics and textiles faces stringent checks. Several chambers of commerce in South India have requested for a proper time-bound process for clearance of these goods.

The ISFTA will be successful only if trade can be carried out without hindrances. For example, there should not be any time wasted in obtaining a certificate. A nodal authority should resolve the issues related to ISFTA instantaneously. Additional checks and non-acceptance of signatures results in high costs and delays. This should be avoided and testing and certification requirements may be designated to any one of the countries for a specified number of items. Currently, in South India, imported edible items are checked by labs situated at a considerable distance from ports. Imports into Chennai are sent to Central Food Technological Research Institute (CFTRI) in Mysore and imports into Mumbai are sent to CFTRI in Pune. It is recommended that both governments agree on certain testing/certifying bodies in either country and recognize these certifications so that additional time and money are not spent on re-testing and re-certification. For some products, (such as frozen food) the procedure is ambiguous. Streamlining of these issues should be given priority. Trade procedures should be laid out very clearly. They should be guided by proper law and most importantly officials should be properly trained so that there is no ambiguity with trade rules/methods under the ISFTA framework.

South Asian countries including India and Sri Lanka acknowledge that existing inefficiencies in trade facilitation measures need to be tackled if they are to become more competitive in the international market. The key issues have similar dimensions across South Asia along with some country-specific concerns. Inefficiency at the port, poor port infrastructure, lack of cross-border transit points and poor road connections across the region, licensing restrictions, poor management at customs with high monetary and time costs, administrative problems, non-transparent trade procedures, lack of technical equipment in

---

http://www.island.lk/2010/02/24/business9.html customs administration, restrictions on information technology and service sector infrastructure, lack of modern infrastructure networks and problems in meeting standards and technical regulations, etc. are very common in the region. In addition, the political will to implement trade facilitation measures seems to be lacking and bureaucratic practices are lengthy and tedious. It is also important to highlight that there is no pressure from stakeholders to implement trade facilitation measures in most of the South Asian countries, partly because the business community is not fully conversant with the potential benefits of trade facilitation. However, a key factor inhibiting trade facilitation measures in South Asia are the costs associated with large-scale improvements in trade infrastructure. Countries tend to take up half-hearted strategies to improve the trade facilitation measures. As a result there is still lack of efficiency even after implementation of some measures (such as EDI).

With this background, it is also important to mention that countries are making attempts to address these issues through regional cooperation also. For example, under SAARC, countries have agreed to cooperate in mutual administration of customs, developing harmonized standards, etc. SAARC has also agreed to set up a South Asian Regional Standards Organization (SARSO) to look after harmonized standards for the region to facilitate intra-regional trade and to have access to the global market. Currently, Asia Pacific Trade Agreement (APTA) members are also making attempts to develop a framework agreement on trade facilitation. India and Sri Lanka are signatories in this agreement and are clearly addressing trade facilitation issues by introducing them in "articles" such as measures for transparency and consistency, measures for simplicity and efficiency, measures for harmonization and standardization, measures for cooperation, etc. A group on trade facilitation will further deliberate on the details of those measures including regional cooperation in arranging investments for improving efficiencies and reducing infrastructure bottlenecks.

In the context of ISFTA, similar measures can be taken up to develop the right focus. This can take care of the problems faced by traders in both the countries. In a tariff-free environment it is important to reduce transaction costs associated with trade in order to harness the full benefits of the ISFTA. Given that the trade-facilitation–related provisions in the Comprehensive Economic Partnership Agreement (CEPA) are limited, it is important that these be implemented in line with the best practices identified in other countries and agreements in areas such as mutual recognition agreement, risk management, and single window. Many of these can be integrated in the ISFTA itself, and lessons can be drawn from other FTAs such as the India–Singapore FTA. For example, in the latter there are specific provisions made in terms of risk management where only 5% of total transactions are to be checked and provisions made for harmonization of procedures, strengthening systems, etc. India–Singapore Comprehensive Economic Cooperation Agreement (CECA) facilitates coordination between various border agencies for facilitating quicker clearance of documentary requirements. A similar process can be replicated between India and Sri Lanka. Both the countries can develop common documents and measures for this purpose. For example, both the customs can identify goods based on level of risk so that they can focus on high risk goods for verification and speed up clearance for the low risk goods. These measures will result in greater transparency and lower transaction costs for business people. India and Sri Lanka should think more innovatively to address trade facilitation issues.

Both India and Sri Lanka have partially automated trading systems, and are working towards a single-window. This would no doubt reap the benefits of lower costs of trading, lower clearance times, increased transparency, and lower rent seeking and less complex bureaucracy.

3.2 NON-TARIFF BARRIERS TO TRADE: ISSUES PERTAINING TO INDO-SRI LANKA FREE TRADE AGREEMENT

Any restriction imposed on the free flow of trade is a trade barrier. Trade barriers can either be tariff barriers or non-tariff barriers (NTB). Tariff barriers levy ordinary customs duties within the binding commitments undertaken by the concerned country in accordance with Article II of GATT.[20] Non-tariff barriers are trade barriers other than the tariff barriers and can take various forms. Broadly these can be categorized as:

1. Import policy barriers;
2. Standards, testing, packaging, and certification requirements;
3. Anti-dumping and countervailing measures;
4. Export subsidies and domestic support; and
5. Government participation in trade.

[20] http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_02_e.htm#article2. Last accessed on 20 December2010.

3.2.1. Import Policy Barriers

Import policy barriers are among the most significant NTBs. This may take different forms like import licensing, tariff-rate quotas (TRQ), etc. This section will cover these issues along with others such as charges on imports.

3.2.1.1. Import Licensing

One of the most commonly known NTBs is the prohibition or restriction on imports maintained through import licensing requirements. Article XI of the GATT requires members not to impose any prohibitions or restrictions other than duties, taxes, or other charges, whether made effective through quotas, import or export licenses, or other measures.[21] Any form of import licensing (other than an automatic license) is, therefore, to be considered as an import restriction.

India maintains a negative list of imports subject to various forms of non-tariff regulation. The negative list is divided into three categories: banned or prohibited items (e.g., tallow, fat, and oils of animal origin); restricted items that require an import license (e.g., livestock products, certain chemicals); and canalized items (e.g., petroleum products, some pharmaceuticals, and bulk grains) importable only by government trading monopolies subject to cabinet approval regarding timing and quantity. Some 415 tariff lines (around 3.5% of the tariff) at the HS 8-digit level are currently subject to import restrictions under Articles XX and XXI of the GATT. The items are mainly in sections 19 (arms and ammunition), 1 (live animals), 21 (works of art), 5 (mineral products) and 2 (vegetable products).[22] Apart from this, India also monitors imports of around 300 items that are considered to be sensitive.[23] The products include milk and milk products, cereals, fruit and vegetables, spices, tea, coffee, alcoholic beverages, edible oil, cotton, silk, automobiles, and products produced by the small-scale industry. Certain items, including second-hand cars (over 3 years old) must be imported through Mumbai port.

[21] http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_05_e.htm#article11. Last accessed on 20 December 2010.

[22] World Trade Organization. 2007. *Trade Policy Review: India: Report by the Government and Secretariat*. Trade Policy Review Body.WT/TPR/G/182 and WT/TPR/S/182/Rev.1.Last accessed on 20 December 2010.

[23] The monitoring mechanism was set up after the removal of quantitative restrictions on imports in 2002.

Certain products from Sri Lanka subject to preferential tariffs (such as tea), used to be imported earlier through specified ports only (Kolkata , Mumbai, Cochin and Vishakhapatnam for tea and Chennai, Mumbai, and Jawaharlal Nehru Port Mumbai for garments). Such port restrictions have, through negotiations, been waived.

Sri Lanka required import licenses of 512 items (in March 2010) at the 8-digit level, compared with 474 in 2004. More than 25% of these lines corresponded to transport equipment, and a similar amount to chemicals. Import licensing system has been imposed mostly for health, environment, and national security reasons. Importers must pay a fee equal to 0.1% of the import price to receive an import license.[24] Products listed in the regulation are subject to non-automatic licensing (goods originating from any foreign country), as and when the country requires such importation, which is considered on a case-by-case basis.[25] There is no automatic import licensing system. WTO indicates that applications for licenses are processed within two days.[26] Licenses are granted 30 days prior to the date of importation, if requested. However, applications for a license may be made up to a week before importation and licenses may be obtained within a shorter time-limit for goods arriving at the port without a license. Certain licenses may be issued only on the basis of past performance. For instance, block licenses, valid for one year, are issued for importers who have imported drugs during the previous 3-year period. In some cases, licenses may be issued on the condition that the goods are exported and not sold in the domestic market. For example, used vehicles imported for reconditioning in Sri Lanka and subsequently re-exported. Enterprises that have an agreement with the Board of Investment (BOI) are eligible to import/export goods free of restrictions and not subject to import licensing restrictions for materials related to the project.

3.2.1.2. Other Restrictions

Certain restrictions on imports, however, can be imposed in accordance with various provisions of the GATT. These include restrictions on the grounds of

[24] www.doc.gov.lk/web/index.php. Last accessed on 10 December 2010.

[25] The licensing system is regulated by the Imports and Exports (Control) Act No. 1 of 1969 and by Special Import License Regulation No. 1 of 1977.

[26] Footnote 10.

safety, security, health, public morals, etc. Article XX of the GATT[27] Agreement provides for certain general exceptions on grounds of protection of:

1. public morals;
2. human, animal, or plant life or health; and
3. national treasures of artistic, historic, or archaeological value.

These are however subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. Similarly Article XXI of the GATT provides for certain security exceptions.[28] Import restrictions on some items on grounds of safety and security are being maintained generally by all the countries, and perhaps these cannot be considered as NTBs considering the purpose for which the restrictions are imposed. Article XVIII (B) of the GATT allows import restrictions to be maintained on grounds of balance of payments problems. Besides import licensing, import charges other than the customs tariffs and quantitative restrictions, there are other forms in which import restrictions can be imposed through import policy.[29]

Import restrictions in Sri Lanka are mainly for health, safety, security, environment, and moral reasons. It maintains import restrictions on a range of goods, which include: appliances for discharging gas; crackers that contain explosives; firearms; toy pistols; counterfeited coins; fish, grain, and other articles unfit for human consumption; meat (fresh or frozen) derived from any warm-blooded animal, if it consists of offal, scraps, trimmings, and other pieces in such condition so as to afford insufficient means of identification with a definite part of a carcass, or from which certain glands have been removed; road vehicles, and agricultural and construction machinery that are more than ten years old; guns designed to be disguised; weapons, ammunition, explosives, vehicles, and equipment capable of being used by the armed forces, except with a license from the Ministry of Defense; jewelry or articles made out of ivory; and some medicaments and chemicals. The importation of articles and

[27] http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_07_e.htm#article20. Last accessed on 15 December 2010.

[28] http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_08_e.htm#article21. Last accessed on 20 December 2010.

[29] http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_06_e.htm#article18. Last accessed on 20 December 2010.

books that are obscene or may offend religious beliefs and narcotic drugs are also prohibited. The government can amend this list through the parliamentary process. In October 2008, the Central Bank of Sri Lanka introduced limits on forward contracts for the sale and purchase of foreign exchange, prevented prepayments on import bills, and imposed a 100% deposit requirement on letters of credit for the import of non-essential items. The list includes confectionary, chocolates, personal care products, electrical items, tableware, apparel, footwear, lighting products, and watches. In the case of motor vehicle imports, the deposit requirement was 200% of the import value. These restrictions were later removed in 2009.[30]

Marketing and Development Research Associates survey has noted that the foreign investment law of the Sri Lankan government in the food sector sets an upper limit of a maximum of $50 million by any company. Therefore regardless of the demand, an Indian company cannot buy any other company in Sri Lanka and can only expand the existing plant by a further maximum investment of $9 million. Although both India and Sri Lanka are part of an FTA, the investment policies of the host country are discriminatory. The survey also identifies that when a pharmaceutical company exports a product to Sri Lanka it cannot market the product in Sri Lanka on its own. The product has to be registered by a local company and can only be marketed by that company. Exporters in India revealed that when they were not satisfied with the marketing efforts of their Sri Lankan counterparts and wanted to involve another agency, they were not allowed to get into an agreement with the other agency till the first company gave its consent in writing.

3.2.1.3. Tariff-Rate Quotas and Related Restrictions

The issue of NTBs reared its head from the early stages of negotiations on the ISFTA framework. No binding commitment on minimizing NTBs could be arrived at.[31] Sri Lankan exporters have charged that trade regulations, administrative procedures, and other trade-related requirements operate as NTBs, thus limiting access to the Indian market. Ceylon Tea from Sri Lanka is acclaimed as the best tea in the world with its inherent unique characteristics and

[30] Footnote 10.

[31] L. Jayawardena, L. Ali, and L. Hulugalle. 1993.Indo-Sri Lanka Economic Cooperation: Facilitating Trade Expansion through a Reciprocal Preference Scheme. Study Group Series No. 9.UNU/WIDER.

a formidable reputation. While exporting, most of the certificates are issued by the Sri Lanka Tea Board. First, the potential trader is supposed to register at the Sri Lanka Tea Board as an exporter. Certificate of Origin is critical for exporting. When exporting to countries like EU, Japan, USA additional certificates like ISO 22000, Europe Gap, Hazard analysis and critical control points (HACCP), etc. are needed. The major concern for Sri Lanka's tea exports in India was with regard to access. While access was granted on a TRQ basis, Sri Lanka was permitted to export tea through only two ports—Kochi and Kolkata—both based on tea-growing areas in India.[32] Sri Lanka has been persuading India to remove this entry point restriction enabling Sri Lankan exporters to utilize the TRQ of 15million kg. At the 9th Round of Technical Level Negotiations, under the CEPA between India and Sri Lanka, held from 29 to 31 March 2007, Colombo, India agreed to the Sri Lankan request. The Government of India issued Custom Notification, no. 75/2007 dated 5 June 2007. Sri Lankan tea exporters now can export tea to India under ISFTA without any port restriction.

Port restrictions were also imposed for garments; as in the case of tea, this restriction too has been waived. In addition, the imposition of state taxes in India has been one of the most pervasive NTBs. Sri Lankan exporters often face entry taxes and sales taxes in Tamil Nadu. India's stance has been that goods from other parts of India are also subject to similar state sales taxes—at a rate higher than that prevailing for domestic producers of Tamil Nadu—and therefore are not discriminatory.[33]

Other concerns have risen with regard to unilateral imposition of quotas. Sri Lanka's shipments of vanaspati under the ISFTA have been a cause of contention in bilateral trade relations. This is due to the sharp increase in exports giving India grounds to slap quantitative restrictions on the grounds of hurting the local industry. Similar problems have emerged in the case of copper, pepper, and bakery shortenings. During the survey by MDRA for this project, pepper importers identified that the quota imposed by India is one of the major impediments. It has been argued that exports of vanaspati from Sri Lanka was flooding the Indian market and destabilizing the domestic Indian industry. During trade negotiations in 2003, both countries had agreed to cap

[32] Indra Nath Mukherji, Tilani Jayawardhana, Saman Kelegama. 2004. *Indo-Sri Lanka Free Trade Agreement: An Assessment of Potential and Impact*. South Asia Network of Economic Research Institutes.

[33] Saman Kelegama and I.N. Mukherji. 2007. India Sri Lanka Bilateral Free Trade Agreement: Six Years Performance and Beyond. RIS Discussion Paper No. 119. RIS. New Delhi.

vanaspati shipments from Sri Lanka to 250,000 metric tons but subsequently India had requested that such imports should be capped at 100,000 metric tons. Such a policy had significant adverse effects on Sri Lankan vanaspati factories, with some facing the possibility of a shut down as a result of the regulations imposed by India. In January 2007, following further negotiations with National Agricultural Cooperative Marketing Federation of India Limited (NAFED) India agreed to a quota of 312,500 metric tons of imports per annum.[34] Similarly, restrictions were imposed on bakery shortenings, margarine, and black pepper. However, while India maintained high tariffs on imports of crude palm oil from countries such as Malaysia, Sri Lanka maintained relatively low tariffs on imports of these products. Thus, Indian manufacturers set up vanaspati manufacturing plants in Sri Lanka, imported crude palm oil, processed it in Sri Lanka to form vanaspati, and exported it to India under the FTA.

3.2.1.4. Other Import Charges

All countries tend to levy different charges on tradable goods apart from custom tariffs. India and Sri Lanka are no different. There are a number of para-tariffs imposed in Sri Lanka.

Since November 2004, the government has been charging an import cess on a relatively large range of products, including fruits, vegetables, processed and unprocessed food, shoes, bags, rubber and plastic products, textile products (both apparel and fabric), consumer items such as toiletry and perfumes, ceramic-ware, glassware, pens, and electrical goods. The list has expanded and taxes increased since its inception. In early 2010, the cess was applied on over 3,500 tariff subheadings at the 8-digit level. Excise duties are levied on tobacco products, oil products, aerated water, liquor, beer, motor vehicles, and certain household electrical items. Although locally manufactured products are also subject to excise duties, an imputed profit margin of 15% is added to the import price before calculation of the duty, and the duty is applied on the value including most other import duties. Imported products also face the Ports and Airports Development Levy (PAL) which attracts a rate of 5% or a concessionary rate for imports using solely for processing and re-export purposes. The PAL rate was increased from 3% to 5% as of 1 January 2009, and the PAL levied on imports used solely for processing and re-export was

[34] Ministry of Commerce and Industry. 2007. Public Notice no. 04 (Re-2007)/2004–09 (Part – I, Section – I). Government of India: New Delhi.

reduced from 0.75% to 0.5%. In 2007 an Export Development Board (EDB) levy or cess ranging from 1% to 35% was imposed on a range of consumer goods identified as "non-essential." The objectives of the levy were: (a) to discourage imports of non-essential items; (b) to accord protection to local farmers/manufacturers; (c) to mobilize funds for the implementation of the country's export development program. With effect from 1 January 2008, Regional Infrastructure Development Levy (Act No. 51 of 2006) declared that at the time of import of any motor vehicles other than auto rickshaw, a payment of excise duty whose rates vary considering the cylinder and seating capacity of the vehicles had to be taken into account. In November 2009, customs duty, port levy, nation building tax, social responsibility levy, and value-added tax were replaced by lower special commodity levy. This levy was reduced further on rice and sugar in December 2009. This was expected to minimize cumbersome administrative procedures, particularly for small traders who were generally engaged in such import business. Amendments made with effect from 10 May 2010 listed 22 items (classified at the HS 6-digit level) as essential. Such products included sprats, potatoes, onions, garlic, chickpeas, peas, green gram, lentils, chillies, salmon, herring, tuna, mackerel, etc. This list is being reviewed every 3months. Apart from all these, importers also need to pay social responsibility levy and nation building tax. Moreover, against the letter of credit, Sri Lankan banks require a margin deposit. Following circular no. 35/01/005/0010/1 of 5 December 2008, commercial banks in Sri Lanka were informed that the margin requirements against the letters of credit for the importation of vehicles under Schedule "A" imposed by the circular no. 35/01/005/0010/01 of 2004 were increased from 100% to 200% with effect immediately. Schedule A lists 80 categories under the HS 8-digit level classification of vehicles under six broad groups. Under Schedule A1, the products listed are mainly consumer goods requiring 100% margin deposit under letter of credit. This list contains around 41 groups of products.

In contrast to the Sri Lankan position, India's imports such as tea and textiles face countervailing duties (CVD) and special CVDs in selected products which are in lieu of central excise duties. Almost 15%–20% of India's imports face Single Payment Scheme (SPS) and Technical Barriers to Trade (TBT) clauses for which importers need to take approval through a process which requires some financial charges. For example, Bureau of Indian Standards

(BIS) provides permits based on the requirements laid down. The certification process requires certain fees. The Ministry of Agriculture also provides permits on the basis of food safety, animal, and plant quarantine rules. This process also attracts some nominal costs. The deposit requirement of the importer's bank is not part of the trade policy. Banks are competing with each other under RBI guidelines and regulations and the deposit requirement is purely a function of the relationship between the bank and the importer. It is important to mention that this requirement varies significantly based on whether the importer is established or new. The government has recognized this particular issue and is showing interest in addressing it.[35]

Table 3.4 depicts 11 taxes/levies on top of customs duties relating to the development of infrastructure, protection to agriculture, value-added tax, excise, and social sector levy.

Table 3.4: Classification of Taxes and Levies on Imports in Sri Lanka

S. no.	*Description*	*Applicable statutes/ authority*	*Revenue accounts officer*
1.	Import/export duties	Customs Ordinance No. 17 of 1869	Director General of Customs
2.	Import/export licenses	Imports and Exports Control Act No. 01 of 1969	Controller of Imports and Exports
3.	Ports and Airports Development Authority	Finance Act No. 11 of 2006	Director General of Customs
4.	Import Cess Levy	Sri Lanka Export Development Act No. 40 of 1979	Director General of Customs
5.	Regional Infrastructure Development Levy	Regional Infrastructure Development Levy Act No.51 of 2006	Director General of Customs
6.	Special Commodity Levy	Special Commodity Levy Act No. 48 of 2007.	Director General of Customs
7.	Value-Added Tax	Value-Added Tax Act No. 14 of 2002.	Commissioner general of Inland Revenue
8.	Excise (ordinance) duty (liquor)	Excise Ordinance No. 8 of 1912	Commissioner General of Excise

[35] Footnote 6.

S. no.	Description	Applicable statutes/ authority	Revenue accounts officer
9.	Excise (Special Provisions Duty) on cigarettes, liquor, petroleum products, others	Excise (Special Provisions) Act No.13 of 1989 Act No.13 of 1989	Director general of Excise (Special Provisions)
10.	Social Responsibility Levy	Finance Act No.05 of 2005.	Director General of Fiscal Policy
11	Nation Building Tax (NBT)	NBT Tax Act No.9	Inland Revenue Department

Source: I.N. Mukherji.2010.Tariffs, NTBs, SAFTA, Bilateral FTAs: The Way Forward Case Study. Sri Lanka. Paper presented at the Conference on Tariff and Non-Tariff Barriers in South Asia. Dhaka. Organized by Policy Research Institute of Bangladesh and Commonwealth Secretariat, London.

3.2.2. Standards, Testing, Packaging, and Certification Requirements

Prima-facie, standards, testing, labeling and certification requirements are insisted upon for ensuring quality of goods seeking access into the domestic markets but many countries use them as measures for protection. The impact of these requirements is felt more by the purpose and the way in which these are used to regulate trade. Agreement on the Application of Sanitary and Phytosanitary Measures (SPM) and the Agreement on Technical Barriers to Trade (TBT), specifically deal with trade-related measures necessary to protect human, animal, or plant life or health, to protect environment, and to ensure quality of goods.

3.2.2.1. Sanitary and Phytosanitary Measures

The SPM agreement gives a right to take SPM necessary for the protection of human, animal, or plant life or health. In regard to the determination of appropriate level of sanitary or phytosanitary protection, the agreement requires the objective of minimizing negative trade effects to be taken into account. Further, it permits introduction or maintenance of SPM resulting in higher level of sanitary and phytosanitary protection that would be achieved by measures based on the relevant international standards, guidelines, or recommendations only if there is a scientific justification. However, where no such international standards, guidelines, or recommendations exist or the content of a proposed sanitary or phytosanitary regulation is not substantially the same as the content of an international standard, guideline, or recommendation and if the regulation may have a significant effect on trade of other members, a notice needs to be published at an early stage and a notification has to be made of the products to be covered with an indication of the objective and rationale of the proposed regulation.

In early 2009, the Government of India revised its mandatory certification compliance list, which now includes 85 specific commodities.[36] The revised list includes products such as milk powder, infant formula, and bottled drinking water, certain types of cement, household, and similar electrical appliances, also gas cylinders, certain steel products, and multi-purpose dry-cell batteries. Products on the mandatory certification list must be certified for safety by the BIS before the products are allowed to enter the country. All manufacturers, foreign and domestic, must register with the BIS in order to comply with this requirement. Standards are delineated in India's Scheme of Testing and Inspection (STI), which are on BIS's website or can be obtained from the BIS upon request. Foreign companies can receive automatic certification for imported products, provided that BIS has first inspected and licensed the production facility. However, a general complaint is that inspection and licensing costs imposed on foreign manufacturers are so high that they restrict trade in these items.

Single Payment Scheme standards in India are governed and enforced through a number of laws and agencies (Table 3.5). The Prevention of Food Adulteration Act, 1954 is the main law on food safety and quality. Imports and quarantine are regulated through additional legislation such as the Livestock Importation Act, 1898 most recently amended in 2001; the import of plants and plant materials is regulated under the provisions of the Plant Quarantine (Regulation of Import into India) Order, 2003, issued under the Destructive Insects and Pests Act, 1914. As different government agencies are involved in implementation of SPS, the process has become quite complex.

[36] www.commerce.nic.in/resourcecenter/TBTSPS.asp. Last accessed on 20 January 2011.

Table 3.5: Principal Single Payment Scheme Legislation and Implementing Agencies in India, 2006

Legislation	*Subject*	*Implementing agency*
Prevention of Food Adulteration Act, 1954	Food safety and quality	Ministry of Agriculture, Ministry of Food Processing, Ministry of Health
Fruit Products Order, 1955	Quality of processed fruit products	Ministry of Food Processing
Meat Food Products Order, 1973	Quality of processed meat products	Ministry of Food Processing (up to 2004 Department of Agriculture and Cooperation, Ministry of Agriculture)
Milk and Milk Products Order, 1973 (last amended 1992)	Quality of milk and milk products	Department of Animal Husbandry, Dairying and Fishing, Ministry of Agriculture
Essential Commodities Act, 1955	Consumer protection	State government agencies
Livestock Importation Act, 1898 (amended in 2001)	Procedures for import of livestock	Department of Animal Husbandry, Dairying and Fishing, Ministry of Agriculture
Destructive Insects and Pests Act, 1914	Procedures for import of plants and plant materials	Directorate of Plant Protection, Quarantine and Storage, Department of Agriculture and Cooperation, Ministry of Agriculture
Drugs and Cosmetics Act, 1940	Regulation of import, manufacture, and sales of drugs	Ministry of Health
Export (Quality Control and Inspection) Act, 1963	Regulation of quality control for exports	Exports Inspection Council, Ministry of Commerce and Industry

Source: World Bank. 2010. *Doing Business in South Asia.*

Recently Indian Institute of Foreign Trade (IIFT) on behalf of the Ministry of Commerce has created a web portal which presents a compendium of imports which attract SPS standards.[37] Indian Institute of Foreign Trade's WTO site also has a collection of WTO notification of TBTs and SPS.[38] India's enquiry points under the SPS Agreement are: the Ministry of Health and Family Welfare for human–health-related issues; and the Department of Animal Husbandry, Dairy, and Fisheries for animal health issues, and Agriculture and Cooperation in the Ministry of Agriculture for plant health issues.[39] In August 2006, in an attempt to streamline SPS procedures and enforcement, the Food Safety and Standards Act was passed by the Indian Parliament. The Act consolidated 13 laws and established the Food Safety and Standards Authority (FSSA). In India there is a labeling requirement for genetically modified (GM) food as directed by the Ministry of Health and Family Welfare. The proposed regulation broadly requires that all packages of food/food ingredients of GM origin be subject to the approval of the Genetic Engineering Approval Committee (GEAC).[40] They should be labeled indicating that they are of GM origin and that the product has been cleared for sales in the exporting country.

Earlier in WTO, members raised questions about India's policy on restrictions on imports of live birds, fresh poultry meat, and meat products, due to avian influenza and also a ban on the use of food grade wax under the Prevention of Food Adulteration Act. With regard to the ban on the use of food grade wax, India has consequently permitted two varieties of edible waxes to be used for coating fresh fruits up to the level of Good Manufacturing Practices or GMP standards, subject to labeling of the type of wax used and the best-before date. Some members also expressed concerns about the delay of India's notifications on new fumigation requirements in place since January 2004. There was also concerns regarding the measures deviated from the international standards. Non-notification of various SPS measures was also raised by several members.[41]

The Ministry of Healthcare and Nutrition is Sri Lanka's enquiry point on SPS matters.[42] Sri Lanka is a member of the Codex Alimentarius Commission and the World Organization for Animal Health (OIE), and a contracting

[37] http://compendium.iift.ac.in/. Last accessed on 22August 2011.

[38] http://wtocentre.iift.ac.in/. Last accessed on 22 August 2011.

[39] WTO document G/SPS/ENQ/19, 25 January 2006. Last accessed on 22March 2011.

[40] Notified as a draft (GSR 152(E), 10 March 2006.

[41] WTO documents G/SPS/GEN/204/Rev.2 to Rev.6.Last accessed on 22 March 2011.

[42] WTO documents G/SPS/ENQ/25, 15 October 2009, and G/SPS/NNA/15, 15 October 2009. Last accessed on 22March 2011.

party to the International Plant Protection Convention (IPPC). Sri Lanka has made 18 notifications to the WTO Committee on SPM, for measures on foodstuffs covered by the Sri Lanka Standards Institution (SLSI); shelf-life of imported foods; wood packaging material; food packaging materials and articles; milk and milk products; meat and meat products; plants, plant products, organisms, soil, and other culture media; food coloring substances; coffee, tea, cocoa, and their products; vinegar; iodized salt; irradiated foods; bottled or packaged drinking water; melamine in food products; and GM food. One emergency measure was notified concerning live domestic and wild birds, hatching eggs, table eggs, etc. Sri Lanka has not made any notifications to the WTO regarding the recognition of the equivalence of other countries' SPS measures. WTO document indicates that no such agreements have been reached.[43] In 2001, Sri Lanka notified the SPS Committee of restrictions on imports of 21 GM categories of products on the grounds that it is not known if it is safe for human consumption.[44] Sri Lanka banned the import of GM food products from 1 September 2001. However, this was amended in 2002 and currently, imports of GM foods require prior approval from the Chief Food Authority in the Ministry of Health; a technical recommendation is provided by the Department of Animal Production and Health in that Ministry.

3.2.2.2. Technical Barriers to Trade and Standards

The TBT agreement also contains similar provisions with regard to preparation, adoption, and application of technical regulations for human, animal or plant safety, protection of the environment, and ensuring quality of goods. Both the agreements also envisage special and differential treatment to the developing country members taking into account their special needs. However, trade by developing country members has often faced more restrictive treatment in the developed countries. This has often raised barriers against developing countries on one pretext or the other. Some of the NTBs falling in this category are: ban on import of goods (textiles and leather) treated with azo-dyes and pentachlorophenol, ban on use of all hormones, natural and synthetic in livestock production for export of meat and meat products, stipulation regarding pesticides and chemicals residues in tea, rice

[43] Footnote 10.

[44] WTO document G/SPS/N/LKA/1, 19 July 2001.Last accessed on 22 December 2010.

and wheat, etc., and requirement of on-board cold treatment for fruits and vegetables export.

The BIS is the institute designated by India as the WTO–TBT Enquiry Point, while the Ministry of Commerce and Industry is responsible for implementing and administering the WTO Agreement on TBT.[45] BIS is responsible for formulating and enforcing standards for 14 sectors.[46] India accepted the Code of Good Practice on 19 December 1995.[47] Bureau of Indian Standards plays an important role in regional cooperation programs such as the SAARC and the Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMST-EC) with regard to discussions on standards and conformity assessment. In addition, the BIS has signed bilateral cooperation agreements in the fields of standardization, conformity assessment, quality assurance, and training with national standards organizations of several trading partners. India currently has around 18,300 standards; 5,821 have corresponding International Organization for Standardization/International Electro-technical Commission (ISO/IEC) standards and 4,307 of these (around 73%) are harmonized with ISO/IEC standards (Table AIII.3). Some 53% of standards issued between July 2002 and October 2006 are harmonized with ISO/IEC standards.

In 2006, the Government of India amended an existing law governing the regulation of pharmaceuticals to include certain medical devices. A draft Medical Devices Regulatory (MDR) Bill has been formulated to cover medical devices not included under the Drugs and Cosmetics Act; however, the legislation is yet to be tabled before the Indian Parliament.[48] India has separately introduced a bill that would create a Central Drug Authority that would eliminate the need for an MDR Authority created under the MDR Bill.

In Sri Lanka, the SLSI is in charge of formulating national standards, and providing services such as certifying of products and systems, inspection of

[45] WTO document G/TBT/2/Add.56, 22 October 1999. Last accessed on 20 December 2010.

[46] These are: production and general engineering; chemicals; civil engineering; electronics and information technology; electro-technical standards; food and agriculture; mechanical engineering; management and systems; medical equipment and hospital planning; metallurgical engineering; petroleum, coal and related products; transport engineering; textiles; and water resources (BIS online information. Available at: http://www.bis.org.in/sf/sfp1.htm. 19 May 2006). Last accessed on 10December 2010.

[47] WTO document G/TBT/CS/N/26, 29 January 1996.

[48] www.dst.gov.in/whats_new/whats_new07/MDRA-Act.pdf. Last accessed on 22 August 2011.

imports and exports, and providing laboratory services such as industrial measurement and calibration and testing services.[49] There are over 1,250 Sri Lanka standards relating to products, commodities, materials, processes, and practices;[50] the authorities indicated to WTO that the majority are in line with international standards. Sri Lanka Standards Institution developed national standards through a committee and consultation process. Since 1996, Sri Lanka has made 32 notifications to the committee on TBT, 16 of which were made after 2004.[51] It has accepted the WTO TBT Code of Good Practice.[52] According to the notifications submitted to the WTO, 103 trade related technical regulations are in place (June 2010); the authorities indicated that all of these follow international standards. There are currently ten laboratories and institutions accredited for chemical testing, two for mechanical testing, six for biological testing, and two for calibration, all operating from Sri Lanka.[53] Sri Lanka has not notified to the WTO any mutual recognition agreements (MRA) with third countries on issues related to technical regulations, standards, or conformity assessment procedures. The Sri Lankan government has initiated a discussion with BIS and is envisaging entering into new agreements.

Barriers related to product standards are a primary concern in India's export. The potential to use product standards as hidden trade barriers is immense. A study by the Indian Council for Research and International Economic Relations

[49] SLSI online information. Available at: http://www.slsi.lk. Last accessed on 20 December 2010.

[50] SLSI online information. Available at: http://www.slsi.lk. Last accessed on 20 December 2010.

[51] WTO documents G/TBT/N/LKA—series.

[52] WTO document G/TBT/CS/N/76, 7 August 1997.

[53] They are: (1) chemical testing: Geocycle Analytical Laboratory, Bamber and Bruece Ltd.—Chemical Laboratory, SGS Lanka Laboratory Services—Chemical Laboratory, Industrial Technology Institute—Chemical and Microbiology Laboratory, Lindel Industrial Laboratories, Ceylon Tobacco Company, Sri Lanka Standards Institute (Chemical Laboratory), Atomic Energy Authority, MJF Holdings (Pvt.) Ltd., and Sri Lanka Standards Institution (Food Laboratory); (2) mechanical testing: Industrial Technology Institute, Ceylon Tobacco Company; (3) biological testing: Bamber and Bruece Ltd.—Chemical Laboratory, SGS Lanka Laboratory Services, Sri Lanka Standards Institute, Industrial Technology Institute, National Aquatic Resources Research and Development Agency (NARA), and Astron Limited; (4) calibration: Atomic Energy Authority Secondary Dosimetry Laboratory, and Sri Lanka Standards Institute-Metrology Division.

(ICRIER)[54] mentions that for exporting transformers to Sri Lanka the exporters require the Keuring Van Electrotechnische Materialen (KEMA)[55] certificate (stating that the product is of ISO standards) even though they have been certified by several reputed third-party inspection agencies like Crown Agents, ISO 9001:2000, Bureau Veritas, Lloyds, S.G.S. Robert, BSI Inspectorate, Griffith UK, Tubescope Vecto GmbH Germany, etc. The exporter cannot export to Sri Lanka without procuring this certificate. Even though obtaining this certificate is not very complex or expensive, it demands a lot of time and effort, which is an irritant for exporters.

Sri Lanka specifies registration of cosmetics in their country even if the Indian exporter has registered in India. Thus, each time the exporter has to export to Sri Lanka he/she has to register the product with the State Pharmaceutical Corporation of Sri Lanka, Ministry of Health of Sri Lanka.[56] The exporter has to send the analytical report of the tests carried out in India along with the samples to Sri Lankan importers. These samples again undergo various tests in Sri Lanka after which the certificate of registration is rewarded. This registration is specific to Sri Lanka and is not a mandatory procedure for exports to other countries.

In case of colored edible food products like flavored milk, etc. most importing countries have standard specifications but in order to export to Sri Lanka, Indian exporters are required to obtain a health certificate from the Ministry of Health of Sri Lanka.[57] In addition, the exporter also needs to get a thread-bare analysis done. This test is conducted over a period of 2 days in order to specify the exact contents of the product; this increases the cost of these products. This was highlighted in a study by ICRIER.[58]

Textile products require quality certification for exports. Most importing countries accept the quality certification from ISO and Bureau Veritas.

[54] M. Saqib. *Non-Tariff Barriers and India's Exports: The Case of Asean and Sri Lanka*. N. Taneja. 2004. Trade Facilitation in the WTO: Implications for India. ICRIER Working Paper No. 128. NishaTaneja, ICRIER Working Paper 165.

[55] KEMA: Established in 1927, KEMA is a commercial enterprise, specializing in high-grade technical consultancy, inspection, testing and certification. KEMA has a formidable reputation as a test house for the famous Dutch KEMA-KEUR and tens of other quality marks. KEMA offers the option of combining the certification of management systems. It offers a combination of the ISO 9001:2000 Quality System with the Environmental Management Certification.

[56] http://www.customs.gov.lk/docs/25822.pdf. Last accessed on 15 March 2011.

[57] http://www.customs.gov.lk/docs/25844.pdf. Last accessed on 15 March 2011.

[58] Footnote 40.

However, Sri Lanka asks for certification from its own agencies like SLSI. The SLSI accepts letters of conformity from foreign laboratories, but retains the discretion to take samples and perform tests. This is a problem for Indian exporters as they have to get this certificate and incur the cost and time even though they have an ISO certificate from a recognized agency in India. Hence, exporters exporting to Sri Lanka have to get this additional certificate, without which export is not possible. The lengthy process involved consumes a lot of time. In an earlier survey by ICRIER Indian exporters mentioned that firms incur an average expense close to 5% (or lower) of the total sales revenue to meet standards and regulations.[59] They also indicated that the expenses are not exorbitantly high.

As sanitary ware is fragile, extra care is taken in packaging of these products. They are usually packed in straw to insulate them from shock and impact. But Sri Lanka does not accept products packed in straw as indicated in ICRIER survey. They demand that such products be packed in 5-ply corrugated boxes. India does not manufacture enough 5-ply corrugated boxes to meet the existing demand. The prices are too high compared to the other countries. This actually increases the costs of the packaging and affects the product pricing in the international market.

3.2.3 Anti-dumping and Countervailing Measures

Anti-dumping and countervailing measures are permitted to be taken by the WTO agreements in specified situations to protect the domestic industry from serious injury arising from dumped or subsidized imports. The way these measures are used may, however, have a great impact on the exports from the targeted countries. If used as protectionist measures, they may act as some of the most effective NTBs. The number of anti-dumping investigations since 2005, has increased excessively. Not every investigation results in the finding of dumping and/or injury to the domestic industry. But the period for which the investigations are on, and this period may be up to 18 months, the exports from the country investigated suffer severely.[60] Anti-dumping and CVD being product-specific and source-specific, the importers prefer switching over to other sources

[59] Footnote 40.

[60] Antidumping, A Guide. Directorate General of Anti-Dumping and Allied Duties. Ministry of Commerce. Government of India. Accessed through http://commerce.nic.in/traderemedies/Anti_Dum.pdf. Last accessed on 22 August 2011.

of supply. In some cases the authorities apply innovative methods to prolong the investigation. The agreements recommend that the duty imposed should be adequate to remove the injury to the domestic industry as any amount in excess of that would only provide an undue protection to the domestic industry. Following the WTO site we find that both India and Sri Lanka have rarely used anti-dumping duty on each other. In 2009, India imposed anti-dumping duty on imports of plain medium density fiber board of thickness 6 mm and above (HS 4411) to protect the domestic industry from cheap shipments from countries like People's Republic of China (PRC), Malaysia, Thailand, and Sri Lanka (Notification No. 116 / 2009—Customs dated 8 October 2009). The duty ranged between $308.7 per cubic meter and $395.5 per cubic meter. Plain medium density fiber board is widely used for partitions, furniture, and cabinets, according to a notification. Acting on the petition of domestic producers on alleged dumping of the board from PRC, Thailand, Malaysia, and Sri Lanka, the Directorate General of Anti-dumping and Allied Duties (DGAD) had carried out an anti-dumping probe and recommended the duty. The DGAD said the domestic industry had suffered material injury due to the dumped imports of plain medium density fiber board from these countries.[61]

3.2.4 Export Subsidies and Domestic Support

Both export subsidies and domestic support have a great bearing on trade by other countries. While export subsidies tend to displace exports from other countries into the third-country markets, the domestic support acts as a direct barrier against access to the domestic market. Generally the developing countries can hardly find resources to grant subsidies or domestic support.

Tax exemption for profits from export earnings in India has been completely phased out, but tax holidays continue for export-oriented units and exporters in Special Economic Zones (SEZ). In addition to these programs, India maintains several duty drawback programs that appear to allow for the drawback of excess of duties levied on imported inputs. India also provides pre-shipment and post-shipment export financing to exporters at a preferential rate. India's textile industry enjoys subsidies through modernization schemes, such as the Technology Upgradation Fund Scheme and the Scheme for Integrated Textile Parks. Apart from tariff concessions, exemptions, and export program, the

[61] http://www.hindu.com/2009/10/20/stories/2009102055081400.htm. Last accessed on 15 December 2010.

Ministry of Commerce encourages exports indirectly through the Assistance to States for Development of Export Infrastructure and Allied Activities (ASIDE) scheme. This provides assistance for setting up new export promotion parks and zones and complementary infrastructure such as road links to ports, container depots, and power supply. Other schemes such as the Marketing Development Assistance (MDA) scheme, to support efforts by the export promotion councils (EPCs) in their export promotion activities; the Market Access Initiative (MAI) scheme, to provide assistance for research on potential export markets, etc. are also in place to encourage exports. The Government of India extends other support also to improve quality, infrastructure, etc. related to agriculture through the commodity boards and councils.

Sri Lanka implements a number of incentive schemes aimed at promoting exports by enhancing competitiveness in the production process. Currently, three main schemes are being handled by Sri Lanka customs: a drawback scheme, a temporary importation for export processing scheme (TIEP), and the manufacture-in-bond scheme. Sri Lanka has 13 free-trade zones administered by the BOI.[62] There are some 268 enterprises operating in the Export Processing Zones (EPZs), employing over 117,000 persons.[63] Data on exports are not complete, but their estimated value was some Rs. 575 billion ($5.1 billion) in 2009. Enterprises located in an EPZ are entitled to tax holidays and duty-free imports. However, under current government policies, foreign investors may establish factories in almost any part of the country and receive tax incentives. These schemes include duty exemptions and refunds of duties and other fiscal levies on imported inputs used in the manufacture of exports. Apart from this Sri Lanka also provides other incentives to exporters such as tax holiday, preferential income tax, etc. Agriculture, fisheries, gems, and jewelry sectors also enjoy different types of incentives.

