OCCASIONAL PAPER 24

2006

A Review of India-Sri Lanka Trade Cooperation

BISWAJIT NAG

INDIAN INSTITUTE OF FOREIGN TRADE
(Deemed University)
NEW DELHI

Dr. Biswajit Nag is Associate Professor of Economics at the Indian Institute of Foreign Trade (IIFT), New Delhi. Earlier, he taught in the Institute of Finance Management, Dar-es-Salaam, Tanzania. He also served in the Poverty and Development Division of the UN-ESCAP, Bangkok.

Dr. Nag works on the applied issues of International Economics including regional cooperation and WTO. Earlier he pursued reserach on Indian industries especially on productivity and efficiency issues. He refereed several articles for national and international journals. He has also published artciles in number of international journals.

Editor: **Anil K. Kanungo**

OCCASIONAL PAPER 24

A Review of India-Sri Lanka Trade Cooperation

BISWAJIT NAG

INDIAN INSTITUTE OF FOREIGN TRADE
(DEEMED UNIVERSITY)
NEW DELHI

First published in 2006

Published by

Registrar,
Indian Institute of Foreign Trade
B-21 Qutab Institutional Area
New Delhi-110016

Printed at
Apex Printing House
S-217 Bank Street
Baba Gang Nath Market
Munirka, New Delhi-110067

Price: Rs 50

FOREWORD

After five years of implementation of India-Sri Lanka FTA, both the countries are now engaged in negotiating "Comprehensive Economic Partnership Agreement" between them. Since the FTA came into force, there has been a dramatic rise in the bilateral trade. In 2005-06, it has crossed the US$ 2 billion mark with an average annual growth close to 30 per cent during 2000-2005. Both India and Sri Lanka are eager to address the concerns and unsolved issues in FTA and to extend the scope of the agreement encompassing other sectors such as services, investment, technology transfer, etc.

The existing trade relationship between India and Sri Lanka has been reviewed in the Paper and an attempt has been made to gauge the future of India-Sri Lanka bilateral trade and investment opportunities. It has also focused on the potential areas of trade in services.

The Paper has noted that India is the major importer of "coffee, tea, and mate" from Sri Lanka but its share has come down in 2004 compared to 1998. Of late, "copper and articles thereof" especially refined copper, has become the most important importable item by India from Sri Lanka. During 1998-04, Indian exports of "mineral fuels, oils, distillation products" have gone up drastically and in 2004 it accounts almost 21 per cent of India's total export to Sri Lanka. In post FTA situation, India's import growth of some leather products, mineral fuels, ores and ashes, milling and paper products, oil seeds, lac & gums, has been relatively high; but for textile products it was not so.

In case of grey areas such as rules of origin and non-tariff measures, it has been suggested in the Paper that common technical standards should be developed and trade defence mechanism kept limited to minimum possible. In case of services, mutual recognition of professions has been found to be most important issues. The service areas and their scopes need to be clearly marked to understand the market access issues.

The Paper, we hope would be useful for policy planning and understanding the trade dynamics between India and Sri lanka. IIFT would be happy to host debates and discussions on the issues flagged in the Paper.

PRABIR SENGUPTA
DIRECTOR
INDIAN INSTITUTE OF FOREIGN TRADE

NEW DELHI
DECEMBER 2006

A Review of India-Sri Lanka Trade Cooperation

Biswajit Nag

India-Sri Lanka Free Trade Agreement was signed on 28th December 1998. It became fully implemented by March 2000. It covers wide range of products. From India's side, significant concessions have been provided in tea and textiles. On the other hand, Sri Lanka provided easy market access for India, mainly in chemical, metal and machinery products. Sri Lanka committed to have phased out reductions in most of the selected products. Now both these countries are finalizing the negotiation of a "Comprehensive Economic Partnership Agreement" (CEPA), which includes trade, investment, technology transfer, etc. At this crucial moment, the article evaluates the bilateral trade relationship and gauges the future potentiality available for both countries in trade and investment. It analyzes the trade basket considering pre- and post-FTA data and identifies the strengths and weaknesses of the existing FTA.

JEL Classification No. F13, F14, F15.

Keywords: Trade Cooperation, Bilateral Trade, Economic Integration, India-Sri Lanka Trade.

I. Introduction

INDIA and Sri Lanka being neighbours wanted to engage themselves in much deeper cooperation process in recent times. As SAARC has been experiencing relatively a slow progress, both the countries were interested to harness the trade potentiality through faster integration. India-Sri Lanka free trade agreement (FTA) signed in 1998 is a reflection of

Research assistance from Gargee Sarkar, Research Fellow, IIFT, New Delhi is acknowledged.

this. This has resulted in significant expansion of trade between the two countries. The total trade between India and Sri Lanka has increased from mere US$475 million in 1998-99 to around US$700 million in 2000-01 and to hopping US$1.7 billion in 2004-05. Looking at the success of the FTA, both the countries are now finalizing the negotiation of a "Comprehensive Economic Partnership Agreement" (CEPA), which includes trade, investment, and technology transfer, etc. The CEPA negotiation was initiated in 2005. Both the countries would like to address the concern and unsolved issues in FTA and bring other sectors for discussion. CEPA comprises four objectives: widening and deepening of the existing FTA, establishing an agreement on trade in services, including measures for promotion of investment in each other's countries, and enhancing economic cooperation.

The current article makes an attempt to review existing trade relationship between India and Sri Lanka and tries to gauge the future of India-Sri Lanka bilateral trade and investment opportunities. It will also focus on different service sectors and their growth potential. The data from India Trades, CMIE and PC-TAS, UNCTAD have been used. The time period used in this analysis is mainly from 1998-2004. PC-TAS provided data for Sri Lanka up to 2002 and the same has been used to analyze Sri Lanka's import.

II. Sri Lanka's Macro-Economy: A Brief Outline

Sri Lanka abandoned import oriented economic policies around late 1970s and opted for more market friendly and export-oriented strategies. Sri Lankan economy was opened to foreign banks in 1979 and developed an offshore insurance and banking industry.

Sri Lanka is primarily an agricultural economy, with around 38 per cent of the labour force (by 1998 estimate) engaged in agricultural activity. Apart from agriculture, around 45 per cent (by 1998 estimate) of the labour force engaged in services sector.

Sri Lanka's GDP grew at the rate of 5.5 per cent during early 1990s until a drought and deteriorating security situation lowered growth to 3.8 per cent in 1996. With average growth rate of 5.3 per cent, the economy rebounded during 1997-2000. However, in 2001, the country experienced a severe contraction and GDP grew by only 1.4 per cent due to budgetary problems, power shortages, global slowdown and continuing civil strife. But growth rebounded in 2002 and 2003 with rates being 4.0 and 5.2 per cent respectively.

Sri Lanka continues to face balance of trade problem despite being a fairly liberalized economy. In 2004, the estimated current account balance has been (-)$278 million. The Sri Lankan currency (LKR) per US dollar depreciated from 70.6354 in the year 1999 to 96.521 in the year 2003.

During 2003, per capita aid (including both official development assistance and official aid) to Sri Lanka was US$34.9 compared to only US$15.0 during 2000. This suggests that Sri Lanka depends to an extent on foreign aid. By 2003 estimate, Sri Lanka's present value of debt (including short term external debt) was US$8.4 billion compared to US$7.0 billion during 2000.[1]

Sri Lanka has laid emphasis on export of plantation crops (tea, rubber, coconut). Cocoa, coffee, cinnamon, cardamom, pepper, cloves are also major exportable items. Rice, fruit, vegetables are grown for local consumption. Among the industrial products, Sri Lanka exports amorphous graphite. Textile products also occupy a significant position in Sri Lankan export basket.

Table 1 provides an overview of the Sri Lankan as well as Indian economy comparing certain basic macro-economic indicators. India is experiencing relatively higher growth rate compared to Sri Lanka during 2003-2004, with GDP growth rate of 8.6 and 5.9 per cent during 2003. Contribution of the three sectors – agriculture, industry and services to GDP is almost the same for India and Sri Lanka. The services sector contributes more than 55 per cent in Sri Lanka, which is marginally less compared to India.

In 2003-2004, exports and imports of goods and services in India as a proportion of GDP is much less compared to that of Sri Lanka.

During 2004, inflation is more or less stable for India (around 5%) compared to 9 per cent for Sri Lanka, even if GDP growth rate is almost the same for both the countries.

In recent era, FDI has become important for Sri Lanka and India, which has been reflected in Table 1.

TABLE 1

SELECT MACRO-ECONOMIC INDICATORS OF INDIA AND SRI LANKA

Indicators	India		Sri Lanka	
	2003	2004	2003	2004
GDP(current US$)	600.6 bn	691.9 bn	18.2 bn	20.1 bn
GDP growth (annual %)	8.6	6.9	5.9	6
Inflation, GDP deflator (annual %)	3.2	5.3	5.1	8.7
Population, total	1.1 bn	1.1 bn	19.2 mn	19.4 mn
Population growth (annual %)	1.5	1.4	1.2	1.1
Agriculture, value added (% of GDP)	22.2	21.8	19	17.4
Industry, value added (% of GDP)	26.6	26.1	26.3	24.9
Services, etc. value added (% of GDP)	51.2	52.2	54.7	57.6
Imports of goods and services (% of GDP)	16.0	17.2	42.4	42.1
Exports of goods and services (% of GDP)	14.5	15.3	35.8	35.4
Current account balance (% of GDP)	-4.3	..	..	-0.8
Foreign Direct Investment	4.3 bn	..	228.7 mn	..

