

Sri Lanka's Preferential Trade Policies, Outcome and Future Directions

A key feature of the contemporary international economic system is the increased tendency towards the formation of varying degrees of preferential economic integration arrangements with extensions and deepening existing ones. Many developing countries have formed preferential integration arrangements since the 1960s. However, they ended, as can be seen, almost entirely as failures by late 1970s.

There are two phases of regional economic arrangements in developing countries. The first phase is based, in general, on import substitution (IS) policies with excessive government intervention and focussed more on industrialization and capturing scale economies in the regional context, while the second phase is based on outward orientation with an open economic regime. The former ended by the late 1970s and the latter was born in the mid-1980s. Most countries have turned towards regionalism in the mid-1980s after looking vigorously at the changes in the international economy. In fact, conversion of the most ardent proponent of the multilateralism, the USA, to the preferential mode of economic integration was an additional impetus to the second phase of regional economic integration and a significant milestone in regionalism in the post World War II years.

Preferential trading groups were promoted in the past partly by regional UN agencies like the Economic and Social Commission for Asia and Pacific (ESCAP) with a view to accelerating development in newly independent developing countries by means of increasing intra-regional and extra-regional trade. Preferential economic integration is considered at present one of the key development strategies by almost all countries in the world.

Preferential Economic Integration Schemes

Although many terms are used interchangeably to refer to preferential economic arrangements, there is a hierarchy of schemes, which are different from one another in terms of the levels of economic integration involved in the scheme. Such schemes are classified as follows:

- (a) Preferential trade area,
- (b) Free trade area,
- (c) Customs unions,
- (d) Common market,

- (e) Economic union,
- (f) Total economic integration.

(a) Preferential Trade Area (PTA): Under this arrangement, a lower level of tariff from the MFN tariff rates is in place for members of the group who retain their own restrictions on imports from the rest of the world (ROW).

(b) Free Trade Area (FTA): Under this arrangement, member countries abolish tariff and quotas on imports from within the group while retaining their own restrictions on imports from ROW.

(c) Custom Union (CU): CU takes yet another step beyond what is found in a FTA. Member countries apply common external tariff vis-a-vis ROW.

(d) Common Market (CM): CM goes further than a CU to allow free movement of factors of production-capital and labor. By this stage, restrictions on both trade in products and factor movement are abolished.

(e) Economic Union (EU): This is a CM with some degree of harmonization of national economic policies

(f) Total Economic Integration (TEI): An EU with unification of monetary, fiscal, social and counter cyclical policies is considered a TEI. Furthermore, it needs a supra-national authority to coordinate and implement its decisions. Some consider that there is one more step beyond TEI, a single currency union like what we see in the European Union today.

It is known that this hierarchy of schemes is based, in general, on the experience of economic integration in the Western Europe and no integration scheme in the world conforms exactly to these schemes. Therefore, these schemes are primarily considered from an analytical viewpoint. In normal parlance it is common to use terms like preferential or free trade areas to refer to any preferential economic arrangement irrespective of the level of integration.

WTO and Preferential Integration Schemes

Obligations under the General Agreement on Tariff and Trade (GATT) (since 1st of January 1995, the World Trade Organization - WTO) governing international trade in goods and services provides the basis

R.H.S. Samaratinga

Director, National Planning Department

for a legal framework for the creation and functioning of preferential trading groups in the international economy. The most fundamental obligation under the GATT is the most favored nation (MFN) clause of Article I under which, principles are set out for non-discrimination among the 'contracting parties' (under WTO, they are 'members'). Under this principle, all contracting parties are obliged to apply all measures of trade equally to all contracting parties. Any concession in regard to trade extended to any country must be given at the same time unconditionally to all contracting parties. The principle behind this is that no contracting party can discriminate against any other contracting party and contracting parties need to treat each other equally in this respect.

