FREE TRADE AGREEMENTS
- ARE WE ON THE RIGHT TRACK

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Deregulation and liberalization have been the trend in the past decade or more, and the number of countries moving from a regulated and restricted environment to a free economy has shown a rapid increase with many countries in the Eastern Europe opening up their economies, in order to join the European Community. This has resulted in the globalization of trade and it has become absolutely essential for countries, especially the smaller ones, to come up with strategies in order to face up to the new challenges they have to face in the highly competitive markets. One of the main strategies adopted by most countries has been to enter into trade agreements with countries in their region and their trading partners in order to ensure that they are able to retain the markets for their products and services in the face of severe competition. The trade agreements may be bilateral or multilateral and in the case of the latter, agreements between regional groups have been common. Regional groupings sometimes do not prove to be very advantageous since they may be competing with each other but they are relatively easier to negotiate and therefore countries have had greater success in negopiating them.

Trade agreements is nothing new for Sri Lanka as we have had for some decades, the China / Sri Lanka Rubber Rice Agreement which is not in existence any longer. The criticism leveled against this agreement was whether Sri Lanka received a fair price for its rubber exported to China and whether it was paying the right price for the rice imported from them. However during low price regimes this helped the country to ensure that they had no problem in selling its rubber production at a decent price. This also benefited us since we were compelled to import large quantities of rice as the domestic production of the crop at that time was well below the quantity demanded, and as a result the import of rice from the other countries was thereby curtailed. However, this type of agreement did not help to sharpen the negotiating skills that are requard in the current business environment.

Sri Lanka continued strengthening its trade ties by actively engaging in negotiations at multilateral, regional and bilateral levels. We have been successful in entering into a number of Free Trade Agreements both with individual countries as well as countries in the region as groups. Negotiations are also underway with many other regional groups for the purpose of having free trade agreements whilst the agreements already entered into are also being reviewed periodically in order to move further forward.

At the multilateral level, Sri Lanka continued its active engagement in the current negotiations of the Doha Development Round in the World Trade Organisation, which members committed to conclude in 2011. Negotiations were held on agriculture and Non-Agricultural Market Access, aimed at ensuring flexibilities for Sri Lanka as a Net-Food Importing Developing Country and improved market access through lowering of high tariffs prevalent in key markets for main exports, particularly in the garments and fisheries sectors. With regard to Non-Agricultural Market Access, Sri Lanka remained exempted from having to undertake tariff reduction commitments. Increased protection for geographical indications, traditional knowledge and biodiversity resources were negotiated under trade related aspects of Intellectual Property Rights. The third round of the Global System of Trade Preferences initiated to increase Trade and Economic Cooperation, concluded in 2010 with the signing of the Sao Paulo Round Protocol. However, due to the similarities in the current structure of exports, many developing countries are effectively competitors and thus do not stand to benefit from it. Further, since many countries have regional or bilateral trade agreements with major trading partners in the Global System of Trade Preferences, they already enjoy lower tariffs than offered under it. Thus, only less than half the members have shown interest in engaging in ongoing negotiations.

Trade under bilateral agreements demonstrated a significant improvement in 2010. Trade with India, under the India-Sri Lanka Free Trade Agreement, recovered considerably after a decline in 2009 may have been due to the impact of the global economic slowdown. Interest in the Pakistan-Sri Lanka Free Trade Agreement which came into force in 2005, is yet to make a significant impact and exporters in both countries are yet to identify its true potential. In order to strengthen the present bilateral economic relations with India and Pakistan, Sri Lanka agreed to negotiating Comprehensive Economic Partnership Agreements (CEPA) with both countries. In addition to trade in goods, the CEPA framework encompasses trade in services, investment and economic cooperation.

South Asian Preferential Trade Agreement / South Asian Free Trade Area

As a part of the SAAARC process the South Asian Preferential Trade Agreement (SAPTA) was implemented in 1995, and in 1996 it was agreed in principle to convert it to South Asian Free Trade Area (SAFTA), and the focus appeared to implement measures to improve intra South Asian economic links

The SAPTA process offered only very limited liberalization although this was a period of general policy liberalisation, and also regional and bilateral initiatives to foster economic partnerships. With the heightening of political tensions between India and Pakistan in the late 1990s the transition to SAFTA stalled. However, as an important result of the limited achievements of the SAPTA process was that the member countries became interested in moving into liberalized bilateral arrangements.