Source: World Development Indicators database, August 2005.

Despite sufficient amount of foreign investment, Sri Lanka continues to be dependent substantially on foreign aid. Tourism was its main source of revenue but after the Tsunami of 2004 the country has suffered severe losses and is still on the way to recovery.

III. Overall Trade Dynamics between India and Sri Lanka

The bilateral free trade agreement (FTA) between India and Sri Lanka was signed in December 1998. The India-Sri Lanka Free Trade Agreement (ISLFTA) came into force in March 2000. During 2002, India-Sri Lanka trade touched US$1 billion for the first time ever. Since the FTA came into force, there has been 195 per cent increase in bilateral trade. During 2004, bilateral trade touched US$1.7 billion. The trade balance has been in favour of India, however, declined during 2003-2004, thereby showing a faster rate of growth of Sri Lankan exports as compared to Indian exports.

According to World Trade Atlas, Sri Lanka ranked 14th (during 2002-2004) in terms of India's import basket, coffee, tea, mate, spices, meat and other seafood preparations being the major imports compared to its 35th rank during 1999-2001. Table 2 provides the estimates of the amount of total exports from India to Sri Lanka and vice versa. India's exports to Sri Lanka saw almost steady increase between 1995-96 to 2004-05 with exceptions in 2001-02 and 2004-05. On the other hand, India's imports from Sri Lanka steadily increased throughout the period 1998-2004, with a value of US$365 million during 2004-05 from just US$36 million during 1995-96.

India accounts for almost 15 per cent of the total Sri Lankan imports (biggest source of Sri Lankan imports) and it is the 3rd largest export destination for Sri Lanka. On the other

TABLE 2

INDIA'S EXPORTS AND IMPORTS TO/FROM WORLD & SRI LANKA

(Value: US$ million)

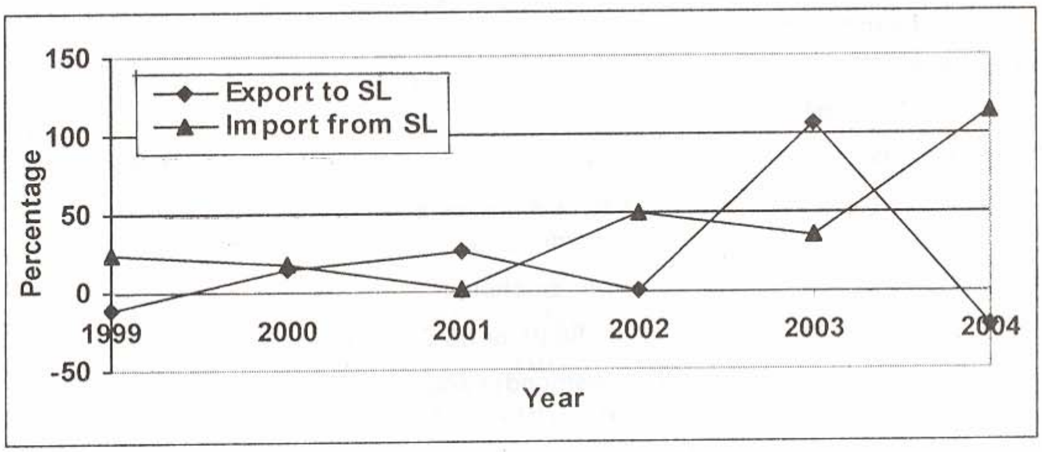
Year	*1995-96*	*1996-97*	*1997-98*	*1998-99*	*1999-00*	*2000-01*	*2001-02*	*2002-03*	*2003-04*	*2004-05*
Export to World (1)	31,326	32,930	34,922	33,086	36,743	44,633	43,975	52,856	64,012	80,705
Export to Sri Lanka (2)	400	475	482	437	500	641	633	923	1323	1358
Per cent export share [(2)/(1)]*100	1.28	1.44	1.38	1.32	1.36	1.44	1.44	1.75	2.07	1.68
Import from World (4)	36,718	39,025	41,650	42,283	47,039	50,619	51,588	61,572	78,355	109,396
Import from Sri Lanka (5)	36	43	30	38	44	45	68	91	195	365
Per cent import share [(5)/(4)]*100	0.10	0.11	0.07	0.09	0.09	0.09	0.13	0.15	0.25	0.33

Source: India Trades, CMIE.

hand, from India's side, Sri Lanka is relatively a small market. It accounts for only 2 per cent of total Indian exports. Over half of Indian investments in SAARC countries are in Sri Lanka. India's exports to Sri Lanka as a percentage share of India's exports to world have gone down during 2004. On the other hand, India's imports from Sri Lanka have increased consistently during the period 1998-2004, from mere 0.07 per cent to around 0.3 per cent. Figure 1 describes the annual growth rate of India's exports and imports to/from Sri Lanka. It is quite distinct that Sri Lanka's export growth to India is quite dramatic after the FTA.

FIGURE 1

INDIA'S EXPORT & IMPORT GROWTH RATE WITH SRI LANKA



Source: Data from India Trades, CMIE.

IV. India-Sri Lanka Trade: Commodity Groups

This section describes differences of commodity composition in the export basket of India and Sri Lanka. A list of 20 commodities (at 4-digit HS level) of Sri Lanka's total exports in 2002 is given in Table 3. Top 20 commodities constitute almost 68 per cent of Sri Lankan total exports. Each of these commodities has more than one per cent share in the total export. Table 3 shows that textiles, clothing and garments form a major share of Sri Lanka's global exports. The important

TABLE 3

SRI LANKA'S GLOBAL EXPORTS: TOP TWENTY COMMODITIES IN 2002

HS Code		*Value (US$ mn)*	*% of Total*
	All Commodities	**4683.42**	**100**
0902	Tea	650.41	13.89
6204	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers	474.14	10.12
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers	336.6	7.19
7102	Diamonds, whether or not worked, but not mounted or set	214.13	4.57
6206	Women's or girls' blouses, shirts and shirt-blouses	173.25	3.7
6110	Jerseys, pullovers, cardigans, waistcoats and similar articles, knitted or crocheted	136.03	2.9
6205	Men's or boys' shirts	132.61	2.83
6212	Brassieres, girdles, corsets, brace, suspenders, garters and similar articles and parts thereof	124.56	2.66
6108	Women's or girls' slips, petticoats, briefs, panties, nightdresses, pyjamas	113.04	2.41
6109	T-shirts, singlets & other vests, knitted or crocheted	110.55	2.36
6208	Women's or girls' singlets and other vests, slips, petticoats, briefs, panties, nightdresses	94.47	2.02
6105	Men's or boys' shirts, knitted or crocheted	93.51	2.00
8803	Parts of goods of heading no. 88.01 or 88.02	88.96	1.9
7103	Precious stones (other than diamonds) and semi-precious stones	85.18	1.82
4015	Articles of apparel and clothing accessories (including gloves), for all purposes, of vulcanized rubber other than hard rubber	66.1	1.41
6104	Women's or girls' suits, ensembles, jackets, blazers, skirts, knitted or crocheted	62.97	1.34
6116	Gloves, mittens & mitts, knitted or crocheted	57.3	1.22
4202	Trunks, suit-cases, vanity-cases, executive-cases, brief-cases	55.39	1.18
4012	Retreaded or used pneumatic tyres of rubber; and tyre flaps, of rubber	52.5	1.12
6111	Babies' garments & clothing accessories, knitted or crocheted, knitted or crocheted	50.11	1.07
	Total of the above	**3171.81**	**67.71**

Source: India Trades, CMIE.

commodity groups of Sri Lanka's exports are tea, textiles commodities, diamonds & precious stones, etc. Other items like "rubber vulcanized", "suit cases, trunk", etc. are also important in Sri Lankan export basket.

Out of the top twenty commodities exported by Sri Lanka to the world, India is the major importer of "coffee, tea, and mate" (under HS chapter 09). Its share has come down to 8.32 per cent during 2004 from 13.15 per cent during 1998. During 2004, "copper and articles thereof" (under HS chapter 74) especially refined copper has become the most important importable item for India from Sri Lanka.

Table A in the Appendix 1 gives the details of India's imports from Sri Lanka during the year 1998 and 2004 and their corresponding shares. The commodity groups are defined broadly by different chapters of 2-digit HS code. India imports around 68 commodity groups at 2-digit level from Sri Lanka. There are some commodities like "Meat, Fish" (under Chap. 16), "Bird skin feather's"(Chap. 67) which were not traded during 1998 but later on during 2004 India has started importing, at a smaller level. Commodities under Chapter 43, i.e. "fur skins, artificial fur" were stopped during 2004. The major item which has gone up to a very high level is 'coffee, tea, mate, spices' (under Chapter 09) and "copper articles" (under Chapter 74). The latter one forms around 41 per cent of India's import basket compared to its earlier level of 4 per cent during 1998. Most of these copper items are produced by Indian companies in Sri Lanka only. It is expected that copper export from Sri Lanka to India will come down in future as the government of Sri Lanka tightens the regulation on value addition.

During 2002, Sri Lanka imported goods worth US$6,039 million. Table 4 gives a list of top twenty commodities (defined by four digit HS code during 2002) imported by Sri Lanka.