Formation of preferential integration schemes would, on strict technical grounds, contravene the spirit of the MFN principle, since such formations will treat preferentially its members over the rest of the world (and, therefore, non-member contracting parties are discriminated against) and, as a consequence, if strictly applied, formation of preferential integration schemes would be barred. Contrary to the spirit of the Article I, however, several exceptions are in place in the GATT itself which accommodated several concerns at the time of the establishment of the GATT and thereafter. They are:

- (i) Article XXIV provides the legal basis for the formation of preferential integration schemes.
- (ii) The Tokyo Round Agreement on 'Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries' (also known as the 'Enabling Clause') also provides an additional basis for the formation of preferential integration schemes among developing countries. Under the decision, developed countries can extend preferential treatment to developing countries while developing countries can also provide preferential treatment among themselves. Hence, the objective is also to encourage trade among developing countries.

Both provisions cover trade in goods but after the establishment of WTO, trade in services

under Article V can be the basis for preferential treatment and provides an additional legal basis for preferential agreements in trade in services.

Under the above modes of preferential integration the largest majority of WTO members were party to one or more regional integration groups by the end of 2002. The growth in the second phase of regional integration groups continues unabated since the early 1990s. About 250 such agreements have been notified to the GATT/WTO up to December 2002, of which 130 were notified after 1995. Of the total, 170 agreements are currently in force. There are about 70 agreements, which have not been notified to WTO but are operational at present.

Preferential Trading in the Asian Context

The upsurge of regional economic groups in the world particularly after the Treaty of Rome in 1957 and subsequent formation of the Europe Economic Community was not found to be a factor for such formations in Asia as had been the case in other continents, although they watched these developments with concern. However, the UN regional body, the Economic and Social Commission for Asia and the Far East (ESCAFE) made efforts to put regional cooperation into action. For example, in 1954, and again in 1959, ESCAFE had looked into the possibilities of setting up an Asian Payment Union. Yet the Economic and Social Commission for Asia and Pacific (ESCAP) was able to initiate a preferential trade agreement – the Bangkok Agreement (BA) by 1975. However, until the formation of the Association of the South East Asian Nations (ASEAN) in 1967 and its subsequent establishment as a PTA, there was not a significant move towards regional economic integration in Asia. But there had been several cooperative arrangements and partial integration arrangements (sectoral, commodity programs and trade liberalization were among the discussions on cooperation by the 1960s) in Asia.

The South Asian region, despite common colonial past, lagged far behind in forging towards forming an economic group due to a complex web of reasons. A great interest in sub regional economic integration was never present till the late 1970s among the countries in South Asia. It is a new comer to regional economic integration and it strictly belongs to the second phase of regionalism. The South Asian Association for Regional Cooperation (SAARC) was established in 1985, with a view to promote, *inter alia*, regional integration. It has since been in the process of enhancing the level of regional economic integration after the conclusion of the

SAARC Preferential Trade Agreement (SAPTA) in April 1993, which was ratified in December 1995 by the countries' respective legislatures. Since the late 1990s, SAARC members have shown interest in developing the SAPTA into a South Asian Free Trade Area (SAFTA). SAPTA was able to complete four rounds of negotiations on intra-regional tariff reductions. However, the conclusion of the fourth round are yet to be implemented.

Unlike other regions of world, leaders of the post independent states were hesitant to form economic groups in Asia. In case they did, there had to be flexibility to so as to ensure minimum inroads into national sovereignty. Besides, all these countries except those in East Asia, just after the independence, incorporated IS policies in their development agendas to begin with. Further the clear lack of integration arrangements in Asia is attributed more to the problems associated with inter-state relations, political ideological differences, historical legacies and territorial disputes. These are some of the reasons behind the lack of preferential trading arrangements in the past in Asia but since the mid-1980s all regions of Asia has seen development of many preferential trade (and economic) arrangements including deepening and widening of existing ones. Sri Lanka has been no exception to the Asian trend in this respect.