3.2.5 Government Participation in Trade

Many a times subsidies are used as a legitimate tool for government policy to serve its constituents. However, it is recognized that subsidies that cause distortion in international trade or inject unfair trade practices need to be discouraged in the interest of free and fair international trade. Therefore,

[62] They are also called Export Processing Zones (EPZ)

[63] Information provided by the authorities and BOI online information. Available at: http://www.boi.lk/2009/free_trade_zones_industrial_parks.asp. Last accessed on 17 November 2010.

WTO disciplines have been developed to counter such subsidies that lead to unfair competition between subsidized goods of one country and similar non-subsidized goods of another country. Hence discipline in subsidies was required to contain the unfair practices.

In India, the central level, the state level and the public agencies and enterprises have different procurement practices. At the central (federal) level, procurement is regulated through executive directives and administered by the government agencies. The General Financial Rules (GFR), issued by the Ministry of Finance,[64] lay down the general rules and procedures for financial management, the procurement of goods and services, and contract management. Sector-specific procurement policies exist in some areas, such as defense procurement. India does not have an authority for establishing procurement policies and overseeing compliance with the procurement procedures. However, a central purchasing agency, the Directorate General of Supplies and Disposal (DGS&D), and state-level central state purchasing organizations enter contracts with registered suppliers for goods and standard items in conformity with the GFR. The Government of India revised the GFR in 2005 to provide greater flexibility. It has also issued a manual on policies and procedures for purchase of goods. A number of instructions, issued by the Central Vigilance Commission of India, supplement these regulations. The individual government agencies also sometimes issue more detailed instructions and their own handbooks, model forms, and model contracts. Government procurement in India is decentralized, and all state and public agencies have their own procurement organizations. India's government procurement practices and procedures are not transparent. Foreign firms rarely win Indian government contracts due to the preference given to Indian state-owned enterprises in the award of government contracts and the prevalence of such enterprises. Under the Purchase Preference Policy (PPP),[65] government enterprises and government departments give preference to any state-owned enterprise that submits an offer that is within 10% of the lowest bid. The PPP lapsed on 31 March 2008 and has not been renewed since then.

State Trading Corporation (STC) plays an important role in trading of several products There has been further liberalization in state trading in

[64] www.finmin.nic.in/the_ministry/dept_expenditure/GFRS/GFR2005.pdf. Last accessed on 17 November 2010.

[65] www.cvc.nic.in/rppp101109.pdf. Last accessed on 17 November 2010.

exports since 2002. The main changes concern onions, which can be freely exported by a number of state cooperatives, while some petroleum products (LPG and kerosene) can be exported subject to obtaining a "no objection" certificate from the Ministry of Petroleum and Natural Gas. It is important to note that sugar can be exported through the Indian Sugar Exim Corporation Limited only, which is a sugar producers' cooperative. This is mainly to handle the situation in developed countries such as USA and EU where it faces TRQ. India is not a party to the WTO Agreement on Government Procurement. However, at the central government level significant efforts have been made to enhance transparency and competition in procurement procedures. It seems that preferences remain for products manufactured by the small-scale sector and state-owned enterprises.

Like India, Sri Lanka is not a signatory to the WTO Agreement on Government Procurement. Government procurement of goods and services is primarily undertaken through a public tender process. Some tenders are open only to registered suppliers. Procurement is also undertaken outside the normal competitive tender process. Examples of such procurement include agreements in 2006 with the Government of PRC to build a coal power plant and to build a new bulk cargo port in Hambantota for two Chinese companies, and an agreement with India to build a coal power plant. The government publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards are common. In 2006, Sri Lanka published new guidelines, as well as a new procurement manual, to improve the public procurement process. However, in early 2008 the government disbanded the National Procurement Agency, which it had established in 2004, and shifted its functions to the Department of Public Finance in the Ministry of Finance and Planning.[66] The Department of Public Finance also acts as a reference point for providing procurement information, technical expertise, and training to streamline, and improve procurement procedures. The department is also in charge of monitoring the tendering process. This move has raised concerns about the government's commitment to improve the transparency of procurements.

Procurement Guidelines and the Procurement Manual provide the main regulations on the procurement process which is to be followed by ministries and departments, as well as by state-owned enterprises, statutory boards, and

[66] www.npa.gov.lk/ProcNotices.php. Last accessed on 17 November 2010.

all other government institutions and agencies, including provincial councils and local authorities.[67] The new guideline on procurement is expected to enhance transparency, speed up the implementation of development programs, both with public and foreign financing, and to obtain the most financially advantageous and best quality services and supplies.[68] Sri Lanka grants price preferences to locally manufactured goods as determined by the Treasury and included in the procurement guidelines. The stated goal of these preferences is to promote value add to local raw materials and domestic bidders, thereby promoting national industry and enterprise. Preference is granted when evaluating the bid. The Sri Lankan government has started implementing a system for electronic tendering (e-procurement). In early 2010, some aspects of the procurement process were being carried out online, such as, the general advertising process, the publication of procurement invitations, or the inspection of pre-qualification applications and bidding documents. However, the electronic submission of bids is not allowed.

India and Sri Lanka being neighbors have worked together in a number projects through government cooperation which include substantial involvement of trade and investment. Indian government participated in various ways in a number of projects in Sri Lanka. It has assisted with 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. Select items were included in the list on the request of the Government of Sri Lanka. India is funding the project for rehabilitation of the southern coastal railway corridor from Colombo to Matara in Sri Lanka. The project is being implemented in two phases and involves track laying on the Kalutara–Matara sector by Indian Railways Construction Company (IRCON) and provision of training and rolling stocks by Rail India Technical and Economic Services (RITES). The total cost of the

[67] Procurement Guidelines viewed at: http://www.treasury.gov.lk/FPPFM/pfd/publications/ProcurementGuidelines2006_amded12June.pdf. Last accessed on 17 November 2010 and Procurement Manual viewed at: http://www.treasury.gov.lk/FPPFM/pfd/publications/guidelines.html#ProcurementManual. Last accessed on 17 November 2010.

[68] The new guidelines, which were drafted in consultation with the World Bank, the Asian Development Bank, and the Japan Bank for International Cooperation, and a manual became effective on 1 February 2006 for all procurements of goods, works and services, other than the selection and employment of consultants, for which a separate manual and guidelines were issued in 2007 but are still in the draft form. National Procurement Agency.

project is $ 167.4 million, which has been provided as line of credit by the Export-Import Bank of India. More recently on 26 November 2010, India has offered a line of credit of $ 416.39 million for the reconstruction of the railway lines in northern Sri Lanka by IRCON International Limited. These activities involve international trade between two nations under close cooperation and participation of the government.

In 2010, the Sri Lankan government identified the possible shortages of pharmaceutical products and decided to import from India almost 44 varieties of drugs.[69] In fact, Sri Lankan official team visited India and discussed the process of import and quality of the medicines to be supplied. The Sri Lankan government started focusing on the quality of drugs and actively participated in identifying the suppliers from India for this purpose.

3.3 CONCLUSION

India and Sri Lanka signed an FTA in 1998. Looking at the success of the agreement both the countries engaged themselves in negotiating a CEPA, which included trade, investment, technology transfer, etc. The CEPA negotiation was initiated in 2005 and halted in July 2008, after 13 rounds of negotiation. CEPA comprises four objectives:

1. Widening and deepening of the existing FTA
2. Establishing an agreement on trade in services
3. Including measures for promotion of investment in each other's countries
4. Enhancing economic cooperation

Both sides had decided to sign the CEPA during the 15th SAARC Summit held in Colombo but due to reservations expressed by the Government of Sri Lanka, the agreement has still not been signed. Reservations were based on two broad concerns: about the nature of the CEPA itself and that the drawbacks in the FTA should be dealt with first, prior to embarking on a CEPA.

It is important to note that CEPA has made attempts to address both issues. Sri Lanka's negative list includes more items than India's as it is a smaller country. Its offer in the service sector is also restrictive and the scope for Indian personnel working in Sri Lanka on a large scale is somewhat limited.

[69] http://www.business-standard.com/india/news/sri-lanka-to-import-drugsindia/94855/on. Last accessed on 15 January 2011.

Hence, CEPA has attempted to reduce the impact of the economic asymmetry between the two countries. There are also several concerns about issues related to custom clearance, transparency, relaxation and simplification of Rules of Origin (ROO), simpler guidelines for issuance of COO, standardization of SPS, dispute settlement, etc. Some of them have been discussed during the negotiation and definite steps have been proposed in this regard. However, the issues related to trade facilitation and non-tariff measures are deep rooted and the scope of improvement goes much beyond the CEPA. Both countries need to undertake a number of unilateral reforms. The current article highlights that both the countries have started taking several steps towards smoother operation of trade.

Studies have already identified a number of NTBs and trade facilitation issues which may be negotiated bilaterally. There are also large numbers of issues which deserve attention for unilateral reform. Following is the list of few such issues.

1. Within the FTA structure, issues related to risk management at the port for faster clearance of goods may also be negotiated. In this context lessons may be taken from the India–Singapore CECA text.
2. Regarding the complexities involved in ROO related issues, literature is suggesting an introduction of "value-added tariff system". Policy makers may take note of this new idea to replace the current system and deliberate further to understand its nuances.
3. During the survey and also in earlier studies it was noticed that many traders were not aware of ROO-related issues despite the fact that most of them are available on the internet. Lack of awareness is a major issue. In many cases, traders are trading through SAPTA/SAFTA ROO even when better facilities are offered through ISFTA. Governments on both sides need to pass on more information to the traders and a simplification of trading process is absolutely necessary for better utilization of FTA routes.
4. Governments in both India and Sri Lanka may negotiate a "trade facilitation" agreement as in case of APTA. APTA members in which India and Sri Lanka are signatories are addressing trade facilitation issues through negotiating and introducing them in "articles" such as measures for transparency and consistency, measures for simplicity and efficiency, measures for harmonization and standardization, measures for

cooperation, etc. A group on trade facilitation will further deliberate on the details of those measures including regional cooperation in arranging investments for improving efficiencies and infrastructure bottlenecks.

5. In case of unilateral reform, a recent report in India has identified a number of issues in transaction cost for which government is taking steps. It has also been noted that in India, full EDI connectivity between SEZs, customs and clearance house will take some more time. There is a need for developing a timeline to complete the project of e-connectivity among all the stakeholders.
6. Proposal has also been mooted for setting up testing centers in more ports in India so that it takes less time to clear the goods. The government needs to make this a time-bound affair.
7. In both Sri Lanka and India, multiple certifications on various issues have been noted by traders as a major problem. This issue may be taken up for bilateral discussion.
8. It has been observed that frequent changes in policies hurt traders. Both the countries need to look into this aspect and bring out a system in which traders can anticipate the changes more scientifically.
9. In Sri Lanka, the layers of taxes indirectly affect the traders. The government must revisit various taxes and compulsions imposed on traders and make an attempt to simplify them.
10. In Sri Lanka, government procedure and transparency need attention. Traders indicated that it took longer for any kind of clearance. A simplification of the procedural system with a focus on reducing transaction time is warranted. Both India and Sri Lanka also require immediate attention in developing better coordination among agencies which are involved in the trading process. Governments may develop expert committees which will prepare half-yearly reports to understand the improvement in the system and recommend further action. In India comprehensive effort is required to implement the provision related to single inquiry point which may involve software compatibility among various agencies apart from addressing the infrastructural constraints.
11. Both India and Sri Lanka require huge investments in integrated trade infrastructure development. A PPP model may prove useful with strict adherence to a time line to complete different projects.
12. The current study has identified a number of barriers beyond traditional SPS and TBT. In Sri Lanka, packaging requirement is stringent in some

cases; marketing of foreign products through domestic companies and regulatory conditions related to change of domestic company require attention; banking deposits by traders also deserve consideration. Barriers on "non-essential" goods are also worth mentioning including the list of "non essentials". The long time taken by Sri Lankan authorities in providing technical certification even to companies which already have internationally recognized certificates also acts as barrier in some cases. In India quota restriction, port restriction, and wide variations of state level taxes impose serious barriers on import from Sri Lanka. India's position on banning products on SPS grounds has been challenged internationally in the past. The government remains slow in withdrawing those bans or inform through notification about its policy more logically. These issues can be put up for bilateral negotiation.

4

India–Sri Lanka Free Trade Agreement

An Impact Assessment Survey of Indian and Sri Lankan Stakeholders

ABHISHEK AGARWAL, MARKETING AND DEVELOPMENT RESEARCH ASSOCIATES, NEW DELHI (INDIA)
NIHAL DE SILVA, LANKA MARKET RESEARCH BUREAU, COLOMBO (SRI LANKA)

4.1 INTRODUCTION

While Chapters 2 and 3 were primarily desk-based studies using secondary data sources and information, in this chapter we bring out, in a comparative framework, the results of two main field surveys: (i) involving Indian stakeholders undertaken by Marketing and Development Research Associates (MDRA), New Delhi; (ii) involving Sri Lankan stakeholders undertaken by Lanka Market Research Bureau (Pvt.) Ltd. (LMRB), Colombo. The results from two surveys help to understand the underlying dynamics of trade relations between India and Sri Lanka and assess the impact of India-Sri Lanka Free Trade Agreement (ISFTA) on bilateral trade. This survey provides the view points and opinions of the stakeholders on both the sides.

4.1.1 Study Objectives

4.1.1.1 Indian Survey

The major objectives of this survey are:

1. To assess the overall current export/import situation between India and Sri Lanka;

2. To assess at the degree and nature of tariff concessions to Indian traders after ISFTA;
3. To determine the major reasons for exporting/importing products and services to and from Sri Lanka;
4. To understand the nature and degree of impediments faced by Indian traders while exporting to/importing from Sri Lanka;
5. To understand the regulatory structure and other consultations/help provided by Government of India (GOI) to Indian traders for export to/import from Sri Lanka.

4.1.1.2 Sri Lankan Survey

The research objectives of both the Indian and Sri Lankan surveys were similar.

The Sri Lankan survey focused on organizations engaged in trade between India and Sri Lanka with respect to selected products having high growth potential; to check if they were included in the positive list for trade, to assess the degree and nature of tariff concessions to Sri Lankan traders after ISFTA, and to assess whether the outcomes were positive or otherwise.

In order to achieve these objectives it was necessary to:

1. Understand the degree and nature of tariff concessions to Sri Lankan traders after the implementation of the ISFTA;
2. Determine the major reasons for exporting/importing products to and from India; and
3. Understand the nature and degree of impediments faced by Sri Lankan traders while exporting to/importing from India.

4.1.2 Methodology

4.1.2.1 Indian Survey

In the current study the various steps involved in the data collection process are:

1. **Exploratory research.** The first step was to get as much information as possible through the secondary sources. In view of the information required, in-depth exploratory research was conducted using published information/data related to the two countries. The desk research contributed to deeper understanding of socio-cultural, historic, and

economic ties between the two countries, helped in gathering details about the ISFTA and forming a database of various companies/firms engaged in trade between the two countries.

2. **Expert consultation.** A consultation with experts on international trade and those who have done extensive research on Free Trade Agreements (FTAs) and have observed bilateral trade between the two countries in the long term was undertaken. Their suggestions were used in identifying parameters for quantitative part of the study. This also helped the researchers in framing the in-depth interview guidelines.
3. **Primary research.** A combination of quantitative and qualitative research methodologies was used for the survey.
4. **Qualitative modules.** In-depth interviews were conducted with various stakeholders in Indo-Sri Lanka bilateral trade relations such as:
   - o exporters/importers;
   - o officials of various trade associations;
   - o officials of India, ASEAN, and the Sri Lanka Chamber of Commerce and Industry; and
   - o experts on international affairs.

The interviews were designed to gain perspective on the current and future scenario of the trade relations between the two countries. The interviews also probed for problems being faced by exporters and importers at different stages. Detailed discussion was held around the impact of ISFTA on bilateral trade, steps taken by different government bodies to facilitate trade between the two countries, and steps that needed to be taken in the future.

5. **Quantitative interviews.** The quantitative phase of the study consisted of following steps and elements:

   i. *Questionnaire design*. Based on expert consultation, a list of parameters for getting the required information from the respondents was created. These parameters were used to design the questionnaire in view of the objectives of the survey. The questionnaire was comprehensive and yet concise keeping in view the time constraints of the respondents.

   ii. *Fine-tuning tools and design*. Finally, in consultation with RIS officials, the questionnaire was finalized.

   iii. *Development of database*. A database was generated from secondary sources, data provided by Indo-ASEAN Sri Lanka Chamber of Commerce and FICCI.

iv. *Orientation and briefing.* A team of experienced investigators and supervisors was briefed by MDRA researchers in the presence of senior field executives of MDRA on various aspects of the survey including purpose and do's and dont's. Mock-tests were conducted in order to select the best teams.

v. *Creation of sample-frame.* Of the large list of exporters and importers to/from Sri Lanka only those which had used the FTA route were chosen for further consideration.

vi. *Target respondents.* Selection of companies was not enough. Now, the task was to identify target respondents who could be interviewed. For this, senior decision-makers in the international business divisions of the companies in the sample frame were identified so that the respondents could share their first-hand experiences.

vii. *Appointments.* Appointments were sought from selected respondents for the interviews to be conducted. This was a complex process because targets were very busy and the festive months of August to October had set in. A series of telephone calls and emails was entailed to finalize each interview. Most often, a confirmed appointment did not guarantee successful completion of the interview as the respondent did not have more than 20–30 minutes to spare.

viii. ***Main fieldwork.*** Finally, interviews were carried out across 44 exporters and 37 importers. The main fieldwork was conducted from 4 October to 15 December 2010 in different states of India. Rigorous quality control ensured the robustness and consistency of data. All the questionnaires were scrutinized and back-checks at various levels were conducted to ensure the highest quality of data.

ix. *Data coding and entry.* The data obtained were coded and entered using pre-designed fox-pro software. Validation exercise was undertaken using Statistical Package for the Social Sciences (SPSS) software.

x. *Analysis.* Looking at the uniqueness of the study, it was ensured that MDRA researchers who were involved in the interviews/exploratory research would be part of the analysis/report writing team. It ensured no information was left out during the interview.

Based on the outcome of in-depth interviews, quantitative methods, and review of secondary data and literature, the findings of the survey were arrived at. The details of overall sample achieved are provided in the Table 4.1.

Table 4.1 Sample of Indian Respondents

S. no.	*Category*	*Sample achieved*
1	In-depth interviews with business associations	22
2	Structured interviews with exporters	44
3	Structured interviews with importers	37
Total		103

Notes: In-depth interviews involved 22 top to middle-level functionaries of Tea Board, Rubber Board, Vanaspati Manufacturer's Association, etc. based in Delhi, Chennai, and Kochi.

Forty-four exporters interviewed were traders, middle-level managers of industries such as Najma Enterprises, Apex Laboratories Pvt. Ltd., Shakti Knitting Ltd., etc, located in Tirpur, Mumbai, Chennai, Coimbatore, Delhi, and Bangalore. Thirty-seven importers interviewed were middle-level managers operating in industries such as Sarawther Spices (Pvt.) Ltd., Eastman Exports, Prakash Biharilal Exports Pvt. Ltd., based in Bangalore, Tirpur, Chennai, Mumbai, Surat, Ahmedabad, Kanpur, Delhi, etc. Detailed list of stakeholders can be obtained from the authors/Research and Information System for Developing Countries (RIS).

4.1.2.2 Sri Lankan Survey

A quantitative study, involving face-to-face interviews using a structured questionnaire with both close and open-ended questions, was conducted among the different stakeholder groups. Background information on the ISFTA was gathered through desk research.

Target group consisted of organizations engaged in trade between India and Sri Lanka, in selected products from the Positive List for trade

Interviews were held with important stakeholders such as: (i) The Ceylon Chamber of Commerce, (ii) The National Chamber of Exporters (iii) Institute of Policy Studies, (iv) Department of Commerce, (v) Sri Lanka Tea Board (vi) Textile Quality Board.

Table 4.2 presents a sample of Sri Lankan respondents.

Table 4.2: Sample of Sri Lankan Respondents

Respondents	*Stakeholders interviewed*	
Exporters	–	20
Importers	–	40
Business Associations	6	–

In each of the above organizations, the senior decision maker handling exports/imports, or in the case of business associations, a senior official, was interviewed face-to-face.

1. **Development of database.** The database of organizations was generated from the directories of the Export Development Board, National Chamber of Commerce and Ceylon Chamber of Commerce.
2. **Orientation and briefing**. A team of experienced interviewers (competent in conducting interviews in English) was briefed by LMRB researchers on various aspects of the survey, including its purpose as well as details of the Free Trade Agreement (FTA). The questionnaire was provided by RIS, Delhi. Fieldwork was conducted between 1 November 2010 and 28 January 2011.
3. **Creation of sample frame.** The criteria for selection of respondent companies, specified in the client brief, was strictly followed by LMRB, which interviewed only those Sri Lankan companies which were engaged in trade with India, using the ISFTA route on products which did not fall in the negative list of both countries.
4. **Appointments.** All appointments were made on telephone. The details of calls made for the same is highlighted in Table 4.3.

Table 4.3: Details of Telephone Calls Made to Fix Appointments

	Counts	*%*
Total no. of telephone calls made	1186	100
Total no. of wrong numbers	182	15
Total no. of no answers	106	9
Total no. requesting call backs (Actual no of call backs exceeding <500 telephone calls)	206	17
Total no. "NOT" exp/imp to/from India	164	14
Total no. exp/imp to/from India	528	45
Total no. "NOT" using FTA	204	39
Total no. "NOT" sure whether using FTA or not	7	1
Total no. using FTA	317	60
Total no. where particular item falls into negative list	136	43
Refused face-to-face	35	11
Appointments made	86	27
Total no. of face-to-face interviews completed	60	19

Source: LMRB.

Appointments were made with senior decision makers in the different companies. This resulted in many difficulties. Being very senior people in the industry, getting appointments to fit their busy schedule was near impossible. In many cases interviews had to be re-scheduled due to the non- availability of the respondent. Many respondents were unaware of the ISFTA and whether their products fell into the negative lists.

In view of the in-depth information required, exploratory research was conducted using published material related to the two countries. The desk research contributed to:

1. Understanding the economic activity between the two countries
2. Finding out details about the ISFTA data coding, data entry, and analysis
3. The data obtained were coded, entered, and analyzed by the researcher

4.2 REASONS OF TRADE

4.2.1 Indian Exporters

To understand the current bilateral trade between the two countries and assess its future it is important to know the main reasons which attract the Indian traders to trade with Sri Lanka.

A variety of reasons like tariff concessions under ISFTA, proximity, etc were cited for trade with Sri Lanka by Indian exporters (Table 4.4).

Table 4.4: Reasons to Trade with Sri Lanka (Indian exporters)

Reason	*Hypothetical marks scored out of 100*	*Rank*
Tariff concessions under ISFTA	53.6	1
Close proximity/low transport cost	53.2	2
Easy to get payments	45.5	3
Comparatively good export price	35.5	4
Availability of export credit	28.6	5
Cultural similarity (language, religion etc.)	25.0	6
More frequent shipping facilities	25.0	6
Good market/demand	17.7	8
Good facilities in Sri Lankan port(s)	6.8	9
Our own factory in Sri Lanka	2.3	10

Reason	*Hypothetical marks scored out of 100*	*Rank*
Geographical similarity	2.3	10
Visa on arrival available for Indians in Sri Lanka	1.8	12

Notes:

- The marks out of 100 have been calculated based on the maximum marks possible and actual score achieved for a particular reason.
- Nx = Number of exporters who responded to the question. It stands for the same meaning wherever used in this study. Here Nx=44

Source: Field survey.

The field survey was started with the initial criteria that only those exporters who are using the FTA route are to be interviewed. Taking this into account it is clear that there is a bias towards the benefits provided by the FTA and it is provided as the most important reason by the respondents. Geographical proximity and easy to get payments are the next two important reasons for trading with Sri Lanka as far as exporters are concerned. The geographical proximity has scored almost equal marks as the tariff concessions due to FTA.

In contrast "visa on arrival" facility being provided by the Sri Lankan government does not figure prominently as a reason for exporting to Sri Lanka.

4.2.2 Sri Lankan Exporters

The main reason for Sri Lankan exporters to export to India was the tariff concessions received under ISFTA. Since the survey was done only among those using the FTA, this came as no surprise. Close proximity, market demand, shipping facilities, a good export price, and ease of payment were other important reasons cited by exporters as may be seen in Table 4.5.

Table 4.5: Reasons to Trade with India (Sri Lankan exporters)

Reason	*Hypothetical marks scored out of 100*	*Rank*
Tariff concessions under ISFTA	60.0	1
Close proximity	49.0	2
Good market demand	32.0	3
More frequent shipping facilities	29.0	4

Reason	*Hypothetical marks scored out of 100*	*Rank*
Comparatively good export price	27.0	5
Ease of payment	21.0	6
Cultural similarities	20.0	7
Availability of export credit	12.0	8
Good facilities at Indian ports	11.0	9

Notes:

- Base: All exporters (20).
- The hypothetical mark for a particular "reason" has been calculated by taking the total marks achieved by that "reason" (sum of each respondents "score" from a maximum 5 and minimum 1) and expressing it as a percentage of the maximum possible total marks (n x 5) for any "reason". For example, 12 out of the 20 exporters mentioned that tariff concession under ISFTA is a reason to trade with India which as a percentage is 60%.

Source: Field survey.

4.2.3 Indian Importers

The importers on the other hand have totally different reasons for trading with Sri Lanka. They have marked the low price or cost of the goods as the most important reason for importing from Sri Lanka. Quality of the product is the second most important reason for importing from Sri Lanka as may be seen in Table 4.6.

Table 4.6: Reasons of Trade with Sri Lanka (Indian importers)

Reason	*Hypothetical marks scored out of 100*	*Rank*
Low price/cost	63.2	1
Quality products	50.3	2
Tariff concessions under ISFTA	40.5	3
Closer proximity	34.1	4
Non-availability of the product in other markets/ Availability of product in Sri Lanka	30.8	5
More frequent shipping facilities	21.6	6
Cultural similarity (language, religion etc.)	17.3	6
Good facilities in Sri Lankan port(s)	13.0	8

Reason	*Hypothetical marks scored out of 100*	*Rank*
Demand for specialized goods via JV partner under buy back mode / Buyer preference / Buyer nominated supplier	11.4	8
Visa on arrival available for Indians in Sri Lanka	9.7	10

Notes:

- The marks out of 100 have been calculated based on the maximum marks possible and actual score achieved for a particular reason.
- Nm = Number of importers who responded to the question. It stands for the same meaning wherever used in this report. Here Nm=37.

Source: Field survey.

"Tariff concessions under ISFTA" is ranked third in case of importers which is just one rank above the reason of geographical proximity as reason to import from Sri Lanka. With growing awareness many steps were taken to plug this gap and import of such items like vanaspati has almost stopped.

So it is clear that while exporters mainly opt to export to Sri Lanka because of the concessions that they get due to ISFTA and close proximity, importers opt for Sri Lanka as a sourcing market probably due to the fact that Sri Lankan products are much more competitive (as major reason for importing from Sri Lanka has been cited as low cost, quality of products, and buyer nominated supplier which again is not possible if quality is poor).

During the interviews carried out in the qualitative phase it was clear that there were various items which were either not available in other countries or were available in Sri Lanka at highly competitive prices. Surprisingly it is particularly in case of spices where India itself is the driving force in the world market. Cloves, cinnamon, black pepper, etc. are a few important items of import from Sri Lanka.

India is heavily dependent on Sri Lanka for cloves, cinnamon, nutmeg and black pepper for its domestic requirements as well as to fulfill the requirement of its export-oriented oleoresin industry.[1] Oleoresins are an important item of Indian exports and this industry relies heavily on spices sourced from Sri Lanka for some of their most important products.

[1] Spice oleoresins are the concentrated liquid form of the spice and reproduce the character of the respective spice and spice oil fully.

For instance, the Director of Synthenite which is one of the leading spice importers from Sri Lanka and manufacturer of oleoresins shared the insight that semi-mature black pepper was more productive for extracting oleoresins than fully mature pepper and such pepper was available only in Sri Lanka. Indian pepper producers were not ready to sell their product till fully mature.

4.2.4 Sri Lankan Importers

The most important reason given by Sri Lankan importers was the low price, followed by proximity of the countries and the benefits offered under FTA. Product quality and shipping facilities were other important reasons given for importing from India.

Table 4.7: Reasons to Trade with India (Sri Lankan importers)

Reason	*Hypothetical marks scored out of 100*	*Rank*
Low price	77.0	1
Closer proximity	66.0	2
Benefits offered by FTA	64.5	3
Quality of products	44.0	4
More frequent shipping facilities	43.5	5
Non-availability of the product in other markets	24.0	6
Cultural similarity	17.5	7

Base: All importers (40).
Note: The hypothetical marks for a particular "reason" has been calculated by taking the total marks achieved by that "reason" (sum of each respondents "score" from a maximum 5 and minimum 0) and expressing it as a % of the maximum possible total marks (n x 5) for any "reason". For example, 31 out of the 40 importers, ie, 77% mentioned that low price is a reason to trade with India.
Source: Field survey.

4.3 REASONS OF OPTING FOR FTA

4.3.1 Indian Perspective

Having discussed the general reasons for trading, it was important to probe the specific reasons for a trader to opt for FTA. All the traders who were availing the FTA route were therefore asked to specify the reasons for choosing the same. This was an open-ended question without providing any hints and the responses thus collected were clubbed together under major heads which is presented in Table 4.8.

Table 4.8: Main Reasons for Opting for FTA Route (India)
(All figures in percentage; multiple responses admitted)

Reasons for opting for FTA	*Exporter*	*Importer*
Lower duty/duty concession/ no duty	50.0	73.0
Easy process	38.6	8.1
Drawback benefits	25.0	0.0
Faster service/clearance	9.1	8.1
Better service	6.8	5.4
Transparent	2.3	0.0
Reasonable/free from tax	13.6	0.0
It is under government rule	2.3	0.0
Exporters are insisted upon to use this route	2.3	0.0
Duty free while re-exporting	0.0	13.5
Buyer nominated supplier	0.0	5.4
Others	0.0	13.5

Note: Nx=44; Nm=37
Source: Field survey.

Clearly, the relaxation in tariff is the most important reason for trading via FTA route. Five out of 10 respondents in case of exporters give this reason while more than 7 out of 10 importers give the same reason. Some of the reasons are specific to exporters while others are specific to importers.

4.3.2 Sri Lankan Perspective

All traders using the FTA were asked to state the reasons for selecting this option. In the case of both exporters and importers, duty concessions were revealed to be the overwhelming the reason for them to choose the FTA route (Table 4.9).

Table 4.9: Main Reasons for Opting for FTA Route (Sri Lanka)

Reasons of opting for FTA	*Exporter*		*Importer*	
	Number	*%*	*Number*	*%*
Base	20		40	
Duty benefits/duty rebates/duty concessions	11	55.0	38	95.0
Good quality	–	–	1	2.5
Compared to other countries, FTA provides preferential rates	–	–	1	2.5
At the buyers request since they get duty concessions	7	35.0	–	–
Cheaper for the buyer and the company gets more orders	1	5.0	–	–
Because it is stipulated in the letter of credit	1	5.0	–	–

Source: Field survey.

Some comments made by respondents from business associations on the advantages of FTAs

"To gain market access: Nowadays everyone signs agreements, mainly because it facilitates access to different markets. For small markets like Sri Lanka, getting into a bilateral agreement with countries like India because it helps to gain access to other markets."

"To improve access and expand trade: To expand current access and gain tariff benefits."

"Easy to iron out problems when there is an agreement."

4.4 EFFECT OF ISFTA ON BILATERAL TRADE

4.4.1 Indian Perception

The qualitative phase of the study tried to find out 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 trade between the two countries but insisted that it was not necessarily always positive. ISFTA was not identified as a major stimulant which could drive and shape the future of the bilateral trade between the two countries. Only a few 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.

On the other hand there were a large number of respondents who had a negative image of FTA, like a senior official in the Vanaspati Manufacturers Association, who said that overall ISFTA might be in the interest to trade between the two companies but at one time it threatened the very existence of the Indian vanaspati industry. This is of special importance as vanaspati was one of the most important items responsible for increasing the value of trade between the two countries.

Major importers of spices from Sri Lanka also felt that the FTA has not played a major role in benefiting the spice traders. They said that the benefits that they are receiving are irrespective of ISFTA. Also, black pepper being in highest demand faces a quantity restriction on import.

In general the opinion was that while ISFTA might have pushed trade, it also suffered from its share of problems and that a more holistic approach was required if a drastic improvement in the long term was desired.

Table 4.10: Effect of ISFTA on the Business of Indian Exporters/Importers
(All figures in percentages)

Q. Has your company experienced additional growth following the implementation of ISFTA since March 2000?		
Response	*Exporters*	*Importers*
Yes	79.5	56.8
No	6.8	21.6
Don't know/can't say (DK/CS)	13.6	21.6

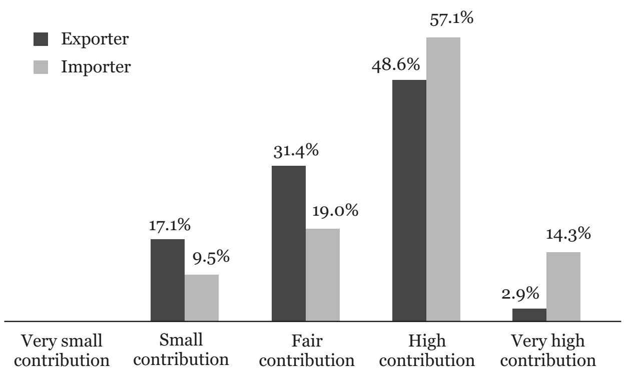
Note: Nx=44; Nm=37
Source: Field survey.

The quantitative survey reveals lower reliance of Indian importers on ISFTA as compared to their counterparts exporting to Sri Lanka. This is clear from Table 4.10. While almost 80% of the exporters said that after implementation of ISFTA they have experienced additional growth only 57% importers experienced an accelerated growth due to ISFTA. [2]

The validity of the finding can also be statistically verified. We will deal with the case of exporters and importers separately.

Figure 4.1 provides the comparative importance that was given to FTA by different exporters and importers who accepted that their trade experienced an accelerated growth after the implementation of the ISFTA agreement. It is clear that though smaller percentage of importers agreed that the ISFTA had contributed to additional growth, those who did, attributed much greater growth to ISFTA than the exporters.

Figure 4.1: Contribution of ISFTA to Additional Growth (Indian traders)



Notes:

- Nx=35; Nm=21
- The chart is based on the response of only 35 exporters and 21 importers who agreed that ISFTA has contributed to their growth. If we take the mean of the scores assigned to the contribution of ISFTA in increasing the growth rate ("1" means "very small" contribution and "5" means "very high contribution") then we find that mean score for exporters is 3.37 and the same for importers is 3.76.

Source: Field survey.

[2] Additional growth means the growth that happened over and above the growth that would have taken place in the absence of ISFTA. The base period for this question is March 2000, i.e., the time when ISFTA was implemented.

Therefore we can say that larger proportion of exporters consider ISFTA as a contributor to export growth than importers but in case of those who agree that ISFTA had contributed to their import growth, importers give higher weightage to ISFTA than exporters.

4.4.2 Sri Lankan Perception

Around two-thirds of both exporters and importers claimed that their businesses had experienced growth after implementation of the ISFTA as may be seen in Table 4.11.

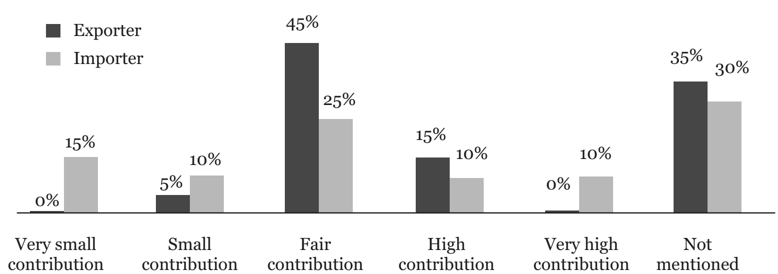
Table 4.11: Effect of ISFTA on Bilateral Trade (Sri Lankan traders)

Q. Has your company experienced additional growth following the implementation of ISFTA since March 2000?

Response	*Exporter*		*Importer*	
	Number	*%*	*Number*	*%*
Base	20		40	
Yes	13	65.0	27	67.5
No	5	25.0	8	20.0
Don't know/can't say	2	10.0	5	12.5

Source: Field survey

Figure 4.2: Contribution of ISFTA to Additional Growth (Sri Lankan traders)



Source: Field survey.

However, as shown in Figure 4.2, when asked about how much the ISFTA had contributed to their additional growth, slightly more than one-third of exporters and almost one-third of importers could not provide an answer to it. Of the remainder, almost half of the exporters and one-fourth of importers said the ISFTA had made a fair contribution, with only about 10% of importers claiming that the ISFTA had made a high contribution. At the other end of the spectrum however, nearly 15% of importers felt that the ISFTA had only made a small contribution.

4.5 INTENTION TO INVEST

4.5.1 Indian Traders

The exporters and importers who were contacted were asked whether they or their company had any plans to make additional investment in order to increase exports to Sri Lanka. This question is critical in finding out the future employment potential that Indo-Sri Lanka trade has. Table 4.12 presents the detailed responses provided by the Indian exporters and importers.

Table 4.12: Indian Traders' Investment Plans to Increase Exports to Sri Lanka

Q. Does your company have any plans for additional investments in order to increase exports to Sri Lanka (in the next 5 years)?
Or
Does your company have plans for investment in Sri Lanka for exports (buyback) to the Indian market (in the next 5 years) ?

Response	*Response percentage*	
	Exporters	*Importers*
Yes	75.0	67.6
No	20.5	21.6
Don't know/can't say	4.5	10.8

Note: Nx=44; Nm=37
Source: Field survey.

Three out of four exporters were seen to be planning to make additional investment in order to increase exports to Sri Lanka. Though the extent of ISFTA's role in this decision is unclear, since all these exporters are using the FTA route so it may be surmised that ISFTA has contributed to creating employment opportunities in India though it might not be significant given the huge size of the Indian economy.

The picture is almost equally bright in case of importers where almost 68% of the respondents replied that they might think of setting up a production base for buyback to India. These figures however seem to be too optimistic and influenced by the end of the civil war in Sri Lanka. The number of trade enquiries and other trade-related activities have increased in Sri Lanka after end of the war and it seems that the Indian traders eager to avail of the opportunity.

4.5.2 Sri Lankan Traders

Similar to Indian traders, the survey sought to collect the responses of Sri Lankan traders on their plans to invest in expanding business with India. The responses are presented in Table 4.13 below.

Table 4.13: Sri Lankan Traders' Investment Plans to Increase Exports to India

Response	*Exporter*		*Importer*	
	Number	*%*	*Number*	*%*
Base	20		40	
Yes	9	45.0	11	27.5
No	9	45.0	22	55.0
Don't know/can't say	2	10.0	7	17.5

Source: Field survey.

Forty-five per cent of exporters claimed they had plans for additional investment in order to increase exports to India. This compared with only 27% of importers who said they wanted to invest in a production base in India for buyback to Sri Lanka.

4.6 PROBLEMS FACED BY EXPORTERS AND IMPORTERS

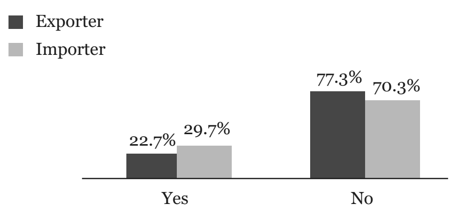
4.6.1 Problems Faced by Indian Traders

International trading is a field in which not all traders like to tread. International trade is typically more costly, time consuming, and complex than domestic trade. An international border imposes additional costs in terms of tariffs, time costs due to border delays, and costs associated with differences in language, the legal system, procedures, or culture.

So, it is not surprising that exporters and importers who typically deal in international trade have to face a number of problems. The current study devoted substantial effort to identifying the major problems faced by exporters and importers. The traders were asked during the study to list the problems that they were facing. Information was also gathered during the qualitative phase and through secondary research to develop an in-depth understanding of these problems.

Figure 4.3 presents the percentage of exporters and importers who reportedly faced problems while trading with Sri Lanka as revealed during the quantitative phase.

Figure 4.3: Indian Traders' Opinion on Problems Faced While Trading With Sri Lanka



Note: Nx=44;Nm=37
Source: Field survey.

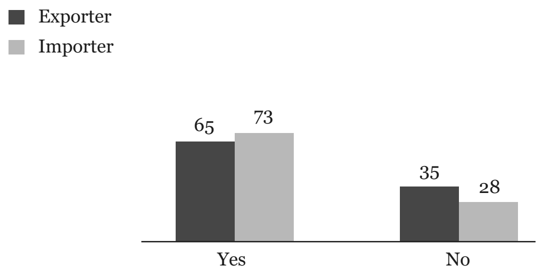
A prominent importer informed that quality check labs are situated far away from the ports. To get the sample tested and obtain the required certificate is a challenge. For instance, food items received at Chennai port are tested at CFTRI lab in Mysore.

Less than a quarter of the exporters said they faced problems while exporting to Sri Lanka. The percentage of respondents facing problem while importing from Sri Lanka was marginally higher than exporters while exporting to Sri Lanka.

4.6.2 Problems Faced by Sri Lankan Traders

It is significant that as much as 65% of exporters and 73% of importers claimed they faced problems when trading with India (as shown in Figure 4.4).

Figure 4.4: Sri Lankan Traders' Opinion on Problems Faced While Trading with India

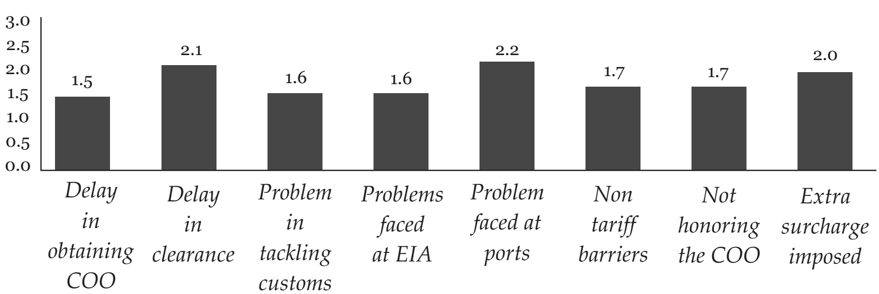


Note: Base: All respondents
Source: Field survey.

4.6.3 Problems Faced by Indian Exporters

The Indian respondent exporters using the FTA route were asked to rate the problems that they faced on a scale of 1 to 5 where 1 meant "no problem" and 5 meant "extremely problematic". Figure 4.5 gives the mean of the ratings given by exporters.