It was envisaged to permit countries willing to proceed at a faster pace to do so within the SAPTA/SAFTA framework. However, from the latter half of 1998 official activities of SAARC came to a virtual standstill, giving way to bilateral foreign trade agreements between the member countries, which were totally outside the SAARC process. In fact, there is little evidence of similar trends in other regional groups. The vast majority of regional blocs began from an agreed base on the degree of cooperation and has progressed from there, taking collective decisions with regard to either the speed of integration or admission of new entrants.

SAFTA or South Asian Free Trade Area agreement was formulated on January 6th, 2004 at the 12th SAARC summit held in Pakistan. The agreement envisages the creation of a model of free trade zone in its seven member nations. The seven member nations consisting of approximately, 1.4 billion people, include the following countries: India, Nepal, Pakistan, Bangladesh, Bhutan, Maldives & Sri Lanka.

The SAFTA agreement was introduced with a view of levying zero Customs duty for trading any product by the year 2012 and was formulated to bring about economic stability in the member nations. The agreement may also facilitate healthy trade as well as investment relationship across borders thereby bringing about many structural reforms in the economy of the seven countries. However, there are certain obstacles which hinder trade across South Asian countries as a result of which trade across borders of the South Asian countries account for only 5% of the total trade. The reason can be attributed to two prominent factors. They are political reasons and too much protectionism.

However, with the recent positive developments in India-Pakistan relations both countries are keen to take steps to facilitate a rapid increase in the trade between the two countries. SAFTA can play a major role in this endeavour and therefore may have received a new lease of life. Pakistan has already announced that they will consider reducing their negative list aimed at boosting trade with India. Since the negative list cannot be confined to India only and is common to all member countries the others including Sri Lanka may stand to benefit from the opportunities that may be created as a result.

India-Sri Lanka Free Trade Agreement

Economic links between India and Sri Lanka have a long history – with recorded commercial links going back many centuries. These links strengthened to the point where legal barriers to movement of goods and labour practically disappeared during the period when both countries fell under British rule. But in the early years of the post-independence period, both countries implemented inward-looking economic policies resulting in the weakening of the economic ties. However, these ties once again started to strengthen when Sri Lanka embarked on a liberalisation policy in 1977, which was followed by India but to a fairly limited extent, but it coincided with a ‘second wave’ of policy reforms in Sri Lanka.

The most popular bilateral free trade agreement to emerge in the region was the India-Sri Lanka Free Trade Agreement signed in December 1998. This was a result of the renewed political confidence between the two countries as well as the labored progress made through the South Asian regional initiatives. There were mixed feelings among the business community regarding the free trade agreement with India. The India-Sri Lanka Free Trade Agreement aims at promoting economic linkages 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 duty free basis and concessionary tariffs. However, the India-Sri Lanka Free Trade Agreement does not provide for elimination of non-tariff barriers.

There were concerns that while some Sri Lankan exports (such as rubber products, ceramic products and leather goods) catering to particular niche markets in India may benefit, some small and medium industrial enterprises, and producers of livestock and subsidized agricultural products not protected under the negative list will face stiffer import competition from Indian exporters, who arguably enjoy the advantages of a relatively sophisticated industrial and agricultural base, and also the economies of scale provided by the larger domestic market.

On the other hand, it was also considered that in some products where current exports are non-existent or minimal, there may be scope for expansion of Sri Lankan exports to the Indian market. While it was obvious that the largest gains from trade would likely to come from opening up precisely those sectors where domestic industries will come under strong import competition, they were naturally also the sectors where domestic producers felt most vulnerable, where adjustment costs were likely to be considerable, and where political resistance the strongest.