Sri Lanka and Preferential Trade

Sri Lanka, as many other Asian countries, has not been interested in developing preferential trade policies in the first phase of regional integration as seen in many other developing countries. Primary occupation in international trade policies is to work in the context of unilateralism and multilateralism. Trade policy liberalization, unilaterally on MFN basis was the key feature, which was predominant in the Sri Lanka's trade policy reform initiatives.

Sri Lanka too inherited an open trade regime by the time it gained independence in 1948. Sri Lanka's economy remained more or less open until about 1955. Hence, the post independent first decade turned out to be a period of a liberal trade regime with a few low tariffs and taxes on imports and exports imposed with a view to gather revenue. The open trade policy regime was based on action unilaterally taken towards improving trade integration with the rest of the world. Sri Lanka's international economic integration efforts from the beginning have been solely unilaterally on MFN basis aimed at undiscriminated international integration. In the initial years of post independence, Sri Lanka has been making efforts to diversity her exports destinations and import sources away from the British Sterling area. Domination in external trade of the sterling area was a result of the colonial legacy. Towards this end, Sri Lanka has success-

fully diversified external trading partner sources by late 1960s while achieving economic integration objectives in trade policy. The country choose to follow import substitution (IS) policies in general between mid 1950s to late 1970s where controls on the trade policy regime were very stringent resulting in less and less trade integration with the rest of the world, with a minor interruption between 1965-1969. In essence, the country's economy moved in the direction of a relatively closed economy during this period.

Sri Lanka had embarked on a program of market oriented economic reforms since the late 1970s, where the phasing out of traditional import substitution policies, liberalization of the investment and trade policy regime and deregulation and privatization in many areas were key elements. In the initial phase, many areas of trade policy were reformed to create a more liberal trade regime. Since the late 1970s, three Presidential Tariff Commissions have tabled reports on the impact of alternative trade policy options, preparing the ground, for subsequent liberalization initiatives. For many years import duties have been used by the government both as a source of revenue and a means of influencing the speed and direction of economic growth by protecting selected local industries. However, in line with the objective of promoting trade liberalization, the tariff structure was modified from time to time. The rationalization of tariff structure began in 1985 and, by 1992, Sri Lanka had a four-band tariff structure (50, 35, 20 and 10 percent). By 1995, tariff bands were reduced to three (35, 20 and 10 percent). At present, Sri Lanka is studying moving into one flat tariff rate on all except a few products. Imports into Sri Lanka are mostly free except a few agricultural items, which need prior licenses. A few exports need licenses (coral and ivory products, timber wood, and passenger motor vehicles registered in the country before 1945 etc.). Most exchange controls were eliminated over the years since the late 1970s. In March 1994, under IMF VIII obligations, transactions on the current account of the balance of payments (BOP) were made free and government has initiated action towards liberalizing the capital account as well.

Sri Lanka has participated in all rounds of negotiations so far under the GATT initiative since the beginning. Although the GATT came into being in 1947, Sri Lanka was not a founding contracting party. Sri Lanka became a contracting party to this world body in 1948 (29 July 1948). Sri Lanka became a founder member of the GATT's successor WTO on the day it was born, 1 January 1995. Sri Lanka has actively participated in multilateral trade nego-

tiations throughout, particularly after the 1960s. Sri Lanka continued to promote international trade and economic integration through active participation in several international and regional organizations. Aimed at achieving the benefits of trade expansion sustained by lowering tariff and non-tariff barriers and strengthening rules and disciplines in international trade, Sri Lanka signed the Final Act of the Uruguay Round (UR) on 15 April 1994. On 1 June 1994, Sri Lanka ratified the agreement on the World Trade Organization (WTO), demonstrating Sri Lanka's commitment to the multilateral trade regime. Besides, there have been several cooperative agreements from which Sri Lanka benefited. The Generalized System of Preferences (GSP) is one such agreement through which Sri Lanka continued to enjoy preferential market access. Sri Lanka has been a beneficiary under different schemes implemented by 26 developed countries including the United States, Japan, Australia, Canada and the EU. Sri Lanka is also a signatory of the Agreement on Generalized System of Trade Preferences (GSTP). Member countries of the GSTP would benefit in each other's market by way reduced tariffs and elimination of non-tariff barriers. A National Schedule of Concessions by Sri Lanka under GSTP contains 24 tariff lines. The margin of preference offered by Sri Lanka ranges from 4 per cent to 50 per cent.