Figure 4.5: Rating of Problems Faced by Indian Exporters



Notes:

- 1 = no problem; 2 = somewhat problematic; 3 = problematic; 4 = very problematic and 5 = extremely problematic
- Nx=10
- Mean derived on the basis of 10 exporters who have rated these problems.
- EIA: Export Inspection Agency
- COD: Certificate of Origin

Source: Field survey.

As per the quantitative survey it is clear that problems faced at ports, delay in clearance and extra surcharge imposed by the government are deemed to be problematic by the exporters. This result is derived from the response of only those respondents who have informed that they are facing problems.

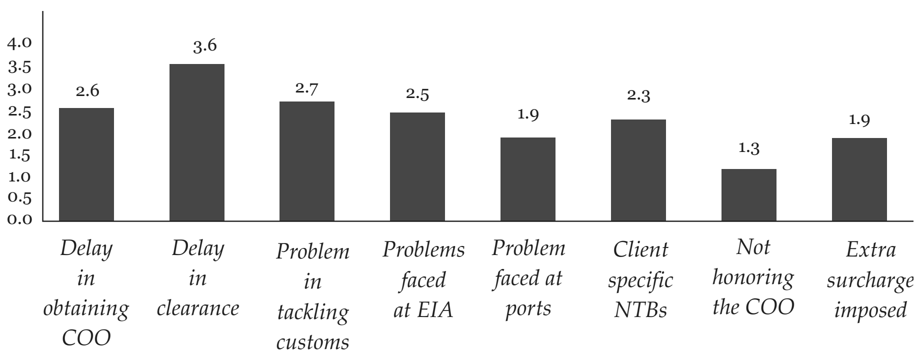
Some problems may be common to both countries. At the same time, problems at the Export Inspection Agency (EIA) are specific to India and those related to non-tariff barriers (NTBs) and dishonoring of the Certificate of Origin (COO) are specific to Sri Lanka.

4.6.4 Problems Faced by Sri Lankan Exporters

Respondents using the FTA route who faced problems were asked to rate the problems they faced while using the FTA route on the following scale 1: no problem, and 5: extremely problematic.

Exporters to India clearly identified "delay in clearance" (mean score 3.6) as the most problematic area. Other problematic areas highlighted were "tackling customs", "delay in obtaining certificate of origin", "difficulties at EIA", and "client specific non-tariff barriers" as may be seen in Figure 4.6.

Figure 4.6: Rating of Problems Faced by Sri Lankan Exporters



Notes:

- Numbers on top of each column refers to the arithmetic mean calculated on the above basis: 1= no problem; 2= somewhat problematic; 3 = problematic; 4 = very problematic 5 = extremely problematic.
- EIA: Export Inspection Agency
- COO: Certificate of Origin
- NTB: Non-tariff barrier

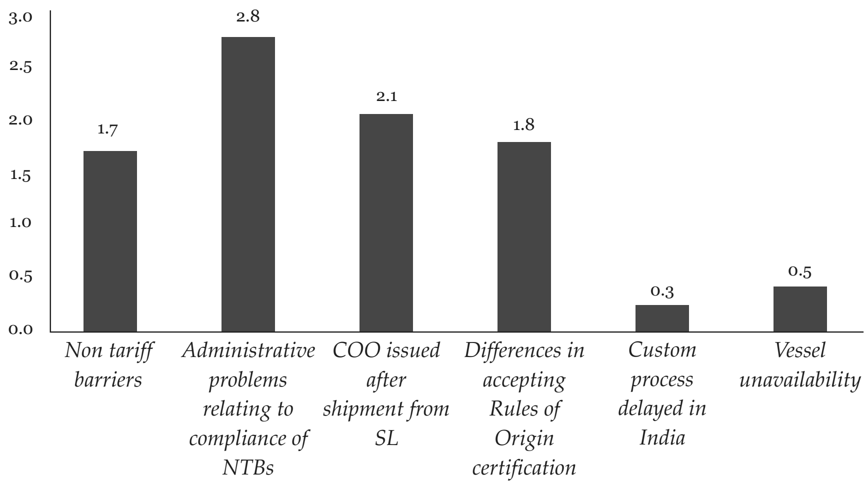
Source: Field survey.

4.6.5 Problems Faced by Indian Importers

In case of importers using the FTA route the mean rating of problems faced was analyzed statistically (Figure 4.7).

Importers find the administrative delays related to compliance of NTBs problematic. The goods imported from Sri Lanka are often perishable in nature and the delay commonly results in wastage of the entire shipment. The COO being issued after shipment from Sri Lanka is the second most important problem as far as importers from Sri Lanka are concerned. The rating mentioned here is the mean of all the ratings given by the importers.

Figure 4.7: Rating of Problems Faced by Indian Importers



Notes:

- Nm=11
- 1= no problem; 2= somewhat problematic; 3= problematic; 4 = very problematic and 5 = extremely problematic
- Mean derived on the basis of 11 importers who have rated these problems.
- COO: Certificate of Origin
- NTB: Non-tariff barrier

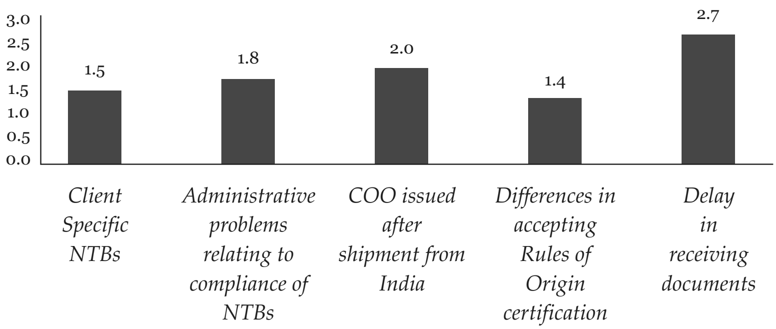
Source: Field survey.

Then there are other problems that are being faced by the importers like the differences in acceptance of "Rules of Origin" and problems in getting custom clearances.

4.6.6 Problems Faced by Sri Lankan Importers

The main problem faced by Sri Lankan importers was "Delays in receiving documents". Other "somewhat problematic" areas mentioned were "Certificate of Origin issued after shipment from India", "Administrative problems related to NTBs" and "Client specific Non-Tariff Barriers" as may be seen in Figure 4.8.

Figure 4.8 Rating of Problems faced by Sri Lankan Importers



Notes:

- COO: Certificate of Origin
- NTB: Non-tariff barrier

Source: Field survey.

4.7 EXTERNAL BARRIERS FACED BY TRADERS

4.7.1 External Barriers Faced by Indian Exporters

The response of exporters when asked about the problems that they face in Sri Lanka is shown in Table 4.14.

Table 4.14: Problems Faced by Indian Exporters in Sri Lanka

Rank	*Problems*	*Percentage*
1	None/no problem/nothing	65.9
2	Administrative delays in compliance with non-tariff measures	13.6
3	Differences in accepting "Rules of Origin" certification between the authorities of the two countries	13.6
4	Problem of handling goods at Sri Lankan ports	2.3
4	Extra surcharge government imposed which had to be paid	2.3

Rank	*Problems*	*Percentage*
4	Strike in Colombo for past 3 months. Exporters suffer due to this	2.3
4	Sri Lankan stopped incentives to buyers (Generalized System of Preferences)	2.3
4	They give second preference to our fabric	2.3
4	Civil war	2.3

Note: Nx = 44
Source: Field survey.

From the table it is clear that two-third of the exporters did not face any problem in Sri Lanka. Almost all of the remaining respondents who faced problems in Sri Lanka cited either difference in accepting "Rules of origin" or administrative delay in compliance of non-tariff measures as the main problem faced by them. There were other problems also which were cited by individual respondents.

So we can say with some degree of confidence that the only major problems faced by exporters are differences about accepting COO and administrative delays.

4.7.2 External Barriers Faced by Sri Lankan Exporters

Around one-third of exporters said they did not face any external barriers.

However, 25% claimed they experienced administrative delays in trying to comply with NTBs while nearly one-fifth had found differences in acceptance of "Rules of Origin" between Indian and Sri Lankan authorities (Table 4.15).

Table 4.15: External Barriers Faced by Sri Lankan Exporters

Problems	*Count*	*Percentage*
Base (all respondents)	20	
No problems at all	7	35.0
Client specific NTBs	3	15.0
Administrative delays in compliance of non-tariff measures	5	25.0
Differences in accepting "Rules of Origin" certification between Indian and Sri Lankan authorities	4	20.0
Problem of handling goods at Indian ports	3	15.0
Extra surcharge government imposed which had to be paid	1	5.0

Source: Field survey

4.7.3 External Barriers Faced by Indian Importers

The nature of engagement of Indian importers with Sri Lanka is of a different nature than that of exporters. The response of importers regarding the problems faced by them is presented in Table 4.16.

Table 4.16: Problems Faced by Indian Importers in Sri Lanka
(All figures in percentages, multiple responses admitted)

Rank	*Problems*	*Percentage*
1	None	48.65
2	Delay in clearance	18.92
3	Corruption/bribing at Sri Lankan ports	13.51
4	Problem of handling goods at Sri Lankan ports	10.81
5	Certificate of origin issued after shipment from Sri Lanka	5.41
6	Vessel unavailability	2.70

Note: Nm = 37
Source: Field survey.

If we compare the response of importers with those of the exporters we can see that a greater number of importers face problems in Sri Lanka as compared to the exporters. In case of importers only 5 out of 10 importers said that they do not face any problem in Sri Lanka as against almost 7 out of 10 in case of exporters.

Delay in clearance is the problem that reflects most prominently in case of importers. Bribing and corruption in Sri Lankan ports is another important problem that has been cited by the importers.

Thus, in case of importers the major problem faced in Sri Lanka is related to the administrative framework of Sri Lankan ports and customs. Nearly 40% respondent importers are facing problems due to delays in clearance, poor handling of goods at ports or corruption in these organizational set ups.

4.7.4 External Barriers Faced by Sri Lankan Importers

More than 80% of importers claimed that they faced external barriers in Sri Lanka whilst importing from India. Over two-fifths issues were related to delays in clearance, just under one-third to the handling of goods at Indian ports and a about a quarter to the certificate of origin being issued after shipment of the goods from India (Table 4.17).

Table 4.17: External Barriers Faced by Sri Lankan Importers in India

Problems	*Count*	*Percentage*
Base (all respondents)	40	
No problems at all	7	17.5
Certificate of origin issued after shipment from India	11	27.5
Delay in clearance	18	45.0
Problem of handling goods at Indian ports	12	30.0
Corruption/bribing at Indian ports	3	7.5
Delays in receiving documents	2	5.0

Source: Field survey.

Some comments made by respondents from business associations on problems faced when exporting/importing

Delays in checking of quality certification/rules of origin—when exporting to India, India requires that all items be certified by the government analyst in Sri Lanka. Once certification is completed products can be exported. However India has only two ports from where goods can be transported to that is, Chennai and Cochin. According to one association, Chennai takes around 14 days to clear the goods whereas, Cochin takes almost a month. Hence due to these delays, processed food like jams, chutney etc, which has a limited lifespan have to be shipped back to Sri Lanka. However another respondent claimed that this has been reduced to 5 days (in Chennai) about a month ago.

Different Indian states have different tax implications which may or may not be public. So for instance, if a product gets duty concessions in one state, it may not be applicable for another state.

Indian customs sometimes allocate wrong HS codes—for instance, where a product which is not so well-known yet receives duty concessions is exported to India, Indian customs say that the product does not fall into the concession list, hence the company has to pay duty.

Labeling issues—From time to time India changes the rules for labeling, which are not always made public.

Health and safety checks are duplicated in India and Sri Lanka.

Quota restrictions—"50% of Sri Lankan exports constituted vanaspati, pepper, desiccated coconut. However since quota restrictions have been imposed, we can export only a certain quantity. Hence Sri Lankan exports have dropped."

Another example is for garments a total of 8 million pieces can be exported to India out of which 3 million pieces should be done from Indian raw materials.

The true position for garments is as follows: A TRQ of 8 million pieces is applicable, of which 3 million can enter duty-free without restriction at entry ports on sourcing of fabrics from India. The balance 5 million pieces also face no port restrictions and can enter India duty-free or with Margin of Preference (MOP) of 75% depending on the product category provided they are manufactured using Indian fabrics.

Sometimes big players tend to book more quota than they actually can export. The authorities only know this unutilized quota towards the end of the year. By this time it is too late for a genuine exporter to utilize the balance quota. For the fear of exceeding the allocated quota and exporting to India (at which point buyer has to pay a higher duty), quota is wasted.

"When exporting to India at some Indian ports there are certain customs officials who are not knowledgeable about the FTA. The bureaucracy involved in clearing flavored tea at Indian ports can be varied. Delays can go up to 6 months resulting in high demurrage costs. Both exporters and importers get frustrated and demoralized in the process which drastically impedes future trade."

"Inter-governmental decisions and information are not passed to the customs. Hence Custom officers are not very aware of changes in rules and regulations."

"Delays in documentation, especially COO in Sri Lanka are a major issue."

4.8 GENERAL PERCEPTION ABOUT BENEFIT SHARING

4.8.1 Indian Perception

During the qualitative phase of the study it was found that a number of Indian respondents felt that ISFTA brought greater benefits to a particular country (some said it was India others said it was Sri Lanka). So the quantitative survey tried to ascertain what the opinion of the majority of respondents was. The quantitative response however shows that this feeling was not common to many respondents. Table 4.18 shows the opinion of exporters as well as importers.

In case of exporters three-fourth of the respondents and in case of importers over two-third of the importers agreed that the free trade agreement has benefited both the nations equally. The second majority was of those who thought that Indian businesses have gained more than Sri Lankan businesses.

Table 4.18: Opinion about the Benefits of ISFTA (Indian perception)

Response	*Response percentage*	
	Exporters	*Importers*
Indian businesses benefit	15.9	21.6
Sri Lankan businesses benefit	9.1	10.8
Both	75.0	67.6

Note: Nx=43; Nm=37
Source: Field survey.

4.8.2 Sri Lankan Perception

In response to a similar question put before Sri Lankan traders as to the relative benefits arising from ISFTA, the general consensus was that the ISFTA benefited Indian businesses more than Sri Lankan businesses.

A higher proportion of Sri Lankan exporters (65%) and importers (43%) believed that the ISFTA benefited Indian businesses. Even among importers, the proportion picking Sri Lankan businesses as the beneficiary was only 10%, with 40% saying that both Indian and Sri Lankan businesses had benefited.

Table 4.19: Opinion about the Benefits of ISFTA (Sri Lankan perception)

Response	*Exporters*		*Importers*	
	number	*%*	*number*	*%*
Base	20		40	
Indian businesses benefit	13	65.0	17	42.5
Sri Lankan businesses benefit	1	5.0	4	10.0
Both	4	20.0	16	40.0
Don't know	2	10.0	3	7.5

Source: Field survey

4.9 NON-TARIFF BARRIERS

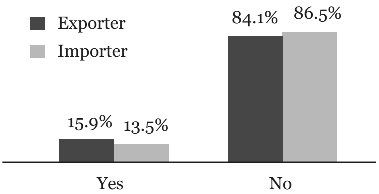
Non-tariff barriers are a form of restrictive trade where barriers to trade are set up in forms other than a tariff. Non-tariff barriers include quotas, levies, embargoes, sanctions, and other restrictions.

The use of NTBs has increased sharply after the WTO rules led to a very significant reduction in tariff use. While market access would improve on account of reduction of import duties, it may be thwarted due to the application of non-tariff measures.

4.9.1 Indian Perception

During the quantitative phase all the respondents were asked about the NTBs faced by them either in Sri Lanka or India. This is clear from Figure 4.9.

Figure 4.9: Non-tariff Barriers Faced by Indian Traders



Notes: Nx = 44; Nm = 37
Source: Field survey.

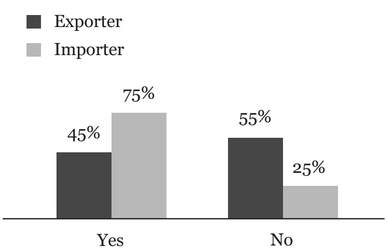
Most of the exporters did not report facing any NTB. This information is in sync with the information that was collected during the qualitative phase of the study. Most of the people interviewed informed that the exports to Sri Lanka reached only a fraction of its potential due to several factors like insurgency and other factors but the government of the island country was never hostile towards Indian exports.

The scenario is almost similar in case of importers. Only 14% of the importers said that they faced NTB in India.

4.9.2 Sri Lankan Perception

A much higher proportion of importers (75%) reported facing NTBs than exporters (45%) as is evident from Figure 4.10.

Figure 4.10: Non-tariff Barriers Faced by Sri Lankan Traders



Source: Field survey.

4.9.3 Major NTBs Faced by Indian Exporters

The exporters and importers were asked to rate the major NTBs faced by them in the two countries. They had to rate a NTB on a scale of 1 to 5 where 1 meant "no barrier" and 5 meant "very high barrier". Table 4.20 provides the details of the major NTBs being faced by Indian exporters as rated by them:

Table 4.20: Rating of NTBs Faced by Indian Exporters

NTBs	*Frequency of rating*					*Mean rating*
	1	*2*	*3*	*4*	*5*	
Quotas	2	3	2	-	-	2.0
Import licensing requirements	4	2	-	1	-	1.7
Proportion restrictions of foreign to domestic goods	2	3	2	-	-	2.0
Minimum import price limit	3	2	1	1	-	2.0
Valuation systems	3	2	2	-	-	1.9
Antidumping practices	2	3	1	1	-	2.1
Tariff classifications	2	3	1	1	-	2.1
Documentation requirements	4	1	1	1	-	1.9
Standard disparities	3	2	-	2	-	2.1
Intergovernmental acceptances of testing methods and standards	3	2	2	-	-	1.9
Packaging, labeling, and marking	4	1	2	-	-	1.7
Countervailing duties	5	-	-	2	-	1.9
Domestic assistance programs	3	2	2	-	-	1.9
Special supplementary duties	4	1	1	1	-	1.9

Note:

- Nx = 7.
- 1 = No barrier; 2 = Low barrier; 3 = Moderate barrier; 4 = High barrier; and 5 = Very high barrier.
- Mean calculated based on only 7 exporters who have faced NTBs and have rated various NTBs

Source: Field survey

The table reflects that even those who reported facing NTBs, said that the barrier is not very high. The most prominent NTBs that the exporters cite are antidumping practices, tariff classification, and standard disparities.

Quotas, minimum import price limit etc. are the other important NTBs faced by exporters. However it is evident that the barriers even in these cases are quite low.

While going through the rating it should always be kept in mind that the rating is based on the ratings provided by only 7 respondents out of 44. The others had no problem regarding NTBs.

4.9.4 Major NTBs Faced by Sri Lankan Exporters

The majority of exporters either did not face any NTB or the barrier was low. In a handful of cases "quotas" were mentioned as a high barrier, so too were "documentation requirements", "acceptance of testing methods and standards", "packaging, labeling" and "domestic assistance programs" (Table 4.21).

Table 4.21: Major NTBs Faced by Sri Lankan Exporters

NTBs	*Frequency*					*Mean rating*
	1	*2*	*3*	*4*	*5*	
Base: All exporters (20)						
Quotas	7			2		1.8
Import licensing requirements	6	2	1			1.4
Proportion restrictions of foreign to domestic goods	7	2				1.3
Minimum import price limit	7	2				1.3
Valuation systems	7	2				1.3
Antidumping practices	7	2				1.3
Tariff classifications	7	2				1.3
Documentation requirements	5	3		1		1.6
Standard disparities	7	2				1.3
Intergovernmental acceptances of testing methods and standards	6	2		1		1.6
Packaging, labeling, and marking	5	2	1	1		1.6
Countervailing duties	6	2	1			1.5
Domestic assistance programs	6	2	1			1.6
Special supplementary duties	6	2	1			1.6

Notes:

- Not all the respondents faced barriers, some did not face any.
- 1= No barrier; 2= Low barrier; 3= Moderate barrier; 4= High barrier; and 5 = Very high barrier

Source: Field survey.

4.9.5 Major NTBs Faced by Indian Importers

Table 4.22 provides the details of the major NTBs being faced by importers in India based on the rating provided by them during the quantitative survey:

Table 4.22: Rating of NTBs Faced by Indian Importers

NTBs	*Frequency of rating*					*Mean rating*
	1	*2*	*3*	*4*	*5*	
Quotas	2	2	-	-	1	2.2
Import licensing requirements	4	-	-	-	1	1.8
Proportion restrictions of foreign to domestic goods	2	2	-	1	-	2.0
Minimum import price limit	4	1	-	-	-	1.2
Valuation systems	3	1	-	1	-	1.8
Antidumping practices	3	2	-	-	-	1.4
Tariff classifications	3	1	1	-	-	1.6
Documentation requirements	4	1	-	-	-	1.2
Standard disparities	3	2	-	-	-	1.4
Intergovernmental acceptances of testing methods and standards	4	-	1	-	-	1.4
Packaging, labeling, and marking	3	2	-	-	-	1.4
Countervailing duties	4	1	-	-	-	1.2
Domestic assistance programs	4	1	-	-	-	1.2
Special supplementary duties	2	3	-	-	-	1.6

Notes:

- Nm=5
- 1= No barrier; 2 = Low barrier; 3 = Moderate barrier; 4 = High barrier; and 5 = Very high barrier.
- Mean calculated based on only 5 importers who have faced NTBs and have rated various NTBs.

Source: Field survey.

The results of the quantitative survey matches with the qualitative findings where the importers especially those who were importing spices reported that the major NTB that they face was quota restriction. But here too the barrier is quite low and these ratings were provided by only 5 out of 37 importers who were interviewed.

4.9.6. Major NTBs faced by Sri Lankan Importers

Compared to exporters, an appreciably larger number of importers mentioned facing "very high" or "high" NTBs. These included "import licensing requirements", "packaging, labeling and marking" and "intergovernmental non-acceptance of testing methods and standards" as may be seen in Table 4.23.

Table 4.23: Major NTBs Faced by Sri Lankan Importers

NTBs	*Frequency*					*Mean rating*
	1	*2*	*3*	*4*	*5*	
Base: All importers (40)						
Quotas	23		2	3	1	1.7
Import licensing requirements	19	1	4		6	2.1
Proportion restrictions of foreign to domestic goods	26	2	2			1.5
Minimum import price limit	28		1		1	1.2
Valuation systems	16	7	4	1	2	1.9
Antidumping practices	26		1	1	2	1.5
Tariff classifications	10	8	6	5	1	2.3
Documentation requirements	10	11	5	4		2.1
Standard disparities	22	2	2	2	2	1.7
Intergovernmental non-acceptance of testing methods standards	22		2	2	4	2.0
Packaging, labeling, and marking	13	4	8		5	2.4
Countervailing duties	20		3		1	1.5
Domestic assistance programs	25	2	2	1		1.3
Special supplementary duties	23	4	2	1		1.7

Notes:

- Not all the respondents faced barriers, some did not face any.
- 1= No barrier; 2= Low barrier; 3= Moderate barrier; 4= High barrier; and 5 = Very high barrier

Source: Field survey.

4.10 TRADE FACILITATION

Trade facilitation is aimed at improving procedures and controls governing the movement of goods across national borders to reduce associated cost burdens and maximize efficiency while safeguarding legitimate regulatory objectives. Trade facilitation has become all the more important in the prevailing ultra-competitive scenario as business costs may be directly related to collecting information and submitting declarations or an indirect consequence of border checks in the form of delays and associated time penalties, forgone business opportunities, and reduced competitiveness.

In order to increase trade between the two countries only extending tariff concessions is not enough. To boost the trade it is equally important that the trade process be properly facilitated so as to dispel the general perception that carrying out international trade is complex.

4.10.1 Reduction in Paperwork at Indian Ports

Change is a gradual process and any development can only be achieved through constant change in a positive direction.

The survey also tries to find out the general perception of exporters and importers about simplification of processes and procedures at ports and customs.

Both exporters and importers were asked during the quantitative survey on whether they agreed that there has been a reduction in documentation process and paperwork at Indian ports. The results are as provided in Table 4.24 below:

Table 4.24: Opinion about Reduction in Paperwork at Indian Ports

Q. Do you feel that there has been a reduction in paperwork and simplification of documentation process at Indian ports?		
Response	*Response percentage*	
	Exporters	*Importers*
Yes	68.2	75.7
No	25.0	18.9
DK/CS	6.8	5.4

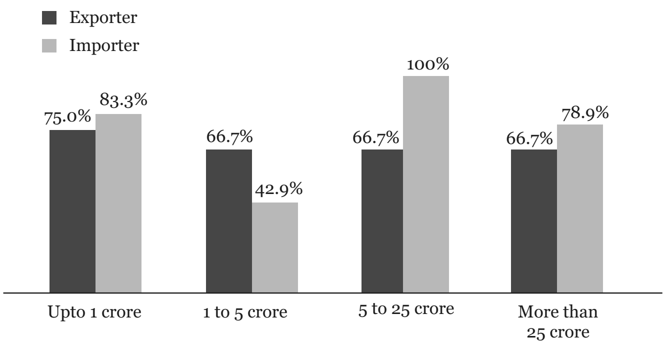
Notes: Nx = 44; Nm = 37

Source: Field survey.

From the table it is clear that the majority of exporters as well as importers agree that paperwork has been reduced and documentation process simplified at Indian ports. Importers seem to be deriving slightly greater benefit from this than exporters. This is probably due to the fact that before liberalization importing something into India was much more difficult than exporting something out of it. With the relaxation of the documentation rules it is apparent that the benefits applied to the importers to a greater extent.

The reduction in paperwork is not limited to the larger companies (Figure 4.11).

Figure 4.11: Percentage Traders who Perceived Reduction in Paperwork (Traders by turnover)



Note: Turnover in Indian Rupees.
Source: Field survey.

Findings drawn from the qualitative survey validate the fact that the documentation process has improved considerably from the past though there is ample scope for the introduction of further efficiencies. A number of processes can now be undertaken online and technically the entire process from the filing of the form to approvals can be completed without a personal visit. In practice, however, due to corruption and other hurdles, digitization has not been able to achieve its full potential.

So it may be said with certainty that at least things are moving in the right direction.

4.10.2 Reduction of Paperwork at Sri Lankan Ports

Among exporters, 40% felt there had been a reduction in paperwork and simplification of the documentation process at Sri Lankan ports, while almost one-third said they were not sure.

The situation was far less favorable for importers, where almost half of the respondents claimed that there had been no reduction (Table 4.25).

Table 4.25: Opinion about the Reduction in Paperwork at Sri Lankan Ports

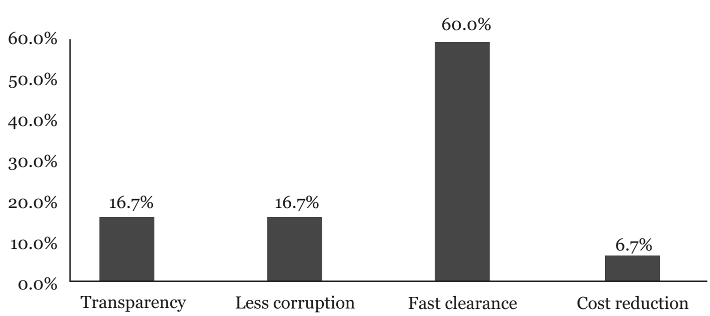
Q. Do you feel that there has been reduction in paperwork and simplification of documentation process at Sri Lankan ports?		
	Exporters	*Importers*
Base	20	40
Response	%	%
Yes	40	45.0
No	30	47.5
Don't know / can't say	30	7.5

Source: Field survey.

4.10.3 Benefits of Paperwork Reduction for Exporters in India

The simplification of documentation process has a number of benefits for all the stakeholders involved. Figure 4.12 presents the opinions of Indian exporters about their perceived benefits from such simplification:

Figure 4.12: Opinions of Indian Exporters on Benefits of Reduction in Paperwork



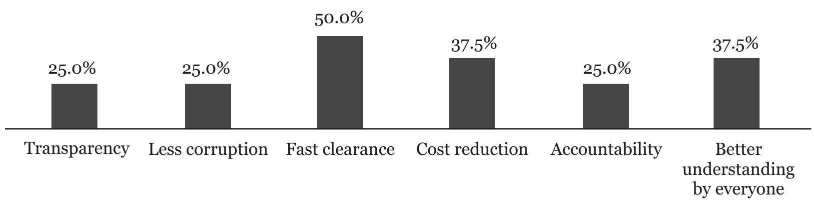
Note: Nx = 30
Source: Field survey.

Out of those exporters who agreed that there had been a reduction in paperwork, 60% of the respondents said that faster clearance was the greatest benefit of simplification and reduction in paperwork. Transparency, reduction in corruption, and reduction in costs are some other benefits cited by the exporters.

4.10.4 Benefits of Paperwork Reduction for Exporters in Sri Lanka

Among the eight exporters who agreed that there had been a reduction in paperwork, four mentioned faster clearances as a benefit while two each mentioned transparency, less corruption, and three mentioned better understanding by everyone as benefits (Figure 4.13).

Figure 4.13: Opinions of Sri Lankan Exporters on Benefits of Reduction in Paperwork

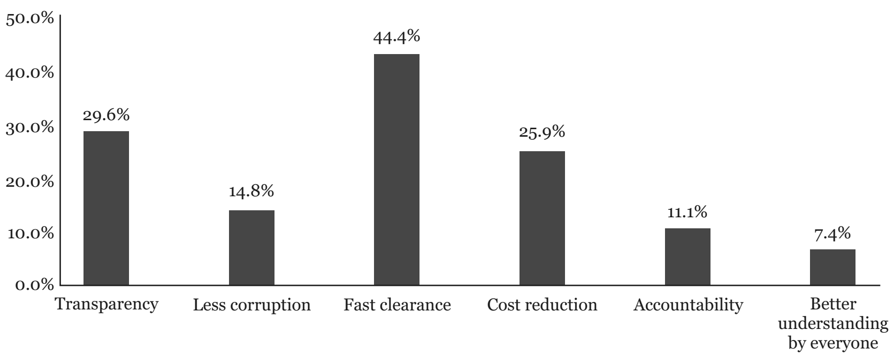


Source: Field survey.

4.10.5 Benefits of Reduction in Paperwork for Importers in India

The response of importers with respect to reduction in paperwork at Indian ports and its benefits is illustrated in Figure 4.14.

Figure 4.14: Opinions of Indian Importers on Benefits of Reduction in Paperwork



Note: Nm = 27
Source: Field survey.

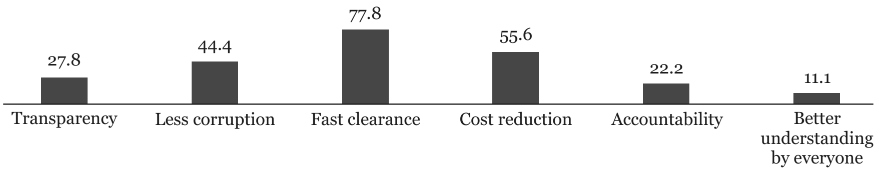
Almost 44% of the importers who have agreed that there had been a reduction in paperwork felt that it had led to faster clearance of their consignments.

Three out of ten agreed that reduction in paperwork and simplification of documentation process had resulted in greater transparency.

4.10.6 Benefits of Paperwork Reduction for Importers in Sri Lanka

Among the 18 importers who said there had been a reduction in paperwork, 14 cited fast clearance as a benefit, 10 mentioned cost reduction, and 8 importers cited less corruption as the benefits (Figure 4.15).

Figure 4.15: Opinions of Sri Lankan Importers on Benefits of Reduction in Paperwork



Source: Field survey.

4.10.7 Rating of Services Provided to Indian Exporters and Importers

The exporters and importers were asked during the quantitative survey to rate the services that were provided to them during the process of export/import on a five point scale where 5 meant "extremely good" and 1 meant "extremely bad". The information provided by them was statistically analyzed and the results in the form of the statistical mean of the ratings are presented in Table 4.26.

Table 4.26: Rating of Services Provided to Indian Exporters and Importers

Services/Process	*Mean rating*	
	Exporters	*Importers*
Issuance of COO	3.66	NA
Custom clearance	3.50	3.62
Accountability of officials	3.50	3.78
Appraisal of value of goods	3.55	3.70
Security checks	3.50	3.62
Terminal handling	3.68	3.68
Infrastructure available in and around the port	3.68	3.76

Services/Process	*Mean rating*	
	Exporters	*Importers*
Performance level of personnel in different government departments	3.57	3.68
Facility of importing against advance license	NA	3.56
Coordination between Indian and Sri Lankan authorities on "Rules of origin"	NA	4.03

Notes:

- Nx = 44; Nm = 37
- 1 = extremely poor; 2 = poor; 3 = good; 4 = very good; and 5 = extremely good.

Source: Field survey.

The table clearly shows that the exporters and importers are satisfied with the services being provided to them but at the same time there is ample scope of improvement in these services. Hardly any service/parameter has received a mean rating of 4 which should in any case be the immediate target of the service providers and Government of India.

4.10.8 Rating of Services Provided to Sri Lankan Exporters and Importers

Exporters and importers were asked to rate the services that were provided to them during the process of their export/import on a 5 point scale from "extremely good" (5) to "extremely poor" (1).

Except for "performance level of personnel in different government departments" for both exporters and importers and "terminal handling" for exporters, the mean scores for satisfaction levels were between "good" and "very good" as may be seen in Table 4.27.

Table 4.27: Rating of Services Provided to Sri Lankan Exporters and Importers

Services/Process	*Rating*	
	Exporters	*Importers*
Base	20	40
Issuance of COO	3.9	-
Customs clearance	3.4	3.2
Accountability of officials	3.1	3.0
Appraisal of value of goods	3.7	3.2

Services/Process	*Rating*	
	Exporters	*Importers*
Security checks	3.2	3.5
Terminal handling	2.9	3.4
Infrastructure available in and around the port	3.5	3.4
Performance level of personnel in different government departments	2.9	2.9
Facility for importing against advance license	-	3.2
Coordination between Indian and Sri Lankan authorities on COO	-	3.7

Note: 1 = extremely poor; 2 = poor; 3 = good; 4 = very good; and 5 = extremely good
Source: Field survey

4.10.9 Transparency on the Indian Side

The exporters and importers were also asked during the quantitative survey to rate the level of transparency on a number of issues on a five point scale where 5 meant "very transparent" and 1 meant "very non-transparent". The overall averages of the ratings are provided in Table 4.28.

Table 4.28: Rating of Transparency by Indian Traders on Certain Issues both in India and Sri Lanka

Services/Process	*Mean rating*			
	Exporters		*Importers*	
	Indian	*Sri Lankan*	*Indian*	*Sri Lankan*
Changes in regulation	3.39	2.88	3.59	3.55
Accessibility of laws/rules	3.27	2.72	3.73	3.35
Customs procedure	3.30	2.79	3.65	3.23
Functioning of enquiry points	3.30	2.94	3.54	3.39

Note:

- Nx from India = 44; Nx from Sri Lanka = 32; Nm from India = 37; and Nm from Sri Lanka = 31.
- 1 = very non-transparent; 2 = non-transparent; 3 = somewhat transparent; 4 = transparent and 5 = very transparent.
- The number of Sri Lankan responses was less than responses from India.

Source: Field survey.

Indian exporters and importers consider Sri Lanka to be less transparent than India. However it is clarified that Sri Lankan responses are far less in number than that for India.

4.10.10 Transparency on the Sri Lankan Side

Exporters and importers were asked to rate the level of transparency on a number of issues on a 5 point scale from "very transparent" (5) to "very non-transparent" (1).

Sri Lankan exporters and importers consider India to be much less transparent than Sri Lanka. This difference is particularly large among exporters (Table 4.29).

Table 4.29: Rating of Transparency by Sri Lankan Traders on Certain Issues both in Sri Lanka and India

Service/Process	*Mean rating*			
	Exporters		*Importers*	
Response	*Indian*	*Sri Lankan*	*Indian*	*Sri Lankan*
Changes in regulation	1.8	3.9	2.8	3.2
Accessibility of laws/rules	2.1	3.7	2.9	3.3
Customs procedure	1.9	3.8	2.8	3.3
Functioning of enquiry points	1.4	3.5	2.5	3.3

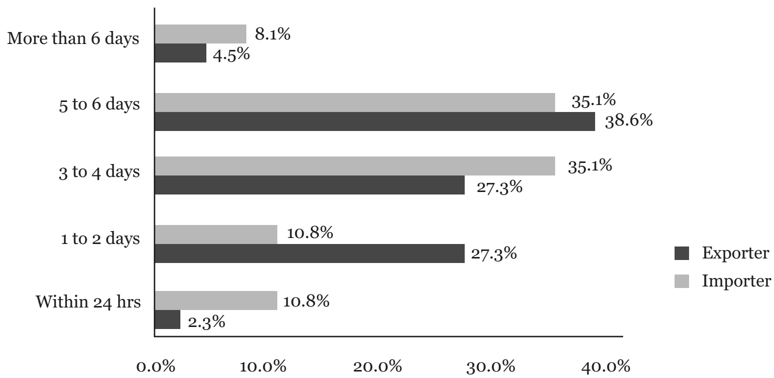
Note: 1 = very non-transparent; 2 = non-transparent; 3 = somewhat transparent; 4 = transparent; and 5 = very transparent
Source: Field survey.

4.10.11 Average Time Required for Clearance at Indian Ports

The reduction of paperwork and online filing of forms has reduced the time required for clearance at Indian ports. Figure 4.16 shows the response of importers and exporters on the time required for clearance at Indian ports:

In case of exporters maximum number of respondents reported that the complete clearance process took around 5 to 6 days. Around three out of 10 exporters reported that it took from 1 to 2 days while a similar number reported that it took around 3 to 4 days.

Figure 4.16: Average Time Taken for Clearance at Indian Ports



Note: Nx = 44; Nm = 37
Source: Field survey

Only one respondent out of the 44 interviewed felt that the clearance process was completed within 24 hours.

In case of importers around 35% said it took 3 to 4 days and similar proportion said it took 5 to 6 days. Another 11% of the importers said that the shipment was cleared within 1 to 2 days.

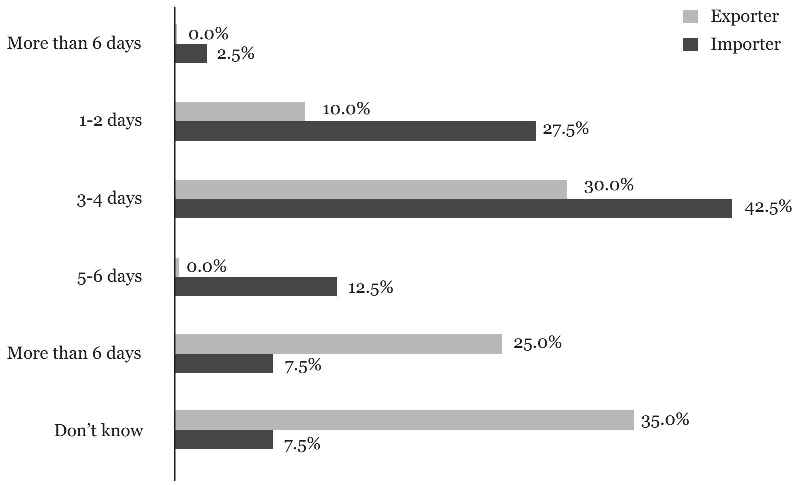
In comparison to exporters larger percentage of importers reported of having their shipment cleared within 24 hours of reaching the Indian port.

If we calculate the average time taken for clearance for exporters and importers separately we find that clearance for exporters takes 3.83 days while in case of importers it is 4.00 days. So we can say that time taken for clearance is much more than 24 hours. On an average an exporter or importer has to invest 3 to 4 days for completing all the processes at customs and ports.

4.10.12 Average Time Required for Clearance at Sri Lankan Ports

Import clearance appears to be faster than export clearance. The time required for clearance at Sri Lankan ports was found to be 3 to 4 days by importers and about 5 days by exporters, where the "don't know" category was high (as shown in Figure 4.17).

Figure 4.17: Average Time Taken for Clearance at Sri Lankan Ports

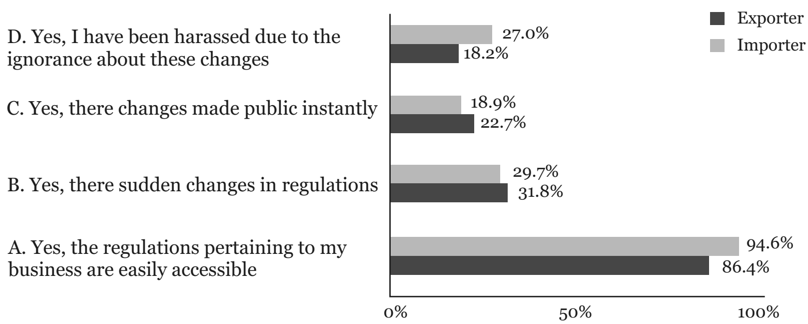


Source: Field survey

4.10.13 Dissemination of Information in India Regarding Rules and Regulation

Information is the source of empowerment so in order to facilitate trade between the two countries, rules and regulations around trade and other information pertaining to it should be disseminated well to its active participants.

Figure 4.18: Dissemination of Information in India Regarding Rules and Regulations



Note:

- Nx=44; Nm=37 except in case of "C" where Nx=14; Nm=11
- Only the positive responses have been shown in the graph. The rest have answered the question in the negative.

Source: Field survey

The response of exporters and importers when they were questioned regarding information dissemination on rules and regulations is illustrated in Figure 4.18.

Almost 9 out of 10 respondents in case of exporters as well as importers reported that rules and regulations that concerned their business were easily accessible to them. The importers had slight advantage on this issue in comparison to exporters.

One-third of the respondents in both the cases reported that there were sudden changes in the rules and regulations and only about 20% of the respondents, further reported that these sudden changes were made public instantly. This means that a sizeable number of exporters and importers did not immediately get to know about the changes in the rules and regulations if they did happen.

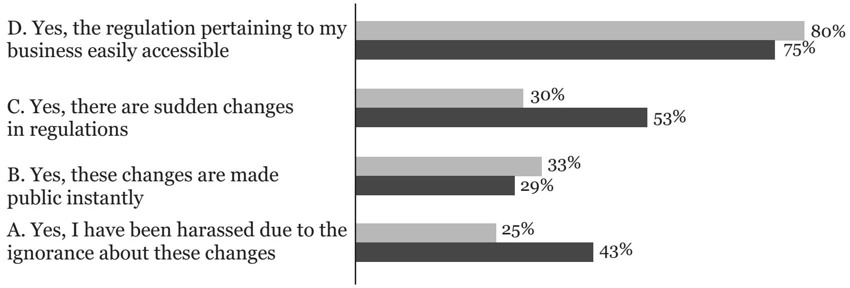
Of the respondents, 18% exporters and 27% of the importers reported having faced harassment due to ignorance about rules and regulations.

It must be ensured that changes in rules and regulations are disseminated to all concerned as fast as possible and in case of default due to ignorance the cases are handled properly with sensitivity and understanding.