TABLE 4

SRI LANKA'S GLOBAL IMPORTS: TOP TWENTY COMMODITIES

(4 digit HS level, 2002)

HS Code	*Description*	*Value (US$ mn)*	*% of Total*
All Commodities		**6038.69**	**100**
2710	Petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70 per cent or more	425.04	7.04
6002	Other knitted or crocheted fabrics.	294.17	4.87
5209	Woven fabrics of cotton, containing 85 per cent or more by weight of cotton, weighing more than 200 g/m2.	223.94	3.71
7102	Diamonds, whether or not worked, but not mounted or set.	178.49	2.96
5512	Woven fabrics of synthetic staple fibres, containing 85 per cent or more by weight of synthetic staple fibres.	145.69	2.41
1001	Wheat and meslin	139.21	2.31
1701	Cane or beet sugar and chemically pure sucrose, in solid form.	135.57	2.25
8703	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading no. 87.02), including station wagons and racing cars	124.35	2.06
8502	Electric generating sets and rotary converters	115.93	1.92
402	Milk and cream, concentrated or containing added sugar or other sweetening matter.	103.74	1.72
8704	Motor vehicles for the transport of goods	83.02	1.37
3004	Medicaments (excluding goods of heading No. 30.02, 30.05 or 30.06) consisting of mixed or unmixed products for therapeutic or prophylactic uses, put up in measured doses or in forms or packings for reUNIT	80.33	1.33
7108	Gold (including gold plated with platinum) unwrought or in semi-manufactured forms, or in powder form.	76.41	1.27
5903	Textile fabrics impregnated, coated, covered or laminated with plastics, other than those of heading No. 59.02.	67.72	1.12
2523	Portland cement, aluminous cement, slag cement, super sulphate cement, and similar hydraulic cements, whether or not colored or in the form of clinkers.	64.27	1.06
5208	Woven fabrics of cotton contain in 85 per cent or more by weight of cotton, weighing not more than 200 g/m2.	55.29	0.92

HS Code	Description	Value (US$ mn)	% of Total
3102	Mineral or chemical fertilizers, nitrogenous.	53.79	0.89
713	Dried leguminous vegetables, Shelled, whether or not skinned or split.	51.49	0.85
5205	Cotton yarn (other than sewing thread), Containing 85 per cent or more by weight of cotton, not put up for retail sale.	50.97	0.84
8473	Parts and accessories (other than covers, carrying cases and the like) suitable for use solely or principally with machines of headings Nos. 84.69 to 84.72.	43.03	0.71
	Total of the above	**2512.45**	**41.61**

Source: India Trades, CMIE.

The list consists of products such as petroleum products, textile commodities, diamonds, medicines, electronic goods, vehicles, cement, sugar, etc. Unlike Sri Lanka's global exports, imports are not confined to few as well as selected commodities. Petroleum products under (HS 2710) was the top most importable item for Sri Lanka with a share of 7 per cent of total imports. "Textile products" mainly consists of woven or knitted or crocheted fabrics and fibres. Top 20 commodities consist of only 42 per cent of Sri Lanka's total imports.

India exports almost 89 commodity groups at 2-digit level. Table B in Appendix 1 provides a list of major products exported from India to Sri Lanka for the period 1998 and 2004. During this time, minerals fuels, oils, distillation products (under Chapter 27) have gone up drastically from a mere level of US$0.07 milion during 1998 to US$273.17 million in 2004. It accounts for almost 21 per cent of India's total export to Sri Lanka in 2004. Apart from minerals products, India's major exports to Sri Lanka are sugar and sugar confectionary, vegetables, inorganic chemicals (mainly carbon), paper and paper board, motor vehicles, etc. Most of them experienced a positive growth rate during 1998-2004. According to Table B in the Appendix commodities such as "meat, fish" (HS 16); "umbrellas, walking sticks" (HS 66)) which were not traded during 1998 but became quite prominent traded items during 2004.

V. India-Sri Lanka Free Trade Agreement

The Governments of India and Sri Lanka recognized that progressive reductions and elimination of obstacles to trade through a bilateral free trade agreement would contribute to the expansion of world trade by expanding their domestic markets. The trade agreement between these two countries initially started with reductions of tariffs and other barriers. Now, both countries are engaged in finalizing the much deeper ties covering the areas of trade, investment, technology transfer, etc.

Both the countries agreed to sign FTA keeping in view their commitments in WTO. Hence, lot of consistency related aspects have been given due importance in the agreement. Also the agreement focuses on several safeguard related issues such as withdrawal of preferences for products for which domestic injury is serious or country has BOP crisis, etc. The agreement takes similar views as in WTO about subsidies and dumping. For any crisis, consultations have been given high priority. It is expected that countries would accord sympathetic consideration to and would afford adequate opportunity for, consultations with respect to any matter affecting the operation of this agreement. In the event of an amicable solution not being found, the matter shall be referred to an Arbitral Tribunal for a binding decision. The Tribunal shall be constituted by the Joint Committee in consultation with the relevant Arbitration Bodies in the two countries. Any dispute between the countries regarding the interpretation and application of the provisions of the agreement or any instrument adopted within its framework is expected to be amicably settled through negotiations failing which a notification may be made to the Committee by any one of the Contracting Parties. Six months' notice is required from a country who wants to terminate the agreement. The agreement provides scope to modify it also.

The agreement is also governed by the "Rules of Origin"[2] as described in the "Annexure C" of the agreement. The rules of origin is specified by three criteria, namely:

- Domestic value addition should be 35 per cent.
- Inputs have to undergo substantial transformation at four digit level.
- Simple operations like packing, cutting, assembly, etc. do not qualify as value addition.

However, if raw materials/inputs are sourced from either India or Sri Lanka, value addition to be reduced to 25 per cent within the limit of 35 per cent. Duty reduction commitments from both sides have been met.

Rules of origin have raised some areas of concern from both sides. Looking from the Indian side, the issues are related to (i) circumvention of rules of origin (huge amount of increase in Sri Lankan exports of specific commodities like copper and pepper), (ii) Exploitation of duty differentials which may harm Indian producers[3] (fear of setting up vanaspati industry in Sri Lanka may adversely affect Indian vanaspati industry.) Similar concerns have been raised from Sri Lankan side also. They are mainly related to (i) Perceived rigidity on rules of origin, (ii) Procedural delays and problems, (iii) Local taxes in India, and (iv) Increase of cement exports from India.

During the early rounds of CEPA negotiations, Sri Lanka has been keen to have rules of origin criteria relaxed by allowing for conversion of HS code at 6-digit and requested India to dispense with the HS conversion requirement where the CIF value of non-domestic input is less than 7 per cent of FOB value of the finished product. Sri Lanka has also been keen to consider imported inputs from either party as domestic inputs of the finished products and to remove the requirement of HS conversion. However, in first two rounds of discussion, India has been unwilling to accept 6-digit HS conversion as a general rule.

If there are products that meet 35 per cent or above value addition but where HS code does not change at 4-digit level and for products that change HS heading at 4-digit level but the value addition is below 35 per cent, India has expressed its willingness to adopt special rules.

In case of vanaspati, about 2.7 lakh tonnes of vanaspati have entered into the country from Sri Lanka between September '05 and March '06, which have forced hundreds of small and medium sized vanaspati units in India to work on just 30 per cent of their capacity. Sharing the industry's concern that moving at this rate vanaspati import from Sri Lanka may rise up to 6 lakh tonnes in the year to September '06, the government is thinking of two major options to check its flow into the country.[4] *First* is through imposing tariff rate quota (TRQ) and the *second* is to have mandatory quality checking of imports of vanaspati. Sri Lanka has already limited its exports to 250,000 m/t per year and India wants to formalize this including both vanaspati (HS 151620) and bakery shortenings (HS 151790). With respect to copper also India has proposed Sri Lanka to limit its exports. As mentioned earlier, Sri Lanka has already tightened the value addition norms and would like to increase domestic investment as well as consumption in this area reducing its exposure to Indian investment. In case of pepper, already Sri Lankan exports to India show a decline on a year-on-year basis during 2003-04.

Both the countries are also having serious concern about non-tariff barriers. Though the most of the products which Sri Lanka imports from India are in the negative list (about 40%), there are plethora of other duties (such as import surcharges, port duties, excise fees on some products, export development fees, etc.) on imports. Agricultural produces, vehicles, etc. are such products. According to USTR report, Sri Lanka has started using SPS on wheat imports. From a Sri Lankan perspective major issues are underutilization of quotas (only 5%) for tea (15 million kg) and ready-made garments (8 million pieces), restrictions on entry points for tea, copper and apparel and relaxation of the rules of origin criteria. Indian government had agreed to allow 6 million pieces of textile and apparel to be exported from Sri Lanka free of duty and to allow 2 million pieces to be exported at a tariff concession of 75 per cent, subject to the condition that Indian fabric is used for production. Sri Lanka feels that this is very restrictive and would like to address it in CEPA discussion. Sri Lanka is also concerned about specific duties in India and would propose that only *ad valorem* duties should be considered for FTA. To overcome the barriers arising from technical standards and regulations, Sri Lanka and India have agreed to sign a Mutual Recognition Agreement (MRA) of standards between Bureau of Indian Standards and Sri Lanka Standards Institute as well as signing MRA between national accreditation boards of the two countries.

VI. Tariff Structure between India and Sri Lanka and the Product Coverage

India has offered different kinds of discount such as zero duty (100% concession) for 1,351 items, fixed concession rate of 25 per cent on 528 textile items under HS code 51, 52, 58, 59, 60, 63 and a majority of textile items under HS code

53-56. There are also some quantity restrictions with a fixed concession rate of 50 per cent for selected items under textiles and tea. Besides tea and textile items, 50 per cent concession rate is granted for the balance 2,799 items [leaving 429 items in the negative list of India - Annexure D (i)].[5] The details of the tariff rate and the product coverage is given in the table in appendix A.

