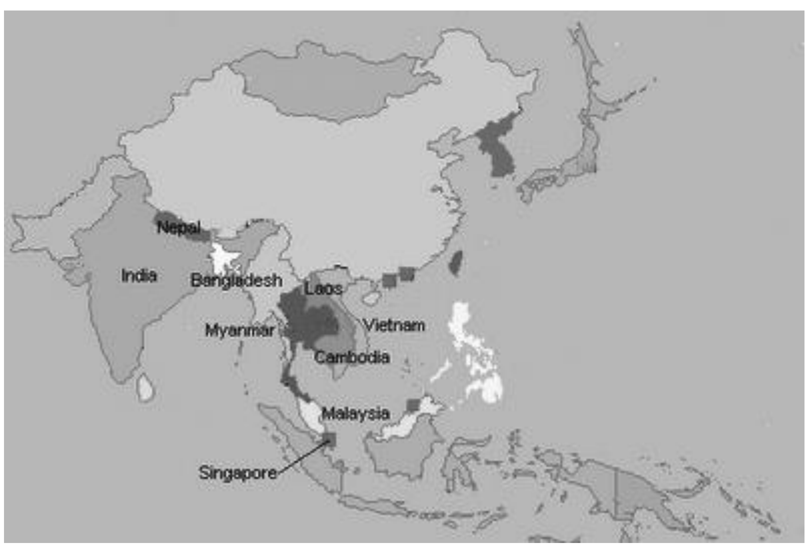
The Pathfinder Economic Alert

India's Expanding Economic Cooperation Arrangements in Asia.

India has reduced its sensitive list of products for the Least Developed Countries (LDC's) under the agreement on the South Asia Free Trade Area (SAFTA) from 480 to 25 tariff lines. This means that Afghanistan, Bhutan, Nepal and most importantly Bangladesh will enjoy a significant competitive advantage over Sri Lankan businesses in accessing the rapidly growing Indian market. (Sri Lanka is ineligible for such preferences as it is a lower middle income country.) Local entrepreneurs have already invested in Bangladesh to take advantage of lower costs and the trade preferences enjoyed by that country as a LDC. Bangladesh's increased preferential access to the Indian market is likely to increase the momentum of such investment and accelerate the loss of growth, employment and incomes experienced by Sri Lanka.

In addition, the India – ASEAN CEPA is at a very advanced stage of negotiation. Once it comes into effect shortly, economies that are somewhat more developed than Sri Lanka (Malaysia, Thailand and Vietnam) as well as those that are less advanced (Cambodia, Laos and Myanmar) will enjoy preferential access to the Indian market. This will give them a significant advantage over Sri Lanka, particularly in services. The services sector accounts for about 60% of the domestic economy and has enjoyed the most rapid growth in recent years.



There is, therefore, an urgent need to finalize the Indo – Sri Lanka CEPA in order to expand the Free Trade Agreement (FTA) on goods to meet the increased competition from Bangladesh and to counter the preferential access on services that will soon become available to the ASEAN countries.

A recent meeting organized jointly by the National Chamber of Commerce of Sri Lanka (NCCSL) and the Ceylon Chamber of Commerce (CCC) revealed there was a general consensus that the Indo-Lanka FTA had yielded significant benefits for the country. Sri Lankan exports to India have increased sharply. Though Sri Lanka's trade deficit with India has also risen sharply, this has been largely due to an increase in imports of items of internationally competitive Indian goods, ie items that are on Sri Lanka's negative list (eg: motor vehicles, petroleum products, agricultural commodities and paper products). These imports have, therefore, grown as part of normal trade replacing traditional sources of import such as Japan, rather than due to preferential access given to Indian producers. In fact, their competitiveness has served to contain Sri Lanka's overall trade deficit by reducing import costs.

The positive sentiments held regarding the Indo- Lanka FTA, which focuses on the trade in goods, do not extend to the CEPA. There is much greater debate about the merits of extending the bilateral agreement with India to the other elements in the CEPA: services, the movement of natural persons (labour mobility) and investment.

By common consent, Sri Lanka and India have been able to negotiate an FTA in goods that has yielded significant benefits to this country. This has been possible because both sides have recognized that the large asymmetry between the two economies should be reflected in any economic arrangement between the two countries. Both the positive and negative lists in the FTA are very much in Sri Lanka's favour.

The CEPA is intended to deepen the FTA in trade (make the positive and negative lists even more in Sri Lanka's favour) and extend the existing disciplinary framework to the other areas mentioned above. The challenge is to negotiate an agreement that takes into account the asymmetry of the two economies in these new areas as well. The question that begs to be asked is if Sri Lanka can negotiate a favourable FTA in goods with India why can't this be replicated in services, movement of natural persons and investment? Strengthening the dispute – resolution process as part of CEPA would also be an additional benefit.

Much of the opposition to CEPA seems to be based on a lack of information. In this regard, it is encouraging that the key outcome to emerge from the NCCSL/CCC organized meeting was the decision to convene a meeting between senior Government and private sector representatives to address the gaps in information and to consider objectively the merits of an early finalization of the CEPA negotiations.

Countries like Bangladesh and the members of ASEAN are already stealing a march on Sri Lanka in gaining preferential access to the rapidly increasing Indian market. Further delay in finalizing the CEPA will result in the loss of even more investment, growth, employment and income. There is a very strong case for placing Sri Lanka's trade and investment relations with a much larger partner on a rules-based and predictable basis. Sri Lanka's economic relations with India (and the rest of Asia) are likely to become ever more important at a time when the US and Europe (destination for 55%- 60% of our exports) are likely to experience very sluggish growth in the medium to long term. In such a context, high priority needs to be attached to maximizing preferential access to the Indian market for Sri Lankan goods and services.

As argued in several previous Economic Alerts, private investment, domestic and foreign, are essential for meeting Sri Lanka's growth targets. At this time, there is merit in providing greater confidence to potential Indian investors by building a predictable and stable investment framework into CEPA. In this connection, consideration could also be given to the creation of a jointly financed investment Fund which promotes both Indian and Sri Lankan investment in each other's country.

A more comprehensive discussion on the merits of an Indo – Lanka CEPA is contained in Economic Alert no: 8, available at www.sanvada.org

This is the Twentieth in the series of Economic Alerts issued by the Pathfinder Foundation.

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