4.10.14 Dissemination of Information in Sri Lanka Regarding Rules and Regulation

A great majority of exporters and importers agreed with the statement that "the regulation pertaining to my business is easily accessible". A greater number

Figure 4.19: Dissemination of Information in Sri Lanka Regarding Rules and Regulations



Source: Field survey

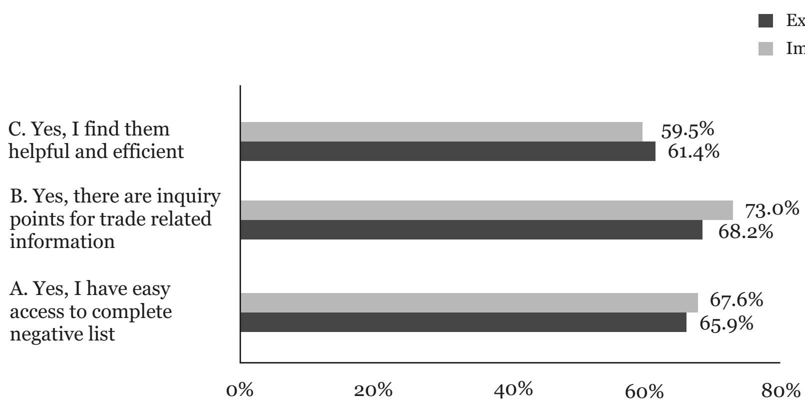
agreed that though there were sudden changes in regulations, these were made public instantly. A few said that they were harassed due to ignorance about these changes.

4.10.15 Knowledge about Negative List and Enquiry Points in India

Negative lists of both the countries are significant for both exporters and importers and should be readily available in the most updated form to the traders of both the countries. Also of significance are enquiry points (either physical or virtual) where enquiries from the business community can be properly handled.

The respondents were asked various questions related to these topics. The responses are presented in Figure 4.20.

Figure 4.20: Knowledge about Negative List and Enquiry Points in India



Note:

- Nx=43; Nm=37 except in case of "C" where Nx=30; Nm=27
- Only the positive responses have been shown in the graph. The rest have answered the question in the negative.

Source: Field survey

Over two-third of the exporters have easy access to the complete negative list of Sri Lanka while 66% of the importers have easy access to the negative list of India.

In case of enquiry points around 73% of the importers and around 68% of the exporters reported that they were aware of enquiry points related to trade.

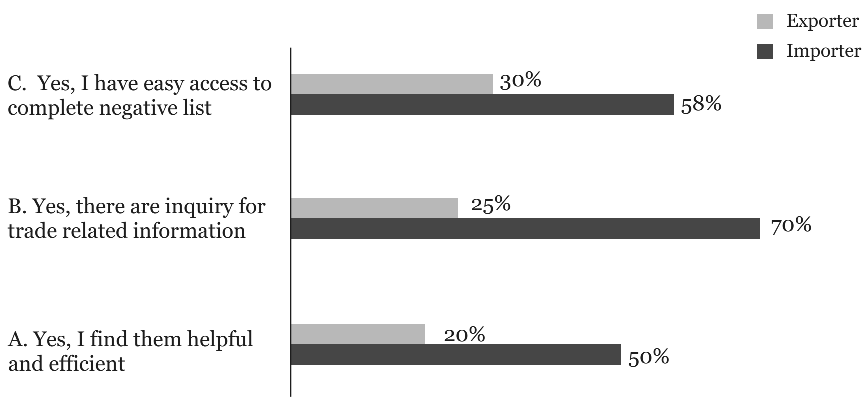
Almost 6 out of 10 respondents who were aware about the enquiry points agreed that it was helpful and efficient in solving problems faced. [3]

4.10.16 Knowledge about Negative List and Enquiry Points in Sri Lanka

Access to the negative list was limited, so was awareness of inquiry points.

Out of 10, 2 to 3 exporters and 6 to 7 importers were aware of various inquiry points that catered to trade related matters. Of these, 2 out of 10 exporters and 5 out of 10 importers said they found them to be helpful and efficient as may be seen in Figure 4.21.

Figure 4.21: Knowledge about Negative List and Enquiry Points in Sri Lanka



Source: Field survey

4.10.17 Physical Proximity of Points of Engagement and Availability of Staff in India

A number of offices have to be approached for either getting certification or submission of documents for clearances. For example, the COO has to be obtained from the Export Inspection Agency (EIA), various clearances have to be taken from customs while many other processes are limited to the port itself. Wide physical distances between these different contact points could

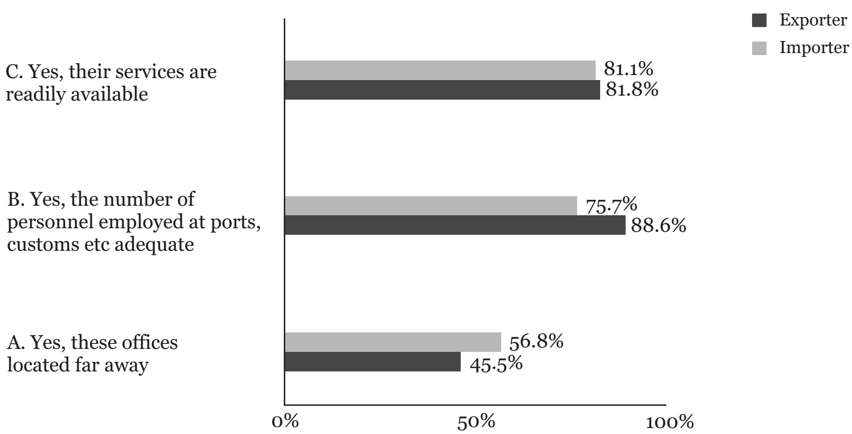
[3] This question was asked only to those respondents who were aware about trade-related enquiry points.

make the process cumbersome. The number of officials and their willingness to help are also equally important. Figure 4.22 shows the information gathered from the respondents on these crucial aspects.

Of the exporters, about 45% and 57% of the importers were of the view that the various offices that have to be contacted for clearance are situated far away from each other.

As far as the number of officials is concerned 9 out of 10 exporters and three quarter of the importers were of the view that there are sufficient number of employees available at the respective offices.

Figure 4.22: Opinion on Physical Proximity of Points of Engagement and Availability of Staff in India



Notes:

- Nx=43; Nm=37 except in case of "A" where Nx=44
- Only the positive responses have been shown in the graph. The rest have answered the question in the negative.

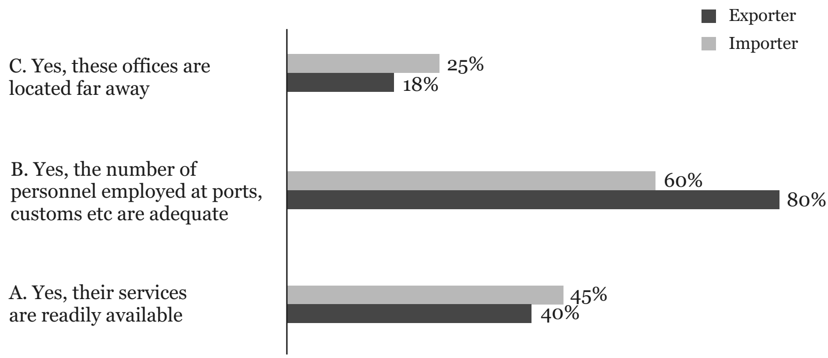
Source: Field survey

If we talk about the willingness of the employees present in the office to work and cooperate then almost 8 out of 10 respondents both in case of the exporters as well as the importers agreed that they were available and willing to help.

4.10.18 Physical Proximity of Points of Engagement and Availability of Staff in Sri Lanka

Less than a third of exporters and importers feel that the various offices to be contacted are located far away (Figure 4.23).

Figure 4.23: Opinion on Physical Proximity of Points of Engagement and Availability of Staff in Sri Lanka



Source: Field survey

With regard to the number of personnel working in these offices, over half the exporters and three-quarters of importers think they are adequate.

However less than half the exporters and importers feel that their services are readily available.

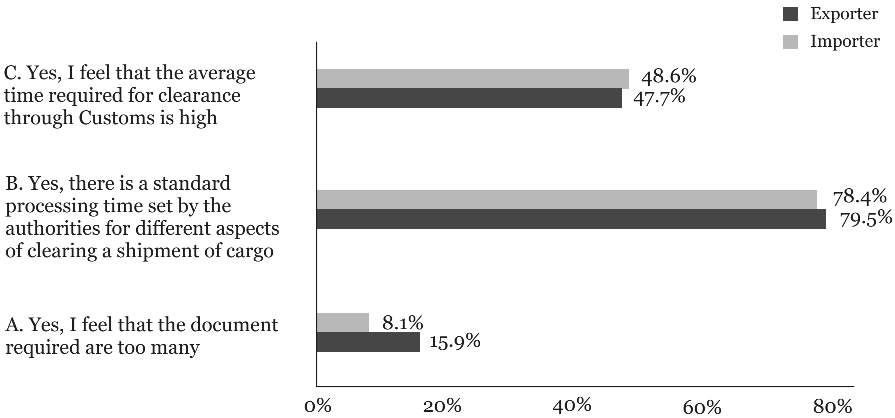
4.10.19 Indian Perception about Documentation Process

Figure 4.24 illustrates the perception of the respondents about the documentation process and the time associated with it.

The percentage of people who felt that the documentation required was too detailed and numerous is quite low. Only 16% of the exporters believed that they had to undergo documentation processes that were too detailed. In case of importers this was only 8%.

More than three-quarters of the respondents in both the categories reported that there is a standard processing time set by the authorities for different aspects of clearing a shipment or cargo but at the same time almost half of the respondents in case of exporters as well as importers believed that the average time taken by ports and customs was higher than it should have been.

Figure 4.24: Indian Perception about the Documentation Process



Notes:

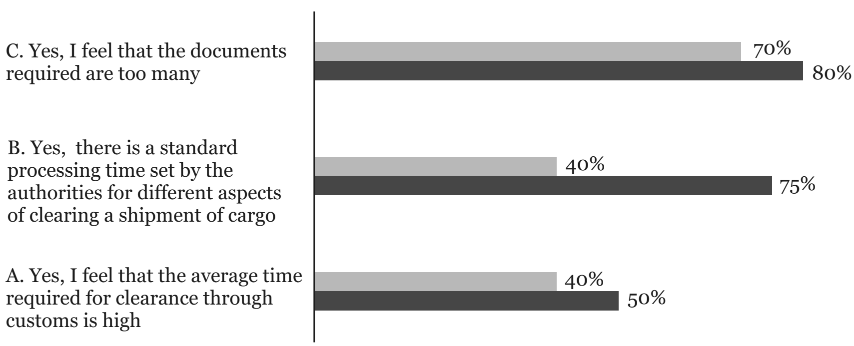
- Nx=43; Nm=37 except in case of "A" where Nx=44
- Only the positive responses have been shown in the chart. The rest have answered the question in the negative.

Source: Field survey

4.10.20 Sri Lankan Perception About Documentation Process

The great majority of both exporters (70%) and importers (80%) were of the opinion that the documents required were too many (Figure 4.25).

Figure 4.25: Sri Lankan Perception about the Documentation Process



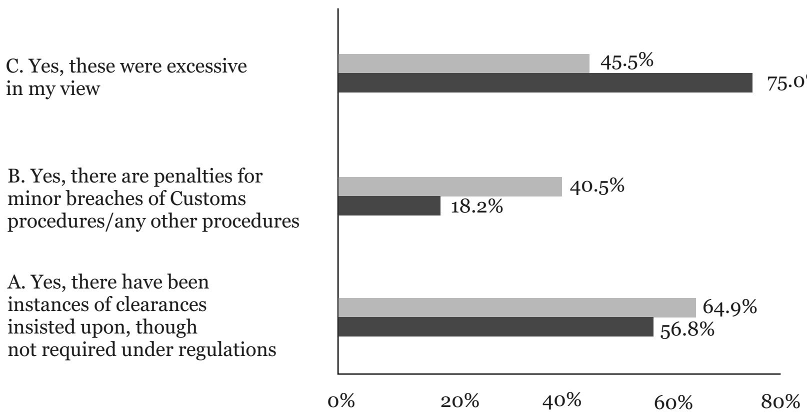
Source: Field survey

While only just over a third of exporters thought there was a standard processing time for different aspects of clearing, among importers this proportion exceeded 50%. Almost half the exporters and over one-third of importers felt that the time required for clearance through customs was high.

4.10.21 Indian Feedback on Harassment

Often the trade community is harassed for petty mistakes and sometimes asked to produce documents which are not mandatorily required. The respondents also provided feedback on these aspects (Figure 4.26).

Figure 4.26: Feedback on Harassment (Indian trading community)



Notes:

- Nx=43; Nm=37 except in case of "C" where Nx=8; Nm=11
- Only the positive responses have been shown in the graph. The rest have answered the question in the negative.

Source: Field survey

Almost 6 out of 10 respondents in both the cases said that they faced situations where the authorities insisted on clearances which were not required under regulations. This was done probably with an intention to harass the exporters and importers in order to extort some money.

Of the exporters, 18% and 41% of the importers paid penalty for minor breach of custom procedures and out of those who have paid such a penalty

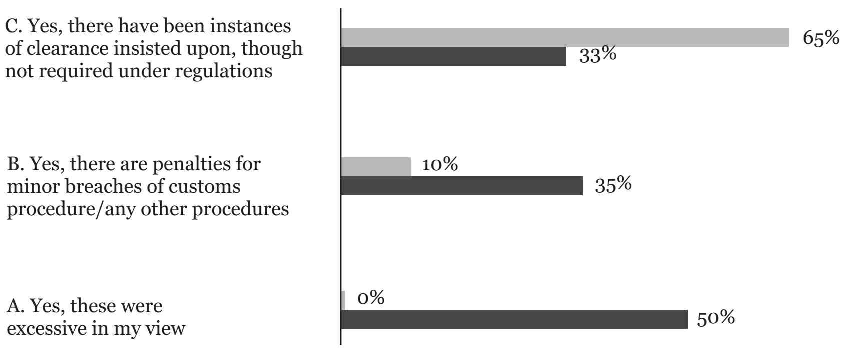
75% of the exporters and 46% of the importers feel that the penalty that they had to pay for such minor offense was excessive.[4]

4.10.22 Sri Lankan Feedback on Harassment

Almost two-thirds of exporters said that there had been instances where the authorities had insisted on clearances and approvals, when none was necessary.

Interestingly, only about one-third of importers expressed the same sentiment. However, more importers were vocal about how penalties had been levied for minor breaches and that these were far too excessive. This information is presented in Figure 4.27.

Figure 4.27: Feedback on Harassment (Sri Lankan trading community)



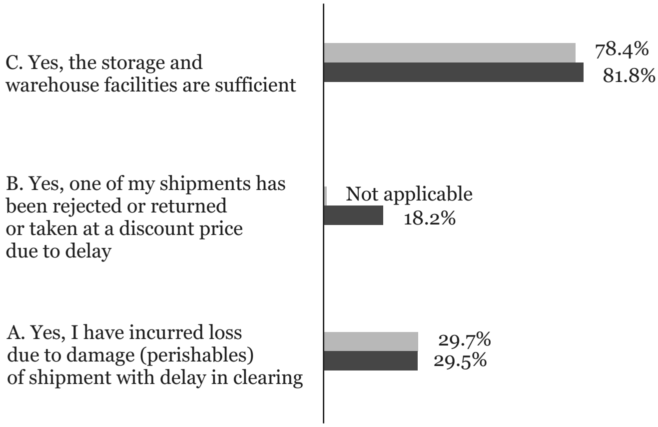
Source: Field survey

4.10.23 Indian Feedback on Operational Issues and Losses Suffered

In case of perishable items operational efficiency at ports and customs is required so that no loss is suffered due to delay. During the survey 82% of the exporters and 78% of the importers agreed that the available storage and warehouse facilities were sufficient. Still one-third of the respondents in both the categories reported having incurred losses due to damage to perishable items (Figure 4.28).

[4] This question was asked only to those who reported that they had paid penalties due to minor breaches in custom rules.

Figure 4.28: Operational Issues and Losses Suffered (Indian traders)



Notes:

- Nx = 43; Nm = 37 except in case of "B" where question was not asked to the importers
- Only the positive responses have been shown in the graph. The rest have answered the question in the negative.

Source: Field survey

In case of exporters 2 out of 10 exporters reported that they had been in situations where their shipment was rejected or taken at a discounted price due to delay in clearance.

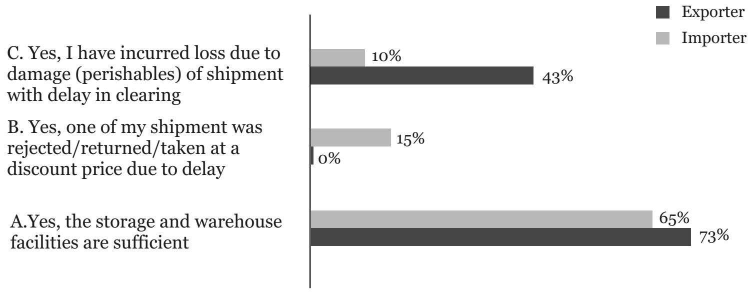
4.10.24 Sri Lankan Feedback on Operational Issues and Losses Suffered

While 65% Sri Lankan exporters and 73% importers felt that the storage and warehouse facilities were sufficient, a substantial proportion of importers said that they had had unpleasant experiences in the past, where delays in clearing had resulted in perishables being wasted (Figure 4.29).

4.10.25 Agencies/Offices that Indian Traders Have to Visit

The exporters and importers have to visit a number of agencies and offices for getting clearance and submitting documents. Table 4.30 gives the details of responses received from the respondents about the agencies/offices they have to visit for documentation purpose:

Figure 4.29: Operational Issues and Losses Suffered (Sri Lankan traders)



Source: Field survey

Table 4.30: Offices/Agencies Visited (Indian traders)
(Multiple responses admitted)

Offices/Agencies	*Response per cent*	
	Exporters	*Importers*
Custom house agents	50.0	62.2
Customs/excise	50.0	43.2
Export inspection agency	13.6	0.0
Shipping agents/cargo partners/freight forwarders	11.4	16.2
Indian Directorate General of Foreign Trade (IGDFT)	11.4	5.4
Chamber of Commerce	9.1	2.7
Sri Lankan importers/importers do all the documentation on our behalf	4.5	0.0
Banks	4.5	0.0
Colombo High Commission	0.0	8.1
Port	0.0	2.7
Bonded warehouse	0.0	2.7

Note: Nx = 44; Nm = 37
Source: Field survey.

Maximum number of exporters and importers are dependent on Custom House Agents (CHAs).

4.10.26 Agencies/ Offices That the Sri Lankan Traders Have to Visit

Exporters and importers need to visit a host of agencies and offices for various transactions. In this respect, the number of exporters visiting the Department of Commerce, Customs, and the Chamber of Commerce were 70%, 35%, and 25%, respectively, while number of importers visiting the Department of Customs, the Ports Authority, and Shipping Agents were 60%, 37%, and 25% respectively (Table 4.31).

Table 4.31: Offices/Agencies Visited (Sri Lankan traders)

Offices/agencies	*Exporters*		*Importers*	
Base	*20*		*40*	
Response	*Number*	*%*	*Number*	*%*
Department of Commerce	14	70.0	1	2.5
Customs	7	35.0	24	60.0
Chamber of Commerce	5	25.0	2	5.0
Board of Investment	4	20.0	5	12.5
Ports authority	2	10.0	15	37.5
Shipping agents	1	5.0	10	25.0
Banks	1	5.0	9	22.5
Health Ministry	1	5.0	1	2.5
Forest Department	1	5.0	0	0.0
Insurance Corporation	1	5.0	0	0.0
Animal husbandry	1	5.0	0	0.0
Import control	0	0.0	4	10.0
Finance Ministry	0	0.0	2	5.0
Clearing agency	0	0.0	2	5.0

Source: Field survey.

4.10.27 Traders on Custom House Agents

We have already seen a major chunk of the traders who are dependent on custom house agents (CHAs) for clearance. Table 4.32 shows that the importers are more dependent on CHAs than exporters. Of the importers, 81% rely on CHAs as against 66% of exporters.

Table 4.32: Dependence of Indian Traders on CHAs

Q. Do you engage in any agency for documentation and clearance?		
Response	*Response percentage*	
	Exporters	*Importers*
Yes	65.9	81.1
No	31.8	18.9
No response	2.3	0.0

Note: Nx = 44; Nm = 37

Source: Field survey.

Personnel on the Spice Board were critical of the role of the CHAs. According to them these are the main perpetrators of corruption in ports and customs but this view was not reflected by the other respondents.

4.10.28 Dependence of Sri Lankan Traders on CHAs

The survey revealed that the majority of exporters (70%) and importers (85%) used CHAs as shown in Table 4.33.

Table 4.33: Dependence of Sri Lankan Traders on CHAs

	Exporter		*Importer*	
Base	*20*		*40*	
Response	*Number*	*%*	*Number*	*%*
Yes	14	70.0	34	85.0
No	5	25.0	5	12.5
No response	1	5.0	1	2.5

Source: Field survey.

4.10.29 Reasons Provided by Indian Traders for Employing CHAs

The respondents who employed the service of CHAs gave reasons as illustrated in Table 4.34.

Table 4.34: Reasons for Engaging CHAs (Indian traders)
(Multiple responses admitted)

Reason for employing CHAs	*Response percentage*	
	Exporters	*Importers*
They have better links in customs/they make the process easy	47.7	40.5
Agency saves time	31.8	16.2
CHAs have better experience of this work as they usually handle such cases	18.2	13.5
We do not have relevant experience/are not licensed carry out this work	6.8	2.7
They are the authorized person to deal in ports	4.5	5.4
Convenience/do not have to go to port/the port is far away from our office	2.3	8.1
No specific reason	2.3	2.7

Note: Nx = 29; Nm = 30
Source: Field survey.

We see that the maximum number of respondents opted for engaging CHAs in order to save time. It was perceived that CHAs had better links with the port officials. Some respondents even believed that only the CHAs could handle these matters and that the traders themselves were not authorized to handle them. On the other hand, people who did not engage CHAs also had their reasons (Table 4.35).

Table 4.35: Reasons for Not Engaging CHAs (Indian traders)

Reason for not employing CHAs	*Response percentage*	
	Exporters	*Importers*
Agency commissions are high/it saves commission	15.9	18.9
Agency takes too much time	6.8	0.0
We ourselves have a specialized department/executives to handle these cases	4.5	0.0
Our company has been directly dealing with the customs from the beginning	4.5	2.7

Reason for not employing CHAs	*Response percentage*	
	Exporters	*Importers*
All our documentation is done by our importer/We normally route the paper through banks	2.3	2.7

Note: Nx = 14; Nm = 7
Source: Field survey.

It was inferred that those who did not opt for engaging CHAs are either very large organizations like Ashok Leyland who have a separate department with skilled manpower to handle such affairs or very small players who try to save on commission by handling their own work.

4.10.30 Reasons for Employing Clearing Agents by Sri Lankan Traders

Convenience, cost effectiveness, and efficiency were revealed to be the main reasons for using a clearing agency, the last two reasons being mentioned mainly by importers (Table 4.36).

We spoke to five clearing agents, and they mentioned that the documentation process has somewhat improved since the implementation of the ISFTA, however as expected there is no reduction in paperwork and time taken for documentation.

Table 4.36: Reasons for Engaging CHAs (Sri Lankan traders)

Response	*Exporters*		*Importers*	
	Number	*%*	*Number*	*%*
Base	*14*		*34*	
Convenience	10	71.4	8	23.5
Lack of employees	2	14.3	-	-
Cost effective	1	7.1	15	44.1
Less time consumption	1	7.1	2	5.9
Efficiency	1	7.1	8	23.5
Better to go to experienced people	–	–	3	8.8

Source: Field survey.

The few who did not use a clearing agent, said they had their own staff to do the job (Table 4.37).

Table 4.37: Reasons for not Engaging CHAs (Sri Lankan traders)

	Exporters		*Importers*	
Base	*6*		*6*	
Response	*Number*	*%*	*Number*	*%*
We have the required staff to do the job / we have the capability	6	100	5	83
We are a big importer	–	-	1	17

Source: Field survey.

4.10.31 Whether the Government Consulted the Traders Before Signing the ISFTA

Of the Sri Lankan exporters, 60% of them and 65% of importers said they had not been consulted by the Government of Sri Lanka prior to signing the ISFTA. In addition, a fairly high proportion said that they did not know about it (Table 4.38).

The main aim of signing the free trade agreement (FTA) was to ensure that the bilateral trade between the two countries increases rapidly. The exporters and importers are the most important stakeholders in this process. Hence they should have been consulted and their inputs sought before signing any such deal. During the survey it was enquired from the exporters and importers whether they had been part of any such consultation process.

Table 4.38: Whether the Sri Lankan Government Consulted with Traders before Signing the ISFTA

	Response percentage	
	Exporters	*Importers*
Base	*20*	*40*
Response	*%*	*%*
Yes	20	10
No	60	65
Don't know/cannot say	20	25
Was not exporting/importing to/from India at that time	-	-

Source: Field survey.

In case of Indian traders also a substantial number of Indian exporters and importers were either consulted or they attended some conferences and were aware about the developments before the ISFTA was signed as may be seen in Table 4.39.

Table 4.39: Whether the Government of India Consulted with Traders before Signing the ISFTA

Q. As an exporter/importer from India, were you consulted by Government of India before signing of ISFTA or did you attend any conference on this?

Response	*Response percentage*	
	Exporters	*Importers*
Yes	45.5	32.4
No	45.5	43.2
Don't know/cannot say	2.3	13.5
Was not exporting/importing to/from Sri Lanka at that time	6.8	10.8

Note: Nx = 44; Nm = 37
Source: Field survey.

Secretary of Vanaspati Manufacturers Association also reported that whenever there was a problem, the government was responsive enough and took necessary action in the interest of the business community.

However this needs to be further improved as almost an equal or higher proportion of respondents said that they were not consulted. So there is ample room for the government to increase consultation with stakeholders. Similar information was not available under the Sri Lankan survey.

4.10.32 Level of Assistance Provided by Indian Government and Other Agencies

The respondents were asked to rate the level of assistance/help/encouragement that they got from different government bodies and other agencies on scale of 1 to 5 where 5 implied "extremely good help" while 1 meant "extremely poor help". The mean of the responses is provided in Table 4.40 below:

Table 4.40: Rating of Assistance by Government of India and Other Agencies

S. No.	*Agency*	*Rating*	
		Exporters	*Importers*
1	Government of India	3.27	3.73
2	State Government	3.25	3.57
3	Business associations/confederations like chamber of commerce, FICCI, ASSOCHAM etc.	3.00	3.57

Notes:

- Nx = 44; Nm = 37
- 1 = extremely poor help; 2 = poor help; 3 = moderate help; 4 = good help; and 5 = extremely good help

Source: Field survey.

The traders got a fair amount of assistance from the government but there is ample opportunity of improvement. It is also clear that the assistance of central government is rated slightly higher than state government and other agencies.

4.10.33 Level of Assistance by Sri Lankan Government and Other Agencies

On a 5 point scale, where 5 represents "extremely good help" and 1 represents "extremely poor help", the rating of Government of Sri Lanka was lower than the rating of Business Associations and Confederations, such as the Chambers of Commerce (Table 4.41).

Table 4.41: Rating of Assistance by Government of Sri Lanka and Other Agencies

Agency	*Rating*	
	Exporters	*Importers*
Base	*20*	*40*
Government of Sri Lanka	3.3	3.0
Business associations/ confederations like chamber of commerce	3.9	3.6

Note: 1= extremely poor help; 2 = poor help; 3 = moderate help; 4 = good help; and 5 = extremely good help

Source: Field survey.

4.10.34 Suggestions from Indian Traders on Improving Operational Aspects

When suggestions for improvement in operational issues were sought, almost half of the respondents across both exporters and importers had no inputs to share.

Suggestions from the other half were related to making the clearance process faster and to eliminating corrupt practices. Exporters were also concerned about the classification of goods while the importers were more concerned about low awareness of products and pricing among the custom officials (Table 4.42).

Table 4.42: Suggestions for the Improvement of Operational Issues (Indian traders)

S. no.	*Suggestions*	*Response percent*	
		Exporters	*Importers*
1	No suggestions	43.2	48.6
2	Faster clearance	15.9	27.0
3	Corruption should be eliminated	13.6	18.9
4	The classification of goods should be transparent and uniform	11.4	0.0
5	Documentation should be easy, flexible, and lesser number of documents should be required	9.1	0.0
6	Reduce delay in getting drawback money	4.5	0.0
7	The process of getting COO should be improved/ EIA be more flexible/ No disagreement regarding COO	4.5	2.7
8	There should be general awareness about items that are not in the negative list	4.5	0.0
9	Custom authorities should be aware about the product and pricing/minimum price of a product should be considered	4.5	10.8
10	Better terminal handling	2.3	0.0
11	The ports in India should be improved so that mother vessels are available from Indian ports	2.3	0.0
12	More vessels are required	2.3	0.0
13	Freight charges to be reduced	2.3	0.0
14	Physical verification can be carried once in two years	2.3	0.0
15	Reduction in custom charges	0.0	5.4
16	Government should give more concessions	0.0	2.7

Note: Nx = 44; Nm = 37

Source: Field survey.

4.10.35 Suggestions from Sri Lankan Traders on Improving Operational Aspects

Under Sri Lankan survey when respondents were asked to give suggestions for improvement of operational issues, 65% of exporters and 50% of importers had no suggestions. Faster clearance and easy systems to issue certificates were some of the improvements mentioned by a relatively small proportion of respondents (Table 4.43).

Table 4.43: Suggestions for the Improvement of Operational Issues (Sri Lankan traders)

Response	*Exporters*		*Importers*	
	Number	*%*	*Number*	*%*
Base	*20*		*40*	
No suggestions	13	65.0	20	50.0
Faster track for testing goods	1	5.0	-	-
Faster clearance	2	10.0	3	7.5
Link information systems between Sri Lankan authorities	1	5.0	-	-
Close coordination between Sri Lankan and Indian authorities	3	15.0	1	2.5
Easy systems to issue certificates	-	-	3	7.5
Officers should be more knowledgeable with regard to the FTA	-	-	2	5.0
Reduce the number of places where custom entries are examined	-	-	3	7.5
Efficiency	-	-	5	12.5
Simplification of documentation	-	-	2	5.0

Source: Field survey.

Some suggestions to improve on the operational issues of FTA made by respondents from business associations:

"Create awareness of the trade agreement: most companies are unaware of the trade agreement and its benefits. Lack of interest among certain parties is also a concern."

"Even though the Department of Commerce of Sri Lanka approves the value addition, the India customs re-checks it from scratch, which is time consuming especially for copper exporters."

"Organize export exhibitions."

"Under Comprehensive Economic Partnership Agreement (CEPA) in 2010, the Tea Board of India and Sri Lanka Tea board signed an agreement with a list of accredited laboratories from both sides. If a tea shipment is accompanied by a quality certificate issued by any of these labs, customs in the other country is bound to honor the certificate. This benefit is spilling over to a different operation when importing teas from India for re-export that does not come under the purview of the FTA."

4.10.36 Indian Perception on Future of Bilateral Trade

Till now we have seen that the trade relation between India and Sri Lanka has seen many ups and downs. Even after the implementation of ISFTA it has seen tumultuous trends.

There have been many recent developments that have had a deep impact on the trade relation between the two countries. The prolonged civil war in Sri Lanka has ended with the fall of the LTTE in 2009. During the qualitative survey the members of Indo-Asean Sri Lanka Chamber of Commerce as well as other exporters and importers seemed upbeat about the future prospects. The traders reported that the number of trade queries that they received from Sri Lanka increased significantly after the end of the civil war.

During the quantitative survey it became apparent that both exporters as well as importers expect the relationship and trade between the two countries to improve. Table 4.44 shows the response of the traders during the quantitative survey.

Table 4.44: Perception of Indian Traders about the Impact of the End of the Civil War on Bilateral Trade (multiple responses are possible)

Effects of the end of the civil war	*Response per cent*	
	Exporters	*Importers*
The situation is improving/the trade will increase or has already increased	72.7	56.8
No effect of the end of the civil war	20.5	27.0
No views or suggestions	13.6	0.0
The financial side from Sri Lanka will be stronger now	9.1	0.0

Effects of the end of the civil war	*Response per cent*	
	Exporters	*Importers*
Financial problems are still there	6.8	0.0
looking forward to set up industry in Sri Lanka	2.3	0.0
Will now support industries in Sri Lanka	2.3	0.0
Has no idea about this issue	0.0	8.1
Easy shipment	0.0	5.4
Smooth in running business	0.0	13.5

Note: Nx = 44; Nm = 37
Source: Field survey.

From the table it is clear that almost three-fourth of the exporters and more than half of the importers are upbeat about the trade relations between the two countries with the end of the civil war. The north-eastern parts of the country that were under the control of the LTTE insurgents till recently will now be opened up for trade. The response of the traders when asked directly about their perception on the Indo-Sri Lankan trade relations in the short as well as long run is provided in Table 4.45.

Table 4.45: Perception of Indian Traders about the Future of Indo-Sri Lanka Trade Relations (Multiple responses are possible)

Traders' perception	*Response %*	
	Exporters	*Importers*
The trade will increase and move in a positive direction in future	90.9	73.0
The trade relations can improve resulting in more bilateral trade if the governments take initiatives	9.1	5.4
No idea	6.8	5.4
The trade is good and might grow but there are also some problems related to finance, transparency etc.	4.5	0.0
Business has already increased/Indian business houses are already searching avenues for investment	4.5	0.0
Exports to areas like Jafna will go up	2.3	0.0
The situation is not going to improve. They are already facing financial problems	2.3	0.0

Traders' perception	*Response %*	
	Exporters	*Importers*
For our product we do not visualize anything great but overall the trade will improve	0.0	2.7
In long term it can increase but at present there are some problems	0.0	10.8
Good business in short term / No comments about long term or not clear about it	0.0	24.3

Note: Nx = 44; Nm = 37
Source: Field survey.

Almost 9 out of the 10 exporters and 7 out of 10 importers share the perception that the trade relations will improve in the future. Respondents also reported that the large Indian business houses are already searching for business avenues in Sri Lanka.

4.10.37 Sri Lankan Perception on Future of Bilateral Trade

Around 75% of both exporters and importers perceived no change in bilateral trade due to the end of the civil war in North East Sri Lanka. However, around 19% of exporters and 24% of importers felt there had been an improvement in business or there would be more business opportunities in the future (Table 4.46).

Table 4.46: Perception of Sri Lankan Traders about the Impact of the End of the Civil War on Business Opportunities

Traders' perception about the end of the civil war	*Exporters*		*Importers*	
Response	*Number*	*%*	*Number*	*%*
Total respondents	16	-	34	-
No effect	12	75.0	26	76.5
There has been an improvement	2	12.5	3	8.8
More business opportunities	1	6.3	5	14.7
No improvement as yet	1	6.3	-	-

Source: Field survey.

In terms of the future of India–Sri Lanka trade relations in general, more than half the exporters and two-fifths of importers thought the future potential was good as may be seen in Table 4.47.

Table 4.47: Perception of Sri Lankan Traders about the Future of Indo-Sri Lanka Trade Relations

Traders' perception about the future of Indo-Sri Lanka trade relations	*Exporters*		*Importers*	
Base	*20*		*40*	
Response	*Number*	*%*	*Number*	*%*
Future potential is good/will grow/shall improve in the future	11	55.0	16	40.0
Nothing to say	3	15.0	5	12.5
FTA encourages people to do more business with India	1	5.0	0	0.0
Will be the same	1	5.0	0	0.0
Better if restrictions are removed for importing all raw materials from India	0	0.0	1	2.5
Indian rupee should be stable or will be a disadvantage for Sri Lankan imports/currencies should stay the same	0	0.0	2	5.0
Improve quality of imports	0	0.0	1	2.5
More foreign direct investment to Sri Lanka	0	0.0		0.0
Add more products to the FTA	0	0.0	2	5.0
No benefit/improvement	0	0.0	2	5.0

Source: Field survey.

4.11 SUGGESTIONS FOR IMPROVEMENT

4.11.1 Suggestions for Improvement by Indian Stakeholders

Various stakeholders have provided suggestions for improvement of bilateral trade during the qualitative phase. Some of them are:

1. **Improvement in physical infrastructure**. Along with the significant improvement in the documentation process and the online system, physical infrastructure needs much greater improvement.
2. **Strict adherence to COO**. Indian customs authorities may be requested to recognize the COO issued by The Department of Commerce, Government of Sri Lanka and if there arises any doubt on the part of customs, the respective High Commissions can be approached to address

the matter. The Indian High Commission in Colombo can play a role in the verification if required.

3. **Special entity to listen to the complaints and problems of traders**. A body may be formed to address the complaints and reduce delays.
4. **Check on local lobbies and regulations**. Powerful local lobbies influence decisions resulting in delays in issuing of licenses thereby imposing additional costs on the importers.
5. **Leaving protected industries out the purview of the agreement**. If certain local industries/sectors are to be protected for whatever reason then these areas need not be included in the agreement as this sends signals that agreements are not being honored by India.
6. **More quality check labs and greater accountability**. Indian government can increase the number of quality check labs so that the requisite checks at the ports can be accomplished within a specified period of time.
7. **Increased staff strength at ports and customs**. The number of personnel should be increased in these offices and they should be made accountable for their work.
8. **Reduction in non-tariff barriers (NTBs)**. This is important for the importers. If the NTBs are reduced then the trade between the two countries will definitely go up.
9. **Take the impact on the domestic industry into consideration while negotiating**. As pointed out by a few respondents specially those related to vanaspati trade it is necessary that while negotiating and finalizing an economic agreement the government keep in mind the interests of the domestic industry.

During the quantitative phase, the respondents were asked for their inputs on making the process of exporting or importing simpler. The analysis of the responses is provided in Table 4.48.

Table 4.48: Traders' Suggestions from India
(Multiple responses are possible)

Steps to improve conditions	*Response %*	
	Exporters	*Importers*
Facilitation in form of counseling, information etc to traders	25.0	0.0

Steps to improve conditions	*Response %*	
	Exporters	*Importers*
Government action (more concessions/deployment of officials related to trade/trader friendly measures/improvement in rules and regulations)	22.7	27.0
Faster clearance	20.5	0.0
Strict action against corruption	18.2	32.4
No suggestions	15.9	18.9
Reduced and simplified documentation	9.1	43.2
Reduce custom duties/taxes	9.1	2.7
Increase transparency	6.8	0.0
Increase drawback percentage/duty drawback	4.5	2.7
Organizing events where direct interaction among the traders of the countries can happen	2.3	0.0
Quick release of drawback amount	2.3	0.0
Integration of all offices (networking)	2.3	0.0
Raw material prices should be reduced	2.3	0.0
Simplification of the process of getting COO and no ambiguity about acceptance	2.3	5.4
Waive physical verification	2.3	0.0
Transit time to be reduced	2.3	0.0
Officers should be more easily accessible/ available	0.0	2.7
More products should be available for import/out of negative list/not banned	0.0	5.4
Improvement in terminal handling	0.0	2.7

Note: Nx = 44; Nm = 37
Source: Field survey.

Traders want greater assistance from the governments. Exporters seek more counseling on trade-related issues. A large chunk of the respondents also emphasize on improved operational aspects and curbing rampant systemic corruption.

4.11.2 Suggestions for Improvement by Sri Lankan Stakeholders

With regard to bilateral trade, almost half (40%) the exporters had no suggestions for improvement while 15% wanted an online documentation process and 10% asked for more transparency. Importers mainly suggested increase in awareness (42.5%), making customs more efficient (12.5%), and simplification of duty structures (7.5%). Details of various suggestions made are illustrated in Table 4.49.

Table 4.49: Traders' Suggestions from Sri Lanka
(Multiple responses are possible)

Traders' suggestions	*Exporters*		*Importers*	
Base	*20*		*40*	
Response	*Number*	*%*	*Number*	*%*
No suggestions	8	40.0	1	2.5
Have an online documentation process	3	15.0	1	2.5
Should be more transparent	2	10.0	1	2.5
Increase awareness	2	10.0	17	42.5
Customs efficiency	2	10.0	5	12.5
Reduce time taken for unloading cargo from vessels	1	5.0	0	0.0
Authorities to be flexible in documentation	1	5.0	0	0.0
Organize more trade promotions and exhibitions	0	0.0	1	2.5
Increase competitiveness and quality	0	0.0	1	2.5
Faster clearance	0	0.0	3	7.5
Duty structure should be simplified	0	0.0	3	7.5
Customs officers and other government officers should be more knowledgeable about the FTA	0	0.0	1	2.5
No corruption	0	0.0	1	2.5
Educate Indian suppliers	0	0.0	2	5.0
Less documentation	0	0.0	3	7.5

Source: Field survey.

4.12 SUMMARY OF FINDINGS

1. **Reasons choosing to trade between India and Sri Lanka**
   For Indian exporters, the benefits provided by ISFTA were revealed to be the most important reason for exporting to Sri Lanka. Geographical proximity between the two countries, good export prices, and ease of payment were other most important reasons for trading with Sri Lanka

in the case of exporters. In the case of importers however the primary reason for importing from Sri Lanka were the competitive prices of the Sri Lankan products. Low prices and quality products were the two most important reasons for importing from Sri Lanka. Benefits under the ISFTA were ranked third as the reason for trading with Sri Lanka. The study also found that many of the imports are mandated by the final buyers. Many apparel manufacturers are therefore compelled to import the accessories from Sri Lanka because it has been thus specified by the buyer. Sri Lankan exporters also mentioned tariff concessions under ISFTA as the main reason for exporting to India. Other important reasons given were close proximity and good market demand.

Low price was the main incentive for importers, followed by benefits obtained under FTA and the close proximity of the two countries.

2. **Reasons of opting for FTA**

Maximum number of Indian respondents both in the case of exporters as well as importers opted for the FTA route due to the tariff concessions that it provides. The exporters cited the easy processes and the drawback benefits as the other two important reasons for using the FTA. The importers on the other hand cited better services, ease in operating through this channel, and the benefits of the duty-free re-export as the other important reasons for using the FTA route. For Sri Lankan respondents too duty concessions under ISFTA were by far, the most important reason for both exporters and importers to trade with India.

3. **Effect of ISFTA on bilateral trade**

Of the Indian exporters, as many as 80% and 57% of the importers reported that they experienced additional growth after the implementation of the ISFTA. Importers gave more credit to ISFTA for this growth as compared to exporters. On the other hand 59% of Sri Lankan exporters and 65% of importers claimed that they had experienced additional growth after the implementation of the ISFTA. However this trend reversed after 2007. Part of the reason for this decline can be attributed to the increased checks and elimination of loopholes in the FTA.

4. **Investments**

Two-fifths of Sri Lankan exporters and almost one-third of importers were willing to increase their investments to expand their presence in the market.