Since the mid-1970s Sri Lanka participated in preferential economic integration arrangements, although its active promotion in regional economic arrangements is seen only from the mid 1990s. Three preferential trade arrangements to which Sri Lanka is a signatory are in operation at present. There are several other preferential trade cum economic arrangements which are under various levels of development and have not yet reach yet the implementation stage. Both arrangements are discussed in detail below:

Arrangements under Implementation

Bangkok Agreement (BA)

The Bangkok Agreement (BA) was agreed upon in 1975. It was the first of its kind among the ESCAP members. Seven ESCAP countries were involved in the negotiation although only five countries – Bangladesh, India, Laos, Korea (ROK), and Sri Lanka became members of the agreement from the inception. China (PRC) acceded to the BA as the sixth member in 2001. Its main objective is to increase economic cooperation by relaxation of barriers to trade – tariffs and non-tariff measures. As stated in the text of the agreement its declared objectives were “to promote economic development through a continuous process of trade

expansion among the developing countries of UNESCAP and to further international economic cooperation through the adoption of mutually beneficial trade liberalization measures...”. BA is a PTA and aims at progressive trade policy liberalization in the ESCAP region. All BA members were developing countries at the time of the signing of the Agreement. The BA was notified to the WTO under the ‘Enabling Clause’ provisions on 2nd November, 1976.

Two rounds of negotiation were concluded under the agreement in 1975 and 1990 and the total product coverage under the agreement was 104 and 438 respectively. When the agreement was signed intra-trade between members was around 1 per cent. It rose to 2.4 percent in the case of exports and 2.2 percent of their world exports and imports by the late 1990s. It should be noted that of the total intra-exports, Korea accounts for over 90 percent. With the accession of China into BA, more opportunities are available for trade expansion within the group. Papua New Guinea acceded to the BA in 1973 but its government is yet to ratify the Agreement. Pakistan, which notified its interest in joining the BA, is in the process of accession. In the recent years many ESCAP countries like Fiji, Iran, Mongolia, Nepal, Vietnam, Cambodia have shown willingness to join the group. The BA's membership is open to all developing countries in the ESCAP region.

The Bangkok Agreement besides being modest in terms of intra-regional trade became rather ineffective on account of differences in approach, interpretation and perception among member countries. Very low levels of trade integration exist between member countries in the ESCAP region, due to the limited product coverage and the limitations in country coverage. However, scope for further integration in the region has received an additional boost with the accession of China to the Agreement. The scope of the arrangements is confined mainly to duty reductions on a relatively small range of goods; services are not covered. BA like SAPTA has two levels of tariff concession – one for all the members and deeper and special reductions of tariffs for least developed country members.

SAARC Preferential Trading Arrangement (SAPTA)

The idea of regional integration in South Asia started in the late 1970s. Bangladesh was the first to moot the idea of South Asian cooperation on the basis of a formal mechanism. The formalization of the regional forum actually took place in 1985 with the adoption of the Charter of the South Asian Association for Regional Cooperation (SAARC) at the summit of the regional state/government heads in Dhaka, Bangladesh. The region being an area of

conflict in interstate relations, initial cooperative programs were limited to areas of mutual confidence building, non conflict and information sharing nature, and economic integration was considered to be outside the agenda. Hence 12 cooperative areas were selected for regional cooperation under the Integrated Programme of Action (IPA) as through: (i) agriculture, (ii) communications, (iii) education, culture and sports, (iv) environment, (v) health and population activities, (vi) meteorology, (vii) prevention of drug trafficking and drug abuse, (viii) rural development, (ix) science and technology, (x) tourism, (xi) transport, and (xii) women and development. Various studies and exchanges on the twelve IPA areas continued in a general way during the first decade of SAARC.