In case of India, quantity restrictions exist for selected items like "green tea", "black tea" under HS code 090210, 090220, 090230 and 090240, and one selected item "extracts, essences and concentrates of tea or mate or instant tea", under HS code 210120, with an annual preferential quota of up to 15 million kg. In case of textile items, defined under HS chapters 61 and 62 (including all the six-digit sub-items), subject to a maximum annual quota of 8 million pieces of which a minimum of 6 million pieces should contain Indian fabrics and no category of garments could exceed 1.5 million pieces per annum. Sri Lankan concession rates are subject to periodic removal of tariffs within a stipulated period.

Sri Lanka offers zero duty for only 319 items defined by 6-digit HS code. Similarly, Sri Lanka offers 50 per cent tariff concession rate for only 889 items under 6-digit HS code (raw materials) which are expected to be 100 per cent at the end of 3rd year compared to 2,799 items for India even if both the countries expect to bring down tariffs within three years. The number of items in the negative list is 1,180 for Sri Lanka for which it offers no duty preference. For the remaining 2,724 items given in Annexure D(ii) defined by 6-digit HS code, the concession rate is expected to be brought down not less than 100 per cent before the end of 8th year.[6] Sri Lanka does not offer any special quota or fixed concession rate for any commodity.

VII. Trade Complementary Index

Trade complementary (TC) index is a useful tool in understanding the dynamics and prospects of trade among a group of countries or within a trade bloc. The index shows how well the structures of a country's imports and exports match with those of its partners.

TC index between countries k and j is defined as: TC_{kj} = 100-sum ($|m_{ik} - x_{ij}| / 2$), where x_{ij} is the share of good i in global exports of country j and m_{ik} is the share of good i in all imports of country k. The index is zero when no goods are exported by one country or imported by the other and 100 when the export and import shares exactly match. It is important to note that the TC index is calculated to match the export-import basket of two countries comparing their global export and import shares; it does not take into account bilateral trade flows between two countries only. Hence the TC index takes into account the possible trade cooperation effect through measures such as trade barrier reduction, foreign investment, and technology transfer and trade facilitation. In other words, TC index provides snapshot view about the FTA compatibility between two countries.

In this paper trade complementary index has been calculated between India and Sri Lanka for the year 1999 and 2004. Sri Lanka's export basket is relatively smaller than its import basket while trading with India. Sri Lanka has higher

TABLE 5

TRADE COMPLEMENTARY INDEX BETWEEN INDIA AND SRI LANKA

Exporting Country	*1999*	*2004*
India	27.42	29.57
Sri Lanka	35.20	34.41

Source: Calculated from the data available in PC-TAS and WITS. world bank.org for the year 1999 and 2004 respectively.

index than India for both 1999 and 2004. However, trade complementary index for India has gone up by 2.15 between 1999 and 2004 whereas the index for Sri Lanka has gone down marginally by 0.79 during 2004.

As trade complementary index both for India and Sri Lanka are not high in terms of its absolute figure, it clearly implies a low success of FTA between these countries. Before and after FTA, there is only a marginal change. In fact, Sri Lanka's index has come down slightly. The possible reasons could be for India, Sri Lanka is increasingly becoming a smaller trade partner as its export to the rest of the world is increasing very fast. Its product basket is getting diversified and their shares are also changing. The products like sugar, paper, carbon, petroleum products and motor vehicles, which constitute a significant share in India's exports to Sri Lanka, have relatively lower share in India's global exports (x_{ij}). On the other hand, these products are having relatively higher share in Sri Lanka's global imports (refer Table 4). Hence, the difference between m_{ik} and x_{ij} are relatively high resulting into low value of the index.

VIII. Import Change during 1998-2002

This section of the paper deals with import change of both countries during the period 1998-2002. Tables C, D in the Appendix 2 of this paper show growth rate of imports during 1998-2002 period. In case of India, commodities under HS code 07, 09, 25, 26, 27, 28, 29, 44, 48, 49 are subject to more than one concession rate. In case of Sri Lanka commodities under HS code 28, 29, 72, 73, 74, 84, 85 are subject to more than one concession rate. Tariffs on most items for both India and Sri Lanka are expected to get removed in phases within a stipulated period.

Table 6 provides the import change of tea and textile items which are subject to both quantity restriction with concession rate of 50 per cent and fixed concession rate of 25 per cent. Items like "green tea (not fermented) not exceeding 3 kg" under HS 090210 and "manmade filaments" under the HS code 54 have gone down significantly with growth rates being -100 and -97.86 per cent respectively. Items like "green tea (not fermented) in packages exceeding 3 kg" under HS code 090220 have experienced positive change of 25 per cent and "special woven fabric" under HS code 58 have experienced import change of -4.52 per cent.

TABLE 6

IMPORT GROWTH RATE OF TEXTILE ITEMS AND TEA ITEMS UNDER 25 PER CENT CONCESSION RATE AND UNDER 50 PER CENT QUANTITY RESTRICTIONS

HS Code	*Product description*	*Import change during 1998-2002 (%)*
Tariff Concession Rate: 25 per cent; Number of Products: 528		
52	Cotton.	-76.64
54	Manmade filaments.	-97.86
55	Manmade staple fibres.	-90.70
56	Wadding, felt, non woven, yarns, twine, cordage, etc.	-40.40
58	Special woven or tufted fabric, lace, tapestry, etc.	-4.52
59	Impregnated, coated or laminated textile fabric.	-86.94
60	Knitted or crocheted fabric.	-82.43
Tariff ConcessionRate: 50 per cent; Number of Products: 120		
09	Coffee, tea, mate and spices (all items under this Code).	-36.75
090210	Green tea (not fermented) in packages not exceeding 3 kg	-100
090220	Green tea (not fermented) in packages exceeding 3 kg	25
090230	Black tea (fermented)&partly fermented tea in packages less than3 kg	-60.12
61	Articles of apparel, accessories, knit or crochet.	-80.26
62	Articles of apparel, accessories, not knit or crochet.	-92.42

Table C in the Appendix 2 provides the import growth rate of commodities for which India offered different tariff concessions. Table 7 provides the change in import for items which were not imported during 1998 but were imported in considerable amount during 2002. This includes six-digit products under HS code 25, 48 with 50 per cent discount and items under HS code 27,28,29,44 with 100 per cent concession rate or zero duty. Table C excludes those items given in Table 7. Table 7 shows changes in import (major increases) of certain commodities during the period 1998-2002. Commodities such as edible "fish, aquatic vertebrates" (under HS chap. 03), consumer goods like "soaps, lubricants, articles of leather, animal gut" (under HS chapter 34, 42) were not traded during the beginning of the agreement but increased drastically during 2002. Similar changes in import have occurred for commodities under zero duty schemes; items like "minerals, oils" (under HS 27), etc have gone up to a very high level.

Major increase in imports occurred under the scheme of 50 per cent discount followed by a phase out removal of 100 per cent in two stages, within three years. Products under HS code 27 subject to zero duty have shown maximum increase. Items like "oils & other products of the distillation of high temperature coal tar, etc." under HS code 270799 have increased significantly during this period. Commodities like HS 071320, HS 071390 and HS 251212 subject to 50 per cent concession and commodities under HS 284910, HS 290243, HS 291221, HS 291830 and HS 482359 subject to zero duty were not imported during 1998 as well as 2002.

Table 8 provides with major commodities which experienced decrease in imports. Items like "edible vegetables" under HS code 07, "edible fruits" under HS code 08 have gone down drastically. Some products like "peas dried, shelled", "fur skins and artificial fur" have come down significantly

TABLE 7

INDIA'S SUDDEN INCREASE OF IMPORT OF CERTAIN SPECIFIC ITEMS

(US$ thousand)

*HS Code**	*Product Description*	*1998*	*2002*
Tariff Discount: 50 per cent			
03	Fish, crustaceans, molluscs, aquatic invertebrates ness 50 per cent	0	57
12	Oil seed, oleagic fruits, grain, seed, fruit, etc, ness	55	1,337
13	Lac, gums, resins, vegetable saps and extracts ness	53	909
16	Meat, fish and seafood food preparations ness	0	61
210120	Tea or mate extracts essences & concentrates & preparations thereof	0	99
23	Residues, wastes of food industry, animal fodder	0	3
32	Tanning, dyeing extracts, tannins, derivs, pigments, etc.	14	473
34	Soaps, lubricants, waxes, candles, modeling pastes	0	288
42	Articles of leather, animal gut, harness, travel goods	0	205
480100	Newsprint, in rolls or sheets	0	95
480260	Paper, fine, wood containing, in rolls or sheets, uncoated, ness	0	3
68	Stone, plaster, cement, asbestos, mica, etc. articles	0	63
262030	Ash and residues containing mainly copper	0	217
Tariff Discount: Zero Duty			
270799	Oils &other products of the distillation of high temp coal tar, etc. ness	0	1,258
282410	Lead monoxide (litharge, massic ot)	0	67
283523	Trisodium phosphate	0	12
283650	Calcium carbonate	0	48
284910	Calcium carbide	0	0
290243	P-xylene	0	0
291221	Benzaldehyde	0	0
291815	Salts and esters of citric acid	0	94
441119	Fibre board >0.8 g/cm 2 ness	0	558
441129	Fibre board >0.5 g/cm 2 <0.8 g/cm 2 nes	0	300
481940	Sacks and bags, of paper, nes; including cones	0	327
482390	Paper and paper articles, nes	0	58

* Two-digit products include only those six-digit products which are subject to same duty reduction and not imported during 1998.