5. **Problems faced by traders while trading with Sri Lanka in India**

Of the Indian exporters as many as 77% and 70% of the importers said that they were not facing any problem while trading with Sri Lanka. However those exporters who faced problems mentioned challenges faced at ports, delays in clearance, and extra surcharge levied by the government as the most problematic ones. The importers on the other hand found the administrative delays in compliance of NTBs and the late issue of COO as the most problematic. In a marked contrast, as much as 70% of Sri Lankan exporters and importers claimed that they faced problems when trading with India. The biggest problem for exporters was the delay in clearance. Other problems mentioned were dealing with customs officials, difficulties at EIA, delay in obtaining the COO and other NTBs such as quota restrictions. Importers identified the delay in receiving documents as the main problem faced by them, followed by delay in issuing COO and NTBs.

6 **External barriers faced by traders while trading with Sri Lanka**

Close to two-thirds of Indian exporters and half of the importers said they did not face any external barriers (problems faced in Sri Lanka). Among those who were facing problems, administrative delays in compliance with NTBs and issues related to the acceptance of COO were the most prominent barriers in case of the exporters. In the case of importers the major problems that they faced in Sri Lanka were delay in clearance, poor handling of goods at the ports, or corruption in organizational set ups.

Fifty nine per cent of Sri Lankan exporters mentioned that they faced external barriers while exporting to India and 85% of importers said they faced external barriers in Sri Lanka while importing from India. In the case of exporters most of the problems were related to NTBs such as quota restrictions, while for importers it was delay in clearance, handling of goods at Indian ports, and delay in issuing COO.

7 **General perception about ISFTA**

Majority of the Indian respondents (75% of the exporters and 68% of the importers) agreed that the ISFTA was in the mutual interest of the countries.

Majority of Sri Lankan exporters felt that ISFTA benefited Indian businesses, while most importers were of the opinion that the benefits were equally shared between Indian and Sri Lankan businesses.

8 **NTBs faced by the traders**

Of the Indian exporters, 84% reported no NTBs in India or Sri Lanka. This figure was 87% for importers. The most prominent NTBs in case of exporters who faced NTBs are antidumping practices, tariff classification, and standard disparities. In case of importers quota restrictions came as the most important NTB. A much higher proportion of Sri Lankan importers (72%) faced NTBs in Sri Lanka than exporters (41%) who faced NTBs in India.

In the case of exporters who faced NTBs, quota restrictions, documentation requirements, and non-acceptance of testing methods were mentioned as barriers.

For importers, import licensing, packaging, labeling, and acceptance of testing methods were revealed to be barriers.

9 **Perception about simplification of documentation and reduction in paperwork**

Majority of Indian exporters and importers agreed that there has been reduction in paperwork at Indian ports and customs. This fact was agreed upon across all segments of the industry because the traders with lesser turnover agreed to this as much as those with higher turnover. Faster clearance was cited as the most important benefit due to reduction in paperwork by both exporters as well as importers.

Almost one-third of Sri Lankan exporters (among whom 35% said dk/cs) and half of importers claimed that there had been no reduction in paperwork at Sri Lankan ports.

10. **Average time taken for clearance**

The average time for completing the clearance process worked out to 3.83 days for Indian exporters while in case of importers it was 4.00 days.

This implied that on an average an exporter or importer had to invest 3 to 4 days for completing all the formalities at customs and ports.

Time taken for import clearance (3 to 4 days) by Sri Lankan importers appeared to be less compared to export clearance (5 days).

11. **Knowledge about rules and regulations and other details**

Ninety-five per cent of the Indian importers and 86% of the exporters were aware of the rules and regulations pertaining to their business but almost one-third of the respondents reported that there were sudden changes in rules and regulations. Eighty per cent of such respondents reported that these changes were not made public instantly. To make matters worse almost one-fifth of the respondents felt that they were harassed for non-compliance due to ignorance about such changes.

In case of Sri Lankan traders 82% of exporters and 79% of importers were aware of the rules and regulations pertaining to their businesses. But over one-third claimed that there were sudden changes. While a third of exporters and just under half of the importers said that these changes were made public instantly, over a quarter complained that they were harassed due to ignorance about changes.

12. **Knowledge about negative list and enquiry points**

Almost seven out of 10 Indian respondents in both the categories were aware about the negative list and various enquiry points that catered to trade-related enquiries. Approximately 60% of those who were aware of such enquiry points reported that they found them helpful and efficient. In case of Sri Lankan traders access to the negative list was low; so was awareness about inquiry points. For every 10, two to three exporters and four to five importers were aware of various inquiry points that catered to trade-related matters. Of these, eight out of 10 exporters and seven out of 10 importers said they found these inquiry points to be helpful and efficient.

13 **Location of various offices and availability of staff**

Forty-six per cent of the Indian exporters, and 57% of the importers felt that the multiple offices that they had to visit to complete all the formalities were situated far away from each other. As far as the availability of staff and their willingness to help is concerned 8 out of 10 respondents agreed that the number of staff deployed was sufficient and the staff is cooperative and willing to help.

Less than a third of Sri Lankan exporters and importers felt that the various offices to be contacted were located far away. With regard to the number of personnel working in these offices, over half the exporters and three-quarters of importers thought they are adequate.

However only about half the exporters and less than a third of importers felt that their services are readily available.

14. **Information about harassment**

A sizeable number of Indian respondents reported that there were cases of harassment. More than half of the respondents have been through situations where clearances or papers not mandatory were insisted upon. Eighteen per cent of the exporters and 45% of the importers reported that they had been penalized for minor breach of rules and regulations. Similarly almost three-quarters of Sri Lankan exporters said that there had been instances where the authorities had insisted on them obtaining clearance, when none was necessary.

Interestingly, only about a quarter of importers expressed the same sentiment. However, more importers were vocal about how penalties had been levied for minor breaches and that these were far too excessive.

15. **Dependence on Custom House Agents**

Two-thirds of the Indian exporters and more than 81% of the importers depended on CHAs for their documentation work. The main reason for employing CHAs is the general perception that the CHAs have better links with custom officials thus making the process easier and time efficient.

In case of those few who did not engage CHAs there are two categories: the first is that of small traders who wanted to save CHA agents' costs and another category was of larger traders or companies who maintain a standalone department to handle such cases.

Majority of Sri Lankan exporters (71%) and importers (81%) used clearing agents whom they say have better knowledge of procedures and links with customs officers, which enable them to save time.

16. **Suggestions**

Suggestions put forth by Indian stakeholders for better bilateral trade were:

- o special entity to handle complaints and problems of traders;
- o check on local lobbies and regulations;
- o improvement in physical infrastructure of ports;
- o strict adherence to rules of origin and no disagreement on COO;
- o reduction in NTBs;
- o increase in number of staff at ports and customs;
- o more quality check labs and greater accountability;
- o better facilitation in form of counseling, information, etc to traders;

- o strict action against corruption;
- o more simplified documentation;
- o faster clearance;
- o more transparency in rules, regulations, and processes; and
- o integration of all offices (networking).

These suggestions are neither comprehensive nor exhaustive. In the quantitative survey of Sri Lankan stakeholders when respondents were asked to give their suggestions, as many as 71% of exporters and 59% of importers had no suggestions.

Some suggestions made are listed below:

- Faster clearance and easier systems for issuing certificates.
- Indian customs authorities to accept COO issued by Sri Lanka Department of Commerce. If doubts persist, seek Sri Lanka High Commission's help. In addition, Indian High Commission in Colombo can verify if necessary.
- There should be a body to which complaints can be addressed to reduce/ eliminate delays.
- Website of Indian customs procedures should be updated regularly to reflect correct total duties rather than traders being expected to workout applicable duties through complex calculations on websites.
- Indian customs to issue clarification in writing when a written inquiry is made.
- Action to be taken against officers who demand documents which are not specified in the FTA.
- Refrain from including products that have opposition from powerful local lobbies in India.
- Procedures for testing and certification to be streamlined and agreed upon by both the governments.
- Indian government to ensure that lab testing of perishable items is carried out at port of entry within a specified time, or arrange for authorized labs in Sri Lanka to check goods prior to shipment.
- Rules and duties governing products to be laid down, and users granted access to prevent ambiguity.

5 India–Sri Lanka Investment Linkages

Nawal K. Paswan

5.1 INTRODUCTION

Economic relations between India and Sri Lanka date back to pre-colonial times. Trade between the two nations began to pickup in the 1990s and received its biggest boost when the two countries signed a bilateral India–Sri Lanka Free Trade Agreement (ISFTA) on 28 December 1998 that entered into force on 1 March 2010. The ISFTA was notified to the WTO in 2002.[1] The ISFTA aims to promote economic links between India and Sri Lanka through enhancement of bilateral trade and investment. The agreement covers only 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. The ISFTA does not provide for elimination of non-tariff barriers. If either party faces balance-of-payment difficulties or critical circumstances and invokes safeguard measures, they may provisionally suspend the preferential treatment and notify the other partner.[2] This was a pioneering attempt in the direction of trade liberalization in the South Asian region and involved the liberalization of trade in goods. Sri Lanka's

The author expresses his thanks to V. Sharan, Alokesh Barua and Saman Kelegama for their valuable comments and suggestions. The author also wishes to thank I.N. Mukherji for his guidance.

[1] WTO document WT/COMTD/N/16, last accessed on 27 June 2012.

[2] For more information on this agreement, see Department of Commerce online information. Viewed at http://www.doc.gov.lk/web/indusrilanka_freetrade_dutycon.php. Last accessed on 11 June 2012.

economic objectives were to increase trade ties with South Asia's dominant economic power, to induce the transformation of Sri Lanka's exports from low-value added goods to high value-added goods aimed at niche markets and to provide low-income groups with cheap consumer imports from India.[3]

Most of the South Asian countries offer an increasingly liberal policy regime to foreign direct investment (FDI) inflows. However, policy reforms in Sri Lanka (since 1978) and India (since 1991), had created conditions conducive to promote bilateral trade and investment flows. It is generally believed that the increase of Indian investment in Sri Lanka may be partially attributed to the free trade agreement (FTA) but is primarily influenced by the increased profile of economic ties between the two countries and increased investors' confidence as a result of the FTA.[4] It also increased the scope for the expansion of trade in goods between the two countries, and thereby broadened the scope for investment expansion to exploit the advantages of bilateral trade between India and Sri Lanka. Besides, Sri Lanka had already entered into a Bilateral Investment Promotion and Protection Agreement (BIPPA) with India to promote foreign investment in 1997 and also signed a Double Taxation Avoidance Agreement (DTAA) and the prevention of fiscal evasion with respect to taxes on income and on capital on 19 May 2010.

The FDI policy regime began to liberalize from early 1990s when India liberalized its FDI policy regime dramatically as a part of a New Industrial Policy adopted in July 1991 after pursuing a rather selective policy towards FDI over four decades. Since then India has gradually liberalized her FDI policy and now the basic policy for FDI of India is that foreign investment is freely permitted in nearly all sectors in India. In a few select sectors, FDI is totally prohibited like retail trade (except single brand retailing), gambling, betting and lottery, and atomic energy.[5]A synoptic view of FDI policies in South Asian countries is presented in Box 5.1.

Sri Lanka has recently introduced an amended Strategic Development Project Act (SDPA) in order to attract FDI in 2008. It is expected that the amended

[3] S. Kelegama. 1999. Indo-Sri Lanka Trade and the Bilateral Free Trade Agreement: A Sri Lankan Perspective. *Asia-Pacific Development Journal* 6(2).

[4] Saman Kelegama. 2009. India–Sri Lanka Bilateral FTA: Sri Lankan Perspective on Emerging Issues. Viewed at http://www.networkideas.org/ideasact/dec09/pdf/Saman_Kelegama.pdf. Last accessed on 27 October 2012.

[5] Ministry of Commerce and Industry has issued a consolidated FDI Policy effective from 1 April 2010 (Circular 1 of 2010).

Box 5.1: Policies and Incentives of Foreign Direct Investment in South Asia

	Bangladesh	*India*	*Sri Lanka*	*Pakistan*	*Nepal*
Entry restrictions	Arms, ammunition and defense products, nuclear energy, security printing and minting, forestry in reserved forest	Arms and ammunition, atomic energy, nuclear power, agriculture and plantations, real estate business, settlements, retail trading (multi brand), atomic energy and lottery business, gambling and betting, railway, coal, lignite, mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc. Investment in stock markets and real estate requires prior approval.	Money lending, pawn broking, retail trade with a capital of less than $ 1 million, coastal fishing, education	Arms and ammunitions, high explosives, radioactive substances, alcoholic beverages or liquors.	Business, management, consulting, accounting, engineering, legal services, defense sector, alcohol, cigarettes agencies, retail sales.
Foreign ownership	Up to 100%	100% in most sectors except insurance (26%), mining (74%). Sectoral caps apply in service sectors.	100% foreign ownership. 40% for negative list.	100% in most sectors, except agriculture 60%, service sector 100% to 60% reduction within 2 years.	Up to 100%

	Bangladesh	*India*	*Sri Lanka*	*Pakistan*	*Nepal*
Profit transfer and convertibility	Full repatriation of invested capital, profit and dividend allowed	• No restriction on remittances for debt service or payments for imported inputs. Dividend remittances permitted without approval from the RBI. • All profits, dividends, royalty, know how payments can be repatriated.	No restriction on repatriation of earnings and fees. Foreign exchange restrictions for current account transaction removed	Full repatriation of capital, capital gains, dividends and profits, is allowed. 100% foreign equity allowed on repatriable basis.	• All profits and dividends are not guaranteed for repatriation.
Taxation	Tax holiday facilities for 5–7 yrs depending on location of the industry.	• 40% with special tax treatment for infrastructure sector • Foreign nationals working in India are generally taxed only on their Indian income. • Corporate tax holiday for a block of 10 years out of 20 years. Tax and duty concessions for mega power projects.	35%–39% tax relief as first year allowance for categories A, B, C, and D for expansion, balancing, modernization and replacement in existing industries	Full tax to holiday from 2–20 years, up to 0% tax on turnover $25 m in EPZ	• 25% with no income tax on profit from export • Hydropower developers exempt first 15 years.

	Bangladesh	*India*	*Sri Lanka*	*Pakistan*	*Nepal*
Other incentives	Duty free import of raw materials, tax holiday of 10 years, concessionary tax for 5 years, fully serviced plots, factory building etc.	• 10 year tax holiday for knowledge based start-ups. Almost 659 units EPZ in 8 sectors, automatic approval for foreign equity investments up to 51% • Issue of equity shares against lump sum fee, royalty and external commercial borrowings in convertible foreign currency already due for payment/repayment permitted	• No import duty or turnover tax on machinery and equipment. Concessionary tax of 15%. Import duty exemption on project related goods, exemption from turnover tax on sales and exchange control • An initial tax holiday, often for five years, followed by a short period of a concessional income tax rate and finally a long-term concessional rate, varying from 15% to 20% depending on the industry	• Custom duty of 5% chargeable on import of plant, machinery and equipment, not manufactured locally. • Zero rated sales tax on import of plant, machinery and equipment. Locally manufactured plant, machinery and equipment are also exempted from payment of sales tax.	Hydropower developers exempted from income tax for first 15 years, no income tax on profit from exports, tax incentives to locate outside Kathmandu. No EPZ or free ports.
Bilateral tax treaties	20 countries	57 countries	39 countries	23 countries	3 countries

	Bangladesh	*India*	*Sri Lanka*	*Pakistan*	*Nepal*
Agreement of double taxation avoidance	20 countries	63 countries	52 countries	52 countries	3 countries

Source: Drawn from Kumar, Nagesh. 2005. Liberalization, Foreign Direct Investment Flows and Development: Indian Experience in the 1990s, *Economic and Political Weekly*, 40(14): 1459–69; Khondaker Golam Moazzem. 2006. F*oreign Direct Investment in South Asia: Lessons from South East Asia*, Dhaka: Centre for Policy Dialogue; Nagesh Kumar and Pooja Sharma. 2009. India. In J. Francois et al., eds. 2009. *National Strategies for Regional Integration: South and East Asian Case Studies*. Manila: Asian Development Bank/ Anthem Press. pp 23–98; Nadeemul Haque and Ejaz Ghani. 2009. Pakistan. In J. Francois et al. pp. 97–136; Mohammed Ali Rashid, Mohammed Ali 2009. Bangladesh. In J. Francois et al. pp. 137–206; B. Karmacharya and Nephil Maskay. 2009. Nepal. In J. Francois et al. pp. 207–76; DushniWeerakoon.2009. Sri Lanka. In J. Francois et al. pp. 277–332, among other sources as presented in Nagesh Kumar. 2010. "Capital Flows and Development: Lessons from South Asian Experiences", *MPDD Working Papers WP/10/11*, Macroeconomic Policy and Development Division (MPDD), United Nations Economic and Social Commission for Asia and the Pacific, Bangkok, Thailand.

SDPA will promote national interests and bring economic and social benefits to the country. It is also likely to change landscape of the country primarily because of: the strategic importance attached to the proposed provision of goods and services that will benefit the public; the substantial inflow of foreign exchange to the country; the substantial employment that it will generate; the enhancement of income earning opportunities; and the transformation envisaged in terms of technology. This act was further amended and came into operation in January 2011.[6]

In the past two decades, FDI has been spurred by the widespread liberalization of its regulatory framework, combined with advances in information and communication technologies and competition among firms. Most countries have opened themselves to foreign investment, improved the operational conditions for foreign affiliates, and strengthened standards of treatment and protection. In fact, virtually all countries now actively encourage FDI, as it is expected to bring capital, technology, skills, employment, and market access. Government of India promotes FDI through a policy framework which is transparent, predictable, simple and clear, and reduces regulatory burden.

With this background, the aim of this paper is to assess the current status and potential scope for promoting bilateral investment between India and Sri Lanka.

We have presented one case study of Sri Lankan investor in India (Brandix India Apparel City) in Box 5.2 and another case study of Indian investors in Sri Lanka (CEAT-Kelani Pvt. Ltd.) in Box 5.3 to understand its impact on employment, domestic production, and exports. These two case studies clearly demonstrate the existing nexus between trade and investment. Investment from India to Sri Lanka is required to raise the supply capacity of the host

[6] With the approval of the SDPA No. 14 of 2008, the following tax exemptions: (a) The Inland Revenue Act No. 10 of 2006–(Income Tax); (b) The Value Added Tax Act No. 14 of 2002–(Value Added Tax); (c) The Finance Act No. 11 of 2002 (Port and Airport Development Levy); (d) The Finance Act No. 05 of 2005 (Social Responsibility Levy, Share Transaction Levy, Construction Industry Guarantee Fund Levy); (e) The Custom Ordinance (Chapter 235); (f) The Excise (Special Provision) Act No. 13 of 1989; (g) The Economic Service Charge Act No. 13 of 2006; and The Debits Tax Act No. 16 of 2006 could be enjoyed by any person investing in such Strategic Development Projects which are considered as strategic projects by Board of Investment of Sri Lanka with the approval of the Parliament of Sri Lanka. It is important to know that most of such exemptions are not available under Board of Investment law. SDPA Act of 2008 was amended with inclusion of The Nation Building Tax Act No. 9 of 2009 and The Ports and Airports Development Levy Act No. 18 of 2011 and came in to operation in January 2011.

country for exports not only for catering to the market of the investing country, but also for exports to the world. This is required since Sri Lanka's domestic market is small and not adequate to generate the economies of scale to make its products globally competitive. The proposed Indo-Sri Lanka Comprehensive Economic Cooperation Agreement (CEPA) seeks to further enhance investment cooperation between the two countries.

5.2 THEORETICAL FRAMEWORK AND REVIEW OF LITERATURE

South Asian economies have limited scope for improving intra-regional trade given the fact that they have comparative advantages in the production of similar products (garments, light manufacturing and agricultural products). New trade theory however suggests greater scope for enhancing intra-regional trade in South Asia. One way to address both problems—low intra-regional trade and persistent trade imbalances—is to invigorate the trade–investment nexus in the region. The theory draws on the relationship between trade theory and industrial organization to suggest theoretical possibilities of the interaction between trade liberalization and FDI.

The first possibility is that of trade and FDI becoming substitutes as trade liberalization leads to factor price equalization between countries. Accordingly, liberalization of trade in goods can substitute for trade in factors of production, thereby negating the incentives for FDI. A second possibility is that through the increased incentive for vertical integration of production between firms in the different trading partners, trade liberalization can result in greater investment flows, and vice-versa. Given the limited empirical support for the factor price equalization theory, greater weight could be given to the study of the nexus between trade and FDI through vertical integration of production between firms.[7]

Evidence from other regional initiatives such as the European Common Market and Association of Southeast Asian Nations (ASEAN) has shown that reduction of barriers and costs to trade, in conjunction with more conducive investment climates, can boost both intra-regional (as well as bilateral) trade and investment as a result of firms forging backward and forward linkages. It is also important to take into account the nexus between trade liberalization

[7] Deshal de Mel and Suwendrani Jayaratne. 2009. *Vertical Integration of Industries in South Asia*. Colombo, Sri Lanka: Institute of Policy Studies.

and FDI through horizontal integration. Firms may invest in production of the same good in multiple countries to overcome the costs of exporting the product from one source to multiple destinations. However, with trade liberalization, the costs of export falls, thereby reducing the incentive for horizontal FDI.

In South Asia, only three pairs of countries (a) India–Sri Lanka; (b) Pakistan–Sri Lanka; and (c) Pakistan–Bangladesh have moderate trade complementarities and this did not develop within the region because of the lack of vertical specialization through a production-sharing arrangement.[8] Vertical specialization allows the countries to reap economies of scale by concentrating on a specific production process in the value addition chain thereby strengthening the trading ties among the regional trading partners. For this purpose, evolving production agreements on a regional basis in a specific sector would be essential. Several sectors like textiles and clothing, leather, rubber, and electronics could qualify for these production integration schemes. This would eventually lead each member country to specialize in a particular spectrum of the value addition chain and emerge as a niche player in that particular segment.[9]

A study by Deshal de Mel and Suwendrani Jayaratne reveal that there is relatively high level of intra-industry trade between India–Sri Lanka due to the impacts of the bilateral FTA these countries are party to.[10] This study is broadly based on two case studies (a) garments and textiles and (b) the automobiles sector that provides greater insights into the opportunities and challenges to

[8] Nawal K.Paswan.2003. *Agricultural Trade in South Asia: Potential and Policy Options*. New Delhi: APH Publishing Corporation.

[9] For example, trade can take place if one country specializes in yarn and fabrics, while another specializes in finished garment products. In the case of primary commodity exports, regional cooperation will allow greater value addition because South Asia is exporting these commodities in bulk, and value addition takes place in importing countries, thereby resulting in lower value realization. A good example of such joint venture was the jute industry in which Bangladesh produced the jute and West Bengal had the processing mills. Joint ventures are an effective way to expand and diversify the production base and trade structure of the economy. Sonu Jain. 2010. Regional Cooperation in South Asia: India Perspectives. In Sadiq Ahmed, Saman Kelegama, and Ejaz Ghani (eds). *Promoting Economic Cooperation in South Asia: Beyond SAFTA*.New Delhi: Sage. Isher Judge Ahluwalia. 2009. Economic Cooperation in South Asia. New Delhi: Indian Council for Research on International Economic Relations (ICRIER). http://www.jbic.go.jp/en/research/report/research-paper/pdf/rp16_e09.pdf, Extracted and accessed on 28 October 2012.

[10] Deshal de Mel and Suwendrani Jayaratne. 2009. *Technical Assistance for Supporting Network of Research Institutes and Think in South Asia Phase II*. Colombo, Sri Lanka.

industrial integration in South Asia. It also draws some policy prescriptions that could be engaged into enhancing the trade-investment nexus in South Asia based on the ASEAN experience which has seen greater success in invigorating the trade–investment nexus. Vertical FDI is likely to be made in neighboring countries in the presence of large gaps in wages and technology. These large gaps lead to FDI and promote technology transfer from headquarters to overseas affiliates and thus increase re-imports, which can increase intra-industry trade.

Agarwal[11] finds that FDI inflows have helped South Asian countries to achieve faster economic growth, beginning in the 1980s and especially over the 1990s.[12] Chakraborty and Basu also find FDI to be positively related to growth in the case of India.[13] However, the evidence, by and large, remains unclear. Other studies suggest that the relationship between FDI and growth depends on country-specific factors and no simple conclusions can be drawn.[14] Even if a positive correlation is found, the issue of causality remains unresolved. It could well be that FDI increases growth, but also that the prospect of higher growth attracts FDI. For most of it, the evidence that FDI contributes to growth is encouraging rather than compelling.[15]

While FDI may contribute to growth in developing countries, benefits also may not always be equally distributed. The distribution of gains from FDI is also linked to some degree to the sectors in which FDI is directed. FDI inflows to relatively capital-intensive and skill-intensive manufacturing sectors will have a different employment and income impact than on FDI flowing to labor-intensive and unskilled manufacturing. Similarly, FDI into

[11] Pradeep Agrawal.2000. Economic Impact of Foreign Direct Investment in South Asia. Indira Gandhi Institute of Development Research, Mumbai, India (mimeo). Last accessed on 28 October 2012 from http://rru.worldbank.org/Documents/PapersLinks/1111.pdf.

[12] The impact of FDI inflows on GDP growth was found to be negative prior to 1980. This is argued because FDI inflows may have earned excessive profits and led to immiserizing growth when there were severe trade and financial markets distortions in most South Asian economies.

[13] C. Chakraborty and P. Basu 2002. Foreign Direct Investment and Growth in India: A Cointegration Approach. *Applied Economics*. 34(9).

[14] De Mello R. 1997. Foreign Direct Investment in developing Countries and Growth: A Selective Survey, *Journal of Development Studies*. 34. pp. 1–34.

[15] R. Lensink and O. Morrissey. 2001. Foreign Direct Investment: Flows, Volatility and Growth in Developing Countries. University of Nottingham. mimeo.

financial services is also more likely to be associated with high skill intensive employment and income. Thus, FDI may have an uneven distributional impact within economies as well as between countries and regions. Recent evidence from five East Asian economies and five African economies suggests that foreign-owned firms tend to pay higher wages, but skilled workers tend to benefit more than less-skilled workers.[16]

Systematic evidence on the effects of FDI in South Asian economies is lacking. In the case of both Sri Lanka and Bangladesh, vertical FDI has been the dominant instrument to take advantage of an abundant source of relatively cheap labor. The leading sector which has attracted FDI has been the textiles and garments sector, employing typically unskilled female labor. In Sri Lanka, the garments sector has come to dominate manufacturing in the post-liberalization period, accounting for over 50% of total export earnings for the country. In addition, it provides employment to over 5% of the total labor force (and one-third of the total manufacturing sector labor employment). Of this, 87% of employment in the garment sector is dominated by females, and they account for 90% of the unskilled machine operator jobs.[17]

If FDI inflows represent additional investment, it should provide employment. However, increasingly FDI inflows are for mergers and acquisitions (M&A), attracted by the trend towards privatization of public utilities and other state owned economic enterprises. Such FDI inflows may not necessarily increase employment. In the case of India, for example, there is evidence to suggest that multinational corporations have been notably active in acquisitions, accounting for nearly a third of all corporate acquisitions

[16] D.W. Velde and O. Morrissey. 2001. Foreign Ownership and Wages: Evidence from Five African Countries. CREDIT Discussion Paper 01/19. Also, D.W. Velde and O. Morrissey. 2002. Foreign Direct Investment, Skills and Wage Inequality in East Asia. www.odi.org.uk/iedg/FDI_who_gains/FDIWhoGains.html. Last accessed on 27 October 2012.

[17] S. Kelegama and R. Epaarachchi. 2002. Productivity, Competitiveness and Job Quality in the Garment Industry in Sri Lanka. In G. Joshi (ed.) *Garment Industry in South Asia-Rags or Riches? Competitiveness, Productivity and Job Quality in the post-MFA Environment*. New Delhi: International Labor Organization. It has been estimated that at the end of the 1990s, the garment industry in Bangladesh provided total employment to approximately 1.5 million, of whom 1.2 million were women. Also, M. Rahman. 1998. *Harnessing Competitive Strength through Enhancement of Technological Capability: A Study on Export Oriented Apparels Sector of Bangladesh*, Bangladesh Institute of Development Studies: Dhaka.

during the period 1991–97.[18] Such FDI inflows can also lead to increasing market concentration in some sectors.[19]

While the exchange of tariff preference between India and Sri Lanka has no doubt induced the accelerated flow of bilateral trade between the two countries, the rapid increase in Sri Lankan exports to India had also much to do with the emergence of Sri Lanka as a production and profit centre for Indian companies seeking access to regional and global markets. Over 50% of Indian joint ventures and wholly owned subsidiaries in the South Asian region are located in Sri Lanka. The inflow of direct investment from Indian companies began in the wake of Sri Lanka's economic liberalization program during the 1980s.[20]

Though there have been hardly any studies into the impact of an FTA on FDI in the South Asian region due to lack of data on bilateral FDI, Jayasuriya and Weerakoon explored the evidence on the trade–investment links in South Asia by focusing on the textile and garment sectors of the region as well as on some firm level evidence from Sri Lanka. [21] Preliminary analysis shows that though the extent of these trade investment links in the South Asian Association for Regional Cooperation (SAARC) region were still rather limited, they do indicate potential. ADB–UNCTAD (2008) study has shown that the lowering of tariffs following the South Asian Free Trade Area (SAFTA) will attract FDI from outside the region into South Asia. SAFTA may not only increase intra-regional trade but also attract more vertically integrated FDI into the region.

Abd-el-Rahman and Greenaway, Hine and Milner argue that making a distinction between these two types of intra-industry trade (IIT) is important, as

[18] R. Basant. 2000. Corporate Response to Economic Reforms. *Economic and Political Weekly*, 35(10).

[19] One of the largest multinationals in India, Hindustan Lever (a subsidiary of Unilever) acquired Tata Oils (its principal rival in oil in India), Brooke Bond Lipton (India's largest company in food and beverages), Pond's India (cosmetics), Kwality, and Milkfood (processed foods) in a series of M&As after 1992. See S. Athreye and S. Kapur. 2001. Private foreign investment in India: Pain or Panacea? *The World Economy*. 24. pp. 399–424. http://dx.doi.org/10.1111/1467-9701.00362.Last accessed on 27 October 2012.

[20] S. Kelegama and I.N. Mukherji. 2007. India–Sri Lanka Bilateral Free Trade Agreement: Six Years Performance and Beyond. RIS Discussion Papers No. 119.

[21] S. Jayasuriya and D. Weerakoon.2001. India–Sri Lanka Trade and Investment Links. In P. Shome (ed.) *India and Economic Cooperation in South Asia*. New Delhi: Indian Council for Research on International Economic Relations.

there are different forces at work in determining the two types of intra-industry trade. [22] For example, vertical IIT is likely to be driven by differences in factor endowment between countries. Contrary to this, horizontal IIT usually takes place between countries which have little disparity in factor endowment. In this study we explore the second aspect of vertical IIT, i.e. product fragmentation and trade in different stages of the value chain.

Rising integration of world markets has not only brought with it a desegregation of the production process but has also generated a break-down in the vertically-integrated mode of production. Product fragmentation refers to cross-border dispersion of component production/ assembly within vertically integrated processes, with each country specializing in a particular stage of the production sequence and trading the value-added components to result in a final product. [23] Product fragmentation first started in the electronics and the garment industries and has subsequently spread to many other industries.[24] The process can now be seen in industries such as automobiles, electrical machinery, telecommunications, and television production. Athukorala (2006) identifies rapid advancements in production technology, technological innovations in communication and transportation, and liberalization policy reforms in investment and trade in both home and host countries as the three mutually reinforcing developments over the last few decades which have expanded international product fragmentation.[25] In the early stages (1960s) multinational enterprises (MNEs) have been the key players in the process of product fragmentation with a view to taking advantage of cost differentials in

[22] K. Abd-el-Rahman. 1991. Firms Competitive and National Comparative Advantages as Joint Determinants of Trade Composition. *Weltwirtschaftiches Archiv*, 127. pp. 83-97. Greenaway D. R. Hine, and C. Milner. 1995. Vertical and Horizontal Intra-industry Trade: A Cross Industry Analysis for the United Kingdom. *The Economic Journal*. 105 (433). pp. 1505–18.

[23] Also referred to as "slicing the value chain" (Krugman 1995), "delocalization" (Leamer 1996) and "intra-mediate trade" (Antweiler and Trefler 1997). See details in Edward E. Leamer. 1996. In Search of Stolper-Samuelson Effects on U.S. Wages. *NBER Working Paper no*. 5427. Werner Antweiler and Daniel Trefler. 1997. Increasing Returns and All That: A View from Trade. University of British Columbia and University of Toronto. P. Krugman. 1995. Growing World Trade: Causes and Consequences. *Brookings Papers on Economic Activity*. 1. pp: 327–7.

[24] Sharpton, Michael. 1975. International Subcontracting. *Oxford Economic Papers*. 27(1): 94–135. Also, Freenstra, Robert C. 1998. Integration of Trade and Disintegration of Production in the Global Economy. *Journal of Economic Perspectives*. 12(4).

[25] P. Athukorala. 2006. Singapore and ASEAN in the New Regional Division of Labour. *Departmental Working Papers*.11. Australian National University, Economics RSPAS.

different countries. Nevertheless, in recent years fragmentation practices have begun to spread beyond the domain of MNEs.[26]

With respect to South Asia in general and India–Sri Lanka in particular, very few studies have estimated the impact of bilateral and regional trade on inward and regional FDI. One of the reasons for this is lack of bilateral data and information on FDI over time. Hence, the present study aims to assess the extent of production fragmentation and intra-industry trade between India and Sri Lanka. Whilst regions such as ASEAN have taken full advantage of such new production methods South Asia has been slow to take off (footnote 27). The first step of the study is to assess the extent of intra-industry trade and product fragmentation by constructing a Grubel–Lloyd index (GL Index) for South Asian trade. The GL Index is a widely used indicator that measures the share of intra-industry trade from a data set which has both homogenous and differentiated goods.

5.3 STATUS AND CHANGING STRUCTURE OF INDIA–SRI LANKA FOREIGN DIRECT INVESTMENT

The FDI policy regime began to be liberalized from early 1990s when India liberalized her FDI policy regime dramatically as a part of a New Industrial Policy (NIP) adopted in July 1991 after pursuing a rather selective policy towards FDI for four decades. The policy marked a major departure from the past with the abolition of the industrial licensing system (except where it is required on strategic or environmental grounds), creation of a system of automatic clearance of FDI proposals fulfilling the conditions laid down (such as the ownership levels of 50%, 51%, 74% and 100% foreign equity), and opening of new sectors such as mining, banking, insurance, telecommunications, construction and management of ports, harbors, roads and highways, airlines, and defense equipment to foreign owned companies subject to sectoral caps. Foreign ownership up to 100% is permitted in most manufacturing sectors—in some sectors even on automatic basis—except for defense equipment where it is limited to 26% and for items reserved for production by small scale industries where it is limited to 24%.[27]

[26] Prema-chandra Athukorala. 2007. *Multinational Enterprises in Asian Development*. Cheltenham: Edward Elgar.

[27] Nagesh Kumar. 2005. Liberalization, Foreign Direct Investment Flows and Development: Indian Experience in the 1990s.*Economic and Political Weekly*. 40(14). pp: 1459–69.

Indian firms began to invest overseas in the 1960s, but India's restrictive outflows foreign direct investment (OFDI) regime limited them to small, minority joint ventures in developing economies. After 1991, intense domestic economic competition, the growing global competitiveness of Indian firms and liberalizations in OFDI and capital market policy triggered a rush of international investments by Indian companies, especially in the IT, pharmaceuticals, telecommunication, automotive, metal, and service sectors. In most of these sectors, Indian companies have sought to be global leaders.[28] Detailed policies and incentives of FDI in India and Sri Lanka as well as other South Asian countries are presented in the Box 5.1 (which is self-explanatory). South Asian countries have been receiving increasing FDI and foreign portfolio investment (FPI) flows over the past few years following the liberalization of their policy regimes and their emergence as fast growing economies.

5.3.1 Global and Regional Foreign Direct Investment Inflows and Outflows

Table 5.1 presents the FDI inflows and outflows of the world, South Asian region as whole and individual South Asian countries during the period between 1990 and 2010. Global FDI inflows had reached a peak of $1970 billion in 2007 from $207 billion in 1990 and in 2010, the FDI inflows declined at the level of $1,243 billion. The share of FDI inflows to South Asia was increasing throughout the period from 1990 to 2009 and reached a peak 3.33%. But in 2010, its share declined and reached 2.28% . Global FDI outflows reached $2,174 billion in 2007 from merely $198 billion in 1991 but it declined in 2010 and recorded $1,323 billion.

South Asian share of FDI outflows was 0.01% in 1992. It increased dramatically and touched 1.37% in 2009. It recorded decline in 2010 and reached at 1.11%.[29] Among the South Asian countries, India topped in terms of FDI inflows from the world with $24,639 million followed by Pakistan ($2,016 million), Bangladesh ($913 million), Sri Lanka ($477 million), Maldives ($163 million), Afghanistan ($75.7 million), Nepal ($39.0 million), and Bhutan ($11.7 million) in 2010. The scenario of FDI outflows from the region is also similar.

[28] P.N. Satyanand and R. Pramila. 2010. Outward FDI from India and its Policy Context. Vale Columbia Center on Sustainable International Investment. 22 September.

[29] The value of global FDI outflows does not match with inflows due to issues of measurement errors and accounting valuation problems. However, FDI outflows followed a pattern similar to inflows.

Table 5.1: FDI Inflows and Outflows in the South Asian Region and Percentage Share of the World

Year	*FDI Inflows ($ million)*											*FDI Outflows ($ million)*						
	World	*AFG*	*BD*	*BHU*	*IND*	*MLD*	*NPL*	*PAK*	*SL*	*SACs-8*	*% Share*	*World*	*BD*	*IND*	*PAK*	*SL*	*SACs -4*	*% Share*
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*	*2 to 9 = (10)*	*10/1= (11)*	*(12)*	*(13)*	*(14)*	*(15)*	*(16)*	*13 to 16 = (17)*	*17/12= (18)*
1990	207454.7	0.0	3.2	1.6	236.7	5.6	5.9	278.3	43.4	574.8	0.28	241498.5	0.5	6.0	2.0	0.8	9.3	0.00
1991	154073.2	–0.3	1.4	0.6	75.0	6.5	2.2	271.9	67.0	424.3	0.28	198041.1	0.4	–11.0	–4.0	4.5	–10.1	-0.01
1992	165880.9	0.4	3.7	0.0	252.0	6.6	0.0	360.6	122.6	745.9	0.45	202634.7	0.1	24.0	–12.0	1.6	13.7	0.01
1993	223316.4	0.0	14.0	0.0	532.0	6.9	0.0	399.3	194.5	1146.7	0.51	242553.7	0.2	0.4	–2.0	6.9	5.5	0.00
1994	256000.2	0.0	11.1	0.0	974.0	8.7	0.0	789.3	166.4	1949.7	0.76	286887.8	0.2	82.0	1.0	8.3	91.5	0.03
1995	342391.4	–0.1	92.3	0.1	2151.0	7.2	0.0	492.1	65.0	2807.6	0.82	362745.5	1.7	119.0	0.0	5.6	126.3	0.03
996	388554.8	0.7	231.6	1.4	2525.0	9.3	19.2	439.3	133.0	3359.5	0.86	396523.8	12.5	240.0	7.0	6.9	266.4	0.07
1997	486389.0	-1.5	575.3	-0.7	3619.0	11.4	23.1	711.0	433.0	5370.6	1.10	476159.6	3.1	113.0	-24.0	5.0	97.1	0.02
1998	707583.5	0.0	575.5	0.0	2633.0	11.5	12.0	506.0	150.0	3888.0	0.55	688310.2	3.0	47.0	50.0	13.0	113.0	0.02
1999	1089597.3	6.0	309.1	1.1	2168.0	12.3	4.4	532.0	201.0	3233.9	0.30	1088197.9	0.1	80.0	21.0	24.0	125.1	0.01
2000	1402680.2	0.2	578.6	0.0	3588.0	22.3	-0.5	309.0	173.0	4670.5	0.33	1232117.1	2.0	514.4	11.0	2.0	529.4	0.04
2001	826177.1	0.7	354.5	0.0	5477.6	20.5	20.9	383.0	171.8	6428.9	0.78	752660.1	20.6	1397.4	31.0	0.0	1449.0	0.19
2002	626873.8	50.0	328.3	2.1	5629.7	24.7	-6.0	823.0	196.5	7048.3	1.12	537183.2	4.1	1678.0	28.0	11.5	1721.6	0.32
2003	572789.6	57.8	350.3	2.5	4321.1	31.8	14.8	534.0	228.7	5540.9	0.97	573792.1	6.2	1875.8	19.0	27.3	1928.3	0.34
2004	742386.3	186.9	460.4	3.5	5777.8	52.9	-0.4	1118.0	233.0	7832.1	1.05	930104.6	5.7	2175.4	56.0	6.0	2243.1	0.24
2005	982593.4	271.0	845.3	9.1	7621.8	53.0	2.4	2201.0	272.0	11275.6	1.15	882131.7	3.3	2985.5	45.0	38.0	3071.8	0.35

Year	FDI Inflows ($ million)											FDI Outflows ($ million)						
	World	*AFG*	*BD*	*BHU*	*IND*	*MLD*	*NPL*	*PAK*	*SL*	*SACs-8*	*% Share*	*World*	*BD*	*IND*	*PAK*	*SL*	*SACs -4*	*% Share*
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*	*2 to 9 = (10)*	*10/1= (11)*	*(12)*	*(13)*	*(14)*	*(15)*	*(16)*	*13 to 16 = (17)*	*17/12= (18)*
2006	1461862.7	238.0	792.5	6.0	20327.8	63.8	-6.6	4273.0	480.0	26174.6	1.79	1405389.5	3.6	14285.0	109.0	29.0	14426.6	1.03
2007	1970939.6	243.0	666.4	78.3	25349.9	90.6	5.9	5590.0	603.4	32627.5	1.66	2174802.7	21.0	17233.5	98.0	55.0	17407.5	0.80
2008	1744101.0	300.0	1086.3	27.5	42545.7	134.8	1.0	5438.0	752.2	50285.6	2.88	1910509.2	9.3	19397.5	49.0	61.7	19517.5	1.02
2009	1185030.1	185.0	700.2	14.7	35648.8	112.3	38.6	2338.0	404.0	39441.5	3.33	1170527.1	29.3	15929.2	71.0	20.0	16049.5	1.37
2010	1243670.9	75.7	913.3	11.7	24639.9	163.8	39.0	2016.0	477.6	28337.0	2.28	1323337.4	15.4	14626.1	46.0	45.7	14733.2	1.11

Notes:

AFG Afghanistan
BD Bangladesh
BHU Bhutan
IND India
MLD Maldives
NPL Nepal
PAK Pakistan
SL Sri Lanka
SACs South Asian Countries

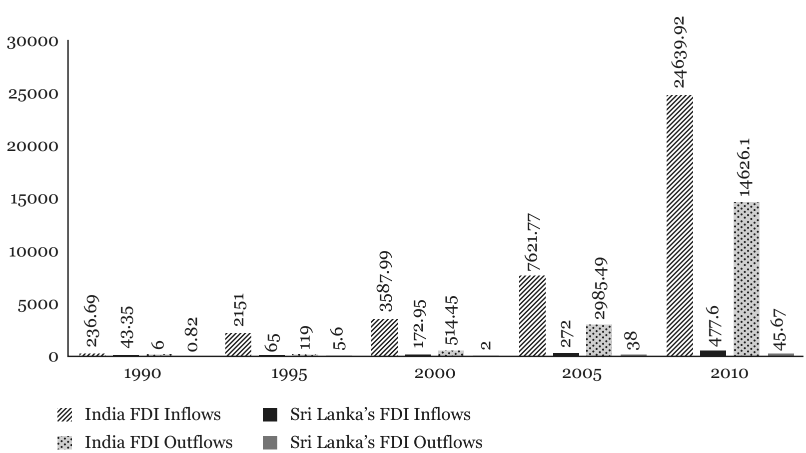
Source: World Investment Report 2011. United Nations Conference on Trade and Development (UNCTAD), Geneva.