South Asian integration as it relates to economic matters began in 1993 with the signing of SAPTA. The aim of SAPTA is “to promote and sustain mutual trade and economic cooperation among contracting States, through exchange of concessions”. Towards this end, the negotiations on and implementation of preferential reduction of tariffs are carried out on a continuing basis. Currently, the countries in the region, while engaging in the SAPTA process, are also working towards the eventual goal of reaching the SAARC Free Trade Area (SAFTA) by year 2005. The SAPTA has concluded three rounds of tariff reduction in 1995 and 1996, and 1998. The exchanges of concessions have been very limited so far, perhaps due to the fact that the SAARC approach in this endeavor is one of gradual movement, being faced with complex problems associated with inter state relations in the region.

SAPTA was notified to GATT under the ‘Enabling Clause’ on 22nd September 1993. SAPTA has embraced the stage of very low integration of a PTA as it relates to the levels of integration. It has selected only a very few products for preferential treatment under a limited tariff reduction programme. SAPTA is based on the principles of discriminatory regionalism, in which agreed product categories originating in the region are designed to be preferentially treated in the context of tariffs, para tariff, and non-tariff measures. The implementation of SAPTA is based on overall reciprocity and mutuality of advantages in granting preferences within the group. Further, there are provisions in the SAPTA agreement allowing different approaches to tariff reduction such as a) product by product basis (b) across the board tariff reductions (c) sectoral basis and (d) direct trade measures, although SAARC has agreed to negotiate tariff preferences initially on a product by product basis. This situation creates a long drawn out process of negotiations even if one assumes

negative factors of interstate relations to be absolutely neutral among member countries. Further SAPTA excludes services from the preferential agreement.

Since SAPTA is a discriminatory preferential trading group, the rules of origin are of importance. The rules of origin in regard to preferential treatment are applied if the product originates in any of the following ways in a member country: (a) wholly produced (b) a product using materials, parts or other produce originating from elsewhere (other than member country), not exceeding 50 percent in f.o.b. value, and (c) a product originating in any member country where the aggregate content of origin in that member country is not less than 60 percent of f.o.b. value. Rules (b) and (c) are allowed a favorable 10 percent for the Least Developed country members. Rules of origin are enforced to avoid trade deflection. Otherwise, products originating outside the group can enter a high tariff member country via a low tariff member country. Since South Asian trade liberalization has taken place at different times and at different speeds in individual countries, tariff rates differ vastly between countries though tariffs have come down considerably in the region.

SAPTA has so far implemented the conclusions of three rounds of preferential tariff reductions. As a founder member of the SAARC Preferential Trading Arrangement (SAPTA), Sri Lanka actively participated in negotiations with a view to promoting trade through mutual concessions.

(a) First round

The first round (1995) was only a modest beginning and subsequent rounds of negotiations are more substantial in terms of tariff reduction and product coverage. By the end of 1995, countries in the region had finalized the products to be included in the Consolidated National Schedule of Concessions (CNSC) under SAPTA. Under the concession schedules there were 226 product categories under various digits of the HS code.

The prevailing (1995) MFN tariff rates in countries of the region were also relatively high when reductions were offered for preferential treatment. SAPTA-wide tariff cuts offered ranged between 70 to 100 from the prevailing MFN rates. It should, however, be noted that the preferential reductions were offered as a percentage of the prevailing tariff rate of the product concerned (ie. if the prevailing tariff rate is 60 percent, 10 percent reduction means, the tariff to be changed will come down to 54 percent- 90 percent of 60 percent). Therefore, the tariff cuts were not sub-

stantial. Tariffs are the only matter dealt with in relation to impediments to intra-regional trade under SAPTA. In essence small tariff reduction like this for a narrowly defined, small number of product categories is not too helpful in promoting intra regional trade in the presence of more complex forms of NTBs in the region. Besides, the unilateral tariff reductions on an MNF basis in the region were really large in the 1990s.