TABLE 8

DECREASES IN INDIA'S IMPORT FROM SRI LANKA OF SPECIFIC COMMODITIES

(US$: thousand; Period: 1998-2002)

*HS Code**	*Product Description*	*1998*	*2002*
Tariff Diccount: Zero Duty			
07	Edible vegetables and certain roots and tubers	493	13
071290	Vegetables and mixtures dried, but not further prepared nes	80	2
Tariff Diccount: 50 per cent			
070320	Garlic, fresh or chilled	46	11
071310	Peas dried, shelled, whether or not skinned or split	367	0
05	Products of animal origin, nes	934	368
08	Edible fruit, nuts, peel of citrus fruit, melons	4,346	246
17	Sugars and sugar confectionery	93	2
18	Cocoa and cocoa preparations	94	8
33	Essential oils, perfumes, cosmetics, toiletries	620	147
35	Aluminous, modified starches, glues, enzymes	93	2
71	Pearls, precious stones, metals, coins, etc.	258	26
090210	Green tea (not fermented) in packages not exceeding 3 kg	5	0
62	Articles of apparel, accessories, not knit or crochet	121	45
43	Fur skins and artificial fur, manufactures thereof	90	0
Tariff Diccount: 25 per cent			
54	Manmade filaments	538	46
55	Manmade staple fibres	121	45
59	Impregnated, coated or laminated textile fabric	111	58

Note: Each two-digit product includes only those 6-digit products whose import value decreased substantially between 1998 and 2002.

during 2002. Textile items such as "manmade staple fibres", "manmade filaments" and "impregnated, coated, laminated staple fibres" under the fixed concession rate of 25 per cent (without any quantity restrictions) have also experienced major decline during 2002 with growth rates of -97.86, -90.70 and -86.94 per cent respectively.

TABLE 9

SRI LANKA'S IMPORT INCREASE (INDIA'S EXPORT CHANGE) DURING 1998-2002

(US$ Thousand)

*HS Code**	*Product Description*	*1998*	*2002*
Tariff Rate: Residual List			
66	Umbrellas, walking-sticks, seat-sticks, whips, etc.	0	55
27	Mineral fuels, oils, distillation products, etc.	211	142,008
89	Ships, boats and other floating structures	143	4281
25	Salt, sulphur, earth, stone, plaster, lime and cement	2,238	25,249
26	Ores, slag and ash	54	444
81	Other base metals, cermets, articles thereof	6	60
280110	Chlorine	129	1721
Tariff Rate: 100 pr cent			
280470	Phosphorus	0	79
843860	Machinery for the preparation of fruits, nuts or vegetables	0	2
Tariff Rate: Zero Duty			
290410	Derivs of hydrocarbons cntg only sulpho groups,thr salts & ethyl esters	0	51
290517	Dodecan -1-ol, hexadecan-1-ol and octadecan-1-ol	0	22
290930	Aromatic ethers and their derivatives	0	56
291439	Aromatic ketones without oxygen function, n.e.s.	0	64
291639	Aromatic monocarboxylic acids and their derivatives, n.e.s.	0	6
292241	Lysine and its esters; salts thereof	0	67
292421	Ureines and their derivatives; salts thereof	0	51
292429	Cyclic amides and their derivatives, n.e.s.; salts thereof	0	106
293390	Heterocyclic compds with nitrogen hetero-atom(s) only, n.e.s.	0	23
293799	Hormones nes&thr derivs,in bulk;steroids n.e.s. usd prim as horm,in bulk	0	45
Tariff Rate: 50 per cemt			
741210	Fittings, pipe or tube, of refined copper	3	536
740400	Waste and scrap, copper or copper alloy	4	1,449
720610	Ingots, iron or non-alloy steel, of a purity of less than 99.94 per cent iron	7	425
740710	Bars, rods and profiles of refined copper	13	2,656
740721	Bars, rods and profiles of copper-zinc base alloys	5	1,074
740811	Wire of refined copper of which the max cross sectional dimension > 6 mm	51	1,303
841199	Parts of gas turbines n.e.s.	3	295
720990	Flat rolled prod, i/nas, not in coil, cr >/=600mm wide, n.e..s	23	768
721810	Ingots and other primary forms, stainless steel	2	396
731100	Containers for compressed or liquefied gas of iron or steel	31	1,594

Sri Lanka also experienced major changes in the import of specific commodities. As said earlier, there are items which are subject to more than one concession rate. Several items in the residual list[7] have experienced positive growth rate. Items under the broad category "nuclear reactors" (HS 84) like parts of gas turbine (841199), transporter or bridge cranes (842619) and "iron and steel" under HS 72 including products under 720711 and 720610 have faced high growth changes in import during the period of 1998-2002.

Sri Lanka also experienced increase in imports under their specific concession rate. The list of such commodities is given in Table 9. The selected commodities come under various concession rates. Commodities which were not traded during 1998 but were imported by Sri Lanka during 2002 include "umbrellas, walking sticks", "phosphorous" under HS 280470, and majority of commodities under HS code 29 under 100 per cent concession rate.

IX. Other Economic Relationship: Services Trade and Investments

India and Sri Lanka relations have undergone major transformation in the recent past. During 2002 and 2003, India was the biggest investor in Sri Lanka, but during 2004 India slipped to fourth position preceded by Switzerland (Holcim Cements), Malaysia (Dialog Mobile network) and UK (HSBC BPO). Along with the investments in many areas, services trade between these two countries is also growing rapidly. It has been identified that services sectors such as transport and logistics, tourism, ICT, education, health, construction and related engineering services and financial services have the potential to be traded between the two countries.

The post FTA period has witnessed quite substantial increase in FDI, major reason being the ability to re-export to

India while benefiting from lower tariffs on raw materials in Sri Lanka. Some of the most visible Indian investments are Indian Oil Corporation, TATAs (Taj Hotels) VSNL, Watawala tea plantations, Apollo Hospitals, LIC, Aditya Birla Group, Ambujas, Jet Airways, etc. Indian human resource and educational institutions like ICFAI have also entered in Sri Lankan market. Apart from these, Indian Banks such as UTI and ICICI and education establishments like Manipal Medical Institute is also in the pipeline.[8]

The initial phase of the cooperation between India and Sri Lanka focused on trade in goods both in the context of SAFTA and Indo-Sri Lanka Free Trade Agreement. In recent years, service sector has gained much importance in terms of its share in GDP and total trade. Sri Lanka concentrated mainly in the export of transhipment services as port of Colombo is a major hub port for India and tourism. India however focused on the export of both traditional services (construction, engineering, tourism) and knowledge-based services (software, education, health).

India allowed 100 per cent FDI investment through automatic route in the construction of ports and harbors. Countries such as Australia, Singapore, etc. have not only invested in the infrastructure but are also maintaining container terminals. Due to investment and modern facilities there has been substantial increase in the productivity of some of the major ports such as JNPT (Jawaharlal Nehru Port Trust) and its world rank moved up from 64th in 1998 to 30th in 2002. Sri Lanka is interested to attract cargo traffic from India to Colombo port as its performance is dependant significantly on Indian traffic. It is also interested to attract Indian investment in Colombo port. However, the comparison between JNPT and Colombo reveals that India may like to develop JNPT as future hub port and in that case priority towards Colombo port may come down. However, we may give priority to Colombo for east cost oriented traffic. In the current round of negotiations Sri Lanka has made a request to India for offering full commitments in freight transportation, maintenance and repair vessels and supporting services for maritime transport under modes 1 and 2 types of trade in services, and undertake market access and national treatment commitments under modes 3 and 4 types of trade in services.[9] India offered at the first stage partial commitments with some conditions such as under mode 1, 40 per cent of the cargo carried by liner shipping companies must be reserved for Indian flag ships. India has offered full commitments under modes 1, 2 and 4 for maintenance and repair of services. As India is already committed to liberalize the port sector it has limited further scope under CEPA.[10]

Air being the main mode of transport for India and Sri Lanka, several measures are taken into consideration. Since late 2003, Jet Airways and Sahara Airlines have been allowed to fly to Colombo. This is one of the first instances where a domestic private airline has been permitted to fly to an international destination. The increase in trade in goods due to FTA, increase in tourism, increased cooperation between two countries and more contacts between people have contributed to a growth in the air services sector. Liberal Air Services Agreement between India and Sri Lanka has enabled market access for airlines between the two countries. Sri Lanka airlines can now access 18 destinations in India. However, high fuel charges in India is a matter of concern for some airlines which may be an issue between India and Sri Lanka discussion.

Indian telecom companies like VSNL and BSNL have made their presence felt in Sri Lanka. During 2003, VSNL received an approval from Board of Investment of Sri Lanka for forming a fully owned subsidiary ('VSNL Lanka Ltd.'). Initially, VSNL plans to launch International Long Distance telephony services to capture majority of Indo-Lanka traffic and then gradually it will expand to other services such as internet and internet-based services. BSNL also signed an agreement with Sri Lanka Telecom in 2003 to renew the microwave link between Rameswaram in India and Talaimannar in Sri Lanka which had been operational earlier. A strong telecommunication network is a major requirement for further ensuring the benefits of FTA. It is due to this reason that the telecom sector receives a priority status in the ongoing rounds of CEPA negotiations. In this issue the point on high call charges between two countries also needs to be addressed.