Among the South Asian countries, India again topped in terms of FDI outflows to the world with $14,626 million followed by Pakistan ($46 million), Sri Lanka ($45 million) and Bangladesh ($15.4) and other four countries (namely Bhutan, Nepal, Maldives, and Afghanistan) FDI outflows are negligible (Table 5.1).

FDI outflows in the South Asian region were merely $424 million in 1991 which increased significantly to $50,285 million in 2008 but registered declining trends and reached $28,337 million in 2010. It is interesting to note that the value of FDI outflows from the South Asian region was even less than half of the total FDI inflows during the period. FDI outflows from South Asian region were merely $5.5 million in 1993 which recorded fluctuating but increasing trends and reached the highest ever level of $19,517 million in 2008 and after which point it recorded declining trends and reached $14,733 in 2010.

It is quite clear from Figure 5.1 that the gap between India and Sri Lanka in terms of FDI (inflows and outflows) widened during last 20 years. India attracted around $237 million FDI from the world whereas Sri Lanka attracted $43 million in 1990. During 1990 to 2010, the pace of growth in FDI inflows were almost similar in both the countries but India's total FDI inflow from the world recorded highest ever value with $24,640 million and Sri Lanka worth $477 million in 2010. India's FDI outflows were merely $6 million in 1990 but increased significantly

Figure 5.1: FDI Inflows and Outflows of India and Sri Lanka ($ million)

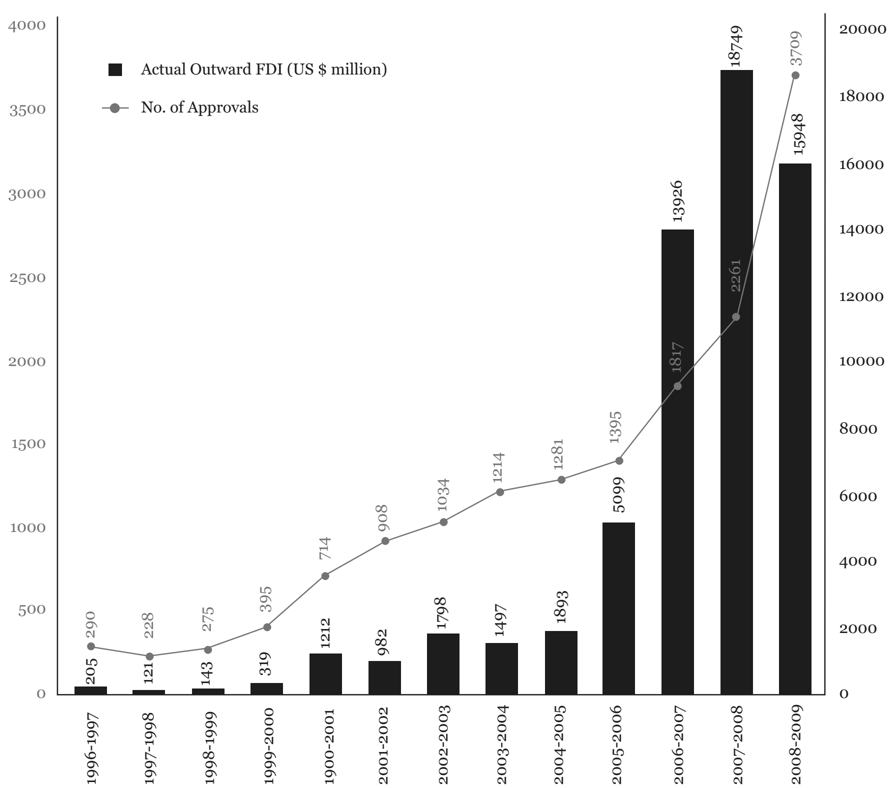


Source: UNCTAD, 2011

to $14,626 million in 2010. Sri Lanka's FDI was merely $0.82 million in 1990 and increased significantly throughout the 1990s to reach $45 million in 2010.

The sources of FDI are highly diversified in most SAARC countries. Though the dominant tendency of FDI inflow is still from developed countries, the share of developing countries is also fairly significant (Figure 5.2). The rationale behind FDI from developed country sources is directly related to the industrial sophistication of the host country. Thus India, which is industrially the most advanced country in the region, attracts most of its FDI inflows from the developed world. FDI flows into South Asia have been increasing more rapidly than in the developing world. Within the region, however, only India, Pakistan,

Figure 5.2 Outward FDI by Indian Enterprises, 1996–2009



Source: Ministry of Finance and Reserve Bank of India.

and Bangladesh have succeeded in stimulating FDI inflows; other countries do not seem to benefit from the current trend.

Individual countries of the South Asian region have highly uneven share in the total regional FDI. India alone contributed 87% of the total FDI to South Asia and remaining 17% comprised of Pakistan (7.11%), Bangladesh (3.22%), and Sri Lanka (1.7%) while the share of the other four countries (Afghanistan, Nepal, Bhutan, and Maldives) was negligible in 2010. In relative terms, however, only Pakistan and Bangladesh improved their share in the regional FDI. All other countries (including India) witnessed a decline in their allocation to regional FDI inflows. India was the only country to contribute significantly to South Asia regional outflows with 99.27% share in 2010.

Although Indian companies have been investing abroad since early 1970s, the magnitude of investments was quite small until mid-1990s. However, the magnitude as well as number of outward investments suddenly swelled after 2000 to around $1.5 billion per annum. Since 2005–2006 the outward investments have climbed new heights as apparent from Figure 5.2. In 2005–2006 the magnitude of outward investment by Indian companies was nearly $5 billion and it jumped to $14 billion in 2006–2007. In 2007–2008 the value increased to $19 billion, before moderating slightly to $16 in the wake of the global financial crisis in 2008–2009. Rising numbers and magnitude of outward investments by Indian companies have made it an important and perhaps more dynamic aspect of increasing global economic integration of the Indian economy along with trade in goods and services and inward FDI. Emergence of India as a source of outward FDI seems to be a part of the broader (new) trend of outward investments from the emerging countries such as PRC, Brazil, India, and South Africa. India's FDI outflows of around 4% share of outward FDI in gross fixed capital formation are impressive for its level of development as compared to PRC's which is around 2.9%.[30]

5.3.2 Bilateral Flow of Investments

The India–Sri Lanka investment link has been quite negligible in the past, although it is growing stronger at present. Though Sri Lanka started to attract

[30] Nagesh Kumar. 2008. Internationalization of Indian Enterprises: Patterns, Strategies, and Ownership Advantages and Implications. *Asian Economic Policy Review,* Japan Centre for Economic Research. 3 (2). pp. 242–261.

significant FDI after 1977, Indian investment in Sri Lanka has been quite limited in terms of its total contribution to FDI, despite the fact that it is the largest investor from the SAARC region.[31] Over 50% of all Indian investments in SAARC countries are made in Sri Lanka. Of the joint ventures, 54% are in Sri Lanka.[32]

Despite close proximity and growing bilateral trade, investment flows between the two countries remained low, although they have been growing faster with the implementation of the ISFTA. The share of total Indian investment in Sri Lanka was only about $105 million, i.e., about 4% of the total FDI approved by the Board of Investment (BOI), at the end of 2000. Total Sri Lankan FDI investment in India was less than $10 million or 0.01% of total FDI inflows to India in the 1990s.

Table 5.2: Sri Lanka: Foreign Direct Investment Inflows from India and World ($ million)

Year	*FDI inflows from India*	*Total FDI inflows*	*FDI from India (%)*
2003	51	211	24.17
2004	15	234	6.41
2005	18	287	6.27
2006	27	604	4.47
2007	43	734	5.86
2008	126	889	14.17
2009	78	601	12.98
2010	110	516	21.32

Source: Board of Investment. 2011. *Sri Lanka: Annual Report 2009*. Central Bank of Sri Lanka and data of 2010 reported in Ministry of External Affairs, Government of India.

India's investment activities in Sri Lanka have increased in the last decade (2000–2010) and more so in the recent years (2011–12) in absolute terms. Compared to the other South Asian countries, Sri Lanka has occupied a place of primacy for Indian investors. However, within the overall ambit of

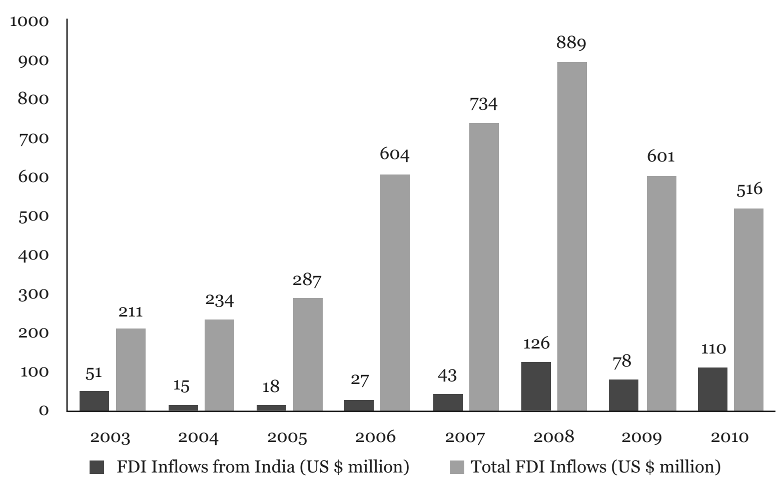
[31] The dominance of FDI by East Asian countries is the result of the early influx of "quota-hopping" firms into the Sri Lankan garment industry, the main manufacturing industry with large FDI.

[32] *India–Sri Lanka Economic and Trade Engagement*. Indian Embassy in Sri Lanka, Colombo. Accessed on 27 October 2012.

Indian outward FDI in developing countries as a whole, the relative share of Sri Lanka is still low at about 6%.[33] India's FDI in Sri Lanka was $51 million in 2003 which increased significantly and reached the highest-ever mark of $126 million in 2008 but also decreased in 2009 and reached $78 million (Table 5.2 and Figure 5.3). Indian companies have also established a strong presence in Sri Lanka with FDI approvals of nearly $500 million. India was the largest FDI contributor in 2010, contributing $110 million of the $516 million received by Sri Lanka.[34]

However, it is encouraging that large Indian investors have shown an increasing interest in investing in various sectors in the Sri Lankan economy, responding positively to the opportunities created by the ISFTA and continuation of economic liberalization. It would be pertinent to highlight that possibly the real significance of Indian FDI in the Sri Lankan economy lies not in its contribution to capital formation, but also in its impact on technology transfer and trade creation.

Figure 5.3: Foreign Direct Investment Inflows into Sri Lanka from India and World (2003–2010)



Source: Board of Investment. 2011. *Sri Lanka: Annual Report 2009*. Central Bank of Sri Lanka and data of 2010 reported in Ministry of External Affairs, Government of India.

[33] Joint Study Group on India–Sri Lanka Comprehensive Economic Partnership Agreement (2003).

[34] Ministry of External Affairs, Government of India, July 2011.

Figure 5.3 presents FDI inflows of Sri Lanka from the world and India (in millions of $) during the period between 2003 and 2009. As shown in the figure, there are some spikes but the trend seems to point towards greater FDI flows per year. A ceasefire in 2002 seems to have provided an impetus for greater growth in inward FDI flows in Sri Lanka.[35] The figures below are up until 2007. According to Bloomberg, more recently, interest among hotel operators and clothing manufacturers seems to be increasing with the end of the civil war. Malaysia was the largest investor in Sri Lanka in 2008 followed by India. Malaysia invested about $150 million in 2008 followed by India which invested $126 million.[36]

Table 5.3: FDI into Sri Lanka by Source Country

Year	*Units*	*Malaysia*	*Luxembourg*	*Sweden*	*Hong Kong*	*UK*	*India*	*Total*
2006	No.	9	3	10	27	11	31	375
	Volume	164.7	54	49.9	46.2	40.4	27.1	603.7
	%	27.30	8.90	8.30	7.70	6.70	4.50	100.00
2005	No.	8	4	6	12	34	19	199
	Volume	99.6	17.3	10.1	15.5	26.4	17.9	287.2
	%	34.70	6.00	3.50	5.40	9.20	6.20	100.00
2004	No.	3	2	3	9	20	21	151
	Volume	39.9	13.2	1.8	9.7	44.1	17.7	234.3
	%	17.00	5.60	0.80	4.10	18.80	7.60	100.00
1978–1995	No.	3	16	10	47	20	10	368
	Volume	0.9	6	9.1	50.8	5.9	5.2	426.6
	%	0.20	1.40	2.10	11.90	1.40	1.20	100.00

Notes: Volume is in $ million and % denotes volume as a percentage of total FDI.
Source: Data for 1978–1995 was sourced from Prema-chandra Athukorala.1995. Foreign Direct Investment and Manufacturing for Export in a New Exporting Country: The Case of Sri Lanka. *World Economy*. 14(2). pp. 543–564. Data for 2004–2006 was sourced from the BOI, Sri Lanka.

FDI outflows from Sri Lanka to India, though relatively small, have increased since the implementation of the ISFTA on 1 March 2010. Total

[35] US State Department. 2008. *Investment Climate Statement: Sri Lanka*.

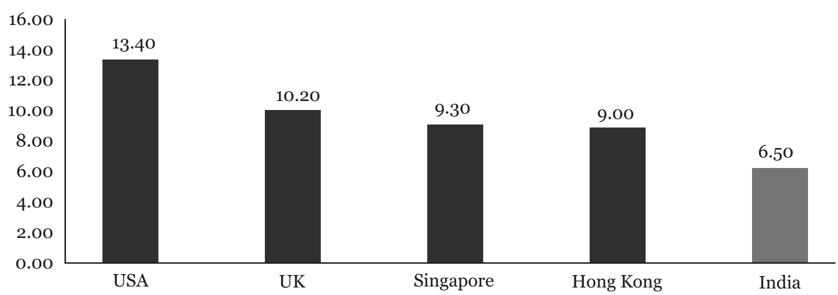
[36] Cherian Thomas. 2010. Sri Lanka sees foreign investment quadrupling as civil war ends. Last accessed on 8 December 2010. <http://www.bloomberg.com/apps/news?pid=20601091&sid=aAn_Qy8nT9mA&refer=india>

Sri Lankan investments in India have been about $4 million since 1997, which is 11% of the total outward investments during the period between 1997 and 2010. The FDI flows between the two countries are changing from a mere one-way flow to an increasingly two-way relationship.

India has increased its share of FDI in Sri Lanka from 1.2% during 1978–1995 to over 5.6% (average) during 2004–2006 (Table 5.3). At times, tense political relationships with India have discouraged more active Indian involvement in the economy. However, with a marked improvement in bilateral relations since the late 1990s, Indian investment has picked up sharply. This process has been assisted by improved economic links following the signing of a bilateral FTA between India and Sri Lanka in 1998. While the FTA was confined to trade in goods, improved business links and business confidence has undoubtedly had an impact in generating more FDI from India into Sri Lanka. However, as an outward destination, Sri Lanka remains fairly marginal to Indian investors—attracting only an estimated 1% of total Indian outbound FDI.

Sri Lanka has gradually become an attractive destination for Indian FDI, particularly since 2000. India was one of the top-five countries investing in Sri Lanka by the end of 2007, accounting for 6.5% of the total FDI stock of

Figure 5.4: Top Five Countries Investing in Sri Lanka
(% of total FDI flowing into Sri Lanka)



Source: Board of Investment, Sri Lanka.

LKR331.2 billion (Figure 5.4).[37] The Board of Investment of Sri Lanka states that over half of Indian investments in the SAARC region are done in Sri Lanka.

[37] Rohan Samarajiva and Priyanwada Herath. 2009. How Sri Lanka Can Grow with India. 10 May. http://www.lankabusinessonline.com/fullstory.php?nid=1480523226

The period after 2000 was even more important because investment from India grew by an average of $33 million per annum, accounting for 16% of the total FDI flows during 2001–2007.

The process of bilateral economic integration (through proposed CEPA) was to be expanded to include trade in services and investments. However, even without an agreement as such, the higher trade profile of Sri Lanka resulting from the bilateral agreements and negotiations appear to have increased Indian FDI to Sri Lanka. The BOI also facilitated greater FDI flows from India.

Compare this with the 1990s, when there were only 12 Indian projects with a total investment of LKR177 million. Indian FDI (the foreign country shares only, excluding the local contribution) increased to over LKR20 billion under 90 projects by the end of 2007. The post-2000 expansion changed the sectoral distribution of Indian FDI remarkably. Indian FDI is now mostly in the service sector (63% of the total). In 2000, the service sector share was only 30%; there was no such investment from India in 1990. This change was due to fast growth of Indian investments in services such as health, education, fuel distribution, hotel industry, tourism, IT training, computer software, and professional services.

By 2007, in addition to the service sector, Indian investment was present in the fabricated metal and food industries in Sri Lanka. The FTA provided opportunities for Indian investors to produce in Sri Lanka for exports to India. Vanaspati and copper exports grew rapidly for this reason, competing with Indian domestic producers. These exports were later restricted due to domestic pressures in India.

The increase in Indian FDI may be partially attributed to the FTA. It increased the scope for the expansion of trade in goods between the two countries, and thereby broadened the scope for investment expansion to exploit the advantages of bilateral trade between India and Sri Lanka. Besides, Sri Lanka had already entered into a Bilateral Investment Promotion and Protection Agreement (BIPPA) with India to promote foreign investment in 1997. Sri Lankan firms made investments in India, though systematic data is difficult to obtain, in the absence of a dedicated investment agency in India. The recorded investments include those in furniture, food manufacturing, and in hotel services.

ISFTA is among first of its kind and demonstrates effectively that if the concerns of the smaller economy are taken into account with more favorable treatment, then the size differential in the economies of the FTA partners does not matter. Given the size of the Indian market, Sri Lankan companies can benefit by realizing economies of scale, integrate into sustainable and low-cost value chains and invite greater investment from India and elsewhere. ISFTA has been a significant success in terms of investment flows and also promoted intra-regional investment in both the countries. Sri Lanka has another FTA in force with Pakistan (Pakistan-Sri Lanka Free Trade Agreement) which was signed in July 2002 and came into operation on 12 June 2005.Trade between India and Pakistan takes place mostly via Singapore or Dubai (third countries). Sri Lanka can promote Indo-Pakistan trade by encouraging investors from Pakistan to open operations in Sri Lanka in order to trade with India using the ISFTA and vice versa and can gradually acquire the hub status in South Asia. This can promote efficiency in seeking investment in Sri Lanka. However, though there have been several inquiries, no significant progress has been made in this direction till date.

5.3.3 Changing Structure and Composition

The scale of expansion of Indian investment in Sri Lanka from the mid-1990s is clear (Table 5.4). Indian investors were involved in a total of 18 projects in 1999. By 2006, the number had risen to 83 with the most significant expansion to be seen in the services sector. In fact, as of 2006, over 71% of total Indian FDI in Sri Lanka was to be found in services related activities. Indian FDI in manufacturing had been mostly concentrated in sectors such as steel, cement, rubber products, T&C, food products, automobile components, electrical equipments, chemicals, and printing. Whilst investment in the food and beverages sector accounted for nearly 77 of total Indian FDI in manufacturing by the late 1990s, this had dropped to 42% by 2006. A key area of Indian manufacturing FDI has been in the fabricated metals, machinery, and transport equipment sector where the share increased to 25% during 1999 to 2006. In the services sector, the principal areas of activity were found in tourism, computer software, advertising, financial, and non-financial services, etc.

Table 5.4: Estimated Investment from India into Sri Lanka (1999 and 2006)

Sectors	*As at end 1999*			*As at end 2006*		
	No. of projects	*Investment (SLRs mn)*[a]	*(%)*[b]	*No. of projects*	*Investment (SLRs mn)*[a]	*%*[b]
Food, beverages, and tobacco	2	621.3	67.83	6	2654.1	12.03
Textile and clothing and leather products	2	24.9	2.72	4	545.3	2.47
Wood and wood products	1	1.6	0.17	3	99.1	0.45

Sectors	*As at end 1999*			*As at end 2006*		
	No. of projects	*Investment (SLRs mn)*[a]	*(%)*[b]	*No. of projects*	*Investment (SLRs mn)*[a]	*%*[b]
Paper and paper products	1	7.4	0.81	1	32	0.15
Chemical, petroleum, rubber and plastic products	4	134.1	14.64	9	427.4	1.94
Non-metallic mineral products	1	10.0	1.09	7	432.2	1.96
Fabricated metal products, machinery and transport equipment			0.00	17	1567.8	7.11
Manufactured products, n.e.s			0.00	6	621.9	2.82
Services	7	116.7	12.74	30	15675.9	71.07
Total	18	916.0	100.00	83	22055.7	100.00

Notes: [a] Data made available from BOI is of a cumulative nature and does not permit conversion to $ on annual basis; [b] Sectoral share of total FDI from India.
Source: Refer to S. Jayasuriya and D. Weerakoon. 2001. India–Sri Lanka Trade and Investment Links. In P. Shome (ed.) *India and Economic Cooperation in South Asia*. New Delhi: Indian Council for Research on International Economic Relations for data pertaining to 1999. Refer to Board of Investment of Sri Lanka for data pertaining to 2006.

The positive business climate and confidence in relations between India and Sri Lanka generated as a result of the ISFTA no doubt contributed in part to the significant increase in Indian FDI in Sri Lanka during the late 1990s and thereafter. According to Kelegama and Mukherji, 40 Indian manufacturing projects were operating in the country (in 2007) as a result of investments driven by the FTA (see Table 5.5).[38] Besides, over 50% of Indian joint ventures and wholly owned subsidiaries in the SAARC region are located in Sri Lanka while 54% of the total equity invested by Indian companies in regional joint ventures is located in Sri Lanka.[39] As evident, the overwhelming bulk of Indian FDI in the manufacturing sector is concentrated in the vanaspati and copper sectors. Other sectors, which have attracted Indian investment, are steel, cement, rubber products, tourism, computer software, IT training, and other

[38] Saman Kelegama and I.N. Mukherji. 2007. India–Sri Lanka Bilateral Free Trade Agreement: Six Years Performance and Beyond. RIS Discussion Papers No. 119.

[39] www.boi.lk.

professional services where there is considerable potential for Indian FDI. For example, the rubber sector has attracted significant attention. Sri Lanka, as a net exporter of natural rubber had been seeking greater access to the protected but growing Indian market, but with little success until the late 1990s. On the other hand, India has successfully penetrated the transport equipment market of Sri Lanka and there has been a large influx of Indian made vehicles creating opportunities for firms to supply rubber products, such as tires, for these vehicles. To the extent that further liberalization or preferential measures may ease Sri Lanka's access to Indian rubber and rubber goods markets, there is clearly an opportunity developing for export-oriented investments in Sri Lanka that can target the Indian market.[40]

Table 5.5: Indian Manufacturing Projects in Sri Lanka Related to the ISFTA

Products	*Country*	*No. in operation*
Copper and copper based products	India/UAE	10
Vanaspati (vegetable oil)	Singapore/Malaysia/Sri Lanka	9
Electrical and electronic products	India/US	7
Lead and lead-based products	India	2
Zinc oxide	India	1
Other chemicals and chemical-based products	India/US/Sri Lanka	3
Marble products	India	3
Pine resins	India	2
Rubber-based sports goods	India	1
Ghee from milk cream	India	1
Diamond cutting tips	India	1

Source: Saman Kelegama and I.N. Mukherji. 2007. India–Sri Lanka Bilateral Free Trade Agreement: Six Years Performance and Beyond. RIS Discussion Papers No. 119/2007.

Indian investment into Sri Lanka has also increased substantially since the FTA came into operation. Cumulative Indian investment which was a mere Rs165 million in 1998 increased to $125.925 million by 2008, contributing to

[40] One firm that has invested in the Sri Lankan rubber goods sector is Ceat Pvt Ltd (Ceat), the flagship company of one of the India's largest group of companies, RPG Enterprises.

14% of total FDI flows to Sri Lanka (Board of Investment of Sri Lanka, 2008).[41] India is now the second biggest investor in the country, exceeded only by Malaysia. The bulk of Indian investment (63%) in Sri Lanka in 2007 has been in the services sector, being focused in sectors such as telecommunications (Bharti Airtel), health (Apollo Hospitals), retail services (Lanka India Oil Company), energy, hospitality (Taj Hotels), and air transport services (Jet Airways).

Despite the investments in vanaspati and copper, employment creation has remained limited. According to Wickremasinghe, data available from the Sri Lanka Board of Investment suggests that 5,900 employment opportunities had been created.[42] This included close to 1500 employment opportunities in the Indian Oil Corporation (IOC) outlets. These were, however, not new employment creation but rehiring of those who lost their jobs when the ownership of the outlets was transferred from the Ceylon Petroleum Corporation to the IOC. Therefore, the actual employment figure when adjusted downward is lower than what was generally anticipated. Nevertheless, there had been gains. There is evidence that the composition of Sri Lanka's exports to India have diversified with more products being exported than before.

While the dominance of services suggests that the impact of the FTA (which only deals with trade in goods) on the investment decision (Indian firms investing in Sri Lanka to take advantage of the FTA to export products to India) is limited, it could be argued that the surge of investment between 2000 and 2008 was influenced by the tighter economic ties between the two countries and increased investor confidence as a result of the FTA.

According to latest figures (2010) from the Board of Investment (BOI) of Sri Lanka, India is among the top five overall investors in Sri Lanka. Investments from India picked up rapidly after the signing of the FTA. The FTA has spurred bilateral investments by capitalizing on the opportunities generated by the FTA and availing of the comparative advantages both countries possess. Total investments from India are estimated to be about $400 million. Investment projects in various stages of implementation for which Sri Lankan Board of

[41] http://www.networkideas.org/ideasact/dec09/pdf/Saman_Kelegama.pdf. Last accessed on 27 Oct. 2012.

[42] U. Wickremasinghe. 2006. Indo-Lanka Free Trade Agreement: A Survey of Progress and Lessons for the Future. Paper presented at the Roundtable on Regional Integration, 24 November 2006, Colombo, Sri Lanka.

Investment approvals have been obtained involve an additional investment of approximately $300 million.

During 2002 and 2003, India was the largest investor in Sri Lanka. However, investments slowed down subsequently as reflected in India's fourth position in 2004, fifth in 2005 and ninth in 2006. In 2007, again investments from India rebounded, and India was placed at fourth position. In 2008, India was ranked second in 2008 among major investors into Sri Lanka.[43] The successful examples of India–Sri Lanka FDI and technical collaboration are presented in Table 5.6.

Table 5.6: Successful Examples of India–Sri Lanka FDI and Technical Collaborations

Indian Company	*Sri Lankan Company*	*Type of Collaboration*	*Sector*
Tata Infotech	John Keells Institute of Information Technology (Pvt) Ltd	Technical collaboration	IT
Aptech Ltd., India	MackwoodInfotec (Pvt) Ltd	Technical collaboration	IT
CEAT India	CEAT-Kelani Associated Holdings Ltd	Joint venture between RPG Goenka Group, India, and the Associated Motorways Group, Sri Lanka	Tire manufacturer
Bengal Waterproof Ltd, Calcutta, India	Bensiri Rubber Products (Pvt) Ltd	Wholly owned subsidiary	Rubber
Ishar Group, Indore, India	GTB Colombo Corporation Pvt Ltd	Subsidiary of Ishar Group	Alloy and special steel
Gujarat Ambuja Cement, India	Ceylon Ambuja Cement and Midigama Cement	Wholly owned subsidiaries	Cement
Indian Hotels Co Ltd	Taj Lanka Hotels Ltd	Subsidiary	Hotels
Asian Paints Ltd	Asian Paints Lanka Ltd	Subsidiary	Paints

[43] Investments and Development Cooperation between India and Sri Lanka, Indian Embassy in Sri Lanka, Colombo, extracted from http://www.hcicolombo.org/index.php?option=com_pages&id=6. Last accessed on 27 October 2012.

Indian Company	*Sri Lankan Company*	*Type of Collaboration*	*Sector*
Nilkamal Plastics, Bombay, India	Nilkamal Easwaran Plastics (Pvt) Ltd	Joint venture between Nilkamal Plastics, Bombay, India and the Easwaren Brothers Group, Sri Lanka	Property development, import and export trading, and manufacturing activities
Gujarat Glass Ltd	Ceylon Glass Company Ltd	Owned by acquisition	Glass
NIIT Ltd, India	Unisoft Institute of Technology (Pvt) Ltd		Joint venture IT

Source: Asian Development Bank and United Nations Conference on Trade and Development. 2008. Impact of SAFTA on Inward and Outward Foreign Direct Investments. In *Quantification of Benefits From Economic Cooperation in South Asia*. Macmillan India Ltd: New Delhi, p. 66.

The increase in Indian investments to Sri Lanka has been a more visible indirect benefit of the ISFTA. India was the world's second largest investor in Sri Lanka; investing $126 million in 2008, second only to Malaysia (which invested $150 million in 2008). This was a contribution of 14% of total FDI inflows to Sri Lanka, and was a marked increase from the previous investment levels during 1978–1995 which amounted to just 1.2% of total investments. The number of projects too increased from 18 in 1999 to 83 in 2006, with a majority of Indian investment being in telecommunications, retail services, energy, hospitality, trade, and air transport services. An example of an Indian investment success story has been the entry of Piramal Glass (acquisition of Ceylon Glass Company), which is now not only catering to the Sri Lankan market but has also begun exporting nearly 70% of their output to the Indian market. The list of the Indian companies in Sri Lanka is presented in Table 5.7.

In contrast to Indian FDI in Sri Lanka, Sri Lankan investments in India are very few reflecting the low volume of outbound FDI from Sri Lanka in general. However, since 1990s, investment from Sri Lanka to India has risen though the flows are low in value. Some successful ventures include outbound FDI in confectionary, apparel, and furniture. In services, the most significant have been in banking and leisure sectors.

Table 5.7: List of the Indian Companies in Sri Lanka

Taj Lanka Hotels Ltd.	Subsidiary of Indian Hotels Co Ltd.	Hospitality
Asian Paints Lanka Ltd.	Acquired majority shares in Delmege Paints Ltd.	Paints
Nilkamal Easwaran Plastics (Pvt) Ltd	Joint venture with Nilkamal Plastics	Plastic products
Ceylon Glass Company Ltd.	Joint venture with Gujarat Glass Ltd.	Glass containers
Unisoft Institute of Technology (Pvt)	Joint venture between NIIT Ltd., and Exemplary Exports Ltd. Singapore	IT training
Life Insurance Corporation Lanka Ltd.	Joint venture of the global life giant Life Insurance Corporation of India and Bartleet & Co. Ltd. Sri Lanka,	Insurance
Watawala Plantations Ltd.	Tata Tea Ltd.	Tea
L&T Co. Ltd.	Joint venture between Ceylinco insurance and Larsen & Toubro of India	Cement
Rediffusion DY & R	Owned subsidiary of Rediffusion	Ad agency
Indian Airlines	Indian Airlines	Airlines
Lanka Ashok Leyland	Joint venture between Ashok Leyland and the Government of Sri Lanka.	Assembles the chassis and builds bodies
ICFAI Education Lanka	Subsidiary of ICFAI, India	Higher education
ICICI Bank	Owned by ICICI	Banking service
Lanka Indian Oil Corporation (LIOC)	Owned subsidiary of IOC	Petroleum products and services
VSNL Lanka	Owned subsidiary of Tata Indicom– VSNL	Telecommunication
MackwoodInfotec (Pvt) Ltd.	Aptech Ltd. (technical collaboration)	Career and professional courses
CEAT-Kelani Associated Holdings Ltd	Joint venture with CEAT India	Tires
Bensiri Rubber Products	Owned subsidiary of Bengal Waterproof Ltd.	Hot water bottles and household gloves

GTB Colombo Corporation (Pvt.) Ltd.	Subsidiary company of the Shri Ishar Group	High tensile deformed bars
Ceylon Ambuja Cement and Midigama Cement	Owned subsidiaries of Gujarat Ambuja Cement	Cement

Source: Board of Investment, Sri Lanka.

The last few years have also witnessed an increasing trend of Sri Lankan investments into India. Main Sri Lankan investments in India include Ceylon Biscuits (Munchee brand), Carsons Cumberbatch (Carlsberg), Brandix (to set up a garment city in Vizag), MAS holdings, John Keels, Hayleys, and Aitken Spence (Hotels). There are also investments in the freight servicing and logistics sector from services industry. Sri Lankan investments in India too have increased, and include areas such as garments, confectionaries, hotels and furniture, with some of Sri Lanka's top blue chip companies opening up ventures there (e.g., Brandix, MAS, Aitken Spence, John Keels).

5.4 HORIZONTAL AND VERTICAL INTEGRATION OF INTRA-INDUSTRY TRADE

Intra-industry trade occurs when a country simultaneously imports and exports similar types of products within the same industry or sector. There are two types of IIT: horizontal and vertical. Horizontal IIT refers to the simultaneous export and import of different varieties of a particular good within the same production stage and in the same quality and price range. This occurs due to product differentiation and the availability of different brands through trade that improve consumer utility through greater choice. Vertical IIT refers to the simultaneous export and import of goods classified in the same sector but which are at different stages of processing. Vertical IIT is used to describe two forms of trade (a) trade in vertically differentiated products in terms of quality and price (where one country exports a lower quality product and the other exports the higher quality product) (b) vertical fragmentation and specialization resulting in trade of the same product at different stages of production. This form of trade received greater attention in the ensuing years in both theoretical and empirical literature.

Rising integration of world markets has not only brought with it a desegregation of the production process but has also generated a break-down in the vertically-integrated mode of production. Product fragmentation refers to cross border dispersion of component production/assembly within vertically integrated processes, with each country specializing in a particular stage of the production sequence and trading the value added components to result in a final product.[44] Product fragmentation first started in the electronics and the garment industries and has subsequently spread to many other industries.[45] The process can now be seen in industries such as automobiles, electrical machinery, telecommunications and television production. Athukorala identifies rapid advancements in production technology, technological innovations in communication and transportation, and liberalization policy reforms in investment and trade in both home and host countries as the three mutually reinforcing developments over the last few decades which have expanded international product fragmentation.[46] In the early stages of 1960s MNEs have been the key players in the process of product fragmentation with a view to taking advantage of cost differentials in different countries. Nevertheless, in recent years fragmentation practices have begun to spread beyond the domain of MNEs.[47]

An attempt has been made here to assess the extent of production fragmentation and IIT between India and Sri Lanka. While regions such as ASEAN have taken full advantage of such new production methods, South Asia region as a whole has been slow to take off. The first step of the study is to assess the extent of IIT and product fragmentation by constructing the Grubel–Lloyd Index (GL index) for India and Sri Lanka. The GL index is a widely used indicator that measures the share of IIT from a data set which has both homogenous and differentiated goods. Since intra-industry integration is an important component in industrial integration, the GL index will be used in this study to see the extent to which IIT takes place between India and Sri Lanka. Grubel and Lloyd provided the definitive empirical study on

[44] Also referred to as "slicing the value chain" (Krugman 1996), "delocalization" (Leamer 1996) and "intra-mediate trade" (Antweiler and Trefler 1997). Footnote 25.

[45] Michael Sharpton. 1975. International Subcontracting. *Oxford Economic Papers*.27(1). pp. 94–135; Robert C. Feenstra. 1998. Integration of Trade and Disintegration of Production in the Global Economy. *Journal of Economic Perspectives*.12(4). pp. 31–50.

[46] P. Athukorala. 2006. Singapore and ASEAN in the New Regional Division of Labour. *Departmental Working Papers* 2006–11. Australian National University. Economics RSPAS.

[47] P. Athukorala and Nobuaki Yamashita. 2007. Patterns and Determinants of Production Fragmentation in World Manufacturing Trade. Accessible at http://rspas.anu.edu.au/~athu/Journal%20Papers/Athukorala%20&%20Yamashita%20April%202007.doc.

the importance of IIT and how to measure it.[48] This measure is calculated as:

$$IIT_{ijk} = [\, \sum(X_{ijk}+M_{ijk}) - \sum |X_{ijk}-M_{ijk}| \;/\; \sum (X_{ijk}+M_{ijk})]*100$$

Where IIT*ijk* is the share of global IIT in the *i*th county in product *k*; IIT*ijk* is the share of IIT in the *j*th country in product *k*; X*ijk* and M*ijk* are respectively exports to and import from country *j* in industry *k*. The measure should by definition, vary between 0 and 100 when expressed as an index. Index value of zero represents that all the trade is inter-industry and there is complete specialization in trade between two countries (the country only imports or only exports goods or services in the same sector), while index value of 100 represents exactly equal exports and imports in a sector or product (a country's exports are exactly equal to its imports within the same sector).

It has been suggested that since developing countries export similar products the possibility of trade between them is limited. However the evidence with industrial countries shows considerable IIT among them. Similarly as developing countries move towards further industrialization the possibilities of IIT emerge with more product differentiation. When this happens, the partner countries may decide to develop different value chains of the same product. The possibilities of setting up joint ventures also emerge so that instead of exporting and importing the same product, one country may decide to set up a joint venture in the partner country (with more favorable investment climate and cost advantage) to buy back the same in the home country. Generally production facility can be built up in the major supplying trade partner as a joint venture with buy-back arrangement in the other partner country as also exports to third countries. The extended scale of production would enable reaping economies of scale that could benefit both the trading partners.

To examine the above-mentioned possibilities, we have examined IIT between India and Sri Lanka at the horizontal level. During the period between 2000 and 2009, intra-industry trade between India and Sri Lanka is taking place in 135 products at SITC 3-digit with more than unity value (and 70 products with less than unity value). Table 5.8 presents the list of the products having more than 20.0 IIT index value between India and Sri Lanka in 2000 and 2009. The products

[48] H.G. Grubel and P.J. Lloyd. 1975. *IIT: The Theory and Measurement of International Trade in Differentiated Products*. Macmillan: London.

Table 5.8: Intra-Industry Trade between India and Sri Lanka at SITC 3-digit Value (in US$ 000s) (sorted by the IIT index value)

SITC 3-digit	*Product description*	*India's export to Sri Lanka*	*India's import from Sri Lanka*	*Trade turnover*	*IIT index value*	*India's export to Sri Lanka*	*India's import from Sri Lanka*	*Trade turnover*	*IIT index value*
		2000				*2009*			
081	Animal feed	9,361	667	10,028	13.300	44,601	44,316	88,918	99.680
793	Ships/boats/etc	80	6	86	14.555	22,184	23,210	45,393	97.740
656	Tulle/lace/embroidery/trimetc	2,106	151	2,258	13.403	3,822	4,265	8,087	94.520
642	Cut paper/board/articles	2,905	644	3,549	36.282	3,082	2,677	5,759	92.972
685	Lead	25	26	51	99.241	2,797	3,993	6,790	82.391
075	Spices	11,409	10,461	21,870	95.663	46,348	29,916	76,264	78.454
625	Rubber tires/treads	3,370	3	3,373	0.189	9,876	6,307	16,184	77.945
845	Articles of apparel *nes*	3,957	11	3,967	0.548	3,934	2,229	6,163	72.333
634	Veneer/plywood/etc	788	8	795	1.990	2,093	3,746	5,838	71.686
892	Printed matter	5,059	379	5,438	13.951	10,442	5,762	16,204	71.116
661	Lime/cement/construction material	24,318	98	24,416	0.804	7,518	3,542	11,060	64.048
292	Crude veg materials *nes*	3,801	1,255	5,055	49.636	7,165	2,107	9,272	45.453
893	Articles *nes* of plastics	7,311	1,559	8,870	35.148	9,786	2,704	12,490	43.297
741	Industrial heat/cool equipment	1,508	122	1,631	14.984	6,983	27,045	34,028	41.044

SITC 3-digit	*Product description*	*India's export to Sri Lanka*	*India's import from Sri Lanka*	*Trade turnover*	*IIT index value*	*India's export to Sri Lanka*	*India's import from Sri Lanka*	*Trade turnover*	*IIT index value*
		2000				*2009*			
074	Tea and mate	1,811	1,906	3,717	97.460	15,919	4,089	20,008	40.875
841	Men's/boys' wear, woven	9,417	6	9,423	0.121	8,236	2,095	10,332	40.560
657	Special yarns/fabrics	1,894	379	2,274	33.363	4,590	1,015	5,605	36.229
682	Copper	930	40	970	8.259	32,242	7,077	39,318	35.997
778	Electrical equipment *nes*	3,096	27	3,124	1.750	7,321	1,550	8,870	34.941
665	Glassware	967	9	976	1.762	1,676	7,951	9,627	34.823
773	Electrical distribution equipment	3,280	15	3,295	0.889	4,592	23,738	28,331	32.419
551	Essential oil/perfume/flavor	1,251	61	1,311	9.228	5,020	678	5,698	23.797
658	Made-up textile articles	3,087		3,087	0.000	5,488	735	6,223	23.629
598	Miscellaneous chemical prods *nes*	2,439	83	2,523	6.616	9,181	1,166	10,348	22.541
848	Headgear/non-text clothing	263	749	1,012	52.036	849	6,799	7,648	22.205
098	Edible products *nes*	2,674	5	2,680	0.405	8,355	949	9,304	20.399
899	Miscellaneous manufacturing articles *nes*	1,735	126	1,862	13.575	8,950	1,016	9,966	20.391

Note: nes not elsewhere specified

Source: Estimated from online WITS Database, 2010.

in IIT having both high volume of trade as well as high value of IIT are the ones that provide for some opportunity for trade-generating joint ventures. There are few such products in India–Sri Lanka trade as presented in Table 5.8.

Some of them having relatively high value and IIT index value (excluding primary products) are animal feed, ships/boats, tulle/lace/embroidery etc., cut paper/board/articles, rubber tires/treads, articles of apparel veneer/plywood etc., lime, cement and construction materials, articles of plastics, industrial heating/cooling equipment, etc. A look at the data shows that Sri Lanka is the larger supplier of table/lace/embroidery, veneer/plywood, industrial heating/cooling equipment, lime, cement and construction materials, articles of plastics, electric distribution equipment, headgear, and non-textile clothing. For such products, possibly an Indian joint venture with a Sri Lankan company could prove to be feasible and cost effective for buyback to India. For other products, given that India is the dominant supplier, joint ventures between Indian and Sri Lankan companies could be set up in India.