The unilateral liberalisation efforts helped to improve the bilateral trade between the two countries with trade flows being largely in favour of India. India was keen to further its trade relations due to its broader industrial base and ability to meet Sri Lanka's import needs. Sri Lanka on the other hand were motivated by the prospect of 'early mover' access to a large market that would help the country to diversify its industrial base and the potential to raise its profile as a destination for foreign direct investment (FDI) on the basis of preferential access to a still relatively 'protected' Indian market. However the rule of origin required a certain percentage of the goods exported to have a local content thereby eliminating the possibility of other countries using Sri Lanka to access the Indian market for their products.

Sri Lanka's exports to India increased from US$ 164.51 million during the first seven months of 2009 to US$ 239.2 million during the corresponding period of 2010 registering a 45.4% growth. This increase was mainly due to a significant increase in exports such as spices (cloves, nutmeg, mace, pepper etc.), electrical machinery and parts, copper products, sheet rubber, pulp, confectionery & bakery products, tyres & tubes, glass products, wooden products, garments, apparel & clothing accessories, furniture, processed fruits & fruit juices, jewellery items etc. in the first seven months of 2010, when compared to the corresponding period of 2009. However, exports of certain products such as tea, ceramic products, cinnamon, gems, boilers & machinery parts, processed food, mineral sand, activated carbon etc. have recorded a decrease during January to July in 2010 compared to 2009. These percentages are exagerated due to the sharp decline in the figures recorded for the year 2009 compared to the year 2008.

While there has been a reduction in major exports such as vegetable oil, primary copper, margarine, marbles and pepper, a variety of other products have gained market access to India. They include insulated wires and cables, poultry feeds, pneumatic tyres, ceramics, apparel, furniture, air conditioners & coolers, measuring and checking instruments, glass bottles, processed meat products, Medium density Fibre (MDF) Boards, rubber gloves, thermal papers, tiles, stones and marbles, boilers & machinery parts, iron & steel articles, panel boards & enclosures, sacks and bags etc. thereby brining about product diversification.

Pakistan-Sri Lanka Free Trade Agreement

The Pakistan Sri Lanka Free Trade Agreement came into force on 12th June 2005. It has seen a substantial improvement in trade between the two countries, with the value of total trade between the two countries, which stood at US$ 147.1 million in 2004, increasing to US$ 252.2 million in 2009. Sri Lanka's exports which was at US$ 39.2 million in 2004 has increased to US$ 55.5 million, making Pakistan Sri Lanka's second largest trading partner in the SAARC region after India.

Sri Lanka's main exports to Pakistan include natural rubber, copra, tea, coconut, spices, betel leaves. A range of new products have also penetrated into the Pakistan market after the implementation of the Pakistan Sri Lanka Free Trade Agreement, including fresh pineapple, sports goods, tamarind with seeds, edible oil, porcelain tableware & kitchenware, ceramic tiles, furniture, electrical switches and sockets, herbal cosmetic products and plastic articles, paints, glass paintings, leather products, frozen fish, prawns, lobsters, crabs, cut flowers and foliage, gems & Jewellery and aquarium fish.

Pakistan implemented its final phasing out commitment in March 2009 and Sri Lanka has now duty free market access for more than 4500 products. Sri Lanka has also completed its 4th phasing out commitment.

Asia– Pacific Trade Agreement (APTA)

The Asia Pacific Trade Agreement, formerly the Bangkok Agreement signed in 1975, is one of the Asia's oldest regional preferential trading agreements with six Participating States - Bangladesh, China, India, Laos, Republic of Korea and Sri Lanka. APTA is a dynamic regional agreement which has been instrumental in producing a favorable outcome to Sri Lanka. It is particularly important for Sri Lanka as it is the only trade agreement Sri Lanka partakes with China and the Republic of Korea.

The exports under the APTA have increased with the implementation of the third round of tariff liberalization in September 2006. Sri Lanka's total exports under APTA in 2009 have increased to US$ 49.48 million compared to US$ 35.3 million in 2008, recording a 40% growth. Remarkably, exports to China under APTA accounts for US$ 28.98 million in 2009, which marks an increase of 53%. Coir products, tea, natural rubber, apparel, fish products, activated carbon, wooden furniture, silver jewellery and porcelain ware are Sri Lanka's main exports under APTA.