Of the total number of tariff reductions, nearly 45 percent have been set apart for LDC members, and cannot be availed of by non-LDC members. It will promote trade between non-LDC and LDC members in the region. However, only 55 percent of product categories are then available for all members. The most notable in the case is India, in this respect, which has offered about 58 percent of product categories under tariff reduction for LDC member. It essentially aimed at boosting trade with its traditional regional trading partner in the region- Nepal, which has been diversifying its trade away from India since the 1980s. As regards the distribution of numbers of tariff reduction, India has offered nearly half of the 226 items. Given the size of international trade, Pakistan has offered a smaller number of items, the number of reductions are being comparable with those of Sri Lanka. Nepal has offered a large number of products under tariff concessions, compared with the relative smallness of its international trade.

(b) Second Round

Second round of negotiations of SAPTA brought about more than symbolic changes in preferential tariff reductions. The second round of negotiations for preferential tariff reduction finalized in 1996 and it included 1871 product categories from 7 countries in the region. This varies considerably across countries. About 39 percent of product categories are for LDC members alone. Hence, India, Pakistan and Sri Lanka cannot avail of such preferences. India offered the largest number of such preferences (about 56 of the its total). Next came Pakistan whose share of this category is about 37 percent of its total. Other countries' offers of preferences for LDC members were very small compared with those of India and Pakistan. Tariff cuts offered under this round ranged from 10-130 percent from the prevailing MFN rates.

(c) Third Round

Deviating from the first two rounds, the third round used a combination of approaches - product by product, sectoral, and across the board - for exchange of concessions. The third round concluded in 1998 and tariff concessions were offered on 3456 tariff lines. The preferential treatment under this round was also heavily biased towards LDCs. LDCs were offered over 70 of the total tariff lines

under preferential treatment. India offered the largest number of tariff lines of 1975 under the third round for preferential treatment of which 1932 were only for LDCs. Preferential tariff cuts offered under this round ranged from 10-75 percent of the prevailing MFN rates. Only Bangladesh, India and Pakistan exchanged tariff concessions on a product by product basis and chapter wise. No member country negotiated concessions on a sectoral or across the board basis.

Sri Lanka's trade with South Asia remained at very low levels even after the implementation of three rounds of tariff reductions under SAPTA. The SAARC region accounted for only about 5 percent of total exports and about 15 percent of total imports by 2002. Some improvements in regional integration were however, seen after the implementation of the ILFTA

Indo-Lanka Free Trade Agreement (ILFTA)

The Free Trade Agreement (FTA) was signed between Sri Lanka and India on 28th December 1998, with the proviso that the details including Negative Lists to be worked out during next two months. However, the two countries agreed on the Negative Lists only in February 2000 and on the subject of the arrangements for operationalization of Tariff Rate Quota (TRQ) exports of tea and garments arrangement was reached in April 2000. This agreement was notified to the GATT under the 'Enabling Clause' on 26th June 2002. As it stands it at present, the FTA is only a partial free trade agreement. It takes only tariffs into account; no other levies or barriers are considered. To make it fully operational, by design, Sri Lanka will take up to eight years while India will take up to three years.

Sri Lanka's Preferential trade under ILFTA has shown some improvement after 1999. Further, the preferential treatment for two product categories of Sri Lanka, ie. tea and apparel were given a limited access to the Indian market by way of quotas. The quota allocated for Sri Lanka per year is 3 million pieces of apparel articles (under HS 61 and 62) a year. In the case of tea Sri Lanka's quota for a year is 15 million-kg. Both quota agreements are functional and the margin of preference is 50 percent of the MFN rate. But the exports under quota are yet to be fully utilized. Both countries are in the process of widening and deepening economic integration between them.