An attempt has been made here to present the case study of investment in textiles and apparel (clothing) (T&C) sector of India and Sri Lanka, as textile and clothing sector is South Asia's largest manufacturing sector. It is also a major source of employment and foreign exchange, providing over 55 million direct employment opportunities and close to 90 million indirect employment opportunities to workers in labor-abundant regions.[49] Despite the scope for specialization in the T&C sector, India and Sri Lanka's trade is very low.

Product level specialization based on comparative advantage of India and Sri Lanka in the T&C sector is presented in Table 5.9. According to leading buyers, each country in the region has niche production expertise in a particular kinds of product/s in the T&C industry. India has a comparative advantage in producing cotton knit and woven women's tops, blouses and skirts, embellished and embroidered, fine-gauge yarn whereas Sri Lanka's forte is in producing lingerie, swimwear, and formal wear. India is also popular among buyers for women's tops, blouses, skirts, embellished and embroidered clothing and for men's bottoms. Technical textiles (i.e, geo textiles, medical textiles, space textiles, and non-wovens) are an emerging area, which both private firms and the government have focused on in terms of investment and policy attention. This suggests that there is potential scope for investment

[49] Meenu Tewari. 2008. Deepening Intraregional Trade and Investment in South Asia: The Case of the Textiles and Clothing Industry. ICRIER Working Paper No. 213. Indian Council for Research on International Economic Relations: New Delhi.

between India and Sri Lanka to specialize in different countries based on the comparative advantages of that country within different sub-sectors of apparel products.[50]

Table 5.9: Product Level Specializations (T&C Sector) in India and Sri Lanka

	Comparative advantage from the perspective of global buyers	*Share of top five items in total T&C exports*[a]
Sri Lanka	Lingerie, swimwear of man-made fibers and cotton blends, formals	30%
India[b]	Cotton knit and woven women's tops, blouses and skirts, embellished and embroidered, fine-gauge yarn	44%

Notes: [a] Export shares include shares to the US and EU markets only. [b] Share to the world market.
Source: Meenu Tewari. 2008. Deepening Intraregional Trade and Investment in South Asia: The Case of the Textiles and Clothing Industry. ICRIER Working Paper No. 213. Indian Council for Research on International Economic Relations: New Delhi.

Even though, India is the leading textile manufacturer in the South Asian region, it doesn't produce the type of fabric required by apparel manufacturing countries. For instance, Sri Lanka which specializes in the production of lingerie, swimwear, and non-cotton outerwear is not able to rely on India because India is better known for its cotton fiber base whereas Sri Lanka's requirement is for man-made fiber yarn and fabric. Transportation bottlenecks including port efficiency; time taken to ship in the Indian sub-continent is substantially higher than that in other regions. This raises inventory costs and increases lead time. Shipping times have increased due to varying duty levels and rules of origin criteria. Customs delays also occur due to mismatches between regional and local regulations.

Despite the potential for product fragmentation in India and Sri Lanka, bilateral investment in this sector has been very limited. The largest South Asian investment in the region has been by Brandix, a large Sri Lankan apparel exporter—the 1000 acre park which was set up in India in 2005 with an investment of $750 million. It was expected to grow to $3 billion in 5 years. This factory supplies fabric to Brandix's plants in Sri Lanka, and Brandix hopes

[50] Deshal de Mel and Suwendrani Jayaratne. 2009. *Vertical Integration of Industries in South Asia*. Colombo, Sri Lanka: Institute of Policy Studies.

to use the large and fast growing Indian market to attain economies of scale and access to new market segments (see Table 5.10).

Table 5.10: Investment in Textiles and Apparel in Sri Lanka and India (as of August 2007)

Name	*Ownership structure*	*Product*	*Employment*
Jay Jay Mills (Pvt) Ltd (India)	Joint venture FDI: Sri Lankan Rs. 42 million Local Investment: Rs. 40 million	Manufacture of textiles and fabric	47
Victory Enterprises (Pvt) Ltd (India)	100% foreign owned Rs. 10 million	Bed linen	Not disclosed
	In India		
Brandix (Sri Lanka)	100% foreign owned FDI: $ 750 million	Apparel park including facilities to manufacture fabric	Not available

Sources: 1. Board of Investment of Sri Lanka. August 2007. 2. Meenu Tewari. 2008. Deepening Intraregional Trade and Investment in South Asia: The Case of the Textiles and Clothing Industry. ICRIER Working Paper No. 213. Indian Council for Research on International Economic Relations: New Delhi.

With regard to production fragmentation, it is often third party investment (for instance Japanese investment in ASEAN) which drives the regional production network. Given the potential benefits of production fragmentation in textiles and clothing, India and Sri Lanka should strive towards greater cooperation, making use of their complementary competitive advantages. Strategic utilization of the unique strengths of both countries will improve the clothing and textile sector in the entire region. The institutional framework required to support this would include a regional investment protocol/agreement along with the need for improved trade facilitation, infrastructure development and tariff reduction through further improvement in SAFTA.

5.5 TWO CASE STUDIES

In Boxes 5.2 and 5.3 we discuss case studies of investments of each country discussed so far.

Box 5.2: Case study of Sri Lankan Investor in India: Brandix India Apparel City

Brandix India Apparel City (BIAC) located in the port city of Visakhapatnam in the eastern state of Andhra Pradesh, India, is an integrated apparel supply chain, managed by Brandix Lanka Ltd., Sri Lanka's largest apparel exporter. According to Brandix the BIAC, spread over 1000 acres of land, brings alive the "Fiber to Store" concept and is expected to be a "fully integrated one-stop-shop" with the capacities in spinning, fabric, accessories, and apparel manufacturing. It draws together world class apparel supply chain players with the view of complete vertical integration and BIAC has already been successful in attracting these investors. This smooth flowing verticality is expected to ensure minimum lead times which are the most critical competitive factor. To leverage India's immense potential for economies of scale and other robust business fundamentals, Brandix has invited experts in the industry to join its value chain to enjoy mutual benefits of investment.

BIAC has been built on the premise that the apparel sector demands speed to market, least cost, flexibility, and the assurance of compliance. Investments have been made based on financial and operational incentives which have been heightened by the duty-free status of BIAC. Furthermore, the greater efficiency in distribution and front-end costs resulting from the single location of all value chain partners, a centralized logistics unit and a just-in-time process, is expected to ensure optimal returns. The main strength is in the pool of resources such as labor, power, and water that are available in bulk in India, at a relatively low cost and also access to the large Indian market. The BIAC hosts knit fabric mills, accessory producers such as button and elastic manufacturers, printing, lamination, etc., with the headquarters in Sri Lanka focusing more on front-end activities.

The state government has allotted 1,000 acres of land for the project while the centre has provided Rs. 3.6 billion under the Union Textile Policy. BIAC will provide employment opportunity to 60,000 people in 2010 and providing training to youth under Rajiv Udhyogsree to make skilled manpower available (already trained one million youth). BIAC would have 20 apparel manufacturing plants, three fabric mills, eight accessories factories, and one finishing plant. The apparel city would attract an investment of $1.2 billion (around Rs. 5 billion). Two manufacturing units—Brandix Apparel India and Ocean India (US) have already commenced exports; four others are at different stages of completion. These six companies, on completion, would cumulatively invest about $70 million (Rs. 3,150 million) for factory infrastructure development. Fabric companies like Fountain Set Holdings of Hong Kong, Pioneer Elastic India Quantum Clothing India (UK), DEB Fashion India and Seeds Intimate Apparel India have come forward to set up joint ventures in the BIAC.

Visakhapatnam would attract investments worth about Rs. 680 billion) over the next five years from 2010 to 2015 and see 71,000 new jobs being created. During the last three years, Vizag district attracted Rs. 170 billion) in different sectors. The centre has sanctioned six integrated textile parks for Andhra Pradesh, including in Visakhapatnam, which was the biggest textile park in Southeast Asia.

Box 5.3: Case Study of Indian Joint Venture in Sri Lanka: CEAT Kelani (Pvt) Ltd

Ceat Pvt Ltd (Ceat) is the flagship company of one of India's largest group of companies, RPG Enterprises and Kelani Tyres is the largest industrial tire manufacturer in Sri Lanka. Ceat entered in to a joint venture agreement with the Associated Motorways Pvt Ltd (AMW) in 1993 creating Associate Ceat Pvt Ltd (ACPL). In expanding its future operations in Sri Lanka, with the aim of competing in the global market, ACPL entered into a second joint venture operation with Kelani Tyres in January 1999 in the best interest of all stakeholders.

The aim of the venture was to unite the tire manufacturing processes of ACPL and Kelani Tyres (ACPL was a limited liability company with the following ownership structure: 60% owned by the Ceat group of companies, 35% by Associated Motorways Pvt Ltd, and 5% by the National Development Bank). The companies that resulted from the second joint venture are Ceat-Kelani Associated Holdings (Pvt) Ltd, Ceat-Kelani International Tyres Pvt Ltd (CKITL), and Associated Ceat Ltd. Management control of the Ceat-Kelani joint venture is vested in Ceat Pvt Ltd.

CKITL has three manufacturing units in Sri Lanka that manufacture truck, light truck, radial, motorcycle, three-wheeler, and agricultural tires and has a total workforce of 900 employees. In 2010, the joint venture company was exporting tires to India, Nepal, Pakistan, Bangladesh, Afghanistan, Philippines, Malaysia, Singapore, Egypt, United Arab Emirates, Mauritius, Nigeria, Kenya, Uganda, Ghana, and South America.

Sri Lanka–India joint venture CEAT Kelani (Pvt) Ltd, engages in the manufacturing and sale of tires and tubes locally and internationally. It manufactures cross-ply rubber tires for trucks, buses and three-wheelers at factories in Nungamugoda, Nagoda, Kalutara district, and Kelaniya. It has commenced export of locally manufactured commercial tires to India under concessionary duties resulting from the Indo-Lanka Free Trade Agreement. Kalutara CEAT Sri Lanka offers a range of tires for trucks, light trucks, farm vehicles, two/three wheelers; and radials for cars, and vans. The company also markets tubes and flaps.

Indian tire major CEAT also commissioned a Rs. 350 million radial tire plant at its Sri Lankan unit and built alongside the existing CEAT plant in Kelaniya in 2006.The plant will be the only radial tire project in the country, with an initial installed capacity of 26,000 tires per month. The plant will initially focus on two ranges of radials, for cars and vans (which is currently the most sought-after sizes in the local market). It has recorded a 49% growth during the years of 2009 and 2010 by catering to both export and domestic markets. In the year ending 31 March 2010, CEAT increased its profit after tax by more than five times over the previous year on sales of Rs. 5.4 billion. Their domestic sales grew by 25% during the last few years. With this proposition the company was able to secure market lead positions in almost all categories in the tire market. The company's export revenue grew by 96% and continues to be steady in the year 2010. The company penetrated new markets like Egypt, Syria, Cambodia, Nigeria Singapore, Dubai, and Vietnam. Its market share in the truck and light truck, three-wheeler and radial segments have grown to 59%, 39%, and 18% respectively, making it the single highest brand in these categories.

The second joint venture (Kelani–Ceat) was seen to be mutually beneficial to both parties for several reasons: (a) to avoid mutual competition between the two main players in the market for local tires—APCL and Kelani Tyres, (b) the decision of the Sri Lankan government to reduce the import duty on imported tires, making locally produced tires relatively expensive and less competitive (in the light of this, horizontal integration was seen as essential for the future viability of the local tire manufacturing industry) (c) to obtain the advantages of economies of scale, by lowering the costs of production via horizontal integration, (d) to capitalize on the high demand for pneumatic tires, (e) Kelani Tyres has an established image and is popular in the domestic market, while Ceat is a familiar brand name in the international market, (f) therefore the joint venture could increase gains through expansion of both domestic and export offtake, and (g) an up-to-date cross-ply manufacturing facility, which can increase production levels. By October 1999 the venture started making butyl rubber tires, motorcycle tires by January 2000 and gradually proceeded to manufacture steel radial tires.

Clearly this shows the kind of incentives that are present for intra-regional trade and investment linkages. The initial trade liberalization in Sri Lanka permitted early penetration of the vehicle market by Indian firms. This also created opportunities for Indian tire manufacturers to supply to the Sri Lankan market, using their specific technological assets and Indian production bases. The privatization program in Sri Lankan provided an investment opportunity to capitalize on cheap Sri Lankan natural rubber- reflecting the country's comparative advantage and acquire a Sri Lankan production base. Indian liberalization facilitated outward FDI. The firm-specific assets enabled the firm to produce tires for both the Sri Lankan and export markets, where the tires could be more competitive due to cheaper raw material costs. Now, a reduction in Indo-Sri Lanka trade costs, through the Indo-Lanka Free Trade Agreement, or other means, can help increase supplies to the Indian market and also reap greater scale economies.

5.6 MEASURES TO ENHANCE EFFECTIVENESS OF BIPA AND DTTAS

5.6.1 Effectiveness of BIPAs and DTTAs: A Regional Perspective

If the situation of intra-regional trade flows in South Asia is disappointing, the picture of intra-regional investment flows is far worse. The participation of South Asian countries in other forms of FDI undertakings such as Bilateral Investment Treaties (BITs) and Double Tax Avoidance Treaties (DTTs) is negligible. Although South Asian countries are involved in 198 BITs, overall, there are only four BITs in the region. Similarly, South Asian countries are involved in total 228 DTTs, but there are only four DTTs that are in force primarily among India, Pakistan, Bangladesh, and Nepal. Bhutan and the Maldives are not members of any such treaty.

In a bid to promote and protect investments in the region, a Draft Regional Agreement on Promotion and Protection of Investment within SAARC has been under consideration since September 1997. However, progress has been excruciatingly slow. India has entered into Double Taxation Avoidance Agreements (DTAAs) with 65 countries including Sri Lanka, USA, UK, Japan, France, Germany, etc. These agreements provide relief from double taxation in respect of incomes by providing exemption and also by providing credit for taxes paid in any one of the countries. Some DTAAs provide that income by way of interest, royalty or fee for technical services is charged to tax on net basis. This may result in tax deducted at source from sums paid to non-residents which may be more than the final tax liability.

One of the important terms that occur in all the DTAAs is the term "Permanent Establishment" (PE) which has not been defined in the Income Tax Act. However as per the DTAA, PE includes a wide variety of arrangements, i.e., a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state. Tax is computed by treating the PE as a distinct and independent enterprise. In case of countries with which India has DTAA, the tax rates are determined by such agreements and are indicated for various countries as under dividend, interest, royalty, and technical fee.

The Sri Lankan government has also entered into agreements with a number of countries to avoid double taxation. These agreements have been ratified by Parliament and have the force of the law. The counterparties to these double taxation agreements (the "Contracting States") are Australia, Bangladesh, Belgium, Canada, Czechoslovakia, Denmark, Finland, France, Germany, India, Italy, Japan, Republic of Korea, Kuwait, Malaysia, Norway, Pakistan, Philippines, Poland, Romania, Singapore, Sweden, Switzerland, Thailand, the Netherlands, the United Kingdom, the USA, and Yugoslavia. These agreements apply to persons who are residents of one or both of the contracting states.

As of now, BITs in the South Asian region are underutilized and investor protection mechanism needs to be strengthened. Participation of South Asian countries in forms of FDI undertakings such as BITs and Double Tax Avoidance Treaties (DTATs) at the regional level is small. Though countries are involved in more than 100 BITs, only two BITs involve countries in the region (covering India, Pakistan, and Sri Lanka); Bhutan and Maldives have no such treaties (see Table 5.11).

South Asia should ensure the conclusion and implementation of BITs, which aim to protect investments abroad, particularly in cases where investor rights are not already protected through existing agreements, and encourage the adoption of market-oriented domestic policies that treat private investment in an open and transparent way. Investment treaties negotiated among South Asian countries should ensure that the investors in a host country are treated as favorably as the host country's local investors throughout the full cycle of the investment (from establishment, acquisition, management to operation and expansion). The BITs should set clear limits on expropriation and provide effective compensation when expropriation does take place. Market exchange rates should be used when investment related funds are transferred into and out of a host country. Those BITs that promote intra-regional investment should also restrict the imposition of performance requirements, such as local content targets or export quotas, as a precondition for an investment. If future trade agreements in South Asia include chapters on investment, terms should be carefully aligned with existing BITs for investment harmonization.

Table 5.11: BITs and DTTs in South Asia (as of October 2011)

Country	*BITs*		*DTTs*	
	Total	*Intra-regional*	*Total*	*Intra-regional*
India	84	with Sri Lanka	83	4 - Involving Sri Lanka, Nepal, Bangladesh
Pakistan	48	with Sri Lanka	67	3 - Involving Sri Lanka, Bangladesh
Sri Lanka	28	with India and Pakistan	43	4 - Involving India, Pakistan, Nepal
Nepal	05	None	07	3 - Involving India, Sri Lanka
Bangladesh	30	None	27	4 - Involving India, Sri Lanka, Pakistan
Afghanistan	03	–	01	
Bhutan	0	–	0	
Maldives	0	–	0	
Total :	198		228	

Note: BIT Bilateral Investment Treaty; DTT Double Tax avoidance Treaty
Source: Compiled from United Nations Conference on Trade and Development (UNCTAD), October 2011.

Expanding intra-regional investment is the key to bolstering the investment regime in South Asia. The sources of FDI are highly diversified in most SAARC countries, though mostly still originating in developed countries, outside the region. India, which is industrially the most advanced country in the region, attracts most of its FDI inflows from countries outside the region. According to India's Ministry of Commerce and Industry FDI statistics, the top investing economies from 2000–2009 were Mauritius (44% of FDI inflows to India), Singapore (9%), the US (8%), and the UK (5%), followed by the Netherlands (4%) and Japan (3%). For Bangladesh and Pakistan, investors are also predominantly from outside the region. While India is a top investor in Nepal and Sri Lanka, accounting for more than two-thirds of inflows into those countries, there is strong case for deeper intra-regional investment. India and Nepal have signed a revised tax treaty (replacing the 1987 treaty) on 27 November 2011 which will facilitate exchange of information on banking between the two countries and will exempt Indian investors and traders from taxes in India once they pay tax in Nepal.

Intra-regional investment in South Asia is stymied by two main restrictive policies in South Asia: (i) the number of excluded sectors, particularly those sectors across countries that may have complementarities if they are opened up (e.g., textiles and garments, retail trading); and (ii) strict equity requirements. For example, in Sri Lanka, investment in retail trading is not permitted with capital of less than $1 million. India imposes restrictions on investment in private sector banks, insurance, telecommunications, and certain types of mining of less than 100%. Nepal does not allow investment in cottage and small-scale industries. In Bhutan, various controls are applied to investment transactions.

Deepening regional cooperation on investment among South Asian economies, as well as addressing issues such as, visa scheme for business travelers, motor vehicular agreement, non-tariff barriers (NTBs), and low-cost country sourcings (LCSs) would be substantial catalysts to improving the business environment and making South Asia a more attractive destination for investment. While South Asia has progressively started to liberalize FDI policies in the last decade, divergent policies among individual countries remain stumbling blocks. The investment regime in SAARC is not only restrictive but lacks policy harmonization. Supporting mechanisms are needed to support the flow of capital and to help attract more FDI from members. While a coordinated program of regulatory reform and investment climate harmonization will take time, efforts at the national level through individual country reforms are a significant first step.

5.6.2 Measures to Enhance the Effectiveness of BIPAs (at Bilateral Level) between India and Sri Lanka

In order to promote and protect on reciprocal basis investment of the investors, Government of India and Sri Lanka signed Bilateral Investment Promotion and Protection Agreement (BIPA) on 22 January 1997 which came into force on 13 February 1998.[51] The objective of BIPA is to promote and protect the interests of investors of either country in each others territory. Such agreements increase the comfort level of the investors by assuring a minimum standard of treatment in all matters and provides for justifiability of disputes with the host

[51] Government of India has, so far, (as on 9 December 2011) signed BIPAs with 82 countries out of which 72 BIPAs have already come into force and the remaining agreements are in the process of being enforced.

country. The ISFTA completed a decade of its operation in March 2010. The proposed Indo-Sri Lanka Comprehensive Economic Cooperation Agreement (CEPA) seeks to further enhance investment cooperation between the two countries. Therefore, there is an urgent need to review the existing BIPA and the Avoidance of Double Taxation and Prevention of Fiscal Evasion Agreement by the both the countries in order to enhance their scope and effectiveness. This section is devoted to review the existing BIPA between India and Sri Lanka to promote investment cooperation and boost confidence of investors under the proposed India–Sri Lanka CEPA.

Very recently India and Nepal have revised their BIPA on 21 October, 2011. This has been taken as a template for making similar modifications to India–Sri Lanka BIPA. An analysis of the contents of the agreement with that of India–Sri Lanka BIPA of 1997 leads us to suggest primarily two modifications. First, there is a need to revise the term "expropriation" to include indirect expropriation, the determination of which requires case-by-case fact-based enquiry. The factors to be taken into account are whether the measures are discriminatory in nature, or are applied so severely as not to be viewed as having been applied in good faith for achieving their objectives.[52]

Further, the India–Nepal BIPA incorporates a new article not present in the India–Sri Lanka BIPA. This relates to denial of benefits. The sense of the article is that the investor of one contracting state can be denied benefits of its investment in another contracting state if it is found that persons non-party to the agreement control the investor while the hosting contracting state has no diplomatic relations with the non-party. Further, such denial of benefits would be applied in case it is found that the investor has no enterprise having substantial business activities in the hosting contracting state, and persons of non-party or hosting/denying contracting state own or control the enterprise.[53]

5.6.3 Measures to Enhance the Effectiveness of India–Sri Lanka Bilateral Double Tax Avoidance Treaty Agreements

The Government of the Republic of India and the Government of the Democratic Socialist Republic of Sri Lanka have signed a Double Taxation

[52] See texts of agreement between the Government of the Democratic Socialist Republic of Sri Lanka (22 January 1997) and agreement between the Government of Nepal and Government of India for the Promotion and Protection of Investments (21 October 2011).

[53] Footnote 56.

Avoidance Agreement and the Prevention of Fiscal Evasion with respect to taxes on income and on capital on 27 January 1982. Some time has elapsed since this agreement was signed. Thus, the current DTTAs between India and Sri Lanka require modifications and amendments to enhance the effectiveness of the treaties.

Again, taking a cue from template of the DTTA recently signed between India and Nepal on 27 November 2011, one may suggest a few modifications to the old DTTA signed between India and Sri Lanka in 1982.

It should include a clause on exchange of information regarding the banking sector and enter into a tax information exchange agreement (TIEA) including tax havens to help prevent tax evasion. This exchange or sharing the banking sector information will assist both the countries in the collection of taxes across tax authorities and the anti-abuse provisions. It will also ensure that the benefits of the agreement are availed of by the genuine residents and not misused by third country residents.

Further, the information received can be shared with other law enforcement agencies with the consent of the information supplying country. This revised clause will also provide stability to the residents of India and Sri Lanka and facilitate mutual economic cooperation and stimulate the flow of investment, technology and services between India and Sri Lanka. DTAA and TIEA are two important instruments which will help the income tax department tackle black money stashed abroad and enable them to impose taxes. In the absence of a clause on the banking sector in the DTTAs, the contracting countries cannot share information in this regard. Strengthening of the transfer pricing mechanism will help both the governments to prevent outflow as a result of dubious practices.

The inclusion of exchange of banking and tax information between India and Sri Lanka in the DTTA would also help in the assessment of taxes and one-time payment in the source or destination country whenever necessary. Further, the threshold withholding tax rates on dividends and interests also need to be rationalized as per international taxation requirements. Hence, the existing rates on dividends should be reduced to 10% (from 15%) and interest rates 7.5% from 10% between India and Sri Lanka.

The agreement on avoidance of double taxation and the prevention of fiscal evasion between India and Sri Lanka needs to incorporate some of the articles related to (a) definition of permanent establishment, (b) income from immovable property, business profits, profit derived from shipping and transport, income from associate enterprises, capital gains, independent and dependent personal services, director's fees, artistes and sportspersons, pensions, government services, professors, teachers, research scholars, students, (c) methods for elimination of double taxation, (d) non-discrimination and mutual agreement procedure, (e) exchange and sharing of information and assistance in the collection of taxes, (f) limitation of benefits and termination of agreement. Inclusion of these articles will not only stimulate the flow of investment but also generate confidence among the investors of both countries.[54] The earlier treaty (27 January 1982) was sketchy and vague and did not incorporate these provisions.

5.7 CONCLUSION

The overall assessment that emerges from this study is that both India and Sri Lanka have created a conducive business environment to enhance bilateral investment flows through the liberalization of the FDI regulatory framework. The progressive liberalization investment regimes (in both India and Sri Lanka) have already transformed the nature of economic links between them, and this process looks set to continue even further.

Prior to the launch of ISFTA, Indian investment in Sri Lanka was limited to food, beverages and tobacco, chemical, petroleum, rubber and plastic products but in 2006, it was diversified to include services, fabricated metal products, machinery and transport equipment, manufactured products, and non-metallic mineral products.

In contrast to Indian FDI in Sri Lanka, Sri Lankan investments in India are very few reflecting the low volume of outbound FDI from Sri Lanka in general. However, since 1990s, investment from Sri Lanka to India has risen (though the flows are low in value). Some successful ventures include outbound FDI in confectionary, apparel, and furniture. In services, the most significant have been in banking and leisure sectors. Main Sri Lankan investments in India include Ceylon Biscuits (Munchee brand), Carsons Cumberbatch (Carlsberg), Brandix (to set up a garment city in Vizag), MAS holdings, John Keels, Hayleys, and Aitken Spence (Hotels). There are also investments in the freight servicing and

[54] Based on an examination of the contents of DTAA between India and Sri Lanka (27 January 1982) and agreement between the Government of Nepal and Government of India for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.

logistics sector from services industry. Sri Lankan investments in India include areas such as garments, confectionaries, hotels and furniture, with some of Sri Lanka's top blue chip companies opening up ventures here (for example, Brandix, MAS, Aitken Spence, John Keells).

These two countries are also moving towards further industrialization. The possibilities of intra-industry trade emerge with more product differentiation which certainly requires different value chains of the same products. The estimated horizontal IIT suggests that instead of exporting and importing the same product, India may decide to set up a joint venture in Sri Lanka (with more favorable investment climate and cost advantage) to buy back the same in the home country (or vice versa). This study highlights some possibilities of both India and Sri Lanka to set up joint ventures in each other's markets to meet the requirements in the other country's market or even beyond.

India and Sri Lanka have not yet transformed to high trade complementarities due to the lack of vertical specialization through a production-sharing arrangement. Hence, vertical specialization will certainly allow them to reap economies of scale by concentrating on a specific production process in the value addition chain. There is a need to evolve production agreements between both countries in specific sectors (that is textiles and clothing, leather, rubber and electronics) which could qualify for this production integration schemes.

Safe and congenial climate for investment is one essential prerequisite for enabling the flow of investments between two sovereign countries. Further, the entrepreneurs in both the countries must ensure that their investors venturing abroad are not taxed twice; once in the host country, and subsequently when they repatriate their profits to their home countries. The study has highlighted some of the measures to enhance the effectiveness of BIPAs and DTTAs between India and Sri Lanka (based on the template of India-Nepal BIPA and DTTA) as suggested by India- Sri Lanka Study Group on CECA. To promote and protect the interests and increase the comfort level of the investors by assuring a minimum standard of treatment in all matters, both countries should take initiative to revise the clause "expropriation" and include article on "denial of benefits" under India–Sri Lanka BIPA. Further, once the existing DTTA between India and Sri Lanka incorporates a clause on exchange of information on banking sector and enter into tax information exchange agreement (TIEA) including tax havens, it will certainly help to prevent tax evasion and provide stability to the residents of the both countries.

It will also facilitate mutual economic cooperation and stimulate the flow of investment, technology, and services between India and Sri Lanka.

It is encouraging that large Indian investors have shown an increasing interest in investing in various sectors in the Sri Lankan economy, responding positively to opportunities created by the ISFTA and continuation of economic liberalization. FDI outflows from Sri Lanka to India, even though relatively small, have increased since the implementation of the ISFTA. The most interesting recent development (2000–10) is that the FDI flows between the two countries changed from a mere one-way flow to an increasingly two-way relationship.

6

Trade in Services between India and Sri Lanka

Deshal De Mel and Anushka Wijesinha

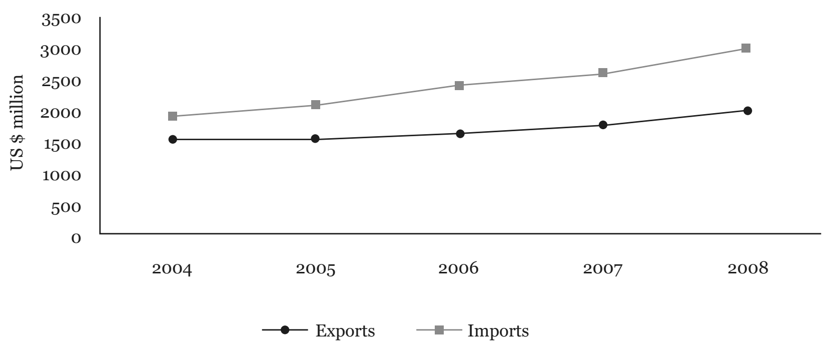
6.1 INTRODUCTION

Economic relations between Sri Lanka and India changed dramatically since the two countries entered into the Indo-Sri Lanka Free Trade Agreement (ISFTA) in 1998. Since then bilateral merchandise trade has grown at a rapid rate. India is now the largest source of imports for Sri Lanka and is the third highest export market after the US and the EU. The governments of the two countries realized that given the early success of the Free Trade Agreement (FTA), it is important to move beyond trade in goods, and as was recommended in the report of the Joint Study Group of 2003, it was decided that the FTA would be developed into a Comprehensive Economic Partnership Agreement (CEPA) which would incorporate trade in services, investment, and economic cooperation in addition to further development of trade in goods. In this paper we will examine the inclusion of trade in services in the CEPA between India and Sri Lanka.

Services account for 59.5% of GDP in Sri Lanka and approximately 55% in India and therefore true economic integration would require services to be taken into account. In India, trade in services has been an important source of economic development, particularly in terms of the role played by IT and business process outsourcing outfits or BPOs. Trade in services has been less significant in Sri Lanka, but service exporters have seen success in certain niche markets and exports of services have begun to grow in recent years.

It is clear from Figures 6.1 and 6.2 that India's trade in services is higher in magnitude and growth. It has been more dynamic than in Sri Lanka particularly exports.

Figure 6.1: Sri Lanka's Trade in Services (2004–2008)



Source: ITC Trade in Services Statistics

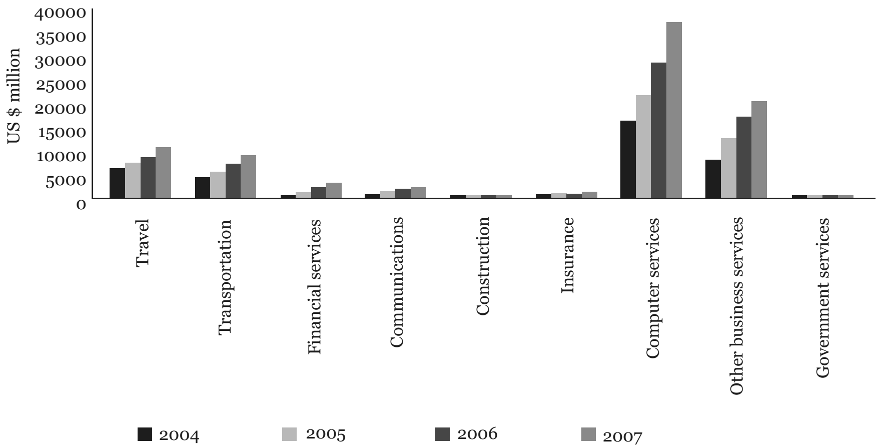
Figure 6.2: India's Trade in Services (2004–2007)

Source: ITC Trade in Services Statistics

6.2 TRADE IN SERVICES BY SECTOR: EXPORTS

Figure 6.3 and Table 6.1 present India's service exports disaggregated by sector. This figure clearly shows that the main drivers of the export boom in India's services have been IT and BPO (other business services). At the same time there has been a steady growth in sectors such as transport and travel, and financial

Figure 6.3: Indian Service Exports by Sector



Source: ITC Trade in Services Statistics

Table 6.1: India's Service Exports by Sector
($ million)

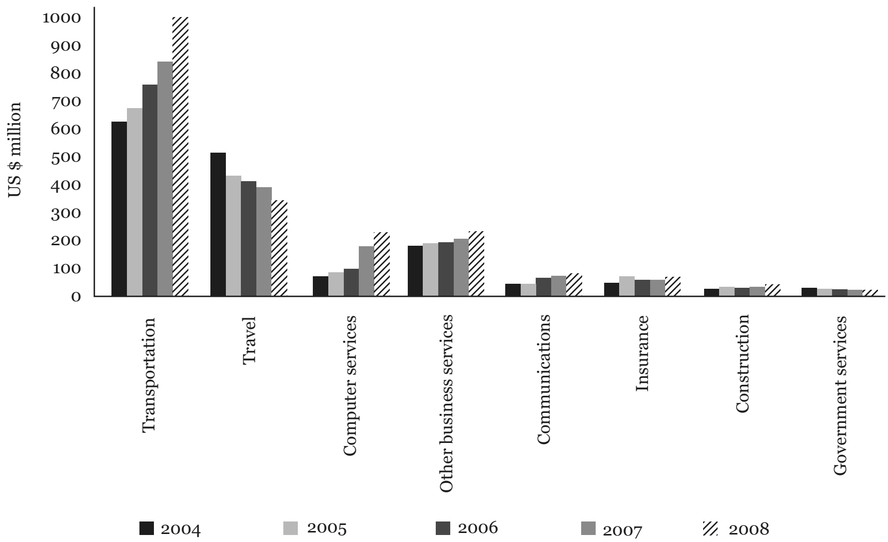
	2004	*2005*	*2006*	*2007*
Travel	6169.69	7492.85	8633.89	10729
Transportation	4372.78	5754.08	7561.01	9035.32
Financial Services	341.18	1143.02	2356.97	3378.96
Communications	1093.76	1565.92	2181.08	2347.93
Construction	516.17	345.78	618.94	753.2
Insurance	841.83	941.08	1113.18	1506.7
Computer Services	16344.3	21874.9	29088.1	37491.2
Other Business Services	8152.62	12764.4	17535.5	20733.6

Source: ITC Trade in Services Statistics

services have grown rapidly, if from a small base. The BPO sector has faced some setbacks due to demand contractions in markets in the US and Europe and also tendencies towards protection. The role of certain service sectors, where data is not well captured in formal statistics, is often neglected in such analyses. In India, sectors such as health services and tertiary education services have become increasingly important, particularly through mode 2 exports (especially in South

Asia) and also increasingly through modes 1 and 3. India's flagship private sector health service provider, Apollo Hospitals, invested in Sri Lanka in the period between 2000 and 2005, and many Sri Lankan patients traveled to India to obtain treatment. Likewise many Sri Lankan students study in Indian universities.

Figure 6.4: Sri Lankan Service Exports by Sector



Source: ITC Trade in Services Statistics

Table 6.2: Sri Lanka's Service Exports by Sector
($ million)

	2004	*2005*	*2006*	*2007*	*2008*
Transportation	624.16	673.37	750.7	837.8	999
Travel	512.88	429.06	410.3	385.3	342
Computer Services	72	82.47	98	175.2	230
Other Business Services	178.21	187.64	190.4	196.4	222
Communications	42.81	43.87	67.9	72	81
Insurance	50.33	72.97	57.2	55.2	68
Construction	25.89	29.36	29.2	32.8	40
Government Services	20.32	21.39	21.21	20.3	21

Source: ITC Trade in Services Statistics

In Figure 6.4 and Table 6.2 Sri Lanka's service exports by sector are depicted. From this it is clear that in recent years Sri Lanka's service exports have been dominated by transport services which comprised almost 50% of total service exports in 2008. The Colombo Port and Sri Lankan airlines are key drivers in this regard. While both sub-sectors suffered in 2009 due to the global economic crisis, with the end of the civil war in 2009, it was expected that both sub-sectors will continue to regain ground after 2010. The same applies to the travel sector (to a greater extent) as tourism has already been growing rapidly since the end of the conflict.

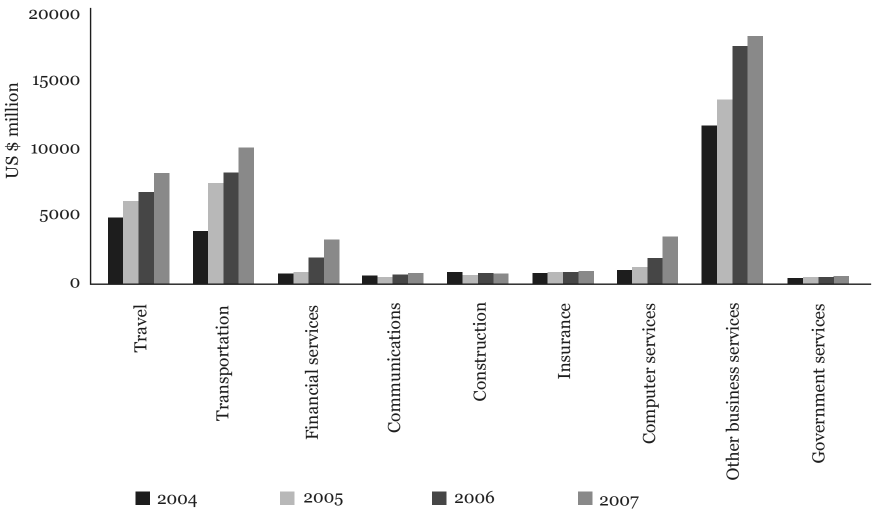
Sri Lanka's IT sector, though nascent, has been growing at a rapid rate in recent years (though base effects are significant), overtaking the contribution of BPOs. Other than transportation (particularly maritime services) and tourism, there are no large scale export interests of services in Sri Lanka. Evident in Sri Lanka's recent experience is the capturing of certain niche markets by Sri Lankan firms, particularly in IT and BPO. In IT for instance, certain Sri Lankan firms have been able to sell services in India despite India's obvious comparative advantage in this sector (Interblocks sold internet banking solutions to Indian banks, Microimage provided Tamil SMS adoption to Airtel India). Unlike India, Sri Lanka as yet has not been able to generate significant trade in services in sectors such as health and tertiary education; however export of tertiary education is within the longer term plans of the government.

6.3 TRADE IN SERVICES BY SECTOR: IMPORTS

Table 6.3 and Figure 6.5 below present data on India's imports of services between 2004 and 2007. India's most significant service imports are other business services, followed by transport services and travel. Imports of computer services have also been growing at a rapid rate. The demand for financial services has also grown substantially in recent years in India. It is evident that the same sectors where exports have been growing have seen growth of imports as well.

Sri Lanka's major service imports are also transportation, travel, and other business services as may be seen in Table 6.4 and Figure 6.6. Insurance has been relatively important given the high security risk premiums that have had to be paid during the conflict. However this trend is likely to be eased in the coming years.

Figure 6.5: India's Service Imports by Sector



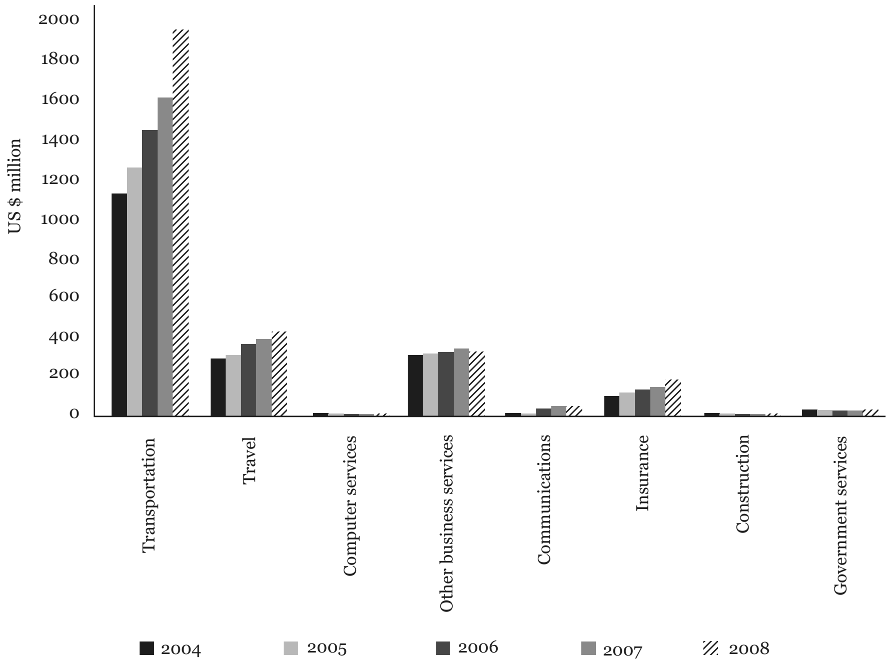
Source: ITC Trade in Services Statistics

Table 6.3: India's Service Imports by Sector
($ million)

	2004	*2005*	*2006*	*2007*
Travel	4815.79	6186.63	6844.96	8219.17
Transportation	3840.73	7413.36	8321.18	10118.7
Financial services	790.57	869.03	1949.9	3236.94
Communications	578.78	418.01	606.07	862.91
Construction	828.7	602.01	793.99	727.99
Insurance	704.1	826.54	834.01	887.13
Computer services	932.19	1265.85	1956.94	3472.81
Other business service	11693.3	13693.8	17593.4	18319.5
Government services	348.11	466.89	473.61	418.47

Source: ITC Trade in Services Statistics

Figure 6.6: Sri Lanka's Service Imports by Sector



Source: ITC Trade in Services Statistics

Table 6.4: Sri Lanka's Service Imports by Sector
($ million)

	2004	*2005*	*2006*	*2007*	*2008*
Transportation	1134.66	1267.5	1462.46	1613.08	1960
Travel	295.98	314.46	373.1	392.9	428
Computer services	0	0	0	0	0
Other business services	315.14	322.01	328.6	349.3	330
Communications	10.2	18.92	49.1	53.9	55
Insurance	110.44	122.94	139.73	152.97	187
Construction	6	5.52	5.52	5.5	6
Government services	35.44	37.39	35.1	34.1	35

Source: ITC Trade in Services Statistics

A cursory examination of the export and import trends in services in India and Sri Lanka suggests scope for complementarities in imports and exports of the services of the two countries, particularly with regard to transport and travel. In order to explore these options further, RCAs in the various traded services were calculated.

6.4 REVEALED COMPARATIVE ADVANTAGES BETWEEN SRI LANKA AND INDIA IN TRADE IN SERVICES

While Sri Lanka had a higher RCA in the travel sector, it declined at the final stages of the civil war (Table 6.5). However with increased tourism in the postwar context, it is likely that Sri Lanka will regain advantage in tourism and travel. Sri Lankan hotels have ventured into India and vice versa, and the trend may continue, with further expansion of mode 4, as the demand for tourism professionals in both countries is likely to increase.