Further concessions are envisaged at the conclusion of the 4th Round of trade negotiations, which were launched at the Second Session of the Ministerial Council of the Asia Pacific Trade Agreement (APTA), held on 26th October 2007 in Goa, India. Ministers launched this new Round with a view to further widening products coverage and deepening the tariff cuts and to adopt modalities for the extension of negotiations into other areas such as non-tariff measures, trade facilitation, services and investment. The Third Ministerial Council was held on 15th December, 2009 in Seoul, Republic of Korea. In addition, two framework agreements on Trade Facilitation and Promotion, Protection and Liberalization of Investment were signed.

It is important to increase the utilisation of this agreement as it will provide preferential market access at 40 per cent margin of preference on 40 per cent of the tariff lines, to emerging markets such as China, India and South Korea upon the full implementation of the fourth round of negotiations. Sri Lanka is however exempted from making the above commitments along with the least developed countries as it is a smaller trading nation compared to China, India and South Korea. Given that APTA is the only trade agreement that jointly links Sri Lanka with foremost emerging economies, there is immense potential for it to expand trade with these large markets which have rapidly growing buying power.

Comprehensive Economic Partnership Agreement (CEPA)

At the time of formulating the free trade agreements with India and Pakistan it was decided that it should be the foundation to move into greater economic partnerships with the two countries in the future. A Joint Study Group was set up in April, 2003 to widen the ambit of India Sri Lanka Free Trade Agreement to go beyond Trade in Goods to include Services and to facilitate greater investment flows between the two countries. The Report of this group was submitted in October, 2003.

Based on the recommendation and conclusion of the Joint Study Group, CEPA negotiations were started in February, 2005 and concluded in July 2008, after thirteen rounds of negotiations. Both sides had decided to sign the CEPA during the 15th SAARC Summit held in Colombo but due to reservations expressed by certain businessman and professionals in Sri Lanka, both sides have still not signed the Agreement.

The salient features of CEPA are as follows:

Trade in Goods

- Reduction in Negative List by each country would provide additional market access.
- The Agreement provides for review of Negative Lists together with TLP within sixty (60) days of signing of CEPA.
- Both India and Sri Lanka have agreed to reduce tariff to zero percentage for items removed from Negative List within 3 years.

Trade in Services

- Both sides had agreed as a base level to offer their schedule of commitments at the WTO level – India at its Revised Offer to the WTO and Sri Lanka at its Initial Offer to the WTO.

Economic Cooperation

- Both countries have also agreed to promote economic cooperation in mutually identified sectors like fish, energy, drugs & pharmaceuticals, textiles, financial, infrastructure, tourism etc. for greater economic integration.

Investment

- The Investment Agreement will provide an institutional framework to create an enabling environment for greater flow of investments between the two countries;

CEPA includes the following agreements:-

MRA on standards - The Agreement on Mutual Recognition / equivalence will facilitate recognition of each other's standards, assessment procedures, equivalence arrangements etc.

MOU on Harmonisation of Ayurvedic medicines will enable both countries to cooperate in traditional system of medicines.

Custom Cooperation Agreement – The Agreement aims at simplifying Custom procedures and expediting Custom clearance.

Agreement on Consumer Protection and Legal Meteorology aimed at protecting the interest of consumers and creating awareness amongst consumers in both countries.

Is CEPA is beneficial or harmful to Sri Lanka?

On a closer examination of the draft agreement it is very difficult to come to a conclusion that signing this agreement may be harmful to Sri Lanka. However, there has been much debate on this subject and what can be observed is that the two sides who are for and against this agreement appears to be drifting further and further away from each other rather than having an open discussion to find out ways and means of improving on any shortcomings so that the agreement can be re-negotiated if necessary and signed. To add to the problem the resident representative of the International Monetary Fund made a statement to the media in August this year that Sri Lanka should not be scared to sign CEPA and earlier this month that Sri Lanka is foolish in not signing CEPA with India. Although the initial statement did not get any response on the second occasion the Governor of the Central Bank of Sri Lanka was quick to respond stating that he had no business to talk about as to what a sovereign state should or should not do. It is statements like these that add fuel to the fire which drive fears into those who are opposing the CEPA thinking that there is a hidden agenda behind these statements.