Agreements in Progress

There are several preferential trade agreements other than those on which Sri Lanka has been

working for sometime. Particularly following the SAPTA agreement Sri Lanka has shown interest in preferential trade (or economic agreements) and preferential integration has been one of the key features of her external trade policies. There are several preferential trade agreements (and/or economic agreements) at different stages of development. The important ones are given below:

IOR-ARC

The Indian Ocean Rim Association for Regional Cooperation (IOR-ARC) is a group of countries around the Indian Ocean wanting an APEC type trade liberalization. There have been discussions at various levels (academia, business community etc.) but finality has not yet been reached. The IOR-ARC is at the early stage of its formation. The first inter-governmental meeting took place in May 1995. The formation of the 14 member IOR-ARC (members are Australia, India, Indonesia, Kenya, Madagascar, Malaysia, Mauritius, Mozambique, Oman, Singapore, South Africa, Sri Lanka, Tanzania, and Yemen) reflects in part the trend for regional integration begun in 1980s.

Many members are from the African continent and to a larger extent their economies being dependent on external trade and commerce. They aim at improving trade among countries around the Indian Ocean. IOR-ARC member countries have been undertaking out-ward – oriented economic reforms within and this process was expected to be strengthened by the regional integration program. There are a few large economies like Australia, India and South Africa in the group. Besides, members being at different levels of development in their economies provide an additional impetus for increasing intra-regional trade. Sri Lanka's trade with IOR-ARC countries is around 20 percent of her total trade in recent years.

Pakistan- Sri Lanka

Sri Lanka has had satisfactory levels of trade relations with Pakistan ever since it came into existence in 1947. Sri Lanka and Pakistan have been members of SAPTA from the beginning. Both countries have shown interest in establishing a preferential trade area since the Indo-Lanka Free Trade agreement signed in 1998. A framework agreement towards an FTA with Pakistan has already been signed. The technical level work leading to the finalization of the agreement has been completed.

BIMST-EC

The initiative for the formation of this group Bangladesh, India, Myanmar, Sri Lanka Thailand- Economic Cooperation ; BIMST-EC) was taken by Thailand in 1994 to look into possibili-

ties of furthering economic cooperation on a sub regional basis and it included only four countries. Later in December 1997 Myanmar was admitted to the group. The countries are from South Asian and South East Asian countries around Bay of Bengal. This group brings some SAARC (Bangladesh, India, Sri Lanka) and ASEAN (Myanmar and Thailand) countries together. These five countries – Bangladesh, India, Myanmar, Sri Lanka and Thailand aim at forming a preferential trade (and/or economic) group.

This, as it stands up to now, is a preferential trade cum economic cooperation organization. Initial studies have shown a considerable potential for trade expansion on a preferential basis among these countries. A dialogue between various groups like academics, officials and business community, and trade and economic Ministers of member nations has been taking place since its inception. Substantial technical work including studies on trade facilitation, inland trade routes and border crossing towards forming a free trade area are now complete and the development of the framework agreement is under way. Further, studies have looked at possibilities for cooperation in the areas of foreign investment and technical assistance. However, from implementation point of view, there is no agreement either for cooperation or preferential trading among the members of BIMST-EC. Intra regional trade at present within the BIMST-EC group is around 2 percent of their total trade and Sri Lanka's trade with this group has not changed very much over the years except in the case of India.

Outcome and Future Directions

With several efforts at preferential integration since the mid 1970s, Sri Lanka's trade integration is centered on developed countries, as has been the case for many developing countries. About 75 percent of the country's exports are directed at and 70 percent of Sri Lanka's imports are originated from developed countries with whom Sri Lanka does not have any preferential trading arrangement. Trade integration with the countries with which Sri Lanka has preferential trading arrangements remains at a very low level for various reasons.