Tourism is another important sector for both India and Sri Lanka in CEPA negotiation. In 2003, both these countries have signed an MOU to develop tourism for mutual benefits. CEPA negotiation is inclined to strengthen this further. Offering on arrival visa from Sri Lanka has increased the number of tourists from India to Sri Lanka. However, Sri Lanka being a labour surplus economy has observed that both workers and professionals from India are using this channel to work illegally in Sri Lanka for short periods. Sri Lanka has revealed the urgency to develop a system by which genuine tourists from India may be identified and benefits can go to Sri Lanka. On the other hand, Sri Lanka is the third largest country in terms of tourists to India. Sri Lankan tourists are mainly divided into three groups: Buddhist tourists are mainly visiting places like Bodhgaya, medical tourists coming to India for treatments and people traveling due to professional reasons and business purposes. Sri Lanka has already invested in small hotels/motels in places like Chennai as most people from Sri Lanka arrive at Chennai first. In fact it is a lucrative idea for the Sri Lankans to invest in the motels in India in actual tourist spots and near the big hospitals.

Under the ongoing negotiations, Sri Lanka has requested India for reciprocity in terms of visas but Indian authorities justify the case on security grounds. Sri Lanka has also allowed the movement of professionals of hotel industries with some conditions. Sri Lanka is interested for investing more in India especially in hotel industry. India's commitment is as per its FDI guidelines (upto 51% of equity). India has not made any request to Sri Lanka.

In 1990s the private sector in India has emerged as a major player in the healthcare sector with the presence of players like Duncans, TATAs, Apollo Group, Fortis, MAX, Piramals, etc. India has already emerged as a major healthcare hub in the region and started attracting a number of international medical tourists. India offers specialized facilities such as heart surgery, dental, eye and cosmetic surgery at very competitive prices thereby making India as a major medical tourism hub. On the other hand, in Sri Lanka government is the main provider of healthcare services. Though it provides good quality services, the shortage of health professionals in Sri Lanka is a matter of concern especially in super-specialty areas such as cardiac treatment, plastic surgery, radiotherapy, etc.[11] Besides, many Sri Lankan students are coming to Indian medical institutes like AIIMS and KMC Manipal to study medicine. Recognizing such a situation, Apollo Group has set up a hospital in Sri Lanka with the approval of BOI (Board of Investment) in 2002. The Escorts Heart Institute and Research Centre (EHIRC) have entered a three-year management contract with Durdans Hospital of Sri Lanka to set up heart care centre. Both India and Sri Lanka have excellent opportunities in the field of alternative medicine like Ayurveda and Homeopathy. Indian doctors visit Sri Lanka frequently on short-term basis to offer consultancy services. Through such short-term visits they draw large number of clientele, the visits being organized exclusively by private initiative without any government initiative or support. The FTA needs to remove barriers in order to ease the movement of doctors to Sri Lanka in terms of giving residency permits and application of long-term registration.

Sri Lankans come to India for training in several disciplines. India has agreed to extend such training facility for various professional courses like financial management, auditing and accounting, rural banking, insurance, plantation management, textile, engineering, railways. The FTA could help in facilitating trade in areas of education, research and training. Such cooperation could help Indian organizations in establishing several institutes in Sri Lanka offering higher education. The issue of mutual recognition of degrees is an important issue that needs to be addressed in the ongoing negotiations of CEPA. Discounts in fees for Sri Lankan students may be another issue of discussion. Recently the Bandaranaike Centre for International Studies (BCIS, Colombo) signed an MOU for academic and research programme with Jawaharlal Nehru University, New Delhi.[12]

Several Indian software companies are interested to expand their presence in Sri Lanka and FTA can facilitate cooperation in software training between two countries. India could explore the possibility of entering the Sri Lankan retail segment under similar conditions as Sri Lanka has entered into the Indian market. The market for Indian ethnic products (such as animation films, etc.) will benefit from such negotiations as that have great demand in Sri Lankan market. The governments of two countries can also enter into a mutual agreement of joint television programme as it will help Indian production houses to increase their market share. Under CEPA steps should be taken to strengthen such issue of cooperation.

India had wanted Sri Lanka to open up telecommunication, professional services, construction and engineering, education, energy, maritime, ICT, tourism, health, audiovisual, transport and logistics and computer related services. Sri Lanka is in the process of formulating the list of service sectors that it wants India to liberalize under CEPA. In case of movement of natural persons, both parties had agreed that the professional associations of the countries should commence negotiations on Mutual Recognition Agreements (MRAs). Sri Lanka wants to link the issue of movement of natural persons with the commercial presence, for example, if an Indian company comes and opens a hotel, they can employ Indian persons. Without commercial presence, Indians cannot come and work in Sri Lanka. However, India is eager to de-link commercial presence from movement of natural persons. CEPA negotiations of services are inclined to focus on six major types of market access such as limitations on number of foreign service suppliers, the value of transactions or assets, the total quantity of services output, the number of natural persons who may be employed, the type of legal entity and the extent of foreign capital participation.[13]

Conclusion

- India-Sri Lanka Free Trade Agreement was signed on 28th December 1998 and it became fully operational by March 2000 as the annexures got finalized by February 2000. It has covered wide spectrum of products. From India's side, significant concessions have been provided in tea and textiles. Sri Lanka provided easy market access to India mainly in chemical, metal and machinery products. Sri Lanka committed to have bring down reductions in most of the selected products.

- Both the countries agreed to sign FTA keeping in view their commitments in WTO. Agreement has ample safeguard measures to take care of any emergency in the country. The agreement takes similar views as in WTO about subsidies and dumping. For any crisis, consultations have been given high priority. Though the agreement is governed by the rules of origin, both the countries have raised specific concerns related to this issue.

- India accounts for almost 15 per cent of total Sri Lankan imports. During 2004, bilateral trade touched US$1.7 billion. The trade balance has been in favour of India but the gap has declined during 2003 and 2004. It shows a faster rate of growth of Sri Lankan exports as compared to Indian exports. The analysis mentions that Sri Lanka's export growth to India is quite dramatic after the FTA. It is expected that CEPA negotiations will address this issue.
- Out of the top twenty commodities exported by Sri Lanka to the world, India is the major importer of "coffee, tea, and mate". Its share has come down to 8.32 per cent during 2004 from 13.15 per cent during 1998. During 2004, "copper and articles thereof" especially refined copper has become the most important importable item for India from Sri Lanka. On the other hand, India exports almost 89 commodity groups at 2-digit level. During 1998-04, Indian exports of "minerals fuels, oils, distillation products" have gone up drastically from a mere level of US$0.07 million during 1998 to US$273.17 million in 2004. It accounts almost 21 per cent of India's total export to Sri Lanka in 2004. Apart from this, other major Indian exports are sugar and sugar confectionary, vegetables, inorganic chemicals (mainly carbon), paper and paper board, motor vehicles, etc. Most of them experienced a positive growth rate during the period 1998 to 2004.
- After the FTA, as expected both the countries experienced surge of imports in some products and decline in others. In case of India, in some leather products, mineral fuels, ores and ashes, milling and paper products, oil seeds, lac

& gums, import growth from Sri Lanka is relatively high. In case of some specific green tea import growth was also high. In textile products, India's import mainly remained negative. Lot of products under HS 09 such as pepper, cloves, nutmeg experienced positive growth after FTA. During 1998-02, there has been marked decline of import of edible fruits, manmade filament, in India from Sri Lanka. In case of Sri Lanka several items in the residual list have experienced positive growth rate. Items like parts of gas turbine, transporter or bridge cranes and "iron and steel" under HS 72 including products under 720711 and 720610 have faced high growth changes. There have been marked rise in imports in mineral fuels, oils, distillation products, salt, sulphur, earth stones, etc. In the final analysis it can be said a quota regime and a fixed concession rate on tea and textiles, have not been that helpful for India to restrict imports where as in case of 50 per cent tariff concession rate, import growth was at the moderate level. Both the countries raised some concern related to rules of origin violations in some products.

- Under the current CEPA negotiations, both the countries are very much interested in negotiating several service oriented sectors as both have identified their core strength in education, health tourism, etc. Besides, other potential areas are investment, transportation and energy. An all round CEPA may prove useful both the countries as it compliment the traditional FTA which were mainly confined in manufacturing.

- To move forward with CEPA, both the countries need to sort out the grey areas of FTA such as rules of origin, non-tariff barriers, etc. Both the parties need to streamline these on the basis of mutual trust and potentiality of future trade possibilities. Sri Lanka is more concerned about imposition of various trade barriers by India on products like vanaspati, pepper and copper exported from Sri Lanka and India is equally concerned about the circumvention of rules of origin. Both India and Sri Lanka can develop similar technical standards to avoid the confusion and keep limited well recognized trade defence tools in hand and apply it after discussion to reduce the sudden surge of imports for short-term basis. In case of services, mutual recognition of professions has been found to be most important issues. The service areas and their scopes need to be clearly marked to understand the market access issues. As both countries are labour surplus countries, some compromise is required to address the issue of movement of natural persons. In case of attracting investment, Sri Lanka is more open and Indian firms find it easier to invest there. However, investment facilitating mechanism for Sri Lankan investment in India is not very clear and needs to be addressed during CEPA rounds of discussion.