It is important to examine the reasons as to why a certain group of businessmen and professionals are against CEPA being signed and implemented. I would like to mention that India being the dominant partner and the history of their strong arm tactics in addressing a number of issues both political and economic and the failure of the government of Sri Lanka to fight them appears to be the principle issue behind the opposition. CEPA being the next step from the India Sri Lanka Free Trade Agreement the problems associated with the latter will definitely be in the back of the minds of the Sri Lankan businessmen. It is no secret that although trade was liberalized and Indian goods had a relatively free passage to Sri Lanka it was not the same when Sri Lankan goods were being brought into India. There were many non-tariff barriers bureaucracy and sometimes discrimination which made it difficult for the Indian importers who were thereby discouraged from sourcing goods from Sri Lanka.

The professionals have expressed their concerns mainly arising from the fact that their carriers are at stake being displaced by Indians. There have been claims that unqualified doctors have been practicing in Sri Lanka and that some of them have been working as Assistant Consultants when there was no such grade in the medical profession in this country.

We therefore need to look at what we should have done better to avoid this stalemate. Some of the questions being asked are: Was the composition of the negotiating team right? Were all sectors affected represented in the negotiating team? Were they experienced negotiators against the strong opposition? (in the negotiating the India Sri Lanka Free trade Agreement, India was smart enough to insist that 80% of the quota for export of garments had to be made of Indian fabric whereas Sri Lank appeared to be more liberal in granting concessions) Were the members of the team appear to be free of any personal bias towards India? Has India forced their draft proposal on us? Were the non-tariff barriers bureaucracy and discrimination issues discussed and acceptable solutions found?

What were the objectives in entering into the CEPA with India? Was it to grow our trade with or Exports to India? How successful have we been in growing our exports to India under the India Sri Lanka Free trade Agreement? Are focusing on the real benefits in signing up agreements rather than the number of agreements signed? Does India reciprocate adequately for the amount of concessions granted by us" Are we taking advantage of our strong relationship with China to force India's hand during negotiations?

It is absolutely essential that CEPA is marketed properly to the Sri Lanka business community and the professionals and any fears that they may have on the agreement allayed so that we all work towards making maximum use of it.

Conclusion

It is important to remember that free trade agreements have become essential especially for the smaller countries like Sri Lanka which have opened up their economies which may not be that successful in facing up to the high competition in the global market. We should not forget that all parties to an agreement would aim to get the best for their own country and it is up to us to negotiate what is best for Sri Lanka. We need to be well prepared for the negotiations armed with up to date statistics. We also need to be strategic. Good examples of such strategic moves are the decision by Australia to identify itself as part of Asia to get the benefit of the huge market and the position taken by the United Kingdom in its membership status with the European Union. Monitoring progress and being aware of the practical issues faced by the Sri Lankan importers and exporters is essential so that they can be addressed and improvements made during the reviews. A mechanism to address such issues on an on-going basis rather than waiting for the next review may be a solution to this problem. Adequate safeguards should also be in place to ensure that the local businessmen and professionals are not unduly affected by their Indian counterparts.

Some of the important issues to be addressed with regard to the successful negotiation of the free trade agreements or their periodic reviews are that there should be greater transparency in the process with discussions held with all parties affected prior to the commencement on the negotiations, selecting what appears to be a competent team for the negotiations and the agreements should be marketed properly to all stakeholders so that there will be the least amount of resistance and optimum utilization of the concessions.

Sri Lanka is a member of several trade agreements, and it is important to consider if access gained is fully utilised and advanced. One of the key issues to be addressed in this regard is for the Department of Commerce or other government authorities or chambers of commerce educating the existing and potential importers and exporters of the advantages that they can derive by making use of such agreements. Therefore it is important that the importers and exporters make the best use of the free trade agreements rather than criticizing them

"A key obstacle to widening the usage of tariff concessions and liberalised trade between partners to the trade agreements is the lack of sufficient knowledge regarding access provided and benefits available to exporters and importers. Thus, extensive and comprehensive awareness programmes regarding the opportunities created by these agreements must be implemented in all member countries. This would be beneficial as international trade would enable people to consume better quality products and services at lower prices and increase export earnings which will, in turn, raise the standards of living in member countries."

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