BA is very limited in scope, limiting itself only to a narrow range of goods and tariff concessions. Non-tariff measures and the service sector are yet to be considered. The outcome has been very low levels of trade integration among members. This is partly attributed to the limited number of concessions extended to the membership. By 2001 the total number of tariff lines under concession for all members was 826, while 94 other tariff lines were offered to LDC members as special concession. However, after the accession of China the total number of tariff line under general concession for all went up to 1558 while tariff lines under special concession given to LDC members rose to 112. This improved the prospect for enhanced trade

integration among the membership. Sri Lanka's trade with the group remains very low around 15 percent (2002) of which two thirds are from India. If India is excluded, trade with BA countries is very small, around 6 percent at present. The only notable trading partners in the group thereafter are Korea and China (PRC) whose share remain less than 6 percent. Even with them, imports are the dominant feature of Sri Lanka's trade with the group.

Sri Lanka's trade with the SAARC region is around 11 percent of which India accounts for over 75 percent. This is primarily due to the ILFTA in the recent years. As it stands at present, trade integration under SAPTA is very low. But countries are in the process of finalizing an agreement towards a free trade area in South Asia. Intra regional trade growth at this stage of development is, to a greater extent, dependent on the presence of trade complementarities. Therefore, if integration is to be enhanced, other sectors such as investment, services are in need of taking into the agreements not only with India but also in other agreements as well. SAPTA considers tariff alone for exchange of concessions yet there are other trade costs. One of the key reasons for the low level of trade integration has been that the many goods under concession are not actively traded or not produced within the group. Another reason is the presence of para and non-tariff measures which, in effect, remain as barriers to trade. Further, tariff reductions are not deep enough to improve trade integration with rest of South Asia. Hence, the impact of SAPTA on Sri Lanka continues to remain marginal. It is known that Sri Lanka has considerable levels of trade complementarities with Pakistan and India. If countries succeed in achieving FTA in South Asia, Sri Lanka could achieve improved trade integration in the region. However, Sri Lanka has one FTA with India and another under negotiation with Pakistan. If the countries are successful in implementing these two agreements, much that is to be achieved in trade integration under SAFTA could be realized.

ILFTA has shown positive results in regard to Sri Lanka's trade integration with India from the beginning. 4 percent of Sri Lanka's total exports is destined for India and India accounts for about 14 percent of the total imports (2002). Sri Lanka has achieved a rapid export growth in the Indian market especially after 1999. Sri Lanka's Import/Export ratio with India has come down from 16:1 in 1998 to 5:1 in 2002. Besides India becomes the largest source of imports for Sri Lanka. After the implementation of the ILFTA, import product coverage rose to 20 percent by 2002.

Sri Lanka's tariff policy has undergone several phases of simplification, rationalization and reduction since the late 1970s with the opening up of the economy. Not only have the number

of tariff rates come down, the levels of tariffs have also come down. Besides, as recent data indicates, a large amount of items remain duty free (around 13 percent). About 24 percent of 6 digit (HS Code) tariff lines are at the tariff rate of 2 percent and 13 percent are at 5 percent and specific duties are applied to a smaller number of items. Only about 47 tariff lines carry duty rates of 10 and 25 percent. Therefore, it is important to note that what is available for preferential tariff is limited. Besides, government's declared policy is to come down to a low and uniform tariff rate in the future. In future agreements, Sri Lanka has to look at tariff lines, which have relatively higher levels of tariff rates for

preferential treatment for elevating into higher levels of integration. This however, will in conflict with revenue objectives. Tariff revenue will form a substantial part of the government's total revenue for several years to come. Therefore, enhancing revenue from other sources has to go hand in hand with tariff reduction under preferential trading as well. It should be noted, that as tariffs are coming down in general, on an MFN basis, the margin of preference extended to preferential trading arrangements is going to be thin in Sri Lanka. Then, the trade integration on preferential basis depends among other things on the levels of tariffs in other countries outside the arrangement.

Sri Lanka has shown much interest in developing several preferential integration arrangements including widening and deepening of existing ones. The results of the arrangements under implementation indicate that, except for ILFTA, trade integration under other two arrangements are very marginal. Yet potential for further integration within the BA after the accession of China has become greater. In the context of worldwide interest in preferential integration at present, a higher level of preferential trade integration for Sri Lanka is possible if she is successful in implementing those arrangements in progress, and deepening and widening existing ones.