APPENDIX 1

TARIFF CONCESSIONS OFFERED BY INDIA AND SRI LANKA

Country	*Tariff Rate*	*Items*
India	Zero duty access	1,351 items. (Annexure E of the agreement)
	25% tariff reduction	528 textile items (all textile items in chapters 51,52,58,59,60,63) and a majority of textile items in chapter 52-56)
	50% tariff reduction on tea imports from Sri Lanka on a preferential basis up to a maximum quota of 15 million kg.	Tea Items under chapters 0902 and 2101.
	50% tariff reduction on garment imports from Sri Lanka subject to • a maximum annual quota of 8 million pieces of which 6 million pieces should contain Indian fabrics. • No category of garments could exceed 1.5 million pieces per annum.	HS chapters 61 & 62.
	50% reduction of tariffs followed by a phase out removal of 100% in 2 stages within three years.	Balance 2,799 items
Sri Lanka	Zero duty access.	319 items under Annexure F-I of the agreement
	50% tariff reduction followed by a phase out removal of tariffs: • 70% at the end of 1st year • 90% at the end of 2nd year • 100% at the end of 3rd year.	For 889 items as in Annexure F–II of the agreement
	Tariffs shall be brought down to: • 35% before the end of 3rd year. • 70% before the end 6th year • 100% before the end of 8th year.	Residual List of 2,724 (chapter 01-97) items defined by 6 digit HS code.

TABLE A

INDIA'S IMPORT FROM SRI LANKA DURING 1998-2004

Value: US$ million (Major Products; Except Textile Products)

HS Code	*Product Description*	*1998*	*%share of 1998*	*2004*	*%share of 2004*
05	**Products of animal origin, nes**	**0.55**	**1.82**	**0.77**	**0.4**
0508	Coral; shells of moluscs, crstcns/echindrms & cuttl bon, smply prpd not shapd, pwdr & waste	0.42	1.38	0.74	0.38
09	**Coffee, tea, mate and spices**	**3.98**	**13.15**	**16.25**	**8.32**
0902	Tea	0.6	1.98	0.69	0.35
0904	Pepper of the genus piper; dried or crushed or ground fruits of the genus capsicum or of the genus pimento	2.26	7.49	7.69	3.94
0907	Cloves (whole fruit, cloves and steams).	0.69	2.28	5.14	2.63
0908	Nutmeg, mace and cardamoms.	0.39	1.28	2.28	1.17
16	**Meat, fish and seafood food preparations nes**	**0**	**0**	**0.06**	**0.03**
74	**Copper and articles thereof**	**1.1**	**3.65**	**80.85**	**41.41**
7403	Refined copper & copper alloys, unwrought	0	0	73.5	37.64
7404	Copper waste & scrap	1.1	3.64	0.5	0.25
7407	Copper bars, rods & profiles	0	0	4.19	2.15
7408	Copper wire	0	0	0.85	0.43
7409	Copper plats, shts & strip of a thic>0.15mm	0	0	1.1	0.56

Source: India Trades, CMIE.

TABLE B

INDIA'S EXPORT TO SRI LANKA (MAJOR PRODUCTS) 1998-2004

(US$ million)

HS Code	*Product Description*	*1998*	*%share of 1998*	*2004*	*%share of 2004*
07	**Edible vegetables and certain roots and tubers**	**39.43**	**8.18**	**22.52**	**1.7**
0703	Onions,shallots,garlic,leeks & other alliaceous vegetables, fresh or chilled	7.81	1.62	18.49	1.4
0713	Dried leguminous veg shld w/n skinned/split	26.22	5.44	2.94	0.22
11	**Milling products, malt, starches, inulin, wheat gluten**	**2.17**	**0.45**	**6.47**	**0.49**
14	**Vegetable plaiting materials, vegetable products nes**	**1.08**	**0.22**	**3.32**	**0.25**
17	**Sugars and sugar confectionery**	**3.3**	**0.68**	**55.48**	**4.19**
1701	Cane/beet sugr chmcly pure sucrse in solid	2.87	0.59	54.18	4.1
19	**Cereal, flour, starch, milk preparations and products**	**3.4**	**0.7**	**2.02**	**0.15**
27	**Mineral fuels, oils, distillation products, etc.**	**0.07**	**0.01**	**273.17**	**20.65**
2710	Petroleum oils& oils obtnd frm bitmns mnrlother than crude prpn nes;cntng70% or moreby weight of these oils	0.02	0	263.91	19.95
28	**Inorganic chemicals, precious metal compound, isotopes**	**7.89**	**1.64**	**14.65**	**1.11**
2803	Carbon (carbon blacks & othr forms nes)	2.67	0.55	9.53	0.72
48	**Paper & paperboard, articles of pulp, paper and board**	**14.22**	**2.95**	**31.28**	**2.36**
4802	Uncoated paper and paperboard, of a kind used for writing, printing or other graphic purposes, and punch card stock and punch tape paper, in rolls or sheets, other than paper of heading No. 48.01 or 4UNIT	9.37	1.94	17.36	1.31
4810	Papr/paprbord coated on one/both sides with kaln/other inorg substs & no otr coating wn surfce colrd/decortd/printed in rols/sheets	0.38	0.08	5.6	0.42

HS Code	Product Description	1998	%share of 1998	2004	%share of 2004
49	**Printed books, newspapers, pictures, etc.**	**2.07**	**0.43**	**6.79**	**0.51**
4901	Printed books, brochures leaflets and smlr printed matter w/n in single sheets	1.62	0.34	4.15	0.31
69	**Ceramic products**	**2.23**	**0.46**	**5.29**	**0.4**
87	**Vehicles other than railway, tramway**	**56.11**	**11.63**	**142.71**	**10.79**
8702	Public-transport type passenger motor vehicles	9.43	1.95	25.93	1.96
8703	Motor cars & other motor vehicles for transport of persons(excl of 8702) incl. racing cars, etc.	2.12	0.44	42.18	3.19
8704	Motor vehicles for transport of goods	2.83	0.59	6.74	0.51
8706	Chassis fitted with engines, for motor vehicles of headings nos 8701 to 8705	9.58	1.99	5.96	0.45
8708	Parts and accessories of the motor vehicles of headings nos 8701 to 8705	5.85	1.21	10.84	0.82
8711	Motorcycles (including mopeds) and cycles fitted with an auxiliary motor, with or without side-cars; side-cars	18.08	3.75	39.42	2.98
8714	Parts and accessories of vehicles or headings nos. 87.11 to 87.13.	3.7	0.77	5.47	0.41
9405	Lamps & lighting fittings incl. search lights and spotlights, etc. n.e.s. illuminated signs & the like with permanent light sorce & parts n.e.s.	0.19	0.04	0.46	0.03

Source: India Trades, CMIE.

APPENDIX 2

TABLE C

INDIA'S GROWTH RATE OF IMPORTS DURING 1998-2002
(SELECTED PRODUCTS ON WHICH CONCESSIONS OFFERED)

HS Codes	*Description*	% Import growth rate during 1998-2002
Tariff Concession Rate: Zero Duty; Number of Products: 1,351		
07	Edible vegetables and certain roots and tubers.	-99.38
071290	Vegetables and mixtures dried, but not further prepared ness	-99.38
*25	*Salt, Sulphur, earth, stone, plaster, lime and cement.	-81.25
*26	*Ores, slag and ash.	45.51
27	Mineral fuels, oils, distillation products, etc.	3045.00
28	Inorganic chemicals, precious metal compound, isotopes.	123.86
29	Organic chemicals.	-20.17
44	Wood and articles of wood, wood charcoal.	-28.15
47	Pulp of wood, fibrous cellulosic material, waste, etc.	-82.06
48	Paper & paperboard, articles of pulp, paper and board.	-5.62
481012	Paper, fine, wood free , in rolls or sheets, >150 g/m2, clay coated	-96.62
481910	Cartons, boxes and cases, of corrugated paper or paperboard	-4.62
481930	Sacks and bags, of paper, having a base of a width of 40 cm or more	84.38
49	Printed books, newspapers, pictures, etc.	-94.64
491110	Trade advertising material, commercial catalogue and the like	-89.29
491199	Printed matter, ness	-100
84	Nuclear reactors, boilers, machinery, etc.	-18.91
Tariff Concession Rate: 50% ; Number of Products: 2,799		
05	Products of animal origin, ness	-90.15
07	Edible vegetables and certain roots and tubers	-97.01
070320	Garlic, fresh or chilled	-94.02
071310	Peas dried, shelled, whether or not skinned or split	-100
08	Edible fruit, nuts, peel of citrus fruit, melons	-98.58
09	Coffee, tea, mate and spices	-36.75
11	Milling products, malt, starches, inulin, wheat gluten	45.83
12	Oil seed, oleagic fruits, grain, seed, fruit, etc, ness	507.73
13	Lac, gums, resins, vegetable saps and extracts ness	328.77

HS Codes	Description	% Import growth rate during 1998-2002
15	Animal, vegetable fats and oils, cleavage products, etc.	-80.38
17	Sugars and sugar confectionery	-99.46
18	Cocoa and cocoa preparations	-97.87
19	Cereal, flour, starch, milk preparations and products	-96.6
25	Salt, sulphur, earth, stone, plaster, lime and cement	-81.25
26	Ores, slag and ash	45.51
27	Mineral fuels, oils, distillation products, etc.	3045
**28	**Inorganic chemicals, precious metal compound, isotopes	123.86
29	Organic chemicals	-100
290545	Glycerol	-100
30	Pharmaceutical products	-81.62
32	Tanning, dyeing extracts, tannins, derives, pigments, etc.	744.64
33	Essential oils, perfumes, cosmetics, toiletries	-94.07
35	Albuminoids, modified starches, glues, enzymes	-99.46
38	Miscellaneous chemical products	-64.43
39	Plastics and articles thereof	-12.3
40	Rubber and articles thereof	-72.38
41	Raw hides and skins (other than fur skins) and leather	-48.14
43	Furskins and artificial fur, manufactures thereof	-100
44	Wood and articles of wood, wood charcoal	-95.31
440349	Logs, tropical hardwoods ness	-95.54
440399	Logs, non-coniferous ness	-95.09
48	Paper & paperboard, articles of pulp, paper and board	48.07
**49	**Printed books, newspapers, pictures, etc.	-70.37
67	Bird skin, feathers, artificial flowers, human hair	-100
69	Ceramic products	-29.01
70	Glass and glassware	-57.22
71	Pearls, precious stones, metals, coins, etc.	-97.48
72	Iron and steel	-81.8

* India offers 100% discount for some products under HS code 25 and 26 and 50% for some products in 28 and 49 to Sri Lanka. However, products under this category were not imported from Sri Lanka during 1998-2002.