Table 6.5: RCAs in Various Services between Sri Lanka and India

Sector	*Country*	*2005*	*2006*	*2007*
Travel	Sri Lanka	1.05	0.97	0.87
	India	0.54	0.48	0.47
Transport	Sri Lanka	1.95	2.09	2.12
	India	0.49	0.49	0.49
Communications	Sri Lanka	1.25	1.73	1.71
	India	1.31	1.29	1.14
Construction	Sri Lanka	0.95	0.86	0.86
	India	0.33	0.42	0.40
Insurance	Sri Lanka	2.53	1.66	1.44
	India	0.96	0.75	0.80
Computer and related services	Sri Lanka	1.27	1.30	2.06
	India	9.89	8.99	8.98
Other business services	Sri Lanka	0.50	0.49	0.46
	India	1.01	1.06	0.99
Government services	Sri Lanka	0.55	0.52	0.50
	India	0.25	0.16	0.16

Source: Calculated using ITC data

6.4.1 Transport

In the transport sector Sri Lanka has a higher RCA given the dominance of maritime transport and the competence and capacity of Colombo Port. In terms of air services however India is likely to have an advantage given the revolution in that sector following liberalization and the emergence of a number of strong private airlines in India. Sri Lanka has developed a competitive ship repair and building sector and this sector has the potential to export services to countries like India through mode 2.

6.4.2 Communications

Sri Lankan export of telecommunications services has been growing rapidly, largely due to base effect; the telecommunications sector overall was growing rapidly until very recently. The telecommunications export services figures do not include exports through mode 3, and therefore may not be an ideal reflection of true comparative advantage in the sector. India for instance has seen telecom service providers such as Airtel venture beyond its borders, investing in countries such as Sri Lanka. The telecom market in Sri Lanka is at present experiencing intense competition. International penetration through mode 3 may not be possible in the immediate future.

6.4.3 Construction Services

Though neither India nor Sri Lanka enjoys significant RCA in construction services, domestic construction has been growing at a significant rate in recent years due to renewed efforts at infrastructure development and in particular, post-conflict reconstruction in Sri Lanka. Therefore the emergence of large firms involved in construction provides potential for future international expansion and provision of services through mode 3 and to a lesser extent through mode 1. Both countries have been exporting construction services through mode 4, particularly to the Middle East and the Maldives, however many of these have been in low-skilled categories, and this is unlikely to be a potential area of commercial services exchange. Nonetheless, in modes 3 and 1 there is scope for construction and engineering services to be exchanged on a commercial basis between the two countries since the demand for such services is likely to increase in the medium term in both geographies.

6.4.4 Computer and Related Services

As is expected, India has significant RCA in computer and related services. Sri Lanka too enjoys comparative advantages in certain niche areas, as has been demonstrated by the success of some firms in penetrating export markets in this sector. Therefore there is scope for exports in this sector for both countries.

6.4.5 Other Business Services

In terms of RCAs neither country enjoys a significant comparative advantage in other business services, however this does not reflect India's tremendous success in the BPO sector in recent years. While this success has been mainly derived through exports to Western markets (where wages are significantly higher than in South Asia) there is scope for trade in this sector among South Asian countries. Indian firms have expressed an interest in investing in BPO operations in Sri Lanka, taking advantage of the country's large pool of internationally qualified accountants and other professionals. Furthermore, there is scope for Sri Lankan firms to tap into various stages of the BPO value chain in supply of services from India to the West.

It is clear from this section that while there are complementarities between the two countries in terms of comparative advantages, even in sectors where such complementarities do not necessarily exist, there is scope for trade within niche areas and through the equivalent of intra-industry trade in services.

6.5 SOME POLICY ISSUES IN THE LIBERALIZATION OF SERVICES

6.5.1 Business Services

Sri Lanka has much to gain from liberalizing the mobility of people engaged in professional services. For example, in developing infrastructure which is necessary for economic growth especially at this time in Sri Lanka, liberalization of professional services such as architectural, engineering, urban planning, and landscape architectural services is important. In order to achieve this, recognition of professional qualifications among countries through professional bodies and institutions should be done. One could start this process in the areas of IT, accountancy, architecture, engineering, urban planning, and health.

There are limitations on market access for professionals who want to work in Sri Lanka. For example, intra-corporate transferees (defined as having worked in the enterprise for at least 12 months) of enterprises who have notified their commercial presence at the Board of Investment (BOI) shall be allowed to work in Sri Lanka for a period of 3 years, extendable to 4 years, subject to sector-specific commitments. Executives, managers, and specialists of enterprises who have notified their commercial presence at the BOI shall be allowed for a period of 3 years, extendable to 4 years, subject to sector-specific commitments. Business visitors shall be permitted for a period of 6 months, subject to demonstration of business purpose at the border.

6.5.2 Financial Services

International trade in financial services includes two broad categories: insurance and insurance-related services, and banking and other financial services.

1. Insurance and insurance-related services cover life and non-life insurances, reinsurance, and insurance intermediation such as brokerage and agency services.
2. Banking includes all the traditional services provided by banks, while other financial services include trading in foreign exchange, trading in securities, securities underwriting, money broking, asset management, settlement and clearing services, provision and transfer of financial information, and advisory services.

In Sri Lanka, the provision of banking and other financial services are subject to entry requirements, domestic laws, rules and regulations, and the terms and conditions of the Central Bank, BOI, the Securities and Exchange Commission, and any other competent authority as the case may be. While Sri Lanka does not maintain restrictions regarding the establishment of foreign financial service providers, approval, registration, and licensing related to banks and other financial institutions are subject to an economic needs test.

Sri Lanka retains very few restrictions with respect to market access for foreign providers of financial services. The total foreign shareholding in any institution providing financial services is permitted up to 100% of issued share capital, subject to normal regulatory requirements. However, supply of financial services remains restricted in accordance with provisions governing the Exchange Control Law. Thus, for example, some existing restrictions include the following:

1. Individual foreign investors are excluded from participating in the domestic debt market.
2. Sri Lankan nationals are not permitted to buy insurance from companies not registered in Sri Lanka under the provision of the Insurance Act of 2000, unless explicit permission is obtained from the Insurance Board of Sri Lanka (IBSL).[1] This measure has been relaxed with respect to travel and health insurance, where insurance can be taken from an insurer licensed or registered overseas irrespective of being registered with the IBSL.
3. Sri Lankan investors are not permitted to borrow freely abroad and are subject to the Exchange Control Act. Exceptions are granted under the BOI. Under prudential requirements, commercial banks are permitted to borrow up to 15% of capital and reserves abroad.

Financial "liberalization" as applied to financial services is primarily concerned with the removal of restrictions on market entry for foreign services providers. While market access should be distinguished from capital account liberalization or convertibility, the two policies are not unrelated. Central to the success of both market access and capital account liberalization, however, is domestic financial reform, i.e., the process of deregulation.[2] Domestic deregulation, market opening, and capital account convertibility do not have to march in lockstep. However, it should be recognized that as a country undertakes domestic financial reform and opens its market to foreign services providers, at some point the provision of such services will be hampered by continued capital account restrictions, thereby increasing pressures for capital account convertibility.

Another element involves the extent to which Sri Lanka can in fact institute prudential regulations and have the machinery as well as the qualified personnel to enforce such regulations. This aspect assumes particular importance if commitments are undertaken that may enable foreign financial institutions to engage in the use of a variety of complex instruments (such as derivatives, swaps, etc.) that even sophisticated counter-parties may find difficult to understand. Instituting safeguards through prudential regulations in the absence of the ability and capacity to supervise and enforce the regulations will be counterproductive.

[1] Permitted under Section 101 of the Insurance Act No. 43 of 2000.

[2] Deregulation has several dimensions such as the withdrawal of government intervention via state-owned banks, freeing of restrictions on intra-sector activities, strengthening of domestic financial institutions, etc.

6.5.3 Education

Education services are important for the development of human capital and acquisition of technology. Student mobility across the borders dominates the trade in education services. This is so especially for Sri Lankan students, who have limited choices in obtaining tertiary education and are looking for opportunities in obtaining educational services either abroad from a foreign university or in an accredited foreign university that can operate in Sri Lanka. Thus commercial presence is also important in education services. By allowing foreign universities to establish local branch campuses or subsidiaries and/or partnerships, the outflow of students is reduced, and foreign exchange is saved. Cross-border flows of teachers, researchers, and scholars can not only help Sri Lankans develop their human capital but also earn foreign exchange through the export of services to another country. With the emergence of new technologies, services such as distance learning have become important in the area of cross-border supply.

6.5.4 Health Services

Sri Lanka allows the establishment of health care facilities under the BOI with no restriction on foreign equity participation. Sri Lanka has also permitted non-national medical personnel to offer health care services with the establishment of the Apollo Hospital under BOI regulations. Domestic regulations governing physicians and nurses (by the Sri Lanka Medical Council and the Sri Lanka Nurses Council) require registration with the respective councils. Sri Lankan nationals who obtain medical qualifications abroad in turn are expected to be approved by the appropriate council. However, in the case of the Apollo Hospital for example, temporary licenses were issued under a different section of the Sri Lanka Medical Council Act.

In the event that the government foresees further inward liberalization in the provision of professional medical services, the regulatory requirements will have to be clearly spelt out to ensure that barriers of entry applicable to Sri Lankan nationals are not then lowered for foreign medical services providers. In the EU for example, qualifying criteria allow each licensing authority to institute a language test and require minimum standards for professionals graduating from medical schools.

6.5.5 Transport Services

An adequate provision of transport services—such as rail, road, air, maritime, etc.—is critical for raising efficiency and productivity of economic activities. Historically, the state has played a major role in the provision of transport services in Sri Lanka. The increasing demands on government expenditure, however, brought about a shift in emphasis to encourage private investment participation (both local and domestic) through build-own-operate (BOO) or build-operate-transfer (BOT) models. Sri Lanka does not retain any restrictions concerning the entry of foreign investment for the provision of transport infrastructure. However, Sri Lanka maintains entry restrictions on FDI in the provision of freight forwarding. Under BOI regulations, automatic approval for foreign investment in the area of freight forwarding is permitted only up to 40% of equity. Foreign ownership in excess of 40% has to be approved on a case-by-case basis.

Maritime services

1. Since 1995, for example, the government has actively sought private sector participation in the development of port infrastructure. The entry of the private sector as a terminal operator in 1999 (for the development of the Queen Elizabeth Quay) was a major milestone.
2. Sri Lanka's main ports are managed by the Sri Lanka Ports Authority (SLPA) which is responsible for all cargo handling operations and harbor development, and holds a monopoly in the provision of certain port services, such as navigation and pilotage.[3] The bunkering sector continues to be handled by the Ceylon Petroleum Corporation. While stated government policy supports further liberalization of port operations, anticipated reforms have been delayed.[4]
3. Sri Lanka maintains entry restrictions on FDI in the provision of shipping services. Under BOI regulations, automatic approval for foreign investment in the area of shipping agencies is permitted only up to 40% of equity. Foreign ownership in excess of 40% has to be approved on a case-by-case basis by the BOI.

[3] SLPA Act of 1979.

[4] Such as the privatization of the Jaye Container Terminal under autonomous management and opening up of port services to private contractors.

Road

1. The Road Development Authority (RDA) is responsible for the development and maintenance of national highways. Private sector participation in funding road construction is actively encouraged with unrestricted entry of foreign investment.
2. Government ownership in the provision of passenger bus services continues under the Regional Transport Companies (RTCs) under the Central Transport Board (CTB). The government has initiated the establishment of private–public partnership arrangements in RTCs, offering 39% equity to private investors. A bus fare policy covers both public and private operators.
3. The regulatory environment for bus transport is fragmented with overlapping responsibilities between the Provincial Councils and the National Transport Commission (NTC).[5]

Air

1. The General Agreement on Trade in Services (GATS) excludes from its scope most air transport services with liberalization being pursued primarily through bilateral agreements. Through such bilateral agreements, the number of flights, passengers, type of craft, fairs, etc. is subject to negotiation.
2. Sri Lanka continues to operate a majority state-owned national carrier. While no formal limits on foreign equity exist, equity share is confined by international laws governing ownership of national carriers. To be considered a national carrier and therefore eligible for routes granted, majority ownership has to reside with Sri Lankan nationals.
3. Under the agreement with Emirates, the national carrier is assured of monopoly in passenger load until 2008. Catering and ground handling monopoly is also vested with the national carrier until 2004.
4. Airport and Aviation Services (Sri Lanka) Limited, a fully state-owned enterprise, continues to provide airport and navigation services (cargo space, refueling, sub-letting of restaurants/shops, etc.).
5. Sri Lanka has operated an open skies policy with regard to air cargo services since 1991 removing existing restrictions on capacity, frequency, routes, etc.

[5] National Transport Commission Act No. 37 of 1991.

6.6 OUTCOMES OF WTO NEGOTIATIONS

Under the Uruguay Round of the WTO, neither country made significant commitments in terms of services. While India scheduled a number of sectors including professional services, telecommunications, financial services, health services, construction services, and tourism, the commitments are substantially less liberal than the autonomous regime. In most cases, modes 1, 2 and 4 are unbound, and mode 3 is subject to an equity limit of around 51%. In the Doha round, initial and revised offers made by India were far more aggressive in liberalization, with a whole range of new services being scheduled, though within the boundaries of the unilateral regime. In many cases of mode 3 the equity limits were increased from 51% to 74%. Some new sectors of interest have also been scheduled including new professional services such as architecture, integrated engineering, medical and dental services, veterinary services, management consultancy, higher education, and a range of maritime services. However mode 4 in most of these new areas remains unbound. Of course none of these new commitments will come into operation until the Doha Round reaches a conclusion.

Sri Lanka's existing GATS commitments are limited only to tourism, telecommunications, and financial services. The autonomous regime is far more liberal than the commitments made and even the numerical quotas and other references are highly outdated and no longer relevant in most cases. The revised commitments saw no new sectors included, and only marginal changes to the existing commitments in the three sectors above. Therefore neither country has been very proactive in the WTO framework, at least in terms of existing actual liberalization as opposed to proposed new commitments.

6.7 THE COMPREHENSIVE ECONOMIC PARTNERSHIP AGREEMENT BETWEEN INDIA AND SRI LANKA

In 2005 India and Sri Lanka commenced negotiations to form a Comprehensive Economic Partnership Agreement (CEPA) to build on the success of the bilateral FTA that had been in operation since March 2000. The CEPA was due to expand upon the existing FTA in goods by deepening and widening the agreement. The FTA was to be deepened by making cuts to the negative list to broaden the scope of goods that would be subject to liberalization. More importantly the CEPA included the liberalization of services and investment along with an agreement on economic cooperation that was intended to support the enhancement of Sri Lanka's supply side capacity to take advantage of the market access obtained through the FTA and other agreements under CEPA. This section of the paper will focus on the trade in services aspect of the CEPA. Technical level negotiations began in February 2005 and after 13 rounds of technical discussions the agreement was ready for signature in July 2008. However the agreement could not be completed due to vocal opposition expressed by a few elements within the Sri Lankan business community backed by a political party, the Janatha Vimukthi Peramuna (JVP). When India's Minister of External Affairs, S.M. Krishna visited Sri Lanka in November 2010, steps were taken to resume formal dialogue on CEPA.

6.7.1 Structure of the Agreement and Special and Differential Treatment

The CEPA services agreement followed many GATS principles. It was based on the four accepted modes of trade in services and adopts a positive list, request–offer approach. Accordingly, both sides exchanged request lists specifying the sectors and sub-sectors where they wished to receive market access and national treatment commitments from the other party. The other party could then choose to make liberalization commitments within their comfort zones and developmental interests and liberalization would occur in the sectors and sub-sectors to the extent specified in the schedules. Therefore, even if India requested Sri Lanka to completely liberalize a particular sector, Sri Lanka was not obliged with the request and could limit commitments only to areas that were within comfort levels and development requirements. It could even refuse to offer commitments in that sector in its entirety. The positive list approach provides both countries with a great deal of flexibility in making commitments. This is unlike the negative list approach, where everything is liberalized except those specified in the negative list. Furthermore, like the existing FTA in goods, the CEPA fully recognized the asymmetries between the two countries and less than full reciprocity was expected of Sri Lanka. Liberalization of services was due to take place in a progressive and sequential manner, with the least contentious sectors being liberalized first. Once these were successfully engaged and confidence was built in the agreement, more contentious sectors would be tackled. Finally, the agreement stipulated that scheduled commitments would be bound for 3 years, after which modifications could be made to address any errors or shortcomings. In this event however, compensation would need to be made to any party facing commercial injury as a result of such modification. These were all in-built measures to take into account the asymmetries between the two economies and the concerns among Sri Lankan stakeholders regarding the challenges associated with liberalizing trade with an economy as large as India.

Similar sentiments were expressed when the FTA in goods was signed, particularly concerns about the flooding of Indian manufactured goods that benefit from the economies of scale that Sri Lankan industries cannot match. There are also concerns about the subsidies granted to Indian agriculture and industry, particularly in energy and water costs, giving them an advantage over Sri Lankan producers. Another perception among Sri Lankan stakeholders is that the lax labor laws in India enable more competitive prices than their Sri Lankan counterparts who have to adhere to strict labor laws, which increase the relative cost of labor in Sri Lanka. At the same time there have been difficulties in exporting products to India, with various para-tariffs and bureaucratic processes contributing to high transaction costs and undermining export performance. This gamut of factors has contributed to a general skepticism among Sri Lankan stakeholders regarding the liberalization of trade with India. These factors continue to dominate debate with regard to CEPA as well, and fresh issues specific to trade in services have been included, such as the regulation of professional services. It is in this context that the flexibilities in the CEPA become important to garner public support for the agreement.

Along with the broad flexibilities described above, the agreement included specific flexibility in scheduling methods to further enhance the comfort levels in liberalizing services. For instance, the agreement utilizes the UN Provisional Central Product Classification (CPC) of services, which disaggregates services to the five digit level. However in the schedules, the liberalizing country could further narrow the scope of the commitment by defining a sector within that sub-sector. For example, CPC 85104 refers to R&D services in agriculture; it could be further limited to fisheries only, as opposed to the entirety of 85104. Like any GATS, the scheduling of services for liberalization could be made subject to limitations and exceptions as deemed necessary by the liberalizing country. These exceptions could include:

1. limitations on the number of service suppliers,
2. limitations on the total value of service transactions or assets,
3. limitations on the total number of service operations or on the total quantity of service output,

4. limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ,
5. measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service, and
6. limitations on the participation of foreign capital.

An Emergency Safeguards clause was also under discussion. However at the time the negotiations came to a close there was no final verdict on its inclusion in the agreement. Accordingly, the structure of the CEPA provided substantial flexibility for Sri Lanka to address stakeholder concerns in liberalizing trade in services with India.

6.7.2 Outcomes of Initial Bilateral Negotiations

At the end of the initial set of technical negotiations, both countries presented draft offers in June 2008. Since then negotiations have resumed to further develop these offers, and in some cases revising them, therefore what is presented below is not necessarily the final outcome of the CEPA negotiations.

India's Draft Offers by India: India's overall commitments were very liberal in modes 1, 2 and 3. There are restrictions in mode 4 but there is market access provided to the following categories.

1. Business visitors (BVs): As long as the BVs do not receive remuneration in India, such visitors can have access for a maximum of 180 days in case they visit India for sale or to secure agreements for trade in services or are employees of a Juridical Person (JP) appointed to set up commercial presence.
2. Intra-Corporate Transferee (ICT): The employee of a JP in Sri Lanka who is transferred to a JP in India owned or controlled by the JP in Sri Lanka, for temporary provision of services would be an ICT. This provision is limited to managers, executives and specialists and the maximum period of stay is 5 years.

In addition to business visitors and ICTs, market access would be provided for contractual service suppliers (CSSs) and independent professionals (IPs) in engineering, computer and related services, hotels and restaurant services, travel agency/tour operator services, architecture, integrated engineering services, urban planning and landscape architecture, R&D services, management consulting and related services, and tourist guide services.

1. A CSS is an employee of a JP owned or controlled by Sri Lanka who travels to India to perform a service pursuant to a contract between the JP in Sri Lanka and the client in India. The CSS has access for up to 1 year.
2. Independent professionals are natural persons traveling to India for short periods up to 1 year to perform services pursuant to contracts between the IPs and their clients in India.

In terms of overall commitments India has made draft offers in: accounting, architecture, urban planning, engineering and integrated engineering, medical and dental, services provided by nurses, midwives, paramedical and physiotherapists, veterinary services, computer and related services, research and development services, real estate services, rental and leasing services, management consultancy, technical testing and analysis, services incidental to energy distribution, maintenance and repair of equipment, building cleaning services, placement and supply of personnel, packaging services, convention services, motion picture or video distribution, construction services, wholesale trade, higher education, environmental services (refuse disposal, sanitation), tourism (including hotels, travel agency and tour guiding), telecommunications, financial services and maritime services.

In almost all of these sectors, Sri Lanka would get full market access to modes 1, 2 and 3 (except in accounting which is limited to modes 1 and 2, architecture where mode 3 access requires a joint venture and R&D in agriculture which is limited to mode 1). In terms of mode 4, BVs and ICTs get access to almost all sectors while CSSs and IPs get access to the sectors specified earlier.

Sri Lanka's Draft Offers: Compared to India, Sri Lanka's draft offers are somewhat limited. Sri Lanka's offers build upon what is on the table at the current Doha round of WTO GATS and include a few additional sectors based Sri Lanka's service import needs. Offers in mode 4 (movement of professionals) are almost nil and other offers are all either at or below the current level of liberalization that is autonomously accorded through Sri Lanka's investment and exchange laws.

In telecom Sri Lanka's offers are the same as those reflected in the WTO but instead of numerical ceilings, service provision in the specific sub-sectors will be allowed once a license is obtained through the standard procedure. In financial services and banking, Sri Lanka provides 100% foreign equity in mode 3 conditional upon licensing. There is also a minor increase in mode 4 allowance for foreign executives, conditional upon extra capital investment. In computer and related services Sri Lanka's draft offer allows access through modes 1, 2 and 3 but mode 4 is limited to expert trainers and high-end technicians—again conditional upon capital investment. In convention services Sri Lanka provides market access through modes 1 and 2 while mode 3 is allowed as long as it is in the form of a joint venture. In health services Sri Lanka has made an offer in mode 1 (telemedicine) on a doctor–doctor basis for purposes of a second opinion. This does not include doctor–patient contact. In mode 3 in health services market access is liberalized outside the Western Province. There are no commitments in mode 4 in health services. In tourism services market access is allowed in modes 1, 2 and 3. In maritime services, offers are made in passenger transportation (not freight) with 40% foreign equity in commercial presence. In freight forwarding the draft offers reflect what is allowed autonomously, that is, 40% foreign equity. In maintenance and repair of sea-going vessels, stakeholder consultations with Sri Lankan service providers including Colombo Dockyards made it clear that the ability to deliver the export of vessel repair services was being impaired by shortages of certain skill categories. Accordingly, Sri Lanka's draft offer included the import of certain skill categories from India in the maintenance and repair of sea-going vessels including naval architects, skilled welders and fitters, project/ship repair managers, repair engineers, and automation engineers. This allows Sri Lankan companies providing such services easier access to much required skilled labor. However any Indian labor entering through this agreement will need to obtain a temporary employment contract with a Sri Lankan employer and will be subject to all relevant immigration laws and work permits.

The next section will look at a few examples of how the specific commitments were further tailored to take into account the concerns of stakeholders.

6.7.3 The Role of Sri Lankan Stakeholders in the CEPA Negotiations

India's request list in the services sector was very extensive and covered almost the entirety of the United Nations Central Product Classification (UN CPC) list. It was up to the Sri Lankan negotiating team to determine which sectors Sri Lanka could liberalize based on the interests of domestic stakeholders and the national developmental interest. Accordingly, the request lists from India were shared with the domestic stakeholders of each requested sector as organized under the Ceylon Chamber of Commerce. Meetings were held with each sector group to determine whether a commitment could be made. In the latter case, industry views on the specific safeguards that need to be incorporated into schedules were sought. Consultations took place with several sectors including accountancy, architecture, audiovisual services, construction services, convention services, engineering, environmental services, financial services, health, ICT, maritime services, and travel and tourism, among others.

It was not surprising to note that the bulk of those consulted had reservations with regard to the liberalization of trade in services, particularly given the fact that they were representing industries which would face greater competition. The relative intangibility of benefits compounded the overall challenge faced by negotiators in consulting consumer interest groups, given the complexity of trade in services. Consumer groups in Sri Lanka are not cohesively organized and therefore the negotiators had to make commitments with consultation largely from the perspective of producers and service suppliers. Naturally this skewed the nature of commitments towards protection. Many sectors such as accountancy, engineering, construction services, other business services (management consultancy, market research and so on), and research and development services could not be liberalized at all given stakeholder concerns.

6.7.4 Legislative and Regulatory Constraints

Concerns included legislative problems (in construction services), regulatory issues (in architecture), and market immaturity (in other business services). For instance, it was impossible to make a commitment in construction services since the Construction Services Act had failed to get parliamentary approval due to a series of delays. Therefore, it was not advisable to schedule a commitment in a legally binding bilateral agreement without finalization of the national act of the industry. Similarly in the architecture sector, the Institute of Architects does not have the provision to register foreign architects and at present only local architects are registered with the institute—a commitment in architectural services in CEPA would have required a change in the local legislation. Local legislation was a concern in many sectors for trade in services in mode 1—where the local legislation more often than not had no reference to electronic exchange of services, and stakeholders were reluctant to agree to a binding commitment in a bilateral agreement without having any national level legal reference to the issue. According to Sri Lanka's exchange laws however transactions occurring in mode 1 are liberalized (except in the case of re-insurance). Nonetheless the concerns of stakeholders were taken into account and Sri Lanka did not enter in binding commitments in these areas.

Even in sectors where draft offers were made, such as in medical services, regulatory constraints limited the extent of liberalization that was possible. For instance, in terms of mode 4 commitments in medicine, there were certain categories of health professionals where there were shortages identified during the consultations with the Medical Association. Therefore it was initially suggested that a limited commitment be made to allow the recruitment of Indian doctors qualified in those specialties where shortages existed, on a temporary basis. However it was argued by stakeholders in the medical profession that there have been cases where under-qualified foreign doctors have been able to work in Sri Lanka, putting the lives of patients at risk, and thereby making the case that the current regulatory framework is not sufficiently robust to enable a legally binding commitment. There is another case where the autonomous regime in place allows private medical institutions to hire foreign medical practitioners as long as it can be demonstrated that the same skills cannot be sourced locally. However the autonomous regime is unilateral and can be overturned if there is any perceived threat to domestic interests—the concern of stakeholders was that a legally binding bilateral agreement lacks the flexibility that would be needed, given the status of the regulatory regime. A further concern in terms of mode 4 commitments in medical services was that India has substantial heterogeneity in terms of quality of medical training institutions; therefore it would require substantial resources on the part of the Sri Lankan regulator to monitor qualifications of applicants. Ultimately the draft schedules in medical services excluded mode 4 entirely.

As discussed earlier, a common concern that figured throughout negotiations was that Indian firms and workers would inundate the Sri Lankan market. This was particularly a concern with regard to mode 4, since this was the most protected segment of trade in services in Sri Lanka's autonomous regime. Therefore in the early stages of negotiations Sri Lanka attempted to keep mode 4 out of the initial round of commitments, arguing that since the agreement was based on progressive and sequential liberalization, mode 4 could initially be linked to mode 3 (investment), and later on could be de-linked once stakeholder confidence in the agreement had been established.

This would have given stakeholders some degree of comfort. Another related regulatory concern was the skepticism expressed by many stakeholders that the department immigration would have the capacity to effectively monitor and control Indian workers coming into Sri Lanka through the proposed CEPA. As it stands, Sri Lanka has unilaterally provided a visa on arrival facility for Indian tourists; this was not reciprocated largely due to security concerns. Anecdotal evidence suggests that many Indian workers had abused the visa on arrival facility (that does not permit employment) to work in Sri Lanka, particularly in copper and vanaspati factories established by Indian investors. Many Sri Lankan stakeholders were concerned that further liberalization may take the situation beyond control if the regulatory capacity of the department of immigration is not strengthened.

6.8 CONCLUSION

In this paper it has emerged that there are substantial benefits that could be reaped through greater cooperation between India and Sri Lanka in the services sector. This has been recognized by both governments and efforts were made to formalize and institutionalize cooperation in the form of CEPA, the negotiations for which began in 2005. However 5 years have passed and the agreement is yet to come to fruition. One of the main reasons has been the inability to get all stakeholders to support the agreement, particularly in Sri Lanka. However it is essential that there be better communication between the government and stakeholders in order to convince the latter that their concerns have been taken into account through the various flexibilities made available in the framework of the services agreement of the CEPA in particular. A bilateral services agreement will be very useful, particularly in the context of slow progress of the Doha Round of the WTO and the delays anticipated in implementing the new commitments in the GATS.

7

Conclusions and Major Recommendations

INDRA NATH MUKHERJI

7.1 BACKGROUND

The India-Sri Lanka Free Trade Agreement (ISFTA) was signed on 28 December 2008 and became operational from 1 March 2000. It was evaluated after a decade of operation in 2010. The agreement is significant as it opens trade between a small island economy and the largest, most populous country in the region and accordingly offered special and differential treatment (SDT) by the larger neighbor to the smaller one, viz. a longer phase-out period and a smaller negative list for duty removal for Sri Lanka.

7.2 MERCHANDISE TRADE

According to an analysis of merchandise trade in Chapter 2 there was buoyant growth in the first eight years of trade under the agreement before the adverse impact of global recession in 2009. India's exports to Sri Lanka grew consistently post-2001 and there was buoyant growth in imports in 2001–2005. Both exports and imports declined in 2009. Since the decline in exports was steeper than that in imports, the balance of trade, which had been increasing steadily in India's favor, declined for the first time in 2009.

There are two phases in Sri Lankan exports to India: (i) 2001–2005, and (ii) 2005–2008. In the first phase Sri Lanka's exports to India grew faster than its imports, leading to a decline in India's export-import balance with Sri Lanka. In the second phase the export-import balance started increasing in India's favor.

The euphoria for the agreement was a result of India's declining trade balance ratio in the first phase when it seemed that the SDT provisions under the agreement had helped Sri Lanka penetrate deeply into the Indian market. This euphoria was dissipated post 2005 with the decline in Sri Lanka's exports to India and the upward movement of India's export-import ratio to pre-agreement levels. Studies in this volume also highlight that the spurt in Sri Lankan exports to India was because of two products: (i) vanaspati (hydrogenated vegetable oil) and (ii) copper.

This trend has been discussed by Behera and Mukherji and brought out in field surveys by MDRA and LMRB pertaining to the following factors:

- Since external tariffs for copper scrap used in the manufacture of copper products, and for crude palm oil used in the manufacture of vanaspati were much lower in Sri Lanka than in India, it became profitable for Indian investors to manufacture these products in Sri Lanka and export them to India duty-free, using the cost advantage of low duty imported inputs. Local labor was usually unwilling to work in these manufacturing facilities since they were often set up under unhygienic conditions, so labor too had to be imported from India, sometimes illegally . This was a lose-lose situation since most inputs were imported and very little local employment was generated. The Indian government lost customs revenue for imports foregone. The only beneficiaries were the "fly-by-night" Indian investors.
- Due to lax enforcement of rules of origin requirement under the agreement the final product, using low duty imported inputs, was not sufficiently processed and was further under-invoiced to meet the rules of origin criteria. To check this malpractice, the Indian and Sri Lankan governments decided to ensure the adherence of copper prices by Sri Lankan exporters to those at the London Metal Exchange. This adversely affected the competitiveness of Sri Lankan exporters.
- As part of its tariff reform policy, the Indian government was constantly lowering external tariffs to bring them at par with those in ASEAN countries. Consequently, the preferential margins of several Sri Lankan exports to India were eroded.
- Rising global prices of essential commodities in 2008 were primarily responsible for the fall in tariff rates on specified products. To protect its consumers from imported inflation the Indian government drastically reduced the extremely high customs tariff on palm oil and copper scrap

to almost nil in 2008/09. This adversely affected the competitiveness of copper and vanaspati exporters in Sri Lanka and resulted in their winding up their facilities.

Importantly, there has been substantial expansion and diversification of trade between India and Sri Lanka post the agreement even apart from the predominant role of copper and vanaspati in augmenting Sri Lankan exports to India. Notably, the number of new Sri Lankan products entering the Indian market has been proportionately much more than the number of such Indian products entering the Sri Lankan market.

The following recommendations emerge from the study.

- Only products with real comparative advantage should be allowed duty-free to each country's markets. Many products entered Indian market not because of real comparative advantage, but due to a false competitive advantage due to low duty imports of principal imported raw materials. There are also a number of products with real comparative advantage in the negative lists of both the countries with the potential to create trade which could be taken out and freed for preferential trade.
- There is need to pre-empt or forestall the recurrence of such trade deflection arising from arbitrage of external tariff disparities in the two countries. Such disparities exist in many products. The study lists them for greater scrutiny by the trade and foreign investing regulatory authorities in both the countries. The Board of Investment needs to particularly screen such investment proposals emanating from India to ensure that such investors have a long term and genuine interest in the Sri Lankan economy and are not moving their capital for quick profits using low duty or duty-free inputs, converting these into manufacturing with minimal processing, with no positive impact on the host country economy, for duty-free entry to the Indian market. On the Indian side, there is need to ensure that such products are not under-invoiced and have undergone the necessary transformation to qualify for entry to the Indian market. While it may not be feasible for the two countries to move towards the third stage of economic integration, viz., a customs union, some attempt could be made to harmonize external tariffs on some of the products identified.
- According to Sirimal Abeyratne, a discussant of this paper, the agreement should not obstruct the overall trade reform process, as there is a danger

that products for trade will be identified based on existing lists and potential products will not be identified. In view of this concern the present study tries to identify such products in the negative lists of both the countries.[1]

Gomi Senadhira, Director General of Commerce, Department of Commerce, Sri Lanka expressed the view that increased Indian exports to Sri Lanka of many products in the negative list have been observed. Growth in such cases is outside the agreement. Exports under the agreement are about 20% of total exports from India to Sri Lanka. However, growth of exports from Sri Lanka to India is within the agreement. Sri Lankan exports under the agreement grew from 25% to 97% with the growth of vanaspati and copper exports. Even without these trade under the agreement was around 70%. In 2010 exports to India under the agreement were around 80% of total exports to India. This suggests that Sri Lanka has benefited from the agreement in expanding access to the Indian market.[2]

- The agreement helped Sri Lanka increase the range of export products to India and has worked better then the Pakistan-Sri Lanka FTA and the SAFTA. The agreement has performed well, even compared against preferential non-reciprocal agreements. Sri Lanka has not benefited much from the US GSP and even with the EU GSP, product diversification was not as much as in the case of the ISFTA. As a downside to the Agreement, however, Senadhira referred to a number of non-tariff barriers applied by India on Sri Lankan products. One such product was sausages in which the Agriculture Ministry took unduly long time to renew the license. Again, he referred to the imposition of anti-dumping duties on BDF Board from Sri Lanka. As a downside to the Agreement, however, Senadhira referred to a number of non-tariff barriers applied by India on Sri Lankan products. One such product was sausages in which the Agriculture Ministry took unduly long time to renew the license. Again, he referred to the imposition of anti-dumping duties on BDF Board from Sri Lanka.[3]

[1] This view was expressed at the Stakeholders' meeting in Colombo, 11 July, 2011.

[2] View expressed at the Stakeholders' meeting in Colombo, 11 July 2011.

[3] Ibid.

7.3 TRADE FACILITATION

The study makes a number of recommendations on trade facilitation.

- Structure issues related to risk management at the port for faster clearance of goods may also be negotiated within the agreement. In this context lessons may be taken from India-Singapore CECA text.
- Many traders are not aware of Rules of Origin (ROO)-related issues despite most of them being available via internet. Lack of awareness is a major issue. In many cases, traders are trading through SAPTA/SAFTA ROO even when better facility is offered through ISFTA. Governments of both sides need to pass on more information to the traders and simplify trading process for better utilization of the agreement routes. The LMRB Survey calls for a website of Indian customs procedures to be updated regularly to reflect correct total duties rather than working out applicable duties in a complicated manner on site. Indian customs also need to issue clarification in writing when a written inquiry is made.
- The governments of both India and Sri Lanka may negotiate a trade facilitation agreement like the Asia Pacific Trade Agreement (APTA) in which India and Sri Lanka are signatories. APTA members are addressing trade facilitation issues through negotiation and introducing them in "articles" such as measures for transparency and consistency, measures for simplicity and efficiency, measures for harmonization and standardization, measures for cooperation, etc. A working group on trade facilitation will further deliberate on the details of these measures including regional cooperation in arranging investments for improving efficiencies and infrastructure bottlenecks.
- A proposal is underway for setting up testing centers in more ports in India to facilitate clearing of goods. The government needs to make this a time-bound affair. The MDRA survey calls for more quality check labs and more accountability: the Indian government can increase the number of quality check labs to enable the requisite checks at the port of entry within a specified period. The LMRB survey also suggests that procedures for testing and certification need to be streamlined and agreed to by both governments. The Indian government needs to ensure that lab testing of perishable items is carried out at the port of entry within a specified time, or arrange for authorized labs in Sri Lanka to check goods prior to shipment.

- Traders have noted multiple certification on various issues as a major problem in both India and Sri Lanka. This issue requires bilateral discussion.
- Frequent changes in policies hurt traders. Both countries need to create a system for traders to anticipate changes more scientifically.
- In Sri Lanka, the layers of taxes indirectly affect traders. The government needs to revisit various taxes and compulsions imposed on traders and simplify them
- In Sri Lanka, government procedure and transparency needs attention. Traders indicated that clearances take a long time. Simplification of procedures to reduce transaction time is warranted. Both India and Sri Lanka require better coordination among agencies involved in the trading process. The two governments could appoint expert committees to prepare six monthly reports to record improvements in the system and recommend further action. In India a comprehensive effort is required to implement the provision for a single inquiry point and requires software compatibility across various agencies apart from addressing the infrastructural constraints.
- Both India and Sri Lanka require huge investments in a variety of trade infrastructure. Both governments need to arrange investment to develop the integrated trade infrastructure. A PPP model with strict adherence to timelines may prove useful. The MDRA Survey mentions that despite significant improvement in the documentation process and the online system, the physical infrastructure needs much improvement.
- The current study has identified a number of barriers beyond the traditional SPS and TBT framework. In Sri Lanka, while packaging requirements are stringent, issues like marketing of foreign products through and conditions related to change of domestic companies and banking deposits by traders require attention, Other issues include barriers to "non-essential" goods, the list of "non essential" goods and the long time taken by Sri Lankan authorities in providing technical certification even to companies already having internationally accepted certificates. In India quota restriction, port restrictions (now addressed) and high differences of state level taxes impose serious barriers on import from Sri Lanka. India's position on banning products on the grounds of SPS has been challenged internationally in the past. The government remains slow in withdrawing these bans and in giving out information

about its policy more logically through notification. These issues can be put up for bilateral negotiation.

- The two field surveys conducted by MDRA and LMRB call for strict adherence to Certificate of Origin. Indian customs authorities may be requested to recognize the Certificate of Origin issued by the department of commerce, government of Sri Lanka and in case of doubt the respective High Commissions can be approached to address the matter.
- The MDRA Survey calls for a special entity to hear the grievances of traders and deal with complaints to ensure no further delays. Similarly the LMRB Survey calls for a body to handle complaints and reduce or eliminate delays.
- The MDRA Survey calls for a check on local lobbies and regulations, taking into consideration the domestic industry. Local powerful lobbies influence decisions resulting in additional cost to importers by causing delays in issue of licenses. If certain local industries/sectors are to be protected, then they should not be included in the agreement as this sends signals that agreements are not being honored by India. It is necessary, especially in *Vanaspati* trade, to keep in mind the interests of the domestic industry while negotiating and finalizing economic agreements. The LMRB survey similarly suggests that negotiators need to refrain from including products that have opposition from powerful local lobbies in India.
- Under the MDRA Survey during the quantitative phase, the respondents were asked for their suggestions to make exporting or importing simpler. The traders want more assistance from the government. Exporters want more counseling on trade related issues. Many respondents also emphasize improved operational aspects and curbing rampant systemic corruption. Under the LMRB quantitative survey, when respondents were asked to give their suggestions, as many as 71% exporters and 59% importers had no suggestions. Faster clearance and easier systems for issuing certificates were some improvements mentioned by a small proportion of respondents.

7.4 INVESTMENT AND SERVICES

The study emphasizes the need to make the agreement more comprehensive beyond "goods trade" to include trade facilitation, investments, and services trade. Pre-investment national and most favored nation treatment for mutual investment flows should be the guiding principle. The present agreements on investment protection and avoidance of double taxation and fiscal evasion are dated. These need to be brought in line with modern practices. The study on investments points to the excluded sections in the agreements that need to be incorporated.

The study on services highlights the existing complementarities in revealed comparative advantage between India and Sri Lanka. As in the case of goods, the negotiations held so far have followed the principle of special and differential treatment. The draft offers negotiated so far reflect this since India's offers have been much more comprehensive than those of Sri Lanka.

The study, however, highlights that the benefits of cooperation in services trade and the possibility of a win-win situation are still not so perceived by a large number of Sri Lankan stakeholders close to the present establishment. Setbacks in goods trade discussed above, has been instrumental in creating such a perception. Building up confidence among all stakeholders, and their involvement in negotiations are essential prerequisites for re-initiating the stalled negotiations.

The CEPA was due for signature at the 15th SAARC Summit in Colombo in August 2008.

However an influential lobby in Sri Lanka believed that it had not been transparently discussed among stakeholders, and hence, it would be premature to put it up, particularly when some contentious trade issues remain to be resolved. It is important to recollect that Sri Lankan negotiators were able to obtain major concessions on tea and textiles under CEPA negotiations by doing away with entry restrictions on ports. Further, major gains on textiles and positive outcomes on tariff liberalization are already visible. Major issues on trade facilitation are on the negotiation agenda. Meanwhile, India is vigorously pursuing its "look east" policy. It has negotiated comprehensive free trade agreements with ASEAN, Japan and Republic of Korea. Many of these countries' exports compete with Sri Lanka's in the world market. Thus, the possibility of Sri Lanka losing its "first mover" advantage to the Indian market remains high. India continues to remain Sri Lanka's largest supplier, even without the agreement route for its exports to that country. Thus, it may be prudent to expedite negotiations.

Deepening Economic Cooperation between India and Sri Lanka

This book analyzes the performance and impact of India–Sri Lanka Free Trade Agreement over the past decade and suggests the way forward. India became an important source of imports for Sri Lanka immediately after the implementation of the FTA. Bilateral trade between the countries increased steadily thereafter, with Sri Lankan commodities finding a large market in India. The composition of trade also changed with an increased number of new goods being traded. The study computes indices and suggests scope for deepening economic cooperation between the two countries by pruning the negative lists for trade in goods, identifying potential investment, and suggesting policies for expanding cooperation in services.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.7 billion people who live on less than $2 a day, with 828 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

Asian Development Bank
India Resident Mission
adbinrm@adb.org
Fax +91 11 26870955

Printed on recycled paper

ISBN 978-92-9254-169-9

9 789292 541699 >

Printed in India