Source: PC-TAS.

TABLE D

SRI LANKA'S IMPORT CHANGE DURING 1998-2002 (MAJOR PRODUCTS UNDER CONCESSION)

Nature of the product (HS description)	*Description*	*% Import growth rate during 1998-2002*
Tariff Concession Rate: Zero Duty; Number of Products: 319		
29	Organic chemicals(including all items)	9.05
290319	Chlorinated derivatives of saturated acyclic hydrocarbons, nes	25.00
291531	Ethyl acetate	1908.33
291739	Aromatic polycarboxylic acids and their derivatives, nes	422.73
291822	O-acetylsalicylic acid, its salts and esters	200.00
292990	Compounds with other nitrogen function, nes	-97.39
293100	Organo-inorganic compounds, nes	-25.00
293319	Heterocyclic compds cntg an unfused pyrazole ring in the structure,nes	30.00
293329	Heterocyclic compds cntg an unfused imidazole rg in the structure,nes	-75.25
293359	Hetercycl compds cntg pyrimidin rng/piperazine rng,nes;nucleic acid&sa	-92.86
294200	Organic compounds nes	-43.54
84	Nuclear reactors, boilers, machinery, etc	-91.98
843830	Machinery for sugar manufacture	-100
845899	Lathes nes for removing metal	-83.96
Tariff Concession Rate: 50 per cent; Number of Products: 889		
28	Inorganic chemicals, precious metal compound, isotopes	-73.62
280200	Sulphur, sublimed or precipitated; colloidal sulphur	-75.49
280300	Carbon (carbon blacks and other forms of carbon, nes)	-52.60
280610	Hydrogen chloride (hydrochloric acid)	-89.34
72	Iron and steel	204.17
720150	Alloy pig iron, spiegeleisen	-45.59
720229	Ferro-silicon, nes	-98.48
720230	Ferro-silico-manganese	53.95
721041	Flat rolled prod,i/nas,pltd or ctd w zinc,corrugated, >/=600m wide,nes	219.16

Nature of the product (HS description)	Description	% Import growth rate during 1998-2002
721049	Flat rolled prod,i/nas,plated or coated with zinc, >/=600mm wide, nes	-7.02
721190	Flat rolled prod, i/nas, <600mm wide, not clad, plated or coated, nes	60.71
721310	Bars&rods,i/nas,hr,in irreg wound coils,cntg indent, ribs,etc prod d rp	-87.20
721320	Bars & rods, i/nas, hr, in irreg wound coils, of free cutting steel	-97.24
73	Articles of iron or steel	47.62
730120	Angles, shapes and sections, welded, iron or steel	-99.83
730300	Tubes, pipes and hollow profiles of cast iron	-95.23
730410	Pipes, line ,iron or steel ,smls, of a kind used for oil or gas pipelines	308.33
730590	Tubes & pipe, i or s, riveted or sim closed, ext dia >406.4mm, nes	-82.45
730610	Pipe,line,i or s,weldd,rivetd or sim closd,nes,for oil or gas pipeline	-35.08
732394	Table,kitchen or oth household art&parts thereof, i or s,enamelled,nes	-52.04
74	Copper and articles thereof	1592.66
740319	Refined copper products, unwrought, nes	-100.00
740400	Waste and scrap, copper or copper alloy	8956.25
740710	Bars, rods and profiles of refined copper	5007.69
740721	Bars, rods and profiles of copper-zinc base alloys	5270.00
740729	Bars, rods and profiles, copper alloy nes	312.50
740811	Wire of refind copper of which the max cross sectional dimension > 6mm	538.73
740929	Plate, sheet &strip of copper-zinc base alloys ,nt in coil,> 0.15 mm thick	-64.95
84	Nuclear reactors, boilers, machinery, etc	-15.60
840211	Watertube boilers with a steam production exceeding 45T per hour	-95.06
840219	Vapour generating boilers nes, including hybrid boilers	-96.65
841199	Parts of gas turbines nes	2358.33
841290	Parts of hydraulic & pneumatic & other power engines and motors nes	-35.87

Nature of the product (HS description)	*Description*	*% Import growth rate during 1998-2002*
841620	Furnace burners nes, including combination burners	-84.80
841790	Parts of industrial/lab furnaces&ovens inc incinerators non-electr nes	119.44
844319	Offset printing machinery nes	-90.54
844330	Flexographic printing machinery	53.13
847990	Parts of machines&mechanical appliances nes havg individual functions	-70.94
848410	Gaskets of metal sheeting combined with other material	-70.36
848420	Mechanical seals	233.33
848490	Gasket sets consisting of gaskets of different materials	229.17
85	Electrical, electronic equipment	47.77
850211	Generatg sets,diesel/semi-diesel engines,of an output not exced 75 KVA	-82.81
850212	Generatg sets,diesel/semi-diesel exceedg KVA but not exced 375 KVA	75 -69.23
850220	Generating sets with spark-ignition internal combustion piston engines	-79.11
850990	Parts of electro-mech dom appliances with self-containd electric motor	-93.15
851110	Spark plugs	141.67
851140	Starter motors	-84.29
851150	Generators and alternators	383.33
851190	Parts of electrical ignition or starting equipment	-78.06

Source: PC-TAS.

NOTES

[1] By World Bank Development Data estimates.

[2] www.indiainfo.com

[3] *Financial Express*, India, 8th March 2004.

[4] *The Economic Times*, 3 June 2006. http://economictimes.indiatimes.com/articleshow/1611206.cms

[5] www.saarcnet.com/newsaarcnet/govtpolicies/srilanka.htm.

[6] www.saarcnet.com/newsaarcnet/govtpolicies/srilanka.htm.

[7] Remaining items given in Annexure D of the agreement - the tariff line for items in Annexure D(i) is 50 per cent and rest of the items in Annexure D(ii) are in the residual list.

[8] Taneja, N.; Mukherjee, A. ; Jayanett, S.; Jayawardane, T., Indian Council for Research on International Economic Relations (ICRIER), 2004.

[9] Mode 1 refers to delivery of services across countries, including cross-country movement of passengers and freight.

Mode 2 refers to physical movement of consumer of the service to the location where it is provided.

Mode 3 refers to establishment of foreign affiliates and subsidiaries of foreign joint ventures, partnerships.

Mode 4 refers to natural persons who are themselves service suppliers.

[10] Taneja, N.; Mukherjee, A. ; Jayanett, S.; Jayawardane, T., Indian Council for Research on International Economic Relations (ICRIER), 2004.

[11] *Ibid.*

[12] *The Island*, 30th March 2004.

[13] *CEPA with India: Opportunities for Trade and Investment* by Subhashini Abeysinghe.

REFERENCES

1. Nisha Taneja, Arpita Mukherjee, Sanath Jayanetti, Tilani Jayawardene (2004), "Indo-Sri Lanka Trade In Services: FTA II and Beyond"; Working Paper No. 145 Indian Council for Research on International Economic Relation, November.
2. Rajesh Mehta (2002), "Potential of India's Bilateral Free Trade Arrangements: a case Study of India and Thailand", RIS Discussion Paper No. 24.
3. Nisha Taneja (1999), "Informal Trade In SAARC Region" Working Paper No. 47, Indian Council for Research on International Economic Relation, March.
4. Biswajit Nag (2005), "Trade Cooperation and Performance in East and South Asia: Towards a Future Integration"; *Asia Pacific Development Journal*, Vol. 12, No, 1, June.
5. Biswajit Nag and Anisha Nandi, (2006); "Analysing India's Trade Dynamics *vis-a-vis* SAARC Members Using the Gravity Model"; *South Asia Economic Journal*, Vol. 7, No. 1, pp. 83-98.

List of web sites:

1. http://www.saarcnet.com/newsaarcnet/govtpolicies/srilanka.htm, used on last week of September, 2005.
2. www.worldbank.org/devdata. used on third week of October, 2005.
3. www.commerce.nic.in used 20 of September 2005.
4. www.bilaterals.org 23 November 2005.
5. www.nationmaster.com 20 of October 2005.
6. www.indiainfo.com 25 of October 2005.

INDIAN INSTITUTE OF FOREIGN TRADE
B-21 QUTAB INSTITUTIONAL AREA, NEW DELHI-110016
TEL: 26965124, 26965051, 26966563
FAX: 91-11-26853952, 26867841, 26867851
WEBSITE:www.iift.edu